



SUMMARY OF METROPOLITAN'S OFFER TO COMPROMISE SDCWA v. Metropolitan, et al. Litigation

Nearly a decade of lawsuits filed by the San Diego County Water Authority (SDCWA) against the Metropolitan Water District of Southern California have cost each agency tens of millions of dollars in attorneys' fees and untold staff time, without producing any new water. With six pending cases and another trial approaching, Metropolitan has made a statutory Offer to Compromise. The agencies are now at a critical juncture with the opportunity to resolve the cases or proceed with a longer litigation battle. Metropolitan is offering a compromise in good faith that is very advantageous to SDCWA and it looks forward to the SDCWA Board of Directors' careful consideration.

BACKGROUND

SDCWA, a Metropolitan member agency, has challenged Metropolitan's rates and made other claims in cases filed in 2010, 2012, 2014, 2016, 2017, and 2018, all of which are pending. Under a SDCWA-Metropolitan Exchange Agreement entered into in 2003, SDCWA makes available to Metropolitan at Lake Havasu conserved water it purchases from the Imperial Irrigation District and from the lining of canals, and in exchange Metropolitan delivers to SDCWA a like amount of water from any source. The exchange price - which SDCWA proposed and Metropolitan accepted - is Metropolitan's transportation rates: the System Access Rate, System Power Rate, and Water Stewardship Rate.

However, basing the price on rates has incentivized SDCWA to challenge Metropolitan's rates and claim breach of the exchange price in every rate cycle since 2010. Metropolitan has prevailed on the major issue in the litigation, when in 2017 the Court of Appeal upheld the System Access Rate and System Power Rate and ruled that Metropolitan may include State Water Project transportation costs in the exchange price. Rates are set by Metropolitan's Board of Directors, comprised of member agency representatives, and apply to all 26 Metropolitan member agencies. No other member agency supports SDCWA's litigation and nine have joined the cases to actively defend the rates. Metropolitan's Offer to Compromise includes a new exchange price that is no longer tied to Metropolitan's rates.

OFFER TO COMPROMISE

On November 12, 2019, Metropolitan's Board of Directors authorized an Offer to Compromise to SDCWA under California Code of Civil Procedure Section 998 to resolve all cases. The key terms are:

(1) Payment of \$72.1 million for Water Stewardship Rate (WSR) Payments on Exchange Agreement Deliveries (2011-2017). This consists of (a) SDCWA's WSR payments on exchange deliveries for 2011-2014, plus interest, based on the court ruling that the administrative record did not support the WSR's inclusion in transportation rates in those years; and (b) SDCWA's WSR payments for 2015-2017, which have never been litigated. This benefits SDCWA because Metropolitan disputes the amount of the 2011-2014 award and may appeal it; disputes the calculation and end-date of interest for 2011-2014; and believes that if the 2015-2017 WSR payments are litigated, Metropolitan would prevail based on a different administrative record. Metropolitan has not charged the WSR on exchange deliveries in 2018-2020 pending a cost of service study, but the exchange price calls for the WSR's inclusion again starting in 2021.

(2) Exchange Agreement Fixed Price Term (2019-2112). The exchange price would no longer be based on Metropolitan's rates and instead would be a fixed amount (\$450 per acre-foot), with a construction industry escalator. This price is a discount by omitting the WSR and adding a further reduction of \$3 per acre-foot, and the construction industry escalator has averaged a 3.3% annual increase compared to a 4.6% average for Metropolitan's transportation rates. Discounted to present value, the changed price is estimated to save SDCWA \$5.5 to \$8.4 billion over the 110 year term of the Exchange Agreement. Should a state Delta conveyance project go forward, and after a cost of service study, Metropolitan would add the transportation cost of the project to the exchange price. SDCWA would otherwise avoid Metropolitan's increased State Water Project, Colorado River Aqueduct, and distribution system costs, and the above estimated savings to SDCWA do not include these amounts. The numbers are high because a large volume of water is exchanged under this lengthy contract. Under the current price, SDCWA is estimated to pay \$11.9 to 17.9 billion for the exchange.

(3) Exchange Agreement Delivery Flexibility. The Exchange Agreement calls for Metropolitan to deliver exchange water in equal monthly installments. Metropolitan would work with SDCWA to allow delivery flexibility within a calendar year - effectively providing SDCWA with access to Metropolitan's storage, treatment, and delivery capabilities - at no cost to SDCWA.

(4) Attorneys' Fees and Costs. Each party would be responsible for its own attorneys' fees and costs. Metropolitan believes the trial court on remand will find that it is the prevailing party in the 2010-2012 cases, based on its significant win as to SWP costs, and rule that SDCWA owes Metropolitan over \$10 million in attorneys' fees and costs.

Judgments/dismissals with prejudice would be entered in all cases. SDCWA would release claims against Metropolitan and its member agencies, and waive any claim to demand management funding for the Carlsbad Desalination Plant and related projects.

EFFECT OF OFFER TO COMPROMISE

A statutory Offer to Compromise is public and is common in cases proceeding to trial. The offer may be accepted within 30 days and is otherwise deemed withdrawn. If not accepted, the remand trial will proceed and the remaining cases may then be litigated. The effect of the Offer to Compromise is that even if SDCWA prevails (which Metropolitan does not believe will occur), if SDCWA does not obtain a better result in the litigation, it cannot recover post-offer costs and must pay Metropolitan's post-offer costs, including attorneys' fees under the Exchange Agreement. Further, unless the matter is resolved, the exchange price increases to \$482 per acre-foot on January 1, when Metropolitan's 2020 rates go into effect.

A PATH FORWARD

Metropolitan believes the Offer to Compromise is generous. It would change the inherent incentive in the Exchange Agreement for SDCWA to challenge rates in every cycle, and provide SDCWA with a lower price with savings to SDCWA valued at over \$5 billion over the 110 year term. The Offer to Compromise would bring closure to longstanding disputes and create an opportunity to find more common ground to work together. The litigation has been expensive and disruptive for all parties. Metropolitan and SDCWA should be spending their time and energy on positive efforts to benefit their customers and service areas, and to address the water challenges of today and tomorrow.