



# San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233  
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

November 6, 2015

Randy Record and  
Members of the Board  
Metropolitan Water District of Southern California  
P.O. Box 54153  
Los Angeles, CA 90054-0153

**MEMBER AGENCIES**

- Carlsbad Municipal Water District
- City of Del Mar
- City of Escondido
- City of National City
- City of Oceanside
- City of Poway
- City of San Diego
- Fallbrook Public Utility District
- Helix Water District
- Lakeside Water District
- Olivenhain Municipal Water District
- Otay Water District
- Padre Dam Municipal Water District
- Camp Pendleton Marine Corps Base
- Rainbow Municipal Water District
- Ramona Municipal Water District
- Rincon del Diablo Municipal Water District
- San Dieguito Water District
- Santa Fe Irrigation District
- South Bay Irrigation District
- Vallejitos Water District
- Valley Center Municipal Water District
- Vista Irrigation District
- Yuima Municipal Water District

RE: Board Memo 8-1: Adopt Twenty-First Supplemental Resolution to the Master Revenue Bond Resolution authorizing the sale of up to \$250 million of Water Revenue Bonds, 2015 Authorization; and approve expenditures to fund the cost of issuance of the Bonds. – **OPPOSE**

Chair Record and Members of the Board:

We have reviewed Board Memo 8-1 seeking the Board’s approval to adopt a supplemental resolution authorizing the sale of up to \$250 million of Water Revenue Bonds. For the reasons described in our September 20, and October 10, 2015 letters (copies of which are attached), we disagree that the interest of MWD requires the sale of these revenue bonds; to the contrary, MWD only needs to sell these bonds due to its profligate spending practices over the past several months. The Water Authority Delegates **OPPOSE** this action, which is tantamount to selling bonds to keep the lights on at MWD.

Last month, we made a number of comments and stated concerns related to inadequate disclosures in and information missing from the draft Official Statement accompanying Board Memo 8-2 (a copy is attached), but have yet to receive a response. We request that a response be provided to the Board of Directors prior to next week's board action. We also ask that you respond to the November 5 letter from the Water Authority's Interim General Counsel on this subject (a copy is attached), prior to the Board's vote at next week's meetings.

Sincerely,

Michael T. Hogan  
Director

Keith Lewinger  
Director

Fern Steiner  
Director

Yen C. Tu  
Director

**OTHER REPRESENTATIVE**

County of San Diego

Attachment:

1. Water Authority Delegates' September 20, 2015 letter on Board Memo 8-6 (Ordinance)
2. Water Authority Delegates' October 10, 2015 letter on Board Memo 8-1 (Ordinance)
3. Water Authority Delegates' October 11, 2015 letter on Board Memo 8-2 (Appendix A)
4. Water Authority General Counsel Office's November 5, 2015 letter on Board memo 8-1



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September 20, 2015

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#### OTHER REPRESENTATIVE

County of San Diego

RE: Board Memo 8-6: Approve the introduction by title only of an Ordinance Determining That The Interests of The District Require The Use of Revenue Bonds In The Aggregate Principal Amount of \$500,000,000 -- **OPPOSE**

Chair Record and Members of the Board:

We have reviewed Board Memo 8-6 seeking the Board's approval for the introduction by title only of an ordinance determining that the interests of MWD require the use of revenue bonds in the aggregate principal amount of \$500 million. We oppose this item because there is no factual basis for a determination by the board of directors that the use of revenue bonds as described in Board Memo 8-6 and attached Ordinance is in MWD's interest. Consideration of whether the use of revenue bonds is in MWD's interest requires a more comprehensive look at a number of actions by the MWD board that are not described in the Board Memo and have had a material impact on MWD's current financial condition.

In April 2014, rather than reducing or maintaining its existing rates, MWD's adopted biennial budget for fiscal years 2015 and 2016 increased MWD's water rates by 1.5 percent per year for fiscal years 2015 and 2016 and presented a schedule projecting rate increases of 3 – 5 percent per year through 2024. In addition, the MWD board voted to suspend tax rate reductions that would otherwise occur, claiming that the increase in tax revenues by an additional tens of millions of dollars were necessary to maintain MWD's fiscal integrity. The MWD board made this finding based on staff recommendation at the same time its cash reserves were so great that the adopted budget planned to pay 100 percent of MWD's Capital Investment Plan for fiscal years 2015 and 2016 out of cash on hand (and then slowly eases to 60 percent cash CIP financing over the remaining years through 2024). Because MWD's recently adopted budget process no longer even attempts to estimate MWD's revenues and expenses based on actual conditions -- choosing instead to set rates based on low water sales that are expected to be exceeded seven out of ten years -- since 2012, MWD has collected \$800 million more than actual expenditures based on original adopted budgets. The MWD board chose to spend this money on unbudgeted expenditures,

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Chair Record and Members of the Board

September 20, 2015

Page 2

including the unprecedented increase in water conservation funding -- more than ten times the adopted budget -- from \$40 million to \$450 million including a hastily structured turf replacement program,<sup>i</sup> now all of these revenues have been spent.

MWD's use of revenue bonds would be entirely unnecessary if the MWD board adopted and followed sound fiscal policies and practices. MWD needs a long-range finance plan. MWD needs to complete the update of its Integrated Resources Plan. MWD needs a new rate structure consistent with California statutes and the Constitution. MWD needs to credibly demonstrate that these plans are functionally integrated.

The Water Authority will need more time to consider the implications of the proposed ordinance. We do not support introduction of the ordinance by title only. Lastly, Board memo 8-6 was not available with the regular board mailing. MWD's consistent late delivery of a majority of the board reports makes it extremely difficult for our staff to provide the technical support necessary for our deliberation of MWD staff recommendations. We renew past requests that board memoranda be distributed at least seven days in advance of MWD board meetings.

Sincerely,



Michael T. Hogan  
Director



Keith Lewinger  
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Fern Steiner  
Director



Yen C. Tu  
Director

Attachment: Water Authority's July 9, 2015 letter to MWD Board

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<sup>i</sup> MWD's turf replacement program was poorly structured and did not incorporate recommendations from a CUWCC report that it participated in and funded. Many have raised questions about MWD's implementation of turf replacement including the most recent LA Times article:  
<http://touch.latimes.com/#section/-1/article/p2p-84445011/>



## San Diego County Water Authority

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July 9, 2015

Randy Record and  
Members of the Board of Directors  
Metropolitan Water District of Southern California  
P.O. Box 54153  
Los Angeles, CA 90054-0153

RE: Board Memo 8-4: Adopt a resolution for the reimbursement with bond proceeds of Capital Investment Plan projects funded from the General Fund and Replacement and Refurbishment Fund -- **OPPOSE**

Chair Record and Members of the Board:

The Water Authority's MWD Delegates have reviewed the July 14, 2015 board memo 8-4 seeking the Board's authorization to declare MWD's intent to issue up to \$300 million of debt to "reimburse" capital expenditures for projects funded from the General Fund and Replacement and Refurbishment (R&R) Fund. We oppose this item because staff's recommendation will obligate MWD to increase water rates by at least \$15 per acre-foot without an actual board vote for the rate increase, and for the reasons further stated in this letter.

Staff's practice of presenting board actions piecemeal has paralyzed the board's ability to make sound public policy decisions. This month's action is another example. The board memo states that the debt issuance would provide MWD the "financial flexibility" desired because of the projected draw down of reserves as a result of the May action to pay for the unbudgeted conservation programs,<sup>i</sup> and that "expenditures for water management activities such as replenishing storage and funding transfer and exchange programs could significantly [further] draw down financial reserves in the near future." But it was staff's own recommendation in May to spend \$350 million on unbudgeted conservation expenditures – namely turf removal -- that placed MWD in this precarious fiscal position. This situation was completely foreseeable.

The May action not only spent MWD's not-yet-realized excess revenue collection,<sup>ii</sup> it also completely drained the Water Management Fund (WMF) – established for the very purpose of covering future costs associated with replenishing storage and water transfers – to fund turf removal, an expense for which the WMF was not intended. Staff expressed no concern when it recommended to spend down the WMF. The Board was repeatedly told in May that

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#### OTHER REPRESENTATIVE

County of San Diego

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Chair Record and Members of the Board

July 9, 2015

Page 2

staff's recommendation would not result in any rate impacts. But this month's action, which was precipitated entirely by May's unbudgeted expenditures, will in fact result in increases in MWD water rates by at least \$15 per acre-foot. (MWD staff reported in the past that every \$20 million in debt issuance equates to \$1 per acre-foot increase in water rates based on 2 million acre-feet of water sales; the rate increase will be higher for lower water sales volumes.) What has changed so drastically that is causing staff to be so concerned with the lack of financial flexibility triggered by an action it recommended just only six weeks ago? Did staff not foresee when it made the recommendation to spend down the WMF in May that its "flexibility" to purchase transfer supplies and to replenish depleted dry-year storage accounts would be more limited?

We disagreed with staff's assessment in May that the increase in conservation funding would not result in rate impacts. However, we believe staff's assertion that the action would have no rate impact persuaded many Board members to support the unprecedented and unbudgeted spending. While this month's action clearly has rate implications, the board memo yet again makes no reference to the rate increases.

Since fiscal year 2012, MWD collected more than \$800 million in revenues that exceed actual expenses. And since 2013 and in each year following, these over-collections have caused MWD's reserves to exceed the Board established maximum limits by hundreds of millions of dollars -- largely caused by staff's strategy, endorsed by this Board's votes of approval -- to set rates based on artificially deflated sales amounts, which staff said would be exceeded seven out of 10 years.<sup>iii</sup> Rather than using the over-collections to manage rate and tax increases, MWD kept and spent the monies on unbudgeted items.

Nearly as quickly as MWD amassed more than \$800 million in over-collected revenues, they are now nearly all gone, and MWD is resorting to budget shell games of taking cash from the capital investment plan to cover massive spending on turf removal. It is obvious that this proposal to issue \$300 million in new debt is a post-facto, 30-year debt financing of turf removal subsidies approved just weeks ago. This is not sound fiscal management.

When the biennial budget for fiscal years 2015 and 2016 was adopted, we asked that MWD use the revenue over-collection to reduce rate increases and not raise taxes, staff instead recommended using part of the over-collections to cash-fund capital projects to "avoid future rate increases." This month's 8-4 recommendation is an about-face from staff's earlier rationale in support of cash-funding the capital program.

## Chair Record and Members of the Board

July 9, 2015

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Finally, MWD's Administrative Code (Section 5200(b)) clearly restricts the use of monies from the R&R Fund to capital program expenditures. It is unclear how staff's proposal to issue debt would afford MWD the ability to use R&R funds for operational costs related to water transfers or purchases of water to replenish storage.

For reasons stated in this letter, we oppose staff's recommendation. We urge our fellow Board members to vote no on this action as well. This action is an inappropriate attempt to debt-finance very expensive turf rebates that produce no significant immediate supply relief during the drought.

Sincerely,



Michael T. Hogan  
Director



Keith Lewinger  
Director



Fern Steiner  
Director



Yen C. Tu  
Director

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<sup>i</sup> MWD increased conservation spending in May by an additional \$350 million and was to be funded by the following sources: 1) Water Stewardship Fund (\$50 million), 2) Water Management Fund (\$140 million), and 3) projected excess revenue collection that exceeded maximum reserves target (\$160 million); however, board memo 9-1 this month indicates that the projected excess revenue collection is trending at \$120 million, requiring the use of \$40 million from Water Rate Stabilization Fund.

<sup>ii</sup> The May action authorized the expenditures of anticipated over-collection of \$160 million, which is trending now at \$120 million (see also footnote ii).

<sup>iii</sup> Fiscal year 2016 is a good example; according to staff, MWD's water sales at the reduced Level 3 supply allocation (15 percent reduction) will still exceed the budgeted assumption of 1.75 million acre-feet.

October 10, 2015

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 Members of the Board of Directors  
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OTHER  
 REPRESENTATIVE

County of San Diego

RE: Board Memo 8-1: Adopt Ordinance No. 149 determining that the interests of Metropolitan require the use of revenue bonds in the aggregate principal amount of \$500 million -- **OPPOSE**

Chair Record and Members of the Board:

We have reviewed Board Memo 8-1 asking the Board to adopt an ordinance determining that the interests of MWD require the use of revenue bonds in the aggregate principal amount of \$500 million to fund a portion of the Capital Investment Program (CIP) through June 30, 2018 and to "reimburse" MWD for capital projects it has already paid for since May 2015.<sup>i</sup> We oppose this item for the same reasons described in our letter in OPPOSITION to last month's board action to approve the introduction of this ordinance: namely, the board memo does not present an accurate factual basis for the MWD Board to make this determination. To the contrary, this action and other spending actions taken by the Board during the current "budget" cycle can be described as anything but consistent with sound financial practices and policies.

MWD management's budget strategy, approved by this board, of setting rates that it knows will collect revenues from water ratepayers that exceed expenses in seven out of 10 years, has led MWD to cumulatively collect \$824 million more than actual expenditures based on the board's adopted "budgets" since just 2012.<sup>ii</sup> The biennial budget for fiscal years 2015 and 2016, adopted by the Board 18-months ago, planned to cash finance all of the CIP contained in the biennial budget. The forecasted rate schedule included in the budget document in fact was based on cash financing a majority of the \$1,069.2 million of planned CIP from July 1, 2014 through June 30, 2018, with only \$45.2 million from revenue bonds. Now, more than half-way through the budget cycle, and having blown through more than \$800 million over budget, staff wants to increase debt for this period more than 10 times, ex post facto, to \$500 million.

The Board memo attributes the need to incur this debt to the drought, and the fact that MWD's water sales and resulting revenues vary from year to year, as much as 30 percent over or under projections. Leaving aside the fact that drought (even severe drought) in Southern California should not come as a surprise to MWD, the solution is not to increase debt; it is to better manage revenues during "over" and "under" years. But MWD chooses not to do that. Rather than establish simple balancing accounts to manage revenues between high and low revenue years, staff has recommended, and this Board has approved massive expenditures outside of budget in good years, leaving MWD with insufficient revenues when they are needed. This practice is now leading MWD to do something it did not plan to do, and which its budget did not forecast: issue debt or raise rates higher than forecast. Board Memo 8-1 does not identify the real problem and does not propose an appropriate solution. MWD may very well need to issue additional bond funding for appropriate purposes at an appropriate time. But it is not credible to say that this action is in the interests of MWD unless the underlying financial policy issues are addressed.<sup>iii</sup>

Most troubling, Board Memo 8-1 states that without this unplanned borrowing, MWD will either have to curtail capital projects (something the Board should at least consider), use additional reserves to fund capital costs (though such reserves do not exist) or increase water rates above forecasted levels. This is information that should have been provided to the Board earlier, when staff recommended, and the Board voted to approve unbudgeted expenditures of more than \$800 million. Now, having blown through all of its cash, staff is saying it needs to borrow money to avoid rate increases. This is fiscal madness.

Finally, Board Memo 8-1 contains language suggesting that staff believes that adoption of this ordinance will allow MWD to use debt to pay for things other than capital projects (bond proceeds may be used "even more broadly for the funding of 'any preliminary and incidental expenses...necessary or convenient to carry out the objects or purposes of the district'"). If this language suggests MWD may spend debt proceeds on operational expenses, we do not read Section 237 of the MWD Act relating to revenue bond purposes that way; rather, this language must be read in the context of Section 237 as a whole being related to the funding of capital projects and public works. We ask that staff clarify this point as part of the record of proceedings at our committee and board meetings.

We oppose this action. MWD needs a long-range finance plan. MWD needs to follow cost-of-service requirements of law. It needs to develop, adopt and – most critically -- follow its budgets. It is imperative that MWD get its fiscal house in order. Issuing this

debt now absent all of these other actions being taken by the Board is not in MWD's interests.

Sincerely,



Michael T. Hogan  
Director



Keith Lewinger  
Director



Fern Steiner  
Director



Yen C. Tu  
Director

Attachment:

1. September 20, 2015 Water Authority letter to MWD Board RE Board Memo 8-6: Approve the introduction by title only of an Ordinance Determining that the Interests of the District require the use of Revenue Bonds in the aggregate principal amount of \$500,000,000 – OPPOSE

<sup>i</sup> It seems obvious that the issuance of debt is necessary in order for MWD to restore and meet its minimum cash reserve requirement. It is apparent from many actions over the past several months that MWD has engaged in a spending spree, with no cost-of-service basis for hundreds of millions of dollars of expenditures, completely disconnected from the two-year budget this Board approved in April 2014.

<sup>ii</sup> Of the \$824 million, \$741 million exceeded the agency's maximum reserve level.

<sup>iii</sup> Board Memo 8-1 also states that the Board "has prudently established a reserve policy designed to deal with significant changed circumstances and buffer the impacts of weather, economy and demand volatility on MWD's revenues." If that were true, staff would not need to be asking to issue debt in order to restore its depleted cash reserves.



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County of San Diego

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In April 2014, rather than reducing or maintaining its existing rates, MWD's adopted biennial budget for fiscal years 2015 and 2016 increased MWD's water rates by 1.5 percent per year for fiscal years 2015 and 2016 and presented a schedule projecting rate increases of 3 – 5 percent per year through 2024. In addition, the MWD board voted to suspend tax rate reductions that would otherwise occur, claiming that the increase in tax revenues by an additional tens of millions of dollars were necessary to maintain MWD's fiscal integrity. The MWD board made this finding based on staff recommendation at the same time its cash reserves were so great that the adopted budget planned to pay 100 percent of MWD's Capital Investment Plan for fiscal years 2015 and 2016 out of cash on hand (and then slowly eases to 60 percent cash CIP financing over the remaining years through 2024). Because MWD's recently adopted budget process no longer even attempts to estimate MWD's revenues and expenses based on actual conditions -- choosing instead to set rates based on low water sales that are expected to be exceeded seven out of ten years -- since 2012, MWD has collected \$800 million more than actual expenditures based on original adopted budgets. The MWD board chose to spend this money on unbudgeted expenditures,

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September 20, 2015

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including the unprecedented increase in water conservation funding -- more than ten times the adopted budget -- from \$40 million to \$450 million including a hastily structured turf replacement program,<sup>i</sup> now all of these revenues have been spent.

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Attachment: Water Authority's July 9, 2015 letter to MWD Board

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Staff's practice of presenting board actions piecemeal has paralyzed the board's ability to make sound public policy decisions. This month's action is another example. The board memo states that the debt issuance would provide MWD the "financial flexibility" desired because of the projected draw down of reserves as a result of the May action to pay for the unbudgeted conservation programs,<sup>i</sup> and that "expenditures for water management activities such as replenishing storage and funding transfer and exchange programs could significantly [further] draw down financial reserves in the near future." But it was staff's own recommendation in May to spend \$350 million on unbudgeted conservation expenditures – namely turf removal -- that placed MWD in this precarious fiscal position. This situation was completely foreseeable.

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We disagreed with staff's assessment in May that the increase in conservation funding would not result in rate impacts. However, we believe staff's assertion that the action would have no rate impact persuaded many Board members to support the unprecedented and unbudgeted spending. While this month's action clearly has rate implications, the board memo yet again makes no reference to the rate increases.

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## Chair Record and Members of the Board

July 9, 2015

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Finally, MWD's Administrative Code (Section 5200(b)) clearly restricts the use of monies from the R&R Fund to capital program expenditures. It is unclear how staff's proposal to issue debt would afford MWD the ability to use R&R funds for operational costs related to water transfers or purchases of water to replenish storage.

For reasons stated in this letter, we oppose staff's recommendation. We urge our fellow Board members to vote no on this action as well. This action is an inappropriate attempt to debt-finance very expensive turf rebates that produce no significant immediate supply relief during the drought.

Sincerely,



Michael T. Hogan  
Director



Keith Lewinger  
Director



Fern Steiner  
Director



Yen C. Tu  
Director

---

<sup>i</sup> MWD increased conservation spending in May by an additional \$350 million and was to be funded by the following sources: 1) Water Stewardship Fund (\$50 million), 2) Water Management Fund (\$140 million), and 3) projected excess revenue collection that exceeded maximum reserves target (\$160 million); however, board memo 9-1 this month indicates that the projected excess revenue collection is trending at \$120 million, requiring the use of \$40 million from Water Rate Stabilization Fund.

<sup>ii</sup> The May action authorized the expenditures of anticipated over-collection of \$160 million, which is trending now at \$120 million (see also footnote ii).

<sup>iii</sup> Fiscal year 2016 is a good example; according to staff, MWD's water sales at the reduced Level 3 supply allocation (15 percent reduction) will still exceed the budgeted assumption of 1.75 million acre-feet.



## San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233  
 (858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

October 12, 2015

Randy Record and  
 Members of the Board of Directors  
 Metropolitan Water District of Southern California  
 P.O. Box 54153  
 Los Angeles, CA 90054-0153

#### MEMBER AGENCIES

Carlsbad  
Municipal Water District

City of Del Mar

City of Escondido

City of National City

City of Oceanside

City of Poway

City of San Diego

Fallbrook  
Public Utility District

Helix Water District

Lakeside Water District

Olivenhain  
Municipal Water District

Otay Water District

Padre Dam  
Municipal Water District

Camp Pendleton  
Marine Corps Base

Rainbow  
Municipal Water District

Ramona  
Municipal Water District

Rincon del Diablo  
Municipal Water District

San Dieguito Water District

Santa Fe Irrigation District

South Bay Irrigation District

Vallecitos Water District

Valley Center  
Municipal Water District

Vista Irrigation District

Yuima  
Municipal Water District

OTHER  
REPRESENTATIVE

County of San Diego

RE: Board Item 8-2: Approve and authorize the execution and distribution of Remarketing Statements in connection with the remarketing of the Water Revenue Refunding Bonds, 2011 Series A1 and A3 and 2009 Series A2 - **OPPOSE**

Dear Chair Record and Members of the Board:

The Water Authority's MWD Delegates have reviewed Board memo 8-2, including the redline copy of Appendix A dated October 1, 2015 ("Appendix A" or "Draft"), and determined we cannot support staff's recommendation to authorize the execution and distribution of the Official Statement in connection with the remarketing of bonds. As we have made clear in the past, we support staff's general financial management objective to reduce debt cost but do not believe the bond disclosures fairly present the facts, as described below, or MWD's current and projected water supply conditions, financial position or risks.

#### I. General Comments

We incorporate by reference all of the comments and objections contained in our delegation's past letters relating to MWD's authorization, execution and distribution of Official Statements in connection with the issuance of bonds. While MWD has from time to time made certain changes in response to the Water Authority's comments, these letters raise several substantive issues that have not been addressed by MWD in prior drafts of Appendix A, are part of the MWD Administrative Record in connection with the respective actions taken by the board and are incorporated herein by reference, along with copies of any MWD responses.

A number of specific questions and comments are noted below. Broadly speaking, there are two new principal areas in which the current draft Appendix A fails to disclose or accurately describe material facts:

- (1) the status of MWD's unrestricted reserves as related to the deposit it has represented to the Superior Court that it maintains and is required to

*A public agency providing a safe and reliable water supply to the San Diego region*

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maintain as security for payment of the Water Authority's judgment and accrued interest in the rate litigation (MWD has represented to the Court that it is holding this money in a "separate account" and yet it appears to be commingled with unrestricted reserves); and

(2) material facts that have been judicially determined in the rate litigation, but which MWD continues to misrepresent in various parts of Appendix A. While we recognize that MWD intends to appeal the judgment of the Court, that does not mean that it is not also required to disclose and accurately present to the MWD Board of Directors and potential investors the Court's factual findings and orders as they relate to MWD's contentions in the litigation and included in Appendix A.

Copies of the Courts Statements of Decision dated April 24, 2014 and August 28, 2015, and its Order Granting San Diego's Motion for Prejudgment Interest dated October 9, 2015, are attached (Attachments 1-3, respectively). MWD management has a responsibility to inform the MWD Board of Directors about the findings and orders the Court has made, and the MWD Board of Directors has a responsibility to be informed about the Court's findings and orders in connection with its review of the Draft Appendix A. This is necessary in order to provide complete and accurate disclosure regarding the bonds being offered and their security and source of payment to potential investors. We also request that MWD's management provide this letter and Attachments to MWD's bond counsel team, financial advisor and underwriters.

**II. MWD is either in breach of its contractual obligation under the Exchange Agreement to maintain a cash deposit sufficient to secure payment of the Water Authority's judgment and accrued interest; or, it is not in compliance with minimum reserve requirements under its Financial Reserve Policy.**

Attachment 4 to this letter provides a graphic representation of the status of MWD's Unrestricted Reserves beginning at July 1, 2015 through the end of September 2015 (all data derived from MWD's Draft Appendix A). If MWD's Unrestricted Funds are reduced by the Water Authority's security deposit -- reflected in Attachment 4 at the \$209.8 million amount MWD informed the Court it is holding as a security deposit<sup>i</sup> -- then it appears that MWD has failed to meet its minimum reserve requirements since the end of July 2015. This would also mean that, on September 22, 2015, MWD did not have sufficient cash available to make the \$44.4 million unbudgeted payment to the Southern Nevada Water Authority without either breaching its contractual obligation to the Water Authority or spending cash that was required by MWD's Financial Reserve Policy to be held in reserve.

**III. Several representations in Draft Appendix A are inconsistent with material facts that have been judicially determined against MWD in the rate litigation.**

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In addition to failing to accurately describe the Court's findings and orders in the rate litigation per se, MWD is continuing to present certain matters as "fact" in Appendix A that were contested in the rate litigation with respect to which MWD did not prevail. As one important example, MWD continues in Appendix A to report revenues paid for wheeling, i.e., for the transportation of third party water, as MWD "water sales revenues" (A-50). Contrary to arguments made by MWD at trial that San Diego was purchasing MWD water under the Exchange Agreement, the Court specifically found that San Diego does not pay MWD's supply rates (August 28, 2015 Statement of Decision at page 3, footnote 8) and **is not purchasing MWD water under the Exchange Agreement** (August 28, 2015 Statement of Decision at page 28, line 13 and generally, Section IV-B, Preferential Rights at pages 25-29). There is no factual or legal basis for MWD to describe wheeling revenues as its "water sales" and no reason to require potential bond investors to "read the fine print" in the footnotes in order to conclude that MWD's "water sales" revenues are in fact, **not** all MWD water sales revenues. MWD's Summary of Receipts by Source (A-50) substantially overstates MWD's water sales because MWD's water sales were at least 180,000 AF less than stated by MWD (i.e., the amount of water the Water Authority actually purchased from third parties) -- and also fails to disclose that MWD receives revenues from the wheeling services it provides.

#### **IV. Comments on Draft Appendix A**

*A-6: Metropolitan's Water Supply.* MWD is changing the statement that "hydrologic conditions can have a significant impact on MWD's 'water supply'" to the statement that, "hydrologic conditions can have a significant impact on MWD's 'two principal imported water supply sources.'" What water supply sources has MWD acquired since its last Official Statement in June 2015 that are not State Water Project or Colorado River supplies, necessitating this change?

*A-7: Drought Response Actions.* Staff's suggested edits to the Draft Appendix A state that implementation of MWD's Water Supply Allocation Plan at a Level 3 Regional Shortage Level is anticipated to reduce supplies delivered by MWD to its member agencies in fiscal year 2015-16 to approximately 1.6 million acre-feet (AF). By contrast, language in the Official Statement of last June - now being deleted - states that, "[o]n April 14, 2015, the Board declared the implementation of the Water Supply Allocation Plan at a Level 3 Regional Shortage Level, effective July 1, 2015 through June 30, 2016. Implementation of the Water Supply Allocation Plan at a Level 3 Regional Shortage Level is anticipated to reduce supplies delivered by MWD to MWD's member agencies by 15 percent and water sales to approximately 1.8 million AF." Even though the June disclosure noted the Governor's Order to reduce water use by 25 percent, it stated that member agencies' diminished local supplies will cause MWD's demands to be at 1.8 million AF. Now, in the space of less than four months, MWD has reduced its estimated water sales by 200,000 acre-feet (AF), even though there are no changed factual circumstances identified in the new Draft. Further, MWD staff

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reported last month that water sales could be as low as 1.5 million AF. Please explain the basis of the new projections and what if anything has changed since June 2015 to account for this substantial reduction in MWD's estimated water sales in fiscal year 2015-16, and, why the new Draft does not disclose the reported potential for water sales to be as low as 1.5 million AF.

Similarly, the storage reserve level as of December 31, 2015 is described in the Draft Appendix A as 1.36 million AF. While this is consistent with reports under MWD's Water Surplus and Drought Management Plan, it is not consistent with forecasted sales of 1.6 million AF, which is lower than a Level 3 water supply allocation. If sales are down, there should be more water in storage. Please explain this apparent discrepancy.

*A-9: Integrated Resources Plan.* The last paragraph on page A-9 states that the second phase of the IRP is development of "implementation" policy after the conclusion of the "technical" update. Unless staff believes that the Board will be limited in its deliberation of the IRP to policies related to "implementation" of the IRP, we suggest deleting the word "implementation."

*A-11: Water Transfers and Exchanges.* Why has staff deleted the word, "acquisition"? Given MWD's recent proposed and consummated land acquisitions in Palos Verde and the Delta, deletion of this word is not warranted. Please explain.

*A-11: Seawater Desalination.* The section on seawater desalination is a sub-paragraph under Integrated Resources Plan Strategy, which is a sub-paragraph of the section describing "Metropolitan's Water Supply," which begins at page A-6. The Water Authority's seawater desalination project is not a MWD Water Supply and the Water Authority does not receive "financial incentives" from MWD for the project, as suggested. The reference to the Water Authority's project should be deleted here and included instead in sections of the Draft that report member agency local projects (Regional Water Resources, for example, like the Los Angeles Aqueduct) and reduced demand for MWD water (MWD Revenues (A-40) and Management's Discussion of Historical and Projected Revenues and Expenses (A-71)).

*A-11-A-16: State Water Project.* We found the proposed edits regarding Bay Delta Conservation Plan (BDCP) collectively, confusing. On the one hand, the Draft is amended to add language stating that the "basic, underlying purpose of the BDCP is to restore and protect Delta water supply, water quality and ecosystem health within a stable regulatory environment" (A-14), but then makes other edits changing statements that the BDCP is "being developed" that way to a statement that that is the BDCP as it was "originally conceived" (A-15). The Draft goes on to disclose that 50-year permits as originally conceived were not possible; but, it does not close the loop on how the need for a stable regulatory environment will be achieved. Please explain or suggest edits to address this concern.

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*A-18: Colorado River Aqueduct.* The proposed edits suggest that it was a severe drought and reduced Colorado River storage that "ended" the availability of surplus water deliveries to MWD and "resulted" in California being limited to 4.4 million AF since 2003. These edits should not be made because they do not accurately describe the circumstances or the factual and legal record why California is limited to 4.4 million AF or why MWD no longer has access to surplus water on the Colorado River. There have been absolutely no changes since the last Official Statement of June 2015 that would explain the need for these edits at this time.

*A-21: Quantification Settlement Agreement.* However artfully described in the Draft Appendix A, MWD cannot credibly deny or change the fact that its projected sales are reduced by 180,000 AF and that San Diego is buying this water from IID, not MWD. The statement that MWD "expects to be able to annually divert 850,000 AF of Colorado River water -- without disclosing that 180,000 AF of that water belongs to the Water Authority -- is misleading, especially as the same sentence goes on to refer to water "from other water augmentation programs [MWD] develops." The section also refers prospective investors to "METROPOLITAN REVENUES--Principal Customers," where MWD continues the charade that its wheeling revenues represent the purchase and sale of MWD water (see page A-50 and section III above). This is misleading by design.

*A-22: Sale of Water by the Imperial Irrigation District to San Diego County Water Authority.* The sentence at the bottom of page A-22 that -- "[i]n consideration for the conserved water made available to MWD by SDCWA, a lower rate is paid by SDCWA for the exchange water delivered by MWD" -- should be deleted. At a minimum, MWD must disclose that MWD's legal theory and argument that the Water Authority is purchasing MWD water under the Exchange Agreement was expressly rejected by Judge Karnow in his Statement of Decision. See discussion at Section III above. Further, the proposed edits to delete reference to the volume of water MWD is wheeling for the Water Authority under the Exchange Agreement is unnecessary. In fact, this information should be provided.

*A-24: Interim Surplus Guidelines.* What is the reason for the proposed deletion stating that, "[t]he Interim Surplus Guidelines contain a series of benchmarks for reductions in agricultural use of Colorado River water within California by set dates"?

*A-51: Water Sales Revenues.* As noted above, MWD fails to disclose that it receives wheeling revenues from the Water Authority. MWD is obligated to disclose the findings and decision by the Superior Court in the rate case, whether or not it intends to appeal. MWD should also disclose here or elsewhere in the draft Appendix A that, since 2012, it has collected \$824,000,000 more from MWD ratepayers than needed to pay its actual budgeted expenses, of which \$743,000,000 exceeded the maximum reserve limits and that this amount may be subject to future claims. Finally, the statement that "MWD uses its financial resources and budgetary tools to manage the financial impact of the variability in revenues

Chair Record and Members of the Board

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due to fluctuations in annual water sales," is patently untrue. This very month, the MWD Board of Directors is being asked by staff to issue \$500 million in bonds, because MWD has now spent not only 100 percent of its budgeted revenues, but also the additional \$824,000,000 it over-collected from MWD ratepayers without any cost of service analysis.

*A-52: Rate Structure.* MWD should disclose in this section on its rate structure (rather than requiring investors to wade through several cross-references) that its rates have been determined to violate the common law, California statutory law and the California Constitution.

*A-53: Litigation Challenging Rate Structure.* We have several objections regarding disclosures related to the litigation challenging MWD's rate structure. In addition to the general concerns expressed at section II above:

MWD states that, "the Court granted MWD's motion for summary adjudication of the cause of action alleging illegality of the 'rate structure integrity' provision in conservation and local resources incentive agreements, dismissing this claim in the first lawsuit." What MWD fails to disclose is that the claim was dismissed on the basis of the Water Authority's supposed lack of standing to challenge the RSI provision; and, that the Court otherwise found the rate structure integrity provision to be unreasonable and inappropriate.

As noted in prior letters, the statement that the "Court found that SDCWA failed to prove its 'dry-year peaking' claim that MWD's rates do not adequately account for variations in member agency purchases" is inaccurate. What the Court stated was that, "the record does not tell us that all these charges are sufficient to account for all of the costs of providing what I have called contingency capacity" (April 24, 2014 Statement of Decision at page 64).

*A-55: Litigation Challenging Rate Structure.* What is MWD's intention and the reason for the proposed edit changing the reference to the "Exchange Agreement" to the "exchange agreement"?

Given the Court's ruling on October 9, MWD now must also disclose the Order Granting San Diego's Request for Prejudgment Interest; and, add this amount to the deposit it is holding as security under the Exchange Agreement.

*A-55: Member Agency Purchase Orders.* The Water Authority has previously expressed its opposition and concerns regarding the illusory contracts described as "Member Agency Purchase Orders;" those concerns and all past communications with MWD on this subject are incorporated herein by reference. There is no cost of service basis for these purported agreements including but not limited to the fact that MWD does not even set a Tier 2 Water Supply Rate as described.

Chair Record and Members of the Board

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*A-58: Financial Reserve Policy.* See the Water Authority's letter of this date RE Board Item 8-2: Approve and authorize the execution and distribution of Remarketing Statements in connection with the remarketing of the Water Revenue Refunding Bonds, 2011 Series A1 and A3 and 2009 Series A2 - **OPPOSE** and Section III above, incorporated herein by reference.

Further, MWD has represented to the Court in the rate litigation that it has established a "separate account" as a "security deposit" to cover the payment of the judgment and interest awarded to the Water Authority. It does not appear from any of the disclosures in the Draft Appendix A that this account exists; rather, it is money that is commingled with MWD's Unrestricted Reserves, which must be maintained to satisfy MWD's minimum reserve requirements and which are potentially subject to being spent or otherwise used by the MWD Board of Directors. As noted in section II above, there isn't enough cash available in order to satisfy the Water Authority's judgment and interest, while at the same time, meeting MWD's minimum reserve requirements.

As a detail, MWD has not corrected its prior reference to holding \$188 million - rather than \$209.8 million - in the last paragraph on page A-58.

Regarding the Board's approval of \$44.4 million to pay Southern Nevada Water Authority from unrestricted reserves, it does not appear that sufficient funds were available in unrestricted reserves to make this payment without either breaching MWD's contractual obligation to the Water Authority or falling below minimum reserve levels.

*A-60: Ten Largest Water Customers.* The numbers reflected in this schedule need to be corrected to show that the Water Authority is not purchasing MWD water when it pays MWD for the transportation of water under the Exchange Agreement.

*A-60: Preferential Rights.* The Draft must be amended to disclose the Court's findings and orders in the rate litigation, which are omitted.

*A-61: California Ballot Initiatives.* The Draft must be amended to disclose the Court's findings and orders in the rate litigation, which are omitted.

*A-77: Water System Revenue Bond Amendment.* Why is the language in the paragraph above the projected costs for State Water Project water being deleted? Is an updated explanation not required?

*A-83: Historical and Projected Revenues and Expenses.* MWD's "water sales" need to be corrected for the reasons discussed in this letter and Statements of Decision by Judge Karnow in the rate cases.

## Chair Record and Members of the Board

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*A-85: Management's Discussion of Historical and Projected Revenues and Expenses.* The statements contained in this section of the Appendix A suffer from the same deficiencies as noted above, particularly with regard to a "budget" process that is designed to collect more revenues than budgeted expenses in seven out of ten years; MWD's adoption of programs and spending measures that have resulted in the unbudgeted spending of hundreds of millions of dollars, with no cost-of-service justification; and MWD's failure to maintain a separate account as a security deposit to secure payment of the judgment and interest owed to the Water Authority, as represented to the Superior Court.

Thank you for your consideration of and response to address these questions and issues.

Sincerely,



Michael T. Hogan  
Director



Keith Lewinger  
Director



Fern Steiner  
Director



Yen C. Tu  
Director

## Attachment:

1. Statement of Decision Rate Setting Challenges dated April 24, 2014
2. Statement of Decision dated August 28, 2015
3. Order Granting San Diego's Motion for Prejudgment Interest dated October 9, 2015
4. MWD's unrestricted reserves monthly balances beginning at July 1, 2015 through the end of September 2015 (as reported in draft Appendix A)

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<sup>i</sup> MWD is suggesting certain edits to the Draft Appendix A to be consistent with the argument it made to the Court (at A-55), claiming that it was holding in its financial reserves a "deposit" equivalent to the amount of money that the Court awarded as damages on August 28, plus the amount of "interest" MWD claimed had accrued on the "deposit." But there was no "deposit" and there was no "interest" earned thereon, as MWD argued to the Court. Instead, MWD has commingled the funds it was required to hold as security deposit in its financial reserves. Although MWD is now claiming that it has since August 31 been holding \$209.8 million in its financial reserves to comply with its obligations under the Exchange Agreement, it does not appear to have been mathematically possible for it to do so without using cash that was at the same time required to be held by MWD in accordance with the Financial Reserve Policy described in A-58 of Appendix A.



**FILED**  
San Francisco County Superior Court

APR 24 2014

CLERK OF THE COURT

BY: [Signature]  
Deputy Clerk

SUPERIOR COURT OF CALIFORNIA

COUNTY OF SAN FRANCISCO

SAN DIEGO COUNTY WATER  
AUTHORITY,

Plaintiff/Petitioner,

vs.

METROPOLITAN WATER DIST. OF  
SOUTHERN CALIFORNIA, et al.

Defendants/Respondents.

Case No. CPF-10-510830

Case No. CPF-12-512466

STATEMENT OF DECISION ON RATE  
SETTING CHALLENGES

San Diego County Water Authority (San Diego) challenges the legality of four rates set by Metropolitan Water District of Southern California (Met).

San Diego alleges three defects. First, San Diego argues that Met improperly allocates the bulk of Met's costs under its contract with the California Department of Water Resources' State Water Project to the System Access Rate and the System Power Rate. Second, San Diego contends that Met illegally treats all of its costs for conservation and local water supply development programs as transportation costs by recovering them through the Water Stewardship Rate, which Met charges as a transportation rate. The asserted result of these

misallocations is that parties who use Met's wheeling services pay an inflated rate for that service.

Third, San Diego asserts that, while Met incurs significant costs to accommodate the practice by some member agencies of "rolling on" to Met's system and buying more water in dry years, and "rolling off" of Met's system and substantially reducing their purchases from Met in average years (dry-year peaking), Met's rates fail to assign those costs to the member agencies that cause the dry-year peaking costs to be incurred or that benefit from the availability of dry-year peaking supplies.

I find for San Diego on the first two issues and for Met on the third.

### **Procedural History**

San Diego filed suit challenging Met's 2011 and 2012 rates on June 11, 2010 (the 2010 case).<sup>1</sup> The operative Third Amended Complaint in the 2010 case includes six causes of action: the Rate Challenges (Causes of Action # 1-3); breach of contract (Cause of Action #4); declaratory relief as to RSI (Cause of Action # 5); and declaratory relief as to preferential rights (Cause of Action #6). Within the Rate Challenges, San Diego asserts that Met's 2011 and 2012 rates violate numerous constitutional and statutory provisions, namely: Article XIII A of the California Constitution (Proposition 13) and its implementing statute, Government Code § 50076; the Wheeling Statute, Water Code § 1810 *et seq.*; Government Code § 54999.7(a);

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<sup>1</sup> San Diego and Met have driven this litigation, but they are not the only parties. Imperial Irrigation District answered the 2010 Complaint, the Third Amended Complaint in the 2010 action, and the 2012 Complaint alleging that some or all of Met's actions violated Water Code §§ 1810-1814. The Utility Consumers' Action Network also answered the 2010 complaint seeking invalidation of the rates, but not the operative Third Amended Complaint in that action or the 2012 complaint. The City of Glendale, Municipal Water District of Orange County, City of Torrance, Las Virgenes Municipal Water District, West Basin Municipal Water District, Foothill Municipal Water District, and City of Los Angeles all answered the 2010 Complaint, the operative Third Amended Complaint in that action, and the 2012 Complaint siding with Met. Three Valleys Municipal Water District answered the 2010 and 2012 Complaints siding with Met, but not the Third Amended Complaint in the 2010 action. Western Municipal Water District and Eastern Municipal Water District answered the 2012 Complaint, siding with Met.

Government Code § 66013; section 134 of the Metropolitan Water District Act; and California common law.

On June 8, 2012, after Met approved rates for calendar years 2013 and 2014 that relied on many of the same cost allocations and ratemaking determinations, San Diego filed a second lawsuit (the 2012 case). The 2012 case includes four causes of action: rate challenges to the 2013 and 2014 rates (Causes of Action # 1-3) and another claim for breach of contract (Cause of Action # 4). Within the 2012 rate challenges, San Diego alleges that Met's 2013 and 2014 rates violate the same common law, constitutional and statutory provisions as in the 2010 case, as well as Article XIII C § 1 of the California Constitution (Proposition 26).

On September 20, 2013, the parties filed cross-motions for summary adjudication. San Diego moved for summary adjudication on the RSI cause of action. Met moved for summary adjudication on the RSI cause of action, the preferential rights cause of action, and both breach of contract causes of action. By order dated December 4, 2013, I denied San Diego's motion for summary adjudication on RSI, granted Met's motion for summary adjudication on RSI, and denied Met's other motions for summary adjudication.

I bifurcated the breach of contract causes of action and set them for trial at a date following resolution of the rate challenges. The parties agreed to postpone the preferential rights claim as well; it will be heard at the same time as the breach of contract claims. The rate challenges were set for trial on December 17, 2013.

The trial for the rate challenges in the 2010 case and the 2012 case commenced on December 17, 2013, and was completed, except for closing arguments, on December 23. The parties filed post-trial briefs on January 17, 2014; closing arguments were heard on January 23, 2014.

I issued a tentative determination and proposed statement of decision February 25, 2014.

I provided the parties additional time for objections, which were filed March 27.

This statement of decision follows.

## **Factual Background**

### **1. The Parties**

Met was established in 1928 by the Metropolitan Water District Act. Stats. 1969, ch. 209 as amended; Water Code Append. §§ 109-134. Met acts as a supplemental wholesale water supplier to 26 cities and water districts throughout Southern California (Met's member agencies). San Diego is one of Met's member agencies, and has been since 1946. Met's member agencies govern Met through their representatives on Met's Board of Directors. Water Code Append. §§ 109-50, 109-51, 109-55. Each member agency has proportional representation on the Board of Directors, and is entitled to at least one seat on the Board, plus an additional seat for every full 3% of the total assessed value of the property within the member agency's service area that is taxable for district purposes. *Id.* at §§ 51-52.

Member agencies are not obligated to buy water from Met. If member agencies have access to local sources of water, they may freely opt out fully or partially from Met's services. JTX-2 (AR2012-016429) at AR2012-016440; *Metropolitan Wat. Dist. of S. Cal. v. Imperial Irrigation Dist.*, 80 Cal.App.4th 1403, 1417 (2000) (*MWD*).

But (with the exception of Los Angeles) member agencies currently have no way to receive imported water supplies except through Met's facilities. If a member agency such as San Diego purchases imported water on its own, it must as a practical matter move the water through

Met's facilities. The use of a water conveyance facility by someone other than the owner or operator is referred to as "wheeling." Met provides wheeling services to its member agencies.

## 2. Water Networks

Met "imports water from two principal sources, the State Water Project in Northern California, via the California Aqueduct, and the Colorado River, via the Colorado River Aqueduct."<sup>2</sup> Met takes delivery of its Colorado River water at Lake Havasu. Met transports its Colorado River water through the Colorado River Aqueduct, which Met owns and operates. Met takes delivery of State Water Project (SWP) water at four delivery points near the northern and eastern boundaries of Met's service area, including two large reservoirs, Castaic Lake and Lake Perris. SWP water is delivered to Met by the Department of Water Resources (DWR) via the California Aqueduct, which is part of the SWP. Met does not own or operate the SWP, nor does Met transport SWP water from Northern California to the terminal reservoirs at Castaic Lake and Lake Perris.<sup>3</sup>

Once the SWP water is received by Met, Met sometimes blends that water with water from the Colorado River, delivering blended water to its member agencies including San Diego. Met's distribution system transports water across a large part of the State, delivers water in six counties, and serves an area home to 19 million residents.<sup>4</sup> Member agencies, in turn, deliver water to their customers.

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<sup>2</sup> JTX-2\* (AR2012-016429) at AR2012-016440. "\*" indicates that a document is present only in the 2012 administrative record. "\*\*\*" indicates that a document is not in any administrative record. All documents in the 2010 administrative record are also in the 2012 administrative record.

<sup>2</sup> DTX-090 at AR2012-000001 (capitalization omitted).

<sup>3</sup> PTX-237A\*\* (Resps. to RFA Nos. 44-47).

<sup>4</sup> DTX-109\* at AR2012-016583.

### 3. Met's Contract with DWR

Met has a contract with DWR entitled "Contract Between [Met] and [DWR] for a Water Supply and Selected Related Agreements."<sup>5</sup> Pursuant to this contract, DWR makes SWP water available to Met at delivery structures established in accordance with the contract.<sup>6</sup> Met is obligated to make all payments under the contract even if it refuses to accept delivery of water made available to it. *Id.* at AR2012-000048 (Art. 9).

The contract distinguishes between the cost to *supply* SWP water to Met, and the cost to *transport* SWP water to Met.<sup>7</sup> The cost to transport the SWP water to Met includes a capital cost component; a minimum operation, maintenance, power, and replacement component; and a variable operation, maintenance, power, and replacement component.<sup>8</sup>

The DWR contract gives Met the right to use the SWP transportation facilities to transport water that does not come from SWP facilities.<sup>9</sup> The contract also gives Met the right to use SWP facilities for "interim storage" of non-project water, for later transportation to Met and its member agencies.<sup>10</sup> Met pays no facilities charge to transport or store non-project water because Met pays for these rights by way of its transportation charge under the DWR Contract. DTX-055 at AR2012-000153 (Art. 55(b)-(c)); DTX-087 at AR2012-011307 ("contractor[s] that participate[] in the repayment for a reach [have] already paid costs of using that reach for conveyance of water supplies in the Transportation Charge invoice under its Statement of

<sup>5</sup> DTX-090 at AR2012-000001 (capitalization omitted).

<sup>6</sup> DTX-055 at AR2012-000048-49 (Arts. 9 (Obligation to Deliver Water Made Available), 10 (delivery structures)).

<sup>7</sup> DTX-055 at AR2012-000065 (Art. 22 (a), defining Delta Water Charge), 000071-72 (Art. 23, defining Transportation Charge).

<sup>8</sup> DTX-055 at 000071 (Art. 23, defining Transportation Charge), 000074 (Art. 24(a), defining Capital Cost Component), 000083 (Art. 25(a), defining Minimum Operation, Maintenance, Power, and Replacement Component), 000086-87 (Art. 26(a), defining Variable Operation, Maintenance, Power, and Replacement Component).

<sup>9</sup> DTX-055 at AR2012-000153 (Art. 55(a)).

<sup>10</sup> *Id.*; see also DTX-087 at AR2012-011307; DTX-109\* at AR2012-016588. These documents refer to Met's use of the SWP to transport non-project water to full-service users.

Charges”); DTX-109\* at AR2012-016588 (“This [non-project water] conveyance service is provided because the state water contractor has paid for the capital and operations and maintenance costs associated with the capacity in the California Aqueduct that is used”).

#### 4. Met’s Rates and Charges

##### a. Rate-Setting

Until 2003, Met charged its member agencies a single, bundled water rate without any separate supply or transportation components.<sup>11</sup> In 1998, Met began the process of designing and implementing unbundled water rates and charges, to reflect the different services Met provides in order to more transparently recover its costs.<sup>12</sup>

Every year, or more recently, every two years, Met’s Board votes on particular rates adopted under that rate structure. In each budget and rate-setting cycle, Met looks at the services it expects to provide and estimates the costs it expects to incur to provide those services. As part of this process, Met evaluates its budget and the required rates necessary to support that budget.<sup>13</sup>

For each rate-setting since the unbundling, Met has presented each Board member with a final letter setting forth the details of the proposed rate options and a staff recommendation, as well as a multi-step cost of service (COS) analysis demonstrating how Met assigns certain expenses to related operation functions.<sup>14</sup>

In Step 1 of the COS process, Met determines its revenue requirements for the given fiscal year.<sup>15</sup> This prospective process is necessarily inexact because Met must estimate both the services it plans to provide and their cost.<sup>16</sup>

<sup>11</sup> DTX-045 at AR2012-006471, 006496.

<sup>12</sup> DTX-132\* at AR2012-006462\_01; DTX-034 at AR2012-005545-46.

<sup>13</sup> DTX-090 at AR2010-011443; DTX-110\* at AR2012-016594.

<sup>14</sup> DTX-090 at AR2010-0011443; DTX-110\* at AR2012-016594.

<sup>15</sup> DTX-090 at AR2010-011467, 011472-011474 (Schedule 1 at AR2010-011474 sets forth the revenue requirements by budget line item); DTX-110\* at AR2012-016674, 016679-016680.

<sup>16</sup> *Id.*

In Step 2 of the COS process, Met functionalizes its costs according to the nature of the service to which the costs correspond.<sup>17</sup> These services are: supply, transportation (conveyance and aqueduct and distribution), storage, and demand management.<sup>18</sup>

Transportation-related costs associated with bringing water to Met's service area—mainly costs associated with the Colorado River Aqueduct and the SWP transportation facilities—are functionalized as conveyance and aqueduct costs. *Id.* Transportation-related costs associated with Met's internal distribution system are functionalized as distribution costs. *Id.* Costs associated with investments in developing local water resources are functionalized as demand management costs. *Id.*

In Step 3 of the COS process, Met categorizes its functionalized costs based on their causes and behavioral characteristics, including identifying which costs are incurred to meet average demands versus peak demands, and which costs are incurred to provide “standby” service.<sup>19</sup> The relevant classification categories include: fixed demand costs, fixed commodity costs, fixed standby costs, and variable commodity costs.<sup>20</sup> Demand costs are “incurred to meet peak demands” and include only the “direct capital financing costs” necessary to build additional physical capacity in Met's system.<sup>21</sup> Commodity costs are generally associated with average system demands. Fixed commodity costs include fixed operations and maintenance and capital financing costs that are not related to accommodating peak demands or standby service. Variable commodity costs include costs of chemicals, most power costs, and other cost components that vary depending on the volume of water supplied. Standby service relates to

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<sup>17</sup> DTX-090 at AR2010-011472, 011474-011482 (Schedule 4 at 011481 sets out the revenue requirements by their service function; DTX-110\* at AR2012-016679, 016681-016687.

<sup>18</sup> DTX-090 at AR2010-011474-011475; DTX-110\* at AR2012-016681-016682.

<sup>19</sup> DTX-090 at AR2010-011472, 011483-011489; DTX-110\* at AR2012-016679, 016688-016694.

<sup>20</sup> DTX-090 at AR2010-011483 (Schedule 7 at 011488 sets out the service revenue requirements by classification category); DTX-110\* at AR2012-016688.

<sup>21</sup> DTX-090 at AR2010-011483, 011488; DTX-110\* at AR2012-016688, 016693.

MWD's ability to ensure system reliabilities during emergencies such as earthquakes or major facility outages. The two principal components of Met's standby service costs are emergency storage within its own system and the standby capacity within the SWP conveyance system.<sup>22</sup>

In Step 4 of the COS process, Met breaks its operation functions down into corresponding rate design elements, which, in Met's rate structure are volumetric rates (*i.e.*, rates charged per acre-foot<sup>23</sup> of water Met delivers to the member agencies), and fixed charges (*i.e.*, charges which do not vary with sales in the current year).<sup>24</sup> Among the unbundled volumetric rates in Met's rate structure are the Supply Rates (Tiers 1 and 2) and the Transportation Rates.<sup>25</sup> Met's fixed charges included a Readiness-to-Serve Charge and a Capacity Charge.<sup>26</sup>

#### **b. Water Rate Versus Wheeling Rate**

Met's full-service water rate, charged when Met sells a member agency water, includes supply rates (Tier 1 and Tier 2), the System Access Rate, the System Power Rate, and the Water Stewardship Rate. These are all volumetric charges. Met's Wheeling Rate includes the System Access Rate, the Water Stewardship Rate, and the incremental cost of power necessary to move the water. MWD Admin. Code §§ 4119, 4405(b). All member agencies are charged the same rates. These components are described below.

#### **i. Supply Rates**

Met's Supply Rates recover costs incurred to maintain and develop water supplies needed to meet the member agencies' demands.<sup>27</sup> These costs include capital financing, operating,

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<sup>22</sup> *Id.*

<sup>23</sup> An acre-foot of water covers one acre one foot deep.

<sup>24</sup> DTX-090 at AR2010-011472, 011490 (Schedule 8 at 011490 sets out Met's classified service functions by rate design element); DTX-110\* at AR2012-016695.

<sup>25</sup> DTX-090 at AR2010-011490-011500; DTX-110\* at AR2012-016695-016700.

<sup>26</sup> *Id.*

<sup>27</sup> DTX-090 at AR2010-011474-011475, 011499-011500; DTX-110\* at AR2012-016681, 016700.

maintenance and overhead costs for storage in Met's reservoirs.<sup>28</sup> These costs are generally recovered through the Tier 1 Supply Rate. However, if purchases in a calendar year by a member agency that executed a purchase order exceed 90% of its base firm demand (an amount based on the member agency's past annual firm demands), that member agency must pay a higher Tier 2 Supply Rate.<sup>29</sup> If a member agency did not execute a purchase order, the member agency must pay the higher Tier 2 Supply Rate for any amount exceeding 60% of its base firm demand.<sup>30</sup>

## ii. System Access Rate

The System Access Rate generates revenues to recover the capital, operating, maintenance, and overhead costs associated with the transportation facilities (*e.g.*, aqueducts and pipelines) necessary to deliver water to meet member agencies' average annual demands.<sup>31</sup> Revenues from the SAR recover the costs of paying for distribution facilities (Met's facilities within its service area) and conveyance facilities (costs associated with the SWP facilities and Colorado River Aqueduct).<sup>32</sup> The System Access Rate also includes regulatory storage costs, which are associated with maintaining additional distribution capacity and help meet peak demands.<sup>33</sup>

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<sup>28</sup> *Id.*

<sup>29</sup> DTX-045 at AR2012-006535-006536; DTX-090 at AR2010-011499; DTX-110\* at AR2012-016700.

<sup>30</sup> *Id.*

<sup>31</sup> DTX-045 at AR2012-006518; DTX-090 at AR2010-011492; DTX-110\* at AR2012-016697.

<sup>32</sup> DTX-045 at AR2012-006518.

<sup>33</sup> DTX-090 at AR2010-011473, 011475, 011484-011485, 011488, 011490-011492; DTX-110\* at AR2012-016680, 016682, 016695-016697.

### iii. System Power Rate

The System Power Rate generates revenues to recover the costs of power necessary to pump water through the SWP and Colorado River facilities to Met, and through Met's facilities to the member agencies.<sup>34</sup>

Met allocates transportation costs associated with the SWP to the System Access Rate and the System Power Rate the same way it allocates those costs associated with the Colorado River Aqueduct.<sup>35</sup>

### iv. Water Stewardship Rate

The Water Stewardship Rate recovers the costs of funding demand management programs (local water resource development programs, water conservation programs, and seawater desalination programs).<sup>36</sup> These demand management programs, discussed in more detail below, are designed to encourage the development of local water supplies and the conservation of water.

### c. Readiness-to-Serve Charge

Met's Readiness-to-Serve Charge recovers, among other things, SWP-related conveyance costs associated with peak demand (*i.e.*, capital financing costs), as well as emergency storage and peak-related storage costs (*i.e.*, storage which provides operational flexibility in meeting peak demands and flow requirements), and costs incurred to stand by and provide services during times of emergency or outage of facilities.<sup>37</sup> Each member agency's Readiness-to-Serve

<sup>34</sup> DTX-045 at AR2012-006520; DTX-090 at AR2010-011492; DTX-110\* at AR2012-016697.

<sup>35</sup> DTX-090 at AR2010-011488, 011490; DTX-110\* at AR2012-016693, 016695.

<sup>36</sup> DTX-045 at AR2012-006519; DTX-090 at AR2010-011492; DTX-110\* at AR2012-016697.

<sup>37</sup> DTX-090 at AR2010-011484-011485, 011488, 011490, and 011494-011495; DTX-110\* at AR2012-016688-016689, 016693, 016695, and 016698-016699.

Charge is based on that agency's ten-year rolling average of past total consumption, *i.e.*, all firm deliveries including water transfers and exchanges that use Met capacity.<sup>38</sup>

**d. Capacity Charge**

The Capacity Charge is intended to pay for the cost of peaking capacity on Met's system, while providing an incentive for local agencies to decrease their use of Met's system to meet peak day demands.<sup>39</sup> Each member agency's Capacity Charge is based on that agency's maximum summer day demand placed on the system between May 1 and September 30 for a three-calendar year period.<sup>40</sup>

**e. Treatment Surcharge**

The treatment surcharge is a uniform system-wide volumetric rate charged to for treated water.<sup>41</sup>

**5. Demand Management Programs**

Met's demand management programs fall under the rubric of the Local Resources Program, which provides incentives for recycled water and groundwater recovery facilities; the Seawater Desalination Program, which provides incentives for member agencies to develop facilities to desalinate seawater; and the Conservation Credits Program, which encourages the installation of water-efficient devices.<sup>42</sup>

Met's demand management programs, are designed to, and do, reduce demand for water. *See* DTX-045 at AR2012-006519 ("Investments in conservation and recycling decrease the

<sup>38</sup> DTX-090 at AR2010-011495; DTX-110\* at AR2012-016699.

<sup>39</sup> DTX-090 at AR2010-011492-011493; DTX-110\* at AR2012-016697-016698.

<sup>40</sup> DTX-090 at AR2010-011492; DTX-110\* at AR2012-016697.

<sup>41</sup> DTX-045 at AR2012-006520.

<sup>42</sup> *See, e.g.*, DTX-027 at AR2012-002868-002873; JTX-2\* (AR2012-016429) at AR2012-016496, 016519.

region's overall dependence on imported water supplies"); 12/20/2013 Tr.\*\* at 588:24-589:1<sup>43</sup> ("That's ultimately what [Met is] paying for is for a reduction in demand for imported water from [Met's] system." (Upadhyay testimony)); DTX-027 at AR2012-002870 (the first key goal of Met's Local Resources Program is to "avoid or defer Met capital expenditures"); 12/20/2013 Tr.\*\* at 578:22-580:11 (Upadhyay testimony stating that Met adopted the Local Resources Program principles and they remain in effect today); DTX-518\*\* at MWD2010-00466049 (Board identifying regional benefits associated with the Local Resources Program, including reduction in capital investments due to deferral and downsizing of regional infrastructure and reduction in operating costs for distribution of imported supplies); 12/20/2013 Tr.\*\* at 580:17-581:21 (Upadhyay testimony that Met adopted the Local Resources Program as described in DTX-518); DTX-527\*\* at MWD2010-00469807 (the first key goal of Met's Seawater Desalination Program is to "avoid or defer MWD capital expenditures"); 12/20/2013 Tr.\*\* at 583:16-585:1 (Upadhyay testimony stating that Met's Seawater Desalination Program results in similar benefits to the Local Resources Program, including its key goals, and Met's Board adoption of the Program).

There are various estimates of the demand for water alleviated by these programs. *See* JTX-2\* (AR2012-016429) at 016519 (Met's 2010 IRP estimates that 1,037,000 acre-feet of water will be conserved annually in southern California by 2025 due to Met's Conservation Credits Program). On an annual basis Met is required to report to the Legislature the effect its demand management programs have on decreasing demands on Met's system. *See, e.g.*, DTX-454\*\* (Senate Bill 60 Report for fiscal year 2011/12); 12/20/2013 Tr. at 601:5-18 (Upadhyay testimony). These reports note the number of acre-feet of water Met was able to avoid

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<sup>43</sup> As explained in note 3, "\*" indicates that a document is present only in the 2012 administrative record. "\*\*\*" indicates that a document is not in any administrative record. All documents in the 2010 administrative record are also in the 2012 administrative record.

transporting to its member agencies in a particular year as a result of its demand management programs. DTX-454\*\* at MWD2010-00310322; 12/20/2013 Tr.\*\* at 601:19-603:15 (Upadhyay testimony). Met calculates the effect demand management programs have by comparing the actual demand in a given year to the amount of reduced demand quantified in its SB-60 Reports. 12/20/2013 Tr.\*\* at 601:19-603:15 (Upadhyay testimony). For example, in fiscal year 2011/12, Met estimated it would have had to transport over 20% more water through its system without its demand management programs. *Id.*; *see also id.* at 603:16-605:19 (Upadhyay testimony explaining that the 20% figure is conservative because the Conservation Credits Program actually reduces demand more than is reflected in the SB-60 Reports).

Met states that these decreases in demand avoid some capital expenditures,<sup>44</sup> including some transportation-related capital expenditures. *See, e.g.*, DTX-090 at AR2010-011511 (“Investments in demand side management programs like conservation, water recycling and groundwater recovery . . . help defer the need for additional conveyance, distribution, and storage facilities.”).

For example, in 1996, Met conducted a study to determine its future demand scenarios and corresponding infrastructure requirements.<sup>45</sup> Met evaluated two scenarios: a “base case,” under which no demand management programs were in place, and a “preferred case,” under which demand management program were in place.<sup>46</sup> Met compared the base and preferred cases and determined that demand management programs would decrease demand, thereby reducing the amount of water passing through Met’s system. Met believes that this equated to \$2

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<sup>44</sup> DTX-020 at AR2012-001655-001657; 12/20/2013 Tr.\*\* at 605:20-606:8 (Upadhyay testimony).

<sup>45</sup> DTX-018\*\*, DTX-019 at AR2012-001406-001519; DTX-020 at AR2012-001520-001657.

<sup>46</sup> DTX-018\*\* at MWD2010-00465826-00465828, 00465831-00465836; 12/20/2013 Tr.\*\* at 566:13-567:24 (Upadhyay testimony).

billion savings in capital infrastructure costs.<sup>47</sup> It is unclear the extent to which the demand management programs contemplated in the preferred case exist.

Met also explored how its anticipated capital expenses relate to demand on Met's system in its 1996 Integrated Resources Plan ("IRP").<sup>48</sup> In the 1996 IRP, Met performed a sensitivity analysis to assess whether changes in future demands would impact the need for additional or expanded distribution facilities.<sup>49</sup> The IRP concludes that a 5% increase/decrease of demand had a correlative effect on when Met would need to incur capital infrastructure costs.<sup>50</sup> For example, Met determined that with a 5% decrease in demand, it could defer building the San Diego Pipeline No. 6 and the Central Pool Augmentation Project, both of which are distribution facilities.<sup>51</sup> Met contends that it has in fact been able to defer both of these projects because demand management programs have decreased demand on Met's system.<sup>52</sup>

## 6. Dry-Year Peaking

Met is a supplemental supplier of water. Thus annual demand for Met water can vary for a variety of reasons. *See JTX-2\** (AR2012-016429) at AR2012-016473 ("[Met's] primary purpose is to provide a supplemental supply of imported water to its member public agencies. . . . The demand for supplemental supplies is dependent on water use at the retail consumer level and the amount of locally supplied water. Consumer demand and locally supplied water vary from year to year, resulting in variability in water sales").

According to San Diego, "dry-year peaking" refers to annual variations in use of Met water as a result of drought conditions. A reference to this is found in in Met's 1996 Integrated

<sup>47</sup> DTX-018\*\* at MWD2010-00465836; 12/20/2013 Tr.\*\* at 568:22-569:12 (Upadhyay testimony).

<sup>48</sup> DTX-020 at AR2012-001520-001657.

<sup>49</sup> DTX-020 at AR2012-001655-001657; 12/20/2013 Tr.\*\* at 571:25-572:10 (Upadhyay testimony).

<sup>50</sup> DTX-020 at AR2012-001655-001657; 12/20/2013 Tr.\*\* at 571:25-573:16 (Upadhyay testimony).

<sup>51</sup> DTX-020 at AR2012-001655-001657; 12/20/2013 Tr.\*\* at 573:6-16 (Upadhyay testimony).

<sup>52</sup> 12/20/2013 Tr.\*\* at 573:17-574:3 (Upadhyay testimony).

Resources Plan (IRP), which spelled out the storage, conveyance, and water supply development costs that Met must incur to satisfy “dry year water demands.”<sup>53</sup> This IRP explained that “because demands and supplies can vary substantially from year to year due to weather and hydrology,” and “because Metropolitan’s supplies are the swing supply for the region as a whole, this variation in demand alone translates into a  $\pm$  14 percent change in Metropolitan’s water sales,” much of which is attributed to the fact that “below-normal runoff in the Owens Valley increases [Los Angeles’s] need for Metropolitan’s deliveries.”<sup>54</sup>

Raftelis’s 1999 cost-of-service report, commissioned by Met, also refers to dry-year peaking and the disparity among member agencies in their peaking behavior, caused by the fact that “agencies with local resources” use Met as their “swing supply.”<sup>55</sup>

According to San Diego, some member agencies increase their reliance on Met water by a greater magnitude than other agencies during dry years. San Diego’s experts calculated each member agency’s average annual variations in purchases over the last ten years (including the ratios of highest annual water use to average annual water) and San Diego submitted this information to Met’s Board for its consideration during the 2012 rate-setting cycle.<sup>56</sup> San Diego’s experts concluded that MWD’s largest customers (*i.e.*, those that purchase over 100,000 acre-feet of water per year, accounting for more than 70% of MWD’s total water deliveries) had ratios between 1.07 and 1.32. *Id.* (San Diego’s ratio was 1.11, Los Angeles Department of Water and Power’s ratio was 1.31).

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<sup>53</sup> AR2010-001406 at 001450, 001452, 001466, 001491, 001493, 001509-10, 001591.

<sup>54</sup> AR2010-001406 at 001486-88 (charting LA’s dry-year peaking); *see also* AR2012-16429 at 16523\* (detailing Los Angeles’s practice of rolling onto Met’s system in dry years and rolling off again in dry years).

<sup>55</sup> AR2012-16288\_2114 at 2189-92\*.

<sup>56</sup> DTX-108\* at AR2012-016177.

## Basic Evidentiary Standards and Burdens

The basic evidentiary standards and burdens applicable to the claims asserted here were discussed in the November 5, 2013 pretrial order. While the determinations made there were subject to revision, Pre-Trial Rulings at 9, the parties have provided no new argument and so I reiterate them here.

### 1. Default Rules

The general principles governing review of a quasi-legislative action on a writ of mandate under C.C.P. § 1085 are discussed in *American Coatings Assn., Inc. v. South Coast Air Quality Dist.*, 54 Cal.4th 446, 460 (2012). The rules are: (1) the standard of review is arbitrary and capricious, (2) petitioner usually bears the burden of proof,<sup>57</sup> and (3) the court considers only the administrative record before the agency at the time of its decision. An administrative agency's rate-making is a form of quasi-legislative action. *20th Century Ins. Co. v. Garamendi*, 8 Cal.4th 216, 277 (1994); *Brydon v. East Bay Mun. Util. Dist.*, 24 Cal.App.4th 178, 196 (1994) (water rate structure is quasi-legislative). Rates are presumed reasonable, fair, and lawful, *Hansen v. City of San Buenaventura*, 42 Cal.3d 1172, 1180 (1986) and petitioners have the burden of showing otherwise. *Id.*; *San Diego Cnty. Water Auth. v. Metro. Water Dist. of S. California*, 117 Cal.App.4th 13, 23 n.4 (2004).

Evidence outside the administrative record is not usually admissible. *Western States Petroleum Ass'n v. Superior Court*, 9 Cal.4th 559, 565, 576 (1995). *Western States* did recognize a narrow exception: Extra-record evidence is admissible in traditional mandamus proceedings if it existed before the agency made its decision and it was not possible in the exercise of reasonable diligence to present it to the agency before the decision was made. *Id.* at

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<sup>57</sup> Evid. C. § 500. The burden of producing evidence is usually, but not always, on the party which has the burden of proof. Evid. C. § 550 (b).

578. Other exceptions might exist, but extra-record evidence cannot be used to contradict the administrative record. *Id.* at 578-79.

## 2. Proposition 26 (California Constitution Article XIII C)

California Constitution Article XIII C § 1(e) provides,

The local government bears the burden of proving by a preponderance of the evidence that a levy, charge, or other exaction is not a tax, that the amount is no more than necessary to cover the reasonable costs of the governmental activity, and that the manner in which those costs are allocated to a pay or bear a fair or reasonable relationship to the payor's burdens on, or benefits received from, the governmental activity.

This is similar to that enacted by Proposition 218 and found in article XIII D § 4(f), which states:

In any legal action contesting the validity of any assessment, the burden shall be on the agency to demonstrate that the property or properties in question receive a special benefit over and above the benefits conferred on the public at large and that the amount of any contested assessment is proportional to, and no greater than, the benefits conferred on the property or properties in question.

Proposition 218 probably requires independent review. *Silicon Valley Taxpayers Ass'n, Inc. v. Santa Clara County Open Space Authority*, 44 Cal.4th 431 (2008).<sup>58</sup> Proposition 26 specifies the “burden of proving by a preponderance of the evidence” that the charge is not a tax, whereas Proposition 218 uses only the general term “burden.” By clarifying the burden, Proposition 26 may more strongly suggest that independent or *de novo* review is required. After Proposition 218, “an assessment’s validity, including the substantive requirements, is now a constitutional question,” and agencies may not exercise discretion to violate the constitution.

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<sup>58</sup> *Silicon Valley* held the Proposition did not specify the burden, and so considered extrinsic evidence of voter intent. *Id.* at 445. The Court found that Proposition 218 was intended to overturn cases that held a deferential view of local government assessments was required. *Id.* at 445-46. And the Court concluded that the primary basis for deferential review, judicial deference to legislative acts, did not apply under Proposition 218, a constitutional amendment designed to limit local power, because Proposition 218 makes an assessment’s validity a constitutional question. *Id.* at 447-48. Neither party here discusses the extrinsic evidence of voter intent as to Proposition 26.

*Silicon Valley*, 44 Cal.4th at 448. This too suggests *de novo* review. See also *Griffith v. City of Santa Cruz*, 207 Cal.App.4th 982, 990 (2012) (reviewing trial court's denial of petition for writ of mandate pursuant to Propositions 218 and 26 *de novo* because it involved a facial constitutional challenge to an ordinance as written); *Greene v. Marin Cnty. Flood Control & Water Conservation Dist.*, 49 Cal.4th 277, 298 (2010) (reciting *Silicon Valley*). Moreover, the statutory language suggests that Met bears the burden of proving that its charge is not a tax under any of the seven exceptions.

As to the scope of the evidence to be considered, given the default rule that the scope of review is limited to the administrative record (with certain exceptions) and the failure of Proposition 26 to clearly modify this standard, I will here follow *Western States* and look only to the administrative record.

### **3. Proposition 13 and Government Code §§ 50075-50077**

Whether a statute imposes a tax or a fee for the purposes of Proposition 13 is a question of law to be decided on an independent review of the facts. See *Cal. Farm Bureau Federation v. State Wat. Resources Control Bd.*, 51 Cal.4th 421, 436 (2011).

The following burden-shifting framework applies: (1) San Diego bears the burden of establishing a *prima facie* case showing that the fee is invalid; and (2) if San Diego's evidence is sufficient, Met then bears the burden of production to show that the challenged components of its rates bear a fair or reasonable relationship to the costs of the service Met provides. San Diego bears the burden of proof, and Met's burden is one of production only. See *Cal. Farm Bureau*, 51 Cal.4th at 436-37. For the same reasons discussed with respect to Proposition 26, I will look solely to the administrative record.

#### 4. Wheeling Statutes

The wheeling statutes provide that no “public agency may deny a bona fide transferor of water the use of a water conveyance facility which has unused capacity, for the period of time for which that capacity is available, if fair compensation is paid for that use, subject to [enumerated exceptions].” Wat. Code § 1810. “‘Fair compensation’ means the reasonable charges incurred by the owner of the conveyance system, including capital, operation, maintenance, and replacement costs, increased costs from any necessitated purchase of supplemental power, and including reasonable credit for any offsetting benefits for the use of the conveyance system.” Wat. Code § 1811(c).

Section 1813 provides,

In making the determinations required by this article, the respective public agency shall act in a reasonable manner consistent with the requirements of the law to facilitate the voluntary sale, lease, or exchange of water and shall support its determinations by written findings. In any judicial action challenging any determination made under this article the court shall consider all relevant evidence, and the court shall give due consideration to the purposes and policies of this article. In any such case the court shall sustain the determination of the public agency if it finds that the determination is supported by substantial evidence.

In *Metropolitan Water Dist. of Southern Cal. v. Imperial Irr. Dist.*, 80 Cal.App.4th 1403, 1423, 1426-33 (2000), the Court found the wheeling statutes do not always preclude the consideration of system-wide costs in a wheeling rate calculation, and in so doing the Court afforded no deference to Met’s position. Accordingly, I should review *de novo* whether the statute applies or bars the inclusion of any component in a rate. But to the extent I must to review Met’s factual “fair compensation” determination, the statute requires me to do so under the substantial evidence standard.

The statutory language does not address the burden of proof, nor is there authority on point. San Diego argued in pre-trial briefing that *Beaumont Investors v. Beaumont-Cherry Valley*

*Water District*, 165 Cal.App.3d 227 (1985) places the burden of proof on the water district to prove that its charges are fairly allocated and do not exceed the reasonable cost of service. But, if anything, *Beaumont* shifts only the burden of production. *Homebuilders Ass'n of Tulare/Kings Cnty., Inc. v. City of Lemoore*, 185 Cal.App.4th 554, 563 (2010) (*Beaumont* conflated the burden of production and the burden of proof, the agency in *Beaumont* failed to meet its burden of production).

Finally, the statute requires me to consider all relevant evidence. *See* Wat. Code § 1813.

#### **5. Government Code § 54999.7(a) and 66013**

Met maintains that these statutes do not apply in this case as a matter of law. *See* Met Closing Brief, 26-29 (arguing that (1) § 66013 does not apply because it provides a basis for challenging capacity charges, not water rates generally; and (2) § 54999.7 does not apply to a water wholesaler like Met, or where all customers are public agencies, or where rates are not imposed). The applicability of the statutes is a legal matter, and no deference is afforded to Met. I resolve those legal issues below.

To the extent San Diego alleges Met acted unreasonably by including certain components in its water rates, this may raise factual questions, challenging Met's quasi-legislative actions. As to such issues, I afford deference to Met. I apply the default rule that San Diego bears the burden of proof and the default rule that I am confined to the administrative record.

#### **6. The Met Act**

San Diego argues that Met violated its enabling statute, the Met Act, by including in its wheeling rate costs that are unrelated to wheeling. At issue is Water Code Appendix § 109-134, which requires Met to set rates that are "uniform for like classes of service throughout the district."

“[T]he judiciary, although taking ultimate responsibility for the construction of the statute, accords great weight and respect to the administrative construction.” *San Diego Cnty. Wat. Authority v. Metropolitan Wat. Dist. of Southern Cal.*, 117 Cal.App.4th 13, 22-23 (2004). The Court further noted that substantial deference must be given to Met’s determination of its rate design and that rates established by a lawful rate-fixing body are presumed reasonable, fair, and lawful. *Id.* at 23 n.4. Accordingly, here I should give substantial deference to Met’s rate design, presume that Met’s rates are reasonable, and accord great weight to Met’s statutory construction while independently taking ultimate responsibility for construction of the statute. *Yamaha Corp. of America v. State Bd. of Education*, 19 Cal.4th 1, 11 n.4 (1998) (court has final responsibility for the interpretation of the law).

To the extent a burden of proof applies, consistent with the presumption that Met’s rates are reasonable the following burden-shifting scheme applies: (1) the plaintiff has the initial burden to establish that rates are different for different classes of like entities; (2) upon that showing, the defendant must make a showing that the rates were fixed by a lawful rate-fixing body, giving rise to an assumption of fact is required to be made that the rates fixed are reasonable, fair, and lawful; and (3) the plaintiff has the ultimate burden to show that the rates fixed are unreasonable. *Elliott v. City of Pacific Grove*, 54 Cal.App.3d 53, 60 (1975). In *Elliott*, the Court stated in dicta that the burden-shifting scheme proposed by defendants should apply in a rate-setting case. *See also Hansen*, 42 Cal.3d at 1180 (citing *Elliott* for the propositions that rates established by a lawful rate-fixing body are presumed reasonable and that, thus, plaintiffs bear the burden of showing that the rates fixed are unreasonable). Absent a showing that evidence is admissible pursuant to an exception under *Western States*, I should consider only the administrative record.

## 7. Common Law

A county, for example, can sue to enjoin rates that discriminate without a reasonable and proper basis. *Cnty. of Inyo v. Pub. Utilities Com.*, 26 Cal.3d 154, 159 (1980) (citing *Elliott*, 54 Cal.App.3d at 59). “A showing that rates are discriminatory is in itself insufficient to fulfill a complainant’s burden of proof [citation]; a showing, however, that such discrimination rests solely on the nonresident status of the customer, and not on the cost of service or some other reasonable basis, will prove the rate invalid.” *Cnty. of Inyo*, 26 Cal.3d at 159 n.4. With respect to the common law theory, I should give Met deference. Even when appellate opinions have not applied the writ of mandate standard to rates, they follow the “substantial deference” standard and presume rates’ reasonableness. *See San Diego*, 117 Cal.App.4th at 23 n.4. The burden-shifting procedure described above should apply to the common law theory for the same reasons it should apply under the Met Act. As with the Met Act claim, I should confine myself to the administrative record, absent San Diego’s showing that an exception to *Western States* applies.

## Key Cases

### 1. Wheeling Cases

“State law mandates that the owner of a water conveyance system with unused capacity allow others to use the facility to transport water. The use of a water conveyance facility by someone other than the owner or operator to transport water is referred to as ‘wheeling.’ In return for wheeling, the water conveyance system owner is entitled to ‘fair compensation.’” *Metropolitan Wat. Dist. of S. Cal. v. Imperial Irrigation Dist.*, 80 Cal.App.4th 1403, 1407 (2000) (*MWD*).

With respect to wheeling, the parties focus on two cases decided less than a month apart. *See MWD*, 80 Cal.App.4th 1403; *San Luis Coastal Unified School Dist. v. City of Morro Bay*, 81 Cal.App.4th 1044 (2000).

In *MWD*, Met sought validation of its wheeling rates. *MWD*, 80 Cal.App.4th at 1408. Then, as now, Met's wheeling rate was based on the amount of water transported without regard to the source of water, the facilities used, or the distance traveled. *Id.* at 1419. The rate was based on the same "transmission-related costs" that Met included in the rates it charged for the water it sold to member agencies. *Id.* The transmission-related charges compensated Met for its capital investment and system-wide costs. *Id.* These costs included: debt service, operations and maintenance expenses, and take-or-pay contract costs associated with aqueducts and pipelines that deliver water from the supply sources to storage facilities, treatment plants and customer service connection points; SWP costs identified as transportation (both capital and maintenance); the costs of operating and maintaining the Colorado River Aqueduct and in-basin systems; the costs of planning and constructing transmission facilities, the costs of operating and maintaining regulating reservoirs; and 50% of Met's "Water Management Program branches' expenses." *Id.* at 1419-20. The transmission costs were discounted for wheeling transactions to take into account the fact that wheeling can only occur when unused capacity is available. *Id.* at 1420. The wheeling rate only applied to member agencies. *Id.*

Met explained that it factored system-wide costs into its wheeling rate to maintain its operational and financial integrity and to avoid adverse impact upon rates and charges of other member agencies. *Id.* Specifically, Met argued that if water sales to member agencies were displaced by wheeling transactions and Met was unable to charge wheelers for its capital investments and system-wide costs, then Met would have to scale back its conservation and

recycling programs or shift costs to other member agencies or taxpayers. *Id.* at 1420-21. Met was concerned that wheeling transactions by member agencies would put at risk its investment in facilities, its capital improvements, its water management programs, and its ability to meet its SWP costs. *Id.* at 1421. In short, Met argued that if a member agency purchasing water from Met paid for the fixed, unavoidable costs of the system, then member agencies using the same system for wheeling must contribute to Met's fixed costs on an equivalent basis. In Met's view, this prevents the water-purchasing agencies from subsidizing part of the wheeling transactions by bearing the full costs of Met's system. *Id.*

The trial court bifurcated trial. *Id.* at 1422. In the first phase, the trial court addressed two legal questions: (1) whether Met may include all of its system-wide costs in calculating its wheeling rates rather than only costs relating to particular facilities; and (2) whether Met may set "postage stamp" rates in advance without regard to any particular wheeling transaction. *Id.* The trial court resolved those legal questions against Met, obviating the need for the second phase of trial. *Id.*

The Court of Appeal reversed. First, the Court held that "neither the plain language of the Wheeling Statutes nor the legislative history supports a conclusion *as a matter of law* that system-wide costs cannot under any circumstances be included in a wheeling rate calculation." *Id.* at 1427. In so doing, the Court left it to the trial court to determine whether the system-wide costs included in Met's wheeling rate are proper. *Id.* at 1433. The Court began its analysis by noting that the Legislature did not use language consistent with the theory that only point-to-point costs may be recovered. *Id.* at 1428. Next, the Court reasoned that the fair compensation to which a water conveyance system owner is entitled for wheeling water includes reasonable capital, maintenance, and operation costs occasioned, caused, or brought about by the use of the

conveyance system. *Id.* at 1431. The Court stated that this includes charges the owner become subject to or liable for in using the conveyance system to wheel water when it has unused capacity. *Id.* The Court rejected San Diego's argument that it would be illogical to pass on Met's past costs to present users, concluding that where present wheelers are member agencies the wheeler did have a role in developing Met's present infrastructure, which is utilized in wheeling water. *Id.* Moreover, the Court noted that the bill enacting the Wheeling Statutes was revised to expand the definition of "fair compensation" to embrace capital as well as maintenance costs, omit narrowing references to marginal costs, and to give water conveyance system owners control over the fair compensation determination. *Id.* at 1432. The Court stated that these revisions came in response to criticism that, among other things, fair compensation should not be less than the use charge to long term contractors served by the facility and that the bill could interfere with water conveyance system owners' ability to meet contract payments if wheelers undercut prices and stole away customers. *Id.*

Second, the Court held that Met is not required to determine its wheeling rate on a case-by-case basis, but may set its wheeling rate ahead of time. *Id.* at 1433. Third, the Court declined to address several other challenges to Met's wheeling rate (that the rate was so high that it discouraged wheeling, that Met improperly included system-wide replacement costs), stating that the trial court would address those issues in the first instance on remand. *Id.* at 1435-36.

*Morro Bay* was decided shortly after *MWD*. In *Morro Bay*, a county agreed to provide a school district seven acre-feet of water annually in exchange for annual payments. *Morro Bay*, 81 Cal.App.4th at 1046. The county was required to transport the water to the Morro Bay city limits, but to bring the water to the schools it had to be carried through facilities belonging to Morro Bay. *Id.* *Morro Bay* denied the school district's wheeling proposal. *Id.* at 1047. In

relevant part, Morro Bay argued that Water Code § 1810(d) prevented the school district from requiring it to transport the water because, if Morro Bay lost the school district as a customer, it would have to increase the rates it charged its remaining customers. *Id.* at 1050. The Court rejected the argument. *Id.* It stated that neither Morro Bay nor its water customers had any right to make the school district purchase any particular amount of water. *Id.* The Court also rejected the notion that loss of income from a customer is the sort of injury to a legal user of water the Legislature had in mind. *Id.*

## 2. Proposition 218 and Proposition 26 Cases

In *City of Palmdale v. Palmdale Water District*, 198 Cal.App.4th 926, (2011), the Court held that a water district failed to satisfy its burden to establish that its new water rate structure complied with Proposition 218. *Palmdale*, 198 Cal.App.4th at 928.<sup>59</sup> The water district had retained Raftelis to provide a rate study and recommend a new rate structure. *Id.* Raftelis advised the water district regarding two options for determining fixed revenues, a “cost of service” option and a “percentage of fixed cost” option. *Id.* at 929. Among the advantages of the cost of service option was: “Defensible – Prop 218.” *Id.* Among the advantages of the other options was: “rate stability.” *Id.* The water district ultimately approved a rate structure that included a fixed monthly service charge based on the size of the customer’s meter and a per unit commodity charge for the amount of water used, with the amount depending on the customer’s adherence to the allocated water budget. *Id.* at 930. The customer paid a higher commodity charge per unit of water above the budgeted allotment, but the incremental rate increase depends on the customer’s class. *Id.* For example, irrigation users are charged disproportionate rates,

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<sup>59</sup> Because it is imposed for the property-related service of water delivery, the district’s water rate, as well as its fixed monthly charges, were fees or charges within the meaning of article XIII D. *Palmdale*, 198 Cal.App.4th at 934.

reaching the highest Tier 5 rates upon use of 130% of their budgeted allocation, as compared to other users who do not reach Tier 5 until reaching either 175% or 190% of their allocation, depending on their classification. *Id.* at 937. The water district made no showing that there was a corresponding disparity in the cost of providing water to these customers at such levels. *Id.* The Court noted that the water district did not choose the option that Raftelis stated was defensible under Proposition 218. *Id.* Based on the foregoing, the Court concluded that the water district failed to carry its burden to demonstrate that its rates complied with Proposition 218. *Id.*

*Griffith v. City of Santa Cruz*, 207 Cal.App.4th 982 (2012) (*Griffith I*) involved a city ordinance subjecting residential rental dwelling units that are not occupied by the owner of the property to annual inspection by city staff. *Griffith I*, 207 Cal.App.4th at 988. The ordinance also provided for fees for annual registration, self-certification, inspection, and re-inspection in amounts to be established by resolution of the city council. *Id.* The city council subsequently set each fee. *Id.* In relevant part, plaintiff challenged the fees as illegal taxes enacted in violation of Proposition 218 and Proposition 26. *Id.* at 989-90. First, the Court noted that Proposition 218 is inapplicable to rental inspection fees. *Id.* at 995.

Second, the Court turned to Proposition 26. The Court stated that Proposition 26 exempts from its definition of “tax,” to which its requirements apply, “[a] charge imposed for the reasonable regulatory costs to a local government for issuing licenses and permits, performing investigations, inspections, and audits, enforcing agricultural marketing orders, and the administrative enforcement of adjudication thereof.” *Id.* at 996. To show a fee is an regulatory fee and not a special tax, the government should prove (1) the estimated costs of the service or regulatory activity, and (2) the basis for determining the manner in which the costs are

apportioned, so that charges allocated to a payer bear a fair or reasonable relationship to the payer's burdens or benefits from the regulatory activity. *Id.* Further, the Court noted that the question of proportionality is not measured on an individual basis, but instead is measured collectively. *Id.* at 997. Permissible fees must be related to the overall cost of the governmental regulation, they need not be finely calibrated to the precise benefit each individual fee payer might derive. *Id.* What a fee cannot do is exceed the reasonable cost of regulation with the generated surplus used for general revenue collection. *Id.*

Against this backdrop, the Court held that the city carried its burden of proof by showing that the fees were valid regulatory fees. *Id.* The Court noted that (1) the city provided a declaration to the effect that the costs of administering the ordinance would be equal to or greater than the fees levied on rental property owners; and (2) the fee schedule was on its face reasonably related to the payer's burden on the inspection program (self-certifications cost less than inspections, which in turn cost less than re-inspections necessitated by property conditions).

*Griffith v. Pajaro Valley Wat. Management Agency*, 220 Cal.App.4th 586 (2013) (*Griffith II*) upheld a water agency's ordinance against a Proposition 218 challenge. *Griffith II*, 220 Cal.App.4th at 589-90. The water agency was created to deal with saltwater intrusion. *Id.* at 590. The Pajaro Valley Groundwater Basin supplies most of the water used in Pajaro Valley. *Id.* Especially near the coast, saltwater seeps into the groundwater basin when the water table drops below sea level. *Id.* The water level drops below sea level when water is extracted faster than it is replenished by natural sources. *Id.* To prevent saltwater intrusion, the water agency's strategy was to use recycled wastewater, supplemental wells, captured storm runoff, and a coastal distribution system to reduce the amount of water taken from the groundwater basin. *Id.* The cost of this process was borne by all users on the theory that even those taking water from inland

wells benefit from the delivery of water to coastal users as that reduces the amount of groundwater the coastal users will extract from their own wells, keeping the water in all the wells from becoming too salty. *Id.* at 590-91. The water agency recovered this cost through an augmentation charge. *Id.* at 591.

The *Griffith II* Court rejected a series of substantive challenges to the augmentation charge. *Id.* at 597-602. First, the Court held that groundwater augmentation charges necessarily included debt service to construct facilities to capture, store, and distribute supplemental water. *Id.* at 598. Second, the Court held that the costs of purchasing, capturing, storing, and distributing supplemental water necessarily included general expenses to administer those functions. *Id.*

Third, the Court rejected the argument that the charge to an individual property owner was disproportionate because only coastal landowners received services, not that property owner. *Id.* at 600-01. The Court rejected this premise, because the water agency was managing water resources in the public interest for the benefit of all water users. *Id.* at 600. The Court further explained that proportionality is measured collectively, considering all rate-payers. *Id.* at 601. Moreover, apportionment is not a determination that lends itself to precise calculation. *Id.* The Court concluded that grouping similar users together for the same augmentation rate and charging users according to usage was a reasonable way to apportion the cost of service, whether or not other reasonable alternatives existed. *Id.* Accordingly, the Court also rejected the argument it was improper to take the costs of chargeable activities, deduct expected revenues from other sources, and apportion the revenue requirement among users. *Id.* at 600-01.

## Key Documents

The parties have focused their attention on several documents in the voluminous administrative record. I summarized them here.

### 1. 1969 Brown and Caldwell

In a 1969 Water Pricing Policy Study, Brown and Caldwell broke down all costs of the Met system into four functional cost groups.<sup>60</sup> In that study, Brown and Caldwell defined Met's supply system: "The supply system includes all facilities involved in the function of making water available to the initial regulating reservoirs of the MWD distribution system. This includes the Colorado River Aqueduct up to the inlet works of Lake Mathews, the proposed Bolsa Island desalination plant and its treated water transmission system, and the SWP facilities excluding the terminal reservoirs of that system. In sum, this category includes the facilities whose function is the delivery of water from the sources of supply to the MWD distribution system but whose operation is essentially unrelated to the problems in meeting short term fluctuations in demand of the individual customer agencies of MWD." Brown and Caldwell defined Met's distribution system as all Met facilities that convey water from supply works to the member agencies. Thus, Brown and Caldwell included those SWP costs arising from construction and operation of terminal storage reservoirs. In accompanying tables, the bulk of Met's SWP transportation charge was attributed to supply, while a smaller portion was attributed to fixed distribution costs. *Id.* at 1745-46.

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<sup>60</sup> AR2012\_016288\_1723 at 1744\*.

## 2. 1993 Raftelis Textbook

The 2012 administrative record includes an excerpt on classifying “O&M”<sup>61</sup> costs taken from a 1993 textbook written by George A. Raftelis. DTX-134\* at AR2012-5282, 5284. The text discusses allocation of water service costs to customers. *Id.* at 5291. It states that this usually takes place in two steps: (1) allocation of costs to functional cost of service categories; and (2) reallocation of functional costs to classification of customers. The text identifies several functional cost of service components, including, among others: (1) “Source of supply: operating and capital costs associated with the source of water supply (reservoir construction and maintenance costs, water right purchases, supply development costs, conservation costs, etc.);” (2) “Pumping and conveyance: costs associated with pumping raw water from the source of supply and transferring it through a piping network for treatment[;]” (3) “Transmission: costs associated with transporting water from the point of treatment through a major trunk to major locations within the service area[;]” and (4) “Distribution: costs associated with smaller local service distribution mains transporting water to specific locations within the service area; water storage costs are normally considered a part of distribution costs.” *Id.* at 5291-92 (emphasis omitted). The text notes that if a utility effectively integrates the NARUC chart of accounts, identification of cost by functional category is provided by the accounting system. *Id.* at 5292. If the accounting system does not provide such a breakdown, it is necessary to develop allocations using appropriate bases.

## 3. Resource Management International, Inc. (RMI) Reports

In October 1995, RMI provided a report outlining its recommendations regarding how a cost of service and rate alternatives study for Met should be conducted. DTX-013, AR2012-

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<sup>61</sup> This appears to mean Operation and Maintenance. See DTX-013 at AR2012-001111 (defining “O&M” as operation and maintenance expenses).

001106. In the October 1995 report, RMI explained that operating expenses should be functionalized into a number of major utility functions, including, among others: (1) “Supply Function – Costs of operating and maintaining water supply facilities, such as dams and associated reservoirs, wells, and desalination plants, and costs of purchasing water from wholesale water suppliers[;]” (2) “Transmission Function – Costs of operating and maintaining aqueducts to move water from sources of supply to major centers of demand[;]” and (3) “Distribution Function – Costs of operating and maintaining distribution pipelines which deliver water from the major aqueducts to storage facilities, to treatment plants, and to customer service connection points.” *Id.* at 001112 (emphasis omitted).

In May 1996, RMI provided a cost of service study to Met. DTX-133\* at AR2012-001796. This report included, among others, the following categories: (1) “Source of Supply – Source of supply costs include the costs of operating and maintaining water source facilities, such as [same examples as listed in October 1995 report][;]” (2) “Transmission Function – Transmission costs consist of [same definition as in October 1995 report][;]” and (3) “Distribution function – Distribution costs consist of [same definition as in October 1995 report].” *Id.* at 1874 (emphasis omitted). The report stated that conservation, groundwater recovery, local projects, and wastewater reclamation were supply costs. *Id.*

In the May 1996 report, RMI treated the SWP Delta Water Charges as source of supply costs, but treated SWP transportation charges as transmission/distribution costs. *Id.* at 1876-77, 1904. The basis for the distinction was the nature of the expense as the SWP bills are categorized and the capital charges for transmission facilities and the operations and maintenance charges for transmission facilities are transmission-related. *Id.* at 1876. RMI treated Water Management Programs as source of supply costs. *Id.* at 1905.

In December 1995, RMI issued a report identifying approaches for pricing water wheeling services. DTX-136 at AR2012-001223. RMI stated that Met's volumetric rate design, coupled with its fixed expenditures (predominantly flowing from what RMI referred to as SWP Supply costs, including costs for the SWP to transport the water),<sup>62</sup> created a risk that Met would either have to increase its rates charged in water sales or suffer revenue under-collection if wheeling transfers supplanted Met water sales. *Id.* at 001225, 001231, 001233, 001233 n.4, 001234-35, 001245-46, 001254. However, RMI understood that a rate increase to member agencies was barred by the "hold harmless" requirement. *Id.* at 001234, 001254. (This requirement is also referred to as part of the San Pedro principles, and is discussed in more detail below.)

RMI discussed four alternatives. Three merit discussion. The first option was a wheeling rate that removed only SWP incremental power and fish program charges from the water rates, retaining all of the other rate elements from the firm sales rate. *Id.* at 001244. RMI recommended that option, acknowledging that it would likely be an extremely high rate and accordingly be considered highly unsatisfactory, because it would remove any economic incentive to wheel water. *Id.* at 001254. The second option was to remove all avoided supply costs, including all SWP and Colorado River supply costs, from the rate. *Id.* at 001245. RMI expressed concern that this rate could displace Met sales, forcing Met to increase its firm sales rate and violating the "hold harmless" principle. *Id.* at 001251. It also noted that non-member agencies might object to this rate because they would be forced to contribute to recovery of Met's fixed costs. *Id.* at 001252. The third option was a wheeling rate based on incremental costs. *Id.* at 001247. RMI stated that this would disregard the costs of building and operating

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<sup>62</sup> The report notes that Met still needed to classify its costs. DTX-136 at AR2012-001227. Obviously, this report predated the May 1996 report, discussed above.

the integrated delivery systems Met utilizes to transport water to the customer. *Id.* RMI also expressed concern that this option would lead to a substantial displacement of Met sales. *Id.* at 001252. As is clear from the discussion of Met's wheeling rate above, Met did not take any of these options.

In the report, RMI also discussed SWP wheeling charges, noting that its charge for wheeling water from the from the Delta to Met's delivery point at Castaic Lake could limit Met's wheeling rates. *Id.* at 001237. However, RMI posited that such a constraint could be avoided if Met wheeled the water on the California Aqueduct under its contract with the SWP, because all fixed charges are covered by Met's annual payment to the SWP it would be expected that member agencies receiving on-behalf wheeling service would be charged only variable SWP power charges.

#### **4. 1996 Integrated Resources Plan**

The 1996 Integrated Resources Plan (IRP) is comprised of two volumes, a long-term resources plan and an overview study of Met's system.<sup>63</sup>

The IRP addressed the impact of increasing demand for water in Southern California. In that context, the IRP discussed water conservation as impacting water demand and as a supply option much like any other traditional supply project. *See* DTX-019 at AR 2012-001448. In the IRP, conservation was defined as long-term programs that require investments in structural programs such as ultra-low-flush toilets, low-flow showerheads, or water efficient landscape irrigation technology – coupled with ongoing public education and information. *Id.* Water recycling was also described as a valuable source of water supply. *Id.* at 001452. Ocean desalination was also described as an abundant source of water supply, although a cost prohibitive one. *Id.* at 001456.

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<sup>63</sup> *See* DTX-019 at AR2012-001406; DTX-020 at AR2012-001520.

The IRP also noted that local management programs reduce the need for additional investment in regional infrastructure. *Id.* at 001491. The IRP stated that changes in water demand can be attributed to weather, structural changes in retail demand, or local supply development. *Id.* The IRP set out guidelines for water management programs and conservation programs, explaining, among other things, that (1) the regional benefits of local water management programs should be measured by reduction in capital investments due to deferral of or down-sizing of regional infrastructure, reduction in O&M expenditures for treatment and distribution of imported water, and reduction in expenditures associated with developing alternative regional supplies; (2) local water management programs must increase regional supplies and provide measurable regional benefits; and (3) the regional benefits of conservation programs should be measured by the same factors, and in addition by environmental benefits from reduced demand on the ecosystem. *Id.* at 001515-16. The IRP included a sensitivity analysis, which discussed the sensitivity of Met's rates to the level of demand on Met's system going forward. DTX-019 at AR2012-001502. For example, the IRP identifies several projects that could be delayed or avoided with a 5% decrease in retail demand. *See* DTX-020 at AR2012-01656.

The IRP also discussed Met's storage, which it divided into "Emergency Storage," "Seasonal or Regulatory Storage," and "Carryover or Drought Storage." *Id.* at 001466. Emergency storage is to be used if a catastrophic event disables a vital conveyance system. *Id.* Seasonal or regulatory storage is designed to balance seasonal demand, ensuring that summer season demand is met. *Id.* Carryover or drought storage is water stored beyond a single year for use in droughts. *Id.* The IRP projected demand under wet, normal, and dry conditions. *See* DTX-020 at AR2012-001566. It also breaks down dry year peak demands of the Met member

agencies. *Id.* at 001572-74; *see also id.* at 001595, 001602, 001610 (charts of projected dry year peak demands in various regions).

#### 5. Resolution 8520

On January 14, 1997, Met's Board issued Resolution 8520. DTX-680 at AR2012-002446, 002451. In Resolution 8520, Met adopted its "postage stamp" wheeling rate. *Id.* at 002448. That is, it adopted a uniform rate per acre-foot of water for wheeling transactions regardless of the facilities used in the transaction or the distance moved. *Id.*

The document begins with a series of "whereas" clauses, including the following statements: (1) Met has a contract with the State of California that requires Met, on a take or pay basis, to pay a proportionate share of the costs of constructing and operating the SWP, including facilities for conserving, storing, and transporting water to Met's service area; (2) under its contract with the State of California, Met has an entitlement to water and associated transportation thereof by the SWP and the right to use SWP transportation facilities for its own purposes, subject to certain conditions; and (3) Met's conveyance system and its rights to use the SWP conveyance system are, together, the conveyance system. *Id.* at 002446.

The Board allocated its transmission costs to reflect the capital, operation, maintenance, and replacement costs incurred by Met to convey water to its conveyance system, including Met's rights in the SWP system, and because it found that including those costs in Met's wheeling rate is necessary to insure recovery of fair compensation for the use of that conveyance system. *Id.* at 002449. Further, the Board found that allocating unavoidable costs attributable to Met's supply, power, storage and customer related functions because including those unavoidable costs in the wheeling rate is necessary in order to protect Met's member agencies

from financial injury by avoiding the shifting of those costs from a wheeling party to Met's other member agencies. *Id.*

Attachment 1 to Resolution 8520 is an October 1996 technical report on the proposed wheeling charge. *Id.* at 002452. The purpose of the report is to describe Met's proposed charge for wheeling, which is defined as provision of transportation-only service for water owned by others rather than the traditional bundled delivery of water owned by Met. *Id.* The report notes that Met has entered into long-term contracts, constructed major capital facilities, issued bonds to finance construction or purchase facilities, and has implemented water management programs to develop, store, transmit, and treat water throughout its service area. *Id.* Further, it notes that one basis for using a postage stamp rate is system integration. *Id.* at 002455. Because the system is integrated, it notes, charges for Met water service should reflect the cost of the whole system, and members using the system to wheel water should pay for the cost of the whole system. *Id.* Moreover, the report lists Met's major facilities and programs as including the SWP, the Colorado River Aqueduct, pumping plants, reservoirs, water treatment facilities, a system of pipelines and control structures, associated facilities for the transportation, storage and delivery of water, as well as water conservation projects and financial assistance for water recycling and groundwater recovery facilities. *Id.* System integration is demonstrated by the blending of water and the ability to compensate for outages by deliveries from other sources. *Id.* at 002455-56.

The report goes on to discuss the proper wheeling rate for member agencies. *Id.* at 002458. The report disaggregates costs into categories for "transmission," "storage," "supply," "power," and "treatment." *Id.* at 002460. At Schedule A, the report charts the allocation of SWP costs and Water Management Program costs between the five categories, above. *Id.* at 002472.

Transmission includes debt service, operations and maintenance expenses, take-or-pay contract costs associated with aqueducts and pipelines that deliver water from supply sources to storage facilities, and treatment plants and customer service connection points. *Id.* at 002460.

Transmission includes SWP costs identified as transportation, the costs of operating and maintaining the Colorado River Aqueduct, the costs of planning and constructing transmission facilities, and the costs of operating and maintaining regulating reservoirs. *Id.* Costs functionalized to transmission include the SWP transportation expenses and 50% of the incentives and program costs for the Water Management Programs. *Id.* at 002464.

Supply costs include the costs of operating and maintaining water source facilities such as dams to control river flows, reservoirs to capture runoff, wells, desalination plants, and transfers to procure additional water supplies. *Id.* at 002460. Costs functionalized as supply include 50% of Water Management Programs branches and the Delta Water Charge charged by the SWP. *Id.* at 002462.

## **6. 2002 Final Report on Rates and Charges and Cost of Service Reports**

In its 2002 Final Report on Rates and Charges, Met described and evaluated what remains its current rate structure. In the cost of service process, Met (1) developed its revenue requirements; (2) functionalized its costs; (3) classified its costs; and (4) allocated its costs to rate design elements. DTX-045 at AR2012-006493. In functionalizing its costs, it defined the terms “supply” and “conveyance and aqueduct.” *Id.* at 006496-97. The supply function includes SWP costs that relate to maintaining and developing supplies – the Delta Water Charge and the cost of storage and transfer programs. *Id.* at 006496. The conveyance and aqueduct function includes capital, operations, maintenance, and overhead costs for SWP facilities that convey water to Met’s internal distribution system as well as the SWP variable power costs, which are

categorized in a separate subcategory. *Id.* The report explains that conveyance and aqueduct costs have been separated from source of supply costs to allow a more detailed level of analysis to be performed during the evaluation of rate design alternatives. *Id.* at 006497. The SWP conveyance and aqueduct revenue requirement outpaced the SWP source of supply revenue requirement. *Id.* at 006504.

In the report, Met identified benefits of the Water Stewardship Rate and System Access Rate. The Water Stewardship Rate reduces dependence on imported supplies, increases water supply reliability, reduces and defers system capacity expansion costs, and creates space availability to complete water transfers. *Id.* 006519. The report included a frequently asked questions section. There, Met justified charging all users, including third party wheelers, the Water Stewardship Rate on the basis that all users would benefit from paying a lower System Access Rate because conservation and local resources projects would lead to a deferral and reduction of facility expansion costs. *Id.* at 006775. The report says the System Access Rate ensures that member agencies will pay the same cost for access to Met's system whether they purchase water from Met or another supply source. *Id.* at 006518.

The 2010 and 2012 cost of service studies, which retain the rate structure identified in the 2002 report, identify drought storage as a distinct storage cost that is recovered through supply rates.<sup>64</sup>

## **7. 2010 Raftelis Study**

In 2010, Raftelis Financial Consultants, Inc. reviewed Met's fiscal year 2010/11 cost of service and rate setting process. *See* DTX-088 at AR2012-011309. The review states that functionalizing SWP costs in accordance with the SWP invoice is appropriate because the invoices from the SWP are detailed and are not aggregated on a per-acre foot basis. *Id.* at

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<sup>64</sup> DTX-090 at AR2012-011474-75, 84, 86, 88; DTX-110\* at AR2012-016653, 016681-82, 016689, 016700.

011318. The study further noted that Met follows the four-step process set forth in American Water Works Association's Manual M-1 by identifying service functions cost, the classification of cost, and allocation of costs to rate design elements to develop a nexus between cost and revenue streams. *Id.* at 011322. Moreover, the study found that the rate design elements meet requirements set forth by AWWA's rate-setting principles and industry guidelines. *Id.*

#### **8. 2010 Bartle Wells Associates Letters**

San Diego retained Bartle Wells Associates to review Met's rates. In a March 2010 letter, Bartle Wells opined that Met improperly, and contrary to industry standards, misallocates some of its supply costs under the SWP contract to a conveyance and distribution category. AR2010-11207-14. According to Bartle Wells, this distorts Met's System Access Rate and Met's supply rates. *Id.* Bartle Wells' rationale was that Met does not own, maintain, or operate any of the SWP facilities, so its SWP costs are the cost of obtaining a supply from the SWP. *Id.* at 11208. Further, Bartle Wells stated that the SWP power costs should be charged to supply, and not the System Power Rate. *Id.* at 11208-09. Bartle Wells stated that three other contracting agencies allocate SWP costs as supply costs, and that it was not aware of any agency that allocated SWP costs in the same way Met does. *Id.* at 11209.

Bartle Wells also found that it was improper for Met to collect the Water Stewardship Rate through its conveyance charges. *Id.* at 11207-08. Bartle Wells explained that the service function was to increase water supply, so the cost should be allocated to supply rates. *Id.* at 11209-10.

Met's general manager and general counsel responded to these concerns in an April 2010 memorandum to the Met Board. AR2010-011307. In it, they asserted that (1) the SWP charges must be paid regardless of the quantity of water delivered; (2) Met uses the SWP as a

conveyance facility to convey both SWP and non-SWP water pursuant to the contract; and (3) Met has consistently recorded SWP capital costs as payments for use of the SWP facilities. *Id.* at 11306-07. Accordingly, they concluded that Met properly charges its SWP contract costs in its conveyance costs, as it pays for conveyance rights in the contract, avoiding a use fee that it would otherwise have to pay to use the facilities. *Id.* at 11307. As to the Water Stewardship Rate, they stated that all users benefit from lower capital costs as a result of resource management programs, so all users should bear a proportional cost for these services. *Id.* at 11307-08.

In an April 2010 letter, Bartle Wells supplemented the above opinions. AR2010-11393-400. In it, Bartle Wells concluded that Met's rates were not consistent with industry best practice or the AWWA Manual M-1<sup>65</sup> or the NARUC system of accounts, and that Met's rates are not apportioned among customers in a manner that reflects the proportionate cost to serve each. *Id.* Bartle Wells wrote that NARUC requires water purchase costs to reflect the cost of water purchased for resale at the point of delivery. *Id.* at 11394. Under NARUC, Bartle Wells stated that SWP costs should be allocated as supply, regardless of the manner in which the Department of Water Resources bills Met. *Id.* In addition, Bartle Wells asserted that Met does not comply with the AWWA manual because its rate system treats the cost of an imported water supply as a transportation cost, inflating Met's transportation charge and disproportionately impacting customers who purchase transportation rather than supply services. *Id.* at 11396. Bartle Wells also restated its conclusion that the Water Stewardship Rate is misallocated, and thus concluded that it is not in compliance with the AWWA manual. *Id.* at 11396-97.

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<sup>65</sup> AWWA Manual M-1 is a part of the administrative record. *See* DTX-030 at AR2010-003865. The AWWA manual defines a cost-of-service approach as one that allocates costs to a customer or class of customers based on cost causation. *Id.* at 003997. The manual discusses charting operation and maintenance expenses, noting that NARUC has a uniform system of accounts that is widely used and can be modified for government-owned utilities. *Id.* at 003904.

The April 2010 letter addressed Met's response to the March 2010 letter. *Id.* at 11397. It responded to Met's argument that uses the SWP as a conveyance facility by stating that Met does not own or control the SWP, but is merely a customer under a water supply contract. *Id.* It responded to Met's argument that it is appropriate for all users to pay the Water Stewardship Rate because all users benefit from reduced capital costs by asserting that Met must measure what portion of the benefit accrues to each class of Met customers to fairly apportion its rates. *Id.* at 11397-98. Bartle Wells states that Met has failed to do that accounting. *Id.*

In March 2012, Bartle Wells confirmed that its position remained the same as to the 2013/2014 rates.<sup>66</sup>

#### **9. 2012 FCS**

In March 2012, the FCS Group provided a review of Met's 2013/2014 rates at San Diego's request. AR2012-16156-91, 16160\*. FCS found that Met's rates were deficient in the following respects: (1) the supply rate should, but does not, include costs to obtain water supplies from the SWP and from local projects that are instead recovered through the System Access Rate, the System Power Rate, and the Water Stewardship Rate; (2) the Readiness-to-Serve Charge was improperly charged to wheeling parties; and (3) the rates did not adequately address seasonal or sporadic annual peaking because the rates consider only peak day cost through the capacity charge. *Id.* at 16163-64. With respect to the Water Stewardship Rate, FCS argued that Met failed to demonstrate that the rate provides a proportionate and direct benefit to transportation in spite of its obligation to demonstrate a reasonable nexus between the charge and the service provided. *Id.* at 16173. With respect to sporadic annual peaking, FCS stated that agencies with constant demand subsidize those with fluctuating demand by paying to maintain standby capacity, whether demand fluctuates based on conservation measures, price elasticity at

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<sup>66</sup> AR2012-16215-16\*.

the local retail level, mandatory water curtailments, weather patterns, the local agency's supply conditions, or other factors. *Id.* at 16176, 16178. FCS opined that Met's capacity charge and Tier 2 Supply Rate recover only a small portion of the billions Met spends on drought insurance, such that agencies with more stable demand end up subsidizing those with variable demand. *Id.* at 16178.

The Met general manager and general counsel responded in a memorandum to Met's Board. AR2012\_016583\*. They asserted that Met has an integrated system, including Met's right to use SWP facilities, from which all system users, including wheelers, benefit. *Id.* at 016586. They stated that Met, as a supplemental supplier of water, must ensure that agencies that transport water acquired from other sources do not evade the costs of maintaining Met's system. *Id.* at 016588. They cite two examples in which Met used the SWP to transport non-SWP water to member agencies. *Id.* They suggest that those SWP costs would have been subsidized if the SWP contract were allocated solely to supply. *Id.* They also noted that each SWP contractor funds the systems development and operations through payments proportional to their rights to use the system, supporting Met's treatment of the SWP as an extension of its system. *Id.* They drew further support from the fact that the Department of Water Resources breaks its invoices into supply charges and transportation charges. *Id.* at 016589. As to the Water Stewardship Rate, they stated that all users benefit from the programs it funds, so all should pay. *Id.* at 016590. They raise the concern that a failure to charge the rate to wheelers would mean that wheelers enjoy the benefits of the program without paying their share. *Id.* As to peaking, they state that Met recovers its standby costs through the Readiness-to-Serve Charge and its distribution peaking costs through the Capacity Charge. *Id.* at 016592.

## Summary of Arguments

San Diego argues that Met's System Access Rate, System Power Rate, Water Stewardship Rate, and wheeling rate are illegal and should be invalidated. San Diego Post-Trial Brief at 4. San Diego argues that (1) Met recovers the costs Met pays the SWP for transportation through its transportation rates without any basis for treating the SWP as its own conveyance system; and (2) Met charges its full Water Stewardship Rate in its wheeling rate even though the programs that are funded by the rate are primarily *supply* benefits. *Id.* at 3-4.

San Diego also contends that Met incurs dry-year peaking costs which benefit some member agencies (such as Los Angeles) which are recovered disproportionately from other member agencies (such as San Diego) through the transportation rates, among others. *Id.*

Met argues that it is reasonable to allocate SWP transportation costs to its transportation rates for four reasons: (1) SWP transportation costs are Met transportation costs;<sup>67</sup> (2) Met uses SWP facilities as an extension of its own system;<sup>68</sup> (3) Met has an integrated, regional system that delivers a blend of water which includes SWP water; and (4) Met's allocation is consistent with industry guidelines.<sup>69</sup> Met Closing Brief at 45-60. San Diego counters that the SWP costs are supply costs, i.e., costs incurred to obtain a supply of water. San Diego Post-Trial Brief at 20-25. San Diego accuses Met of improperly protecting member agencies that do not wheel water from facing increased rates when wheeling member agencies purchase water from other sources. *Id.* at 7.

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<sup>67</sup> Met relies on the facts that (1) its contract with the Department of Water Resources breaks down its charges to Met to reflect both costs associated with supply water and those associated with water delivery; and (2) it pays a share of the capital costs of expanding the SWP system in the reaches it uses. Met Post-Trial Brief, 45-49.

<sup>68</sup> Met relies on its contractual right to use SWP facilities to transport non-project water and the fact that it has exercised that right. Met Closing Brief, 49-53.

<sup>69</sup> Met points to the 1993 Raftelis textbook, the RMI reports, and the 2010 Raftelis report. Met Closing Brief, 55-59.

Second, Met contends that it is reasonable to allocate the Water Stewardship Rate to its transportation rates because the Water Stewardship Rate recovers the cost of funding programs that help avoid or defer transportation-related capital expenses and increase system capacity. Met Closing Brief at 61-74.<sup>70</sup> San Diego responds that the programs funded by the Water Stewardship Rate are primarily designed to meet supply programs; therefore Met should have studied and quantified the transportation benefits of those programs if they were to allocate any of the costs of those programs to a charge other than their supply rates. San Diego Post-Trial Brief at 26-29.

Third, Met argues that San Diego's dry-year peaking claim fails because: (1) Met recovers storage-related costs;<sup>71</sup> (2) annual variation in demand has a number of causes; (3) there are only minor differences in member agency demand fluctuations;<sup>72</sup> (4) Met's rates recover the costs of variations in water purchases from year to year and within a single year;<sup>73</sup> and (5) San Diego lacks standing. Met Closing Brief at 87-100. San Diego responds that Met's SWP contract, its demand management programs, its conveyance capacity, and its reservoirs and storage are all necessary to meet dry year demand. San Diego Post-Trial Brief, 30-31. San Diego contends that agencies that have a higher annual variation enjoy these benefits while paying a lesser share of the costs due to Met's use of volumetric rates. *Id.* at 33. That is, in a year when a highly variable agency uses less water, it pays less to maintain Met's system even

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<sup>70</sup> Met refers to the 1996 IRP to demonstrate the importance of reduced demand. Met Closing Brief, 63. Further, Met notes that the goal of local resources programs have long included assisting local projects that improve regional water supply reliability and avoid or defer Met capital expenditures. *See* AR2010-002870.

<sup>71</sup> Met states that it recovers drought storage through its supply rates. Met Closing Brief, 89.

<sup>72</sup> Met emphasizes that San Diego's annual variation from its ten year average was 1.11, whereas Los Angeles' was 1.31. Met Closing Brief, 93. Met also argues that, even if this variation is significant, it is irrelevant because it does not impact Met's costs, based on system-sizing. *Id.* at 95.

<sup>73</sup> Met relies on (1) its volumetric rates, which ensure that an agency pays more in a year it purchases more water; (2) its tiered supply rates, which are tiered to reflect the cost of Met obtaining new supplies if a member agency executed a purchase order exceeding 90% of its base firm demand; (3) its Readiness-to-Serve Charge, which recovers standby, emergency storage, and capital costs for facilities to meet peak monthly or seasonal demand (based on a ten-year rolling average of past consumption); and (4) its Capacity Charge, which is based on peak week demands.

though it contributes to the overall need for system capacity and available water supply at a level based on its peak year. On the other hand, an agency that varies little pays a greater share of the burden of maintaining the whole system in a year in which the highly variable agency uses less water.

Fourth, Met asserts that its wheeling rate is reasonable because: (1) it is reasonably based on the principle that all member agencies should pay for the fixed, unavoidable system costs when using Met's system; (2) it is reasonable to recover system-wide SWP costs in the wheeling rate;<sup>74</sup> and (3) it is reasonable to charge the Water Stewardship Rate in connection with wheeling transactions.<sup>75</sup> Met Closing Brief, 74-87. San Diego argues that Met's wheeling rate illegally discourages wheeling by improperly including its SWP costs, Water Stewardship Rate, and dry-year peaking costs in its wheeling rate. San Diego Post-Trial Brief, 45, 48-58.

## Discussion

The parties agree that Met is obligated to set its rates based on principles of cost causation, that is, that Met must charge for its services based only on what it costs to provide them. Met Closing Brief at 60; San Diego's Amended First Pretrial Brief at 1. This is the central focus of this case, and provides a good shorthand for the varied tests implicated by the varied causes of action, as revealed by the summaries just below.

For each of the claims, I now review whether the statutes or law apply.

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<sup>74</sup> According to Met, this is because the wheeling statute allows Met to charge system-wide costs in its wheeling rate and Met exercises its contractual right to use SWP facilities to complete wheeling transactions. Met Closing Brief, 83-85.

<sup>75</sup> Met argues that this is because wheelers benefit from available capacity, as that enables Met to wheel water. Met Closing Brief, 86. Met also reiterates that this recovers from wheelers the cost of using the system. *Id.* at 85-86.

## 1. Application of Statutes

**Proposition 26.** Here the issue is whether rates are commensurate with the reasonable costs of the services. Proposition 26 does not apply, Met says, for four reasons. (1) The rates are not “imposed,” rather, the member agencies join voluntarily. I have previously rejected Met’s argument in denying its motion for judgment on the pleadings. Sept. 19, 2013 Order Denying Motion for Judgment on the Pleadings at 3 (citing *Bighorn-Desert View Water Agency v. Verjil*, 39 Cal. 4th 205 (2006)). I did allow for the possibility “that facts adduced at trial will reveal the extent to which the rates are or are not ‘imposed,’ such as the choices available to San Diego for water and water transport.” *Id.* at 3. But Met did not adduce any such facts, whether from the administrative record, to which this claim is limited at Met’s suggestion, or otherwise. Indeed the record contains numerous references to the fact that Met will “IMPOSE RATES AND CHARGES.” AR2010-6159-162 (capitalization in original); *see also, e.g.*, AR2010-6166-222; AR2010-6223-239; AR2010-6945-7029. More substantively, the 2012 Official Statement to Met’s bondholders confirms that SD had no choice but to use Met’s facilities to wheel water. AR2012-16429 at 16509\*. (2) The rates are in fact reasonable. This is the issue on the merits; and I defer here to my discussions below on the merits. (3, 4) The rates are charges for the use of ‘local governmental property,’ and 2/3 of the appropriate “electorate” approved them. These are arguments which I have previously rejected in the September 19, 2013 Order, and my reasoning remains unchanged.

Propositions 26 applies here.

**Proposition 13** (Govt. Code §§ 50075, 50076). The issue whether there is a fair or reasonable relationship between the rates and services. Met argues that Prop 13 does not apply,

because water rates are outside the purview of Proposition 13. Met cites *Brydon v. E. Bay Mun. Util. Dist.*, 24 Cal.App.4th 178 (1994), and *Rincon Del Diablo Mun. Water Dist. v. SDCWA*, 121 Cal.App.4th 813 (2004), suggesting that San Diego obtained just that ruling from the *Rincon* court. 121 Cal.App.4th at 821-22. San Diego agrees that the water rates in those cases were not taxes because they were “not designed to replace property tax monies lost in consequence of the enactment of California Constitution, article XIII A,” *Brydon*, 24 Cal.App.4th at 194; *accord Rincon*, 121 Cal.App.4th at 822. But in this case, San Diego tells us, Met’s Engineers’ Reports explicitly say the opposite about Met’s rates:

Since the passage of Article XIII A of the California Constitution, Metropolitan has necessarily relied more on water sales revenue than on ad valorem property taxes for the repayment of debt. Water sales have become the dominant source of revenue, not only for operation and maintenance of the vast network of facilities supplying water to Southern California, but also for replacement and improvement of capital facilities. The increased reliance on highly variable water sales revenue increases the probability of substantial rate swings from year to year. ***The use of water rates as a primary source of revenue has placed an increasing burden on ratepayers, which might more equitably be paid in part by assessments on land that in part derives its value from the availability of water.***<sup>76</sup>

This Engineer Report does not distinguish *Brydon* and *Rincon*. The notion that in the abstract some sort of “assessments on land” might be used to pay for water does not mean the extant rates were as a matter of fact “designed to replace property tax monies lost in consequence of the enactment of California Constitution, article XIII A.” *Rincon*, 121 Cal.App.4th at 822. Met is correct that Proposition 13 does not apply here.

**Wheeling statute** (Water Code § 1810 *et seq.*). The issue is whether the rates are “fair compensation” for the services provided. Water Code § 1811(c).

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<sup>76</sup> AR2010-11443 at 11511-12 (emphases added by San Diego); *accord* 2012-16594 at 16806-07\*.

**Govt. Code §§ 54999.7(a), 66013.** The issue is whether the costs of providing the service are reasonable. Met argues that Govt. Code § 66013, which San Diego invokes solely in the 2012 action, does not apply. That sections reads, “[n]otwithstanding any other provision of law, when a local agency imposes fees for water connections or sewer connections, or imposes capacity charges, those fees or charges shall not exceed the estimated reasonable cost of providing the service for which the fee or charge is imposed,” unless approved by a popular two-thirds vote. This language does not suggest the statute applies to San Diego’s complaints—San Diego does not allege problems with water or sewer connections, or capacity charges as the term is used in that statute. As Met notes, the “legislative history does not show the Legislature intended to impose a new standard on water rates.” *Rincon Del Diablo Mun. Water Dist. v. San Diego Cnty. Water Auth.*, 121 Cal.App.4th 813, 820 (2004). Here I agree with Met.

Met also argues that § 54999.7(a) does not apply. This section provides that the rates and charges one public agency imposes on another for public utility service “shall not exceed the reasonable cost of providing the public utility service.” Gov’t Code § 54999.7(a). Met and San Diego are both public agencies. Met charges San Diego rates and charges for a “public utility service.” Nothing in the statute suggests that it is not applicable here. Met’s reference to services to “public schools” in § 54999.7(c) is not useful, as San Diego is not invoking that section, nor does § 54999.7(a) necessarily invoke or rely on § 54999.7(c). Here I agree with San Diego; the statute applies.

**Met Act** (Water Code Append. § 109-134). The Met Act requires that rates “be uniform for like classes of service throughout the district.” Water Code Append. § 109-134. The core issue is whether there is unjustifiable rate discrimination. San Diego must as an initial matter prove

that Met's rates are not "uniform for like classes of service" in the district. *Id.* That is, San Diego must establish as an initial matter that there is rate discrimination. San Diego may have misconstrued the court's pre-trial rulings to suggest that that burden may be met simply by showing there are "different classes of entities." Pretrial Rulings at 21 n.18 (dated November 5, 2013). Without showing varying rates of course San Diego's case is stymied, but proving those different rates alone is not the same as showing that there is rate discrimination. One might for example have different classes of entities but yet show no rate discrimination.

As Met notes,

In order to accommodate a water transfer market, Metropolitan maintains an unbundled rate structure based on types of service provided. As a result, member agencies pay rates based on the services they use, and agencies that use the same service pay the same rate. Agencies that purchase Metropolitan supplied water pay for supply, whereas agencies that purchase no water pay no supply costs. Agencies that take treated water cover treatment costs, whereas agencies that take untreated water pay no treatment costs. An agency that transports a third party's water through Metropolitan's system (known as "wheeling") pays transportation costs, but no supply costs.<sup>77</sup>

In brief, Met charges different rates to users differently situated: one set of rates to member agency wheelers, and one to member agencies for water purchases. Based on that simple description, there is no reason to conclude that there is price *discrimination*, a concept which depends on a comparison between similarly situated entities. To be sure, San Diego argues—persuasively, I find below—that Met actually *does* charge supply costs to those who wheel, but that is a violation of other laws, not rate discrimination. Here, the entities (wheelers and non-wheelers) are not similarly situated, and accordingly the Met Act does not apply.

**Common law.** There are two aspects to this claim; one tracks the Met Act and asks whether there is unjustifiable discrimination between rate payers; the second asks whether there is a

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<sup>77</sup> DTX-109\* at AR2012-016587.

“reasonable basis” for the rates. *Inyo*. For reasons summarized just above, the latter, but not the former, rules apply here.

**Summary.** In sum, I conclude Proposition 26, the Wheeling statute, Govt. Code § 54999.7(a), and the common law (reasonable rates requirement) apply here. In each case the core inquiry is the same, and looks to cost causation, that is, whether the costs of the services (e.g. wheeling) are reasonably related to the costs of providing those services.

## 2. Analysis On The Merits

Setting aside San Diego’s challenge to the dry year peaking (discussed below), I summarize the challenges to Met’s rates, phrased as function of the cost causation principle: Is it reasonable for Met to include in its transportation rates (A) via the Systems Access Rate and the System Power Rate, the cost the state charges to Met to transport water to Met? (B) the Water Stewardship Rate?

I summarize here the basic guidance from the central cases. *MWD* tells us that the relevant costs may--or may not--be system-wide costs; but it is clear that I do not simply look to the marginal costs of providing e.g. wheeling services. (Had I done so, and because wheeling occurs solely when there is unused capacity, I might have concluded that aside from power and other costs required to literally move the wheeled water, no other costs could be included in wheeling rates.) *Morro Bay* reminds us that rates may not discourage wheeling, and loss of income attributable to lost water sales is not a permissible justification for [increasing] wheeling rates. *Palmdale* emphasizes cost causation, and bars unjustified price discrimination. *Griffith I* and *Griffith II* emphasize the rule that it is permissible to spread the costs of programs across all

benefitted users, and approves rates as long as they do not generate a surplus over and above what is needed to provide the program.

#### A. Met's System Access Rate and System Power Rate

These two rates include the state transportation costs, i.e., SWP's costs. Met's contract with the state makes clear that Met does not own or operate the SWP transportation facilities.<sup>78</sup> Previously, Met allocated SWP costs to supply, and none to transportation (including the SWP costs that DWR bills as its own transportation costs).<sup>79</sup> No reasonable basis appears in the record as to why this has changed. To be sure, the state now does disaggregate its bills to Met, and displays *its* transportation costs on those bills, but that does not suggest those are also (or instead?) *Met's* transportation costs, any more than the overhead or payroll costs of Ford Motor Company are the overhead or payroll costs of a customer who buys a Ford car. And while Met may from time to time use the state's transport capability to move some its water (Met Closing Brief at 49), that does not support the reasonableness of including **all** the state's transportation costs as part of Met's transportation costs. The record does not, for example, quantify the use of the state systems for Met's transportation,<sup>80</sup> nor does it establish whether it is necessary for wheeling at all. Nor does it matter whether Met delivers a blend of water to wheelers (Met Closing Brief at 53). The blend might be useful<sup>81</sup> but, as to wheelers, the benefit is gratuitous, and not required by wheeling agreements. Nor, with one exception, does Met explain why the use of blended water requires the use of the state's transportation capability. The exception is to note RMI's opinions that the costs of operating Met's Colorado River Aqueduct arguably are

<sup>78</sup> AR2010-001 art. 13; PTX-237-A\*\* (Admissions) Nos. 44-47; *Metro. Water Dist. of S. Cal. v. Marquardt*, 59 Cal.2d 159, 202 (1963)(Met is not an "equitable owner" of the SWP).

<sup>79</sup> 1969 Study\*, AR2012-16288\_1723 at 1743-46; Trial Transcript\* at 469:23-470:12.

<sup>80</sup> Met Closing Brief at 49 ("SWP facilities **at times** serve *solely* a transportation function for MWD")(bolded emphasis supplied). Occasions on which this capability has been used are described at *id.*, 50-51.

<sup>81</sup> Met has noted that the blend provides lower salinity water.

classifiable as transportation costs (Met Closing Brief at 57), but Met has not described how, or the extent to which, wheeling uses that aqueduct. Nor are the costs associated with transportation through that aqueduct the issue; the issue relates to costs associated with the movement of water through the SWP's facilities.

I do note, at Met's behest, the fact that in May 1996 RMI treated the SWP transportation costs as Met's like costs. The bases set forth there, however, are impenetrable. The bases are that the (a) transportation charges are disaggregated—an issue I address just above—and (b) capital charges for the transmission facilities are transmission related: which is a tautology. The issue is not whether they are transportation related; the issue is whether there is any reasonable basis to conclude they are *Met's* transmission charges. Unless I must accept as an adequate record any outside consultants' unsupported view (and I do not), this is insufficient.

There are other parts of the record that Met has urged support its view. Met's Closing Brief at 50. (a) DTX-055 (SWP Contract at Art. 55(a)), gives Met the right to use SWP facilities for transportation. (b) In DTX-087, Met discusses the fact that it has in fact conveyed non-project water through SWP facilities, for example on two occasions in 2009. *Id* at AR2012-011307. (c) DTX-109\* is another statement by Met, dated April 2012, that it conveys non-project water through SWP facilities, *see e.g., id.* at AR2012-016586, referring to the same two events in 2009. *Id.* at AR2012-016588. And Met notes other occasions when it has bought non-project water (i.e. not from the SWP) to resell to its member agencies. Met Closing Brief at 51.

Fundamentally, Met's position seems to be based on the facts that (a) it does use SWP's facilities to move its own [non-project] water on occasion, and (b) all member agencies benefit in some way from that capability. From those predicates Met concludes that the sums it pays to the state attributable to the state's transportation costs are allocable to Met's own transportation

rates. Met Closing Brief at 53. But this is no syllogism. While one can easily conclude from these predicates that all water-purchasing member agencies should pay some share of those SWP's costs—indeed, of all costs billed by the SWP to Met—it does not follow that a given portion of those costs (such as SWP's transportation constituent) ought to be billed to wheelers who happen to be member agencies. This is especially true as it appears that the water moved by the SWP system, even when it is not water purchased from the SWP, is nevertheless generally water which is sold by Met to its member agencies, *not wheeled water*.

The position Met takes here reflects its position on the core legal dispute presented by this case, and I turn to that more specifically now.

***The Core Dispute.*** Met writes that, on the subject of system-wide costs such as (i) those paid for SWP's transportation of water and (ii) for programs funded by the water stewardship rates, "In 1997, MWD recognized that if it did not charge these costs to wheelers as well as its full-service customers, then its full-service customers would end up subsidizing the costs of wheeling transactions." Closing Brief at 6. Compare, e.g., *MWD v. IID*, 80 Cal.App.4th at 1432-33.

The core dispute is whether, under the current rate structure, wheelers are subsidizing water purchasers. San Diego says that wheelers such as itself subsidize the other member agencies. Under the wheeling statute, for example, that is not permitted because it would discourage wheeling, and under the balance of the statutes at play in this case wheelers would be paying more than a reasonable fee for the service.

This core dispute centers on the impact of the so-called San Pedro principles adopted in 1997, which San Diego characterizes as implementing an illegal rate stability plan and Met

characterizes are implementing a legal plan to avoid having its full-service customers subsidize wheeling transactions. *See, MWD v. IID*, 80 Cal.App.4th at 1418-19 (outline of principles).

Underlying Met's approach here is the position that Met is entitled to sweep into all of its charges to members agencies apparently *any* of the system-wide costs it incurs, perhaps on the theory that member agencies, in their wheeling capacity, had a role in causing all system-wide costs. Met may have in mind the words of the *Griffith I* Court, 207 Cal.App.4th at 997:

The question of proportionality is not measured on an individual basis. Rather, it is measured collectively, considering all rate payors. ... Thus, permissible fees must be related to the overall cost of the government regulation. They need not be finely calibrated to the precise benefit each individual fee payor might derive. What a fee cannot do is exceed the reasonable cost of regulation with the generated surplus used for general revenue collection. An excessive fee that is used to generate revenue becomes a tax.

While Met on occasion appears to suggest that the *MWD* opinion determines the core dispute in its favor, Met accurately recites the impact of *MWD* thusly:

The question of whether system-wide costs may be included in MWD's wheeling rate at all was already decided by the California Court of Appeal, which held that system-wide costs may be included under the Wheeling Statute. *See MWD v. IID*, 80 Cal.App.4th at 1422-23. The inquiry for this Court is whether inclusion of **particular** system-wide costs (*i.e.*, MWD's fixed SWP costs and the Water Stewardship Rate) in MWD's rate for wheeling service charges fair compensation.

Met Closing Brief at 30 (bolded emphasis supplied).

*MWD* teaches us that system-wide changes are *eligible* for this sort of treatment. But the opinion did not obviate the cost causation requirement. In *MWD*, the Court endorsed *certain kinds* of system-wide costs as properly part of the wheeling charges—those that relate to the conveyance system:

Hence, the "fair compensation" (§ 1810) to which a water conveyance system owner is entitled for wheeling water includes reasonable capital, maintenance, and operation costs occasioned, caused, or brought about by "the use of the conveyance system." (§ 1811, subd. (c).) "[F]air compensation" (§ 1810) includes charges the owner, in this case the

Metropolitan Water District, becomes subject to or liable for in using the “conveyance system” (§ 1811, subd. (c)) to wheel water when it has unused capacity.

*MWD*, 80 Cal.App.4th at 1431.

I need not determine here whether the San Pedro principles are generally appropriate; but as they have been implemented to determine the wheeling rate, they are not supportable. Here’s Met’s assessment of that implementation:

In order to ensure that both full-service users and wheelers are ultimately held responsible for their respective costs, MWD determined that if a member agency purchasing MWD water “pays for the fixed, unavoidable costs of the system . . . then member agencies using that same system for wheeling must contribute to [MWD’s] fixed costs on an equivalent basis.” *Id.* MWD also determined that this principle is consistent with the San Pedro Integrated Resources Plan Assembly Statement “that wheeling should not result in adverse impacts to the rates and charges of any member agency.” *Id.* at 002458. In other words, MWD properly recognized that member agencies that wheel would gain an unfair subsidy if they did not have to pay for the costs that they caused MWD to incur, or for the benefits they received from MWD’s system, as a result of MWD’s fixed, unavoidable costs.

Met Closing Brief at 75-76.

RMI’s December 1995 report, putatively reflecting the San Pedro principles, too opined that that wheeling “**must not negatively impact the rates or charges to any other Member Agencies.**” AR2010-1222 at 1234 (emphasis in original).

Because one of Met’s chief “fixed, unavoidable costs” is the price of water it pays to the State, Met and its consultants may have thought that wheeling rates ought to be set such that there was no effect on the rates of non-wheelers, including rates attributable to the cost of water.

But under the wheeling statute and more generally the general cost causation principles which underlie all the claims in this case, only system-wide costs attributable to the “conveyance system” should be the basis for wheeling rates. *MWD*, above. To accommodate this reference to ‘conveyance facilities,’ Met argues that the state’s (DWR’s) conveyance facilities are a part of Met’s conveyance facilities. But with all deference to Met, I have found no reasonable basis for

this conclusion in the record. The language of *Griffith I*, 207 Cal.App.4th at 997, that proportionality is properly measured not “on an individual basis [but r]ather, it is measured collectively, considering all rate payors” is not a license to impose any system-wide charge on any user. San Diego as a purchaser of water may well have a variety of system-wide financial obligations, which presumably are reflected in the price it pays for the water it buys from Met, but that does not necessarily mean that San Diego as a wheeler must have those same financial obligations. At argument Met’s counsel stated that the wheeling rate to member agencies would rightfully include system-wide charges that a wheeling rate for non-member agencies would not.<sup>82</sup> This approach inappropriately focuses on the identity of the customer as opposed to the cost of the service being rendered.

Because Met pays a fixed price for the water it buys, whether it sells it or not to member agencies, water prices to non-wheeling member agencies may rise as a function of increasing wheeling (and foregone purchases from Met). While that might result in “adverse impacts to the rates and charges” imposed on the other member agencies,<sup>83</sup> Met must nevertheless permit such wheeling. *Morro Bay*, 81 Cal.App.4th at 1050.

#### **B. Water Stewardship Rate.**

Met forthrightly notes that the Water Stewardship Rate recovers the costs of “demand management programs,” and those in turn provide incentives for recycling, groundwater recovery, desalinization programs and other water conservation efforts. Met Closing Brief at 61. Obviously, under these programs the demand for water of various member agencies is reduced, and so Met may in turn reduce its purchases. The record shows that at least a significant benefit of these programs is the creation of new water “supply,” reducing Met’s need to purchase water

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<sup>82</sup> Transcript of closing argument at 918-19 (January 23, 2014)\*\*.

<sup>83</sup> Met Closing Brief at 75-76.

from other sources.<sup>84</sup> San Diego notes that Met’s brief, its witnesses and own documents all confirm that the primary purpose of these programs is to “incentivize development of *local* water *supplies*.”<sup>85</sup> The 1999 Raftelis Report also notes that at least some of the programs’ costs should be associated with supply.<sup>86</sup>

Met itself knows that the *primary* benefit is not for transportation, but for supply: The central objective of Metropolitan’s water conservation program is to help ensure adequate, reliable and affordable water supplies for Southern California by actively promoting efficient water use. The importance of conservation to the region has increased in recent years because of drought conditions in the State Water Project watershed and court-ordered restrictions on Bay-Delta pumping, as described under “METROPOLITAN’S WATER SUPPLY—State Water Project” in this Appendix A under “METROPOLITAN’S WATER SUPPLY.”

Met Official Bond Statement: AR2012-16429 at 16519\*.

The Raftelis’s textbook too states that “conservation costs” should be functionalized to “Source of supply.” AR2012-16288\_5282 at 5291\*. Raftelis wrote that “all or at least a portion” of programs for local “conservation, water recycling, and the recovery of contaminated groundwater” should be functionalized as “supply costs.” AR2012-16288\_2114 at 2179\*.<sup>87</sup>

San Diego notes that Met has judicially admitted that it does not calculate the proportional benefits that individual member agencies receive from its Water Stewardship Rate or the programs it funds, neither on the basis of individual programs, nor in the aggregate. PTX-237-A\*\* (RFA) Nos. 20, 32. Met has further judicially admitted that it “has never calculated the

<sup>84</sup> PTX-393\*\* (Upadhyay Depo.) at 52:11-53:19; 109:16-111:19.

<sup>85</sup> MWD Br. at 7:14 (emphases added); *see also* AR2010-1101 at 1115, 1124; AR2010-1222 at 1249; AR-2012-16288\_1723 at 1744\*; PTX-037\* at 14; PTX-119\*\*; PTX-181\*\*; PTX-183\*\*; PTX-199\*\*; PTX-237-A\*\* (Admissions) Nos. 17-43; PTX-393\*\* (Upadhyay Depo.) at 52:11-53:19; 104:17-105:25, 109:16-110:13, 116:1-117:14, 134:17-135:24; Ex. 77\*\* (Arakawa Depo.) at 91:2-13; PTX-390\*\* (Kostopoulos Depo.) at 42:14-42:23; PTX-392\*\* (Thomas Depo.) at 79:3-22.

<sup>86</sup> AR2012-16288\_2179\*.

<sup>87</sup> The primary purpose of these programs is to “incentivize development of *local* water *supplies*.” MWD Br. at 7:14 (emphases added by San Diego). *See also* AR2010-1101 at 1115, 1124; AR2010-1222 at 1249; AR2012-16288\_1723 at 1744\*; PTX-037\* at 14; PTX-119\*\*; PTX-181\*\*; PTX-183\*\*; PTX-199\*\*; PTX-237-A\*\* (Admissions) Nos. 17-43; PTX-393\*\* (Upadhyay Depo.) at 52:11-53:19; 104:17-105:25, 109:16-110:13, 116:1-117:14, 134:17-135:24; Ex. 77\*\* (Arakawa Depo.) at 91:2-13; PTX-390\*\* (Kostopoulos Depo.) at 42:14-42:23; PTX-392\*\* (Thomas Depo.) at 79:3-22.

regional benefit to MWD created by the aggregate group of local water supply projects, seawater desalination projects, or conservation programs funded or subsidized with revenue collected through the Water Stewardship Rate in a given calendar year.” *Id.* No. 38.

Nevertheless Met argues that the demand management programs also reduce the demand for transportation. This, Met says, justified the inclusion of the Water Stewardship Rate in the transportation rates. Perhaps; perhaps to some extent. But the central problem here is that Met treats the *entirety* of the Water Stewardship Rate as a “transportation” rate that is then incorporated into the wheeling rate.

It is certainly reasonable to conclude that transportation capacity needs are reduced when supply needs are reduced, including reductions attributable to the demand management programs. See e.g. Met Closing Brief at 64-65. Met has documented at least a few of these. Upadhyay has testified (Met Closing Brief at 63) that some transportation facilities have been deferred as a result of conservation programs.<sup>88</sup> But the record does not show correlation between those avoided costs and water stewardship rates. While I cannot fault Met for not providing a transportation benefit number for *each* of the specific demand management programs, the best we can do with this record is to conclude that to some unspecified extent, some portion of the Water Stewardship Rate is causally linked to some avoided transportation costs. This is not enough to show that the costs of the service have a reasonable relationship to the service provided. The Rafetelis 1999 report suggests 50-50 allocation, but that suggestion was made simply because no data supported any other allocation;<sup>89</sup> the number is wholly arbitrary, as is the allocation of 100% of these Water Stewardship Rate charges to transportation.

It is also worth noting here that wheelers secure their benefits only when there is unused

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<sup>88</sup> The 1996 IRP (DTX -019)(Met slide 28).

<sup>89</sup> AR2012-16288\_2114 at 2179, 2216-17.

capacity in the extant transportation system. Wheeling is “[s]ubject to the General Manager’s determination of available system capacity.” Admin. Code § 4405(a). And Met notes, “MWD also resolved that it would make the determination of whether there is unused capacity in its conveyance system (as required by the Wheeling Statue) on a ‘case-by-case basis in response to particular requests for wheeling [services].’ DTX-680 at AR2012-002450; JTX-1 AR2010-002450.” Met Closing Brief at 20. While wheelers would benefit as a general matter by reason of increased capacity in that they might be able to wheel more water, those who in fact are permitted to wheel do so in a system built out to move non-wheeled water, that is, water that Met sells to its member agencies. Thus the costs and avoided costs attributable to the demand management programs relate to the transportation needs to provide purchased water. This too suggests that the cost of wheeling, while properly a function of system-wide costs associated with transportation as such, should not be a function of system-wide avoided costs of transporting purchased water.

### **C. Dry Year Peaking**

San Diego alleges that costs attributable to dry year peaking are improperly part of the wheeling rate. Here’s how San Diego phrases it:

The dry-year peaking costs at issue here are those associated with purchasing and storing water and having capacity available in MWD’s facilities to deliver water supplies to its member agencies when they “roll on” to MWD’s system in dry years. For example, Los Angeles has a long history of rolling on and off the system, depending on the hydrological conditions in the Owens Valley where it obtains much of its water: between 2004 and 2009, Los Angeles’s purchases from MWD swung from 367,000 acre-feet in 2004 to 208,000 acre-feet in 2006 and back up to 434,000 acre-feet in 2009 San Diego’s Amended Reply To MWD’s First Pretrial Brief at 17.

It remains unclear exactly how these costs are part of the wheeling rate. Presumably some capital storage costs, some transportation costs, and some supply costs are part of what San Diego calls dry year peaking. *Cf.* San Diego’s Post-Trial Brief at 30:20-28. Of course dry year

peaking costs are not expressly part of the wheeling charges; indeed, Met argues that there is no such thing as dry year peaking (as opposed to, for example, peaking for other reasons). Perhaps it is done implicitly, in the sense that portions of some rates San Diego pays *must* include it. As San Diego notes, Met has admitted that it does not separately allocate costs to “dry year peaking.”<sup>90</sup>

Met has essentially two responses to San Diego’s complaint. First (as noted above) there is no such thing as dry year peaking, and secondly, the differences in demand patterns which underlie San Diego’s argument are in fact fairly handled by volumetric and other rates.

First, a few words on certain graphs the parties have presented, directed to whether there really is a material variation among member agencies in their patterns of demand on Met’s water. In an effort to show that the dry year peaking issue exists, San Diego prepared a chart<sup>91</sup> to graphically represent peaking. This chart apparently shows that (assuming a baseline based on the average of 1994-2000 purchases) Los Angeles ranged from that baseline to 2.5 of that baseline average, down to a bit under 1.5 of that average, and up to about three time that ratio. San Diego’s ranges are within about 1.5 of the assumed average. Met also has a graph<sup>92</sup> which shows 2003-2012 purchases, with vaguely similar curves for both Los Angeles and San Diego, dipping in the 2005-06 and 2011 periods and rising in between around 2007 (for San Diego) and around 2009 (for Los Angeles). This includes San Diego’s exchange water, but nevertheless it shows (i) that San Diego obtained more water from Met than did Los Angeles, and (ii) the variation of San Diego’s purchases (about 675,000-400,000, i.e., 275,000) as compared to those of Los Angeles (about 425,000-175,000, i.e., 250,000), which are accordingly roughly the same.

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<sup>90</sup> Order on MILS, December 10, 2013 at 4.

<sup>91</sup> SDCWA Opening Presentation, December 17, 2013, at unnumbered page 87, based on PTX-203\*\*, 347\*\*, 299\*\*, 300\*\*, 301\*\*.

<sup>92</sup> MWD’s Opening Presentation, December 17, 2013 at 34, based on DTX-691\*\*.

Because it appears exchange water is included in Met's graph, it is not possible to make an even rough conclusion concerning the extent to which one of those two member agencies benefits more from expenditures to account for peaking. And it is not clear that measuring the net difference between high and low purchases, rather than deviations from an average baseline, helps ascertain the impact of peaking.

But San Diego's graph does not answer that question either. The fact that for some time period one customer as opposed to another has a higher ratio of maximum purchases to average purchases does not mean that the former customer imposes higher charges on the supplier who must keep water (and associated facilities) available for the peak demand. This is especially true when the customer with the lower ratio buys more water during 'peak' periods, as may be the case here.<sup>93</sup>

It is of course true that as a general matter some members agencies in some years buy more water for various reasons, including drought. And it also true, as Met agrees (Closing Brief at 89), that Met incurs costs for this sort of contingency storage. Met also agrees that this contingency capacity is significant, and designed to meet unexpected needs. *Id.* But there are many reasons for a member agency to seek additional water, such as changes in the local economy. And as Met notes, in some times of drought many member agencies actually lowered, not increased, their demand for water. Met Brief at 92; DTX-110\*. The record shows that while there are variations in demands, the variations have many causes. For example as the FCS document discussed above notes, demand may fluctuate as a result of conservation measures, price elasticity at the local retail level, mandatory water curtailments, weather patterns, the local agency's supply conditions, and other factors.

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<sup>93</sup> I exaggerate for illustration: if customer X averages 2 gallons a year in purchases, but sometimes peaks to 20 gallons (a ratio of 1:10), the water supplier will nevertheless presumably spend more to keep standby capacity available for customer Y who varies from 100 to 150 gallons (a ratio of 1:1.5).

There is no reasonable basis supporting the notion that a given amount of storage infrastructure (or any amount) is attributable to ‘dry year peaking.’

Met does impose charges for the cost of this contingency capacity. First, of course, the more water one buys the more one pays. Next, Met’s Tier 2 rates impose higher charges per volume when member agencies substantially exceed their past annual demands. Met Brief at 96. Met’s Readiness To Serve and Capacity Charges also account for unexpected additional demands from member agencies. These latter charges do not necessarily recover expenses attributable to ‘dry year peaking’ but they do recover costs attributable to some aspects of peak usage; and the ‘peak usage’ which measures the Capacity Charge is not on an annual basis but rather on a maximum summer day basis. Met Closing Brief at 99.

In the end, I do agree with San Diego that the record does not tell us that all these charges are sufficient to account for all of the costs of providing what I have called contingency capacity, but it is also true that there is no showing that this is a problem. This conclusion does not place the burden on San Diego when contesting validity of assessment under Proposition 26; rather I have turned to San Diego to show me there is an ‘assessment’ in the first place.

There is no substantial evidence that some member agencies reap a benefit for ‘dry year peaking,’ or that they do so at the expense of other member agencies such as San Diego.

## **Conclusion**

Aside from the Wheeling statute, I have been required to confine my review to the administrative record. The extra record evidence has not made any substantial difference to my evaluation in any event, although for purposes of background, illustration, or to show that some

proposition did not seem to be seriously disputed, I have from time to time mentioned that evidence.

As to the standard of review, the higher de novo standard probably applies to Proposition 26, and under the Wheeling statute to the question of whether a rate might properly include a certain component. Under the Wheeling statute, the deferential standard applies to the issue of fair compensation, as it does to Govt. Code § 549997(a) and the common law's 'reasonable basis' standard.

But in this case, regardless of the standard, the result the same. There is no substantial evidence in the record to support Met's inclusion in its transportation rates, and hence in its wheeling rate, of 100% of (1) the sums it pays to the California Department of Water Resources' SWP disaggregated by the SWP as for transportation of that purchased water; and (2) the costs for conservation and local water supply development programs recovered through the Water Stewardship Rate. Indeed, the record confirms that these rates over-collect from wheelers, because at least a significant portion of these costs are attributable to supply, not transportation. These rates – the System Access Rate, System Power Rate, Water Stewardship Rate, and Met's wheeling rate – therefore violate Proposition 26 (2013-14 rates only), the Wheeling statute, Govt. Code § 549997(a), and the common law. The Court invalidates each rate for both the 2011-2012 and 2013-2014 rate cycles.

So too, under either the substantial deference or de novo standard, San Diego has not shown that there is a "dry year peaking" phenomenon for which Met's rates fail to fairly account. No violation of the pertinent law has been shown with respect to 'dry year peaking'.

*Further Orders.* San Diego has asked me to retain jurisdiction to ensure compliance with this ruling. At least until judgment is entered an appeal is taken, such an order does not appear

necessary. San Diego has also suggested the entry of a separate order along the lines its proposed in its proposed statement of decision at 55-57. The parties should confer on the matter and report their views at the next case management conference.

Dated: April 24, 2014



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Curtis E.A. Karnow  
Judge Of The Superior Court

Superior Court of California  
County of San Francisco

SAN DIEGO COUNTY WATER  
AUTHORITY, et. al.,

Plaintiff(s)

vs.

METROPOLITAN WATER DIST. OF  
SOUTHERN CALIFORNIA, et al  
Defendant(s)

Case Number: CPF-10-510830  
CPF-12-512466

**CERTIFICATE OF ELECTRONIC SERVICE**  
(CCP 1010.6(6) & CRC 2.260(g))

IN RE: SAN DIEGO COUNTY WATER  
AUTHORITY

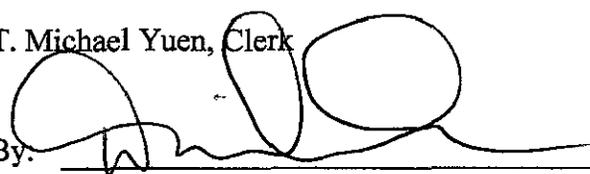
I, DANIAL LEMIRE, a Deputy Clerk of the Superior Court of the County of San Francisco, certify that I am not a party to the within action.

On April 24, 2014, I electronically served STATEMENT OF DECISION ON RATE SETTING CHALLENGES via File & ServeXpress on the recipients designated on the Transaction Receipt located on the File & ServeXpress website.

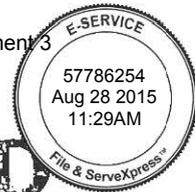
Dated: April 24, 2014

T. Michael Yuen, Clerk

By:



DANIAL LEMIRE, Deputy Clerk



**FILED**  
San Francisco County Superior Court

AUG 28 2015

CLERK OF THE COURT  
BY: [Signature]  
Deputy Clerk

SUPERIOR COURT OF CALIFORNIA  
COUNTY OF SAN FRANCISCO

SAN DIEGO COUNTY WATER  
AUTHORITY,

Plaintiff/Petitioner,

vs.

METROPOLITAN WATER DIST. OF  
SOUTHERN CALIFORNIA, et al.

Defendants/Respondents.

Case No. CFP-10-510830  
Case No. CFP-12-512466

STATEMENT OF DECISION

**I. Introduction**

San Diego County Water Authority (San Diego) claims that the Metropolitan Water District of Southern California (Met) breached the Exchange Agreement<sup>1</sup> and improperly computed preferential rights. Met disputes the merits and raised some affirmative defenses. I find for San Diego on both claims.

**II. Factual Background<sup>2</sup>**

San Diego is one of Met's member agencies. It purchases water from Met and may obtain wheeling services from Met. If San Diego purchases water from an entity other than Met, it is impossible for San Diego to receive the water without moving it through Met's facilities.

<sup>1</sup> The "Amended and Restated Agreement Between Metropolitan Water District of Southern California and the San Diego County Water Authority for the Exchange of Water." PTX-65.

<sup>2</sup> Most of this background is extracted from my April 24, 2014 Statement of Decision (April Statement of Decision).

1 This movement is termed ‘wheeling’ the water, i.e., the use of a water conveyance facility by  
2 someone other than the owner or operator.

3 Met’s current rate structure dates to 2003. Met’s full-service water rate, charged when  
4 Met sells a member agency water, includes supply rates, the System Access Rate, the System  
5 Power Rate, and the Water Stewardship Rate. These are volumetric<sup>3</sup> charges. Met’s Wheeling  
6 Rate is different: it includes the System Access Rate, the Water Stewardship Rate, and the  
7 incremental cost of power necessary to move the water.  
8

9 San Diego acquired an annual supply of transfer water from the Imperial Irrigation  
10 District (IID) in 1998. PTX-28. Later in 1998 San Diego and Met agreed to the 1998 Exchange  
11 Agreement. PTX-31.<sup>4</sup> There San Diego paid Met to take transfer water and have Met make  
12 Exchange Water<sup>5</sup> available to San Diego. *Id.* §§ 3.1-3.2, 5.2. The contract was to last 30 years.  
13 *Id.* § 5.2. For the first 20 years, San Diego would pay \$90 per acre-foot plus an annual  
14 percentage escalator. *Id.* For the final 10 years, San Diego would pay \$80 per acre-foot plus an  
15 annual percentage escalator running from 1998. *Id.* The 1998 Exchange Agreement permitted  
16 the parties to request a change in the price after 10 years. *Id.* § 5.3. The price term was close to  
17 an \$80 per acre-foot wheeling rate proposed by Department of Water Resources Director David  
18 Kennedy in January 1998 as a compromise between wheeling rates advocated by Met and San  
19 Diego in a dispute over an appropriate wheeling rate. PTX-481 at MWD 2010-00264720.  
20  
21

22 There were no IID water transfers to San Diego between 1998 and 2003. Met Pre-Trial  
23 Brief, 10; San Diego Post-Trial Brief for Phase II, 13. On October 10, 2003, the parties entered  
24

25 <sup>3</sup> That is they are based on the volume of water at issue such as gallons, *Klein v. Chevron U.S.A., Inc.*, 202 Cal. App.  
26 4th 1342, 1385 (2012), or acre feet where one acre-foot is an acre of water one foot deep.

27 <sup>4</sup> The “Agreement Between Metropolitan Water District of Southern California and the San Diego County Water  
Authority for the Exchange of Water.”

<sup>5</sup> Exchange Water is a creature of contract. It is water delivered to San Diego by Met in the same quantity as that  
made available to Met by San Diego. PTX-31 § 1.1(q); PTX-65 § 1.1(m).

1 the operative Exchange Agreement. PTX-65 at MWD2010-00190698. That day, the parties and  
2 other agencies signed two other agreements: the Quantification Settlement Agreement and the  
3 Allocation Agreement. *Id.* §§ F-G.

4  
5 Most importantly for present purposes, the operative Exchange Agreement contained a  
6 revised price provision.<sup>6</sup> The new price was initially \$253 per acre-foot, and thereafter “equal to  
7 the charge or charges set by [Met’s] Board of Directors pursuant to applicable law and regulation  
8 and generally applicable to the conveyance of water by [Met] on behalf of its member agencies.”  
9 *Id.* § 5.2.<sup>7</sup> By this term, Met charged San Diego the volumetric transportation rates it charged  
10 when it sold full-service water as of 2003 – the System Access Rate, System Power Rate, and  
11 Water Stewardship Rate.<sup>8</sup> Met’s rate *structure* has remained the same since 2003, but Met  
12 periodically adjusts the dollar figures for the rates. San Diego has paid those charges under the  
13 Exchange Agreement.  
14

### 15 16 **III. Procedural History**

17 This action includes two complaints, responsive to Met’s 2010 and 2012 rate settings  
18 respectively. April Statement of Decision, 2-3. The 2010 case included six causes of action:  
19 three that directly challenged Met’s rate setting, one breach of contract claim, a declaratory relief  
20 claim on Rate Structure Integrity, and one declaratory relief claim on preferential rights. *Id.* The  
21 2012 case included four causes of action: three that directly challenged Met’s rate setting and  
22 one breach of contract claim. *Id.* at 3. I phased proceedings. Phase I addressed the rate  
23

24 <sup>6</sup> The revised price term was proposed by San Diego as Option 2. Option 1 was closer to the original terms of the  
25 1998 Exchange Agreement whereas Option 2 involved a more significant shift in responsibilities. Trial Transcript,  
1214:1-1217:22.

26 <sup>7</sup> The revised price provision also contained a sentence addressing the parties’ rights to seek to change those charges.  
The meaning of that sentence is disputed by the parties.

27 <sup>8</sup> The rates differ from Met’s full-service water rate because San Diego does not pay the supply rates. The rates  
differ from Met’s wheeling rate because San Diego pays the System Power Rate rather than the incremental cost of  
power to move wheeled water.

1 challenges and the declaratory relief claim on Rate Structure Integrity. Phase II concerns the  
2 breach of contract and preferential rights claims.

3           On April 24, 2014, I issued a Statement of Decision following Phase I of trial. There I  
4 invalidated Met's System Access Rate, System Power Rate, Water Stewardship Rate, and  
5 Wheeling Rate for calendar years 2011-2014 because Met improperly included "100% of (1) the  
6 sums it pays to the California Department of Water Resources' SWP disaggregated by the SWP  
7 as for transportation of that purchased water; and (2) the costs for conservation and local water  
8 supply development programs recovered through the Water Stewardship Rate" in its  
9 transportation rates. *Id.* at 65. I found that "at least a significant portion of these costs are  
10 attributable to supply, not transportation." *Id.* I did not determine the proper allocation of the  
11 disputed charges.  
12

13           Met had earlier moved for summary adjudication of, among other things, San Diego's  
14 preferential rights claim. Met's motion was predicated on the rule that payments for the  
15 purchase of water do not give rise to preferential rights credit. December 4, 2013 Order, 6-7.  
16 Met argued that San Diego pays several volumetric rates under the Exchange Agreement and as  
17 a wheeler that Met also charges for the purchase of water, such that San Diego essentially paid  
18 for the purchase of water. *Id.* I denied summary adjudication, finding that San Diego did not  
19 pay any rate for the cost of water under the Exchange Agreement and that indeed San Diego had  
20 already paid *someone else* for the purchase of water in the Exchange Agreement and wheeling  
21 contexts. *Id.* at 7. I held that Met had not established as a matter of law that San Diego was  
22 purchasing Exchange Water as opposed to making some other sort of payment. *Id.*  
23  
24

25           The parties have now completed a Phase II bench trial on San Diego's breach of contract  
26 and preferential rights claims. Closing argument was held on June 5, 2015. The parties  
27

1 submitted supplemental briefs on June 19, 2015. I issued a proposed statement of decision,  
2 granted Met's request for an extension of time to file objections, and now file this statement of  
3 decision resolving the Phase II issues including Met's motion for partial judgment interposed at  
4 the conclusion of San Diego's case in the Phase II trial.  
5

#### 6 7 **IV. Discussion**

##### 8 **A. Breach of Contract**

9 To prove a cause of action for breach of contract a plaintiff must establish the contractual  
10 terms, the plaintiff's performance or excuse for failure to perform, the defendant's breach, and  
11 damage to the plaintiff resulting from the defendant's breach. *McKell v. Washington Mut., Inc.*,  
12 142 Cal.App.4th 1457, 1489 (2006); CACI No. 303.  
13

##### 14 **1. Terms**

15 In the Exchange Agreement San Diego agreed to both pay a price and make "Conserved  
16 Water" and/or "Canal Lining Water" and "Early Transfer Water" available to Met each year at  
17 the "SDCWA Point of Transfer," in exchange for which Met agreed to make "Exchange Water"  
18 available to San Diego each year at the "Metropolitan Point(s) of Delivery." PTX-65 §§ 3.1-3.2,  
19 5.1.<sup>9</sup> The aggregate quantity of Exchange Water delivered by Met in a given year was to be  
20 equal to the aggregate quantity of Conserved Water (including Early Transfer Water) and Canal  
21 Lining Water San Diego made available to Met in the same year. *Id.* §§ 1.1(m), 3.2(c).  
22

23 The Exchange Agreement provided for the Price, as follows:  
24

---

25 <sup>9</sup> The Exchange Agreement was one of several agreements executed pursuant to the Quantification Settlement  
26 Agreement. PTX-65 § F. San Diego entered the Allocation Agreement on the same day. *Id.* at § G. In the  
27 Allocation Agreement, Met assigned certain water rights to San Diego and its right to receive substantial  
reimbursements for certain canal lining projects from San Diego. DTX-884 § 4A.1. San Diego's obligations under  
the Exchange Agreement were subject to the execution and delivery of the Allocation Agreement, among other  
things. PTX-65 § 7.2.

1 The Price on the date of Execution of this Agreement shall be [\$253]. Thereafter, the  
 2 Price shall be equal to the charge or charges set by Metropolitan's Board of Directors  
 3 pursuant to applicable law and regulation and generally applicable to the conveyance of  
 4 water by Metropolitan on behalf of its member agencies. For the term of this Agreement,  
 5 neither SDCWA nor Metropolitan shall seek or support in any legislative, administrative  
 6 or judicial forum, any change in the form, substance, or interpretation of any applicable  
 7 law or regulation (including the Administrative Code) in effect on the date of this  
 8 Agreement or pertaining to the charge or charges set by Metropolitan's Board of  
 9 Directors and generally applicable to the conveyance of water by Metropolitan on behalf  
 10 of its member agencies; provided, however, that Metropolitan may at any time amend the  
 11 Administrative Code in accordance with Paragraph 13.12, and the Administrative Code  
 as thereby amended shall be included within the foregoing restriction; and, provided,  
 further, that (a) after the conclusion of five (5) Years, nothing herein shall preclude  
 SDCWA from contesting in an administrative or judicial forum whether such charge or  
 charges have been set in accordance with applicable law and regulation; and (b) SDCWA  
 and Metropolitan may agree in writing at any time to exempt any specified matter from  
 the foregoing limitation.

12 PTX-65 § 5.2.

13 The first sentence of § 5.2 sets the initial price. The second sentence of § 5.2 constrains  
 14 subsequent prices to charges Met sets pursuant to applicable law and regulation for the  
 15 conveyance of water by Met to its member agencies.

16 The parties dispute the import of the lengthy third sentence of § 5.2. Met contends that  
 17 San Diego there agreed to the rate structure Met had in place at the time of the Exchange  
 18 Agreement but reserved the ability to challenge only *amendments* to Met's rate structure (after  
 19 the five year period). Met Closing Brief, 20-22.<sup>10</sup> San Diego contends that San Diego agreed  
 20 not to challenge Met's existing rate structure or any amendments to it for five years, but reserved  
 21 the ability to challenge Met's existing rate structure or any amendments to it after five years.  
 22

23 San Diego's position is consistent with the plain language of the provision and Met's  
 24 position is not.

25 The third sentence begins with a limitation on the parties' ability to seek changes to the  
 26 form, substance, or interpretation of any applicable law or regulation, including the  
 27

<sup>10</sup> Citations to "Met Closing Brief" refer to Met's corrected closing brief.

1 Administrative Code, that pertains to the charge or charges set by Met and generally applicable  
2 to Met's conveyance of water on behalf of its member agencies. This limitation is followed by a  
3 proviso that permits Met to amend its Administrative Code and extends the scope of the  
4 limitation to any of Met's amendments to the Administrative Code. The first proviso is followed  
5 by a second proviso that constrains the scope of the general limitation in two ways – one that  
6 sunsets restrictions on challenges brought by San Diego, and one that permits the parties to make  
7 mutually agreeable changes.  
8

9 This plain language shows the parties agreed to preclude certain challenges with the  
10 exception of those challenges expressly permitted, including the specified challenges identified  
11 in the final proviso. Among the permitted challenges are those brought by San Diego after the  
12 passage of five years contesting Met's charges for the conveyance of water on the basis they  
13 were not set pursuant to applicable law. Whether or not Met amended the underlying rate  
14 structure is irrelevant to whether San Diego may challenge Met's rate structure.  
15

16 Met's argument turns on the assertion that the second proviso modifies the first proviso,  
17 not the general limitation. Met Closing Brief, 20-22. The key to Met's argument is the premise  
18 that the language "such charge or charges" in the second proviso refers to the charge or charges  
19 contained in any amendments made pursuant to the first proviso. *Id.* at 22. This reading is  
20 irreconcilable with the plain language. The general limitation, not the first proviso, contains a  
21 reference to "charge or charges." In using the "charge or charges" language, the general  
22 limitation echoed the price term itself. The general limitation precludes San Diego from  
23 attacking any law or regulation pertaining to Met's "charge or charges" "generally applicable to  
24 the conveyance of water." The general limitation precludes San Diego from bringing a challenge  
25 that could impact the contract price. The reference to "such charge or charges" in the second  
26  
27

1 proviso refers to those charges.<sup>11</sup> It does not refer to the first proviso, which contains no  
2 reference to any “charge or charges.”

3           The structure of this section makes this conclusion inescapable. The first proviso begins  
4 with the language “provided, however.” The second proviso begins with the language “and,  
5 provided, further.” This makes it plain that the second proviso was a further proviso to the  
6 general limitation.  
7

8           Met hopes to inject ambiguity into the contract with extrinsic evidence such as the  
9 testimony of Jeffrey Kightlinger, who negotiated the deal for Met. Met Closing Brief, 22; Trial  
10 Transcript, 1327:21-1328:8. He said the purpose of the second proviso was to protect San Diego  
11 from adverse changes in Met’s rate structure, *id.* at 1300:13-1307:2, 1328:9-14, noting that San  
12 Diego’s negotiators told him that San Diego would not challenge Met’s existing rate structure  
13 and that this concession was material to Met. *Id.* at 1300:13-1301:6, 1304:19-1305:7. One of  
14 San Diego’s negotiators, Maureen Stapleton, disputed Kightlinger’s testimony. She said San  
15 Diego always had concerns with the rates themselves and raised them repeatedly with Met. *Id.* at  
16 1554:22-1555:14.<sup>12</sup>  
17

18           Met also notes San Diego’s analysis of the future costs under the pricing agreement that  
19 the parties ultimately adopted. San Diego analyzed the cost of that price plan over 20, 35, 45,  
20 and 75 years, but not over five years. Met Closing Brief, 23; Trial Transcript, 1218:6-1221:6.  
21 Met also seeks to corroborate its interpretation by looking to a San Diego memo to its Imported  
22 Water Committee from 2007, in which San Diego stated that it did not intend to litigate Met’s  
23  
24

---

25 <sup>11</sup> Met contends that if the second proviso refers to the general limitation then San Diego could challenge every  
26 charge. Met Closing Brief, 22. Not so. The general limitation referred to a limited subset of Met’s charges, to which  
27 the second proviso refers.

<sup>12</sup> Met disputes Stapleton’s credibility. Met Closing Brief, 22-23 n.10. But a Met person ‘most knowledgeable’ also testified, in his deposition, that pursuant to these provisions San Diego could contest whether Met’s rates and charges are consistent with applicable law after five years. PTX-392 at 121:10-124:25. I credit Stapleton’s testimony, and not contrary Kightlinger testimony.

1 current rate structure but could not know what future actions Met may take. Met Closing Brief,  
2 23; DTX-355 at 2.

3           None of this extrinsic evidence creates ambiguity in the contract.<sup>13</sup> That San Diego  
4 projected its exposure over periods exceeding five years is unsurprising, because even if San  
5 Diego could succeed in a rate challenge San Diego would still pay Met's full, if reconfigured,  
6 conveyance rates over the life of the Exchange Agreement. Stapleton testified that San Diego  
7 was only interested in projecting a worst case scenario under the pricing plan. Trial Transcript,  
8 1465:22-1466:1. A worst case scenario projection would not include savings from rate  
9 restructuring as a result of litigation, even in the dubious event that one could estimate such  
10 savings.  
11

12           That in 2007 San Diego did not intend to challenge Met's existing rate structure does not  
13 clarify the parties' intent when they signed the agreement in 2003. If anything, San Diego's  
14 statement in 2007 is consistent with San Diego's interpretation of the contract, not Met's. By  
15 stating that it did not intend to challenge Met's existing rate structure, San Diego implied that it  
16 thought it had, or would soon have, a right to challenge Met's existing rate structure. (If San  
17 Diego had no right to challenge Met's rate structure, there would be no reason for San Diego to  
18 discuss whether it intended to do so.) This implication is inconsistent with Met's interpretation  
19 of the contract, pursuant to which San Diego would never have any right to challenge Met's  
20 existing, unamended, rate structure.  
21

22           While Kightlinger's testimony supports Met's position, it is contradicted, and I reject it.  
23 PTX-392 at 122:21-123:1; Trial Transcript, 1194:16-1196:6. His reading is in any event  
24  
25

26  
27 <sup>13</sup> Only if the contract is reasonably susceptible to an interpretation urged does a court admit extrinsic evidence to aid in the interpretation of the contract. *Wolf v. Superior Court*, 114 Cal.App.4th 1343, 1350-51 (2004). The determination of whether an ambiguity exists is a question of law. *Id.* at 1351.

1 irreconcilable with the plain language of the contract. It does not create an ambiguity and the  
2 unambiguous plain language controls.

3 The third sentence of § 5.2 permits San Diego to challenge Met's charges applicable to  
4 the conveyance of water by Met to member agencies.<sup>14</sup>

## 6 2. Breach

7 In the rate years at issue, Met charged San Diego its transportation rates – the System  
8 Access Rate, System Power Rate, and Water Stewardship Rate – pursuant to the price term.<sup>15</sup>  
9 San Diego contends that Met breached the price term because Met's transportation rates were not  
10 set pursuant to applicable law and regulation. San Diego Pre-Trial Brief, 1. In Phase I, I held  
11 that Met's System Access Rate, System Power Rate, and Water Stewardship Rate were unlawful.  
12 April Statement of Decision, 65. There is no dispute that those rates are the rates generally  
13 applicable to Met's member agencies for the conveyance of water. Because Met's charges were  
14 not consistent with law and regulation, Met breached § 5.2 of the Exchange Agreement. PTX-65  
15 § 5.2.

17 To escape this result, Met argues that San Diego did in fact agree to Met's existing rate  
18 structure by (1) agreeing to an initial price of \$253, based in turn on Met's existing rate structure;  
19 (2) entering the Exchange Agreement knowing Met's existing rate structure; (3) voting in favor  
20 of the challenged rate structure before and after the Exchange Agreement was entered into; and  
21 (4) accepting Met's performance under the contract. Amended Motion for Partial Judgment, 2-3;  
22 Met Pre-Trial Brief, 12.

24 <sup>14</sup> In passing, San Diego refers to this state of affairs as an "agree[ment] to disagree" about the law pertaining to  
25 Met's rates. San Diego Post-Trial Brief for Phase II, 14. Met contends that San Diego agreed to a contract price  
26 including the Water Stewardship Rate, the System Power Rate, and the System Access Rate, the latter two  
27 components including State Water Project costs that the Department of Water Resources allocated to infrastructure.  
Met Pre-Trial Brief, 12. Through this litigation Met has never contended the price term is uncertain or indefinite.  
*Compare, e.g., California Lettuce Growers v. Union Sugar Co.*, 45 Cal.2d 474, 481 (1955).

<sup>15</sup> This is undisputed. *E.g.*, Met Pre-Trial Brief, 11; Met Closing Brief, 15; San Diego Post-Trial Brief for Phase II,  
4, 21-22.

1           The first two points are not persuasive. Regardless of the parties' thinking which led to  
2 the initial price, the parties just agreed to that number. San Diego's agreement to pay rates Met  
3 set pursuant to applicable law and regulation does not amount to a tacit adoption of the then-  
4 existing rate structure where the very same paragraph sets out provisions governing how and  
5 when San Diego will be precluded from, and permitted to, a challenge whether those same  
6 charges, whether or not amended, were in fact properly set pursuant to applicable law and  
7 regulation. PTX-65 § 5.2.

8  
9           Met contends there can be no breach when it uses the rate structure that has been in  
10 existence since 2003, because San Diego entered the contract knowing Met's future performance  
11 would be a continuation of that very structure. Amended Motion for Partial Judgment, 6. San  
12 Diego may well have known that it was in substance agreeing to pay the Water Stewardship Rate  
13 and for all State Water Project costs in Met's rate elements for five years. But San Diego also  
14 bargained for the right to attack Met's conveyance rates after five years. If the charges were  
15 removed from Met's generally applicable rates as the result of a change obtained by San Diego,  
16 the charges would also be removed from the contract price. So San Diego did not agree to pay  
17 any specific rate or abide by any specific rate structure for the life of the contract – it expressly  
18 only agreed to pay rates set in accordance with applicable law and regulation, reserving the right  
19 to challenge whether Met set its rates in accordance with applicable law and regulation (after five  
20 years).

21  
22           Accepting Met's performance for some period of time, even exceeding the five year  
23 period, does not show San Diego agreed in the contract<sup>16</sup> to a rate structure when at the same  
24 time San Diego expressly retained the right to challenge Met's charges in court after the five year  
25 period.  
26  
27

---

<sup>16</sup> I separately address Met's waiver defense.

1 Below, I discuss the impact of San Diego's representatives' votes on Met's Board of  
2 Directors on waiver. Here, I find that the voting history does not suggest that the plain language  
3 of the contract is ambiguous or that San Diego agreed to pay under Met's existing rate structure  
4 for the life of the contract. The unambiguous plain language again controls.  
5

### 6 3. Damages

7 There are two issues under the rubric of damages. First, San Diego must prove the fact  
8 that it suffered some damage as an element of its breach of contract claim. Second, if liability  
9 for breach of contract is established, I must determine the appropriate measure of damages.  
10

#### 11 a. Background Law

12 Damages are of course an essential element of a breach of contract claim. *Behnke v.*  
13 *State Farm General Ins. Co.*, 196 Cal.App.4th 1443, 1468 (2011); C.C. § 3300. "The damages  
14 awarded should, insofar as possible, place the injured party in the same position it would have  
15 held had the contract properly been performed, but such damages may not exceed the benefit  
16 which it would have received had the promisor performed." *Brandon & Tibbs v. George*  
17 *Kevorkian Accountancy Corp.*, 226 Cal.App.3d 442, 468 (1990); *Lewis Jorge Const.*  
18 *Management, Inc. v. Pomona Unified School Dist.*, 34 Cal.4th 960, 967-68 (2004). "Where the  
19 fact of damages is certain, the amount of damages need not be calculated with absolute certainty.  
20 [Citations.] The law requires only that some reasonable basis of computation of damages be  
21 used, and the damages may be computed even if the result reached is an approximation." *GHK*  
22 *Associates v. Mayer Group, Inc.*, 224 Cal.App.3d 856, 873 (1990).  
23

24 Importantly, a defendant cannot escape liability for its breach because damages cannot be  
25 measured exactly. *SCI Cal. Funeral Servs., Inc. v. Five Bridges Foundation*, 203 Cal.App.4th  
26 519, 571 (2012).  
27

1                                   **b.      Fact of Damages**

2                   To establish the fact of damages San Diego relies on the April Statement of Decision as  
3 well as testimony to the effect that Met's rates resulted in inflated conveyance rates. San Diego  
4 Post-Trial Brief for Phase II, 21.<sup>17</sup> In Phase I, I held that Met's conveyance rates over-collect  
5 from wheelers because Met allocated all of the State Water Project costs for the transportation of  
6 purchased water to its conveyance rates and all of the costs for conservation and local water  
7 supply development programs to its conveyance rates. April Statement of Decision, 65. The  
8 same logic applies to the Exchange Agreement. San Diego paid more than it agreed to under the  
9 Exchange Agreement because Met improperly included all of the State Water Project costs for  
10 the transportation of purchased water to its conveyance rates and all of the costs for conservation  
11 and local water supply development programs to its conveyance rates.  
12

13  
14                   Met responds that contract damages may only be the difference between the price Met  
15 charged San Diego and the highest price Met could have charged San Diego had it performed its  
16 obligation to set a lawful rate. Met Closing Brief, 3. So, Met says San Diego bore a burden of  
17 proving at least that its damages theory is based on some lawful rate structure, and (possibly) that  
18 under every imaginable lawful alternative rate structure San Diego would have paid less than it  
19 did in the real world.<sup>18</sup>  
20

21                   There are two points to be made here. First, Met's present argument flies in the face of  
22 the positions it has repeatedly taken in the past; and secondly, Met's argument does not in any  
23 event obviate the obvious point that San Diego has established the fact of damages.

24 <sup>17</sup> See also, Trial Transcript, 991:16-992:6 (Dennis Cushman's testimony that San Diego has overpaid State Water  
25 Project and Water Stewardship Rate charges as a result of Met's rates), 1911:24-1912:9 (testimony from Met's  
26 expert to the effect that if the State Water Project costs should not have been included then San Diego overpaid  
those charges).

27 <sup>18</sup> Met Closing Brief, 3 (arguing that San Diego did not prove that it paid more under the Exchange Agreement than  
it could have under an alternative lawful rate structure, and therefore did not prove damages, because it did not  
prove what alternative rate structures may exist); Amended Memorandum in Support of Partial Judgment, 8-9  
(arguing that San Diego must prove its allocation is based on a lawful rate structure).

1           On the matter of stating or fixing damages through some sort of analysis of  
2 counterfactual arguably legal rates, Met has repeatedly tried to have its cake and eat it too, as it  
3 were. It has told me both that (i) only a new rate setting procedure may be used in this case to  
4 fix lawful rates which in turn must be done before damages can be ascertained,<sup>19</sup> and (ii) superior  
5 courts may not do this. Met's January 9, 2015 Motion to Dismiss, 1-5; Trial Transcript, 2013:6-  
6 2018:16; *see also* Met's March 27, 2014 Objections to Tentative Statement of Decision, 2-3  
7 (court is not a rate-fixing body).<sup>20</sup> Met has had no useful response when I have enquired whether  
8 its vision of damages requires me to defer a calculation of damages until after Met resets rates  
9 (which would come after, and be a function of, appellate proceedings in this very case) which  
10 new rates themselves might very well be subject to further independent litigation, pushing out  
11 the decision on both the fact and calculation of damage in this case to many, many years hence.  
12 Met's January 9, 2015 Motion to Dismiss, 5-6. These parties were keenly, almost painfully,  
13 aware that contract litigation (after five years) was likely; but the notion that they also intended  
14 to have the anticipated contract dispute resolved in this way is inconceivable.<sup>21</sup>

17           On the second point, Phase I established Met unlawfully included supply costs in  
18 transportation rate elements. Met charged the same transportation rate elements to San Diego  
19 under the Exchange Agreement as charges generally applicable to the conveyance of water by  
20 Met on behalf of its member agencies. It is thus patently obvious that San Diego has established  
21 that some costs should have been removed from the rates it paid under the Exchange Agreement  
22

23 <sup>19</sup> E.g., Met's Amended Motion for Partial Judgment at 7:20 ("rates must be recalculated").

24 <sup>20</sup> This logical twist got to the point where I had to instruct Met not to press a damages theory which Met at the same  
25 time maintained I had no jurisdiction to entertain. Nov. 4, 2014 Order Setting Case Management Conference, 1-2;  
26 Dec. 4, 2014 Order Denying Met's Motion to Reopen Expert Discovery. The effect of Met's fabricated conundrum  
27 would be, of course, that damages could *never* be fixed if Met ever breached the Exchange Agreement. Despite this,  
I allowed the parties, and Met specifically, to introduce evidence of a "lawful spectrum of rates" to estimate  
damages. Order Re: Metropolitan's Motion To Dismiss For Lack Of Subject Matter Jurisdiction And [On] The  
Parties' Motions In Limine, dated February 6, 2015. In the event, Met did not do so.

<sup>21</sup> Dennis Cushman's testimony at e.g. DTX-710 at 443:10-444:2 is not to the contrary: he does not there endorse  
this mode of calculating damages.

1 – the rates were obviously overinclusive. The precise amount of overinclusion is not established,  
2 nor is any resulting impact on other Met rates.

3 I turn to Met’s argument that San Diego failed to account for (or set off) benefits it  
4 secured by Met’s illegal rates, and as a consequence failed to establish damages.

5  
6 Met argues the same conduct that breached the contract also must have resulted in  
7 decreased supply rates, saving San Diego some money when it purchased full-service water from  
8 Met. Met Closing Brief, 6. These savings must be treated as an offset against San Diego’s  
9 damages, Met says, for it must have under-collected its supply costs in such a way that  
10 necessarily resulted in under-collection from full-service water purchases.<sup>22</sup> But Met as  
11 defendant has the burden on matters of offset and unjust enrichment. *Textron Fin. Corp. v. Nat’l*  
12 *Union Fire Ins. Co. of Pittsburgh*, 118 Cal.App.4th 1061, 1077 (2004), *disapproved of on other*  
13 *grounds by Yanting Zhang v. Superior Court*, 57 Cal.4th 364 (2013). Met bore the burden of  
14 demonstrating that San Diego’s damages were offset by incidental extra-contractual benefits San  
15 Diego obtained as a result of the same conduct amounting to breach. *Space Properties, Inc. v.*  
16 *Tool Research Co.*, 203 Cal.App.2d 819, 827 (1962) (defendant has burden of proof on defenses  
17 such as unjust enrichment and or setoff). No evidence shows San Diego would have received a  
18 consequential benefit from paying reduced supply charges that equaled or outweighed its  
19 damages under the contract during the rate years in question if Met had reallocated the unlawful  
20 transportation charges to its supply rates. Accordingly, Met’s argument for an offset does not  
21 defeat liability. It has not met that burden.

22  
23  
24  
25  
26 <sup>22</sup> *Hicks v. Drew*, 117 Cal. 305, 314-15 (1897) (approving the jury instruction “If the jury find from the evidence that  
27 the plaintiff has sustained any damage by the act of defendant, as she has complained against him, and that by the  
same act she has received benefit, then, in estimating such damage, such benefit should be deducted”). See Trial  
Transcript, 1136:25-1138:14.

1 Finally as I have suggested above a recalculation of Met's supply rates conflicts with  
2 Met's view that such an approach is impermissible in superior court.

3 San Diego has proven by a preponderance of the evidence that it was in fact damaged by  
4 paying conveyance rates that were higher than Met could have set pursuant to applicable law and  
5 regulation. PTX-65 § 5.2. San Diego should not be required to prove the fact of damages  
6 beyond any shadow of doubt by proving the entire universe of possible alternative legal rate  
7 structures Met might have implemented.  
8

9 **c. Amount of Damages**

10 San Diego seeks an award of \$188,295,602 plus interest. San Diego Post-Trial Brief for  
11 Phase II, 29. San Diego computed its damages by removing the SWP costs and the Water  
12 Stewardship Rate from the Price. *Id.* at 30. Met correctly notes the Phase I ruling did not go so  
13 far as to hold that Met is not permitted to include any of its SWP costs or Water Stewardship  
14 Rate in its conveyance rates. Met argues that San Diego bore a Phase II burden of demonstrating  
15 the appropriate percentage that Met could have included; and failed to carry that burden. Met  
16 Closing Brief, 5-6; Trial Transcript, 2033:15-22, 2035:20-2037:19. Met also argues that any  
17 damage award should be offset by whatever increases San Diego would have paid in its supply  
18 rates. Met Closing Brief, 6; Trial Transcript, 2021:4-10.  
19  
20

21 San Diego's approach may overcompensate San Diego, because San Diego (1) removed  
22 all State Water Project costs from Met's conveyance rates although I have only ruled that Met  
23 could not include 100% of those costs through its conveyance rates;<sup>23</sup> and (2) removed the entire  
24

25 <sup>23</sup> Met argues that Exchange Water included State Water Project water, so San Diego should be charged with some  
26 costs from the State Water Project system under the Exchange Agreement. Met Closing Brief, 8-12. But the  
27 question is not whether Met should recover State Water Project costs under the Exchange Agreement, the question is  
whether State Water Project costs can properly be recovered through the lawfully set conveyance rates that San  
Diego agreed to pay under the Exchange agreement. Met's argument that San Diego should have accounted for the  
power costs to move water pursuant to the Exchange Agreement appears to suffer from the same defect. *Id.* at 13.  
In a similar vein, Met challenges the methodology by which San Diego's expert recalculated the rates. Met Closing

1 Water Stewardship Rate from Met's conveyance rates although I only ruled that Met could not  
2 recover 100% of those costs through its conveyance rates. Nor does San Diego account for  
3 possible set-offs, although as suggested above it is not San Diego's burden to do so.<sup>24</sup>  
4

5 There is no viable alternate methodology available. Neither party has computed alternate  
6 conveyance rates assuming that less than 100% of the charges are shifted from conveyance to  
7 supply. Neither party has explained the basis for an appropriate offset as a result of reduced  
8 supply rates.

9 Met seeks dismissal because of this uncertainty. Trial Transcript, 2033:12-19. But  
10 where, as here, the fact of damage flowing from the breach is proven the amount of damages  
11 may be fixed using an approximation if there is a reasonable basis for the approximation. *GHK*,  
12 224 Cal.App.3d at 873-74.<sup>25</sup> The rationale for San Diego's calculation is (1) San Diego has  
13 removed from Met's transportation rates only certain charges that this Court ruled cannot be  
14 wholly included in transportation rates; (2) attempting to allocate the charges at issue between  
15 transportation and supply would embroil the Court in an inappropriate ratemaking exercise (a  
16 proposition with which Met has repeatedly agreed) (Trial Transcript, 2017:23-2018:7; Met's  
17 January 9, 2015 Motion to Dismiss, 3-5; Met's March 27, 2014 Objections to Tentative  
18

19  
20 Brief, 7-8; Trial Transcript, 1140:5-17. San Diego's expert removed the challenged costs from the cost pool and  
21 divided the cost pool by the sales assumption. Trial Transcript, 1140:5-17. Met's expert opined that San Diego  
22 should have instead divided only Colorado River costs by Colorado River sales. Trial Transcript, 1899:8-1900:14.  
23 But, once again, the proper approach was to determine what Met's rate would have been if certain charges in Met's  
24 generally applicable conveyance rates were moved from conveyance to supply. To do this, it was appropriate to  
25 look at Met's total conveyance costs and its total sales assumption.

26 <sup>24</sup> San Diego provided some evidence in support of a 15% figure. Trial Transcript, 1258:7-1260:8. While Met  
27 contends quantifying an offset is not its problem, Trial Transcript, 2022:11-14, defendants usually *do* have this sort  
of burden. *Textron Fin. Corp. v. Nat'l Union Fire Ins. Co. of Pittsburgh*, 118 Cal.App.4th 1061, 1077 (2004),  
*disapproved of on other grounds by Yanting Zhang v. Superior Court*, 57 Cal.4th 364 (2013). At closing argument  
Met expressed no confidence in or support for this 15% figure. E.g., Trial Transcript (closing argument) June 5,  
2015 at 2020. See also, Met Closing Brief, 7.

<sup>25</sup> The *GHK* Court noted that an approximation for which there is a reasonable basis is particularly permissible when  
the wrongful acts of the defendant created difficulty in proving the amount of lost profits or where the wrongful acts  
of the defendant caused the other party not to realize a profit to which it was entitled. *GHK*, 224 Cal.App.3d at 873-  
74.

1 Statement of Decision, 2-3). San Diego Post-Trial Brief for Phase II, 31; San Diego Pre-Trial  
2 Brief, 11-12.

3 San Diego has offered a reasonable computation. It is not possible to know how Met may  
4 in the future allocate its State Water Project conveyance costs or Water Stewardship Rate  
5 between transportation and supply rates. One reasonable assumption is that the entirety of the  
6 rate would have been moved. San Diego computed its damages under the contract for the 2011-  
7 2014 rate years using that assumption.

8 Met did not offer a competing computation.

9 It asks too much of San Diego to require it to recalculate Met's rates with any useful  
10 degree of precision. *MCI Telecommunications Corp. v. F.C.C.*, 59 F.3d 1407, 1415 (D.C. Cir.  
11 1995) (inequitable to permit defendants who were in the best position to set their rates at lawful  
12 levels in the first place and who later had opportunities to correct those rates to avoid  
13 responsibility for those unlawful rates because the complainant to establish an appropriate rate  
14 without making simplifying assumptions); *SCI*, 203 Cal.App.4th at 571 (defendant cannot escape  
15 liability for breach simply because damages cannot be measured exactly).

16 For these reasons, San Diego has proven that it is entitled to damages in the amount of  
17 \$188,295,602 plus interest.

#### 18 **4. Affirmative Defenses**

##### 19 **a. Waiver**

20 Met contends that San Diego waived<sup>26</sup> any claim for damages arising from Met's use of  
21 the rate structure to set the Price by the following conduct inconsistent with an intent to claim  
22 damages: (1) proposing the Price with knowledge of the rate structure and its components; (2)  
23 voting, through its delegates to Met's Board of Directors, in favor of the rate structure and rates;

24 <sup>26</sup> *Carmel Valley Fire Prot. Dist. v. California*, 190 Cal.App.3d 521, 534 (1987) (elements of waiver).

1 (3) failing to object to the structure of the rates until 2010; (4) stating in 2007 that San Diego did  
 2 not intend to litigate Met's existing rate structure; and (5) accepting Met's performance with  
 3 knowledge of the breach. Met Closing Brief, 14-20.

4 Met's waiver theories are precluded by the anti-waiver provision<sup>27</sup> in the Exchange  
 5 Agreement. Met has not identified any conduct that could have waived the protections of the  
 6 anti-waiver provision. *Id.* at 24-25. Nor has Met identified any written and signed waiver.  
 7  
 8 PTX-65 § 13.9.<sup>28</sup>

9 **b. Consent**

10 Met asserts that San Diego consented<sup>29</sup> to using Met's then-existing rate structure to set  
 11 the Price by entering the Exchange Agreement with knowledge of the unlawfulness of the rate  
 12 structure, voting in favor of the rate structure, and accepting the benefits of the agreement. Met  
 13 Closing Brief, 25-28.

14 First, San Diego's agreement to the price term in the Exchange Agreement does not  
 15 amount to San Diego's approval of Met's rate structure. As discussed above,<sup>30</sup> contrary to Met's  
 16 reading of the Exchange Agreement San Diego retained the right to challenge Met's existing rate  
 17 structure after five years. San Diego agreed to pay only (1) a fixed initial rate; and (2) a rate set  
 18  
 19  
 20

21 <sup>27</sup> "No waiver of a breach, failure of condition, or any right or remedy contained in or granted by the provisions of  
 22 this Agreement is effective unless it is in writing and signed by the Party waiving the breach, failure, right, or  
 23 remedy. No waiver of a breach, failure of condition, or right or remedy is or may be deemed a waiver of any other  
 24 breach, failure, right, or remedy, whether similar or not. In addition, no waiver will constitute a continuing waiver  
 25 unless the writing so specifies." PTX-65 § 13.9.

26 <sup>28</sup> Met looks to San Diego's written statement in 2007 that it did not intend to litigate Met's existing rate structure as  
 27 a written waiver. Met Closing Brief, 19-20; DTX-355 at 2; DTX-1114 at 11-12; Trial Transcript, 1070:17-22. But  
 none of these documents shows San Diego's intention to give up any right to challenge the existing rates. Rather,  
 the documents reflect whether San Diego had the intent to challenge the existing rates in 2007. San Diego may not  
 have *then* intended to challenge the existing rates, but still not have intended to give up the right to do so in the  
 future.

<sup>29</sup> Consent is a free and mutual agreement to an act. C.C. § 1567. "A voluntary acceptance of the benefit of a  
 transaction is equivalent to a consent to all the obligations arising from it, so far as the facts are known, or ought to  
 be known, to the person accepting it." C.C. § 1589.

<sup>30</sup> Section IV(A)(1).

1 pursuant to applicable law. San Diego did not agree to Met's existing rate structure, but  
2 bargained away the ability to challenge that rate structure for five years.

3  
4 Second, the voting records do not support the assertion that San Diego consented to the  
5 use of Met's rate structure in the years at issue. San Diego's representatives on Met's board  
6 voted in favor of Met's rates in 2002, 2005, 2006, 2007, 2008, and 2009. Trial Transcript,  
7 1506:14-17; DTX-129. San Diego's representatives voted against the rates in the years at issue  
8 in this case. DTX-129. In voting, San Diego's representatives acted as Met's fiduciaries in the  
9 scope of their duties as members of the board. Trial Transcript, 1506:12-13. Each time Met set  
10 an unlawful rate, Met breached its obligations under the Exchange Agreement. *Arcadia*  
11 *Development Co. v. City of Morgan Hill*, 169 Cal.App.4th 253, 262 (2008). Even if San Diego  
12 can be said to have consented to Met's breaches in prior years because its delegates voted in  
13 favor of the rates, a proposition with which I do not agree,<sup>31</sup> San Diego's delegates did not vote  
14 in favor of the rates at issue now.

15  
16 Third, San Diego did not accept the benefits of the contract without protest in the rate  
17 years at issue here. Again, each time Met sets unlawful conveyance rates, it breached its  
18 obligations. Perhaps San Diego accepted Met's performance in prior years, even after the  
19 expiration of the five year period; but San Diego did not accept Met's performance without  
20 protest in the rate years at issue. Rather, it sued to challenge these breaches.

21  
22 **c. Estoppel**

23 Met argues that San Diego is estopped<sup>32</sup> from asserting that setting the Price based on the  
24 existing rate structure is a breach of contract because San Diego's delegates to Met's Board of  
25

26 <sup>31</sup> As the text suggests these delegates wore at least two hats, and in voting for Met rates may well have acted in the  
27 best interests of Met.

<sup>32</sup> In general, there are four elements of equitable estoppel: (1) the party to be estopped must be apprised of the facts;  
(2) the party to be estopped must intend that his conduct shall be acted upon or have acted in such a way that the

1 Directors failed to disclose that Met's rate structure was unlawful and instead in effect  
2 represented that the Price could be based on the existing rate structure. Met Closing Brief, 28-  
3 31. Met asserts that San Diego agreed to a price term based on the rate structure and the 2003  
4 rates; did not communicate that any of Met's rates might be unlawful; did not object to the price;  
5 and represented that it did not intend to sue over the existing structure. *Id.* at 30.  
6

7 In short Met contends that San Diego, knowing Met's rate structure was unlawful,  
8 engaged in conduct that created the impression Met's existing rate structure was lawful, and that  
9 Met, not knowing that its rate structure was unlawful, relied on San Diego's conduct.

10 But as Met recognized in its First Phase I Pre-trial Brief, the plain language of the  
11 Exchange Agreement is itself an "open[] threat[] to litigate over [Met's] existing rate structure"  
12 because San Diego agreed not to challenge Met's rates for five years after execution but reserved  
13 the right sue to challenge the validity of Met's rates thereafter. Met Oct. 18, 2013 Brief, 14  
14 (providing background concerning Met's use of Rate Structure Integrity provisions); PTX-65 §  
15 5.2. San Diego's right to challenge Met's existing rate structure is itself part of the price term  
16 section. Met could not have relied on San Diego's proposal of or agreement to this price term to  
17 conclude that its rate structure is lawful. Moreover, the contract itself demonstrates that neither  
18 party knew that Met's rate structure was unlawful;<sup>33</sup> both parties were bargaining in the context  
19  
20  
21  
22

23 party asserting estoppel had the right to believe the conduct was so intended; (3) the party asserting estoppel must be  
24 ignorant of the true facts; and (4) the party asserting estoppel must rely on the conduct. *Ashou v. Liberty Mut. Fire*  
25 *Ins. Co.*, 138 Cal.App.4th 748, 766-67 (2006). Met's arguments conceivably satisfy the first two elements, but not  
26 the rest, so setting aside my discussions in the text the estoppel defense fails in any event. Met does not show it was  
27 ignorant of facts to which San Diego was privy nor does it show reliance, that is, that it would have acted otherwise.  
<sup>33</sup> Indeed, my determination on the lawfulness of Met's rate structure is itself exceedingly likely to be appealed. The  
notion that Met relied on representations from San Diego to act on the belief that its rate structure is lawful is  
particularly unpersuasive where Met continues to set its rates based on the belief that its rate structure is lawful even  
after San Diego voted against the rates, sued Met over the rate structure, and obtained my trial court ruling that the  
rate structure is unlawful. Met, as experienced in state water law as any entity, and served by some of the best  
lawyers in the country, has never been misled by San Diego; it just disagrees with San Diego.

1 of uncertainty. The negotiations and terms of the Agreement make it plain—in way that is not  
2 often found in contracts—that a lawsuit was contemplated.

3 Nor, in this context, could Met have reasonably relied on San Diego's other conduct to  
4 conclude that its rate structure was legal. For example, in 2007 San Diego stated in internal  
5 documents that it did not intend to litigate Met's existing rate structure.<sup>34</sup> But San Diego could  
6 have determined not to litigate Met's existing rate structure for a number of reasons, only one of  
7 which is San Diego's likelihood of success; and an internal document surely could not create an  
8 estoppel as to Met. Met also notes San Diego's delegates voted to approve Met's rates in 2002  
9 and 2005-2009 but did not tell Met that its rate structure might be illegal. But again the plain  
10 language of the Exchange Agreement eviscerates this argument. Even as San Diego acquiesced  
11 to Met's rates on a year-to-year basis after the expiration of the five year period, the possibility  
12 of a legal challenge to the rates was written into the Exchange Agreement.

13  
14  
15 San Diego did not represent to Met, by omission or by conduct on which Met could  
16 reasonably rely, that Met's rates were lawful knowing Met's rates were in fact illegal. Rather,  
17 San Diego bargained for the right to challenge Met's rates in court in the future, and Met  
18 bargained to constrain San Diego's ability to do so. San Diego's suit is not barred by the  
19 doctrine of equitable estoppel.

20  
21 **d. Illegality**

22 Met argues that the Exchange Agreement is void as illegal if Met's rate structure or rates  
23 in existence at the time the parties entered into the Exchange Agreement were illegal. Met  
24 Closing Brief, 31-33. This is so because if San Diego is right, Met's performance of the price

25  
26  
27 <sup>34</sup> Met Closing Brief, 19-20; DTX-355 at 2 (San Diego memo weighing whether to enter contracts with a Rate  
Structure Integrity provision); DTX-1114 at 11-12; Trial Transcript, 1070:17-22.

1 term was unlawful, Met says, because the rate structure includes unlawful rates. Met Pre-Trial  
2 Brief, 12.

3 Although San Diego agreed not to challenge the manner in which Met set its charge or  
4 charges for the following five years, the parties did not agree the setting of charges was legal or  
5 illegal. Fixing a \$253 price is not illegal. Nor is it illegal to require Met to set its charges for the  
6 conveyance of water pursuant to applicable law and regulation; precisely the opposite is true.<sup>35</sup>

7 The parties obviously bargained for—by definition—a *legal* price term.  
8

9 **e. Mistake of Law**

10 Met argues that there was a mistake of law with respect to whether its existing rates at the  
11 time the parties entered the Exchange Agreement were lawful. To the extent that neither party  
12 was aware the rate structure was unlawful, Met contends that it is entitled to rescission based on  
13 mutual mistake. Met Closing Brief, 34-35; C.C. § 1578(1).<sup>36</sup> To the extent that San Diego but  
14 not Met was aware that Met's rate structure was unlawful, Met is entitled to rescission because  
15 San Diego failed to rectify Met's mistake. Met Closing Brief, 35-36; C.C. § 1578(2). San Diego  
16 says there was no mistake of law – the parties disagreed about the lawfulness of Met's rate  
17 structure and bargained around that disagreement. San Diego Post-Trial Brief for Phase II, 28-  
18 29.  
19  
20

21 Where parties are aware that a doubt exists in regard to a certain matter and contract on  
22 that assumption, the risk of the existence of the doubtful matter is an element of the bargain.  
23 *Guthrie v. Times-Mirror Co.*, 51 Cal.App.3d 879, 885 (1975). The kind of mistake that renders a  
24

25 \_\_\_\_\_  
26 <sup>35</sup> "It is well settled that if a contract can be performed legally, it will not be presumed that the parties intended for it  
27 to be performed in an illegal manner, and it will not be declared void merely because it was performed in an illegal  
manner." *Freeman v. Jergins*, 125 Cal.App.2d 536, 546 (1954).

<sup>36</sup> Met never tells us how this rescission, based on mistake or other grounds, would be carried out. Presumably San  
Diego would not have to return the transported water.

1 contract voidable does not include mistakes as to matters which the contracting parties had in  
2 mind as possibilities and as to the existence of which they took the risk. *Id.*

3 It is not clear when San Diego reached the conclusion that Met's rates were unlawful.  
4 San Diego notes evidence that San Diego suggested to Met that Met's wheeling rate was  
5 unlawful and that Met understood the suggestion. PTX-398; PTX-392 at 121:10-124:25  
6 (purpose of five year standstill was to permit San Diego to bring a challenge to the rates). Met  
7 asserts that San Diego's own negotiator vacillated as to whether San Diego had identified  
8 anything unlawful about Met's rates at the time the parties entered the Exchange Agreement.<sup>37</sup>  
9 The parties were unclear on exactly what the law was.<sup>38</sup>

10  
11 Neither party knew how a court would rule on Met's rate structure. But they contracted  
12 around this uncertainty. For five years, the parties precluded San Diego from challenging Met's  
13 interpretation of the law, whether or not that interpretation changed during that period.  
14 Thereafter, if San Diego disagreed it was free to bring a judicial challenge. The structure of the  
15 contract itself, against this backdrop of uncertainty, demonstrates that the parties knew San  
16 Diego might challenge Met's rate structure, were unsure which party would prevail in such a  
17 lawsuit, and contracted in a way that accounted for Met's interests if its rates were unlawful.<sup>39</sup>  
18 There was no mistake of law.  
19  
20  
21  
22

23 <sup>37</sup> Compare Trial Transcript, 1590:7-1591:17 (Stapleton confronted with Slater's deposition testimony that San  
24 Diego did not a violation although it knew there were laws that could be pertinent); with Trial Transcript, 1452:16-  
25 1454:2 (Stapleton confronted with Slater's testimony that certain rates were unlawfully included in Met's  
26 conveyance rates).

27 <sup>38</sup> Trial Transcript, 1237:8-1243:17, 1248:13-1253:20, 1255:25-1256:8.

<sup>39</sup> San Diego forfeited its ability to challenge Met's rates in court for five years; to the extent Met's rates were  
unlawfully inflated, Met received a benefit at San Diego's expense at least for the first five years of the contract.  
Kightlinger testified that he did not have any doubt as to the lawfulness of Met's rates and that Met would not have  
entered the Exchange Agreement if San Diego had said that Met's rates were unlawful during negotiations. Trial  
Transcript, 1316:3-18. In section IV(A)(1), I rejected Kightlinger's testimony that San Diego told him that San  
Diego would not challenge Met's existing rate structure and that the concession was material to Met.

1 **f. Offset and Unjust Enrichment**

2 These defenses are subsumed within the damages questions and are addressed there.<sup>40</sup>

3 **B. Preferential Rights**

4 San Diego seeks a declaration that Met's methodology of computing preferential rights  
5 violates § 135 of the Metropolitan Water District Act<sup>41</sup> because it excludes San Diego's  
6 payments relating to the conveyance of water San Diego purchases from other sources. Third  
7 Amended 2010 Complaint ¶¶ 113-15. Specifically, the parties dispute whether (1) San Diego's  
8 payments pursuant to the Exchange Agreement should be included in the preferential rights  
9 calculation; and (2) payments under wheeling agreements should be included in the preferential  
10 rights calculation.<sup>42</sup>

11 Section 135 includes the following:

12 Each member public agency shall have a preferential right to purchase from the district  
13 ... a portion of the water served by the district which shall, from time to time, bear the  
14 same ratio to all of the water supply of the district as the total accumulation of amounts  
15 paid by such agency to the district on tax assessments and otherwise, excepting purchase  
16 of water, toward the capital cost and operating expense of the district's works shall bear  
17 to the total payments received by the district on account of tax assessments and  
18 otherwise, excepting purchase of water, toward such capital cost and operating expense.

19  
20  
21 <sup>40</sup> Met's briefing does not separately address these defenses.

<sup>41</sup> Water Code Appendix § 109-135.

22 <sup>42</sup> San Diego Post-Trial Brief for Phase II, 39-40 (referring to the Exchange Agreement and other wheeling  
23 agreements); Met Closing Brief, 36-40 (addressing only the Exchange Agreement); Trial Transcript, 2037:20-  
24 2038:1; Third Amended 2010 Complaint ¶¶ 113-15 ("113. ... The Water Authority formally requested a  
25 determination that its preferential rights should include the amount paid as 'transportation' costs for Metropolitan's  
26 conveyance of Non-Metropolitan Water through its pipelines and facilities. Metropolitan has formally denied that  
27 request, taking the position that money paid by the Water Authority for the transportation of its IID and Canal  
Lining water are for the 'purchase of water' (i.e., supply)... [¶] 114. In the absence of declaratory relief,  
Metropolitan will continue its wrongful calculation of the Water Authority's preferential rights... [¶] 115.  
Therefore, the Water Authority prays for a judicial declaration (a) that the current methodology used by  
Metropolitan to calculate the Water Authority's preferential rights violates section 135 of the MWD Act; and (b)  
directing Metropolitan to follow the requirements of the MWD Act by including the Water Authority's payments to  
Metropolitan for transportation of IID Water and Canal Lining Water (which payments are not for 'purchase of  
water') in the calculation of the Water Authority's preferential rights to water") (footnote omitted).

1 As explained by our Court of Appeal:

2 Under section 135, in the event of a water supply shortage, each Metropolitan member  
3 public agency, including San Diego, has a preferential right to a percentage of  
4 Metropolitan's available water supplies based on a legislatively established formula.  
5 That formula affords each member an aliquot preference equal to the ratio of that  
6 member's total accumulated payments toward Metropolitan's capital costs and operating  
7 expenses when compared to the total of all member agencies' payments toward those  
8 costs, excluding amounts paid by the member for "purchase of water."

7 *San Diego County Water Authority v. Metropolitan Water Dist.*, 117 Cal.App.4th 13, 17 (2004).

8 Met moved for summary adjudication of San Diego's preferential rights claim in 2013. I  
9 denied Met's motion by order issued December 4, 2013. From *SDCWA*, I derived the rule that  
10 the preferential rights calculation includes all payments for capital costs and operating expenses,  
11 excluding those payments that were tied to the "purchase of water." Dec. 4, 2014 Order, 6. Met  
12 attempted to draw a parallel to *SDCWA* based on the rate components charged for the purchase  
13 of water in *SDCWA* and the similar rate components charged under, for example, the Exchange  
14 Agreement. *Id.* at 6-7. I held that Met had not established that San Diego was purchasing water  
15 from Met through the Exchange Agreement. *Id.* at 7.

17 At the Phase II closing argument, Met again pressed the argument that no payment of a  
18 volumetric rate is properly credited to preferential rights. Trial Transcript, 2038:18-2039:11,  
19 2040:21-2041:10. This reading contradicts the plain language of the statute and *SDCWA*. The  
20 Court of Appeal agreed with Met's longstanding interpretation that "amounts paid for water  
21 purchases are not to be taken into account in determining preferential rights, whatever those  
22 amounts are used for." *SDCWA*, 117 Cal.App.4th at 24-25. The Court independently analyzed  
23 the language of the statute, the structure of the statutory scheme, and the legislative history to  
24 interpret the Legislature's intent. *Id.* at 25-28. *SDCWA* found the statute reflected the  
25 Legislature's intent to create a general rule that all revenue used to pay capital costs and  
26  
27

1 operating expenses would count toward the calculation of preferential rights, except payments  
2 for the purchase of water. *Id.* at 27. In the pure wheeling context, the wheeler does not purchase  
3 water from Met but pays a volumetric rate for Met to move water that belongs to the wheeler. I  
4 discern no basis for Met's decision to treat volumetric wheeling payments as payments for the  
5 purchase of water. Volumetric payments to Met to cover Met's operating expenses that are not  
6 connected to a purchase of water from Met are entitled to preferential rights credit under § 135 of  
7 the Met Act and *SDCWA*.<sup>43</sup> Wheeling payments must be included in the preferential rights  
8 calculation.

9  
10 Whether payments specifically under the Exchange Agreement give rise to preferential  
11 rights credit is a more difficult question. As in the wheeling context, San Diego pays volumetric  
12 rates to cover Met's operating expenses in exchange for the conveyance of water. Unlike in the  
13 wheeling context, the Exchange Agreement does not literally call for the conveyance of water  
14 but instead for the *exchange* of water. PTX-65 §§ 3.1-3.2. The question here is whether the  
15 exchange of water facilitated by the Exchange Agreement brings San Diego's payments into the  
16 statutory "purchase of water" exception.  
17

18 Met says that the Exchange Agreement facilitates a purchase of water because, under the  
19 agreement, San Diego gives Met water and money and obtains different water<sup>44</sup> from Met. Met  
20

21  
22 <sup>43</sup> Met argues that its interpretation of the statute to treat all volumetric payments as payments for the purchase of  
23 water is entitled to deference. Met Closing Brief, 39; Trial Transcript, 1847:5-1848:13, 2040:21-2041:10. I do  
24 defer, but this sort of deference is not tantamount to giving the agency a veto on the interpretation of the statute.  
25 Courts must ultimately construe statutes. *Compare, SDCWA*, 117 Cal.App.4th at 22. The fact that Met uses  
26 volumetric rates to collect its payments for the purchase of water as well as to collect payments under wheeling  
27 contracts does not show payments under wheeling contracts are for the purchase of water. It is the purpose of the  
28 payment, not the manner in which the amount of the required payment is computed, that controls under the statute.  
29 Nothing in the statute or *SDCWA* supports Met's interpretation. *Compare, Met Supplemental Brief*, 5 (asserting that  
30 *SDCWA* compels the conclusion that all volumetric payments are excluded from the preferential rights calculation,  
31 presumably because all volumetric rates are payments for the purchase of water). Accordingly, I reject Met's  
32 interpretation as contrary to the legislative intent of the statute, as interpreted in *SDCWA*.

33 <sup>44</sup> San Diego correctly argues that the Exchange Agreement defines Exchange Water as Local Water, not Met Water,  
34 except for the purposes of the price provision and the Interim Agricultural Water Program, which are not relevant

1 Pre-Trial Brief, 15-16; Met Closing Brief, 39. San Diego contends that the Exchange Agreement  
2 is, in practical terms, no different from any other conveyance agreement because in any wheeling  
3 agreement the party receiving the service obtains molecules of water different from those  
4 initially put into the conveyance system. San Diego's Post-Trial Brief for Phase II, 39-40.  
5

6 The parties have not pointed me to legislative history or other sources which would  
7 explain why the Legislature excluded payments for the purchase of water from the preferential  
8 rights calculation. *SDCWA*, 117 Cal.App.4th at 24 (Legislature has not defined the "excepting  
9 purchase of water" terminology). The fact remains that the Legislature included all contributions  
10 toward capital costs or operating expenses in the preferential rights calculation with a single  
11 exception: payments for the purchase of water.  
12

13 San Diego is not purchasing water from Met. San Diego is exchanging water with Met to  
14 make use of its own independent supplies. PTX-65 §§ 1.1(m), 3.1-3.2, 3.6.<sup>45</sup> The parties agreed  
15 to exchange an equal amount of water; the only water quality requirement was for Met to provide  
16 San Diego with water of at least the same quality as the water Met received from San Diego.  
17 These facts underscore that the Exchange Agreement was not an agreement pursuant to which  
18 San Diego obtained water from Met, but instead an agreement pursuant to which Met in effect  
19 conveyed water on behalf of San Diego. That the Exchange Agreement differs in some respects  
20 from a wheeling contract<sup>46</sup> does not mean that the Exchange Agreement was not in substance an  
21

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22 here. San Diego Supplemental Brief, 1; PTX-65 at §§ 4.1-4.2. Exchange Water is Met water for the purposes of the  
23 price provision and the Interim Agricultural Program. PTX-65 at §§ 4.1-4.2.

24 <sup>45</sup> The parties' characterization of the Exchange Water does not control whether the agreement is a purchase  
25 agreement for the purposes of the preferential rights statute. PTX-65 §§ 4.1-4.2.

26 <sup>46</sup> Met says there are five differences. Met Closing Brief, 38-39. But it remains unclear why these differences  
27 matter. The differences Met asserts are: (1) wheelers can only move water when there is available capacity, but Met  
makes deliveries every month regardless of capacity on the Colorado River Aqueduct; (2) water is wheeled only  
when it is available, but Met wheels water every month regardless of the amount San Diego has made available; (3)  
wheelers bear carriage losses as a result of loss in transit, but Met bears the carriage loss under the Exchange  
Agreement; (4) San Diego was not billed for wheeling water, but instead for purchasing water with a monetary  
credit for the supply it made available; and (5) to wheel Colorado River water, San Diego would have needed a

1 agreement to convey, rather than purchase, water. San Diego's payments under the Exchange  
2 Agreement must be included in the preferential rights calculation.

3  
4  
5 **V. Conclusion**

6 On the breach of contract claim, San Diego is entitled to \$188,295,602 plus interest.  
7 Met's motion for partial judgment is denied.

8 On the preferential rights claim, San Diego is entitled to a judicial declaration (a) that  
9 Met's current methodology for calculating San Diego's preferential rights violates § 135 of the  
10 Metropolitan Water District Act; and (b) directing Met to include San Diego's payments for the  
11 transportation of water under the Exchange Agreement in Met's calculation of San Diego's  
12 preferential rights.  
13

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16 Dated: August 28, 2015



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Curtis E.A. Karnow  
Judge of The Superior Court

24 federal contract, but San Diego did not need a federal contract under the Exchange Agreement because the water  
25 would be Met water. *Id.* at 38-39. Met says this demonstrates that San Diego is in effect "paying" for the water  
26 with—water; making Exchange Water a water "purchase." *Id.* at 8. There can be nice distinctions between barter,  
27 currency and investment, and conceivably water might have any of these roles—and in circumstances of increasing  
drought, water may be a currency of the future (see *Mad Max Beyond Thunderdome* (1985),  
<http://www.imdb.com/title/tt0089530/>), but there is no good reason to treat it so in this case. And as noted above,  
the parties' characterization of a transaction does not control whether the transaction is a purchase for the purposes  
of the preferential rights statute.

**CERTIFICATE OF ELECTRONIC SERVICE**  
(CCP 1010.6(6) & CRC 2.260(g))

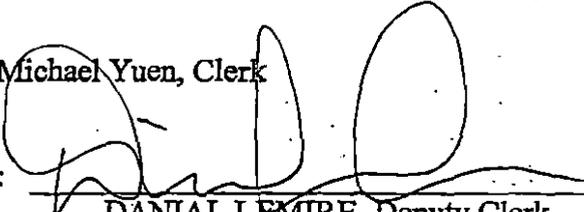
I, DANIAL LEMIRE, a Deputy Clerk of the Superior Court of the County of San Francisco, certify that I am not a party to the within action.

On : **AUG 28 2015**, I electronically served THE ATTACHED ORDER via File & ServeXpress on the recipients designated on the Transaction Receipt located on the File & ServeXpress website.

Dated: **AUG 28 2015**

T. Michael Yuen, Clerk

By:

  
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DANIAL LEMIRE, Deputy Clerk

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Attachment 3  
**FILED**  
San Francisco County Superior Court  
OCT 9 - 2015  
CLERK OF THE COURT  
BY: [Signature] Deputy Clerk  
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File & ServeXpress

SUPERIOR COURT OF CALIFORNIA  
COUNTY OF SAN FRANCISCO

SAN DIEGO COUNTY WATER  
AUTHORITY,  
  
Plaintiff/Petitioner,  
  
vs.  
  
METROPOLITAN WATER DIST. OF  
SOUTHERN CALIFORNIA, et al.  
  
Defendants/Respondents.

Case No. CFP-10-510830  
Case No. CFP-12-512466

ORDER GRANTING SAN DIEGO'S  
MOTION FOR PREJUDGMENT  
INTEREST

I have previously found that the Metropolitan Water District of Southern California (Met) breached its Exchange Agreement with the San Diego County Water Authority (San Diego) and awarded San Diego nearly \$200 million in damages, "plus interest." Phase II Statement of Decision, 29. San Diego now moves for prejudgment interest, seeking an additional \$44,139,469.<sup>1</sup> I heard argument October 8, 2015.

**Legal Background**

Civil Code § 3287(a) provides that "[e]very person who is entitled to recover damages certain, or capable of being made certain by calculation, and the right to recover which is vested in him upon a particular day, is entitled also to recover interest thereon from that day...."

<sup>1</sup> San Diego initially requested \$47,277,747, but modified the request after Met pointed out a timing error. Opposition, 12-13; Reply, 1. I have further reduced this to a small extent to account for Met's further calculations. See n.8 below.

1 Section 3289 provides that when a contract “does not stipulate a legal rate of interest, the  
2 obligation shall bear interest at a rate of 10 percent per annum after a breach.” The dispute here  
3 centers on whether § 12.4(c) of the Exchange Agreement “stipulate[s] a legal rate of interest.”  
4  
5 The parties also disagree as to whether the damages awarded were “certain” or “capable of being  
6 made certain.”

### 7 **The Agreement’s Language**

8 Section 12.4(c) of the Exchange Agreement reads:

9 In the event of a dispute over the Price, SDCWA shall pay when  
10 due the full amount claimed by Metropolitan; provided, however,  
11 that, during the pendency of the dispute, Metropolitan shall deposit  
12 the difference between the Price asserted by SDCWA and the Price  
13 claimed by Metropolitan in a separate interest bearing account. If  
14 SDCWA prevails in the dispute, Metropolitan shall forthwith pay  
15 the disputed amount, plus all interest earned thereon, to SDCWA.  
16 If Metropolitan prevails in the dispute, Metropolitan may then  
17 transfer the disputed amount, plus all interest earned thereon, into  
18 any other fund or account of Metropolitan.

19 Met says § 12.4(c) establishes a legal rate for purposes of § 3289 and so the 10%  
20 statutory rate does not apply. It asserts that the interest bearing account prescribed by § 12.4(c)  
21 has accrued interest of \$4,156,907.46 – the maximum interest to which SDCWA could be  
22 entitled. *Id.* at 2:1-3.

23 But at argument, Met explained that it had set aside less than the damages awarded.<sup>2</sup> So,  
24 it has now in effect retrospectively increased the principal set aside amounts over the period of  
25 the dispute to reach the awarded damages, and then Met has recalculated interest using whatever  
26 interest Met had, historically, obtained on the set-side money. Thus, Met now proposes to give  
27 San Diego not, as § 12.4(c) suggests, “all interest earned thereon” i.e. the interest historically

---

<sup>2</sup> This is not shocking. As I noted in my earlier discussion of § 12.4(c) when San Diego unsuccessfully presented it as a liquidated damages provision, there is no reason to think that money set aside under § 12.4(c) would perfectly match the damages award.

1 earned on the set-aside money, but *more* money to account for the damages which Met had *not*  
2 set aside. This is the first signal that Met's proffered understanding § 12.4(c) is not correct.

3 Met argues both in its papers and at argument that that if I do not accept its reading, the  
4 phrase "shall forthwith pay . . . all interest earned thereon" is meaningless. E.g., Opposition at 5.  
5 I do not agree. The clauses on interest, just like the remainder of the section, as I have previously  
6 interpreted it, are all designed to increase the odds that there will be money available to pay  
7 damages. Just as it is wise to set aside principal for potential future damages, so too it is wise to  
8 insist on an interest bearing account to account for the devaluation of money over time. Met's  
9 reading is not necessary to give meaning to the terms.

10 And this leads to the central problem with Met's view. I have previously found, at Met's  
11 urging, that § 12.4(c) was a security provision, not a damages provision. The provision's  
12 "primary purpose . . . was to prevent either side from spending disputed funds during the  
13 pendency of a dispute and to ensure that disputed funds were promptly available to the prevailing  
14 party upon the resolution of a dispute." Phase II SOD at 7. One reason for this conclusion was  
15 that, if read as a damages provision, SDCWA would be able to "fix extraordinarily high damages  
16 through the simple expedient of *claiming* extraordinarily high damages." *Id.* The same logic  
17 applies to the interest clause here.

18 Met's view is that the contract requires prejudgment interest generated on an amount that  
19 may be totally different than the damages actually awarded. That's not reasonable; as I note  
20 above, even Met does not so calculate interest.<sup>3</sup>

21 Met also argues that extrinsic evidence shows the parties meant this clause to reflect their  
22 agreement on applicable interest. Met notes communications between the parties in 2011 and  
23

24  
25  
26  
27 <sup>3</sup> That is, Met now adds more interest to account for the actual damages awarded; and I suppose, if I had awarded  
*less* than the set-aside, Met would nevertheless would not have turned over to San Diego either the full amount set  
aside nor "all interest earned thereon".

1 2012 indicated that the disputed money was being set aside and would earn interest “using the  
2 effective yield earned . . . on Metropolitan’s investment portfolio.” *Id.* at 7, citing Soper Decl.,  
3 ¶3, Ex. B. San Diego, Met stresses, did not object to this characterization. *Id.* <sup>4</sup> San Diego retorts  
4 that its failure to object to Met’s communications does not constitute “acceptance” of a  
5 “stipulated rate.” Reply, 4. I agree. See e.g., *Unocal Corp. v. United States*, 222 F.3d 528, 542  
6 (9th Cir. 2000) (interest rate unilaterally placed in invoice is not a stipulated legal interest rate  
7 under § 3289). I agree.

8  
9 Met also suggests that even if the contract is ambiguous, extrinsic evidence shows the  
10 parties’ “intent that the interest to be paid would be the interest earned in the interest bearing  
11 account.” Opposition at 9. But this is not so. Met’s evidence is just that it informed San Diego  
12 that it would comply with § 12.4(c) by placing disputed funds in a separate account, and that San  
13 Diego did not object. See Opposition at 7-8.

### 14 **Judicial Estoppel**

15  
16 San Diego suggests Met is barred by judicial estoppel. See generally, *Jackson v. Cnty. of*  
17 *Los Angeles*, 60 Cal.App.4th 171, 181 (1997); *MW Erectors, Inc. v. Niederhauser Ornamental &*  
18 *Metal Works Co., Inc.* 36 Cal. 4th 412, 422 (2005). Met had previously insisted that § 12.4(c)  
19 was a security deposit and did not pertain to damages at all. I agreed; § 12.4(c) only served to  
20 prevent either side from spending disputed funds. But Met has not taken two positions which are  
21 “totally inconsistent,” 60 Cal.App.4<sup>th</sup> at 183. It is at least conceivable that § 12.4(c) both acted to  
22 secure some money towards damages *and* set forth the parties’ agreement on interest calculation.  
23  
24  
25

26 <sup>4</sup> Met also notes that San Diego’s second and third amended complaints requested interest “as a result of the express  
27 term in section 12.4(c) . . .” *Id.*, citing Emanuel Dec., Ex. 4, ¶4. The same request appeared in San Diego’s June  
2012 lawsuit. *Id. Nesbit v. MacDonald*, 203 Cal. 219, 222 (1928) notes “a prayer for ‘interest,’ without specifying  
the rate, is deemed a prayer for legal interest” – here, set at 10 percent by statute. I do not take these allegations as  
reasonable evidence that the parties had agreed to calculate interest as Met now claims.

1 But, while I do not think judicial estoppel applies to actually block Met's position now, as I have  
2 noted the logic of my earlier ruling does refute it.

3 **Certainty**

4 San Diego must show that the damages I awarded were "certain, or capable of being  
5 made certain" under § 3287(a). Met tells us that this means San Diego must show there was "no  
6 dispute as to the computation of damages." Opposition at 9, citing *Fireman's Fund Ins. Co. v.*  
7 *Allstate Ins. Co.*, 234 Cal.App.3d 1154, 1173 (1991). Because "the parties vigorously disputed  
8 the computation," Met continues, there could not have been certainty. Opposition at 2. If this  
9 were so, a party could avoid prejudgment interest merely by contesting damages at trial.

10  
11 As San Diego notes cases distinguish between disputes over the measure of damages and  
12 the absence of data necessary to allow the defendant to calculate damages. Only the latter makes  
13 damages uncertain. Reply, 6. *Howard v. Am. Nat. Fire Ins. Co.*, 187 Cal.App.4th 498, 535  
14 (2010) ("test for determining certainty under section 3287(a) is whether the defendant knew the  
15 amount of damages owed to the claimant or could have computed that amount from reasonably  
16 available information...") See also, *Collins v. City of Los Angeles*, 205 Cal.App.4th 140, 151  
17 (2012).

18  
19 Here I awarded exactly the amount of damages requested by San Diego. The calculation  
20 was as San Diego suggested, a simple deduction of some sums from others. The calculation was  
21 just "math" as Met's counsel noted.<sup>5</sup> Met had all the information it needed to determine the  
22 degree of the overcharges; indeed, the data came from Met. See *Chesapeake Indus., Inc. v.*  
23 *Togova Enterprises, Inc.*, 149 Cal. App. 3d 901, 907 (1983) (prejudgment interest awarded if  
24 defendant "from reasonably available information could ... have computed" damages). Thus  
25  
26  
27

---

<sup>5</sup> See also TR 1913-1914 (San Diego's math correct, according to Met witness).

1 these damages were “capable of being made certain” and San Diego is entitled to prejudgment  
2 interest.

3 In its papers, Met confronts San Diego with its earlier statements that damages were  
4 difficult to quantify, statements made in connection with its liquidated damages argument on §  
5 12.4(c). Met is accurate,<sup>6</sup> but after I rejected its position San Diego changed its theory, and as  
6 Met counsel agreed at argument, changes in damages theory do not demonstrate that damages  
7 are uncertain.<sup>7</sup>

8  
9 At argument Met emphasized its concerns that the damages here were uncertain in the  
10 sense that they were a function of deduction of uncertain amounts of charges, that it was never  
11 clear exactly what portion of certain charges could (had Met properly calculated them) be billed  
12 to San Diego. Perhaps; but it was San Diego’s theory, repeated in communications to Met before  
13 litigation and found in statements made during this case, that any such uncertainty was not its  
14 problem; that it should not be required to pay those charges unless they were justified, that they  
15 were not justified, and thus they should all be deleted from San Diego’s bill. My finding that Met  
16 might have been able to justify some unknown portion of the challenged charges, but in the event  
17 did not do so, is not a demonstration that the damages were uncertain. Of course Met disputed  
18 both damages (including maintaining the position that the court was without power to calculate  
19 them) as well as San Diego’s damage theories (not to speak of its liability theories) but not the  
20 facts used to calculate the damages.  
21  
22  
23

24 <sup>6</sup> It is literally accurate to note San Diego’s argument that damages could be difficult to quantify, but the situation  
25 was then more nuanced: San Diego was arguing that, *absent a liquidated damages* provision, damages could be or  
26 were difficult to quantify, and so urged liquidated damages—which would have been exceedingly certain. San  
27 Diego has not, I think, ever urged a theory of damages which is uncertain. See n.7.

<sup>7</sup> The fact that a court might have to select among damages models does not mean the damages awarded are not  
“capable of being made certain.” *Children’s Hosp. & Med. Ctr. v. Bonta*, 97 Cal. App. 4th 740, 774 (2002). San  
Diego presented essentially two models, one of which I rejected; Met presented none, and each of San Diego’s  
models was “capable of being made certain.”

1           The test may be focused this way: damages are not ‘certain’ when to fix damages, the  
2 court is required to resolve (aside from the liability issues) “disputed facts,” *Collins v. City of Los*  
3 *Angeles*, 205 Cal. App. 4th 140, 151 (2012) or “conflicting evidence,” Dennis L. Greenwald,  
4 CALIFORNIA PRACTICE GUIDE: REAL PROPERTY TRANSACTIONS 11:134.2 (2014). While one can  
5 imagine that I might have had to resolve disagreements on exactly how much of a rate ought to  
6 have been included in San Diego’s bills (because, for example there was disagreement on how  
7 much to allocate to supply (compare Met’s Opposition at 10:20)), in the event, I did not. No  
8 party wanted to lead me down that path. These sorts of conflicts were avoided, and not presented  
9 to me for resolution, by the parties’ approaches to damages.  
10

11  
12  
13 **Conclusion**

14           San Diego’s motion for prejudgment interest is granted. The parties agree that, using the  
15 10 percent rate, the interest is \$43,415,802.<sup>8</sup>

16  
17 Dated: October 9, 2015



18 \_\_\_\_\_  
19 Curtis E.A. Karnow  
20 Judge Of The Superior Court  
21  
22  
23  
24  
25  
26  
27

<sup>8</sup> The parties agree that at 10% this is the minimum to which San Diego is entitled. Reply at 10:3-26.

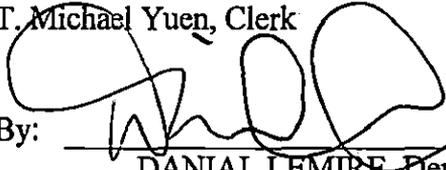
**CERTIFICATE OF ELECTRONIC SERVICE**  
(CCP 1010.6(6) & CRC 2.260(g))

I, DANIAL LEMIRE, a Deputy Clerk of the Superior Court of the County of San Francisco, certify that I am not a party to the within action.

On **OCT 9 - 2015**, I electronically served THE ATTACHED DOCUMENT via File & ServeXpress on the recipients designated on the Transaction Receipt located on the File & ServeXpress website.

Dated: **OCT 9 - 2015**

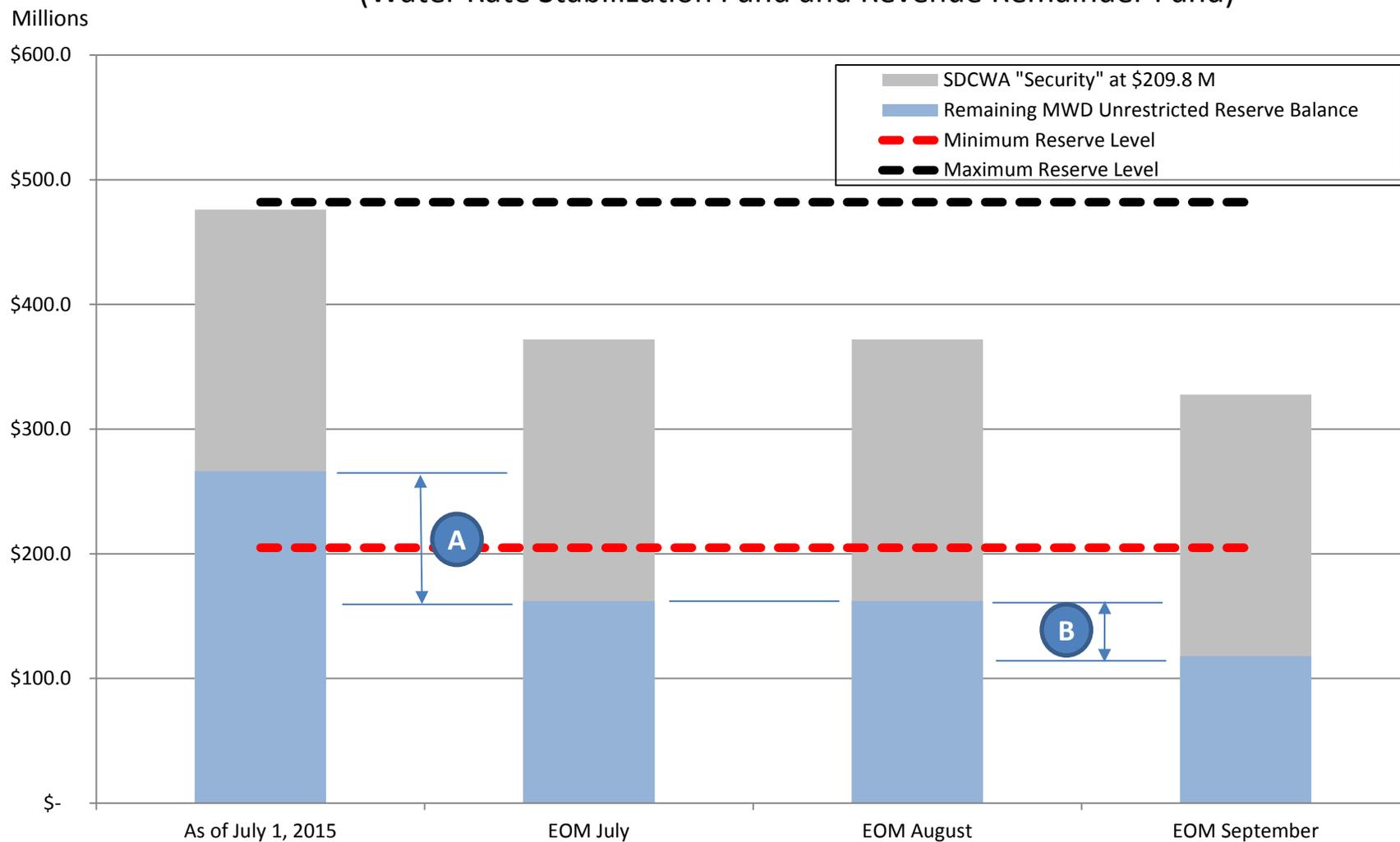
T. Michael Yuen, Clerk

By: 

DANIAL LEMIRE, Deputy Clerk

# Unrestricted Reserves

(Water Rate Stabilization Fund and Revenue Remainder Fund)



**A** 07/14/15 - \$264 Million unbudgeted cash payment to acquire real property (\$104 million of which from unrestricted reserves).

**B** 09/22/15 - \$44.4 Million unbudgeted cash payment to Southern Nevada Water Authority



## San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233  
 (858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

November 5, 2015

Marcia Scully, General Counsel  
 Metropolitan Water District of Southern California  
 P.O. Box 54153  
 Los Angeles, CA 90054-0153

### MEMBER AGENCIES

Carlsbad  
 Municipal Water District

City of Del Mar

City of Escondido

City of National City

City of Oceanside

City of Poway

City of San Diego

Fallbrook  
 Public Utility District

Helix Water District

Lakeside Water District

Olivenhain  
 Municipal Water District

Olay Water District

Padre Dam  
 Municipal Water District

Camp Pendleton  
 Marine Corps Base

Rainbow  
 Municipal Water District

Ramona  
 Municipal Water District

Rincon del Diablo  
 Municipal Water District

San Dieguito Water District

Santa Fe Irrigation District

South Bay Irrigation District

Vallecitos Water District

Valley Center  
 Municipal Water District

Vista Irrigation District

Yuima  
 Municipal Water District

### OTHER REPRESENTATIVE

County of San Diego

**Re: Board Item 8-1 – Adopt Twenty-First Supplemental Resolution to the Master Revenue Bond Resolution authorizing the sale of up to \$250 million of Water Revenue Bonds, 2015 Authorization; and approve expenditures to fund the cost of issuance of the Bonds**

Dear Ms. Scully:

The purpose of this letter is to inquire regarding the procedures followed by MWD in authorizing the sale of water revenue bonds under Board Item 8-1, but more broadly to inquire regarding procedures the district has followed since at least 1991 to authorize its water revenue bonds. Under our analysis, as discussed below, it appears that MWD has been issuing water revenue bonds since at least 1991, for a total of over \$4 billion, without statutory authority.

According to the Board Memorandum, The Twenty-First Supplemental Resolution authorizes the sale of up to \$250 million of bonds pursuant to MWD Ordinance No. 149, which determined that the interests of MWD require the use of revenue bonds up to an aggregate amount of \$500 million. Such an ordinance, adopted by a two-thirds vote, is required by MWD Act Section 237 before water revenue bonds can be issued. The Twenty-First Supplemental Resolution also references MWD Resolution 8329, adopted in 1991, which is the "Master Resolution" upon which subsequent supplemental resolutions and individual bond issues are based.

The procedures followed by MWD in authorizing this water revenue bond prompted us to review the procedures followed by MWD for previous bond issues, particularly water revenue bonds issued since the 1991 Master Resolution was adopted. Our concern was that we could not recall that previous bonds had been preceded by an ordinance as required by Section 237 of the MWD Act. The Master Resolution does not cite any ordinance that might comply with Section 237, or for that matter any ordinance at all. Likewise, none of the twenty subsequent supplemental resolutions cite any ordinance. In fact, our research shows that Ordinance No. 148 was issued in 1981 regarding the sale of \$150 million in revenue bonds, and assuming ordinances are numbered in sequence, no ordinances were enacted by MWD for the next 34 years, until Ordinance No. 149 was adopted last month.

*A public agency providing a safe and reliable water supply to the San Diego region*

Ms. Scully  
November 5, 2015  
Page 2

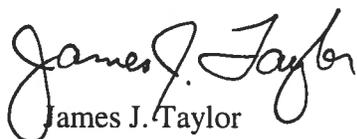
It appears then, that at least since 1991, MWD had not issued any new revenue bonds pursuant to the ordinance required by statute. While Section 62 of the MWD Act provides that any act to be done by resolution may be done by ordinance, there is no mirror provision that any act to be done by ordinance may be done by resolution. We simply do not see any exception to the ordinance requirement.

The Water Authority is concerned that MWD's apparent failure to follow statutory requirements in issuing new water revenue bonds for at least the last 24 years places a cloud on the validity of all of those bonds. To apprise the district, its directors, and member agencies of possible consequences of this situation, we request answers to the following questions:

- Do you disagree with the analysis contained in this letter indicating that MWD has failed to follow statutory requirements in issuing revenue bonds, as described? If so, please let me know the basis of your analysis and conclusion.
- Has MWD obtained or will MWD obtain an opinion from its bond counsel on the implications of failure to follow statutory requirements since at least 1991?
- Does MWD now have a disclosure obligation to its current and future bond holders of the failure to issue debt in conformance with statutory requirements?
- Does MWD now have any continuing obligation to disclose this deficiency in its annual financial statements?

I would appreciate a response to this letter by email by Friday afternoon so that I can advise the Water Authority's MWD delegates on the issue. My email address is [jtaylor@sdewa.org](mailto:jtaylor@sdewa.org). The Water Authority's MWD board representatives may have other comments on Board Item 8-1; this letter is solely to address the legal questions as described. Thank you.

Sincerely,



James J. Taylor  
Interim Deputy General Counsel

cc: Water Authority's MWD Delegates