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SUPERIOR COURT OF THE STATE OF CALIFORNIA

COUNTY OF SAN FRANCISCO

SAN DIEGO COUNTY WATER AUTHORITY,

Petitioner and Plaintiff,

v.

METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA; et al.,

Respondents and Defendants.

Case Nos. CPF-10-510830; CPF-12-512466

RESPONDENT/DEFENDANT METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA'S FIRST PRETRIAL BRIEF

Date: November 4, 2013
Time: 9:00 a.m.
Dept.: 304
Judge: Hon. Curtis E. A. Karnow

Actions Filed: June 11, 2010; June 8, 2012
Trial Date: December 17, 2013

TABLE OF CONTENTS

Page

TABLE OF CONTENTS
(continued)

Page

TABLE OF AUTHORITIES

Page(s)

CASES

STATUTES

OTHER AUTHORITIES

I. INTRODUCTION

On July 22, 2013 the Court issued a Case Management Order instructing the parties to file pretrial briefs "expressing their views regarding, on a claim-by-claim basis (i) the standard of review, if the court is reviewing the actions of another entity, (ii) the burden of proof; and (iii) the evidence the court is required to evaluate." July 22, 2013 Order at 3. On the third point, the Court directed the parties to "include[e] (a) a description of the pertinent administrative record and (b) a generic description of the witnesses which the court may or should consider including (if the parties wish) argument on why the court ought not to consider evidence likely to be offered by opposing parties." *Id.* This pretrial briefing relates to all claims in the two cases except for the breach of contract claims, which will be tried (if at all) at a later date and on which the court did not request briefing. *Id.*

Accordingly, Respondent and Defendant Metropolitan Water District of Southern California ("MWD") submits its First Pretrial Brief in advance of the November 4, 2013 pretrial hearing. Below, MWD discusses each of the San Diego County Water Authority's ("SDCWA") claims in the *2010 Action* (Case No. CPF-10-510830) and the *2012 Action* (Case No. CPF-12-512466) other than the breach of contract claims, and sets forth the standard of review, burden of proof, and appropriate evidence for each claim.

II. FACTUAL OVERVIEW

A brief factual background is important to understand the standard of review, burden of proof and the appropriate evidence on a claim by claim basis. At the December 17 final hearing/trial, the Court will adjudicate three areas of claims: (1) the final hearing on SDCWA's rate challenges, which is the first three causes of action in both the *2010* and *2012 Actions*; (2) the trial on SDCWA's challenge to MWD's rate structure integrity clause, which is the fifth cause of action in the *2010 Action*; and (3) the trial on SDCWA's preferential rights claim, which is the sixth cause of action in the *2010 Action.* Below MWD sets forth the relevant factual background for these three areas of claims.

A. Factual Background Relevant to the Rate Challenges

MWD is a public agency, and a supplemental supplier of wholesale water, meaning it is

not the sole supplier of wholesale water to its member agencies. It operates as a collective of its member agencies, which themselves are public agencies, and it is governed by a Board of Directors composed of representatives from these member agencies. Today, MWD is made up of 26 member agencies.

To provide a supplemental wholesale water supply, MWD imports water from the Colorado River via the Colorado River Aqueduct, and from the State Water Project ("SWP"). The SWP is operated by the California Department of Water Resources ("DWR"). The water MWD imports is delivered to member agencies through an extensive regional network of canals, pipelines, and appurtenant facilities, as well as supply, treatment, and storage facilities. To pay the costs associated with providing water to its member agencies, MWD sets and maintains water rates and charges.

SDCWA's claims challenge features of MWD's rate structure that have been in place for a decade and a half.

1. The 1997 Wheeling Rate

In January 1997, MWD's Board of Directors voted to adopt a "postage stamp" wheeling rate, effective January 15, 1997, applicable to member agencies that convey non-MWD water through MWD's water conveyance system in transactions of one year or less. A postage stamp rate for wheeling a given quantity of water, as its name indicates, is the same regardless of how far the water is transported. The postage stamp nature of the wheeling rate substantially benefits SDCWA, because water must travel a longer distance to get to it as compared to most other member agencies. The Board developed this rate in consultation and cooperation with MWD's 26 member agencies, of which SDCWA is one. As a general matter, MWD's wheeling rate applies to the conveyance of non-MWD water through MWD's system. It consists of certain system-wide costs (*i.e.*, costs of capital, operation, and/or maintenance of MWD's interconnected facilities, as opposed to just those portions of the system used in the wheeling transactions).

This wheeling rate included, among other things, both MWD's conveyance costs under

its "take-or-pay" contract[1] with DWR for SWP, water and costs to assist funding of water conservation and other water demand management programs. Both of those cost allocations are inconsistent with the allegations SDCWA now asserts—more than 15 years later—that all SWP costs, including conveyance and power costs, and water conservation and demand management program costs, must be allocated solely to MWD's water supply rate. This wheeling rate was assessed on any member agency engaged in a wheeling transaction of one year or less since January 15, 1997, until it was modified in 2003 by the "unbundling" of MWD's rate structure, which unbundling is discussed in more detail below.

2. The Unbundling of MWD's Water Rates

In the late 1990s, MWD began a revision of its overall water rates and charges, in consultation and cooperation with SDCWA and MWD's other member agencies. On October 16, 2001, MWD's Board of Directors voted to adopt a revised rate structure, effective January 1, 2003. Among other things, this rate structure unbundled water rates and charges to reflect the different services provided by MWD and to more transparently allocate costs to operation functions.

Among the unbundled rates in the new structure are a "System Access Rate" charged on every acre-foot of water conveyed through MWD's conveyance system, whether the water is purchased from MWD or is non-MWD water, a "System Power Rate" which recovers MWD's cost of pumping water through both SWP and MWD facilities, and a "Water Stewardship Rate" to recover the costs of conservation and other demand management programs. In addition, the rates for the wheeling of non-MWD water through MWD's conveyance system for agreements of one year or less, which slightly modified the wheeling rate adopted in 1997, include the System Access Rate, Water Stewardship Rate and, for treated water, a treatment surcharge, as well as power costs. The basis for MWD's adoption of the unbundled rates was a detailed and thorough administrative record.

On March 12, 2002, with the affirmative vote of SDCWA's representatives on MWD's

[1] The SWP contract is "take or pay" because MWD must pay a certain amount under the contract regardless of how much water it gets from the SWP.

Board, MWD adopted specific rates and charges to be effective on January 1, 2003, pursuant to the rate structure adopted in 2001.

3. The Rate-Setting Process

For each rate-setting since the unbundling, MWD has engaged in a multi-step cost of service ("COS") process during which it assigns certain expenses to related operation functions. Procedurally, as in prior years, MWD undertook the following steps to set its 2011 and 2012 rates, as well as its 2013 and 2014 rates.

First, MWD determined its revenue requirements for the given fiscal year. Next, MWD allocated those revenue requirements (*i.e.*, MWD's expenses) to operation functions. Each of MWD's rate components is designed to generate revenue to pay costs of the operation functions related to it. For example, MWD generates revenue to pay for its conveyance expenses by allocating conveyance-related expenses to its transportation functions. Likewise, MWD generates revenue to pay for supplies of water by allocating supply-related expenses to its supply function. Next, MWD broke its operation functions down into cost classifications, and then corresponding rate design elements. As discussed, the rate components at issue in these actions are the System Access Rate, the System Power Rate, and the Water Stewardship Rate. SDCWA also erroneously asserts in the *2012 Action*[2] that MWD's rates and charges do not account for "peaking" and "standby" service, when they in fact do.

SDCWA and all of MWD's member agencies have been fully aware of these cost allocation decisions in MWD's structure of rates and charges, as evidenced by the written proposals and analyses that MWD regularly provides to them, their own knowledge and understanding of these charges, and especially in SDCWA's case, the affirmative votes of its representatives on MWD's Board in favor of these rates and charges in multiple rate cycles.

Each year, MWD's Board of Directors adopts by majority vote the specific rates and charges for the coming fiscal year or, more recently, for the coming two fiscal years. Several

[2] While the TAC contains a few references to dry year peaking in the factual background section, it is not a basis for any of the claims in the first three causes of action in the *2010 Action*. *See* TAC ¶¶ 68-97.

months in advance of the meeting at which the rate vote is to take place, MWD's General Manager presents to each Board member, member agency, and the public a detailed letter setting forth the proposed revenue requirements and proposed rates and charges for the coming fiscal year or, more recently, for the coming two fiscal years. The proposed rates are presented and discussed at public meetings, Board meetings, and its Business and Finance Committee and Executive Committee meetings, meetings with all member agency managers, and a noticed public hearing. Following these meetings and hearing, the General Manager presents to each Board member, member agency, and the public a second comprehensive letter setting forth the details of the proposed rates for the coming fiscal year or, more recently, for the coming two fiscal years, a list of the Board's options as they pertain to the rate structure, and a staff recommendation. This ensures that Board members, and the member agencies they represent, are fully informed in advance of each vote and have sufficient time to consider and raise questions, comments, and objections, as SDCWA did regularly. This documentation creates a detailed administrative record sufficient to support MWD's adoption of each year's rate structure.

Minutes of MWD's Board meetings indicate that in 2005, 2006, and 2007, the Board adopted new rates under the existing cost-of-service methodology without comment or objection from SDCWA. For 2002, 2009, and 2012 (for the 2013 and 2014 fiscal years) the minutes show that SDCWA's representatives on the Board actually voted to approve rates under the structure SDCWA now challenges.

The different components of MWD's rate structure are interrelated in that they must collectively recoup MWD's costs as a water district. SDCWA has voted in favor of rates under the rate structure that was adopted in 2001, and has accepted the financial benefits of that rate structure, for a decade or more before commencing litigation to challenge it. If MWD's rate structure were reorganized in the manner SDCWA now claims it should be—in other words, to exempt all SWP costs, as well as the Water Stewardship Rate, from the rates charged on all water conveyed through MWD's system—other rate components and charges would have been higher and would be higher in the future for all member agencies.

MWD, as noted, is a supplemental supplier. Thus, member agencies have options regarding how they obtain their water supplies, including local water supply, water purchases and conveyance from non-MWD third-party providers, purchases from MWD, or purchases from third-party providers and conveyance using MWD services and facilities. Wheeling charges are incurred only if an agency elects to use MWD's conveyance services and facilities to transport non-MWD water. In that sense, the charges are voluntary, not imposed.

The member agencies are each separate public agencies, all of which have their own independent governing bodies (*e.g.*, boards of directors, city councils, or other governing bodies). Each has at least one representative on MWD's Board. SDCWA has four representatives on the MWD Board (no member agency has more than four) and SDCWA controls approximately 18% of the Board's vote. Each member agency has staff who educate themselves and inform and advise the member agency's representatives on the issues before MWD's Board. If staff of any separate agencies wish to meet to discuss water strategy or other matters, they may legally hold meetings and engage in advocacy like any other interested party.

Despite SDCWA's allegations, MWD has never "colluded" with any member agency or group of member agencies. No member agency or member agency group exerts unlawful influence over MWD. SDCWA's claims that MWD has made decisions, including regarding its rate structure, rates, "dry year peaking," and awards of "subsidy contracts" to intentionally discriminate against SDCWA are untrue, and, as this court has held, are irrelevant to the claims alleged in SDCWA's Third Amended Petition/Complaint ("TAC") in the *2010 Action* and SDCWA's Petition/Complaint in the *2012 Action* ("2012 Complaint"). 7/2/2012 Tr. at 40:26-43:1 and 62:27-63:6 (the Court ruled that SDCWA's allegations of a "cabal" are "not part of this case.")

4. The Rates at Issue

The rates and charges that have been assessed in every year since 2003, through the present—and in support of which SDCWA has repeatedly voted—reflect the cost-of-service methodology that SDCWA challenges here. Specifically, in every year since 2003, MWD has (i) included in its System Access Rate and System Power Rate, not in its water Supply Rate, SWP

conveyance and power costs charged to MWD under its take-or-pay SWP contract; and (ii) charged the Water Stewardship Rate to all users of the MWD system. These are the three cost allocation practices that SDCWA challenges in these actions.

The System Access Rate generates revenues to pay for maintenance of conveyance facilities by recovering the cost of providing conveyance and distribution capacity to meet average annual demands. This includes the facilities costs for conveying water from non-MWD facilities to MWD. The System Access Rate is charged on a volumetric, acre-foot basis.

The System Power Rate pays for the cost of power necessary to move water through MWD's and DWR's conveyance facilities, including the costs of pumping water from DWR's facilities to MWD, and the cost of pumping MWD water to its member agencies. The System Power Rate also is charged on a volumetric, acre-foot basis.

The Water Stewardship Rate, recovers the budgeted costs for local resources development, regional water conservation, and seawater desalination programs, which incentivize development of local water supplies and the conservation of water. This conservation and local resource development reduces the demand and burden on MWD's conveyance system; decreases and avoids operating and capital maintenance and improvement costs, such as costs for repair of and construction of additional or expanded water conveyance, distribution, and storage facilities; and frees up capacity in MWD's system to convey both MWD water and water from other non-MWD sources. The Water Stewardship Rate is also charged on a volumetric, acre-foot basis.

SDCWA also asserts that MWD's rates and charges are flawed because it does not have a charge specifically for "dry-year peaking." By way of background, MWD incurs certain expenses due to the need to have or have access to facilities that are capable of handling peak water demands, including peak seasonal or summer water deliveries. These peaking-related expenses concern the overall need to have facilities capable of handling peak usage and do not relate to whether the peaking occurs because a particular period of time is "dry" (*i.e.*, less rainfall or snowfall), or if peak usage is due to greater water demand, to relative price differentials between MWD water and other water supplies available to a given member agency, or another

reason. Also, these expenses related to peaking facilities concern peak usage, not year-to-year variability in member agency demands as SDCWA's allegation concerns.

In these lawsuits, SDCWA uses the term "peaking" in a way that is inconsistent with industry guidelines to refer to an agency's *annual* variations in water purchases and reliance on MWD's system. MWD properly uses the term "peaking" as the busiest times of year, or the times at which demand on MWD's system is at its highest peak. Regardless of nomenclature, however, MWD's rates and charges appropriately recover costs associated with both annual variations and peak usage. If a member agency purchases or conveys greater quantities of water in one year as opposed to another, this is accounted for across MWD's rates and charges: in the Readiness-to-Serve Charge and the volumetric Supply Rate, System Access Rate, System Power Rate, and Water Stewardship Rate. For instance, a member agency that purchases more water pays more under the volumetric Supply Rate and the three volumetric conveyance rates. And, if the member agency's water purchases exceed a certain level, the member agency pays a higher Supply Rate (the Tier 2 Rate, rather than the lower Tier 1 Rate).

MWD recoups the costs of conferring the benefit of standby and peaking capability (correctly defined) through its Readiness-to-Serve and Capacity Charges. The Readiness-to-Serve Charge recovers the costs of standby service for peak-related capacity; and the Capacity Charge accounts for peaking-capacity costs. Both the Readiness-to-Serve and Capacity Charges are allocated among member agencies based on their historical use of, or reliance on, standby and peaking facilities and capacity. For instance, MWD calculates the Readiness-to-Serve Charge for each member agency by using a ten-year rolling average of that member agency's past total consumption, *i.e.*, all firm deliveries including water transfers and exchanges that use MWD capacity. And the Capacity Charge is a fixed charge assessed on each member agency based on the maximum summer day demand placed on MWD's system between May 1 and September 30 for a three-calendar year period. Therefore, member agencies pay the Readiness-to-Serve and Capacity Charges in proportion to their reliance on MWD's system and facilities.

MWD first implemented its Readiness-to-Serve Charge in fiscal year 1995-96. In fiscal year 2002-03, MWD adopted a new calculation of the Readiness-to-Serve Charge, which

remains in place today. MWD's Capacity Charge was first implemented in 2003. In 2004, MWD redesigned this charge as the present day Capacity Charge.

In every year since 2003, MWD has maintained a System Access Rate, System Power Rate, Water Stewardship Rate, Readiness-to-Serve Charge, and Capacity Charge, and has used a consistent methodology for allocating costs to these rates and charges and for apportioning the rates and charges among member agencies. Indeed, when MWD's Board considered and reaffirmed its cost allocation methodology on November 10, 2009, SDCWA voted in the affirmative. Likewise, SDCWA proposed and voted in favor of a 3% rate increase for the 2013/14 years based on this same rate structure that it is now challenging for those years.

B. Factual Background Relevant to the Rate Structure Integrity Provision Claim

1. MWD's Integrated Resources Plan and Statutory Mandates Provide the Foundation for MWD's Water Demand Management Programs

Southern California's nearly 19 million residents depend on MWD's continuing investments in water demand management programs that help ensure a reliable and high quality water supply. During the two-year budget cycle that ends in June 2014 alone, MWD has budgeted more than $40 million to fund water conservation programs and another $66 million on water recycling and groundwater recovery programs. Over the past 20 years, MWD has invested more than $322 million on conservation efforts and another $413 million on recycled water and groundwater recovery. MWD is slated to spend hundreds of millions of dollars more in the future on its demand management programs to meet its local water development and conservation goals. These commitments are part of a larger blueprint for reliability, detailed in MWD's key water supply planning and reporting document—the Integrated Water Resources Plan ("IRP"). Developed in 1996, updated in 2004 and again in 2010, the IRP sets forth MWD's long-term plan to protect the region from future water supply shortages. It emphasizes a diverse "preferred mix" of water resources, including conservation and local resource development. To that end, the IRP sets water resource targets to achieve MWD's water supply reliability goals over the next 25 years. For example, the 2010 IRP update set the following targets to be

achieved by the year 2035: (1) an annual savings of 2,168,000 acre-feet[3] of water through water use efficiency efforts, including conservation and recycling; and (2) the production of an additional 2,025,000 acre-feet annually through local resources.

Furthermore, these commitments are essential to meeting statutory mandates that require an increased focus on conservation and local resource development. In 1999, the California Legislature passed Senate Bill 60, which amended the MWD Act to require that MWD place an "increased emphasis on sustainable, environmentally sound, and cost-effective water conservation, recycling, and groundwater storage and replenishment measures." MWD Act § 130.5. In 2009, the Legislature added a provision to the California Water Code that requires the state to reduce its per capita water use by 20% by 2020. Cal. Water Code § 10608.16. The Legislature requires MWD to provide yearly reports outlining its progress toward these conservation goals. These "SB60 reports" detail MWD's achievements in promoting conservation, recycling, and groundwater recharge, and quantify the number of acre-feet of water developed and/or conserved by various projects and programs implemented throughout MWD's service region.

2. MWD's Water Demand Management Programs are Implemented Through Contracts with Member Agencies

To achieve its long-term IRP regional water supply reliability goals and statutory mandates, MWD has implemented three programs aimed at developing or conserving local water resources: the Local Resources Program ("LRP"), the Conservation Credits Program ("CCP"), and the Seawater Desalination Program ("SDP"). To carry out these programs, MWD enters into project contracts with its member agencies and, at times, with third parties, which require these entities to develop and implement local resource development, conservation, and desalination projects. Under the LRP and SDP contracts, MWD typically pays up to $250 for each acre-foot of water actually produced. Under the CCP contracts, MWD pays a certain specific amount of money for each acre-foot of water estimated to be conserved. Revenues collected through

[3] A single acre-foot of water is approximately 326,000 gallons—enough to supply 5-7 people with water for a full year.

MWD's water rates fund the payments under these project contracts, many of which have 25-year terms. More specifically, they are funded by MWD's Water Stewardship Rate, which is integrated with and interdependent on MWD's other water rate components in MWD's rate structure.

MWD does not offer LRP, CCP, or SDP contracts to the general public. Rather, at its discretion, MWD enters into these contracts with those member agencies whose projects meet certain performance criteria. Although member agencies have the right to apply for LRP, CCP, and SDP funds, they have no right to obtain them. The payments made under these project contracts are not grants. They are payments made by MWD in exchange for the development or conservation of a specific amount of water.

MWD's Board of Directors made a policy decision to undertake local conservation and resource development programs in consideration of the regional benefits they provide. Water conserved or developed at the local level benefits MWD, its member agencies, and the general public throughout MWD's service region in several ways. For example, every acre-foot of water conserved or developed by a member agency within the region reduces reliance on future increases of imported water from MWD. As a result, less water must be conveyed through MWD's system than might otherwise be needed. This reduces the demand and burden on MWD's conveyance system; decreases and avoids operating, maintenance, capital, and improvement costs, such as costs for repair of additional water conveyance, distribution, and storage facilities, and costs for construction of additional or expanded water conveyance, distribution, and storage facilities; and frees up capacity in MWD's system to convey both MWD water and water from other non-MWD sources. The development of local resources also increases the amount of water available throughout MWD's service region; water that would have otherwise been purchased by a member agency is made available to other member agencies. With more water available from diverse sources, water supply reliability is increased throughout the region. Were it not for these programs, MWD would be required to develop alternative sources to avoid water shortages.

SDCWA has admitted the existence of these regional benefits. In a January 2010 letter to

the Coastal Commission, SDCWA represented that there are "regional benefit[s] from new recycling projects, groundwater recovery projects and water use efficiency gains developed under MWD's and the Water Authority's longstanding local resource and conservation programs." SDCWA further acknowledged that the project contracts provided by MWD are aimed at "avoiding the following costs:

- Acquisition of new imported supplies such as transfers and exchanges;
- State Water Project (SWP) energy consumption for pumping imported supplies;
- Treating imported supplies; and
- MWD distribution system expansions."

These benefits are also supported by MWD's in depth 1996 analysis of the economic benefits of conservation and local resource development efforts. This analysis—set forth in an issue paper entitled "Economic Benefits of Local Water Management Programs"—quantified, among other things, the economic benefits associated with groundwater storage and local resource development projects, including avoided capital costs. These benefits were quantified by estimating MWD's projected costs over 25 years under three scenarios: one that assumed no local resource development or groundwater storage programs, a second that assumed groundwater storage programs but no local resource development, and a third that assumed a preferred mix of both groundwater storage and local resource development. This analysis revealed that by developing the preferred mix of groundwater and local resource programs, MWD could expect to save approximately $2.27 billion over 25 years.

These benefits are further demonstrated by the sheer number of acre-feet of water developed and/or conserved on an annual basis through these programs. These benefits are reflected in MWD's yearly SB60 Reports to the Legislature. For example, in fiscal year 2011-2012, MWD-assisted conservation programs saved approximately 156,000 acre-feet of water—enough to provide water for more than 750,000 to 1 million people for a full year. In that same year, LRP programs contributed an additional 171,000 acre-feet of recycled water for non-potable uses and another 40,000 acre-feet of recovered groundwater for municipal use. Since 1991, these programs have produced almost 4 million acre-feet of water for the residents of

Southern California. In addition to these direct benefits, these programs also have derivative consequences resulting in additional water conservation and local resource development because of factors such as changed behavior and legislative actions.

3. MWD Funds Its LRP, CCP, and SDP Contracts through Revenue from Its Integrated Rate Structure

MWD funds its LRP, CCP, and SDP contracts through revenue generated by its integrated rate structure. Starting in July 1998, MWD began the long and arduous process of unbundling its water rate into various rate components. In October 2001, after years of consideration and planning, MWD's Board voted to adopt its current rate structure, effective as of January 2003. As previously discussed, under the existing rate structure, MWD's rates are unbundled into the following components: the Tier 1 and Tier 2 Supply Rates; the System Access Rate; the System Power Rate; the Water Stewardship Rate; and a Treatment Surcharge (when MWD delivers treated water). MWD also collects fixed, non-volumetric charges from its member agencies, including a Capacity Charge and a Readiness-to-Serve Charge.

Every two years MWD's Board sets a rate for each component based on MWD's overall budgeted costs. Thus, the unbundled nature of MWD's integrated rate structure does not change the fact that the rate components are interdependent. In that regard, while the Water Stewardship Rate is set to recover MWD's LRP, CCP, and SDP related costs, that rate component is integrated with the System Access Rate and System Power Rate, all of which are set to recover MWD's budgeted costs related to the conveyance of water. To ensure that MWD's overall costs are accounted for, an adjustment to any one of these rates could necessitate an adjustment to all of the rates, which may undermine the funding for project contracts.

4. MWD Adopted and Implemented the RSI Provision

Having made the collective decision to commit hundreds of millions of dollars to conservation, local resources and seawater desalination projects, MWD recognized the financial risk—to both itself and its member agencies—posed by the threat of legal or legislative actions that might undermine the existing rate structure that was designed, in part, to generate the revenues necessary to fund these local projects. This threat was not imagined. In the years

leading up to the adoption of the RSI provision, MWD had faced both legal and legislative challenges to its rates. For example, in 1997 SDCWA and IID challenged the validity of MWD's "wheeling" rate, which led to years of protracted litigation that culminated in appellate court decision. *See Metropolitan Water Dist. of S. Cal. v. Imperial Irrigation District*, 80 Cal. App. 4th 1403 (2000).

Moreover, the threat of future litigation was made explicit by SDCWA in the context of negotiating its 35-year water exchange agreement ("Exchange Agreement") with MWD in late 2003. Under the Exchange Agreement, SDCWA makes available water it purchases from the Imperial Irrigation District to MWD at the intake to MWD's Colorado River Aqueduct on Lake Havasu, and MWD, in turn, delivers an equivalent amount of Exchange Water to SDCWA. In negotiating the Exchange Agreement's Price provision, SDCWA agreed not to challenge MWD's water rates for a period of five years after its execution. Thereafter, SDCWA reserved its right to challenge the validity of MWD's rates "in an administrative or judicial forum." In that context, SDCWA openly threatened to litigate over MWD's existing rate structure and destabilize MWD's rates.

Given the risks posed by this threat, in early 2004 MWD began considering options to ensure the availability of long-term funding for its LRP, CCP, and SDP contracts. To that end, in April 2004, MWD proposed the inclusion of an early draft of the RSI provision in an LRP contract with one of its member agencies, Metropolitan Water District of Orange County. Thereafter, in a June 18, 2004 memorandum to all member agency managers, MWD's then CEO, Ron Gastelum, proposed including the RSI provision in all future LRP, CCP, and SDP contracts. The principal objective of this proposal was to ensure sufficient funding for long-term local project contracts by protecting the stability of MWD's rate structure. To do so, the provision encourages member agencies that avail themselves of these funds to make a commitment to resolve challenges to MWD's existing rate structure through the MWD Board process rather than through piecemeal litigation or legislative challenges.

The RSI proposal was vigorously debated among the member agencies, with SDCWA objecting to the proposal in detail. SDCWA was represented and advised by counsel in

developing its objections. Specifically, SDCWA claimed that the RSI provision was overbroad in that it sought to protect MWD's entire rate structure, not just the Water Stewardship Rate. SDCWA further objected that the provision would impose an unconstitutional condition on its claimed constitutional right to petition the courts. SDCWA was given the opportunity to air its objections to the RSI proposal and present its analysis to MWD's Board.

MWD responded to SDCWA's criticisms. For example, in November 2004, before the RSI proposal was presented to MWD's Board for consideration, MWD explained that, given the integrated and interdependent nature of its rate structure, to be effective, the RSI provision had to apply not only the Water Stewardship Rate, but to all of MWD's rates. Because all of MWD's costs must be recovered through its rates, an attack on any one rate component would amount to an attack on the entire rate structure. If any one component was eliminated or found to be unlawful, the other rate components would have to be adjusted to account for lost revenue from the challenged component, leading to increases in other rates. Thus, piecemeal attacks on individual rate components that fail to consider all of the factors the Board must consider in allocating costs and setting rates threatens to destabilize MWD's entire rate structure. Instability in its existing rate structure affects not only MWD, but all of MWD's member agencies, which are left unable to properly plan and budget for the future. By encouraging member agencies to address objections to MWD's rates through the Board process, the RSI provision stabilizes MWD's existing rate structure by ensuring that rate decisions are made in consideration of the larger picture, taking into account MWD's overall costs and revenue streams.

Between the time the RSI provision was initially proposed to the member agencies and December 2004, when it was considered by MWD's Board, the provision changed significantly to address issues raised by the member agencies. For example, in the initially proposed version, any member agency that violated its terms would be subject to automatic termination of the project contract. However, the final version gave MWD's Board discretion on whether to ultimately terminate a project contract in the event of a violation. The final version also added a term allowing the member agencies to challenge MWD's rates if (1) there was a "material change" in MWD's existing rate structure and/or cost-of-service methodology, or (2) MWD

failed to comply with the requisite procedural requirements in amending its rate structure.

MWD's Board was presented with four options at its December 14, 2004 meeting, and the Board voted to adopt the RSI provision at issue. As adopted, the RSI provision requires parties that enter into these project contracts with MWD to address "any and all future issues, concerns and disputes relating to [MWD's] existing rate structure, through administrative opportunities available to them pursuant to Metropolitan's public board process." If, however, a contracting party chooses to challenge MWD's rate structure through outside litigation and/or legislation, MWD has the option to initiate a termination process, and if the mandated mediation is unsuccessful, MWD's Board has the option of terminating payments under the contract. The RSI provision does not prohibit litigation over MWD's rates. Nor does it purport to exempt MWD from liability. Rather, it simply provides that a party cannot avail itself of the project contract payments while simultaneously challenging the very source of those funds.

5. SDCWA Executed Project Contracts with MWD that Contain the RSI Provision

On July 22, 2004, before the MWD Board adopted the RSI proposal, SDCWA's Board established a policy not to enter into any project contracts with an RSI provision. For the next three years, SDCWA followed that policy and refused to enter into any LRP, CCP, or SDP contracts with MWD. In 2007, however, SDCWA's Board changed its position. SDCWA did so because it wanted the money from MWD, and SDCWA admits that, at the time, it did not plan to litigate MWD's rate structure.

Between 2007 and 2010, SDCWA entered into six project contracts with MWD that included the RSI provision. Under these contracts, SDCWA agreed to develop and implement local conservation and water recycling projects subject to certain performance provisions. In consideration, MWD agreed to make payments to SDCWA based on the acre-feet of water developed or conserved. Under each of the project contracts between MWD and SDCWA, SDCWA accepted money from MWD.

SDCWA was represented by counsel in the negotiation of each of these project contracts, and SDCWA's counsel executed the contracts. None contain any purported "reservation of

rights," and SDCWA never communicated any such reservation to MWD, either orally or in writing, after SDCWA's Board authorized execution of project contracts with the RSI provision.

6. SDCWA Filed Suit, Triggering the RSI Provision

On June 11, 2010, SDCWA filed its lawsuit challenging the rates adopted by MWD's Board in April 2010. Thereafter, on August 17, 2010, MWD's Board authorized its general manager to initiate the termination process with regard to six outstanding project contracts with SDCWA that contained the RSI provision. MWD's general manager gave SDCWA the requisite notice of its intent to terminate. In response, SDCWA requested mediation, which was ultimately unsuccessful. By the time mediation was complete, there were only four ongoing project contracts subject to termination, as the other two had been fully performed according to their terms.

On June 14, 2011, MWD's Board voted to terminate two of the four active contracts with SDCWA, one that funded landscaping retrofits and the other for construction of a water recycling unit for the San Vincente Golf Course. The other two active contracts—the commercial and residential conservation agreements—were amended to provide payments directly to residents and businesses.

As part of its decision to initiate the termination process of existing project contracts, MWD's Board also voted to defer the execution of three pending project contracts with SDCWA. These contracts had not yet been finalized and were in various stages of negotiation. Two of these deferred agreements provided funding for water conservation—one for an agricultural conservation program and the other for research regarding flow control valves. The third deferred contract was for a proposed Seawater Desalination Project in Carlsbad, California. This project was designed to produce 56,000 acre-feet of potable water a year from desalinated seawater. Under the proposal, SDCWA requested from MWD up to $350 million for approximately 1.4 million acre-feet of water over the span of 25 years. Ultimately, the Carlsbad project went forward without MWD's participation. SDCWA has admitted that this project will provide region-wide benefits.

C. Factual Background Relevant to the Preferential Rights Claim

Under section 135 of the MWD Act, each member agency has a preferential right to purchase a certain percentage of MWD's available water supply based on the Legislature's formula set forth in that section. Section 135 was enacted in 1927 and amended in 1931; it provides:

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

(Emphasis added.) Under this formula, each member agency's preferential right is based on the total accumulation of amounts paid by that member agency on "tax assessments and otherwise" that go to MWD's "capital costs and operating expenses," "excepting purchase of water." Thus, payments for the "purchase of water"—even if used for capital costs and operating expenses—are not included in the preferential rights calculation.

MWD collects revenues from its member agencies in a variety of ways, including ad valorem property taxes and fixed charges unrelated to the purchase of water, and uniform volumetric water rates for each unit of water purchased. As stated above, in October 2001, MWD adopted its existing rate structure, effective as of January 2003, which unbundled its rates into the Tier 1 and Tier 2 Supply Rates; the System Access Rate; the System Power Rate; the Water Stewardship Rate; and a Treatment Surcharge (applied when MWD delivers treated water). The System Access Rate, the System Power Rate, and the Water Stewardship Rate are set to recover MWD's budgeted costs related to delivery (or transportation) of water. MWD also collects fixed, non-volumetric charges from its member agencies, including a Capacity Charge and a Readiness-to-Serve Charge.

MWD calculates each member agency's preferential right annually. It does so by calculating the accumulative total monies paid by that member agency in taxes, Readiness-to-

Serve Charges, Capacity Charges, and various other fixed charges and then calculating the percentage of that amount against the same accumulative amounts paid by all of the member agencies. MWD excludes from that calculation the member agencies' payments for the "purchase of water" through the volumetric water rate components, including the System Access Rate, the System Power Rate, and the Water Stewardship Rate.

Each member agency, when receiving water from MWD, pays the System Access Rate, the System Power Rate, and the Water Stewardship Rate components per acre-foot of water delivered. If the water is from MWD-developed supplies, the member agency receiving the water also pays a Tier 1 or Tier 2 Supply Rate for each acre-foot of water; if the water being delivered initially originated from a third party, the member agency does not pay the Supply Rate.

SDCWA purchases from MWD both water from MWD-developed supplies, i.e., MWD water, and Exchange Water under the 2003 Exchange Agreement. Under the 2003 Exchange Agreement, SDCWA makes available water it purchases from the Imperial Irrigation District to MWD at the intake to MWD's Colorado River Aqueduct on Lake Havasu, and in turn, MWD delivers an equivalent amount of "Exchange Water" to SDCWA at various delivery points within San Diego County. Exchange Water means "water that is delivered to SDCWA by Metropolitan . . . in a like quantity as the quantity of water that SDCWA has Made Available to Metropolitan. . . .." "The Exchange Water may come from whatever source or sources" available to MWD. SDCWA pays MWD a Price for each acre-foot of Exchange Water MWD delivers, *i.e.*, a volumetric water rate. The Price is defined as "the applicable amount to be paid per acre-foot of Exchange Water delivered by Metropolitan to SDCWA . . . ." The Price SDCWA pays for Exchange Water under the Exchange Agreement is composed of (1) the System Access Rate, (2) the System Power Rate, and (3) the Water Stewardship Rate, each of which, SDCWA admits, is a component of MWD's volumetric water rates. In short, SDCWA pays MWD "water rates" to obtain Exchange Water under the Exchange Agreement.

As SDCWA pays MWD's volumetric water rate components under the Exchange Agreement for each acre-foot of Exchange Water delivered to SDCWA, those payments are for

the "purchase of water" under section 135, particularly as that provision has been interpreted by the Court of Appeal in prior litigation that SDCWA initiated on the issue. *See SDCWA v. MWD*, 117 Cal. App. 4th 13 (2004). MWD thus properly excludes those payments from the preferential rights calculation. SDCWA's own documents repeatedly admit that the "[c]urrent Preferential Rights Formula does not include any component of the water rate." SDCWA admits that this statement constitutes its paraphrasing of section 135. SDCWA's internal documents further acknowledge: "Section 135 does not include revenue collected through water rates in the preferential rights calculations."

III. STANDARD OF REVIEW, BURDEN OF PROOF, AND ADMISSIBLE EVIDENCE FOR THE RATE CHALLENGES (FIRST THREE CAUSES OF ACTION)

The rate challenges in the first three causes of action in both the *2010* and *2012 Actions* consist of a writ of mandate (first cause of action), request for declaratory relief (second cause of action), and request for determination of invalidity of the rates (third cause of action). Each of these causes of action in both actions alleges that MWD's rates violate the following five laws: the MWD Act, common law, Government Code Section 54999.7(a), Water Code Section 1810, *et seq.*, and Proposition 13. In addition, in the *2012 Action* only, SDCWA alleges MWD's rates also violate Proposition 26. As the Court has previously recognized, stated in simplest terms under all laws the Court is to assess whether the rates are reasonable. *See* 3/27/2013 Tr. at 15:10-16 (Court stating that whether evaluating MWD's rates and charges under Proposition 26 or any other law, "the substantive issue, of course, as we all know, will be exactly the same, which is the reasonableness of the rates.").

A. Standard of Review Generally Applicable to Challenges to Quasi-Legislative Decisions Such As MWD's Rate-Setting

In determining whether MWD's rates comply with California law, this Court "is reviewing the actions of another entity" (July 22, 2013 Order at 3); specifically, MWD's rate-making decisions. As is well established, challenges to the lawfulness of quasi-legislative decisions are reviewed under the "arbitrary and capricious" standard of review. *See Brydon v. East Bay Mun. Util. Dist.*, 24 Cal. App. 4th 178, 196 (1994); *Am. Coatings Ass'n., Inc. v. S.*

Coast Air Quality Dist., 54 Cal. 4th 446, 460 (2012).

There is no question that MWD engages in a quasi-legislative process when it sets its water rates, and therefore the arbitrary and capricious standard applies here. *See 20th Century Ins. Co. v. Garamendi*, 8 Cal. 4th 216, 277 (1994) ("When performed by an administrative agency, ratemaking has uniformly been considered a quasi-legislative action."); *see also Brydon v. East Bay Mun. Util. Dist.*, 24 Cal. App. 4th 178, 196 (1994) (enactment of a water rate structure design is "quasi-legislative [in] nature"); *Durant v. Beverly Hills*, 39 Cal. App. 2d 133, 139 (1940) ("the matter of fixing water rates is . . . legislative in character").

This standard requires that a challenge to an agency action be denied unless that action was "entirely lacking in evidentiary support." *Brydon*, 24 Cal. App. 4th at 196 ("Given the quasi-legislative nature of the District's enactment of the rate structure design, review is appropriate only by means of ordinary mandate where the court is limited to a determination of whether District's actions were arbitrary, capricious or entirely lacking in evidentiary support.") (citations omitted); *see also Am. Coatings*, 54 Cal. 4th at 460 ("In assessing the validity of a quasi-legislative [decision] in an action for mandamus under Code of Civil Procedure section 1085, our inquiry necessarily is confined to the question whether the classification is 'arbitrary, capricious, or without reasonable or rational basis.'") (citations omitted).[4]

Under this standard, review is highly deferential (*see Brydon*, 24 Cal. App. 4th at 196, 204) and California courts have recognized that "[s]ubstantial deference must be given to [MWD's] determination of its rate design." *San Diego Cnty. Water Auth. v. Metro. Water Dist.*

[4] The arbitrary and capricious standard of review applies equally to SDCWA's causes of action for declaratory relief and determinations of invalidity. The standard for mandamus review applies regardless of how the case is captioned or how the plaintiff articulates its requested relief; the relevant inquiry is whether the action challenges a quasi-legislative agency decision, not whether plaintiff seeks its relief in the form of a writ, declaratory judgment, or statement of decision. *See generally Bunnett v. Regents of the University of California*, 35 Cal. App. 4th 843, 848 (1995) (regardless of how denominated, "the causes of action are no more than challenges to the administrative decision of a state agency," and therefore the standards applicable to "a writ of mandate" apply); *Le Strange v. City of Berkeley*, 210 Cal. App. 2d 313, 320 (1962) ("[t]he appropriate method of reviewing the decisions or orders of local administrative agencies . . . is by mandamus," and when the complaint is captioned otherwise, "it may be regarded as a petition for a writ of mandate").

of S. Cal. (*SDCWA v. MWD*), 117 Cal. App. 4th 13, 23 n.4 (2004) (observing that while SDCWA did not allege any "untoward conduct" by MWD in structuring its rates, even if SDCWA had "[t]hat argument would be futile. Substantial deference must be given to [MWD's] Board's determination of its rate design.") (citations omitted). As part of the substantial deference given to the ratemaking agency, "where the [agency] had the legislatively delegated authority to enact the regulatory means in dispute, it must be presumed the board did not act arbitrarily or unreasonably . . . but that it was guided by sound discretion and a conscientious and intelligent judgment." *Brydon*, 24 Cal. App. 4th at 196.

Quasi-legislative decisions are entitled to significant deference for two important reasons: first, to guarantee that courts will not "usurp legislative power and thereby violate the separation of powers," and, second, because agencies such as MWD "develop a high degree of expertise" in their subject areas. *Western States Petroleum Ass'n v. Super. Ct.*, 9 Cal. 4th 559, 572 (1995); *see also Pitts v. Perluss*, 58 Cal. 2d 824, 834-35 (1962) ("The substitution of the judgment of a court . . . in quasi-legislative matters would effectuate neither the legislative mandate nor sound social policy"); *Carrancho v. California Air Resources Bd.*, 111 Cal. App. 4th 1255, 1272 (2003) ("A court passing on the means employed by an agency to effectuate a statutory purpose will not substitute its judgment for that of the agency in the absence of arbitrary and capricious action."); *Brydon*, 24 Cal. App. 4th at 196 ("Such limited review is grounded on the doctrine of the separation of powers which (1) sanctions the delegation of authority to the agency and (2) acknowledges the presumed expertise of the agency.") (quoting *Garrick Development Co. v. Hayward Unified School Dist*., 3 Cal. App. 4th 320, 328 (1992)) (citations omitted); *Durant v. City of Beverly Hills*, 39 Cal. App. 2d 133, 139 (1940) ("The universal rule is that . . . the court is not a rate-fixing body").

While the arbitrary and capricious standard is even "*more* deferential to agency decisionmaking" than the highly deferential substantial evidence standard (*see Am. Coatings*, 54 Cal. 4th at 461 (emphasis added)), courts often utilize the substantial evidence test to determine if an agency's decision is arbitrary and capricious. *See Golden Drugs Co., Inc. v. Maxwell-Jolly*, 179 Cal. App. 4th 1455, 1467 (2009) ("We recognize that not everyone acknowledges a

distinction between 'devoid of evidentiary support' and 'substantial evidence'") (citations omitted). Indeed, the arbitrary and capricious standard "generally means that a court cannot disturb the agency's decision if substantial evidence in the administrative record supports the decision." *Plastic Pipe and Fittings Ass'n v. California Bldg. Standards Comm'n*, 124 Cal. App. 4th 1390, 1406 (2004).

The crux of the Court's inquiry is whether MWD can "cite[] a legitimate reason" for its rate structure design. *San Joaquin Local Agency Formation Comm'n v. Super. Ct.*, 162 Cal. App. 4th 159, 170 (2008); *see also Am. Coatings*, 54 Cal. 4th at 461 (the arbitrary and capricious standard "require[s] a reasonable basis for the [agency] decision") (citations omitted). Indeed, in rate discrimination cases, reasonableness "is the beginning and end of the judicial inquiry." *Hansen v. City of San Buenaventura*, 42 Cal. 3d 1172, 1181 (1986).

Therefore, any allegations of bias SDCWA has or may make are irrelevant to the reasonableness inquiry. *Wilson v. Hidden Valley Mun. Water Dist.*, 256 Cal. App. 2d 271, 286 (1967) (it is well established that "[a]ny claim of prejudgment, bias or prejudice" on the part of an agency "is beside the point" in reviewing the legality of quasi-legislative decisions).[5] The California Supreme Court has held that "the validity of a legislative act does not depend on the subjective motivation of its draftsmen but rests instead on the objective effect of the legislative terms." *Cnty. of Los Angeles v. Super. Ct.*, 13 Cal. 3d 721, 727 (1975). A duly enacted rate supported by substantial evidence in the record cannot be invalidated because it was alleged to have "resulted from" subjective feelings or purposes that the court found impure or distasteful. *San Francisco v. Cooper*, 13 Cal. 3d 898, 905 (1975) ("the judiciary has no authority to withdraw the legislative prerogative on the basis of allegedly improper influences brought to bear upon individual legislators"). Indeed, courts have rejected allegations that water districts are biased that are similar to those SDCWA has made in this matter:

> Any claim of prejudgment, bias or prejudice in favor of this policy on the part of the four directors in acting upon the petitions is beside the point.

[5] As noted, this Court has ruled that SDCWA's allegations of a "cabal" are "not part of the case." 7/2/2012 Tr. at 40:26-43:1 and 62:27-63:6.

> Decisions of a governing board of a quasi-legislative character *are expected to reflect the majority will* of its constituents on matters of quasi-legislative policy. *This is the essence of representative government.*

Hidden Valley, 256 Cal. App. 2d at 286-87 (emphasis added).

Accordingly, under an arbitrary and capricious review, this Court should uphold MWD's 2011/12 and 2013/14 water rates and charges if there is substantial evidence supporting their reasonableness in the administrative record.[6]

B. SDCWA's MWD Act Claim

SDCWA alleges that MWD's 2011/12 and 2013/14 water rates violate section 134 of MWD's enabling statute, the MWD Act. *See, e.g.*, TAC ¶¶ 70, 96; 2012 Complaint ¶¶ 70, 98. Section 134 authorizes and requires MWD to set rates for water that will result in "revenue which . . . will pay the operating expenses of the district" and which must be "uniform for like classes of service throughout the district." MWD Act § 134. The MWD Act authorizes MWD to set water rates and vests discretion in MWD to do so. *See* MWD Act § 130 (MWD may "[f]ix the rates for water"); *id*. § 133 ("The board shall fix the rate or rates at which water shall be sold. Such rates, in the discretion of the board, may differ with reference to different sources from which water shall be obtained by the district. The board, under conditions and on terms found and determined by the board to be equitable, may fix rates for the sale and delivery to member public agencies of water obtained by the district from one source of supply in substitution for water obtained by the district from another and different source of supply, and may charge for such substitute water at the rate fixed for the water for which it is so substituted.").

To have a claim under section 134, SDCWA must identify two classes of service that are "like" each other but for which MWD charges non-uniform rates. SDCWA has made no attempt to do so, and, as demonstrated below, cannot.

[6] The arbitrary and capricious review is applicable to all claims in SDCWA's rate challenge except for SDCWA's Article XIII C/Proposition 26 and Wheeling Statute claims, which specify a different standard of review.

1. Standard of Review

As discussed in Section III.A *supra*, the standard of review for determining whether MWD's rates comply with the law is the arbitrary and capricious standard. "Substantial deference must be given to [MWD's] Board's determination of its rate design. Rates established by the lawful rate-fixing body are presumed reasonable, fair and lawful." *SDCWA v. MWD*, 117 Cal. App. 4th at 23 n.4 (citations omitted).

Where there is any dispute over the meaning or interpretation of MWD Act Section 134, MWD's interpretation is entitled to substantial deference. In *SDCWA v. MWD*, where SDCWA challenged MWD's compliance with a different section of the MWD Act, the Court of Appeal stated that it must "accord[] great weight and respect to [MWD's] construction." 117 Cal. App. 4th at 22. This is in keeping with the long-standing rule that courts "give deference to an agency's interpretation" of a statute "by its implementing agency." *Kern Cnty. Water Agency v. Watershed Enforcers*, 185 Cal. App. 4th 969, 982 (2010); *see also San Bernardino Valley Audubon Soc'y v. City of Moreno Valley*, 44 Cal. App. 4th 593, 603 (1996) ("[W]e give great deference to an agency's interpretation of its governing statutes."); *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.").

2. Burden of Proof

SDCWA bears the burden of establishing that MWD's water rates violate the MWD Act. Common law dictates that MWD's rates must be presumed reasonable and the "burden of overcoming this presumption is on the assailant." *Boynton v. City of Lakeport Mun. Sewer Dist. No. 1*, 28 Cal. App. 3d 91, 95 (1972). Specifically, the burden of proof first falls on the plaintiff to establish that the rates are different for like classes of people, and then it "shifts to defendants to establish that the rates were fixed by a lawful rate-fixing body." *Elliott v. City of Pac. Grove*, 54 Cal. App. 3d 53, 60 (1975). "Upon such a showing an assumption of fact is required to be made that the rates fixed are reasonable, fair and lawful." *Id.* Finally, "[t]he burden then shifts back to plaintiff to establish . . . that the rates fixed are unreasonable, unfair or unlawful." *Id.*

The rebuttable presumption affecting the burden of proof as to whether MWD's rates are

fair and reasonable under common law similarly affects whether MWD's rates are *lawful* under the MWD Act. *See e.g.,* Cal. Evid. Code § 660 (all other rebuttable presumptions established by law that fall within the criteria of Section 605 are presumptions affecting the burden of proof). Because "[r]ates established by [a] lawful rate-fixing body are presumed reasonable, fair and lawful," (*Hansen,* 42 Cal. 3d at 1180) SDCWA ultimately bears the burden of overcoming this presumption and establishing that MWD's rates are not lawful, and, instead, violate the MWD Act.

3. Evidence the Court Is Required to Evaluate

a. Scope of Allowable Evidence

The California Supreme Court has stated the "well settled" rule that "extra-record evidence is generally not admissible in . . . traditional mandamus actions challenging quasi-legislative administrative decisions." *Western States*, 9 Cal. 4th at 574. In other words, a court should "consider *only* the administrative record" (which excludes extra-record documents, as well as fact and expert witness testimony) in determining whether a quasi-legislative decision was reasonable. *Id.* at 573 (emphasis added); *see also Am. Coatings*, 54 Cal. 4th at 460 (when evaluating the validity of a quasi-legislative decision, courts "consider only the administrative record before the agency at that time [the decision was made]"); *Plastic Pipe & Fittings Ass'n.*, 124 Cal. App. 4th at 1406 (review of quasi-legislative action was limited to determining whether agency action was arbitrary, capricious, or "entirely without evidentiary support," which "generally means that a court cannot disturb the agency's decision if . . . evidence in the administrative record supports the decision").

The Courts of Appeal have unanimously followed the rule in *Western States* on this point: "An unbroken line of cases holds that, in traditional mandamus actions challenging quasi-legislative administrative decisions, . . . 'extra-record evidence' is not admissible."' *Carrancho*, 111 Cal. App. 4th at 1269 (citations omitted); *see also San Joaquin*, 162 Cal. App. 4th at 163, 167 (granting writ petition to quash discovery on this basis).[7]

[7] *See also, e.g., Poway Royal Mobilehome Owners Ass'n v. City of Poway*, 149 Cal. App. 4th 1460, 1479 (2007) ("The scope of judicial review of a legislative type activity is limited to an

The prohibition on reviewing extra-record evidence includes fact and expert witness testimony. *See, e.g.*, *Carrancho*, 111 Cal. App. 4th at 1271 (upholding grant of a protective order prohibiting depositions of California Air Resources Board personnel about a quasi-legislative proposal to control rice-burning in the Central Valley because "[t]he trial court correctly ruled that extra-record evidence was not admissible" and "review is properly confined to the administrative record"); *San Joaquin*, 162 Cal. App. 4th at 172 (holding that review of extra-record evidence would "violate the deliberative process privilege," and thus depositions ordered by the trial court could not take place). As the Supreme Court explained in *Western States*, the existence of substantial evidence in the administrative record is a "question of law"—not a question of fact. 9 Cal. 4th at 573. Therefore, "the only evidence that is relevant to the question of whether there was substantial evidence to support a quasi-legislative administrative decision . . . is that which was *before the agency at the time it made its decision*." *Id.* at 574, n.4 (emphasis added). In other words, extra-record evidence such as fact or expert witness testimony or documents that were not before the agency when it made its decision may not be admitted to challenge the substantiality of the evidence before the agency, and is therefore irrelevant to administrative record review. *Id.* at 573.

There are two primary reasons for such limited review. First, courts must not "usurp legislative power and thereby violate the separation of powers," and, second, courts recognize

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examination of the Record . . . to test for sufficiency with legal requirements.") (citations omitted); *Neilson v. City of California City*, 146 Cal. App. 4th 633, 641 (2007); *Evans v. San Jose*, 128 Cal. App. 4th 1123, 1143 (2005) ("A fundamental rule of administrative law is that a court's review is confined to an examination of the record before the administrative agency"); *Shapell Indus., Inc. v. Governing Bd.*, 1 Cal. App. 4th 218, 233 (1991); *Morgan v. Cmty. Redevelopment Agency*, 231 Cal. App. 3d 243, 258-60 (1991) (affirming a trial court's order prohibiting discovery in a validation action seeking review of a quasi-legislative decision); *Fosselman's, Inc. v. City of Alhambra*, 178 Cal. App. 3d 806, 810-13 (1986); *Karlson v. City of Camarillo*, 100 Cal. App. 3d 789, 803-04 (1980); *Lewin v. St. Joseph Hasp. of Orange*, 82 Cal. App. 3d 368, 387 n.13 (1978); *E.M. Consumer Corp. v. Christensen*, 47 Cal. App. 3d 642, 653 (1975) ("[T]he court is authorized to review only the administrative record and is not permitted to admit new evidence."); *Beverly Hills Fed. Sav. & Loan Ass'n v. Super. Ct.*, 259 Cal. App. 2d 306, 324 (1968) ("The sufficiency of the evidence . . . stands or falls on the administrative record . . . . [T]he trial court did not abuse its discretion in refusing to permit the requested discovery."); *Pitts*, 58 Cal. 2d at 833 (1962); *Brock v. Super. Ct.*, 109 Cal. App. 2d 594, 605 (1952).

that agencies such as MWD "develop a high degree of expertise" in their subject areas. *Western States*, 9 Cal. 4th at 572; *see also id.* at 574 ("We have neither the resources nor . . . expertise to engage in such analysis, even if the statutorily prescribed standard of review permitted us to do so."); *Brydon*, 24 Cal. App. 4th at 196 ("Such limited review is grounded on the doctrine of the separation of powers which (1) sanctions the delegation of authority to the agency and (2) acknowledges the presumed expertise of the agency.").

SDCWA has not pointed to any legitimate reason to stray from the rule generally applicable to judicial review of quasi-legislative decisions. As MWD demonstrates herein, its rate-setting process is highly complex, and took years of consultation and cooperation with MWD's 26 member agencies, including SDCWA. Any extra-record evidence SDCWA may rely on could only contradict the evidence MWD's Board relied on when setting its rates, or look to the subjective motivations of MWD's Board when setting the rates, both of which are impermissible under the law.[8] *See, e.g., Western States*, 9 Cal. 4th at 579 ("[E]xtra record evidence can never be admitted merely to contradict the evidence the administrative agency relied on in making a quasi-legislative decision or to raise a question regarding the wisdom of that decision."); *Wilson*, 256 Cal. App. 2d at 286 (it is well established that "[a]ny claim of prejudgment, bias or prejudice" on the part of an agency "is beside the point" in reviewing the legality of quasi-legislative decisions).

Additionally, earlier this year, the Court confirmed that the "usual situation in a review of administrative decisions" is that review "is based. . . solely on the administrative record, where [the Court is] generally speaking barred from going outside the record." April 29, 2013 Order at 2. While the Court stated review could be based on the administrative record and "possibly other evidence" with regard to SDCWA's Wheeling Statute claims, it is clear that this is unnecessary. *See id.* When the Court revisited the issue of extra-record evidence regarding the Wheeling Statute claim in response to IID's deposition notices, the Court clarified that IID would only be entitled to discovery into extra-record evidence if such discovery would protect IID from being

[8] This Court has ruled that SDCWA's allegations of a "cabal" are "not part of the case." 7/2/2012 Tr. at 40:26-43:1 and 62:27-63:6.

"caught off guard as Metropolitan (at trial) explains its rate structure and rationales." *See* May 28, 2013 Order at 2. The Court explained that "[a]s long as Imperial is given an adequate opportunity to review and respond to Metropolitan's [explanation and bases for its rate structure], the interests animating [IID] in this discovery dispute will be satisfied." *Id.* Because MWD does not intend to introduce extra-record evidence to explain or justify its rate structure at trial, there is no reason for IID or SDCWA to introduce extra-record evidence, including witness testimony, at trial.

On December 13, 2011, MWD filed with the Court the administrative record for the rate challenge in the *2010 Action.* That record consists of 40 volumes, totaling 11,574 pages. On March 19, 2013, MWD filed with the Court the administrative record for the rate challenge in the *2012 Action*. That record consists of 61 volumes, totaling 17,522 pages. These administrative records contain the documents that MWD's Board was presented and considered when setting the 2011/12 and 2013/14 water rates.[9] Although it had ample time and opportunity to do so, SDCWA has not attempted to supplement the administrative record with a single additional document it contends was before MWD's Board at the time it set MWD's 2011/12 and 2013/14 water rates.

When the Court reviews the evidence in these administrative records, its inquiry must be whether MWD's rates are reasonable, *i.e.*, whether MWD can "cite[] a legitimate reason" for its rate structure design. *San Joaquin*, 162 Cal. App. 4th at 170.

While MWD believes there is ample evidence in its administrative records to support a finding that the rates are reasonable, review of an agency's administrative record is deferential and the agency's action should only be overturned if the record shows that it is arbitrary, capricious, or "entirely without evidentiary support." *Plastic Pipe & Fittings Ass'n*, 124 Cal. App. 4th at 1406. Evidence in the administrative record is sufficient to support a quasi-

[9] An administrative record consists of the evidence that "was before the agency at the time it made its decision." *Western States*, 9 Cal. 4th at 574 n.4; *see also* Continuing Education of the Bar, *California Civil Writ Practice*, § 7.7 (4th Ed.) (an administrative record in a traditional mandamus case consists of the documents and testimony "presented to the decision-making body that are relevant to the petitioner's challenge to the underlying action or decision").

legislative decision "if a reasonable trier of fact could conclude that the evidence is reasonable, credible, and of solid value." *Id.* at 1407; *see also id.* at 1407-08 (court found that an agency's reliance on a single comment letter in the record constituted substantial evidence to support its decision); *Associated Builders & Contractors, Inc. v. San Francisco Airports Com.*, 21 Cal.4th 352, 374-75 (1999) (concluding that substantial evidence supported an agency decision based on a record consisting of only two public meetings to hear evidence and argument on the desirability of the agreement at issue as well as a declaration submitted by the Commission in opposition to the agreement).

Therefore, the Court's review of SDCWA's MWD Act (as well as all of the other claims in SDCWA's rate challenges,[10] as discussed below), should be limited to the administrative records in the *2010* and *2012 Actions*.

b. Pertinent Administrative Record Documents

Documents in each action's administrative record shows that SDCWA's challenge under the MWD Act fails at the outset under the plain language of the statute. As stated, SDCWA relies on section 134 of the MWD Act, which provides that MWD's rates must be "uniform for like classes of service throughout the district." To have a claim under section 134, SDCWA

[10] The rule limiting review of the legality of MWD's rates to the administrative record applies to all causes of action that challenge MWD's rate structure and rates—whether styled as a petition for writ of mandate, a claim for declaratory relief, or a validation action under Code of Civil Procedure §§ 860 *et seq.* Regardless of how a cause of action is styled, the relevant inquiry is whether the action challenges a quasi-legislative agency decision. *See, e.g., Voss v. Super. Ct.*, 46 Cal. App. 4th 900, 922-23 (1996) (stating that both mandamus and declaratory relief are available "to challenge the quasi-legislative actions of the [agency]" and that such actions are reviewed "within the bounds of the standards applicable to judicial review of such [actions]"); *Poway Royal Mobilehome Owners Ass'n v. City of Poway*, 149 Cal. App. 4th 1460, 1478-79 (2007) (holding that in validation actions "[t]he scope of judicial review of a legislative type activity is limited to an examination of the record before the authorized decision makers to test for sufficiency with legal requirements"); *Kucharczyk Regents of Univ. of Cal.*, 946 F. Supp. 1419, 1434 (N.D. Cal. 1996) ("Plaintiffs contend that mandamus does not apply at all in this action, which they characterize as a breach of contract action. However, the plaintiff's characterization of his cause of action is not determinative."); *see also Western States*, 9 Cal. 4th at 576 (as a result of the deference afforded to quasi-legislative decisions, the California Supreme Court held "that extra-record evidence is generally not admissible" even on claims "that the agency has not proceeded in a manner required by law").

would need to identify two classes of service that are "like" each other but for which MWD charges non-uniform rates. SDCWA makes no attempt to do that, and cannot.

As explained below, the record shows that MWD's postage stamp rates are *uniform, i.e.*, each member agency is charged the same volumetric rate per acre-foot of water; SDCWA simply does not like what expenses they recover or that they are charged to all system users. And, even if section 134 contained a hidden "reasonableness" requirement, record evidence supports the conclusion that MWD's rates would satisfy that standard too.

The documents in the administrative record show that MWD's current rate structure, including the rates challenged here, is the result of a lengthy and reasoned analysis of the propriety of recouping expenses from related operation functions, through the application of MWD's Cost of Service ("COS") methodology. A rates consultant engaged by MWD, a well-respected and nationally recognized expert in the field,[11] concluded in his April 6, 2010 report that the rates are "consistent with water industry best practices, and [comply] with COS and rate guidelines in the American Water Works Association's ('AWWA') Manual M-1, *Principles of Water Rates, Fees, and Charges*." *See* 2010/2012 Administrative Records ("2010 Record" and "2012 Record", respectively) Document No. 591.[12] The review further determined that MWD's "rate methodology is reasonable", "consistent with Board policies and, more specifically, with the 2001 Rate Structure Framework" and "accurate and consistent with the 2001 COS." *Id.*

(1) Allocation of SWP Transportation Costs

With regard to MWD's allocation of SWP expenses to its System Access Rate and System Power Rate, evidence in the administrative record shows that MWD's allocation of DWR contract expenses for water transportation to the System Access Rate and System Power Rate is reasonable because these rate elements generate revenue to pay MWD's transportation-related expenses.[13]

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[11] *See* 2010/2012 Records Document No. 183 (consultant was a contributing member to the American Water Works Association's ('AWWA') Manual M-1, *Principles of Water Rates, Fees, and Charges,* (5th Ed.)).

[12] All citations to administrative record documents are to the administrative record index number.

[13] Case law acknowledges that a water seller with a take-or-pay contract (such as MWD has with

Under its contract with DWR, MWD pays to DWR separate supply and transportation charges. Article 22 of the contract establishes a supply charge (called the "Delta Water Charge"), which is "for project water." 2010/2012 Records Document No. 1. Article 23 establishes the transportation charge "to *deliver* project water" and states that it consists of "capital, operation, maintenance, power and replacement costs." *Id*. (emphasis added). Article 24 describes the capital cost component of the transportation charge, which "shall return to the State . . . those costs of all project transportation facilities necessary to deliver project water to [MWD]." *Id.* Article 25 sets forth a minimum transportation charge for "operation, maintenance, power and replacement" of DWR's transportation facilities "irrespective of the amount of project water delivered to the contractor." *Id.* This charge covers such expenses as operating and repairing the California Aqueduct, a transportation facility necessary for water to be transported to MWD and its member agencies. The transportation charge also contains a variable charge for operation, maintenance, power and replacement costs, which is dependent upon the amount of water delivered to MWD. *Id.* This variable transportation charge is principally composed of the power cost to pump water through the aqueduct and over the Tehachapi Mountains to transport water to MWD and its member agencies.

The DWR contract also allows MWD to use SWP "transportation facilities to transport water procured . . . from [non-DWR] sources for delivery to [its] service areas," and provides the charge for using SWP facilities to transport this water. *See id.*

MWD allocates these transportation costs based on their *transportation function* and recovers the costs from member agencies through MWD's transportation charges, namely the System Access Rate and System Power Rate. The DWR transportation charges in Articles 23-26 and 55 are part of MWD's transportation expenses because they are what MWD must pay for the fixed capital, operations, and maintenance of the SWP facilities that transport water from the

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DWR) may charge its customers for both supply and transportation. The California Court of Appeal has observed that all parties to the water contract at issue there, for which the DWR Contract was a prototype, "must make payments according to their respective maximum annual water entitlements and the portion of the System *required to deliver* such entitlements." *Goodman v. Cnty. of Riverside*, 140 Cal. App. 3d 900, 904 (1983) (emphasis added).

sources of supply (in Northern California) to MWD's service area, as well as for the variable power-related cost of pumping water through those facilities, and for MWD's contractual right to use the SWP facilities to transport non-SWP water.

The administrative record shows that allocation of these SWP costs to the System Access Rate and System Power Rate is reasonable, because the System Access Rate and System Power Rate recoup the capital, operation, and maintenance costs MWD must pay for SWP transportation facilities, as well as the costs to convey water to MWD's internal distribution system. *See id.*; *see also* 2010/2012 Records Document No. 310; 2010/2012 Records Document No. 599; 2012 Record Document No. 944. The 2010 review of MWD's rate methodology concluded that "[f]unctionalizing [SWP] costs in this manner is appropriate because: 1) DWR invoices in a very detailed manner that allows MWD staff to functionalize costs . . . and 2) DWR does not aggregate invoices to MWD on a per-acre-foot basis." 2010/2012 Records Document No. 591.

In addition, allocation of the SWP transportation charges to MWD's System Access Rate is reasonable because MWD uses DWR's conveyance facilities to transport both "Project and Non-Project water [to] Metropolitan and its member agencies." 2010/2012 Records Document No. 590; *see also* 2010/2012 Records Document No. 84. Furthermore, the rationale behind including fixed system-wide costs from all users, including SWP costs, in the System Access Rate has been upheld by the California Court of Appeal. In *Metro. Water Dist. of S. Cal. v. Imperial Irrigation Dist.*, 80 Cal. App. 4th 1403 (2000) (hereinafter "*MWD v. IID*"), the Court held that MWD may recover fixed system-wide costs from all users in the comparable context of MWD setting its wheeling rate. *Id.* at 1427. The Court stated that passing these costs on to users was reasonable because it prevented some users from subsidizing others, and enabled member agencies receiving comparable services to pay comparable costs. *Id.*at 1427-32.

In terms of the System Power Rate, Article 26 of the DWR contract states that "[t]he variable operation, maintenance, power and replacement component of the Transportation Charge [returns] to the State those costs of the project transportation facilities necessary to deliver water to the contractor." 2010/2012 Records Document No. 1. It is difficult to imagine

how else MWD would have reasonably allocated the SWP transportation facility and power costs given that conveyance of water is the very essence of transportation.

The primary argument SDCWA has raised to support allocating SWP transportation charges to MWD's Supply Rate as opposed to its transportation rates is that MWD does not own the SWP conveyance facilities. *See, e.g.*, TAC ¶¶ 3, 25; 2010/2012 Records Document No. 581. The administrative record shows that this argument lacks merit. Documents in the administrative record show that MWD allocates its expenses to different rate elements based on operation functions, not ownership. *See, e.g.*, 2010/2012 Records Document No. 590. Even though MWD does not own the conveyance facilities, MWD must pay DWR for the costs invoiced by DWR, including costs that DWR bills as "Transportation Costs" under DWR Contract Articles 23-26 and Article 55. *See* 2010/2012 Records Document No. 1; 2010/2012 Records Document No. 591. MWD possesses the right to use the SWP for transportation of water and must pay for this right. There is no operational difference between a transportation expense MWD incurs from a third party, and a transportation expense MWD incurs by use of its own facilities. Indeed, the very purpose of water rates is to recover a water district's expenses. MWD Act §134 (MWD's Board "shall fix such rate or rates for water as will result in revenue which . . . will pay the operating expenses of the district, provide for repairs and maintenance, provide for payment of the purchase price or other charges for property or services or other rights required by the district"); 2010/2012 Records Document No. 183 ("In providing adequate water service to its customers, every water utility must receive sufficient total revenue to ensure proper operation and maintenance . . . and preservation of the utility's financial integrity. Nearly all of total revenue requirements for most utilities are met from revenues derived from selling water to their customers.").

(2) Allocation of the Water Stewardship Rate

The administrative record also supports MWD's contention that including the Water Stewardship Rate in transportation charges is reasonable because development of local water resources decreases the need for additional conveyance facilities, and thus reduces conveyance

costs. Specifically, as demonstrated in the administrative record, the Water Stewardship Rate recovers the budgeted costs for conservation and local resource development, which reduces the demand and burden on MWD's conveyance system; decreases and avoids operating and capital maintenance and improvement costs, such as costs for repair of and construction of additional or expanded water conveyance, distribution, and storage facilities; and frees up capacity in MWD's system to convey both MWD water and water from other non-MWD sources.

In the Cost of Service process, MWD allocated the costs that the Water Stewardship Rate is designed to recover to its "Demand Management" function. 2010/2012 Records Document No. 599; 2012 Record Document No. 944. The purpose of Demand Management is to generate additional local resources, which reduces the amount of water that must otherwise be transported through MWD's system. "Investments in demand side management programs like conservation, water recycling and groundwater recovery . . . help defer the need for additional conveyance, distribution, and storage facilities." 2010/2012 Records Document No. 599 (estimating financial benefits to water conveyance, storage, distribution and supply programs from Demand Management); 2012 Record Document No. 944 (same); 2010/2012 Records Document No. 590 ("Demand management is an important part of Metropolitan's resource management efforts. Metropolitan's incentives in these areas contribute to savings for all users of the system in terms of lower capital costs that would otherwise have been required to expand the system."). The costs recovered by the Water Stewardship Rate therefore reduce system capacity expansion costs and increase available capacity for water transfers through MWD's facilities. Without investments in conservation and recycling, MWD would have to build additional system capacity, which would burden all the member agencies. 2010/2012 Records Document No. 310 (Investments in conservation "reduce and defer system capacity expansion costs; and create available capacity to be used to complete water transfers. Because conservation measures and local resource investments reduce the overall level of dependence on the imported water system, more capacity is available in existing facilities for a longer period of time. The capacity made available by conservation and recycling is open to all system users and can be used to complete water transfers.").

(3) Peaking Expenses

The administrative record also shows that SDCWA's contention that MWD "fails to fully account for the costs of 'dry-year peaking'" is entirely incorrect. *See, e.g.*, 2012 Complaint ¶ 65. MWD properly accounts for the costs associated with standby and peak usage by its member agencies.

As explained above, and in the administrative record, MWD incurs certain expenses due to the need to have or have access to facilities that are capable of handling peak water demands, including peak seasonal or summer water deliveries ("peaking expenses"), and expenses associated with having a system that is standing by in case of need, such as for emergencies such as earthquakes that could otherwise interrupt the delivery of water ("standby expenses"). Peaking-related expenses concern the overall need to have facilities capable of handling peak usage and do not relate to whether the peaking occurs because a particular period of time is "dry" (*i.e.*, less rainfall or snowfall), or if peak usage is due to greater water demand, to relative price differentials between MWD water and other water supplies available to a given member agency, or another reason. Also, these expenses related to peaking facilities concern peak usage, not year-to-year variability in member agency demands as SDCWA's allegations concern. MWD recoups the costs of conferring the benefit of standby and peaking capability through its Readiness-to-Serve and Capacity Charges. MWD first implemented its Readiness-to-Serve Charge in fiscal year 1995-96. 2010/2012 Records Document No. 32. In fiscal year 2002-03, MWD adopted a new calculation of the Readiness-to-Serve Charge, which remains in place today. *See* 2010/2012 Records Document No. 306. MWD's Capacity Charge was first implemented in 2003. *See id.* In 2004, MWD redesigned this charge as the present day Capacity Charge. *See* 2010/2012 Records Document No. 335.

Contrary to SDCWA's assertions that MWD has not conducted a cost of service study that accounts for the costs associated with peak demand on its system (*see* 2012 Complaint ¶ 65), MWD allocated these costs to its Readiness-to-Serve and Capacity Charges after engaging in ts multi-step COS process in which it classified its functionalized costs based on their causes and behavioral characteristics. 2010/2012 Records Document No. 599; 2012 Record Document No.

944. Pertinent functionalized costs include Conveyance and Aqueduct, which includes the capital, operations, maintenance, and overhead costs for SWP and Colorado River Aqueduct facilities that convey water to MWD's distribution system; Storage, which includes drought storage that produces additional supplies during times of shortage; and Distribution, which includes the capital, financing, operating, maintenance, and overhead costs for MWD's distribution system to its member agencies within its service area. 2010/2012 Records Document No. 599; 2012 Record Document No. 944. The method MWD used to classify its costs—the modified Commodity/Demand method—distinguishes between utility costs "incurred to meet average or base demands and costs incurred to meet peak demands." 2010/2012 Records Document No. 599; 2012 Record Document No. 944. The commodity and demand classifications recoup, respectively, MWD's supply costs and costs incurred to meet peak demands. 2010/2012 Records Document No. 599; 2012 Record Document No. 944. MWD modified this method to include a separate cost classification for costs related to providing standby service (*i.e.*, ensuring system reliability by having water available for its member agencies in the event of an emergency such as an earthquake). 2010/2012 Records Document No. 599; 2012 Record Document No. 944.

MWD classified both Conveyance and Aqueduct and Distribution costs into its demand and commodity categories (and also allocated Conveyance and Aqueduct to its standby category), and conducted an analysis to determine the appropriate allocation to each category. This included determining the percentage of available capacity used to meet peak monthly and daily deliveries to its member agencies (which falls into the demand classification). 2010/2012 Records Document No. 599; 2012 Record Document No. 944. MWD then allocated the demand and standby cost classifications to its Readiness-to-Serve Charge, Capacity Charge, and Treatment Surcharge. 2010/2012 Records Document No. 599; 2012 Record Document No. 944. MWD allocated its drought storage operation function to its fixed commodity classification, and finally to its supply rates. 2010/2012 Records Document No. 599; 2012 Record Document No. 944.

Administrative record evidence shows that allocating costs associated with satisfying

peak demand in this manner is reasonable.

The Readiness-to-Serve Charge recovers SWP-related conveyance costs associated with peak demand as well as emergency and peak-related storage costs and standby costs. *See* 2010/2012 Records Document No. 599; 2012 Record Document No. 944. MWD calculates the Readiness-to-Serve Charge for each member agency by using a ten-year rolling average of that member agency's past total consumption, *i.e.*, all firm deliveries including water transfers and exchanges that use MWD capacity. 2010/2012 Records Document No. 599; 2012 Record Document No. 944. This calculation leads to a relatively stable Readiness-to-Serve Charge that reasonably represents an agency's potential long-term need for standby services and access to MWD's facilities under different demand conditions, including peak demand. 2010/2012 Records Document No. 599; 2012 Record Document No. 944. MWD allows its member agencies to choose whether or not to pay a Standby Charge (a property tax) as a way to offset their Readiness-to-Serve Charge. 2010/2012 Records Document No. 599; 2012 Record Document No. 944.

The Readiness-to-Serve Charge is a fixed charge that does not vary with sales in a current year, and thus it ensures that agencies that only occasionally buy water from MWD, but receive the reliability benefits of MWD's system, pay in proportion to their share of the cost to provide that reliability.[14] *See* 2010/2012 Records Document No. 599; 2012 Record Document No. 944. Because of the fixed nature of the Readiness-to-Serve Charge, member agencies pay the charge each and every year regardless of the amount of water they take in a given year. It is reasonable to recover these costs in this manner because MWD is standing by ready to serve in any given year. 2010/2012 Records Document No. 310.

The capital facilities the Readiness-to-Serve Charge funds benefit all system users as

[14] A major advantage of a firm revenue source is that it contributes to revenue stability during times of drought or low water sales. The Readiness-to-Serve Charge affords MWD additional security, when borrowing funds, that a portion of its revenue stream will be unaffected by drought or by rainfall. This security helps maintain MWD's historically high credit rating, which results in lower interest expenses to MWD, and therefore, lower overall costs to the residents of its service area. *Id.*

these facilities contribute directly to the reliable delivery of water supplies throughout MWD's service area. 2010/2012 Records Document No. 599; 2012 Record Document No. 944.

MWD also recoups costs associated with peaking through its Capacity Charge, which recovers the cost of providing seasonal peak storage capacity and MWD's distribution facilities for peak usage "while providing an incentive for local agencies to decrease their use of the Metropolitan system to meet peak day demands and to shift demands into lower use time periods particularly October through April." 2010/2012 Records Document No. 599; 2012 Record Document No. 944. The Capacity Charge is a fixed charge assessed on each member agency based on the maximum summer day demand placed on MWD's system between May 1 and September 30 for a three-calendar year period. 2010/2012 Records Document No. 599; 2012 Record Document No. 944. SDCWA has not argued, and it could not, that the Capacity Charge violates any law. Indeed, when MWD's Board first decided a decade ago to implement the current Capacity Charge, SDCWA stated that it believed that the Capacity Charge would "provide the greatest economic incentive to actively manage system peaking." 2010/2012 Record Document No. 335.

Furthermore, drought storage creates supply, and is one component of the portfolio of resources that result in a reliable amount of annual system supplies, especially during times of peak need during dry times. 2010/2012 Records Document No. 599; 2012 Record Document No. 944. As a result, it is logical to recoup MWD's costs associated with drought storage through its Supply Rates.

As the record shows, MWD has clearly allocated costs associated with peak demand on its system to the member agencies through its rates and charges. Furthermore, these allocations are reasonable because they are directly related to each member agency's peaking behavior, *i.e.*, each member agency pays the Readiness-to-Serve and Capacity Charges based on its share of historical projections for total and peak demands. 2010/2012 Records Document No. 599; 2012 Record Document No. 944. For example, as evidenced by the Peak Day Demand tables MWD prepares as part of its COS for calculating the Capacity Charge, it is clear that *SDCWA* historically exerts the *highest* peak demand on MWD's system from May 1-September 30, and

therefore pays the highest Capacity Charge. *See* 2010/2012 Records Document No. 599; 2012 Record Document No. 944. For the years at issue in the *2010* and *2012 Actions*, SDCWA's peak demand accounted for around 26% of the total member agency 3-year peak demand, and SDCWA paid between 25.2 and 25.9% of the Readiness-to-Serve Charge. 2010/2012 Records Document No. 599; 2012 Record Document No. 944. Thus, evidence in the administrative record shows that the member agencies, including SDCWA, pay MWD's rates and charges associated with peak demand in nearly direct proportion to the amount they themselves utilize MWD to satisfy their peak demand.

As noted above, in this litigation SDCWA uses the word "peaking" in a manner that is contrary to industry guidelines to refer to an agency's annual variations in water purchases and reliance on MWD's system. As explained in greater detail herein and in Sections III.B.3.b.1-2, MWD's rates and charges already account for the costs associated with the member agencies' annual variations. If a member agency purchases or conveys greater quantities of water in one year as opposed to another, this is accounted for in the Readiness-to-Serve Charge and the volumetric Supply Rate, System Access Rate, System Power Rate, and Water Stewardship Rate. For instance, a member agency that purchases more water pays more under the volumetric Supply Rate and the three volumetric conveyance rates. And, if the member agency's water purchases exceed a certain level, the member agency pays a higher Supply Rate (the Tier 2 Rate, rather than the lower Tier 1 Rate). *See* 2010/2012 Records Document No. 599 ("The Tier 2 Supply Rate also recovers a greater proportion of the cost of developing additional supplies from member agencies that have increasing demands on the Metropolitan system" and the price is set based at least in part on "the uncertainty about supply and critically dry conditions."); 2012 Record Document No. 944 (same).

Finally, it is clear from the record that MWD's rates are uniform. As the record shows, all member agencies pay the same volumetric System Access Rate, System Power Rate, and Water Stewardship Rate. 2010/2012 Records Document No. 591 ("All member agencies pay the [System Access Rate] to use MWD's system for conveyance and distribution."); 2010/2012 Records Document No. 599; ("All system users (member agency or third party) pay the System

Access Rate to use Metropolitan's conveyance and distribution system."); 2012 Record Document No. 944 (same); 2010/2012 Records Document No. 310 (The System Power Rate "is applied to all deliveries to member agencies. Wheeling parties will pay for the actual cost (not system average) of power needed to move the water."); 2010/2012 Records Document No. 599 ("All system users (member agency or third parties) will pay the same proportional costs for existing and future conservation and recycling investments."); 2012 Record Document No. 944 (same); 2010/2012 Records Document No. 591 ("All users will pay the same proportional costs for [investments made from the Water Stewardship Rate revenue]"). And, as discussed above, the Readiness-to-Serve and Capacity Charges are calculated in the same way for each member agency: either the ten-year rolling average of an agency's past total consumption, or a three-year rolling average of that agency's peak summer demand. And, a member agency's supply charges are directly proportionate to the amount of water that member agency purchases from MWD in a given year.

C. SDCWA's Common Law Claim

SDCWA alleges that MWD's 2011/12 and 2013/14 water rates violate California common law because they are not fair, reasonable, and proportionate to the cost of service. *See, e.g.*, TAC ¶¶ 73, 83; 2012 Complaint ¶¶ 74, 84, 98.

1. Standard of Review

As discussed, courts review ratemaking under the arbitrary and capricious standard of review. *See* Section III.A. "Rates established by [a] lawful rate-fixing body are presumed reasonable, fair, and lawful" and reasonableness "is the beginning and end of the judicial inquiry." *Hansen*, 42 Cal.3d at 1180-81.

Under the common law, "[i]t is only unjust or unreasonable discrimination which renders a rate or charge unreasonable." *Hansen*, 42 Cal.3d at 1180-81. Unreasonable discrimination is defined as "draw[ing] an unfair line or strik[ing] an unfair balance between those in like circumstances having equal rights and privileges." *Id.* (citations omitted); *see also Brydon*, 24 Cal. App. 4th at 197 (same); *Durant*, 39 Cal. App. 2d at 138 (The "fundamental theory of rate making . . . is that there shall be but one rate for a particular service") (quoting 51 C.J. 29, 30) (a

charge is unreasonable if it is "made to one patron or consumer different from that made to another, for the same service under like circumstances"). "[A] utility may, *without being guilty of unlawful discrimination*, classify its customers or patrons upon *any reasonable basis*, as according to the purpose for which they receive the utility's service or product." *Id*. at 139 (quoting same) (emphasis added); *see also City and Cnty. of San Francisco v. Western Air Lines, Inc*., 204 Cal. App. 2d 105, 134 (1962) ("In this state there is no cause of action at common law. . . in the absence of allegation and proof that the charges paid by the plaintiff were unreasonable and excessive.").

Therefore, employing the arbitrary and capricious standard, the Court should review MWD's rates only for reasonableness.

2. Burden of Proof

As discussed above, SDCWA bears the burden of establishing that MWD's rates violate the common law. *See* Section III.B.2, *supra*.[15] Applying this rule to SDCWA's common law claim, SDCWA must first show that MWD's 2011/12 and 2013/14 water rates are different for like classes of member agencies. If it can do so, the burden would then shift to MWD to show that it was lawfully authorized to set its 2011/12 and 2013/14 water rates. Finally, the burden would shift back to SDCWA to establish that the 2011/12 and 2013/14 water rates are unreasonable.

3. Evidence the Court Is Required to Evaluate

a. Scope of Allowable Evidence

Because this claim challenges the lawfulness of the quasi-legislative act of rate setting (like SDCWA's MWD Act claim discussed above), the Court's review of evidence is limited to the administrative records in the *2010* and *2012 Actions* and should exclude extra-record

[15] SDCWA bears the burden of establishing that MWD charges non-uniform rates to like classes of people, and then MWD must establish that the rates were fixed by a lawful rate-fixing body. *See Elliott*, 54 Cal. App. 3d at 60. Upon such showing, "an assumption of fact is required to be made that the rates fixed are reasonable, fair and lawful." *Id.* Finally, "[t]he burden then shifts back to plaintiff to establish . . . that the rates fixed are unreasonable, unfair or unlawful." *Id.*

documents and witness testimony.[16] *See* Section III.C.3.a, *supra*. Judicial review of quasi-legislative actions, such as MWD's determination of its rate structure and water rates, is limited to a deferential analysis based on the existing administrative record.

b. Pertinent Administrative Record Documents

The evidence in the administrative record, discussed above in Section III.B.3.b demonstrates that MWD's allocation of SWP costs to its System Access Rate and System Power Rate, and the calculation of those rates and the Water Stewardship Rate based on quantities of water conveyed, is reasonable. Furthermore, the evidence shows that, contrary to SDCWA's allegations, MWD does have rates and charges in place to recover peaking-related costs, and those rates and charges are also reasonable. *See id.*

D. SDCWA's Government Code Section 54999.7 Claim

SDCWA also contends that MWD's rates violate Government Code section 54999.7(a). *See, e.g.*, TAC ¶¶ 71, 96; 2012 Complaint ¶¶ 71, 98. That provision states:

> Any public agency providing *public utility service* may impose a fee, including a rate, charge, or surcharge, for any product, commodity, or service provided to a public agency, and any public agency receiving service from a public agency providing public utility service shall pay that fee so imposed. Such a fee for public utility service, other than electricity or gas, shall not exceed the reasonable cost of providing the *public utility service*.
> Cal. Gov. Code § 54999.7(a) (emphasis added).

This statute is inapplicable to MWD—and SDCWA agrees. First, in a letter to MWD's Board of Directors concerning the rate dispute at issue, SDCWA admitted that Section 54999 "is a provision of the San Marcos legislation governing the application of water service and other public utility rates to schools and other public agencies," and it *"does not apply to a water wholesaler like [Metropolitan*]." TAC, Ex. D (emphasis added). Second, the statute also cannot apply to MWD for the additional reason that, on its face, it requires that rates charged to public agencies be the same as those charged to *non-public* agencies. MWD's 26 customers are all

[16] Where a quasi-legislative agency action is being reviewed, courts "consider only the administrative record" in determining whether a quasi-legislative decision was reasonable. *Western States*, 9 Cal. 4th at 573.

public agencies. Third, the statute cannot apply because MWD's rates are not imposed (for the same reasons discussed below under Proposition 26).

To further explain SDCWA's concession, Government Code section 54999 was enacted in response to the California Supreme Court's decision in *San Marcos Water Dist. v. San Marcos Unified Sch. Dist.*, 42 Cal. 3d 154 (1986). *San Marcos* involved a sewer capacity right fee that a retail water district had imposed onto its end-user customers, including a school district. *Id.* at 157-58. The Supreme Court held that the capacity fee amounted to a special assessment or tax and under the California Constitution and public entities are generally excepted from liability for such charges absent specific statutory authorization. *Id.* at 168. In response, the California Legislature passed Government Code section 54999 providing that, under certain circumstances, such charges were not assessments, but capacity fees that could be levied against public entities. Cal Gov. Code § 54999(b) ("The Legislature . . . finds that the holding in [*San Marcos*] should be revised to authorize payment and collection of capital facilities fees . . ."). There is no reasonable claim that MWD's rates and charges are special assessments that cannot be levied against other public entities unless they conform to the requirements set out in the *San Marcos* legislation.

The inapplicability of Government Code section 54999.7(a) to MWD's rates and charges is made especially clear by subsection 54999.7(c), which states that "[a] public agency providing public utility service shall complete a cost of service study at least once every 10 years that addresses the cost of providing public utility service *to public schools*." (emphasis added). MWD does not provide any service to school districts and does not levy any charges on school districts. The San Marcos legislation is clearly not directed at charges and rates such as MWD's.

1. Standard of Review

Even assuming *arguendo* that Section 54999.7 applied to wholesale water charges at all, or applied to components of charges for water services as opposed to water service as a whole, or applied where all customers are public agencies, the standard of review for SDCWA's claim would be the same as the standard described above under common law. *See* Section III.B.1. The Government Code does not provide for a particular standard of review for claims under section 54999.7 and MWD is not aware of any case law specifying the standard of review for such

claims. However, there are strong indications that the standard of review for claims challenging the quasi-legislative act of rate making under common law would apply here.

First, the application of the common law standard for public entity rate-setting is consistent with the plain language of Government Code section 54999.7(a) which requires that fees subject to the statute "shall not exceed the reasonable cost of providing the public utility service." The word "reasonable" contemplates a range of choices that may be permissible, rather than one fixed fee, which is consistent with the discretion the common law gives to public entities engaged in rate-setting.

Likewise, section 54999.7(c) delegates to the public entity the task of determining rates in the first instance that it will charge to public schools by using "appropriate industry ratemaking principles" for "public agencies providing public utility service." Cal. Gov. Code § 54999.7(c) ("A public agency providing public utility service shall complete a cost of service study at least once every 10 years that addresses the cost of providing public utility service to public schools. The study shall describe the methodology for the determination of cost responsibility, which may be identified by reference to appropriate industry ratemaking principles . . . [such as guidance] issued by the American Water Works Association or guidance associated with other comparable industry principles recognized by public agencies providing public utility service."). Although the reference to "public schools" makes it obvious that this statute has no application to wholesale providers such as MWD, the generalized reference to "appropriate industry ratemaking principles" is another indicator that the traditional standard of review applicable to public entities engaged in rate-setting is appropriate.

Second, because section 54999.7 simply restored the ability of a publicly owned utility to assess a particular type of utility fee on another public entity, the standard of review should be the pre-existing standard that normally applies to such fees, *i.e.*, the common law standards discussed above. Section 54999.7 was enacted to overturn the California Supreme Court's decision in *San Marcos Water Dist.*, which "held that the constitutional public entity exemption from special assessments prohibited a local water district from imposing a capacity fee used to fund capital improvements to the water system, absent legislative authorization." *Regents of*

Univ. of Cal. v. East Bay Mun. Util. Dist., 130 Cal. App. 4th 1361, 1366 (2005); *see generally id.* at 1368-72. "In direct response to the *San Marcos* decision, the Legislature granted public utilities authority to impose capital facilities fees on other public entities, thereby removing the public entity exemption as to those fees." *Id.* at 1370-71.

Third, the established procedure for a public entity to challenge another public entity's rates indicates that the common law standard should apply. As a general principle, public utility fees charged to public entities are outside the regulatory jurisdiction of the Public Utilities Commission, which regulates privately owned entities. *See County of Inyo v. Public Utils. Comm'n*, 26 Cal. 3d 154, 165-67 (1980). Instead, if one public entity wishes to challenge another public entity's utility rates, it "can institute suit in superior court." *Id*. at 159. "Judicial review of rates, however, does not provide protection comparable to PUC proceedings." *Id*. The plaintiff can only "sue to enjoin rates which are themselves 'unreasonable, unfair, or fraudulently or arbitrarily established' (*Durant*, 39 Cal. App. 2d at 139), or which discriminate without a reasonable and proper basis (*Elliott*, 54 Cal. App. 3d at 59)." *Id*. The Supreme Court's citation to the common law rate-setting cases *Durant* and *Elliott* in the context of a rate challenge by one public entity (the County of Inyo) against another public entity (the Los Angeles Department of Water and Power) indicates that the common law standard of review applies in this context.

Accordingly, SDCWA's Government Code claim must be reviewed under the arbitrary and capricious standard, with substantial deference given to MWD's rate-setting expertise. *See* Section III.C.1.

2. Burden of Proof

For the same reasons that the common law standard of review should apply to a Government Code section 54999.7 claim, the common law burden of proof (as discussed in Section III.B.2) should also apply. MWD's rates are presumed reasonable (because "rates established by [a] lawful rate-fixing body are presumed reasonable, fair and lawful" (*Hansen*, 42 Cal.3d at 1180), and SDCWA bears the burden of overcoming this presumption and establishing that MWD's rates violate Government Code section 54999.7 by failing to charge only for the "reasonable cost of providing the public utility service" (Cal. Gov. Code § 54999.7(a)); *Hansen*,

42 Cal.3d at 1180-81 (reasonableness "is the beginning and end of the judicial inquiry").

3. Evidence the Court Is Required to Evaluate

a. Scope of Allowable Evidence

Because this claim challenges the reasonableness of a charge for a public utility service (allegedly MWD's 2011/12 and 2013/14 water rates), the Court's review of evidence is limited to the administrative records in the *2010* and *2012 Actions* (*i.e.*, excludes extra-record documents and fact and witness testimony). *See* Section III.B.3.a, *supra*. As explained, this is because MWD's setting of its water rates is a quasi-legislative act (*Brydon*, 24 Cal. App. 4th at 196; *Durant*, 39 Cal. App. 2d at 139) and review of the reasonableness of quasi-legislative acts is limited to the administrative record before the agency at the time of the act. *Western States*, 9 Cal. 4th at 573.

b. Pertinent Administrative Record Documents

Even if section 54999.7 applied to wholesale water charges at all, or applied to components of charges for water service rather than to water service as a whole, or applied where all customers are public agencies, the administrative record shows that MWD's rates do "not exceed the reasonable cost of providing the public utility service." This is because, for the reasons explained above, the System Access Rate, System Power Rate and Water Stewardship Rate recoup amounts MWD pays for conveyances-related expenses, and therefore allocating them to MWD's transportation rate is reasonable, and MWD's rates and charges address peaking reasonably. *See* Section III.B.3.b.

E. SDCWA's California Water Code Claim (the "Wheeling Statute")

SDCWA alleges that MWD's 2011/12 and 2013/14 water rates violate California's Wheeling Statute (Cal. Water Code §§ 1810-14) "because the rates [MWD] charges for conveyance to [SDCWA] exceed 'fair compensation' for use of [MWD's] system." TAC ¶ 96; 2012 Complaint ¶ 98; *see also* TAC ¶¶ 72, 101; 2012 Complaint ¶ 73. The Wheeling Statute govern the rates an agency sets for "wheeling," which is a term for the conveyance of non-agency water through the agency's system. *See MWD v. IID*, 80 Cal. App. 4th at 1407.

MWD maintains a wheeling rate, which applies only to the use of MWD's facilities to

transport (1) *non-MWD water*; (2) to *MWD's member agencies*; (3) for a period *of up to one year*. MWD Administrative Code §§ 4119, 4405.[17]

As SDCWA has pointed to no transaction for which it is paying a wheeling rate that is subject to the Wheeling Statute, it is unclear why the Wheeling Statute is relevant to the legality of MWD's water rates generally.[18]

If SDCWA means to suggest that the Exchange Agreement between it and MWD is a wheeling transaction subject to the Wheeling Statute, it is indisputable that SDCWA is incorrect for three reasons (despite the fact the Wheeling Statute mentions the exchange of water).

First, SDCWA agrees the Exchange Agreement is not a wheeling agreement. As is set forth in MWD's concurrently filed motion in limine regarding SDCWA's Wheeling Statute claims, both SDCWA and IID have previously, and successfully, asserted that the Exchange Agreement is not a wheeling agreement and is therefore not governed by the Wheeling Statute. SDCWA and IID are estopped from changing their positions now. *See* Defendant's Motion in Limine #5.

Second, the Wheeling Statute applies only to the use of an agency's facilities to transport *third party water*, not water owned by the agency. *See* Cal. Water Code § 1811. Here, as SDCWA states in the TAC, it "purchases . . . water *from Metropolitan*" for transport through MWD's facilities. TAC ¶ 2 (emphasis added). This type of transaction is not wheeling under the Water Code. Similarly, as explained in the TAC, SDCWA also "purchases water from the Imperial Irrigation District." *Id.* Pursuant to the Exchange Agreement, SDCWA makes available to MWD the water it obtains from IID, and in return MWD delivers a like quantity of Exchange Water to SDCWA." TAC, Ex. A. MWD provides the Exchange Water from *any available source*. *Id.* This Exchange Water is a blend of SWP water, water from the Colorado

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[17] The price for other wheeling transactions – wheeling for a duration of more than one year, and/or wheeling to a party other than a MWD member agency – are negotiated on a one-to-one contractual basis.

[18] SDCWA does not currently have any active wheeling agreements with MWD. Neither does IID, who like SDCWA, has asserted that MWD's rates violate the Wheeling Statute. *See* IID's Answer to SDCWA's TAC, ¶ 96, First Affirmative Defense.

River, and other sources. *See id.* MWD delivers the Exchange Water to SDCWA using the facilities as determined by MWD. *See id.* The Wheeling Statute does not apply to *exchanges* of water such as the one created by the Exchange Agreement; it is only applicable to conveyance of third party water. *See* Cal. Water Code § 1811.

Third, the Wheeling Statute only allows bona fide transferors of water the right to use 70% of an agency's conveyance facilities' "*unused capacity,* for the period of time for which that capacity is available." Cal. Water Code §§ 1810, 1814 (emphasis added). This means that if an agency, such as MWD, has no available capacity in its facilities, it is not obligated to provide wheeling service. Under the Exchange Agreement, service to SDCWA is *uninterruptible*; MWD is *obligated* to exchange IID water for Exchange Water and convey this Exchange Water to SDCWA regardless of whether there is unused capacity or its level. And the Exchange Agreement requires MWD to dedicate sufficient capacity in its facilities for the exchange for at least 35 years, not just for the short term of a specific wheeling transaction. *See* TAC, Ex. A.

1. Standard of Review

The Wheeling Statute has a "substantial evidence" standard of review. Cal. Water Code § 1813. Under the Wheeling Statute, no "public agency may deny a bona fide transferor of water the use of a water conveyance facility which has unused capacity, for the period of time for which that capacity is available, if fair compensation is paid for that use . . . . Cal. Water Code § 1810. "Fair compensation" is defined as "the reasonable charges incurred by the owner of the conveyance system, including capital, operation, maintenance, and replacement costs, increased costs from any necessitated purchase of supplemental power . . . ." *Id.* § 1811(c). In making the determinations required by the Wheeling Statute, the "public agency shall act in a reasonable manner consistent with the requirements of law to facilitate the voluntary sale, lease, or exchange of water and shall support its determinations by written findings." *Id.* § 1813. "[T]he court shall sustain the determination of the public agency if it finds that the determination is supported by substantial evidence." *Id.* Therefore, in sum, the Wheeling Statute inquiry is reasonableness.

The determination of what constitutes "fair compensation" for use of its system to wheel water lies within MWD's discretion. *San Luis Coastal Unified Sch. Dist. v. City of Morro Bay,*

81 Cal. App. 4th 1044, 1051 (2000) (under the Wheeling Statute, determination of fair compensation constitutes an act of discretion and "[m]andate may not order the exercise of discretion in a particular manner unless discretion can be lawfully exercised only one way under the facts."); *MWD v. IID*, 80 Cal. App. 4th at 1425, 1428 ("The water conveyance facility owner, in this case the Metropolitan Water District, is specifically authorized to determine what is 'fair compensation' provided the determination is made in a timely and reasonable manner" and "[t]he construction of the Wheeling Statute by the Metropolitan Water District is entitled to great weight and respect.") (citations omitted).

As with the arbitrary and capricious standard, the substantial evidence standard is "highly deferential." *Western States*, 9 Cal.4th at 572. Indeed, the two standards are nearly identical in practice; they both require a reasonable basis for an agency decision. *See id.*(under substantial evidence standard a court's review is limited to evaluating an administrative decision based on whether it was "rational in light of the evidence before the agency" and not "whether it was the wisest decision given all the available scientific data"); *Golden Drugs Co., Inc.*, 179 Cal. App. 4th at 1467 ("we recognize that not everyone acknowledges a distinction between 'devoid of evidentiary support' and 'substantial evidence'") (citations omitted); *Warmington Old Town Assocs. v. Tustin Unified Sch. Dist.*, 101 Cal. App. 4th 840, 850 (2002) (upon reviewing a quasi-legislative action of the School District, court held that "the inquiry into arbitrariness or capriciousness is like substantial evidence review in that both require a reasonable basis for the decision."); *Balch Enters. v. New Haven Unified Sch. Dist.*, 219 Cal. App. 3d 783, 792 (1990) (court could see "no way, however, that [the arbitrary and capricious] determination can be distinguished from application of the substantial evidence rule as applied in administrative mandamus actions — in either case the question is whether there was a reasonable basis for the decision").

Thus, the standard of review for SDCWA's Wheeling Statute claim is highly deferential and as long as the Court finds that the charges are "reasonable" as supported by "substantial evidence," they must be upheld. *See* Section III.B.1.

2. Burden of Proof

The Wheeling Statute does not specify which party would bear the burden of proof under a proper claim that MWD's wheeling rate exceeds "fair compensation." However, as discussed throughout, "rates established by [a] lawful rate-fixing body are presumed reasonable, fair and lawful." *See* Sections III.A and III.B.2, *supra*. MWD's determination of its wheeling rate, as with the determination of its 2011/12 and 2013/14 water rates, is an exercise of its discretion subject to a presumption of reasonableness, fairness, and lawfulness. As such, the common law burden of proof would apply to a proper claim brought under the Wheeling Statute. *See* Sections III.B.2 and III.C.2.

3. Evidence the Court Is Required to Evaluate

a. Scope of Allowable Evidence

While review of claims challenging the reasonableness of MWD's water rates is limited to the administrative record, in January 2012, the Court carved out a narrow exception *for discovery* under the Wheeling Statute to "see what's out there." 1/6/2012 Tr. at 5:16-21; 9:8. The Court explained that, despite the allowance of discovery, a judicial determination would still need to be made regarding the relevance of extra-record evidence. *Id.* at 9:8-11 (once the discovery has resulted in the gathering of facts "there would be the need to screen what was relevant and what is not relevant").

In May 2013, the Court provided further clarification in an order denying IID's request to take depositions concerning MWD's rates. The Court stated that the Wheeling Statute might authorize "discovery . . . which explores extra-record justifications for the rates, or discovery which in some fashion undermines those justifications." May 28, 2013 Order on IID's Deposition Notices at 2. However, as discussed, the Supreme Court has expressly prohibited extra record evidence in cases challenging quasi-legislative acts which serves "merely to contradict the evidence the administrative agency relied on in making a quasi-legislative decision or to raise a question regarding the wisdom of that decision." *Western States*, 9 Cal. 4th at 579. Even if limited extra-record evidence were admissible under the Wheeling Statute, which it is not, SDCWA cannot use such evidence merely to "undermine," or contradict, MWD's rate-

making. As *Western States* makes clear, under the substantial evidence standard prescribed by the Wheeling Statute, a court's review is limited to evaluating an administrative decision based on whether it was "rational in light of the evidence before the agency" and not "whether it was the wisest decision given all the available scientific data." *Id.* at 572.

The Court disallowed IID's requested depositions because "[t]he proposed discovery in essence demands that Metropolitan explain itself, including why its determination were in accord with law," but "Metropolitan will presumably do so during the briefing to be schedule in connection with the final hearing in this matter." May 28, 2013 Order at 2. As the Court expected, MWD will "explain itself, including why its determinations were in accord with law" at the December final hearing. Further, MWD does not intend to offer any extra-record justifications for its wheeling rate. As explained, there are not any particular wheeling transactions at issue in this case. Therefore, the only adjudication here would be regarding MWD's fixed wheeling rate for transactions of one year or less, not in the context of any particular transaction. *See* MWD Administrative. Code §§ 4119, 4405.

Accordingly, what is relevant to SDCWA's claim is the evidence in the administrative record. The Wheeling Statute requires only that MWD's wheeling rate be comprised of "reasonable charges." Cal. Water Code § 1811. As defined in its Administrative Code, MWD's wheeling rate for transactions of one year or less consists of the System Access Rate, Water Stewardship Rate, and the actual cost of power for a wheeling transaction (if the wheeling party does not provide its own power). MWD Administrative Code § 4119, 4405(b). As MWD intends to show at the December hearing, the evidence in the administrative record demonstrates that the only wheeling rate components that can be assessed outside of a particular transaction – the System Access Rate and Water Stewardship Rate – are reasonable. Furthermore, limiting review of SDCWA's Wheeling Statute claim (which, as discussed, contains a "substantial evidence" standard) to the administrative record comports with the California Supreme Court's holding in *Western States*. 9 Cal. 4th at 572-73 (explaining that, where a statute contained a "substantial evidence" standard, review was limited to "*only* the administrative record") (emphasis added).

Thus, for these reasons, and the reasons discussed in Section III.B.3.a, *supra*, it is MWD's position that the Court should only evaluate evidence in the administrative record (and accordingly exclude extra-record documents and fact and expert witness testimony) for the Wheeling Statute claim as well as the other rate challenges.

b. Pertinent Administrative Record Documents

The Water Code requires only that MWD's charges for wheeling be "reasonable charges" that MWD set in a "reasonable manner" supported by written findings. Cal. Water Code §§ 1811, 1813. As discussed, no specific wheeling transaction is at issue here. When MWD adopted its general wheeling rate, it made written findings that supported that rate's reasonableness. *See e.g.*, 2010/2012 Records Document No. 82. MWD's wheeling rate in the abstract consists of the System Access Rate and Water Stewardship Rate (which, as explained previously, were adopted in 2001 and first implemented in 2003), and the actual cost of power for a particular wheeling transaction (if the party does not provide its own power). MWD Administrative Code § 4405(b). The evidence in the administrative record, discussed above in Section III.B.3.b demonstrates that MWD's allocation of SWP costs to MWD's System Access Rate, and the calculation of that rate and the Water Stewardship Rate based on quantities of water conveyed, took years of reasoned analysis, and was reasonable.

F. SDCWA's Constitutional Claims

SDCWA alleges that MWD's water rates violate California Constitution Article XIII's requirement that certain types of charges (which allegedly fall under definitions of "taxes") be approved by two-thirds of the relevant electorate.

1. Article XIII A (Proposition 13)

SDCWA alleges that MWD's 2011/12 and 2013/14 water rates violate Article XIII A and Proposition 13's implementing statute, Government Code section 50076, because those rates do not charge the "reasonable cost of providing the service . . . for which the fee is charged" and, accordingly, are taxes and required a two-thirds vote in order to be enacted. *See, e.g.*, TAC ¶¶ 69; 82, 95; 2012 Complaint ¶¶ 68, 96. Proposition 13 added Article XIII A to the California Constitution for the purpose of limiting rising property taxes. Section 4 of Proposition 13

provides that "Cities, Counties and special districts, by a two-thirds vote of the qualified electors of such district, may impose *special taxes* on such district, except ad valorem taxes on real property or a transaction tax or sales tax on the sale of real property within such City, County or special district." Cal. Const., art XIII A, § 4 (emphasis added). Proposition 13's implementing statute, Cal. Gov. Code § 50076, clarifies what falls *outside* the definition of a "special tax" under Section 4: A "'special tax' *shall not include* any fee which does not exceed the reasonable cost of providing the service or regulatory activity for which the fee is charged. . . " (emphasis added).

As with SDCWA's Government Code claim, its Proposition 13 claim fails at the outset because MWD's water rates fall outside the scope of Proposition 13. *See Brydon*, 24 Cal. App. 4th at 194 ("'[I]f the fee is not the type of exaction which article XIII A was designed to reach, then resort to sections 50075-50077, the enabling legislation for the article, is unnecessary.'") Two courts have held that water rates fall outside Proposition 13. *See Brydon*, 24 Cal. App. 4th at 194-95; *Rincon*, 121 Cal. App. 4th at 822. And SDCWA cannot plausibly deny this, although it has attempted to do so in these actions. SDCWA itself successfully argued before the Court of Appeal that Proposition 13 does not apply to water rates, and obtained a published opinion with that holding that is now conclusive here. *See Rincon*, 121 Cal. App. 4th at 821-22.[19]

In *Brydon*, the court considered an "inclining block rate structure" that "imposes higher charges per unit of water as the level of consumption increases" charged by a publicly owned public utility to end user customers. 24 Cal. App. 4th at 182-84. The court held that "[t]he inclining block rate structure *bears none of the indicia of taxation* which the California Constitution, article XIII A purported to address." *Id.* at 194 (emphasis added). "The rates were levied against water consumers in accordance with patterns of usage, and at no cost to taxpayers generally." *Id.* The court noted that the "prior submission of water rates to the voters for

[19] Remarkably, in response to this definitive impediment, SDCWA's counsel previously told this Court that merely that it was entitled to take different positions in different cases. *See* 7/2/2012 Tr. at 57:4-13 (SDCWA contended that MWD is "wrong" in asserting that by making "one argument in the *Rincon* case in 2004. . . now [SDCWA] can't make a different argument").

approval would be nonsensical." *Id.* (citations omitted) (emphasis added). In short, it "[could not] conclude that California Constitution, article XIII A was intended either by the framers or the electorate to accomplish the essential destruction of the rate setting structure of public utilities, nor the evisceration of constitutional mandates compelling water conservation." *Id.* at 195. Accordingly, the court "conclude[d] that the rate structure enacted by the District is not a 'special tax' requiring two-thirds voter approval by the local electorate." *Id.*

After *Brydon* came *Rincon*, the SDCWA decision that is controlling on the question of whether Proposition 13 applies to MWD's water rates. *Rincon* dealt with wholesale water sales by SDCWA to its member districts, 121 Cal. App. 4th at 815, and in this respect is directly on point with respect to the present challenge to MWD's wholesale rates.[20] Further, in *Rincon* SDCWA defended against a challenge specifically to its water transportation charges, *see* 121 Cal. App. 4th at 816, the equivalent charges that SDCWA challenges here.

The specific question in *Rincon* was whether SDCWA could have a "postage stamp" transportation rate, like MWD does, *i.e.*, a flat dollar rate for each acre-foot of water transported, regardless of distance or which portions of the transportation infrastructure available to MWD were used. *Id.* at 816. In answering this question, the court recognized the traditional distinction between water rates (which are a commodity charge) and special assessments (which are a tax). Under California case law, "water rates are considered user or commodity charges because they are based on the actual consumption of water." *Id.* at 819. The court explained that "user rates are functionally distinct from special assessments, which are compulsory charges levied against certain properties for public improvements that directly or indirectly benefit the property owner and are not related to the use of the public improvement." *Id.* "It also reasoned that "the power to set water rates comes from the public agency's proprietary and quasi-public capacity, while the power to impose special assessments or other capital charges derives from the taxing power."

[20] SDCWA is essentially just like MWD: It is a water wholesaler that sells only to its member public agencies. SDCWA has 24 member agencies. SDCWA is governed by a Board of Directors, comprised of representatives of its member agencies. The SDCWA Board votes on matters, including the quasi-legislative decision of the setting of SDCWA's rates.

Id. (citations omitted).

The court then addressed Proposition 13 directly. The plaintiff challenging SDCWA's transportation rate argued that the rates covering certain capital costs had to be deemed a special tax rather than a user fee "in order to adhere to the spirit of Proposition 13." *Id.* at 821. The court rejected that argument, *holding that Proposition 13 does not apply to water rates*. *Id.* at 821-22. The court quoted at length from *Brydon*, and reasoned that "[a]lthough the transportation rate is a postage stamp rate rather than a block rate . . . we find the analysis in *Brydon* compelling. *The transportation rate was not designed to replace property tax revenue lost due to Proposition 13 nor is there any indication the Legislature intended to revise the statutory scheme governing water rates.*" *Id.* at 822 (emphasis added).[21]

In sum, the outcome in *Rincon* is controlling here because MWD's water rates are the same kind of rates at issue in that case. The rates in *Rincon* were wholesale postage stamp water rates. *Id.* at 816. MWD's 2011/12 and 2013/14 water rates are also wholesale postage stamp water rates. Moreover, SDCWA of course is well aware of Proposition 13's inapplicability to wholesale postage stamp water rates, as it was the party that made that argument to the Court of Appeal in *Rincon* and established that law. *See* RJN in Support of MWD's Demurrers to the First Through Fourth Causes of Action In, And Motions to Strike portions of, the Second Amended Petition/Complaint in the *2010 Action*, Ex. 15 at 34 (Brief for SDCWA, *Rincon Del Diablo Mun. Water Dist. v. San Diego Cnty. Water Auth.*, 121 Cal. App. 4th 813 (2004) (SDCWA stating "more to the point, *water rates were not the type of charge Proposition 13 was intended to reach.*") (emphasis added)).

Even if these authorities did not control here, Proposition 13 is inapplicable because MWD's rates are not "imposed." *See* discussion in Section III.F.1, *infra*. And, the

[21] Like MWD, SDCWA does have the power to tax property. *See* County Water Authority Act, Water Code Append., ch. 45, §§ 45-5(8), 45-7(j); *see also* MWD Act § 124 ("[MWD] may levy and collect taxes on all property within the district for the purposes of carrying on the operations and paying the obligations of the district . . . ."). However, the court found that SDCWA was not exercising its taxation power when it enacted its transportation rate based on the historical distinction between "water rates" and "special assessments." *Rincon*, 121 Cal. App. 4th at 822.

aforementioned cases show that neither Proposition 13 or its implementing statute—both directed at real property taxes and supplemental charges to replace lost real property tax revenue—was applied to a charge, like MWD's rates, which were established by a governing board of directors made up of representatives of member agencies and charged only to those member agencies who choose to purchase property, purchase a product, or engage a service. Nothing suggests that the voters intended Proposition 13 to cover such a charge.

a. Standard of Review

To assert a violation of Proposition 13, SDCWA must show that MWD's water rates in the aggregate bear no reasonable relationship to the costs they recoup. *See, e.g., Evans v. City of San Jose*, 3 Cal. App. 4th 728, 736-37 (1992) (Proposition 13 "does not embrace fees . . . that do not exceed the reasonable cost of providing services necessary to the activity for which the fees are charged."). This Court's inquiry into the reasonableness of MWD's water rates for purposes of Proposition 13's reasonableness requirement is straightforward: "[P]ermissible fees must be related to the *overall* cost of the" governmental service. *Cal. Farm Bureau Fed'n v. State Water Res. Control Bd.*, 51 Cal. 4th 421, 438 (2011) (emphasis added). "They need not be finely calibrated to the precise benefit each individual fee payor might derive." *Id.*

In determining whether a fee exceeds the reasonable cost of the service, California courts ignore whether the fee charged to the user is proportional to the benefit received by that user or the burden that user's conduct imposes on the system. A "fee does not become a tax simply because the fee may be disproportionate to the service rendered to individual payors. The question of proportionality is not measured on an individual basis. Rather, it is measured collectively, considering *all* rate payors." *Id.* (emphasis added); *see also Rincon*, 121 Cal. App. 4th at 823 (holding that water rates need not be proportionate to the specific burden caused by particular rate payors, because "when the Legislature intends a fee be based upon a particular user's burden on the facility, it has stated that intention clearly"); *Griffith v. Pajaro Valley Water Mgmt. Agency*, Nos. H038087, H038264, 2013 Cal. App. LEXIS 822, at *26-27 (Cal. App. 6th

Dist. Oct. 15, 2013) (in the Proposition 218 context[22], Court of Appeal stated that "[a]pportionment is not a determination that lends itself to precise calculation" and a proportionality requirement does not compel a "parcel-by-parcel proportionality analysis."). In *Griffith*, the Court held that where, as here, a proposition prescribes no particular method for apportioning a fee other than that the amount shall not exceed the proportional cost of the service, grouping similar users together for the same rate and charging them according to usage is a reasonable way to apportion the cost of service. *Griffith*, 2013 Cal. App. LEXIS 822, at *27 ("That there may be other methods favored by plaintiffs does not render defendant's method unconstitutional.").

Accordingly, SDCWA's contention that MWD's water rates are not finely calibrated to the precise benefit each individual fee payor receives is irrelevant. *See* TAC ¶ 52 (alleging that SDCWA is "uniquely situated among [MWD's] member agencies" and is being "overcharge[d]" by MWD's 2011 and 2012 water rates); 2012 Complaint ¶ 52. The only inquiry for the Court is whether MWD's 2011/12 and 2013/14 water rates, in the aggregate, bear a reasonable relationship to the costs they recoup. As stated (*see* Section III.A), when determining the reasonableness of the quasi-legislative act of rate making, a court applies an arbitrary and capricious standard of review and presumes the rates are reasonable. This standard applies equally in the Proposition 13 context. *See Shapell Industries*, 1 Cal. App. 4th at 233-34 (finding that lower court erred by admitting extra-record evidence in a Proposition 13 case because "[t]he determination whether the decision was arbitrary, capricious or entirely lacking in evidentiary support must be based on the 'evidence' considered by the administrative agency.") (citations omitted).

Thus, the Court should employ the arbitrary and capricious standard when determining whether MWD's 2011/12 and 2013/14 water rates violate Proposition 13.

[22] The court in *Griffith* notes that Proposition 218 is closely related to Proposition 13, and, indeed, applies Proposition 13 case law when construing Proposition 218. *See* 2013 Cal. App. LEXIS 822, at *10, 27 (citing *Cal. Farm Bureau Fed'n v. State Water Res. Control Bd.*, 51 Cal. 4th 421 (2011)).

b. Burden of Proof

If the Court permits the Proposition 13 claims in both actions to go forward despite its inapplicability to MWD's rates, then under Proposition 13 case law, SDCWA "bears the burden of proof to establish a prima facie case showing that the fee is invalid." *Cal. Farm Bureau*, 51 Cal. 4th at 436. If SDCWA's evidence is sufficient, MWD then bears the "burden of production" to show that the challenged components of its 2011/12 and 2013/13 rates bear a "fair or reasonable relationship" to the costs of the service MWD provides. *Id.* at 436-37. MWD's burden requires producing evidence demonstrating that the manner in which it apportioned contemplated transportation costs to its transportation rate bears a "fair or reasonable relation to [its member agencies'] burden on, and benefits from, [MWD's] system." *Beaumont Investors v. Beaumont-Cherry Valley Water Dist.*, 165 Cal. App. 3d 227, 235 (1985). Similarly, MWD's burden requires producing evidence demonstrating the manner in which it accounts for peaking bears a fair or reasonable relationship to its member agencies' burden on, and benefits from, MWD's system. *Id.* California courts have held that the agency's burden is only one of production; at all times SDCWA bears the burden of proof on its Proposition 13 claim. *Cal. Farm Bureau*, 51 Cal. 4th at 436 & n. 18 (The burden of proof is "synonymous" with the "burden of persuasion" and is different from the "burden of production," which may shift between the parties. "The burden of proof does not shift . . . it remains with the party who originally bears it.").

c. Evidence the Court Is Required to Evaluate

(1) Scope of Allowable Evidence

As with the other rate challenges claims discussed above, because SDCWA's Proposition 13 claim challenges the quasi-legislative act of rate setting, the Court's review of evidence is limited to the administrative records in the *2010* and *2012 Actions* and should exclude extra-record documents and fact and expert witness testimony. *See* Section III.B.3.a.

(2) Pertinent Administrative Record Documents

Even if Proposition 13 and its implementing statute did apply to the water rates at issue, the administrative record demonstrates that MWD's water rates in the aggregate bear a

reasonable relationship to the costs they recover.

As noted above, charges can be considered "taxes" subject to Proposition 13 only when the revenue they generate exceeds the reasonable cost of the service, for which they were imposed in the aggregate, or in other words, measuring all rate payors together. MWD's rate-setting process ensures that this does not happen. The evidence shows that MWD's rates are set at a level designed to recover costs. When determining the amounts of the water rate elements, MWD first estimates its revenue requirements for the coming fiscal year, which it then allocates to different operation functions. *See, e.g.*, 2010/2012 Records Document No. 599; 2012 Record Document No. 944. MWD's allocation of costs to operation functions makes sure that MWD's rates generate revenue to pay for related expenses. *See* 2010/2012 Records Document No. 599; 2012 Record Document No. 944 (MWD uses functional allocation to "correlate charges for different types of service with the costs of providing those different types of service"). Then MWD uses these operation functions to assign costs to various cost classifications, and finally the rate components to which they relate. 2010/2012 Records Document No. 599; 2012 Record Document No. 944. MWD's rate component allocations are designed to "fully recover" the cost of service for that fiscal year. 2010/2012 Records Document No. 599; 2012 Record Document No. 944.[23]

Furthermore, Section III.B.3.b, *supra*, sets forth evidence in the administrative record that demonstrates MWD's water rates in aggregate are reasonably related to the overall cost of the governmental service, including peaking and transportation. Because the evidence in the administrative record demonstrates that MWD's System Access Rate, System Power Rate, Water Stewardship Rate, and other rates and charges reasonably charged all of the member agencies according to both their use of MWD's conveyance system for MWD's reasonable costs related to transportation, and for their use of MWD's facilities to satisfy peak demand, MWD's water rates

[23] California case law specifically sanctions this approach. *See Griffith*, 2013 Cal. App. LEXIS 822, at *24-25 (Court rejected plaintiff's argument that defendant "improperly 'worked backwards'" by following a revenue-requirement model like the one MWD follows. Further, the court stated that following this approach was recommended by the American Water Works Association Manual, which does not offend the proportionality requirement in Proposition 218.).

are not special taxes and thus Proposition 13 does not apply.

2. Article XIII C (Proposition 26): *2012 Action* only

SDCWA alleges that MWD's 2013/14 water rates[24] violate Article XIII C, Section 1 because they meet that section's definition of "tax" and were not approved by a two-thirds vote. *See, e.g.*, 2012 Complaint ¶ 56. It is SDCWA's position that MWD's 2013/14 water rates are special taxes because they exceed the costs MWD bears to provide services to its member agencies and because MWD allegedly misclassifies various supply-related costs as transportation. *Id.* at ¶ 58. Article XIII C defines the "tax" that requires two-thirds voter approval as "any levy, charge, or exaction of any kind imposed by a local government," and states seven exceptions to its application. *See* Cal. Const. art. XIII C, § 1(e)(1)-(7).

As MWD explained in its recent briefing on Article XIII C, the provisions added by Proposition 26 are inapplicable to MWD's water rates because MWD's rates are not taxes subject to Proposition 26 for two separate reasons: (1) the rates are not "imposed"; and (2) even if they were, MWD's rates fall within two exceptions to Proposition 26. Moreover, as also previously briefed, even assuming *arguendo* that MWD's rates were subject to Proposition 26, Proposition 26 has been satisfied because the rates were approved by 2/3 of the relevant electorate. *See generally* Memorandum of Points and Authorities in Support of MWD's Motion for Judgment on the Pleadings; MWD's Reply in Support of its Motion for Judgment on the Pleadings. While the Court denied MWD's motion, it did so on procedural grounds and because it found that the applicability of Proposition 26 depends on factual issues. *See* September 19, 2013 Order at 3; 9/18/2013 Tr. at 9:9-15 ("[T]here are a lot of factual issues that still remain. . . and it's very possible that Metropolitan will win on some of these or all of these issues. But there are factual issues. . . so I can't grant the motion today."). While MWD believes the inapplicability of Proposition 26 and the fact that MWD satisfied the requisite vote are legal questions based on judicially noticeable facts, as set forth in MWD's prior briefing, MWD will

[24] On March 29, 2013, the Court dismissed SDCWA's Proposition 26 claim in the *2010 Action* on the ground that Proposition 26 does not apply retroactively to rates passed before its enactment. March 29, 2013 Order at 6.

present further factual explanation from the administrative record at the December hearing as the Court's September 19, 2013 Order requested. MWD is confident that the Court will agree that SDCWA's Article XIII C/Proposition 26 claim should be dismissed.

a. Standard of Review and Burden of Proof

The charges governed by Article XIII C are only those that are "imposed" by a government entity. *See* Cal. Const. art. XIII C, § 1(e). Therefore, the Court's inquiry begins with determining if MWD's rates are imposed. If the Court determines that the rates are imposed, the Court next looks to see if MWD's rates and charges fall into one of the seven enumerated exceptions to Proposition 26. *See* Cal. Const. art. XIII C, § 1(e)(1)-(7). Several exceptions require that the charge "not exceed the reasonable costs." *E.g.*, Cal. Const. art. XIII C, § 1(e)(2). Others, such as Article XIII C Section 1(e)(4), do not contain such a requirement. If the Court finds that no exception applies, and MWD's rates and charges fall under the provisions of Proposition 26, then the Court must determine whether the rates were approved by a two-thirds vote of the relevant electorate. Cal. Const. art. XIII C, §§ 1(e), (2)(d).

At trial, MWD intends to prove (a) that its water rates do not fall under the definition of taxes because they are not "imposed,"; and (b) even if the water rates were imposed, the rates are excepted from the definition of taxes for two separate reasons: because they are charges for the purchase or use of "local government property" (Cal. Const. art. XIII C, § 1(e)(4)) and because they are charges imposed for a specific government service provided directly to the payor and which do not exceed the reasonable costs of providing the service (Cal. Const. art. XIII C, § 1(e)(2)). Moreover, at trial MWD intends to prove that even assuming *arguendo* its rates are considered a tax under Proposition 26 (which they are not), its rates satisfy Proposition 26 because they were approved by 2/3 of the relevant electorate: the MWD Board of Directors. Pursuant to Article XIII C, Section 1, it is only under exception (e)(2) that MWD is required to prove its water rates are reasonable by a preponderance of the evidence.

An unnumbered paragraph of Article XIII C, § 1(e) which provides the preponderance of the evidence burden has *no effect* on the exceptions that do not contain a reasonableness

requirement, such as exception (e)(4).[25] This is because the requirement for proof that a charge does not exceed the reasonable costs of the government activity and is allocated based on a fair or reasonable relationship to the payor's burdens mirrors requirements set forth in the exceptions stated in sections (e)(1) through (e)(3) of Article XIII C, § 1, which were also added by Proposition 26. In contrast, the exceptions stated in sections (e)(4) through (e)(7) contain no such requirements. All of section (e) must be read together, so that the requirements set out in the unnumbered paragraph can only be applicable to those exceptions that include the same standards. Where an exception to the definition of "tax" states no reasonable requirement (like section (e)(4)), there can be no reasonableness requirement nor a burden to prove this.

To establish the exception provided in Article XIII C section 1(e)(2), MWD must prove by a preponderance of the evidence that the "fees are imposed to cover the cost of performing [the service provided]." *Griffith*, 207 Cal. App. 4th at 997; *see also* Cal. Const. art. XIII C, § 1(e)(2) (under this exception, MWD bears the burden of proving by a preponderance of the evidence that its water rates (1) are no more than necessary to recover the reasonable costs of providing the service and (2) that the manner in which the costs were allocated bears a fair or reasonable relationship to the burden on or benefits received from the service provided).

In *Griffith*, a landlord filed a petition for writ of mandate seeking to invalidate an ordinance enacted by the City of Santa Cruz which called for annual inspections of residential rental properties, arguing, among other things, that the ordinance imposed a tax in violation of Proposition 26. *Id.* at 987. In evaluating the ordinance under Proposition 26, the court applied the holdings in *Cal. Farm Bureau Federation v. State Water Resources Control Bd.* ("*Cal. Farm Bureau*"), 51 Cal.4th 421 (2011), which addressed Proposition 13. *Id.* at 996-97. While *Cal. Farm Bureau* did not concern Proposition 26 directly, the *Griffith* court found its analysis

[25] That paragraph was added by Proposition 26 and states: "The local government bears the burden of proving by a preponderance of the evidence that a levy, charge, or other exaction is not a tax, that the amount is no more than necessary to cover the reasonable costs of the governmental activity, and that the manner in which those costs are allocated to a payor bear a fair or reasonable relationship to the payor's burdens on, or benefits received from, the government activity."

controlling in the Proposition 26 context because the court in that case analyzed the language that originated in case law and was later adopted by the drafters of Proposition 26. *Id.*

The *Griffith* court therefore held that under Proposition 26, "permissible fees must be related to the overall cost of the governmental regulation. They need not be finely calibrated to the precise benefit each individual fee payor might derive." *Id.* at 997 (quoting *Cal. Farm Bureau*, 51 Cal.4th at 438). Furthermore, a fee does not become a tax simply because the fee may be disproportionate to the service rendered to individual payors; "[t]he question of proportionality is not measured on an individual basis. Rather, it is measured collectively, considering *all* rate payors." *Id.* (quoting *Cal. Farm Bureau*, 51 Cal.4th at 438) (emphasis added).

California case law "suggest[s] a flexible assessment of proportionality within a broad range of reasonableness in setting fees." *Equilon Enters. LLC v. State Bd. of Equalization*, 189 Cal. App. 4th 865, 882 (2010) (citations omitted). It does not matter for purposes of the apportionment requirement that a challenger can propose an alternative better suited to a fee's purposes as long as an agency's apportionment of costs among payers is reasonable in light of the fee's purpose. *Id.* at 882-86 (Court rejected plaintiff gasoline company's argument that its allocation of a lead program fee was unreasonable because the majority of childhood lead poisoning comes from paint, not gasoline, because the fee allocation was directed at addressing childhood lead exposure, not just poisoning, and thus the fee did not need to be allocated based on responsibility for lead contamination.); *see also Griffith v. City of Santa Cruz*, 207 Cal. App. 4th 982, 997 (2012) (court found city satisfied the reasonableness requirements of Proposition 26 because fees imposed on rental property owners pursuant to a new ordinance were equal to or less than the cost of implementing the ordinance); *Griffith*, 2013 Cal. App. LEXIS 822, at *26-27 (court of appeal stated that "[a]pportionment is not a determination that lends itself to precise calculation" and a proportionality requirement does not compel a "parcel-by-parcel proportionality analysis.").

b. Evidence the Court Is Required to Evaluate

(1) Scope of Allowable Evidence

The Court is limited to review of solely the administrative record when addressing whether MWD's rates and charges comply with Proposition 26. As discussed, it is well established that the Court's inquiry into the reasonableness of MWD's rates and charges is limited to review of the administrative record because, as with SDCWA's other rate challenges, SDCWA's Proposition 26 claim challenges the quasi-legislative act of rate setting through a mandamus proceeding. *See, e.g., Western States*, 9 Cal. 4th at 573, 576; *Coachella Valley Unif. Sch. Dist. v. State of Cal*., 176 Cal. App. 4th 93, 117 (2009); *Shapell Indus.*, 1 Cal. App. 4th at 233-34. Although Proposition 26 changed the traditional rule concerning which party bears the burden of proof under certain circumstances (as relevant here, the determination regarding the applicability of exception (e)(2)), the Proposition says nothing about altering the rule that review of a quasi-legislative agency decision is limited to the administrative record. Where, as here, there is no clear indication that a new law was meant to change an established rule, the existing rule should stand. *See Aryeh v. Canon Business Solutions, Inc.*, 55 Cal. 4th 1185, 1193 (2013) (laws "should not be interpreted to alter the common law, and should be construed to avoid conflict with common law rules . . . unless [a law's] language clearly and unequivocally discloses an intention to depart from, alter, or abrogate the common-law rule") (citations omitted).

Therefore, review of evidence pertaining to whether MWD's rates and charges fall under or satisfy Proposition 26 is limited to the administrative record in the *2012 Action* and should exclude extra-record documents and fact and expert witness testimony. *See* Section III.B.3.a, *supra*.

(2) Pertinent Administrative Record Documents

During the September 18, 2013 hearing, and in its September 19, 2013 Order, the Court set out two outstanding factual issues relating to whether SDCWA has asserted a valid claim under Article XIII C: (1) whether MWD's rates are "imposed," and therefore taxes under the law, and (2) whether the water and facilities MWD provides constitute "government property"

such that the rates fall into Article XIII C, section 1(e)'s exception to Proposition 26. *See* September 19, 2013 Order at 3-4; 9/18/2013 Tr. at 10:22-27, 11:20-22 (Court stated that outstanding factual issues with regard to the application of Proposition 26 include (1) whether "Metropolitan has a monopoly on [the water SDCWA purchases]," *i.e.*, "whether or not San Diego actually has a choice as to whether it gets its water this way or whether there are other ways in which it can get its water" and (2) "whether we have an exemption because we have governmental property at issue.").

As explained, the Court may only evaluate evidence in the administrative record to address these preliminary issues, which evidence supports MWD's position that the rates at issue in the *2012 Action* are exempt from the requirements of Proposition 26. First, evidence shows that the rates are not imposed because all payors – the member agencies – are voluntary members of MWD and set the rates themselves via their representatives on the MWD Board of Directors, which votes in accordance with state law mandate. MWD Act § 57. Second, evidence shows MWD's water rates are not "imposed" and MWD is not an alleged monopoly because, by law, MWD is only a supplemental supplier of water. *See id.* § 130. Third, evidence shows that MWD's water rates are not "imposed" because SDCWA has many choices regarding where it purchases its water; as SDCWA itself alleges, it purchases a large share of its water supplies from third party sources. *See, e.g.*, 2012 Complaint ¶ 3 (SDCWA "purchases conserved Colorado River water from [IID and] has also obtained conserved water from the lining of the All American and Coachella Canals"). SDCWA also has access to local sources of water. Instead of obtaining water from alternate sources, however, SDCWA chose both to purchase water from MWD, and to enter into a *voluntary* contract with MWD in which SDCWA agreed to exchange water purchased from IID for a like quantity of Exchange Water from MWD. *See* TAC Ex. A. Evidence shows, therefore, that SDCWA's receipt of water from MWD is not due to any alleged monopoly over all available water sources, but is rather a consequence of a series of voluntary choices SDCWA has made to obtain water from MWD. Because MWD's rates and charges are not "imposed," they do not fall within the ambit of Proposition 26.

Evidence also supports application of the government service/reasonable costs exception.

As discussed above, evidence in the administrative record makes clear that even if SDCWA's Proposition 26 claim is valid, MWD's water rates fall under an exception to Article XIII C (section 1(e)(2)) because they are no more than necessary to recover the reasonable costs of providing MWD's services and the manner in which MWD's costs were allocated to its rates and charges bears a reasonable relationship to the burden on or benefits received from the member agencies. *See* Sections III.B.3.b and III.F.1.c.2, *supra* (setting forth evidence in the administrative record that demonstrates MWD's water peaking and transportation rates and charges in aggregate are reasonably related to the overall cost of the governmental service and are uniformly and reasonably allocated to the member agencies).

Evidence also supports application of the government property exception to MWD's rates. As also discussed in MWD's briefing on Proposition 26, MWD's water rates are charges for use of MWD's own conveyance facilities, as well as MWD's contractual right to use the SWP. *See* MWD's Reply in Support of its Motion for Judgment on the Pleadings at 5-7. Charges to use either MWD's facilities or facilities MWD has a property interest in are for the "use of local government property" which are excepted from Proposition 26's definition of tax. *See* MWD's Reply in Support of its Motion for Judgment on the Pleadings at 7; 2012 Record Document No. 1 (contract between MWD and DWR for use of the SWP). Purchases of water also fall under this exception because the water MWD conveys to SDCWA is its property, which is also properly considered "government property" within the exception to Proposition 26. *See* MWD's Reply in Support of its Motion for Judgment on the Pleadings at 6-7; 2012 Record Document No. 1; TAC Ex. A.

IV. STANDARD OF REVIEW, BURDEN OF PROOF, AND ADMISSIBLE EVIDENCE FOR THE RATE STRUCTURE INTEGRITY PROVISION CLAIM (FIFTH CAUSE OF ACTION IN *2010 ACTION*)

SDCWA's fifth cause of action for declaratory relief regarding the RSI provision contained in MWD's project contracts is without merit. SDCWA alleges that the RSI provision imposes an unconstitutional condition on its right to petition the courts under Article I, section 3, of the California Constitution. (TAC ¶¶ 104-105.) SDCWA also attacks the RSI provision

under California Civil Code section 1668, alleging that the term operates to illegally exempt MWD from liability for its rates decisions. (TAC ¶ 106.) SDCWA seeks a judicial declaration that the RSI provision is invalid and unenforceable, and an order reinstating all project contracts that were terminated pursuant to the RSI provision. (TAC, Prayer for Relief ¶ 5.) SDCWA's claims fail for at least five reasons: (1) SDCWA, a government agency, lacks a constitutional right to petition the government; (2) consideration paid under the project contracts does not qualify as a "public benefit" to which the unconstitutional conditions doctrine applies; (3) SDCWA waived its claimed right to petition regarding MWD's "existing rate structure" by executing project contracts with the RSI provision and consented to the RSI provision by accepting payments under the project contracts; (4) even if the Court were to find the unconstitutional conditions doctrine applies, the RSI provision satisfies the relevant test; and (5) the RSI provision does not "exempt" MWD from responsibility, rendering section 1668 inapplicable.

MWD has a pending Motion for Summary Adjudication as to SDCWA's Fourth, Fifth, and Sixth Causes of Action, set for hearing on December 3, 2013 ("MWD's Motion for Summary Adjudication"), which MWD believes should be granted as it addresses legal issues only. Below MWD addresses the matters requested by the Court in its July 22, 2013 Case Management Order, in the event SDCWA's fifth cause of action proceeds to trial.

A. Standard of Review and Burden of Proof

SDCWA's fifth cause of action asserts civil claims for declaratory relief regarding the RSI provision included in project contracts between MWD and SDCWA. As such, it does not involve any separate standard of review. Rather, the burden of proof that applies to SDCWA's RSI provision challenge is the same as with regard to any civil claim: as the plaintiff, SDCWA bears the burden of proving its claims by a preponderance of the evidence. Cal. Evid. Code §§ 115 & 500.

1. Legal Standard Applicable to SDCWA's Unconstitutional Conditions Claim

SDCWA bears the burden of establishing that the unconstitutional conditions doctrine

applies to the RSI provision and to SDCWA. Specifically, SDCWA must show that (1) it is a potential recipient of a "public benefit" to which the unconstitutional conditions doctrine applies; (2) the RSI provision implicates a constitutional right enjoyed by SDCWA; and (3) the RSI provision impinges on that constitutional right. *See Sanchez v. Cnty. of San Diego*, 464 F.3d 916, 930-31 (9th Cir. 2006) ("A plaintiff alleging a violation of the unconstitutional conditions doctrine, however, must first establish that a constitutional right is infringed upon.") (citing *Parrish v. Civil Service Comm'n of the County of Alameda*, 66 Cal. 2d 260 (1967)).

If SDCWA carries this initial burden, which MWD believes it cannot do (*see* Section IV.C below and MWD's Motion for Summary Adjudication), the burden shifts to MWD to demonstrate, by a preponderance of the evidence, the "practical necessity for the limitation." *Robbins v. Super. Ct. of Sacramento County*, 38 Cal. 3d 199, 213 (1985); *Lee v. Civil Service Comm'n of L.A. Cnty.*, 129 Cal. App. 3d 9, 13 (1982). To do so, MWD must show that: "(1) the condition reasonably relates to the purpose of the legislation which confers the benefit; (2) the value accruing to the public from imposition of the condition manifestly outweighs any resulting impairment of the constitutional right; and (3) there are no available alternative means that could maintain the integrity of the benefits program without severely restricting a constitutional right." *Robbins*, 38 Cal. 3d at 213.

2. Legal Standard Applicable to SDCWA's Section 1668 Claim

California Civil Code section 1668 provides: "All contracts which have for their object, directly or indirectly, to exempt anyone from responsibility for his own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law." Cal. Civ. Code § 1668. SDCWA must establish by a preponderance of the evidence that the RSI provision violates section 1668.

B. Evidence the Court Is Required to Evaluate

As SDCWA's fifth cause of action is a civil claim, the Court may consider all evidence admissible under the rules of evidence regarding the RSI provision issues. This includes both documentary evidence and testimony from fact witnesses. MWD expects to introduce testimony from its current Manager of the Water Resources Management Group and its current Manager of

Bay Delta Initiatives, who will testify to the facts surrounding MWD's adoption and implementation of the RSI provision. MWD may also present testimony from its Manager of the Budget and Financial Planning Section to testify regarding the nature of MWD's rate structure to the extent it relates to the RSI provision issues. In addition, MWD may present testimony by SDCWA's Assistant General Manager, Dennis Cushman, who was deposed as SDCWA's "person most knowledgeable" on RSI-related issues. Finally, MWD may offer expert testimony with regard to issues set forth herein. MWD expects that the evidence at trial will establish, among other things, the facts regarding the RSI provision set forth above in Section II.B.

C. SDCWA Will Be Unable to Prove Its Unconstitutional Conditions Claim

1. The Unconstitutional Conditions Doctrine Does Not Apply Here

MWD has briefed the inapplicability of the unconstitutional conditions doctrine in detail in its Motion for Summary Adjudication. Accordingly, set forth below is a summary of MWD's position demonstrating that the doctrine does not apply.

a. SDCWA, a Government Agency, Does Not Have a Constitutional Right to Petition Under the California Constitution

It is undisputed that SDCWA is a public agency. As such, it does not enjoy a constitutional right to petition the courts.[26] As the California Supreme Court has held, certain provisions of the state and federal constitutions confer "'fundamental rights on individual citizens,'" not on units of the government. *Star-Kist Foods, Inc. v. Cnty. of Los Angeles*, 42 Cal. 3d 1, 8 (1986) (quoting *San Diego Unified Port Dist. v. Gianturco*, 457 F. Supp. 283, 290 (1978)). These types of constitutional rights, "which are intended to limit governmental action vis-à-vis individual citizens," cannot be asserted by political subdivisions, such as SDCWA. *Id*. Indeed, Article I, section 3, of the California Constitution explicitly provides, "The *people* have the right to instruct their representatives, petition government for redress of grievances, and assemble freely to consult for the common good." Cal. Const. Art. I, § 3(a) (emphasis added). Neither this section nor any other section within Article I makes any reference to government

[26] *See* MWD's Motion for Summary Adjudication, at 7-9.

agencies. *Id.* This is entirely fatal to SDCWA's claim. Under California law, because SDCWA is a public agency, it does not enjoy a right to petition under the California Constitution and therefore lacks standing to assert an unconstitutional conditions claim here.[27]

b. Payments Made by MWD Under the Project Contracts Are Not "Public Benefits" to Which the Unconstitutional Conditions Doctrine Applies

Payments by MWD to its member agencies pursuant to LRP, CCP, and SDP project contracts are not "public benefits" protected by California's unconstitutional conditions doctrine.[28] These payments are distinguishable from the "public benefits" at issue in California's unconstitutional conditions cases. As the California Supreme Court has recognized, the unconstitutional conditions doctrine is implicated when the government "implements a general public benefit program." *Comm. to Defend Reproductive Rights v. Myers*, 29 Cal. 3d 252, 269-70 (1981). Specifically, the Court has held that the doctrine applies to such public benefits as "access to a public forum, public employment, welfare benefits, public housing, unemployment benefits, or the use of public property." *Id*. at 264.[29] There is no comparable "general public

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[27]*See Star-Kist Foods*, 42 Cal. 3d at 5-9 (discussing cases); *Native Am. Heritage Comm'n v. Bd. of Trustees*, 51 Cal. App. 4th 675, 683 (1996) (rejecting first amendment claim asserted by one state agency against another); *San Miguel Consol. Fire Prot. Dist. v. Davis*, 25 Cal. App. 4th 134, 143-45 (1994) (holding special fire and municipal improvement districts had no standing to challenge provisions of revenue and tax code on equal protection, due process, or other constitutional grounds); *Bd. of Supervisors v. McMahon*, 219 Cal. App. 3d 286, 296-97 (1990) (dismissing county's due process challenge to state welfare statute); *see also S. Lake Tahoe v. Cal. Tahoe Reg'l Planning Agency*, 625 F.2d 231, 233 (9th Cir. 1980) (holding city had no standing to assert takings and due process challenge to regional transportation plan); *Santa Monica Cmty. Coll. Dist. v. Pub. Emp't Relations Bd.*, 112 Cal. App. 3d 684, 690 (1980) (citing "long line of cases" holding that a public entity, being a creature of the state, is not a "person" within the meaning of the due process clause); *Cnty. of Los Angeles v. Super. Ct. of Alameda Cnty*, 128 Cal. App. 522, 526 (1933) ("the county is not a 'person' within the meaning of either the federal or the state Constitution"); *Riley v. Stack*, 128 Cal. App. 480, 484 (1933) (same).

[28]*See* MWD's Motion for Summary Adjudication, at 9-11.

[29]Lower courts throughout California have applied the doctrine to similar "public benefits." *See, e.g.*, *Evans v. City of Berkeley*, 38 Cal. 4th 1 (2006) (use of public property); *Smith v. Los Angeles Cnty. Bd. of Supervisors*, 104 Cal. App. 4th 1104 (2002) (welfare benefits); *Ofsevit v. Trustees of Cal. State Univ. & Colleges*, 21 Cal. 3d 763 (1978) (public employment); *Atkisson v. Kern Cnty. Housing Auth*., 59 Cal. App. 3d 89 (1976) (public housing); *Thornton v. Dep't of Human Res. Dev.*, 32 Cal. App. 3d 180 (1973) (unemployment benefits).

benefit program" at issue here. Rather, SDCWA seeks to convert payments under the project contracts into "public benefits" so that it may try to avail itself of the unconstitutional conditions doctrine. But, unlike the parties in California's unconstitutional conditions cases, SDCWA is not a private citizen receiving funding from a general public benefits program, and MWD does not act as a governmental benefactor when it enters into the project contracts. What SDCWA attempts to cast as "public benefits" is in reality consideration paid by one contracting party to another.

MWD's payments to contracting parties under the LRP, CCP, and SDP contracts are not generalized benefits paid to the general public. They are restricted to member agencies and certain third parties involved in conservation, desalination, and local resource development projects. MWD enters into these project contracts at its discretion. Member agencies submit project proposals, but they are not automatically entitled to payments under the LRP, CCP, and SDP programs. In consideration of payments made under the contracts, member agencies are required to deliver a tangible item in return—local water conservation and development. Under the LRP and SDP contracts, MWD pays up to $250 for each acre-foot of water produced, and, under the CCP contracts, MWD pays a specific amount for each acre-foot of water estimated to be conserved. Thus, the consideration paid under the project contracts by MWD to its member agencies is inapposite to the "public benefits" conferred through a "general public benefit program" that are at issue in California's unconstitutional conditions cases, rendering the doctrine inapplicable here.

c. SDCWA Waived Its Claimed Right to Petition by Executing the Project Contracts, and Consented by Accepting Payments Thereunder

Even assuming *arguendo* that SDCWA could assert an unconstitutional conditions claim here, SDCWA waived its claimed right to petition regarding MWD's existing rate structure by executing six separate RSI-containing project contracts with MWD, and further consented to the RSI provision by accepting payments under those contracts.[30] *See Miller v. Elite Ins. Co.*, 100

[30]*See* MWD's Motion for Summary Adjudication, at 11-13.

Cal. App. 3d 739, 753-54, (1980); *Saret-Cook v. Gilbert, Kelly, Crowley & Jennett*, 74 Cal. App. 4th 1211, 1226 (1999) ("[V]oluntary acceptance of the benefit of a transaction is equivalent to a consent of all the obligations arising from it."). Purported constitutional rights, including the right to petition, may be waived upon clear and convincing evidence that the waiver was knowing, voluntary, and intentional. *D. H. Overmyer Co. v. Frick Co*., 405 U.S. 174 (1972); *Miller*, 100 Cal. App. 3d at 753-54 ("Waiver is the voluntary and intentional relinquishment of a known right.").[31]

SDCWA waived its claimed right to petition here. SDCWA was fully aware of the RSI provision and its implications at the time it executed the project contracts. SDCWA was represented by competent counsel in considering the RSI proposal and later entering into the contracts. Indeed, in 2004, before MWD's Board voted to include an RSI provision in future project contracts, SDCWA led a campaign to defeat the proposal, objecting extensively and in great detail. During these negotiations, SDCWA even considered whether executing the contracts might constitute a waiver of its rights. Nonetheless, after approximately three years of standing by its objections and refusing to enter into any project contracts that contained the RSI provision, SDCWA reconsidered its position, and in 2007, decided to apply for project contract funding from MWD.

Over the next two years, SDCWA entered into six separate project contracts with MWD, all of which contain the RSI provision. In executing these contracts, SDCWA conceded that MWD's existing rate structure was "properly adopted in accordance with [MWD's] rules and regulations." SDCWA further acknowledged that MWD's existing rate structure "provides the revenues necessary to support the development of new water supplies by local agencies" under MWD's LRP, CCP, and SDP programs. Each contract was executed by SDCWA managers and counsel. SDCWA's objections to the RSI provision do "not make [its] execution of the

[31] *See also Navellier v. Sletten*, 29 Cal. 4th 82, 97 (2002) ("Many preexisting legal relationships may properly limit a party's right to petition, including enforceable contracts in which parties waive rights to otherwise legitimate petitioning."); *Sanchez v. Cnty. of San Bernardino*, 176 Cal. App. 4th 516, 528 (2009) ("It is possible to waive even First Amendment free speech rights by contract."); *Leonard v. Clark*, 12 F.3d 885, 889 (9th Cir. 1993) (same).

agreement any less voluntary." *Leonard v. Clark*, 12 F.3d 885, 890 (9th Cir. 1993). SDCWA thus knowingly and voluntarily waived any right to petition it claims to have had by executing the project contracts with MWD, and consented by accepting payments thereunder. *See id.*; *Saret-Cook*, 74 Cal. App. 4th at 1226; *see also Sanchez*, 176 Cal. App. 4th at 528 (enforcing waiver of First Amendment rights by contract); *Lockyer v. R.J. Reynolds Tobacco Co.*, 107 Cal. App. 4th 516, 533 (2003) (enforcing provision in settlement agreement that waived all state and federal constitutional challenges).

2. The Evidence Demonstrates the Validity of the RSI Provision Under California's Unconstitutional Conditions Doctrine

Even if the Court were to apply the unconstitutional conditions doctrine, the evidence will demonstrate the validity of the RSI provision under the *Robbins* standard, which is set forth above.

Not all restrictions on a constitutional right rise to the level of an "unconstitutional condition." *See, e.g.*, *Lee*, 129 Cal. App. 3d at 13-14; *Norton v. City of Santa Ana*, 15 Cal. App. 3d 419, 426-27 (1971). Indeed, courts have consistently recognized that the "government may, when circumstances inexorably so require, impose conditions upon the enjoyment of publicly conferred benefits despite a resulting qualification of constitutional rights." *Lee*, 129 Cal. App. 3d at 13-14; *Norton*, 15 Cal. App. 3d at 426-27. In particular, restrictions on the exercise of constitutional rights in the context of a commercial transaction, where the relinquishment of rights constitutes consideration under the associated contract, are fundamentally different from restrictions in other contexts. As the evidence will demonstrate, the elements of California's unconstitutional conditions test are satisfied here.

a. The RSI Provision's Restriction on Receipt of LRP, CCP, and SDP Funding Relates Directly to the Purpose of the Programs that Offer that Funding

As stated, the RSI provision was implemented to ensure funding for long-term project contracts by protecting the stability of MWD's existing rate structure, which provides the funds necessary to pay for the LRP, CCP, and SDP contracts. To that end, the provision encourages member agencies who wish to avail themselves of LRP, CCP, and SDP funds to resolve disputes

over MWD's rates through the Board process rather than through piecemeal litigation or legislative challenges.

The RSI provision applies to all member agencies that seek funding from MWD and enter into project contracts. MWD has undertaken and expects to undertake future commitments to pay hundreds of millions of dollars under the project contracts, many of which have 25-year terms. Those project contracts and MWD's ability to fund them are necessary to reach MWD's long-term water supply reliability targets set forth in its IRP and to satisfy statutory mandates to promote water conservation. MWD funds the project contracts through its existing rate structure. The requirement that member agencies may forgo project contract payments if they challenge MWD's existing rate structure is aimed at preserving the integrity of the very mechanism by which the funds for such projects are collected.

By encouraging resolution of disputes regarding the existing rate structure through the MWD Board process, the RSI provision protects the stability of MWD's existing rate structure by ensuring that rate decisions are made in consideration of the larger picture, taking into account MWD's overall costs and revenue streams. Without a stable rate structure to provide funding for the LRP, CCP, and SDP programs, these programs could cease to exist in the manner calculated to reach MWD's IRP targets, which in turn would adversely affect MWD's plan for long-term water supply reliability. The following is illustrative. If, for example, MWD was required to eliminate its Water Stewardship Rate, MWD would have to make fundamental changes in its overall rate structure, which would be destabilizing. In particular, absent changes in MWD's budgeted costs, MWD would have to increase its other rates to cover the cost of existing LRP, CCP, and SDP programs and contractual commitments. This kind of unplanned for rate increase would interfere with MWD and its member agencies' ability to properly plan and budget for the future. So, faced with the choice between disruptive rate increases and lowering overall costs to avoid such increases, MWD's Board would have to consider decreasing or discontinuing its investment in local conservation and resource development projects.

Thus, the RSI provision, which protects the stability of MWD's rates, bears more than a reasonable relationship to the purpose of the LRP, CCP, and SDP programs—it is directed to

protect the very existence of those programs.

b. The Compelling Public Benefits Protected by the RSI Provision Manifestly Outweigh the Limited Restriction on SDCWA's Claimed Right to Petition

The benefits that accrue to the general public as a result of the RSI provision, which protects the ongoing administration of the LRP, CCP, and SDP programs, cannot be overstated: these programs allow MWD, in cooperation with its member agencies, to ensure a safe and reliable water supply for the almost 19 million people who live and work in Southern California. As SDCWA has said, water is "a literal essential of life."[32] In an effort to ensure the continued availability of this precious resource, since 1991, these programs have produced almost 4 million acre-feet of water. This undeniable public benefit, which requires a stable funding source, manifestly outweighs the limited condition placed on SDCWA's claimed right to petition.

MWD's Board made a policy decision to undertake local conservation and resource development efforts in consideration of the regional benefits attained by these programs. Water conserved or developed at the local level benefits MWD, its member agencies, and the general public throughout MWD's service region in several ways:

- Every acre-foot of water developed by a member agency decreases that member agency's reliance on imported water from MWD.
- Reducing the amount of water that must be imported by MWD and conveyed through its system reduces the demand and burden on MWD's conveyance system.
- Reducing the amount of water that must be conveyed through MWD's system decreases and avoids operating, maintenance, capital and improvement costs.
- Reliance by member agencies on locally developed water frees up space in MWD's system to convey both MWD water and water from non-MWD sources, allowing for transactions such as the 2003 Exchange Agreement.

[32]SDCWA's Memorandum of Points and Authorities in Support of Plaintiff SDCWA's Motion for Summary Adjudication (Fifth Cause of Action), at 1:16-19.

- Developing and conserving local water resources increases the amount of water available throughout MWD's region, so water that would have otherwise been purchased by a member agency is made available to other member agencies who may be facing increased demands.
- Reducing Southern California's need for future increases of imported water reduces MWD's future supply and transportation costs.
- With more water available from diverse sources, water supply reliability is improved throughout the region.
- Absent these programs, MWD would be required to develop and pay for alternative water supply sources to avoid water shortages, and pay for additional capital development and operation costs in connection with importing that alternative water supply.

In 1996, MWD's economic analysis showed that, among other things, by developing a preferred mix of groundwater storage and local resource programs, MWD could expect to save approximately $2.27 billion over 25 years. To that end, since 1991, these programs have produced almost 4 million acre-feet of water for the residents of Southern California—a palpable and significant regional benefit.

As stated, SDCWA is well aware of the regional benefits of the LRP, CCP, and SDP programs. SDCWA admitted that there are "regional benefit[s] from new recycling projects, groundwater recovery projects and water use efficiency gains developed under MWD's and the Water Authority's longstanding local resource and conservation programs." SDCWA also admits that the project contracts provided by MWD are aimed at "avoiding the following costs:

- Acquisition of new imported supplies such as transfers and exchanges;
- State Water Project (SWP) energy consumption for pumping imported supplies;
- Treating imported supplies; and
- MWD distribution system expansions."

The condition imposed by the RSI provision is minor in comparison to the public benefits that flow from MWD's LRP, CCP, and SDP programs. Although SDCWA attempts to

characterize the RSI provision as extinguishing its claimed right to petition, such is not the case. The RSI provision does not prevent a member agency from challenging MWD's rates in court, as this action shows. Rather, it simply prevents a member agency from challenging the source of the project funding judicially or legislatively, while simultaneously receiving that funding. *See Graham v. Kirkwood Meadows Publ. Utils. Dist.*, 21 Cal. App. 4th 1631, 1643-44 (1994) (holding that "[t]he question is not whether a man is free to live where he wishes, it is whether a man is free to live where he wishes and at the same time insist upon employment by the government.") To that end, the RSI provision provides that a member agency that decides to challenge MWD's existing rate structure in the courts or legislature may forgo continued funding under the project contract. The RSI provision thus seeks to discourage member agencies that enter into LRP, CCP, and SDP project contracts from engaging in judicial and legislative challenges that threaten to disrupt the continued administration of the programs that fund those projects, and instead seeks to encourage any challenge to be pursued through the MWD Board process, where all relevant policy decisions can be weighed and considered by the collective stakeholders.

This is precisely the kind of condition California courts have found permissible. *See Lee*, 129 Cal. App. 3d at 13-14. *Lee* is instructive. There, a civil service worker employed by the county department of public social services decided to run for state senate and was fired as a result. *Id*. at 10-11. The county fired Lee because, under the Hatch Act (5 U.S.C. § 1501 *et seq*.), his participation in the election threatened the department's continued federal funding. *Id*. Specifically, the Hatch Act provides that a local agency may be faced with a withdrawal of federal funds unless it discharges an employee found to be in violation of the Act. *Id*. Because Lee's participation in the election threatened the department's funding, the benefit of the condition was found to manifestly outweigh the restriction imposed on Lee's right to run for office. *Id*. at 13-14. As the court explained, California courts have "recognized the right of governmental agencies to preserve their harmonious operation by restricting such political activities as directly threaten administrative disruption or loss of integrity." *Id*.

The benefits of the LRP, CCP, and SDP programs similarly outweigh the limited

restriction on SDCWA's claimed right to petition. A piecemeal attack on individual rate components that fails to consider all of the factors MWD's Board must consider in allocating costs and setting rates threatens to destabilize MWD's entire rate structure. This in turn threatens the continued administration of the LRP, CCP, and SDP programs because without a stable rate structure, MWD cannot ensure the continued availability of funds necessary to administer these programs and honor its contractual commitments under the programs. By encouraging member agencies to address any objections to MWD's existing rate structure through the Board process, the RSI provision seeks to protect the stability of that rate structure by ensuring that rate decisions are made in consideration of the larger picture, taking into account MWD's overall costs and revenue streams. As such, the value accruing to the member agencies and the general public from inclusion of the RSI provision outweighs any resulting impairment of SDCWA's claimed right to challenge MWD's existing rate structure judicially without consequence. *See Lee*, 129 Cal. App. 3d at 14; *see also Norton v. City of Santa Ana*, 15 Cal. App. 3d 419 (1971) (upholding condition that sought to prevent "a direct challenge to the structure of the department" and its continued efficiency).

c. The RSI Provision Is Narrowly Tailored to Maintain the Integrity of MWD's LRP, CCP, and SDP Programs

After considering multiple alternatives, some of which were proposed by member agencies, including SDCWA, MWD's Board adopted an RSI provision that is both narrow in scope and necessary to protect the public benefits of its LRP, CCP, and SDP programs. First, the RSI provision, unlike a statute of general application, is a contract term that applies only to those member agencies and third parties that enter into project contracts voluntarily with MWD. MWD could have instead amended its Administrative Code to limit rate challenges, but chose to adopt a more narrow restriction tied directly to the project contracts that provide LRP, CCP, and SDP funding. Second, as noted above, the provision does not preclude a contracting member agency from exercising a claimed right to petition. Instead, it simply provides that a member agency cannot continue to accept project contract payments while challenging MWD's existing rate structure—the very source of those payments—outside the Board process. Third, the

provision is limited to challenges to MWD's existing rate structure; member agencies remain free, without consequence, to bring legal and/or legislative challenges to other acts by MWD, including any "material changes" to the existing rate structure and/or procedural deficiencies in the adoption of MWD's rates.

Norton is instructive. There, a city police lieutenant was dismissed after filing various defamation lawsuits against his captain. 15 Cal. App. 3d at 427. In upholding this restriction on the lieutenant's right to petition the courts, the court noted that "[t]he departmental rules do not impose an absolute prohibition against resort to the courts. . . . It was not that petitioner filed an action; rather, it was that he filed the specific actions" that threatened the structure and efficiency of the department. *Id.* The lieutenant's dismissal was therefore justified under the circumstances. *Id.* The RSI provision is similarly narrow in that it does not apply to *all* legal and/or legislative challenges; it applies only to those challenges that threaten the stability of MWD's rate structure, the continued administration of the LRP, CCP, and SDP programs, and MWD's and its member agencies' ability to plan and budget for the future.

The RSI provision is also appropriately tailored to fit the circumstances in which it was adopted and implemented. As opposed to typical unconstitutional conditions cases involving statutes of general application, the alleged "imposition" on a constitutional right in this case is incorporated into a contract. This is significant. Unlike a statute of general applicability that, by definition, imposes conditions upon everyone, contractual provisions incorporate the consideration received by both parties in exchange for the burdens imposed. Here, as in many commercial agreements, SDCWA agreed to accept some limitations on its right to litigate, in exchange for a financial benefit. An agreement with a general release of claims, which is of course both common and lawful, is far more of a limitation on a party's ability to sue, since that ability is completely extinguished. Removing a contractual burden without removing a corresponding contractual benefit is clearly inappropriate. In addition, any imposition on a claimed right to petition here is limited to the terms and conditions of individual contracts, which may be terminated by either party for other reasons or amended when circumstances change.

SDCWA's claim that the RSI provision is fatally overbroad because it seeks to protect

not just the Water Stewardship Rate, but all rates, is without merit. First, even under SDCWA's argument, the RSI provision is not overbroad as applied here because SDCWA's has challenged the Water Stewardship Rate in this action. Second, although the Water Stewardship Rate is set to recover LRP, CCP, and SDP project contract costs, that rate is integrated with and interdependent on the various other rate components. And while it is true that a successful legal challenge to MWD's rate structure would not preclude MWD's Board from resetting its rates to cover its current overall costs, the story does not end there. Indeed, such a result would create the destabilizing effect on MWD and its member agencies that the RSI provision was intended to prevent. Especially given that MWD's current rate structure, in place since 2003, took years to develop.

If MWD, for example, were required to eliminate its Water Stewardship Rate, absent changes in MWD's budgeted costs, MWD would have to increase its other rates to cover the cost of existing LRP, CCP, and SDP programs. This threat to the stability of MWD's existing rate structure undermines the ability of both MWD and its member agencies to properly plan and budget for the future. To avoid future disruptive rate increases, MWD's Board would be faced with the possibility of having to decrease or discontinue funding for local conservation and resource development projects, despite long-term contractual commitments of up to 25 years. Thus, an attack on any one of MWD's rate components amounts to an attack on the stability of the entire rate structure, which in turn threatens the continued administration of the LRP, CCP, and SDP programs. The RSI provision is therefore narrowly tailored to meet the goal of protecting LRP, CCP, and SDP program funding.

D. SDCWA Will Be Unable to Prove Its Section 1668 Claim

As more fully briefed in conjunction with MWD's Motion for Summary Adjudication, SDCWA's claim that the RSI provision violates California Civil Code section 1668 is entirely without merit. Section 1668 "invalidates contracts that purport to *exempt* an individual or entity from liability" for certain tortious or unlawful acts. *Frittelli, Inc. v. 350 N. Canon Drive, LP*, 202 Cal. App. 4th 35, 43 (2011) (emphasis added). Accordingly, courts have routinely voided express contractual provisions discharging a party from liability. *See City of Santa Barbara v.*

Super. Ct., 41 Cal. 4th 747, 757-58 (2007) (collecting cases). In *City of Santa Barbara*, for example, the California Supreme Court invalidated a contract term that purported to release the City "from all liability" for "any loss, damage, or claim[.]" *Id.* at 751 n.3; *see also Tunkl v. Regents of Univ. of Cal.*, 60 Cal. 2d 92, 94, 97 (1963) (invalidating provision that required patients to "release[] . . . the hospital from any and all liability").

In contrast, section 1668 has been held inapplicable where the challenged provision does not "totally exempt" a party from liability. *See, e.g., Beynon v. Garden Grove Med. Grp.*, 100 Cal. App. 3d 698, 710 (1980); *Lagatree v. Luce, Forward, Hamilton & Scripps LLP*, 74 Cal. App. 4th 1105 (1999). In *Beynon*, for example, the court refused to apply section 1668 to an arbitration provision that allowed the hospital to reject an arbitrator's decision without cause and to require resubmission of the controversy to a second arbitration panel of physicians. 100 Cal. App. 3d at 710. The court reasoned that even though the provision was "heavily weighted in favor of the health care provider," it did not "totally exempt" the hospital from liability. *Id.*

Unlike the facially exculpatory provisions held invalid by courts under section 1668, the RSI provision does not purport to "exempt," "exculpate," or otherwise release MWD from *any* liability for unlawful rates or any other violation of law. It does not prevent SDCWA from bringing a rate challenge, as SDCWA has done here. It does not discharge MWD's responsibility for allegedly illegal rates. And it does not restrict the claims or remedies available to SDCWA or others. While the RSI provision provides that SDCWA may forgo continued payments under a project contract if it chooses to judicially or legislatively challenge MWD's existing rate structure, the RSI provision neither exempts MWD from liability nor prevents SDCWA from filing a lawsuit. Section 1668 is simply inapplicable here.

V. STANDARD OF REVIEW, BURDEN OF PROOF, AND ADMISSIBLE EVIDENCE FOR THE PREFERENTIAL RIGHTS CLAIM (SIXTH CAUSE OF ACTION IN *2010 ACTION*)

SDCWA's sixth cause of action regarding MWD's preferential rights calculation under section 135 of the MWD Act is an attempt to re-litigate issues SDCWA already lost in *SDCWA v. MWD*,117 Cal. App. 4th 13 (2004). SDCWA asserts a claim for declaratory relief

regarding MWD's "preferential rights" calculations under section 135 of the MWD Act. (TAC ¶¶ 112-115.) SDCWA alleges that MWD has improperly calculated its preferential right because MWD does not include SDCWA's payment of volumetric water rates for the purchase of water—which is expressly excluded from the preferential rights calculation by section 135—under the 2003 Exchange Agreement. According to SDCWA, these payments do not constitute payments for the "purchase of water" and should therefore be included in calculating its preferential right. SDCWA seeks a judicial declaration that MWD's current method for calculating SDCWA's preferential right violates section 135, and an order directing MWD to include in the calculation SDCWA's payments under the 2003 Exchange Agreement. (TAC, Prayer for Relief at ¶ 6.)

A. Standard of Review and Burden of Proof

SDCWA's sixth cause of action asserts a civil claim for declaratory relief. SDCWA's claim turns on an interpretation of section 135 of the MWD Act. As MWD is the agency tasked with implementing section 135, SDCWA's claim requires this Court to review MWD's administrative construction of section 135. MWD's construction of section 135 must be accorded deference—"great weight" and "respect." As held by the Court of Appeal in *SDCWA v. MWD*: "Here, we are called upon to review the language of section 135. . . . '[T]he judiciary, although taking ultimate responsibility for the construction of the statute, accords *great weight* and *respect* to the administrative construction.'" 117 Cal. App. 4th at 22-23 (emphasis added); *see also Kern County Water Agency*, 185 Cal. App. 4th at 982 (courts "give deference to an agency's interpretation" of a statute "by its implementing agency"); *San Bernardino Valley Audubon Soc'y*, 44 Cal. App. 4th at 603 ("We give great deference to an agency's interpretation of its governing statutes."); *City of Long Beach*, 34 Cal. 4th at 956 ("In construing an ambiguous statute, courts generally defer to the views of an agency charged with administering the statute."). As the Court recognized in SDCWA's earlier unsuccessful preferential rights challenge, judicial deference is particularly appropriate to MWD's interpretation and implementation of its preferential rights statute; in that case the Court "hesitate[d] to pronounce the preferential rights formula in section 135 inequitable" because "water policy in this state has

proven to be an exquisitely political endeavor." *SDCWA*, 117 Cal. App. 4th at 28, n.8.

As set forth in MWD's Motion for Summary Adjudication, the facts relevant to SDCWA's preferential rights claim are not in dispute. Thus, the question to be decided is a legal one: whether payments made by SDCWA under the Exchange Agreement qualify as payments for the "purchase of water" under section 135. If, however, the Court determines that summary adjudication of SDCWA's preferential rights claim is precluded by a factual dispute, at trial SDCWA bears the burden of proving a violation of section 135 by a preponderance of the evidence. Cal. Evid. Code §§ 115 & 500.

B. Evidence the Court Is Required to Evaluate

The Court may consider all relevant evidence admissible under the rules of evidence that pertains to MWD's calculation of preferential rights under section 135. This includes both documentary evidence and testimony from MWD fact witnesses, including but not necessarily limited to MWD's current Manager of the Budget and Financial Planning Section, who MWD expects will testify regarding MWD's method of calculating preferential rights under section 135 and related matters. MWD may also present testimony by SDCWA's Assistant General Manager, Dennis Cushman, who SDCWA designated as its "person most knowledgeable" on the subject. MWD expects that the evidence at trial will establish the facts regarding MWD's calculation of preferential rights set forth above in Section II.C.

1. MWD's Method of Calculating Preferential Rights Is Valid, and SDCWA Is Collaterally Estopped from Arguing Otherwise

a. *SDCWA v. MWD* Held that All Water Rate Payments Toward Capital Costs and Operating Expenses Constitute the "Purchase of Water" Under Section 135

As in this case, in *SDCWA v. MWD*, SDCWA sought declaratory relief turning on an "[i]nterpretation of Section 135" based on MWD's then bundled rates. 117 Cal. App. 4th at 18. In that action, SDCWA argued that the calculation of preferential rights must include "that portion of the water rates being used by Metropolitan for capital expenditures and operating expenses, excepting only that portion spent for the direct purchase of water." *SDCWA*, 117 Cal. App. 4th at 20. SDCWA's statement of the issue in that case covers its claim here: "Does § 135

exclude all water rate revenue from preferential rights credit?" The court said yes. This Court entered judgment for MWD, *SDCWA v. MWD* affirmed, and the Supreme Court denied review. *SDCWA*, 117 Cal. App. 4th at 13; *SDCWA v. MWD*, No. S124550, 2004 Cal. LEXIS 6433 (Cal. July 14, 2004).

After an extensive interpretive analysis of section 135, including review of section 135's text, purpose, statutory context, and Legislative history[33] and intent, the Court of Appeal interpreted section 135 to mean that all components of MWD's "charge for the 'purchase of water' to its members may include amounts allocated for capital costs and operating expenses." *SDCWA v. MWD*, 117 Cal. App. 4th at 26. The court held that "the statute excludes from the preference formula any amount of capital costs and operating expenses which might be included as part of the 'purchase of water.'" *Id.* The court specifically "reject[ed] San Diego's interpretation of the phrase 'purchase of water' as being intended to mean only 'the cost of the water resource,' and not the 'bundled' charge for water inclusive of capital costs and operating expenses." *Id.* at 17, 26. The court rejected SDCWA's "attempt to draw any meaningful distinction between the Water Code's use of the alternative phrases 'water rates' (which [SDCWA] argues can include capital and operating costs) and the 'purchase of water.'" *Id.* at 26 n.6. The court further held that "the Legislature's inclusion of the language 'excepting purchase of water' supports the evident purpose of *excluding any portion of water rates* used to pay capital costs and operating expenses from the formula for calculating preferential rights." *Id.* at 28 (emphasis added). In short, *SDCWA v. MWD* adopted MWD's interpretation and application of section 135, which is the same interpretation at issue here.

b. SDCWA's "Water Rate" Payments Under the Exchange Agreement Are Properly Excluded in Calculating Its Preferential Right

SDCWA will be unable to establish that MWD's method for calculating preferential rights is invalid. SDCWA admits that it pays MWD's "water rates," specifically three

[33]In 1984, the Legislature overhauled the MWD Act but did not change section 135. In fact, the Legislature affirmatively *rejected* a bill proposed by San Diego's state legislators to *include* water rates in the preferential rights calculation. Senate Bill No. 2192.

components of these rates, to obtain Exchange Water under the Exchange Agreement. As SDCWA pays MWD's "water rates" under the Exchange Agreement for each acre-foot of Exchange Water delivered to SDCWA, those payments are for the "purchase of water" under section 135, and MWD properly excludes them from the preferential rights calculation.

SDCWA contends, however, that its payments for Exchange Water under the 2003 Exchange Agreement should be included in calculating its preferential right because it is not purchasing the "supply" of water from MWD and is paying only the transportation rate MWD charges its member agencies for transportation in its unbundled rate structure. *See* TAC ¶¶ 61-63, 113. But SDCWA's fallacy is its attempt to equate "purchase of water" under section 135 with MWD's "supply" rates. *Id*. (referring to "'purchase of water' (i.e., supply)"). *SDCWA v. MWD* expressly rejected that interpretation. "[P]urchase of water" in section 135 is not limited to payments for the "direct purchase of water"; rather, it includes all portions of "water rates"—regardless of whether the rate is used to pay for "supply" or for MWD's other capital costs and operating expenses. For purposes of section 135 under *SDCWA v. MWD*, whether SDCWA's water rate payments pay for "supply" costs, *i.e.*, the cost of the water resource, or the costs of conveying water, *does not matter*: Any payment by SDCWA of "water rates" constitutes "purchase of water" under section 135. SDCWA's interpretation of section 135 is wrong as a matter of law and has already been rejected by *SDCWA v. MWD*.

There is no material difference between *SDCWA v. MWD* and this action.[34] To the extent SDCWA argues that its claim here involves payments for the "transportation" of Exchange Water under the Exchange Agreement rather than payments for the purchase of MWD water, that is a distinction without a difference for purposes of the preferential rights calculation under section 135. In both instances, SDCWA pays MWD's volumetric water rate components for delivery of water, which as a matter of law constitute payments for the "purchase of water" under section 135. It matters not whether the System Access Rate, System Power Rate, or Water

[34]When *SDCWA v. MWD* was initiated, MWD had a "bundled" rate that included both supply and conveyance costs. Since 2003, MWD has unbundled its rates, meaning that the rates now expressly state which rate components are allocated for conveyance costs and supply costs.

Stewardship Rate are paid for delivery of MWD water or Exchange Water. In both cases, the payments constitute water rate payments to recover MWD's capital and operating costs for delivery of water, which *SDCWA v. MWD* held constitute "purchase of water" under section 135. These payments are thus properly excluded from the calculation of SDCWA's preferential right. As set forth in detail in MWD's Motion for Summary Adjudication, SDCWA is collaterally estopped from relitigating the issue again here.

DATED: October 18, 2013

Bingham McCutchen LLP

By: _____
Thomas S. Hixson
Attorneys for Respondent and Defendant
Metropolitan Water District of Southern California

San Diego County Water Authority v. Metropolitan Water District of Southern California, et al., San Francisco County Superior Court Case Nos. CPF-10-510830 and CPF-12-512466

PROOF OF SERVICE

I am over eighteen years of age, not a party in this action, and employed in San Francisco County, California at Three Embarcadero Center, San Francisco, California 94111-4067. I am readily familiar with the practice of this office for collection and processing of correspondence for mail/fax/hand delivery/next business day Federal Express delivery, and they are deposited that same day in the ordinary course of business.

On October 18, 2013, I served the attached:

RESPONDENT/DEFENDANT METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA'S FIRST PRETRIAL BRIEF

☒ (VIA LEXISNEXIS) by causing a true and correct copy of the document(s) listed above to be sent via electronic transmission through LexisNexis File & Serve to the person(s) at the address(es) set forth below.

as indicated on the following **Service List.**

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct and that this declaration was executed on October 18, 2013, at San Francisco, California.

Kelley A. Garcia

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PROOF OF SERVICE

I am over eighteen years of age, not a party in this action, and employed in San Francisco County, California at Three Embarcadero Center, San Francisco, California 94111-4067. I am readily familiar with the practice of this office for collection and processing of correspondence for mail/fax/hand delivery/next business day Federal Express delivery, and they are deposited that same day in the ordinary course of business.

On October 18, 2013, I served the attached:

RESPONDENT/DEFENDANT METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA'S FIRST PRETRIAL BRIEF

☒ (VIA LEXISNEXIS) by causing a true and correct copy of the document(s) listed above to be sent via electronic transmission through LexisNexis File & Serve to the person(s) at the address(es) set forth below.

as indicated on the following **Service List.**

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct and that this declaration was executed on October 18, 2013, at San Francisco, California.

Kelley A. Garcia

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