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SUPERIOR COURT OF THE STATE OF CALIFORNIA

FOR THE COUNTY OF SAN FRANCISCO

SAN DIEGO COUNTY WATER AUTHORITY,

Petitioner and Plaintiff,

vs.

METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA; ALL PERSONS INTERESTED IN THE VALIDITY OF THE RATES ADOPTED BY THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA ON APRIL 10, 2012 TO BE EFFECTIVE JANUARY 1, 2013 AND JANUARY 1, 2014; and DOES 1-10,

Respondents and Defendants.

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

RESPONDENT AND DEFENDANT METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA'S CORRECTED CLOSING BRIEF

Hon. Curtis E.A. Karnow
Dept.: 304
Hearing Date: June 5, 2015
Hearing Time: 2:00 p.m.

Trial: Completed

Actions Filed: June 11, 2010; June 8, 2012

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PRELIMINARY STATEMENT

Even if SDCWA had succeeded in proving liability – which it did not – the Court will search the record in vain for evidence proving any amount of damages by the proper measure; that is, the difference between what SDCWA paid and what it should have paid. SDCWA never tried to prove that difference. Instead, it simply assumed the entirety of costs it disputed in Phase I should not have been paid by SDCWA and that that is all it had to do. That was wrong for several reasons, each of which is fatal to SDCWA's case.

First, in Phase I, the Court did not rule, as SDCWA assumed, that none of the disputed costs could be properly charged to SDCWA. The finding in Phase I was limited to the conclusion that the record did not support including 100% of the challenged costs in conveyance. The Court did not find that none of those costs could be included. Second, because (as is undisputed) MWD must recover all its costs, SDCWA could not simply assume those costs disappeared and that SDCWA should never pay any portion of them. Costs deducted from conveyance had to be included in other rates; to determine damages, SDCWA needed to account for the additional amounts it would have paid in those other rates. Third, SDCWA ignored entirely that the agreement was not to "move" Colorado River water but, in exchange for the Colorado River water made available MWD by SDCWA, deliver a like amount of MWD supplies from any source. Yet SDCWA simply assumed that it would not pay any of the costs attributable to the State Water Project ("SWP") water it necessarily received.

Independent of these errors, SDCWA did not correctly perform the calculations it did do even on its own incorrect assumptions. SDCWA sought to show what it cost to convey an acre-foot of Colorado River water. Yet SDCWA's expert divided the costs of conveying Colorado River water by the quantity of *all* water sold by MWD, which included far more than Colorado River water. He should have divided by the quantity of Colorado River water alone. His miscalculations resulted in a number that had nothing whatsoever to do with cost per acre-foot of Colorado River water. As a result, SDCWA's conclusion as to the amount of damages, based on that erroneous calculation, was grossly inflated. Thus, even if it were proper to calculate damages using SDCWA's assumptions, it failed to do it right.

In any event, the Court need not, and should not, reach the issue of damages at all. *First*, SDCWA failed to show breach. The undisputed evidence showed that SDCWA paid what it promised to pay. And SDCWA failed to prove any damages, an essential element of a cause of action for breach of contract.

Second, even if SDCWA had shown breach or a proper measure of damages (which it did not), MWD showed that SDCWA's conduct fits squarely within the affirmative defenses of waiver, estoppel, and consent. SDCWA proposed the price term at issue; knew the components and costs included in the price; voted in favor of the conveyance rates it proposed; voted to approve the contract with those conveyance rates; and voted to approve the rates thereafter for several years, even beyond the five-year period. In exchange for its promise to pay what it proposed to pay, SDCWA accepted enormous benefits; namely, $235 million and the rights to 77,700 acre-feet of water each year for 110 years, worth over a billion dollars.

If SDCWA's offer was to pay an illegal amount, then the affirmative defenses of mistake and illegality apply. Neither MWD nor SDCWA lawfully could have agreed to illegal terms. In an attempt to avoid these defenses, SDCWA witnesses have had to contradict each other. To avoid the defense of illegality, some witnesses (including the person most knowledgeable on the subject) denied they knew the rates were illegal, which would support the defense of mistake. To avoid the defense of mistake, another witness claimed she believed the contract illegal from the moment it was entered into, which would support the defense of illegality. SDCWA cannot have it both ways.

ARGUMENT

I. SDCWA FAILED TO PROVE THAT MWD BREACHED THE EXCHANGE AGREEMENT

A. SDCWA Cannot Show Breach When It Paid What It Agreed to Pay

MWD previously demonstrated in its motion for partial judgment that SDCWA knew all the components of the conveyance charges, including SWP costs and the Water Stewardship Rate ("WSR"). Knowing these facts, SDCWA proposed to pay $253 per acre-foot – the total of the three conveyance charges – and to pay future prices based on those charges. MWD will not repeat

that showing here. *See, e.g.*, Cushman 1030:11-1031:11; Slater 1214:1-1215:25; Stapleton 1594:19-1599:8. SDCWA can hardly prove breach of contract when SDCWA has paid the amount it proposed and agreed to pay.

B. SDCWA Failed to Prove That MWD Charged More Than a Lawful Rate

The Exchange Agreement provides that the price "shall be *equal to* the charge or charges set by Metropolitan's Board of Directors pursuant to applicable law and regulation . . . ." DTX-51 at § 5.2 (emphasis added). Therefore, to establish breach, SDCWA must prove that it was charged an amount *greater than* the amount of lawful charges. *Behnke v. State Farm Gen. Ins. Co.*, 196 Cal. App. 4th 1443, 1468 (2011). It failed to do so.

Dennis Cushman, SDCWA's Assistant General Manager and person most knowledgeable concerning breach of contract and damages, testified that to determine whether SDCWA was overcharged one would have to calculate both what SDCWA actually was charged and what it should have been charged. Cushman 1050:7-22. He acknowledged that there are different lawful rate structures that MWD could have adopted, but he does not know what these other structure are. Cushman 1047:17-24,1051:17-21. Cushman conceded, accordingly, that even as SDCWA's person most knowledgeable, *he did not know whether SDCWA was, in fact, overcharged*:

> Q. And you don't know – I mean as San Diego's designated person most knowledgeable, you don't know whether San Diego would necessarily be better off under some of those alternative rate structures that Metropolitan could lawfully adopt, correct?
>
> A. Correct.
>
> Q. There might be other lawful rate structures, as far as you know, that Met could adopt for conveying water where San Diego would be worse off, correct?
>
> A. Possibly.
>
> [Objection; overruled.]
>
> Q. BY MR. QUINN: You just don't know?
>
> A. We don't know.

Cushman 1047:25-1048:15.

Thus, SDCWA admittedly could not show that it was overcharged because it does not know, and never tried to prove, that it paid more than the amount of lawful charges.

II. SDCWA DID NOT PROVE DAMAGES UNDER THE PROPER MEASURE

A. To Prove Damages, SDCWA Had to Prove the Difference Between the Charges It Paid and Lawful Charges It Could Have Paid

1. SDCWA Is Not Entitled to Be Placed in a Better Position Than If the Promise Had Been Performed

A plaintiff suing for breach of contract damages should not be placed in a better position than if the promise had been performed. Cal. Civ. Code § 3358; *see also Brandon & Tibbs v. George Kevorkian Accountancy Corp*., 226 Cal. App. 3d 442, 468 (1990); *Glendale Fed. Sav. & Loan Ass'n v. Marina View Heights Dev. Co*., 66 Cal. App. 3d 101, 123 (1977). Where there are multiple potential measures of damages, and each would place the plaintiff in the position he would have been in if the promise had been performed, then *the measure least costly to defendant is to be awarded*. *A. A. Baxter Corp. v. Colt Indus., Inc.*, 10 Cal. App. 3d 144, 160 (1970) ("[I]f the facts show that either of two measures of damages will fully compensate plaintiff for his loss, that measure must be adopted which is less expensive to defendant."); *State v. Pac. Indem. Co.*, 63 Cal. App. 4th 1535, 1551 (1998).

2. To Prove the Amount That Would Place It in the Position in Which It Would Have Been, SDCWA Had to Prove the Amount That MWD Could Have Charged

As this Court recognized in ruling on MWD's motion to reopen discovery, damages must be measured based on "a price that Met could have set in compliance with the contract." *See* Nov. 4, 2014 Order re Measure of Damages at 8. Having promised to pay lawful conveyance charges, SDCWA had to prove what MWD could have lawfully charged.

This measure of damages does not require speculation. It requires evidence of what the costs are and how they could properly be allocated under cost causation principles. SDCWA presented no such evidence. Its expert was instructed simply to assume that SDCWA would not pay any of the disputed costs. *See, e.g.*, Denham 1135:15-22, 1137:6-14, 1138:2-18. Consequently, SDCWA presented no evidence whatsoever of the amount it would have paid if the contract had been performed in compliance with the Court's ruling in Phase I. Without evidence that it paid more than a lawful rate, SDCWA failed to prove an essential element of its cause of action.

B. SDCWA Could Not and Did Not Prove That It Would Be Appropriate to Simply Eliminate All Disputed Costs, As It Assumed.

1. SDCWA's Expert Opinion Testimony Lacked Reliable Evidentiary Basis

SDCWA's damages expert Dan Denham assumed that SDCWA would not have paid any of the costs SDCWA had disputed in Phase I. Expert opinion may not be based on assumptions of fact that are without evidentiary support. *Sargon Enters., Inc. v. Univ. of S. Cal.*, 55 Cal. 4th 747, 770 (2012) ("[T]he matter relied on must provide a reasonable basis for the particular opinion offered, and . . . an expert opinion based on speculation or conjecture is inadmissible.") (quoting *Lockheed Litig. Cases*, 115 Cal. App. 4th 558, 564 (2004)); *see also Bushling v. Fremont Med. Ctr.*, 117 Cal. App. 4th 493, 510 (2004) ("'[A]n expert's opinion that something *could* be true if certain assumed facts are true, without any foundation for concluding those assumed facts exist' . . . has no evidentiary value.") (emphasis in original) (citation omitted) (quoting *Jennings v. Palomar Pomerado Health Sys., Inc.*, 114 Cal. App. 4th 1108, 1117 (2003)*; Pac. Gas & Elec. Co. v. Zuckerman*, 189 Cal. App. 3d 1113, 1135 (1987). Denham's assumptions were not supported by evidence; to the contrary, each was contradicted by substantial evidence.

2. SDCWA Did Not Present Evidence Justifying the Assumption That SDCWA Could Not Have Been Charged Any of the Disputed Costs

SDCWA's entire damages case was based on the assumption that SDCWA had no obligation to pay any of the disputed costs. The reason Denham calculated damages assuming SDCWA would not have paid any of the disputed costs is because that is what Cushman told him to do. Cushman 992:14-21. That assumption has no legal or evidentiary basis.

SDCWA will presumably contend that the Court's ruling in Phase I is the basis for the assumption that SDCWA would have paid none of the disputed costs. However, the ruling in Phase I on its face does not justify the assumption. In Phase I, the Court did not rule that all disputed costs were not proper exchange costs. The Court ruled that the record did not support including 100% of the challenged costs. *See* Stmt. of Dec. at 65. The Court did not find that 0% could be included. In Phase II, SDCWA had the burden of proving what percentage could be included. SDCWA made no effort to do so. For example, Denham assumed SDCWA would pay

none of the WSR, but SDCWA adduced no evidence that all WSR costs benefited only supply and none benefited the conveyance system. *See, e.g.*, Denham 1134:19-1135:14. As shown below, the evidence was exactly the opposite.

SDCWA's entire damages case was based on the assumption that SDCWA would not pay any of the disputed costs. That assumption had no evidentiary basis at all. Without that evidence, SDCWA failed to prove an essential element of its cause of action.

3. SDCWA Failed to Present Evidence of Net Loss

To show the position it would have been in had the contract been performed, SDCWA had to prove net loss. SDCWA failed to meet its burden of proof.

SDCWA's expert assumed that SDCWA would not have paid any portion of the disputed costs. Yet Denham conceded that, in fact, SDCWA would have paid some of those costs. *See., e.g.*, Denham 1137:6-14. Denham considered the disputed costs supply. Denham 1104:22-1105:22, 1120:22-1121:2; Woodcock 1895:24-1896:15, 1918:2-25. That would, of course, mean that SDCWA would still pay some of the costs in the form of higher payments for full service water it bought from MWD. Yet Denham did not factor in an increase in the cost of supply. *See, e.g.*, Denham 1137:6-1138:12. He acknowledged that MWD must recover all its costs, *see, e.g.*, Denham 1148:18-1149:3, and that a reduction in the amount SDCWA paid for exchange water would necessarily increase other rates. Denham 1137:6-1138:18, 1148:18-1149:3. He testified that "*supply costs will go up if you move costs from transportation to supply*," Denham 1137:6-14 (emphasis added). Denham, however, was not asked to calculate net effect, and thus did not include it in his report. Denham 1137:11-1138:18.

MWD's expert, Chris Woodcock, pointed out the absence of analysis of the impact of increasing supply costs. Woodcock 1895:24-1896:15, 1918:2-25. As Woodcock phrased it, the costs that were removed were "left hanging." *Id.*

Damages must be measured by the *net* effect of the breach versus performance. Where a breach of contract results in a savings of some cost that the injured party would otherwise have incurred, then that avoided cost must be subtracted from the damage caused by the breach. Restatement (Second) of Contracts § 347(c); *see also Meister v. Mensinger*, 230 Cal. App. 4th

381, 397 (2014) ("In business cases, damages are based on net profits, as opposed to gross revenue."). Here, decreases in some rates necessarily result in increases in others, as experts for both sides testified. *See* Woodcock 1896:23-1897:2, 1914:3-11; Denham 1137:6-14, 1148:18-1149:3. SDCWA would be placed in a better position if its damages are the amount some rates are reduced without taking into account the amount other rates are increased.

Nor did SDCWA provide any evidentiary basis for its assertion that Denham's original opinion as to damages would be reduced by 15%. Cushman testified that Denham told him that as the result of increases in the cost of supply, SDCWA damages would decrease by about 15%. Cushman 1258:8-14. But there is no evidentiary basis for Denham's alleged assertion of a 15% reduction. Woodcock had pointed out that changes to the supply rate would impact total sales. Woodcock 1897:12-20. Yet Denham testified that he did no analysis whether demand would go down as supply costs went up. Denham 1136:11-15. He did nothing to test his assumption that if supply costs went up, everything would stay the same. Denham 1136:20-24.

C. Even Using SDCWA's Assumptions, SDCWA Did Not Correctly Calculate Its Alleged Damages

SDCWA's expert purported to present evidence of the cost per acre-foot to convey Colorado River water. But he did not calculate the cost properly. Denham divided the cost of conveying Colorado River water by the total volume of water sold by MWD, which included both SWP water and Colorado River water. Denham 1140:5-17, 1144:1-4. But Denham was purporting to calculate the cost per acre-foot of Colorado River water alone, not the cost per acre-foot of all water. To determine the cost of an acre-foot of Colorado River water, Denham should have divided the costs of conveying Colorado River water by the acre-feet of *Colorado River water*. *See, e.g.*, Skillman 1829:6-1830:18; Woodcock 1900:8-14, 1942:5-18. Because Denham incorrectly divided by a much larger denominator that did not correspond to Colorado River water, the result had nothing to do with the cost per acre-foot of that water.

Without a proper calculation of the cost per acre-foot of Colorado River water, Denham's conclusion has no evidentiary value. Without Denham's opinion, SDCWA has no evidence to

satisfy its burden of proof. This methodological failure impacts both power and access unit cost components of the Exchange Water costs.

D. A Proper Calculation of Damages Would Have Included a Substantial Portion of the Disputed Costs

1. SDCWA's Expert Should Have Accounted for the SWP Costs Associated with the SWP Water Received by SDCWA

To determine what SDCWA would have paid if the contract had been performed, SDCWA had to account for all the water it received under the contract, and how much it could lawfully have been charged for it. Denham assumed SDCWA received only Colorado River water under the Exchange Agreement and/or that any delivery of SWP water was for MWD's sole convenience. *See, e.g.*, Denham 1129:8-16. In fact, the evidence showed that MWD's performance of the Exchange Agreement *required* it to deliver SWP water, and SDCWA knew and expected it.

a. The Exchange Agreement Could Not Be Performed Without SWP Water

First, because of the structure of the MWD system, it is impossible to deliver Colorado River water alone; a blend had to be delivered. Pipes carrying SWP water and Colorado River water meet above the San Diego Canal and SDCWA's connection point. *See* Yamasaki 1668:7-23, 1703:15-1704:4; Woodcock 1944:19-1946:19, 1955:1-9. Water flowing down the East Branch of the California Aqueduct (carrying SWP water) flows into the San Diego Canal before reaching SDCWA or, for that matter, the Skinner reservoir that serves SDCWA. *See, e.g.*, Yamasaki 1703:15-1704:2. Consequently, the water MWD delivered to SDCWA under the Exchange Agreement had to be a blend.[1] In fact, it is the essence of an exchange agreement that

[1] During cross-examination, Yamasaki was asked whether there was a bypass around Lake Skinner. Yamasaki 1697:5-10. The insinuation was that the "bypass" would permit MWD, if it chose, to avoid blending Colorado River and SWP water. The bypass, however, is after the Colorado River water and SWP water flow together. Yamasaki 1706:22-1707:19; Woodcock 1946:13-19. Unblended Colorado River water would only occur in the event of "something extraordinary *like a lack of SWP water supplies*." Yamasaki 1703:15-1704:2 (emphasis added); *see also* Woodcock 1944:19-1946:19. In other words, so long as SWP water is flowing in the East Branch, the water delivered to SDCWA is blended.

one type of water (here Colorado River water) is exchanged for another type of water (here, a blend). It would be surprising – and here a physical impossibility – if an exchange agreement contemplated exchanging Colorado River water for only other Colorado River water. Here, Colorado River water was made available by SDCWA and went into the MWD system and was exchanged for MWD water which was necessarily a blend.

Second, the Exchange Agreement required MWD to deliver fixed, equal installments of exchange water month in and month out. DTX-51 at § 3.2(c); *see also* Woodcock 1947:6-15. To do so, MWD must draw water from both sources. *See*, *e.g.*, Yamasaki 1663:15-1670:18; Woodcock 1949:18-1954:4. Southern California's demand for water is voracious and weather patterns are unpredictable. *See* DTX-1152 at ¶¶ 5-8, 23; Woodcock 1885:21-1886:11. Like the SWP, the watershed in the Rocky Mountains that fills the Colorado River is also subject to drought. *See* DTX-1152 at ¶ 7. There simply is not a predictable supply of Colorado River water or SWP water. MWD must store both SWP and Colorado River water, DTX-1152 at ¶¶ 5-6, 8; Woodcock 1947:18-1948:18, and the storage facility for the water SDCWA receives necessarily contains a blend. Yamasaki 1167:1-1168:23; Woodcock 1944:19-1946:19. Also, the Colorado River Aqueduct is shut down annually for maintenance and repairs. Yamasaki 1663:22-1664:20; *see also* Woodcock 1946:20-1947:5.

Third, state law requires MWD to blend.[2] "[W]here a blend of the waters from such different sources is to be served, it shall be the objective of the district that, to the extent determined by such district to be reasonable and practical, not less than 50 percent of such blended water shall be water from the State Water Resources Development System." MWD Act § 136; *see also* Yamasaki 1688:5-8. SDCWA knew that MWD was required to blend. *See* Cushman 236:10-238:11 (MWD has legal obligation to provide blend under Met Act). SDCWA also knew as a historical fact that SDCWA had received blends. Stapleton 1510:19-23.

[2] There cannot be any doubt that under the Exchange Agreement, MWD is delivering MWD water. DTX-51 at § 4.2 ("[T]he Exchange Water delivered to SDCWA shall be characterized as Metropolitan water . . . .").

Fourth, MWD must deliver a blend to avoid wasting water.[3] Although MWD is required to pay the State under its State Water Contract, it is not guaranteed any water supply. DTX-1152 at ¶¶ 21, 23; Woodcock 1876:11-1878:14. When SWP water is available, MWD must take it. *See, e.g.*, Yamasaki 1669:10-1670:9, 1701:22-1703:6; Woodcock 1947:18-1948:18. The result of not doing so would be the diversion of water – water it has paid for – to other agencies or to the ocean. *Id*. MWD needs all the water made available by the State. Woodcock 1885:21-1886:11, 1947:18-1948:18. Once water enters the MWD system, it is blended in reservoirs or it flows through to the MWD member agencies. *See, e.g.*, Yamasaki 1665:24-1668:23; Woodcock 1944:19-1947:5.

Fifth, the contract contemplated that SWP water would be used. The agreement does not include any promise that only Colorado River water would be exchanged for Colorado River water. To the contrary, the agreement contemplated that Colorado River water would be exchanged for a blend. Thus, the agreement addressed what may happen in the event of loss of SWP facilities: such a loss could excuse MWD's performance, at least temporarily. *See* DTX-51 at § 3.3. The parties would never have included a provision dealing with the loss of SWP facilities – and provided that deliveries to SDCWA could be curtailed – unless the parties recognized that SWP water was essential. For this reason, the parties agreed in the contract that MWD could deliver both SWP and Colorado River water. DTX-51 at § 3.6. Indeed, SDCWA's General Manager Maureen Stapleton acknowledged the importance of SWP water to the contract. She testified that she "understood from [the fact that a shutdown of SWP facilities might have certain consequences for the schedule of the deliveries] that Met might well be using the SWP facilities to perform under the exchange agreement." Stapleton 1510:11-18.

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[3] If MWD were to waste water, it would violate the California Constitution: "It is hereby declared that because of the conditions prevailing in this State the general welfare requires that the water resources of the State be put to beneficial use to the fullest extent of which they are capable, and that the waste or unreasonable use or unreasonable method of use of water be prevented . . . ." Cal. Const., Art. X § 2.

Sixth, notwithstanding SDCWA's professed indifference Colorado River water at trial, SDCWA clearly wanted to continue receiving a blend (as it had in the past) rather than raw Colorado River water alone. In a presentation by SDCWA, SDCWA acknowledged that the "Colorado River has relatively high salinity." DTX-116 at 2. SDCWA also stated in its presentation that "[e]xcess salinity causes ~$375 million/year economic damage" and "can create environmental impacts." *Id.*

Seventh, SDCWA is on the same pipeline as two other member agencies. Yamasaki 1668:7-23; Woodcock 1954:9-25. Even if the Court were to give credence to Stapleton's dubious assertion that SDCWA was "prepared to take 100 percent Colorado River water" and did not "have any concern about it," Stapleton 1568:15-19, 1569:18-1570:2, SDCWA could not receive Colorado River water without forcing the Eastern and Western Municipal Water Districts to do so too. Yamasaki 1706:9-1708:7. MWD could not deliver only Colorado River water to SDCWA without compromising its deliveries to other agencies. *See, e.g.*, MWD Act § 136.

b. SDCWA Received Approximately 40% SWP Water and 60% Colorado River Water

Brent Yamasaki, MWD's Section Manager of Operations and Planning, explained that MWD keeps records of the daily blend of SWP and Colorado River water delivered to SDCWA. Yamasaki 1671:2-1672:11; *see also* DTX-1105. From this data, Yamasaki was able to calculate the monthly average blend, Yamasaki 1683:10-16; DTX-1155, and then "the amount of State Water Project delivery and Colorado River water deliveries . . . for each month." Yamasaki 1684:2-8; DTX-1156. Yamasaki's calculations showed that, during the years at issue, SDCWA received roughly 41% SWP water and 59% Colorado River water. *See* DTX-1156 (showing 282,943.1 acre-feet of SWP water in 690,352.9 acre-feet of exchange water for the four years in question).

c. Because SWP Water Was Necessarily Delivered, Proper Cost Accounting Principles Required That SWP Costs Be Allocated to the SWP Water Delivered

The Court's ruling in Phase I – that MWD may not include SWP costs in a system-wide access rate – did not mean SWP costs were irrelevant. Because SDCWA received, and was

expected to receive, SWP water under the Exchange Agreement, to properly account for the causal relationships of costs to water received, Denham had to account for a portion of the SWP costs. Woodcock 1867:20-1868:5, 1903:4-25, 1931:8-1932:7, 1942:5-1943:12. Otherwise all the other member agencies would be subsidizing deliveries of SWP water to SDCWA. That is, SDCWA would not be paying the fair and reasonable cost of the water it was receiving under the Exchange Agreement and the other member agencies would be making up the shortfall through higher rates imposed on them. Denham, however, ignored SWP costs entirely. *See, e.g.*, Denham 1129:8-16.

2. A Correct Calculation Would Have Included WSR Costs

Denham assumed that no percentage of the WSR could be allocated to conveyance. No such finding was made in the Statement of Decision in Phase I. The Court did find that the record did not support allocating 100% of WSR costs to MWD's transportation rates. Stmt. of Dec. at 65. But, again, there is a wide gulf between not 100%, as the Court stated, and 0%, as Denham assumed. *See* Denham 1129:12-16, 1134:19-1135:14. SDCWA introduced no evidence to support its assumption.

A proper calculation would have included an allocation of WSR to conveyance. The programs funded by the WSR – called "demand management programs," Upadhyay 1398:24-1399:19, 1403:23-1404:1 – are all "downstream," Upadhyay at 1403:20-22; that is, the conservation and other water saving or recycling programs are implemented below the connection between MWD and local agencies. Upadhyay 1403:7-19. Because MWD delivers imported water from the SWP and Colorado River, DTX-1152 at ¶¶ 5, 6, the downstream programs do not add any water to the quantity MWD obtains. DTX-1152 at ¶¶ 29, 30. The effect of the downstream programs is to produce a local supply of water for the local agencies. *Id.*

Woodcock pointed out that demand management programs do not add to MWD's supply. Woodcock 1907:15-1908:7. MWD always takes all the water it can get, and the aggregate supply is not increased by demand management programs. Woodcock 1884:15-1886:11. Woodcock further explained that for purposes of rate setting, costs that do not add to supply are not appropriately charged as supply. Woodcock 1907:24-1908:7; *see also generally* DTX-123 at 19-21; DTX-11 at 168-76. The causal and beneficial effect of reducing demand from the downstream

member agencies is to the infrastructure. Woodcock 1885:5-15; *see also* DTX-123 at 19 ("If MWD did not invest in local supplies it would have to enlarge its transportation systems.") (footnote omitted).

Notably, SDCWA's expert opined that the allocation of WSR costs was "all or nothing." Denham 1135:7-14. But SDCWA presented no evidence that downstream demand management programs added to the amount of MWD's water supply upstream. Even though SDCWA recognized that it faced an "all or nothing" issue – on which it carried the burden of proof – SDCWA presented nothing.

3. SDCWA Failed to Properly Account for the Power

Because it takes electrical power to move water, a correct damages calculation should have included data as to how much additional electrical power would be needed to deliver quantities of water specific under the Exchange Agreement, and how much that power would have cost. The undisputed evidence showed that MWD has several sources of power for use on the Colorado River Aqueduct. The chart depicting the percentages of power from each source showed that MWD has had to purchase power for the Colorado River Aqueduct. *See, e.g.*, PTX-490A. Therefore, a correct calculation by Denham should have included data as to how much additional power would be needed to deliver the quantities of water specified under the Exchange Agreement, and how much that power would have cost. Denham did not include that data in his calculation. He seems to have assumed that the quantities of water specified in the Exchange Agreement would not increase power costs at all. To show whether his assumption was justified, SDCWA needed to present evidence. Without evidence to support his assumptions regarding power, Denham's opinion has no evidentiary value. Moreover, Denham makes no allowance for the power costs associated with the SWP water SDCWA necessarily received under the Exchange Agreement, *see supra* Section II.D.1.c, and his corrected Colorado River power rate suffers from the same denominator error discussed previously, *see supra* Section II.C.

III. SDCWA'S CLAIMS ARE BARRED BY WAIVER, CONSENT, ESTOPPEL, ILLEGALITY AND MISTAKE OF LAW

A. SDCWA Waived Any Claim for Damages Based on the Use of the Rate Structure to Set the Price

From 2002 – when SDCWA's representatives voted to adopt the rate structure SDCWA now claims is the breach of contract – to 2010, over two years after the end of any "standstill" – SDCWA acted inconsistently with any claim that MWD's rate structure was illegal. During those eight years, SDCWA voted repeatedly for the challenged rate structure; endorsed MWD findings that the cost allocation was proper; proposed the price and approved the Exchange Agreement despite supposedly believing the price was unlawful; performed and accepted performance without objection; represented to its member agencies and the public that it had no intent to sue over the rate structure; failed to assert breach of contract; and did not sue. Meanwhile, SDCWA took the consideration for its agreement to pay full rates: hundreds of millions of dollars of State funding and the assignment of millions of acre-feet of canal lining water worth over a billion dollars.[4] SDCWA, therefore, waived any purported right to claim damages based on the use of the rate structure to set the price.

1. Law of Waiver

"Waiver is the intentional relinquishment of a known right after knowledge of the facts." *Roesch v. De Mota*, 24 Cal. 2d 563, 572 (1944). Waiver "may be either express, based on the words of the waiving party, or implied, based on conduct indicating an intent to relinquish the right." *Waller v. Truck Ins. Exch., Inc.*, 11 Cal. 4th 1, 31 (1995); *see also Carmel Valley Fire Prot. Dist. v. California*, 190 Cal. App. 3d 521, 534 (1987) ("Waiver occurs where there is an existing right; actual or constructive knowledge of its existence; and either an actual intention to relinquish it, or conduct so inconsistent with an intent to enforce the right as to induce a reasonable belief that it has been waived.")

[4] Jeff Kightlinger explained that MWD had worked for seven to eight years to obtain the rights to canal lining water, which required, *inter alia*, an act of the United States Congress. Kightlinger 1273:12-1276:15.

Where a party enters a contract knowing the other party's future performance will constitute what it now claims is a breach, it waives the breach. *Coughlin v. Blair*, 41 Cal. 2d 587, 602 (1953) ("If the injured party accepts or urges performance by the promisor, he will not be allowed to obtain damages on the theory that performance has not been made."); *see also Bolar Pharm. Co., Inc. v. Hercon Labs. Corp.*, No. 12,102, 1992 WL 201899, at *6 (Del. Ch. Aug. 19, 1992) ("A party executing a contract knowing that a condition of termination already occurred is deemed to have waived that condition.") (*citing T.G.I. E. Coast Constr. v. Fireman's Fund Ins. Co.*, 600 F. Supp. 178, 181 (S.D.N.Y. 1985) ("[W]aiver is implied by law because the conduct of the contractor is inconsistent with an intent to enforce his rights.")).

Further, where a plaintiff with knowledge of a breach continues to accept performance from the defendant, it waives the breach. *Kern Sunset Oil Co. v. Good Roads Oil Co.*, 214 Cal. 435, 440–41 (1931); *see also DuBeck v. Cal. Physicians' Serv.*, 234 Cal. App. 4th 1254, 1265 (2015) (insurance company waived right to rescind a policy where, despite knowledge of facts giving it the option, it impliedly recognized continuing effect of the policy); *Gould v. Corinthian Colls., Inc.*, 192 Cal. App. 4th 1176, 1179 (2011) (acceptance of benefits under a lease supports finding of waiver).

2. SDCWA Acted Inconsistently with an Intent to Claim Damages

a. SDCWA Knew the Components of the Price It Proposed

SDCWA knew the rate structure and its components since the completion of the unbundling process in 2001. Stapleton 1444:7-1446:25; Slater 1190:3-1191:3, 1206:14-25, 1208:11-1209:1; Cushman 1028:7-19; DTX-45; DTX-49; DTX-52; DTX-57; DTX-60; DTX-64; DTX-68; DTX-90; DTX-475; DTX-767. Specifically, SDCWA knew the amount of the SWP costs in the System Access Rate ("SAR") and System Power Rate ("SPR") and the amount of the WSR prior to the vote in 2002 to adopt the 2003 rates and prior to the negotiation, approval and execution of the Exchange Agreement. *Id*. The structure, including the SWP costs and the WSR, has remained the same to date, *i.e.*, it is the same structure that SDCWA claims to be a breach of contract. Cushman 1071:1-1073:2; Kightlinger 1307:14-18; DTX-355. As Slater testified, at the time the Exchange Agreement was executed, "San Diego knew every single fact about the

components of MWD's rate structure that it contends in this lawsuit made it illegal." Slater 1206:14-25.

b. SDCWA Voted for the Rate Structure and Rates

Nevertheless, in 2002, SDCWA's delegates to MWD's Board voted in favor of implementing the SAR, SPR and WSR for calendar year 2003 (which eventually constituted the initial price – which SDCWA also proposed – and the basis for future prices), as well as the underlying rate structure, cost of service analysis and cost allocations. In fact, in an extraordinary step, the SDCWA Board directed its delegates to vote in favor of the rates.[5] Stapleton 1448:11-1452:8, 1503:11-1504:9, 1620:3-1622:9, 1624:1-18; DTX-129.

Specifically, the resolution SDCWA approved states that the Board "adopts the rates and charges contained in the Chief Executive Officer's recommendations" and:

> . . . finds and determines that the rates and charges contained in the Chief Executive Officer's recommendations are *supported by the cost of service process* and that such rates and charges *reasonably and fairly allocate the costs of providing service of Metropolitan's water system* to its member agencies and third-party transporters of water, if any.
>
> . . . The Board finds and determines that the cost of service process reasonably and fairly: (i) *allocates costs to the service functions* that Metropolitan provides to its member agencies; (ii) *classifies service function costs based upon use of Metropolitan's system*, and (iii) allocates costs to rates and charges based upon *customary water industry standards*. Accordingly, the Board finds that *the cost of service process supports the Chief Executive Officer's rates and charges recommendation by creating a logical nexus between the revenues required and the rates and charges necessary to defray the costs of providing service of Metropolitan's water system*.

DTX-41, Attachment 3, page 4 (emphasis added); DTX-42.

SDCWA's delegates then voted in favor of the rates, and the underlying rate structure, cost of service analyses and costs allocations, every year until 2010 (except 2005).[6] Stapleton 1502:25-

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[5] Although Stapleton initially testified twice that the delegates voted for the "*rate structure*," not just the "rates," after the three week break in the trial, she inexplicably changed her testimony to say that the delegates voted for the "rates," not the "structure." *Compare* Stapleton 1451:5-12, *with* Stapleton 1622:17-1623:25. Later Stapleton reverted back to her original testimony, stating that SDCWA approved the "structure." Stapleton 1633:14-17.

[6] In voting for rates for 2004, one SDCWA delegate voted against the resolution in issue, two abstained, and the fourth SDCWA delegate was silent. DTX-129.

1504:9, 1506:14-17; DTX-129. Strikingly, SDCWA claims that the action of adopting the rates in 2008 and 2009 are the very breaches it later sued on. Stapleton 1634:2-1636:19, 1637:20-1638:24. SDCWA's delegates voted to adopt those rates on the "recommendation" of SDCWA's staff. Stapleton 1506:14-17, 1627:25-1631:4; DTX-129. Thus, SDCWA finds itself in the extraordinary position of agreeing that *it joined in the very acts it contends are breaches of contract*. Stapleton 1451:5-1452:8, 1502:25-1504:9, 1637:15-1638:5; Cushman 1033:11-1034:21. In other words, SDCWA voted to breach its own contract!

During this time, the SDCWA delegates (who, as MWD Board members, were also MWD fiduciaries) did not tell the MWD Board (at least not in writing or reflected in writing) that SDCWA believed any of the rates might be unlawful even though they claim they were told that by SDCWA staff. Stapleton 1461:21-1462:15, 1499:6-1500:12; 1583:19-1585:24, 1631:1-1633:17; Cushman 1037:11-19, 1040:1-10, 1041:14-24, 1061:17-22.[7]

c. SDCWA Proposed and Approved the Price Term

After having voted for the 2003 rates and underlying rate structure, SDCWA proposed the price term that it now claims to be a breach of contract, basing the initial price – and knowing that future prices would be based – on those rates and that structure. Specifically, Slater proposed Option 2. It had an initial price of $253, which was calculated by adding the SAR and SPR (including SWP costs) to the WSR. Slater 1214:1-1217:6, 1223:18-1225:1; Cushman 1030:22-1031:10; Stapleton 1594:25-1595:17; DTX-50.

SDCWA and MWD both understood that future prices would be based on the same rate structure, starting at $253 and escalating over the life of the Exchange Agreement. Stapleton 1464:4-1466:2, 1479:17-1480:22, 1482:20-1483:8, 1487:1-6, 1489:15-1491:7, 1597:25-1600:17; Slater 1218:6-1221:16; Cushman 1029:5-9; DTX-50; DTX-221; DTX-829; DTX-856; DTX-859.

[7] SDCWA voted against the original unbundling resolution in 2001. However, the reason had nothing to do with SWP costs or the WSR; rather, it involved seasonal shift benefits, the volume of water provided at Tier 1 pricing and preferential rights. DTX-129.

Both parties analyzed the economics of the transaction on that basis. *Id*; *see also* Kightlinger 1307:25-1308:6.

Stapleton testified that SDCWA believed the $253 price, along with the rate structure and rates themselves, were unlawful at the time. Stapleton 1453:23-1455:4, 1601:7-10. She conceded, accordingly, that *SDCWA proposed a price term it supposedly believed was unlawful*. Stapleton 1594:25-1595:25.

Stapleton also testified that staff informed SDCWA's Board that the rate structure and the rates were unlawful. Stapleton 1588:15-1590:6, 1595:22-1596:23. The SDCWA Board, nevertheless, approved the price term as part of the agreement. Stapleton 1483:9-1485:6, 1595:22-1596:23. Thus, *SDCWA approved a price term it supposedly believed was unlawful.*

d. SDCWA Did Not Object to the Price

SDCWA claims it believed that the rate structure and rates were unlawful. Even if that were true, its conduct shows an intent to waive that claim by not objecting to the structure or rates until 2010. SDCWA points to the five-year provision to excuse its failure, but that provision *never* prohibited SDCWA from communicating its belief in the unlawfulness of the rates or from voting against the rates at MWD Board meetings. That provision only prohibited efforts "in any legislative, administrative or judicial forum [seeking] any change in the form, substance or interpretation of any applicable law or regulation" in effect at the time. DTX 51 at § 5.2. In fact, SDCWA did not object to the price (at least not in writing) for over two years *after* the expiration of the five-year period.

Stapleton's claim that she complained about the lawfulness of the rates is not credible. Cushman said a claim of unlawfulness never would have been made orally; according to Cushman, that is not how SDCWA does things. Cushman 1041:14-24. It is undisputed that no one from SDCWA ever told anyone from MWD in writing that the rates were illegal before 2010. Stapleton 1499:24-1500:4; *see also* Slater 1247:5-16. There was never any written objection to the price or even a statement of a reservation of rights. Stapleton 1500:5-12. In contradiction to Cushman, Stapleton claimed she did communicate orally, but to only one person, Dennis Underwood. Stapleton 1496:22-1498:17, 1516:25-1519:15, 1521:18-1522:4. Nobody else, not

even Cushman or Slater, knew of the alleged conversations between Stapleton and Underwood. Notably, Slater specifically contradicted her as to the WSR; he said that he did not recall Stapleton ever talking about the WSR to Underwood. Stapleton 1584:1-1586:16 (quoting Slater depo.). No witness or document corroborated Stapleton. Moreover, after she initially testified that she had discussed the SWP costs with Underwood as late as 2009, she later corrected herself to admit Underwood died in 2005. Stapleton 1497:10-1498:3, 1520:10-20, 1517:8-1518:4. After Underwood passed away in 2005, Stapleton did not identify anyone else to whom she ever complained. *See, e.g.,* Stapleton 1498:8-17, 1516:25-1519:15. In other words, according to her account, she complained during the negotiations of the Exchange Agreement in 2003 until Underwood died in 2005 – two years later – but then she fell silent, never again raising the issue with anyone else at MWD until suit was filed.[8] Her testimony deserves no weight. If rates and the lawfulness of the rates were as important as she stated, and she as vocal as she claimed, she would have complained in writing, and not orally and privately to just one person for only as long as he lived.

e. SDCWA Did Not Intend to Assert a Claim for Damages Based on the Rate Structure

That SDCWA had waived any assertion of illegality is confirmed by a memorandum written in 2007, just shortly before the expiration of the five-year period. Stapleton, along with Cushman and SDCWA's General Counsel, Daniel Hentschke, sent a memorandum to SDCWA's Imported Water Committee stating: "The Water Authority *does not intend to litigate MWD's current rate structure*, but it cannot know what future actions the MWD Board may take since the MWD rates are established annually and are subject to change by MWD's Board of Directors." DTX-355 at 2 (emphasis added). Later in 2007, SDCWA prepared its "MWD Work Plan" expressing the same intent. It says: "No expectation of litigation" and "'Peace treaty' expired - no litigation." DTX-1114 at 11, 12.

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[8] In the purported conversations with Underwood, Stapleton relied exclusively on the Katz Wheeling Law which, even according to SDCWA, does not apply to the Exchange Agreement. Stapleton 1574:1-8, 1576:23-1577:25, 1580:5-1581:16; DTX-78; DTX-1143.

Cushman confirmed the lack of intent to challenge the rate structure. He said that although MWD breached the Exchange Agreement by adopting the rates in 2008 and 2009, SDCWA never made a claim of a breach at any time during those years. Cushman 1033:11-15, 1040:1-1042:2. In fact, according to Cushman, SDCWA never told anyone *inside or outside* SDCWA that MWD had not complied with the Exchange Agreement before 2010. Cushman 1037:12-19, 1070:17-1073:2. Consistent with the other evidence, he testified that as late as 2007 SDCWA "did not intend to litigate MWD's current rate structure." Cushman 1070:17-22.

f. SDCWA Accepted MWD's Performance with Knowledge of What It Now Claims Was a Breach

Stapleton testified that MWD first breached the Exchange Agreement in 2003. Stapleton 1637:15-1638:12. Cushman, the person most knowledgeable on breach, said that MWD first breached the agreement in 2008. Stapleton 1634:2-1636:22 (quoting Cushman depo.); Cushman 1033:11-15. Either way, SDCWA accepted MWD's performance after the alleged breach and paid all MWD's invoices *without objection*. Stapleton 1499:14-1500:12; *see also infra* Section III.B.4.

g. The Standstill Provision Does Not Save SDCWA from Waiver

SDCWA argues that its waiver is limited by the five-year period in § 5.2. *See, e.g.*, Cushman 1002:20-1003:24, 1005:15-22; Slater 1195:3-1200:13. But this provision does not apply, and even if it did, SDCWA waived its claim after the expiration of the five-year period.[9]

SDCWA construes § 5.2 as an agreement to the rates for only five years, *see, e.g.*, Stapleton 1488:15-21, 1492:14-19, and a complete freeze on any litigation or other efforts to protest the conveyance charges, *see, e.g.*, Cushman 1003:21-24. It is neither. SDCWA's argument is based on inferences it draws from the second proviso of the clause, ignoring the proviso and provisions that precede it.

The initial provision in § 5.2 prohibits seeking any change in the law:

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[9] SDCWA also has referred to § 11.1 of the Exchange Agreement as providing that it could not dispute the price for five years. But that provision merely applies to efforts to resolve disputes by negotiation. DTX-51 at § 11.1.

> . . . For the term of this Agreement, neither SDCWA nor Metropolitan shall seek or support in any legislative, administrative or judicial forum, any *change in the form, substance or interpretation of any applicable law or regulation* (including the Administrative Code) *in effect on the date of this Agreement* and pertaining to the charge or charges set by Metropolitan's Board of Directors and generally applicable to the conveyance of water by Metropolitan on behalf of its member agencies . . . .

Both Slater and Stapleton acknowledged that the only restriction on SDCWA was that it could not seek a "*change*" in law or regulation in effect in October 2003. Slater 1238:8-1240:7, 1248:19-1255:15; Stapleton, 1603:24-1606:16. Thus SDCWA was free to inform MWD of the purported unlawfulness of the rates, notify MWD that it had breached the contract, vote against the rates or request that MWD deposit any disputed amount under § 12.4(c). Both Slater and Stapleton conceded the contract did not bar any other litigation or limit the agreement on price to five years. *Id.*

Section 5.2 continues with the first proviso, permitting MWD to amend its Administrative Code:

> provided, however, that Metropolitan may at any time amend the Administrative Code in accordance with Paragraph 13.12, and the Administrative Code as thereby amended shall be included within the foregoing restriction . . . .

The significance of this proviso is that MWD sets and changes its rates through its Administrative Code. Kightlinger 1324:3-23; Stapleton 1608:1-11. The effect of the first proviso is that MWD could change its rates without violating the prohibition against seeking to change regulations.

SDCWA relies on the next proviso, which it interprets out of context. It allows SDCWA to challenge "such charge or charges":

> provided, further, that (a) after the conclusion of the first 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 . . . .

SDCWA argues that this second proviso means that SDCWA only agreed to the rate structure for five years, but that is not what it says. The second proviso follows the first proviso that permitted MWD to change its code; that is, change the rates. If MWD did, the second proviso allowed SDCWA to challenge the change. This becomes clear when they are read together, as they must be under settled rules of contract interpretation. Cal. Civ. Code § 1641; *see also*

Balandran v. Labor Ready, Inc., 124 Cal. App. 4th 1522, 1529-30 (2004). The phrase "*such* charge or charges" in the second proviso refers to the charge or charges contained in the amendments to the Administrative Code under the first proviso. DTX-51 at § 5.2 (emphasis added). That phrase would be superfluous if SDCWA could challenge every charge, as well as the original rate structure. Under basic rules of contract interpretation, an interpretation that renders terms superfluous is to be avoided. *Founding Members of the Newport Beach Country Club v. Newport Beach Country Club, Inc.*, 109 Cal. App. 4th 944, 957 (2003); *City of Atascadero v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 68 Cal. App. 4th 445, 473 (1998).

The testimony of witnesses for both SDCWA and MWD confirms that they understood that § 5.2 applied to *changes* in the rate structure. Kightlinger explained that SDCWA would not sue over the existing rate structure, but reserved its right to sue over future changes in the structure or rates made pursuant to the first proviso. Kightlinger 1300:9-1303:24, 1304:19-1307:2, 1326:11-1328:14. Scott Slater's testimony was consistent, *i.e.*, SDCWA was concerned about changes in the rates or the law and future discrimination against SDCWA. Slater 1184:19-1185:4, 1238:22-1240:7, 1248:19-1255:19.

In fact, Kightlinger testified to a conversation with Slater and Stapleton in which he asked them if SDCWA would be challenging MWD's rate structure and said that there would be no agreement if SDCWA was going to do so. He testified that SDCWA responded: "[W]e have no objection to the rate structure. We agree to pay that. What we are concerned about are changes Metropolitan might make in the future and we want to reserve the right to challenge those." Kightlinger 1304:19-1307:2. Tellingly, SDCWA chose not to ask Slater about the conversation. Although Stapleton disputed Kightlinger's testimony, Stapleton 1554:7-1555:14, as explained above, Stapleton was not a credible witness.[10]

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[10] Stapleton's testimony was not credible in a number of other respects. Among other things: (i) she testified that SDCWA did not care about the salinity of the water delivered under the Exchange Agreement, but the Court recognized that anyone "would rather have less saline water than not, and that saline water does damage in a way that non-saline water doesn't," Stapleton 1568:15-1570:2; 1962:19-23; *see* DTX-116 at 2, 17 (excess salinity causes damage and "salinity

(footnote continued)

Additional corroboration for the interpretation that SDCWA could only challenge changes is found in SDCWA's memorandum to its Imported Water Committee in 2007, just before the end of the five-year period. It confirms Kightlinger's testimony: "[SDCWA] does not intend to litigate MWD's current rate structure, but it cannot know what future actions the MWD Board may take since the MWD rates are established annually and are subject to change by MWD's Board of Directors." DTX-355 at 2. Thus, the evidence from both parties was that SDCWA would not challenge the *existing* rate structure, but reserved its rights to challenge *future* changes to the rates.

In addition, when SDCWA analyzed Option 2, it projected future costs based on the initial price of $253 per acre-foot and escalated the cost by various percentages for the life of the contract, not just five years. Nowhere in the record is there any presentation to the SDCWA Board reflecting the possibility of suit after five years because the agreed-upon rates were illegal or even a possibility that the rate might be illegal. The analysis provided to the SDCWA Board analyzed the cost of Option 2 over the entire life of the contract – for 20, 35, 45 and 75 years – but never for five years.[11] Stapleton 1464:4-1466:2, 1479:17-1480:22, 1482:20-1483:8, 1487:1-6, 1489:15-1491:7, 1597:25-1600:16; Slater 1218:6-1221:16; Cushman 1029:5-9; DTX-50; DTX-221; DTX-829; DTX-856; DTX-859.

Moreover, SDCWA knew from prior negotiations that MWD would not agree to a contract price less than the full conveyance rates. When SDCWA and MWD were negotiating the 1998 Exchange Agreement, MWD took the position that it would not enter into an agreement for less

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depends on the mix of SWP and CR water"); (ii) she said she had conversations with Underwood six years after execution of the Exchange Agreement, but Underwood passed away four years earlier, Stapleton 1520:10-20, 1517:8-1518:4; (iii) she testified that the Colorado River Aqueduct was never full, but she testified in an administrative hearing that it was full at that time, Stapleton 1570:14-1571:17, 1576:8-22; DTX-44; (iv) she claimed that the SDCWA Board only wanted to hear the "worst-case scenario" for the projection of the cost of Option 2, and not a projection of the five-year deal she said SDCWA was agreeing to, Stapleton 1465:18-1469:20; and (v) she went back and forth as to whether SDCWA approved the "rate structure" or just the "rates," Stapleton 1451:5-12, 1622:17-1623:25, 1633:14-17.

[11] In addition, SDCWA's analyses were based on MWD's full wheeling rate rather than an alternative rate that it considered to be lawful. Stapleton 1599:17-1600:17.

than the full amount. Kightlinger 1288:8-1293:2, 1300:9-1301:6, 1302:17-1303:24, 1306:9-23. Because MWD would not budge, the State ultimately agreed to appropriate $235 million to be paid to MWD to make up the difference. *See* Slater 1203:19-1204:19. Ironically, if this lawsuit succeeds, the $235 million from the California Legislature would not achieve what it was supposed to. It was intended to compensate MWD for SDCWA's paying less than full rates. Under SDCWA's theory, SDCWA will pay less than full rates and also get the money from the State that was intended for MWD to make up the shortfall.

Even if the five-year provision were a freeze of litigation for five years, SDCWA still waived a claim for damages based on the existing rate structure. Even under SDCWA's interpretation, § 5.2 did not prevent it from: (i) notifying MWD of its purported belief in the unlawfulness of the rates; (ii) informing MWD that the price was a breach of contract; (iii) voting against the rates; (iv) asking MWD to deposit any disputed amount under § 12.4(c); or (v) taking other action to address any issue concerning the price (apart from filing a lawsuit). SDCWA cannot vote for the rates it claims are unlawful and then turn around and claim it never waived a challenge to them.

The waiver continued after the five-year period ended. In 2008 and 2009, SDCWA still did not communicate any claim that any of the rates were unlawful, object to the price, claim that MWD breached the contract, invoke § 12.4(c), file a lawsuit or take any other action indicating an intent to claim damages from the use of the rate structure to set the price. Stapleton 1532:6-13, 1611:8-1616:10, 1638:25-1639:25. SDCWA did not assert a claim for breach of contract (or invoke § 12.4(c)) until 2011.[12]

h. Waiver Is Not Precluded by Contract

Section 13.9 of the Exchange Agreement provides that no waiver of a breach "is effective unless it is in writing and signed by the Party waiving the breach. . . ." DTX-51. However, such provisions themselves may be waived expressly *or implicitly*. *Gould v. Corinthian Colls., Inc.*,

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[12] The discussion of the five-year provision and the no-waiver clause also applies to the defenses of consent and estoppel. To avoid duplication it will not be repeated below.

192 Cal. App. 4th 1176, 1180 (2011) ("[Plaintiff] cites no authority that an anti-waiver provision in a lease cannot itself be waived."); *see also Jeffrey Kavin, Inc. v. Frye*, 204 Cal. App. 4th 35, 52 (2012) (Turner, P.J., concurring) ("[Plaintiff's] *conduct* . . . constitutes waiver of the anti-waiver provisions of the original lease.") (emphasis added). For the reasons stated above, SDCWA waived § 13.9 by its conduct.

There are multiple writings evidencing the waiver. For example, in their memorandum to the Imported Water Committee, SDCWA's General Manager, Assistant General Manager and General Counsel wrote that SDCWA "does not intend to litigate MWD's current rate structure . . . ." DTX-355 at 2. SDCWA also evidenced its waiver in the writings documenting its votes for the rate structure, rates and findings; SDCWA's 2007 Work Plan; and all the documents showing SDCWA's performance of the contract and acceptance of MWD's performance without objection. DTX-41 at -309; DTX-129; DTX-1114. In fact, SDCWA's waiver of damages based on the price term is evidenced by the Exchange Agreement itself by setting the initial price at $253 which SDCWA believed to be unlawful.

B. SDCWA Consented to Using the Rate Structure to Set the Price

Slater, SDCWA's person most knowledgeable on the negotiation and terms of the Exchange Agreement, testified repeatedly that SDCWA "consented" to MWD setting the Exchange Agreement price by calculating conveyance charges pursuant to MWD's Administrative Code. *See, e.g.*, Slater 1208:11-1209:1, 1212:17-1213:10, 1226:20-24. Stapleton, SDCWA's General Manager, said she told SDCWA's Board that the rates were unlawful but it agreed to them anyway to get the benefits of the agreement. Stapleton 1595:22-1596:23. Cushman, SDCWA's person most knowledgeable concerning breach of contract, testified that SDCWA did not maintain to anyone internally or externally (including MWD) that MWD had breached the agreement until 2010. Cushman 1037:11-19. And, during the many years after proposing and agreeing to the price term, SDCWA performed under the agreement, accepted MWD's performance without objection and received the benefits of the deal. SDCWA thus consented to the use of the existing charges in the Administrative Code to set price.

1. Law of Consent

Consent is a free and mutual agreement to an act. Cal. Civ. Code § 1567. California Civil Code § 3515 provides: "He who consents to an act is not wronged by it." Accordingly, the California Supreme Court has held that a party who has consented to an act cannot maintain an action for any resulting loss. *Edward Brown & Sons v. City & Cnty. of San Francisco*, 36 Cal. 2d 272, 279 (1950); *see also Lauderdale Assocs. v. Dep't of Health Servs.*, 67 Cal. App. 4th 117, 125 (1998) (party who consents to conduct is not wronged).

Furthermore, 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." Cal. Civ. Code § 1589; *see also Fogel v. Farmers Group., Inc.*, 160 Cal. App. 4th 1403, 1420 (2008) ("By accepting the insurance policies, Fogel consented to all of the obligations arising from them . . . ."); *Anderson, McPharlin & Connors v. Yee*, 135 Cal. App. 4th 129, 135 (2005) ("Having accepted the benefits of his bargain, Yee will not now be heard to complain that he ought to escape its burdens."); *Saret-Cook v. Gilbert, Kelly, Crowley & Jennett*, 74 Cal. App. 4th 1211, 1226 (1999) (claim failed because of continued acceptance of benefits under agreement). According to a leading California treatise: "Consent may [] be a defense to an action for breach of contract when, for example, the defendant can show that the plaintiff previously accepted and consented to the performance now asserted as a breach." 2 Ann Taylor Schwing, *California Affirmative Defenses* (2015 ed.), at 203-04.

In addition, where a party executes a contract knowing that the other party's future performance will constitute what it now claims is a breach, it consents to that performance. As the California Supreme Court wrote in *Coughlin v. Blair*, 41 Cal. 2d 587 (1953): "If the injured party accepts or urges performance by the promisor, he will not be allowed to obtain damages on the theory that performance has not been made." *Id.* at 602.

In *California Lettuce Growers, Inc. v. Union Sugar Company*, 45 Cal. 2d 474 (1955), the price for sugar beets was based on a certain formula and one party claimed the formula could not be the basis of the price because it was illusory and lacked mutuality. *Id.* at 481. The California Supreme Court held: "Since the parties contracted with reference to an existing accounting

system, California Lettuce may not now claim that the accounting procedures are unilateral and unfair." *Id.* at 484; *see also Leiter v. Eltinge*, 246 Cal. App. 2d 306, 317 (1966) (plaintiff, by his "conduct in accepting the late tender of performance by Hunsaker, indicated an election to affirm the contract.").

Thus, SDCWA cannot claim a breach of contract for the performance it proposed and accepted, *i.e.*, setting the price based on the formula in MWD's Administrative Code.

2. SDCWA Approved the Price Believing That MWD's Performance Would Be Unlawful

Before the SDCWA Board approved the Exchange Agreement, Slater had more than fifty communications with SDCWA about the legality of MWD's rates, including the legality of including SWP costs in the SAR and SPR and including the WSR in conveyance charges. Stapleton 1588:15-1590:6. Stapleton said that she advised the Board that the rate structure was unlawful. Stapleton 1484:18-23, 1595:22-1596:23.

Nevertheless, SDCWA *consented* to setting the price pursuant to the existing rate structure. Slater 1208:11-1209:1, 1212:12-1213:10; Stapleton 1484:18-1485:6, 1595:22-1596:23. Specifically, Slater testified that, "in signing the exchange agreement, San Diego *consented* to pay the amount for conveyance charges calculated pursuant to the Met Administrative Code." Slater 1226:20-24 (emphasis added). Slater further testified:

> . . . San Diego thought that [the charges for conveyance of water] were consistent with the application of the Administrative Code that – that then prevailed, and that San Diego was willing to pay that charge as designated under the context of the agreement – the set of agreements that were charged. So they *consented* . . . .

Slater 1227:23-1229:12 (emphasis added).

Thus, SDCWA agreed to the Exchange Agreement, including the price term, with knowledge of the rate structure as well as the existing and anticipated future prices, and after being advised by counsel and staff concerning the lawfulness of the rates.

3. SDCWA's Delegates to MWD's Board Voted for the Rate Structure

As discussed above, SDCWA's delegates to MWD's Board voted for the rate structure, rates and findings when they were adopted in 2002 (which set the initial price of $253) and thereafter until 2010 (except 2005) and, during those eight years, failed to communicate to the

MWD Board that SDCWA believed any of the rates were unlawful. *See supra* Sections III.A.2.b, d. Again, SDCWA consented to the rates on which MWD based the price.

4. SDCWA Accepted the Benefits of the Transaction

SDCWA accepted the benefits of the transaction, *i.e.*, it accepted hundreds of millions of dollars of State funding, the assignment of 110 years of canal lining water worth in excess of one billion dollars and the exchange of the IID and canal lining water. Stapleton 1640:24-1645:8; Cushman 1067:3-1068:17, 1069:19-25. SDCWA concluded, even paying $253 per acre-foot plus an escalator for the entire term, it was a "great deal." Slater 1217:3-1218:5; Stapleton 1482:25-1485:6, 1645:5-8; DTX-856.

C. SDCWA Is Estopped from Asserting That Setting the Price Based on the Rate Structure It Proposed and Approved Is a Breach of Contract

SDCWA's delegates to the MWD Board are fiduciaries, with a duty to MWD to disclose any belief that the Board was acting unlawfully or in breach of contract. According to Stapleton, she had advised the delegates that the rate structure was unlawful. SDCWA's representatives could not, consistent with their fiduciary duties, conceal that information from the MWD Board. Nevertheless, they not only failed to disclose that the structure or any of the rates may be unlawful but they also voted to adopt the structure, rates and findings. SDCWA is, therefore, estopped from asserting that MWD's use of the rate structure to set the price was a breach of contract.

1. The Law of Equitable Estoppel

The elements of equitable estoppel are: (1) the party to be estopped must know the facts; (2) the party to be estopped must intend that its conduct be acted on, or must act in such a way that the party asserting estoppel had the right to believe the conduct was so intended; (3) the party asserting estoppel must be ignorant of the true facts; and (4) the party asserting estoppel must rely on the conduct. *Ashou v. Liberty Mut. Fire Ins. Co.*, 138 Cal. App. 4th 748, 766–67 (2006).

Equitable estoppel is not limited to fraudulent conduct; rather, it "has been applied in a broader context, where the party to be estopped has engaged in inequitable conduct, induced another party to suffer a disadvantage, and then sought to exploit the disadvantage." *Hoopes v. Dolan*, 168 Cal. App. 4th 146, 162 (2008); *see also Brown v. Brown*, 274 Cal. App. 2d 178, 188

(1969) ("[I]t is the object of equitable estoppel to prevent a person from asserting a right which has come into existence by contract . . . where because of his conduct, silence or omission, it would be unconscionable to allow him to do so.").

California Evidence Code § 623 provides: "Whenever a party has, by his own statement or conduct, intentionally and deliberately led another to believe a particular thing true and to act upon such belief, he is not, in any litigation arising out of such statement or conduct, permitted to contradict it." Section 623 is a "conclusive presumption" and "will apply to prevent a person from asserting a claim when the person's own silence or conduct makes the assertion of the claim unconscionable." Schwing, *California Affirmative Defenses*, at 266.

Estoppel "may arise as an incident of the relationship between the defendant and plaintiff[,]" such as a fiduciary relationship. *SCC Acquisitions Inc. v. Cent. Pac. Bank*, 207 Cal. App. 4th 859, 864 (2012); *see also People v. Ocean Shore R.R.*, 32 Cal. 2d 406, 421-22 (1948). As the Court wrote in *Professional Hockey Corporation v. World Hockey Association*, 143 Cal. App. 3d 410 (1983), the "duty of undivided loyalty applies even though the members of the board may also serve on subsidiary bodies or groups which make up the constituent element of the corporation." *Id.* at 415.

SDCWA's delegates to the MWD Board are fiduciaries. Stapleton 1505:5-1506:13; Cushman 1058:23-1059:6. Consequently, they had a duty from 2002 to 2010 to advise the MWD Board of the belief that the rate structure may be unlawful, the findings in support of the structure may be wrong, and that MWD may be breaching the Exchange Agreement by adopting rates based on that structure and those findings.

2. SDCWA Represented Through Its Conduct and Failures to Disclose That the Price Could Be Based on the Existing Rate Structure

SDCWA represented through its conduct and its failures to disclose that MWD could set the price based on the rate structure and rates adopted in 2002 and existing at the time the Exchange Agreement was negotiated in 2003. SDCWA either intended that its conduct be acted on by MWD or acted so that MWD had a right to believe SDCWA's conduct was so intended.

As discussed above, SDCWA knew the components of the rates; believed the rates to be unlawful; understood that MWD thought they were lawful; repeatedly voted for the structure, rates and findings; proposed and agreed to the price term based on the structure and 2003 rates; failed to communicate to MWD that any of the rates may be unlawful; failed to object to the price; and represented that it did not intend to sue over the structure. *See supra* Sections III.A.2.a-e.

And, in this context, SDCWA also failed to disclose the belief that the initial price and the rate structure were unlawful during the negotiations of the Exchange Agreement. Slater said that he told Kightlinger the price had to be based on a lawful rate, knowing the existing rate of $253 per acre-foot included SWP costs and the WSR, but conceded that "at no point during [his] discussions with [Kightlinger] did [he] tell [Kightlinger] that that rate or any other rate or the components of it were illegal." Slater 1225:6-23. In fact, Kightlinger asked him: "[I]s there something you aren't telling me? Is there a dog in the manger?" Still, Slater did not speak up; he did not say that the rates were unlawful. Indeed, Slater did not recall any instance where he used either of the words "illegal" or "unlawful." Slater 1241:15-1243:14, 1231:24-1232:22. Kightlinger concurred. Kightlinger 1304:19-1305:7, 1316:3-18.

3. MWD Was Ignorant of the True Facts

When the parties were negotiating the Exchange Agreement, MWD believed the rates were lawful and that SDCWA accepted the rate structure. Kightlinger 1316:3-18, 1304:19-1306:8. Slater and Stapleton both acknowledged that MWD believed the rates were lawful. Slater 1192:13-17, 1231:16-19; Stapleton 1527:3-17.

4. MWD Relied on SDCWA's Conduct

MWD relied on SDCWA's conduct and failures to disclose by: (i) approving and executing the Exchange Agreement; (ii) assigning to SDCWA $235 million and the canal lining water worth over $1 billion; (iii) adopting rates based on the rate structure and findings approved by SDCWA in 2002 and re-adopting them thereafter[13]; (iv) delivering exchange water and

[13] As Cushman testified, there were other lawful rate structures that MWD could have adopted. Cushman 1047:17-24,1051:17-21.

invoicing SDCWA in accordance with the initial price and subsequent prices based on the same structure; (v) charging members based on the rate structure; and (vi) setting budgets and revenue requirements based, in part, on the payments anticipated from SDCWA. Kightlinger 1306:15-1307:2, 1316:3-18, 1318:3-24; Skillman 1798:17-1799:11.

5. SDCWA Took the Benefits of the Transaction

SDCWA took the benefits of the State funding, the canal lining water and the exchange of water. *See, e.g.*, Slater 1247:13-1248:10; Stapleton 1515:1-11, 1640:24-1643:23.

6. SDCWA Is Estopped from Claiming a Breach Based on the Unlawfulness of the Rates

SDCWA misled MWD and now seeks to have the other 25 member agencies pay damages. SDCWA is estopped from claiming that using the rate structure to set the price was a breach of contract and from denying the propriety of the findings that it approved year after year, *i.e.*, that MWD's rates (i) are supported by the cost of service process; (ii) reasonably allocate costs; (iii) allocate costs based on industry standards; and (iv) create a logical nexus between revenues and the charges necessary to pay MWD's costs. It would be inequitable to allow SDCWA to profit further from its conduct.

D. The Exchange Agreement Is Void as Illegal

With respect to the legality of the price, SDCWA cannot have it both ways. Either the rate structure and rates are unlawful in a manner material to the Exchange Agreement or they are not. If they are, the contract is unlawful and cannot be enforced; if they are not, there was no material breach and SDCWA cannot recover damages. Under SDCWA's construction of the law and the Statement of Decision in Phase I, the agreement must fail due to illegality.

1. The Law of Illegal Contracts

The defense of illegality of contract arises where a central aspect of the contract, or *performance of such a term*, is unlawful. A contract may be illegal "because the performance that is bargained for is illegal . . . . This is true whether the performance bargained for is one that is merely promised, to be rendered in the future, or is one that is rendered as the executed

consideration for a return promise. *Kashani v. Tsann Kuen China Enter. Co., Ltd.*, 118 Cal. App. 4th 531, 541-42 (2004).

In particular, a contract is void due to illegality if it has an unlawful objective or provides for unlawful consideration. *See* Cal. Civ. Code § 1598 (if single object of contract is unlawful, the contract is wholly void); Cal. Civ. Code § 1599 (if one of several objects is unlawful, contract is partially void); Cal. Civ. Code § 1607 (consideration of a contract must be lawful within the meaning of § 1667); Cal. Civ. Code §1608 (if any part of consideration for contract is unlawful, the contract is void); Cal. Civ. Code § 1667 (contract is unlawful if contrary to express law or policy of express law). As the court wrote in *Stockton Morris Plan Co. v. California Tractor & Equipment Corp.*, 112 Cal. App. 2d 684 (1952), "[t]he illegality of an agreement may be in the consideration, in a promise, or in its performance." *Id.* at 689; *see also Cnty. of Amador v. City of Plymouth*, 149 Cal. App. 4th 1089, 1114 (2007) (illegal term fatal to contract where it was sole consideration for entering contract); *Dunkin v. Boskey*, 82 Cal. App. 4th 171, 183 (2000) (a contract may be illegal "in the consideration upon which it is based."); *McGillycuddy v. Los Verjels Land & Water Co.*, 213 Cal. 145, 146-47 (1931) (performance of services was legal but payment of the specified compensation was illegal).

An illegal contract "may not serve as the foundation of any action, either in law or in equity." *Kashani*, 118 Cal. App. 4th at 541-42 (*citing Tiedje v. Aluminum Taper Milling Co.*, 46 Cal. 2d 450, 453-54 (1956)). Therefore, SDCWA cannot recover damages on the basis that the performance of the price term – MWD's consideration – was illegal.

2. Performance of the Price Term – MWD's Consideration – Was Unlawful Under the Statement of Decision in Phase I

Payment of the full conveyance rates, including the initial price and future prices, was MWD's consideration under the Exchange Agreement. Slater 1215:8-1217:6, 1220:13-1221:3; Stapleton 1476:15-1477:18, 1492:9-1493:9; DTX-50, 51, 221, 837, 884. In Phase I, the Court invalidated the SAR, SPR and WSR – the conveyance rates – on the grounds that they are unlawful. Stmt. of Dec. at 65. Under SDCWA's reasoning that would mean the initial price of $253 was unlawful because it was calculated using these rates. Indeed, Stapleton testified that the

initial price was unlawful. Stapleton 1527:3-17. The Exchange Agreement was, thus, unlawful *ab initio*. *See* Cal. Civ. Code § 1596 (contract must be lawful "when the contract is made"). Similarly, the future prices anticipated by the parties – based on that initial price and underlying structure – also were unlawful under the Statement of Decision. Again, the agreement would be unlawful as a result.

The agreement, as construed by SDCWA, is also unlawful because it would be against public policy. Cal. Civ. Code § 1667; *see also Bovard v. Am. Horse Enters.*, 201 Cal. App. 3d 832, 838 (1988); *Stockton Morris*, 112 Cal. App. 2d at 689-90. According to SDCWA, it knowingly proposed and agreed to an unlawful price and performed unlawfully for years by paying invoices containing unlawful charges. Because SDCWA is a public agency and must collect its costs from its customers, it unlawfully overcharged its own members throughout that time.[14]

E. The Exchange Agreement Is Void Because of Mistake of Law

SDCWA's witnesses testified both (i) that SDCWA believed in 2003 that the rates were unlawful and (ii) that it did not have such a belief. Before MWD amended its Answers to assert the defense of mistake of law, Slater, SDCWA's person most knowledgeable concerning mistake of law,[15] testified that SDCWA did not see a "violation" of the "pertinent" laws when the contract was signed. Stapleton 1590:14-1591:7 (quoting Slater depo.). However, after MWD amended to assert mistake, he claimed in his second deposition that he had believed the rate structure was unlawful. Stapleton 1452:9-1453:22 (quoting Slater depo.). Either way, there was a mistake of law – if the mistake was not mutual as to one or more of the rates, it was unilateral and SDCWA failed to rectify MWD's mistake.

[14] SDCWA has stated that it plans to remit any damages it obtains in this case to its members (minus litigation costs), but that covers only four years. SDCWA knowingly paid and charged its members unlawful payments for 12 years.

[15] Slater was designated as the person most knowledgeable concerning mistake of law after MWD's motion to amend was granted.

1. The Law of Mistake

A mutual mistake is "[a] misapprehension of the law by all parties, all supposing that they knew and understood it, and all making substantially the same mistake as to the law." Cal. Civ. Code § 1578(1). A unilateral mistake is "[a] misapprehension of the law by one party, of which the others are aware at the time of contracting, but which they do not rectify." Cal. Civ. Code § 1578(2). In particular, where a party's historic understanding of the law differs from a court's current interpretation, there is a mistake of law. *See Metro. Water Dist. of S. Cal. v. Superior Court*, 32 Cal. 4th 491, 516-17 (2004) (concurring and dissenting) ("If the historic understanding of the parties with respect to the PERL is at odds with the court's present construction of that law, then the contract involves a mutual mistake of law") (*citing* 1 Witkin, Summary of Cal. Law, Contracts, §§ 377, 378 (9th ed. 1987) (§§ 272, 273 in 10th ed. 2005).

A party is entitled to rescission where the mistake is material. *Harris v. Rudin, Richman & Appel*, 95 Cal. App. 4th 1332, 1339 (2002). In the mistake of fact context, the California Supreme Court has held that "[a] significant error in the price term of a contract constitutes a mistake regarding a basic assumption upon which the contract is made, and such a mistake ordinarily has a material effect adverse to the mistaken party." *Donovan v. RRL Corp.*, 26 Cal. 4th 261, 282 (2001). A significant mistake in the legality of a price term similarly would be material.

2. MWD and SDCWA Were Mistaken as to the Lawfulness of One or More of the Rates

At the time of the execution of the Exchange Agreement, MWD believed that the SWP costs were lawfully included in the SAR and SPR and that the WSR was lawfully included in conveyance charges. Kightlinger 1316:3-18. SDCWA knew that MWD believed the rates were lawful. Slater 1192:13-17, 1231:16-19; Stapleton 1527:3-17. MWD would not have agreed to enter into the Exchange Agreement if it had known that it was mistaken as to the law as to any of these rates. Kightlinger 1306:15-24, 1316:3-18, 1318:10-24.

Although SDCWA now contends that it believed the rates were unlawful in 2003, the evidence is to the contrary. As discussed above, SDCWA sent no written statement to MWD that the rates were unlawful until 2010; made no oral statement to MWD that the rates were

unlawful;[16] made no contention internally or externally that MWD had breached the contract until 2010; instructed and recommended to its delegates that they vote to approve the structure, rates and findings; proposed the price term; approved and entered into the contract; did not invoke § 12.4(c) until 2011; and did not file a rates challenge until 2010.[17] *See supra* Sections III.A.2.b-e, g. Moreover, Slater, SDCWA's outside counsel and an expert in water law, said he did not see a violation of law in 2003. Stapleton 1590:14-1591:7 (quoting Slater depo.); Slater 1209:2-1213:10. In fact, there is not a single SDCWA document before 2010 suggesting that the rates may be unlawful (and any purported oral statement allegedly was made in a closed session of its Board). Stapleton 1481:4-21.

3. SDCWA Failed to Rectify MWD's Mistake

If SDCWA believed that the SAR, SPR or WSR was unlawfully included in conveyance charges, it had a duty to rectify MWD's mistake as to each. But despite knowing that MWD believed the rates were lawful, SDCWA did not do so – it did not communicate to MWD that it believed any of the rates were unlawful until 2010.

SDCWA has asserted that it expressed its disagreement with MWD's allocations of SWP costs on several occasions. However, even if true, there is no evidence that it communicated that the allocations were *unlawful*. As Cushman testified, there were different lawful rate structures that MWD could have adopted. Cushman 1047:17-24, 1051:17-21. When SDCWA said that SWP costs should be moved from conveyance to supply, it was proposing a different rate structure that it considered to be lawful; it did not tell MWD that the existing structure was unlawful. Thus, in her February 2003 letter to MWD about the rates, Stapleton wrote that SDCWA objected to the inclusion of SWP costs in the SAR not because it was unlawful, but because it "sends

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[16] Although Stapleton testified she told Underwood that the rates were unlawful based on the Katz Wheeling law, her testimony was not credible. *See supra* notes 5, 10. Furthermore, as SDCWA has acknowledged, the Katz Wheeling law does not apply to the Exchange Agreement. Stapleton 1574:1-8, 1576:23-1577:25, 1580:5-1581:16.

[17] There was conflicting testimony as to whether SDCWA agreed to pay MWD's existing wheeling rate or a lawful wheeling rate. Some of SDCWA's own documents refer to the full wheeling rate. *See, e.g.*, DTX-50; DTX-855; Slater 1215:15-1216:14. However, the conflict is easily resolved – both parties believed that the existing wheeling rate was lawful.

inappropriate economic signals on both the cost of alternative supplies and appropriate delivery costs." DTX-794. In her letter, Stapleton did not object at all to either the SPR or the WSR. *Id.*; *see also* Cushman 1038:17-1039:25; Stapleton 1459:13-1463:16. In fact, there is no credible evidence that SDCWA ever objected to the inclusion of SWP costs in the SPR or to the WSR before 2010.[18]

4. The Mistakes Were Material

The price was MWD's consideration for the exchange of IID and canal lining water and for the assignments of the State funding and the canal lining water. Slater 1215:8-1217:6, 1220:13-1221:3; Stapleton 1476:15-1477:18, 1492:9-1493:9; DTX-50; DTX-51; DTX-221; DTX-837; DTX-884. The claimed overcharges add up to almost $200 million: $73.3 million for the SAR; $86.3 million for the SPR; and $28.6 million for the WSR. PTX-471. Therefore, even if there was a mistake as to only one of the rates, the mistake would be material.

IV. SDCWA FAILED TO PROVE MWD MISCALCULATED PREFERENTIAL RIGHTS

A. The Court of Appeal Has Held That All Volumetric Water Rates Are Excluded from the Calculation of Preferential Rights as the Purchase of Water

Member agencies are entitled to a percentage of MWD water in proportion to the amounts they have contributed to the construction and financing of the system. *See* MWD Act §135. The Legislature determined that preferential rights would be measured based on financial contributions, "*excepting purchase of water*." *Id.* (emphasis added). When SDCWA previously challenged MWD's calculation of preferential rights, the Court of Appeal held that the exclusion of payments for water was fair and correct, and upheld MWD's exclusion of all payments for water, even though those rates included conveyance costs. *San Diego Cnty. Water Auth. v. Metro. Water Dist.*, 117 Cal. App. 4th 13, 27-28 (2004). In *San Diego*, SDCWA argued that only the cost

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[18] Although Stapleton testified that she told Underwood that the WSR did not comply with the law, her testimony was not credible and, even if believed, was based on the Katz Wheeling Law which SDCWA admitted does not apply to the Exchange Agreement. *See supra* note 8. Furthermore, her testimony was contradicted by Slater. Stapleton 1585:7-25 (quoting Slater depo.).

of the water supply itself should be excluded from the preferential rights calculation. *Id.* at 23. The court posed the question, "But where the operating expenses and capital costs of Metropolitan *are included in the rate charged for the water*, is a member entitled to receive preferential rights credits for that amount of the water charges attributable to these costs and expenses?" *Id.* at 25 (emphasis added). The answer was no. *Id.* at 26. After examining the legislative history and the preferential rights statute in context, the Court concluded:

> [W]e have uncovered nothing in section 135, its legislative history, or the overall statutory scheme supporting San Diego's argument that the Legislature intended the phrase "excepting purchase of water" to impose a requirement that Metropolitan break down its water rate into component parts thereby giving preferential rights credit for "amounts . . . applied to the categories or classifications of capital costs and operating expenses." On the contrary, we conclude that the express legislative intention indicates just the opposite.

Id. at 27-28.

Here, volumetric water rates are charged for the exchange of water. That the rates have components attributable to capital or operating expenses is irrelevant for purposes of preferential rights. SDCWA's payments are water rates and thus ineligible for inclusion in the preferential rights calculation.

June Skillman explained that the payments included in the preferential rights calculation are property taxes, two fixed charges (Readiness-to-Serve Charge and Capacity Charge) and revenue from construction of connections. Skillman 1847:5-15. The calculation has been the same for all member agencies, Skillman 1848:2-5, and has been the same since the MWD Act was amended in 1931, Skillman 1848:6-13, and has been the same for SDCWA, Skillman 1848:14-16.

B. The Exchange Agreement Is the Purchase of Water

1. The Exchange Agreement Provides That the Price Is for the Purchase of MWD Water

Under the Exchange Agreement, the parties agreed that SDCWA's payments were for MWD water: "the Exchange Water delivered to SDCWA shall be characterized as Metropolitan water and not as Local Water only for the limited purposes of Paragraph 5.2 . . . ." DTX-51 at § 4.2. Paragraph 5.2 is the price SDCWA pays for the water MWD delivers. SDCWA therefore

agreed that it was purchasing MWD water. The preferential rights statute excludes purchases of water. *See* MWD Act §135.

2. The Exchange Agreement Is Not a Wheeling Contract to Convey Water

To avoid the statutory exclusion for purchases of water, SDCWA has asserted that the Exchange Agreement is a conveyance, transportation or wheeling agreement. *See, e.g.*, Cushman 1086:1-8 ("[The Exchange Agreement i]s fundamentally a *transportation agreement*.") (emphasis added); Slater 1175:2-4 ("PTX 65 [is] the 2003 *wheeling agreement* between the Water Authority and Metropolitan.") (emphasis added). But in fact SDCWA admitted that the Exchange Agreement is not a wheeling agreement. *See, e.g.*, Stapleton 1574:9-1583:18; DTX-44A at 438:14-20 ("[T]he exchange agreement between San Diego and Metropolitan . . . is radically different than a wheeling agreement . . . ."); DTX-78 at 20-22; DTX-1143 at 153-57. Indeed, SDCWA's person most knowledgeable conceded the parties had tried to negotiate a wheeling agreement but could not. They entered into an exchange agreement instead. *See, e.g.*, Cushman 1087:2-5.

The difference between exchanging water and wheeling water is not semantics: (i) A wheeler can only move water if available capacity exists to do so. *See, e.g.*, Kightlinger 1309:6-24; Stapleton 1577:19-25, 1578:21-23. Under the Exchange Agreement, MWD delivers every month, even if the Colorado River Aqueduct is running at full capacity. *See, e.g.*, DTX-51 at § 3.2(c). (ii) Water is not wheeled unless and until it is available. *See, e.g.*, Kightlinger 1314:6-11; Stapleton 1577:19-25, 1578:17-20. Under the Exchange Agreement, MWD delivers an agreed-upon quantity of water every month regardless of the amount, if any, SDCWA has made available.[19] *See* Kightlinger 1312:19-1314:5. (iii) Under a wheeling agreement, the amount of water delivered is less than the amount of water the wheeler made available as the result of "carriage losses." Kightlinger 1310:22-1311:15. A percentage of water evaporates or is otherwise

[19] On at least one occasion, SDCWA did not make the agreed amount available, but MWD still performed its promise to deliver exchange water. *See, e.g.*, DTX-256; Cushman 1095:22-1096:19; Kightlinger 1312:19-1314:5; *see also* Woodcock 1947:6-15.

loss in transit, Kightlinger 1311:1-2, and the wheeler bears that loss, Kightlinger 1311:8-15. By contrast, under the Exchange Agreement, MWD bears the carriage loss, Kightlinger 1310:22-1311:7, just as it does for all the water MWD takes from the Colorado River. (iv) SDCWA was not billed for wheeling water, but instead was billed for purchasing water, with a monetary credit for the supply it made available in kind.[20] Finally, (v) to wheel Colorado River water, SDCWA would have needed a federal contract to take water from the Colorado River. Kightlinger 1395:1-22; *see also* 43 U.S.C. § 617d. SDCWA avoided the need for a federal contract by agreeing to exchange water because under the Exchange Agreement the water would be MWD water. Kightlinger 1395:1-22.

The economic reality of an Exchange Agreement is the same as the purchase of water. MWD agreed to deliver its water and in exchange it received the right to pump a like quantity of water out of Lake Havasu, plus receive cash from SDCWA. From SDCWA's perspective, instead of paying entirely cash for the delivered MWD water, SDCWA pays partly with cash and partly with water, which is the supply it provides to MWD in kind. It is like buying a car with cash and a trade-in. In fact, Cushman acknowledged that the transaction is "like a trade-in" and indistinguishable from the purchase of water. Cushman 1095:15-19.

C. SDCWA's Position Would Disadvantage All the Other Member Agencies That Pay the Same Conveyance Rates but Would Not Get Credit

SDCWA's assertion that its payments under the Exchange Agreement entitle it to an increase in its preferential rights would cause an anomalous and unfair result. Every member

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[20] As Cushman conceded, MWD charges for all water delivered – full service water and exchange water – and then gives a credit for the water supply SDCWA is deemed to have made available. Cushman 1094:13-17. The invoices in evidence corroborated Cushman. *See generally* PTX-469. They show that each month MWD billed SDCWA for all water delivered at the full service rate whether it was exchange water or not. *See, e.g.*, DTX-1130 at -657 ("Jan 2004 - iid-sd exchange"); Cushman 1095:9-12. In a separate line item, MWD provided SDCWA with a credit for the water SDCWA was deemed to have made available, by subtracting the Supply Rate. *See, e.g.*, DTX-1130 at -657 ("Jan 2004 - iid-sd exchange (San Diego CWA)"); Cushman 1095:13-14. Cushman acknowledged that on the occasion when SDCWA did not make available the requisite quantity of exchange water, SDCWA ended up paying the full service rate just like the purchase full service water. Cushman 1095:22-1096:12.

agency that buys full service water pays the conveyance rates that are included in the price of the water. Cushman 1081:7-16. Any member agency that wheels also pays conveyance rates. *See* DTX-1149A, MWD Admin. Code § 4405(b) ("The rates for wheeling service shall include the System Access Rate, Water Stewardship Rate and . . . wheeling parties must pay for their own cost for power . . . ."). As discussed above, the Court of Appeal held that paying conveyance costs do not increase preferential rights. *San Diego*, 117 Cal. App. 4th at 27-28. If SDCWA's contention were accepted, that would mean its payments of conveyance rates would increase its preferential rights, but all other member agencies' payments of conveyance charges would not. It makes no sense to treat member agencies differently when each pays the same charges. There should not be a special carve-out so that only SDCWA's payments for conveyance are included in the preferential rights calculation. All member agencies paying conveyance rates should be treated alike.

D. MWD's Interpretation of Its Implementing Statute Is Afforded Deference

MWD's interpretation of section 135 is long-standing and consistent. Skillman 1848:2-16. MWD's construction of the preferential rights statute, part of its implementing act, is accorded "great weight and respect." *San Diego*, 117 Cal. App. 4th at 22; *see also City of Long Beach v. Dep't of Indus. Relations*, 34 Cal. 4th 942, 956 (2004) ("In construing an ambiguous statute, courts generally defer to the views of an agency charged with administering the statute."); *Watershed Enforcers v. Dep't of Water Res.*, 185 Cal. App. 4th 969, 982 (2010) ("[Courts] will give deference to an [implementing] agency's interpretation [of a statute] . . . ."); *San Bernardino Valley Audubon Soc'y v. City of Moreno Valley*, 44 Cal. App. 4th 593, 603 (1996) ("In interpreting a statute, we give great deference to an agency's interpretation of its governing statutes.").

CONCLUSION

For the foregoing reasons, the Court should find that (i) MWD is not liable for breach of the Exchange Agreement, or alternatively, SDCWA was not damaged, and (ii) MWD properly calculated SDCWA's preferential rights.

DATED: May 26, 2015

QUINN EMANUEL URQUHART & SULLIVAN, LLP

By _____
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PROOF OF SERVICE

I am employed in the County of Los Angeles, State of California. I am over the age of eighteen years and not a party to the within action; my business address is 865 South Figueroa Street, 10th Floor, Los Angeles, California 90017-2543.

On May 28, 2015, I served true copies of the following document(s) described as

RESPONDENT AND DEFENDANT METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA'S CORRECTED CLOSING BRIEF

on the interested parties in this action as follows:

SEE ATTACHED LIST

BY FILE & SERVEXPRESS: by causing a true and correct copy of the documents(s) listed above to be sent via electronic transmission through File & ServeXpress to the person(s) at the address(es) set forth below.

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

Executed on May 28, 2015, at Los Angeles, California.

Pamela S. Davis

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