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METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

Date: September 6, 2000

To: Board of Directors

From: General Counsel

Subject: Morro Bay Wheeling Case

Some Board members have raised general questions regarding the recent Court of Appeal decision in the Morro Bay wheeling case (San Luis Coastal Unified School District v. City of Morro Bay) and whether the decision may have an effect on Metropolitan's wheeling policy. As discussed below, we believe that the Morro Bay decision should have little impact on Metropolitan's wheeling policy. The decision may, however, have some influence on whether the California Supreme Court agrees to grant the pending petitions to review the Court of Appeal decision in Metropolitan's wheeling case.

The San Luis Coastal Unified School District (school district) is a retail water customer of the City of Morro Bay (city). The school district entered into an agreement to purchase a portion of the County of San Luis Obispo Flood Control and Water Conservation District's State Water Project supply. In order to deliver the water to its schools, the school district requested the use of unused capacity in the city's conveyance system to wheel the water. The city denied access to its system based on a perceived lose in revenue if the school district were allowed to wheel the water, which would require an increase the city's water rates. Since it simply denied the wheeling request, the city did not determine the terms and conditions of a wheeling arrangement, including any "fair compensation" for wheeling.

The school district filed a petition for a writ of mandate to compel the city to wheel the water through its facilities under Water Code sections 1810-1814. Under section 1810, a public conveyance system owner may not deny access of unused capacity to a "bona fide transferor" of water. The city argued that since the school district was a buyer rather than a seller of water, it was a *transferee* rather than a *transferor* of water and therefore was not within the coverage of the statute.[1] The trial court agreed with the city's interpretation, holding that the school district was not a bona fide transferor under the statute. The interpretation of the "fair compensation" provision of the wheeling statute was not an issue in the case.

The Court of Appeal reversed the decision of the trial court. The appellate court held that a contract for a water purchase is also a contract for a water sale, and that there is no practical

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[1] Unlike Morro Bay, Metropolitan's wheeling policy has never attempted to limit wheeling access to bona fide transferors only.

difference whether the buyer or seller makes the arrangements for wheeling the water.[2] According to the court, "'transferor' does not mean 'seller', but an entity that transfers water from one place to another"; since the school district was transferring water from one place to another, it was a bona fide transferor and thus entitled to access to the city's conveyance system. Again, "fair compensation" was not an issue in the appellate proceeding, nor was it discussed by the appellate court.

The central issue in the Morro Bay case—who is entitled to seek wheeling capacity—is fundamentally different from the central issue in Metropolitan's wheeling case—what is "fair compensation" for the use of wheeling capacity.[3] Metropolitan has not argued that it can deny bona fide transferors access to its system, and the Morro Bay case did not consider how the "fair compensation" provision should be construed. Therefore, in our view, the Morro Bay decision does not affect Metropolitan's wheeling policy or how the "fair compensation" provision is defined.

In the Morro Bay case, the city also argued that even if the school district was a bona fide transferor, the city had the right to deny access under Water Code Section 1810(d). That section provides that a wheeling transaction shall not injure any legal user of water. The city argued that allowing the school district to wheel on its system would result in a loss of revenue that would cause harm to its other customers, and that it could deny access to protect against that harm. Citing no authority to support its view, the Court of Appeal ruled that although the loss of a customer and related income could cause financial difficulties, that did not amount to an injury that would authorize the city to deny access to its system. Since the court rejected the city's position on other grounds, its statement regarding the no injury provision was unnecessary to its decision and therefore was dictum. In Metropolitan's wheeling case, the Court of Appeal—in holding that the wheeling statute does not preclude a conveyance system owner from recovering a pro rata share of its system wide costs—stated that "the Legislature did not intend that the impact of the wheeling statutes should be to cause a water conveyance system owner to lose money or to subsidize wheeling transfers." The Imperial Irrigation District and the San Diego County Water Authority have cited this language in support of their argument that the Metropolitan wheeling decision is inconsistent with the Morro Bay opinion.[4]

We do not believe that the Morro Bay and Metropolitan decisions are in conflict and have pointed this out in response to our petitions for review. As noted above, the Metropolitan wheeling case dealt with the "fair compensation" provision and the Morro Bay case dealt with a transferor's access to unused capacity. Indeed, the appellate court in the Metropolitan wheeling case did not even discuss the no injury provision. Nonetheless, the Morro Bay decision, by

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[2] One member of the three justice panel dissented from the opinion, arguing that the Legislature's use of the word bona fide transferor was intentional and that it did not intend the wheeling statute to apply to a transferee or end user of water.

[3] The court also held that a conveyance system owner may have to allow access to unused capacity in storage facilities if the storage facilities are so integrated that they are necessary to *conveyance of the water*. On the other hand, it specifically held that the system owner has no duty to allow the use of storage facilities to *store* water.

[4] Additionally, the city has requested the Supreme Court to review the Morro Bay opinion. While not asserting that its case and Metropolitan's case are in conflict, it does suggest that the Supreme Court may wish to accept both cases to resolve all of the wheeling issues currently before the courts.

heightening awareness of the wheeling statutes, could influence the Supreme Court's decision whether to review the Metropolitan wheeling decision. In any event, for the reasons set forth above, we do not believe that the decisions are inconsistent.

If any Board members have any specific questions regarding the Morro Bay case that they would like to direct to my attention, I will try to answer such questions. Thank you.

Roderick E. Walston