



San Diego County Water Authority

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

November 7, 2015

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

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- Camp Pendleton Marine Corps Base
- Rainbow Municipal Water District
- Ramona Municipal Water District
- Rincon del Diablo Municipal Water District
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- Santa Fe Irrigation District
- South Bay Irrigation District
- Vallecitos Water District
- Valley Center Municipal Water District
- Vista Irrigation District
- Yuima Municipal Water District

OTHER REPRESENTATIVE

- County of San Diego

RE: Board Memo 8-6: Authorize entering storage and exchange agreements with Antelope Valley-East Kern Water Agency; and approve payment of up to \$16.6 million for funding the agreements – **Request to Postpone Action; Request for Additional Information; in the alternative, OPPOSE**

Chair Record and Members of the Board:

We have reviewed Board Memo 8-6, proposing storage and "uneven exchange" agreements with Antelope Valley-East Kern Water Agency (AVEK). The net effect of the uneven exchange is that MWD may purchase 30,000 acre feet (AF) of water over a period of ten years, with an obligation to "return" half of the water to AVEK upon the call of AVEK, while the storage component may provide MWD with 30,000 AF of storage capacity. It is not possible from the information provided in the Board Memo to understand the extent to which these agreements will actually provide reliability benefits; why the unusual form of transaction is superior to other alternatives; or, the cost of the respective water supply and storage rights being acquired. Here are our specific comments and questions:

Water Supply Reliability. The Board Memo claims that the proposed "uneven exchange" will improve water supply reliability for the region. However, the Board Memo does not provide any data or analysis to demonstrate that this will occur; or, that the "uneven exchange" transaction provides more reliability than a purchase of water. The provisions allowing AVEK to decide when to make water available and when to call it back are significant limitations that could require MWD to return the water to AVEK when MWD most needs it. Staff should provide an analysis how these agreements provide more reliability than the acquisition of water and use of existing MWD storage.

Storage Needs Assessment. According to MWD's most recent Water Surplus and Drought Management report, MWD currently has more than 6 million AF of storage capacity, of which more than 1.8 million AF is located in the State Water Project system. Please explain why additional storage capacity is needed.

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"Uneven Exchange." Half of the water "exchanged" to MWD (it is unclear exactly what meaning is associated with this terminology in this context) must be returned to AVEK within 10 years. AVEK has the right to "call" the water at any time in order to meet its own consumptive needs. Although the Board Memo states that, "the exchange is initiated by mutual agreement," that is not an accurate characterization because the same sentence goes on to say, "AVEK would have discretion on how much of its SWP Table A supplies would be available in a given year." A more accurate description of the draft terms is that AVEK has the right to decide how much water is available in any given year and also to call the water if it needs it. In the event MWD exercises its "discretion" to return the water when AVEK does not need it, MWD will incur at least \$300/AF for the returned water, which means not only does MWD return the water; it must also pay AVEK for the water it is returning. There is no explanation in the Board Memo why MWD wouldn't simply buy AVEK's excess Table A entitlement water. This would appear to be both more cost-effective and give MWD more operational flexibility and supply reliability.

Pricing. In addition to the factors noted above, the pricing schedule listed on the term sheet for the "uneven exchange" is 50 percent higher than the pricing schedule under DWR's Multi-Year Water Pool Demonstration Program. What is the rationale for staff's recommendation given the availability of water at a lower cost? Since the actual price MWD pays for water under the proposed agreement varies depending on SWP allocation, staff should model the likelihood of various SWP allocations over the life of the agreement and provide that information as part of its analysis of the comparative benefits of these agreements.

Fiscal Impact. This is yet another unbudgeted expenditure. In addition, staff is asking for another blank check if program costs exceed the estimated costs (see Option #1c, "approve additional payments from the Supply Program Budget should the exchange or storage programs exceed the initial allocated 30,000 AF"). Staff should not be given a blank check; if more funds are needed then staff should come back to the Board for approval.

The proposed "uneven exchange" appears to make sense for AVEK; however, it is not apparent that the same is true for MWD and its ratepayers. Although we understand the desire for MWD to secure additional imported supplies, its actions must be intelligible and financially responsible. We request that the questions contained in this letter be addressed before the Board takes an action; otherwise, we must OPPOSE the action based on the incomplete information and analysis provided by staff.

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
Director



Fern Steiner
Director



Yen C. Tu
Director



San Diego County Water Authority

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November 6, 2015

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

MEMBER AGENCIES

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- Yuima Municipal Water District

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

Chair Record and Members of the Board:

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

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

Sincerely,

Michael T. Hogan
Director

Keith Lewinger
Director

Fern Steiner
Director

Yen C. Tu
Director

OTHER REPRESENTATIVE

County of San Diego

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Attachment:

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



San Diego County Water Authority

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September 20, 2015

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

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OTHER REPRESENTATIVE

County of San Diego

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

Chair Record and Members of the Board:

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

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

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Chair Record and Members of the Board

September 20, 2015

Page 2

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

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

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

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
Director



Fern Steiner
Director



Yen C. Tu
Director

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

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



San Diego County Water Authority

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July 9, 2015

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

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

Chair Record and Members of the Board:

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

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

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

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Chair Record and Members of the Board

July 9, 2015

Page 2

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

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

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

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

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

Chair Record and Members of the Board

July 9, 2015

Page 3

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

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

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
Director



Fern Steiner
Director



Yen C. Tu
Director

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

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

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

October 10, 2015

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OTHER
 REPRESENTATIVE

County of San Diego

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

Chair Record and Members of the Board:

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

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

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

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

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

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

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

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
Director



Fern Steiner
Director



Yen C. Tu
Director

Attachment:

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

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

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

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



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September 20, 2015

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OTHER REPRESENTATIVE

County of San Diego

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

Chair Record and Members of the Board:

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

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

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Chair Record and Members of the Board

September 20, 2015

Page 2

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

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

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

Sincerely,



Michael T. Hogan
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Attachment: Water Authority's July 9, 2015 letter to MWD Board

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



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July 9, 2015

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

Chair Record and Members of the Board:

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

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

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

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City of Escondido

City of National City

City of Oceanside

City of Poway

City of San Diego

Fallbrook
Public Utility District

Helix Water District

Lakeside Water District

Olivenhain
Municipal Water District

Otay Water District

Padre Dam
Municipal Water District

Camp Pendleton
Marine Corps Base

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San Dieguito Water District

Santa Fe Irrigation District

South Bay Irrigation District

Vallecitos Water District

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OTHER REPRESENTATIVE

County of San Diego

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Chair Record and Members of the Board

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

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

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

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

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

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

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

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
Director



Fern Steiner
Director



Yen C. Tu
Director

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

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

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



San Diego County Water Authority

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

October 12, 2015

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

MEMBER AGENCIES

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OTHER
REPRESENTATIVE

County of San Diego

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

Dear Chair Record and Members of the Board:

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

I. General Comments

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

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

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

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

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

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

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

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

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

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

IV. Comments on Draft Appendix A

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Chair Record and Members of the Board

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

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

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
Director



Fern Steiner
Director



Yen C. Tu
Director

Attachment:

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

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



FILED
San Francisco County Superior Court

APR 24 2014

CLERK OF THE COURT

BY: [Signature]
Deputy Clerk

SUPERIOR COURT OF CALIFORNIA

COUNTY OF SAN FRANCISCO

SAN DIEGO COUNTY WATER
AUTHORITY,

Plaintiff/Petitioner,

vs.

METROPOLITAN WATER DIST. OF
SOUTHERN CALIFORNIA, et al.

Defendants/Respondents.

Case No. CPF-10-510830

Case No. CPF-12-512466

STATEMENT OF DECISION ON RATE
SETTING CHALLENGES

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

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

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

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

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

Procedural History

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

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

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

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

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

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

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

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

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

This statement of decision follows.

Factual Background

1. The Parties

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

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

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

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

2. Water Networks

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

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

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

² DTX-090 at AR2012-000001 (capitalization omitted).

³ PTX-237A** (Resps. to RFA Nos. 44-47).

⁴ DTX-109* at AR2012-016583.

3. Met's Contract with DWR

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

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

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

⁵ DTX-090 at AR2012-000001 (capitalization omitted).

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

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

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

⁹ DTX-055 at AR2012-000153 (Art. 55(a)).

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

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

4. Met’s Rates and Charges

a. Rate-Setting

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

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

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

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

¹¹ DTX-045 at AR2012-006471, 006496.

¹² DTX-132* at AR2012-006462_01; DTX-034 at AR2012-005545-46.

¹³ DTX-090 at AR2010-011443; DTX-110* at AR2012-016594.

¹⁴ DTX-090 at AR2010-0011443; DTX-110* at AR2012-016594.

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

¹⁶ *Id.*

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

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

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

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

¹⁸ DTX-090 at AR2010-011474-011475; DTX-110* at AR2012-016681-016682.

¹⁹ DTX-090 at AR2010-011472, 011483-011489; DTX-110* at AR2012-016679, 016688-016694.

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

²¹ DTX-090 at AR2010-011483, 011488; DTX-110* at AR2012-016688, 016693.

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

In Step 4 of the COS process, Met breaks its operation functions down into corresponding rate design elements, which, in Met's rate structure are volumetric rates (*i.e.*, rates charged per acre-foot²³ of water Met delivers to the member agencies), and fixed charges (*i.e.*, charges which do not vary with sales in the current year).²⁴ Among the unbundled volumetric rates in Met's rate structure are the Supply Rates (Tiers 1 and 2) and the Transportation Rates.²⁵ Met's fixed charges included a Readiness-to-Serve Charge and a Capacity Charge.²⁶

b. Water Rate Versus Wheeling Rate

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

i. Supply Rates

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

²² *Id.*

²³ An acre-foot of water covers one acre one foot deep.

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

²⁵ DTX-090 at AR2010-011490-011500; DTX-110* at AR2012-016695-016700.

²⁶ *Id.*

²⁷ DTX-090 at AR2010-011474-011475, 011499-011500; DTX-110* at AR2012-016681, 016700.

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

ii. System Access Rate

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

²⁸ *Id.*

²⁹ DTX-045 at AR2012-006535-006536; DTX-090 at AR2010-011499; DTX-110* at AR2012-016700.

³⁰ *Id.*

³¹ DTX-045 at AR2012-006518; DTX-090 at AR2010-011492; DTX-110* at AR2012-016697.

³² DTX-045 at AR2012-006518.

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

iii. System Power Rate

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

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

iv. Water Stewardship Rate

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

c. Readiness-to-Serve Charge

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

³⁴ DTX-045 at AR2012-006520; DTX-090 at AR2010-011492; DTX-110* at AR2012-016697.

³⁵ DTX-090 at AR2010-011488, 011490; DTX-110* at AR2012-016693, 016695.

³⁶ DTX-045 at AR2012-006519; DTX-090 at AR2010-011492; DTX-110* at AR2012-016697.

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

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

d. Capacity Charge

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

e. Treatment Surcharge

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

5. Demand Management Programs

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

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

³⁸ DTX-090 at AR2010-011495; DTX-110* at AR2012-016699.

³⁹ DTX-090 at AR2010-011492-011493; DTX-110* at AR2012-016697-016698.

⁴⁰ DTX-090 at AR2010-011492; DTX-110* at AR2012-016697.

⁴¹ DTX-045 at AR2012-006520.

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

region's overall dependence on imported water supplies"); 12/20/2013 Tr.** at 588:24-589:1⁴³ ("That's ultimately what [Met is] paying for is for a reduction in demand for imported water from [Met's] system." (Upadhyay testimony)); DTX-027 at AR2012-002870 (the first key goal of Met's Local Resources Program is to "avoid or defer Met capital expenditures"); 12/20/2013 Tr.** at 578:22-580:11 (Upadhyay testimony stating that Met adopted the Local Resources Program principles and they remain in effect today); DTX-518** at MWD2010-00466049 (Board identifying regional benefits associated with the Local Resources Program, including reduction in capital investments due to deferral and downsizing of regional infrastructure and reduction in operating costs for distribution of imported supplies); 12/20/2013 Tr.** at 580:17-581:21 (Upadhyay testimony that Met adopted the Local Resources Program as described in DTX-518); DTX-527** at MWD2010-00469807 (the first key goal of Met's Seawater Desalination Program is to "avoid or defer MWD capital expenditures"); 12/20/2013 Tr.** at 583:16-585:1 (Upadhyay testimony stating that Met's Seawater Desalination Program results in similar benefits to the Local Resources Program, including its key goals, and Met's Board adoption of the Program).

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

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

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

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

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

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

⁴⁵ DTX-018**, DTX-019 at AR2012-001406-001519; DTX-020 at AR2012-001520-001657.

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

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

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

6. Dry-Year Peaking

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

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

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

⁴⁸ DTX-020 at AR2012-001520-001657.

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

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

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

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

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

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

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

⁵³ AR2010-001406 at 001450, 001452, 001466, 001491, 001493, 001509-10, 001591.

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

⁵⁵ AR2012-16288_2114 at 2189-92*.

⁵⁶ DTX-108* at AR2012-016177.

Basic Evidentiary Standards and Burdens

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

1. Default Rules

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

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

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

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

2. Proposition 26 (California Constitution Article XIII C)

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

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

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

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

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

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

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

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

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

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

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

4. Wheeling Statutes

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

Section 1813 provides,

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

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

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

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

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

5. Government Code § 54999.7(a) and 66013

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

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

6. The Met Act

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

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

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

7. Common Law

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

Key Cases

1. Wheeling Cases

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

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

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

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

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

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

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

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

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

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

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

2. Proposition 218 and Proposition 26 Cases

In *City of Palmdale v. Palmdale Water District*, 198 Cal.App.4th 926, (2011), the Court held that a water district failed to satisfy its burden to establish that its new water rate structure complied with Proposition 218. *Palmdale*, 198 Cal.App.4th at 928.⁵⁹ The water district had retained Raftelis to provide a rate study and recommend a new rate structure. *Id.* Raftelis advised the water district regarding two options for determining fixed revenues, a “cost of service” option and a “percentage of fixed cost” option. *Id.* at 929. Among the advantages of the cost of service option was: “Defensible – Prop 218.” *Id.* Among the advantages of the other options was: “rate stability.” *Id.* The water district ultimately approved a rate structure that included a fixed monthly service charge based on the size of the customer’s meter and a per unit commodity charge for the amount of water used, with the amount depending on the customer’s adherence to the allocated water budget. *Id.* at 930. The customer paid a higher commodity charge per unit of water above the budgeted allotment, but the incremental rate increase depends on the customer’s class. *Id.* For example, irrigation users are charged disproportionate rates,

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

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

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

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

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

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

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

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

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

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

Key Documents

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

1. 1969 Brown and Caldwell

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

⁶⁰ AR2012_016288_1723 at 1744*.

2. 1993 Raftelis Textbook

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

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

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

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

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

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

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

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

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

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

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

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

4. 1996 Integrated Resources Plan

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

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

⁶³ *See* DTX-019 at AR2012-001406; DTX-020 at AR2012-001520.

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

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

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

5. Resolution 8520

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

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

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

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

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

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

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

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

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

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

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

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

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

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

7. 2010 Raftelis Study

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

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

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

8. 2010 Bartle Wells Associates Letters

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

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

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

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

In an April 2010 letter, Bartle Wells supplemented the above opinions. AR2010-11393-400. In it, Bartle Wells concluded that Met's rates were not consistent with industry best practice or the AWWA Manual M-1⁶⁵ or the NARUC system of accounts, and that Met's rates are not apportioned among customers in a manner that reflects the proportionate cost to serve each. *Id.* Bartle Wells wrote that NARUC requires water purchase costs to reflect the cost of water purchased for resale at the point of delivery. *Id.* at 11394. Under NARUC, Bartle Wells stated that SWP costs should be allocated as supply, regardless of the manner in which the Department of Water Resources bills Met. *Id.* In addition, Bartle Wells asserted that Met does not comply with the AWWA manual because its rate system treats the cost of an imported water supply as a transportation cost, inflating Met's transportation charge and disproportionately impacting customers who purchase transportation rather than supply services. *Id.* at 11396. Bartle Wells also restated its conclusion that the Water Stewardship Rate is misallocated, and thus concluded that it is not in compliance with the AWWA manual. *Id.* at 11396-97.

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

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

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

9. 2012 FCS

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

⁶⁶ AR2012-16215-16*.

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

The Met general manager and general counsel responded in a memorandum to Met's Board. AR2012_016583*. They asserted that Met has an integrated system, including Met's right to use SWP facilities, from which all system users, including wheelers, benefit. *Id.* at 016586. They stated that Met, as a supplemental supplier of water, must ensure that agencies that transport water acquired from other sources do not evade the costs of maintaining Met's system. *Id.* at 016588. They cite two examples in which Met used the SWP to transport non-SWP water to member agencies. *Id.* They suggest that those SWP costs would have been subsidized if the SWP contract were allocated solely to supply. *Id.* They also noted that each SWP contractor funds the systems development and operations through payments proportional to their rights to use the system, supporting Met's treatment of the SWP as an extension of its system. *Id.* They drew further support from the fact that the Department of Water Resources breaks its invoices into supply charges and transportation charges. *Id.* at 016589. As to the Water Stewardship Rate, they stated that all users benefit from the programs it funds, so all should pay. *Id.* at 016590. They raise the concern that a failure to charge the rate to wheelers would mean that wheelers enjoy the benefits of the program without paying their share. *Id.* As to peaking, they state that Met recovers its standby costs through the Readiness-to-Serve Charge and its distribution peaking costs through the Capacity Charge. *Id.* at 016592.

Summary of Arguments

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

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

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

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

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

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

Second, Met contends that it is reasonable to allocate the Water Stewardship Rate to its transportation rates because the Water Stewardship Rate recovers the cost of funding programs that help avoid or defer transportation-related capital expenses and increase system capacity. Met Closing Brief at 61-74.⁷⁰ San Diego responds that the programs funded by the Water Stewardship Rate are primarily designed to meet supply programs; therefore Met should have studied and quantified the transportation benefits of those programs if they were to allocate any of the costs of those programs to a charge other than their supply rates. San Diego Post-Trial Brief at 26-29.

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

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

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

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

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

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

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

Discussion

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

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

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

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

1. Application of Statutes

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

Propositions 26 applies here.

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

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

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

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

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

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

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

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

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

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

As Met notes,

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

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

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

⁷⁷ DTX-109* at AR2012-016587.

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

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

2. Analysis On The Merits

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

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

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

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

These two rates include the state transportation costs, i.e., SWP's costs. Met's contract with the state makes clear that Met does not own or operate the SWP transportation facilities.⁷⁸ Previously, Met allocated SWP costs to supply, and none to transportation (including the SWP costs that DWR bills as its own transportation costs).⁷⁹ No reasonable basis appears in the record as to why this has changed. To be sure, the state now does disaggregate its bills to Met, and displays *its* transportation costs on those bills, but that does not suggest those are also (or instead?) *Met's* transportation costs, any more than the overhead or payroll costs of Ford Motor Company are the overhead or payroll costs of a customer who buys a Ford car. And while Met may from time to time use the state's transport capability to move some its water (Met Closing Brief at 49), that does not support the reasonableness of including **all** the state's transportation costs as part of Met's transportation costs. The record does not, for example, quantify the use of the state systems for Met's transportation,⁸⁰ nor does it establish whether it is necessary for wheeling at all. Nor does it matter whether Met delivers a blend of water to wheelers (Met Closing Brief at 53). The blend might be useful⁸¹ but, as to wheelers, the benefit is gratuitous, and not required by wheeling agreements. Nor, with one exception, does Met explain why the use of blended water requires the use of the state's transportation capability. The exception is to note RMI's opinions that the costs of operating Met's Colorado River Aqueduct arguably are

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

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

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

⁸¹ Met has noted that the blend provides lower salinity water.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Met Closing Brief at 30 (bolded emphasis supplied).

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

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

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

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

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

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

Met Closing Brief at 75-76.

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

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

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

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

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

B. Water Stewardship Rate.

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

⁸² Transcript of closing argument at 918-19 (January 23, 2014)**.

⁸³ Met Closing Brief at 75-76.

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

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

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

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

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

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

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

⁸⁶ AR2012-16288_2179*.

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

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

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

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

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

⁸⁸ The 1996 IRP (DTX -019)(Met slide 28).

⁸⁹ AR2012-16288_2114 at 2179, 2216-17.

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

C. Dry Year Peaking

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

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

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

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

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

First, a few words on certain graphs the parties have presented, directed to whether there really is a material variation among member agencies in their patterns of demand on Met’s water. In an effort to show that the dry year peaking issue exists, San Diego prepared a chart⁹¹ to graphically represent peaking. This chart apparently shows that (assuming a baseline based on the average of 1994-2000 purchases) Los Angeles ranged from that baseline to 2.5 of that baseline average, down to a bit under 1.5 of that average, and up to about three time that ratio. San Diego’s ranges are within about 1.5 of the assumed average. Met also has a graph⁹² which shows 2003-2012 purchases, with vaguely similar curves for both Los Angeles and San Diego, dipping in the 2005-06 and 2011 periods and rising in between around 2007 (for San Diego) and around 2009 (for Los Angeles). This includes San Diego’s exchange water, but nevertheless it shows (i) that San Diego obtained more water from Met than did Los Angeles, and (ii) the variation of San Diego’s purchases (about 675,000-400,000, i.e., 275,000) as compared to those of Los Angeles (about 425,000-175,000, i.e., 250,000), which are accordingly roughly the same.

⁹⁰ Order on MILS, December 10, 2013 at 4.

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

⁹² MWD’s Opening Presentation, December 17, 2013 at 34, based on DTX-691**.

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

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

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

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

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

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

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

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

Conclusion

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

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

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

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

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

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

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

Dated: April 24, 2014



Curtis E.A. Karnow
Judge Of The Superior Court

Superior Court of California
County of San Francisco

SAN DIEGO COUNTY WATER
AUTHORITY, et. al.,

Plaintiff(s)

vs.

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

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

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

IN RE: SAN DIEGO COUNTY WATER
AUTHORITY

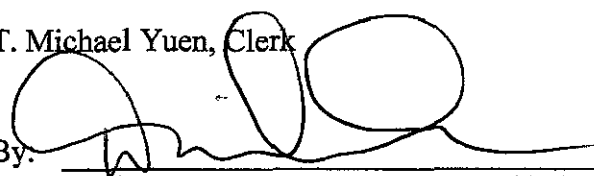
I, DANIAL LEMIRE, a Deputy Clerk of the Superior Court of the County of San Francisco, certify that I am not a party to the within action.

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

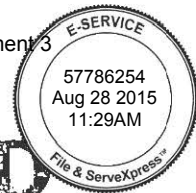
Dated: April 24, 2014

T. Michael Yuen, Clerk

By:



DANIAL LEMIRE, Deputy Clerk



FILED
San Francisco County Superior Court

AUG 28 2015

CLERK OF THE COURT
BY: [Signature]
Deputy Clerk

SUPERIOR COURT OF CALIFORNIA
COUNTY OF SAN FRANCISCO

SAN DIEGO COUNTY WATER
AUTHORITY,

Plaintiff/Petitioner,

vs.

METROPOLITAN WATER DIST. OF
SOUTHERN CALIFORNIA, et al.

Defendants/Respondents.

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

STATEMENT OF DECISION

I. Introduction

San Diego County Water Authority (San Diego) claims that the Metropolitan Water District of Southern California (Met) breached the Exchange Agreement¹ and improperly computed preferential rights. Met disputes the merits and raised some affirmative defenses. I find for San Diego on both claims.

II. Factual Background²

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

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

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

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

3 Met’s current rate structure dates to 2003. Met’s full-service water rate, charged when
4 Met sells a member agency water, includes supply rates, the System Access Rate, the System
5 Power Rate, and the Water Stewardship Rate. These are volumetric³ charges. Met’s Wheeling
6 Rate is different: it includes the System Access Rate, the Water Stewardship Rate, and the
7 incremental cost of power necessary to move the water.
8

9 San Diego acquired an annual supply of transfer water from the Imperial Irrigation
10 District (IID) in 1998. PTX-28. Later in 1998 San Diego and Met agreed to the 1998 Exchange
11 Agreement. PTX-31.⁴ There San Diego paid Met to take transfer water and have Met make
12 Exchange Water⁵ available to San Diego. *Id.* §§ 3.1-3.2, 5.2. The contract was to last 30 years.
13 *Id.* § 5.2. For the first 20 years, San Diego would pay \$90 per acre-foot plus an annual
14 percentage escalator. *Id.* For the final 10 years, San Diego would pay \$80 per acre-foot plus an
15 annual percentage escalator running from 1998. *Id.* The 1998 Exchange Agreement permitted
16 the parties to request a change in the price after 10 years. *Id.* § 5.3. The price term was close to
17 an \$80 per acre-foot wheeling rate proposed by Department of Water Resources Director David
18 Kennedy in January 1998 as a compromise between wheeling rates advocated by Met and San
19 Diego in a dispute over an appropriate wheeling rate. PTX-481 at MWD 2010-00264720.
20
21

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

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

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

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

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

4
5 Most importantly for present purposes, the operative Exchange Agreement contained a
6 revised price provision.⁶ The new price was initially \$253 per acre-foot, and thereafter “equal to
7 the charge or charges set by [Met’s] Board of Directors pursuant to applicable law and regulation
8 and generally applicable to the conveyance of water by [Met] on behalf of its member agencies.”
9 *Id.* § 5.2.⁷ By this term, Met charged San Diego the volumetric transportation rates it charged
10 when it sold full-service water as of 2003 – the System Access Rate, System Power Rate, and
11 Water Stewardship Rate.⁸ Met’s rate *structure* has remained the same since 2003, but Met
12 periodically adjusts the dollar figures for the rates. San Diego has paid those charges under the
13 Exchange Agreement.
14

15 16 **III. Procedural History**

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

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

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

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

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

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

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

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

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

6 7 **IV. Discussion**

8 **A. Breach of Contract**

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

14 **1. Terms**

15 In the Exchange Agreement San Diego agreed to both pay a price and make "Conserved
16 Water" and/or "Canal Lining Water" and "Early Transfer Water" available to Met each year at
17 the "SDCWA Point of Transfer," in exchange for which Met agreed to make "Exchange Water"
18 available to San Diego each year at the "Metropolitan Point(s) of Delivery." PTX-65 §§ 3.1-3.2,
19 5.1.⁹ The aggregate quantity of Exchange Water delivered by Met in a given year was to be
20 equal to the aggregate quantity of Conserved Water (including Early Transfer Water) and Canal
21 Lining Water San Diego made available to Met in the same year. *Id.* §§ 1.1(m), 3.2(c).
22

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

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

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

12 PTX-65 § 5.2.

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

16 The parties dispute the import of the lengthy third sentence of § 5.2. Met contends that
 17 San Diego there agreed to the rate structure Met had in place at the time of the Exchange
 18 Agreement but reserved the ability to challenge only *amendments* to Met's rate structure (after
 19 the five year period). Met Closing Brief, 20-22.¹⁰ San Diego contends that San Diego agreed
 20 not to challenge Met's existing rate structure or any amendments to it for five years, but reserved
 21 the ability to challenge Met's existing rate structure or any amendments to it after five years.
 22

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

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

¹⁰ Citations to "Met Closing Brief" refer to Met's corrected closing brief.

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

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

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

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

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

8 Met hopes to inject ambiguity into the contract with extrinsic evidence such as the
9 testimony of Jeffrey Kightlinger, who negotiated the deal for Met. Met Closing Brief, 22; Trial
10 Transcript, 1327:21-1328:8. He said the purpose of the second proviso was to protect San Diego
11 from adverse changes in Met’s rate structure, *id.* at 1300:13-1307:2, 1328:9-14, noting that San
12 Diego’s negotiators told him that San Diego would not challenge Met’s existing rate structure
13 and that this concession was material to Met. *Id.* at 1300:13-1301:6, 1304:19-1305:7. One of
14 San Diego’s negotiators, Maureen Stapleton, disputed Kightlinger’s testimony. She said San
15 Diego always had concerns with the rates themselves and raised them repeatedly with Met. *Id.* at
16 1554:22-1555:14.¹²
17

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

24
25 ¹¹ Met contends that if the second proviso refers to the general limitation then San Diego could challenge every
charge. Met Closing Brief, 22. Not so. The general limitation referred to a limited subset of Met’s charges, to which
the second proviso refers.

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

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

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

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

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

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

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

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

6 2. Breach

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

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

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

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

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

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

21
22 Accepting Met's performance for some period of time, even exceeding the five year
23 period, does not show San Diego agreed in the contract¹⁶ to a rate structure when at the same
24 time San Diego expressly retained the right to challenge Met's charges in court after the five year
25 period.
26
27

¹⁶ I separately address Met's waiver defense.

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

6 3. Damages

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

11 a. Background Law

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

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

1 **b. Fact of Damages**

2 To establish the fact of damages San Diego relies on the April Statement of Decision as
3 well as testimony to the effect that Met's rates resulted in inflated conveyance rates. San Diego
4 Post-Trial Brief for Phase II, 21.¹⁷ In Phase I, I held that Met's conveyance rates over-collect
5 from wheelers because Met allocated all of the State Water Project costs for the transportation of
6 purchased water to its conveyance rates and all of the costs for conservation and local water
7 supply development programs to its conveyance rates. April Statement of Decision, 65. The
8 same logic applies to the Exchange Agreement. San Diego paid more than it agreed to under the
9 Exchange Agreement because Met improperly included all of the State Water Project costs for
10 the transportation of purchased water to its conveyance rates and all of the costs for conservation
11 and local water supply development programs to its conveyance rates.
12

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

9 **c. Amount of Damages**

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

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

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

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

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

9 Met seeks dismissal because of this uncertainty. Trial Transcript, 2033:12-19. But
10 where, as here, the fact of damage flowing from the breach is proven the amount of damages
11 may be fixed using an approximation if there is a reasonable basis for the approximation. *GHK*,
12 224 Cal.App.3d at 873-74.²⁵ The rationale for San Diego's calculation is (1) San Diego has
13 removed from Met's transportation rates only certain charges that this Court ruled cannot be
14 wholly included in transportation rates; (2) attempting to allocate the charges at issue between
15 transportation and supply would embroil the Court in an inappropriate ratemaking exercise (a
16 proposition with which Met has repeatedly agreed) (Trial Transcript, 2017:23-2018:7; Met's
17 January 9, 2015 Motion to Dismiss, 3-5; Met's March 27, 2014 Objections to Tentative
18

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

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

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

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

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

8 Met did not offer a competing computation.

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

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

18 **4. Affirmative Defenses**

19 **a. Waiver**

20 Met contends that San Diego waived²⁶ any claim for damages arising from Met's use of
21 the rate structure to set the Price by the following conduct inconsistent with an intent to claim
22 damages: (1) proposing the Price with knowledge of the rate structure and its components; (2)
23 voting, through its delegates to Met's Board of Directors, in favor of the rate structure and rates;

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

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

4 Met's waiver theories are precluded by the anti-waiver provision²⁷ in the Exchange
 5 Agreement. Met has not identified any conduct that could have waived the protections of the
 6 anti-waiver provision. *Id.* at 24-25. Nor has Met identified any written and signed waiver.
 7 PTX-65 § 13.9.²⁸

8
 9 **b. Consent**

10 Met asserts that San Diego consented²⁹ to using Met's then-existing rate structure to set
 11 the Price by entering the Exchange Agreement with knowledge of the unlawfulness of the rate
 12 structure, voting in favor of the rate structure, and accepting the benefits of the agreement. Met
 13 Closing Brief, 25-28.

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

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

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

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

³⁰ Section IV(A)(1).

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

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

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

21 22 c. Estoppel

23 Met argues that San Diego is estopped³² from asserting that setting the Price based on the
24 existing rate structure is a breach of contract because San Diego's delegates to Met's Board of
25

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

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

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

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

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

21
22
23 party asserting estoppel had the right to believe the conduct was so intended; (3) the party asserting estoppel must be
24 ignorant of the true facts; and (4) the party asserting estoppel must rely on the conduct. *Ashou v. Liberty Mut. Fire*
25 *Ins. Co.*, 138 Cal.App.4th 748, 766-67 (2006). Met's arguments conceivably satisfy the first two elements, but not
26 the rest, so setting aside my discussions in the text the estoppel defense fails in any event. Met does not show it was
27 ignorant of facts to which San Diego was privy nor does it show reliance, that is, that it would have acted otherwise.
33 Indeed, my determination on the lawfulness of Met's rate structure is itself exceedingly likely to be appealed. The
notion that Met relied on representations from San Diego to act on the belief that its rate structure is lawful is
particularly unpersuasive where Met continues to set its rates based on the belief that its rate structure is lawful even
after San Diego voted against the rates, sued Met over the rate structure, and obtained my trial court ruling that the
rate structure is unlawful. Met, as experienced in state water law as any entity, and served by some of the best
lawyers in the country, has never been misled by San Diego; it just disagrees with San Diego.

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

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

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

20
21 **d. Illegality**

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

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

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

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

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

9 **e. Mistake of Law**

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

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

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

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

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

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

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

21
22
23 ³⁷ Compare Trial Transcript, 1590:7-1591:17 (Stapleton confronted with Slater's deposition testimony that San
24 Diego did not a violation although it knew there were laws that could be pertinent); with Trial Transcript, 1452:16-
1454:2 (Stapleton confronted with Slater's testimony that certain rates were unlawfully included in Met's
conveyance rates).

25 ³⁸ Trial Transcript, 1237:8-1243:17, 1248:13-1253:20, 1255:25-1256:8.

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

1 **f. Offset and Unjust Enrichment**

2 These defenses are subsumed within the damages questions and are addressed there.⁴⁰

3 **B. Preferential Rights**

4 San Diego seeks a declaration that Met's methodology of computing preferential rights
5 violates § 135 of the Metropolitan Water District Act⁴¹ because it excludes San Diego's
6 payments relating to the conveyance of water San Diego purchases from other sources. Third
7 Amended 2010 Complaint ¶¶ 113-15. Specifically, the parties dispute whether (1) San Diego's
8 payments pursuant to the Exchange Agreement should be included in the preferential rights
9 calculation; and (2) payments under wheeling agreements should be included in the preferential
10 rights calculation.⁴²

11 Section 135 includes the following:

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

19
20
21 ⁴⁰ Met's briefing does not separately address these defenses.

⁴¹ Water Code Appendix § 109-135.

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

1 As explained by our Court of Appeal:

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

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

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

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

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

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

18 Met says that the Exchange Agreement facilitates a purchase of water because, under the
19 agreement, San Diego gives Met water and money and obtains different water⁴⁴ from Met. Met
20

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

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

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

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

13 San Diego is not purchasing water from Met. San Diego is exchanging water with Met to
14 make use of its own independent supplies. PTX-65 §§ 1.1(m), 3.1-3.2, 3.6.⁴⁵ The parties agreed
15 to exchange an equal amount of water; the only water quality requirement was for Met to provide
16 San Diego with water of at least the same quality as the water Met received from San Diego.
17 These facts underscore that the Exchange Agreement was not an agreement pursuant to which
18 San Diego obtained water from Met, but instead an agreement pursuant to which Met in effect
19 conveyed water on behalf of San Diego. That the Exchange Agreement differs in some respects
20 from a wheeling contract⁴⁶ does not mean that the Exchange Agreement was not in substance an
21

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

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

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

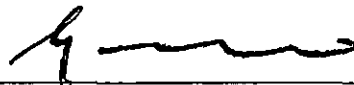
1 agreement to convey, rather than purchase, water. San Diego's payments under the Exchange
2 Agreement must be included in the preferential rights calculation.

3
4
5 **V. Conclusion**

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

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

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16 Dated: August 28, 2015



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Curtis E.A. Karnow
Judge of The Superior Court

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

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

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

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

Dated: **AUG 28 2015**

T. Michael Yuen, Clerk

By:



DANIAL LEMIRE, Deputy Clerk

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Attachment 3
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CLERK OF THE COURT
BY: [Signature] Deputy Clerk

SUPERIOR COURT OF CALIFORNIA
COUNTY OF SAN FRANCISCO

SAN DIEGO COUNTY WATER
AUTHORITY,

Plaintiff/Petitioner,

vs.

METROPOLITAN WATER DIST. OF
SOUTHERN CALIFORNIA, et al.

Defendants/Respondents.

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

ORDER GRANTING SAN DIEGO'S
MOTION FOR PREJUDGMENT
INTEREST

I have previously found that the Metropolitan Water District of Southern California (Met) breached its Exchange Agreement with the San Diego County Water Authority (San Diego) and awarded San Diego nearly \$200 million in damages, "plus interest." Phase II Statement of Decision, 29. San Diego now moves for prejudgment interest, seeking an additional \$44,139,469.¹ I heard argument October 8, 2015.

Legal Background

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

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

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

7 **The Agreement’s Language**

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

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

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

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

26
 27 ² This is not shocking. As I noted in my earlier discussion of § 12.4(c) when San Diego unsuccessfully presented it
 as a liquidated damages provision, there is no reason to think that money set aside under § 12.4(c) would perfectly
 match the damages award.

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

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

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

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

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

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

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

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

14 **Judicial Estoppel**

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

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

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

3 **Certainty**

4 San Diego must show that the damages I awarded were "certain, or capable of being
5 made certain" under § 3287(a). Met tells us that this means San Diego must show there was "no
6 dispute as to the computation of damages." Opposition at 9, citing *Fireman's Fund Ins. Co. v.*
7 *Allstate Ins. Co.*, 234 Cal.App.3d 1154, 1173 (1991). Because "the parties vigorously disputed
8 the computation," Met continues, there could not have been certainty. Opposition at 2. If this
9 were so, a party could avoid prejudgment interest merely by contesting damages at trial.
10

11 As San Diego notes cases distinguish between disputes over the measure of damages and
12 the absence of data necessary to allow the defendant to calculate damages. Only the latter makes
13 damages uncertain. Reply, 6. *Howard v. Am. Nat. Fire Ins. Co.*, 187 Cal.App.4th 498, 535
14 (2010) ("test for determining certainty under section 3287(a) is whether the defendant knew the
15 amount of damages owed to the claimant or could have computed that amount from reasonably
16 available information...") See also, *Collins v. City of Los Angeles*, 205 Cal.App.4th 140, 151
17 (2012).
18

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

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

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

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

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

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

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

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

12 **Conclusion**

13
14 San Diego’s motion for prejudgment interest is granted. The parties agree that, using the
15 10 percent rate, the interest is \$43,415,802.⁸

16
17 Dated: October 9, 2015



18 _____
19 Curtis E.A. Karnow
20 Judge Of The Superior Court
21
22
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24
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26
27

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

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

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

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

Dated: **OCT 9 - 2015**

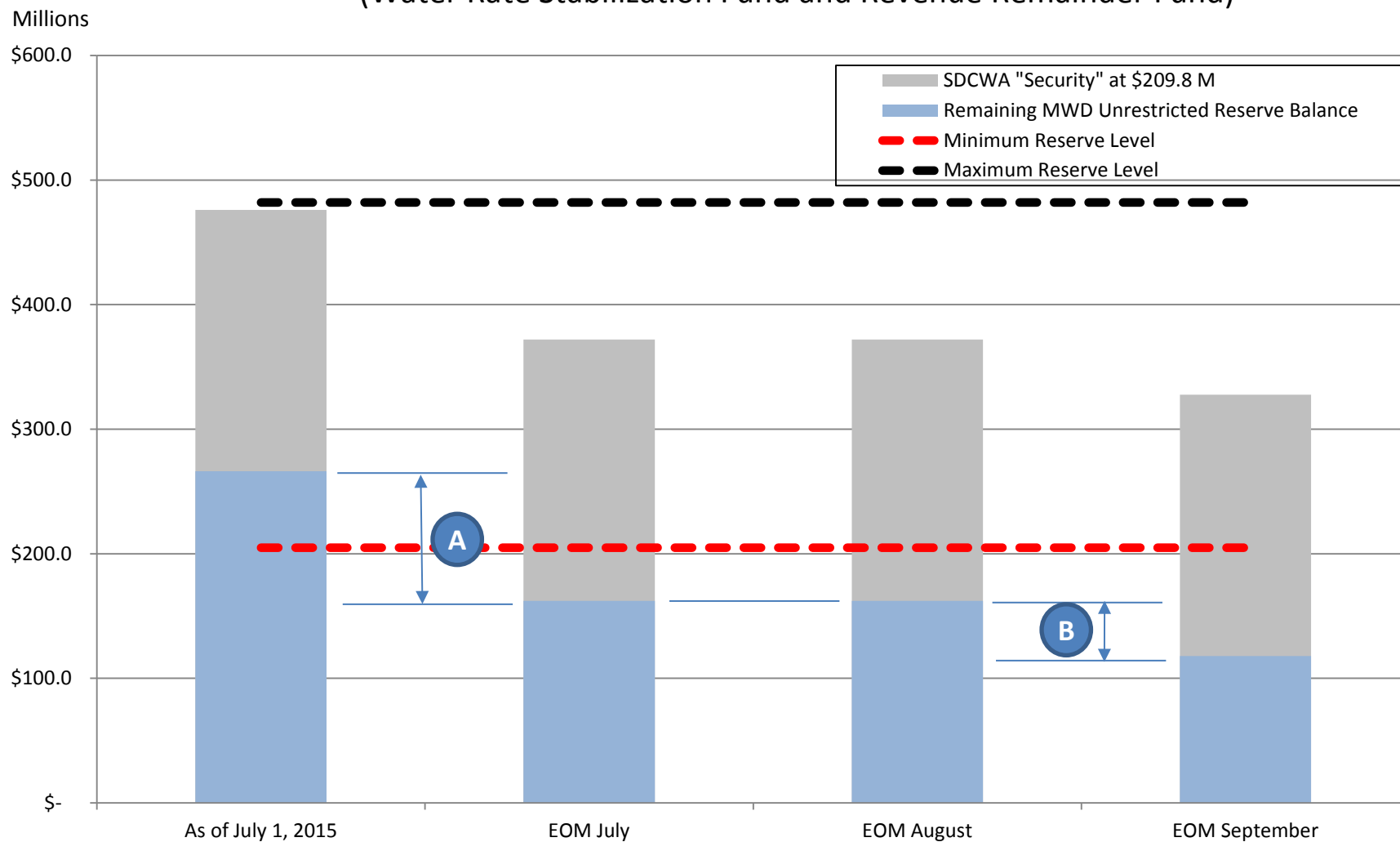
T. Michael Yuen, Clerk

By: 

DANIAL LEMIRE, Deputy Clerk

Unrestricted Reserves

(Water Rate Stabilization Fund and Revenue Remainder Fund)



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

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



San Diego County Water Authority

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

November 5, 2015

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

MEMBER AGENCIES

Carlsbad
 Municipal Water District

City of Del Mar

City of Escondido

City of National City

City of Oceanside

City of Poway

City of San Diego

Fallbrook
 Public Utility District

Helix Water District

Lakeside Water District

Olivenhain
 Municipal Water District

Olay Water District

Padre Dam
 Municipal Water District

Camp Pendleton
 Marine Corps Base

Rainbow
 Municipal Water District

Ramona
 Municipal Water District

Rincon del Diablo
 Municipal Water District

San Dieguito Water District

Santa Fe Irrigation District

South Bay Irrigation District

Vallecitos Water District

Valley Center
 Municipal Water District

Vista Irrigation District

Yuima
 Municipal Water District

OTHER REPRESENTATIVE

County of San Diego

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

Dear Ms. Scully:

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

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

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

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

Ms. Scully
November 5, 2015
Page 2

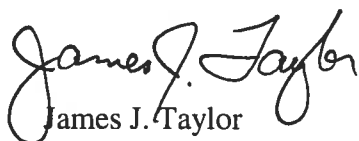
It appears then, that at least since 1991, MWD had not issued any new revenue bonds pursuant to the ordinance required by statute. While Section 62 of the MWD Act provides that any act to be done by resolution may be done by ordinance, there is no mirror provision that any act to be done by ordinance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

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

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

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

Sincerely,



James J. Taylor
Interim Deputy General Counsel

cc: Water Authority's MWD Delegates



San Diego County Water Authority

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



November 5, 2015

MEMBER AGENCIES

- Carlsbad Municipal Water District
- City of Del Mar
- City of Escondido
- City of National City
- City of Oceanside
- City of Poway
- City of San Diego
- Folsom Public Utility District
- Helix Water District
- Lakeside Water District
- Olivainain Municipal Water District
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- San Dieguito Water District
- Santa Fe Irrigation District
- South Bay Irrigation District
- Vallecitos Water District
- Valley Center Municipal Water District
- Vista Irrigation District
- Yuima Municipal Water District

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

Re: Board Item 8-8 – Authorize the General Manager to enter into an Option-to-Purchase agreement for future acquisition of property from Delta Wetlands Properties Located in Contra Costa, San Joaquin, and Solano Counties

Dear Ms. Scully:

I am Jim Taylor, currently serving as interim Deputy General Counsel at the San Diego County Water Authority. The purpose of this letter is to express the Water Authority's serious concern that matters to be discussed in closed session pursuant to Board Item 8-8 will exceed the limits of the cited statutory exception to the open meeting requirements of the Brown Act (Gov. Code Section 54956.8).

Government Code Section 54956.8 permits a local agency to hold a closed session "with its negotiator prior to the purchase, sale, exchange, or lease of real property by or for the local agency to grant authority to its negotiator regarding the price and terms of payment for the purchase, sale, exchange, or lease." In a recent extensive examination of that code section, the state Attorney General has opined that the code section must be interpreted according to its plain language and to the premise that closed session authorizations are to be construed narrowly, in favor of the public's right of access to public information. 94 Ops Cal Atty Gen 82 (2011). In light of those considerations, the Attorney General has further opined:

... [W]e conclude that the real-estate-negotiations exception to the open meeting requirements of the Brown Act permits the closed-session discussion of: (1) the amount of consideration that the local agency is willing to pay or accept in exchange for the real property rights to be acquired or transferred in the particular transaction; (2) the form, manner, and timing of how that consideration will be paid; and (3) items that are essential to arriving at the authorized price and payment terms....

OTHER REPRESENTATIVE

County of San Diego

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

Marcia Scully
November 5, 2015
Page 2

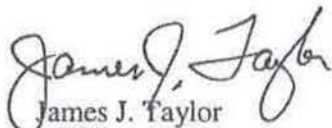
Any discussion outside these parameters would be contrary to the Brown Act requirement for an open and public meeting. The fact that the Board Item contemplates an option to purchase rather than a completed acquisition does not in any way change the analysis or conclusion. The closed session will be conducted pursuant to Government Code Section 54956.8, and its limitation on the scope of discussions applies.

Regarding Board Item 8-8, I am advised that the MWD Board of Directors has never been informed or discussed in open session the purpose of the option to purchase the properties listed. Section 140 of the MWD Act does authorize the district to acquire real property, but with the proviso that the acquisition be "necessary and convenient to the exercise of its powers...." Section 140 and common sense dictate that the Board of Directors be informed of the purpose of an option to purchase prior to a closed session discussion regarding price and terms. As discussed above, the *purpose* of a real property acquisition cannot be presented to the Board in a closed session called pursuant to Section 54956.8, because that is outside the bounds described in the Attorney General opinion.

The Water Authority requests that the board meeting agenda be revised to include an open board meeting presentation and discussion regarding the purpose of the option to purchase the properties prior to the closed session discussion of price and terms. If the purpose for the option to purchase is not first disclosed in open session, the only option board members have is to either violate open meeting laws or authorize price and terms to acquire property without any purpose having been established.

So that I may advise the Water Authority's MWD delegates concerning this matter, I request that you respond to this letter by fax or email by Friday afternoon to let me know whether an open session regarding the purpose of acquiring an option to purchase will precede the closed session discussion of price and terms. My email address is jtaylor@sdewa.org and my fax number is 858-522-6566.

Sincerely,



James J. Taylor
Interim Deputy General Counsel

cc: Water Authority's MWD Delegates



San Diego County Water Authority

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

November 5, 2015

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

MEMBER AGENCIES

- Carlsbad
Municipal Water District
- City of Del Mar
- City of Escondido
- City of National City
- City of Oceanside
- City of Poway
- City of San Diego
- Fallbrook
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- Lakeside Water District
- Oliverhain
Municipal Water District
- Okay Water District
- Padre Dam
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- Camp Pendleton
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- Vallecitos Water District
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- Vista Irrigation District
- Yuima
Municipal Water District
- OTHER REPRESENTATIVE**
County of San Diego

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

Dear Ms. Scully:

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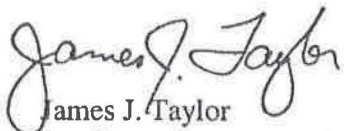
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Sincerely,


James J. Taylor
Interim Deputy General Counsel

cc: Water Authority's MWD Delegates



San Diego County Water Authority

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(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

October 26, 2015

Laura Friedman and
Audit and Ethics Committee Members
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

MEMBER AGENCIES

- Carlsbad Municipal Water District
- City of Del Mar
- City of Escondido
- City of National City
- City of Oceanside
- City of Poway
- City of San Diego
- Fallbrook Public Utility District
- Helix Water District
- Lakeside Water District
- Olivenhain Municipal Water District
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- San Dieguito Water District
- Santa Fe Irrigation District
- South Bay Irrigation District
- Vallecitos Water District
- Valley Center Municipal Water District
- Vista Irrigation District
- Yuima Municipal Water District

RE: Audit and Ethics Committee Agenda Item 3-b
Discussion of independent Auditor's Report from MGO LLP for fiscal year 2014/15

Dear Chair Friedman and Committee Members,

We have reviewed the Independent Auditor's Report dated October 19, 2015 ("Report") on MWD's basic financial statements for the fiscal years ended June 30, 2015 and 2014. We have a number of concerns that certain characterizations contained in the Report are misleading, for example, that MWD had "water sales" of \$1,382.9 (dollars in millions) (page 8) for the fiscal year ended June 30, 2015. That is not accurate; that number is only achieved by characterizing as "water sales" the revenue MWD is actually paid for wheeling the Water Authority's independent Colorado River water under the Exchange Agreement. Note 1(c) purports to itemize MWD's sources of revenue but again, does not acknowledge its receipt of substantial revenues for the transportation of third-party water (which reduces the volume of MWD's own "water sales").

It appears that the independent Auditor may not have been provided with a copy of the Water Authority's communications regarding MWD's draft Official Statements. A copy of our last letter dated October 12, 2015 is attached. MWD management has an obligation to inform the auditor both about questions that have been raised and about material events occurring prior to issuance of the Report in a timely fashion, in order to prevent the Report from being misleading.

Note 9(d), *Sale of Water by the Imperial Irrigation District to San Diego County Water Authority*, is not only inconsistent with key findings by the Court in the Water Authority rate litigation, it is inconsistent with some of MWD's own arguments in the case. Contrary to the characterization in the Report, Judge Karnow specifically found that the Water Authority is not buying water from MWD under the Exchange Agreement. The Court has also determined that the amount due to the Water Authority as damages is substantially more than "the amount paid by SDCWA under the Exchange Agreement and interest thereon," as

OTHER REPRESENTATIVE

County of San Diego

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

October 26, 2015

Page 2

described in Note 9(d) to the financial statement (pages 67-68). In fact, the Court has awarded \$188,295,602 in damages (August 28, 2015 Statement of Decision) and \$43,415,802 in prejudgment interest (October 9, 2015 Order Granting San Diego's Motion for Prejudgment Interest) to the Water Authority. At a minimum, these rulings by the Court should have been included at Note 15, *Subsequent Events*, prior to the Report being issued on October 19, 2015. MWD's management including its Chief Financial Officer has an obligation to inform the independent Auditor of material events in a timely fashion. That apparently did not occur in this case. We request that a copy of this letter and the attachment be provided to the auditor and that the auditor correct the misleading statements and reissue the report.

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
Director



Fern Steiner
Director



Yen C. Tu
Director

Attachment:

1. Water Authority's October 12, 2015 Letter to MWD Board re 8-2

cc: MWD Board of Directors
Jeff Kightlinger, MWD General Manager
Macias Gini & O'Connell LLP, MWD Independent Auditor



San Diego County Water Authority

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

October 12, 2015

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

MEMBER AGENCIES

- Carlsbad Municipal Water District
 - City of Del Mar
 - City of Escondido
 - City of National City
 - City of Oceanside
 - City of Poway
 - City of San Diego
 - Fallbrook Public Utility District
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 - South Bay Irrigation District
 - Vallecitos Water District
 - Valley Center Municipal Water District
 - Vista Irrigation District
 - Yuima Municipal Water District
- OTHER REPRESENTATIVE**
- County of San Diego

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

Dear Chair Record and Members of the Board:

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

I. General Comments

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

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

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

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

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

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

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

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

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

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

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

IV. Comments on Draft Appendix A

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
Director



Fern Steiner
Director



Yen C. Tu
Director

Attachment:

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

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



FILED
San Francisco County Superior Court

APR 24 2014

CLERK OF THE COURT

BY: [Signature]
Deputy Clerk

SUPERIOR COURT OF CALIFORNIA
COUNTY OF SAN FRANCISCO

SAN DIEGO COUNTY WATER
AUTHORITY,

Plaintiff/Petitioner,

vs.

METROPOLITAN WATER DIST. OF
SOUTHERN CALIFORNIA, et al.

Defendants/Respondents.

Case No. CPF-10-510830

Case No. CPF-12-512466

STATEMENT OF DECISION ON RATE
SETTING CHALLENGES

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

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

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

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

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

Procedural History

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

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

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

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

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

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

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

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

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

This statement of decision follows.

Factual Background

1. The Parties

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

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

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

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

2. Water Networks

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

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

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

² DTX-090 at AR2012-000001 (capitalization omitted).

³ PTX-237A** (Resps. to RFA Nos. 44-47).

⁴ DTX-109* at AR2012-016583.

3. Met's Contract with DWR

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

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

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

⁵ DTX-090 at AR2012-000001 (capitalization omitted).

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

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

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

⁹ DTX-055 at AR2012-000153 (Art. 55(a)).

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

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

4. Met’s Rates and Charges

a. Rate-Setting

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

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

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

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

¹¹ DTX-045 at AR2012-006471, 006496.

¹² DTX-132* at AR2012-006462_01; DTX-034 at AR2012-005545-46.

¹³ DTX-090 at AR2010-011443; DTX-110* at AR2012-016594.

¹⁴ DTX-090 at AR2010-0011443; DTX-110* at AR2012-016594.

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

¹⁶ *Id.*

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

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

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

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

¹⁸ DTX-090 at AR2010-011474-011475; DTX-110* at AR2012-016681-016682.

¹⁹ DTX-090 at AR2010-011472, 011483-011489; DTX-110* at AR2012-016679, 016688-016694.

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

²¹ DTX-090 at AR2010-011483, 011488; DTX-110* at AR2012-016688, 016693.

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

In Step 4 of the COS process, Met breaks its operation functions down into corresponding rate design elements, which, in Met's rate structure are volumetric rates (*i.e.*, rates charged per acre-foot²³ of water Met delivers to the member agencies), and fixed charges (*i.e.*, charges which do not vary with sales in the current year).²⁴ Among the unbundled volumetric rates in Met's rate structure are the Supply Rates (Tiers 1 and 2) and the Transportation Rates.²⁵ Met's fixed charges included a Readiness-to-Serve Charge and a Capacity Charge.²⁶

b. Water Rate Versus Wheeling Rate

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

i. Supply Rates

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

²² *Id.*

²³ An acre-foot of water covers one acre one foot deep.

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

²⁵ DTX-090 at AR2010-011490-011500; DTX-110* at AR2012-016695-016700.

²⁶ *Id.*

²⁷ DTX-090 at AR2010-011474-011475, 011499-011500; DTX-110* at AR2012-016681, 016700.

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

ii. System Access Rate

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

²⁸ *Id.*

²⁹ DTX-045 at AR2012-006535-006536; DTX-090 at AR2010-011499; DTX-110* at AR2012-016700.

³⁰ *Id.*

³¹ DTX-045 at AR2012-006518; DTX-090 at AR2010-011492; DTX-110* at AR2012-016697.

³² DTX-045 at AR2012-006518.

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

iii. System Power Rate

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

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

iv. Water Stewardship Rate

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

c. Readiness-to-Serve Charge

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

³⁴ DTX-045 at AR2012-006520; DTX-090 at AR2010-011492; DTX-110* at AR2012-016697.

³⁵ DTX-090 at AR2010-011488, 011490; DTX-110* at AR2012-016693, 016695.

³⁶ DTX-045 at AR2012-006519; DTX-090 at AR2010-011492; DTX-110* at AR2012-016697.

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

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

d. Capacity Charge

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

e. Treatment Surcharge

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

5. Demand Management Programs

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

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

³⁸ DTX-090 at AR2010-011495; DTX-110* at AR2012-016699.

³⁹ DTX-090 at AR2010-011492-011493; DTX-110* at AR2012-016697-016698.

⁴⁰ DTX-090 at AR2010-011492; DTX-110* at AR2012-016697.

⁴¹ DTX-045 at AR2012-006520.

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

region’s overall dependence on imported water supplies”); 12/20/2013 Tr.** at 588:24-589:1⁴³ (“That’s ultimately what [Met is] paying for is for a reduction in demand for imported water from [Met’s] system.” (Upadhyay testimony)); DTX-027 at AR2012-002870 (the first key goal of Met’s Local Resources Program is to “avoid or defer Met capital expenditures”); 12/20/2013 Tr.** at 578:22-580:11 (Upadhyay testimony stating that Met adopted the Local Resources Program principles and they remain in effect today); DTX-518** at MWD2010-00466049 (Board identifying regional benefits associated with the Local Resources Program, including reduction in capital investments due to deferral and downsizing of regional infrastructure and reduction in operating costs for distribution of imported supplies); 12/20/2013 Tr.** at 580:17-581:21 (Upadhyay testimony that Met adopted the Local Resources Program as described in DTX-518); DTX-527** at MWD2010-00469807 (the first key goal of Met’s Seawater Desalination Program is to “avoid or defer MWD capital expenditures”); 12/20/2013 Tr.** at 583:16-585:1 (Upadhyay testimony stating that Met’s Seawater Desalination Program results in similar benefits to the Local Resources Program, including its key goals, and Met’s Board adoption of the Program).

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

⁴³ As explained in note 3, “*” indicates that a document is present only in the 2012 administrative record. “**” indicates that a document is not in any administrative record. All documents in the 2010 administrative record are also in the 2012 administrative record.

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

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

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

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

⁴⁵ DTX-018**, DTX-019 at AR2012-001406-001519; DTX-020 at AR2012-001520-001657.

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

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

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

6. Dry-Year Peaking

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

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

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

⁴⁸ DTX-020 at AR2012-001520-001657.

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

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

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

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

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

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

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

⁵³ AR2010-001406 at 001450, 001452, 001466, 001491, 001493, 001509-10, 001591.

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

⁵⁵ AR2012-16288_2114 at 2189-92*.

⁵⁶ DTX-108* at AR2012-016177.

Basic Evidentiary Standards and Burdens

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

1. Default Rules

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

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

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

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

2. Proposition 26 (California Constitution Article XIII C)

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

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

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

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

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

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

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

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

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

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

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

4. Wheeling Statutes

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

Section 1813 provides,

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

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

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

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

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

5. Government Code § 54999.7(a) and 66013

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

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

6. The Met Act

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

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

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

7. Common Law

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

Key Cases

1. Wheeling Cases

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

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

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

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

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

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

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

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

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

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

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

2. Proposition 218 and Proposition 26 Cases

In *City of Palmdale v. Palmdale Water District*, 198 Cal.App.4th 926, (2011), the Court held that a water district failed to satisfy its burden to establish that its new water rate structure complied with Proposition 218. *Palmdale*, 198 Cal.App.4th at 928.⁵⁹ The water district had retained Raftelis to provide a rate study and recommend a new rate structure. *Id.* Raftelis advised the water district regarding two options for determining fixed revenues, a “cost of service” option and a “percentage of fixed cost” option. *Id.* at 929. Among the advantages of the cost of service option was: “Defensible – Prop 218.” *Id.* Among the advantages of the other options was: “rate stability.” *Id.* The water district ultimately approved a rate structure that included a fixed monthly service charge based on the size of the customer’s meter and a per unit commodity charge for the amount of water used, with the amount depending on the customer’s adherence to the allocated water budget. *Id.* at 930. The customer paid a higher commodity charge per unit of water above the budgeted allotment, but the incremental rate increase depends on the customer’s class. *Id.* For example, irrigation users are charged disproportionate rates,

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

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

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

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

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

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

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

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

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

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

Key Documents

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

1. 1969 Brown and Caldwell

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

⁶⁰ AR2012_016288_1723 at 1744*.

2. 1993 Raftelis Textbook

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

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

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

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

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

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

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

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

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

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

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

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

4. 1996 Integrated Resources Plan

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

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

⁶³ *See* DTX-019 at AR2012-001406; DTX-020 at AR2012-001520.

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

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

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

5. Resolution 8520

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

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

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

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

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

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

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

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

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

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

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

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

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

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

7. 2010 Raftelis Study

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

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

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

8. 2010 Bartle Wells Associates Letters

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

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

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

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

In an April 2010 letter, Bartle Wells supplemented the above opinions. AR2010-11393-400. In it, Bartle Wells concluded that Met's rates were not consistent with industry best practice or the AWWA Manual M-1⁶⁵ or the NARUC system of accounts, and that Met's rates are not apportioned among customers in a manner that reflects the proportionate cost to serve each. *Id.* Bartle Wells wrote that NARUC requires water purchase costs to reflect the cost of water purchased for resale at the point of delivery. *Id.* at 11394. Under NARUC, Bartle Wells stated that SWP costs should be allocated as supply, regardless of the manner in which the Department of Water Resources bills Met. *Id.* In addition, Bartle Wells asserted that Met does not comply with the AWWA manual because its rate system treats the cost of an imported water supply as a transportation cost, inflating Met's transportation charge and disproportionately impacting customers who purchase transportation rather than supply services. *Id.* at 11396. Bartle Wells also restated its conclusion that the Water Stewardship Rate is misallocated, and thus concluded that it is not in compliance with the AWWA manual. *Id.* at 11396-97.

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

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

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

9. 2012 FCS

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

⁶⁶ AR2012-16215-16*.

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

The Met general manager and general counsel responded in a memorandum to Met's Board. AR2012_016583*. They asserted that Met has an integrated system, including Met's right to use SWP facilities, from which all system users, including wheelers, benefit. *Id.* at 016586. They stated that Met, as a supplemental supplier of water, must ensure that agencies that transport water acquired from other sources do not evade the costs of maintaining Met's system. *Id.* at 016588. They cite two examples in which Met used the SWP to transport non-SWP water to member agencies. *Id.* They suggest that those SWP costs would have been subsidized if the SWP contract were allocated solely to supply. *Id.* They also noted that each SWP contractor funds the systems development and operations through payments proportional to their rights to use the system, supporting Met's treatment of the SWP as an extension of its system. *Id.* They drew further support from the fact that the Department of Water Resources breaks its invoices into supply charges and transportation charges. *Id.* at 016589. As to the Water Stewardship Rate, they stated that all users benefit from the programs it funds, so all should pay. *Id.* at 016590. They raise the concern that a failure to charge the rate to wheelers would mean that wheelers enjoy the benefits of the program without paying their share. *Id.* As to peaking, they state that Met recovers its standby costs through the Readiness-to-Serve Charge and its distribution peaking costs through the Capacity Charge. *Id.* at 016592.

Summary of Arguments

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

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

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

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

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

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

Second, Met contends that it is reasonable to allocate the Water Stewardship Rate to its transportation rates because the Water Stewardship Rate recovers the cost of funding programs that help avoid or defer transportation-related capital expenses and increase system capacity. Met Closing Brief at 61-74.⁷⁰ San Diego responds that the programs funded by the Water Stewardship Rate are primarily designed to meet supply programs; therefore Met should have studied and quantified the transportation benefits of those programs if they were to allocate any of the costs of those programs to a charge other than their supply rates. San Diego Post-Trial Brief at 26-29.

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

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

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

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

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

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

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

Discussion

The parties agree that Met is obligated to set its rates based on principles of cost causation, that is, that Met must charge for its services based only on what it costs to provide them. Met Closing Brief at 60; San Diego's Amended First Pretrial Brief at 1. This is the central focus of this case, and provides a good shorthand for the varied tests implicated by the varied causes of action, as revealed by the summaries just below.

For each of the claims, I now review whether the statutes or law apply.

⁷⁴ According to Met, this is because the wheeling statute allows Met to charge system-wide costs in its wheeling rate and Met exercises its contractual right to use SWP facilities to complete wheeling transactions. Met Closing Brief, 83-85.

⁷⁵ Met argues that this is because wheelers benefit from available capacity, as that enables Met to wheel water. Met Closing Brief, 86. Met also reiterates that this recovers from wheelers the cost of using the system. *Id.* at 85-86.

1. Application of Statutes

Proposition 26. Here the issue is whether rates are commensurate with the reasonable costs of the services. Proposition 26 does not apply, Met says, for four reasons. (1) The rates are not “imposed,” rather, the member agencies join voluntarily. I have previously rejected Met’s argument in denying its motion for judgment on the pleadings. Sept. 19, 2013 Order Denying Motion for Judgment on the Pleadings at 3 (citing *Bighorn-Desert View Water Agency v. Verjil*, 39 Cal. 4th 205 (2006)). I did allow for the possibility “that facts adduced at trial will reveal the extent to which the rates are or are not ‘imposed,’ such as the choices available to San Diego for water and water transport.” *Id.* at 3. But Met did not adduce any such facts, whether from the administrative record, to which this claim is limited at Met’s suggestion, or otherwise. Indeed the record contains numerous references to the fact that Met will “IMPOSE RATES AND CHARGES.” AR2010-6159-162 (capitalization in original); *see also, e.g.*, AR2010-6166-222; AR2010-6223-239; AR2010-6945-7029. More substantively, the 2012 Official Statement to Met’s bondholders confirms that SD had no choice but to use Met’s facilities to wheel water. AR2012-16429 at 16509*. (2) The rates are in fact reasonable. This is the issue on the merits; and I defer here to my discussions below on the merits. (3, 4) The rates are charges for the use of ‘local governmental property,’ and 2/3 of the appropriate “electorate” approved them. These are arguments which I have previously rejected in the September 19, 2013 Order, and my reasoning remains unchanged.

Propositions 26 applies here.

Proposition 13 (Govt. Code §§ 50075, 50076). The issue whether there is a fair or reasonable relationship between the rates and services. Met argues that Prop 13 does not apply,

because water rates are outside the purview of Proposition 13. Met cites *Brydon v. E. Bay Mun. Util. Dist.*, 24 Cal.App.4th 178 (1994), and *Rincon Del Diablo Mun. Water Dist. v. SDCWA*, 121 Cal.App.4th 813 (2004), suggesting that San Diego obtained just that ruling from the *Rincon* court. 121 Cal.App.4th at 821-22. San Diego agrees that the water rates in those cases were not taxes because they were “not designed to replace property tax monies lost in consequence of the enactment of California Constitution, article XIII A,” *Brydon*, 24 Cal.App.4th at 194; *accord Rincon*, 121 Cal.App.4th at 822. But in this case, San Diego tells us, Met’s Engineers’ Reports explicitly say the opposite about Met’s rates:

Since the passage of Article XIII A of the California Constitution, Metropolitan has necessarily relied more on water sales revenue than on ad valorem property taxes for the repayment of debt. Water sales have become the dominant source of revenue, not only for operation and maintenance of the vast network of facilities supplying water to Southern California, but also for replacement and improvement of capital facilities. The increased reliance on highly variable water sales revenue increases the probability of substantial rate swings from year to year. ***The use of water rates as a primary source of revenue has placed an increasing burden on ratepayers, which might more equitably be paid in part by assessments on land that in part derives its value from the availability of water.***⁷⁶

This Engineer Report does not distinguish *Brydon* and *Rincon*. The notion that in the abstract some sort of “assessments on land” might be used to pay for water does not mean the extant rates were as a matter of fact “designed to replace property tax monies lost in consequence of the enactment of California Constitution, article XIII A.” *Rincon*, 121 Cal.App.4th at 822. Met is correct that Proposition 13 does not apply here.

Wheeling statute (Water Code § 1810 *et seq.*). The issue is whether the rates are “fair compensation” for the services provided. Water Code § 1811(c).

⁷⁶ AR2010-11443 at 11511-12 (emphases added by San Diego); *accord* 2012-16594 at 16806-07*.

Govt. Code §§ 54999.7(a), 66013. The issue is whether the costs of providing the service are reasonable. Met argues that Govt. Code § 66013, which San Diego invokes solely in the 2012 action, does not apply. That sections reads, “[n]otwithstanding any other provision of law, when a local agency imposes fees for water connections or sewer connections, or imposes capacity charges, those fees or charges shall not exceed the estimated reasonable cost of providing the service for which the fee or charge is imposed,” unless approved by a popular two-thirds vote. This language does not suggest the statute applies to San Diego’s complaints—San Diego does not allege problems with water or sewer connections, or capacity charges as the term is used in that statute. As Met notes, the “legislative history does not show the Legislature intended to impose a new standard on water rates.” *Rincon Del Diablo Mun. Water Dist. v. San Diego Cnty. Water Auth.*, 121 Cal.App.4th 813, 820 (2004). Here I agree with Met.

Met also argues that § 54999.7(a) does not apply. This section provides that the rates and charges one public agency imposes on another for public utility service “shall not exceed the reasonable cost of providing the public utility service.” Gov’t Code § 54999.7(a). Met and San Diego are both public agencies. Met charges San Diego rates and charges for a “public utility service.” Nothing in the statute suggests that it is not applicable here. Met’s reference to services to “public schools” in § 54999.7(c) is not useful, as San Diego is not invoking that section, nor does § 54999.7(a) necessarily invoke or rely on § 54999.7(c). Here I agree with San Diego; the statute applies.

Met Act (Water Code Append. § 109-134). The Met Act requires that rates “be uniform for like classes of service throughout the district.” Water Code Append. § 109-134. The core issue is whether there is unjustifiable rate discrimination. San Diego must as an initial matter prove

that Met's rates are not "uniform for like classes of service" in the district. *Id.* That is, San Diego must establish as an initial matter that there is rate discrimination. San Diego may have misconstrued the court's pre-trial rulings to suggest that that burden may be met simply by showing there are "different classes of entities." Pretrial Rulings at 21 n.18 (dated November 5, 2013). Without showing varying rates of course San Diego's case is stymied, but proving those different rates alone is not the same as showing that there is rate discrimination. One might for example have different classes of entities but yet show no rate discrimination.

As Met notes,

In order to accommodate a water transfer market, Metropolitan maintains an unbundled rate structure based on types of service provided. As a result, member agencies pay rates based on the services they use, and agencies that use the same service pay the same rate. Agencies that purchase Metropolitan supplied water pay for supply, whereas agencies that purchase no water pay no supply costs. Agencies that take treated water cover treatment costs, whereas agencies that take untreated water pay no treatment costs. An agency that transports a third party's water through Metropolitan's system (known as "wheeling") pays transportation costs, but no supply costs.⁷⁷

In brief, Met charges different rates to users differently situated: one set of rates to member agency wheelers, and one to member agencies for water purchases. Based on that simple description, there is no reason to conclude that there is price *discrimination*, a concept which depends on a comparison between similarly situated entities. To be sure, San Diego argues—persuasively, I find below—that Met actually *does* charge supply costs to those who wheel, but that is a violation of other laws, not rate discrimination. Here, the entities (wheelers and non-wheelers) are not similarly situated, and accordingly the Met Act does not apply.

Common law. There are two aspects to this claim; one tracks the Met Act and asks whether there is unjustifiable discrimination between rate payers; the second asks whether there is a

⁷⁷ DTX-109* at AR2012-016587.

“reasonable basis” for the rates. *Inyo*. For reasons summarized just above, the latter, but not the former, rules apply here.

Summary. In sum, I conclude Proposition 26, the Wheeling statute, Govt. Code § 54999.7(a), and the common law (reasonable rates requirement) apply here. In each case the core inquiry is the same, and looks to cost causation, that is, whether the costs of the services (e.g. wheeling) are reasonably related to the costs of providing those services.

2. Analysis On The Merits

Setting aside San Diego’s challenge to the dry year peaking (discussed below), I summarize the challenges to Met’s rates, phrased as function of the cost causation principle: Is it reasonable for Met to include in its transportation rates (A) via the Systems Access Rate and the System Power Rate, the cost the state charges to Met to transport water to Met? (B) the Water Stewardship Rate?

I summarize here the basic guidance from the central cases. *MWD* tells us that the relevant costs may--or may not--be system-wide costs; but it is clear that I do not simply look to the marginal costs of providing e.g. wheeling services. (Had I done so, and because wheeling occurs solely when there is unused capacity, I might have concluded that aside from power and other costs required to literally move the wheeled water, no other costs could be included in wheeling rates.) *Morro Bay* reminds us that rates may not discourage wheeling, and loss of income attributable to lost water sales is not a permissible justification for [increasing] wheeling rates. *Palmdale* emphasizes cost causation, and bars unjustified price discrimination. *Griffith I* and *Griffith II* emphasize the rule that it is permissible to spread the costs of programs across all

benefitted users, and approves rates as long as they do not generate a surplus over and above what is needed to provide the program.

A. Met's System Access Rate and System Power Rate

These two rates include the state transportation costs, i.e., SWP's costs. Met's contract with the state makes clear that Met does not own or operate the SWP transportation facilities.⁷⁸ Previously, Met allocated SWP costs to supply, and none to transportation (including the SWP costs that DWR bills as its own transportation costs).⁷⁹ No reasonable basis appears in the record as to why this has changed. To be sure, the state now does disaggregate its bills to Met, and displays *its* transportation costs on those bills, but that does not suggest those are also (or instead?) *Met's* transportation costs, any more than the overhead or payroll costs of Ford Motor Company are the overhead or payroll costs of a customer who buys a Ford car. And while Met may from time to time use the state's transport capability to move some its water (Met Closing Brief at 49), that does not support the reasonableness of including **all** the state's transportation costs as part of Met's transportation costs. The record does not, for example, quantify the use of the state systems for Met's transportation,⁸⁰ nor does it establish whether it is necessary for wheeling at all. Nor does it matter whether Met delivers a blend of water to wheelers (Met Closing Brief at 53). The blend might be useful⁸¹ but, as to wheelers, the benefit is gratuitous, and not required by wheeling agreements. Nor, with one exception, does Met explain why the use of blended water requires the use of the state's transportation capability. The exception is to note RMI's opinions that the costs of operating Met's Colorado River Aqueduct arguably are

⁷⁸ AR2010-001 art. 13; PTX-237-A** (Admissions) Nos. 44-47; *Metro. Water Dist. of S. Cal. v. Marquardt*, 59 Cal.2d 159, 202 (1963)(Met is not an "equitable owner" of the SWP).

⁷⁹ 1969 Study*, AR2012-16288_1723 at 1743-46; Trial Transcript* at 469:23-470:12.

⁸⁰ Met Closing Brief at 49 ("SWP facilities **at times** serve *solely* a transportation function for MWD")(bolded emphasis supplied). Occasions on which this capability has been used are described at *id.*, 50-51.

⁸¹ Met has noted that the blend provides lower salinity water.

classifiable as transportation costs (Met Closing Brief at 57), but Met has not described how, or the extent to which, wheeling uses that aqueduct. Nor are the costs associated with transportation through that aqueduct the issue; the issue relates to costs associated with the movement of water through the SWP's facilities.

I do note, at Met's behest, the fact that in May 1996 RMI treated the SWP transportation costs as Met's like costs. The bases set forth there, however, are impenetrable. The bases are that the (a) transportation charges are disaggregated—an issue I address just above—and (b) capital charges for the transmission facilities are transmission related: which is a tautology. The issue is not whether they are transportation related; the issue is whether there is any reasonable basis to conclude they are *Met's* transmission charges. Unless I must accept as an adequate record any outside consultants' unsupported view (and I do not), this is insufficient.

There are other parts of the record that Met has urged support its view. Met's Closing Brief at 50. (a) DTX-055 (SWP Contract at Art. 55(a)), gives Met the right to use SWP facilities for transportation. (b) In DTX-087, Met discusses the fact that it has in fact conveyed non-project water through SWP facilities, for example on two occasions in 2009. *Id* at AR2012-011307. (c) DTX-109* is another statement by Met, dated April 2012, that it conveys non-project water through SWP facilities, *see e.g., id.* at AR2012-016586, referring to the same two events in 2009. *Id.* at AR2012-016588. And Met notes other occasions when it has bought non-project water (i.e. not from the SWP) to resell to its member agencies. Met Closing Brief at 51.

Fundamentally, Met's position seems to be based on the facts that (a) it does use SWP's facilities to move its own [non-project] water on occasion, and (b) all member agencies benefit in some way from that capability. From those predicates Met concludes that the sums it pays to the state attributable to the state's transportation costs are allocable to Met's own transportation

rates. Met Closing Brief at 53. But this is no syllogism. While one can easily conclude from these predicates that all water-purchasing member agencies should pay some share of those SWP's costs—indeed, of all costs billed by the SWP to Met—it does not follow that a given portion of those costs (such as SWP's transportation constituent) ought to be billed to wheelers who happen to be member agencies. This is especially true as it appears that the water moved by the SWP system, even when it is not water purchased from the SWP, is nevertheless generally water which is sold by Met to its member agencies, *not wheeled water*.

The position Met takes here reflects its position on the core legal dispute presented by this case, and I turn to that more specifically now.

The Core Dispute. Met writes that, on the subject of system-wide costs such as (i) those paid for SWP's transportation of water and (ii) for programs funded by the water stewardship rates, "In 1997, MWD recognized that if it did not charge these costs to wheelers as well as its full-service customers, then its full-service customers would end up subsidizing the costs of wheeling transactions." Closing Brief at 6. Compare, e.g., *MWD v. IID*, 80 Cal.App.4th at 1432-33.

The core dispute is whether, under the current rate structure, wheelers are subsidizing water purchasers. San Diego says that wheelers such as itself subsidize the other member agencies. Under the wheeling statute, for example, that is not permitted because it would discourage wheeling, and under the balance of the statutes at play in this case wheelers would be paying more than a reasonable fee for the service.

This core dispute centers on the impact of the so-called San Pedro principles adopted in 1997, which San Diego characterizes as implementing an illegal rate stability plan and Met

characterizes are implementing a legal plan to avoid having its full-service customers subsidize wheeling transactions. *See, MWD v. IID*, 80 Cal.App.4th at 1418-19 (outline of principles).

Underlying Met’s approach here is the position that Met is entitled to sweep into all of its charges to members agencies apparently *any* of the system-wide costs it incurs, perhaps on the theory that member agencies, in their wheeling capacity, had a role in causing all system-wide costs. Met may have in mind the words of the *Griffith I* Court, 207 Cal.App.4th at 997:

The question of proportionality is not measured on an individual basis. Rather, it is measured collectively, considering all rate payors. ... Thus, permissible fees must be related to the overall cost of the government regulation. They need not be finely calibrated to the precise benefit each individual fee payor might derive. What a fee cannot do is exceed the reasonable cost of regulation with the generated surplus used for general revenue collection. An excessive fee that is used to generate revenue becomes a tax.

While Met on occasion appears to suggest that the *MWD* opinion determines the core dispute in its favor, Met accurately recites the impact of *MWD* thusly:

The question of whether system-wide costs may be included in MWD’s wheeling rate at all was already decided by the California Court of Appeal, which held that system-wide costs may be included under the Wheeling Statute. *See MWD v. IID*, 80 Cal.App.4th at 1422-23. The inquiry for this Court is whether inclusion of **particular** system-wide costs (*i.e.*, MWD’s fixed SWP costs and the Water Stewardship Rate) in MWD’s rate for wheeling service charges fair compensation.

Met Closing Brief at 30 (bolded emphasis supplied).

MWD teaches us that system-wide changes are *eligible* for this sort of treatment. But the opinion did not obviate the cost causation requirement. In *MWD*, the Court endorsed *certain kinds* of system-wide costs as properly part of the wheeling charges—those that relate to the conveyance system:

Hence, the “fair compensation” (§ 1810) to which a water conveyance system owner is entitled for wheeling water includes reasonable capital, maintenance, and operation costs occasioned, caused, or brought about by “the use of the conveyance system.” (§ 1811, subd. (c).) “[F]air compensation” (§ 1810) includes charges the owner, in this case the

Metropolitan Water District, becomes subject to or liable for in using the “conveyance system” (§ 1811, subd. (c)) to wheel water when it has unused capacity.

MWD, 80 Cal.App.4th at 1431.

I need not determine here whether the San Pedro principles are generally appropriate; but as they have been implemented to determine the wheeling rate, they are not supportable. Here’s Met’s assessment of that implementation:

In order to ensure that both full-service users and wheelers are ultimately held responsible for their respective costs, MWD determined that if a member agency purchasing MWD water “pays for the fixed, unavoidable costs of the system . . . then member agencies using that same system for wheeling must contribute to [MWD’s] fixed costs on an equivalent basis.” *Id.* MWD also determined that this principle is consistent with the San Pedro Integrated Resources Plan Assembly Statement “that wheeling should not result in adverse impacts to the rates and charges of any member agency.” *Id.* at 002458. In other words, MWD properly recognized that member agencies that wheel would gain an unfair subsidy if they did not have to pay for the costs that they caused MWD to incur, or for the benefits they received from MWD’s system, as a result of MWD’s fixed, unavoidable costs.

Met Closing Brief at 75-76.

RMI’s December 1995 report, putatively reflecting the San Pedro principles, too opined that that wheeling “**must not negatively impact the rates or charges to any other Member Agencies.**” AR2010-1222 at 1234 (emphasis in original).

Because one of Met’s chief “fixed, unavoidable costs” is the price of water it pays to the State, Met and its consultants may have thought that wheeling rates ought to be set such that there was no effect on the rates of non-wheelers, including rates attributable to the cost of water.

But under the wheeling statute and more generally the general cost causation principles which underlie all the claims in this case, only system-wide costs attributable to the “conveyance system” should be the basis for wheeling rates. *MWD*, above. To accommodate this reference to ‘conveyance facilities,’ Met argues that the state’s (DWR’s) conveyance facilities are a part of Met’s conveyance facilities. But with all deference to Met, I have found no reasonable basis for

this conclusion in the record. The language of *Griffith I*, 207 Cal.App.4th at 997, that proportionality is properly measured not “on an individual basis [but r]ather, it is measured collectively, considering all rate payors” is not a license to impose any system-wide charge on any user. San Diego as a purchaser of water may well have a variety of system-wide financial obligations, which presumably are reflected in the price it pays for the water it buys from Met, but that does not necessarily mean that San Diego as a wheeler must have those same financial obligations. At argument Met’s counsel stated that the wheeling rate to member agencies would rightfully include system-wide charges that a wheeling rate for non-member agencies would not.⁸² This approach inappropriately focuses on the identity of the customer as opposed to the cost of the service being rendered.

Because Met pays a fixed price for the water it buys, whether it sells it or not to member agencies, water prices to non-wheeling member agencies may rise as a function of increasing wheeling (and foregone purchases from Met). While that might result in “adverse impacts to the rates and charges” imposed on the other member agencies,⁸³ Met must nevertheless permit such wheeling. *Morro Bay*, 81 Cal.App.4th at 1050.

B. Water Stewardship Rate.

Met forthrightly notes that the Water Stewardship Rate recovers the costs of “demand management programs,” and those in turn provide incentives for recycling, groundwater recovery, desalinization programs and other water conservation efforts. Met Closing Brief at 61. Obviously, under these programs the demand for water of various member agencies is reduced, and so Met may in turn reduce its purchases. The record shows that at least a significant benefit of these programs is the creation of new water “supply,” reducing Met’s need to purchase water

⁸² Transcript of closing argument at 918-19 (January 23, 2014)**.

⁸³ Met Closing Brief at 75-76.

from other sources.⁸⁴ San Diego notes that Met’s brief, its witnesses and own documents all confirm that the primary purpose of these programs is to “incentivize development of *local* water *supplies*.”⁸⁵ The 1999 Raftelis Report also notes that at least some of the programs’ costs should be associated with supply.⁸⁶

Met itself knows that the *primary* benefit is not for transportation, but for supply: The central objective of Metropolitan’s water conservation program is to help ensure adequate, reliable and affordable water supplies for Southern California by actively promoting efficient water use. The importance of conservation to the region has increased in recent years because of drought conditions in the State Water Project watershed and court-ordered restrictions on Bay-Delta pumping, as described under “METROPOLITAN’S WATER SUPPLY—State Water Project” in this Appendix A under “METROPOLITAN’S WATER SUPPLY.”

Met Official Bond Statement: AR2012-16429 at 16519*.

The Raftelis’s textbook too states that “conservation costs” should be functionalized to “Source of supply.” AR2012-16288_5282 at 5291*. Raftelis wrote that “all or at least a portion” of programs for local “conservation, water recycling, and the recovery of contaminated groundwater” should be functionalized as “supply costs.” AR2012-16288_2114 at 2179*.⁸⁷

San Diego notes that Met has judicially admitted that it does not calculate the proportional benefits that individual member agencies receive from its Water Stewardship Rate or the programs it funds, neither on the basis of individual programs, nor in the aggregate. PTX-237-A** (RFA) Nos. 20, 32. Met has further judicially admitted that it “has never calculated the

⁸⁴ PTX-393** (Upadhyay Depo.) at 52:11-53:19; 109:16-111:19.

⁸⁵ MWD Br. at 7:14 (emphases added); *see also* AR2010-1101 at 1115, 1124; AR2010-1222 at 1249; AR-2012-16288_1723 at 1744*; PTX-037* at 14; PTX-119**; PTX-181**; PTX-183**; PTX-199**; PTX-237-A** (Admissions) Nos. 17-43; PTX-393** (Upadhyay Depo.) at 52:11-53:19; 104:17-105:25, 109:16-110:13, 116:1-117:14, 134:17-135:24; Ex. 77** (Arakawa Depo.) at 91:2-13; PTX-390** (Kostopoulos Depo.) at 42:14-42:23; PTX-392** (Thomas Depo.) at 79:3-22.

⁸⁶ AR2012-16288_2179*.

⁸⁷ The primary purpose of these programs is to “incentivize development of *local* water *supplies*.” MWD Br. at 7:14 (emphases added by San Diego). *See also* AR2010-1101 at 1115, 1124; AR2010-1222 at 1249; AR2012-16288_1723 at 1744*; PTX-037* at 14; PTX-119**; PTX-181**; PTX-183**; PTX-199**; PTX-237-A** (Admissions) Nos. 17-43; PTX-393** (Upadhyay Depo.) at 52:11-53:19; 104:17-105:25, 109:16-110:13, 116:1-117:14, 134:17-135:24; Ex. 77** (Arakawa Depo.) at 91:2-13; PTX-390** (Kostopoulos Depo.) at 42:14-42:23; PTX-392** (Thomas Depo.) at 79:3-22.

regional benefit to MWD created by the aggregate group of local water supply projects, seawater desalination projects, or conservation programs funded or subsidized with revenue collected through the Water Stewardship Rate in a given calendar year.” *Id.* No. 38.

Nevertheless Met argues that the demand management programs also reduce the demand for transportation. This, Met says, justified the inclusion of the Water Stewardship Rate in the transportation rates. Perhaps; perhaps to some extent. But the central problem here is that Met treats the *entirety* of the Water Stewardship Rate as a “transportation” rate that is then incorporated into the wheeling rate.

It is certainly reasonable to conclude that transportation capacity needs are reduced when supply needs are reduced, including reductions attributable to the demand management programs. See e.g. Met Closing Brief at 64-65. Met has documented at least a few of these. Upadhyay has testified (Met Closing Brief at 63) that some transportation facilities have been deferred as a result of conservation programs.⁸⁸ But the record does not show correlation between those avoided costs and water stewardship rates. While I cannot fault Met for not providing a transportation benefit number for *each* of the specific demand management programs, the best we can do with this record is to conclude that to some unspecified extent, some portion of the Water Stewardship Rate is causally linked to some avoided transportation costs. This is not enough to show that the costs of the service have a reasonable relationship to the service provided. The Rafetelis 1999 report suggests 50-50 allocation, but that suggestion was made simply because no data supported any other allocation;⁸⁹ the number is wholly arbitrary, as is the allocation of 100% of these Water Stewardship Rate charges to transportation.

It is also worth noting here that wheelers secure their benefits only when there is unused

⁸⁸ The 1996 IRP (DTX -019)(Met slide 28).

⁸⁹ AR2012-16288_2114 at 2179, 2216-17.

capacity in the extant transportation system. Wheeling is “[s]ubject to the General Manager’s determination of available system capacity.” Admin. Code § 4405(a). And Met notes, “MWD also resolved that it would make the determination of whether there is unused capacity in its conveyance system (as required by the Wheeling Statue) on a ‘case-by-case basis in response to particular requests for wheeling [services].’ DTX-680 at AR2012-002450; JTX-1 AR2010-002450.” Met Closing Brief at 20. While wheelers would benefit as a general matter by reason of increased capacity in that they might be able to wheel more water, those who in fact are permitted to wheel do so in a system built out to move non-wheeled water, that is, water that Met sells to its member agencies. Thus the costs and avoided costs attributable to the demand management programs relate to the transportation needs to provide purchased water. This too suggests that the cost of wheeling, while properly a function of system-wide costs associated with transportation as such, should not be a function of system-wide avoided costs of transporting purchased water.

C. Dry Year Peaking

San Diego alleges that costs attributable to dry year peaking are improperly part of the wheeling rate. Here’s how San Diego phrases it:

The dry-year peaking costs at issue here are those associated with purchasing and storing water and having capacity available in MWD’s facilities to deliver water supplies to its member agencies when they “roll on” to MWD’s system in dry years. For example, Los Angeles has a long history of rolling on and off the system, depending on the hydrological conditions in the Owens Valley where it obtains much of its water: between 2004 and 2009, Los Angeles’s purchases from MWD swung from 367,000 acre-feet in 2004 to 208,000 acre-feet in 2006 and back up to 434,000 acre-feet in 2009
San Diego’s Amended Reply To MWD’s First Pretrial Brief at 17.

It remains unclear exactly how these costs are part of the wheeling rate. Presumably some capital storage costs, some transportation costs, and some supply costs are part of what San Diego calls dry year peaking. *Cf.* San Diego’s Post-Trial Brief at 30:20-28. Of course dry year

peaking costs are not expressly part of the wheeling charges; indeed, Met argues that there is no such thing as dry year peaking (as opposed to, for example, peaking for other reasons). Perhaps it is done implicitly, in the sense that portions of some rates San Diego pays *must* include it. As San Diego notes, Met has admitted that it does not separately allocate costs to “dry year peaking.”⁹⁰

Met has essentially two responses to San Diego’s complaint. First (as noted above) there is no such thing as dry year peaking, and secondly, the differences in demand patterns which underlie San Diego’s argument are in fact fairly handled by volumetric and other rates.

First, a few words on certain graphs the parties have presented, directed to whether there really is a material variation among member agencies in their patterns of demand on Met’s water. In an effort to show that the dry year peaking issue exists, San Diego prepared a chart⁹¹ to graphically represent peaking. This chart apparently shows that (assuming a baseline based on the average of 1994-2000 purchases) Los Angeles ranged from that baseline to 2.5 of that baseline average, down to a bit under 1.5 of that average, and up to about three time that ratio. San Diego’s ranges are within about 1.5 of the assumed average. Met also has a graph⁹² which shows 2003-2012 purchases, with vaguely similar curves for both Los Angeles and San Diego, dipping in the 2005-06 and 2011 periods and rising in between around 2007 (for San Diego) and around 2009 (for Los Angeles). This includes San Diego’s exchange water, but nevertheless it shows (i) that San Diego obtained more water from Met than did Los Angeles, and (ii) the variation of San Diego’s purchases (about 675,000-400,000, i.e., 275,000) as compared to those of Los Angeles (about 425,000-175,000, i.e., 250,000), which are accordingly roughly the same.

⁹⁰ Order on MILS, December 10, 2013 at 4.

⁹¹ SDCWA Opening Presentation, December 17, 2013, at unnumbered page 87, based on PTX-203**, 347**, 299**, 300**, 301**.

⁹² MWD’s Opening Presentation, December 17, 2013 at 34, based on DTX-691**.

Because it appears exchange water is included in Met's graph, it is not possible to make an even rough conclusion concerning the extent to which one of those two member agencies benefits more from expenditures to account for peaking. And it is not clear that measuring the net difference between high and low purchases, rather than deviations from an average baseline, helps ascertain the impact of peaking.

But San Diego's graph does not answer that question either. The fact that for some time period one customer as opposed to another has a higher ratio of maximum purchases to average purchases does not mean that the former customer imposes higher charges on the supplier who must keep water (and associated facilities) available for the peak demand. This is especially true when the customer with the lower ratio buys more water during 'peak' periods, as may be the case here.⁹³

It is of course true that as a general matter some members agencies in some years buy more water for various reasons, including drought. And it also true, as Met agrees (Closing Brief at 89), that Met incurs costs for this sort of contingency storage. Met also agrees that this contingency capacity is significant, and designed to meet unexpected needs. *Id.* But there are many reasons for a member agency to seek additional water, such as changes in the local economy. And as Met notes, in some times of drought many member agencies actually lowered, not increased, their demand for water. Met Brief at 92; DTX-110*. The record shows that while there are variations in demands, the variations have many causes. For example as the FCS document discussed above notes, demand may fluctuate as a result of conservation measures, price elasticity at the local retail level, mandatory water curtailments, weather patterns, the local agency's supply conditions, and other factors.

⁹³ I exaggerate for illustration: if customer X averages 2 gallons a year in purchases, but sometimes peaks to 20 gallons (a ratio of 1:10), the water supplier will nevertheless presumably spend more to keep standby capacity available for customer Y who varies from 100 to 150 gallons (a ratio of 1:1.5).

There is no reasonable basis supporting the notion that a given amount of storage infrastructure (or any amount) is attributable to ‘dry year peaking.’

Met does impose charges for the cost of this contingency capacity. First, of course, the more water one buys the more one pays. Next, Met’s Tier 2 rates impose higher charges per volume when member agencies substantially exceed their past annual demands. Met Brief at 96. Met’s Readiness To Serve and Capacity Charges also account for unexpected additional demands from member agencies. These latter charges do not necessarily recover expenses attributable to ‘dry year peaking’ but they do recover costs attributable to some aspects of peak usage; and the ‘peak usage’ which measures the Capacity Charge is not on an annual basis but rather on a maximum summer day basis. Met Closing Brief at 99.

In the end, I do agree with San Diego that the record does not tell us that all these charges are sufficient to account for all of the costs of providing what I have called contingency capacity, but it is also true that there is no showing that this is a problem. This conclusion does not place the burden on San Diego when contesting validity of assessment under Proposition 26; rather I have turned to San Diego to show me there is an ‘assessment’ in the first place.

There is no substantial evidence that some member agencies reap a benefit for ‘dry year peaking,’ or that they do so at the expense of other member agencies such as San Diego.

Conclusion

Aside from the Wheeling statute, I have been required to confine my review to the administrative record. The extra record evidence has not made any substantial difference to my evaluation in any event, although for purposes of background, illustration, or to show that some

proposition did not seem to be seriously disputed, I have from time to time mentioned that evidence.

As to the standard of review, the higher de novo standard probably applies to Proposition 26, and under the Wheeling statute to the question of whether a rate might properly include a certain component. Under the Wheeling statute, the deferential standard applies to the issue of fair compensation, as it does to Govt. Code § 549997(a) and the common law's 'reasonable basis' standard.

But in this case, regardless of the standard, the result the same. There is no substantial evidence in the record to support Met's inclusion in its transportation rates, and hence in its wheeling rate, of 100% of (1) the sums it pays to the California Department of Water Resources' SWP disaggregated by the SWP as for transportation of that purchased water; and (2) the costs for conservation and local water supply development programs recovered through the Water Stewardship Rate. Indeed, the record confirms that these rates over-collect from wheelers, because at least a significant portion of these costs are attributable to supply, not transportation. These rates – the System Access Rate, System Power Rate, Water Stewardship Rate, and Met's wheeling rate – therefore violate Proposition 26 (2013-14 rates only), the Wheeling statute, Govt. Code § 549997(a), and the common law. The Court invalidates each rate for both the 2011-2012 and 2013-2014 rate cycles.

So too, under either the substantial deference or de novo standard, San Diego has not shown that there is a "dry year peaking" phenomenon for which Met's rates fail to fairly account. No violation of the pertinent law has been shown with respect to 'dry year peaking'.

Further Orders. San Diego has asked me to retain jurisdiction to ensure compliance with this ruling. At least until judgment is entered an appeal is taken, such an order does not appear

necessary. San Diego has also suggested the entry of a separate order along the lines its proposed in its proposed statement of decision at 55-57. The parties should confer on the matter and report their views at the next case management conference.

Dated: April 24, 2014



Curtis E.A. Karnow
Judge Of The Superior Court

Superior Court of California
County of San Francisco

SAN DIEGO COUNTY WATER
AUTHORITY, et. al.,

Plaintiff(s)

vs.

METROPOLITAN WATER DIST. OF
SOUTHERN CALIFORNIA, et al
Defendant(s)

Case Number: CPF-10-510830
CPF-12-512466

CERTIFICATE OF ELECTRONIC SERVICE
(CCP 1010.6(6) & CRC 2.260(g))

IN RE: SAN DIEGO COUNTY WATER
AUTHORITY

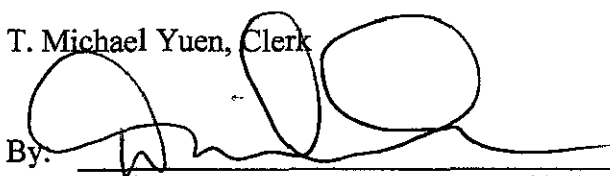
I, DANIAL LEMIRE, a Deputy Clerk of the Superior Court of the County of San Francisco, certify that I am not a party to the within action.

On April 24, 2014, I electronically served STATEMENT OF DECISION ON RATE SETTING CHALLENGES via File & ServeXpress on the recipients designated on the Transaction Receipt located on the File & ServeXpress website.

Dated: April 24, 2014

T. Michael Yuen, Clerk

By:



DANIAL LEMIRE, Deputy Clerk



FILED
San Francisco County Superior Court

AUG 28 2015

CLERK OF THE COURT
BY: [Signature]
Deputy Clerk

SUPERIOR COURT OF CALIFORNIA
COUNTY OF SAN FRANCISCO

SAN DIEGO COUNTY WATER
AUTHORITY,

Plaintiff/Petitioner,

Case No. CFP-10-510830
Case No. CFP-12-512466

vs.

STATEMENT OF DECISION

METROPOLITAN WATER DIST. OF
SOUTHERN CALIFORNIA, et al.

Defendants/Respondents.

I. Introduction

San Diego County Water Authority (San Diego) claims that the Metropolitan Water District of Southern California (Met) breached the Exchange Agreement¹ and improperly computed preferential rights. Met disputes the merits and raised some affirmative defenses. I find for San Diego on both claims.

II. Factual Background²

San Diego is one of Met's member agencies. It purchases water from Met and may obtain wheeling services from Met. If San Diego purchases water from an entity other than Met, it is impossible for San Diego to receive the water without moving it through Met's facilities.

¹ The "Amended and Restated Agreement Between Metropolitan Water District of Southern California and the San Diego County Water Authority for the Exchange of Water." PTX-65.

² Most of this background is extracted from my April 24, 2014 Statement of Decision (April Statement of Decision).

1 This movement is termed ‘wheeling’ the water, i.e., the use of a water conveyance facility by
2 someone other than the owner or operator.

3 Met’s current rate structure dates to 2003. Met’s full-service water rate, charged when
4 Met sells a member agency water, includes supply rates, the System Access Rate, the System
5 Power Rate, and the Water Stewardship Rate. These are volumetric³ charges. Met’s Wheeling
6 Rate is different: it includes the System Access Rate, the Water Stewardship Rate, and the
7 incremental cost of power necessary to move the water.
8

9 San Diego acquired an annual supply of transfer water from the Imperial Irrigation
10 District (IID) in 1998. PTX-28. Later in 1998 San Diego and Met agreed to the 1998 Exchange
11 Agreement. PTX-31.⁴ There San Diego paid Met to take transfer water and have Met make
12 Exchange Water⁵ available to San Diego. *Id.* §§ 3.1-3.2, 5.2. The contract was to last 30 years.
13 *Id.* § 5.2. For the first 20 years, San Diego would pay \$90 per acre-foot plus an annual
14 percentage escalator. *Id.* For the final 10 years, San Diego would pay \$80 per acre-foot plus an
15 annual percentage escalator running from 1998. *Id.* The 1998 Exchange Agreement permitted
16 the parties to request a change in the price after 10 years. *Id.* § 5.3. The price term was close to
17 an \$80 per acre-foot wheeling rate proposed by Department of Water Resources Director David
18 Kennedy in January 1998 as a compromise between wheeling rates advocated by Met and San
19 Diego in a dispute over an appropriate wheeling rate. PTX-481 at MWD 2010-00264720.
20
21

22 There were no IID water transfers to San Diego between 1998 and 2003. Met Pre-Trial
23 Brief, 10; San Diego Post-Trial Brief for Phase II, 13. On October 10, 2003, the parties entered
24

25 ³ That is they are based on the volume of water at issue such as gallons, *Klein v. Chevron U.S.A., Inc.*, 202 Cal. App.
26 4th 1342, 1385 (2012), or acre feet where one acre-foot is an acre of water one foot deep.

27 ⁴ The “Agreement Between Metropolitan Water District of Southern California and the San Diego County Water
Authority for the Exchange of Water.”

⁵ Exchange Water is a creature of contract. It is water delivered to San Diego by Met in the same quantity as that
made available to Met by San Diego. PTX-31 § 1.1(q); PTX-65 § 1.1(m).

1 the operative Exchange Agreement. PTX-65 at MWD2010-00190698. That day, the parties and
2 other agencies signed two other agreements: the Quantification Settlement Agreement and the
3 Allocation Agreement. *Id.* §§ F-G.

4
5 Most importantly for present purposes, the operative Exchange Agreement contained a
6 revised price provision.⁶ The new price was initially \$253 per acre-foot, and thereafter “equal to
7 the charge or charges set by [Met’s] Board of Directors pursuant to applicable law and regulation
8 and generally applicable to the conveyance of water by [Met] on behalf of its member agencies.”
9 *Id.* § 5.2.⁷ By this term, Met charged San Diego the volumetric transportation rates it charged
10 when it sold full-service water as of 2003 – the System Access Rate, System Power Rate, and
11 Water Stewardship Rate.⁸ Met’s rate *structure* has remained the same since 2003, but Met
12 periodically adjusts the dollar figures for the rates. San Diego has paid those charges under the
13 Exchange Agreement.
14

15 16 **III. Procedural History**

17 This action includes two complaints, responsive to Met’s 2010 and 2012 rate settings
18 respectively. April Statement of Decision, 2-3. The 2010 case included six causes of action:
19 three that directly challenged Met’s rate setting, one breach of contract claim, a declaratory relief
20 claim on Rate Structure Integrity, and one declaratory relief claim on preferential rights. *Id.* The
21 2012 case included four causes of action: three that directly challenged Met’s rate setting and
22 one breach of contract claim. *Id.* at 3. I phased proceedings. Phase I addressed the rate
23

24 ⁶ The revised price term was proposed by San Diego as Option 2. Option 1 was closer to the original terms of the
25 1998 Exchange Agreement whereas Option 2 involved a more significant shift in responsibilities. Trial Transcript,
1214:1-1217:22.

26 ⁷ The revised price provision also contained a sentence addressing the parties’ rights to seek to change those charges.
The meaning of that sentence is disputed by the parties.

27 ⁸ The rates differ from Met’s full-service water rate because San Diego does not pay the supply rates. The rates
differ from Met’s wheeling rate because San Diego pays the System Power Rate rather than the incremental cost of
power to move wheeled water.

1 challenges and the declaratory relief claim on Rate Structure Integrity. Phase II concerns the
2 breach of contract and preferential rights claims.

3 On April 24, 2014, I issued a Statement of Decision following Phase I of trial. There I
4 invalidated Met's System Access Rate, System Power Rate, Water Stewardship Rate, and
5 Wheeling Rate for calendar years 2011-2014 because Met improperly included "100% of (1) the
6 sums it pays to the California Department of Water Resources' SWP disaggregated by the SWP
7 as for transportation of that purchased water; and (2) the costs for conservation and local water
8 supply development programs recovered through the Water Stewardship Rate" in its
9 transportation rates. *Id.* at 65. I found that "at least a significant portion of these costs are
10 attributable to supply, not transportation." *Id.* I did not determine the proper allocation of the
11 disputed charges.
12

13
14 Met had earlier moved for summary adjudication of, among other things, San Diego's
15 preferential rights claim. Met's motion was predicated on the rule that payments for the
16 purchase of water do not give rise to preferential rights credit. December 4, 2013 Order, 6-7.
17 Met argued that San Diego pays several volumetric rates under the Exchange Agreement and as
18 a wheeler that Met also charges for the purchase of water, such that San Diego essentially paid
19 for the purchase of water. *Id.* I denied summary adjudication, finding that San Diego did not
20 pay any rate for the cost of water under the Exchange Agreement and that indeed San Diego had
21 already paid *someone else* for the purchase of water in the Exchange Agreement and wheeling
22 contexts. *Id.* at 7. I held that Met had not established as a matter of law that San Diego was
23 purchasing Exchange Water as opposed to making some other sort of payment. *Id.*
24

25 The parties have now completed a Phase II bench trial on San Diego's breach of contract
26 and preferential rights claims. Closing argument was held on June 5, 2015. The parties
27

1 submitted supplemental briefs on June 19, 2015. I issued a proposed statement of decision,
2 granted Met's request for an extension of time to file objections, and now file this statement of
3 decision resolving the Phase II issues including Met's motion for partial judgment interposed at
4 the conclusion of San Diego's case in the Phase II trial.
5

6 7 **IV. Discussion**

8 **A. Breach of Contract**

9 To prove a cause of action for breach of contract a plaintiff must establish the contractual
10 terms, the plaintiff's performance or excuse for failure to perform, the defendant's breach, and
11 damage to the plaintiff resulting from the defendant's breach. *McKell v. Washington Mut., Inc.*,
12 142 Cal.App.4th 1457, 1489 (2006); CACI No. 303.
13

14 **1. Terms**

15 In the Exchange Agreement San Diego agreed to both pay a price and make "Conserved
16 Water" and/or "Canal Lining Water" and "Early Transfer Water" available to Met each year at
17 the "SDCWA Point of Transfer," in exchange for which Met agreed to make "Exchange Water"
18 available to San Diego each year at the "Metropolitan Point(s) of Delivery." PTX-65 §§ 3.1-3.2,
19 5.1.⁹ The aggregate quantity of Exchange Water delivered by Met in a given year was to be
20 equal to the aggregate quantity of Conserved Water (including Early Transfer Water) and Canal
21 Lining Water San Diego made available to Met in the same year. *Id.* §§ 1.1(m), 3.2(c).
22

23 The Exchange Agreement provided for the Price, as follows:
24

25 ⁹ The Exchange Agreement was one of several agreements executed pursuant to the Quantification Settlement
26 Agreement. PTX-65 § F. San Diego entered the Allocation Agreement on the same day. *Id.* at § G. In the
27 Allocation Agreement, Met assigned certain water rights to San Diego and its right to receive substantial
reimbursements for certain canal lining projects from San Diego. DTX-884 § 4A.1. San Diego's obligations under
the Exchange Agreement were subject to the execution and delivery of the Allocation Agreement, among other
things. PTX-65 § 7.2.

1 The Price on the date of Execution of this Agreement shall be [\$253]. Thereafter, the
2 Price shall be equal to the charge or charges set by Metropolitan's Board of Directors
3 pursuant to applicable law and regulation and generally applicable to the conveyance of
4 water by Metropolitan on behalf of its member agencies. For the term of this Agreement,
5 neither SDCWA nor Metropolitan shall seek or support in any legislative, administrative
6 or judicial forum, any change in the form, substance, or interpretation of any applicable
7 law or regulation (including the Administrative Code) in effect on the date of this
8 Agreement or pertaining to the charge or charges set by Metropolitan's Board of
9 Directors and generally applicable to the conveyance of water by Metropolitan on behalf
10 of its member agencies; provided, however, that Metropolitan may at any time amend the
11 Administrative Code in accordance with Paragraph 13.12, and the Administrative Code
12 as thereby amended shall be included within the foregoing restriction; and, provided,
13 further, that (a) after the conclusion of five (5) Years, nothing herein shall preclude
14 SDCWA from contesting in an administrative or judicial forum whether such charge or
15 charges have been set in accordance with applicable law and regulation; and (b) SDCWA
16 and Metropolitan may agree in writing at any time to exempt any specified matter from
17 the foregoing limitation.

18 PTX-65 § 5.2.

19 The first sentence of § 5.2 sets the initial price. The second sentence of § 5.2 constrains
20 subsequent prices to charges Met sets pursuant to applicable law and regulation for the
21 conveyance of water by Met to its member agencies.

22 The parties dispute the import of the lengthy third sentence of § 5.2. Met contends that
23 San Diego there agreed to the rate structure Met had in place at the time of the Exchange
24 Agreement but reserved the ability to challenge only *amendments* to Met's rate structure (after /
25 the five year period). Met Closing Brief, 20-22.¹⁰ San Diego contends that San Diego agreed
26 not to challenge Met's existing rate structure or any amendments to it for five years, but reserved
27 the ability to challenge Met's existing rate structure or any amendments to it after five years.

San Diego's position is consistent with the plain language of the provision and Met's
position is not.

The third sentence begins with a limitation on the parties' ability to seek changes to the
form, substance, or interpretation of any applicable law or regulation, including the

¹⁰ Citations to "Met Closing Brief" refer to Met's corrected closing brief.

1 Administrative Code, that pertains to the charge or charges set by Met and generally applicable
2 to Met's conveyance of water on behalf of its member agencies. This limitation is followed by a
3 proviso that permits Met to amend its Administrative Code and extends the scope of the
4 limitation to any of Met's amendments to the Administrative Code. The first proviso is followed
5 by a second proviso that constrains the scope of the general limitation in two ways – one that
6 sunsets restrictions on challenges brought by San Diego, and one that permits the parties to make
7 mutually agreeable changes.
8

9 This plain language shows the parties agreed to preclude certain challenges with the
10 exception of those challenges expressly permitted, including the specified challenges identified
11 in the final proviso. Among the permitted challenges are those brought by San Diego after the
12 passage of five years contesting Met's charges for the conveyance of water on the basis they
13 were not set pursuant to applicable law. Whether or not Met amended the underlying rate
14 structure is irrelevant to whether San Diego may challenge Met's rate structure.
15

16 Met's argument turns on the assertion that the second proviso modifies the first proviso,
17 not the general limitation. Met Closing Brief, 20-22. The key to Met's argument is the premise
18 that the language "such charge or charges" in the second proviso refers to the charge or charges
19 contained in any amendments made pursuant to the first proviso. *Id.* at 22. This reading is
20 irreconcilable with the plain language. The general limitation, not the first proviso, contains a
21 reference to "charge or charges." In using the "charge or charges" language, the general
22 limitation echoed the price term itself. The general limitation precludes San Diego from
23 attacking any law or regulation pertaining to Met's "charge or charges" "generally applicable to
24 the conveyance of water." The general limitation precludes San Diego from bringing a challenge
25 that could impact the contract price. The reference to "such charge or charges" in the second
26
27

1 proviso refers to those charges.¹¹ It does not refer to the first proviso, which contains no
2 reference to any “charge or charges.”

3 The structure of this section makes this conclusion inescapable. The first proviso begins
4 with the language “provided, however.” The second proviso begins with the language “and,
5 provided, further.” This makes it plain that the second proviso was a further proviso to the
6 general limitation.
7

8 Met hopes to inject ambiguity into the contract with extrinsic evidence such as the
9 testimony of Jeffrey Kightlinger, who negotiated the deal for Met. Met Closing Brief, 22; Trial
10 Transcript, 1327:21-1328:8. He said the purpose of the second proviso was to protect San Diego
11 from adverse changes in Met’s rate structure, *id.* at 1300:13-1307:2, 1328:9-14, noting that San
12 Diego’s negotiators told him that San Diego would not challenge Met’s existing rate structure
13 and that this concession was material to Met. *Id.* at 1300:13-1301:6, 1304:19-1305:7. One of
14 San Diego’s negotiators, Maureen Stapleton, disputed Kightlinger’s testimony. She said San
15 Diego always had concerns with the rates themselves and raised them repeatedly with Met. *Id.* at
16 1554:22-1555:14.¹²
17

18 Met also notes San Diego’s analysis of the future costs under the pricing agreement that
19 the parties ultimately adopted. San Diego analyzed the cost of that price plan over 20, 35, 45,
20 and 75 years, but not over five years. Met Closing Brief, 23; Trial Transcript, 1218:6-1221:6.
21 Met also seeks to corroborate its interpretation by looking to a San Diego memo to its Imported
22 Water Committee from 2007, in which San Diego stated that it did not intend to litigate Met’s
23
24

25 ¹¹ Met contends that if the second proviso refers to the general limitation then San Diego could challenge every
26 charge. Met Closing Brief, 22. Not so. The general limitation referred to a limited subset of Met’s charges, to which
27 the second proviso refers.

¹² Met disputes Stapleton’s credibility. Met Closing Brief, 22-23 n.10. But a Met person ‘most knowledgeable’ also testified, in his deposition, that pursuant to these provisions San Diego could contest whether Met’s rates and charges are consistent with applicable law after five years. PTX-392 at 121:10-124:25. I credit Stapleton’s testimony, and not contrary Kightlinger testimony.

1 current rate structure but could not know what future actions Met may take. Met Closing Brief,
2 23; DTX-355 at 2.

3 None of this extrinsic evidence creates ambiguity in the contract.¹³ That San Diego
4 projected its exposure over periods exceeding five years is unsurprising, because even if San
5 Diego could succeed in a rate challenge San Diego would still pay Met's full, if reconfigured,
6 conveyance rates over the life of the Exchange Agreement. Stapleton testified that San Diego
7 was only interested in projecting a worst case scenario under the pricing plan. Trial Transcript,
8 1465:22-1466:1. A worst case scenario projection would not include savings from rate
9 restructuring as a result of litigation, even in the dubious event that one could estimate such
10 savings.
11

12 That in 2007 San Diego did not intend to challenge Met's existing rate structure does not
13 clarify the parties' intent when they signed the agreement in 2003. If anything, San Diego's
14 statement in 2007 is consistent with San Diego's interpretation of the contract, not Met's. By
15 stating that it did not intend to challenge Met's existing rate structure, San Diego implied that it
16 thought it had, or would soon have, a right to challenge Met's existing rate structure. (If San
17 Diego had no right to challenge Met's rate structure, there would be no reason for San Diego to
18 discuss whether it intended to do so.) This implication is inconsistent with Met's interpretation
19 of the contract, pursuant to which San Diego would never have any right to challenge Met's
20 existing, unamended, rate structure.
21

22 While Kightlinger's testimony supports Met's position, it is contradicted, and I reject it.
23 PTX-392 at 122:21-123:1; Trial Transcript, 1194:16-1196:6. His reading is in any event
24
25

26
27 ¹³ Only if the contract is reasonably susceptible to an interpretation urged does a court admit extrinsic evidence to aid in the interpretation of the contract. *Wolf v. Superior Court*, 114 Cal.App.4th 1343, 1350-51 (2004). The determination of whether an ambiguity exists is a question of law. *Id.* at 1351.

1 irreconcilable with the plain language of the contract. It does not create an ambiguity and the
2 unambiguous plain language controls.

3 The third sentence of § 5.2 permits San Diego to challenge Met's charges applicable to
4 the conveyance of water by Met to member agencies.¹⁴

6 2. Breach

7 In the rate years at issue, Met charged San Diego its transportation rates – the System
8 Access Rate, System Power Rate, and Water Stewardship Rate – pursuant to the price term.¹⁵
9 San Diego contends that Met breached the price term because Met's transportation rates were not
10 set pursuant to applicable law and regulation. San Diego Pre-Trial Brief, 1. In Phase I, I held
11 that Met's System Access Rate, System Power Rate, and Water Stewardship Rate were unlawful.
12 April Statement of Decision, 65. There is no dispute that those rates are the rates generally
13 applicable to Met's member agencies for the conveyance of water. Because Met's charges were
14 not consistent with law and regulation, Met breached § 5.2 of the Exchange Agreement. PTX-65
15 § 5.2.
16

17 To escape this result, Met argues that San Diego did in fact agree to Met's existing rate
18 structure by (1) agreeing to an initial price of \$253, based in turn on Met's existing rate structure;
19 (2) entering the Exchange Agreement knowing Met's existing rate structure; (3) voting in favor
20 of the challenged rate structure before and after the Exchange Agreement was entered into; and
21 (4) accepting Met's performance under the contract. Amended Motion for Partial Judgment, 2-3;
22 Met Pre-Trial Brief, 12.
23

24 ¹⁴ In passing, San Diego refers to this state of affairs as an "agree[ment] to disagree" about the law pertaining to
25 Met's rates. San Diego Post-Trial Brief for Phase II, 14. Met contends that San Diego agreed to a contract price
26 including the Water Stewardship Rate, the System Power Rate, and the System Access Rate, the latter two
27 components including State Water Project costs that the Department of Water Resources allocated to infrastructure.
Met Pre-Trial Brief, 12. Through this litigation Met has never contended the price term is uncertain or indefinite.
Compare, e.g., California Lettuce Growers v. Union Sugar Co., 45 Cal.2d 474, 481 (1955).

¹⁵ This is undisputed. *E.g.*, Met Pre-Trial Brief, 11; Met Closing Brief, 15; San Diego Post-Trial Brief for Phase II,
4, 21-22.

1 The first two points are not persuasive. Regardless of the parties' thinking which led to
2 the initial price, the parties just agreed to that number. San Diego's agreement to pay rates Met
3 set pursuant to applicable law and regulation does not amount to a tacit adoption of the then-
4 existing rate structure where the very same paragraph sets out provisions governing how and
5 when San Diego will be precluded from, and permitted to, a challenge whether those same
6 charges, whether or not amended, were in fact properly set pursuant to applicable law and
7 regulation. PTX-65 § 5.2.

8
9 Met contends there can be no breach when it uses the rate structure that has been in
10 existence since 2003, because San Diego entered the contract knowing Met's future performance
11 would be a continuation of that very structure. Amended Motion for Partial Judgment, 6. San
12 Diego may well have known that it was in substance agreeing to pay the Water Stewardship Rate
13 and for all State Water Project costs in Met's rate elements for five years. But San Diego also
14 bargained for the right to attack Met's conveyance rates after five years. If the charges were
15 removed from Met's generally applicable rates as the result of a change obtained by San Diego,
16 the charges would also be removed from the contract price. So San Diego did not agree to pay
17 any specific rate or abide by any specific rate structure for the life of the contract – it expressly
18 only agreed to pay rates set in accordance with applicable law and regulation, reserving the right
19 to challenge whether Met set its rates in accordance with applicable law and regulation (after five
20 years).

21
22
23 Accepting Met's performance for some period of time, even exceeding the five year
24 period, does not show San Diego agreed in the contract¹⁶ to a rate structure when at the same
25 time San Diego expressly retained the right to challenge Met's charges in court after the five year
26 period.

27

¹⁶ I separately address Met's waiver defense.

1 Below, I discuss the impact of San Diego's representatives' votes on Met's Board of
2 Directors on waiver. Here, I find that the voting history does not suggest that the plain language
3 of the contract is ambiguous or that San Diego agreed to pay under Met's existing rate structure
4 for the life of the contract. The unambiguous plain language again controls.
5

6 3. Damages

7 There are two issues under the rubric of damages. First, San Diego must prove the fact
8 that it suffered some damage as an element of its breach of contract claim. Second, if liability
9 for breach of contract is established, I must determine the appropriate measure of damages.
10

11 a. Background Law

12 Damages are of course an essential element of a breach of contract claim. *Behnke v.*
13 *State Farm General Ins. Co.*, 196 Cal.App.4th 1443, 1468 (2011); C.C. § 3300. "The damages
14 awarded should, insofar as possible, place the injured party in the same position it would have
15 held had the contract properly been performed, but such damages may not exceed the benefit
16 which it would have received had the promisor performed." *Brandon & Tibbs v. George*
17 *Kevorkian Accountancy Corp.*, 226 Cal.App.3d 442, 468 (1990); *Lewis Jorge Const.*
18 *Management, Inc. v. Pomona Unified School Dist.*, 34 Cal.4th 960, 967-68 (2004). "Where the
19 fact of damages is certain, the amount of damages need not be calculated with absolute certainty.
20 [Citations.] The law requires only that some reasonable basis of computation of damages be
21 used, and the damages may be computed even if the result reached is an approximation." *GHK*
22 *Associates v. Mayer Group, Inc.*, 224 Cal.App.3d 856, 873 (1990).
23

24 Importantly, a defendant cannot escape liability for its breach because damages cannot be
25 measured exactly. *SCI Cal. Funeral Servs., Inc. v. Five Bridges Foundation*, 203 Cal.App.4th
26 519, 571 (2012).
27

1 **b. Fact of Damages**

2 To establish the fact of damages San Diego relies on the April Statement of Decision as
3 well as testimony to the effect that Met's rates resulted in inflated conveyance rates. San Diego
4 Post-Trial Brief for Phase II, 21.¹⁷ In Phase I, I held that Met's conveyance rates over-collect
5 from wheelers because Met allocated all of the State Water Project costs for the transportation of
6 purchased water to its conveyance rates and all of the costs for conservation and local water
7 supply development programs to its conveyance rates. April Statement of Decision, 65. The
8 same logic applies to the Exchange Agreement. San Diego paid more than it agreed to under the
9 Exchange Agreement because Met improperly included all of the State Water Project costs for
10 the transportation of purchased water to its conveyance rates and all of the costs for conservation
11 and local water supply development programs to its conveyance rates.
12

13
14 Met responds that contract damages may only be the difference between the price Met
15 charged San Diego and the highest price Met could have charged San Diego had it performed its
16 obligation to set a lawful rate. Met Closing Brief, 3. So, Met says San Diego bore a burden of
17 proving at least that its damages theory is based on some lawful rate structure, and (possibly) that
18 under every imaginable lawful alternative rate structure San Diego would have paid less than it
19 did in the real world.¹⁸
20

21 There are two points to be made here. First, Met's present argument flies in the face of
22 the positions it has repeatedly taken in the past; and secondly, Met's argument does not in any
23 event obviate the obvious point that San Diego has established the fact of damages.

24 ¹⁷ See also, Trial Transcript, 991:16-992:6 (Dennis Cushman's testimony that San Diego has overpaid State Water
25 Project and Water Stewardship Rate charges as a result of Met's rates), 1911:24-1912:9 (testimony from Met's
26 expert to the effect that if the State Water Project costs should not have been included then San Diego overpaid
those charges).

27 ¹⁸ Met Closing Brief, 3 (arguing that San Diego did not prove that it paid more under the Exchange Agreement than
it could have under an alternative lawful rate structure, and therefore did not prove damages, because it did not
prove what alternative rate structures may exist); Amended Memorandum in Support of Partial Judgment, 8-9
(arguing that San Diego must prove its allocation is based on a lawful rate structure).

1 On the matter of stating or fixing damages through some sort of analysis of
2 counterfactual arguably legal rates, Met has repeatedly tried to have its cake and eat it too, as it
3 were. It has told me both that (i) only a new rate setting procedure may be used in this case to
4 fix lawful rates which in turn must be done before damages can be ascertained,¹⁹ and (ii) superior
5 courts may not do this. Met's January 9, 2015 Motion to Dismiss, 1-5; Trial Transcript, 2013:6-
6 2018:16; *see also* Met's March 27, 2014 Objections to Tentative Statement of Decision, 2-3
7 (court is not a rate-fixing body).²⁰ Met has had no useful response when I have enquired whether
8 its vision of damages requires me to defer a calculation of damages until after Met resets rates
9 (which would come after, and be a function of, appellate proceedings in this very case) which
10 new rates themselves might very well be subject to further independent litigation, pushing out
11 the decision on both the fact and calculation of damage in this case to many, many years hence.
12 Met's January 9, 2015 Motion to Dismiss, 5-6. These parties were keenly, almost painfully,
13 aware that contract litigation (after five years) was likely; but the notion that they also intended
14 to have the anticipated contract dispute resolved in this way is inconceivable.²¹

17 On the second point, Phase I established Met unlawfully included supply costs in
18 transportation rate elements. Met charged the same transportation rate elements to San Diego
19 under the Exchange Agreement as charges generally applicable to the conveyance of water by
20 Met on behalf of its member agencies. It is thus patently obvious that San Diego has established
21 that some costs should have been removed from the rates it paid under the Exchange Agreement
22

23 ¹⁹ E.g., Met's Amended Motion for Partial Judgment at 7:20 ("rates must be recalculated").

24 ²⁰ This logical twist got to the point where I had to instruct Met not to press a damages theory which Met at the same
25 time maintained I had no jurisdiction to entertain. Nov. 4, 2014 Order Setting Case Management Conference, 1-2;
26 Dec. 4, 2014 Order Denying Met's Motion to Reopen Expert Discovery. The effect of Met's fabricated conundrum
27 would be, of course, that damages could *never* be fixed if Met ever breached the Exchange Agreement. Despite this,
I allowed the parties, and Met specifically, to introduce evidence of a "lawful spectrum of rates" to estimate
damages. Order Re: Metropolitan's Motion To Dismiss For Lack Of Subject Matter Jurisdiction And [On] The
Parties' Motions In Limine, dated February 6, 2015. In the event, Met did not do so.

²¹ Dennis Cushman's testimony at e.g. DTX-710 at 443:10-444:2 is not to the contrary: he does not there endorse
this mode of calculating damages.

1 – the rates were obviously overinclusive. The precise amount of overinclusion is not established,
2 nor is any resulting impact on other Met rates.

3 I turn to Met’s argument that San Diego failed to account for (or set off) benefits it
4 secured by Met’s illegal rates, and as a consequence failed to establish damages.

5
6 Met argues the same conduct that breached the contract also must have resulted in
7 decreased supply rates, saving San Diego some money when it purchased full-service water from
8 Met. Met Closing Brief, 6. These savings must be treated as an offset against San Diego’s
9 damages, Met says, for it must have under-collected its supply costs in such a way that
10 necessarily resulted in under-collection from full-service water purchases.²² But Met as
11 defendant has the burden on matters of offset and unjust enrichment. *Textron Fin. Corp. v. Nat’l*
12 *Union Fire Ins. Co. of Pittsburgh*, 118 Cal.App.4th 1061, 1077 (2004), *disapproved of on other*
13 *grounds by Yanting Zhang v. Superior Court*, 57 Cal.4th 364 (2013). Met bore the burden of
14 demonstrating that San Diego’s damages were offset by incidental extra-contractual benefits San
15 Diego obtained as a result of the same conduct amounting to breach. *Space Properties, Inc. v.*
16 *Tool Research Co.*, 203 Cal.App.2d 819, 827 (1962) (defendant has burden of proof on defenses
17 such as unjust enrichment and or setoff). No evidence shows San Diego would have received a
18 consequential benefit from paying reduced supply charges that equaled or outweighed its
19 damages under the contract during the rate years in question if Met had reallocated the unlawful
20 transportation charges to its supply rates. Accordingly, Met’s argument for an offset does not
21 defeat liability. It has not met that burden.

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26 ²² *Hicks v. Drew*, 117 Cal. 305, 314-15 (1897) (approving the jury instruction “If the jury find from the evidence that
27 the plaintiff has sustained any damage by the act of defendant, as she has complained against him, and that by the
same act she has received benefit, then, in estimating such damage, such benefit should be deducted”). See Trial
Transcript, 1136:25-1138:14.

1 Finally as I have suggested above a recalculation of Met's supply rates conflicts with
2 Met's view that such an approach is impermissible in superior court.

3 San Diego has proven by a preponderance of the evidence that it was in fact damaged by
4 paying conveyance rates that were higher than Met could have set pursuant to applicable law and
5 regulation. PTX-65 § 5.2. San Diego should not be required to prove the fact of damages
6 beyond any shadow of doubt by proving the entire universe of possible alternative legal rate
7 structures Met might have implemented.
8

9 **c. Amount of Damages**

10 San Diego seeks an award of \$188,295,602 plus interest. San Diego Post-Trial Brief for
11 Phase II, 29. San Diego computed its damages by removing the SWP costs and the Water
12 Stewardship Rate from the Price. *Id.* at 30. Met correctly notes the Phase I ruling did not go so
13 far as to hold that Met is not permitted to include any of its SWP costs or Water Stewardship
14 Rate in its conveyance rates. Met argues that San Diego bore a Phase II burden of demonstrating
15 the appropriate percentage that Met could have included; and failed to carry that burden. Met
16 Closing Brief, 5-6; Trial Transcript, 2033:15-22, 2035:20-2037:19. Met also argues that any
17 damage award should be offset by whatever increases San Diego would have paid in its supply
18 rates. Met Closing Brief, 6; Trial Transcript, 2021:4-10.
19
20

21 San Diego's approach may overcompensate San Diego, because San Diego (1) removed
22 all State Water Project costs from Met's conveyance rates although I have only ruled that Met
23 could not include 100% of those costs through its conveyance rates;²³ and (2) removed the entire
24

25 ²³ Met argues that Exchange Water included State Water Project water, so San Diego should be charged with some
26 costs from the State Water Project system under the Exchange Agreement. Met Closing Brief, 8-12. But the
27 question is not whether Met should recover State Water Project costs under the Exchange Agreement, the question is
whether State Water Project costs can properly be recovered through the lawfully set conveyance rates that San
Diego agreed to pay under the Exchange agreement. Met's argument that San Diego should have accounted for the
power costs to move water pursuant to the Exchange Agreement appears to suffer from the same defect. *Id.* at 13.
In a similar vein, Met challenges the methodology by which San Diego's expert recalculated the rates. Met Closing

1 Water Stewardship Rate from Met's conveyance rates although I only ruled that Met could not
2 recover 100% of those costs through its conveyance rates. Nor does San Diego account for
3 possible set-offs, although as suggested above it is not San Diego's burden to do so.²⁴
4

5 There is no viable alternate methodology available. Neither party has computed alternate
6 conveyance rates assuming that less than 100% of the charges are shifted from conveyance to
7 supply. Neither party has explained the basis for an appropriate offset as a result of reduced
8 supply rates.

9 Met seeks dismissal because of this uncertainty. Trial Transcript, 2033:12-19. But
10 where, as here, the fact of damage flowing from the breach is proven the amount of damages
11 may be fixed using an approximation if there is a reasonable basis for the approximation. *GHK*,
12 224 Cal.App.3d at 873-74.²⁵ The rationale for San Diego's calculation is (1) San Diego has
13 removed from Met's transportation rates only certain charges that this Court ruled cannot be
14 wholly included in transportation rates; (2) attempting to allocate the charges at issue between
15 transportation and supply would embroil the Court in an inappropriate ratemaking exercise (a
16 proposition with which Met has repeatedly agreed) (Trial Transcript, 2017:23-2018:7; Met's
17 January 9, 2015 Motion to Dismiss, 3-5; Met's March 27, 2014 Objections to Tentative
18

19
20 Brief, 7-8; Trial Transcript, 1140:5-17. San Diego's expert removed the challenged costs from the cost pool and
21 divided the cost pool by the sales assumption. Trial Transcript, 1140:5-17. Met's expert opined that San Diego
22 should have instead divided only Colorado River costs by Colorado River sales. Trial Transcript, 1899:8-1900:14.
23 But, once again, the proper approach was to determine what Met's rate would have been if certain charges in Met's
24 generally applicable conveyance rates were moved from conveyance to supply. To do this, it was appropriate to
25 look at Met's total conveyance costs and its total sales assumption.

26 ²⁴ San Diego provided some evidence in support of a 15% figure. Trial Transcript, 1258:7-1260:8. While Met
27 contends quantifying an offset is not its problem, Trial Transcript, 2022:11-14, defendants usually *do* have this sort
of burden. *Textron Fin. Corp. v. Nat'l Union Fire Ins. Co. of Pittsburgh*, 118 Cal.App.4th 1061, 1077 (2004),
disapproved of on other grounds by Yanting Zhang v. Superior Court, 57 Cal.4th 364 (2013). At closing argument
Met expressed no confidence in or support for this 15% figure. E.g., Trial Transcript (closing argument) June 5,
2015 at 2020. See also, Met Closing Brief, 7.

²⁵ The *GHK* Court noted that an approximation for which there is a reasonable basis is particularly permissible when
the wrongful acts of the defendant created difficulty in proving the amount of lost profits or where the wrongful acts
of the defendant caused the other party not to realize a profit to which it was entitled. *GHK*, 224 Cal.App.3d at 873-
74.

1 Statement of Decision, 2-3). San Diego Post-Trial Brief for Phase II, 31; San Diego Pre-Trial
2 Brief, 11-12.

3 San Diego has offered a reasonable computation. It is not possible to know how Met may
4 in the future allocate its State Water Project conveyance costs or Water Stewardship Rate
5 between transportation and supply rates. One reasonable assumption is that the entirety of the
6 rate would have been moved. San Diego computed its damages under the contract for the 2011-
7 2014 rate years using that assumption.

8 Met did not offer a competing computation.

9 It asks too much of San Diego to require it to recalculate Met's rates with any useful
10 degree of precision. *MCI Telecommunications Corp. v. F.C.C.*, 59 F.3d 1407, 1415 (D.C. Cir.
11 1995) (inequitable to permit defendants who were in the best position to set their rates at lawful
12 levels in the first place and who later had opportunities to correct those rates to avoid
13 responsibility for those unlawful rates because the complainant to establish an appropriate rate
14 without making simplifying assumptions); *SCI*, 203 Cal.App.4th at 571 (defendant cannot escape
15 liability for breach simply because damages cannot be measured exactly).

16 For these reasons, San Diego has proven that it is entitled to damages in the amount of
17 \$188,295,602 plus interest.

18 **4. Affirmative Defenses**

19 **a. Waiver**

20 Met contends that San Diego waived²⁶ any claim for damages arising from Met's use of
21 the rate structure to set the Price by the following conduct inconsistent with an intent to claim
22 damages: (1) proposing the Price with knowledge of the rate structure and its components; (2)
23 voting, through its delegates to Met's Board of Directors, in favor of the rate structure and rates;

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²⁶ *Carmel Valley Fire Prot. Dist. v. California*, 190 Cal.App.3d 521, 534 (1987) (elements of waiver).

1 (3) failing to object to the structure of the rates until 2010; (4) stating in 2007 that San Diego did
 2 not intend to litigate Met's existing rate structure; and (5) accepting Met's performance with
 3 knowledge of the breach. Met Closing Brief, 14-20.

4 Met's waiver theories are precluded by the anti-waiver provision²⁷ in the Exchange
 5 Agreement. Met has not identified any conduct that could have waived the protections of the
 6 anti-waiver provision. *Id.* at 24-25. Nor has Met identified any written and signed waiver.
 7
 8 PTX-65 § 13.9.²⁸

9 **b. Consent**

10 Met asserts that San Diego consented²⁹ to using Met's then-existing rate structure to set
 11 the Price by entering the Exchange Agreement with knowledge of the unlawfulness of the rate
 12 structure, voting in favor of the rate structure, and accepting the benefits of the agreement. Met
 13 Closing Brief, 25-28.

14 First, San Diego's agreement to the price term in the Exchange Agreement does not
 15 amount to San Diego's approval of Met's rate structure. As discussed above,³⁰ contrary to Met's
 16 reading of the Exchange Agreement San Diego retained the right to challenge Met's existing rate
 17 structure after five years. San Diego agreed to pay only (1) a fixed initial rate; and (2) a rate set
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 19
 20

21 ²⁷ "No waiver of a breach, failure of condition, or any right or remedy contained in or granted by the provisions of
 22 this Agreement is effective unless it is in writing and signed by the Party waiving the breach, failure, right, or
 23 remedy. No waiver of a breach, failure of condition, or right or remedy is or may be deemed a waiver of any other
 24 breach, failure, right, or remedy, whether similar or not. In addition, no waiver will constitute a continuing waiver
 25 unless the writing so specifies." PTX-65 § 13.9.

26 ²⁸ Met looks to San Diego's written statement in 2007 that it did not intend to litigate Met's existing rate structure as
 27 a written waiver. Met Closing Brief, 19-20; DTX-355 at 2; DTX-1114 at 11-12; Trial Transcript, 1070:17-22. But
 none of these documents shows San Diego's intention to give up any right to challenge the existing rates. Rather,
 the documents reflect whether San Diego had the intent to challenge the existing rates in 2007. San Diego may not
 have *then* intended to challenge the existing rates, but still not have intended to give up the right to do so in the
 future.

²⁹ Consent is a free and mutual agreement to an act. C.C. § 1567. "A voluntary acceptance of the benefit of a
 transaction is equivalent to a consent to all the obligations arising from it, so far as the facts are known, or ought to
 be known, to the person accepting it." C.C. § 1589.

³⁰ Section IV(A)(1).

1 pursuant to applicable law. San Diego did not agree to Met's existing rate structure, but
2 bargained away the ability to challenge that rate structure for five years.

3
4 Second, the voting records do not support the assertion that San Diego consented to the
5 use of Met's rate structure in the years at issue. San Diego's representatives on Met's board
6 voted in favor of Met's rates in 2002, 2005, 2006, 2007, 2008, and 2009. Trial Transcript,
7 1506:14-17; DTX-129. San Diego's representatives voted against the rates in the years at issue
8 in this case. DTX-129. In voting, San Diego's representatives acted as Met's fiduciaries in the
9 scope of their duties as members of the board. Trial Transcript, 1506:12-13. Each time Met set
10 an unlawful rate, Met breached its obligations under the Exchange Agreement. *Arcadia*
11 *Development Co. v. City of Morgan Hill*, 169 Cal.App.4th 253, 262 (2008). Even if San Diego
12 can be said to have consented to Met's breaches in prior years because its delegates voted in
13 favor of the rates, a proposition with which I do not agree,³¹ San Diego's delegates did not vote
14 in favor of the rates at issue now.

15
16 Third, San Diego did not accept the benefits of the contract without protest in the rate
17 years at issue here. Again, each time Met sets unlawful conveyance rates, it breached its
18 obligations. Perhaps San Diego accepted Met's performance in prior years, even after the
19 expiration of the five year period; but San Diego did not accept Met's performance without
20 protest in the rate years at issue. Rather, it sued to challenge these breaches.

21 22 c. Estoppel

23 Met argues that San Diego is estopped³² from asserting that setting the Price based on the
24 existing rate structure is a breach of contract because San Diego's delegates to Met's Board of
25

26
27 ³¹ As the text suggests these delegates wore at least two hats, and in voting for Met rates may well have acted in the best interests of Met.

³² In general, there are four elements of equitable estoppel: (1) the party to be estopped must be apprised of the facts; (2) the party to be estopped must intend that his conduct shall be acted upon or have acted in such a way that the

1 Directors failed to disclose that Met's rate structure was unlawful and instead in effect
2 represented that the Price could be based on the existing rate structure. Met Closing Brief, 28-
3 31. Met asserts that San Diego agreed to a price term based on the rate structure and the 2003
4 rates; did not communicate that any of Met's rates might be unlawful; did not object to the price;
5 and represented that it did not intend to sue over the existing structure. *Id.* at 30.

7 In short Met contends that San Diego, knowing Met's rate structure was unlawful,
8 engaged in conduct that created the impression Met's existing rate structure was lawful, and that
9 Met, not knowing that its rate structure was unlawful, relied on San Diego's conduct.

10 But as Met recognized in its First Phase I Pre-trial Brief, the plain language of the
11 Exchange Agreement is itself an "open[] threat[] to litigate over [Met's] existing rate structure"
12 because San Diego agreed not to challenge Met's rates for five years after execution but reserved
13 the right sue to challenge the validity of Met's rates thereafter. Met Oct. 18, 2013 Brief, 14
14 (providing background concerning Met's use of Rate Structure Integrity provisions); PTX-65 §
15 5.2. San Diego's right to challenge Met's existing rate structure is itself part of the price term
16 section. Met could not have relied on San Diego's proposal of or agreement to this price term to
17 conclude that its rate structure is lawful. Moreover, the contract itself demonstrates that neither
18 party knew that Met's rate structure was unlawful;³³ both parties were bargaining in the context

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22
23 party asserting estoppel had the right to believe the conduct was so intended; (3) the party asserting estoppel must be
24 ignorant of the true facts; and (4) the party asserting estoppel must rely on the conduct. *Ashou v. Liberty Mut. Fire*
25 *Ins. Co.*, 138 Cal.App.4th 748, 766-67 (2006). Met's arguments conceivably satisfy the first two elements, but not
26 the rest, so setting aside my discussions in the text the estoppel defense fails in any event. Met does not show it was
27 ignorant of facts to which San Diego was privy nor does it show reliance, that is, that it would have acted otherwise.
33 Indeed, my determination on the lawfulness of Met's rate structure is itself exceedingly likely to be appealed. The
notion that Met relied on representations from San Diego to act on the belief that its rate structure is lawful is
particularly unpersuasive where Met continues to set its rates based on the belief that its rate structure is lawful even
after San Diego voted against the rates, sued Met over the rate structure, and obtained my trial court ruling that the
rate structure is unlawful. Met, as experienced in state water law as any entity, and served by some of the best
lawyers in the country, has never been misled by San Diego; it just disagrees with San Diego.

1 of uncertainty. The negotiations and terms of the Agreement make it plain—in way that is not
2 often found in contracts—that a lawsuit was contemplated.

3 Nor, in this context, could Met have reasonably relied on San Diego's other conduct to
4 conclude that its rate structure was legal. For example, in 2007 San Diego stated in internal
5 documents that it did not intend to litigate Met's existing rate structure.³⁴ But San Diego could
6 have determined not to litigate Met's existing rate structure for a number of reasons, only one of
7 which is San Diego's likelihood of success; and an internal document surely could not create an
8 estoppel as to Met. Met also notes San Diego's delegates voted to approve Met's rates in 2002
9 and 2005-2009 but did not tell Met that its rate structure might be illegal. But again the plain
10 language of the Exchange Agreement eviscerates this argument. Even as San Diego acquiesced
11 to Met's rates on a year-to-year basis after the expiration of the five year period, the possibility
12 of a legal challenge to the rates was written into the Exchange Agreement.

13
14
15 San Diego did not represent to Met, by omission or by conduct on which Met could
16 reasonably rely, that Met's rates were lawful knowing Met's rates were in fact illegal. Rather,
17 San Diego bargained for the right to challenge Met's rates in court in the future, and Met
18 bargained to constrain San Diego's ability to do so. San Diego's suit is not barred by the
19 doctrine of equitable estoppel.

20 21 **d. Illegality**

22 Met argues that the Exchange Agreement is void as illegal if Met's rate structure or rates
23 in existence at the time the parties entered into the Exchange Agreement were illegal. Met
24 Closing Brief, 31-33. This is so because if San Diego is right, Met's performance of the price

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27 ³⁴ Met Closing Brief, 19-20; DTX-355 at 2 (San Diego memo weighing whether to enter contracts with a Rate Structure Integrity provision); DTX-1114 at 11-12; Trial Transcript, 1070:17-22.

1 term was unlawful, Met says, because the rate structure includes unlawful rates. Met Pre-Trial
2 Brief, 12.

3 Although San Diego agreed not to challenge the manner in which Met set its charge or
4 charges for the following five years, the parties did not agree the setting of charges was legal or
5 illegal. Fixing a \$253 price is not illegal. Nor is it illegal to require Met to set its charges for the
6 conveyance of water pursuant to applicable law and regulation; precisely the opposite is true.³⁵
7 The parties obviously bargained for—by definition—a *legal* price term.
8

9 **e. Mistake of Law**

10 Met argues that there was a mistake of law with respect to whether its existing rates at the
11 time the parties entered the Exchange Agreement were lawful. To the extent that neither party
12 was aware the rate structure was unlawful, Met contends that it is entitled to rescission based on
13 mutual mistake. Met Closing Brief, 34-35; C.C. § 1578(1).³⁶ To the extent that San Diego but
14 not Met was aware that Met's rate structure was unlawful, Met is entitled to rescission because
15 San Diego failed to rectify Met's mistake. Met Closing Brief, 35-36; C.C. § 1578(2). San Diego
16 says there was no mistake of law – the parties disagreed about the lawfulness of Met's rate
17 structure and bargained around that disagreement. San Diego Post-Trial Brief for Phase II, 28-
18 29.
19
20

21 Where parties are aware that a doubt exists in regard to a certain matter and contract on
22 that assumption, the risk of the existence of the doubtful matter is an element of the bargain.
23 *Guthrie v. Times-Mirror Co.*, 51 Cal.App.3d 879, 885 (1975). The kind of mistake that renders a
24

25 _____
26 ³⁵ "It is well settled that if a contract can be performed legally, it will not be presumed that the parties intended for it
27 to be performed in an illegal manner, and it will not be declared void merely because it was performed in an illegal
manner." *Freeman v. Jergins*, 125 Cal.App.2d 536, 546 (1954).

³⁶ Met never tells us how this rescission, based on mistake or other grounds, would be carried out. Presumably San
Diego would not have to return the transported water.

1 contract voidable does not include mistakes as to matters which the contracting parties had in
2 mind as possibilities and as to the existence of which they took the risk. *Id.*

3 It is not clear when San Diego reached the conclusion that Met's rates were unlawful.
4 San Diego notes evidence that San Diego suggested to Met that Met's wheeling rate was
5 unlawful and that Met understood the suggestion. PTX-398; PTX-392 at 121:10-124:25
6 (purpose of five year standstill was to permit San Diego to bring a challenge to the rates). Met
7 asserts that San Diego's own negotiator vacillated as to whether San Diego had identified
8 anything unlawful about Met's rates at the time the parties entered the Exchange Agreement.³⁷
9 The parties were unclear on exactly what the law was.³⁸

10
11 Neither party knew how a court would rule on Met's rate structure. But they contracted
12 around this uncertainty. For five years, the parties precluded San Diego from challenging Met's
13 interpretation of the law, whether or not that interpretation changed during that period.
14 Thereafter, if San Diego disagreed it was free to bring a judicial challenge. The structure of the
15 contract itself, against this backdrop of uncertainty, demonstrates that the parties knew San
16 Diego might challenge Met's rate structure, were unsure which party would prevail in such a
17 lawsuit, and contracted in a way that accounted for Met's interests if its rates were unlawful.³⁹
18 There was no mistake of law.
19
20
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23 ³⁷ Compare Trial Transcript, 1590:7-1591:17 (Stapleton confronted with Slater's deposition testimony that San
24 Diego did not a violation although it knew there were laws that could be pertinent); with Trial Transcript, 1452:16-
25 1454:2 (Stapleton confronted with Slater's testimony that certain rates were unlawfully included in Met's
26 conveyance rates).

27 ³⁸ Trial Transcript, 1237:8-1243:17, 1248:13-1253:20, 1255:25-1256:8.

³⁹ San Diego forfeited its ability to challenge Met's rates in court for five years; to the extent Met's rates were
unlawfully inflated, Met received a benefit at San Diego's expense at least for the first five years of the contract.
Kightlinger testified that he did not have any doubt as to the lawfulness of Met's rates and that Met would not have
entered the Exchange Agreement if San Diego had said that Met's rates were unlawful during negotiations. Trial
Transcript, 1316:3-18. In section IV(A)(1), I rejected Kightlinger's testimony that San Diego told him that San
Diego would not challenge Met's existing rate structure and that the concession was material to Met.

1 **f. Offset and Unjust Enrichment**

2 These defenses are subsumed within the damages questions and are addressed there.⁴⁰

3 **B. Preferential Rights**

4 San Diego seeks a declaration that Met's methodology of computing preferential rights
5
6 violates § 135 of the Metropolitan Water District Act⁴¹ because it excludes San Diego's
7 payments relating to the conveyance of water San Diego purchases from other sources. Third
8 Amended 2010 Complaint ¶¶ 113-15. Specifically, the parties dispute whether (1) San Diego's
9 payments pursuant to the Exchange Agreement should be included in the preferential rights
10 calculation; and (2) payments under wheeling agreements should be included in the preferential
11 rights calculation.⁴²

12 Section 135 includes the following:

13 Each member public agency shall have a preferential right to purchase from the district
14 ... a portion of the water served by the district which shall, from time to time, bear the
15 same ratio to all of the water supply of the district as the total accumulation of amounts
16 paid by such agency to the district on tax assessments and otherwise, excepting purchase
17 of water, toward the capital cost and operating expense of the district's works shall bear
18 to the total payments received by the district on account of tax assessments and
19 otherwise, excepting purchase of water, toward such capital cost and operating expense.

20
21 ⁴⁰ Met's briefing does not separately address these defenses.

22 ⁴¹ Water Code Appendix § 109-135.

23 ⁴² San Diego Post-Trial Brief for Phase II, 39-40 (referring to the Exchange Agreement and other wheeling
24 agreements); Met Closing Brief, 36-40 (addressing only the Exchange Agreement); Trial Transcript, 2037:20-
25 2038:1; Third Amended 2010 Complaint ¶¶ 113-15 ("113. ... The Water Authority formally requested a
26 determination that its preferential rights should include the amount paid as 'transportation' costs for Metropolitan's
27 conveyance of Non-Metropolitan Water through its pipelines and facilities. Metropolitan has formally denied that
request, taking the position that money paid by the Water Authority for the transportation of its IID and Canal
Lining water are for the 'purchase of water' (i.e., supply)... [¶] 114. In the absence of declaratory relief,
Metropolitan will continue its wrongful calculation of the Water Authority's preferential rights... [¶] 115.
Therefore, the Water Authority prays for a judicial declaration (a) that the current methodology used by
Metropolitan to calculate the Water Authority's preferential rights violates section 135 of the MWD Act; and (b)
directing Metropolitan to follow the requirements of the MWD Act by including the Water Authority's payments to
Metropolitan for transportation of IID Water and Canal Lining Water (which payments are not for 'purchase of
water') in the calculation of the Water Authority's preferential rights to water") (footnote omitted).

1 As explained by our Court of Appeal:

2 Under section 135, in the event of a water supply shortage, each Metropolitan member
3 public agency, including San Diego, has a preferential right to a percentage of
4 Metropolitan's available water supplies based on a legislatively established formula.
5 That formula affords each member an aliquot preference equal to the ratio of that
6 member's total accumulated payments toward Metropolitan's capital costs and operating
7 expenses when compared to the total of all member agencies' payments toward those
8 costs, excluding amounts paid by the member for "purchase of water."

7 *San Diego County Water Authority v. Metropolitan Water Dist.*, 117 Cal.App.4th 13, 17 (2004).

8 Met moved for summary adjudication of San Diego's preferential rights claim in 2013. I
9 denied Met's motion by order issued December 4, 2013. From *SDCWA*, I derived the rule that
10 the preferential rights calculation includes all payments for capital costs and operating expenses,
11 excluding those payments that were tied to the "purchase of water." Dec. 4, 2014 Order, 6. Met
12 attempted to draw a parallel to *SDCWA* based on the rate components charged for the purchase
13 of water in *SDCWA* and the similar rate components charged under, for example, the Exchange
14 Agreement. *Id.* at 6-7. I held that Met had not established that San Diego was purchasing water
15 from Met through the Exchange Agreement. *Id.* at 7.

17 At the Phase II closing argument, Met again pressed the argument that no payment of a
18 volumetric rate is properly credited to preferential rights. Trial Transcript, 2038:18-2039:11,
19 2040:21-2041:10. This reading contradicts the plain language of the statute and *SDCWA*. The
20 Court of Appeal agreed with Met's longstanding interpretation that "amounts paid for water
21 purchases are not to be taken into account in determining preferential rights, whatever those
22 amounts are used for." *SDCWA*, 117 Cal.App.4th at 24-25. The Court independently analyzed
23 the language of the statute, the structure of the statutory scheme, and the legislative history to
24 interpret the Legislature's intent. *Id.* at 25-28. *SDCWA* found the statute reflected the
25 Legislature's intent to create a general rule that all revenue used to pay capital costs and
26
27

1 operating expenses would count toward the calculation of preferential rights, except payments
2 for the purchase of water. *Id.* at 27. In the pure wheeling context, the wheeler does not purchase
3 water from Met but pays a volumetric rate for Met to move water that belongs to the wheeler. I
4 discern no basis for Met's decision to treat volumetric wheeling payments as payments for the
5 purchase of water. Volumetric payments to Met to cover Met's operating expenses that are not
6 connected to a purchase of water from Met are entitled to preferential rights credit under § 135 of
7 the Met Act and *SDCWA*.⁴³ Wheeling payments must be included in the preferential rights
8 calculation.

9
10 Whether payments specifically under the Exchange Agreement give rise to preferential
11 rights credit is a more difficult question. As in the wheeling context, San Diego pays volumetric
12 rates to cover Met's operating expenses in exchange for the conveyance of water. Unlike in the
13 wheeling context, the Exchange Agreement does not literally call for the conveyance of water
14 but instead for the *exchange* of water. PTX-65 §§ 3.1-3.2. The question here is whether the
15 exchange of water facilitated by the Exchange Agreement brings San Diego's payments into the
16 statutory "purchase of water" exception.
17

18 Met says that the Exchange Agreement facilitates a purchase of water because, under the
19 agreement, San Diego gives Met water and money and obtains different water⁴⁴ from Met. Met
20

21
22 ⁴³ Met argues that its interpretation of the statute to treat all volumetric payments as payments for the purchase of
23 water is entitled to deference. Met Closing Brief, 39; Trial Transcript, 1847:5-1848:13, 2040:21-2041:10. I do
24 defer, but this sort of deference is not tantamount to giving the agency a veto on the interpretation of the statute.
25 Courts must ultimately construe statutes. *Compare, SDCWA*, 117 Cal.App.4th at 22. The fact that Met uses
26 volumetric rates to collect its payments for the purchase of water as well as to collect payments under wheeling
27 contracts does not show payments under wheeling contracts are for the purchase of water. It is the purpose of the
28 payment, not the manner in which the amount of the required payment is computed, that controls under the statute.
29 Nothing in the statute or *SDCWA* supports Met's interpretation. *Compare, Met Supplemental Brief*, 5 (asserting that
30 *SDCWA* compels the conclusion that all volumetric payments are excluded from the preferential rights calculation,
31 presumably because all volumetric rates are payments for the purchase of water). Accordingly, I reject Met's
32 interpretation as contrary to the legislative intent of the statute, as interpreted in *SDCWA*.

33 ⁴⁴ San Diego correctly argues that the Exchange Agreement defines Exchange Water as Local Water, not Met Water,
34 except for the purposes of the price provision and the Interim Agricultural Water Program, which are not relevant

1 Pre-Trial Brief, 15-16; Met Closing Brief, 39. San Diego contends that the Exchange Agreement
2 is, in practical terms, no different from any other conveyance agreement because in any wheeling
3 agreement the party receiving the service obtains molecules of water different from those
4 initially put into the conveyance system. San Diego's Post-Trial Brief for Phase II, 39-40.
5

6 The parties have not pointed me to legislative history or other sources which would
7 explain why the Legislature excluded payments for the purchase of water from the preferential
8 rights calculation. *SDCWA*, 117 Cal.App.4th at 24 (Legislature has not defined the "excepting
9 purchase of water" terminology). The fact remains that the Legislature included all contributions
10 toward capital costs or operating expenses in the preferential rights calculation with a single
11 exception: payments for the purchase of water.
12

13 San Diego is not purchasing water from Met. San Diego is exchanging water with Met to
14 make use of its own independent supplies. PTX-65 §§ 1.1(m), 3.1-3.2, 3.6.⁴⁵ The parties agreed
15 to exchange an equal amount of water; the only water quality requirement was for Met to provide
16 San Diego with water of at least the same quality as the water Met received from San Diego.
17 These facts underscore that the Exchange Agreement was not an agreement pursuant to which
18 San Diego obtained water from Met, but instead an agreement pursuant to which Met in effect
19 conveyed water on behalf of San Diego. That the Exchange Agreement differs in some respects
20 from a wheeling contract⁴⁶ does not mean that the Exchange Agreement was not in substance an
21

22
23 here. San Diego Supplemental Brief, 1; PTX-65 at §§ 4.1-4.2. Exchange Water is Met water for the purposes of the
price provision and the Interim Agricultural Program. PTX-65 at §§ 4.1-4.2.

24 ⁴⁵ The parties' characterization of the Exchange Water does not control whether the agreement is a purchase
agreement for the purposes of the preferential rights statute. PTX-65 §§ 4.1-4.2.

25 ⁴⁶ Met says there are five differences. Met Closing Brief, 38-39. But it remains unclear why these differences
26 matter. The differences Met asserts are: (1) wheelers can only move water when there is available capacity, but Met
27 makes deliveries every month regardless of capacity on the Colorado River Aqueduct; (2) water is wheeled only
when it is available, but Met wheels water every month regardless of the amount San Diego has made available; (3)
wheelers bear carriage losses as a result of loss in transit, but Met bears the carriage loss under the Exchange
Agreement; (4) San Diego was not billed for wheeling water, but instead for purchasing water with a monetary
credit for the supply it made available; and (5) to wheel Colorado River water, San Diego would have needed a

1 agreement to convey, rather than purchase, water. San Diego's payments under the Exchange
2 Agreement must be included in the preferential rights calculation.

3
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5 **V. Conclusion**

6 On the breach of contract claim, San Diego is entitled to \$188,295,602 plus interest.
7 Met's motion for partial judgment is denied.

8 On the preferential rights claim, San Diego is entitled to a judicial declaration (a) that
9 Met's current methodology for calculating San Diego's preferential rights violates § 135 of the
10 Metropolitan Water District Act; and (b) directing Met to include San Diego's payments for the
11 transportation of water under the Exchange Agreement in Met's calculation of San Diego's
12 preferential rights.
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16 Dated: August 28, 2015



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Curtis E.A. Karnow
Judge of The Superior Court

24 federal contract, but San Diego did not need a federal contract under the Exchange Agreement because the water
25 would be Met water. *Id.* at 38-39. Met says this demonstrates that San Diego is in effect "paying" for the water
26 with—water; making Exchange Water a water "purchase." *Id.* at 8. There can be nice distinctions between barter,
27 currency and investment, and conceivably water might have any of these roles—and in circumstances of increasing
drought, water may be a currency of the future (see *Mad Max Beyond Thunderdome* (1985),
<http://www.imdb.com/title/tt0089530/>), but there is no good reason to treat it so in this case. And as noted above,
the parties' characterization of a transaction does not control whether the transaction is a purchase for the purposes
of the preferential rights statute.

CERTIFICATE OF ELECTRONIC SERVICE
(CCP 1010.6(6) & CRC 2.260(g))

I, DANIAL LEMIRE, a Deputy Clerk of the Superior Court of the County of San Francisco, certify that I am not a party to the within action.

On : **AUG 28 2015**, I electronically served THE ATTACHED ORDER via File & ServeXpress on the recipients designated on the Transaction Receipt located on the File & ServeXpress website.

Dated: **AUG 28 2015**

T. Michael Yuen, Clerk

By:



DANIAL LEMIRE, Deputy Clerk

FILED
San Francisco County Superior Court



OCT 9 - 2015

CLERK OF THE COURT

BY: [Signature] Deputy Clerk

SUPERIOR COURT OF CALIFORNIA

COUNTY OF SAN FRANCISCO

SAN DIEGO COUNTY WATER
AUTHORITY,

Plaintiff/Petitioner,

vs.

METROPOLITAN WATER DIST. OF
SOUTHERN CALIFORNIA, et al.

Defendants/Respondents.

Case No. CFP-10-510830
Case No. CFP-12-512466

ORDER GRANTING SAN DIEGO'S
MOTION FOR PREJUDGMENT
INTEREST

I have previously found that the Metropolitan Water District of Southern California (Met) breached its Exchange Agreement with the San Diego County Water Authority (San Diego) and awarded San Diego nearly \$200 million in damages, "plus interest." Phase II Statement of Decision, 29. San Diego now moves for prejudgment interest, seeking an additional \$44,139,469.¹ I heard argument October 8, 2015.

Legal Background

Civil Code § 3287(a) provides that "[e]very person who is entitled to recover damages certain, or capable of being made certain by calculation, and the right to recover which is vested in him upon a particular day, is entitled also to recover interest thereon from that day...."

¹ San Diego initially requested \$47,277,747, but modified the request after Met pointed out a timing error. Opposition, 12-13; Reply, 1. I have further reduced this to a small extent to account for Met's further calculations. See n.8 below.

1 Section 3289 provides that when a contract “does not stipulate a legal rate of interest, the
2 obligation shall bear interest at a rate of 10 percent per annum after a breach.” The dispute here
3 centers on whether § 12.4(c) of the Exchange Agreement “stipulate[s] a legal rate of interest.”
4

5 The parties also disagree as to whether the damages awarded were “certain” or “capable of being
6 made certain.”

7 **The Agreement’s Language**

8 Section 12.4(c) of the Exchange Agreement reads:

9 In the event of a dispute over the Price, SDCWA shall pay when
10 due the full amount claimed by Metropolitan; provided, however,
11 that, during the pendency of the dispute, Metropolitan shall deposit
12 the difference between the Price asserted by SDCWA and the Price
13 claimed by Metropolitan in a separate interest bearing account. If
14 SDCWA prevails in the dispute, Metropolitan shall forthwith pay
15 the disputed amount, plus all interest earned thereon, to SDCWA.
16 If Metropolitan prevails in the dispute, Metropolitan may then
17 transfer the disputed amount, plus all interest earned thereon, into
18 any other fund or account of Metropolitan.

19 Met says § 12.4(c) establishes a legal rate for purposes of § 3289 and so the 10%
20 statutory rate does not apply. It asserts that the interest bearing account prescribed by § 12.4(c)
21 has accrued interest of \$4,156,907.46 – the maximum interest to which SDCWA could be
22 entitled. *Id.* at 2:1-3.

23 But at argument, Met explained that it had set aside less than the damages awarded.² So,
24 it has now in effect retrospectively increased the principal set aside amounts over the period of
25 the dispute to reach the awarded damages, and then Met has recalculated interest using whatever
26 interest Met had, historically, obtained on the set-side money. Thus, Met now proposes to give
27 San Diego not, as § 12.4(c) suggests, “all interest earned thereon” i.e. the interest historically

² This is not shocking. As I noted in my earlier discussion of § 12.4(c) when San Diego unsuccessfully presented it as a liquidated damages provision, there is no reason to think that money set aside under § 12.4(c) would perfectly match the damages award.

1 earned on the set-aside money, but *more* money to account for the damages which Met had *not*
2 set aside. This is the first signal that Met's proffered understanding § 12.4(c) is not correct.

3 Met argues both in its papers and at argument that that if I do not accept its reading, the
4 phrase "shall forthwith pay . . . all interest earned thereon" is meaningless. E.g., Opposition at 5.
5 I do not agree. The clauses on interest, just like the remainder of the section, as I have previously
6 interpreted it, are all designed to increase the odds that there will be money available to pay
7 damages. Just as it is wise to set aside principal for potential future damages, so too it is wise to
8 insist on an interest bearing account to account for the devaluation of money over time. Met's
9 reading is not necessary to give meaning to the terms.

10 And this leads to the central problem with Met's view. I have previously found, at Met's
11 urging, that § 12.4(c) was a security provision, not a damages provision. The provision's
12 "primary purpose . . . was to prevent either side from spending disputed funds during the
13 pendency of a dispute and to ensure that disputed funds were promptly available to the prevailing
14 party upon the resolution of a dispute." Phase II SOD at 7. One reason for this conclusion was
15 that, if read as a damages provision, SDCWA would be able to "fix extraordinarily high damages
16 through the simple expedient of *claiming* extraordinarily high damages." *Id.* The same logic
17 applies to the interest clause here.

18 Met's view is that the contract requires prejudgment interest generated on an amount that
19 may be totally different than the damages actually awarded. That's not reasonable; as I note
20 above, even Met does not so calculate interest.³

21 Met also argues that extrinsic evidence shows the parties meant this clause to reflect their
22 agreement on applicable interest. Met notes communications between the parties in 2011 and
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27 ³ That is, Met now adds more interest to account for the actual damages awarded; and I suppose, if I had awarded
less than the set-aside, Met would nevertheless would not have turned over to San Diego either the full amount set
aside nor "all interest earned thereon".

1 2012 indicated that the disputed money was being set aside and would earn interest “using the
2 effective yield earned . . . on Metropolitan’s investment portfolio.” *Id.* at 7, citing Soper Decl.,
3 ¶3, Ex. B. San Diego, Met stresses, did not object to this characterization. *Id.*⁴ San Diego retorts
4 that its failure to object to Met’s communications does not constitute “acceptance” of a
5 “stipulated rate.” Reply, 4. I agree. See e.g., *Unocal Corp. v. United States*, 222 F.3d 528, 542
6 (9th Cir. 2000) (interest rate unilaterally placed in invoice is not a stipulated legal interest rate
7 under § 3289). I agree.

8
9 Met also suggests that even if the contract is ambiguous, extrinsic evidence shows the
10 parties’ “intent that the interest to be paid would be the interest earned in the interest bearing
11 account.” Opposition at 9. But this is not so. Met’s evidence is just that it informed San Diego
12 that it would comply with § 12.4(c) by placing disputed funds in a separate account, and that San
13 Diego did not object. See Opposition at 7-8.

14 **Judicial Estoppel**

15
16 San Diego suggests Met is barred by judicial estoppel. See generally, *Jackson v. Cnty. of*
17 *Los Angeles*, 60 Cal.App.4th 171, 181 (1997); *MW Erectors, Inc. v. Niederhauser Ornamental &*
18 *Metal Works Co., Inc.* 36 Cal. 4th 412, 422 (2005). Met had previously insisted that § 12.4(c)
19 was a security deposit and did not pertain to damages at all. I agreed; § 12.4(c) only served to
20 prevent either side from spending disputed funds. But Met has not taken two positions which are
21 “totally inconsistent,” 60 Cal.App.4th at 183. It is at least conceivable that § 12.4(c) both acted to
22 secure some money towards damages *and* set forth the parties’ agreement on interest calculation.
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26 ⁴ Met also notes that San Diego’s second and third amended complaints requested interest “as a result of the express
27 term in section 12.4(c) . . .” *Id.*, citing Emanuel Dec., Ex. 4, ¶4. The same request appeared in San Diego’s June
2012 lawsuit. *Id. Nesbit v. MacDonald*, 203 Cal. 219, 222 (1928) notes “a prayer for ‘interest,’ without specifying
the rate, is deemed a prayer for legal interest” – here, set at 10 percent by statute. I do not take these allegations as
reasonable evidence that the parties had agreed to calculate interest as Met now claims.

1 But, while I do not think judicial estoppel applies to actually block Met's position now, as I have
2 noted the logic of my earlier ruling does refute it.

3 **Certainty**

4 San Diego must show that the damages I awarded were "certain, or capable of being
5 made certain" under § 3287(a). Met tells us that this means San Diego must show there was "no
6 dispute as to the computation of damages." Opposition at 9, citing *Fireman's Fund Ins. Co. v.*
7 *Allstate Ins. Co.*, 234 Cal.App.3d 1154, 1173 (1991). Because "the parties vigorously disputed
8 the computation," Met continues, there could not have been certainty. Opposition at 2. If this
9 were so, a party could avoid prejudgment interest merely by contesting damages at trial.

10 As San Diego notes cases distinguish between disputes over the measure of damages and
11 the absence of data necessary to allow the defendant to calculate damages. Only the latter makes
12 damages uncertain. Reply, 6. *Howard v. Am. Nat. Fire Ins. Co.*, 187 Cal.App.4th 498, 535
13 (2010) ("test for determining certainty under section 3287(a) is whether the defendant knew the
14 amount of damages owed to the claimant or could have computed that amount from reasonably
15 available information...") See also, *Collins v. City of Los Angeles*, 205 Cal.App.4th 140, 151
16 (2012).

17 Here I awarded exactly the amount of damages requested by San Diego. The calculation
18 was as San Diego suggested, a simple deduction of some sums from others. The calculation was
19 just "math" as Met's counsel noted.⁵ Met had all the information it needed to determine the
20 degree of the overcharges; indeed, the data came from Met. See *Chesapeake Indus., Inc. v.*
21 *Togova Enterprises, Inc.*, 149 Cal. App. 3d 901, 907 (1983) (prejudgment interest awarded if
22 defendant "from reasonably available information could ... have computed" damages). Thus
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⁵ See also TR 1913-1914 (San Diego's math correct, according to Met witness).

1 these damages were “capable of being made certain” and San Diego is entitled to prejudgment
2 interest.

3 In its papers, Met confronts San Diego with its earlier statements that damages were
4 difficult to quantify, statements made in connection with its liquidated damages argument on §
5 12.4(c). Met is accurate,⁶ but after I rejected its position San Diego changed its theory, and as
6 Met counsel agreed at argument, changes in damages theory do not demonstrate that damages
7 are uncertain.⁷

8
9 At argument Met emphasized its concerns that the damages here were uncertain in the
10 sense that they were a function of deduction of uncertain amounts of charges, that it was never
11 clear exactly what portion of certain charges could (had Met properly calculated them) be billed
12 to San Diego. Perhaps; but it was San Diego’s theory, repeated in communications to Met before
13 litigation and found in statements made during this case, that any such uncertainty was not its
14 problem; that it should not be required to pay those charges unless they were justified, that they
15 were not justified, and thus they should all be deleted from San Diego’s bill. My finding that Met
16 might have been able to justify some unknown portion of the challenged charges, but in the event
17 did not do so, is not a demonstration that the damages were uncertain. Of course Met disputed
18 both damages (including maintaining the position that the court was without power to calculate
19 them) as well as San Diego’s damage theories (not to speak of its liability theories) but not the
20 facts used to calculate the damages.
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24 ⁶ It is literally accurate to note San Diego’s argument that damages could be difficult to quantify, but the situation
25 was then more nuanced: San Diego was arguing that, *absent a liquidated damages* provision, damages could be or
26 were difficult to quantify, and so urged liquidated damages—which would have been exceedingly certain. San
27 Diego has not, I think, ever urged a theory of damages which is uncertain. See n.7.

⁷ The fact that a court might have to select among damages models does not mean the damages awarded are not
“capable of being made certain.” *Children’s Hosp. & Med. Ctr. v. Bonta*, 97 Cal. App. 4th 740, 774 (2002). San
Diego presented essentially two models, one of which I rejected; Met presented none, and each of San Diego’s
models was “capable of being made certain.”

1 The test may be focused this way: damages are not ‘certain’ when to fix damages, the
2 court is required to resolve (aside from the liability issues) “disputed facts,” *Collins v. City of Los*
3 *Angeles*, 205 Cal. App. 4th 140, 151 (2012) or “conflicting evidence,” Dennis L. Greenwald,
4 CALIFORNIA PRACTICE GUIDE: REAL PROPERTY TRANSACTIONS 11:134.2 (2014). While one can
5 imagine that I might have had to resolve disagreements on exactly how much of a rate ought to
6 have been included in San Diego’s bills (because, for example there was disagreement on how
7 much to allocate to supply (compare Met’s Opposition at 10:20)), in the event, I did not. No
8 party wanted to lead me down that path. These sorts of conflicts were avoided, and not presented
9 to me for resolution, by the parties’ approaches to damages.
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13 **Conclusion**

14 San Diego’s motion for prejudgment interest is granted. The parties agree that, using the
15 10 percent rate, the interest is \$43,415,802.⁸

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17 Dated: October 9, 2015



Curtis E.A. Karnow
Judge Of The Superior Court

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⁸ The parties agree that at 10% this is the minimum to which San Diego is entitled. Reply at 10:3-26.

CERTIFICATE OF ELECTRONIC SERVICE
(CCP 1010.6(6) & CRC 2.260(g))

I, DANIAL LEMIRE, a Deputy Clerk of the Superior Court of the County of San Francisco, certify that I am not a party to the within action.

On **OCT 9 - 2015**, I electronically served THE ATTACHED DOCUMENT via File & ServeXpress on the recipients designated on the Transaction Receipt located on the File & ServeXpress website.

Dated: **OCT 9 - 2015**

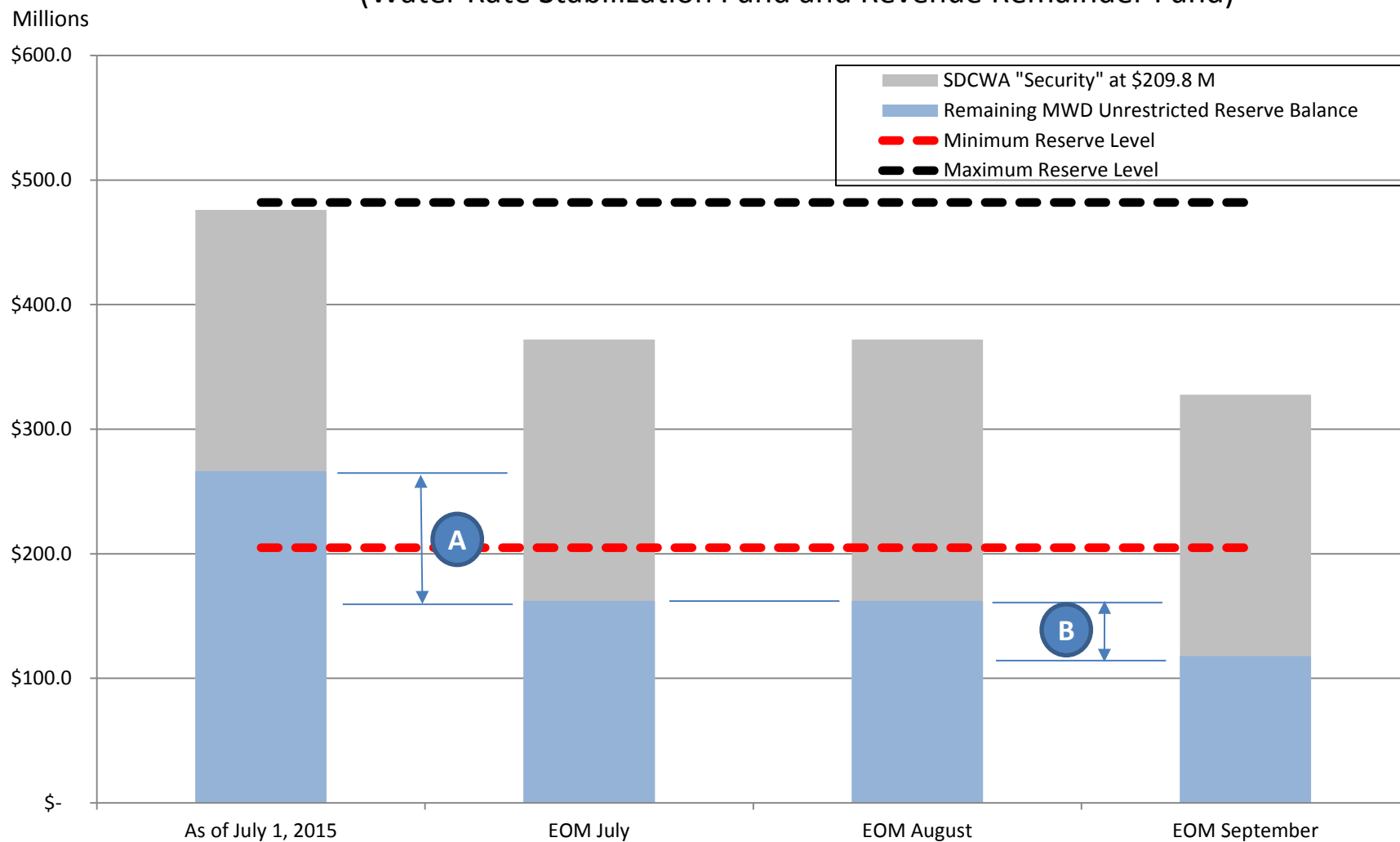
T. Michael Yuen, Clerk

By: 

DANIAL LEMIRE, Deputy Clerk

Unrestricted Reserves

(Water Rate Stabilization Fund and Revenue Remainder Fund)



A 07/14/15 - \$264 Million unbudgeted cash payment to acquire real property (\$104 million of which from unrestricted reserves).

B 09/22/15 - \$44.4 Million unbudgeted cash payment to Southern Nevada Water Authority



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

October 12, 2015

Randy Record and
Members of the Board of Directors
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

MEMBER AGENCIES

- Carlsbad Municipal Water District
 - City of Del Mar
 - City of Escondido
 - City of National City
 - City of Oceanside
 - City of Poway
 - City of San Diego
 - Fallbrook Public Utility District
 - Helix Water District
 - Lakeside Water District
 - Olivenhain Municipal Water District
 - Otay Water District
 - Padre Dam Municipal Water District
 - Camp Pendleton Marine Corps Base
 - Rainbow Municipal Water District
 - Ramona Municipal Water District
 - Rincon del Diablo Municipal Water District
 - San Dieguito Water District
 - Santa Fe Irrigation District
 - South Bay Irrigation District
 - Vallecitos Water District
 - Valley Center Municipal Water District
 - Vista Irrigation District
 - Yuima Municipal Water District
- OTHER REPRESENTATIVE**
- County of San Diego

RE: Board Item 8-2: Approve and authorize the execution and distribution of Remarketing Statements in connection with the remarketing of the Water Revenue Refunding Bonds, 2011 Series A1 and A3 and 2009 Series A2 - **OPPOSE**

Dear Chair Record and Members of the Board:

The Water Authority’s MWD Delegates have reviewed Board memo 8-2, including the redline copy of Appendix A dated October 1, 2015 ("Appendix A" or "Draft"), and determined we cannot support staff’s recommendation to authorize the execution and distribution of the Official Statement in connection with the remarketing of bonds. As we have made clear in the past, we support staff’s general financial management objective to reduce debt cost but do not believe the bond disclosures fairly present the facts, as described below, or MWD's current and projected water supply conditions, financial position or risks.

I. General Comments

We incorporate by reference all of the comments and objections contained in our delegation's past letters relating to MWD's authorization, execution and distribution of Official Statements in connection with the issuance of bonds. While MWD has from time to time made certain changes in response to the Water Authority's comments, these letters raise several substantive issues that have not been addressed by MWD in prior drafts of Appendix A, are part of the MWD Administrative Record in connection with the respective actions taken by the board and are incorporated herein by reference, along with copies of any MWD responses.

A number of specific questions and comments are noted below. Broadly speaking, there are two new principal areas in which the current draft Appendix A fails to disclose or accurately describe material facts:

- (1) the status of MWD's unrestricted reserves as related to the deposit it has represented to the Superior Court that it maintains and is required to

A public agency providing a safe and reliable water supply to the San Diego region

maintain as security for payment of the Water Authority's judgment and accrued interest in the rate litigation (MWD has represented to the Court that it is holding this money in a "separate account" and yet it appears to be commingled with unrestricted reserves); and

(2) material facts that have been judicially determined in the rate litigation, but which MWD continues to misrepresent in various parts of Appendix A. While we recognize that MWD intends to appeal the judgment of the Court, that does not mean that it is not also required to disclose and accurately present to the MWD Board of Directors and potential investors the Court's factual findings and orders as they relate to MWD's contentions in the litigation and included in Appendix A.

Copies of the Courts Statements of Decision dated April 24, 2014 and August 28, 2015, and its Order Granting San Diego's Motion for Prejudgment Interest dated October 9, 2015, are attached (Attachments 1-3, respectively). MWD management has a responsibility to inform the MWD Board of Directors about the findings and orders the Court has made, and the MWD Board of Directors has a responsibility to be informed about the Court's findings and orders in connection with its review of the Draft Appendix A. This is necessary in order to provide complete and accurate disclosure regarding the bonds being offered and their security and source of payment to potential investors. We also request that MWD's management provide this letter and Attachments to MWD's bond counsel team, financial advisor and underwriters.

II. MWD is either in breach of its contractual obligation under the Exchange Agreement to maintain a cash deposit sufficient to secure payment of the Water Authority's judgment and accrued interest; or, it is not in compliance with minimum reserve requirements under its Financial Reserve Policy.

Attachment 4 to this letter provides a graphic representation of the status of MWD's Unrestricted Reserves beginning at July 1, 2015 through the end of September 2015 (all data derived from MWD's Draft Appendix A). If MWD's Unrestricted Funds are reduced by the Water Authority's security deposit -- reflected in Attachment 4 at the \$209.8 million amount MWD informed the Court it is holding as a security depositⁱ -- then it appears that MWD has failed to meet its minimum reserve requirements since the end of July 2015. This would also mean that, on September 22, 2015, MWD did not have sufficient cash available to make the \$44.4 million unbudgeted payment to the Southern Nevada Water Authority without either breaching its contractual obligation to the Water Authority or spending cash that was required by MWD's Financial Reserve Policy to be held in reserve.

III. Several representations in Draft Appendix A are inconsistent with material facts that have been judicially determined against MWD in the rate litigation.

In addition to failing to accurately describe the Court's findings and orders in the rate litigation per se, MWD is continuing to present certain matters as "fact" in Appendix A that were contested in the rate litigation with respect to which MWD did not prevail. As one important example, MWD continues in Appendix A to report revenues paid for wheeling, i.e., for the transportation of third party water, as MWD "water sales revenues" (A-50). Contrary to arguments made by MWD at trial that San Diego was purchasing MWD water under the Exchange Agreement, the Court specifically found that San Diego does not pay MWD's supply rates (August 28, 2015 Statement of Decision at page 3, footnote 8) and **is not purchasing MWD water under the Exchange Agreement** (August 28, 2015 Statement of Decision at page 28, line 13 and generally, Section IV-B, Preferential Rights at pages 25-29). There is no factual or legal basis for MWD to describe wheeling revenues as its "water sales" and no reason to require potential bond investors to "read the fine print" in the footnotes in order to conclude that MWD's "water sales" revenues are in fact, **not** all MWD water sales revenues. MWD's Summary of Receipts by Source (A-50) substantially overstates MWD's water sales because MWD's water sales were at least 180,000 AF less than stated by MWD (i.e., the amount of water the Water Authority actually purchased from third parties) -- and also fails to disclose that MWD receives revenues from the wheeling services it provides.

IV. Comments on Draft Appendix A

A-6: Metropolitan's Water Supply. MWD is changing the statement that "hydrologic conditions can have a significant impact on MWD's 'water supply'" to the statement that, "hydrologic conditions can have a significant impact on MWD's 'two principal imported water supply sources.'" What water supply sources has MWD acquired since its last Official Statement in June 2015 that are not State Water Project or Colorado River supplies, necessitating this change?

A-7: Drought Response Actions. Staff's suggested edits to the Draft Appendix A state that implementation of MWD's Water Supply Allocation Plan at a Level 3 Regional Shortage Level is anticipated to reduce supplies delivered by MWD to its member agencies in fiscal year 2015-16 to approximately 1.6 million acre-feet (AF). By contrast, language in the Official Statement of last June - now being deleted - states that, "[o]n April 14, 2015, the Board declared the implementation of the Water Supply Allocation Plan at a Level 3 Regional Shortage Level, effective July 1, 2015 through June 30, 2016. Implementation of the Water Supply Allocation Plan at a Level 3 Regional Shortage Level is anticipated to reduce supplies delivered by MWD to MWD's member agencies by 15 percent and water sales to approximately 1.8 million AF." Even though the June disclosure noted the Governor's Order to reduce water use by 25 percent, it stated that member agencies' diminished local supplies will cause MWD's demands to be at 1.8 million AF. Now, in the space of less than four months, MWD has reduced its estimated water sales by 200,000 acre-feet (AF), even though there are no changed factual circumstances identified in the new Draft. Further, MWD staff

reported last month that water sales could be as low as 1.5 million AF. Please explain the basis of the new projections and what if anything has changed since June 2015 to account for this substantial reduction in MWD's estimated water sales in fiscal year 2015-16, and, why the new Draft does not disclose the reported potential for water sales to be as low as 1.5 million AF.

Similarly, the storage reserve level as of December 31, 2015 is described in the Draft Appendix A as 1.36 million AF. While this is consistent with reports under MWD's Water Surplus and Drought Management Plan, it is not consistent with forecasted sales of 1.6 million AF, which is lower than a Level 3 water supply allocation. If sales are down, there should be more water in storage. Please explain this apparent discrepancy.

A-9: Integrated Resources Plan. The last paragraph on page A-9 states that the second phase of the IRP is development of "implementation" policy after the conclusion of the "technical" update. Unless staff believes that the Board will be limited in its deliberation of the IRP to policies related to "implementation" of the IRP, we suggest deleting the word "implementation."

A-11: Water Transfers and Exchanges. Why has staff deleted the word, "acquisition"? Given MWD's recent proposed and consummated land acquisitions in Palos Verde and the Delta, deletion of this word is not warranted. Please explain.

A-11: Seawater Desalination. The section on seawater desalination is a sub-paragraph under Integrated Resources Plan Strategy, which is a sub-paragraph of the section describing "Metropolitan's Water Supply," which begins at page A-6. The Water Authority's seawater desalination project is not a MWD Water Supply and the Water Authority does not receive "financial incentives" from MWD for the project, as suggested. The reference to the Water Authority's project should be deleted here and included instead in sections of the Draft that report member agency local projects (Regional Water Resources, for example, like the Los Angeles Aqueduct) and reduced demand for MWD water (MWD Revenues (A-40) and Management's Discussion of Historical and Projected Revenues and Expenses (A-71)).

A-11-A-16: State Water Project. We found the proposed edits regarding Bay Delta Conservation Plan (BDCP) collectively, confusing. On the one hand, the Draft is amended to add language stating that the "basic, underlying purpose of the BDCP is to restore and protect Delta water supply, water quality and ecosystem health within a stable regulatory environment" (A-14), but then makes other edits changing statements that the BDCP is "being developed" that way to a statement that that is the BDCP as it was "originally conceived" (A-15). The Draft goes on to disclose that 50-year permits as originally conceived were not possible; but, it does not close the loop on how the need for a stable regulatory environment will be achieved. Please explain or suggest edits to address this concern.

A-18: Colorado River Aqueduct. The proposed edits suggest that it was a severe drought and reduced Colorado River storage that "ended" the availability of surplus water deliveries to MWD and "resulted" in California being limited to 4.4 million AF since 2003. These edits should not be made because they do not accurately describe the circumstances or the factual and legal record why California is limited to 4.4 million AF or why MWD no longer has access to surplus water on the Colorado River. There have been absolutely no changes since the last Official Statement of June 2015 that would explain the need for these edits at this time.

A-21: Quantification Settlement Agreement. However artfully described in the Draft Appendix A, MWD cannot credibly deny or change the fact that its projected sales are reduced by 180,000 AF and that San Diego is buying this water from IID, not MWD. The statement that MWD "expects to be able to annually divert 850,000 AF of Colorado River water -- without disclosing that 180,000 AF of that water belongs to the Water Authority -- is misleading, especially as the same sentence goes on to refer to water "from other water augmentation programs [MWD] develops." The section also refers prospective investors to "METROPOLITAN REVENUES--Principal Customers," where MWD continues the charade that its wheeling revenues represent the purchase and sale of MWD water (see page A-50 and section III above). This is misleading by design.

A-22: Sale of Water by the Imperial Irrigation District to San Diego County Water Authority. The sentence at the bottom of page A-22 that -- "[i]n consideration for the conserved water made available to MWD by SDCWA, a lower rate is paid by SDCWA for the exchange water delivered by MWD" -- should be deleted. At a minimum, MWD must disclose that MWD's legal theory and argument that the Water Authority is purchasing MWD water under the Exchange Agreement was expressly rejected by Judge Karnow in his Statement of Decision. See discussion at Section III above. Further, the proposed edits to delete reference to the volume of water MWD is wheeling for the Water Authority under the Exchange Agreement is unnecessary. In fact, this information should be provided.

A-24: Interim Surplus Guidelines. What is the reason for the proposed deletion stating that, "[t]he Interim Surplus Guidelines contain a series of benchmarks for reductions in agricultural use of Colorado River water within California by set dates"?

A-51: Water Sales Revenues. As noted above, MWD fails to disclose that it receives wheeling revenues from the Water Authority. MWD is obligated to disclose the findings and decision by the Superior Court in the rate case, whether or not it intends to appeal. MWD should also disclose here or elsewhere in the draft Appendix A that, since 2012, it has collected \$824,000,000 more from MWD ratepayers than needed to pay its actual budgeted expenses, of which \$743,000,000 exceeded the maximum reserve limits and that this amount may be subject to future claims. Finally, the statement that "MWD uses its financial resources and budgetary tools to manage the financial impact of the variability in revenues

due to fluctuations in annual water sales," is patently untrue. This very month, the MWD Board of Directors is being asked by staff to issue \$500 million in bonds, because MWD has now spent not only 100 percent of its budgeted revenues, but also the additional \$824,000,000 it over-collected from MWD ratepayers without any cost of service analysis.

A-52: Rate Structure. MWD should disclose in this section on its rate structure (rather than requiring investors to wade through several cross-references) that its rates have been determined to violate the common law, California statutory law and the California Constitution.

A-53: Litigation Challenging Rate Structure. We have several objections regarding disclosures related to the litigation challenging MWD's rate structure. In addition to the general concerns expressed at section II above:

MWD states that, "the Court granted MWD's motion for summary adjudication of the cause of action alleging illegality of the 'rate structure integrity' provision in conservation and local resources incentive agreements, dismissing this claim in the first lawsuit." What MWD fails to disclose is that the claim was dismissed on the basis of the Water Authority's supposed lack of standing to challenge the RSI provision; and, that the Court otherwise found the rate structure integrity provision to be unreasonable and inappropriate.

As noted in prior letters, the statement that the "Court found that SDCWA failed to prove its 'dry-year peaking' claim that MWD's rates do not adequately account for variations in member agency purchases" is inaccurate. What the Court stated was that, "the record does not tell us that all these charges are sufficient to account for all of the costs of providing what I have called contingency capacity" (April 24, 2014 Statement of Decision at page 64).

A-55: Litigation Challenging Rate Structure. What is MWD's intention and the reason for the proposed edit changing the reference to the "Exchange Agreement" to the "exchange agreement"?

Given the Court's ruling on October 9, MWD now must also disclose the Order Granting San Diego's Request for Prejudgment Interest; and, add this amount to the deposit it is holding as security under the Exchange Agreement.

A-55: Member Agency Purchase Orders. The Water Authority has previously expressed its opposition and concerns regarding the illusory contracts described as "Member Agency Purchase Orders;" those concerns and all past communications with MWD on this subject are incorporated herein by reference. There is no cost of service basis for these purported agreements including but not limited to the fact that MWD does not even set a Tier 2 Water Supply Rate as described.

A-58: Financial Reserve Policy. See the Water Authority's letter of this date RE Board Item 8-2: Approve and authorize the execution and distribution of Remarketing Statements in connection with the remarketing of the Water Revenue Refunding Bonds, 2011 Series A1 and A3 and 2009 Series A2 - **OPPOSE** and Section III above, incorporated herein by reference.

Further, MWD has represented to the Court in the rate litigation that it has established a "separate account" as a "security deposit" to cover the payment of the judgment and interest awarded to the Water Authority. It does not appear from any of the disclosures in the Draft Appendix A that this account exists; rather, it is money that is commingled with MWD's Unrestricted Reserves, which must be maintained to satisfy MWD's minimum reserve requirements and which are potentially subject to being spent or otherwise used by the MWD Board of Directors. As noted in section II above, there isn't enough cash available in order to satisfy the Water Authority's judgment and interest, while at the same time, meeting MWD's minimum reserve requirements.

As a detail, MWD has not corrected its prior reference to holding \$188 million - rather than \$209.8 million - in the last paragraph on page A-58.

Regarding the Board's approval of \$44.4 million to pay Southern Nevada Water Authority from unrestricted reserves, it does not appear that sufficient funds were available in unrestricted reserves to make this payment without either breaching MWD's contractual obligation to the Water Authority or falling below minimum reserve levels.

A-60: Ten Largest Water Customers. The numbers reflected in this schedule need to be corrected to show that the Water Authority is not purchasing MWD water when it pays MWD for the transportation of water under the Exchange Agreement.

A-60: Preferential Rights. The Draft must be amended to disclose the Court's findings and orders in the rate litigation, which are omitted.

A-61: California Ballot Initiatives. The Draft must be amended to disclose the Court's findings and orders in the rate litigation, which are omitted.

A-77: Water System Revenue Bond Amendment. Why is the language in the paragraph above the projected costs for State Water Project water being deleted? Is an updated explanation not required?

A-83: Historical and Projected Revenues and Expenses. MWD's "water sales" need to be corrected for the reasons discussed in this letter and Statements of Decision by Judge Karnow in the rate cases.

A-85: Management's Discussion of Historical and Projected Revenues and Expenses. The statements contained in this section of the Appendix A suffer from the same deficiencies as noted above, particularly with regard to a "budget" process that is designed to collect more revenues than budgeted expenses in seven out of ten years; MWD's adoption of programs and spending measures that have resulted in the unbudgeted spending of hundreds of millions of dollars, with no cost-of-service justification; and MWD's failure to maintain a separate account as a security deposit to secure payment of the judgment and interest owed to the Water Authority, as represented to the Superior Court.

Thank you for your consideration of and response to address these questions and issues.

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
Director



Fern Steiner
Director



Yen C. Tu
Director

Attachment:

1. Statement of Decision Rate Setting Challenges dated April 24, 2014
2. Statement of Decision dated August 28, 2015
3. Order Granting San Diego's Motion for Prejudgment Interest dated October 9, 2015
4. MWD's unrestricted reserves monthly balances beginning at July 1, 2015 through the end of September 2015 (as reported in draft Appendix A)

ⁱ MWD is suggesting certain edits to the Draft Appendix A to be consistent with the argument it made to the Court (at A-55), claiming that it was holding in its financial reserves a "deposit" equivalent to the amount of money that the Court awarded as damages on August 28, plus the amount of "interest" MWD claimed had accrued on the "deposit." But there was no "deposit" and there was no "interest" earned thereon, as MWD argued to the Court. Instead, MWD has commingled the funds it was required to hold as security deposit in its financial reserves. Although MWD is now claiming that it has since August 31 been holding \$209.8 million in its financial reserves to comply with its obligations under the Exchange Agreement, it does not appear to have been mathematically possible for it to do so without using cash that was at the same time required to be held by MWD in accordance with the Financial Reserve Policy described in A-58 of Appendix A.



FILED
San Francisco County Superior Court

APR 24 2014

CLERK OF THE COURT

BY: [Signature]
Deputy Clerk

SUPERIOR COURT OF CALIFORNIA

COUNTY OF SAN FRANCISCO

SAN DIEGO COUNTY WATER
AUTHORITY,

Plaintiff/Petitioner,

vs.

METROPOLITAN WATER DIST. OF
SOUTHERN CALIFORNIA, et al.

Defendants/Respondents.

Case No. CPF-10-510830

Case No. CPF-12-512466

STATEMENT OF DECISION ON RATE
SETTING CHALLENGES

San Diego County Water Authority (San Diego) challenges the legality of four rates set by Metropolitan Water District of Southern California (Met).

San Diego alleges three defects. First, San Diego argues that Met improperly allocates the bulk of Met's costs under its contract with the California Department of Water Resources' State Water Project to the System Access Rate and the System Power Rate. Second, San Diego contends that Met illegally treats all of its costs for conservation and local water supply development programs as transportation costs by recovering them through the Water Stewardship Rate, which Met charges as a transportation rate. The asserted result of these

misallocations is that parties who use Met's wheeling services pay an inflated rate for that service.

Third, San Diego asserts that, while Met incurs significant costs to accommodate the practice by some member agencies of "rolling on" to Met's system and buying more water in dry years, and "rolling off" of Met's system and substantially reducing their purchases from Met in average years (dry-year peaking), Met's rates fail to assign those costs to the member agencies that cause the dry-year peaking costs to be incurred or that benefit from the availability of dry-year peaking supplies.

I find for San Diego on the first two issues and for Met on the third.

Procedural History

San Diego filed suit challenging Met's 2011 and 2012 rates on June 11, 2010 (the 2010 case).¹ The operative Third Amended Complaint in the 2010 case includes six causes of action: the Rate Challenges (Causes of Action # 1-3); breach of contract (Cause of Action #4); declaratory relief as to RSI (Cause of Action # 5); and declaratory relief as to preferential rights (Cause of Action #6). Within the Rate Challenges, San Diego asserts that Met's 2011 and 2012 rates violate numerous constitutional and statutory provisions, namely: Article XIII A of the California Constitution (Proposition 13) and its implementing statute, Government Code § 50076; the Wheeling Statute, Water Code § 1810 *et seq.*; Government Code § 54999.7(a);

¹ San Diego and Met have driven this litigation, but they are not the only parties. Imperial Irrigation District answered the 2010 Complaint, the Third Amended Complaint in the 2010 action, and the 2012 Complaint alleging that some or all of Met's actions violated Water Code §§ 1810-1814. The Utility Consumers' Action Network also answered the 2010 complaint seeking invalidation of the rates, but not the operative Third Amended Complaint in that action or the 2012 complaint. The City of Glendale, Municipal Water District of Orange County, City of Torrance, Las Virgenes Municipal Water District, West Basin Municipal Water District, Foothill Municipal Water District, and City of Los Angeles all answered the 2010 Complaint, the operative Third Amended Complaint in that action, and the 2012 Complaint siding with Met. Three Valleys Municipal Water District answered the 2010 and 2012 Complaints siding with Met, but not the Third Amended Complaint in the 2010 action. Western Municipal Water District and Eastern Municipal Water District answered the 2012 Complaint, siding with Met.

Government Code § 66013; section 134 of the Metropolitan Water District Act; and California common law.

On June 8, 2012, after Met approved rates for calendar years 2013 and 2014 that relied on many of the same cost allocations and ratemaking determinations, San Diego filed a second lawsuit (the 2012 case). The 2012 case includes four causes of action: rate challenges to the 2013 and 2014 rates (Causes of Action # 1-3) and another claim for breach of contract (Cause of Action # 4). Within the 2012 rate challenges, San Diego alleges that Met's 2013 and 2014 rates violate the same common law, constitutional and statutory provisions as in the 2010 case, as well as Article XIII C § 1 of the California Constitution (Proposition 26).

On September 20, 2013, the parties filed cross-motions for summary adjudication. San Diego moved for summary adjudication on the RSI cause of action. Met moved for summary adjudication on the RSI cause of action, the preferential rights cause of action, and both breach of contract causes of action. By order dated December 4, 2013, I denied San Diego's motion for summary adjudication on RSI, granted Met's motion for summary adjudication on RSI, and denied Met's other motions for summary adjudication.

I bifurcated the breach of contract causes of action and set them for trial at a date following resolution of the rate challenges. The parties agreed to postpone the preferential rights claim as well; it will be heard at the same time as the breach of contract claims. The rate challenges were set for trial on December 17, 2013.

The trial for the rate challenges in the 2010 case and the 2012 case commenced on December 17, 2013, and was completed, except for closing arguments, on December 23. The parties filed post-trial briefs on January 17, 2014; closing arguments were heard on January 23, 2014.

I issued a tentative determination and proposed statement of decision February 25, 2014.

I provided the parties additional time for objections, which were filed March 27.

This statement of decision follows.

Factual Background

1. The Parties

Met was established in 1928 by the Metropolitan Water District Act. Stats. 1969, ch. 209 as amended; Water Code Append. §§ 109-134. Met acts as a supplemental wholesale water supplier to 26 cities and water districts throughout Southern California (Met's member agencies). San Diego is one of Met's member agencies, and has been since 1946. Met's member agencies govern Met through their representatives on Met's Board of Directors. Water Code Append. §§ 109-50, 109-51, 109-55. Each member agency has proportional representation on the Board of Directors, and is entitled to at least one seat on the Board, plus an additional seat for every full 3% of the total assessed value of the property within the member agency's service area that is taxable for district purposes. *Id.* at §§ 51-52.

Member agencies are not obligated to buy water from Met. If member agencies have access to local sources of water, they may freely opt out fully or partially from Met's services. JTX-2 (AR2012-016429) at AR2012-016440; *Metropolitan Wat. Dist. of S. Cal. v. Imperial Irrigation Dist.*, 80 Cal.App.4th 1403, 1417 (2000) (*MWD*).

But (with the exception of Los Angeles) member agencies currently have no way to receive imported water supplies except through Met's facilities. If a member agency such as San Diego purchases imported water on its own, it must as a practical matter move the water through

Met's facilities. The use of a water conveyance facility by someone other than the owner or operator is referred to as "wheeling." Met provides wheeling services to its member agencies.

2. Water Networks

Met "imports water from two principal sources, the State Water Project in Northern California, via the California Aqueduct, and the Colorado River, via the Colorado River Aqueduct."² Met takes delivery of its Colorado River water at Lake Havasu. Met transports its Colorado River water through the Colorado River Aqueduct, which Met owns and operates. Met takes delivery of State Water Project (SWP) water at four delivery points near the northern and eastern boundaries of Met's service area, including two large reservoirs, Castaic Lake and Lake Perris. SWP water is delivered to Met by the Department of Water Resources (DWR) via the California Aqueduct, which is part of the SWP. Met does not own or operate the SWP, nor does Met transport SWP water from Northern California to the terminal reservoirs at Castaic Lake and Lake Perris.³

Once the SWP water is received by Met, Met sometimes blends that water with water from the Colorado River, delivering blended water to its member agencies including San Diego. Met's distribution system transports water across a large part of the State, delivers water in six counties, and serves an area home to 19 million residents.⁴ Member agencies, in turn, deliver water to their customers.

² JTX-2* (AR2012-016429) at AR2012-016440. "*" indicates that a document is present only in the 2012 administrative record. "***" indicates that a document is not in any administrative record. All documents in the 2010 administrative record are also in the 2012 administrative record.

² DTX-090 at AR2012-000001 (capitalization omitted).

³ PTX-237A** (Resps. to RFA Nos. 44-47).

⁴ DTX-109* at AR2012-016583.

3. Met's Contract with DWR

Met has a contract with DWR entitled "Contract Between [Met] and [DWR] for a Water Supply and Selected Related Agreements."⁵ Pursuant to this contract, DWR makes SWP water available to Met at delivery structures established in accordance with the contract.⁶ Met is obligated to make all payments under the contract even if it refuses to accept delivery of water made available to it. *Id.* at AR2012-000048 (Art. 9).

The contract distinguishes between the cost to *supply* SWP water to Met, and the cost to *transport* SWP water to Met.⁷ The cost to transport the SWP water to Met includes a capital cost component; a minimum operation, maintenance, power, and replacement component; and a variable operation, maintenance, power, and replacement component.⁸

The DWR contract gives Met the right to use the SWP transportation facilities to transport water that does not come from SWP facilities.⁹ The contract also gives Met the right to use SWP facilities for "interim storage" of non-project water, for later transportation to Met and its member agencies.¹⁰ Met pays no facilities charge to transport or store non-project water because Met pays for these rights by way of its transportation charge under the DWR Contract. DTX-055 at AR2012-000153 (Art. 55(b)-(c)); DTX-087 at AR2012-011307 ("contractor[s] that participate[] in the repayment for a reach [have] already paid costs of using that reach for conveyance of water supplies in the Transportation Charge invoice under its Statement of

⁵ DTX-090 at AR2012-000001 (capitalization omitted).

⁶ DTX-055 at AR2012-000048-49 (Arts. 9 (Obligation to Deliver Water Made Available), 10 (delivery structures)).

⁷ DTX-055 at AR2012-000065 (Art. 22 (a), defining Delta Water Charge), 000071-72 (Art. 23, defining Transportation Charge).

⁸ DTX-055 at 000071 (Art. 23, defining Transportation Charge), 000074 (Art. 24(a), defining Capital Cost Component), 000083 (Art. 25(a), defining Minimum Operation, Maintenance, Power, and Replacement Component), 000086-87 (Art. 26(a), defining Variable Operation, Maintenance, Power, and Replacement Component).

⁹ DTX-055 at AR2012-000153 (Art. 55(a)).

¹⁰ *Id.*; *see also* DTX-087 at AR2012-011307; DTX-109* at AR2012-016588. These documents refer to Met's use of the SWP to transport non-project water to full-service users.

Charges”); DTX-109* at AR2012-016588 (“This [non-project water] conveyance service is provided because the state water contractor has paid for the capital and operations and maintenance costs associated with the capacity in the California Aqueduct that is used”).

4. Met’s Rates and Charges

a. Rate-Setting

Until 2003, Met charged its member agencies a single, bundled water rate without any separate supply or transportation components.¹¹ In 1998, Met began the process of designing and implementing unbundled water rates and charges, to reflect the different services Met provides in order to more transparently recover its costs.¹²

Every year, or more recently, every two years, Met’s Board votes on particular rates adopted under that rate structure. In each budget and rate-setting cycle, Met looks at the services it expects to provide and estimates the costs it expects to incur to provide those services. As part of this process, Met evaluates its budget and the required rates necessary to support that budget.¹³

For each rate-setting since the unbundling, Met has presented each Board member with a final letter setting forth the details of the proposed rate options and a staff recommendation, as well as a multi-step cost of service (COS) analysis demonstrating how Met assigns certain expenses to related operation functions.¹⁴

In Step 1 of the COS process, Met determines its revenue requirements for the given fiscal year.¹⁵ This prospective process is necessarily inexact because Met must estimate both the services it plans to provide and their cost.¹⁶

¹¹ DTX-045 at AR2012-006471, 006496.

¹² DTX-132* at AR2012-006462_01; DTX-034 at AR2012-005545-46.

¹³ DTX-090 at AR2010-011443; DTX-110* at AR2012-016594.

¹⁴ DTX-090 at AR2010-0011443; DTX-110* at AR2012-016594.

¹⁵ DTX-090 at AR2010-011467, 011472-011474 (Schedule 1 at AR2010-011474 sets forth the revenue requirements by budget line item); DTX-110* at AR2012-016674, 016679-016680.

¹⁶ *Id.*

In Step 2 of the COS process, Met functionalizes its costs according to the nature of the service to which the costs correspond.¹⁷ These services are: supply, transportation (conveyance and aqueduct and distribution), storage, and demand management.¹⁸

Transportation-related costs associated with bringing water to Met's service area—mainly costs associated with the Colorado River Aqueduct and the SWP transportation facilities—are functionalized as conveyance and aqueduct costs. *Id.* Transportation-related costs associated with Met's internal distribution system are functionalized as distribution costs. *Id.* Costs associated with investments in developing local water resources are functionalized as demand management costs. *Id.*

In Step 3 of the COS process, Met categorizes its functionalized costs based on their causes and behavioral characteristics, including identifying which costs are incurred to meet average demands versus peak demands, and which costs are incurred to provide “standby” service.¹⁹ The relevant classification categories include: fixed demand costs, fixed commodity costs, fixed standby costs, and variable commodity costs.²⁰ Demand costs are “incurred to meet peak demands” and include only the “direct capital financing costs” necessary to build additional physical capacity in Met's system.²¹ Commodity costs are generally associated with average system demands. Fixed commodity costs include fixed operations and maintenance and capital financing costs that are not related to accommodating peak demands or standby service. Variable commodity costs include costs of chemicals, most power costs, and other cost components that vary depending on the volume of water supplied. Standby service relates to

¹⁷ DTX-090 at AR2010-011472, 011474-011482 (Schedule 4 at 011481 sets out the revenue requirements by their service function; DTX-110* at AR2012-016679, 016681-016687.

¹⁸ DTX-090 at AR2010-011474-011475; DTX-110* at AR2012-016681-016682.

¹⁹ DTX-090 at AR2010-011472, 011483-011489; DTX-110* at AR2012-016679, 016688-016694.

²⁰ DTX-090 at AR2010-011483 (Schedule 7 at 011488 sets out the service revenue requirements by classification category); DTX-110* at AR2012-016688.

²¹ DTX-090 at AR2010-011483, 011488; DTX-110* at AR2012-016688, 016693.

MWD's ability to ensure system reliabilities during emergencies such as earthquakes or major facility outages. The two principal components of Met's standby service costs are emergency storage within its own system and the standby capacity within the SWP conveyance system.²²

In Step 4 of the COS process, Met breaks its operation functions down into corresponding rate design elements, which, in Met's rate structure are volumetric rates (*i.e.*, rates charged per acre-foot²³ of water Met delivers to the member agencies), and fixed charges (*i.e.*, charges which do not vary with sales in the current year).²⁴ Among the unbundled volumetric rates in Met's rate structure are the Supply Rates (Tiers 1 and 2) and the Transportation Rates.²⁵ Met's fixed charges included a Readiness-to-Serve Charge and a Capacity Charge.²⁶

b. Water Rate Versus Wheeling Rate

Met's full-service water rate, charged when Met sells a member agency water, includes supply rates (Tier 1 and Tier 2), the System Access Rate, the System Power Rate, and the Water Stewardship Rate. These are all volumetric charges. Met's Wheeling Rate includes the System Access Rate, the Water Stewardship Rate, and the incremental cost of power necessary to move the water. MWD Admin. Code §§ 4119, 4405(b). All member agencies are charged the same rates. These components are described below.

i. Supply Rates

Met's Supply Rates recover costs incurred to maintain and develop water supplies needed to meet the member agencies' demands.²⁷ These costs include capital financing, operating,

²² *Id.*

²³ An acre-foot of water covers one acre one foot deep.

²⁴ DTX-090 at AR2010-011472, 011490 (Schedule 8 at 011490 sets out Met's classified service functions by rate design element); DTX-110* at AR2012-016695.

²⁵ DTX-090 at AR2010-011490-011500; DTX-110* at AR2012-016695-016700.

²⁶ *Id.*

²⁷ DTX-090 at AR2010-011474-011475, 011499-011500; DTX-110* at AR2012-016681, 016700.

maintenance and overhead costs for storage in Met's reservoirs.²⁸ These costs are generally recovered through the Tier 1 Supply Rate. However, if purchases in a calendar year by a member agency that executed a purchase order exceed 90% of its base firm demand (an amount based on the member agency's past annual firm demands), that member agency must pay a higher Tier 2 Supply Rate.²⁹ If a member agency did not execute a purchase order, the member agency must pay the higher Tier 2 Supply Rate for any amount exceeding 60% of its base firm demand.³⁰

ii. System Access Rate

The System Access Rate generates revenues to recover the capital, operating, maintenance, and overhead costs associated with the transportation facilities (*e.g.*, aqueducts and pipelines) necessary to deliver water to meet member agencies' average annual demands.³¹ Revenues from the SAR recover the costs of paying for distribution facilities (Met's facilities within its service area) and conveyance facilities (costs associated with the SWP facilities and Colorado River Aqueduct).³² The System Access Rate also includes regulatory storage costs, which are associated with maintaining additional distribution capacity and help meet peak demands.³³

²⁸ *Id.*

²⁹ DTX-045 at AR2012-006535-006536; DTX-090 at AR2010-011499; DTX-110* at AR2012-016700.

³⁰ *Id.*

³¹ DTX-045 at AR2012-006518; DTX-090 at AR2010-011492; DTX-110* at AR2012-016697.

³² DTX-045 at AR2012-006518.

³³ DTX-090 at AR2010-011473, 011475, 011484-011485, 011488, 011490-011492; DTX-110* at AR2012-016680, 016682, 016695-016697.

iii. System Power Rate

The System Power Rate generates revenues to recover the costs of power necessary to pump water through the SWP and Colorado River facilities to Met, and through Met's facilities to the member agencies.³⁴

Met allocates transportation costs associated with the SWP to the System Access Rate and the System Power Rate the same way it allocates those costs associated with the Colorado River Aqueduct.³⁵

iv. Water Stewardship Rate

The Water Stewardship Rate recovers the costs of funding demand management programs (local water resource development programs, water conservation programs, and seawater desalination programs).³⁶ These demand management programs, discussed in more detail below, are designed to encourage the development of local water supplies and the conservation of water.

c. Readiness-to-Serve Charge

Met's Readiness-to-Serve Charge recovers, among other things, SWP-related conveyance costs associated with peak demand (*i.e.*, capital financing costs), as well as emergency storage and peak-related storage costs (*i.e.*, storage which provides operational flexibility in meeting peak demands and flow requirements), and costs incurred to stand by and provide services during times of emergency or outage of facilities.³⁷ Each member agency's Readiness-to-Serve

³⁴ DTX-045 at AR2012-006520; DTX-090 at AR2010-011492; DTX-110* at AR2012-016697.

³⁵ DTX-090 at AR2010-011488, 011490; DTX-110* at AR2012-016693, 016695.

³⁶ DTX-045 at AR2012-006519; DTX-090 at AR2010-011492; DTX-110* at AR2012-016697.

³⁷ DTX-090 at AR2010-011484-011485, 011488, 011490, and 011494-011495; DTX-110* at AR2012-016688-016689, 016693, 016695, and 016698-016699.

Charge is based on that agency's ten-year rolling average of past total consumption, *i.e.*, all firm deliveries including water transfers and exchanges that use Met capacity.³⁸

d. Capacity Charge

The Capacity Charge is intended to pay for the cost of peaking capacity on Met's system, while providing an incentive for local agencies to decrease their use of Met's system to meet peak day demands.³⁹ Each member agency's Capacity Charge is based on that agency's maximum summer day demand placed on the system between May 1 and September 30 for a three-calendar year period.⁴⁰

e. Treatment Surcharge

The treatment surcharge is a uniform system-wide volumetric rate charged to for treated water.⁴¹

5. Demand Management Programs

Met's demand management programs fall under the rubric of the Local Resources Program, which provides incentives for recycled water and groundwater recovery facilities; the Seawater Desalination Program, which provides incentives for member agencies to develop facilities to desalinate seawater; and the Conservation Credits Program, which encourages the installation of water-efficient devices.⁴²

Met's demand management programs, are designed to, and do, reduce demand for water. *See* DTX-045 at AR2012-006519 ("Investments in conservation and recycling decrease the

³⁸ DTX-090 at AR2010-011495; DTX-110* at AR2012-016699.

³⁹ DTX-090 at AR2010-011492-011493; DTX-110* at AR2012-016697-016698.

⁴⁰ DTX-090 at AR2010-011492; DTX-110* at AR2012-016697.

⁴¹ DTX-045 at AR2012-006520.

⁴² *See, e.g.*, DTX-027 at AR2012-002868-002873; JTX-2* (AR2012-016429) at AR2012-016496, 016519.

region's overall dependence on imported water supplies"); 12/20/2013 Tr.** at 588:24-589:1⁴³ ("That's ultimately what [Met is] paying for is for a reduction in demand for imported water from [Met's] system." (Upadhyay testimony)); DTX-027 at AR2012-002870 (the first key goal of Met's Local Resources Program is to "avoid or defer Met capital expenditures"); 12/20/2013 Tr.** at 578:22-580:11 (Upadhyay testimony stating that Met adopted the Local Resources Program principles and they remain in effect today); DTX-518** at MWD2010-00466049 (Board identifying regional benefits associated with the Local Resources Program, including reduction in capital investments due to deferral and downsizing of regional infrastructure and reduction in operating costs for distribution of imported supplies); 12/20/2013 Tr.** at 580:17-581:21 (Upadhyay testimony that Met adopted the Local Resources Program as described in DTX-518); DTX-527** at MWD2010-00469807 (the first key goal of Met's Seawater Desalination Program is to "avoid or defer MWD capital expenditures"); 12/20/2013 Tr.** at 583:16-585:1 (Upadhyay testimony stating that Met's Seawater Desalination Program results in similar benefits to the Local Resources Program, including its key goals, and Met's Board adoption of the Program).

There are various estimates of the demand for water alleviated by these programs. *See* JTX-2* (AR2012-016429) at 016519 (Met's 2010 IRP estimates that 1,037,000 acre-feet of water will be conserved annually in southern California by 2025 due to Met's Conservation Credits Program). On an annual basis Met is required to report to the Legislature the effect its demand management programs have on decreasing demands on Met's system. *See, e.g.*, DTX-454** (Senate Bill 60 Report for fiscal year 2011/12); 12/20/2013 Tr. at 601:5-18 (Upadhyay testimony). These reports note the number of acre-feet of water Met was able to avoid

⁴³ As explained in note 3, "*" indicates that a document is present only in the 2012 administrative record. "***" indicates that a document is not in any administrative record. All documents in the 2010 administrative record are also in the 2012 administrative record.

transporting to its member agencies in a particular year as a result of its demand management programs. DTX-454** at MWD2010-00310322; 12/20/2013 Tr.** at 601:19-603:15 (Upadhyay testimony). Met calculates the effect demand management programs have by comparing the actual demand in a given year to the amount of reduced demand quantified in its SB-60 Reports. 12/20/2013 Tr.** at 601:19-603:15 (Upadhyay testimony). For example, in fiscal year 2011/12, Met estimated it would have had to transport over 20% more water through its system without its demand management programs. *Id.*; *see also id.* at 603:16-605:19 (Upadhyay testimony explaining that the 20% figure is conservative because the Conservation Credits Program actually reduces demand more than is reflected in the SB-60 Reports).

Met states that these decreases in demand avoid some capital expenditures,⁴⁴ including some transportation-related capital expenditures. *See, e.g.*, DTX-090 at AR2010-011511 (“Investments in demand side management programs like conservation, water recycling and groundwater recovery . . . help defer the need for additional conveyance, distribution, and storage facilities.”).

For example, in 1996, Met conducted a study to determine its future demand scenarios and corresponding infrastructure requirements.⁴⁵ Met evaluated two scenarios: a “base case,” under which no demand management programs were in place, and a “preferred case,” under which demand management program were in place.⁴⁶ Met compared the base and preferred cases and determined that demand management programs would decrease demand, thereby reducing the amount of water passing through Met’s system. Met believes that this equated to \$2

⁴⁴ DTX-020 at AR2012-001655-001657; 12/20/2013 Tr.** at 605:20-606:8 (Upadhyay testimony).

⁴⁵ DTX-018**, DTX-019 at AR2012-001406-001519; DTX-020 at AR2012-001520-001657.

⁴⁶ DTX-018** at MWD2010-00465826-00465828, 00465831-00465836; 12/20/2013 Tr.** at 566:13-567:24 (Upadhyay testimony).

billion savings in capital infrastructure costs.⁴⁷ It is unclear the extent to which the demand management programs contemplated in the preferred case exist.

Met also explored how its anticipated capital expenses relate to demand on Met's system in its 1996 Integrated Resources Plan ("IRP").⁴⁸ In the 1996 IRP, Met performed a sensitivity analysis to assess whether changes in future demands would impact the need for additional or expanded distribution facilities.⁴⁹ The IRP concludes that a 5% increase/decrease of demand had a correlative effect on when Met would need to incur capital infrastructure costs.⁵⁰ For example, Met determined that with a 5% decrease in demand, it could defer building the San Diego Pipeline No. 6 and the Central Pool Augmentation Project, both of which are distribution facilities.⁵¹ Met contends that it has in fact been able to defer both of these projects because demand management programs have decreased demand on Met's system.⁵²

6. Dry-Year Peaking

Met is a supplemental supplier of water. Thus annual demand for Met water can vary for a variety of reasons. *See JTX-2** (AR2012-016429) at AR2012-016473 ("[Met's] primary purpose is to provide a supplemental supply of imported water to its member public agencies. . . . The demand for supplemental supplies is dependent on water use at the retail consumer level and the amount of locally supplied water. Consumer demand and locally supplied water vary from year to year, resulting in variability in water sales").

According to San Diego, "dry-year peaking" refers to annual variations in use of Met water as a result of drought conditions. A reference to this is found in in Met's 1996 Integrated

⁴⁷ DTX-018** at MWD2010-00465836; 12/20/2013 Tr.** at 568:22-569:12 (Upadhyay testimony).

⁴⁸ DTX-020 at AR2012-001520-001657.

⁴⁹ DTX-020 at AR2012-001655-001657; 12/20/2013 Tr.** at 571:25-572:10 (Upadhyay testimony).

⁵⁰ DTX-020 at AR2012-001655-001657; 12/20/2013 Tr.** at 571:25-573:16 (Upadhyay testimony).

⁵¹ DTX-020 at AR2012-001655-001657; 12/20/2013 Tr.** at 573:6-16 (Upadhyay testimony).

⁵² 12/20/2013 Tr.** at 573:17-574:3 (Upadhyay testimony).

Resources Plan (IRP), which spelled out the storage, conveyance, and water supply development costs that Met must incur to satisfy “dry year water demands.”⁵³ This IRP explained that “because demands and supplies can vary substantially from year to year due to weather and hydrology,” and “because Metropolitan’s supplies are the swing supply for the region as a whole, this variation in demand alone translates into a \pm 14 percent change in Metropolitan’s water sales,” much of which is attributed to the fact that “below-normal runoff in the Owens Valley increases [Los Angeles’s] need for Metropolitan’s deliveries.”⁵⁴

Raftelis’s 1999 cost-of-service report, commissioned by Met, also refers to dry-year peaking and the disparity among member agencies in their peaking behavior, caused by the fact that “agencies with local resources” use Met as their “swing supply.”⁵⁵

According to San Diego, some member agencies increase their reliance on Met water by a greater magnitude than other agencies during dry years. San Diego’s experts calculated each member agency’s average annual variations in purchases over the last ten years (including the ratios of highest annual water use to average annual water) and San Diego submitted this information to Met’s Board for its consideration during the 2012 rate-setting cycle.⁵⁶ San Diego’s experts concluded that MWD’s largest customers (*i.e.*, those that purchase over 100,000 acre-feet of water per year, accounting for more than 70% of MWD’s total water deliveries) had ratios between 1.07 and 1.32. *Id.* (San Diego’s ratio was 1.11, Los Angeles Department of Water and Power’s ratio was 1.31).

⁵³ AR2010-001406 at 001450, 001452, 001466, 001491, 001493, 001509-10, 001591.

⁵⁴ AR2010-001406 at 001486-88 (charting LA’s dry-year peaking); *see also* AR2012-16429 at 16523* (detailing Los Angeles’s practice of rolling onto Met’s system in dry years and rolling off again in dry years).

⁵⁵ AR2012-16288_2114 at 2189-92*.

⁵⁶ DTX-108* at AR2012-016177.

Basic Evidentiary Standards and Burdens

The basic evidentiary standards and burdens applicable to the claims asserted here were discussed in the November 5, 2013 pretrial order. While the determinations made there were subject to revision, Pre-Trial Rulings at 9, the parties have provided no new argument and so I reiterate them here.

1. Default Rules

The general principles governing review of a quasi-legislative action on a writ of mandate under C.C.P. § 1085 are discussed in *American Coatings Assn., Inc. v. South Coast Air Quality Dist.*, 54 Cal.4th 446, 460 (2012). The rules are: (1) the standard of review is arbitrary and capricious, (2) petitioner usually bears the burden of proof,⁵⁷ and (3) the court considers only the administrative record before the agency at the time of its decision. An administrative agency's rate-making is a form of quasi-legislative action. *20th Century Ins. Co. v. Garamendi*, 8 Cal.4th 216, 277 (1994); *Brydon v. East Bay Mun. Util. Dist.*, 24 Cal.App.4th 178, 196 (1994) (water rate structure is quasi-legislative). Rates are presumed reasonable, fair, and lawful, *Hansen v. City of San Buenaventura*, 42 Cal.3d 1172, 1180 (1986) and petitioners have the burden of showing otherwise. *Id.*; *San Diego Cnty. Water Auth. v. Metro. Water Dist. of S. California*, 117 Cal.App.4th 13, 23 n.4 (2004).

Evidence outside the administrative record is not usually admissible. *Western States Petroleum Ass'n v. Superior Court*, 9 Cal.4th 559, 565, 576 (1995). *Western States* did recognize a narrow exception: Extra-record evidence is admissible in traditional mandamus proceedings if it existed before the agency made its decision and it was not possible in the exercise of reasonable diligence to present it to the agency before the decision was made. *Id.* at

⁵⁷ Evid. C. § 500. The burden of producing evidence is usually, but not always, on the party which has the burden of proof. Evid. C. § 550 (b).

578. Other exceptions might exist, but extra-record evidence cannot be used to contradict the administrative record. *Id.* at 578-79.

2. Proposition 26 (California Constitution Article XIII C)

California Constitution Article XIII C § 1(e) provides,

The local government bears the burden of proving by a preponderance of the evidence that a levy, charge, or other exaction is not a tax, that the amount is no more than necessary to cover the reasonable costs of the governmental activity, and that the manner in which those costs are allocated to a pay or bear a fair or reasonable relationship to the payor's burdens on, or benefits received from, the governmental activity.

This is similar to that enacted by Proposition 218 and found in article XIII D § 4(f), which states:

In any legal action contesting the validity of any assessment, the burden shall be on the agency to demonstrate that the property or properties in question receive a special benefit over and above the benefits conferred on the public at large and that the amount of any contested assessment is proportional to, and no greater than, the benefits conferred on the property or properties in question.

Proposition 218 probably requires independent review. *Silicon Valley Taxpayers Ass'n, Inc. v. Santa Clara County Open Space Authority*, 44 Cal.4th 431 (2008).⁵⁸ Proposition 26 specifies the “burden of proving by a preponderance of the evidence” that the charge is not a tax, whereas Proposition 218 uses only the general term “burden.” By clarifying the burden, Proposition 26 may more strongly suggest that independent or *de novo* review is required. After Proposition 218, “an assessment’s validity, including the substantive requirements, is now a constitutional question,” and agencies may not exercise discretion to violate the constitution.

⁵⁸ *Silicon Valley* held the Proposition did not specify the burden, and so considered extrinsic evidence of voter intent. *Id.* at 445. The Court found that Proposition 218 was intended to overturn cases that held a deferential view of local government assessments was required. *Id.* at 445-46. And the Court concluded that the primary basis for deferential review, judicial deference to legislative acts, did not apply under Proposition 218, a constitutional amendment designed to limit local power, because Proposition 218 makes an assessment’s validity a constitutional question. *Id.* at 447-48. Neither party here discusses the extrinsic evidence of voter intent as to Proposition 26.

Silicon Valley, 44 Cal.4th at 448. This too suggests *de novo* review. See also *Griffith v. City of Santa Cruz*, 207 Cal.App.4th 982, 990 (2012) (reviewing trial court's denial of petition for writ of mandate pursuant to Propositions 218 and 26 *de novo* because it involved a facial constitutional challenge to an ordinance as written); *Greene v. Marin Cnty. Flood Control & Water Conservation Dist.*, 49 Cal.4th 277, 298 (2010) (reciting *Silicon Valley*). Moreover, the statutory language suggests that Met bears the burden of proving that its charge is not a tax under *any* of the seven exceptions.

As to the scope of the evidence to be considered, given the default rule that the scope of review is limited to the administrative record (with certain exceptions) and the failure of Proposition 26 to clearly modify this standard, I will here follow *Western States* and look only to the administrative record.

3. Proposition 13 and Government Code §§ 50075-50077

Whether a statute imposes a tax or a fee for the purposes of Proposition 13 is a question of law to be decided on an independent review of the facts. See *Cal. Farm Bureau Federation v. State Wat. Resources Control Bd.*, 51 Cal.4th 421, 436 (2011).

The following burden-shifting framework applies: (1) San Diego bears the burden of establishing a *prima facie* case showing that the fee is invalid; and (2) if San Diego's evidence is sufficient, Met then bears the burden of production to show that the challenged components of its rates bear a fair or reasonable relationship to the costs of the service Met provides. San Diego bears the burden of proof, and Met's burden is one of production only. See *Cal. Farm Bureau*, 51 Cal.4th at 436-37. For the same reasons discussed with respect to Proposition 26, I will look solely to the administrative record.

4. Wheeling Statutes

The wheeling statutes provide that no “public agency may deny a bona fide transferor of water the use of a water conveyance facility which has unused capacity, for the period of time for which that capacity is available, if fair compensation is paid for that use, subject to [enumerated exceptions].” Wat. Code § 1810. “‘Fair compensation’ means the reasonable charges incurred by the owner of the conveyance system, including capital, operation, maintenance, and replacement costs, increased costs from any necessitated purchase of supplemental power, and including reasonable credit for any offsetting benefits for the use of the conveyance system.” Wat. Code § 1811(c).

Section 1813 provides,

In making the determinations required by this article, the respective public agency shall act in a reasonable manner consistent with the requirements of the law to facilitate the voluntary sale, lease, or exchange of water and shall support its determinations by written findings. In any judicial action challenging any determination made under this article the court shall consider all relevant evidence, and the court shall give due consideration to the purposes and policies of this article. In any such case the court shall sustain the determination of the public agency if it finds that the determination is supported by substantial evidence.

In *Metropolitan Water Dist. of Southern Cal. v. Imperial Irr. Dist.*, 80 Cal.App.4th 1403, 1423, 1426-33 (2000), the Court found the wheeling statutes do not always preclude the consideration of system-wide costs in a wheeling rate calculation, and in so doing the Court afforded no deference to Met’s position. Accordingly, I should review *de novo* whether the statute applies or bars the inclusion of any component in a rate. But to the extent I must to review Met’s factual “fair compensation” determination, the statute requires me to do so under the substantial evidence standard.

The statutory language does not address the burden of proof, nor is there authority on point. San Diego argued in pre-trial briefing that *Beaumont Investors v. Beaumont-Cherry Valley*

Water District, 165 Cal.App.3d 227 (1985) places the burden of proof on the water district to prove that its charges are fairly allocated and do not exceed the reasonable cost of service. But, if anything, *Beaumont* shifts only the burden of production. *Homebuilders Ass'n of Tulare/Kings Cnty., Inc. v. City of Lemoore*, 185 Cal.App.4th 554, 563 (2010) (*Beaumont* conflated the burden of production and the burden of proof, the agency in *Beaumont* failed to meet its burden of production).

Finally, the statute requires me to consider all relevant evidence. *See* Wat. Code § 1813.

5. Government Code § 54999.7(a) and 66013

Met maintains that these statutes do not apply in this case as a matter of law. *See* Met Closing Brief, 26-29 (arguing that (1) § 66013 does not apply because it provides a basis for challenging capacity charges, not water rates generally; and (2) § 54999.7 does not apply to a water wholesaler like Met, or where all customers are public agencies, or where rates are not imposed). The applicability of the statutes is a legal matter, and no deference is afforded to Met. I resolve those legal issues below.

To the extent San Diego alleges Met acted unreasonably by including certain components in its water rates, this may raise factual questions, challenging Met's quasi-legislative actions. As to such issues, I afford deference to Met. I apply the default rule that San Diego bears the burden of proof and the default rule that I am confined to the administrative record.

6. The Met Act

San Diego argues that Met violated its enabling statute, the Met Act, by including in its wheeling rate costs that are unrelated to wheeling. At issue is Water Code Appendix § 109-134, which requires Met to set rates that are "uniform for like classes of service throughout the district."

“[T]he judiciary, although taking ultimate responsibility for the construction of the statute, accords great weight and respect to the administrative construction.” *San Diego Cnty. Wat. Authority v. Metropolitan Wat. Dist. of Southern Cal.*, 117 Cal.App.4th 13, 22-23 (2004). The Court further noted that substantial deference must be given to Met’s determination of its rate design and that rates established by a lawful rate-fixing body are presumed reasonable, fair, and lawful. *Id.* at 23 n.4. Accordingly, here I should give substantial deference to Met’s rate design, presume that Met’s rates are reasonable, and accord great weight to Met’s statutory construction while independently taking ultimate responsibility for construction of the statute. *Yamaha Corp. of America v. State Bd. of Education*, 19 Cal.4th 1, 11 n.4 (1998) (court has final responsibility for the interpretation of the law).

To the extent a burden of proof applies, consistent with the presumption that Met’s rates are reasonable the following burden-shifting scheme applies: (1) the plaintiff has the initial burden to establish that rates are different for different classes of like entities; (2) upon that showing, the defendant must make a showing that the rates were fixed by a lawful rate-fixing body, giving rise to an assumption of fact is required to be made that the rates fixed are reasonable, fair, and lawful; and (3) the plaintiff has the ultimate burden to show that the rates fixed are unreasonable. *Elliott v. City of Pacific Grove*, 54 Cal.App.3d 53, 60 (1975). In *Elliott*, the Court stated in dicta that the burden-shifting scheme proposed by defendants should apply in a rate-setting case. *See also Hansen*, 42 Cal.3d at 1180 (citing *Elliott* for the propositions that rates established by a lawful rate-fixing body are presumed reasonable and that, thus, plaintiffs bear the burden of showing that the rates fixed are unreasonable). Absent a showing that evidence is admissible pursuant to an exception under *Western States*, I should consider only the administrative record.

7. Common Law

A county, for example, can sue to enjoin rates that discriminate without a reasonable and proper basis. *Cnty. of Inyo v. Pub. Utilities Com.*, 26 Cal.3d 154, 159 (1980) (citing *Elliott*, 54 Cal.App.3d at 59). “A showing that rates are discriminatory is in itself insufficient to fulfill a complainant’s burden of proof [citation]; a showing, however, that such discrimination rests solely on the nonresident status of the customer, and not on the cost of service or some other reasonable basis, will prove the rate invalid.” *Cnty. of Inyo*, 26 Cal.3d at 159 n.4. With respect to the common law theory, I should give Met deference. Even when appellate opinions have not applied the writ of mandate standard to rates, they follow the “substantial deference” standard and presume rates’ reasonableness. *See San Diego*, 117 Cal.App.4th at 23 n.4. The burden-shifting procedure described above should apply to the common law theory for the same reasons it should apply under the Met Act. As with the Met Act claim, I should confine myself to the administrative record, absent San Diego’s showing that an exception to *Western States* applies.

Key Cases

1. Wheeling Cases

“State law mandates that the owner of a water conveyance system with unused capacity allow others to use the facility to transport water. The use of a water conveyance facility by someone other than the owner or operator to transport water is referred to as ‘wheeling.’ In return for wheeling, the water conveyance system owner is entitled to ‘fair compensation.’” *Metropolitan Wat. Dist. of S. Cal. v. Imperial Irrigation Dist.*, 80 Cal.App.4th 1403, 1407 (2000) (*MWD*).

With respect to wheeling, the parties focus on two cases decided less than a month apart. *See MWD*, 80 Cal.App.4th 1403; *San Luis Coastal Unified School Dist. v. City of Morro Bay*, 81 Cal.App.4th 1044 (2000).

In *MWD*, Met sought validation of its wheeling rates. *MWD*, 80 Cal.App.4th at 1408. Then, as now, Met's wheeling rate was based on the amount of water transported without regard to the source of water, the facilities used, or the distance traveled. *Id.* at 1419. The rate was based on the same "transmission-related costs" that Met included in the rates it charged for the water it sold to member agencies. *Id.* The transmission-related charges compensated Met for its capital investment and system-wide costs. *Id.* These costs included: debt service, operations and maintenance expenses, and take-or-pay contract costs associated with aqueducts and pipelines that deliver water from the supply sources to storage facilities, treatment plants and customer service connection points; SWP costs identified as transportation (both capital and maintenance); the costs of operating and maintaining the Colorado River Aqueduct and in-basin systems; the costs of planning and constructing transmission facilities, the costs of operating and maintaining regulating reservoirs; and 50% of Met's "Water Management Program branches' expenses." *Id.* at 1419-20. The transmission costs were discounted for wheeling transactions to take into account the fact that wheeling can only occur when unused capacity is available. *Id.* at 1420. The wheeling rate only applied to member agencies. *Id.*

Met explained that it factored system-wide costs into its wheeling rate to maintain its operational and financial integrity and to avoid adverse impact upon rates and charges of other member agencies. *Id.* Specifically, Met argued that if water sales to member agencies were displaced by wheeling transactions and Met was unable to charge wheelers for its capital investments and system-wide costs, then Met would have to scale back its conservation and

recycling programs or shift costs to other member agencies or taxpayers. *Id.* at 1420-21. Met was concerned that wheeling transactions by member agencies would put at risk its investment in facilities, its capital improvements, its water management programs, and its ability to meet its SWP costs. *Id.* at 1421. In short, Met argued that if a member agency purchasing water from Met paid for the fixed, unavoidable costs of the system, then member agencies using the same system for wheeling must contribute to Met's fixed costs on an equivalent basis. In Met's view, this prevents the water-purchasing agencies from subsidizing part of the wheeling transactions by bearing the full costs of Met's system. *Id.*

The trial court bifurcated trial. *Id.* at 1422. In the first phase, the trial court addressed two legal questions: (1) whether Met may include all of its system-wide costs in calculating its wheeling rates rather than only costs relating to particular facilities; and (2) whether Met may set "postage stamp" rates in advance without regard to any particular wheeling transaction. *Id.* The trial court resolved those legal questions against Met, obviating the need for the second phase of trial. *Id.*

The Court of Appeal reversed. First, the Court held that "neither the plain language of the Wheeling Statutes nor the legislative history supports a conclusion *as a matter of law* that system-wide costs cannot under any circumstances be included in a wheeling rate calculation." *Id.* at 1427. In so doing, the Court left it to the trial court to determine whether the system-wide costs included in Met's wheeling rate are proper. *Id.* at 1433. The Court began its analysis by noting that the Legislature did not use language consistent with the theory that only point-to-point costs may be recovered. *Id.* at 1428. Next, the Court reasoned that the fair compensation to which a water conveyance system owner is entitled for wheeling water includes reasonable capital, maintenance, and operation costs occasioned, caused, or brought about by the use of the

conveyance system. *Id.* at 1431. The Court stated that this includes charges the owner become subject to or liable for in using the conveyance system to wheel water when it has unused capacity. *Id.* The Court rejected San Diego's argument that it would be illogical to pass on Met's past costs to present users, concluding that where present wheelers are member agencies the wheeler did have a role in developing Met's present infrastructure, which is utilized in wheeling water. *Id.* Moreover, the Court noted that the bill enacting the Wheeling Statutes was revised to expand the definition of "fair compensation" to embrace capital as well as maintenance costs, omit narrowing references to marginal costs, and to give water conveyance system owners control over the fair compensation determination. *Id.* at 1432. The Court stated that these revisions came in response to criticism that, among other things, fair compensation should not be less than the use charge to long term contractors served by the facility and that the bill could interfere with water conveyance system owners' ability to meet contract payments if wheelers undercut prices and stole away customers. *Id.*

Second, the Court held that Met is not required to determine its wheeling rate on a case-by-case basis, but may set its wheeling rate ahead of time. *Id.* at 1433. Third, the Court declined to address several other challenges to Met's wheeling rate (that the rate was so high that it discouraged wheeling, that Met improperly included system-wide replacement costs), stating that the trial court would address those issues in the first instance on remand. *Id.* at 1435-36.

Morro Bay was decided shortly after *MWD*. In *Morro Bay*, a county agreed to provide a school district seven acre-feet of water annually in exchange for annual payments. *Morro Bay*, 81 Cal.App.4th at 1046. The county was required to transport the water to the Morro Bay city limits, but to bring the water to the schools it had to be carried through facilities belonging to Morro Bay. *Id.* *Morro Bay* denied the school district's wheeling proposal. *Id.* at 1047. In

relevant part, Morro Bay argued that Water Code § 1810(d) prevented the school district from requiring it to transport the water because, if Morro Bay lost the school district as a customer, it would have to increase the rates it charged its remaining customers. *Id.* at 1050. The Court rejected the argument. *Id.* It stated that neither Morro Bay nor its water customers had any right to make the school district purchase any particular amount of water. *Id.* The Court also rejected the notion that loss of income from a customer is the sort of injury to a legal user of water the Legislature had in mind. *Id.*

2. Proposition 218 and Proposition 26 Cases

In *City of Palmdale v. Palmdale Water District*, 198 Cal.App.4th 926, (2011), the Court held that a water district failed to satisfy its burden to establish that its new water rate structure complied with Proposition 218. *Palmdale*, 198 Cal.App.4th at 928.⁵⁹ The water district had retained Raftelis to provide a rate study and recommend a new rate structure. *Id.* Raftelis advised the water district regarding two options for determining fixed revenues, a “cost of service” option and a “percentage of fixed cost” option. *Id.* at 929. Among the advantages of the cost of service option was: “Defensible – Prop 218.” *Id.* Among the advantages of the other options was: “rate stability.” *Id.* The water district ultimately approved a rate structure that included a fixed monthly service charge based on the size of the customer’s meter and a per unit commodity charge for the amount of water used, with the amount depending on the customer’s adherence to the allocated water budget. *Id.* at 930. The customer paid a higher commodity charge per unit of water above the budgeted allotment, but the incremental rate increase depends on the customer’s class. *Id.* For example, irrigation users are charged disproportionate rates,

⁵⁹ Because it is imposed for the property-related service of water delivery, the district’s water rate, as well as its fixed monthly charges, were fees or charges within the meaning of article XIII D. *Palmdale*, 198 Cal.App.4th at 934.

reaching the highest Tier 5 rates upon use of 130% of their budgeted allocation, as compared to other users who do not reach Tier 5 until reaching either 175% or 190% of their allocation, depending on their classification. *Id.* at 937. The water district made no showing that there was a corresponding disparity in the cost of providing water to these customers at such levels. *Id.* The Court noted that the water district did not choose the option that Raftelis stated was defensible under Proposition 218. *Id.* Based on the foregoing, the Court concluded that the water district failed to carry its burden to demonstrate that its rates complied with Proposition 218. *Id.*

Griffith v. City of Santa Cruz, 207 Cal.App.4th 982 (2012) (*Griffith I*) involved a city ordinance subjecting residential rental dwelling units that are not occupied by the owner of the property to annual inspection by city staff. *Griffith I*, 207 Cal.App.4th at 988. The ordinance also provided for fees for annual registration, self-certification, inspection, and re-inspection in amounts to be established by resolution of the city council. *Id.* The city council subsequently set each fee. *Id.* In relevant part, plaintiff challenged the fees as illegal taxes enacted in violation of Proposition 218 and Proposition 26. *Id.* at 989-90. First, the Court noted that Proposition 218 is inapplicable to rental inspection fees. *Id.* at 995.

Second, the Court turned to Proposition 26. The Court stated that Proposition 26 exempts from its definition of “tax,” to which its requirements apply, “[a] charge imposed for the reasonable regulatory costs to a local government for issuing licenses and permits, performing investigations, inspections, and audits, enforcing agricultural marketing orders, and the administrative enforcement of adjudication thereof.” *Id.* at 996. To show a fee is an regulatory fee and not a special tax, the government should prove (1) the estimated costs of the service or regulatory activity, and (2) the basis for determining the manner in which the costs are

apportioned, so that charges allocated to a payer bear a fair or reasonable relationship to the payer's burdens or benefits from the regulatory activity. *Id.* Further, the Court noted that the question of proportionality is not measured on an individual basis, but instead is measured collectively. *Id.* at 997. Permissible fees must be related to the overall cost of the governmental regulation, they need not be finely calibrated to the precise benefit each individual fee payer might derive. *Id.* What a fee cannot do is exceed the reasonable cost of regulation with the generated surplus used for general revenue collection. *Id.*

Against this backdrop, the Court held that the city carried its burden of proof by showing that the fees were valid regulatory fees. *Id.* The Court noted that (1) the city provided a declaration to the effect that the costs of administering the ordinance would be equal to or greater than the fees levied on rental property owners; and (2) the fee schedule was on its face reasonably related to the payer's burden on the inspection program (self-certifications cost less than inspections, which in turn cost less than re-inspections necessitated by property conditions).

Griffith v. Pajaro Valley Wat. Management Agency, 220 Cal.App.4th 586 (2013) (*Griffith II*) upheld a water agency's ordinance against a Proposition 218 challenge. *Griffith II*, 220 Cal.App.4th at 589-90. The water agency was created to deal with saltwater intrusion. *Id.* at 590. The Pajaro Valley Groundwater Basin supplies most of the water used in Pajaro Valley. *Id.* Especially near the coast, saltwater seeps into the groundwater basin when the water table drops below sea level. *Id.* The water level drops below sea level when water is extracted faster than it is replenished by natural sources. *Id.* To prevent saltwater intrusion, the water agency's strategy was to use recycled wastewater, supplemental wells, captured storm runoff, and a coastal distribution system to reduce the amount of water taken from the groundwater basin. *Id.* The cost of this process was borne by all users on the theory that even those taking water from inland

wells benefit from the delivery of water to coastal users as that reduces the amount of groundwater the coastal users will extract from their own wells, keeping the water in all the wells from becoming too salty. *Id.* at 590-91. The water agency recovered this cost through an augmentation charge. *Id.* at 591.

The *Griffith II* Court rejected a series of substantive challenges to the augmentation charge. *Id.* at 597-602. First, the Court held that groundwater augmentation charges necessarily included debt service to construct facilities to capture, store, and distribute supplemental water. *Id.* at 598. Second, the Court held that the costs of purchasing, capturing, storing, and distributing supplemental water necessarily included general expenses to administer those functions. *Id.*

Third, the Court rejected the argument that the charge to an individual property owner was disproportionate because only coastal landowners received services, not that property owner. *Id.* at 600-01. The Court rejected this premise, because the water agency was managing water resources in the public interest for the benefit of all water users. *Id.* at 600. The Court further explained that proportionality is measured collectively, considering all rate-payers. *Id.* at 601. Moreover, apportionment is not a determination that lends itself to precise calculation. *Id.* The Court concluded that grouping similar users together for the same augmentation rate and charging users according to usage was a reasonable way to apportion the cost of service, whether or not other reasonable alternatives existed. *Id.* Accordingly, the Court also rejected the argument it was improper to take the costs of chargeable activities, deduct expected revenues from other sources, and apportion the revenue requirement among users. *Id.* at 600-01.

Key Documents

The parties have focused their attention on several documents in the voluminous administrative record. I summarized them here.

1. 1969 Brown and Caldwell

In a 1969 Water Pricing Policy Study, Brown and Caldwell broke down all costs of the Met system into four functional cost groups.⁶⁰ In that study, Brown and Caldwell defined Met's supply system: "The supply system includes all facilities involved in the function of making water available to the initial regulating reservoirs of the MWD distribution system. This includes the Colorado River Aqueduct up to the inlet works of Lake Mathews, the proposed Bolsa Island desalination plant and its treated water transmission system, and the SWP facilities excluding the terminal reservoirs of that system. In sum, this category includes the facilities whose function is the delivery of water from the sources of supply to the MWD distribution system but whose operation is essentially unrelated to the problems in meeting short term fluctuations in demand of the individual customer agencies of MWD." Brown and Caldwell defined Met's distribution system as all Met facilities that convey water from supply works to the member agencies. Thus, Brown and Caldwell included those SWP costs arising from construction and operation of terminal storage reservoirs. In accompanying tables, the bulk of Met's SWP transportation charge was attributed to supply, while a smaller portion was attributed to fixed distribution costs. *Id.* at 1745-46.

⁶⁰ AR2012_016288_1723 at 1744*.

2. 1993 Raftelis Textbook

The 2012 administrative record includes an excerpt on classifying “O&M”⁶¹ costs taken from a 1993 textbook written by George A. Raftelis. DTX-134* at AR2012-5282, 5284. The text discusses allocation of water service costs to customers. *Id.* at 5291. It states that this usually takes place in two steps: (1) allocation of costs to functional cost of service categories; and (2) reallocation of functional costs to classification of customers. The text identifies several functional cost of service components, including, among others: (1) “Source of supply: operating and capital costs associated with the source of water supply (reservoir construction and maintenance costs, water right purchases, supply development costs, conservation costs, etc.);” (2) “Pumping and conveyance: costs associated with pumping raw water from the source of supply and transferring it through a piping network for treatment[;]” (3) “Transmission: costs associated with transporting water from the point of treatment through a major trunk to major locations within the service area[;]” and (4) “Distribution: costs associated with smaller local service distribution mains transporting water to specific locations within the service area; water storage costs are normally considered a part of distribution costs.” *Id.* at 5291-92 (emphasis omitted). The text notes that if a utility effectively integrates the NARUC chart of accounts, identification of cost by functional category is provided by the accounting system. *Id.* at 5292. If the accounting system does not provide such a breakdown, it is necessary to develop allocations using appropriate bases.

3. Resource Management International, Inc. (RMI) Reports

In October 1995, RMI provided a report outlining its recommendations regarding how a cost of service and rate alternatives study for Met should be conducted. DTX-013, AR2012-

⁶¹ This appears to mean Operation and Maintenance. See DTX-013 at AR2012-001111 (defining “O&M” as operation and maintenance expenses).

001106. In the October 1995 report, RMI explained that operating expenses should be functionalized into a number of major utility functions, including, among others: (1) “Supply Function – Costs of operating and maintaining water supply facilities, such as dams and associated reservoirs, wells, and desalination plants, and costs of purchasing water from wholesale water suppliers[;]” (2) “Transmission Function – Costs of operating and maintaining aqueducts to move water from sources of supply to major centers of demand[;]” and (3) “Distribution Function – Costs of operating and maintaining distribution pipelines which deliver water from the major aqueducts to storage facilities, to treatment plants, and to customer service connection points.” *Id.* at 001112 (emphasis omitted).

In May 1996, RMI provided a cost of service study to Met. DTX-133* at AR2012-001796. This report included, among others, the following categories: (1) “Source of Supply – Source of supply costs include the costs of operating and maintaining water source facilities, such as [same examples as listed in October 1995 report][;]” (2) “Transmission Function – Transmission costs consist of [same definition as in October 1995 report][;]” and (3) “Distribution function – Distribution costs consist of [same definition as in October 1995 report].” *Id.* at 1874 (emphasis omitted). The report stated that conservation, groundwater recovery, local projects, and wastewater reclamation were supply costs. *Id.*

In the May 1996 report, RMI treated the SWP Delta Water Charges as source of supply costs, but treated SWP transportation charges as transmission/distribution costs. *Id.* at 1876-77, 1904. The basis for the distinction was the nature of the expense as the SWP bills are categorized and the capital charges for transmission facilities and the operations and maintenance charges for transmission facilities are transmission-related. *Id.* at 1876. RMI treated Water Management Programs as source of supply costs. *Id.* at 1905.

In December 1995, RMI issued a report identifying approaches for pricing water wheeling services. DTX-136 at AR2012-001223. RMI stated that Met's volumetric rate design, coupled with its fixed expenditures (predominantly flowing from what RMI referred to as SWP Supply costs, including costs for the SWP to transport the water),⁶² created a risk that Met would either have to increase its rates charged in water sales or suffer revenue under-collection if wheeling transfers supplanted Met water sales. *Id.* at 001225, 001231, 001233, 001233 n.4, 001234-35, 001245-46, 001254. However, RMI understood that a rate increase to member agencies was barred by the "hold harmless" requirement. *Id.* at 001234, 001254. (This requirement is also referred to as part of the San Pedro principles, and is discussed in more detail below.)

RMI discussed four alternatives. Three merit discussion. The first option was a wheeling rate that removed only SWP incremental power and fish program charges from the water rates, retaining all of the other rate elements from the firm sales rate. *Id.* at 001244. RMI recommended that option, acknowledging that it would likely be an extremely high rate and accordingly be considered highly unsatisfactory, because it would remove any economic incentive to wheel water. *Id.* at 001254. The second option was to remove all avoided supply costs, including all SWP and Colorado River supply costs, from the rate. *Id.* at 001245. RMI expressed concern that this rate could displace Met sales, forcing Met to increase its firm sales rate and violating the "hold harmless" principle. *Id.* at 001251. It also noted that non-member agencies might object to this rate because they would be forced to contribute to recovery of Met's fixed costs. *Id.* at 001252. The third option was a wheeling rate based on incremental costs. *Id.* at 001247. RMI stated that this would disregard the costs of building and operating

⁶² The report notes that Met still needed to classify its costs. DTX-136 at AR2012-001227. Obviously, this report predated the May 1996 report, discussed above.

the integrated delivery systems Met utilizes to transport water to the customer. *Id.* RMI also expressed concern that this option would lead to a substantial displacement of Met sales. *Id.* at 001252. As is clear from the discussion of Met's wheeling rate above, Met did not take any of these options.

In the report, RMI also discussed SWP wheeling charges, noting that its charge for wheeling water from the from the Delta to Met's delivery point at Castaic Lake could limit Met's wheeling rates. *Id.* at 001237. However, RMI posited that such a constraint could be avoided if Met wheeled the water on the California Aqueduct under its contract with the SWP, because all fixed charges are covered by Met's annual payment to the SWP it would be expected that member agencies receiving on-behalf wheeling service would be charged only variable SWP power charges.

4. 1996 Integrated Resources Plan

The 1996 Integrated Resources Plan (IRP) is comprised of two volumes, a long-term resources plan and an overview study of Met's system.⁶³

The IRP addressed the impact of increasing demand for water in Southern California. In that context, the IRP discussed water conservation as impacting water demand and as a supply option much like any other traditional supply project. *See* DTX-019 at AR 2012-001448. In the IRP, conservation was defined as long-term programs that require investments in structural programs such as ultra-low-flush toilets, low-flow showerheads, or water efficient landscape irrigation technology – coupled with ongoing public education and information. *Id.* Water recycling was also described as a valuable source of water supply. *Id.* at 001452. Ocean desalination was also described as an abundant source of water supply, although a cost prohibitive one. *Id.* at 001456.

⁶³ *See* DTX-019 at AR2012-001406; DTX-020 at AR2012-001520.

The IRP also noted that local management programs reduce the need for additional investment in regional infrastructure. *Id.* at 001491. The IRP stated that changes in water demand can be attributed to weather, structural changes in retail demand, or local supply development. *Id.* The IRP set out guidelines for water management programs and conservation programs, explaining, among other things, that (1) the regional benefits of local water management programs should be measured by reduction in capital investments due to deferral of or down-sizing of regional infrastructure, reduction in O&M expenditures for treatment and distribution of imported water, and reduction in expenditures associated with developing alternative regional supplies; (2) local water management programs must increase regional supplies and provide measurable regional benefits; and (3) the regional benefits of conservation programs should be measured by the same factors, and in addition by environmental benefits from reduced demand on the ecosystem. *Id.* at 001515-16. The IRP included a sensitivity analysis, which discussed the sensitivity of Met's rates to the level of demand on Met's system going forward. DTX-019 at AR2012-001502. For example, the IRP identifies several projects that could be delayed or avoided with a 5% decrease in retail demand. *See* DTX-020 at AR2012-01656.

The IRP also discussed Met's storage, which it divided into "Emergency Storage," "Seasonal or Regulatory Storage," and "Carryover or Drought Storage." *Id.* at 001466. Emergency storage is to be used if a catastrophic event disables a vital conveyance system. *Id.* Seasonal or regulatory storage is designed to balance seasonal demand, ensuring that summer season demand is met. *Id.* Carryover or drought storage is water stored beyond a single year for use in droughts. *Id.* The IRP projected demand under wet, normal, and dry conditions. *See* DTX-020 at AR2012-001566. It also breaks down dry year peak demands of the Met member

agencies. *Id.* at 001572-74; *see also id.* at 001595, 001602, 001610 (charts of projected dry year peak demands in various regions).

5. Resolution 8520

On January 14, 1997, Met's Board issued Resolution 8520. DTX-680 at AR2012-002446, 002451. In Resolution 8520, Met adopted its "postage stamp" wheeling rate. *Id.* at 002448. That is, it adopted a uniform rate per acre-foot of water for wheeling transactions regardless of the facilities used in the transaction or the distance moved. *Id.*

The document begins with a series of "whereas" clauses, including the following statements: (1) Met has a contract with the State of California that requires Met, on a take or pay basis, to pay a proportionate share of the costs of constructing and operating the SWP, including facilities for conserving, storing, and transporting water to Met's service area; (2) under its contract with the State of California, Met has an entitlement to water and associated transportation thereof by the SWP and the right to use SWP transportation facilities for its own purposes, subject to certain conditions; and (3) Met's conveyance system and its rights to use the SWP conveyance system are, together, the conveyance system. *Id.* at 002446.

The Board allocated its transmission costs to reflect the capital, operation, maintenance, and replacement costs incurred by Met to convey water to its conveyance system, including Met's rights in the SWP system, and because it found that including those costs in Met's wheeling rate is necessary to insure recovery of fair compensation for the use of that conveyance system. *Id.* at 002449. Further, the Board found that allocating unavoidable costs attributable to Met's supply, power, storage and customer related functions because including those unavoidable costs in the wheeling rate is necessary in order to protect Met's member agencies

from financial injury by avoiding the shifting of those costs from a wheeling party to Met's other member agencies. *Id.*

Attachment 1 to Resolution 8520 is an October 1996 technical report on the proposed wheeling charge. *Id.* at 002452. The purpose of the report is to describe Met's proposed charge for wheeling, which is defined as provision of transportation-only service for water owned by others rather than the traditional bundled delivery of water owned by Met. *Id.* The report notes that Met has entered into long-term contracts, constructed major capital facilities, issued bonds to finance construction or purchase facilities, and has implemented water management programs to develop, store, transmit, and treat water throughout its service area. *Id.* Further, it notes that one basis for using a postage stamp rate is system integration. *Id.* at 002455. Because the system is integrated, it notes, charges for Met water service should reflect the cost of the whole system, and members using the system to wheel water should pay for the cost of the whole system. *Id.* Moreover, the report lists Met's major facilities and programs as including the SWP, the Colorado River Aqueduct, pumping plants, reservoirs, water treatment facilities, a system of pipelines and control structures, associated facilities for the transportation, storage and delivery of water, as well as water conservation projects and financial assistance for water recycling and groundwater recovery facilities. *Id.* System integration is demonstrated by the blending of water and the ability to compensate for outages by deliveries from other sources. *Id.* at 002455-56.

The report goes on to discuss the proper wheeling rate for member agencies. *Id.* at 002458. The report disaggregates costs into categories for "transmission," "storage," "supply," "power," and "treatment." *Id.* at 002460. At Schedule A, the report charts the allocation of SWP costs and Water Management Program costs between the five categories, above. *Id.* at 002472.

Transmission includes debt service, operations and maintenance expenses, take-or-pay contract costs associated with aqueducts and pipelines that deliver water from supply sources to storage facilities, and treatment plants and customer service connection points. *Id.* at 002460.

Transmission includes SWP costs identified as transportation, the costs of operating and maintaining the Colorado River Aqueduct, the costs of planning and constructing transmission facilities, and the costs of operating and maintaining regulating reservoirs. *Id.* Costs functionalized to transmission include the SWP transportation expenses and 50% of the incentives and program costs for the Water Management Programs. *Id.* at 002464.

Supply costs include the costs of operating and maintaining water source facilities such as dams to control river flows, reservoirs to capture runoff, wells, desalination plants, and transfers to procure additional water supplies. *Id.* at 002460. Costs functionalized as supply include 50% of Water Management Programs branches and the Delta Water Charge charged by the SWP. *Id.* at 002462.

6. 2002 Final Report on Rates and Charges and Cost of Service Reports

In its 2002 Final Report on Rates and Charges, Met described and evaluated what remains its current rate structure. In the cost of service process, Met (1) developed its revenue requirements; (2) functionalized its costs; (3) classified its costs; and (4) allocated its costs to rate design elements. DTX-045 at AR2012-006493. In functionalizing its costs, it defined the terms “supply” and “conveyance and aqueduct.” *Id.* at 006496-97. The supply function includes SWP costs that relate to maintaining and developing supplies – the Delta Water Charge and the cost of storage and transfer programs. *Id.* at 006496. The conveyance and aqueduct function includes capital, operations, maintenance, and overhead costs for SWP facilities that convey water to Met’s internal distribution system as well as the SWP variable power costs, which are

categorized in a separate subcategory. *Id.* The report explains that conveyance and aqueduct costs have been separated from source of supply costs to allow a more detailed level of analysis to be performed during the evaluation of rate design alternatives. *Id.* at 006497. The SWP conveyance and aqueduct revenue requirement outpaced the SWP source of supply revenue requirement. *Id.* at 006504.

In the report, Met identified benefits of the Water Stewardship Rate and System Access Rate. The Water Stewardship Rate reduces dependence on imported supplies, increases water supply reliability, reduces and defers system capacity expansion costs, and creates space availability to complete water transfers. *Id.* 006519. The report included a frequently asked questions section. There, Met justified charging all users, including third party wheelers, the Water Stewardship Rate on the basis that all users would benefit from paying a lower System Access Rate because conservation and local resources projects would lead to a deferral and reduction of facility expansion costs. *Id.* at 006775. The report says the System Access Rate ensures that member agencies will pay the same cost for access to Met's system whether they purchase water from Met or another supply source. *Id.* at 006518.

The 2010 and 2012 cost of service studies, which retain the rate structure identified in the 2002 report, identify drought storage as a distinct storage cost that is recovered through supply rates.⁶⁴

7. 2010 Raftelis Study

In 2010, Raftelis Financial Consultants, Inc. reviewed Met's fiscal year 2010/11 cost of service and rate setting process. *See* DTX-088 at AR2012-011309. The review states that functionalizing SWP costs in accordance with the SWP invoice is appropriate because the invoices from the SWP are detailed and are not aggregated on a per-acre foot basis. *Id.* at

⁶⁴ DTX-090 at AR2012-011474-75, 84, 86, 88; DTX-110* at AR2012-016653, 016681-82, 016689, 016700.

011318. The study further noted that Met follows the four-step process set forth in American Water Works Association's Manual M-1 by identifying service functions cost, the classification of cost, and allocation of costs to rate design elements to develop a nexus between cost and revenue streams. *Id.* at 011322. Moreover, the study found that the rate design elements meet requirements set forth by AWWA's rate-setting principles and industry guidelines. *Id.*

8. 2010 Bartle Wells Associates Letters

San Diego retained Bartle Wells Associates to review Met's rates. In a March 2010 letter, Bartle Wells opined that Met improperly, and contrary to industry standards, misallocates some of its supply costs under the SWP contract to a conveyance and distribution category. AR2010-11207-14. According to Bartle Wells, this distorts Met's System Access Rate and Met's supply rates. *Id.* Bartle Wells' rationale was that Met does not own, maintain, or operate any of the SWP facilities, so its SWP costs are the cost of obtaining a supply from the SWP. *Id.* at 11208. Further, Bartle Wells stated that the SWP power costs should be charged to supply, and not the System Power Rate. *Id.* at 11208-09. Bartle Wells stated that three other contracting agencies allocate SWP costs as supply costs, and that it was not aware of any agency that allocated SWP costs in the same way Met does. *Id.* at 11209.

Bartle Wells also found that it was improper for Met to collect the Water Stewardship Rate through its conveyance charges. *Id.* at 11207-08. Bartle Wells explained that the service function was to increase water supply, so the cost should be allocated to supply rates. *Id.* at 11209-10.

Met's general manager and general counsel responded to these concerns in an April 2010 memorandum to the Met Board. AR2010-011307. In it, they asserted that (1) the SWP charges must be paid regardless of the quantity of water delivered; (2) Met uses the SWP as a

conveyance facility to convey both SWP and non-SWP water pursuant to the contract; and (3) Met has consistently recorded SWP capital costs as payments for use of the SWP facilities. *Id.* at 11306-07. Accordingly, they concluded that Met properly charges its SWP contract costs in its conveyance costs, as it pays for conveyance rights in the contract, avoiding a use fee that it would otherwise have to pay to use the facilities. *Id.* at 11307. As to the Water Stewardship Rate, they stated that all users benefit from lower capital costs as a result of resource management programs, so all users should bear a proportional cost for these services. *Id.* at 11307-08.

In an April 2010 letter, Bartle Wells supplemented the above opinions. AR2010-11393-400. In it, Bartle Wells concluded that Met's rates were not consistent with industry best practice or the AWWA Manual M-1⁶⁵ or the NARUC system of accounts, and that Met's rates are not apportioned among customers in a manner that reflects the proportionate cost to serve each. *Id.* Bartle Wells wrote that NARUC requires water purchase costs to reflect the cost of water purchased for resale at the point of delivery. *Id.* at 11394. Under NARUC, Bartle Wells stated that SWP costs should be allocated as supply, regardless of the manner in which the Department of Water Resources bills Met. *Id.* In addition, Bartle Wells asserted that Met does not comply with the AWWA manual because its rate system treats the cost of an imported water supply as a transportation cost, inflating Met's transportation charge and disproportionately impacting customers who purchase transportation rather than supply services. *Id.* at 11396. Bartle Wells also restated its conclusion that the Water Stewardship Rate is misallocated, and thus concluded that it is not in compliance with the AWWA manual. *Id.* at 11396-97.

⁶⁵ AWWA Manual M-1 is a part of the administrative record. *See* DTX-030 at AR2010-003865. The AWWA manual defines a cost-of-service approach as one that allocates costs to a customer or class of customers based on cost causation. *Id.* at 003997. The manual discusses charting operation and maintenance expenses, noting that NARUC has a uniform system of accounts that is widely used and can be modified for government-owned utilities. *Id.* at 003904.

The April 2010 letter addressed Met's response to the March 2010 letter. *Id.* at 11397. It responded to Met's argument that uses the SWP as a conveyance facility by stating that Met does not own or control the SWP, but is merely a customer under a water supply contract. *Id.* It responded to Met's argument that it is appropriate for all users to pay the Water Stewardship Rate because all users benefit from reduced capital costs by asserting that Met must measure what portion of the benefit accrues to each class of Met customers to fairly apportion its rates. *Id.* at 11397-98. Bartle Wells states that Met has failed to do that accounting. *Id.*

In March 2012, Bartle Wells confirmed that its position remained the same as to the 2013/2014 rates.⁶⁶

9. 2012 FCS

In March 2012, the FCS Group provided a review of Met's 2013/2014 rates at San Diego's request. AR2012-16156-91, 16160*. FCS found that Met's rates were deficient in the following respects: (1) the supply rate should, but does not, include costs to obtain water supplies from the SWP and from local projects that are instead recovered through the System Access Rate, the System Power Rate, and the Water Stewardship Rate; (2) the Readiness-to-Serve Charge was improperly charged to wheeling parties; and (3) the rates did not adequately address seasonal or sporadic annual peaking because the rates consider only peak day cost through the capacity charge. *Id.* at 16163-64. With respect to the Water Stewardship Rate, FCS argued that Met failed to demonstrate that the rate provides a proportionate and direct benefit to transportation in spite of its obligation to demonstrate a reasonable nexus between the charge and the service provided. *Id.* at 16173. With respect to sporadic annual peaking, FCS stated that agencies with constant demand subsidize those with fluctuating demand by paying to maintain standby capacity, whether demand fluctuates based on conservation measures, price elasticity at

⁶⁶ AR2012-16215-16*.

the local retail level, mandatory water curtailments, weather patterns, the local agency's supply conditions, or other factors. *Id.* at 16176, 16178. FCS opined that Met's capacity charge and Tier 2 Supply Rate recover only a small portion of the billions Met spends on drought insurance, such that agencies with more stable demand end up subsidizing those with variable demand. *Id.* at 16178.

The Met general manager and general counsel responded in a memorandum to Met's Board. AR2012_016583*. They asserted that Met has an integrated system, including Met's right to use SWP facilities, from which all system users, including wheelers, benefit. *Id.* at 016586. They stated that Met, as a supplemental supplier of water, must ensure that agencies that transport water acquired from other sources do not evade the costs of maintaining Met's system. *Id.* at 016588. They cite two examples in which Met used the SWP to transport non-SWP water to member agencies. *Id.* They suggest that those SWP costs would have been subsidized if the SWP contract were allocated solely to supply. *Id.* They also noted that each SWP contractor funds the systems development and operations through payments proportional to their rights to use the system, supporting Met's treatment of the SWP as an extension of its system. *Id.* They drew further support from the fact that the Department of Water Resources breaks its invoices into supply charges and transportation charges. *Id.* at 016589. As to the Water Stewardship Rate, they stated that all users benefit from the programs it funds, so all should pay. *Id.* at 016590. They raise the concern that a failure to charge the rate to wheelers would mean that wheelers enjoy the benefits of the program without paying their share. *Id.* As to peaking, they state that Met recovers its standby costs through the Readiness-to-Serve Charge and its distribution peaking costs through the Capacity Charge. *Id.* at 016592.

Summary of Arguments

San Diego argues that Met's System Access Rate, System Power Rate, Water Stewardship Rate, and wheeling rate are illegal and should be invalidated. San Diego Post-Trial Brief at 4. San Diego argues that (1) Met recovers the costs Met pays the SWP for transportation through its transportation rates without any basis for treating the SWP as its own conveyance system; and (2) Met charges its full Water Stewardship Rate in its wheeling rate even though the programs that are funded by the rate are primarily *supply* benefits. *Id.* at 3-4.

San Diego also contends that Met incurs dry-year peaking costs which benefit some member agencies (such as Los Angeles) which are recovered disproportionately from other member agencies (such as San Diego) through the transportation rates, among others. *Id.*

Met argues that it is reasonable to allocate SWP transportation costs to its transportation rates for four reasons: (1) SWP transportation costs are Met transportation costs;⁶⁷ (2) Met uses SWP facilities as an extension of its own system;⁶⁸ (3) Met has an integrated, regional system that delivers a blend of water which includes SWP water; and (4) Met's allocation is consistent with industry guidelines.⁶⁹ Met Closing Brief at 45-60. San Diego counters that the SWP costs are supply costs, i.e., costs incurred to obtain a supply of water. San Diego Post-Trial Brief at 20-25. San Diego accuses Met of improperly protecting member agencies that do not wheel water from facing increased rates when wheeling member agencies purchase water from other sources. *Id.* at 7.

⁶⁷ Met relies on the facts that (1) its contract with the Department of Water Resources breaks down its charges to Met to reflect both costs associated with supply water and those associated with water delivery; and (2) it pays a share of the capital costs of expanding the SWP system in the reaches it uses. Met Post-Trial Brief, 45-49.

⁶⁸ Met relies on its contractual right to use SWP facilities to transport non-project water and the fact that it has exercised that right. Met Closing Brief, 49-53.

⁶⁹ Met points to the 1993 Raftelis textbook, the RMI reports, and the 2010 Raftelis report. Met Closing Brief, 55-59.

Second, Met contends that it is reasonable to allocate the Water Stewardship Rate to its transportation rates because the Water Stewardship Rate recovers the cost of funding programs that help avoid or defer transportation-related capital expenses and increase system capacity. Met Closing Brief at 61-74.⁷⁰ San Diego responds that the programs funded by the Water Stewardship Rate are primarily designed to meet supply programs; therefore Met should have studied and quantified the transportation benefits of those programs if they were to allocate any of the costs of those programs to a charge other than their supply rates. San Diego Post-Trial Brief at 26-29.

Third, Met argues that San Diego's dry-year peaking claim fails because: (1) Met recovers storage-related costs;⁷¹ (2) annual variation in demand has a number of causes; (3) there are only minor differences in member agency demand fluctuations;⁷² (4) Met's rates recover the costs of variations in water purchases from year to year and within a single year;⁷³ and (5) San Diego lacks standing. Met Closing Brief at 87-100. San Diego responds that Met's SWP contract, its demand management programs, its conveyance capacity, and its reservoirs and storage are all necessary to meet dry year demand. San Diego Post-Trial Brief, 30-31. San Diego contends that agencies that have a higher annual variation enjoy these benefits while paying a lesser share of the costs due to Met's use of volumetric rates. *Id.* at 33. That is, in a year when a highly variable agency uses less water, it pays less to maintain Met's system even

⁷⁰ Met refers to the 1996 IRP to demonstrate the importance of reduced demand. Met Closing Brief, 63. Further, Met notes that the goal of local resources programs have long included assisting local projects that improve regional water supply reliability and avoid or defer Met capital expenditures. *See* AR2010-002870.

⁷¹ Met states that it recovers drought storage through its supply rates. Met Closing Brief, 89.

⁷² Met emphasizes that San Diego's annual variation from its ten year average was 1.11, whereas Los Angeles' was 1.31. Met Closing Brief, 93. Met also argues that, even if this variation is significant, it is irrelevant because it does not impact Met's costs, based on system-sizing. *Id.* at 95.

⁷³ Met relies on (1) its volumetric rates, which ensure that an agency pays more in a year it purchases more water; (2) its tiered supply rates, which are tiered to reflect the cost of Met obtaining new supplies if a member agency executed a purchase order exceeding 90% of its base firm demand; (3) its Readiness-to-Serve Charge, which recovers standby, emergency storage, and capital costs for facilities to meet peak monthly or seasonal demand (based on a ten-year rolling average of past consumption); and (4) its Capacity Charge, which is based on peak week demands.

though it contributes to the overall need for system capacity and available water supply at a level based on its peak year. On the other hand, an agency that varies little pays a greater share of the burden of maintaining the whole system in a year in which the highly variable agency uses less water.

Fourth, Met asserts that its wheeling rate is reasonable because: (1) it is reasonably based on the principle that all member agencies should pay for the fixed, unavoidable system costs when using Met's system; (2) it is reasonable to recover system-wide SWP costs in the wheeling rate;⁷⁴ and (3) it is reasonable to charge the Water Stewardship Rate in connection with wheeling transactions.⁷⁵ Met Closing Brief, 74-87. San Diego argues that Met's wheeling rate illegally discourages wheeling by improperly including its SWP costs, Water Stewardship Rate, and dry-year peaking costs in its wheeling rate. San Diego Post-Trial Brief, 45, 48-58.

Discussion

The parties agree that Met is obligated to set its rates based on principles of cost causation, that is, that Met must charge for its services based only on what it costs to provide them. Met Closing Brief at 60; San Diego's Amended First Pretrial Brief at 1. This is the central focus of this case, and provides a good shorthand for the varied tests implicated by the varied causes of action, as revealed by the summaries just below.

For each of the claims, I now review whether the statutes or law apply.

⁷⁴ According to Met, this is because the wheeling statute allows Met to charge system-wide costs in its wheeling rate and Met exercises its contractual right to use SWP facilities to complete wheeling transactions. Met Closing Brief, 83-85.

⁷⁵ Met argues that this is because wheelers benefit from available capacity, as that enables Met to wheel water. Met Closing Brief, 86. Met also reiterates that this recovers from wheelers the cost of using the system. *Id.* at 85-86.

1. Application of Statutes

Proposition 26. Here the issue is whether rates are commensurate with the reasonable costs of the services. Proposition 26 does not apply, Met says, for four reasons. (1) The rates are not “imposed,” rather, the member agencies join voluntarily. I have previously rejected Met’s argument in denying its motion for judgment on the pleadings. Sept. 19, 2013 Order Denying Motion for Judgment on the Pleadings at 3 (citing *Bighorn-Desert View Water Agency v. Verjil*, 39 Cal. 4th 205 (2006)). I did allow for the possibility “that facts adduced at trial will reveal the extent to which the rates are or are not ‘imposed,’ such as the choices available to San Diego for water and water transport.” *Id.* at 3. But Met did not adduce any such facts, whether from the administrative record, to which this claim is limited at Met’s suggestion, or otherwise. Indeed the record contains numerous references to the fact that Met will “IMPOSE RATES AND CHARGES.” AR2010-6159-162 (capitalization in original); *see also, e.g.*, AR2010-6166-222; AR2010-6223-239; AR2010-6945-7029. More substantively, the 2012 Official Statement to Met’s bondholders confirms that SD had no choice but to use Met’s facilities to wheel water. AR2012-16429 at 16509*. (2) The rates are in fact reasonable. This is the issue on the merits; and I defer here to my discussions below on the merits. (3, 4) The rates are charges for the use of ‘local governmental property,’ and 2/3 of the appropriate “electorate” approved them. These are arguments which I have previously rejected in the September 19, 2013 Order, and my reasoning remains unchanged.

Propositions 26 applies here.

Proposition 13 (Govt. Code §§ 50075, 50076). The issue whether there is a fair or reasonable relationship between the rates and services. Met argues that Prop 13 does not apply,

because water rates are outside the purview of Proposition 13. Met cites *Brydon v. E. Bay Mun. Util. Dist.*, 24 Cal.App.4th 178 (1994), and *Rincon Del Diablo Mun. Water Dist. v. SDCWA*, 121 Cal.App.4th 813 (2004), suggesting that San Diego obtained just that ruling from the *Rincon* court. 121 Cal.App.4th at 821-22. San Diego agrees that the water rates in those cases were not taxes because they were “not designed to replace property tax monies lost in consequence of the enactment of California Constitution, article XIII A,” *Brydon*, 24 Cal.App.4th at 194; *accord Rincon*, 121 Cal.App.4th at 822. But in this case, San Diego tells us, Met’s Engineers’ Reports explicitly say the opposite about Met’s rates:

Since the passage of Article XIII A of the California Constitution, Metropolitan has necessarily relied more on water sales revenue than on ad valorem property taxes for the repayment of debt. Water sales have become the dominant source of revenue, not only for operation and maintenance of the vast network of facilities supplying water to Southern California, but also for replacement and improvement of capital facilities. The increased reliance on highly variable water sales revenue increases the probability of substantial rate swings from year to year. ***The use of water rates as a primary source of revenue has placed an increasing burden on ratepayers, which might more equitably be paid in part by assessments on land that in part derives its value from the availability of water.***⁷⁶

This Engineer Report does not distinguish *Brydon* and *Rincon*. The notion that in the abstract some sort of “assessments on land” might be used to pay for water does not mean the extant rates were as a matter of fact “designed to replace property tax monies lost in consequence of the enactment of California Constitution, article XIII A.” *Rincon*, 121 Cal.App.4th at 822. Met is correct that Proposition 13 does not apply here.

Wheeling statute (Water Code § 1810 *et seq.*). The issue is whether the rates are “fair compensation” for the services provided. Water Code § 1811(c).

⁷⁶ AR2010-11443 at 11511-12 (emphases added by San Diego); *accord* 2012-16594 at 16806-07*.

Govt. Code §§ 54999.7(a), 66013. The issue is whether the costs of providing the service are reasonable. Met argues that Govt. Code § 66013, which San Diego invokes solely in the 2012 action, does not apply. That sections reads, “[n]otwithstanding any other provision of law, when a local agency imposes fees for water connections or sewer connections, or imposes capacity charges, those fees or charges shall not exceed the estimated reasonable cost of providing the service for which the fee or charge is imposed,” unless approved by a popular two-thirds vote. This language does not suggest the statute applies to San Diego’s complaints—San Diego does not allege problems with water or sewer connections, or capacity charges as the term is used in that statute. As Met notes, the “legislative history does not show the Legislature intended to impose a new standard on water rates.” *Rincon Del Diablo Mun. Water Dist. v. San Diego Cnty. Water Auth.*, 121 Cal.App.4th 813, 820 (2004). Here I agree with Met.

Met also argues that § 54999.7(a) does not apply. This section provides that the rates and charges one public agency imposes on another for public utility service “shall not exceed the reasonable cost of providing the public utility service.” Gov’t Code § 54999.7(a). Met and San Diego are both public agencies. Met charges San Diego rates and charges for a “public utility service.” Nothing in the statute suggests that it is not applicable here. Met’s reference to services to “public schools” in § 54999.7(c) is not useful, as San Diego is not invoking that section, nor does § 54999.7(a) necessarily invoke or rely on § 54999.7(c). Here I agree with San Diego; the statute applies.

Met Act (Water Code Append. § 109-134). The Met Act requires that rates “be uniform for like classes of service throughout the district.” Water Code Append. § 109-134. The core issue is whether there is unjustifiable rate discrimination. San Diego must as an initial matter prove

that Met's rates are not "uniform for like classes of service" in the district. *Id.* That is, San Diego must establish as an initial matter that there is rate discrimination. San Diego may have misconstrued the court's pre-trial rulings to suggest that that burden may be met simply by showing there are "different classes of entities." Pretrial Rulings at 21 n.18 (dated November 5, 2013). Without showing varying rates of course San Diego's case is stymied, but proving those different rates alone is not the same as showing that there is rate discrimination. One might for example have different classes of entities but yet show no rate discrimination.

As Met notes,

In order to accommodate a water transfer market, Metropolitan maintains an unbundled rate structure based on types of service provided. As a result, member agencies pay rates based on the services they use, and agencies that use the same service pay the same rate. Agencies that purchase Metropolitan supplied water pay for supply, whereas agencies that purchase no water pay no supply costs. Agencies that take treated water cover treatment costs, whereas agencies that take untreated water pay no treatment costs. An agency that transports a third party's water through Metropolitan's system (known as "wheeling") pays transportation costs, but no supply costs.⁷⁷

In brief, Met charges different rates to users differently situated: one set of rates to member agency wheelers, and one to member agencies for water purchases. Based on that simple description, there is no reason to conclude that there is price *discrimination*, a concept which depends on a comparison between similarly situated entities. To be sure, San Diego argues—persuasively, I find below—that Met actually *does* charge supply costs to those who wheel, but that is a violation of other laws, not rate discrimination. Here, the entities (wheelers and non-wheelers) are not similarly situated, and accordingly the Met Act does not apply.

Common law. There are two aspects to this claim; one tracks the Met Act and asks whether there is unjustifiable discrimination between rate payers; the second asks whether there is a

⁷⁷ DTX-109* at AR2012-016587.

“reasonable basis” for the rates. *Inyo*. For reasons summarized just above, the latter, but not the former, rules apply here.

Summary. In sum, I conclude Proposition 26, the Wheeling statute, Govt. Code § 54999.7(a), and the common law (reasonable rates requirement) apply here. In each case the core inquiry is the same, and looks to cost causation, that is, whether the costs of the services (e.g. wheeling) are reasonably related to the costs of providing those services.

2. Analysis On The Merits

Setting aside San Diego’s challenge to the dry year peaking (discussed below), I summarize the challenges to Met’s rates, phrased as function of the cost causation principle: Is it reasonable for Met to include in its transportation rates (A) via the Systems Access Rate and the System Power Rate, the cost the state charges to Met to transport water to Met? (B) the Water Stewardship Rate?

I summarize here the basic guidance from the central cases. *MWD* tells us that the relevant costs may--or may not--be system-wide costs; but it is clear that I do not simply look to the marginal costs of providing e.g. wheeling services. (Had I done so, and because wheeling occurs solely when there is unused capacity, I might have concluded that aside from power and other costs required to literally move the wheeled water, no other costs could be included in wheeling rates.) *Morro Bay* reminds us that rates may not discourage wheeling, and loss of income attributable to lost water sales is not a permissible justification for [increasing] wheeling rates. *Palmdale* emphasizes cost causation, and bars unjustified price discrimination. *Griffith I* and *Griffith II* emphasize the rule that it is permissible to spread the costs of programs across all

benefitted users, and approves rates as long as they do not generate a surplus over and above what is needed to provide the program.

A. Met's System Access Rate and System Power Rate

These two rates include the state transportation costs, i.e., SWP's costs. Met's contract with the state makes clear that Met does not own or operate the SWP transportation facilities.⁷⁸ Previously, Met allocated SWP costs to supply, and none to transportation (including the SWP costs that DWR bills as its own transportation costs).⁷⁹ No reasonable basis appears in the record as to why this has changed. To be sure, the state now does disaggregate its bills to Met, and displays *its* transportation costs on those bills, but that does not suggest those are also (or instead?) *Met's* transportation costs, any more than the overhead or payroll costs of Ford Motor Company are the overhead or payroll costs of a customer who buys a Ford car. And while Met may from time to time use the state's transport capability to move some its water (Met Closing Brief at 49), that does not support the reasonableness of including **all** the state's transportation costs as part of Met's transportation costs. The record does not, for example, quantify the use of the state systems for Met's transportation,⁸⁰ nor does it establish whether it is necessary for wheeling at all. Nor does it matter whether Met delivers a blend of water to wheelers (Met Closing Brief at 53). The blend might be useful⁸¹ but, as to wheelers, the benefit is gratuitous, and not required by wheeling agreements. Nor, with one exception, does Met explain why the use of blended water requires the use of the state's transportation capability. The exception is to note RMI's opinions that the costs of operating Met's Colorado River Aqueduct arguably are

⁷⁸ AR2010-001 art. 13; PTX-237-A** (Admissions) Nos. 44-47; *Metro. Water Dist. of S. Cal. v. Marquardt*, 59 Cal.2d 159, 202 (1963)(Met is not an "equitable owner" of the SWP).

⁷⁹ 1969 Study*, AR2012-16288_1723 at 1743-46; Trial Transcript* at 469:23-470:12.

⁸⁰ Met Closing Brief at 49 ("SWP facilities **at times** serve *solely* a transportation function for MWD")(bolded emphasis supplied). Occasions on which this capability has been used are described at *id.*, 50-51.

⁸¹ Met has noted that the blend provides lower salinity water.

classifiable as transportation costs (Met Closing Brief at 57), but Met has not described how, or the extent to which, wheeling uses that aqueduct. Nor are the costs associated with transportation through that aqueduct the issue; the issue relates to costs associated with the movement of water through the SWP's facilities.

I do note, at Met's behest, the fact that in May 1996 RMI treated the SWP transportation costs as Met's like costs. The bases set forth there, however, are impenetrable. The bases are that the (a) transportation charges are disaggregated—an issue I address just above—and (b) capital charges for the transmission facilities are transmission related: which is a tautology. The issue is not whether they are transportation related; the issue is whether there is any reasonable basis to conclude they are *Met's* transmission charges. Unless I must accept as an adequate record any outside consultants' unsupported view (and I do not), this is insufficient.

There are other parts of the record that Met has urged support its view. Met's Closing Brief at 50. (a) DTX-055 (SWP Contract at Art. 55(a)), gives Met the right to use SWP facilities for transportation. (b) In DTX-087, Met discusses the fact that it has in fact conveyed non-project water through SWP facilities, for example on two occasions in 2009. *Id* at AR2012-011307. (c) DTX-109* is another statement by Met, dated April 2012, that it conveys non-project water through SWP facilities, *see e.g., id.* at AR2012-016586, referring to the same two events in 2009. *Id.* at AR2012-016588. And Met notes other occasions when it has bought non-project water (i.e. not from the SWP) to resell to its member agencies. Met Closing Brief at 51.

Fundamentally, Met's position seems to be based on the facts that (a) it does use SWP's facilities to move its own [non-project] water on occasion, and (b) all member agencies benefit in some way from that capability. From those predicates Met concludes that the sums it pays to the state attributable to the state's transportation costs are allocable to Met's own transportation

rates. Met Closing Brief at 53. But this is no syllogism. While one can easily conclude from these predicates that all water-purchasing member agencies should pay some share of those SWP's costs—indeed, of all costs billed by the SWP to Met—it does not follow that a given portion of those costs (such as SWP's transportation constituent) ought to be billed to wheelers who happen to be member agencies. This is especially true as it appears that the water moved by the SWP system, even when it is not water purchased from the SWP, is nevertheless generally water which is sold by Met to its member agencies, *not wheeled water*.

The position Met takes here reflects its position on the core legal dispute presented by this case, and I turn to that more specifically now.

The Core Dispute. Met writes that, on the subject of system-wide costs such as (i) those paid for SWP's transportation of water and (ii) for programs funded by the water stewardship rates, "In 1997, MWD recognized that if it did not charge these costs to wheelers as well as its full-service customers, then its full-service customers would end up subsidizing the costs of wheeling transactions." Closing Brief at 6. Compare, e.g., *MWD v. IID*, 80 Cal.App.4th at 1432-33.

The core dispute is whether, under the current rate structure, wheelers are subsidizing water purchasers. San Diego says that wheelers such as itself subsidize the other member agencies. Under the wheeling statute, for example, that is not permitted because it would discourage wheeling, and under the balance of the statutes at play in this case wheelers would be paying more than a reasonable fee for the service.

This core dispute centers on the impact of the so-called San Pedro principles adopted in 1997, which San Diego characterizes as implementing an illegal rate stability plan and Met

characterizes are implementing a legal plan to avoid having its full-service customers subsidize wheeling transactions. *See, MWD v. IID*, 80 Cal.App.4th at 1418-19 (outline of principles).

Underlying Met's approach here is the position that Met is entitled to sweep into all of its charges to members agencies apparently *any* of the system-wide costs it incurs, perhaps on the theory that member agencies, in their wheeling capacity, had a role in causing all system-wide costs. Met may have in mind the words of the *Griffith I* Court, 207 Cal.App.4th at 997:

The question of proportionality is not measured on an individual basis. Rather, it is measured collectively, considering all rate payors. ... Thus, permissible fees must be related to the overall cost of the government regulation. They need not be finely calibrated to the precise benefit each individual fee payor might derive. What a fee cannot do is exceed the reasonable cost of regulation with the generated surplus used for general revenue collection. An excessive fee that is used to generate revenue becomes a tax.

While Met on occasion appears to suggest that the *MWD* opinion determines the core dispute in its favor, Met accurately recites the impact of *MWD* thusly:

The question of whether system-wide costs may be included in MWD's wheeling rate at all was already decided by the California Court of Appeal, which held that system-wide costs may be included under the Wheeling Statute. *See MWD v. IID*, 80 Cal.App.4th at 1422-23. The inquiry for this Court is whether inclusion of **particular** system-wide costs (*i.e.*, MWD's fixed SWP costs and the Water Stewardship Rate) in MWD's rate for wheeling service charges fair compensation.

Met Closing Brief at 30 (bolded emphasis supplied).

MWD teaches us that system-wide changes are *eligible* for this sort of treatment. But the opinion did not obviate the cost causation requirement. In *MWD*, the Court endorsed *certain kinds* of system-wide costs as properly part of the wheeling charges—those that relate to the conveyance system:

Hence, the "fair compensation" (§ 1810) to which a water conveyance system owner is entitled for wheeling water includes reasonable capital, maintenance, and operation costs occasioned, caused, or brought about by "the use of the conveyance system." (§ 1811, subd. (c).) "[F]air compensation" (§ 1810) includes charges the owner, in this case the

Metropolitan Water District, becomes subject to or liable for in using the “conveyance system” (§ 1811, subd. (c)) to wheel water when it has unused capacity.

MWD, 80 Cal.App.4th at 1431.

I need not determine here whether the San Pedro principles are generally appropriate; but as they have been implemented to determine the wheeling rate, they are not supportable. Here’s Met’s assessment of that implementation:

In order to ensure that both full-service users and wheelers are ultimately held responsible for their respective costs, MWD determined that if a member agency purchasing MWD water “pays for the fixed, unavoidable costs of the system . . . then member agencies using that same system for wheeling must contribute to [MWD’s] fixed costs on an equivalent basis.” *Id.* MWD also determined that this principle is consistent with the San Pedro Integrated Resources Plan Assembly Statement “that wheeling should not result in adverse impacts to the rates and charges of any member agency.” *Id.* at 002458. In other words, MWD properly recognized that member agencies that wheel would gain an unfair subsidy if they did not have to pay for the costs that they caused MWD to incur, or for the benefits they received from MWD’s system, as a result of MWD’s fixed, unavoidable costs.

Met Closing Brief at 75-76.

RMI’s December 1995 report, putatively reflecting the San Pedro principles, too opined that that wheeling “**must not negatively impact the rates or charges to any other Member Agencies.**” AR2010-1222 at 1234 (emphasis in original).

Because one of Met’s chief “fixed, unavoidable costs” is the price of water it pays to the State, Met and its consultants may have thought that wheeling rates ought to be set such that there was no effect on the rates of non-wheelers, including rates attributable to the cost of water.

But under the wheeling statute and more generally the general cost causation principles which underlie all the claims in this case, only system-wide costs attributable to the “conveyance system” should be the basis for wheeling rates. *MWD*, above. To accommodate this reference to ‘conveyance facilities,’ Met argues that the state’s (DWR’s) conveyance facilities are a part of Met’s conveyance facilities. But with all deference to Met, I have found no reasonable basis for

this conclusion in the record. The language of *Griffith I*, 207 Cal.App.4th at 997, that proportionality is properly measured not “on an individual basis [but r]ather, it is measured collectively, considering all rate payors” is not a license to impose any system-wide charge on any user. San Diego as a purchaser of water may well have a variety of system-wide financial obligations, which presumably are reflected in the price it pays for the water it buys from Met, but that does not necessarily mean that San Diego as a wheeler must have those same financial obligations. At argument Met’s counsel stated that the wheeling rate to member agencies would rightfully include system-wide charges that a wheeling rate for non-member agencies would not.⁸² This approach inappropriately focuses on the identity of the customer as opposed to the cost of the service being rendered.

Because Met pays a fixed price for the water it buys, whether it sells it or not to member agencies, water prices to non-wheeling member agencies may rise as a function of increasing wheeling (and foregone purchases from Met). While that might result in “adverse impacts to the rates and charges” imposed on the other member agencies,⁸³ Met must nevertheless permit such wheeling. *Morro Bay*, 81 Cal.App.4th at 1050.

B. Water Stewardship Rate.

Met forthrightly notes that the Water Stewardship Rate recovers the costs of “demand management programs,” and those in turn provide incentives for recycling, groundwater recovery, desalinization programs and other water conservation efforts. Met Closing Brief at 61. Obviously, under these programs the demand for water of various member agencies is reduced, and so Met may in turn reduce its purchases. The record shows that at least a significant benefit of these programs is the creation of new water “supply,” reducing Met’s need to purchase water

⁸² Transcript of closing argument at 918-19 (January 23, 2014)**.

⁸³ Met Closing Brief at 75-76.

from other sources.⁸⁴ San Diego notes that Met’s brief, its witnesses and own documents all confirm that the primary purpose of these programs is to “incentivize development of *local* water *supplies*.”⁸⁵ The 1999 Raftelis Report also notes that at least some of the programs’ costs should be associated with supply.⁸⁶

Met itself knows that the *primary* benefit is not for transportation, but for supply: The central objective of Metropolitan’s water conservation program is to help ensure adequate, reliable and affordable water supplies for Southern California by actively promoting efficient water use. The importance of conservation to the region has increased in recent years because of drought conditions in the State Water Project watershed and court-ordered restrictions on Bay-Delta pumping, as described under “METROPOLITAN’S WATER SUPPLY—State Water Project” in this Appendix A under “METROPOLITAN’S WATER SUPPLY.”

Met Official Bond Statement: AR2012-16429 at 16519*.

The Raftelis’s textbook too states that “conservation costs” should be functionalized to “Source of supply.” AR2012-16288_5282 at 5291*. Raftelis wrote that “all or at least a portion” of programs for local “conservation, water recycling, and the recovery of contaminated groundwater” should be functionalized as “supply costs.” AR2012-16288_2114 at 2179*.⁸⁷

San Diego notes that Met has judicially admitted that it does not calculate the proportional benefits that individual member agencies receive from its Water Stewardship Rate or the programs it funds, neither on the basis of individual programs, nor in the aggregate. PTX-237-A** (RFA) Nos. 20, 32. Met has further judicially admitted that it “has never calculated the

⁸⁴ PTX-393** (Upadhyay Depo.) at 52:11-53:19; 109:16-111:19.

⁸⁵ MWD Br. at 7:14 (emphases added); *see also* AR2010-1101 at 1115, 1124; AR2010-1222 at 1249; AR-2012-16288_1723 at 1744*; PTX-037* at 14; PTX-119**; PTX-181**; PTX-183**; PTX-199**; PTX-237-A** (Admissions) Nos. 17-43; PTX-393** (Upadhyay Depo.) at 52:11-53:19; 104:17-105:25, 109:16-110:13, 116:1-117:14, 134:17-135:24; Ex. 77** (Arakawa Depo.) at 91:2-13; PTX-390** (Kostopoulos Depo.) at 42:14-42:23; PTX-392** (Thomas Depo.) at 79:3-22.

⁸⁶ AR2012-16288_2179*.

⁸⁷ The primary purpose of these programs is to “incentivize development of *local* water *supplies*.” MWD Br. at 7:14 (emphases added by San Diego). *See also* AR2010-1101 at 1115, 1124; AR2010-1222 at 1249; AR2012-16288_1723 at 1744*; PTX-037* at 14; PTX-119**; PTX-181**; PTX-183**; PTX-199**; PTX-237-A** (Admissions) Nos. 17-43; PTX-393** (Upadhyay Depo.) at 52:11-53:19; 104:17-105:25, 109:16-110:13, 116:1-117:14, 134:17-135:24; Ex. 77** (Arakawa Depo.) at 91:2-13; PTX-390** (Kostopoulos Depo.) at 42:14-42:23; PTX-392** (Thomas Depo.) at 79:3-22.

regional benefit to MWD created by the aggregate group of local water supply projects, seawater desalination projects, or conservation programs funded or subsidized with revenue collected through the Water Stewardship Rate in a given calendar year.” *Id.* No. 38.

Nevertheless Met argues that the demand management programs also reduce the demand for transportation. This, Met says, justified the inclusion of the Water Stewardship Rate in the transportation rates. Perhaps; perhaps to some extent. But the central problem here is that Met treats the *entirety* of the Water Stewardship Rate as a “transportation” rate that is then incorporated into the wheeling rate.

It is certainly reasonable to conclude that transportation capacity needs are reduced when supply needs are reduced, including reductions attributable to the demand management programs. See e.g. Met Closing Brief at 64-65. Met has documented at least a few of these. Upadhyay has testified (Met Closing Brief at 63) that some transportation facilities have been deferred as a result of conservation programs.⁸⁸ But the record does not show correlation between those avoided costs and water stewardship rates. While I cannot fault Met for not providing a transportation benefit number for *each* of the specific demand management programs, the best we can do with this record is to conclude that to some unspecified extent, some portion of the Water Stewardship Rate is causally linked to some avoided transportation costs. This is not enough to show that the costs of the service have a reasonable relationship to the service provided. The Rafetelis 1999 report suggests 50-50 allocation, but that suggestion was made simply because no data supported any other allocation;⁸⁹ the number is wholly arbitrary, as is the allocation of 100% of these Water Stewardship Rate charges to transportation.

It is also worth noting here that wheelers secure their benefits only when there is unused

⁸⁸ The 1996 IRP (DTX -019)(Met slide 28).

⁸⁹ AR2012-16288_2114 at 2179, 2216-17.

capacity in the extant transportation system. Wheeling is “[s]ubject to the General Manager’s determination of available system capacity.” Admin. Code § 4405(a). And Met notes, “MWD also resolved that it would make the determination of whether there is unused capacity in its conveyance system (as required by the Wheeling Statue) on a ‘case-by-case basis in response to particular requests for wheeling [services].’ DTX-680 at AR2012-002450; JTX-1 AR2010-002450.” Met Closing Brief at 20. While wheelers would benefit as a general matter by reason of increased capacity in that they might be able to wheel more water, those who in fact are permitted to wheel do so in a system built out to move non-wheeled water, that is, water that Met sells to its member agencies. Thus the costs and avoided costs attributable to the demand management programs relate to the transportation needs to provide purchased water. This too suggests that the cost of wheeling, while properly a function of system-wide costs associated with transportation as such, should not be a function of system-wide avoided costs of transporting purchased water.

C. Dry Year Peaking

San Diego alleges that costs attributable to dry year peaking are improperly part of the wheeling rate. Here’s how San Diego phrases it:

The dry-year peaking costs at issue here are those associated with purchasing and storing water and having capacity available in MWD’s facilities to deliver water supplies to its member agencies when they “roll on” to MWD’s system in dry years. For example, Los Angeles has a long history of rolling on and off the system, depending on the hydrological conditions in the Owens Valley where it obtains much of its water: between 2004 and 2009, Los Angeles’s purchases from MWD swung from 367,000 acre-feet in 2004 to 208,000 acre-feet in 2006 and back up to 434,000 acre-feet in 2009 San Diego’s Amended Reply To MWD’s First Pretrial Brief at 17.

It remains unclear exactly how these costs are part of the wheeling rate. Presumably some capital storage costs, some transportation costs, and some supply costs are part of what San Diego calls dry year peaking. *Cf.* San Diego’s Post-Trial Brief at 30:20-28. Of course dry year

peaking costs are not expressly part of the wheeling charges; indeed, Met argues that there is no such thing as dry year peaking (as opposed to, for example, peaking for other reasons). Perhaps it is done implicitly, in the sense that portions of some rates San Diego pays *must* include it. As San Diego notes, Met has admitted that it does not separately allocate costs to “dry year peaking.”⁹⁰

Met has essentially two responses to San Diego’s complaint. First (as noted above) there is no such thing as dry year peaking, and secondly, the differences in demand patterns which underlie San Diego’s argument are in fact fairly handled by volumetric and other rates.

First, a few words on certain graphs the parties have presented, directed to whether there really is a material variation among member agencies in their patterns of demand on Met’s water. In an effort to show that the dry year peaking issue exists, San Diego prepared a chart⁹¹ to graphically represent peaking. This chart apparently shows that (assuming a baseline based on the average of 1994-2000 purchases) Los Angeles ranged from that baseline to 2.5 of that baseline average, down to a bit under 1.5 of that average, and up to about three time that ratio. San Diego’s ranges are within about 1.5 of the assumed average. Met also has a graph⁹² which shows 2003-2012 purchases, with vaguely similar curves for both Los Angeles and San Diego, dipping in the 2005-06 and 2011 periods and rising in between around 2007 (for San Diego) and around 2009 (for Los Angeles). This includes San Diego’s exchange water, but nevertheless it shows (i) that San Diego obtained more water from Met than did Los Angeles, and (ii) the variation of San Diego’s purchases (about 675,000-400,000, i.e., 275,000) as compared to those of Los Angeles (about 425,000-175,000, i.e., 250,000), which are accordingly roughly the same.

⁹⁰ Order on MILS, December 10, 2013 at 4.

⁹¹ SDCWA Opening Presentation, December 17, 2013, at unnumbered page 87, based on PTX-203**, 347**, 299**, 300**, 301**.

⁹² MWD’s Opening Presentation, December 17, 2013 at 34, based on DTX-691**.

Because it appears exchange water is included in Met's graph, it is not possible to make an even rough conclusion concerning the extent to which one of those two member agencies benefits more from expenditures to account for peaking. And it is not clear that measuring the net difference between high and low purchases, rather than deviations from an average baseline, helps ascertain the impact of peaking.

But San Diego's graph does not answer that question either. The fact that for some time period one customer as opposed to another has a higher ratio of maximum purchases to average purchases does not mean that the former customer imposes higher charges on the supplier who must keep water (and associated facilities) available for the peak demand. This is especially true when the customer with the lower ratio buys more water during 'peak' periods, as may be the case here.⁹³

It is of course true that as a general matter some members agencies in some years buy more water for various reasons, including drought. And it also true, as Met agrees (Closing Brief at 89), that Met incurs costs for this sort of contingency storage. Met also agrees that this contingency capacity is significant, and designed to meet unexpected needs. *Id.* But there are many reasons for a member agency to seek additional water, such as changes in the local economy. And as Met notes, in some times of drought many member agencies actually lowered, not increased, their demand for water. Met Brief at 92; DTX-110*. The record shows that while there are variations in demands, the variations have many causes. For example as the FCS document discussed above notes, demand may fluctuate as a result of conservation measures, price elasticity at the local retail level, mandatory water curtailments, weather patterns, the local agency's supply conditions, and other factors.

⁹³ I exaggerate for illustration: if customer X averages 2 gallons a year in purchases, but sometimes peaks to 20 gallons (a ratio of 1:10), the water supplier will nevertheless presumably spend more to keep standby capacity available for customer Y who varies from 100 to 150 gallons (a ratio of 1:1.5).

There is no reasonable basis supporting the notion that a given amount of storage infrastructure (or any amount) is attributable to ‘dry year peaking.’

Met does impose charges for the cost of this contingency capacity. First, of course, the more water one buys the more one pays. Next, Met’s Tier 2 rates impose higher charges per volume when member agencies substantially exceed their past annual demands. Met Brief at 96. Met’s Readiness To Serve and Capacity Charges also account for unexpected additional demands from member agencies. These latter charges do not necessarily recover expenses attributable to ‘dry year peaking’ but they do recover costs attributable to some aspects of peak usage; and the ‘peak usage’ which measures the Capacity Charge is not on an annual basis but rather on a maximum summer day basis. Met Closing Brief at 99.

In the end, I do agree with San Diego that the record does not tell us that all these charges are sufficient to account for all of the costs of providing what I have called contingency capacity, but it is also true that there is no showing that this is a problem. This conclusion does not place the burden on San Diego when contesting validity of assessment under Proposition 26; rather I have turned to San Diego to show me there is an ‘assessment’ in the first place.

There is no substantial evidence that some member agencies reap a benefit for ‘dry year peaking,’ or that they do so at the expense of other member agencies such as San Diego.

Conclusion

Aside from the Wheeling statute, I have been required to confine my review to the administrative record. The extra record evidence has not made any substantial difference to my evaluation in any event, although for purposes of background, illustration, or to show that some

proposition did not seem to be seriously disputed, I have from time to time mentioned that evidence.

As to the standard of review, the higher de novo standard probably applies to Proposition 26, and under the Wheeling statute to the question of whether a rate might properly include a certain component. Under the Wheeling statute, the deferential standard applies to the issue of fair compensation, as it does to Govt. Code § 549997(a) and the common law's 'reasonable basis' standard.

But in this case, regardless of the standard, the result the same. There is no substantial evidence in the record to support Met's inclusion in its transportation rates, and hence in its wheeling rate, of 100% of (1) the sums it pays to the California Department of Water Resources' SWP disaggregated by the SWP as for transportation of that purchased water; and (2) the costs for conservation and local water supply development programs recovered through the Water Stewardship Rate. Indeed, the record confirms that these rates over-collect from wheelers, because at least a significant portion of these costs are attributable to supply, not transportation. These rates – the System Access Rate, System Power Rate, Water Stewardship Rate, and Met's wheeling rate – therefore violate Proposition 26 (2013-14 rates only), the Wheeling statute, Govt. Code § 549997(a), and the common law. The Court invalidates each rate for both the 2011-2012 and 2013-2014 rate cycles.

So too, under either the substantial deference or de novo standard, San Diego has not shown that there is a "dry year peaking" phenomenon for which Met's rates fail to fairly account. No violation of the pertinent law has been shown with respect to 'dry year peaking'.

Further Orders. San Diego has asked me to retain jurisdiction to ensure compliance with this ruling. At least until judgment is entered an appeal is taken, such an order does not appear

necessary. San Diego has also suggested the entry of a separate order along the lines its proposed in its proposed statement of decision at 55-57. The parties should confer on the matter and report their views at the next case management conference.

Dated: April 24, 2014



Curtis E.A. Karnow
Judge Of The Superior Court

Superior Court of California
County of San Francisco

SAN DIEGO COUNTY WATER
AUTHORITY, et. al.,

Plaintiff(s)

vs.

METROPOLITAN WATER DIST. OF
SOUTHERN CALIFORNIA, et al
Defendant(s)

Case Number: CPF-10-510830
CPF-12-512466

CERTIFICATE OF ELECTRONIC SERVICE
(CCP 1010.6(6) & CRC 2.260(g))

IN RE: SAN DIEGO COUNTY WATER
AUTHORITY

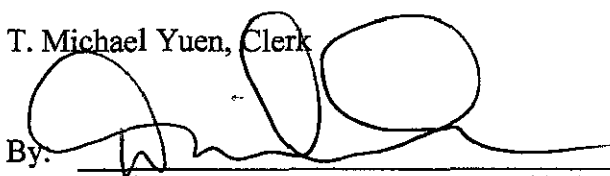
I, DANIAL LEMIRE, a Deputy Clerk of the Superior Court of the County of San Francisco, certify that I am not a party to the within action.

On April 24, 2014, I electronically served STATEMENT OF DECISION ON RATE SETTING CHALLENGES via File & ServeXpress on the recipients designated on the Transaction Receipt located on the File & ServeXpress website.

Dated: April 24, 2014

T. Michael Yuen, Clerk

By:



DANIAL LEMIRE, Deputy Clerk



FILED
San Francisco County Superior Court

AUG 28 2015

CLERK OF THE COURT
BY: [Signature]
Deputy Clerk

SUPERIOR COURT OF CALIFORNIA
COUNTY OF SAN FRANCISCO

SAN DIEGO COUNTY WATER
AUTHORITY,

Plaintiff/Petitioner,

vs.

METROPOLITAN WATER DIST. OF
SOUTHERN CALIFORNIA, et al.

Defendants/Respondents.

Case No. CFP-10-510830
Case No. CFP-12-512466

STATEMENT OF DECISION

I. Introduction

San Diego County Water Authority (San Diego) claims that the Metropolitan Water District of Southern California (Met) breached the Exchange Agreement¹ and improperly computed preferential rights. Met disputes the merits and raised some affirmative defenses. I find for San Diego on both claims.

II. Factual Background²

San Diego is one of Met's member agencies. It purchases water from Met and may obtain wheeling services from Met. If San Diego purchases water from an entity other than Met, it is impossible for San Diego to receive the water without moving it through Met's facilities.

¹ The "Amended and Restated Agreement Between Metropolitan Water District of Southern California and the San Diego County Water Authority for the Exchange of Water." PTX-65.

² Most of this background is extracted from my April 24, 2014 Statement of Decision (April Statement of Decision).

1 This movement is termed ‘wheeling’ the water, i.e., the use of a water conveyance facility by
2 someone other than the owner or operator.

3 Met’s current rate structure dates to 2003. Met’s full-service water rate, charged when
4 Met sells a member agency water, includes supply rates, the System Access Rate, the System
5 Power Rate, and the Water Stewardship Rate. These are volumetric³ charges. Met’s Wheeling
6 Rate is different: it includes the System Access Rate, the Water Stewardship Rate, and the
7 incremental cost of power necessary to move the water.
8

9 San Diego acquired an annual supply of transfer water from the Imperial Irrigation
10 District (IID) in 1998. PTX-28. Later in 1998 San Diego and Met agreed to the 1998 Exchange
11 Agreement. PTX-31.⁴ There San Diego paid Met to take transfer water and have Met make
12 Exchange Water⁵ available to San Diego. *Id.* §§ 3.1-3.2, 5.2. The contract was to last 30 years.
13 *Id.* § 5.2. For the first 20 years, San Diego would pay \$90 per acre-foot plus an annual
14 percentage escalator. *Id.* For the final 10 years, San Diego would pay \$80 per acre-foot plus an
15 annual percentage escalator running from 1998. *Id.* The 1998 Exchange Agreement permitted
16 the parties to request a change in the price after 10 years. *Id.* § 5.3. The price term was close to
17 an \$80 per acre-foot wheeling rate proposed by Department of Water Resources Director David
18 Kennedy in January 1998 as a compromise between wheeling rates advocated by Met and San
19 Diego in a dispute over an appropriate wheeling rate. PTX-481 at MWD 2010-00264720.
20
21

22 There were no IID water transfers to San Diego between 1998 and 2003. Met Pre-Trial
23 Brief, 10; San Diego Post-Trial Brief for Phase II, 13. On October 10, 2003, the parties entered
24

25 ³ That is they are based on the volume of water at issue such as gallons, *Klein v. Chevron U.S.A., Inc.*, 202 Cal. App.
26 4th 1342, 1385 (2012), or acre feet where one acre-foot is an acre of water one foot deep.

27 ⁴ The “Agreement Between Metropolitan Water District of Southern California and the San Diego County Water
Authority for the Exchange of Water.”

⁵ Exchange Water is a creature of contract. It is water delivered to San Diego by Met in the same quantity as that
made available to Met by San Diego. PTX-31 § 1.1(q); PTX-65 § 1.1(m).

1 the operative Exchange Agreement. PTX-65 at MWD2010-00190698. That day, the parties and
2 other agencies signed two other agreements: the Quantification Settlement Agreement and the
3 Allocation Agreement. *Id.* §§ F-G.

4
5 Most importantly for present purposes, the operative Exchange Agreement contained a
6 revised price provision.⁶ The new price was initially \$253 per acre-foot, and thereafter “equal to
7 the charge or charges set by [Met’s] Board of Directors pursuant to applicable law and regulation
8 and generally applicable to the conveyance of water by [Met] on behalf of its member agencies.”
9 *Id.* § 5.2.⁷ By this term, Met charged San Diego the volumetric transportation rates it charged
10 when it sold full-service water as of 2003 – the System Access Rate, System Power Rate, and
11 Water Stewardship Rate.⁸ Met’s rate *structure* has remained the same since 2003, but Met
12 periodically adjusts the dollar figures for the rates. San Diego has paid those charges under the
13 Exchange Agreement.
14

15 16 **III. Procedural History**

17 This action includes two complaints, responsive to Met’s 2010 and 2012 rate settings
18 respectively. April Statement of Decision, 2-3. The 2010 case included six causes of action:
19 three that directly challenged Met’s rate setting, one breach of contract claim, a declaratory relief
20 claim on Rate Structure Integrity, and one declaratory relief claim on preferential rights. *Id.* The
21 2012 case included four causes of action: three that directly challenged Met’s rate setting and
22 one breach of contract claim. *Id.* at 3. I phased proceedings. Phase I addressed the rate
23

24 ⁶ The revised price term was proposed by San Diego as Option 2. Option 1 was closer to the original terms of the
25 1998 Exchange Agreement whereas Option 2 involved a more significant shift in responsibilities. Trial Transcript,
1214:1-1217:22.

26 ⁷ The revised price provision also contained a sentence addressing the parties’ rights to seek to change those charges.
The meaning of that sentence is disputed by the parties.

27 ⁸ The rates differ from Met’s full-service water rate because San Diego does not pay the supply rates. The rates
differ from Met’s wheeling rate because San Diego pays the System Power Rate rather than the incremental cost of
power to move wheeled water.

1 challenges and the declaratory relief claim on Rate Structure Integrity. Phase II concerns the
2 breach of contract and preferential rights claims.

3 On April 24, 2014, I issued a Statement of Decision following Phase I of trial. There I
4 invalidated Met's System Access Rate, System Power Rate, Water Stewardship Rate, and
5 Wheeling Rate for calendar years 2011-2014 because Met improperly included "100% of (1) the
6 sums it pays to the California Department of Water Resources' SWP disaggregated by the SWP
7 as for transportation of that purchased water; and (2) the costs for conservation and local water
8 supply development programs recovered through the Water Stewardship Rate" in its
9 transportation rates. *Id.* at 65. I found that "at least a significant portion of these costs are
10 attributable to supply, not transportation." *Id.* I did not determine the proper allocation of the
11 disputed charges.
12

13
14 Met had earlier moved for summary adjudication of, among other things, San Diego's
15 preferential rights claim. Met's motion was predicated on the rule that payments for the
16 purchase of water do not give rise to preferential rights credit. December 4, 2013 Order, 6-7.
17 Met argued that San Diego pays several volumetric rates under the Exchange Agreement and as
18 a wheeler that Met also charges for the purchase of water, such that San Diego essentially paid
19 for the purchase of water. *Id.* I denied summary adjudication, finding that San Diego did not
20 pay any rate for the cost of water under the Exchange Agreement and that indeed San Diego had
21 already paid *someone else* for the purchase of water in the Exchange Agreement and wheeling
22 contexts. *Id.* at 7. I held that Met had not established as a matter of law that San Diego was
23 purchasing Exchange Water as opposed to making some other sort of payment. *Id.*
24

25 The parties have now completed a Phase II bench trial on San Diego's breach of contract
26 and preferential rights claims. Closing argument was held on June 5, 2015. The parties
27

1 submitted supplemental briefs on June 19, 2015. I issued a proposed statement of decision,
2 granted Met's request for an extension of time to file objections, and now file this statement of
3 decision resolving the Phase II issues including Met's motion for partial judgment interposed at
4 the conclusion of San Diego's case in the Phase II trial.
5

6 7 **IV. Discussion**

8 **A. Breach of Contract**

9 To prove a cause of action for breach of contract a plaintiff must establish the contractual
10 terms, the plaintiff's performance or excuse for failure to perform, the defendant's breach, and
11 damage to the plaintiff resulting from the defendant's breach. *McKell v. Washington Mut., Inc.*,
12 142 Cal.App.4th 1457, 1489 (2006); CACI No. 303.
13

14 **1. Terms**

15 In the Exchange Agreement San Diego agreed to both pay a price and make "Conserved
16 Water" and/or "Canal Lining Water" and "Early Transfer Water" available to Met each year at
17 the "SDCWA Point of Transfer," in exchange for which Met agreed to make "Exchange Water"
18 available to San Diego each year at the "Metropolitan Point(s) of Delivery." PTX-65 §§ 3.1-3.2,
19 5.1.⁹ The aggregate quantity of Exchange Water delivered by Met in a given year was to be
20 equal to the aggregate quantity of Conserved Water (including Early Transfer Water) and Canal
21 Lining Water San Diego made available to Met in the same year. *Id.* §§ 1.1(m), 3.2(c).
22

23 The Exchange Agreement provided for the Price, as follows:
24

25 ⁹ The Exchange Agreement was one of several agreements executed pursuant to the Quantification Settlement
26 Agreement. PTX-65 § F. San Diego entered the Allocation Agreement on the same day. *Id.* at § G. In the
27 Allocation Agreement, Met assigned certain water rights to San Diego and its right to receive substantial
reimbursements for certain canal lining projects from San Diego. DTX-884 § 4A.1. San Diego's obligations under
the Exchange Agreement were subject to the execution and delivery of the Allocation Agreement, among other
things. PTX-65 § 7.2.

1 The Price on the date of Execution of this Agreement shall be [\$253]. Thereafter, the
2 Price shall be equal to the charge or charges set by Metropolitan's Board of Directors
3 pursuant to applicable law and regulation and generally applicable to the conveyance of
4 water by Metropolitan on behalf of its member agencies. For the term of this Agreement,
5 neither SDCWA nor Metropolitan shall seek or support in any legislative, administrative
6 or judicial forum, any change in the form, substance, or interpretation of any applicable
7 law or regulation (including the Administrative Code) in effect on the date of this
8 Agreement or pertaining to the charge or charges set by Metropolitan's Board of
9 Directors and generally applicable to the conveyance of water by Metropolitan on behalf
10 of its member agencies; provided, however, that Metropolitan may at any time amend the
11 Administrative Code in accordance with Paragraph 13.12, and the Administrative Code
12 as thereby amended shall be included within the foregoing restriction; and, provided,
13 further, that (a) after the conclusion of five (5) Years, nothing herein shall preclude
14 SDCWA from contesting in an administrative or judicial forum whether such charge or
15 charges have been set in accordance with applicable law and regulation; and (b) SDCWA
16 and Metropolitan may agree in writing at any time to exempt any specified matter from
17 the foregoing limitation.

18 PTX-65 § 5.2.

19 The first sentence of § 5.2 sets the initial price. The second sentence of § 5.2 constrains
20 subsequent prices to charges Met sets pursuant to applicable law and regulation for the
21 conveyance of water by Met to its member agencies.

22 The parties dispute the import of the lengthy third sentence of § 5.2. Met contends that
23 San Diego there agreed to the rate structure Met had in place at the time of the Exchange
24 Agreement but reserved the ability to challenge only *amendments* to Met's rate structure (after
25 the five year period). Met Closing Brief, 20-22.¹⁰ San Diego contends that San Diego agreed
26 not to challenge Met's existing rate structure or any amendments to it for five years, but reserved
27 the ability to challenge Met's existing rate structure or any amendments to it after five years.

San Diego's position is consistent with the plain language of the provision and Met's
position is not.

The third sentence begins with a limitation on the parties' ability to seek changes to the
form, substance, or interpretation of any applicable law or regulation, including the

¹⁰ Citations to "Met Closing Brief" refer to Met's corrected closing brief.

1 Administrative Code, that pertains to the charge or charges set by Met and generally applicable
2 to Met's conveyance of water on behalf of its member agencies. This limitation is followed by a
3 proviso that permits Met to amend its Administrative Code and extends the scope of the
4 limitation to any of Met's amendments to the Administrative Code. The first proviso is followed
5 by a second proviso that constrains the scope of the general limitation in two ways – one that
6 sunsets restrictions on challenges brought by San Diego, and one that permits the parties to make
7 mutually agreeable changes.
8

9 This plain language shows the parties agreed to preclude certain challenges with the
10 exception of those challenges expressly permitted, including the specified challenges identified
11 in the final proviso. Among the permitted challenges are those brought by San Diego after the
12 passage of five years contesting Met's charges for the conveyance of water on the basis they
13 were not set pursuant to applicable law. Whether or not Met amended the underlying rate
14 structure is irrelevant to whether San Diego may challenge Met's rate structure.
15

16 Met's argument turns on the assertion that the second proviso modifies the first proviso,
17 not the general limitation. Met Closing Brief, 20-22. The key to Met's argument is the premise
18 that the language "such charge or charges" in the second proviso refers to the charge or charges
19 contained in any amendments made pursuant to the first proviso. *Id.* at 22. This reading is
20 irreconcilable with the plain language. The general limitation, not the first proviso, contains a
21 reference to "charge or charges." In using the "charge or charges" language, the general
22 limitation echoed the price term itself. The general limitation precludes San Diego from
23 attacking any law or regulation pertaining to Met's "charge or charges" "generally applicable to
24 the conveyance of water." The general limitation precludes San Diego from bringing a challenge
25 that could impact the contract price. The reference to "such charge or charges" in the second
26
27

1 proviso refers to those charges.¹¹ It does not refer to the first proviso, which contains no
2 reference to any “charge or charges.”

3 The structure of this section makes this conclusion inescapable. The first proviso begins
4 with the language “provided, however.” The second proviso begins with the language “and,
5 provided, further.” This makes it plain that the second proviso was a further proviso to the
6 general limitation.

7
8 Met hopes to inject ambiguity into the contract with extrinsic evidence such as the
9 testimony of Jeffrey Kightlinger, who negotiated the deal for Met. Met Closing Brief, 22; Trial
10 Transcript, 1327:21-1328:8. He said the purpose of the second proviso was to protect San Diego
11 from adverse changes in Met’s rate structure, *id.* at 1300:13-1307:2, 1328:9-14, noting that San
12 Diego’s negotiators told him that San Diego would not challenge Met’s existing rate structure
13 and that this concession was material to Met. *Id.* at 1300:13-1301:6, 1304:19-1305:7. One of
14 San Diego’s negotiators, Maureen Stapleton, disputed Kightlinger’s testimony. She said San
15 Diego always had concerns with the rates themselves and raised them repeatedly with Met. *Id.* at
16 1554:22-1555:14.¹²

17
18 Met also notes San Diego’s analysis of the future costs under the pricing agreement that
19 the parties ultimately adopted. San Diego analyzed the cost of that price plan over 20, 35, 45,
20 and 75 years, but not over five years. Met Closing Brief, 23; Trial Transcript, 1218:6-1221:6.
21 Met also seeks to corroborate its interpretation by looking to a San Diego memo to its Imported
22 Water Committee from 2007, in which San Diego stated that it did not intend to litigate Met’s
23

24
25 ¹¹ Met contends that if the second proviso refers to the general limitation then San Diego could challenge every
26 charge. Met Closing Brief, 22. Not so. The general limitation referred to a limited subset of Met’s charges, to which
27 the second proviso refers.

¹² Met disputes Stapleton’s credibility. Met Closing Brief, 22-23 n.10. But a Met person ‘most knowledgeable’ also
testified, in his deposition, that pursuant to these provisions San Diego could contest whether Met’s rates and
charges are consistent with applicable law after five years. PTX-392 at 121:10-124:25. I credit Stapleton’s
testimony, and not contrary Kightlinger testimony.

1 current rate structure but could not know what future actions Met may take. Met Closing Brief,
2 23; DTX-355 at 2.

3 None of this extrinsic evidence creates ambiguity in the contract.¹³ That San Diego
4 projected its exposure over periods exceeding five years is unsurprising, because even if San
5 Diego could succeed in a rate challenge San Diego would still pay Met's full, if reconfigured,
6 conveyance rates over the life of the Exchange Agreement. Stapleton testified that San Diego
7 was only interested in projecting a worst case scenario under the pricing plan. Trial Transcript,
8 1465:22-1466:1. A worst case scenario projection would not include savings from rate
9 restructuring as a result of litigation, even in the dubious event that one could estimate such
10 savings.
11

12 That in 2007 San Diego did not intend to challenge Met's existing rate structure does not
13 clarify the parties' intent when they signed the agreement in 2003. If anything, San Diego's
14 statement in 2007 is consistent with San Diego's interpretation of the contract, not Met's. By
15 stating that it did not intend to challenge Met's existing rate structure, San Diego implied that it
16 thought it had, or would soon have, a right to challenge Met's existing rate structure. (If San
17 Diego had no right to challenge Met's rate structure, there would be no reason for San Diego to
18 discuss whether it intended to do so.) This implication is inconsistent with Met's interpretation
19 of the contract, pursuant to which San Diego would never have any right to challenge Met's
20 existing, unamended, rate structure.
21

22 While Kightlinger's testimony supports Met's position, it is contradicted, and I reject it.
23 PTX-392 at 122:21-123:1; Trial Transcript, 1194:16-1196:6. His reading is in any event
24
25

26
27 ¹³ Only if the contract is reasonably susceptible to an interpretation urged does a court admit extrinsic evidence to aid in the interpretation of the contract. *Wolf v. Superior Court*, 114 Cal.App.4th 1343, 1350-51 (2004). The determination of whether an ambiguity exists is a question of law. *Id.* at 1351.

1 irreconcilable with the plain language of the contract. It does not create an ambiguity and the
2 unambiguous plain language controls.

3 The third sentence of § 5.2 permits San Diego to challenge Met's charges applicable to
4 the conveyance of water by Met to member agencies.¹⁴

6 2. Breach

7 In the rate years at issue, Met charged San Diego its transportation rates – the System
8 Access Rate, System Power Rate, and Water Stewardship Rate – pursuant to the price term.¹⁵
9 San Diego contends that Met breached the price term because Met's transportation rates were not
10 set pursuant to applicable law and regulation. San Diego Pre-Trial Brief, 1. In Phase I, I held
11 that Met's System Access Rate, System Power Rate, and Water Stewardship Rate were unlawful.
12 April Statement of Decision, 65. There is no dispute that those rates are the rates generally
13 applicable to Met's member agencies for the conveyance of water. Because Met's charges were
14 not consistent with law and regulation, Met breached § 5.2 of the Exchange Agreement. PTX-65
15 § 5.2.

17 To escape this result, Met argues that San Diego did in fact agree to Met's existing rate
18 structure by (1) agreeing to an initial price of \$253, based in turn on Met's existing rate structure;
19 (2) entering the Exchange Agreement knowing Met's existing rate structure; (3) voting in favor
20 of the challenged rate structure before and after the Exchange Agreement was entered into; and
21 (4) accepting Met's performance under the contract. Amended Motion for Partial Judgment, 2-3;
22 Met Pre-Trial Brief, 12.

24 ¹⁴ In passing, San Diego refers to this state of affairs as an "agree[ment] to disagree" about the law pertaining to
25 Met's rates. San Diego Post-Trial Brief for Phase II, 14. Met contends that San Diego agreed to a contract price
26 including the Water Stewardship Rate, the System Power Rate, and the System Access Rate, the latter two
27 components including State Water Project costs that the Department of Water Resources allocated to infrastructure.
Met Pre-Trial Brief, 12. Through this litigation Met has never contended the price term is uncertain or indefinite.
Compare, e.g., California Lettuce Growers v. Union Sugar Co., 45 Cal.2d 474, 481 (1955).

¹⁵ This is undisputed. *E.g.*, Met Pre-Trial Brief, 11; Met Closing Brief, 15; San Diego Post-Trial Brief for Phase II,
4, 21-22.

1 The first two points are not persuasive. Regardless of the parties' thinking which led to
2 the initial price, the parties just agreed to that number. San Diego's agreement to pay rates Met
3 set pursuant to applicable law and regulation does not amount to a tacit adoption of the then-
4 existing rate structure where the very same paragraph sets out provisions governing how and
5 when San Diego will be precluded from, and permitted to, a challenge whether those same
6 charges, whether or not amended, were in fact properly set pursuant to applicable law and
7 regulation. PTX-65 § 5.2.

8
9 Met contends there can be no breach when it uses the rate structure that has been in
10 existence since 2003, because San Diego entered the contract knowing Met's future performance
11 would be a continuation of that very structure. Amended Motion for Partial Judgment, 6. San
12 Diego may well have known that it was in substance agreeing to pay the Water Stewardship Rate
13 and for all State Water Project costs in Met's rate elements for five years. But San Diego also
14 bargained for the right to attack Met's conveyance rates after five years. If the charges were
15 removed from Met's generally applicable rates as the result of a change obtained by San Diego,
16 the charges would also be removed from the contract price. So San Diego did not agree to pay
17 any specific rate or abide by any specific rate structure for the life of the contract – it expressly
18 only agreed to pay rates set in accordance with applicable law and regulation, reserving the right
19 to challenge whether Met set its rates in accordance with applicable law and regulation (after five
20 years).

21
22
23 Accepting Met's performance for some period of time, even exceeding the five year
24 period, does not show San Diego agreed in the contract¹⁶ to a rate structure when at the same
25 time San Diego expressly retained the right to challenge Met's charges in court after the five year
26 period.

27

¹⁶ I separately address Met's waiver defense.

1 Below, I discuss the impact of San Diego's representatives' votes on Met's Board of
2 Directors on waiver. Here, I find that the voting history does not suggest that the plain language
3 of the contract is ambiguous or that San Diego agreed to pay under Met's existing rate structure
4 for the life of the contract. The unambiguous plain language again controls.
5

6 3. Damages

7 There are two issues under the rubric of damages. First, San Diego must prove the fact
8 that it suffered some damage as an element of its breach of contract claim. Second, if liability
9 for breach of contract is established, I must determine the appropriate measure of damages.
10

11 a. Background Law

12 Damages are of course an essential element of a breach of contract claim. *Behnke v.*
13 *State Farm General Ins. Co.*, 196 Cal.App.4th 1443, 1468 (2011); C.C. § 3300. "The damages
14 awarded should, insofar as possible, place the injured party in the same position it would have
15 held had the contract properly been performed, but such damages may not exceed the benefit
16 which it would have received had the promisor performed." *Brandon & Tibbs v. George*
17 *Kevorkian Accountancy Corp.*, 226 Cal.App.3d 442, 468 (1990); *Lewis Jorge Const.*
18 *Management, Inc. v. Pomona Unified School Dist.*, 34 Cal.4th 960, 967-68 (2004). "Where the
19 fact of damages is certain, the amount of damages need not be calculated with absolute certainty.
20 [Citations.] The law requires only that some reasonable basis of computation of damages be
21 used, and the damages may be computed even if the result reached is an approximation." *GHK*
22 *Associates v. Mayer Group, Inc.*, 224 Cal.App.3d 856, 873 (1990).
23

24 Importantly, a defendant cannot escape liability for its breach because damages cannot be
25 measured exactly. *SCI Cal. Funeral Servs., Inc. v. Five Bridges Foundation*, 203 Cal.App.4th
26 519, 571 (2012).
27

1 **b. Fact of Damages**

2 To establish the fact of damages San Diego relies on the April Statement of Decision as
3 well as testimony to the effect that Met's rates resulted in inflated conveyance rates. San Diego
4 Post-Trial Brief for Phase II, 21.¹⁷ In Phase I, I held that Met's conveyance rates over-collect
5 from wheelers because Met allocated all of the State Water Project costs for the transportation of
6 purchased water to its conveyance rates and all of the costs for conservation and local water
7 supply development programs to its conveyance rates. April Statement of Decision, 65. The
8 same logic applies to the Exchange Agreement. San Diego paid more than it agreed to under the
9 Exchange Agreement because Met improperly included all of the State Water Project costs for
10 the transportation of purchased water to its conveyance rates and all of the costs for conservation
11 and local water supply development programs to its conveyance rates.
12

13
14 Met responds that contract damages may only be the difference between the price Met
15 charged San Diego and the highest price Met could have charged San Diego had it performed its
16 obligation to set a lawful rate. Met Closing Brief, 3. So, Met says San Diego bore a burden of
17 proving at least that its damages theory is based on some lawful rate structure, and (possibly) that
18 under every imaginable lawful alternative rate structure San Diego would have paid less than it
19 did in the real world.¹⁸
20

21 There are two points to be made here. First, Met's present argument flies in the face of
22 the positions it has repeatedly taken in the past; and secondly, Met's argument does not in any
23 event obviate the obvious point that San Diego has established the fact of damages.

24 ¹⁷ See also, Trial Transcript, 991:16-992:6 (Dennis Cushman's testimony that San Diego has overpaid State Water
25 Project and Water Stewardship Rate charges as a result of Met's rates), 1911:24-1912:9 (testimony from Met's
26 expert to the effect that if the State Water Project costs should not have been included then San Diego overpaid
those charges).

27 ¹⁸ Met Closing Brief, 3 (arguing that San Diego did not prove that it paid more under the Exchange Agreement than
it could have under an alternative lawful rate structure, and therefore did not prove damages, because it did not
prove what alternative rate structures may exist); Amended Memorandum in Support of Partial Judgment, 8-9
(arguing that San Diego must prove its allocation is based on a lawful rate structure).

1 On the matter of stating or fixing damages through some sort of analysis of
2 counterfactual arguably legal rates, Met has repeatedly tried to have its cake and eat it too, as it
3 were. It has told me both that (i) only a new rate setting procedure may be used in this case to
4 fix lawful rates which in turn must be done before damages can be ascertained,¹⁹ and (ii) superior
5 courts may not do this. Met's January 9, 2015 Motion to Dismiss, 1-5; Trial Transcript, 2013:6-
6 2018:16; *see also* Met's March 27, 2014 Objections to Tentative Statement of Decision, 2-3
7 (court is not a rate-fixing body).²⁰ Met has had no useful response when I have enquired whether
8 its vision of damages requires me to defer a calculation of damages until after Met resets rates
9 (which would come after, and be a function of, appellate proceedings in this very case) which
10 new rates themselves might very well be subject to further independent litigation, pushing out
11 the decision on both the fact and calculation of damage in this case to many, many years hence.
12 Met's January 9, 2015 Motion to Dismiss, 5-6. These parties were keenly, almost painfully,
13 aware that contract litigation (after five years) was likely; but the notion that they also intended
14 to have the anticipated contract dispute resolved in this way is inconceivable.²¹

17 On the second point, Phase I established Met unlawfully included supply costs in
18 transportation rate elements. Met charged the same transportation rate elements to San Diego
19 under the Exchange Agreement as charges generally applicable to the conveyance of water by
20 Met on behalf of its member agencies. It is thus patently obvious that San Diego has established
21 that some costs should have been removed from the rates it paid under the Exchange Agreement
22

23 ¹⁹ E.g., Met's Amended Motion for Partial Judgment at 7:20 ("rates must be recalculated").

24 ²⁰ This logical twist got to the point where I had to instruct Met not to press a damages theory which Met at the same
25 time maintained I had no jurisdiction to entertain. Nov. 4, 2014 Order Setting Case Management Conference, 1-2;
26 Dec. 4, 2014 Order Denying Met's Motion to Reopen Expert Discovery. The effect of Met's fabricated conundrum
27 would be, of course, that damages could *never* be fixed if Met ever breached the Exchange Agreement. Despite this,
I allowed the parties, and Met specifically, to introduce evidence of a "lawful spectrum of rates" to estimate
damages. Order Re: Metropolitan's Motion To Dismiss For Lack Of Subject Matter Jurisdiction And [On] The
Parties' Motions In Limine, dated February 6, 2015. In the event, Met did not do so.

²¹ Dennis Cushman's testimony at e.g. DTX-710 at 443:10-444:2 is not to the contrary: he does not there endorse
this mode of calculating damages.

1 – the rates were obviously overinclusive. The precise amount of overinclusion is not established,
2 nor is any resulting impact on other Met rates.

3 I turn to Met’s argument that San Diego failed to account for (or set off) benefits it
4 secured by Met’s illegal rates, and as a consequence failed to establish damages.

5 Met argues the same conduct that breached the contract also must have resulted in
6 decreased supply rates, saving San Diego some money when it purchased full-service water from
7 Met. Met Closing Brief, 6. These savings must be treated as an offset against San Diego’s
8 damages, Met says, for it must have under-collected its supply costs in such a way that
9 necessarily resulted in under-collection from full-service water purchases.²² But Met as
10 defendant has the burden on matters of offset and unjust enrichment. *Textron Fin. Corp. v. Nat’l*
11 *Union Fire Ins. Co. of Pittsburgh*, 118 Cal.App.4th 1061, 1077 (2004), *disapproved of on other*
12 *grounds by Yanting Zhang v. Superior Court*, 57 Cal.4th 364 (2013). Met bore the burden of
13 demonstrating that San Diego’s damages were offset by incidental extra-contractual benefits San
14 Diego obtained as a result of the same conduct amounting to breach. *Space Properties, Inc. v.*
15 *Tool Research Co.*, 203 Cal.App.2d 819, 827 (1962) (defendant has burden of proof on defenses
16 such as unjust enrichment and or setoff). No evidence shows San Diego would have received a
17 consequential benefit from paying reduced supply charges that equaled or outweighed its
18 damages under the contract during the rate years in question if Met had reallocated the unlawful
19 transportation charges to its supply rates. Accordingly, Met’s argument for an offset does not
20 defeat liability. It has not met that burden.

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26 ²² *Hicks v. Drew*, 117 Cal. 305, 314-15 (1897) (approving the jury instruction “If the jury find from the evidence that
27 the plaintiff has sustained any damage by the act of defendant, as she has complained against him, and that by the
same act she has received benefit, then, in estimating such damage, such benefit should be deducted”). See Trial
Transcript, 1136:25-1138:14.

1 Finally as I have suggested above a recalculation of Met's supply rates conflicts with
2 Met's view that such an approach is impermissible in superior court.

3 San Diego has proven by a preponderance of the evidence that it was in fact damaged by
4 paying conveyance rates that were higher than Met could have set pursuant to applicable law and
5 regulation. PTX-65 § 5.2. San Diego should not be required to prove the fact of damages
6 beyond any shadow of doubt by proving the entire universe of possible alternative legal rate
7 structures Met might have implemented.
8

9 **c. Amount of Damages**

10 San Diego seeks an award of \$188,295,602 plus interest. San Diego Post-Trial Brief for
11 Phase II, 29. San Diego computed its damages by removing the SWP costs and the Water
12 Stewardship Rate from the Price. *Id.* at 30. Met correctly notes the Phase I ruling did not go so
13 far as to hold that Met is not permitted to include any of its SWP costs or Water Stewardship
14 Rate in its conveyance rates. Met argues that San Diego bore a Phase II burden of demonstrating
15 the appropriate percentage that Met could have included; and failed to carry that burden. Met
16 Closing Brief, 5-6; Trial Transcript, 2033:15-22, 2035:20-2037:19. Met also argues that any
17 damage award should be offset by whatever increases San Diego would have paid in its supply
18 rates. Met Closing Brief, 6; Trial Transcript, 2021:4-10.
19
20

21 San Diego's approach may overcompensate San Diego, because San Diego (1) removed
22 all State Water Project costs from Met's conveyance rates although I have only ruled that Met
23 could not include 100% of those costs through its conveyance rates;²³ and (2) removed the entire
24

25 ²³ Met argues that Exchange Water included State Water Project water, so San Diego should be charged with some
26 costs from the State Water Project system under the Exchange Agreement. Met Closing Brief, 8-12. But the
27 question is not whether Met should recover State Water Project costs under the Exchange Agreement, the question is
whether State Water Project costs can properly be recovered through the lawfully set conveyance rates that San
Diego agreed to pay under the Exchange agreement. Met's argument that San Diego should have accounted for the
power costs to move water pursuant to the Exchange Agreement appears to suffer from the same defect. *Id.* at 13.
In a similar vein, Met challenges the methodology by which San Diego's expert recalculated the rates. Met Closing

1 Water Stewardship Rate from Met's conveyance rates although I only ruled that Met could not
2 recover 100% of those costs through its conveyance rates. Nor does San Diego account for
3 possible set-offs, although as suggested above it is not San Diego's burden to do so.²⁴
4

5 There is no viable alternate methodology available. Neither party has computed alternate
6 conveyance rates assuming that less than 100% of the charges are shifted from conveyance to
7 supply. Neither party has explained the basis for an appropriate offset as a result of reduced
8 supply rates.

9 Met seeks dismissal because of this uncertainty. Trial Transcript, 2033:12-19. But
10 where, as here, the fact of damage flowing from the breach is proven the amount of damages
11 may be fixed using an approximation if there is a reasonable basis for the approximation. *GHK*,
12 224 Cal.App.3d at 873-74.²⁵ The rationale for San Diego's calculation is (1) San Diego has
13 removed from Met's transportation rates only certain charges that this Court ruled cannot be
14 wholly included in transportation rates; (2) attempting to allocate the charges at issue between
15 transportation and supply would embroil the Court in an inappropriate ratemaking exercise (a
16 proposition with which Met has repeatedly agreed) (Trial Transcript, 2017:23-2018:7; Met's
17 January 9, 2015 Motion to Dismiss, 3-5; Met's March 27, 2014 Objections to Tentative
18

19
20 Brief, 7-8; Trial Transcript, 1140:5-17. San Diego's expert removed the challenged costs from the cost pool and
21 divided the cost pool by the sales assumption. Trial Transcript, 1140:5-17. Met's expert opined that San Diego
22 should have instead divided only Colorado River costs by Colorado River sales. Trial Transcript, 1899:8-1900:14.
23 But, once again, the proper approach was to determine what Met's rate would have been if certain charges in Met's
24 generally applicable conveyance rates were moved from conveyance to supply. To do this, it was appropriate to
25 look at Met's total conveyance costs and its total sales assumption.

26 ²⁴ San Diego provided some evidence in support of a 15% figure. Trial Transcript, 1258:7-1260:8. While Met
27 contends quantifying an offset is not its problem, Trial Transcript, 2022:11-14, defendants usually *do* have this sort
of burden. *Textron Fin. Corp. v. Nat'l Union Fire Ins. Co. of Pittsburgh*, 118 Cal.App.4th 1061, 1077 (2004),
disapproved of on other grounds by Yanting Zhang v. Superior Court, 57 Cal.4th 364 (2013). At closing argument
Met expressed no confidence in or support for this 15% figure. E.g., Trial Transcript (closing argument) June 5,
2015 at 2020. See also, Met Closing Brief, 7.

²⁵ The *GHK* Court noted that an approximation for which there is a reasonable basis is particularly permissible when
the wrongful acts of the defendant created difficulty in proving the amount of lost profits or where the wrongful acts
of the defendant caused the other party not to realize a profit to which it was entitled. *GHK*, 224 Cal.App.3d at 873-
74.

1 Statement of Decision, 2-3). San Diego Post-Trial Brief for Phase II, 31; San Diego Pre-Trial
2 Brief, 11-12.

3 San Diego has offered a reasonable computation. It is not possible to know how Met may
4 in the future allocate its State Water Project conveyance costs or Water Stewardship Rate
5 between transportation and supply rates. One reasonable assumption is that the entirety of the
6 rate would have been moved. San Diego computed its damages under the contract for the 2011-
7 2014 rate years using that assumption.

8 Met did not offer a competing computation.

9 It asks too much of San Diego to require it to recalculate Met's rates with any useful
10 degree of precision. *MCI Telecommunications Corp. v. F.C.C.*, 59 F.3d 1407, 1415 (D.C. Cir.
11 1995) (inequitable to permit defendants who were in the best position to set their rates at lawful
12 levels in the first place and who later had opportunities to correct those rates to avoid
13 responsibility for those unlawful rates because the complainant to establish an appropriate rate
14 without making simplifying assumptions); *SCI*, 203 Cal.App.4th at 571 (defendant cannot escape
15 liability for breach simply because damages cannot be measured exactly).

16 For these reasons, San Diego has proven that it is entitled to damages in the amount of
17 \$188,295,602 plus interest.

18 **4. Affirmative Defenses**

19 **a. Waiver**

20 Met contends that San Diego waived²⁶ any claim for damages arising from Met's use of
21 the rate structure to set the Price by the following conduct inconsistent with an intent to claim
22 damages: (1) proposing the Price with knowledge of the rate structure and its components; (2)
23 voting, through its delegates to Met's Board of Directors, in favor of the rate structure and rates;

24 ²⁶ *Carmel Valley Fire Prot. Dist. v. California*, 190 Cal.App.3d 521, 534 (1987) (elements of waiver).

1 (3) failing to object to the structure of the rates until 2010; (4) stating in 2007 that San Diego did
 2 not intend to litigate Met's existing rate structure; and (5) accepting Met's performance with
 3 knowledge of the breach. Met Closing Brief, 14-20.

4 Met's waiver theories are precluded by the anti-waiver provision²⁷ in the Exchange
 5 Agreement. Met has not identified any conduct that could have waived the protections of the
 6 anti-waiver provision. *Id.* at 24-25. Nor has Met identified any written and signed waiver.
 7 PTX-65 § 13.9.²⁸

8
 9 **b. Consent**

10 Met asserts that San Diego consented²⁹ to using Met's then-existing rate structure to set
 11 the Price by entering the Exchange Agreement with knowledge of the unlawfulness of the rate
 12 structure, voting in favor of the rate structure, and accepting the benefits of the agreement. Met
 13 Closing Brief, 25-28.

14 First, San Diego's agreement to the price term in the Exchange Agreement does not
 15 amount to San Diego's approval of Met's rate structure. As discussed above,³⁰ contrary to Met's
 16 reading of the Exchange Agreement San Diego retained the right to challenge Met's existing rate
 17 structure after five years. San Diego agreed to pay only (1) a fixed initial rate; and (2) a rate set
 18
 19
 20

21 ²⁷ "No waiver of a breach, failure of condition, or any right or remedy contained in or granted by the provisions of
 22 this Agreement is effective unless it is in writing and signed by the Party waiving the breach, failure, right, or
 23 remedy. No waiver of a breach, failure of condition, or right or remedy is or may be deemed a waiver of any other
 24 breach, failure, right, or remedy, whether similar or not. In addition, no waiver will constitute a continuing waiver
 25 unless the writing so specifies." PTX-65 § 13.9.

26 ²⁸ Met looks to San Diego's written statement in 2007 that it did not intend to litigate Met's existing rate structure as
 27 a written waiver. Met Closing Brief, 19-20; DTX-355 at 2; DTX-1114 at 11-12; Trial Transcript, 1070:17-22. But
 none of these documents shows San Diego's intention to give up any right to challenge the existing rates. Rather,
 the documents reflect whether San Diego had the intent to challenge the existing rates in 2007. San Diego may not
 have *then* intended to challenge the existing rates, but still not have intended to give up the right to do so in the
 future.

²⁹ Consent is a free and mutual agreement to an act. C.C. § 1567. "A voluntary acceptance of the benefit of a
 transaction is equivalent to a consent to all the obligations arising from it, so far as the facts are known, or ought to
 be known, to the person accepting it." C.C. § 1589.

³⁰ Section IV(A)(1).

1 pursuant to applicable law. San Diego did not agree to Met's existing rate structure, but
2 bargained away the ability to challenge that rate structure for five years.

3
4 Second, the voting records do not support the assertion that San Diego consented to the
5 use of Met's rate structure in the years at issue. San Diego's representatives on Met's board
6 voted in favor of Met's rates in 2002, 2005, 2006, 2007, 2008, and 2009. Trial Transcript,
7 1506:14-17; DTX-129. San Diego's representatives voted against the rates in the years at issue
8 in this case. DTX-129. In voting, San Diego's representatives acted as Met's fiduciaries in the
9 scope of their duties as members of the board. Trial Transcript, 1506:12-13. Each time Met set
10 an unlawful rate, Met breached its obligations under the Exchange Agreement. *Arcadia*
11 *Development Co. v. City of Morgan Hill*, 169 Cal.App.4th 253, 262 (2008). Even if San Diego
12 can be said to have consented to Met's breaches in prior years because its delegates voted in
13 favor of the rates, a proposition with which I do not agree,³¹ San Diego's delegates did not vote
14 in favor of the rates at issue now.

15
16 Third, San Diego did not accept the benefits of the contract without protest in the rate
17 years at issue here. Again, each time Met sets unlawful conveyance rates, it breached its
18 obligations. Perhaps San Diego accepted Met's performance in prior years, even after the
19 expiration of the five year period; but San Diego did not accept Met's performance without
20 protest in the rate years at issue. Rather, it sued to challenge these breaches.

21 22 c. Estoppel

23 Met argues that San Diego is estopped³² from asserting that setting the Price based on the
24 existing rate structure is a breach of contract because San Diego's delegates to Met's Board of
25

26 ³¹ As the text suggests these delegates wore at least two hats, and in voting for Met rates may well have acted in the
27 best interests of Met.

³² In general, there are four elements of equitable estoppel: (1) the party to be estopped must be apprised of the facts;
(2) the party to be estopped must intend that his conduct shall be acted upon or have acted in such a way that the

1 Directors failed to disclose that Met's rate structure was unlawful and instead in effect
2 represented that the Price could be based on the existing rate structure. Met Closing Brief, 28-
3 31. Met asserts that San Diego agreed to a price term based on the rate structure and the 2003
4 rates; did not communicate that any of Met's rates might be unlawful; did not object to the price;
5 and represented that it did not intend to sue over the existing structure. *Id.* at 30.
6

7 In short Met contends that San Diego, knowing Met's rate structure was unlawful,
8 engaged in conduct that created the impression Met's existing rate structure was lawful, and that
9 Met, not knowing that its rate structure was unlawful, relied on San Diego's conduct.

10 But as Met recognized in its First Phase I Pre-trial Brief, the plain language of the
11 Exchange Agreement is itself an "open[] threat[] to litigate over [Met's] existing rate structure"
12 because San Diego agreed not to challenge Met's rates for five years after execution but reserved
13 the right sue to challenge the validity of Met's rates thereafter. Met Oct. 18, 2013 Brief, 14
14 (providing background concerning Met's use of Rate Structure Integrity provisions); PTX-65 §
15 5.2. San Diego's right to challenge Met's existing rate structure is itself part of the price term
16 section. Met could not have relied on San Diego's proposal of or agreement to this price term to
17 conclude that its rate structure is lawful. Moreover, the contract itself demonstrates that neither
18 party knew that Met's rate structure was unlawful;³³ both parties were bargaining in the context
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23 party asserting estoppel had the right to believe the conduct was so intended; (3) the party asserting estoppel must be
24 ignorant of the true facts; and (4) the party asserting estoppel must rely on the conduct. *Ashou v. Liberty Mut. Fire*
25 *Ins. Co.*, 138 Cal.App.4th 748, 766-67 (2006). Met's arguments conceivably satisfy the first two elements, but not
26 the rest, so setting aside my discussions in the text the estoppel defense fails in any event. Met does not show it was
27 ignorant of facts to which San Diego was privy nor does it show reliance, that is, that it would have acted otherwise.
33 Indeed, my determination on the lawfulness of Met's rate structure is itself exceedingly likely to be appealed. The
notion that Met relied on representations from San Diego to act on the belief that its rate structure is lawful is
particularly unpersuasive where Met continues to set its rates based on the belief that its rate structure is lawful even
after San Diego voted against the rates, sued Met over the rate structure, and obtained my trial court ruling that the
rate structure is unlawful. Met, as experienced in state water law as any entity, and served by some of the best
lawyers in the country, has never been misled by San Diego; it just disagrees with San Diego.

1 of uncertainty. The negotiations and terms of the Agreement make it plain—in way that is not
2 often found in contracts—that a lawsuit was contemplated.

3 Nor, in this context, could Met have reasonably relied on San Diego's other conduct to
4 conclude that its rate structure was legal. For example, in 2007 San Diego stated in internal
5 documents that it did not intend to litigate Met's existing rate structure.³⁴ But San Diego could
6 have determined not to litigate Met's existing rate structure for a number of reasons, only one of
7 which is San Diego's likelihood of success; and an internal document surely could not create an
8 estoppel as to Met. Met also notes San Diego's delegates voted to approve Met's rates in 2002
9 and 2005-2009 but did not tell Met that its rate structure might be illegal. But again the plain
10 language of the Exchange Agreement eviscerates this argument. Even as San Diego acquiesced
11 to Met's rates on a year-to-year basis after the expiration of the five year period, the possibility
12 of a legal challenge to the rates was written into the Exchange Agreement.

13
14
15 San Diego did not represent to Met, by omission or by conduct on which Met could
16 reasonably rely, that Met's rates were lawful knowing Met's rates were in fact illegal. Rather,
17 San Diego bargained for the right to challenge Met's rates in court in the future, and Met
18 bargained to constrain San Diego's ability to do so. San Diego's suit is not barred by the
19 doctrine of equitable estoppel.

20 21 **d. Illegality**

22 Met argues that the Exchange Agreement is void as illegal if Met's rate structure or rates
23 in existence at the time the parties entered into the Exchange Agreement were illegal. Met
24 Closing Brief, 31-33. This is so because if San Diego is right, Met's performance of the price

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27 ³⁴ Met Closing Brief, 19-20; DTX-355 at 2 (San Diego memo weighing whether to enter contracts with a Rate Structure Integrity provision); DTX-1114 at 11-12; Trial Transcript, 1070:17-22.

1 term was unlawful, Met says, because the rate structure includes unlawful rates. Met Pre-Trial
2 Brief, 12.

3 Although San Diego agreed not to challenge the manner in which Met set its charge or
4 charges for the following five years, the parties did not agree the setting of charges was legal or
5 illegal. Fixing a \$253 price is not illegal. Nor is it illegal to require Met to set its charges for the
6 conveyance of water pursuant to applicable law and regulation; precisely the opposite is true.³⁵
7 The parties obviously bargained for—by definition—a *legal* price term.
8

9 **e. Mistake of Law**

10 Met argues that there was a mistake of law with respect to whether its existing rates at the
11 time the parties entered the Exchange Agreement were lawful. To the extent that neither party
12 was aware the rate structure was unlawful, Met contends that it is entitled to rescission based on
13 mutual mistake. Met Closing Brief, 34-35; C.C. § 1578(1).³⁶ To the extent that San Diego but
14 not Met was aware that Met's rate structure was unlawful, Met is entitled to rescission because
15 San Diego failed to rectify Met's mistake. Met Closing Brief, 35-36; C.C. § 1578(2). San Diego
16 says there was no mistake of law – the parties disagreed about the lawfulness of Met's rate
17 structure and bargained around that disagreement. San Diego Post-Trial Brief for Phase II, 28-
18 29.
19
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21 Where parties are aware that a doubt exists in regard to a certain matter and contract on
22 that assumption, the risk of the existence of the doubtful matter is an element of the bargain.
23 *Guthrie v. Times-Mirror Co.*, 51 Cal.App.3d 879, 885 (1975). The kind of mistake that renders a
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25
26 ³⁵ "It is well settled that if a contract can be performed legally, it will not be presumed that the parties intended for it
to be performed in an illegal manner, and it will not be declared void merely because it was performed in an illegal
manner." *Freeman v. Jergins*, 125 Cal.App.2d 536, 546 (1954).

27 ³⁶ Met never tells us how this rescission, based on mistake or other grounds, would be carried out. Presumably San
Diego would not have to return the transported water.

1 contract voidable does not include mistakes as to matters which the contracting parties had in
2 mind as possibilities and as to the existence of which they took the risk. *Id.*

3 It is not clear when San Diego reached the conclusion that Met's rates were unlawful.
4 San Diego notes evidence that San Diego suggested to Met that Met's wheeling rate was
5 unlawful and that Met understood the suggestion. PTX-398; PTX-392 at 121:10-124:25
6 (purpose of five year standstill was to permit San Diego to bring a challenge to the rates). Met
7 asserts that San Diego's own negotiator vacillated as to whether San Diego had identified
8 anything unlawful about Met's rates at the time the parties entered the Exchange Agreement.³⁷
9 The parties were unclear on exactly what the law was.³⁸

10
11 Neither party knew how a court would rule on Met's rate structure. But they contracted
12 around this uncertainty. For five years, the parties precluded San Diego from challenging Met's
13 interpretation of the law, whether or not that interpretation changed during that period.
14 Thereafter, if San Diego disagreed it was free to bring a judicial challenge. The structure of the
15 contract itself, against this backdrop of uncertainty, demonstrates that the parties knew San
16 Diego might challenge Met's rate structure, were unsure which party would prevail in such a
17 lawsuit, and contracted in a way that accounted for Met's interests if its rates were unlawful.³⁹
18 There was no mistake of law.
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23 ³⁷ Compare Trial Transcript, 1590:7-1591:17 (Stapleton confronted with Slater's deposition testimony that San
24 Diego did not a violation although it knew there were laws that could be pertinent); with Trial Transcript, 1452:16-
25 1454:2 (Stapleton confronted with Slater's testimony that certain rates were unlawfully included in Met's
26 conveyance rates).

27 ³⁸ Trial Transcript, 1237:8-1243:17, 1248:13-1253:20, 1255:25-1256:8.

³⁹ San Diego forfeited its ability to challenge Met's rates in court for five years; to the extent Met's rates were
unlawfully inflated, Met received a benefit at San Diego's expense at least for the first five years of the contract.
Kightlinger testified that he did not have any doubt as to the lawfulness of Met's rates and that Met would not have
entered the Exchange Agreement if San Diego had said that Met's rates were unlawful during negotiations. Trial
Transcript, 1316:3-18. In section IV(A)(1), I rejected Kightlinger's testimony that San Diego told him that San
Diego would not challenge Met's existing rate structure and that the concession was material to Met.

1 **f. Offset and Unjust Enrichment**

2 These defenses are subsumed within the damages questions and are addressed there.⁴⁰

3 **B. Preferential Rights**

4 San Diego seeks a declaration that Met's methodology of computing preferential rights
5
6 violates § 135 of the Metropolitan Water District Act⁴¹ because it excludes San Diego's
7 payments relating to the conveyance of water San Diego purchases from other sources. Third
8 Amended 2010 Complaint ¶¶ 113-15. Specifically, the parties dispute whether (1) San Diego's
9 payments pursuant to the Exchange Agreement should be included in the preferential rights
10 calculation; and (2) payments under wheeling agreements should be included in the preferential
11 rights calculation.⁴²

12 Section 135 includes the following:

13 Each member public agency shall have a preferential right to purchase from the district
14 ... a portion of the water served by the district which shall, from time to time, bear the
15 same ratio to all of the water supply of the district as the total accumulation of amounts
16 paid by such agency to the district on tax assessments and otherwise, excepting purchase
17 of water, toward the capital cost and operating expense of the district's works shall bear
18 to the total payments received by the district on account of tax assessments and
19 otherwise, excepting purchase of water, toward such capital cost and operating expense.

20
21 ⁴⁰ Met's briefing does not separately address these defenses.

22 ⁴¹ Water Code Appendix § 109-135.

23 ⁴² San Diego Post-Trial Brief for Phase II, 39-40 (referring to the Exchange Agreement and other wheeling
24 agreements); Met Closing Brief, 36-40 (addressing only the Exchange Agreement); Trial Transcript, 2037:20-
25 2038:1; Third Amended 2010 Complaint ¶¶ 113-15 ("113. ... The Water Authority formally requested a
26 determination that its preferential rights should include the amount paid as 'transportation' costs for Metropolitan's
27 conveyance of Non-Metropolitan Water through its pipelines and facilities. Metropolitan has formally denied that
request, taking the position that money paid by the Water Authority for the transportation of its IID and Canal
Lining water are for the 'purchase of water' (i.e., supply)... [¶] 114. In the absence of declaratory relief,
Metropolitan will continue its wrongful calculation of the Water Authority's preferential rights... [¶] 115.
Therefore, the Water Authority prays for a judicial declaration (a) that the current methodology used by
Metropolitan to calculate the Water Authority's preferential rights violates section 135 of the MWD Act; and (b)
directing Metropolitan to follow the requirements of the MWD Act by including the Water Authority's payments to
Metropolitan for transportation of IID Water and Canal Lining Water (which payments are not for 'purchase of
water') in the calculation of the Water Authority's preferential rights to water") (footnote omitted).

1 As explained by our Court of Appeal:

2 Under section 135, in the event of a water supply shortage, each Metropolitan member
3 public agency, including San Diego, has a preferential right to a percentage of
4 Metropolitan's available water supplies based on a legislatively established formula.
5 That formula affords each member an aliquot preference equal to the ratio of that
6 member's total accumulated payments toward Metropolitan's capital costs and operating
7 expenses when compared to the total of all member agencies' payments toward those
8 costs, excluding amounts paid by the member for "purchase of water."

7 *San Diego County Water Authority v. Metropolitan Water Dist.*, 117 Cal.App.4th 13, 17 (2004).

8 Met moved for summary adjudication of San Diego's preferential rights claim in 2013. I
9 denied Met's motion by order issued December 4, 2013. From *SDCWA*, I derived the rule that
10 the preferential rights calculation includes all payments for capital costs and operating expenses,
11 excluding those payments that were tied to the "purchase of water." Dec. 4, 2014 Order, 6. Met
12 attempted to draw a parallel to *SDCWA* based on the rate components charged for the purchase
13 of water in *SDCWA* and the similar rate components charged under, for example, the Exchange
14 Agreement. *Id.* at 6-7. I held that Met had not established that San Diego was purchasing water
15 from Met through the Exchange Agreement. *Id.* at 7.

17 At the Phase II closing argument, Met again pressed the argument that no payment of a
18 volumetric rate is properly credited to preferential rights. Trial Transcript, 2038:18-2039:11,
19 2040:21-2041:10. This reading contradicts the plain language of the statute and *SDCWA*. The
20 Court of Appeal agreed with Met's longstanding interpretation that "amounts paid for water
21 purchases are not to be taken into account in determining preferential rights, whatever those
22 amounts are used for." *SDCWA*, 117 Cal.App.4th at 24-25. The Court independently analyzed
23 the language of the statute, the structure of the statutory scheme, and the legislative history to
24 interpret the Legislature's intent. *Id.* at 25-28. *SDCWA* found the statute reflected the
25 Legislature's intent to create a general rule that all revenue used to pay capital costs and
26
27

1 operating expenses would count toward the calculation of preferential rights, except payments
2 for the purchase of water. *Id.* at 27. In the pure wheeling context, the wheeler does not purchase
3 water from Met but pays a volumetric rate for Met to move water that belongs to the wheeler. I
4 discern no basis for Met's decision to treat volumetric wheeling payments as payments for the
5 purchase of water. Volumetric payments to Met to cover Met's operating expenses that are not
6 connected to a purchase of water from Met are entitled to preferential rights credit under § 135 of
7 the Met Act and *SDCWA*.⁴³ Wheeling payments must be included in the preferential rights
8 calculation.

9
10 Whether payments specifically under the Exchange Agreement give rise to preferential
11 rights credit is a more difficult question. As in the wheeling context, San Diego pays volumetric
12 rates to cover Met's operating expenses in exchange for the conveyance of water. Unlike in the
13 wheeling context, the Exchange Agreement does not literally call for the conveyance of water
14 but instead for the *exchange* of water. PTX-65 §§ 3.1-3.2. The question here is whether the
15 exchange of water facilitated by the Exchange Agreement brings San Diego's payments into the
16 statutory "purchase of water" exception.
17

18 Met says that the Exchange Agreement facilitates a purchase of water because, under the
19 agreement, San Diego gives Met water and money and obtains different water⁴⁴ from Met. Met
20

21
22 ⁴³ Met argues that its interpretation of the statute to treat all volumetric payments as payments for the purchase of
23 water is entitled to deference. Met Closing Brief, 39; Trial Transcript, 1847:5-1848:13, 2040:21-2041:10. I do
24 defer, but this sort of deference is not tantamount to giving the agency a veto on the interpretation of the statute.
25 Courts must ultimately construe statutes. *Compare, SDCWA*, 117 Cal.App.4th at 22. The fact that Met uses
26 volumetric rates to collect its payments for the purchase of water as well as to collect payments under wheeling
27 contracts does not show payments under wheeling contracts are for the purchase of water. It is the purpose of the
28 payment, not the manner in which the amount of the required payment is computed, that controls under the statute.
29 Nothing in the statute or *SDCWA* supports Met's interpretation. *Compare, Met Supplemental Brief*, 5 (asserting that
30 *SDCWA* compels the conclusion that all volumetric payments are excluded from the preferential rights calculation,
31 presumably because all volumetric rates are payments for the purchase of water). Accordingly, I reject Met's
32 interpretation as contrary to the legislative intent of the statute, as interpreted in *SDCWA*.

33 ⁴⁴ San Diego correctly argues that the Exchange Agreement defines Exchange Water as Local Water, not Met Water,
34 except for the purposes of the price provision and the Interim Agricultural Water Program, which are not relevant

1 Pre-Trial Brief, 15-16; Met Closing Brief, 39. San Diego contends that the Exchange Agreement
2 is, in practical terms, no different from any other conveyance agreement because in any wheeling
3 agreement the party receiving the service obtains molecules of water different from those
4 initially put into the conveyance system. San Diego's Post-Trial Brief for Phase II, 39-40.
5

6 The parties have not pointed me to legislative history or other sources which would
7 explain why the Legislature excluded payments for the purchase of water from the preferential
8 rights calculation. *SDCWA*, 117 Cal.App.4th at 24 (Legislature has not defined the "excepting
9 purchase of water" terminology). The fact remains that the Legislature included all contributions
10 toward capital costs or operating expenses in the preferential rights calculation with a single
11 exception: payments for the purchase of water.
12

13 San Diego is not purchasing water from Met. San Diego is exchanging water with Met to
14 make use of its own independent supplies. PTX-65 §§ 1.1(m), 3.1-3.2, 3.6.⁴⁵ The parties agreed
15 to exchange an equal amount of water; the only water quality requirement was for Met to provide
16 San Diego with water of at least the same quality as the water Met received from San Diego.
17 These facts underscore that the Exchange Agreement was not an agreement pursuant to which
18 San Diego obtained water from Met, but instead an agreement pursuant to which Met in effect
19 conveyed water on behalf of San Diego. That the Exchange Agreement differs in some respects
20 from a wheeling contract⁴⁶ does not mean that the Exchange Agreement was not in substance an
21

22 here. San Diego Supplemental Brief, 1; PTX-65 at §§ 4.1-4.2. Exchange Water is Met water for the purposes of the
23 price provision and the Interim Agricultural Program. PTX-65 at §§ 4.1-4.2.

24 ⁴⁵ The parties' characterization of the Exchange Water does not control whether the agreement is a purchase
25 agreement for the purposes of the preferential rights statute. PTX-65 §§ 4.1-4.2.

26 ⁴⁶ Met says there are five differences. Met Closing Brief, 38-39. But it remains unclear why these differences
27 matter. The differences Met asserts are: (1) wheelers can only move water when there is available capacity, but Met
makes deliveries every month regardless of capacity on the Colorado River Aqueduct; (2) water is wheeled only
when it is available, but Met wheels water every month regardless of the amount San Diego has made available; (3)
wheelers bear carriage losses as a result of loss in transit, but Met bears the carriage loss under the Exchange
Agreement; (4) San Diego was not billed for wheeling water, but instead for purchasing water with a monetary
credit for the supply it made available; and (5) to wheel Colorado River water, San Diego would have needed a

1 agreement to convey, rather than purchase, water. San Diego's payments under the Exchange
2 Agreement must be included in the preferential rights calculation.

3
4
5 **V. Conclusion**

6 On the breach of contract claim, San Diego is entitled to \$188,295,602 plus interest.
7 Met's motion for partial judgment is denied.

8 On the preferential rights claim, San Diego is entitled to a judicial declaration (a) that
9 Met's current methodology for calculating San Diego's preferential rights violates § 135 of the
10 Metropolitan Water District Act; and (b) directing Met to include San Diego's payments for the
11 transportation of water under the Exchange Agreement in Met's calculation of San Diego's
12 preferential rights.
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16 Dated: August 28, 2015



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Curtis E.A. Karnow
Judge of The Superior Court

24 federal contract, but San Diego did not need a federal contract under the Exchange Agreement because the water
25 would be Met water. *Id.* at 38-39. Met says this demonstrates that San Diego is in effect "paying" for the water
26 with—water; making Exchange Water a water "purchase." *Id.* at 8. There can be nice distinctions between barter,
27 currency and investment, and conceivably water might have any of these roles—and in circumstances of increasing
drought, water may be a currency of the future (see *Mad Max Beyond Thunderdome* (1985),
<http://www.imdb.com/title/tt0089530/>), but there is no good reason to treat it so in this case. And as noted above,
the parties' characterization of a transaction does not control whether the transaction is a purchase for the purposes
of the preferential rights statute.

CERTIFICATE OF ELECTRONIC SERVICE
(CCP 1010.6(6) & CRC 2.260(g))

I, DANIAL LEMIRE, a Deputy Clerk of the Superior Court of the County of San Francisco, certify that I am not a party to the within action.

On : **AUG 28 2015**, I electronically served THE ATTACHED ORDER via File & ServeXpress on the recipients designated on the Transaction Receipt located on the File & ServeXpress website.

Dated: **AUG 28 2015**

T. Michael Yuen, Clerk

By:



DANIAL LEMIRE, Deputy Clerk

FILED
San Francisco County Superior Court



OCT 9 - 2015

CLERK OF THE COURT

BY: [Signature] Deputy Clerk

SUPERIOR COURT OF CALIFORNIA
COUNTY OF SAN FRANCISCO

SAN DIEGO COUNTY WATER
AUTHORITY,

Plaintiff/Petitioner,

vs.

METROPOLITAN WATER DIST. OF
SOUTHERN CALIFORNIA, et al.

Defendants/Respondents.

Case No. CFP-10-510830
Case No. CFP-12-512466

ORDER GRANTING SAN DIEGO'S
MOTION FOR PREJUDGMENT
INTEREST

I have previously found that the Metropolitan Water District of Southern California (Met) breached its Exchange Agreement with the San Diego County Water Authority (San Diego) and awarded San Diego nearly \$200 million in damages, "plus interest." Phase II Statement of Decision, 29. San Diego now moves for prejudgment interest, seeking an additional \$44,139,469.¹ I heard argument October 8, 2015.

Legal Background

Civil Code § 3287(a) provides that "[e]very person who is entitled to recover damages certain, or capable of being made certain by calculation, and the right to recover which is vested in him upon a particular day, is entitled also to recover interest thereon from that day...."

¹ San Diego initially requested \$47,277,747, but modified the request after Met pointed out a timing error. Opposition, 12-13; Reply, 1. I have further reduced this to a small extent to account for Met's further calculations. See n.8 below.

1 Section 3289 provides that when a contract “does not stipulate a legal rate of interest, the
2 obligation shall bear interest at a rate of 10 percent per annum after a breach.” The dispute here
3 centers on whether § 12.4(c) of the Exchange Agreement “stipulate[s] a legal rate of interest.”
4

5 The parties also disagree as to whether the damages awarded were “certain” or “capable of being
6 made certain.”

7 **The Agreement’s Language**

8 Section 12.4(c) of the Exchange Agreement reads:

9 In the event of a dispute over the Price, SDCWA shall pay when
10 due the full amount claimed by Metropolitan; provided, however,
11 that, during the pendency of the dispute, Metropolitan shall deposit
12 the difference between the Price asserted by SDCWA and the Price
13 claimed by Metropolitan in a separate interest bearing account. If
14 SDCWA prevails in the dispute, Metropolitan shall forthwith pay
15 the disputed amount, plus all interest earned thereon, to SDCWA.
16 If Metropolitan prevails in the dispute, Metropolitan may then
17 transfer the disputed amount, plus all interest earned thereon, into
18 any other fund or account of Metropolitan.

19 Met says § 12.4(c) establishes a legal rate for purposes of § 3289 and so the 10%
20 statutory rate does not apply. It asserts that the interest bearing account prescribed by § 12.4(c)
21 has accrued interest of \$4,156,907.46 – the maximum interest to which SDCWA could be
22 entitled. *Id.* at 2:1-3.

23 But at argument, Met explained that it had set aside less than the damages awarded.² So,
24 it has now in effect retrospectively increased the principal set aside amounts over the period of
25 the dispute to reach the awarded damages, and then Met has recalculated interest using whatever
26 interest Met had, historically, obtained on the set-side money. Thus, Met now proposes to give
27 San Diego not, as § 12.4(c) suggests, “all interest earned thereon” i.e. the interest historically

² This is not shocking. As I noted in my earlier discussion of § 12.4(c) when San Diego unsuccessfully presented it as a liquidated damages provision, there is no reason to think that money set aside under § 12.4(c) would perfectly match the damages award.

1 earned on the set-aside money, but *more* money to account for the damages which Met had *not*
2 set aside. This is the first signal that Met's proffered understanding § 12.4(c) is not correct.

3 Met argues both in its papers and at argument that that if I do not accept its reading, the
4 phrase "shall forthwith pay . . . all interest earned thereon" is meaningless. E.g., Opposition at 5.
5 I do not agree. The clauses on interest, just like the remainder of the section, as I have previously
6 interpreted it, are all designed to increase the odds that there will be money available to pay
7 damages. Just as it is wise to set aside principal for potential future damages, so too it is wise to
8 insist on an interest bearing account to account for the devaluation of money over time. Met's
9 reading is not necessary to give meaning to the terms.

10 And this leads to the central problem with Met's view. I have previously found, at Met's
11 urging, that § 12.4(c) was a security provision, not a damages provision. The provision's
12 "primary purpose . . . was to prevent either side from spending disputed funds during the
13 pendency of a dispute and to ensure that disputed funds were promptly available to the prevailing
14 party upon the resolution of a dispute." Phase II SOD at 7. One reason for this conclusion was
15 that, if read as a damages provision, SDCWA would be able to "fix extraordinarily high damages
16 through the simple expedient of *claiming* extraordinarily high damages." *Id.* The same logic
17 applies to the interest clause here.

18 Met's view is that the contract requires prejudgment interest generated on an amount that
19 may be totally different than the damages actually awarded. That's not reasonable; as I note
20 above, even Met does not so calculate interest.³

21 Met also argues that extrinsic evidence shows the parties meant this clause to reflect their
22 agreement on applicable interest. Met notes communications between the parties in 2011 and
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27 ³ That is, Met now adds more interest to account for the actual damages awarded; and I suppose, if I had awarded
less than the set-aside, Met would nevertheless not have turned over to San Diego either the full amount set
aside nor "all interest earned thereon".

1 2012 indicated that the disputed money was being set aside and would earn interest “using the
2 effective yield earned . . . on Metropolitan’s investment portfolio.” *Id.* at 7, citing Soper Decl.,
3 ¶3, Ex. B. San Diego, Met stresses, did not object to this characterization. *Id.*⁴ San Diego retorts
4 that its failure to object to Met’s communications does not constitute “acceptance” of a
5 “stipulated rate.” Reply, 4. I agree. See e.g., *Unocal Corp. v. United States*, 222 F.3d 528, 542
6 (9th Cir. 2000) (interest rate unilaterally placed in invoice is not a stipulated legal interest rate
7 under § 3289). I agree.

8
9 Met also suggests that even if the contract is ambiguous, extrinsic evidence shows the
10 parties’ “intent that the interest to be paid would be the interest earned in the interest bearing
11 account.” Opposition at 9. But this is not so. Met’s evidence is just that it informed San Diego
12 that it would comply with § 12.4(c) by placing disputed funds in a separate account, and that San
13 Diego did not object. See Opposition at 7-8.

14 **Judicial Estoppel**

15
16 San Diego suggests Met is barred by judicial estoppel. See generally, *Jackson v. Cnty. of*
17 *Los Angeles*, 60 Cal.App.4th 171, 181 (1997); *MW Erectors, Inc. v. Niederhauser Ornamental &*
18 *Metal Works Co., Inc.* 36 Cal. 4th 412, 422 (2005). Met had previously insisted that § 12.4(c)
19 was a security deposit and did not pertain to damages at all. I agreed; § 12.4(c) only served to
20 prevent either side from spending disputed funds. But Met has not taken two positions which are
21 “totally inconsistent,” 60 Cal.App.4th at 183. It is at least conceivable that § 12.4(c) both acted to
22 secure some money towards damages *and* set forth the parties’ agreement on interest calculation.
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26 ⁴ Met also notes that San Diego’s second and third amended complaints requested interest “as a result of the express
27 term in section 12.4(c) . . .” *Id.*, citing Emanuel Dec., Ex. 4, ¶4. The same request appeared in San Diego’s June
2012 lawsuit. *Id. Nesbit v. MacDonald*, 203 Cal. 219, 222 (1928) notes “a prayer for ‘interest,’ without specifying
the rate, is deemed a prayer for legal interest” – here, set at 10 percent by statute. I do not take these allegations as
reasonable evidence that the parties had agreed to calculate interest as Met now claims.

1 But, while I do not think judicial estoppel applies to actually block Met's position now, as I have
2 noted the logic of my earlier ruling does refute it.

3 **Certainty**

4 San Diego must show that the damages I awarded were "certain, or capable of being
5 made certain" under § 3287(a). Met tells us that this means San Diego must show there was "no
6 dispute as to the computation of damages." Opposition at 9, citing *Fireman's Fund Ins. Co. v.*
7 *Allstate Ins. Co.*, 234 Cal.App.3d 1154, 1173 (1991). Because "the parties vigorously disputed
8 the computation," Met continues, there could not have been certainty. Opposition at 2. If this
9 were so, a party could avoid prejudgment interest merely by contesting damages at trial.

10 As San Diego notes cases distinguish between disputes over the measure of damages and
11 the absence of data necessary to allow the defendant to calculate damages. Only the latter makes
12 damages uncertain. Reply, 6. *Howard v. Am. Nat. Fire Ins. Co.*, 187 Cal.App.4th 498, 535
13 (2010) ("test for determining certainty under section 3287(a) is whether the defendant knew the
14 amount of damages owed to the claimant or could have computed that amount from reasonably
15 available information...") See also, *Collins v. City of Los Angeles*, 205 Cal.App.4th 140, 151
16 (2012).

17 Here I awarded exactly the amount of damages requested by San Diego. The calculation
18 was as San Diego suggested, a simple deduction of some sums from others. The calculation was
19 just "math" as Met's counsel noted.⁵ Met had all the information it needed to determine the
20 degree of the overcharges; indeed, the data came from Met. See *Chesapeake Indus., Inc. v.*
21 *Togova Enterprises, Inc.*, 149 Cal. App. 3d 901, 907 (1983) (prejudgment interest awarded if
22 defendant "from reasonably available information could ... have computed" damages). Thus
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⁵ See also TR 1913-1914 (San Diego's math correct, according to Met witness).

1 these damages were “capable of being made certain” and San Diego is entitled to prejudgment
2 interest.

3 In its papers, Met confronts San Diego with its earlier statements that damages were
4 difficult to quantify, statements made in connection with its liquidated damages argument on §
5 12.4(c). Met is accurate,⁶ but after I rejected its position San Diego changed its theory, and as
6 Met counsel agreed at argument, changes in damages theory do not demonstrate that damages
7 are uncertain.⁷

8
9 At argument Met emphasized its concerns that the damages here were uncertain in the
10 sense that they were a function of deduction of uncertain amounts of charges, that it was never
11 clear exactly what portion of certain charges could (had Met properly calculated them) be billed
12 to San Diego. Perhaps; but it was San Diego’s theory, repeated in communications to Met before
13 litigation and found in statements made during this case, that any such uncertainty was not its
14 problem; that it should not be required to pay those charges unless they were justified, that they
15 were not justified, and thus they should all be deleted from San Diego’s bill. My finding that Met
16 might have been able to justify some unknown portion of the challenged charges, but in the event
17 did not do so, is not a demonstration that the damages were uncertain. Of course Met disputed
18 both damages (including maintaining the position that the court was without power to calculate
19 them) as well as San Diego’s damage theories (not to speak of its liability theories) but not the
20 facts used to calculate the damages.
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24 ⁶ It is literally accurate to note San Diego’s argument that damages could be difficult to quantify, but the situation
25 was then more nuanced: San Diego was arguing that, *absent a liquidated damages* provision, damages could be or
26 were difficult to quantify, and so urged liquidated damages—which would have been exceedingly certain. San
27 Diego has not, I think, ever urged a theory of damages which is uncertain. See n.7.

⁷ The fact that a court might have to select among damages models does not mean the damages awarded are not
“capable of being made certain.” *Children’s Hosp. & Med. Ctr. v. Bonta*, 97 Cal. App. 4th 740, 774 (2002). San
Diego presented essentially two models, one of which I rejected; Met presented none, and each of San Diego’s
models was “capable of being made certain.”

1 The test may be focused this way: damages are not ‘certain’ when to fix damages, the
2 court is required to resolve (aside from the liability issues) “disputed facts,” *Collins v. City of Los*
3 *Angeles*, 205 Cal. App. 4th 140, 151 (2012) or “conflicting evidence,” Dennis L. Greenwald,
4 CALIFORNIA PRACTICE GUIDE: REAL PROPERTY TRANSACTIONS 11:134.2 (2014). While one can
5 imagine that I might have had to resolve disagreements on exactly how much of a rate ought to
6 have been included in San Diego’s bills (because, for example there was disagreement on how
7 much to allocate to supply (compare Met’s Opposition at 10:20)), in the event, I did not. No
8 party wanted to lead me down that path. These sorts of conflicts were avoided, and not presented
9 to me for resolution, by the parties’ approaches to damages.
10

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13 **Conclusion**

14 San Diego’s motion for prejudgment interest is granted. The parties agree that, using the
15 10 percent rate, the interest is \$43,415,802.⁸

16
17 Dated: October 9, 2015



Curtis E.A. Karnow
Judge Of The Superior Court

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⁸ The parties agree that at 10% this is the minimum to which San Diego is entitled. Reply at 10:3-26.

CERTIFICATE OF ELECTRONIC SERVICE
(CCP 1010.6(6) & CRC 2.260(g))

I, DANIAL LEMIRE, a Deputy Clerk of the Superior Court of the County of San Francisco, certify that I am not a party to the within action.

On **OCT 9 - 2015**, I electronically served THE ATTACHED DOCUMENT via File & ServeXpress on the recipients designated on the Transaction Receipt located on the File & ServeXpress website.

Dated: **OCT 9 - 2015**

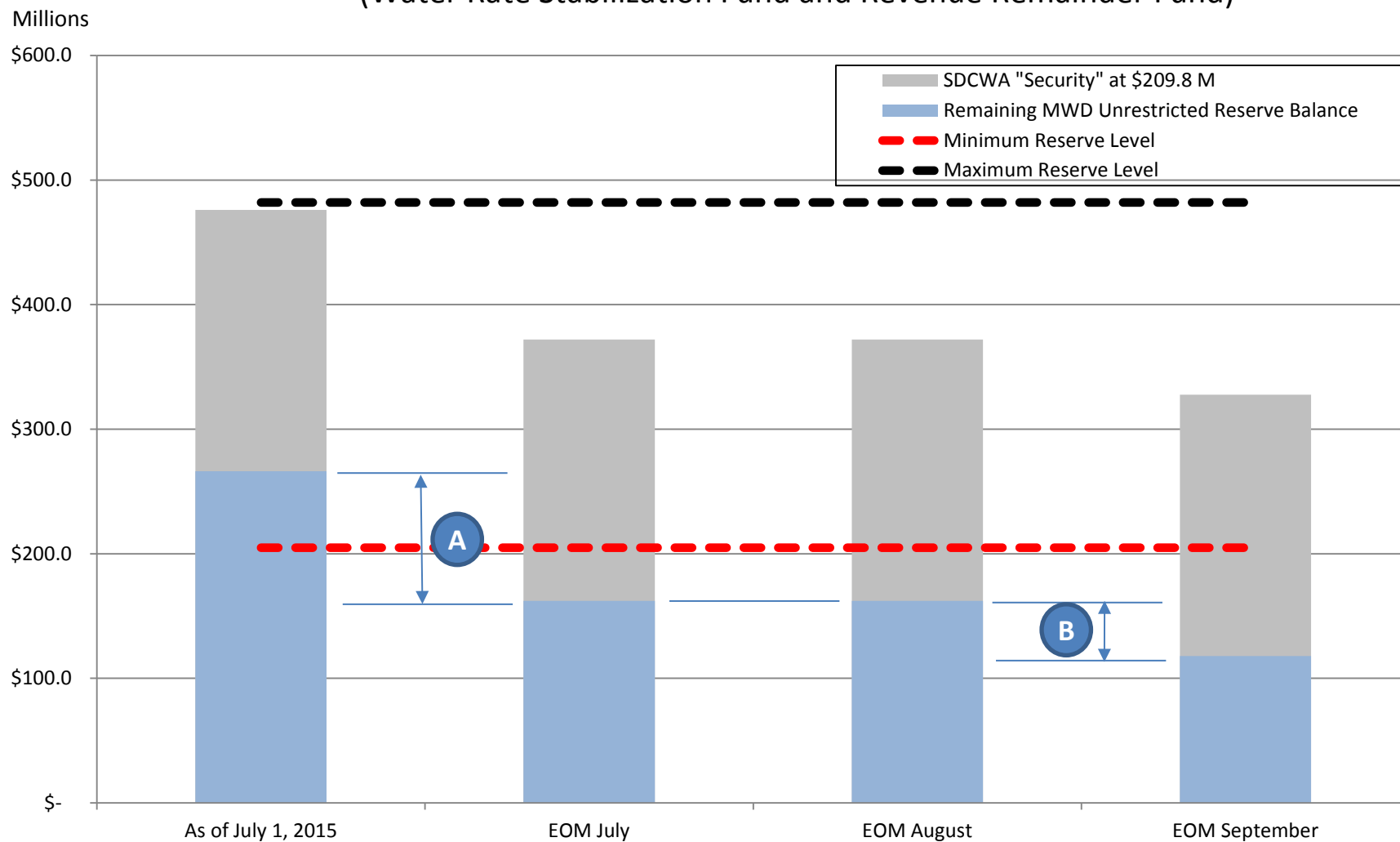
T. Michael Yuen, Clerk

By: 

DANIAL LEMIRE, Deputy Clerk

Unrestricted Reserves

(Water Rate Stabilization Fund and Revenue Remainder Fund)



A 07/14/15 - \$264 Million unbudgeted cash payment to acquire real property (\$104 million of which from unrestricted reserves).

B 09/22/15 - \$44.4 Million unbudgeted cash payment to Southern Nevada Water Authority



San Diego County Water Authority

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October 10, 2015

Randy Record and
Members of the Board of Directors
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

MEMBER AGENCIES

- Carlsbad Municipal Water District
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- South Bay Irrigation District
- Vallecitos Water District
- Valley Center Municipal Water District
- Vista Irrigation District
- Yuima Municipal Water District
- OTHER REPRESENTATIVE**
- County of San Diego

RE: Board Memo 8-1: Adopt Ordinance No. 149 determining that the interests of Metropolitan require the use of revenue bonds in the aggregate principal amount of \$500 million -- **OPPOSE**

Chair Record and Members of the Board:

We have reviewed Board Memo 8-1 asking the Board to adopt an ordinance determining that the interests of MWD require the use of revenue bonds in the aggregate principal amount of \$500 million to fund a portion of the Capital Investment Program (CIP) through June 30, 2018 and to "reimburse" MWD for capital projects it has already paid for since May 2015.ⁱ We oppose this item for the same reasons described in our letter in **OPPOSITION** to last month's board action to approve the introduction of this ordinance: namely, the board memo does not present an accurate factual basis for the MWD Board to make this determination. To the contrary, this action and other spending actions taken by the Board during the current "budget" cycle can be described as anything but consistent with sound financial practices and policies.

MWD management's budget strategy, approved by this board, of setting rates that it knows will collect revenues from water ratepayers that exceed expenses in seven out of 10 years, has led MWD to cumulatively collect \$824 million more than actual expenditures based on the board's adopted "budgets" since just 2012.ⁱⁱ The biennial budget for fiscal years 2015 and 2016, adopted by the Board 18-months ago, planned to cash finance all of the CIP contained in the biennial budget. The forecasted rate schedule included in the budget document in fact was based on cash financing a majority of the \$1,069.2 million of planned CIP from July 1, 2014 through June 30, 2018, with only \$45.2 million from revenue bonds. Now, more than half-way through the budget cycle, and having blown through more than \$800 million over budget, staff wants to increase debt for this period more than 10 times, ex post facto, to \$500 million.

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The Board memo attributes the need to incur this debt to the drought, and the fact that MWD's water sales and resulting revenues vary from year to year, as much as 30 percent over or under projections. Leaving aside the fact that drought (even severe drought) in Southern California should not come as a surprise to MWD, the solution is not to increase debt; it is to better manage revenues during "over" and "under" years. But MWD chooses not to do that. Rather than establish simple balancing accounts to manage revenues between high and low revenue years, staff has recommended, and this Board has approved massive expenditures outside of budget in good years, leaving MWD with insufficient revenues when they are needed. This practice is now leading MWD to do something it did not plan to do, and which its budget did not forecast: issue debt or raise rates higher than forecast. Board Memo 8-1 does not identify the real problem and does not propose an appropriate solution. MWD may very well need to issue additional bond funding for appropriate purposes at an appropriate time. But it is not credible to say that this action is in the interests of MWD unless the underlying financial policy issues are addressed.ⁱⁱⁱ

Most troubling, Board Memo 8-1 states that without this unplanned borrowing, MWD will either have to curtail capital projects (something the Board should at least consider), use additional reserves to fund capital costs (though such reserves do not exist) or increase water rates above forecasted levels. This is information that should have been provided to the Board earlier, when staff recommended, and the Board voted to approve unbudgeted expenditures of more than \$800 million. Now, having blown through all of its cash, staff is saying it needs to borrow money to avoid rate increases. This is fiscal madness.

Finally, Board Memo 8-1 contains language suggesting that staff believes that adoption of this ordinance will allow MWD to use debt to pay for things other than capital projects (bond proceeds may be used "even more broadly for the funding of 'any preliminary and incidental expenses...necessary or convenient to carry out the objects or purposes of the district'"). If this language suggests MWD may spend debt proceeds on operational expenses, we do not read Section 237 of the MWD Act relating to revenue bond purposes that way; rather, this language must be read in the context of Section 237 as a whole being related to the funding of capital projects and public works. We ask that staff clarify this point as part of the record of proceedings at our committee and board meetings.

We oppose this action. MWD needs a long-range finance plan. MWD needs to follow cost-of-service requirements of law. It needs to develop, adopt and – most critically -- follow its budgets. It is imperative that MWD get its fiscal house in order. Issuing this

debt now absent all of these other actions being taken by the Board is not in MWD's interests.

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
Director



Fern Steiner
Director



Yen C. Tu
Director

Attachment:

1. September 20, 2015 Water Authority letter to MWD Board RE Board Memo 8-6: Approve the introduction by title only of an Ordinance Determining that the Interests of the District require the use of Revenue Bonds in the aggregate principal amount of \$500,000,000 – OPPOSE

ⁱ It seems obvious that the issuance of debt is necessary in order for MWD to restore and meet its minimum cash reserve requirement. It is apparent from many actions over the past several months that MWD has engaged in a spending spree, with no cost-of-service basis for hundreds of millions of dollars of expenditures, completely disconnected from the two-year budget this Board approved in April 2014.

ⁱⁱ Of the \$824 million, \$741 million exceeded the agency's maximum reserve level.

ⁱⁱⁱ Board Memo 8-1 also states that the Board "has prudently established a reserve policy designed to deal with significant changed circumstances and buffer the impacts of weather, economy and demand volatility on MWD's revenues." If that were true, staff would not need to be asking to issue debt in order to restore its depleted cash reserves.



San Diego County Water Authority

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September 20, 2015

Randy Record and
Members of the Board of Directors
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

MEMBER AGENCIES

Carlsbad
Municipal Water District

City of Del Mar

City of Escondido

City of National City

City of Oceanside

City of Poway

City of San Diego

Fallbrook
Public Utility District

Helix Water District

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South Bay Irrigation District

Vallecitos Water District

Valley Center
Municipal Water District

Vista Irrigation District

Yuima
Municipal Water District

OTHER REPRESENTATIVE

County of San Diego

RE: Board Memo 8-6: Approve the introduction by title only of an Ordinance Determining That The Interests of The District Require The Use of Revenue Bonds In The Aggregate Principal Amount of \$500,000,000 -- **OPPOSE**

Chair Record and Members of the Board:

We have reviewed Board Memo 8-6 seeking the Board's approval for the introduction by title only of an ordinance determining that the interests of MWD require the use of revenue bonds in the aggregate principal amount of \$500 million. We oppose this item because there is no factual basis for a determination by the board of directors that the use of revenue bonds as described in Board Memo 8-6 and attached Ordinance is in MWD's interest. Consideration of whether the use of revenue bonds is in MWD's interest requires a more comprehensive look at a number of actions by the MWD board that are not described in the Board Memo and have had a material impact on MWD's current financial condition.

In April 2014, rather than reducing or maintaining its existing rates, MWD's adopted biennial budget for fiscal years 2015 and 2016 increased MWD's water rates by 1.5 percent per year for fiscal years 2015 and 2016 and presented a schedule projecting rate increases of 3 – 5 percent per year through 2024. In addition, the MWD board voted to suspend tax rate reductions that would otherwise occur, claiming that the increase in tax revenues by an additional tens of millions of dollars were necessary to maintain MWD's fiscal integrity. The MWD board made this finding based on staff recommendation at the same time its cash reserves were so great that the adopted budget planned to pay 100 percent of MWD's Capital Investment Plan for fiscal years 2015 and 2016 out of cash on hand (and then slowly eases to 60 percent cash CIP financing over the remaining years through 2024). Because MWD's recently adopted budget process no longer even attempts to estimate MWD's revenues and expenses based on actual conditions -- choosing instead to set rates based on low water sales that are expected to be exceeded seven out of ten years -- since 2012, MWD has collected \$800 million more than actual expenditures based on original adopted budgets. The MWD board chose to spend this money on unbudgeted expenditures,

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Chair Record and Members of the Board

September 20, 2015

Page 2

including the unprecedented increase in water conservation funding -- more than ten times the adopted budget -- from \$40 million to \$450 million including a hastily structured turf replacement program,ⁱ now all of these revenues have been spent.

MWD's use of revenue bonds would be entirely unnecessary if the MWD board adopted and followed sound fiscal policies and practices. MWD needs a long-range finance plan. MWD needs to complete the update of its Integrated Resources Plan. MWD needs a new rate structure consistent with California statutes and the Constitution. MWD needs to credibly demonstrate that these plans are functionally integrated.

The Water Authority will need more time to consider the implications of the proposed ordinance. We do not support introduction of the ordinance by title only. Lastly, Board memo 8-6 was not available with the regular board mailing. MWD's consistent late delivery of a majority of the board reports makes it extremely difficult for our staff to provide the technical support necessary for our deliberation of MWD staff recommendations. We renew past requests that board memoranda be distributed at least seven days in advance of MWD board meetings.

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
Director



Fern Steiner
Director



Yen C. Tu
Director

Attachment: Water Authority's July 9, 2015 letter to MWD Board

ⁱ MWD's turf replacement program was poorly structured and did not incorporate recommendations from a CUWCC report that it participated in and funded. Many have raised questions about MWD's implementation of turf replacement including the most recent LA Times article:
<http://touch.latimes.com/#section/-1/article/p2p-84445011/>



San Diego County Water Authority

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July 9, 2015

Randy Record and
Members of the Board of Directors
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

RE: Board Memo 8-4: Adopt a resolution for the reimbursement with bond proceeds of Capital Investment Plan projects funded from the General Fund and Replacement and Refurbishment Fund -- **OPPOSE**

Chair Record and Members of the Board:

The Water Authority's MWD Delegates have reviewed the July 14, 2015 board memo 8-4 seeking the Board's authorization to declare MWD's intent to issue up to \$300 million of debt to "reimburse" capital expenditures for projects funded from the General Fund and Replacement and Refurbishment (R&R) Fund. We oppose this item because staff's recommendation will obligate MWD to increase water rates by at least \$15 per acre-foot without an actual board vote for the rate increase, and for the reasons further stated in this letter.

Staff's practice of presenting board actions piecemeal has paralyzed the board's ability to make sound public policy decisions. This month's action is another example. The board memo states that the debt issuance would provide MWD the "financial flexibility" desired because of the projected draw down of reserves as a result of the May action to pay for the unbudgeted conservation programs,ⁱ and that "expenditures for water management activities such as replenishing storage and funding transfer and exchange programs could significantly [further] draw down financial reserves in the near future." But it was staff's own recommendation in May to spend \$350 million on unbudgeted conservation expenditures – namely turf removal -- that placed MWD in this precarious fiscal position. This situation was completely foreseeable.

The May action not only spent MWD's not-yet-realized excess revenue collection,ⁱⁱ it also completely drained the Water Management Fund (WMF) – established for the very purpose of covering future costs associated with replenishing storage and water transfers – to fund turf removal, an expense for which the WMF was not intended. Staff expressed no concern when it recommended to spend down the WMF. The Board was repeatedly told in May that

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City of Poway

City of San Diego

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OTHER REPRESENTATIVE

County of San Diego

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Chair Record and Members of the Board

July 9, 2015

Page 2

staff's recommendation would not result in any rate impacts. But this month's action, which was precipitated entirely by May's unbudgeted expenditures, will in fact result in increases in MWD water rates by at least \$15 per acre-foot. (MWD staff reported in the past that every \$20 million in debt issuance equates to \$1 per acre-foot increase in water rates based on 2 million acre-feet of water sales; the rate increase will be higher for lower water sales volumes.) What has changed so drastically that is causing staff to be so concerned with the lack of financial flexibility triggered by an action it recommended just only six weeks ago? Did staff not foresee when it made the recommendation to spend down the WMF in May that its "flexibility" to purchase transfer supplies and to replenish depleted dry-year storage accounts would be more limited?

We disagreed with staff's assessment in May that the increase in conservation funding would not result in rate impacts. However, we believe staff's assertion that the action would have no rate impact persuaded many Board members to support the unprecedented and unbudgeted spending. While this month's action clearly has rate implications, the board memo yet again makes no reference to the rate increases.

Since fiscal year 2012, MWD collected more than \$800 million in revenues that exceed actual expenses. And since 2013 and in each year following, these over-collections have caused MWD's reserves to exceed the Board established maximum limits by hundreds of millions of dollars -- largely caused by staff's strategy, endorsed by this Board's votes of approval -- to set rates based on artificially deflated sales amounts, which staff said would be exceeded seven out of 10 years.ⁱⁱⁱ Rather than using the over-collections to manage rate and tax increases, MWD kept and spent the monies on unbudgeted items.

Nearly as quickly as MWD amassed more than \$800 million in over-collected revenues, they are now nearly all gone, and MWD is resorting to budget shell games of taking cash from the capital investment plan to cover massive spending on turf removal. It is obvious that this proposal to issue \$300 million in new debt is a post-facto, 30-year debt financing of turf removal subsidies approved just weeks ago. This is not sound fiscal management.

When the biennial budget for fiscal years 2015 and 2016 was adopted, we asked that MWD use the revenue over-collection to reduce rate increases and not raise taxes, staff instead recommended using part of the over-collections to cash-fund capital projects to "avoid future rate increases." This month's 8-4 recommendation is an about-face from staff's earlier rationale in support of cash-funding the capital program.

Chair Record and Members of the Board

July 9, 2015

Page 3

Finally, MWD's Administrative Code (Section 5200(b)) clearly restricts the use of monies from the R&R Fund to capital program expenditures. It is unclear how staff's proposal to issue debt would afford MWD the ability to use R&R funds for operational costs related to water transfers or purchases of water to replenish storage.

For reasons stated in this letter, we oppose staff's recommendation. We urge our fellow Board members to vote no on this action as well. This action is an inappropriate attempt to debt-finance very expensive turf rebates that produce no significant immediate supply relief during the drought.

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
Director



Fern Steiner
Director



Yen C. Tu
Director

ⁱ MWD increased conservation spending in May by an additional \$350 million and was to be funded by the following sources: 1) Water Stewardship Fund (\$50 million), 2) Water Management Fund (\$140 million), and 3) projected excess revenue collection that exceeded maximum reserves target (\$160 million); however, board memo 9-1 this month indicates that the projected excess revenue collection is trending at \$120 million, requiring the use of \$40 million from Water Rate Stabilization Fund.

ⁱⁱ The May action authorized the expenditures of anticipated over-collection of \$160 million, which is trending now at \$120 million (see also footnote ii).

ⁱⁱⁱ Fiscal year 2016 is a good example; according to staff, MWD's water sales at the reduced Level 3 supply allocation (15 percent reduction) will still exceed the budgeted assumption of 1.75 million acre-feet.



San Diego County Water Authority

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September 20, 2015

Randy Record and
Members of the Board of Directors
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

MEMBER AGENCIES

- Carlsbad Municipal Water District
- City of Del Mar
- City of Escondido
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- Vista Irrigation District
- Yuima Municipal Water District

OTHER REPRESENTATIVE

- County of San Diego

RE: Board Memo 8-5: Express Support and Seek Amendments to S. 1894 (Feinstein, D-CA) – California Emergency Drought Relief Act of 2015 – **SUPPORT WITH MODIFICATIONS**

Chair Record and Members of the Board:

We write in response to Board Memo 8-5, asking the board to express support and seek amendments to Senator Feinstein’s S. 1894 – California Emergency Drought Relief Act of 2015. We have the following requests and comments.

At its August board meeting, the Water Authority board adopted a Support and Seek Amendments position on S. 1894. Specifically, the Water Authority has requested an amendment to include on the list of entities eligible for federal funding assistance for water recycling projects, the San Dieguito Water District and the San Elijo Joint Powers Authority. We request that MWD add this provision to the amendments it is requesting.

We are concerned with staff’s third bullet point recommendation to delete references to the need to “reduce reliance on imported water supplies.” Given that it is the express policy of the State of California to reduce reliance on the Delta in meeting California’s future water supply needs (Water Code Section 85021), we are concerned that this requested amendment sends the wrong message. We do not support and do not believe that MWD should request this amendment.

Subject to these changes, we support staff recommendation in Board Memo 8-5. On a separate note, Board Memo 8-5 was not available with the regular board mailing. MWD’s consistent late delivery of a majority of the board reports makes it extremely difficult for our staff to provide the technical support necessary for our deliberation of MWD staff recommendations. We renew past requests that board memoranda be distributed at least seven days in advance of MWD board meetings.

A public agency providing a safe and reliable water supply to the San Diego region

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
Director



Fern Steiner
Director



Yen C. Tu
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- OTHER REPRESENTATIVE**
- County of San Diego

RE: Board Memo 8-6: Approve the introduction by title only of an Ordinance Determining That The Interests of The District Require The Use of Revenue Bonds In The Aggregate Principal Amount of \$500,000,000 -- **OPPOSE**

Chair Record and Members of the Board:

We have reviewed Board Memo 8-6 seeking the Board’s approval for the introduction by title only of an ordinance determining that the interests of MWD require the use of revenue bonds in the aggregate principal amount of \$500 million. We oppose this item because there is no factual basis for a determination by the board of directors that the use of revenue bonds as described in Board Memo 8-6 and attached Ordinance is in MWD’s interest. Consideration of whether the use of revenue bonds is in MWD's interest requires a more comprehensive look at a number of actions by the MWD board that are not described in the Board Memo and have had a material impact on MWD's current financial condition.

In April 2014, rather than reducing or maintaining its existing rates , MWD’s adopted biennial budget for fiscal years 2015 and 2016 increased MWD's water rates by 1.5 percent per year for fiscal years 2015 and 2016 and presented a schedule projecting rate increases of 3 – 5 percent per year through 2024. In addition, the MWD board voted to suspend tax rate reductions that would otherwise occur, claiming that the increase in tax revenues by an additional tens of millions of dollars were necessary to maintain MWD's fiscal integrity. The MWD board made this finding based on staff recommendation at the same time its cash reserves were so great that the adopted budget planned to pay 100 percent of MWD's Capital Investment Plan for fiscal years 2015 and 2016 out of cash on hand (and then slowly eases to 60 percent cash CIP financing over the remaining years through 2024). Because MWD’s recently adopted budget process no longer even attempts to estimate MWD's revenues and expenses based on actual conditions -- choosing instead to set rates based on low water sales that are expected to be exceeded seven out of ten years -- since 2012, MWD has collected \$800 million more than actual expenditures based on original adopted budgets. The MWD board chose to spend this money on unbudgeted expenditures,

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including the unprecedented increase in water conservation funding -- more than ten times the adopted budget -- from \$40 million to \$450 million including a hastily structured turf replacement program,ⁱ now all of these revenues have been spent.

MWD's use of revenue bonds would be entirely unnecessary if the MWD board adopted and followed sound fiscal policies and practices. MWD needs a long-range finance plan. MWD needs to complete the update of its Integrated Resources Plan. MWD needs a new rate structure consistent with California statutes and the Constitution. MWD needs to credibly demonstrate that these plans are functionally integrated.

The Water Authority will need more time to consider the implications of the proposed ordinance. We do not support introduction of the ordinance by title only. Lastly, Board memo 8-6 was not available with the regular board mailing. MWD's consistent late delivery of a majority of the board reports makes it extremely difficult for our staff to provide the technical support necessary for our deliberation of MWD staff recommendations. We renew past requests that board memoranda be distributed at least seven days in advance of MWD board meetings.

Sincerely,



Michael T. Hogan
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Attachment: Water Authority's July 9, 2015 letter to MWD Board

ⁱ MWD's turf replacement program was poorly structured and did not incorporate recommendations from a CUWCC report that it participated in and funded. Many have raised questions about MWD's implementation of turf replacement including the most recent LA Times article:
<http://touch.latimes.com/#section/-1/article/p2p-84445011/>



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July 9, 2015

Randy Record and
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RE: Board Memo 8-4: Adopt a resolution for the reimbursement with bond proceeds of Capital Investment Plan projects funded from the General Fund and Replacement and Refurbishment Fund -- **OPPOSE**

Chair Record and Members of the Board:

The Water Authority's MWD Delegates have reviewed the July 14, 2015 board memo 8-4 seeking the Board's authorization to declare MWD's intent to issue up to \$300 million of debt to "reimburse" capital expenditures for projects funded from the General Fund and Replacement and Refurbishment (R&R) Fund. We oppose this item because staff's recommendation will obligate MWD to increase water rates by at least \$15 per acre-foot without an actual board vote for the rate increase, and for the reasons further stated in this letter.

Staff's practice of presenting board actions piecemeal has paralyzed the board's ability to make sound public policy decisions. This month's action is another example. The board memo states that the debt issuance would provide MWD the "financial flexibility" desired because of the projected draw down of reserves as a result of the May action to pay for the unbudgeted conservation programs,ⁱ and that "expenditures for water management activities such as replenishing storage and funding transfer and exchange programs could significantly [further] draw down financial reserves in the near future." But it was staff's own recommendation in May to spend \$350 million on unbudgeted conservation expenditures – namely turf removal -- that placed MWD in this precarious fiscal position. This situation was completely foreseeable.

The May action not only spent MWD's not-yet-realized excess revenue collection,ⁱⁱ it also completely drained the Water Management Fund (WMF) – established for the very purpose of covering future costs associated with replenishing storage and water transfers – to fund turf removal, an expense for which the WMF was not intended. Staff expressed no concern when it recommended to spend down the WMF. The Board was repeatedly told in May that

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OTHER REPRESENTATIVE

County of San Diego

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Chair Record and Members of the Board

July 9, 2015

Page 2

staff's recommendation would not result in any rate impacts. But this month's action, which was precipitated entirely by May's unbudgeted expenditures, will in fact result in increases in MWD water rates by at least \$15 per acre-foot. (MWD staff reported in the past that every \$20 million in debt issuance equates to \$1 per acre-foot increase in water rates based on 2 million acre-feet of water sales; the rate increase will be higher for lower water sales volumes.) What has changed so drastically that is causing staff to be so concerned with the lack of financial flexibility triggered by an action it recommended just only six weeks ago? Did staff not foresee when it made the recommendation to spend down the WMF in May that its "flexibility" to purchase transfer supplies and to replenish depleted dry-year storage accounts would be more limited?

We disagreed with staff's assessment in May that the increase in conservation funding would not result in rate impacts. However, we believe staff's assertion that the action would have no rate impact persuaded many Board members to support the unprecedented and unbudgeted spending. While this month's action clearly has rate implications, the board memo yet again makes no reference to the rate increases.

Since fiscal year 2012, MWD collected more than \$800 million in revenues that exceed actual expenses. And since 2013 and in each year following, these over-collections have caused MWD's reserves to exceed the Board established maximum limits by hundreds of millions of dollars -- largely caused by staff's strategy, endorsed by this Board's votes of approval -- to set rates based on artificially deflated sales amounts, which staff said would be exceeded seven out of 10 years.ⁱⁱⁱ Rather than using the over-collections to manage rate and tax increases, MWD kept and spent the monies on unbudgeted items.

Nearly as quickly as MWD amassed more than \$800 million in over-collected revenues, they are now nearly all gone, and MWD is resorting to budget shell games of taking cash from the capital investment plan to cover massive spending on turf removal. It is obvious that this proposal to issue \$300 million in new debt is a post-facto, 30-year debt financing of turf removal subsidies approved just weeks ago. This is not sound fiscal management.

When the biennial budget for fiscal years 2015 and 2016 was adopted, we asked that MWD use the revenue over-collection to reduce rate increases and not raise taxes, staff instead recommended using part of the over-collections to cash-fund capital projects to "avoid future rate increases." This month's 8-4 recommendation is an about-face from staff's earlier rationale in support of cash-funding the capital program.

Chair Record and Members of the Board

July 9, 2015

Page 3

Finally, MWD's Administrative Code (Section 5200(b)) clearly restricts the use of monies from the R&R Fund to capital program expenditures. It is unclear how staff's proposal to issue debt would afford MWD the ability to use R&R funds for operational costs related to water transfers or purchases of water to replenish storage.

For reasons stated in this letter, we oppose staff's recommendation. We urge our fellow Board members to vote no on this action as well. This action is an inappropriate attempt to debt-finance very expensive turf rebates that produce no significant immediate supply relief during the drought.

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
Director



Fern Steiner
Director



Yen C. Tu
Director

ⁱ MWD increased conservation spending in May by an additional \$350 million and was to be funded by the following sources: 1) Water Stewardship Fund (\$50 million), 2) Water Management Fund (\$140 million), and 3) projected excess revenue collection that exceeded maximum reserves target (\$160 million); however, board memo 9-1 this month indicates that the projected excess revenue collection is trending at \$120 million, requiring the use of \$40 million from Water Rate Stabilization Fund.

ⁱⁱ The May action authorized the expenditures of anticipated over-collection of \$160 million, which is trending now at \$120 million (see also footnote ii).

ⁱⁱⁱ Fiscal year 2016 is a good example; according to staff, MWD's water sales at the reduced Level 3 supply allocation (15 percent reduction) will still exceed the budgeted assumption of 1.75 million acre-feet.



San Diego County Water Authority

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August 16, 2015

Randy Record and
Members of the Board of Directors
Metropolitan Water District of Southern California
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Los Angeles, CA 90054-0153

MEMBER AGENCIES

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- Yuima Municipal Water District
- OTHER REPRESENTATIVE**
- County of San Diego

RE: Board Memo 8-3 - Authorize Amendment to the California Agreement for the Creation and Delivery of Extraordinary Conservation Intentionally Created Surplus - **OPPOSE**

Dear Chairman Record and Board Members,

For the reasons described in the attached letter dated August 15, 2015 to Marcia Scully, we **OPPOSE** staff's recommendation to authorize amendment to the above agreement.

We would very much like to support MWD's efforts to obtain additional water supplies to meet the current severe water supply challenges it faces. However, for the reasons stated in the letter from our special counsel we cannot do so until the issues noted in the letter are addressed.

Sincerely,

Michael T. Hogan
Director

Keith Lewinger
Director

Fern Steiner
Director

Yen C. Tu
Director

Attachment:
Brad Herrema Letter to Marcia Scully dated August 16, 2015

cc: Jeff Kightlinger, MWD General Manager
San Diego County Water Authority Board of Directors

August 16, 2015

Bradley J. Herrema
Attorney at Law
805.882.1493 tel
805.965.4333 fax
BHerrema@bhfs.comMarcia Scully, General Counsel
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0513

RE: Water Planning and Stewardship Committee Board Memo 8-3 (Authorize Amendment to the California Agreement for the Creation and Delivery of Extraordinary Conservation Intentionally Created Surplus)

Dear Ms. Scully:

Regarding the above Committee Meeting and Board Meeting scheduled for next Monday and Tuesday, respectively, Board Memo 8-3 requests authorization to amend the 2007 California Agreement for the Creation and Delivery of Extraordinary Conservation Intentionally Created Surplus ("ICS Agreement"), to increase the maximum amount of conserved water that the IID may store in Metropolitan Water District of Southern California's (MWD) facilities for a three-year term (Amendment). The Amendment would expand the mechanisms through which IID might generate water to be stored as ICS within MWD's facilities to include not only fallowing, but also on-farm and system conservation improvements. The Board Memo also states that, "utilization of this additional storage by IID would provide [MWD] access to additional water during the ongoing California Drought."

Under section 3.2 of the IID/SDCWA Agreement for Transfer of Conserved Water (IID/SDCWA Transfer Agreement), during Agreement Years 1 through 18, the Water Authority holds a right of first refusal (ROFR) to any transfer by IID of Additional Available Water. (See my May 12, 2015 letter to Ross Simmons, Esq., for further discussion of the ROFR.) Thus, SDCWA's ROFR attaches to the water proposed to be conserved by IID and made available for MWD's use under the proposed Amendment.

The Water Authority's consent to the earlier action taken by the IID Board of Directors on April 29, 2015 in regard to additional conservation during 2014-15 did not, and does not constitute a waiver by the Water Authority of its rights under the IID/SDCWA Transfer Agreement or its ability to exercise its ROFR as to this subsequently conserved water. Rather, the Water Authority's past correspondence on this issue should be understood by IID and by MWD as a continuing objection to IID's transfer of Additional Available Water without the consent of the Water Authority.

Subject to your acknowledgement of the Water Authority's ROFR, and in the interest of helping MWD meet the current severe water supply challenges it faces, the Water Authority is willing to consider giving its consent to the transfer of this Additional Available Water and proposed Amendment. However, SDCWA is concerned that MWD has not sufficiently considered the potential environmental impacts of the proposed action and that approval of the Amendment likely requires compliance with the California Environmental Quality Act (CEQA) by analyzing the impacts of this Agreement on the Salton Sea. Although Board Memo 8-3 states that, "***IID would be responsible for and would defend and indemnify Metropolitan from any claim or liability associated with the Salton Sea from this action,***" that is not a sufficient basis for the

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main 310.500.4600

Marcia Scully
August 16, 2015
Page 2

MWD Board to approve the Amendment based on the CEQA determination for Option #1 as described in Board Memo 8-3.

The Board Memo's proposed CEQA determination, should the Board approve the Amendment, is that the Amendment is exempt from CEQA and identifies three Guidelines sections that cover the Amendment. The Board Memo states that the Amendment is not defined as a project under CEQA because it involves continuing administrative activities (Section 15378(b)(2) of the State CEQA Guidelines). The Board Memo additionally states that the proposed action qualifies for a Class 1 categorical exemption from the provisions of CEQA because the Amendment is associated with operating existing public water conveyance facilities with negligible or no expansion of use and no possibility of significantly impacting the physical environment, and the general rule that CEQA applies only to projects with the potential for causing significant effects (Section 15301 and 15061 (b)(3) of the State CEQA Guidelines).

SDCWA is concerned that Guidelines sections 15378(b)(2) and 15301 do not appear to apply to MWD's proposed action, as the potential environmental impacts of concern do not arise solely from the use of existing facilities but the potential impacts on the environment of creating the conserved water to be stored in these facilities, particularly upon the Salton Sea. Guidelines section 15061(b)(3) would not appear to apply either because it can be relied on only if "it can be seen **with certainty** that there is **no possibility** that the activity in question may have a significant impact on the environment...." (emphasis added). Such a determination must be supported with evidence, which the Board Memo does not identify. Without this evidence, a Court could not make the required evidentiary findings confirming the application of the claimed exemptions.

Moreover, the Board Memo's finding as to a certainty of no possibility of significant environmental impacts is puzzling and would appear to be unsupported, given that the QSA project EIRs found that the conservation mechanism of fallowing was found to have fewer impacts on the Salton Sea than on farm and system conservation improvements. That is why the State Board Order approving the QSA transfers required the use of fallowing in the first 15 years of the QSA project. In light of this, it does not seem likely that the Board Memo conclusion that it is certain that there is no possibility that the Amendment may have a significant impact on the environment can be supported with substantial evidence.

Further, the Board Memo does not discuss, as required, that the exemption is not barred by one of the exceptions in section 15300.2. As MWD must consider "evidence in its files of potentially significant effects" (*Berkeley Hillside Preservation v. City of Berkeley* (2015) 60 Cal.4th 1086, 1103), given its extensive knowledge of the prior environmental analyses supporting IID's transfer supporting conservation activities, it does not seem that MWD could make such a finding.

The Water Authority cannot and will not consent to the transfer and proposed Amendment unless IID and MWD address the impacts to the Salton Sea resulting from decreased inflows to the Salton Sea and plans for mitigation of those impacts. (See Interim Guidelines for Operation of Lake Mead and Lake Powell, § 3.B [creation of ICS is "subject to such environmental compliance as may be required."]).

Given the concerns that IID has expressed in multiple forums – including its petition to the State Water Resources Control Board, before the Little Hoover Commission and at the QSA-JPA – regarding air quality impacts related to the decline of the Salton Sea, it is imperative that IID and MWD identify the mitigation proposed for the transfer and Amendment that will certainly further exacerbate the projected recession of the Sea's shoreline. As noted above, Board Memo 8-3 indicates that, as part of the proposed Amendment, "IID would be responsible for and indemnify [MWD] from any claim or liability associated with the Salton Sea from this action." Given the possibility of impacts to the Salton Sea discussed above, it must also be demonstrated that the proposed transfer and Amendment will not affect the financial or direct mitigation obligations of the QSA-JPA.

Marcia Scully
August 16, 2015
Page 3

We look forward to working cooperatively with all parties to improve water supply reliability during the drought, provided that these important issues are addressed. A copy of my letter of today's date to counsel for IID is enclosed. Hopefully, some progress will be made at our upcoming meeting to that these issues may be addressed to all parties' mutual satisfaction.

Please contact me if you have any questions.

Sincerely,



Bradley J. Herrema

cc: Maureen A. Stapleton
Dan Denham
Terry Fulp
Paul Matuska
Chuck Bonham
Curt Tauscher
Kevin Kelley
Tina Shields
Charles DuMars
Jeffrey Kightlinger
Bill Hasencamp
Jim Barrett
Robert Chang

August 16, 2015

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Ms. Joanna Smith Hoff, Counsel
Imperial Irrigation District
P.O. Box 937
Imperial, CA 92251

RE: Water Planning and Stewardship Committee Board Memo 8-3 (Authorize Amendment to the California Agreement for the Creation and Delivery of Extraordinary Conservation Intentionally Created Surplus)

Dear Ms. Hoff:

Enclosed is a copy of my letter to Marcia Scully of today's date, regarding the above item.

As the Water Authority has stated in its letters of May 21 and July 10, 2015, it looks forward to the opportunity to have further discussions with IID regarding opportunities to promote flexibility and facilitate implementation of the Transfer Agreement. To this end, we look forward to meeting with you on September 2, 2015. Given the timing of MWD's board meeting and request for board approval of Board Memo 8-3, the Water Authority had no alternative but to object to the board action for the reasons stated. We hope that all issues may ultimately be addressed to all parties' mutual satisfaction.

Sincerely,



Bradley J. Herrema

cc: Kevin Kelley
Tina Shields
Charles DuMars
Maureen A. Stapleton
Dan Denham
Terry Fulp
Paul Matuska
Chuck Bonham
Curt Tauscher
Jeffrey Kightlinger
Marcia Scully
Bill Hasencamp
Jim Barrett
Robert Chang



San Diego County Water Authority

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August 15, 2015

Randy Record and
Members of the Board of Directors
Metropolitan Water District of Southern California
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Los Angeles, CA 90054-0153

MEMBER AGENCIES

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- OTHER REPRESENTATIVE**
- County of San Diego

RE: Board Memo 5G-2 - Adopt (1) the resolution finding that continuing an ad valorem tax rate at the rate levied for fiscal year 2013/14 is essential to Metropolitan's fiscal integrity; and (2) the resolution establishing the tax rate for fiscal year 2014/15 - OPPOSE OPTION 1

Dear Chair Record and Board Members,

We have reviewed Board Memo 5G-2 and OPPOSE the action recommended to be adopted by the Board of Directors (i.e., to suspend the tax limitation of Section 124.5, thereby increasing the amount of property tax revenue to be collected by MWD). We have stated our objections previously, each time MWD has proposed to suspend the property tax rate limitations imposed by the Legislature, now embodied in Section 124.5 of the MWD Act. Copies of our May 14, June 5 and August 16, 2013 letters are attached for your ease of reference (Attachment 1). We SUPPORT adoption of OPTION 2 as described at page one of the Board Memorandum.

We OPPOSE the action recommended by staff because MWD has failed to make the requisite factual showing that additional tax revenues are "essential to the fiscal integrity of the District." Such a finding would be impossible to make given that MWD has collected almost \$800 million more than necessary to pay the actual expense items included in its adopted budgets over the past three years (even with this spending, MWD still has substantial cash reserves that are nearly at the maximum level prescribed by the Board of Directors). The fact that the MWD board later chose to spend this rate revenue on unbudgeted expenditures does not change the fact that these revenues were available to the District and therefore the collection of higher taxes was not, and is not necessary, let alone "essential" to the fiscal integrity of the district.

MWD has also failed to show why the other fixed revenue options it has available, such as the Readiness-to-Serve charge and benefit assessments, are not feasible. Indeed, it is clear from the legislative history of SB 1445 that the Legislature intended that MWD would use

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these alternatives in lieu of property taxes. See April 21, 1988 Memorandum from MWD's General Counsel to the Subcommittee on Financial Policy (Attachment 2).

Board Memorandum 5G-2 is incorrect when it states that MWD's fixed costs, particularly its fixed State Water Contract obligations, are increasing "in ways unforeseen by the Legislature in 1984" (Board Memorandum 5G-2, last paragraph at page 4). To the contrary, MWD's own Report to the California Legislature in Response to AB 322 (March 1984), clearly identified that fixed costs of the State Water Project were expected to increase dramatically (excerpts from the Report - Figures 18 and 19 - are included as Attachment 3).

We also OPPOSE staff recommendation because MWD has failed to provide the public with sufficient information to have a reasonable opportunity to be heard at the public hearing, as required by Section 124.5. The Board meeting agenda does not even reference the related Committee agenda item. Even if the Board Memorandum is located by a member of the public, it asks them to cull through all of the financial information appearing on MWD's web site, rather than providing an analysis of MWD's current financial condition, demonstrating that increased tax revenues are "essential" to its fiscal integrity within the meaning of the statute passed by the Legislature and signed into law (SB 1445).

MWD needs a long-range finance plan to address how it will pay for current and anticipated costs of the State Water Project. Revenues from property taxes – as one source of revenues, fixed or otherwise – should be considered and discussed by the board in the broader context of a plan to ensure MWD's long-term fiscal sustainability. Taking action, one year at a time, to increase property tax revenues without a comprehensive long-term fiscal strategy and plan does little to assure the public and our ratepayers that MWD is a fiscally prudent and sustainable agency. We would welcome the opportunity to have that dialogue.

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
Director



Fern Steiner
Director



Yen C. Tu
Director

Attachments:

1. Water Authority's Letters to MWD Board (May 14, June 5 and August 16, 2013)
2. Memorandum from MWD's General Counsel to the Subcommittee on Financial Policy (April 21, 1988)
3. MWD Report to California Legislature in Response to AB 322, excerpts - Figures 18 and 19 (March 1984)



San Diego County Water Authority

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May 14, 2013

John (Jack) V. Foley and
 Members of the Board of Directors
 Metropolitan Water District of Southern California
 P.O. Box 54153
 Los Angeles, CA 90054-0153

MEMBER AGENCIES

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 Santa Fe Irrigation District
 South Bay Irrigation District
 Vallecitos Water District
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 Municipal Water District

OTHER REPRESENTATIVE
 County of San Diego

RE: Board Memo 8-1 – Set public hearing to consider suspending Section 124.5 of the Metropolitan Water District Act to maintain the current ad valorem tax rate

Dear Chairman Foley and Members of the Board,

We have reviewed Board Memo 8-1 as well as the Legislative History of SB 1445 (Presley), now embodied in Section 124.5 of the MWD Act. While we support having a long term financing plan to increase MWD's fixed revenues in a manner which is proportional to benefits received by its member agencies, we are troubled by the ad hoc nature of staff's recommendation to schedule a public hearing to suspend tax limitations on the grounds that such action is "essential to the fiscal integrity of the district" this year. It is particularly difficult to understand the justification for taking this action at the same time MWD is, through its water rates and charges, already collecting hundreds of millions of dollars of revenues far in excess of its actual costs of service. Suspending the tax limitation, in isolation -- without addressing all of MWD's financial policies, rates, revenues and expenses -- will only exacerbate the over-collection of revenues in FY 2014 beyond what is necessary to meet the agency's expenses.

While ad valorem taxes may be an important tool over the long term for ensuring that the cost of MWD's services are shared proportionally by all of those who benefit, Board Memo 8-1 fails to mention other statutory and Constitutional requirements MWD's rates and charges must meet, including but not limited to compliance with Proposition 26. MWD is legally required to align the costs that it incurs with the services it provides. Developing a plan to pay for additional State Water Project costs must be part of that process. A one-year suspension of the limitation on the ad valorem tax rate is not a panacea for the hard work and changes that will be needed so that MWD has the funds it needs to pay its future costs from rates that truly represent a fair distribution of its costs.

As noted in our letter commenting on the draft Appendix A, we are concerned what the public perception will be of MWD declaring that these ad valorem taxes are "essential to the

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Chairman Foley and Members of the Board

May 14, 2013

Page 2

fiscal integrity of the district.” Read in the context of the Legislative History of SB 1445, we doubt this is the kind of situation the Legislature envisioned in establishing the limitations of Section 124.5.

Rather than set a public hearing to suspend the tax limitations for one year, we would like to suggest that the board of directors use this time to establish a Fiscal Sustainability Task Force to update MWD’s Long Range Finance Plan. The plan would take into account all of MWD’s liabilities, and facilities and resource needs and align them to rates and charges including fixed cost recovery that will be proportional to the benefits its member agencies desire and for which they are willing to pay.

Sincerely,



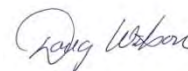
Keith Lewinger
Director



Vincent Mudd
Director



Fern Steiner
Director



Doug Wilson
Director

cc: Jeff Kightlinger, MWD General Manager
San Diego County Water Authority Board of Directors and Member Agencies



San Diego County Water Authority

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June 5, 2013

John (Jack) V. Foley and
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 Metropolitan Water District of Southern California
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OTHER REPRESENTATIVE

County of San Diego

June 5, 2013

RE: Board Memo 8-1 – Mid-cycle Biennial Budget Review and Recommendation for Use of Reserves over Target Water Rate Increases – OPPOSE AND REQUEST FOR REFUND TO RATEPAYERS OF EXCESS RESERVES

Board Memo 8-2 – Suspend the tax rate limitations in Section 124.5 of the Metropolitan Water District Act to maintain the ad valorem tax rate for fiscal year 2013/14 – OPPOSE

Dear Chairman Foley and Board Members:

In April 2012, this Board voted to raise water rates by 5% for 2013 and 2014 based on the staff's report that limiting water rate increases to no more than 3% would leave MWD unable to pay for critical infrastructure needs on the Colorado River Aqueduct. At that time, MWD staff also represented that the rate increases were based on maintaining reserve levels from 2012 through 2017 at, or close to the board-adopted minimum target.

As in past years, MWD's estimations of water sales and actual expenditures have proven to be materially different than assumed for budget and rate-setting purposes. Far from being unable to pay for critical infrastructure, MWD ended fiscal year 2012 – less than three months after adopting rates -- with an extra \$97 million to add to its reserves. According to this month's board report, MWD will, before it ends fiscal year 2013 at the end of this month, add another \$217 million to its unrestricted reserves, causing the reserves to exceed the maximum limit by \$75 million. ***In less than 15 months, MWD has collected \$314 million more than needed to pay 100% of its budgeted expenditures.***

Many of the cities we serve are struggling with their own budgets to make ends meet and pay for critical infrastructure. Many of the ratepayers we serve are also struggling to make ends meet during a period of lower incomes and escalating costs. We owe it to our cities and ratepayers to be better stewards of the precious dollars water ratepayers entrust to us when they pay their water bills. We once again call on this Board to establish a ***Fiscal Sustainability Task Force*** to develop a long-range finance plan and accounting, budget, and rate-setting protocols to ensure that every dollar MWD collects is used for its intended purpose, and, that MWD does not collect more money than it really needs.

Chairman Foley and Members of the Board
 June 5, 2013
 Page 2

In the meantime, we call on the board to **REFUND the \$75 million in excess reserves**, rather than shift this money to unplanned, unbudgeted expenditures. Attachment 1 to this letter shows approximately¹ how much MWD could refund to each of its member agencies. We also once again call on the Board to act now to **REDUCE the planned water rate increase for 2014 from 5% to 3%**. Reliance on budget estimates proven to be materially incorrect is unwarranted in the face of the actual facts.

For the same reason, we **OPPOSE Board Memo 8-2 proposing to suspend the tax rate limitations** in Section 124.5 of the MWD Act. We have reviewed the legislative history of SB 1445. We disagree that it was “meant to increase Metropolitan’s financial flexibility.” The clear purpose of the legislation was to limit the imposition of future taxes by MWD, with the ultimate goal that the tax be eliminated. The Legislature instead provided different tools to allow MWD to cover its fixed costs including standby or readiness-to-serve charges and benefit assessments, as clearly acknowledged in the Board Memo. The fact that MWD has failed to better utilize these and other tools as part of a long-range plan to cover its fixed costs does not translate to a need for higher taxes.

MWD cannot credibly claim that additional tax revenues of \$4.4 million are “essential to the fiscal integrity of the District” at the very same time it has amassed \$549 million in unrestricted cash reserves, exceeding the projected reserve levels forecasted in the adopted biennial budget (\$220.8 million)² by \$328.2 million, and surpassing the board-adopted maximum reserve target by \$75 million. This issue should also be addressed as part of a long-range finance planning process in which all long term costs and sources of revenue may be considered, rather than the ad hoc decision-making that is being presented to this board.

Finally, there is no factual support for the statements in Board Memo 8-2 that the imposition of a tax increase is necessary to “preserve equity across member agencies” or that MWD’s current rates and charges have been assessed in a manner designed to reflect equity or the actual costs of the services MWD provides. While we support the fiscal objectives as described – balance between fixed costs and fixed revenues and equity across member agencies – we do not agree that the way to achieve this is to suspend the tax limitation for one year. Instead, MWD should conduct a cost-of-service study as part of a long-range financial planning process in order to ensure accomplishment of these important objectives.

Sincerely,



Keith Lewinger
 Director



Vincent Mudd
 Director



Fern Steiner
 Director

Attachment 1: Estimated refund of MWD over-collection

Attachment 2: Comparison of MWD reserves forecast

cc: Jeffrey Kightlinger
 San Diego County Water Authority Board of Directors

¹ Based on 11 months (July 2012 through May 2013) of member agencies’ payment of rates and charges (data source: MWD WINS).

² Attachment 2 to this letter shows MWD’s projected reserves when the budget was adopted in April 2012 compared to reserves projected in April 2013 (data source: MWD PowerPoint dated 4/8/2013)

Estimated Refund of MWD Over-Collection

Fiscal Year 2013*			
MWD Member Agency	Total Contribution Rates and Charges (07/12 - 06/13)	Total Contribution (in %)	\$ 75,000,000
Anaheim	\$ 14,178,498.33	1.13%	\$ 847,769
Beverly Hills	\$ 9,133,714.68	0.73%	\$ 546,129
Burbank	\$ 9,864,635.91	0.79%	\$ 589,832
Calleguas	\$ 87,186,626.45	6.95%	\$ 5,213,115
Central Basin	\$ 28,231,187.87	2.25%	\$ 1,688,016
Compton	\$ 1,364,481.90	0.11%	\$ 81,586
Eastern	\$ 71,031,751.96	5.66%	\$ 4,247,173
Foothill	\$ 6,603,113.95	0.53%	\$ 394,817
Fullerton	\$ 7,611,689.48	0.61%	\$ 455,123
Glendale	\$ 14,894,768.04	1.19%	\$ 890,597
Inland Empire	\$ 30,355,607.00	2.42%	\$ 1,815,041
Las Virgenes	\$ 18,087,663.81	1.44%	\$ 1,081,508
Long Beach	\$ 25,055,739.11	2.00%	\$ 1,498,148
Los Angeles	\$ 261,368,067.87	20.84%	\$ 15,627,876
MWDOC	\$ 149,249,392.78	11.90%	\$ 8,924,009
Pasadena	\$ 14,646,995.66	1.17%	\$ 875,782
San Diego	\$ 273,850,600.54	21.83%	\$ 16,374,239
San Fernando	\$ 72,742.55	0.01%	\$ 4,349
San Marino	\$ 615,129.24	0.05%	\$ 36,780
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Torrance	\$ 13,646,271.90	1.09%	\$ 815,946
Upper San Gabriel	\$ 8,975,149.06	0.72%	\$ 536,647
West Basin	\$ 94,668,219.86	7.55%	\$ 5,660,459
Western	\$ 51,409,167.96	4.10%	\$ 3,073,888
Total	\$ 1,254,335,822.76	100.00%	\$ 75,000,000

Note: Totals may not foot due to rounding

*Based on 11 months (July 2012 through May 2013) of member agencies' payment of rates and charges (data source: MWD WINS, June 5, 2013)

FY2013 & FY2014 Budget



Avg Rate Increase	6%	14%	20%	7.5%	7.5%	5%	5%	← 3% to 5% →		
Sales, MAF	2.3	2.2	1.8	1.7	1.7	1.7	1.7	1.75	1.75	1.75
PAYGO, \$M	43	30	37	45	45	55	125	125	125	125
Rev. Bond Cvg	1.8	1.8	1.6	1.5	1.5	1.6	1.9	1.9	2.0	2.0
Fixed Chg Cvg	1.3	1.3	1.1	1.0	1.1	1.2	1.3	1.3	1.3	1.3

* Includes Water Stewardship Fund
 FY2013 and beyond are based on modified accrual

Updated Forecast



Avg Rate Increase	6%	14%	20%	7.5%	7.5%	5%	5%	3%	3%	3%
Sales, MAF	2.3	2.2	1.8	1.7	1.7	1.8	1.7	1.75	1.75	1.75
PAYGO, \$M	43	30	37	45	45	55	125	125	125	125
Rev. Bond Cvg	1.8	1.8	1.6	1.5	1.8	2.2	1.9	2.1	2.0	2.1
Fixed Chg Cvg	1.3	1.3	1.1	1.0	1.3	1.7	1.3	1.4	1.4	1.4

* Includes Water Stewardship Fund
 FY2013 and beyond are based on modified accrual



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

August 16, 2013

John (Jack) V. Foley and
Members of the Board of Directors
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

MEMBER AGENCIES

- Carlsbad Municipal Water District
- City of Del Mar
- City of Escondido
- City of National City
- City of Oceanside
- City of Poway
- City of San Diego
- Fallbrook Public Utility District
- Helix Water District
- Lakeside Water District
- Olivenhain Municipal Water District
- Otay Water District
- Padre Dam Municipal Water District
- Camp Pendleton Marine Corps Base
- Rainbow Municipal Water District
- Ramona Municipal Water District
- Rincon del Diablo Municipal Water District
- San Dieguito Water District
- Santa Fe Irrigation District
- South Bay Irrigation District
- Vallecitos Water District
- Valley Center Municipal Water District
- Vista Irrigation District
- Yuima Municipal Water District

RE: Board Memo 5G-2: Adopt resolution maintaining the tax rate for fiscal year 2013/14 – OPPOSE

Dear Chairman Foley:

For the reasons set forth in our letter to you dated June 5, 2013 (copy attached), we OPPOSE the proposed board action to adopt a resolution maintaining the tax rate for fiscal year 2013/14. Among other things, it is clear that this action is not “essential to the fiscal integrity of the District,” at a time when MWD has amassed hundreds of millions of dollars by overcharging ratepayers utility rates that greatly exceed the costs of the services MWD is providing.

MWD has filed a motion for judgment on the pleadings in the Water Authority’s litigation challenging its rates, on the grounds that the Constitutional limitations of Proposition 26 do not apply to MWD; that motion is scheduled to be heard September 18. Should MWD not prevail on the motion, we hope that the board of directors will immediately direct staff to conduct a cost-of-service study as part of a long-range financial planning process. This is the right way to ensure accomplishment of the board’s objectives, in a manner that is consistent with the legal requirement that MWD charge no more than the proportionate cost of the services it provides to its member agencies. This ad hoc action to suspend the tax rate limitations in Section 124.5 of the MWD Act for one year is unwarranted, and does nothing to address the long-term fiscal challenges confronting MWD.

Sincerely,

Keith Lewinger
Director

Vincent Mudd
Director

Fern Steiner
Director

OTHER REPRESENTATIVE

County of San Diego

Attachment: Water Authority letter to MWD on MWD June 2013 actions re 8-1 and 8-2, dated June 5, 2013

A public agency providing a safe and reliable water supply to the San Diego region



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

June 5, 2013

John (Jack) V. Foley and
Members of the Board of Directors
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

MEMBER AGENCIES

Carlsbad
Municipal Water District

City of Del Mar

City of Escondido

City of National City

City of Oceanside

City of Poway

City of San Diego

Fallbrook
Public Utility District

Helix Water District

Lakeside Water District

Olivenhain
Municipal Water District

Otay Water District

Padre Dam
Municipal Water District

Camp Pendleton
Marine Corps Base

Rainbow
Municipal Water District

Ramona
Municipal Water District

Rincon del Diablo
Municipal Water District

San Dieguito Water District

Santa Fe Irrigation District

South Bay Irrigation District

Vallecitos Water District

Valley Center
Municipal Water District

Vista Irrigation District

Yuima
Municipal Water District

OTHER REPRESENTATIVE

County of San Diego

June 5, 2013

RE: Board Memo 8-1 – Mid-cycle Biennial Budget Review and Recommendation for Use of Reserves over Target Water Rate Increases – OPPOSE AND REQUEST FOR REFUND TO RATEPAYERS OF EXCESS RESERVES

Board Memo 8-2 – Suspend the tax rate limitations in Section 124.5 of the Metropolitan Water District Act to maintain the ad valorem tax rate for fiscal year 2013/14 – OPPOSE

Dear Chairman Foley and Board Members:

In April 2012, this Board voted to raise water rates by 5% for 2013 and 2014 based on the staff's report that limiting water rate increases to no more than 3% would leave MWD unable to pay for critical infrastructure needs on the Colorado River Aqueduct. At that time, MWD staff also represented that the rate increases were based on maintaining reserve levels from 2012 through 2017 at, or close to the board-adopted minimum target.

As in past years, MWD's estimations of water sales and actual expenditures have proven to be materially different than assumed for budget and rate-setting purposes. Far from being unable to pay for critical infrastructure, MWD ended fiscal year 2012 – less than three months after adopting rates -- with an extra \$97 million to add to its reserves. According to this month's board report, MWD will, before it ends fiscal year 2013 at the end of this month, add another \$217 million to its unrestricted reserves, causing the reserves to exceed the maximum limit by \$75 million. ***In less than 15 months, MWD has collected \$314 million more than needed to pay 100% of its budgeted expenditures.***

Many of the cities we serve are struggling with their own budgets to make ends meet and pay for critical infrastructure. Many of the ratepayers we serve are also struggling to make ends meet during a period of lower incomes and escalating costs. We owe it to our cities and ratepayers to be better stewards of the precious dollars water ratepayers entrust to us when they pay their water bills. We once again call on this Board to establish a ***Fiscal Sustainability Task Force*** to develop a long-range finance plan and accounting, budget, and rate-setting protocols to ensure that every dollar MWD collects is used for its intended purpose, and, that MWD does not collect more money than it really needs.

Chairman Foley and Members of the Board

June 5, 2013

Page 2

In the meantime, we call on the board to **REFUND the \$75 million in excess reserves**, rather than shift this money to unplanned, unbudgeted expenditures. Attachment 1 to this letter shows approximately¹ how much MWD could refund to each of its member agencies. We also once again call on the Board to act now to **REDUCE the planned water rate increase for 2014 from 5% to 3%**. Reliance on budget estimates proven to be materially incorrect is unwarranted in the face of the actual facts.

For the same reason, we **OPPOSE Board Memo 8-2 proposing to suspend the tax rate limitations** in Section 124.5 of the MWD Act. We have reviewed the legislative history of SB 1445. We disagree that it was “meant to increase Metropolitan’s financial flexibility.” The clear purpose of the legislation was to limit the imposition of future taxes by MWD, with the ultimate goal that the tax be eliminated. The Legislature instead provided different tools to allow MWD to cover its fixed costs including standby or readiness-to-serve charges and benefit assessments, as clearly acknowledged in the Board Memo. The fact that MWD has failed to better utilize these and other tools as part of a long-range plan to cover its fixed costs does not translate to a need for higher taxes.

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Keith Lewinger
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Attachment 2: Comparison of MWD reserves forecast

cc: Jeffrey Kightlinger
San Diego County Water Authority Board of Directors

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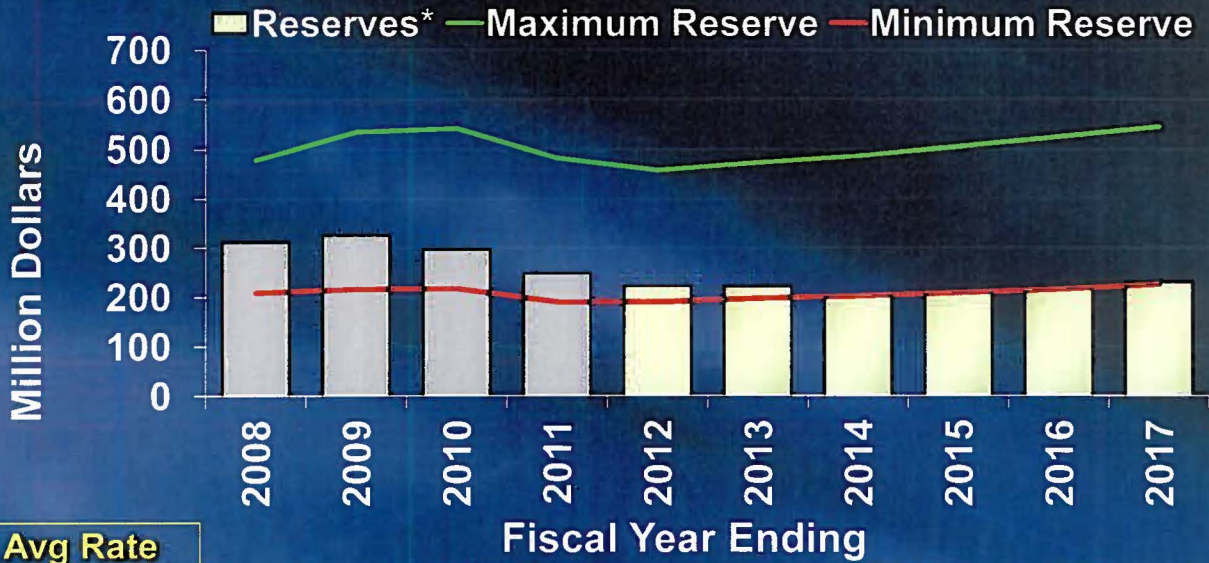
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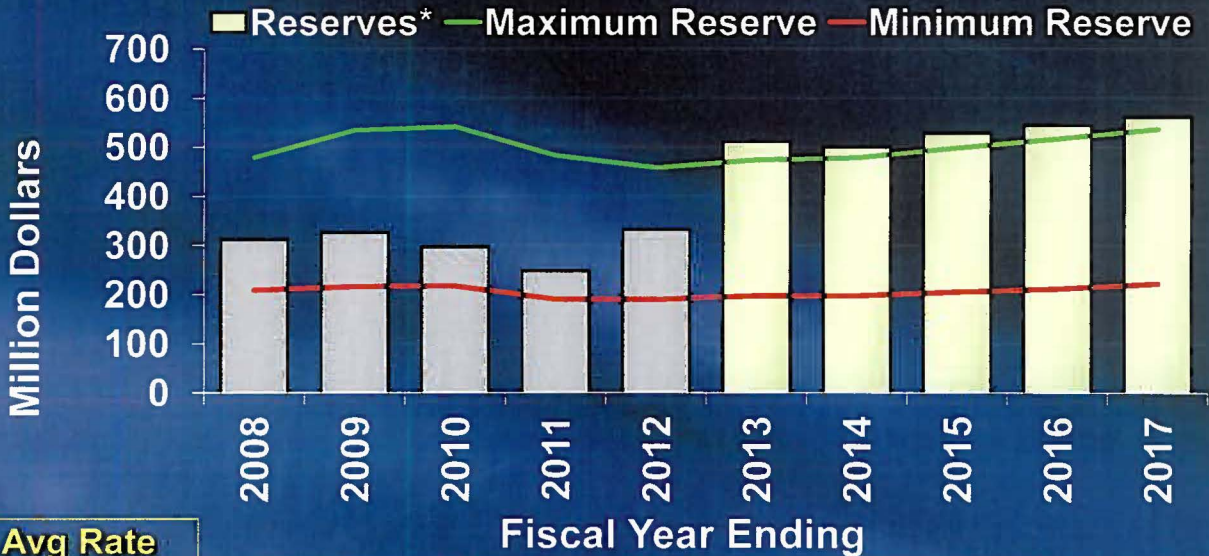
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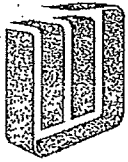
Updated Forecast



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 FY2013 and beyond are based on modified accrual

38732

**MWD**

METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

April 21, 1988

To Subcommittee on Financial Policy--Information

From General Counsel

Subject The History of the Tax Limitation Provisions of Section 124.5 of the Metropolitan Water District Act

Summary

In 1983, in response to a California Supreme Court decision allowing property tax levies for voter-approved pension funds, the Legislature enacted AB 377, which unintentionally would have had the effect of prohibiting the levy of taxes for voter-approved water contract payments, including the State Water Project. AB 322, passed later in the 1983 session, corrected this matter by authorizing property tax levies for the State Water Project contract payments and voter-approved Federal water contract payments. At that time, Metropolitan had substantially raised its property tax rate for fiscal year 1983-84, and in response AB 322 prohibited any increase in Metropolitan's taxes above the 1982-83 level for the tax year 1984-85 and 1985-86 and requested a report to the Legislature on the District's program to reduce reliance on property taxes and to assure equitable distribution of the tax burden.

After extensive study by a staff task force and negotiations among Directors representing various member agencies, with the General Manager serving as an intermediary, a compromise was reached resulting in additional statutory financial flexibility, revisions to the Administrative Code reducing the allocation of revenue requirements to taxes under the proportionate use formula, and the addition of Section 124.5 of the MWD Act, which essentially places an upper limit on District taxes commencing in 1990-91 based upon debt service for District general obligation bonds and an allocable share of the State's debt service on Burns-Porter bonds used to finance State Water Project facilities benefiting the District. The compromise was enacted by

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April 21, 1988

SB 1445 which also removed the two-year tax limitation on the District and the reporting requirement. Under the compromise it was estimated that with the sale and redemption of the remaining authorized District general obligation bonds, barring emergencies, the District would reduce its tax rate to zero in approximately 2023-24. At that time, there was no authority to authorize further general obligation bonds. The compromise also amended the Administrative Code to exclude debt service for water treatment plants from tax levies.

Recommendation

For information only.

Detailed Report

SB 1445 is the culmination of three pieces of legislation enacted in 1983 and 1984 relative to the District's taxing authority, among other matters. In 1983 the Legislature, in response to a concern that a number of local public entities, particularly the City of Los Angeles, would significantly increase their property tax rates under the ruling of the California Supreme Court in 1982 in Carman v. Alvord allowing the use of property taxes for the payment of voter-approved pension liabilities, enacted AB 377. That bill, with major amendments, emerged from a conference committee on July 19 and was adopted by both the Senate and Assembly that day. It was sent to the Governor and approved July 28. A significant provision of that bill added Section 97.6 of the Revenue and Taxation Code, which was intended as an interim control pending further legislative consideration, and it essentially provided that for the 1983-84 and 1984-85 fiscal years no local public entity would be permitted to impose a property tax under the pre-1978 voter-approved indebtedness which was in excess of the tax rate imposed by the public entity in the 1982-83 fiscal year for other than bonded indebtedness. Thus, the scope of the prohibition went far beyond the pension tax exception that generated the legislative concern, including what appeared to be a prohibition on property tax levies for payments under State Water Project contracts.

Due in part to an adjustment provision to compensate for tax over-collections in the previous year which had caused the 1982-83 tax rate to be abnormally low and a \$20 million "one-shot" additional charge from the State for a project interest rate adjustment, the District's proportionate use

April 21, 1988

formula (under which water rates are set) required a substantially higher tax rate for 1983-84 for the purpose of making payments to the State of California pursuant to its State water contract. The authority to levy property taxes for that program had been confirmed by the court's ruling in Goodman v. County of Riverside in 1983 as within the pre-1978 voter-approved indebtedness exception to the one percent of value property tax limitation of Article XIII A of the State Constitution (Proposition 13). When it became apparent that no corrective legislation would be enacted by mid-August of 1983, the District proceeded to levy the tax rate for 1983-84 determined under its proportionate use formula on the grounds that AB 377 was an unconstitutional impairment of contract as applied to the District for that year.

Following the District's action in setting its tax rate, the Legislature recognized the potential for default by the various State water contractors in their payment obligations to the State if their taxing authority was restricted in the manner provided by AB 377. Another bill, AB 322 (Roos), was substantially rewritten and emerged from conference on September 15, amending Section 97.6 (which had been added by AB 377) to provide that the limitation of Section 97.6 did not apply to taxes levied to meet obligations to make payments to either the State of California under contracts for the sale, delivery or use of water entered into pursuant to the California Water Resources Development Bond Act or the United States under voter-approved contracts for the sale, delivery or use of water or for repayment of voter-approved obligations for the construction, maintenance or operation of water conservation, treatment or distribution facilities.

AB 322 also specifically validated the District's 1983-84 tax rate but provided further that a metropolitan water district should not impose a property tax rate for fiscal years 1984-85 and 1985-86 which would be in excess of the rate imposed in fiscal year 1982-83 unless at least 80 percent of the Board of Directors found that a fiscal emergency existed which required a property tax rate increase and approved the rate increase. The provision also required the District to submit a report to the Legislature on or before March 31, 1984 detailing its program to reduce the reliance of the District on property taxes and to assure that the property tax burden would be equitably distributed. AB 322, which became law without the Governor's signature, became effective October 1 as an urgency statute.

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April 21, 1988

The District appointed a task force to develop the required response to the Legislature which was completed and filed with the Legislature in March 1984. (A copy of the cover letter is attached.) As submitted, the response was intended to be an interim report, and the Board requested a two-year extension of the Legislature for the submission of a final report. The response explained in detail the historical development and application of the District's financial policy with regard to property taxes and water revenues. It further indicated that the District would be increasing its reliance on variable water revenues to meet the substantial growth in fixed costs with which the District was confronted that were to continue into the 21st century. The report included proposed legislation which provided additional financial flexibility to the District with regard to revenue sources, i.e., the authority to levy water standby or availability service charges, benefit assessments and the authority to issue commercial paper.

After the report was submitted, SB 1445, which had already passed the Senate, was amended in the Assembly to extend the reporting date to March 31, 1986, and to add the financial flexibility provisions requested in the report to the Legislature. On April 30, 1984, the General Manager by letter to the Board of Directors (copy attached) proposed as a further amendment to the Metropolitan Water District Act the addition of Section 124.5 which was approved by the Board. This would provide that, commencing with fiscal year 1990-91, the District's ad valorem property taxes, other than annexation taxes, shall not exceed (1) the amount required to pay debt service on Metropolitan's general obligations bonds and (2) that portion of the District's payment obligation to the State under the State water service contract which is reasonably allocable to the State's payment of debt service of existing Burns-Porter Bonds used to finance construction of facilities for the benefit of the District. The proposal also provided that these restrictions would not be applicable if the Board, after a hearing to consider that issue, found that a tax in excess of this restriction would be essential to the fiscal integrity of the District and the offices of the Speaker of the Assembly and the President Pro Tempore of the Senate were given written notice of hearing at least 10 days prior to the date of hearing.

Those amendments were incorporated in SB 1445. Following a few additional minor amendments, including the deletion of the two-year extension for filing the report,

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April 21, 1988

Senate Bill 1445 was enacted, effectively restoring the District's authority to levy taxes in accordance with the revised proportionate use formula until fiscal year 1990-91.

The tax limitation provisions contained in SB 1445 resulted from extensive negotiations among the Directors. The task force developed a series of water revenue/taxation policy alternatives which were presented for consideration. The compromise method, designated Alternative 17A at the time, that was eventually adopted by the Board and reflected in SB 1445, assumed that the District would issue its then remaining \$365 million in authorized but unissued general obligation bonds. This was shown in the attachment to the General Manager's April 30 letter which projected aggregate debt service of the District and allocated State Water Project general obligation bonds to reach \$107 million by 1988-89. (Debt service on the then outstanding District general obligation bonds was \$30 million per year, the estimated share of State Water Project general obligation debt service was \$41 million, and the projected debt service on the \$365 million in unissued District general obligation bonds would be \$36 million.) Based on that, it was estimated that District taxes would cease after fiscal year 2022-23 except in fiscal emergencies.

It should be noted that during this period, Article XIII A effectively precluded the authorization of additional general obligation debt, and thus the compromise effected by Section 124.5 of the MWD Act did not contemplate such additional debt authorization or a tax to service it. With the adoption of Proposition 46 in 1986, Article XIII A has been amended to permit property tax support for bonded indebtedness for the acquisition or improvement of real property approved by a two-thirds vote, and the literal provisions of Section 124.5 would permit a tax to service such bonds if they were so approved.

The General Manager's letter of April 30, 1984, also recommended revision of the District's Administrative Code to redefine certain categories of capital costs to be used in the proportionate use formula to determine the allowable tax levy through 1990-91. They excluded from the definition of capital costs under the proportionate use formula debt service attributable to bonds used to finance the construction of treatment plants and included such debt service within the definition of operation and maintenance costs, chargeable to the water treatment surcharge. This reclassification caused a

Subcomm. on Financial Policy -6-

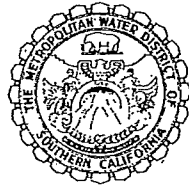
April 21, 1988

reduction in the calculation of tax rates for fiscal year 1984-85 and thereafter and, if not further revised in the future, would cause all debt service on bonds authorized or issued to finance water treatment, whether revenue or general obligation, to be a charge upon water revenues. This, of course, is consistent with the District's long-standing policy of recovering all costs of treatment from the users of treated water through the treatment surcharge on water rates.

Warren J. Abbott
Warren J. Abbott

JWM:jh
LDBOARD2-366
Attachments

35099
5-7 (2)



The Metropolitan Water District of Southern California

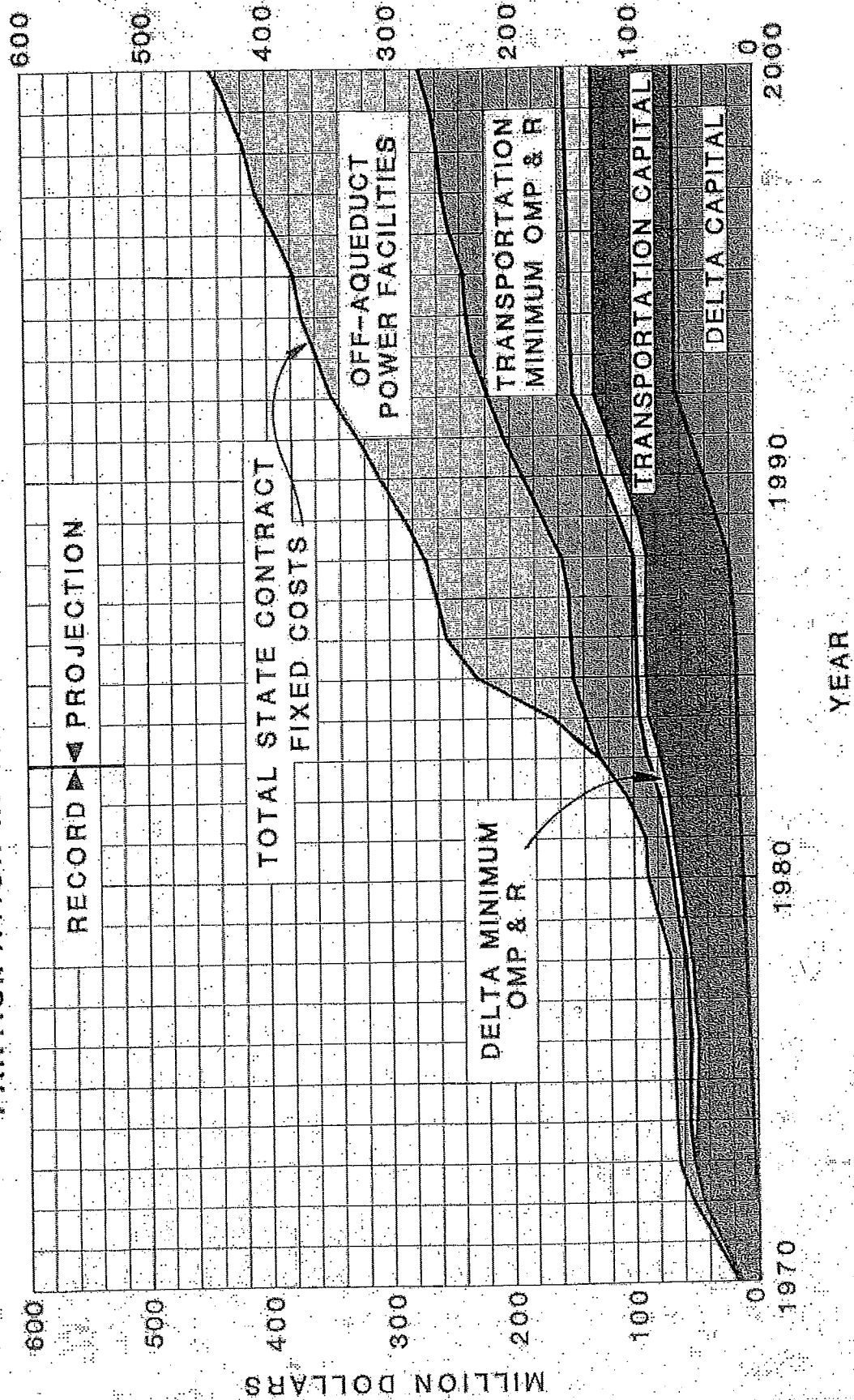
Report to the California Legislature
in
Response to AB 322

March 1984

FIXED COSTS ASSOCIATED WITH PARTICIPATION IN THE STATE WATER PROJECT

MILLION DOLLARS

FIGURE 18



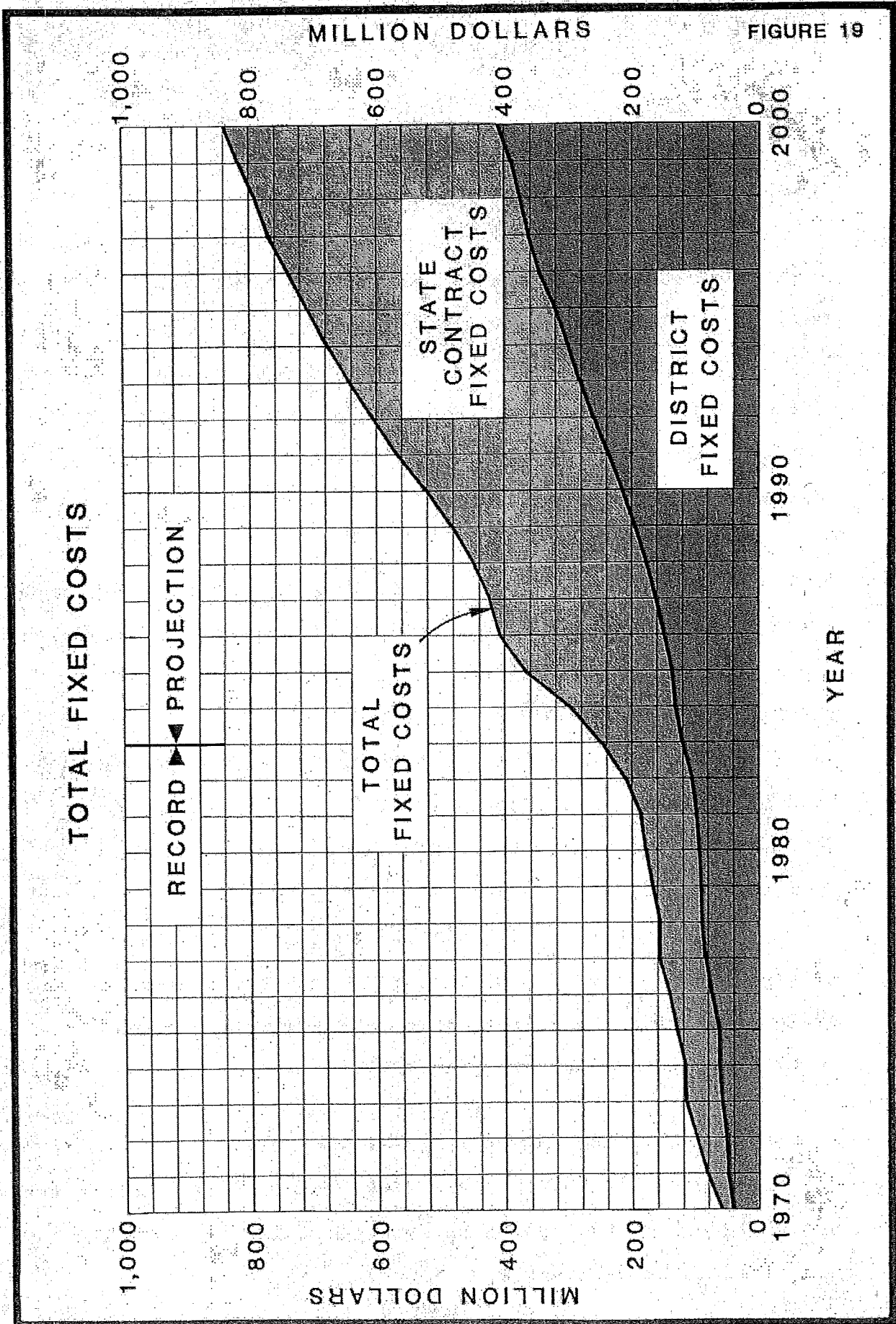


FIGURE 19



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

July 9, 2015

Randy Record and
Members of the Board of Directors
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

MEMBER AGENCIES

- Carlsbad Municipal Water District
- City of Del Mar
- City of Escondido
- City of National City
- City of Oceanside
- City of Poway
- City of San Diego
- Fairbrook Public Utility District
- Helix Water District
- Lakeside Water District
- Olivenhain Municipal Water District
- Clay Water District
- Padre Dam Municipal Water District
- Camp Pendleton Marine Corps Base
- Rainbow Municipal Water District
- Ranona Municipal Water District
- Rincon del Diablo Municipal Water District
- San Dieguito Water District
- Santa Fe Irrigation District
- South Bay Irrigation District
- Vallecitos Water District
- Valley Center Municipal Water District
- Vista Irrigation District
- Yuma Municipal Water District

RE: Board Memo 8-4: Adopt a resolution for the reimbursement with bond proceeds of Capital Investment Plan projects funded from the General Fund and Replacement and Refurbishment Fund -- OPPOSE

Chair Record and Members of the Board:

The Water Authority’s MWD Delegates have reviewed the July 14, 2015 board memo 8-4 seeking the Board’s authorization to declare MWD’s intent to issue up to \$300 million of debt to “reimburse” capital expenditures for projects funded from the General Fund and Replacement and Refurbishment (R&R) Fund. We oppose this item because staff’s recommendation will obligate MWD to increase water rates by at least \$15 per acre- foot without an actual board vote for the rate increase, and for the reasons further stated in this letter.

Staff’s practice of presenting board actions piecemeal has paralyzed the board’s ability to make sound public policy decisions. This month’s action is another example. The board memo states that the debt issuance would provide MWD the “financial flexibility” desired because of the projected draw down of reserves as a result of the May action to pay for the unbudgeted conservation programs,ⁱ and that “expenditures for water management activities such as replenishing storage and funding transfer and exchange programs could significantly [further] draw down financial reserves in the near future.” But it was staff’s own recommendation in May to spend \$350 million on unbudgeted conservation expenditures – namely turf removal -- that placed MWD in this precarious fiscal position. This situation was completely foreseeable.

The May action not only spent MWD’s not-yet-realized excess revenue collection,ⁱⁱ it also completely drained the Water Management Fund (WMF) – established for the very purpose of covering future costs associated with replenishing storage and water transfers – to fund turf removal, an expense for which the WMF was not intended. Staff expressed no concern when it recommended to spend down the WMF. The Board was repeatedly told in May that

OTHER REPRESENTATIVE

County of San Diego

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staff's recommendation would not result in any rate impacts. But this month's action, which was precipitated entirely by May's unbudgeted expenditures, will in fact result in increases in MWD water rates by at least \$15 per acre-foot. (MWD staff reported in the past that every \$20 million in debt issuance equates to \$1 per acre-foot increase in water rates based on 2 million acre-feet of water sales; the rate increase will be higher for lower water sales volumes.) What has changed so drastically that is causing staff to be so concerned with the lack of financial flexibility triggered by an action it recommended just only six weeks ago? Did staff not foresee when it made the recommendation to spend down the WMF in May that its "flexibility" to purchase transfer supplies and to replenish depleted dry-year storage accounts would be more limited?

We disagreed with staff's assessment in May that the increase in conservation funding would not result in rate impacts. However, we believe staff's assertion that the action would have no rate impact persuaded many Board members to support the unprecedented and unbudgeted spending. While this month's action clearly has rate implications, the board memo yet again makes no reference to the rate increases.

Since fiscal year 2012, MWD collected more than \$800 million in revenues that exceed actual expenses. And since 2013 and in each year following, these over-collections have caused MWD's reserves to exceed the Board established maximum limits by hundreds of millions of dollars -- largely caused by staff's strategy, endorsed by this Board's votes of approval -- to set rates based on artificially deflated sales amounts, which staff said would be exceeded seven out of 10 years.ⁱⁱⁱ Rather than using the over-collections to manage rate and tax increases, MWD kept and spent the monies on unbudgeted items.

Nearly as quickly as MWD amassed more than \$800 million in over-collected revenues, they are now nearly all gone, and MWD is resorting to budget shell games of taking cash from the capital investment plan to cover massive spending on turf removal. It is obvious that this proposal to issue \$300 million in new debt is a post-facto, 30-year debt financing of turf removal subsidies approved just weeks ago. This is not sound fiscal management.

When the biennial budget for fiscal years 2015 and 2016 was adopted, we asked that MWD use the revenue over-collection to reduce rate increases and not raise taxes, staff instead recommended using part of the over-collections to cash-fund capital projects to "avoid future rate increases." This month's 8-4 recommendation is an about-face from staff's earlier rationale in support of cash-funding the capital program.

Finally, MWD's Administrative Code (Section 5200(b)) clearly restricts the use of monies from the R&R Fund to capital program expenditures. It is unclear how staff's proposal to issue debt would afford MWD the ability to use R&R funds for operational costs related to water transfers or purchases of water to replenish storage.

For reasons stated in this letter, we oppose staff's recommendation. We urge our fellow Board members to vote no on this action as well. This action is an inappropriate attempt to debt-finance very expensive turf rebates that produce no significant immediate supply relief during the drought.

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
Director



Fern Steiner
Director



Yen C. Tu
Director

ⁱ MWD increased conservation spending in May by an additional \$350 million and was to be funded by the following sources: 1) Water Stewardship Fund (\$50 million), 2) Water Management Fund (\$140 million), and 3) projected excess revenue collection that exceeded maximum reserves target (\$160 million); however, board memo 9-1 this month indicates that the projected excess revenue collection is trending at \$120 million, requiring the use of \$40 million from Water Rate Stabilization Fund.

ⁱⁱ The May action authorized the expenditures of anticipated over-collection of \$160 million, which is trending now at \$120 million (see also footnote ii).

ⁱⁱⁱ Fiscal year 2016 is a good example; according to staff, MWD's water sales at the reduced Level 3 supply allocation (15 percent reduction) will still exceed the budgeted assumption of 1.75 million acre-feet.



San Diego County Water Authority

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June 5, 2015

Randy Record and
Members of the Board of Directors
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

MEMBER AGENCIES

- Carlsbad Municipal Water District
- City of Del Mar
- City of Escondido
- City of National City
- City of Oceanside
- City of Poway
- City of San Diego
- Fallbrook Public Utility District
- Helix Water District
- Lakeside Water District
- Olivenhain Municipal Water District
- Otay Water District
- Padre Dam Municipal Water District
- Camp Pendleton Marine Corps Base
- Rainbow Municipal Water District
- Ramona Municipal Water District
- Rincon del Diablo Municipal Water District
- San Dieguito Water District
- Santa Fe Irrigation District
- South Bay Irrigation District
- Vallecitos Water District
- Valley Center Municipal Water District
- Vista Irrigation District
- Yuima Municipal Water District

RE: Board Item 8-2 – OPPOSE: Approve and Authorize the execution and distribution of the Official Statement in connection with the issuance of the Special Variable Rate, Water Revenue Refunding Bonds 2015 Series 1 and 2015 Series A-2, and authorize the payment of cost of issuance from bond proceeds. (F&I)

Dear Chair Record and Members of the Board:

The Water Authority’s MWD Delegates have reviewed the June 8, 2015 board memo 8-2, including the redline copy of Appendix A dated May 28, 2015, and determined we cannot support staff’s recommendation to authorize the execution and distribution of the Official Statement in connection with the refunding of bonds. As we’ve consistently stated previously, while we support staff’s general financial management objective, we do not find the bond disclosures fairly present current and projected water supply conditions, nor MWD’s financial positions or risks.

General Comments

We incorporate by reference all of the comments and objections contained in past letters RE MWD's authorization, execution and distribution of Official Statements in connection with the issuance of bonds. Those letters raise several issues that have not been addressed by MWD in prior drafts of Appendix A, are part of the MWD Administrative Record in connection with the respective actions taken by the board and are incorporated herein by reference.

Comments on Draft Appendix A

A-7: Metropolitan’s Water Supply and A-8-9 Drought Response Actions. MWD continues to understate the severity of MWD’s current water supply conditions. See Attachment 1: March 6, 2015 letter to MWD board RE Water Supply Management Strategies including Use of Storage. Regarding drought response actions, it is unclear -- if not misleading -- for MWD to state that the conservation program largely made up of turf removal "is expected to result" in annual water savings of 80,000 acre-feet in the context of discussion of the current

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drought and without a time reference. No one, not even MWD itself, has estimated current or near-term annual water savings of that magnitude as a result of these expenditures; indeed, even long-term Turf Removal Program results are uncertain. MWD should also disclose that its recent action to increase conservation program spending, primarily turf removal spending, leaves MWD with limited available funding to purchase water transfers if the drought persists, or to replenish depleted storage reserves if supplies become available, *without adopting significant water rate increases*. See Attachment 2: May 8 and May 25, 2015 letters to the MWD board RE: Board Memo 8-2: Authorize (1) \$150 million in additional funding for conservation incentives from the Water Stewardship Fund and the Water Management Fund; and (2) Implementation of modifications to the Turf Removal Program – Oppose and RE: Board Memo 5-1: Authorize (1) Additional funding for conservation incentives; and (2) Implementation of modification to the Turf Removal Program.

A-11: Water Transfers and Exchanges. What is the addition of the term "acquisition" to this section of the draft Appendix A intended to convey?

A-26: Intentionally-Created Surplus Program. This section, as amended, more accurately describes potential limitations on MWD's access to intentionally-created surplus (ICS) as a result of current water supply and storage conditions. This information was not provided to the board at the time it voted to declare the Water Supply Condition 3 and implementation of the Water Supply Allocation Plan at a Level 3 Regional Storage Level.

A-33-34: Water Supply Allocation Plan. The draft Appendix A states that, "[i]mplementation of the Water Supply Allocation Plan at a Level 3 Regional Shortage Level is anticipated to reduce supplies delivered by MWD to MWD's member agencies by 15 percent and water sales to approximately 1.8 million acre-feet." However, this month's Water Surplus and Drought Management (WSDM) Plan states that demand at Level 3 equates to 1.93 million acre-feet, more than 100,000 acre-feet more than stated in the draft Appendix A. Under current water supply and storage conditions, this discrepancy is material; please provide information to reconcile these numbers or correct the staff WSDM report or draft Appendix A.

A-35: Los Angeles Aqueduct. The Agreement between DWR, Antelope Valley-East Kern Water Agency and MWD contains specific limitations regarding the use of the subject turnout for delivery of non-State Water Project water annually to the City of Los Angeles. Why is the language at the bottom of page A-35 being deleted?

A-58: Litigation Challenging Rate Structure. What is your reasoning for deleting the statement that, "[a]mounts held pursuant to the Exchange Agreement are transferable to SDCWA to pay any amounts awarded by the court in the event SDCWA prevails in its claim for breach of the Exchange Agreement"? We disagree with the change because it conceals a large potential liability from MWD's bondholders, and is inconsistent with MWD's prior


practice of disclosure, its litigation position that the interest-bearing account is a set-aside to pay for possible damages, and the fact that MWD has already been held liable for breaching the Exchange Agreement.

A-61: Water Standby Charges. In an effort to avoid the application of Proposition 26, MWD has argued (unsuccessfully) in the rate litigation that it does not "impose" its water standby charge. The suggested edit at page A-61 is purely litigation-driven and a matter of form over substance; it is misleading to state or suggest that MWD does not impose a water standby charge.

A-87: Historical and Projected Revenues and Expenses. This table includes the transfer and expenditure of monies from the Water Management Fund and Water Rate Stabilization Fund, but does not identify expenditures from the Water Stewardship Fund. We assume that these fund transfers will be used for to pay for the Conservation and Turf Removal Program, as approved by the Board at its May 26, 2015 Special Workshop. The Board also approved the transfer and use of monies from the Water Stewardship Fund, and yet the table does not reflect the transfer and use of this fund.

MWD should also disclose here or elsewhere in the draft Appendix A that, since 2012, it has over-collected \$803,000,000 from MWD ratepayers in excess of its expenses and that this amount may be subject it to future claims.

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
Director



Fern Steiner
Director



Yen C. Tu
Director

Attachment 1: March 6, 2015 letter to MWD board RE Water Supply Management Strategies including Use of Storage

Attachment 2: May 8 and May 25, 2015 letters to the MWD board RE: Board Memo 8-2: Authorize (1) \$150 million in additional funding for conservation incentives from the Water Stewardship Fund and the Water Management Fund; and (2) Implementation of modifications to the Turf Removal Program – Oppose and RE: Board Memo 5-1: Authorize (1) Additional funding for conservation incentives; and (2) Implementation of modification to the Turf Removal Program.

cc: Jeff Kightlinger, MWD General Manager
San Diego County Water Board of Directors and Member Agencies



San Diego County Water Authority

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(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

March 6, 2015

Randy Record and
Members of the Board of Directors
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

MEMBER AGENCIES

Carlsbad
Municipal Water District
City of Del Mar
City of Escondido
City of National City
City of Oceanside
City of Poway
City of San Diego
Fallbrook
Public Utility District
Helix Water District
Lakeside Water District
Olivenhain
Municipal Water District
Otay Water District
Padre Dam
Municipal Water District
Camp Pendleton
Marine Corps Base
Rainbow
Municipal Water District
Ramona
Municipal Water District
Rincon del Diablo
Municipal Water District
San Dieguito Water District
Santa Fe Irrigation District
South Bay Irrigation District
Vallecitos Water District
Valley Center
Municipal Water District
Vista Irrigation District
Yuima
Municipal Water District
OTHER
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County of San Diego

RE: Water Planning and Stewardship Committee Agenda
Water Supply Management Strategies Including Use of Storage

Chair Record and Members of the Board,

As we find ourselves in a fourth-consecutive drought year, and look ahead to 2016 and beyond, we must again express our extraordinary concern, not only about MWD's unprecedented withdrawal of water from storage in 2014 to meet demand (more than 1 million acre feet), but with the status of MWD's water management strategies and storage programs generally. We have repeatedly requested a comprehensive staff report and board review analyzing MWD's water management and storage strategies, including put, take and funding issues, as well as the relationship to potential water supply allocation.ⁱ These requests have been dismissed by staff under the banner of "needed flexibility" in operations. The Water Authority has never advocated against operational flexibility. But, operational flexibility should not be used as an excuse for a failure to adopt sound water management policies and strategies, and thoughtful, informed decision-making by this board of directors.

Many board members may not know that MWD's storage programs have taken on an increasingly important - indeed, critical - role over the last 20 years as MWD's Colorado River and State Water Project supplies have become less plentiful and less reliable.ⁱⁱ But the board lacks a coherent strategy for management of these storage reserves, including how management of storage ties into decisions about water supply allocation and the need for replenishment of storage. Similarly, it is impossible to understand how discreet water management recommendations by staff tie into any storage, allocation or investment strategy.ⁱⁱⁱ Given its seriously outdated Integrated Resources Plan,^{iv} MWD is reduced to making ad hoc decisions on a case-by-case basis.

The MWD board must look ahead now, **to 2016 and beyond**, to plan how to best manage the limited remaining supplies MWD has in storage, as well as address other operating concerns (including the unique issues presented in the State Water Project (SWP)-Exclusive

Area where jeopardy is greater than any other region).^v Looking ahead, we cannot say with any credibility that we were "surprised" by the drought or that it might continue; we have to assume that it will continue and plan accordingly. That's our responsibility as board members to the more than 18 million people who live and work in Southern California.

We ask that a Special Board Workshop be set at the earliest possible date to review a detailed staff report^{vi} (to be made available at least ten days in advance of the meeting), deliberate our options and potential actions, and set sound policies to guide this agency.

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
Director



Fern Steiner
Director



Yen C. Tu
Director

Attachments:

1. Water Authority Letter, dated April 25, 2011
2. Water Authority Letter, dated May 6, 2011

cc: Jeff Kightlinger, General Manager
Dawn Chin, Office of the Board of Directors

ⁱ The Water Authority's board members have been requesting a staff report and board policy discussion for more than one year, including requests made at the March, April, May, June, September and November committee/board meetings and at both the January and February meetings this year. Decisions about water supply allocation cannot reasonably be made without an understanding how MWD plans to withdraw water from storage and the impacts that will have on water supply balances in subsequent years.

ⁱⁱ Briefly stated, MWD has lost access to 662,000 AF of surplus Colorado River supplies that it had relied upon for decades, as Arizona and Nevada increased their use of Colorado River water. The Water Authority's firm Imperial Irrigation District water transfer and canal lining water will make up for 280,000 AF of this loss, but is still ramping up, leaving a remaining gap of almost 300,000 AF annually, only a portion of which MWD has been able to fill. During this same time, MWD's State Water Project (SWP) supplies have also become more vulnerable and susceptible to annual hydrologic variations, as this board is well aware.

ⁱⁱⁱ Examples include:

1) MWD's staff recommendation in April 2011 to **sell MWD water at a discount rather than place the water into MWD's own storage reserves**. At the time of that recommendation by staff, it was clear that MWD had ample storage and put capacity available to store all of the available water. Had that water been stored by MWD, storage reserves would be greater today than they are now and thus offset the need for MWD to take the kind of extraordinary measures it is taking, including spending almost \$100 million replacing turf on private golf courses at a cost of more than \$1,600 per AF (see also Board Memos 8-2, 8-3 and 8-10). Copies of the Water Authority's board letters dated April 25, 2011 and May 6, 2011 objecting to MWD's staff recommendation to sell rather than store the water are attached.

2) MWD's staff decision in 2014 to not pursue Sacramento Valley water transfer supplies - even though the board had already approved action to acquire such water, which was available. At the January 2015 board meeting, staff informed the board about the decision *it* had made, stating that its decision was based upon a "combination of factors," including carriage losses and that the cost of the water was between \$500-600/AF.

^{iv} The Water Authority has written numerous letters objecting to MWD's continued reliance upon its factually outdated 2010 Integrated Resources Plan; the 2015 update has only just begun and is now being proposed to trail into 2016.

^v This is one of the reasons why the Water Authority board members voted in December 2014 against the MWD staff recommendation to create a special new water supply allocation for groundwater basins *as such*. At the same time, we intended to be clear that all agencies paying the full service water rate should be treated equally. We also note that the existence of MWD's SWP-Exclusive Area has received very little attention by this board and is not described or even noted in the IRP or other MWD planning documents.

^{vi} As requested previously, the staff report should provide the data needed to have a meaningful policy discussion, including put, take and funding strategies. The staff report should note specific contractual and other limitations on the use of storage limiting its access to water (e.g., limitations on MWD's access to Central Valley storage accounts and Desert Water Coachella Valley account). Further, the timing and impact of the "pay-back" terms and conditions of MWD's various storage agreements must be understood (e.g., MWD's agreement to pay back 219,000 AF of "flex storage" from DWR reservoirs and 168,000 AF of borrowed water from Southern Nevada Water Authority). In short, the details very much matter in the board's review and deliberation of next steps in meeting the water supply challenges confronting Southern California this year, and in following years as the hydrologic and regulatory challenges continue.



San Diego County Water Authority

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(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

April 25, 2011

John V. (Jack) Foley, Chairman
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

MEMBER AGENCIES

Carlsbad
Municipal Water District

City of Del Mar

City of Escondido

City of National City

City of Oceanside

City of Poway

City of San Diego

Fallbrook
Public Utility District

Helix Water District

Lakeside Water District

Olivienhain
Municipal Water District

Oray Water District

Padre Dam
Municipal Water District

Camp Pendleton
Marine Corps Base

Rainbow
Municipal Water District

Ramona
Municipal Water District

Rincon del Diablo
Municipal Water District

San Dieguito Water District

Santa Fe Irrigation District

South Bay Irrigation District

Vallacitos Water District

Valley Center
Municipal Water District

Vista Irrigation District

Yuma
Municipal Water District

OTHER REPRESENTATIVE

County of San Diego

Re: Board Memo 5-1 – Sale of discounted water

Dear Chairman Foley:

We have reviewed Board Memorandum 5-1 regarding the sale of discounted water by MWD and would like the following comments to be placed in the record by this letter and its attachment. The sale of discounted water by MWD at this time raises many questions and concerns, which we have organized and discuss in detail in Attachment 1 to this letter. We request that the staff respond in writing to these questions and concerns prior to the board taking any action.

Given the staff's own analysis, which describes its concerns about the performance and equity of the existing Replenishment Service Program (replenishment program) – it acknowledges that there is an "imbalance" between MWD costs and benefits under the Program (page 4) – we are surprised that the staff recommendation is nonetheless to support the sale of discounted water under the replenishment program.

While the recommended action takes into account the budgetary and fiscal constraints the member agencies have, it does not analyze or meaningfully address the unprecedented budgetary and fiscal constraints plaguing MWD. Our board's fiduciary duty is to MWD – not the member agencies. We fail to meet that duty if we vote to sell discounted water under a program that does not provide commensurate benefits to MWD. This is all the more important at a time when we are confronting a nearly \$200 million budget shortfall in the current fiscal year.

The board memo is clear on its face that the replenishment program does not provide a proper foundation for the sale of discounted water. The Water Authority does not support the sale of discounted water by MWD under these conditions. But if the board chooses to do so in order to generate sales in the current fiscal year, then it should be made available to all of MWD's member agencies, rather than limited to replenishment sales.

Sincerely,

Jim Bowersox
Director

Lynne Heidel
Director

Keith Lewinger
Director

Fern Steiner
Director

Attachment 1: Issues Associated with the Sale of Discounted Water by MWD

cc: Jeff Kightlinger, General Manager

A public agency providing a safe and reliable water supply to the San Diego region

Attachment 1**Board Memorandum 5-1 – April 26, 2011 Special Board Meeting
Issues Associated with the Sale of Discounted Water by MWD****1. The real issue before the board is price – not local water storage.**

The board memo talks about “optimizing the reliability of water supply into the service area,” but it is apparent that the real issue before the board is the price. MWD has already adopted a 2010/11 Water Management Program for local storage that allows member agencies to purchase additional water for local storage while protecting them from Water Supply Allocation Plan (WSAP) penalties. Some member agencies have purchased supplies under this program, but others have held out in hopes of receiving discounted replenishment water.

2. MWD should be fully utilizing its own dry-year storage portfolio, rather than selling water at a discount to its member agencies.

The board memo states that MWD is facing the “unexpected challenge” of managing and storing water in 2011. This is a very perplexing statement and calls into question MWD’s water supply management capabilities. Storing water in good years is at the very heart of the water supply reliability program MWD developed through its Integrated Resources Plan (IRP).

Nine years ago, when MWD lost 662,000 AF of surplus water on the Colorado River *annually*, it shifted to a water supply reliability strategy that depends heavily on storing water in wet years in order to meet water demands during subsequent dry years. When this strategy was initially employed, MWD was counting on having water supplies that were “surplus” to its needs and available for storage seven out of every 10 years. To implement this strategy, MWD established rates and collected revenues from its member agencies and paid billions of dollars to create the dry-year storage accounts that today are in excess of 5 MAF. The Water Supply and Drought Management (WSDM) plan attached to the board memo shows a 2011 storage put capacity of more than 1 MAF.

More recently, MWD staff has consistently stated that the constraints in the Delta now mean that MWD can count on wet-year supplies being available for storage in only three of every 10 years; this is one of those three years. But rather than filling its own storage accounts, MWD staff is recommending selling this water at a discount to its member agencies.

We also find it troubling that for the first time – and in the context of a recommendation to sell water at a discount – the board has been informed that “some of the storage programs and locations” are “less desirable choices” for storage management. Further, that there are “increased risks of future losses from those programs, potential cost implications, and concerns about future dry-year performance.” Given this description, it is difficult to understand why MWD made these “less desirable” dry-year storage investments in the first place. We request that a complete review of the dry-year storage program be placed on the agenda at the next board meeting and before the board takes action to sell the water that is available for storage at a discount.

A final note on MWD’s dry-year storage portfolio relates to the budget. It is not possible to manage a dry-year storage account without incurring costs associated with the put and take of water into and from storage. The fact that MWD failed to adequately budget these costs is

certainly no excuse to sell discounted water now in order to generate cash-flow. We request an analysis of how staff has budgeted these costs in the past and how it proposes to budget the costs associated with its dry-year storage program in the next and subsequent budget years. We also request a schedule of all costs and capital investments associated with developing new water supplies that will be needed to replace the water now proposed to be sold at a discount.

3. The sale of discounted water will displace full-service sales and exacerbate MWD's current budget and fiscal crisis.

The board letter is completely silent on the most damaging consequence of selling discounted water: every acre foot sold at the proposed discount will displace an acre-foot sale of water out of MWD's dry-year storage program at the full-service rate. The promise that this discounted water sales program will increase revenues to MWD focuses only on the revenues from discounted water sales and associated near-term fiscal consequences. Ignored in the board memo entirely is the indisputable truth that agencies that would have purchased water at the full service rate – either this fiscal year or in a subsequent year – will instead purchase that water at a discount through the direct discount of up to \$143 per acre-foot and by avoiding future full service rate increases. MWD will not “make money” by selling water at a discount, it will lose money – 200,000 acre-feet of discounted water sales results in the loss of potentially more than \$28 million in revenues. The impact of the lost revenues may not be fully realized in FY 2012, but will certainly be felt in the future.

It is apparent that the reason some MWD member agencies are holding back from purchasing water at the full service rate is precisely because they are waiting to buy it at a discount. That's a smart move for the member agency, but is certainly not in MWD's best interest.

The MWD board is legally required annually to adopt a cost of service and revenue requirement and fix rates that, taken together with other revenue sources, will be sufficient to pay MWD's fixed costs and other expenses. The MWD board has failed to do this and, instead, continues to rely upon inflated sales projections to support its water rates, budget and overspending. At its last meeting, the board was presented with information that projected MWD sales in the current fiscal year are trending to be 291,300 acre-feet below budget. At its meeting on the budget, MWD staff also assessed the value of its water in storage using full service rates. There is no way to reconcile the board's actions in adopting cost of service and revenue requirements with the proposed sale of discounted water.

4. The board memo does not provide a policy or legal basis for the sale of discounted water for replenishment.

The board memo presents a detailed list of concerns with the replenishment program (page 2), notably:

- Questionable and unquantifiable performance and expectations;
- Potential of shifting water sales within a year as opposed to generating true longer-term storage;
- Potential offset of full service sales;

- Unequal distribution of costs and benefits among participating and non-participating agencies;
- Questions on whether water was being stored for future use as opposed to being purchased to refill overdraft;
- Difficulties in measuring and verifying in-lieu deliveries to storage; and
- Cash-flow and budgeting issues associated with the frequency under which replenishment supplies are available.

Each of these seven concerns should be significant enough to dissuade the board from approving discounted replenishment sales. Taken together, however, the seven concerns represent perhaps the most troubled program in MWD's recent history. It is a confounding disconnect, therefore, that the board is being asked to forge ahead with the program without regard to these concerns. The board memo, as written, is very clear that there are significant questions about the performance and equity of the replenishment program. We request that the staff present a further analysis and respond to the "disconnect" between the information provided in the board memo and the staff recommendation for action.

5. The sale of discounted water sends the wrong message at a time when MWD is promising to pay substantial costs associated with a Delta Fix.

If MWD's member agencies are – as is clear from the board memo – unable or unwilling to pay for MWD's current fixed costs, how can MWD credibly commit to pay the additional costs associated with a Delta Fix? Will MWD's member agencies not be subject to the same "budgetary and fiscal constraints" when faced with the costs of a Delta Fix and other IRP investments? If this is indeed the economic reality – that current full service rates are too expensive to encourage MWD water sales to its member agencies – then the MWD board must reconsider MWD's entire water resources strategy. If we can't afford to pay our current fixed costs then it is difficult to see how we can afford to pay the billions of dollars of investment outlined in the 2010 IRP, including the Delta Fix being negotiated by management, seawater desalination projects and a host of other projects.

The continued disconnect between the board's decisions to spend money and the member agencies' willingness to pay for MWD projects is threatening MWD's very financial viability.



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
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May 6, 2011

Jeff Kightlinger, General Manager
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

MEMBER AGENCIES

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OTHER REPRESENTATIVE

County of San Diego

Board Memo 5-1 – Sale of Discounted Water

Dear Jeff,

Thank you for responding to our April 25, 2011 letter regarding MWD's proposed sale of discounted water to selected member agencies. We appreciate that water supply conditions in 2011 have improved significantly; however, the question before the board is what to do with the water that is now available to MWD.

You state in your letter that MWD will maximize the use of its storage assets in 2011 to store available supplies. Director Steiner has requested and you have agreed to provide detailed information how MWD will do that. *Past MWD board reports show that MWD has ample storage and put capacity available to store all of the available water in MWD storage facilities.* Indeed, by our calculation, even if all of the available water is stored by MWD – as we believe it should be – MWD's storage will remain less than half full.

You also state that MWD will likely end the year with its regional storage reserves at the "highest levels in history"; however, this observation fails to take into account the *fundamental shift in MWD's water supply reliability planning which – unlike past history – now relies heavily upon the withdrawal of water from storage in dry years.* That is why the Water Authority has supported MWD's multi-billion dollar investment in storage facilities and agreements, which provide more than 5 million acre feet of storage capacity. Given this water supply strategy and investment, it is difficult to understand why MWD now has no intention of maximizing its investment in storage in a year like this, when water is available. MWD is barely out of a multi-year allocation, yet instead of filling its storage reserves, it wants to sell it at a discount.

The problems with the replenishment program have been previously documented and we will not repeat them here. MWD has been well aware of these concerns for many years but has failed to address the problems in any revised board policy or otherwise. Suffice it to say that the program does not provide benefits to MWD commensurate with the cost to MWD of the program. If MWD is intent on selling discounted water, then it should be made available to all MWD member agencies equally, not just to select agencies on the purported basis of a clearly flawed water supply management program.

On the financial side, the board memo and your letter are clear that under the discounted sales

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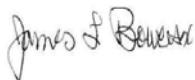
Mr. Kightlinger
 May 6, 2011
 Page 2

proposal, MWD will not recover its fixed costs. This month's staff report shows MWD's FY 2011 sales have further dropped to 1.6 million acre feet (MAF), from the budgeted 1.93 MAF. Although short term cash flow may be improved by the proposed sale of discounted water, it has a deleterious effect on MWD's financial position overall. We believe you know that MWD's fiscal crisis is real – we would welcome the opportunity to work with you on finding real solutions.

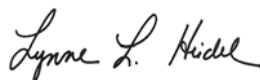
Regarding your comments on the member agencies' willingness to pay for current and future fixed costs, our comments were taken directly from the MWD board memo citing the member agencies' "budgetary and fiscal constraints" as the reason they are not buying MWD water now at the full price that was assumed in the current fiscal year budget. Clearly, the sale of water at full price would be the preferred option because the region would achieve the same storage and water supply benefits and MWD would come closer to hitting its own budget, which is more than \$150 million short that also threatens to leave reserves precariously low.

Finally, we believe you know that the Water Authority's litigation has nothing to do with challenging State Water Project costs – the only question is how those costs should be allocated between supply and transportation. The Water Authority expects to remain one of MWD's largest customers and to pay its fair share of MWD's costs under its State Water Project supply contract. Indeed, to our knowledge, the Water Authority is the only MWD member agency that has actually offered to enter into a long-term contract with MWD for the purchase of State Water Project water and other supplies and services. With firm contracts, MWD could count on being able to cover its fixed costs, now and in the future. We would be happy to make a presentation to the board on the history of that offer as well as make a proposal for the future. We agree that MWD is in a fiscal crisis and the gimmicks being employed this year – including a "fire sale" of discounted water – will not solve or even address the real problem.

Sincerely,



Jim Bowersox
 Director



Lynne Heidel
 Director



Keith Lewinger
 Director



Fern Steiner
 Director

cc: Jack Foley, MWD Board Chairman



San Diego County Water Authority

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May 8, 2015

Randy Record and
Members of the Board of Directors
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

MEMBER AGENCIES

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OTHER
REPRESENTATIVE
County of San Diego

RE: Board Memo 8-2: Authorize (1) \$150 million in additional funding for conservation incentives from the Water Stewardship Fund and the Water Management Fund; and (2) Implementation of modifications to the Turf Removal Program -- **OPPOSE**

Chair Record and Members of the Board:

As you know, the Water Authority and its member agencies have an outstanding record of leadership in water conservation planning, programs and implementation. The San Diego region's per capita water use has dropped by 22 percent since 2007. More than a year ago, in response to the current drought, the Water Authority launched its *When in Drought, Save Every Day, Every Way* campaign to further increase public awareness. Through our continuous efforts, a recent poll shows 87 percent of San Diegans believe saving water is a civic duty, 85 percent are aware the drought is very serious, and 81 percent have taken additional actions to reduce water use since mandatory water use restrictions were implemented in San Diego County last August. It is clear that San Diegans are doing our part to reduce water use, and we will continue to support the Governor's call for increased water conservation and strive to meet the State Board's newly adopted regulations. Against this backdrop, we must oppose staff's recommendation for the following reasons:

- **Lack of accountability.** In spite of repeated requests, MWD has failed to demonstrate actual near-term water savings resulting from the turf removal program. At an estimated cost of almost \$1,500 per acre-foot (AF), which staff has amortized over ten years, the near-term cost of any water savings would be substantially more than \$1,500/AF and well in excess of MWD's current spot market transfers. Short term, there has been no demonstration of meaningful water savings as a result of these subsidies, and certainly no demonstration of water savings that would not otherwise have occurred, either as a result of the high cost of water or state mandates limiting the amount of water retail agencies and their ratepayers may use on ornamental landscapes. Long term, MWD's program includes *no measures* to ensure that turf that someone is paid to remove today won't be reestablished in the future. *Without*

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such accountability, this program constitutes a waste of ratepayer dollars and a gift of public funds.

- ***Lack of transparency.*** MWD has not even provided an accounting of the participants who have received the more than \$77 million that has already been spent on the program. No further public rate dollars should be allocated or spent without an accounting of past expenditures. We renew our request for an immediate audit of this program, including identification of fund recipients, evidence of the turf removal or other "conservation" improvements that have been made with these public funds, and disclosure of any consultants or business entities that have benefitted from the implementation of this program by MWD.ⁱ
- ***Lack of available funding to pay for this massive, unbudgeted program expansion.*** It appears that there are insufficient funds available to pay for the staff recommendationⁱⁱ; and it is therefore highly probable that rate increases will be required for which there has been no public notice. In a PowerPoint presentation to the Finance and Insurance Committee last month, staff reported a Water Management Fund balance of \$32.2 million as of March 31, 2015.ⁱⁱⁱ This month, staff is requesting to use \$9.975 million of that remaining balance to purchase transfer supplies from Yuba County Water Agency, leaving only \$22.25 million available in the Water Management Fund.^{iv} This means that the rest of the funding - \$127.8 million - must come from the Water Stewardship Fund. But in order for the Water Stewardship Fund to generate that level of funding, *MWD would have to sell 3.12 million acre-feet of water (MWD must also make payments due on long term contracts paid for with Water Stewardship Rate dollars).* Since MWD's water sales are obviously going to be much lower than 3 million acre-feet, there is no identified source from which to generate the \$150 million needed for this program. MWD is running this program as an "open checkbook," but it has not planned or budgeted for these expenditures.
- ***The conservation program is being funded with rates the Superior Court has already ruled are illegal.*** MWD is continuing to collect the Water Stewardship Rate even though the Superior Court has already ruled that it is an illegal tax. In addition, San Diegans are being excluded from full participation in the member agency program as a result of MWD's inclusion of the "Rate Structure Integrity" clause, as to which the Court has also ruled substantively in San Diego's favor, subject only to the question of standing.
- ***The turf removal program is a regressive tax.*** Many low income ratepayers allowed their lawns to die many months if not years ago due to the cost of water. Now, they are being forced to subsidize turf replacement by private golf clubs and other commercial and residential high water users.

We have stated our deep concerns about the turf replacement program and MWD's water conservation programs generally, due to the absence of accountability actually measuring conservation results or accounting for the ratepayer dollars being spent on these programs. We have provided suggestions and made requests for information and for an audit on many prior occasions. A copy of our most recent letter dated December 8, 2014, is attached.

Instead of adopting staff's recommendation, we urge the board to: 1) order an immediate audit of the \$77 million that has been spent to date, including the information described above; and 2) request that staff bring back a detailed report including (a) data and an analysis demonstrating the near-term and long-term benefit of these programs, (b) a recommendation and firm budget cap for any proposed expanded conservation program, and (c) identify the source of available funding to pay for it. Staff should also report on the demand reduction impacts from permanent landscape ordinances and/or code changes limiting outdoor water use and how such changes should contribute to phasing out subsidies as a primary means to achieve water conservation.

For these reasons, we oppose staff's recommendations.

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
Director



Fern Steiner
Director



Yen C. Tu
Director

Attachments:

1. Water Authority's December 8, 2014 Letter to MWD Board re 8-1

ⁱ We have been asked, for example, what role MWD's past General Manager, Ron Gastelum, has played in the development and implementation of the turf removal program and whether he has benefitted financially from it on behalf of his client "Turf Terminators." In addition to his former role as General Manager of MWD, Mr. Gastelum also represents a number of MWD member agencies.

ⁱⁱ MWD's budgeted conservation program funding for fiscal years 2014/15 and 2015/16 totaled \$40 million; the staff recommendation in this month's Board Memo 8-2 will increase that budget more than six-fold to \$250 million.

ⁱⁱⁱ In this month's presentation, the projected balance of the Water Management Fund is shown as \$141.9 million as of June 30, 2015; no explanation is provided how the balance will increase by more than \$100 million from March to June 2015.

^{iv} This is all the money that is left in the Water Management Fund of the \$232 million transferred there from the almost **\$500 million MWD has over-collected from ratepayers since June 2013.**



San Diego County Water Authority

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December 8, 2014

Randy Record and
Members of the Board of Directors
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

MEMBER AGENCIES

Carlsbad
Municipal Water District

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OTHER REPRESENTATIVE

County of San Diego

RE: Board Memo 8-1: Authorize: (1) increase of \$40 million for conservation incentives and (2) increase to contract authority of the five-year agreement with Electric and Gas Industries Association for administration of Metropolitan's regional conservation rebate program – **OPPOSE**

Chair Record and Members of the Board:

The Water Authority and its member agencies strongly support and have an outstanding record of leadership in water conservation planning, programs and implementation. Through our collective efforts, the San Diego region's per capita water use has been reduced by almost 25 percent since 2007. In response to the current drought, we launched our *When in Drought, Save Every Day, Every Way* campaign in order to further increase public awareness. As a result of these efforts, a recent poll shows that more than 80 percent of San Diegans now believe saving water is a civic duty. While we continue to support the Governor and State Board's call to increase conservation, we must oppose staff's recommendation due to the manner in which ratepayer dollars are being spent and the absence of any accountability or demonstration that the expenditure of these funds is actually achieving the intended purpose.

Staff's recommendation is to spend five times more than its adopted budget on conservation programs in this fiscal year alone (leaving no conservation funding for the following fiscal year).ⁱ Funding would come from money MWD has over-collected from ratepayers over the last two fiscal years. This money could have been invested directly at the local level, on water conservation and supply programs that would not only alleviate the impacts of drought, but also provide long term water supply benefits. Instead, MWD is proposing to spend a significant portion of this money, over-collected from all ratepayers, on turf replacement on commercial properties including private golf courses. At MWD's \$2 per square foot rebate, this costs MWD ratepayers more than \$1,500 per acre-foot.

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Against this backdrop, we find it ironic that the MWD board just last month adopted a purchase order policy that allows MWD member agencies to increase purchases of low priced Tier 1 water (and avoid the higher Tier 2 rate on an annual basis as costs are incurred), completely eliminating the pricing signal Tier 2 was originally intended to send. MWD's "pricing signals" and behaviors - including this water conservation program - are completely upside down and inconsistent.

MWD is simply burning through ratepayer dollars irresponsibly in the name of water conservation. It could accomplish much more by structuring its rates according to its cost of service and sending true price signals about the value of water. At a minimum, before approving any further funding, MWD should redesign this program to place a cap on the amount of rebate applicants may receive so that conservation rebates are possible involving the general public and a wider range of applicants.

Given the proposed unprecedented level of spending associated with money being paid to private business, we request the General Auditor conduct a financial audit of all rebate programs, starting with a specific emphasis on the turf removal program. For the same reason, we request that the contract authority for EGIA be extended only to match the biennial budget, rather than through 2017. We believe this is absolutely essential to ensure that the MWD board of directors is being a responsible steward of ratepayer dollars.

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
Director



Fern Steiner
Director



Yen C. Tu
Director

ⁱ The staff letter states that the current proposed increase is "intended to address immediate issues in the conservation program for the current fiscal year." MWD's adopted biennial budget for conservation for fiscal years 2014/15 and 2015/16 was \$40 million. With the addition of \$20 million in February and this request to add another \$40 million, the conservation budget for the current year alone would total \$100 million.



San Diego County Water Authority

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May 25, 2015

Randy Record and
Members of the Board of Directors
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

MEMBER AGENCIES

- Carlsbad Municipal Water District
- City of Del Mar
- City of Escondido
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- City of Poway
- City of San Diego
- Fallbrook Public Utility District
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- Santa Fe Irrigation District
- South Bay Irrigation District
- Vallecitos Water District
- Valley Center Municipal Water District
- Vista Irrigation District
- Yuima Municipal Water District

RE: Board Memo 5-1: Authorize: (1) Additional funding for conservation incentives; and (2) Implementation of modifications to the Turf Removal Program

Chair Record and Members of the Board:

We submit for the record the following comments to supplement our May 8, 2015 letter and address Board Memo 5-1. A copy of our May 8 letter is attached and incorporated by reference.

We support turf removal in Southern California. We also understand why the public would respond enthusiastically to a program it is being told is "free." However, MWD's program, even with the modest changes described by staff, is neither sustainable nor fiscally responsible.

- First, the program is not "free." As the General Manager stated at our last meeting, every \$100,000,000 in program costs represents a 7 percent rate increase.
- Staff's recommendation to increase conservation program expenditures to \$450 million is more than ten times the \$40 million budget the board adopted for the current budget cycle. By staff's own estimate, even this extraordinary amount of funding will only pay for the MWD program for the next six months or so, through fall 2015. Staff's proposal is silent on what it would recommend the board do at that point, or, what impact this spending will have on the budget or water supply availability next year.
- Board adoption of the staff recommendation will exhaust **all** of MWD's water management reserves, leaving no funding available to purchase additional water transfer supplies should the drought continue in 2016 or to purchase water to refill our depleted storage, should additional water supplies become available.

OTHER REPRESENTATIVE

County of San Diego

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- MWD is not paying for this program with state bond money or "extra" money it has lying around. **One hundred percent of the program is being paid for with water rates** that have been set by this board to generate net revenues in excess of MWD's adopted budgets and maximum reserve targets. **Since 2012, MWD has collected from ratepayers \$795,000,000 more than necessary to pay 100 percent of its costs.**

Rate increases to pay for the unprecedented expansion of this program are inevitable.

Ratepayers are already at risk of facing stiff MWD rate increases in 2016 if the drought continues (as well as rate increases from retail water suppliers). Worse yet, these rate increases will hit Southern California's low-income ratepayers hardest, forcing them to pay for a program which benefits those who can better afford to pay for their own turf removal.

The MWD program needs an immediate overhaul that is not accomplished by the recommendations contained in Board Memo 5-1. The problems with MWD's program, including the fact **it is clearly paying far more than is needed to "incentivize" turf removal**, are apparent to any agency that has administered successful programs in the past. See *Turf Removal & Replacement: Lessons Learned*, California Urban Water Conservation Council (March 2015).

Our objections notwithstanding, the Water Authority and its member agencies will seek a fair share of any funds that are authorized by the board under Board Memo 5-1 since our ratepayers will be forced to pay roughly 25 percent of these increased costs and inevitable rate increases.

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
Director



Fern Steiner
Director



Yen C. Tu
Director

Attachments:

1. Water Authority's May 8, 2015 Letter to MWD Board RE: Board Memo 8-2
2. *Turf Removal & Replacement: Lessons Learned*, California Urban Water Conservation Council (March 2015).



San Diego County Water Authority

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May 8, 2015

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OTHER
REPRESENTATIVE

County of San Diego

RE: Board Memo 8-2: Authorize (1) \$150 million in additional funding for conservation incentives from the Water Stewardship Fund and the Water Management Fund; and (2) Implementation of modifications to the Turf Removal Program -- **OPPOSE**

Chair Record and Members of the Board:

As you know, the Water Authority and its member agencies have an outstanding record of leadership in water conservation planning, programs and implementation. The San Diego region's per capita water use has dropped by 22 percent since 2007. More than a year ago, in response to the current drought, the Water Authority launched its *When in Drought, Save Every Day, Every Way* campaign to further increase public awareness. Through our continuous efforts, a recent poll shows 87 percent of San Diegans believe saving water is a civic duty, 85 percent are aware the drought is very serious, and 81 percent have taken additional actions to reduce water use since mandatory water use restrictions were implemented in San Diego County last August. It is clear that San Diegans are doing our part to reduce water use, and we will continue to support the Governor's call for increased water conservation and strive to meet the State Board's newly adopted regulations. Against this backdrop, we must oppose staff's recommendation for the following reasons:

- **Lack of accountability.** In spite of repeated requests, MWD has failed to demonstrate actual near-term water savings resulting from the turf removal program. At an estimated cost of almost \$1,500 per acre-foot (AF), which staff has amortized over ten years, the near-term cost of any water savings would be substantially more than \$1,500/AF and well in excess of MWD's current spot market transfers. Short term, there has been no demonstration of meaningful water savings as a result of these subsidies, and certainly no demonstration of water savings that would not otherwise have occurred, either as a result of the high cost of water or state mandates limiting the amount of water retail agencies and their ratepayers may use on ornamental landscapes. Long term, MWD's program includes *no measures* to ensure that turf that someone is paid to remove today won't be reestablished in the future. *Without*

A public agency providing a safe and reliable water supply to the San Diego region

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- **Lack of transparency.** MWD has not even provided an accounting of the participants who have received the more than \$77 million that has already been spent on the program. No further public rate dollars should be allocated or spent without an accounting of past expenditures. We renew our request for an immediate audit of this program, including identification of fund recipients, evidence of the turf removal or other "conservation" improvements that have been made with these public funds, and disclosure of any consultants or business entities that have benefitted from the implementation of this program by MWD.ⁱ
- **Lack of available funding to pay for this massive, unbudgeted program expansion.** It appears that there are insufficient funds available to pay for the staff recommendationⁱⁱ; and it is therefore highly probable that rate increases will be required for which there has been no public notice. In a PowerPoint presentation to the Finance and Insurance Committee last month, staff reported a Water Management Fund balance of \$32.2 million as of March 31, 2015.ⁱⁱⁱ This month, staff is requesting to use \$9.975 million of that remaining balance to purchase transfer supplies from Yuba County Water Agency, leaving only \$22.25 million available in the Water Management Fund.^{iv} This means that the rest of the funding - \$127.8 million - must come from the Water Stewardship Fund. But in order for the Water Stewardship Fund to generate that level of funding, *MWD would have to sell 3.12 million acre-feet of water (MWD must also make payments due on long term contracts paid for with Water Stewardship Rate dollars)*. Since MWD's water sales are obviously going to be much lower than 3 million acre-feet, there is no identified source from which to generate the \$150 million needed for this program. MWD is running this program as an "open checkbook," but it has not planned or budgeted for these expenditures.
- **The conservation program is being funded with rates the Superior Court has already ruled are illegal.** MWD is continuing to collect the Water Stewardship Rate even though the Superior Court has already ruled that it is an illegal tax. In addition, San Diegans are being excluded from full participation in the member agency program as a result of MWD's inclusion of the "Rate Structure Integrity" clause, as to which the Court has also ruled substantively in San Diego's favor, subject only to the question of standing.
- **The turf removal program is a regressive tax.** Many low income ratepayers allowed their lawns to die many months if not years ago due to the cost of water. Now, they are being forced to subsidize turf replacement by private golf clubs and other commercial and residential high water users.

We have stated our deep concerns about the turf replacement program and MWD's water conservation programs generally, due to the absence of accountability actually measuring conservation results or accounting for the ratepayer dollars being spent on these programs. We have provided suggestions and made requests for information and for an audit on many prior occasions. A copy of our most recent letter dated December 8, 2014, is attached.

Instead of adopting staff's recommendation, we urge the board to: 1) order an immediate audit of the \$77 million that has been spent to date, including the information described above; and 2) request that staff bring back a detailed report including (a) data and an analysis demonstrating the near-term and long-term benefit of these programs, (b) a recommendation and firm budget cap for any proposed expanded conservation program, and (c) identify the source of available funding to pay for it. Staff should also report on the demand reduction impacts from permanent landscape ordinances and/or code changes limiting outdoor water use and how such changes should contribute to phasing out subsidies as a primary means to achieve water conservation.

For these reasons, we oppose staff's recommendations.

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
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Director



Yen C. Tu
Director

Attachments:

1. Water Authority's December 8, 2014 Letter to MWD Board re 8-1

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ⁱⁱ MWD's budgeted conservation program funding for fiscal years 2014/15 and 2015/16 totaled \$40 million; the staff recommendation in this month's Board Memo 8-2 will increase that budget more than six-fold to \$250 million.

ⁱⁱⁱ In this month's presentation, the projected balance of the Water Management Fund is shown as \$141.9 million as of June 30, 2015; no explanation is provided how the balance will increase by more than \$100 million from March to June 2015.

^{iv} This is all the money that is left in the Water Management Fund of the \$232 million transferred there from the almost **\$500 million MWD has over-collected from ratepayers since June 2013.**



San Diego County Water Authority

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December 8, 2014

Randy Record and
Members of the Board of Directors
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

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Municipal Water District

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Santa Fe Irrigation District

South Bay Irrigation District

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Municipal Water District

Vista Irrigation District

Yuima
Municipal Water District

OTHER REPRESENTATIVE

County of San Diego

RE: Board Memo 8-1: Authorize: (1) increase of \$40 million for conservation incentives and (2) increase to contract authority of the five-year agreement with Electric and Gas Industries Association for administration of Metropolitan's regional conservation rebate program – **OPPOSE**

Chair Record and Members of the Board:

The Water Authority and its member agencies strongly support and have an outstanding record of leadership in water conservation planning, programs and implementation. Through our collective efforts, the San Diego region's per capita water use has been reduced by almost 25 percent since 2007. In response to the current drought, we launched our *When in Drought, Save Every Day, Every Way* campaign in order to further increase public awareness. As a result of these efforts, a recent poll shows that more than 80 percent of San Diegans now believe saving water is a civic duty. While we continue to support the Governor and State Board's call to increase conservation, we must oppose staff's recommendation due to the manner in which ratepayer dollars are being spent and the absence of any accountability or demonstration that the expenditure of these funds is actually achieving the intended purpose.

Staff's recommendation is to spend five times more than its adopted budget on conservation programs in this fiscal year alone (leaving no conservation funding for the following fiscal year).ⁱ Funding would come from money MWD has over-collected from ratepayers over the last two fiscal years. This money could have been invested directly at the local level, on water conservation and supply programs that would not only alleviate the impacts of drought, but also provide long term water supply benefits. Instead, MWD is proposing to spend a significant portion of this money, over-collected from all ratepayers, on turf replacement on commercial properties including private golf courses. At MWD's \$2 per square foot rebate, this costs MWD ratepayers more than \$1,500 per acre-foot.

A public agency providing a safe and reliable water supply to the San Diego region

Against this backdrop, we find it ironic that the MWD board just last month adopted a purchase order policy that allows MWD member agencies to increase purchases of low priced Tier 1 water (and avoid the higher Tier 2 rate on an annual basis as costs are incurred), completely eliminating the pricing signal Tier 2 was originally intended to send. MWD's "pricing signals" and behaviors - including this water conservation program - are completely upside down and inconsistent.

MWD is simply burning through ratepayer dollars irresponsibly in the name of water conservation. It could accomplish much more by structuring its rates according to its cost of service and sending true price signals about the value of water. At a minimum, before approving any further funding, MWD should redesign this program to place a cap on the amount of rebate applicants may receive so that conservation rebates are possible involving the general public and a wider range of applicants.

Given the proposed unprecedented level of spending associated with money being paid to private business, we request the General Auditor conduct a financial audit of all rebate programs, starting with a specific emphasis on the turf removal program. For the same reason, we request that the contract authority for EGIA be extended only to match the biennial budget, rather than through 2017. We believe this is absolutely essential to ensure that the MWD board of directors is being a responsible steward of ratepayer dollars.

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
Director



Fern Steiner
Director



Yen C. Tu
Director

ⁱ The staff letter states that the current proposed increase is "intended to address immediate issues in the conservation program for the current fiscal year." MWD's adopted biennial budget for conservation for fiscal years 2014/15 and 2015/16 was \$40 million. With the addition of \$20 million in February and this request to add another \$40 million, the conservation budget for the current year alone would total \$100 million.

Turf Removal & Replacement: Lessons Learned

March, 2015
Author: Briana Seapy



California
Urban Water
Conservation
Council

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~Acknowledgements~

Thank you to all Council member agencies for making this report possible through your annual dues. Thank you also to the ten water agencies that contributed data and invaluable anecdotal lessons to inform this report. Your contributions will help guide water distributors looking to start or improve their own turf removal programs.



Turf Removal & Replacement: Lessons Learned

Introduction

A thirsty California uses over half of its urban water deliveries on landscape irrigation. Water intense turf grasses are the historical foundation of California landscaping. Water shortages, among other catalysts, are pushing California away from traditional turf grass landscapes towards sustainable landscaping. Sustainable landscaping intends a holistic, watershed-based approach to landscaping that transcends water-use efficiency to address the related benefits of cost savings, run-off reduction, green waste reduction, pesticide and fertilizer reduction, habitat improvement, and energy/greenhouse gas (GHG) reductions.

The transition from a turf-based landscape involves two steps. Turf removal is the first step, turf replacement the second. Customers' aesthetic preferences, geographic location, and bank accounts, along with product market availability, influence both turf removal and turf replacement decisions. Statewide, water agencies¹ are managing turf removal programs that stipulate replacement requirements, incentivizing a California landscaping transformation. These programs vary in size, scope, and specifications. The following report takes both a closer look at lessons learned from existing turf removal programs as well as a cursory glance at turf replacement options and implications.

Turf Removal Programs

Turf Removal Rebate Programs

Turf removal rebate programs offer rebates to end-users for removal and replacement of water-intensive turf lawns. Local and regional agencies are adopting these turf removal programs, anticipating that their upfront investment in rebates will yield long-term outdoor water savings dividends for years to come. For example, the Metropolitan Water District (MWD) spearheads a large-scale regional 'Cash for Grass' lawn conversion program. Currently, MWD provides water distributors within its service area a \$2 per square foot (sq. ft.) turf rebate subsidy. Agencies can add to this rebate as they desire. MWD has earmarked over \$85 million in funding for the rebate programs. Statewide, rebates range from \$0.50/sq. ft. to \$3.75/sq. ft.

Rebate Program Strategies

In general, rebate programs offer customers a dollar amount per square foot of turf removed. More specifically, individual programs require compliance with any number of turf replacement specifications;

¹ This report only includes information from local government water suppliers, referred to throughout as 'agencies.'

from pre- and post-removal inspections, to updated irrigation systems; in order to qualify for the rebate. To maximize the 'bang for their buck,' agencies invoke rebate qualification strategies to foster program growth and sustainability and to maximize water savings. Common rebate qualification policies include:

- Requiring well-documented rebate applications with historical water bills, landscape 'before' photos, and other documentation of maintained turf landscape
- Requiring attendance at a landscaping/irrigation workshop/class before submitting an application
- Requiring landscape design submission before property inspection
- Prohibiting re-installation of turf on rebated property under the same owner
- Prohibiting spray irrigation on converted landscapes
- Requiring drip or point source irrigation, micro-spray irrigation, low precipitation-rate nozzle spray irrigation, or hand-watering; requiring pressure regulators and filters for point source irrigators; requiring a smart irrigation controller
- Rebating only properties with evidence of living, maintained turf within a specified number of months prior to turf removal
- Rebating only properties that use sprinkler irrigation systems
- Rebating only areas that are visible to the public
- Requiring a specific percentage (e.g., 25%) of replacement landscape to be re-planted with water-efficient, or drought-tolerant plants
- Requiring sheet mulching to a specified number of inches (e.g., 2-4 in.) on all landscaped ground
- Rebating parkways (the strips of land between sidewalk and curb) separately and under different rebate terms and conditions
- Offering partial rebates for lawn removal, irrigation updates, and sheet mulching; offering complete rebates after planting appropriate plants in appropriate seasons (i.e., not mid-summer)
- Requiring replacement landscape to be made up of native, climate appropriate, or California-Friendly plants
- Requiring a specified percentage of pre-conversion property, or landscaped area (sq. ft.), to be made up of turf in order to qualify for a rebate
- Requiring California-licensed landscape contractors to convert landscapes if the property owners do not re-landscape themselves
- Requiring design consultation for do-it-yourselfers
- Prohibiting or restricting specific turf replacement options such as synthetic turf, concrete, permeable hardscapes, and gravel
- Setting a dollar or square foot rebate minimum
- Setting a dollar or square foot rebate maximum
- Requiring pre- and post-replacement inspections
- Setting a due date for landscape replacement completion
- Accepting only residential properties
- Accepting only CII properties.

Water distributors employ any number of these strategies with the intention of maximizing program cost-effectiveness and long-term water savings, while maintaining or increasing program participation. In the following section, data collected from water agencies across the state reveal a number of quantitative turf rebate program results, as calculated or estimated by the water agencies themselves.

Rebate Program Data Summary

Turf removal rebate program data collected from nine agencies are summarized in the table below. The data presented in the following table come from the following agencies, variable in size and geographic location: City of Long Beach, City of Roseville, City of Sacramento, City of Santa Cruz, City of Santa Rosa, Contra Costa Water District, Los Angeles Department of Water and Power, Municipal Water District of Orange County, and San Diego County Water Authority.² These agencies are neither a random sample nor a statistically significant grouping; rather they are agencies that run well-known turf rebate programs and that have a wealth of insights to share.

The data collected, presented in Table 1 below, covers the following parameters: year started, rebate cost then, rebate cost now, total removals to date, average expected water savings, rebate costs to date, customer participation and breakdown by customer category, minimum and maximum rebates, and large landscape participation.

Table 1 demonstrates the challenge of objectively and quantitatively reviewing turf rebate removal programs. Fundamentally, this challenge stems from the absence of widely shared, consistent data collection standards. Additional variability comes from other factors. For example, not all agencies submitted data for all parameters presented below. In addition, both retail and wholesale agencies participated. The size and geographic location of participating agencies varies broadly, as well as the program years for which data was available. And finally, agencies use different calculation methodologies to report their program results, even for the same program parameter. Keep these caveats in mind while reviewing Table 1.

² The Metropolitan Water District of Southern California (MWD) shared its program information, but its service area includes other water agencies that volunteered data for this report. Consequently, MWD's data is not included in Table 1 to prevent double-counting rebate data.

Table 1: Average, median, minimum, and maximum turf rebate program statistics from nine California water agencies.³

	Year Started	Rebate Then (\$/sq. ft.)	Rebate Now (\$/sq. ft.)	Total Removals to date (sq. ft.)	Total Removals to date (# program participants)	Average Expected Water Savings (gal/sq.ft./yr)	Rebate Cost to Date	Total Program Cost to Date	Average \$/AF saved
Average	2010	\$1.00	\$1.44	2,316,107	1,308	31	\$1,754,187	\$1,798,895	\$2,011
Median	2010	\$1.00	\$1.00	543,838	883	34.0	\$721,517	\$931,692	\$1,413
Min	2007	\$0.50	\$0.50	57,556	138	13.5	\$33,461	\$478,472	\$354
Max	2014	\$2.50	\$3.75	11,872,491	4,103	46	\$3,800,000	\$3,986,520	\$5,840
Response Rate	100%	100%	100%	100%	100%	89%	56%	33%	56%

	Residential Customer % (SF)	Commercial Customer % (MF, CII)	Minimum Rebate Residential (sq. ft.)	Maximum Rebate Residential (sq. ft.)	Minimum Rebate CII (sq. ft.)	Maximum Rebate CII (sq. ft.)	% Participation made up by Large Landscapes (CII, MF, and > 1 acre)
Average	93%	7%	300	1214	500	6500	9%
Median	92%	8%	275	1000	250	5500	7%
Min	88%	0%	250	500	250	5000	0%
Max	100%	12%	400	2000	1000	10000	30%
Response Rate	89%	89%	100%	100%	100%	100%	78%

Table 1 offers a general quantitative context for existing turf rebate programs. It is evident that turf rebate programs are relatively new to California, launching within the last decade. Though average rebate value has increased over time and though the maximum rebates offered are roughly 50% higher now than at the start of these programs, there are still successful programs that offer the minimum \$0.50 rebate. In fact, median rebate value has stayed consistent over time for this sample of agencies. Cumulative program turf removals by area and by participants vary widely and correlate strongly with agency size and available funding. Anticipated water savings trend with agency climate - the warmer the climate, the greater the water savings - and range from 13.5 to 46 gallons per square foot of turf removal per year. Associated rebate costs and overall program costs vary by rebate levels, program participation, and cost calculation methodology. Agencies estimate that their costs for every acre-foot (AF) of water saved on account of the rebate program, pro-rated over an assumed 10-year program life, are anywhere from \$354 to \$5,840 (see [Rebate Program Cost-Effectiveness](#) below for further details on the \$/AF metric). Program participation breakdowns hover around 90% residential and 10% commercial, as measured by number of participants and not by rebated area. In general, large landscapes make up less than 10% of overall program participants. Minimum and maximum rebated areas typically increase for commercial customers when

³ Note the following five data annotations: 1) of the nine agencies, seven are retail, two are wholesale; 2) of the nine agencies, four receive external program funding, five do not receive external program funding; 3) no statistically significant outliers were found in the data used to develop Table 1; 4) no numeric data was entered for the 'Minimum and Maximum Rebate' categories for agencies with no defined minimum or maximum rebate restrictions; 5) 'Total Program Cost to Date' had the lowest parameter response rate –agencies did not have the information available, they were unwilling to share the information, and/or their information did not include third-party contractor time, pre- and post- rebate inspection time, and/or retail agency administration time.

compared with residential customers. These general data conclusions are to be taken with a grain of salt given the inconsistent data quality and verification; to draw any further detailed and specific quantitative conclusions from the presented data would be imprudent given the quantity, quality and consistency of available data.

Rebate Program Challenges & Risks

The wide variability in the data reported in Table 1 makes it difficult to draw precise, quantitative lessons. Nevertheless, the program managers interviewed for this survey have developed a body of anecdotal information regarding the array of expected and unexpected challenges and risks they have faced while administering turf rebate programs. Agencies contemplating a new, expanded or simply continued program can take advantage of this information to anticipate the challenges and risks and to design their programs to improve the odds of success. The following list details the ten most prevalent challenges and risks faced by existing rebate programs.

1. **Rebate Funding** – Approximately half of the agencies interviewed depended on external funding to run their turf rebate program. External funding has pros and cons. On the positive side, it enables a water agency to run a program that it otherwise might have been unable to run. On the flip side, once the funding has run out, the program must be put on hold. Indeed, the more popular the program, the sooner the funds run out. External funding also requires compliance with grant terms. Funders can impose restrictions or requirements on funding that complicate a program's implementation or popularity. For example, a grant might require all converted landscapes to include specific features like drip irrigation or 50% plant coverage.

Things are not necessarily easier for the half of surveyed agencies that rely solely on internal funding. On the positive side, internal program management streamlines funding processes and allows program managers to pace the distribution and continuation of funding as they deem fit. On the negative side, it can be difficult to find the money for rebate programs, especially absent sufficient political will.

2. **Non-Savers** – One risk common to all turf rebate programs is the chance that participants will undertake lawn transformations that ultimately do not save water. See [*Non-Savers*](#) below for an elaboration.
3. **Behavioral Limitations on Water Savings** – Regardless of the number of requirements and stipulations an agency establishes to maximize water savings, the actual water savings realized are subject to a factor out of agency control – end user behavior. Even super efficient irrigation systems are prone to improper use or failure absent proper maintenance.
4. **Staff Time & Resources** – Considering the standard stages of a rebate process – customer application, review, and acceptance; pre-inspection; customer guidance; and post-inspection – an internally managed rebate program is time-intensive. For example, one agency designates one

Full Time Equivalent staff person solely to its turf rebate program. To mitigate these staff costs, some agencies hire third party management consultants to help run the programs. While most of the agencies that follow this path still formally approve refund applications internally, the ability to outsource many of the rebate program tasks has proved cost effective for larger agencies.

5. **Growth Capacity** – Overall rebate program participation appears largely predictable, but managing the sometimes dramatic fluctuations in participation requires foresight. Agencies consistently note big jumps in program participation over periods as short as a few months. For example, one agency experienced a 600% increase in participation from one month to the following (50 to 300 participants). See *Application Trends* in the [following section](#) for participation triggers.
6. **DIY Landscapers** – Eager participants that wish to convert their lawns but lack sustainable landscaping knowledge and the will or funds to hire a designer or contractor can produce aesthetically displeasing landscapes. These landscapes leave negative impressions on neighbors and the public and can deter others from participating. Of course, not all do-it-yourselfers are guilty of 'ugly' outcomes, but agencies throughout the survey consistently identified 'ugly' outcomes that hurt rather than helped their programs.
7. **Savings Calculations** – Quantifying water savings attributable to the rebate program can challenge water agencies, especially those without Automated Meter Infrastructure (AMI). To accurately capture water savings, an agency must account both for weather variations and for water use patterns that are not directly attributable to the rebate program. In addition, irrigation patterns immediately before and after a landscape conversion produce their own water use anomalies. Just before the conversion, outdoor water use generally *declines*, as property managers tend to quit watering their old lawns. In contrast, just after the conversion, outdoor water use tends to *increase* as the same property managers frequently overwater their new plants until the plants establish themselves. To compensate for water use variability and obtain statistically significant water savings calculations, water distributors need to analyze both historical water use records and records several years after the conversion. Without sophisticated metering, let alone designated landscape meters, attributing water savings directly to turf replacement can be nearly impossible.
8. **Replacement Plant/Landscaping/Irrigation Materials & Requirements** – Programs across California lack a consensus on what to allow in replacement landscapes. Ultimately, a program encouraging holistic, sustainable landscaping may have stricter stipulations than a program simply seeking maximum water savings. Where each agency decides to land on the spectrum of replacement landscape requirements is left to a number of factors. These include funding obligations, geographic restrictions, customer and political will, and individual program managers. Managers face particularly hard decisions when deciding program requirements that require due-diligence research. For example, one Southern California agency removed permeable hardscapes from its

list of acceptable replacement options because it was observing the failure of certain permeable pavers. Other agencies continue to permit permeable pavers. They point to research that shows long-term infiltration benefits, even accounting for degradation and clogging over time. Similarly, one agency found that the plants it was recommending were not available in its region, causing undue stress on landowners trying to find responsible plant materials.

9. **Collaboration** – Overlap between or proximity to other turf rebate programs can cause confusion in customers, especially when replacement requirements and rebate values vary drastically. Without proper agency alignment, 'double-dipping' is also a concern (when crafty customers seek double the rebate – one rebate from a local agency, one from a regional agency). For example, one Southern California regional distributor offered a rebate program at the same time as a city of within its jurisdiction. The agencies diligently worked together to align expectations and preempt complications; however, inevitable variation in rebate values and specifications and ultimately the abrupt end and re-start of the city's program led to customer confusion.
10. **Customer Communication** – In an effort to set clear expectations, achieve maximum water savings, and offer comprehensive customer support, agencies often overwhelm turf rebate customers with information. On the one hand, an agency's posting of detailed turf removal documents on its website (e.g., program requirements, terms and conditions, design advice, and tax warnings) risks shutting customers down with information overload. On the other hand, not posting these materials risks unclear messaging and legal vulnerabilities.

Rebate Program Take-Aways: What to Expect & How to Manage for Success

To create and manage successful turf rebate programs, agencies must learn from their peers and anticipate the trends and patterns that can predict or pre-empt program issues. The following list details 14 reasonable program expectations and management tips for mitigating associated program challenges and risks.

1. **Application Trends** – Agencies consistently observe spikes in program applications and participation immediately following three events: a drought emergency declaration; a rebate increase; and a special, landscape-focused agency event. Agencies also note that participation has held relatively high ever since the governor's emergency drought declaration in January, 2014 and the State Water Board's promulgation of emergency drought regulations in the summer of 2014.
2. **Rebate Value** – While the decision on the dollar-value of a program's rebate has real implications for customer attraction and retention, it alone does not dictate participation. For example, an agency with an eight-year-old turf rebate program recently cut its rebate value in half when funding was getting low, from \$1 to 50 cents per square foot, yet the program did not see a drop in participation. Since then, the agency has even grown its program participation and has effectively doubled its impact (i.e., the agency can double the

landscape conversion area supported by the program using the same remaining funds). Understanding local/regional costs for landscaping replacement, the marginal value of the anticipated water savings to your agency, and target customer demographics' willingness to 'pay' can help with rebate selection. Rebate levels can always be changed (unless specified otherwise by a funding entity), and many successful rebate programs have increased their rates temporarily as a 'drought' special, indicating a flexibility to adapt the value as needed.

3. **Marketing** – Agencies employ a range of marketing strategies to get the word out about turf rebate programs. These include bill inserts, direct mailings, social media, radio tags during weather and traffic announcements, Google ad-words, garden tours and landscape events and workshops, program-specific websites, and word of mouth. Most agencies indicate that three outreach and advertising strategies are most effective: a) bill inserts and direct mailings; b) annual spring garden tours or landscape workshops; and c) word of mouth via existing and aesthetically pleasing landscape conversions.
4. **Customer Care and Communication** – Many customers are completely new to landscaping, let alone to turf conversion. They require significant handholding on the program application, the landscape design, and the landscape installation. How a program 'holds' customers' hands varies from indirect strategies such as "check the website for information," to direct strategies such as "call the turf rebate program manager when needed." Though water agencies vary on how they manage continual customer need, an emerging theme suggests that kind and flexible customer service that rewards good intentions is key to successful landscape conversions and program longevity. For example, a delayed landscape conversion that fails to meet a program deadline because the customer was concerned about watering new plants in the summer may save more water than an incomplete conversion that fell-through because the customer did not comply with the program timeline and the rebate offer was revoked.

Maintaining flexibility with customers can come at the cost of increased program administration time. Streamlining and minimizing customer communication and standardizing customer expectations reduces program staff time. Agencies must seek an internal balance between customer intervention and customer independence that considers the impact on targeted outcomes such as successful conversions and water savings. Persuading customers to read available rebate parameters and conversion expectations before calling agencies with questions is a key strategy to streamline customer interaction, but as previously noted, turf rebate information can be overwhelming and daunting to the landscape novice. Clear and concise rebate program informational materials, easily understood by customers, will contribute to program efficiencies. Some agencies require customers to check a box indicating that the customer has thoroughly read and understood all the program terms and conditions before applying. This strategy may decrease agency liability, but many internet-users have been conditioned to check that box regardless of whether they have actually

reviewed the content. Implementing innovative strategies that encourage customers to do their own program research and that address multiple customer questions and concerns at the same time may pay back dividends in the rebate process by saving staff time. For example, one agency hosted a twitter chat when it first launched its program, answering many would-be participants' questions in one concerted effort.

5. **Customer Demographic Breakdown** – Generally speaking, agencies that offer rebates to both residential and commercial customers draw roughly 90% of their participants from the residential sector and 10% from the commercial sector. Spatially and financially, however, results vary, and commercial customers can far exceed residential customers in terms of acres of turf converted and rebates received. Depending on program goals (e.g., landscape awareness, magnitude of conversions, or customer relationship-building), an agency may delegate specific proportions of available funding to the residential or commercial sectors. For example, a water agency that wants to increase engagement with the CII sector can allocate more rebate funds to that sector than to the residential sector. Agencies have also noted a breakdown of roughly 15% do-it-yourself participants versus 85% hire-a-contractor participants, though this ratio is prone to vary significantly by region, program requirements, and customer demographics.
6. **The Design Phase** – Agencies have found that the landscape design component of rebate programs is instrumental in eliciting positive transformations and that most customer drop-outs occur upon facing program design hurdles. Most programs require some sort of landscape design submission to be eligible for the rebate. Some agencies will not even inspect properties until a landscape design is submitted, because they observe up to a 50% drop-out rate during the design phase. To empower customers and to encourage excellent designs, agencies adopt different strategies. Two of these are; a) customer class requirements where customers participate in a landscaping class before they apply to the program; and b) discounted design consultations where customers can receive a two-hour landscape architect consultation for a heavily reduced price.
7. **Rebate Timeline** - From the application to the final inspection, rebate processes can last anywhere from 45 days to over 4 months. Customer and agency enthusiasm can wane during this time, and participant paper trails can get lost and confused. An agency needs a consistent approach to managing the lengthy conversion processes. It also needs to capitalize on the increased customer contact that a rebate program generates by encouraging long-term customer commitments to landscape maintenance that extend beyond the rebate time-frame. For context, the average, healthy, California native garden takes two years to fully establish. Customer communication and education during the rebate time-frame is critical to the future establishment and management of replacement landscapes after the rebate process concludes.

8. **Customer Fallout** – Turf rebate program attrition rates are consistently high. Three reasons for this are: a) the lengthy conversion timeline; b) the rigorous replacement requirements; and c) landscaping's complexity. Agencies observe anywhere from 25-45% of applicants pulling out of the rebate process before they receive their rebate check – typically the last step of the process. Applicants will be rejected by the program or drop out of the rebate process for multiple reasons. These include: fatal flaws in their applications, failure to comply with the turf replacement requirements, and simple process fatigue. Programs with strict deadline cycles see most of their drop-outs leave the program right before the final deadline, because they were unable to stay on track. Programs with an involved design component see most drop-outs during the design submission phase.

Agencies use a range of strategies to minimize drop-out rates. Some agencies explicitly confirm that the customer is aware of all the program requirements by requiring attendance to a sustainable landscape class or workshop that sets explicit expectations as an application pre-requisite. Others provide design advice, tools, or professional services to applicants who are do-it-yourselfers, as these customers struggle the most with program design components.

9. **Lawn Acceptance Status** – Traditionally, agencies require lawns to be well-maintained prior to a rebated conversion in order to realize real water savings. California's lasting drought, however, has stressed lawns. Agencies can no longer expect perfectly watered and manicured lawns upon rebate program pre-inspection. With drought watering restrictions and increased conservation ethics, it is more common to find homeowners these days who are willing to 'let their lawn go.' Some agencies realize that to follow the watering restrictions is to see some decrease in lawn health. Other agencies do not wish to punish homeowners for good behavior. Still others view lawn conversions as a long-term investment that may not yield immediate savings, but will ultimately realize long-term water conservation. For all these reasons, some agencies have relaxed their pre-inspection lawn status requirements and are accepting rebate applications for less-than-perfect lawns. Agencies are particularly willing to overlook a stressed lawn during pre-inspection if seasonal and historical billing data or aerial imagery is available to prove that the property was recently fully irrigated. Accessing historical water use data to support claims of historic irrigation is easier for districts with automated metering infrastructure and dedicated irrigation meters. Even then, the records must be normalized for weather.

10. **Replacement Requirements** – What an agency chooses to allow or prohibit within its turf replacement requirements can determine the cost and feasibility of successful conversions. Agencies who make the requirements too strict will find that fewer people will apply to the program or comply with the terms and conditions. Those who make them too loose will find that the resulting landscapes will not meet agency expectations. When designing rebate program requirements, agencies with existing turf rebate programs suggest five points: a) align

with near-by rebate program requirements; b) focus on the aesthetics of early conversions to boost program popularity; c) offer specific climate-appropriate and native plant suggestions and work with local nurseries and plant retailers to make sure suggested plants are available; d) require irrigation system upgrades; and e) specifically address - through required educational opportunities - the behavioral and educational barriers to water conservation. These include irrigation management and sustainable landscaping practices.

11. **Social Norms** – Powerful in their ability to attract or dissuade customers to a rebate program, social norms can make or break a program's success. For example, agencies have seen that one to two stunning conversions in a neighborhood can catalyze an entire neighborhood's transformation. Conversely, a single ugly conversion can discourage a neighborhood from participating in a rebate program. Agencies suggest that managers of new programs do whatever it takes to promote a neighborhood's beautification, and not its 'uglification.'
12. **From Early Adopters to High Water Users** – Existing turf rebate programs have shown that a water district's most water-conscious customers will undertake the initial lawn conversions. Over time and with successful conversions, agencies have found that the program ultimately attracts the less-conscious, high-water users.
13. **Cross-Agency Collaboration** – Two rebate program situations involving multiple agencies in the same geographic area have lead to customer confusion. First, some retail water agencies fall within the jurisdiction of a regional wholesaler. Second, many retail agencies have service area boundaries contiguous with one or more other retailers. In either case, customers can be confused by the existence of multiple turf rebate programs, and agencies can experience cross-agency program conflict. To minimize confusion and avoid conflict, regional programs must generate buy-in from member agencies and stakeholders early on in the program design process. Similarly, independent retailer rebate programs should seek alignment with other regional or proximate agency programs to provide their customers with consistent and clear expectations.
14. **Wisdom Over Time** – As with any new program, there is a learning curve to turf rebate programs. Though this report hopes to help flatten that curve, existing programs are learning new "lessons" daily. Agencies starting new programs should consult directly with well-established turf rebate programs. Additionally, agencies with existing programs recommend trying small scale pilots before launching large scale rebate programs. These pilots allow agency staff to work out program hiccups and save significant time and money down the road. For example, one agency piloted its turf rebate program with a small subset of customers before implementing it on a large scale. Based on the pilot, this agency ultimately decided to only require commercial entities to submit conversion plans, not residential homes; that agency had found that the otherwise required conversion plan 'homework' significantly deterred residential participation.

Landscape Conversion Water Use Impacts

Water Savings

Water savings attributable to landscape conversions - with or without irrigation system upgrades - vary between regions and between neighbors. Geographic climate differences, programmatic variability in landscape and irrigation replacement options, and capricious human behavior complicate water savings predictions and reduce the transferability of reported results. Studies across California measure, model, and/or predict average turf-replacement water savings of anywhere from 18% to 83%. In gallons per square foot converted area per year (g/sq ft/yr), agencies estimate and calculate a water savings metric that ranges from 13 to 70+ g/sq ft/yr. Southern California agencies consistently report savings of around 45 g/sq ft/yr. Table 1 below summarizes percent water savings attributable to landscape conversions as measured, modeled, or predicted by a variety of California and non-California sources and studies.

Table 2: Percent water savings attributable to landscape conversions; Single Family (SF), Commercial Institutional and Industrial (CII)

Source	Water Savings Average	Conditions
UC Davis Study	60% City-Wide	Student model of replacing turf areas with native plants, City of Davis, CA
Metropolitan Water District Study	18% SF 24% CII	Sample of CII and SF turf conversions within MWD Cash for Grass rebate program; water usage from agency billing data
Santa Monica City Garden-Garden Case Study	83% SF	Controlled, side-by-side, Single Family Residence case study in Santa Monica, CA
Council 'Turf Removal PBMP'	35-75% per capita use	Range identified via literature review of 'typical residential' site replacing cool season turf grass in CO ⁱ and NV ⁱⁱ
AWE Outdoor Water Savings Research Initiative	33-76%	Range identified via literature review of landscape conversions in FL ⁱⁱⁱ and NM ^{iv}

Water Savings Caveats

Replacing turf grass with low water-demand ground cover is not solely responsible for the quantifiable changes in outdoor water use before and after landscape conversion. In part, water savings may be attributable to other factors such as fluctuating climates, customer behavioral change, decaying irrigation system upgrades, expanded knowledge and awareness of landscape managers, and decreased ET from a reduced canopy cover immediately following a conversion. Some of these factors are intentionally captured in program design to reduce water use. It would be informative to separate out the quantitative value of water savings attributable to each program requirement, but for water distributors, it is often more important to include as many water-saving program requirements as is realistic to maximize program value. An improved understanding of the percentage of conversion water savings attributable to specific program results such as irrigation system updates or behavioral change would help to refine program

design and to achieve the highest water saving potential. For example, if a rebate program's plant coverage replacement requirement yielded negligible water savings, and 99% of actualized water savings were attributable to customer behavioral change, then rebate programs could increase their cost-effectiveness by emphasizing the components of their programs that most impact property owner behavior. Of course, water savings are not the only benefit achieved from landscape conversions. Indeed, the multiple benefits associated with turf replacement projects such as GHG emission reduction and native habitat creation will complement water savings in the bigger watershed picture.

Non-Savers

As mentioned above in [Rebate Program Challenges & Risks](#), some rebate customers see no water savings despite replacing their turf. Anecdotally, water agency employees observe negligible initial water savings on many turf conversions. They note that while climate appropriate and native landscapes require different irrigation techniques, they still use roughly the same quantity of water as efficiently-watered turf grasses upon *installation*. Once established, however, they need less water.

The Southern Nevada Water Authority (SNWA) presented on this 'non-saver' phenomenon during the 2014 WaterSmart Innovations conference. In SNWA's presentation, 'The Non-Savers: An Evaluation of Turf Conversion Properties That Don't Save Water,' presenters concluded that approximately 10% of customers increase their water use after a landscape conversion and 10% neither increase nor decrease their water use after a landscape conversion. The study found few statistically significant factors predicting differences between non-savers and savers. It did, however, note three interesting differences: 1) non-savers converted a lower percentage of their landscaped area or house lot area; 2) non-savers had a higher minimum percent plant cover pre-conversion; and 3) non-savers had newer home construction and/or more valuable property. Qualitatively, sites ranked as having 'very poor' pre-conversion turf quality were also more likely to fall into the non-saver category than program participants with higher pre-conversion turf quality.

These results are intuitive – smaller conversion projects on plots with significant pre-existing plant coverage and newer construction (and therefore newer irrigation) with stressed turf conditions may show lower water savings post conversion than their counterparts. Creatively designed rebate program requirements can help to minimize the number of non-savers and maximize water savings. Even non-savers, however, can still benefit programs by expanding the visibility of sustainable landscapes and increasing the level of customer awareness of sustainable landscaping practices.

Turf Replacement Cost-Effectiveness

Both turf rebate programs and third parties have quantified the value of water savings attributable to rebated conversions. Their results show that for every acre-foot (AF) of water saved, pro-rated over an assumed program lifetime of 10 years, water distributors and their funders typically pay anywhere from

\$1,000 to \$1,700⁴. Quantified cost outliers approach \$400/AF and \$5,900/AF. Among other factors, this cost-effectiveness metric (\$/AF saved over 10 years) depends on rebate values, program administrative costs, regional water savings potential, and end user behavior. Compared with other conservation strategies, an average lawn conversion rebate program, as it is valued now, is one of the most costly conservation and supply augmentation approaches that a water agency can undertake (see [Appendix A](#) for details).

The \$/AF saved ratios may change over time. On the one hand, savings attributable to conversions may increase over time as the climate appropriate plants mature and require less water or as hotter and drier climates increase turf grass water needs disproportionately to drought-tolerant-plant water needs. On the other hand, water savings attributable to rebate programs may decrease over time due to property management changes, irrigation system decay, or decreased end-user water consciousness in post-drought years. Water savings may also stay constant over time. A Nevada-based study on xeriscape lawn conversions (see [Climate Appropriate Landscapes](#) below for the meaning of Xeriscape) found that water savings did not significantly change over time. This study used only Nevada Xeriscapes limiting the transferability of the study results, but it does suggest stabilized water savings as a third possible outcome.^v The degree of change over time in water savings will ultimately determine the return on turf rebate program investments. Extensive program cost analyses that capture additional externalities from turf conversions, positive or negative, such as waste generation, maintenance time, and habitat value, are not readily available. Future studies should consider the multiple effects of landscape conversion when calculating cost-effectiveness metrics.

The Future of Turf Replacement Rebate Programs

Turf rebate programs have an uncertain future. Program success over the past year, as measured by dramatic participant growth, could foreshadow a future in which the programs continue to grow exponentially, both expanding in popularity and shaping social norms. On the flip side, the rapid growth could give way to saturated target demographics, insufficient funding for continued programming, or calculated cost-benefit decisions to end programs.

In the long term, California cannot afford to spend \$3 per square foot to replace the roughly 2.5 million acres of turf grass (1.089e+11 square feet) in the state. Given that current expenditures are unsustainable, existing programs should be considered loss-leaders. They should seek a defensible and repeatable proof of concept that substantiates the value (economic, aesthetic, environmental, and health) of turf removal and sustainable landscaping on a state-wide scale. The following seven program considerations stand out as top priority program improvements to support water savings, improve fiscal investments, increase program defensibility, and generate streamlined rebate processes:

⁴ These values were calculated and estimated using a wide range of methodologies. From statistical evaluation capturing several years of water use data before and after participant conversions and controlling for confounding factors such as weather, to simplified calculations that multiply an average water savings number (e.g., 45 gallons per square foot per year - approximated and adopted by many Southern California agencies) by the area of conversions completed.

1. From the start of a turf rebate program, collect the necessary data to defensibly calculate and statistically analyze the water savings attributable to conversions. Commit to a standardized and transferable calculation methodology for measurement and verification of program outcomes.
2. Offer and/or require hands-on landscape design and irrigation guidance through classes or other means to educate and engage homeowners and to realize high-quality and sustainable conversions that expand beyond turf removal to embrace the principles of the watershed approach. (See [Appendix B](#) for an explanation of the watershed approach.)
3. Design, test, and implement innovative strategies to maximize conversion impact. Strategies could include varying rebate levels to correspond with microclimates; increasing rebates for simultaneous neighborhood conversions; or acknowledging successful conversions with yard signs that attribute beautiful new landscapes to the turf rebate program. These strategies should simultaneously maximize water savings while attracting participants and establishing social norms.
4. Use multiple post-conversion inspections to determine how conversions hold-up or change over time. For example, check the landscape immediately after a conversion completion, then check it again one year later to evaluate plant health, aesthetic appearance, and irrigation system decay. Additional inspections will also remind property owners to continually manage their own landscapes.
5. Design program finances and rebate levels to achieve the desirable degree of participation, water savings, and longevity. This process requires studying participation trends over time from similar agencies and determining how an agency can manage available funding and staff resources to implement and sustain a program. This design process may also require including additional water-saving criteria in rebate terms and conditions.
6. Emphasize long-term customer behavioral changes throughout the rebate process by:
 - seeking customer commitment to water conservation ethics;
 - educating participants on the multiple benefits of landscape conversion and on the practicalities of landscape maintenance;
 - reminding customers of these topics throughout the project; and by
 - positively reinforcing customer progress and program participation.

Importantly, a (sometimes large) portion of water savings post conversion is attributable to the increased customer knowledge and understanding of landscape irrigation and maintenance needs. Consistent customer contact and prompts that extend beyond the conversion project timeline will reinforce behavioral change and maximize water savings impacts.

7. Motivate a shift to the watershed approach to landscaping by coupling turf rebate programs with additional holistic landscape considerations and incentives. Incentivize on-site stormwater capture

and retention through all-inclusive or tiered rebates that encourage rainwater harvesting and stormwater retention in addition to turf replacement and irrigation upgrades.⁵ Seek funding from mutually benefited organizations such as stormwater agencies. Consider soil health improvements and/or the use of compost for rebate requirements or additional rebate incentives to ultimately increase water retention capacity and reduce the need for supplemental irrigation. Design variable or tiered rebates that incentivize planting new landscapes during the appropriate season. For example, offer an initial, nominal rebate for sheet-mulching a lawn during spring or summer months. Then, offer an additional rebate for new landscape planting during the fall months.

Challenging questions about rebate programs remain: do these programs only reward wasteful water users or well-off home owners who could afford the conversions without rebates? Is there social equity in rebate programs? Should California water agencies be implementing comparatively non-cost-effective conservation programs in a drought? Are there cost-effective, alternative approaches to incentivize landscape conversion (see [Appendix C](#))? These are thought-provoking, valuable questions to ask. Given the current popularity of these programs, they are likely to remain until they simply become too expensive for water distributors. Only time and a continued commitment to improving region-specific program design and data collection will reveal the true impact and potential of turf removal rebate programs.

⁵ For ideas on incentivizing stormwater retention, check out Portland Oregon's '[Clean River Rewards](#)' program and '[Downspout Disconnect](#)' program, or Seattle's [RainWise Rebates](#).

Turf Replacement Specifications

Different rebate programs permit a range of replacement ground covers. Three primary material replacements are available: climate appropriate plants, permeable hardscapes, and synthetic turf. Where one rebate program allows any of the three, another program allows only one. The following section briefly covers what each of these replacement options entail and lists their pros and cons including water use; maintenance; retention, runoff, and erosion; ecosystem services such as habitat creation, fire control, and cooling; GHG emissions and waste generation; public health; and cost effectiveness. (Please see [References & Resources](#) at the end of the report for further research.)

Climate Appropriate Landscapes

Climate appropriate, drought tolerant, and/or native plants and planting materials are a preferred turf replacement option for many water distributors. Most rebate programs require that a certain percentage of replaced landscape area consists of climate appropriate plants. Dubbed 'climate-appropriate,' these plants are better adapted to California climate zones than their water-intensive peers, and therefore, they require less irrigation. Drought tolerant plants are those specifically recognized for their ability to survive extended periods of time with little to no rain or irrigation. Not to be confused with climate-appropriate or drought tolerant plants, native plants are plants indigenous to a specific region, as identified during a specific period of history. California native plants, generally thought of as plants that existed in California prior to European settlement, are by definition climate-appropriate because they exist naturally in a climate that suits their needs. These plants have co-evolved with native animals, fungi, and microbes over long periods of time, and therefore they provide the additional benefit of habitat creation for native animals. Not all climate appropriate or California native plants, however, are drought tolerant simply because not all California climates commonly experience (or used to experience) repeated droughts. Thus, landscapers must ensure that their choice of native is appropriate for their specific micro-climates.



Image Credit: www.gopixpic.com

Among recognizable climate-appropriate landscape brands are: Xeriscape™, California-Friendly™, Bay-Friendly, River-Friendly, and Garden-Friendly.

Xeriscaping, the first widely-recognized turf alternative, gained its popularity in the arid southwestern United States. For many, it conjures images of gravel, adobe, succulents, and cactuses. In actuality, however, Xeriscaping encompasses a broader array of plant varieties selected for water efficiency and soil health.

The wide array of 'Friendly' brands indicates California

climate-appropriate and native plants. They are growing in popularity, especially since the 2014 drought emergency declaration and the growth of turf rebate programs. Gardens built using climate-appropriate plants are often also designed around watershed-approach principles such as decreased water use and

increased percolation, healthier soils, habitat creation, and hydrozones that cluster plants with similar water and sun requirements and help minimize erosion and unused runoff.

Critics disapprove of climate-appropriate and native gardens as a viable turf replacement options for four principal reasons:

1. Cost – Compared to turf grasses, native and climate appropriate gardens are typically more expensive to purchase and install.
2. Maintenance – Heterogeneous gardens often require a greater depth of landscaping knowledge and understanding; even if resulting gardens ultimately require less maintenance, the initial learning curve is steep.
3. Aesthetics – Some landscape conversions designed with native or climate-appropriate plants do not result in aesthetically pleasing front yards, offending neighbors and discouraging further conversions.
4. Property Value – The market value for homes **may** decrease based on the absence of a turf grass lawn.



Image Credit: www.californianativeflora.com

In contrast, supporters give seven reasons for favoring climate-appropriate and native gardens as a viable turf replacement option:

1. Cost – Long term cost analyses suggest that money saved on maintenance, waste removal, and water costs yield a reasonable return on investment, particularly when landscape conversions are large-scale commercial projects or when property managers receive rebates.
2. Maintenance – Property owners and managers spend fewer hours maintaining an established native or climate appropriate garden than a turf lawn.
3. Aesthetics – The plants available to native and climate-appropriate gardens vary in size, shape, and color, and can yield beautiful landscapes when designed properly.
4. Property Value – Market value for homes **may** increase based on the presence of a water efficient landscape based on native or climate-appropriate plants.
5. Water, Waste, and Energy Savings – The decreased water, fertilizer, and pesticide needs, and the decreased maintenance time associated with native and climate-appropriate gardens saves water while reducing chemical use, green waste, and GHG emissions when compared with 'mow-blow-and-go' turf grass maintenance.
6. Habitat Creation and Soil health – Native plants can create habitat for native animals, such as bees, that are key species in keeping our watersheds healthy. Native plants can also help to restore soil health through habitat creation by incorporating animal byproducts into the soil.
7. Stormwater Management – Well-designed native gardens retain stormwater, allowing it to percolate to subsurface aquifers, filter pollutants, and avoid at-capacity sewer lines.

Permeable Hardscapes



Image Credit:
<http://www.santacruz.watersavingplants.com/>

Permeable hardscapes are ground covers constructed above drainable soils or stone aggregates. When compared to traditional solid concrete, brick, or asphalt pavers, permeable hardscapes reduce runoff and erosion. Permeable hardscapes vary widely in permeability. They include: gravel; gridded or interlocking pavers with gravel or dirt infill; cobblestones; and porous, pervious, or permeable pavers (e.g., porous asphalt and pervious concrete).

Critics disapprove of permeable hardscapes as a viable turf replacement option for five reasons:

1. Failure Over Time – Anecdotal evidence has led some agencies to remove permeable hardscapes as an allowable alternative to turf grass. These agencies note that property managers/owners report a decrease of permeability over time, as percolation pores and grooves clog with compacted dust and grit. Research shows that after a few years of use or after poor installation practices, percolation from some 'permeable pavers' can decrease by orders of magnitude.
2. High-Maintenance – Porous pavers require a stone aggregate detention basin below the pavement surface. To maintain infiltration rates, this basin must be periodically washed out to prevent dirt and particulate build up. Some porous surfaces require vacuum sweeping to maintain infiltration rates; certain old porous surfaces can only be reclaimed as 'permeable' by drilling half-inch holes in the surface to allow water to reach the stone aggregate basin.
3. Climate- and Soil-Sensitive – Climates that experience freeze-thaw cycles frequently see damaged pavers. They crack after partially clogged pores fill with water, freeze, and then expand. Sanding surfaces for snow traction also quickly renders porous pavers ineffective by clogging pore spaces. Similarly, snow-plow piles with high sediment content can melt into pavers and clog them. Finally, regardless of a hardscape's permeability, high clay-content soils limit infiltration into aquifers and can cause pooling and runoff.
4. Heat Island – Some porous pavers are dark surfaces (e.g., porous asphalt) that increase heat absorption and contribute to the urban heat island effect.
5. Limited Environmental Benefits – In contrast to other turf replacement alternatives like climate appropriate plants, permeable hardscapes do not offer ecosystem services such as GHG sequestration, air filtration, or habitat creation.

Supporters give seven reasons for favoring permeable hardscapes as a viable turf replacement option:

1. Reduced Runoff / Increased Percolation – At least upon installation, the runoff coefficients of most porous pavers are more similar to grass (and some in far excess of grass) than to non-porous

pavements. These lower runoff coefficients mean increased infiltration into the soils and increased subsurface water storage.

2. Low-Maintenance and Functional – In contrast with plant and turf grass ground covers, hardscapes require little to no maintenance or chemical application. They also serve as a functional space for many activities.
3. Water Savings – With little to no watering requirements after installation, permeable hardscapes can reduce outdoor water usage by almost 100%.
4. Water Filtration – Stormwater pollutants are removed by filtration through the paver pores and/or in the permeable ground underneath or in-between permeable hardscape surfaces.
5. Efficient Construction – In comparison with traditional pavements, porous pavements take less time to construct and install.
6. Durability – Properly constructed pavers can last 20-40 years and maintain infiltration rates orders of magnitude higher than turf grass throughout their lifetime.
7. Low Cost – Well-installed and designed permeable pavers or other permeable hardscapes can save money over a landscape's lifetime through water savings, landscape materials applications, and maintenance opportunity cost savings. Indeed, considering just installation costs, permeable pavers are cost-competitive with both plant and synthetic turf alternatives. Permeable pavers are also cost-competitive with traditional pavers when storm water management systems are included in the cost calculations. Alternative permeable hardscapes like gravel beds cost significantly less than plant and synthetic turf coverage of a similar area.

Synthetic Turf

Artificial grasses have been around since the mid to late 1900's. Consisting of synthetic fibers, rubbery infill, and subsurface layers designed to pad, drain, filter, and ground the fibrous artificial turf, this groundcover was originally popularized in sporting arenas. It offered water and maintenance cost and time savings. Synthetic grass design has evolved over time to combat its negative reputation in the environmental and public health world, though artificial grass critics remain skeptical. Improved technologies have bettered the ergonomics of synthetic grasses to decrease the threat of athletic injury. New materials limit lead-contaminated infill and minimize heat dangers. Recently, spurred by ongoing drought and decreased water and maintenance costs, synthetic turf has gained popularity among California single family homeowners.

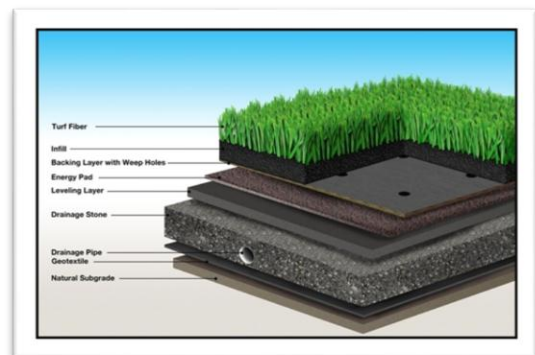


Image Credit: The Synthetic Turf Council

Critics disapprove of synthetic turf as a viable turf replacement option for six reasons:

1. Heat Risks – Surface temperatures on synthetic fields have been documented as high as 199 °F, increasing potential for heat-related health hazards and increasing the urban island effect.

2. Health Hazards – Beyond heat injuries, researchers have documented increased incidence of sports injuries, increased risk for bacterial infections, and increased asthma triggers. They have hypothesized connections between heavy metals and toxic compounds found in synthetic turf infills (and their cleaning agents) and diseases such as cancer.
3. Waste Generation – At the end of its 6-15 year lifetime, synthetic turf typically ends up in a landfill, even if it is technically recyclable.
4. Aesthetics – Wear and tear on synthetic turf materials creates damaged-looking and faded groundcover; unlike natural grasses, artificial turf cannot regenerate itself.
5. Environmental Impact – Artificial turf does not offer several environmental benefits offered by turf grass and living plant alternatives such as biofiltration, cooling effects, carbon sequestration, and habitat creation. Instead, the synthetic turf can increase runoff, leach toxins into soils, and cause soil compaction and loss of microbes.
6. Limited Water & Maintenance Savings – Hot or dirty synthetic turf surfaces require irrigation and cleaning maintenance. This increases water and time costs and occasionally requires costly specialized equipment and toxic chemical cleaning solutions. These maintenance factors can lengthen the return on investment time for synthetic turf installation well beyond the industry-supported claims of three to five years.

Supporters offer six reasons for favoring synthetic turf as a viable turf replacement option:



Image Credit: frassfakegrass.com

1. Convenience – Artificial turf can be used continuously as a functional space; no “down time” has to occur for fertilizing and cutting. In addition, synthetic lawns can be enjoyed year-around in climates that do not support continuous natural turf growth.
2. Health Benefits – Industry supporters claim modern synthetic turf technologies reduce sports injuries and control for bacteria growth.
3. Waste Reduction – Some artificial turfs are now 100% recyclable. In addition, artificial turf manufacturers themselves integrate into their product post-consumer, recycled materials such as tire rubber that would otherwise be sitting in a landfill.
4. Aesthetics – Fade-resistant, durable artificial turf products resemble a perfectly manicured lawn, year-around.
5. Environmental Impact – Artificial turf eliminates the need for fertilizers and pesticides that can run off in stormwater and leach into water tables. Artificial turf also reduces GHG emissions and green waste by eliminating ‘mow-and- blow’ maintenance.
6. Water & Maintenance Savings – Artificial turf requires little to no water or maintenance. This saves property owners and managers money and time. These savings mean property owners can see their purchase and installation expenses paid back within three to five years.

Conclusions

The limited quantity and quality of turf removal program data undermines conclusive program evaluation and recommendations, but anecdotal lessons learned can inform agencies as they manage new and expanding turf removal programs. Common challenges faced by program managers include limited time and money resources, customer unfamiliarity with landscaping, and undesirable conversion outcomes. Key strategies to overcome these challenges and to realize water-saving, aesthetically-pleasing landscape conversions include educational customer outreach, thorough conversion monitoring, and carefully designed program requirements.

A central component of turf removal program design are the turf replacement options. Without a complete life cycle analysis of all natural turf alternatives – i.e., climate-appropriate plants, permeable hardscape, and synthetic turf - it is difficult to quantitatively and conclusively compare the impacts of these groundcovers on financial resources as well as environmental impact. It is simpler; however, for agencies and property managers to consider the above qualitative pros and cons and choose based on what is most valuable to them as a water agency or as an individual.

Even if turf rebate programs are not a cost-effective method to augment urban water supply, there are substantial positive externalities associated with them. These include end-user education, multiple benefits from climate-appropriate landscapes, and encouragement of a general cultural shift towards understanding and accepting environmentally beneficial alternatives to turf grass. For agencies considering these programs, these non-quantifiable benefits may tip the scale and justify the investment in limited rebate programs. Program popularity with homeowners and program timeliness given California's ongoing drought indicate that these programs have the potential to catalyze broad transformations on a state-wide scale. Program design and limitations must be carefully considered to manage expectations and to generate desirable results for water agencies, customers, and the state as a whole.



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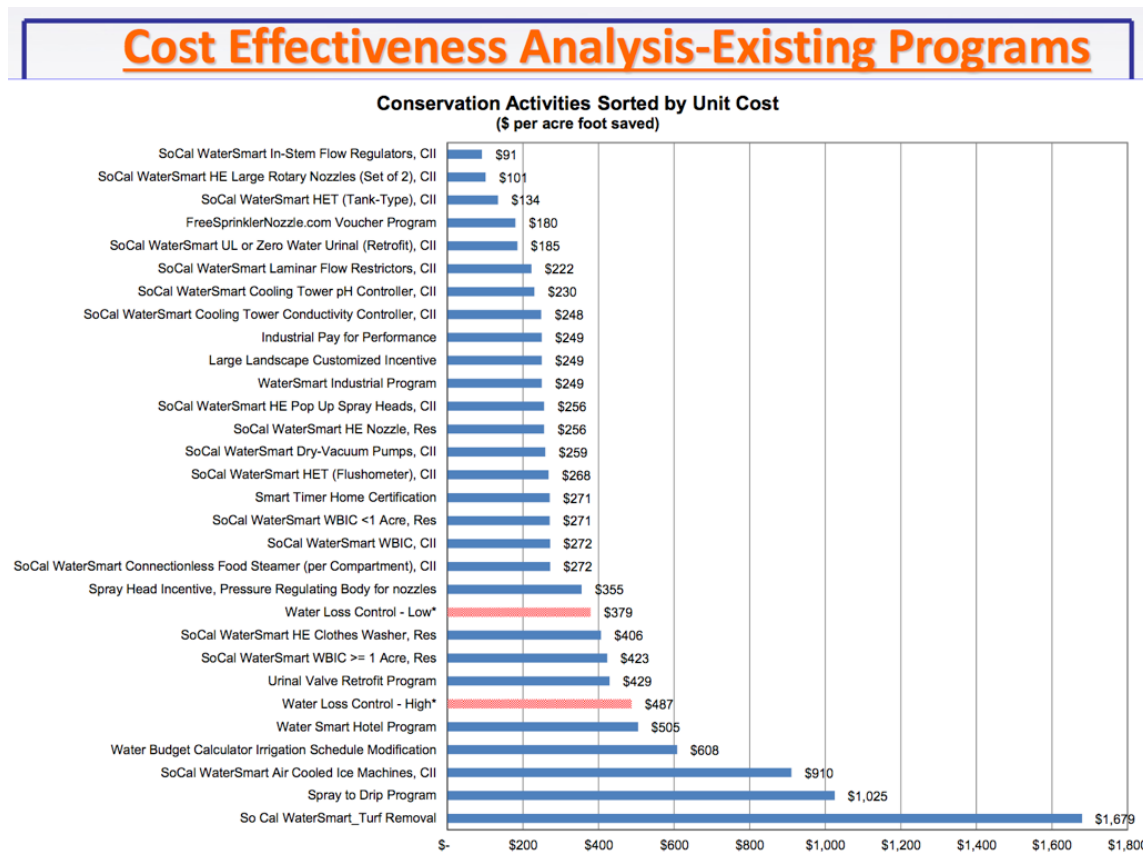
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Appendix A: Conservation Program Cost Effectiveness

The following chart, presented by Joe Berg from the Municipal Water District of Orange County at the WaterSmart Innovations Conference 2014, details the relative cost per acre foot (AF) of water saved for various water conservation programs. The turf rebate program value is found at the bottom of the chart, indicating that it is the most expensive program alternative evaluated in this study with a cost of \$1,679/AF water saved. It should be noted that since 2014, cost effectiveness numbers may have changed.



The following are California water source costs as calculated by the Public Policy Institute of California:

Method	Annual cost per acre-foot (\$)	
	Low	High
Conjunctive use and groundwater storage	10	600
Water transfers	50	550
Agricultural water use efficiency (net)	145	240
Urban water use efficiency (gross)	230	635
Recycled municipal water	300	1,300
Surface storage (state projects)	340	1,070
Desalination, brackish	500	900
Desalination, seawater	900	2,500

Appendix B: The Watershed Approach

A watershed approach intends an integrated, holistic approach to landscape design, construction, and maintenance that transcends water-use efficiency to reflect a site's climate, geography, and soils and to address the related benefits of cost savings, run-off reduction, green waste reduction, pesticide and fertilizer reduction, habitat improvement, and energy/GHG reductions.

California's landscapes provide essential functions throughout our urban environment. They are where we recreate; capture, clean and recharge groundwater; shade and cool our buildings; enhance property values; provide wildlife habitat; create space to grow food locally; provide a sense of place and much more. The optimal design, installation, and management of these spaces are critical to enhancing California's quality of life while protecting our limited natural resources.

The transition to the watershed approach will be a system-wide upgrade to the urban environment. In addition to reducing outdoor irrigation, the transformation promotes multiple environmental benefits for municipalities:

- Increased rainwater and graywater capture, storage, and reuse
- Increased stormwater capture and infiltration, decreased stormwater runoff
- Reduced synthetic pesticide and fertilizer application and runoff
- Reduced "green waste" production
- Increased soil health and water retention capacity
- Reduced energy consumption and greenhouse gas emissions and improved air quality, and
- Increased food production and habitat for beneficial insects and wildlife, and the restoration of native biodiversity

The transformation also promotes benefits for individual property owners:

- Increased cost savings (lower water bills and upkeep costs)
- Reduced landscaping maintenance
- Healthier neighborhoods and communities
- Increased sense of place and appreciation for local resources
- Improved stewardship ethics and associated positive feelings towards self and neighborhood, and
- Increased shared values between neighbors via increased community participation in a social-norm-defining transformation.

Appendix C: Other Turf Conversions – Demonstration Gardens

Turf rebate programming is not the only approach to catalyzing landscape conversions in California. There is a need for parallel efforts that leverage shifts in cultural preferences towards sustainable landscapes.

Among existing programmatic efforts to encourage turf removal, and more specifically to redefine social norms, is the installation and advertisement of demonstration gardens. These educational garden spaces replace turf in well-visited locations. Their beautifully-designed and functional landscapes attract the passersby and their informative signage educates garden explorers. Though less tangible than cash incentives, demonstration gardens can re-define public perception of unorthodox landscapes and gradually shift the current California landscaping paradigm from turf grass towards sustainable alternatives.



*Image Credit: Big Bear Lake
Department of Water & Power*

A series of California-Friendly® garden examples are hyperlinked through the Metropolitan Water District's [BeWaterWise](#) website. Though, some are designated botanical gardens, many are specifically demonstration gardens found in public spaces like libraries and water agencies. Numerous other demonstration gardens are scattered throughout the state on public and private property. These garden spaces often host gardening tours and workshops, school field trips, and other educational events. Beyond providing educational venues in pleasant and sustainable landscapes, these gardens increase public familiarity with non-turf landscaping alternatives. This familiarity breeds comfort and acceptance. Though demonstration garden impact on turf removal is not directly quantifiable, the gardens are readying the population of California for a landscaping paradigm shift.

ⁱ Knopf, J. (2003). "Water Wise Landscaping with Trees, Shrubs and Vines: A Xeriscape Guide for the Rocky Mountain Region." Chamisa Books, Boulder, CO.

ⁱⁱ Sovocool, K. A., Rosales, J. L., & Southern Nevada Water Authority (2004). "A Five-Year Investigation Into the Potential Water and Monetary Savings of Residential Xeriscape in the Mojave Desert." Las Vegas, NV.

Sovocool, K.A. (2005). "Xeriscape Conversion Study: Final Report." Southern Nevada Water Authority. Las Vegas, NV.

ⁱⁱⁱ Boyer, M.J., M.D. Dukes, L.J. Young, and S. Wang. 2014 Irrigation conservation of Florida-Friendly Landscaping based on water billing data. Journal of Irrigation and Drainage Engineering 04014037.

^{iv} Price, J.I., J.m. Chermak, and J. Felardo. 2014. Low-flow appliances and household water demand: An evaluation of demand-side management policy in Albuquerque, New Mexico. Journal of Environmental Management 133:37-44.

^v Hudak, T. (2005) Converting turfgrass to xeriscape: Evaluation Southern Nevada water authority's "Water smart program"



San Diego County Water Authority

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May 25, 2015

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- Vista Irrigation District
- Yuima Municipal Water District

RE: Board Memo 5-1: Authorize: (1) Additional funding for conservation incentives; and (2) Implementation of modifications to the Turf Removal Program

Chair Record and Members of the Board:

We submit for the record the following comments to supplement our May 8, 2015 letter and address Board Memo 5-1. A copy of our May 8 letter is attached and incorporated by reference.

We support turf removal in Southern California. We also understand why the public would respond enthusiastically to a program it is being told is "free." However, MWD's program, even with the modest changes described by staff, is neither sustainable nor fiscally responsible.

- First, the program is not "free." As the General Manager stated at our last meeting, every \$100,000,000 in program costs represents a 7 percent rate increase.
- Staff's recommendation to increase conservation program expenditures to \$450 million is more than ten times the \$40 million budget the board adopted for the current budget cycle. By staff's own estimate, even this extraordinary amount of funding will only pay for the MWD program for the next six months or so, through fall 2015. Staff's proposal is silent on what it would recommend the board do at that point, or, what impact this spending will have on the budget or water supply availability next year.
- Board adoption of the staff recommendation will exhaust **all** of MWD's water management reserves, leaving no funding available to purchase additional water transfer supplies should the drought continue in 2016 or to purchase water to refill our depleted storage, should additional water supplies become available.

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- MWD is not paying for this program with state bond money or "extra" money it has lying around. **One hundred percent of the program is being paid for with water rates** that have been set by this board to generate net revenues in excess of MWD's adopted budgets and maximum reserve targets. **Since 2012, MWD has collected from ratepayers \$795,000,000 more than necessary to pay 100 percent of its costs.**

Rate increases to pay for the unprecedented expansion of this program are inevitable.

Ratepayers are already at risk of facing stiff MWD rate increases in 2016 if the drought continues (as well as rate increases from retail water suppliers). Worse yet, these rate increases will hit Southern California's low-income ratepayers hardest, forcing them to pay for a program which benefits those who can better afford to pay for their own turf removal.

The MWD program needs an immediate overhaul that is not accomplished by the recommendations contained in Board Memo 5-1. The problems with MWD's program, including the fact **it is clearly paying far more than is needed to "incentivize" turf removal**, are apparent to any agency that has administered successful programs in the past. See *Turf Removal & Replacement: Lessons Learned*, California Urban Water Conservation Council (March 2015).

Our objections notwithstanding, the Water Authority and its member agencies will seek a fair share of any funds that are authorized by the board under Board Memo 5-1 since our ratepayers will be forced to pay roughly 25 percent of these increased costs and inevitable rate increases.

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
Director



Fern Steiner
Director



Yen C. Tu
Director

Attachments:

1. Water Authority's May 8, 2015 Letter to MWD Board RE: Board Memo 8-2
2. *Turf Removal & Replacement: Lessons Learned*, California Urban Water Conservation Council (March 2015).



San Diego County Water Authority

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May 8, 2015

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Camp Pendleton
Marine Corps Base
Rainbow
Municipal Water District
Ramona
Municipal Water District
Rincon del Diablo
Municipal Water District
San Dieguito Water District
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South Bay Irrigation District
Vallecitos Water District
Valley Center
Municipal Water District
Vista Irrigation District
Yuima
Municipal Water District

OTHER
REPRESENTATIVE
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RE: Board Memo 8-2: Authorize (1) \$150 million in additional funding for conservation incentives from the Water Stewardship Fund and the Water Management Fund; and (2) Implementation of modifications to the Turf Removal Program -- **OPPOSE**

Chair Record and Members of the Board:

As you know, the Water Authority and its member agencies have an outstanding record of leadership in water conservation planning, programs and implementation. The San Diego region's per capita water use has dropped by 22 percent since 2007. More than a year ago, in response to the current drought, the Water Authority launched its *When in Drought, Save Every Day, Every Way* campaign to further increase public awareness. Through our continuous efforts, a recent poll shows 87 percent of San Diegans believe saving water is a civic duty, 85 percent are aware the drought is very serious, and 81 percent have taken additional actions to reduce water use since mandatory water use restrictions were implemented in San Diego County last August. It is clear that San Diegans are doing our part to reduce water use, and we will continue to support the Governor's call for increased water conservation and strive to meet the State Board's newly adopted regulations. Against this backdrop, we must oppose staff's recommendation for the following reasons:

- **Lack of accountability.** In spite of repeated requests, MWD has failed to demonstrate actual near-term water savings resulting from the turf removal program. At an estimated cost of almost \$1,500 per acre-foot (AF), which staff has amortized over ten years, the near-term cost of any water savings would be substantially more than \$1,500/AF and well in excess of MWD's current spot market transfers. Short term, there has been no demonstration of meaningful water savings as a result of these subsidies, and certainly no demonstration of water savings that would not otherwise have occurred, either as a result of the high cost of water or state mandates limiting the amount of water retail agencies and their ratepayers may use on ornamental landscapes. Long term, MWD's program includes *no measures* to ensure that turf that someone is paid to remove today won't be reestablished in the future. *Without*

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such accountability, this program constitutes a waste of ratepayer dollars and a gift of public funds.

- ***Lack of transparency.*** MWD has not even provided an accounting of the participants who have received the more than \$77 million that has already been spent on the program. No further public rate dollars should be allocated or spent without an accounting of past expenditures. We renew our request for an immediate audit of this program, including identification of fund recipients, evidence of the turf removal or other "conservation" improvements that have been made with these public funds, and disclosure of any consultants or business entities that have benefitted from the implementation of this program by MWD.ⁱ
- ***Lack of available funding to pay for this massive, unbudgeted program expansion.*** It appears that there are insufficient funds available to pay for the staff recommendationⁱⁱ; and it is therefore highly probable that rate increases will be required for which there has been no public notice. In a PowerPoint presentation to the Finance and Insurance Committee last month, staff reported a Water Management Fund balance of \$32.2 million as of March 31, 2015.ⁱⁱⁱ This month, staff is requesting to use \$9.975 million of that remaining balance to purchase transfer supplies from Yuba County Water Agency, leaving only \$22.25 million available in the Water Management Fund.^{iv} This means that the rest of the funding - \$127.8 million - must come from the Water Stewardship Fund. But in order for the Water Stewardship Fund to generate that level of funding, *MWD would have to sell 3.12 million acre-feet of water (MWD must also make payments due on long term contracts paid for with Water Stewardship Rate dollars).* Since MWD's water sales are obviously going to be much lower than 3 million acre-feet, there is no identified source from which to generate the \$150 million needed for this program. MWD is running this program as an "open checkbook," but it has not planned or budgeted for these expenditures.
- ***The conservation program is being funded with rates the Superior Court has already ruled are illegal.*** MWD is continuing to collect the Water Stewardship Rate even though the Superior Court has already ruled that it is an illegal tax. In addition, San Diegans are being excluded from full participation in the member agency program as a result of MWD's inclusion of the "Rate Structure Integrity" clause, as to which the Court has also ruled substantively in San Diego's favor, subject only to the question of standing.
- ***The turf removal program is a regressive tax.*** Many low income ratepayers allowed their lawns to die many months if not years ago due to the cost of water. Now, they are being forced to subsidize turf replacement by private golf clubs and other commercial and residential high water users.

We have stated our deep concerns about the turf replacement program and MWD's water conservation programs generally, due to the absence of accountability actually measuring conservation results or accounting for the ratepayer dollars being spent on these programs. We have provided suggestions and made requests for information and for an audit on many prior occasions. A copy of our most recent letter dated December 8, 2014, is attached.

Instead of adopting staff's recommendation, we urge the board to: 1) order an immediate audit of the \$77 million that has been spent to date, including the information described above; and 2) request that staff bring back a detailed report including (a) data and an analysis demonstrating the near-term and long-term benefit of these programs, (b) a recommendation and firm budget cap for any proposed expanded conservation program, and (c) identify the source of available funding to pay for it. Staff should also report on the demand reduction impacts from permanent landscape ordinances and/or code changes limiting outdoor water use and how such changes should contribute to phasing out subsidies as a primary means to achieve water conservation.

For these reasons, we oppose staff's recommendations.

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
Director



Fern Steiner
Director



Yen C. Tu
Director

Attachments:

1. Water Authority's December 8, 2014 Letter to MWD Board re 8-1

ⁱ We have been asked, for example, what role MWD's past General Manager, Ron Gastelum, has played in the development and implementation of the turf removal program and whether he has benefitted financially from it on behalf of his client "Turf Terminators." In addition to his former role as General Manager of MWD, Mr. Gastelum also represents a number of MWD member agencies.

ⁱⁱ MWD's budgeted conservation program funding for fiscal years 2014/15 and 2015/16 totaled \$40 million; the staff recommendation in this month's Board Memo 8-2 will increase that budget more than six-fold to \$250 million.

ⁱⁱⁱ In this month's presentation, the projected balance of the Water Management Fund is shown as \$141.9 million as of June 30, 2015; no explanation is provided how the balance will increase by more than \$100 million from March to June 2015.

^{iv} This is all the money that is left in the Water Management Fund of the \$232 million transferred there from the almost **\$500 million MWD has over-collected from ratepayers since June 2013.**



San Diego County Water Authority

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December 8, 2014

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Camp Pendleton
Marine Corps Base

Rainbow
Municipal Water District

Ramona
Municipal Water District

Rincon del Diablo
Municipal Water District

San Dieguito Water District

Santa Fe Irrigation District

South Bay Irrigation District

Vallecitos Water District

Valley Center
Municipal Water District

Vista Irrigation District

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Municipal Water District

OTHER REPRESENTATIVE

County of San Diego

RE: Board Memo 8-1: Authorize: (1) increase of \$40 million for conservation incentives and (2) increase to contract authority of the five-year agreement with Electric and Gas Industries Association for administration of Metropolitan's regional conservation rebate program – **OPPOSE**

Chair Record and Members of the Board:

The Water Authority and its member agencies strongly support and have an outstanding record of leadership in water conservation planning, programs and implementation. Through our collective efforts, the San Diego region's per capita water use has been reduced by almost 25 percent since 2007. In response to the current drought, we launched our *When in Drought, Save Every Day, Every Way* campaign in order to further increase public awareness. As a result of these efforts, a recent poll shows that more than 80 percent of San Diegans now believe saving water is a civic duty. While we continue to support the Governor and State Board's call to increase conservation, we must oppose staff's recommendation due to the manner in which ratepayer dollars are being spent and the absence of any accountability or demonstration that the expenditure of these funds is actually achieving the intended purpose.

Staff's recommendation is to spend five times more than its adopted budget on conservation programs in this fiscal year alone (leaving no conservation funding for the following fiscal year).ⁱ Funding would come from money MWD has over-collected from ratepayers over the last two fiscal years. This money could have been invested directly at the local level, on water conservation and supply programs that would not only alleviate the impacts of drought, but also provide long term water supply benefits. Instead, MWD is proposing to spend a significant portion of this money, over-collected from all ratepayers, on turf replacement on commercial properties including private golf courses. At MWD's \$2 per square foot rebate, this costs MWD ratepayers more than \$1,500 per acre-foot.

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Against this backdrop, we find it ironic that the MWD board just last month adopted a purchase order policy that allows MWD member agencies to increase purchases of low priced Tier 1 water (and avoid the higher Tier 2 rate on an annual basis as costs are incurred), completely eliminating the pricing signal Tier 2 was originally intended to send. MWD's "pricing signals" and behaviors - including this water conservation program - are completely upside down and inconsistent.

MWD is simply burning through ratepayer dollars irresponsibly in the name of water conservation. It could accomplish much more by structuring its rates according to its cost of service and sending true price signals about the value of water. At a minimum, before approving any further funding, MWD should redesign this program to place a cap on the amount of rebate applicants may receive so that conservation rebates are possible involving the general public and a wider range of applicants.

Given the proposed unprecedented level of spending associated with money being paid to private business, we request the General Auditor conduct a financial audit of all rebate programs, starting with a specific emphasis on the turf removal program. For the same reason, we request that the contract authority for EGIA be extended only to match the biennial budget, rather than through 2017. We believe this is absolutely essential to ensure that the MWD board of directors is being a responsible steward of ratepayer dollars.

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
Director



Fern Steiner
Director



Yen C. Tu
Director

ⁱ The staff letter states that the current proposed increase is "intended to address immediate issues in the conservation program for the current fiscal year." MWD's adopted biennial budget for conservation for fiscal years 2014/15 and 2015/16 was \$40 million. With the addition of \$20 million in February and this request to add another \$40 million, the conservation budget for the current year alone would total \$100 million.

Turf Removal & Replacement: Lessons Learned

March, 2015
Author: Briana Seapy



California
Urban Water
Conservation
Council

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~Acknowledgements~

Thank you to all Council member agencies for making this report possible through your annual dues. Thank you also to the ten water agencies that contributed data and invaluable anecdotal lessons to inform this report. Your contributions will help guide water distributors looking to start or improve their own turf removal programs.



Turf Removal & Replacement: Lessons Learned

Introduction

A thirsty California uses over half of its urban water deliveries on landscape irrigation. Water intense turf grasses are the historical foundation of California landscaping. Water shortages, among other catalysts, are pushing California away from traditional turf grass landscapes towards sustainable landscaping. Sustainable landscaping intends a holistic, watershed-based approach to landscaping that transcends water-use efficiency to address the related benefits of cost savings, run-off reduction, green waste reduction, pesticide and fertilizer reduction, habitat improvement, and energy/greenhouse gas (GHG) reductions.

The transition from a turf-based landscape involves two steps. Turf removal is the first step, turf replacement the second. Customers' aesthetic preferences, geographic location, and bank accounts, along with product market availability, influence both turf removal and turf replacement decisions. Statewide, water agencies¹ are managing turf removal programs that stipulate replacement requirements, incentivizing a California landscaping transformation. These programs vary in size, scope, and specifications. The following report takes both a closer look at lessons learned from existing turf removal programs as well as a cursory glance at turf replacement options and implications.

Turf Removal Programs

Turf Removal Rebate Programs

Turf removal rebate programs offer rebates to end-users for removal and replacement of water-intensive turf lawns. Local and regional agencies are adopting these turf removal programs, anticipating that their upfront investment in rebates will yield long-term outdoor water savings dividends for years to come. For example, the Metropolitan Water District (MWD) spearheads a large-scale regional 'Cash for Grass' lawn conversion program. Currently, MWD provides water distributors within its service area a \$2 per square foot (sq. ft.) turf rebate subsidy. Agencies can add to this rebate as they desire. MWD has earmarked over \$85 million in funding for the rebate programs. Statewide, rebates range from \$0.50/sq. ft. to \$3.75/sq. ft.

Rebate Program Strategies

In general, rebate programs offer customers a dollar amount per square foot of turf removed. More specifically, individual programs require compliance with any number of turf replacement specifications;

¹ This report only includes information from local government water suppliers, referred to throughout as 'agencies.'

from pre- and post-removal inspections, to updated irrigation systems; in order to qualify for the rebate. To maximize the 'bang for their buck,' agencies invoke rebate qualification strategies to foster program growth and sustainability and to maximize water savings. Common rebate qualification policies include:

- Requiring well-documented rebate applications with historical water bills, landscape 'before' photos, and other documentation of maintained turf landscape
- Requiring attendance at a landscaping/irrigation workshop/class before submitting an application
- Requiring landscape design submission before property inspection
- Prohibiting re-installation of turf on rebated property under the same owner
- Prohibiting spray irrigation on converted landscapes
- Requiring drip or point source irrigation, micro-spray irrigation, low precipitation-rate nozzle spray irrigation, or hand-watering; requiring pressure regulators and filters for point source irrigators; requiring a smart irrigation controller
- Rebating only properties with evidence of living, maintained turf within a specified number of months prior to turf removal
- Rebating only properties that use sprinkler irrigation systems
- Rebating only areas that are visible to the public
- Requiring a specific percentage (e.g., 25%) of replacement landscape to be re-planted with water-efficient, or drought-tolerant plants
- Requiring sheet mulching to a specified number of inches (e.g., 2-4 in.) on all landscaped ground
- Rebating parkways (the strips of land between sidewalk and curb) separately and under different rebate terms and conditions
- Offering partial rebates for lawn removal, irrigation updates, and sheet mulching; offering complete rebates after planting appropriate plants in appropriate seasons (i.e., not mid-summer)
- Requiring replacement landscape to be made up of native, climate appropriate, or California-Friendly plants
- Requiring a specified percentage of pre-conversion property, or landscaped area (sq. ft.), to be made up of turf in order to qualify for a rebate
- Requiring California-licensed landscape contractors to convert landscapes if the property owners do not re-landscape themselves
- Requiring design consultation for do-it-yourselfers
- Prohibiting or restricting specific turf replacement options such as synthetic turf, concrete, permeable hardscapes, and gravel
- Setting a dollar or square foot rebate minimum
- Setting a dollar or square foot rebate maximum
- Requiring pre- and post-replacement inspections
- Setting a due date for landscape replacement completion
- Accepting only residential properties
- Accepting only CII properties.

Water distributors employ any number of these strategies with the intention of maximizing program cost-effectiveness and long-term water savings, while maintaining or increasing program participation. In the following section, data collected from water agencies across the state reveal a number of quantitative turf rebate program results, as calculated or estimated by the water agencies themselves.

Rebate Program Data Summary

Turf removal rebate program data collected from nine agencies are summarized in the table below. The data presented in the following table come from the following agencies, variable in size and geographic location: City of Long Beach, City of Roseville, City of Sacramento, City of Santa Cruz, City of Santa Rosa, Contra Costa Water District, Los Angeles Department of Water and Power, Municipal Water District of Orange County, and San Diego County Water Authority.² These agencies are neither a random sample nor a statistically significant grouping; rather they are agencies that run well-known turf rebate programs and that have a wealth of insights to share.

The data collected, presented in Table 1 below, covers the following parameters: year started, rebate cost then, rebate cost now, total removals to date, average expected water savings, rebate costs to date, customer participation and breakdown by customer category, minimum and maximum rebates, and large landscape participation.

Table 1 demonstrates the challenge of objectively and quantitatively reviewing turf rebate removal programs. Fundamentally, this challenge stems from the absence of widely shared, consistent data collection standards. Additional variability comes from other factors. For example, not all agencies submitted data for all parameters presented below. In addition, both retail and wholesale agencies participated. The size and geographic location of participating agencies varies broadly, as well as the program years for which data was available. And finally, agencies use different calculation methodologies to report their program results, even for the same program parameter. Keep these caveats in mind while reviewing Table 1.

² The Metropolitan Water District of Southern California (MWD) shared its program information, but its service area includes other water agencies that volunteered data for this report. Consequently, MWD's data is not included in Table 1 to prevent double-counting rebate data.

Table 1: Average, median, minimum, and maximum turf rebate program statistics from nine California water agencies.³

	Year Started	Rebate Then (\$/sq. ft.)	Rebate Now (\$/sq. ft.)	Total Removals to date (sq. ft.)	Total Removals to date (# program participants)	Average Expected Water Savings (gal/sq.ft./yr)	Rebate Cost to Date	Total Program Cost to Date	Average \$/AF saved
Average	2010	\$1.00	\$1.44	2,316,107	1,308	31	\$1,754,187	\$1,798,895	\$2,011
Median	2010	\$1.00	\$1.00	543,838	883	34.0	\$721,517	\$931,692	\$1,413
Min	2007	\$0.50	\$0.50	57,556	138	13.5	\$33,461	\$478,472	\$354
Max	2014	\$2.50	\$3.75	11,872,491	4,103	46	\$3,800,000	\$3,986,520	\$5,840
Response Rate	100%	100%	100%	100%	100%	89%	56%	33%	56%

	Residential Customer % (SF)	Commercial Customer % (MF, CII)	Minimum Rebate Residential (sq. ft.)	Maximum Rebate Residential (sq. ft.)	Minimum Rebate CII (sq. ft.)	Maximum Rebate CII (sq. ft.)	% Participation made up by Large Landscapes (CII, MF, and > 1 acre)
Average	93%	7%	300	1214	500	6500	9%
Median	92%	8%	275	1000	250	5500	7%
Min	88%	0%	250	500	250	5000	0%
Max	100%	12%	400	2000	1000	10000	30%
Response Rate	89%	89%	100%	100%	100%	100%	78%

Table 1 offers a general quantitative context for existing turf rebate programs. It is evident that turf rebate programs are relatively new to California, launching within the last decade. Though average rebate value has increased over time and though the maximum rebates offered are roughly 50% higher now than at the start of these programs, there are still successful programs that offer the minimum \$0.50 rebate. In fact, median rebate value has stayed consistent over time for this sample of agencies. Cumulative program turf removals by area and by participants vary widely and correlate strongly with agency size and available funding. Anticipated water savings trend with agency climate - the warmer the climate, the greater the water savings - and range from 13.5 to 46 gallons per square foot of turf removal per year. Associated rebate costs and overall program costs vary by rebate levels, program participation, and cost calculation methodology. Agencies estimate that their costs for every acre-foot (AF) of water saved on account of the rebate program, pro-rated over an assumed 10-year program life, are anywhere from \$354 to \$5,840 (see [Rebate Program Cost-Effectiveness](#) below for further details on the \$/AF metric). Program participation breakdowns hover around 90% residential and 10% commercial, as measured by number of participants and not by rebated area. In general, large landscapes make up less than 10% of overall program participants. Minimum and maximum rebated areas typically increase for commercial customers when

³ Note the following five data annotations: 1) of the nine agencies, seven are retail, two are wholesale; 2) of the nine agencies, four receive external program funding, five do not receive external program funding; 3) no statistically significant outliers were found in the data used to develop Table 1; 4) no numeric data was entered for the 'Minimum and Maximum Rebate' categories for agencies with no defined minimum or maximum rebate restrictions; 5) 'Total Program Cost to Date' had the lowest parameter response rate –agencies did not have the information available, they were unwilling to share the information, and/or their information did not include third-party contractor time, pre- and post- rebate inspection time, and/or retail agency administration time.

compared with residential customers. These general data conclusions are to be taken with a grain of salt given the inconsistent data quality and verification; to draw any further detailed and specific quantitative conclusions from the presented data would be imprudent given the quantity, quality and consistency of available data.

Rebate Program Challenges & Risks

The wide variability in the data reported in Table 1 makes it difficult to draw precise, quantitative lessons. Nevertheless, the program managers interviewed for this survey have developed a body of anecdotal information regarding the array of expected and unexpected challenges and risks they have faced while administering turf rebate programs. Agencies contemplating a new, expanded or simply continued program can take advantage of this information to anticipate the challenges and risks and to design their programs to improve the odds of success. The following list details the ten most prevalent challenges and risks faced by existing rebate programs.

1. **Rebate Funding** – Approximately half of the agencies interviewed depended on external funding to run their turf rebate program. External funding has pros and cons. On the positive side, it enables a water agency to run a program that it otherwise might have been unable to run. On the flip side, once the funding has run out, the program must be put on hold. Indeed, the more popular the program, the sooner the funds run out. External funding also requires compliance with grant terms. Funders can impose restrictions or requirements on funding that complicate a program's implementation or popularity. For example, a grant might require all converted landscapes to include specific features like drip irrigation or 50% plant coverage.

Things are not necessarily easier for the half of surveyed agencies that rely solely on internal funding. On the positive side, internal program management streamlines funding processes and allows program managers to pace the distribution and continuation of funding as they deem fit. On the negative side, it can be difficult to find the money for rebate programs, especially absent sufficient political will.

2. **Non-Savers** – One risk common to all turf rebate programs is the chance that participants will undertake lawn transformations that ultimately do not save water. See [*Non-Savers*](#) below for an elaboration.
3. **Behavioral Limitations on Water Savings** – Regardless of the number of requirements and stipulations an agency establishes to maximize water savings, the actual water savings realized are subject to a factor out of agency control – end user behavior. Even super efficient irrigation systems are prone to improper use or failure absent proper maintenance.
4. **Staff Time & Resources** – Considering the standard stages of a rebate process – customer application, review, and acceptance; pre-inspection; customer guidance; and post-inspection – an internally managed rebate program is time-intensive. For example, one agency designates one

Full Time Equivalent staff person solely to its turf rebate program. To mitigate these staff costs, some agencies hire third party management consultants to help run the programs. While most of the agencies that follow this path still formally approve refund applications internally, the ability to outsource many of the rebate program tasks has proved cost effective for larger agencies.

5. **Growth Capacity** – Overall rebate program participation appears largely predictable, but managing the sometimes dramatic fluctuations in participation requires foresight. Agencies consistently note big jumps in program participation over periods as short as a few months. For example, one agency experienced a 600% increase in participation from one month to the following (50 to 300 participants). See *Application Trends* in the [following section](#) for participation triggers.
6. **DIY Landscapers** – Eager participants that wish to convert their lawns but lack sustainable landscaping knowledge and the will or funds to hire a designer or contractor can produce aesthetically displeasing landscapes. These landscapes leave negative impressions on neighbors and the public and can deter others from participating. Of course, not all do-it-yourselfers are guilty of 'ugly' outcomes, but agencies throughout the survey consistently identified 'ugly' outcomes that hurt rather than helped their programs.
7. **Savings Calculations** – Quantifying water savings attributable to the rebate program can challenge water agencies, especially those without Automated Meter Infrastructure (AMI). To accurately capture water savings, an agency must account both for weather variations and for water use patterns that are not directly attributable to the rebate program. In addition, irrigation patterns immediately before and after a landscape conversion produce their own water use anomalies. Just before the conversion, outdoor water use generally *declines*, as property managers tend to quit watering their old lawns. In contrast, just after the conversion, outdoor water use tends to *increase* as the same property managers frequently overwater their new plants until the plants establish themselves. To compensate for water use variability and obtain statistically significant water savings calculations, water distributors need to analyze both historical water use records and records several years after the conversion. Without sophisticated metering, let alone designated landscape meters, attributing water savings directly to turf replacement can be nearly impossible.
8. **Replacement Plant/Landscaping/Irrigation Materials & Requirements** – Programs across California lack a consensus on what to allow in replacement landscapes. Ultimately, a program encouraging holistic, sustainable landscaping may have stricter stipulations than a program simply seeking maximum water savings. Where each agency decides to land on the spectrum of replacement landscape requirements is left to a number of factors. These include funding obligations, geographic restrictions, customer and political will, and individual program managers. Managers face particularly hard decisions when deciding program requirements that require due-diligence research. For example, one Southern California agency removed permeable hardscapes from its

list of acceptable replacement options because it was observing the failure of certain permeable pavers. Other agencies continue to permit permeable pavers. They point to research that shows long-term infiltration benefits, even accounting for degradation and clogging over time. Similarly, one agency found that the plants it was recommending were not available in its region, causing undue stress on landowners trying to find responsible plant materials.

9. **Collaboration** – Overlap between or proximity to other turf rebate programs can cause confusion in customers, especially when replacement requirements and rebate values vary drastically. Without proper agency alignment, 'double-dipping' is also a concern (when crafty customers seek double the rebate – one rebate from a local agency, one from a regional agency). For example, one Southern California regional distributor offered a rebate program at the same time as a city of within its jurisdiction. The agencies diligently worked together to align expectations and preempt complications; however, inevitable variation in rebate values and specifications and ultimately the abrupt end and re-start of the city's program led to customer confusion.
10. **Customer Communication** – In an effort to set clear expectations, achieve maximum water savings, and offer comprehensive customer support, agencies often overwhelm turf rebate customers with information. On the one hand, an agency's posting of detailed turf removal documents on its website (e.g., program requirements, terms and conditions, design advice, and tax warnings) risks shutting customers down with information overload. On the other hand, not posting these materials risks unclear messaging and legal vulnerabilities.

Rebate Program Take-Aways: What to Expect & How to Manage for Success

To create and manage successful turf rebate programs, agencies must learn from their peers and anticipate the trends and patterns that can predict or pre-empt program issues. The following list details 14 reasonable program expectations and management tips for mitigating associated program challenges and risks.

1. **Application Trends** – Agencies consistently observe spikes in program applications and participation immediately following three events: a drought emergency declaration; a rebate increase; and a special, landscape-focused agency event. Agencies also note that participation has held relatively high ever since the governor's emergency drought declaration in January, 2014 and the State Water Board's promulgation of emergency drought regulations in the summer of 2014.
2. **Rebate Value** – While the decision on the dollar-value of a program's rebate has real implications for customer attraction and retention, it alone does not dictate participation. For example, an agency with an eight-year-old turf rebate program recently cut its rebate value in half when funding was getting low, from \$1 to 50 cents per square foot, yet the program did not see a drop in participation. Since then, the agency has even grown its program participation and has effectively doubled its impact (i.e., the agency can double the

landscape conversion area supported by the program using the same remaining funds). Understanding local/regional costs for landscaping replacement, the marginal value of the anticipated water savings to your agency, and target customer demographics' willingness to 'pay' can help with rebate selection. Rebate levels can always be changed (unless specified otherwise by a funding entity), and many successful rebate programs have increased their rates temporarily as a 'drought' special, indicating a flexibility to adapt the value as needed.

3. **Marketing** – Agencies employ a range of marketing strategies to get the word out about turf rebate programs. These include bill inserts, direct mailings, social media, radio tags during weather and traffic announcements, Google ad-words, garden tours and landscape events and workshops, program-specific websites, and word of mouth. Most agencies indicate that three outreach and advertising strategies are most effective: a) bill inserts and direct mailings; b) annual spring garden tours or landscape workshops; and c) word of mouth via existing and aesthetically pleasing landscape conversions.
4. **Customer Care and Communication** – Many customers are completely new to landscaping, let alone to turf conversion. They require significant handholding on the program application, the landscape design, and the landscape installation. How a program 'holds' customers' hands varies from indirect strategies such as "check the website for information," to direct strategies such as "call the turf rebate program manager when needed." Though water agencies vary on how they manage continual customer need, an emerging theme suggests that kind and flexible customer service that rewards good intentions is key to successful landscape conversions and program longevity. For example, a delayed landscape conversion that fails to meet a program deadline because the customer was concerned about watering new plants in the summer may save more water than an incomplete conversion that fell-through because the customer did not comply with the program timeline and the rebate offer was revoked.

Maintaining flexibility with customers can come at the cost of increased program administration time. Streamlining and minimizing customer communication and standardizing customer expectations reduces program staff time. Agencies must seek an internal balance between customer intervention and customer independence that considers the impact on targeted outcomes such as successful conversions and water savings. Persuading customers to read available rebate parameters and conversion expectations before calling agencies with questions is a key strategy to streamline customer interaction, but as previously noted, turf rebate information can be overwhelming and daunting to the landscape novice. Clear and concise rebate program informational materials, easily understood by customers, will contribute to program efficiencies. Some agencies require customers to check a box indicating that the customer has thoroughly read and understood all the program terms and conditions before applying. This strategy may decrease agency liability, but many internet-users have been conditioned to check that box regardless of whether they have actually

reviewed the content. Implementing innovative strategies that encourage customers to do their own program research and that address multiple customer questions and concerns at the same time may pay back dividends in the rebate process by saving staff time. For example, one agency hosted a twitter chat when it first launched its program, answering many would-be participants' questions in one concerted effort.

5. **Customer Demographic Breakdown** – Generally speaking, agencies that offer rebates to both residential and commercial customers draw roughly 90% of their participants from the residential sector and 10% from the commercial sector. Spatially and financially, however, results vary, and commercial customers can far exceed residential customers in terms of acres of turf converted and rebates received. Depending on program goals (e.g., landscape awareness, magnitude of conversions, or customer relationship-building), an agency may delegate specific proportions of available funding to the residential or commercial sectors. For example, a water agency that wants to increase engagement with the CII sector can allocate more rebate funds to that sector than to the residential sector. Agencies have also noted a breakdown of roughly 15% do-it-yourself participants versus 85% hire-a-contractor participants, though this ratio is prone to vary significantly by region, program requirements, and customer demographics.
6. **The Design Phase** – Agencies have found that the landscape design component of rebate programs is instrumental in eliciting positive transformations and that most customer drop-outs occur upon facing program design hurdles. Most programs require some sort of landscape design submission to be eligible for the rebate. Some agencies will not even inspect properties until a landscape design is submitted, because they observe up to a 50% drop-out rate during the design phase. To empower customers and to encourage excellent designs, agencies adopt different strategies. Two of these are; a) customer class requirements where customers participate in a landscaping class before they apply to the program; and b) discounted design consultations where customers can receive a two-hour landscape architect consultation for a heavily reduced price.
7. **Rebate Timeline** - From the application to the final inspection, rebate processes can last anywhere from 45 days to over 4 months. Customer and agency enthusiasm can wane during this time, and participant paper trails can get lost and confused. An agency needs a consistent approach to managing the lengthy conversion processes. It also needs to capitalize on the increased customer contact that a rebate program generates by encouraging long-term customer commitments to landscape maintenance that extend beyond the rebate time-frame. For context, the average, healthy, California native garden takes two years to fully establish. Customer communication and education during the rebate time-frame is critical to the future establishment and management of replacement landscapes after the rebate process concludes.

8. **Customer Fallout** – Turf rebate program attrition rates are consistently high. Three reasons for this are: a) the lengthy conversion timeline; b) the rigorous replacement requirements; and c) landscaping's complexity. Agencies observe anywhere from 25-45% of applicants pulling out of the rebate process before they receive their rebate check – typically the last step of the process. Applicants will be rejected by the program or drop out of the rebate process for multiple reasons. These include: fatal flaws in their applications, failure to comply with the turf replacement requirements, and simple process fatigue. Programs with strict deadline cycles see most of their drop-outs leave the program right before the final deadline, because they were unable to stay on track. Programs with an involved design component see most drop-outs during the design submission phase.

Agencies use a range of strategies to minimize drop-out rates. Some agencies explicitly confirm that the customer is aware of all the program requirements by requiring attendance to a sustainable landscape class or workshop that sets explicit expectations as an application pre-requisite. Others provide design advice, tools, or professional services to applicants who are do-it-yourselfers, as these customers struggle the most with program design components.

9. **Lawn Acceptance Status** – Traditionally, agencies require lawns to be well-maintained prior to a rebated conversion in order to realize real water savings. California's lasting drought, however, has stressed lawns. Agencies can no longer expect perfectly watered and manicured lawns upon rebate program pre-inspection. With drought watering restrictions and increased conservation ethics, it is more common to find homeowners these days who are willing to 'let their lawn go.' Some agencies realize that to follow the watering restrictions is to see some decrease in lawn health. Other agencies do not wish to punish homeowners for good behavior. Still others view lawn conversions as a long-term investment that may not yield immediate savings, but will ultimately realize long-term water conservation. For all these reasons, some agencies have relaxed their pre-inspection lawn status requirements and are accepting rebate applications for less-than-perfect lawns. Agencies are particularly willing to overlook a stressed lawn during pre-inspection if seasonal and historical billing data or aerial imagery is available to prove that the property was recently fully irrigated. Accessing historical water use data to support claims of historic irrigation is easier for districts with automated metering infrastructure and dedicated irrigation meters. Even then, the records must be normalized for weather.

10. **Replacement Requirements** – What an agency chooses to allow or prohibit within its turf replacement requirements can determine the cost and feasibility of successful conversions. Agencies who make the requirements too strict will find that fewer people will apply to the program or comply with the terms and conditions. Those who make them too loose will find that the resulting landscapes will not meet agency expectations. When designing rebate program requirements, agencies with existing turf rebate programs suggest five points: a) align

with near-by rebate program requirements; b) focus on the aesthetics of early conversions to boost program popularity; c) offer specific climate-appropriate and native plant suggestions and work with local nurseries and plant retailers to make sure suggested plants are available; d) require irrigation system upgrades; and e) specifically address - through required educational opportunities - the behavioral and educational barriers to water conservation. These include irrigation management and sustainable landscaping practices.

11. **Social Norms** – Powerful in their ability to attract or dissuade customers to a rebate program, social norms can make or break a program's success. For example, agencies have seen that one to two stunning conversions in a neighborhood can catalyze an entire neighborhood's transformation. Conversely, a single ugly conversion can discourage a neighborhood from participating in a rebate program. Agencies suggest that managers of new programs do whatever it takes to promote a neighborhood's beautification, and not its 'uglification.'
12. **From Early Adopters to High Water Users** – Existing turf rebate programs have shown that a water district's most water-conscious customers will undertake the initial lawn conversions. Over time and with successful conversions, agencies have found that the program ultimately attracts the less-conscious, high-water users.
13. **Cross-Agency Collaboration** – Two rebate program situations involving multiple agencies in the same geographic area have lead to customer confusion. First, some retail water agencies fall within the jurisdiction of a regional wholesaler. Second, many retail agencies have service area boundaries contiguous with one or more other retailers. In either case, customers can be confused by the existence of multiple turf rebate programs, and agencies can experience cross-agency program conflict. To minimize confusion and avoid conflict, regional programs must generate buy-in from member agencies and stakeholders early on in the program design process. Similarly, independent retailer rebate programs should seek alignment with other regional or proximate agency programs to provide their customers with consistent and clear expectations.
14. **Wisdom Over Time** – As with any new program, there is a learning curve to turf rebate programs. Though this report hopes to help flatten that curve, existing programs are learning new "lessons" daily. Agencies starting new programs should consult directly with well-established turf rebate programs. Additionally, agencies with existing programs recommend trying small scale pilots before launching large scale rebate programs. These pilots allow agency staff to work out program hiccups and save significant time and money down the road. For example, one agency piloted its turf rebate program with a small subset of customers before implementing it on a large scale. Based on the pilot, this agency ultimately decided to only require commercial entities to submit conversion plans, not residential homes; that agency had found that the otherwise required conversion plan 'homework' significantly deterred residential participation.

Landscape Conversion Water Use Impacts

Water Savings

Water savings attributable to landscape conversions - with or without irrigation system upgrades - vary between regions and between neighbors. Geographic climate differences, programmatic variability in landscape and irrigation replacement options, and capricious human behavior complicate water savings predictions and reduce the transferability of reported results. Studies across California measure, model, and/or predict average turf-replacement water savings of anywhere from 18% to 83%. In gallons per square foot converted area per year (g/sq ft/yr), agencies estimate and calculate a water savings metric that ranges from 13 to 70+ g/sq ft/yr. Southern California agencies consistently report savings of around 45 g/sq ft/yr. Table 1 below summarizes percent water savings attributable to landscape conversions as measured, modeled, or predicted by a variety of California and non-California sources and studies.

Table 2: Percent water savings attributable to landscape conversions; Single Family (SF), Commercial Institutional and Industrial (CII)

Source	Water Savings Average	Conditions
UC Davis Study	60% City-Wide	Student model of replacing turf areas with native plants, City of Davis, CA
Metropolitan Water District Study	18% SF 24% CII	Sample of CII and SF turf conversions within MWD Cash for Grass rebate program; water usage from agency billing data
Santa Monica City Garden-Garden Case Study	83% SF	Controlled, side-by-side, Single Family Residence case study in Santa Monica, CA
Council 'Turf Removal PBMP'	35-75% per capita use	Range identified via literature review of 'typical residential' site replacing cool season turf grass in CO ⁱ and NV ⁱⁱ
AWE Outdoor Water Savings Research Initiative	33-76%	Range identified via literature review of landscape conversions in FL ⁱⁱⁱ and NM ^{iv}

Water Savings Caveats

Replacing turf grass with low water-demand ground cover is not solely responsible for the quantifiable changes in outdoor water use before and after landscape conversion. In part, water savings may be attributable to other factors such as fluctuating climates, customer behavioral change, decaying irrigation system upgrades, expanded knowledge and awareness of landscape managers, and decreased ET from a reduced canopy cover immediately following a conversion. Some of these factors are intentionally captured in program design to reduce water use. It would be informative to separate out the quantitative value of water savings attributable to each program requirement, but for water distributors, it is often more important to include as many water-saving program requirements as is realistic to maximize program value. An improved understanding of the percentage of conversion water savings attributable to specific program results such as irrigation system updates or behavioral change would help to refine program

design and to achieve the highest water saving potential. For example, if a rebate program's plant coverage replacement requirement yielded negligible water savings, and 99% of actualized water savings were attributable to customer behavioral change, then rebate programs could increase their cost-effectiveness by emphasizing the components of their programs that most impact property owner behavior. Of course, water savings are not the only benefit achieved from landscape conversions. Indeed, the multiple benefits associated with turf replacement projects such as GHG emission reduction and native habitat creation will complement water savings in the bigger watershed picture.

Non-Savers

As mentioned above in [*Rebate Program Challenges & Risks*](#), some rebate customers see no water savings despite replacing their turf. Anecdotally, water agency employees observe negligible initial water savings on many turf conversions. They note that while climate appropriate and native landscapes require different irrigation techniques, they still use roughly the same quantity of water as efficiently-watered turf grasses upon *installation*. Once established, however, they need less water.

The Southern Nevada Water Authority (SNWA) presented on this 'non-saver' phenomenon during the 2014 WaterSmart Innovations conference. In SNWA's presentation, 'The Non-Savers: An Evaluation of Turf Conversion Properties That Don't Save Water,' presenters concluded that approximately 10% of customers increase their water use after a landscape conversion and 10% neither increase nor decrease their water use after a landscape conversion. The study found few statistically significant factors predicting differences between non-savers and savers. It did, however, note three interesting differences: 1) non-savers converted a lower percentage of their landscaped area or house lot area; 2) non-savers had a higher minimum percent plant cover pre-conversion; and 3) non-savers had newer home construction and/or more valuable property. Qualitatively, sites ranked as having 'very poor' pre-conversion turf quality were also more likely to fall into the non-saver category than program participants with higher pre-conversion turf quality.

These results are intuitive – smaller conversion projects on plots with significant pre-existing plant coverage and newer construction (and therefore newer irrigation) with stressed turf conditions may show lower water savings post conversion than their counterparts. Creatively designed rebate program requirements can help to minimize the number of non-savers and maximize water savings. Even non-savers, however, can still benefit programs by expanding the visibility of sustainable landscapes and increasing the level of customer awareness of sustainable landscaping practices.

Turf Replacement Cost-Effectiveness

Both turf rebate programs and third parties have quantified the value of water savings attributable to rebated conversions. Their results show that for every acre-foot (AF) of water saved, pro-rated over an assumed program lifetime of 10 years, water distributors and their funders typically pay anywhere from

\$1,000 to \$1,700⁴. Quantified cost outliers approach \$400/AF and \$5,900/AF. Among other factors, this cost-effectiveness metric (\$/AF saved over 10 years) depends on rebate values, program administrative costs, regional water savings potential, and end user behavior. Compared with other conservation strategies, an average lawn conversion rebate program, as it is valued now, is one of the most costly conservation and supply augmentation approaches that a water agency can undertake (see [Appendix A](#) for details).

The \$/AF saved ratios may change over time. On the one hand, savings attributable to conversions may increase over time as the climate appropriate plants mature and require less water or as hotter and drier climates increase turf grass water needs disproportionately to drought-tolerant-plant water needs. On the other hand, water savings attributable to rebate programs may decrease over time due to property management changes, irrigation system decay, or decreased end-user water consciousness in post-drought years. Water savings may also stay constant over time. A Nevada-based study on xeriscape lawn conversions (see [Climate Appropriate Landscapes](#) below for the meaning of Xeriscape) found that water savings did not significantly change over time. This study used only Nevada Xeriscapes limiting the transferability of the study results, but it does suggest stabilized water savings as a third possible outcome.^v The degree of change over time in water savings will ultimately determine the return on turf rebate program investments. Extensive program cost analyses that capture additional externalities from turf conversions, positive or negative, such as waste generation, maintenance time, and habitat value, are not readily available. Future studies should consider the multiple effects of landscape conversion when calculating cost-effectiveness metrics.

The Future of Turf Replacement Rebate Programs

Turf rebate programs have an uncertain future. Program success over the past year, as measured by dramatic participant growth, could foreshadow a future in which the programs continue to grow exponentially, both expanding in popularity and shaping social norms. On the flip side, the rapid growth could give way to saturated target demographics, insufficient funding for continued programming, or calculated cost-benefit decisions to end programs.

In the long term, California cannot afford to spend \$3 per square foot to replace the roughly 2.5 million acres of turf grass (1.089e+11 square feet) in the state. Given that current expenditures are unsustainable, existing programs should be considered loss-leaders. They should seek a defensible and repeatable proof of concept that substantiates the value (economic, aesthetic, environmental, and health) of turf removal and sustainable landscaping on a state-wide scale. The following seven program considerations stand out as top priority program improvements to support water savings, improve fiscal investments, increase program defensibility, and generate streamlined rebate processes:

⁴ These values were calculated and estimated using a wide range of methodologies. From statistical evaluation capturing several years of water use data before and after participant conversions and controlling for confounding factors such as weather, to simplified calculations that multiply an average water savings number (e.g., 45 gallons per square foot per year - approximated and adopted by many Southern California agencies) by the area of conversions completed.

1. From the start of a turf rebate program, collect the necessary data to defensibly calculate and statistically analyze the water savings attributable to conversions. Commit to a standardized and transferable calculation methodology for measurement and verification of program outcomes.
2. Offer and/or require hands-on landscape design and irrigation guidance through classes or other means to educate and engage homeowners and to realize high-quality and sustainable conversions that expand beyond turf removal to embrace the principles of the watershed approach. (See [Appendix B](#) for an explanation of the watershed approach.)
3. Design, test, and implement innovative strategies to maximize conversion impact. Strategies could include varying rebate levels to correspond with microclimates; increasing rebates for simultaneous neighborhood conversions; or acknowledging successful conversions with yard signs that attribute beautiful new landscapes to the turf rebate program. These strategies should simultaneously maximize water savings while attracting participants and establishing social norms.
4. Use multiple post-conversion inspections to determine how conversions hold-up or change over time. For example, check the landscape immediately after a conversion completion, then check it again one year later to evaluate plant health, aesthetic appearance, and irrigation system decay. Additional inspections will also remind property owners to continually manage their own landscapes.
5. Design program finances and rebate levels to achieve the desirable degree of participation, water savings, and longevity. This process requires studying participation trends over time from similar agencies and determining how an agency can manage available funding and staff resources to implement and sustain a program. This design process may also require including additional water-saving criteria in rebate terms and conditions.
6. Emphasize long-term customer behavioral changes throughout the rebate process by:
 - seeking customer commitment to water conservation ethics;
 - educating participants on the multiple benefits of landscape conversion and on the practicalities of landscape maintenance;
 - reminding customers of these topics throughout the project; and by
 - positively reinforcing customer progress and program participation.

Importantly, a (sometimes large) portion of water savings post conversion is attributable to the increased customer knowledge and understanding of landscape irrigation and maintenance needs. Consistent customer contact and prompts that extend beyond the conversion project timeline will reinforce behavioral change and maximize water savings impacts.

7. Motivate a shift to the watershed approach to landscaping by coupling turf rebate programs with additional holistic landscape considerations and incentives. Incentivize on-site stormwater capture

and retention through all-inclusive or tiered rebates that encourage rainwater harvesting and stormwater retention in addition to turf replacement and irrigation upgrades.⁵ Seek funding from mutually benefited organizations such as stormwater agencies. Consider soil health improvements and/or the use of compost for rebate requirements or additional rebate incentives to ultimately increase water retention capacity and reduce the need for supplemental irrigation. Design variable or tiered rebates that incentivize planting new landscapes during the appropriate season. For example, offer an initial, nominal rebate for sheet-mulching a lawn during spring or summer months. Then, offer an additional rebate for new landscape planting during the fall months.

Challenging questions about rebate programs remain: do these programs only reward wasteful water users or well-off home owners who could afford the conversions without rebates? Is there social equity in rebate programs? Should California water agencies be implementing comparatively non-cost-effective conservation programs in a drought? Are there cost-effective, alternative approaches to incentivize landscape conversion (see [Appendix C](#))? These are thought-provoking, valuable questions to ask. Given the current popularity of these programs, they are likely to remain until they simply become too expensive for water distributors. Only time and a continued commitment to improving region-specific program design and data collection will reveal the true impact and potential of turf removal rebate programs.

⁵ For ideas on incentivizing stormwater retention, check out Portland Oregon's '[Clean River Rewards](#)' program and '[Downspout Disconnect](#)' program, or Seattle's [RainWise Rebates](#).

Turf Replacement Specifications

Different rebate programs permit a range of replacement ground covers. Three primary material replacements are available: climate appropriate plants, permeable hardscapes, and synthetic turf. Where one rebate program allows any of the three, another program allows only one. The following section briefly covers what each of these replacement options entail and lists their pros and cons including water use; maintenance; retention, runoff, and erosion; ecosystem services such as habitat creation, fire control, and cooling; GHG emissions and waste generation; public health; and cost effectiveness. (Please see [References & Resources](#) at the end of the report for further research.)

Climate Appropriate Landscapes

Climate appropriate, drought tolerant, and/or native plants and planting materials are a preferred turf replacement option for many water distributors. Most rebate programs require that a certain percentage of replaced landscape area consists of climate appropriate plants. Dubbed 'climate-appropriate,' these plants are better adapted to California climate zones than their water-intense peers, and therefore, they require less irrigation. Drought tolerant plants are those specifically recognized for their ability to survive extended periods of time with little to no rain or irrigation. Not to be confused with climate-appropriate or drought tolerant plants, native plants are plants indigenous to a specific region, as identified during a specific period of history. California native plants, generally thought of as plants that existed in California prior to European settlement, are by definition climate-appropriate because they exist naturally in a climate that suits their needs. These plants have co-evolved with native animals, fungi, and microbes over long periods of time, and therefore they provide the additional benefit of habitat creation for native animals. Not all climate appropriate or California native plants, however, are drought tolerant simply because not all California climates commonly experience (or used to experience) repeated droughts. Thus, landscapers must ensure that their choice of native is appropriate for their specific micro-climates.



Image Credit: www.gopixpic.com

Among recognizable climate-appropriate landscape brands are: Xeriscape™, California-Friendly™, Bay-Friendly, River-Friendly, and Garden-Friendly.

Xeriscaping, the first widely-recognized turf alternative, gained its popularity in the arid southwestern United States. For many, it conjures images of gravel, adobe, succulents, and cactuses. In actuality, however, Xeriscaping encompasses a broader array of plant varieties selected for water efficiency and soil health.

The wide array of 'Friendly' brands indicates California

climate-appropriate and native plants. They are growing in popularity, especially since the 2014 drought emergency declaration and the growth of turf rebate programs. Gardens built using climate-appropriate plants are often also designed around watershed-approach principles such as decreased water use and

increased percolation, healthier soils, habitat creation, and hydrozones that cluster plants with similar water and sun requirements and help minimize erosion and unused runoff.

Critics disapprove of climate-appropriate and native gardens as a viable turf replacement options for four principal reasons:

1. Cost – Compared to turf grasses, native and climate appropriate gardens are typically more expensive to purchase and install.
2. Maintenance – Heterogeneous gardens often require a greater depth of landscaping knowledge and understanding; even if resulting gardens ultimately require less maintenance, the initial learning curve is steep.
3. Aesthetics – Some landscape conversions designed with native or climate-appropriate plants do not result in aesthetically pleasing front yards, offending neighbors and discouraging further conversions.
4. Property Value – The market value for homes **may** decrease based on the absence of a turf grass lawn.



Image Credit: www.californianativeflora.com

In contrast, supporters give seven reasons for favoring climate-appropriate and native gardens as a viable turf replacement option:

1. Cost – Long term cost analyses suggest that money saved on maintenance, waste removal, and water costs yield a reasonable return on investment, particularly when landscape conversions are large-scale commercial projects or when property managers receive rebates.
2. Maintenance – Property owners and managers spend fewer hours maintaining an established native or climate appropriate garden than a turf lawn.
3. Aesthetics – The plants available to native and climate-appropriate gardens vary in size, shape, and color, and can yield beautiful landscapes when designed properly.
4. Property Value – Market value for homes **may** increase based on the presence of a water efficient landscape based on native or climate-appropriate plants.
5. Water, Waste, and Energy Savings – The decreased water, fertilizer, and pesticide needs, and the decreased maintenance time associated with native and climate-appropriate gardens saves water while reducing chemical use, green waste, and GHG emissions when compared with 'mow-blow-and-go' turf grass maintenance.
6. Habitat Creation and Soil health – Native plants can create habitat for native animals, such as bees, that are key species in keeping our watersheds healthy. Native plants can also help to restore soil health through habitat creation by incorporating animal byproducts into the soil.
7. Stormwater Management – Well-designed native gardens retain stormwater, allowing it to percolate to subsurface aquifers, filter pollutants, and avoid at-capacity sewer lines.

Permeable Hardscapes



Image Credit:
<http://www.santacruz.watersavingplants.com/>

Permeable hardscapes are ground covers constructed above drainable soils or stone aggregates. When compared to traditional solid concrete, brick, or asphalt pavers, permeable hardscapes reduce runoff and erosion. Permeable hardscapes vary widely in permeability. They include: gravel; gridded or interlocking pavers with gravel or dirt infill; cobblestones; and porous, pervious, or permeable pavers (e.g., porous asphalt and pervious concrete).

Critics disapprove of permeable hardscapes as a viable turf replacement option for five reasons:

1. Failure Over Time – Anecdotal evidence has led some agencies to remove permeable hardscapes as an allowable alternative to turf grass. These agencies note that property managers/owners report a decrease of permeability over time, as percolation pores and grooves clog with compacted dust and grit. Research shows that after a few years of use or after poor installation practices, percolation from some 'permeable pavers' can decrease by orders of magnitude.
2. High-Maintenance – Porous pavers require a stone aggregate detention basin below the pavement surface. To maintain infiltration rates, this basin must be periodically washed out to prevent dirt and particulate build up. Some porous surfaces require vacuum sweeping to maintain infiltration rates; certain old porous surfaces can only be reclaimed as 'permeable' by drilling half-inch holes in the surface to allow water to reach the stone aggregate basin.
3. Climate- and Soil-Sensitive – Climates that experience freeze-thaw cycles frequently see damaged pavers. They crack after partially clogged pores fill with water, freeze, and then expand. Sanding surfaces for snow traction also quickly renders porous pavers ineffective by clogging pore spaces. Similarly, snow-plow piles with high sediment content can melt into pavers and clog them. Finally, regardless of a hardscape's permeability, high clay-content soils limit infiltration into aquifers and can cause pooling and runoff.
4. Heat Island – Some porous pavers are dark surfaces (e.g., porous asphalt) that increase heat absorption and contribute to the urban heat island effect.
5. Limited Environmental Benefits – In contrast to other turf replacement alternatives like climate appropriate plants, permeable hardscapes do not offer ecosystem services such as GHG sequestration, air filtration, or habitat creation.

Supporters give seven reasons for favoring permeable hardscapes as a viable turf replacement option:

1. Reduced Runoff / Increased Percolation – At least upon installation, the runoff coefficients of most porous pavers are more similar to grass (and some in far excess of grass) than to non-porous

pavements. These lower runoff coefficients mean increased infiltration into the soils and increased subsurface water storage.

2. Low-Maintenance and Functional – In contrast with plant and turf grass ground covers, hardscapes require little to no maintenance or chemical application. They also serve as a functional space for many activities.
3. Water Savings – With little to no watering requirements after installation, permeable hardscapes can reduce outdoor water usage by almost 100%.
4. Water Filtration – Stormwater pollutants are removed by filtration through the paver pores and/or in the permeable ground underneath or in-between permeable hardscape surfaces.
5. Efficient Construction – In comparison with traditional pavements, porous pavements take less time to construct and install.
6. Durability – Properly constructed pavers can last 20-40 years and maintain infiltration rates orders of magnitude higher than turf grass throughout their lifetime.
7. Low Cost – Well-installed and designed permeable pavers or other permeable hardscapes can save money over a landscape's lifetime through water savings, landscape materials applications, and maintenance opportunity cost savings. Indeed, considering just installation costs, permeable pavers are cost-competitive with both plant and synthetic turf alternatives. Permeable pavers are also cost-competitive with traditional pavers when storm water management systems are included in the cost calculations. Alternative permeable hardscapes like gravel beds cost significantly less than plant and synthetic turf coverage of a similar area.

Synthetic Turf

Artificial grasses have been around since the mid to late 1900's. Consisting of synthetic fibers, rubbery infill, and subsurface layers designed to pad, drain, filter, and ground the fibrous artificial turf, this groundcover was originally popularized in sporting arenas. It offered water and maintenance cost and time savings. Synthetic grass design has evolved over time to combat its negative reputation in the environmental and public health world, though artificial grass critics remain skeptical. Improved technologies have bettered the ergonomics of synthetic grasses to decrease the threat of athletic injury. New materials limit lead-contaminated infill and minimize heat dangers. Recently, spurred by ongoing drought and decreased water and maintenance costs, synthetic turf has gained popularity among California single family homeowners.

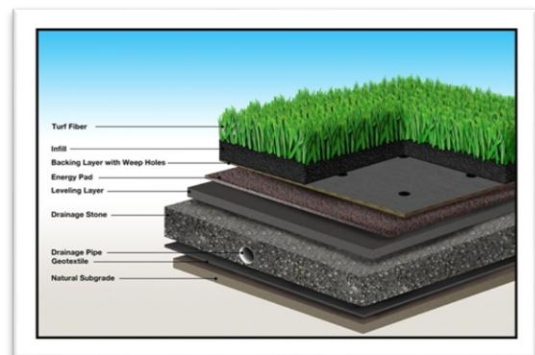


Image Credit: The Synthetic Turf Council

Critics disapprove of synthetic turf as a viable turf replacement option for six reasons:

1. Heat Risks – Surface temperatures on synthetic fields have been documented as high as 199 °F, increasing potential for heat-related health hazards and increasing the urban island effect.

2. Health Hazards – Beyond heat injuries, researchers have documented increased incidence of sports injuries, increased risk for bacterial infections, and increased asthma triggers. They have hypothesized connections between heavy metals and toxic compounds found in synthetic turf infills (and their cleaning agents) and diseases such as cancer.
3. Waste Generation – At the end of its 6-15 year lifetime, synthetic turf typically ends up in a landfill, even if it is technically recyclable.
4. Aesthetics – Wear and tear on synthetic turf materials creates damaged-looking and faded groundcover; unlike natural grasses, artificial turf cannot regenerate itself.
5. Environmental Impact – Artificial turf does not offer several environmental benefits offered by turf grass and living plant alternatives such as biofiltration, cooling effects, carbon sequestration, and habitat creation. Instead, the synthetic turf can increase runoff, leach toxins into soils, and cause soil compaction and loss of microbes.
6. Limited Water & Maintenance Savings – Hot or dirty synthetic turf surfaces require irrigation and cleaning maintenance. This increases water and time costs and occasionally requires costly specialized equipment and toxic chemical cleaning solutions. These maintenance factors can lengthen the return on investment time for synthetic turf installation well beyond the industry-supported claims of three to five years.

Supporters offer six reasons for favoring synthetic turf as a viable turf replacement option:



Image Credit: frassfakegrass.com

1. Convenience – Artificial turf can be used continuously as a functional space; no “down time” has to occur for fertilizing and cutting. In addition, synthetic lawns can be enjoyed year-around in climates that do not support continuous natural turf growth.
2. Health Benefits – Industry supporters claim modern synthetic turf technologies reduce sports injuries and control for bacteria growth.
3. Waste Reduction – Some artificial turfs are now 100% recyclable. In addition, artificial turf manufacturers themselves integrate into their product post-consumer, recycled materials such as tire rubber that would otherwise be sitting in a landfill.
4. Aesthetics – Fade-resistant, durable artificial turf products resemble a perfectly manicured lawn, year-around.
5. Environmental Impact – Artificial turf eliminates the need for fertilizers and pesticides that can run off in stormwater and leach into water tables. Artificial turf also reduces GHG emissions and green waste by eliminating ‘mow-and- blow’ maintenance.
6. Water & Maintenance Savings – Artificial turf requires little to no water or maintenance. This saves property owners and managers money and time. These savings mean property owners can see their purchase and installation expenses paid back within three to five years.

Conclusions

The limited quantity and quality of turf removal program data undermines conclusive program evaluation and recommendations, but anecdotal lessons learned can inform agencies as they manage new and expanding turf removal programs. Common challenges faced by program managers include limited time and money resources, customer unfamiliarity with landscaping, and undesirable conversion outcomes. Key strategies to overcome these challenges and to realize water-saving, aesthetically-pleasing landscape conversions include educational customer outreach, thorough conversion monitoring, and carefully designed program requirements.

A central component of turf removal program design are the turf replacement options. Without a complete life cycle analysis of all natural turf alternatives – i.e., climate-appropriate plants, permeable hardscape, and synthetic turf - it is difficult to quantitatively and conclusively compare the impacts of these groundcovers on financial resources as well as environmental impact. It is simpler; however, for agencies and property managers to consider the above qualitative pros and cons and choose based on what is most valuable to them as a water agency or as an individual.

Even if turf rebate programs are not a cost-effective method to augment urban water supply, there are substantial positive externalities associated with them. These include end-user education, multiple benefits from climate-appropriate landscapes, and encouragement of a general cultural shift towards understanding and accepting environmentally beneficial alternatives to turf grass. For agencies considering these programs, these non-quantifiable benefits may tip the scale and justify the investment in limited rebate programs. Program popularity with homeowners and program timeliness given California's ongoing drought indicate that these programs have the potential to catalyze broad transformations on a state-wide scale. Program design and limitations must be carefully considered to manage expectations and to generate desirable results for water agencies, customers, and the state as a whole.



References & Resources

General Turf Removal Resources

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- BeWaterWise, [Demonstration Gardens](#), Metropolitan Water District
- Ellen Hanak and Matthew Davis, [Lawns and Water Demand in California](#), California Economic Policy, Volume 2, Number 2. July 2006. (Jan. 20, 2015)
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- Kathy Ramos, [Does Turf Removal Save Water?](#), Metropolitan Water District, 2014 WaterSmart Innovations Conference
- Kristen Shapiro, Andrew Chan, Elliot Carson, Romina Tayag, [Outdoor Water Use Conservation through Native Plants](#), UC Davis
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- Office of Sustainability and the Environment, [Garden-Garden](#), City of Santa Monica
- San Diego County Water Authority News Release, Jan. 8, 2015, [Customer Demand Exhausts Funds for Water Authority's Turf Replacement Program](#)
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- Tom Hudak, 2005, Converting turfgrass to xeriscape: Evaluating Southern Nevada water authority's "Water smart program," University of Nevada
- WaterSmart, 2014, [Tapping into Behavioral Science](#)

Interviews & Data Provided by the following Turf Removal Programs

- [City of Long Beach – Lawn to Garden](#)
- [City of Roseville- Cash for Grass](#)
- [City of Santa Cruz – Lawn Removal Rebate](#)
- [City of Santa Rosa – "Green Exchange" Rebate Program](#)
- [City of Sacramento – River Friendly Landscape Rebates](#)
- [Contra Costa Water District – Lawn to Garden Rebate Program](#)
- [Los Angeles Department of Water and Power](#)
- [Municipal Water District of Orange County – Orange County Turf Removal Program](#)
- [Metropolitan Water District of Southern California – Turf Removal Program](#)
- [San Diego County Water Authority – WaterSmart Turf Replacement Program](#)

Climate Appropriate Landscapes

- The California Native Plant Society, <http://www.cnps.org/>
- TreePeople, [Plant Native and Climate Appropriate](#)

Hardscapes

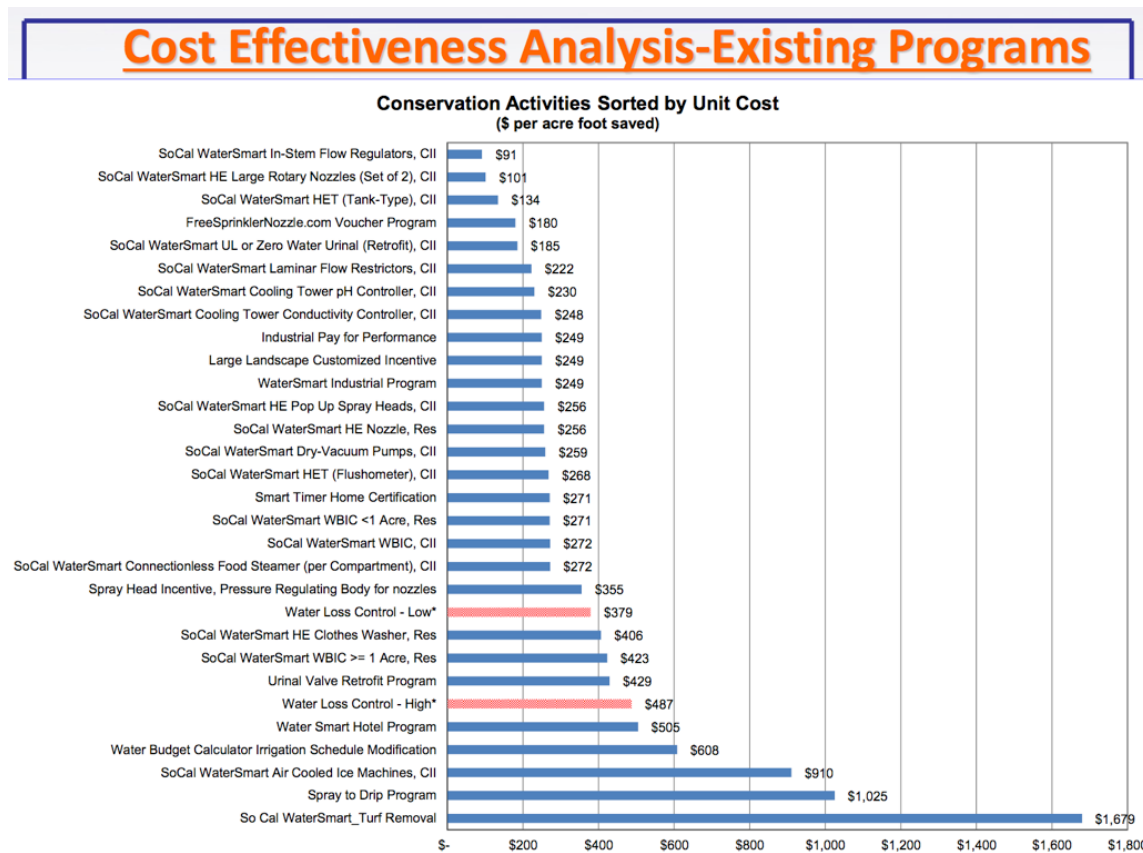
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- Santa Clara Valley Water District, [Field, Pilot, and Laboratory Studies for the Assessment of Water Quality Impacts of Artificial Turf](#)
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Appendix A: Conservation Program Cost Effectiveness

The following chart, presented by Joe Berg from the Municipal Water District of Orange County at the WaterSmart Innovations Conference 2014, details the relative cost per acre foot (AF) of water saved for various water conservation programs. The turf rebate program value is found at the bottom of the chart, indicating that it is the most expensive program alternative evaluated in this study with a cost of \$1,679/AF water saved. It should be noted that since 2014, cost effectiveness numbers may have changed.



The following are California water source costs as calculated by the Public Policy Institute of California:

Method	Annual cost per acre-foot (\$)	
	Low	High
Conjunctive use and groundwater storage	10	600
Water transfers	50	550
Agricultural water use efficiency (net)	145	240
Urban water use efficiency (gross)	230	635
Recycled municipal water	300	1,300
Surface storage (state projects)	340	1,070
Desalination, brackish	500	900
Desalination, seawater	900	2,500

Appendix B: The Watershed Approach

A watershed approach intends an integrated, holistic approach to landscape design, construction, and maintenance that transcends water-use efficiency to reflect a site's climate, geography, and soils and to address the related benefits of cost savings, run-off reduction, green waste reduction, pesticide and fertilizer reduction, habitat improvement, and energy/GHG reductions.

California's landscapes provide essential functions throughout our urban environment. They are where we recreate; capture, clean and recharge groundwater; shade and cool our buildings; enhance property values; provide wildlife habitat; create space to grow food locally; provide a sense of place and much more. The optimal design, installation, and management of these spaces are critical to enhancing California's quality of life while protecting our limited natural resources.

The transition to the watershed approach will be a system-wide upgrade to the urban environment. In addition to reducing outdoor irrigation, the transformation promotes multiple environmental benefits for municipalities:

- Increased rainwater and graywater capture, storage, and reuse
- Increased stormwater capture and infiltration, decreased stormwater runoff
- Reduced synthetic pesticide and fertilizer application and runoff
- Reduced "green waste" production
- Increased soil health and water retention capacity
- Reduced energy consumption and greenhouse gas emissions and improved air quality, and
- Increased food production and habitat for beneficial insects and wildlife, and the restoration of native biodiversity

The transformation also promotes benefits for individual property owners:

- Increased cost savings (lower water bills and upkeep costs)
- Reduced landscaping maintenance
- Healthier neighborhoods and communities
- Increased sense of place and appreciation for local resources
- Improved stewardship ethics and associated positive feelings towards self and neighborhood, and
- Increased shared values between neighbors via increased community participation in a social-norm-defining transformation.

Appendix C: Other Turf Conversions – Demonstration Gardens

Turf rebate programming is not the only approach to catalyzing landscape conversions in California. There is a need for parallel efforts that leverage shifts in cultural preferences towards sustainable landscapes.

Among existing programmatic efforts to encourage turf removal, and more specifically to redefine social norms, is the installation and advertisement of demonstration gardens. These educational garden spaces replace turf in well-visited locations. Their beautifully-designed and functional landscapes attract the passersby and their informative signage educates garden explorers. Though less tangible than cash incentives, demonstration gardens can re-define public perception of unorthodox landscapes and gradually shift the current California landscaping paradigm from turf grass towards sustainable alternatives.



*Image Credit: Big Bear Lake
Department of Water & Power*

A series of California-Friendly® garden examples are hyperlinked through the Metropolitan Water District's [BeWaterWise](#) website. Though, some are designated botanical gardens, many are specifically demonstration gardens found in public spaces like libraries and water agencies. Numerous other demonstration gardens are scattered throughout the state on public and private property. These garden spaces often host gardening tours and workshops, school field trips, and other educational events. Beyond providing educational venues in pleasant and sustainable landscapes, these gardens increase public familiarity with non-turf landscaping alternatives. This familiarity breeds comfort and acceptance. Though demonstration garden impact on turf removal is not directly quantifiable, the gardens are readying the population of California for a landscaping paradigm shift.

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ⁱⁱ Sovocool, K. A., Rosales, J. L., & Southern Nevada Water Authority (2004). "A Five-Year Investigation Into the Potential Water and Monetary Savings of Residential Xeriscape in the Mojave Desert." Las Vegas, NV.

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^v Hudak, T. (2005) Converting turfgrass to xeriscape: Evaluation Southern Nevada water authority's "Water smart program"



San Diego County Water Authority

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May 9, 2015

Randy Record and
Members of the Board of Directors
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

MEMBER AGENCIES

- Carlsbad Municipal Water District
- City of Del Mar
- City of Escondido
- City of National City
- City of Oceanside
- City of Poway
- City of San Diego
- Fallbrook Public Utility District
- Helix Water District
- Lakeside Water District
- Olivenhain Municipal Water District
- Otay Water District
- Padre Dam Municipal Water District
- Camp Pendleton Marine Corps Base
- Rainbow Municipal Water District
- Ramona Municipal Water District
- Rincon del Diablo Municipal Water District
- San Dieguito Water District
- Santa Fe Irrigation District
- South Bay Irrigation District
- Vallecitos Water District
- Valley Center Municipal Water District
- Vista Irrigation District
- Yuima Municipal Water District

RE: Adopt resolution to continue Metropolitan’s Water Standby Charge for fiscal year 2015/16 – **OPPOSE**

Chair Record and Members of the Board:

While we do not oppose use of a water standby charge in the abstract, we vote NO on Board Memo 8-1 for the reasons stated in our April 13, 2015 letter RE: Board Memo 8-1: Approve resolutions fixing and adopting a Readiness-to-Serve Charge and a Capacity Charge for calendar year 2016 - OPPOSE, a copy of which is attached.

Sincerely,

Michael T. Hogan
Director

Keith Lewinger
Director

Fern Steiner
Director

Yen C. Tu
Director

Attachment:

1. Water Authority’s April 13, 2015 Letter to MWD Board re 8-1

OTHER REPRESENTATIVE

County of San Diego

A public agency providing a safe and reliable water supply to the San Diego region



San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

April 13, 2015

Randy Record and
Members of the Board of Directors
Metropolitan Water District of Southern California
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 - Santa Fe Irrigation District
 - South Bay Irrigation District
 - Vallecitos Water District
 - Valley Center Municipal Water District
 - Vista Irrigation District
 - Yuima Municipal Water District
- OTHER REPRESENTATIVE**
- County of San Diego

RE: Board Memo 8-1: Approve resolutions fixing and adopting a Readiness-to-Serve Charge and a Capacity Charge for calendar year 2016 - OPPOSE

Chair Record and Members of the Board,

Copies of the following letters (without attachments) are attached:

- 1) April 8, 2014 letter from Dennis Cushman to Dawn Chin, Clerk of the Board RE: Board Memo 8-1 - Approve proposed biennial budget for fiscal years 2014/15 and 2015/16, proposed ten-year forecast, proposed revenue requirements for fiscal years 2014/15 and 2015/16, and recommended water rates and charges to be effective on January 1, 2015 and January 1, 2016; and transmit the General Manager's Business Plan Strategic Priorities for FY 2014/15 and 2015/16 - COMMENTS ON PROPOSED WATER RATES AND CHARGES (FOR 2015 AND 2016); and
- 2) April 8, 2014 letter from Dennis Cushman to Jeff Kightlinger RE: April 8, 2014 Board Meeting, Board Memo 8-1 - Approve proposed biennial budget for fiscal years 2014/15 and 2015/16, proposed ten-year forecast, proposed revenue requirements for fiscal years 2014/15 and 2015/16, and recommended water rates and charges to be effective on January 1, 2015 and January 1, 2016; and transmit the General Manager's Business Plan Strategic Priorities for FY 2014/15 and 2015/16 - REQUEST TO CONTINUE BOARD ACTION ONE MONTH, UNTIL THE MAY BOARD MEETING, TO ALLOW AN OPPORTUNITY FOR REVIEW OF INFORMATION PROVIDED TO THE BOARD OF DIRECTORS ON APRIL 4, 2014, AT 4:03 PM; IN THE ALTERNATIVE - OPPOSE.

The Water Authority requests inclusion of this letter and the attached letters and each and every attachment provided to MWD on April 8, 2014, in the record of proceedings relating to the actions and resolutions to fix and adopt Readiness-to-Serve (RTS) Charge and a Capacity Charge effective January 1, 2016, based on the rates and charges adopted by the Board on April 8, 2014. MWD's Engineer's Report dated April 2015 and 2014 cost of service reports are lacking a reasonable basis to support the RTS and Capacity Charges being imposed on the Water Authority for calendar year 2016, in that they fail to identify either the benefit of each facility or project to be financed with RTS revenues or the recipient of that benefit. Declarations by the Chief Financial Officer and Board of Directors in resolutions are not a sufficient factual or legal basis for the assessment of the RTS and Capacity Charges and are, in fact, contrary to testimony provided by MWD itself in the Water Authority litigation presently pending against MWD, in which MWD's cost allocations and rates have already been determined to violate the common law, Govt. Code Section 54999.7(a), the Wheeling Statute and Proposition 26. The Water Authority also requests inclusion of the April 2, 2015 trial testimony of Devendra Upadhyay in the record of proceedings relating to the Board's actions and resolutions to fix and adopt the RTS and Capacity Charges.

For these reasons, we OPPOSE Board Memo 8-1.

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
Director



Fern Steiner
Director



Yen C. Tu
Director

Attachments:

1. Letter to Dawn Chin re: Board Memo 8-1, dated April 8, 2014
2. Letter to Jeff Kightlinger re: Board Memo 8-1, dated April 8, 2014
3. Trial testimony of Devendra Upadhyay, dated April 2, 2015



San Diego County Water Authority

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HAND DELIVERED

April 8, 2014

Dawn Chin, Clerk of the Board
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

MEMBER AGENCIES

Carlsbad
Municipal Water District

City of Del Mar

City of Escondido

City of National City

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San Dieguito Water District

Santa Fe Irrigation District

South Bay Irrigation District

Vallecitos Water District

Valley Center
Municipal Water District

Viata Irrigation District

Yuima
Municipal Water District

OTHER REPRESENTATIVE

County of San Diego

RE: April 7, 2014 Finance and Insurance Committee Meeting
Board Memo 8-1 – Approve proposed biennial budget for fiscal years 2014/15 and 2015/16, proposed ten-year forecast, proposed revenue requirements for fiscal years 2014/15 and 2015/16, and recommended water rates and charges to be effective on January 1, 2015 and January 1, 2016; adopt resolutions fixing and adopting water rates and charges for 2015 and 2016; and transmit the General Manager's Business Plan Strategic Priorities for FY 2014/15 and 2015/16 – **COMMENTS ON PROPOSED WATER RATES AND CHARGES (FOR 2015 AND 2016)**

Dear Ms. Chin:

Accompanying this letter are a CD containing a copy of all of the documents listed in the attached Index, "Documents San Diego County Water Authority Requests be Included in the Administrative Record for Setting of 2015-2016 MWD Rates, Part II" (a copy is marked as Attachment 1 to this letter). The documents on the CD are comprised solely of prior correspondence between the San Diego County Water Authority and MWD.

Also attached are copies of the following letters and information:

1. Letter from Marcia Scully to Dan Hentschke dated March 19, 2014 RE: Response to Request for Information Dated February 28, 2014 (a copy is marked as Attachment 2 to this letter).
2. Letter from Marcia Scully to Dan Hentschke dated April 4, 2014 RE: Further Response to Request for Information Dated February 28, 2014 (a copy is marked as Attachment 3 to this letter).
3. Email transmittal of the April 4, 2014 information to the MWD Board of Directors dated April 4, 2014, transmitted at 4:03 PM (a copy is marked as Attachment 4 to this letter).
4. Government Finance Officers Association, Best Practice, Long-Term Financial Planning (2008) (BUDGET) (a copy is marked as Attachment 5 to this letter) and Overview of the Characteristics of Effective Financial Planning Documents, which may be found at the following link:
http://www.gfoa.org/index.php?option=com_content&task=view&id=366.
5. Public meeting excerpt RE MWD's draft 2010 Integrated Resources Plan, August 10, 2010. (Attachment 6)

6. Audio files of the following MWD Finance and Insurance Committee (F&I) and Board meetings (Board), which may be found at the following links (discussions at the April 7 F&I and April 8 board meetings are not yet available from MWD but are requested to be made part of the record):
- a. Feb 10, 2014 F&I meeting: Proposed biennial budget and rates; setting public hearings (8-1) http://mwdh2o.granicus.com/MediaPlayer.php?view_id=29&clip_id=3517
 - b. Feb 11, 2014 Board meeting: Proposed biennial budget and rates; setting public hearings (8-1) http://mwdh2o.granicus.com/MediaPlayer.php?view_id=12&clip_id=3515
 - c. Feb 25, 2014 F&I meeting: Proposed biennial budget and rates
http://mwdh2o.granicus.com/MediaPlayer.php?view_id=29&clip_id=3559
 - d. March 10, 2014 F&I meeting: Proposed biennial budget and rates
http://mwdh2o.granicus.com/MediaPlayer.php?view_id=29&clip_id=3620
 - e. March 11, 2014 Board meeting: public hearings
http://mwdh2o.granicus.com/MediaPlayer.php?view_id=12&clip_id=3583
 - f. April 7, 2014 F&I meeting: Approve biennial budget and rates (8-1)
 - g. April 8, 2014 Board meeting: Approve biennial budget and rates (8-1)

The Water Authority requests inclusion of this letter and its Attachments, including each and every document listed on the Index and included on the CD, in the record of the proceedings relating to the actions and resolutions for adoption and imposition of MWD's rates and charges for 2015 and 2016.

Sincerely,



Dennis A. Cushman
Assistant General Manager

Attachments

Documents San Diego County Water Authority Requests be Included in the Administrative Record for Setting of 2015-2016 MWD Rates, Part II

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- Water Authority Delegation letter re: Board Memo 8-1: Authorize the execution and distribution of the Remarketing Statement in connection with the remarketing of the Water Revenue Bonds (August 20, 2012)
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- Water Authority Director Lewinger's letter re: Tracking Revenues from Rate Components Against Actual Expenditures (November 4, 2012)
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- MWD letter re: Public Hearing scheduled pursuant to section 124.5 of the Metropolitan Water District Act (Stats. 1984, ch. 271) (May 29, 2013)
- MWD Board Memo 8-1 re: Mid-cycle Biennial Budget Review and Recommendations for Use of Reserves over Target signed by the general manager on May 30, 2013
- MWD Board Memo 8-2 re: Suspend the tax rate limitations in Section 124.5 of the Metropolitan Water District Act to maintain the ad valorem tax rate for fiscal year 2013/14 signed by the general manager on May 31, 2013
- Water Authority Delegation letter re 8-1 – Mid-cycle Biennial Budget Review and Recommendation for Use of Reserves over Target Water Rate Increases – Oppose and Request for Refund to Ratepayers of Excess Reserves and Board Memo 8-2 – Suspend the tax rate limitations in Section 124.5 of the Metropolitan Water District Act to maintain the ad valorem tax rate for fiscal years 2013/14 – Oppose (June 5, 2013)
- Water Authority Delegation letter re: Board Memo 5G-2: Adopt resolution maintaining the tax rate for fiscal year 2013/14 – Oppose (August 16, 2013)
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- MWD letter re: Further Response to Request for Information Dated February 28, 2014 (April 4, 2014)
- Water Authority Delegation letter re: KPMG Audit Report of MWD's Basic Statements for Years ended June 30, 2011 and 2010 (October 25, 2011)
- Water Authority letter re: San Diego County Water Authority's Annexation (March 13, 2012)
- Water Authority Delegation letter re: Adoption of 2010 Integrated Resources Plan - Oppose (October 11, 2010)
- Water Authority Delegation letter re: Board Memo 8-3 – Adjustments to Metropolitan's Water Supply Allocation Plan Formula; Request to Defer Action Pending Board Workshop (September 9, 2011)
- Water Authority Delegation letter re: Water Planning and Stewardship Committee items 6a, 6b, and 6d (October 7, 2011)
- Water Authority Delegation letter re: SB 60 Annual Public Hearing and Report to the Legislature Regarding Adequacy of MWD's Urban Water Management Plan; Request to Include Information in Report to Legislature (December 13, 2011)
- Water Authority Delegation letter re: Board Memo 7-2: Authorize execution of Memorandum of Understanding for the greater Los Angeles County Region Integrated Regional Water Management (IRWM) Plan leadership committee and join other IRWM groups in our service area if invited by member agencies (December 10, 2012)
- Water Authority Delegation Letter re: SB 60 Annual Public Hearing and Report to the Legislature Regarding Adequacy of MWD's UWMP; Request to Include Information in Report to Legislature (December 10, 2012)
- Water Authority Delegation Letter re: Board Item 9-1 – Proposed Foundational Actions Funding Program (March 7, 2013)
- Water Authority Delegation Letter re: Board Item 8-4: Approve Foundational Actions Funding Program -- OPPOSE (April 8, 2013)

- Water Authority Delegation letter re: Board Memo 7-3: Authorize entering into an exchange and purchase agreement with the San Gabriel Valley Municipal Water District (August 19, 2013)
- Water Authority Delegation letter re: Board Memo 8-2: Authorize staff to enter into funding agreements for Foundational Actions Funding Program proposals - Oppose (September 10, 2013)
- Residents for Sustainable Mojave Development letter re: Metropolitan Water District's Role in Approving the Cadiz Valley Water Conservation, Recovery and Storage Project (October 4, 2013)
- Water Authority Delegation letter re: Board Memo 8-3- Authorize (1) agreement with the State Water Contractors, Inc. to pursue 2014 Sacramento Valley water transfer supplies; and (2) \$5 per acre-foot initial administrative deposit not to exceed \$500,000 – Support with Reservation of Rights to object to cost allocation (October 4, 2013)
- Water Authority Delegation letter re : Board Letter 8-1 - Authorize amendment to Metropolitan's Cyclic Storage Agreement with Upper San Gabriel Valley Municipal Water District and the Main San Gabriel Basin Watermaster – Request to Table or in the Alternative to Oppose (October 8, 2013)
- Water Authority letter re: Foundational Actions Funding Program Agreement (November 13, 2013)
- Water Authority Delegation letter re: SB 60 Report – Water Planning and Stewardship Committee Public Hearing (December 9, 2013)
- Water Authority Delegation letter re: Board Memo 8-6 – Consolidated Agreement for Chino Basin Desalination Program – Oppose (June 13, 2011)
- Water Authority Delegation letter re: Board Item 8-3 –Oppose: Authorize entering into a Local Resources Program Agreement with Municipal Water District of Orange County and the city of San Clemente for the San Clemente Recycled Water System Expansion Project (June 11, 2012)
- Water Authority Delegation letter re: Board Item 7-1 –Oppose: Authorize entering into a Local Resources Program Agreement with Municipal Water District of Orange County and El Toro Water District for the El Toro Recycled Water System Expansion Project (August 20, 2012)
- Water Authority Delegation letter re: Board Item 7-1 –Oppose: Authorize entering into a Local Resources Program Agreement with Three Valleys Municipal Water District and California State Polytechnic University, Pomona, for the Cal Poly Pomona Water Treatment Plant (December 10, 2012)
- Water Authority Delegation letter re: Board Item 7-4 –Oppose: Authorize entering into a Local Resources Program Agreement with Calleguas Municipal Water District and Camrosa Water District for the Round Mountain Water Treatment Plant (February 11, 2013)

- Water Authority Delegation letter re: Board Item 7-2 –Oppose: Authorize entering into a Local Resources Program Agreement with the city of Long Beach and Water Replenishment District of Southern California for the Leo J. Vander Lands Water Treatment Facility Expansion Project (May 10, 2013)
- Water Authority Delegation letter re: Board Item 7-1 –Oppose: Authorize entering into a Local Resources Program Agreement with the city of Anaheim for the Anaheim Water Recycling Demonstration Project (July 5, 2013)
- Water Authority Delegation letter re: Board Item 7-4 –Oppose: Authorize entering into a Local Resources Program Agreement with Eastern Municipal Water District for the Perris II Brackish Groundwater Desalter (October 4, 2013)
- Water Authority Director Steiner letter re: August 2010 Board Memo 9-1, MWD Water Conservation Program (August 16, 2010)
- Water Authority letter re: Metropolitan’s Draft Long Term Conservation Plan (November 29, 2010)
- Water Authority letter re: Comments on Long Term Conservation Plan Working Draft Version 11 (July 20, 2011)
- Water Authority letter re: Turf Replacement Grant Programs (November 23, 2011)
- Water Authority Delegation letter re: Board Memo 8-4 – Oppose: Authorize changes to water conservation incentives (subsidies) as described (May 7, 2012)
- Water Authority Delegation statement re: Item 7-5: Adopt resolutions to (1) support applications and (2) authorize General manager to accept funding and enter into contracts with the Bureau of Reclamation for WaterSMART grant funding if awarded (February 11, 2013)
- Water Authority Delegation letter re: Board Memo 8-3 – Oppose: Authorization to implement New Conservation Program Initiatives (September 9, 2013)
- Water Authority Delegation letter re: Board Memo 8-2 – Authorize \$3 million for an On-Site Retrofit Pilot Program: Table Pending Development of Program Criteria and Cost of Service Analysis, or in the Alternative, Oppose and Board Memo 8-7 – Authorize an increase of \$20 million for conservation incentives and outreach: Oppose Unless Amended to Allow the Water Authority to Receive Program Benefits and Comply with Cost of Service Requirements (February 10, 2014)
- Water Authority Delegation letter re: Board Memo 8-3 – Table Pending Receipt of Additional Information or in the Alternative, Oppose: Authorize entering into a Water Savings Incentive Program (WSIP) Agreement with Altman’s Specialty Plants, Inc. to provide financial incentives for a water use efficiency project (March 10, 2014)
- Water Authority Delegation letter re: Board Memo 5-1 – Sale of discounted water Program (April 25, 2011)
- MWD response letter re: Response to April 25, 2011 letter on Board Memo 5-1 – Sale of Discounted Water (May 4, 2011)

- Water Authority Delegation letter re: Board Memo 5-1 Sale of Discounted Water (May 6, 2011)
- Water Authority Director Lewinger re: Comments and Questions on Board Memo 9-2 – Update on Replenishment Service Program (September 12, 2011)
- Water Authority Delegation letter re: Board Memo 8-8 - Approve Policy Principles for a Replenishment (Discounted Water) Program (November 4, 2011)
- Water Authority Delegation letter re: Board Memo 9-1 - Review Options for Updated Replenishment (Discounted Water) Program (December 12, 2011)
- Water Authority Delegation letter re: MWD Letters on Replenishment dated December 21, 2011 (January 5, 2012)
- MWD response letter re: Replenishment Workgroup Documentation (January 18, 2012)
- Water Authority Delegation letter re: Item 7-3 – Approve amendments to the Metropolitan Water District Administrative Code to current laws and practices and makes corrections (September 10, 2012)
- Testimony of Dennis Cushman, Water Authority assistant general manager, re: Water Planning and Stewardship Committee Item 6-c: oral report on QSA issues (October 9, 2012)
- Water Authority letter re: Record of September 10, 2013 Meeting of the Board of Directors of the Metropolitan Water District of Southern California - Item 8-2 (September 11, 2013)
- MWD response letter re: Record of September 10, 2013 MWD Board Meeting of the Board of Directors of the Metropolitan Water District of Southern California - Item 8-2 (September 16, 2013)
- MWD letter re: Responses to Director Questions re Ethics Workshops (November 14, 2013)
- Water Authority Delegation letter re: Applicability of MWD’s Administrative Code (December 9, 2013)
- MWD response letter re: Applicability of MWD’s Administrative Code (January 10, 2014)



THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

Office of the General Counsel

VIA FEDERAL EXPRESS

March 19, 2014

Daniel Hentschke, Esq.
San Diego County Water Authority
4677 Overland Avenue
San Diego, CA 92123-1233

Re: Response to Request for Information Dated February 28, 2014

Dear Dan:

Enclosed is a DVD containing Metropolitan records provided in response to San Diego County Water Authority's (SDCWA) February 28, 2014 Public Records Act request for the "database, inputs, outputs, spreadsheets, and reports used or prepared by Metropolitan staff or consultants in the development of the recommended rates, charges, surcharges, or fees," to the extent that such material has not already been provided to Metropolitan's Board of Directors, including SDCWA's delegates. Proprietary formulas and programming code have been removed from spreadsheets, and employee names and identifying employee numbers have been redacted.

As stated in my March 10 letter, although Metropolitan disagrees with SDCWA's assertion that Government Code Section 54999.7 is applicable to Metropolitan (and SDCWA has agreed in the past that the Section does not apply to Metropolitan), Metropolitan has fully complied with Government Code Section 54999.7's requirements through the proposed budget and rates information that has been provided and will continue to be provided to the Board, member agencies and the public. As part of its regular budget-setting and rate-setting process, Metropolitan provides to the Board, member agencies and the public the detailed data and proposed methodology for the proposed rates and charges, through the budget and rate Board letters, proposed budget, costs of services studies for various rate proposals, presentations and discussions at the multiple committee and Board meetings and workshops.

The DVD contains Metropolitan Finance staff's working materials that underlie this detailed, previously-provided material. This includes drafts and calculations, and also includes materials concerning potential rate scenarios that were not presented to the Board. Metropolitan's budget-setting and rate-setting process is still in progress. The DVD contains materials through the February 25, 2014 Board budget and rate workshop and some subsequent underlying materials. As the staff continues to work on rate scenarios in response to requests from the Board and

Daniel Hentschke, Esq.
March 19, 2014
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direction from management until final adoption of the budget and rates, we will provide one or more additional productions with later records as well.

As noted in my March 10 letter, we will post this material on-line so it is available to all Metropolitan Board members, member agency staff and the public. If any Board member requests, we will also provide the material on a DVD.

Very truly yours,



Marcia Scully
General Counsel

MS:jmm

Enclosure

cc (without enclosure):

Members of the Metropolitan Board of Directors
Member Agency Managers
Jeffrey Kightlinger
Maureen Stapleton



THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

Office of the General Counsel

April 4, 2014

Daniel Hentschke, Esq.
San Diego County Water Authority
4677 Overland Avenue
San Diego, CA 92123-1233

Re: Further Response to Request for Information Dated February 28, 2014

Dear Dan:

This follows up on my letter of March 19, 2014, which enclosed a DVD containing materials provided in response to San Diego County Water Authority's February 28, 2014 Public Records Act request. My March 19 letter noted that as Metropolitan's budget-setting and rate-setting process is still in progress, we would also provide one or more additional productions of later records. Enclosed is a DVD containing Metropolitan's second production of requested records. Proprietary formulas and programming code have been removed from spreadsheets.

As with Metropolitan's first production, we have posted this material on-line so it is available to all Metropolitan Board members, member agency staff and the public. If any Board member requests, we will also provide the material on a DVD.

Very truly yours,

A handwritten signature in cursive script that reads "Marcia".

Marcia Scully
General Counsel

MS:jmm

Enclosure

cc: (without enclosure)

Members of the Metropolitan Board of Directors
Member Agency Managers
Jeffrey Kightlinger
Maureen Stapleton

From: Office of the General Counsel
Sent: Friday, April 04, 2014 4:03:02 PM (UTC-08:00) Pacific Time (US & Canada)
Cc: Kightlinger, Jeffrey; Lichtenberger, Julia
Subject: Further Response to San Diego County Water Authority's Request for Information Dated February 28, 2014



*THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA*

Date: April 4, 2014
To: Board of Directors
Member Agency Managers
From: Marcia Scully, General Counsel
Subject: Further Response to San Diego County Water Authority's Request for Information Dated February 28, 2014

Attached is our further response to SDCWA's Request for Information dated February 28. If you have any questions, please feel free to contact me.

This communication, together with any attachments or embedded links, is for the sole use of the intended recipient(s) and may contain information that is confidential or legally protected. If you are not the intended recipient, you are hereby notified that any review, disclosure, copying, dissemination, distribution or use of this communication is strictly prohibited. If you have received this communication in error, please notify the sender immediately by return e-mail message and delete the original and all copies of the communication, along with any attachments or embedded links, from your system.



BEST PRACTICE

Long-Term Financial Planning (2008) (BUDGET)

Background. Long-term financial planning combines financial forecasting with strategizing. It is a highly collaborative process that considers future scenarios and helps governments navigate challenges. Long-term financial planning works best as part of an overall strategic plan.

Financial forecasting is the process of projecting revenues and expenditures over a long-term period, using assumptions about economic conditions, future spending scenarios, and other salient variables.

Long-term financial planning is the process of aligning financial capacity with long-term service objectives. Financial planning uses forecasts to provide insight into future financial capacity so that strategies can be developed to achieve long-term sustainability in light of the government's service objectives and financial challenges.

Many governments have a comprehensive long-term financial planning process because it stimulates discussion and engenders a long-range perspective for decision makers. It can be used as a tool to prevent financial challenges; it stimulates long-term and strategic thinking; it can give consensus on long-term financial direction; and it is useful for communications with internal and external stakeholders.

Recommendation. The Government Finance Officers Association (GFOA) recommends that all governments regularly engage in long-term financial planning that encompasses the following elements and essential steps.

A long-term financial plan should include these elements.

- (1) *Time Horizon.* A plan should look at least five to ten years into the future. Governments may elect to extend their planning horizon further if conditions warrant.
- (2) *Scope.* A plan should consider all appropriated funds, but especially those funds that are used to account for the issues of top concern to elected officials and the community.
- (3) *Frequency.* Governments should update long-term planning activities as needed in order to provide direction to the budget process, though not every element of the long-range plan must be repeated.
- (4) *Content.* A plan should include an analysis of the financial environment, revenue and expenditure forecasts, debt position and affordability analysis, strategies for achieving and maintaining financial balance, and plan monitoring mechanisms, such as scorecard of key indicators of financial health.
- (5) *Visibility.* The public and elected officials should be able to easily learn about the long-term financial prospects of the government and strategies for financial balance. Hence, governments should devise an effective means for communicating this information, through either separate plan documents or by integrating it with existing communication devices.

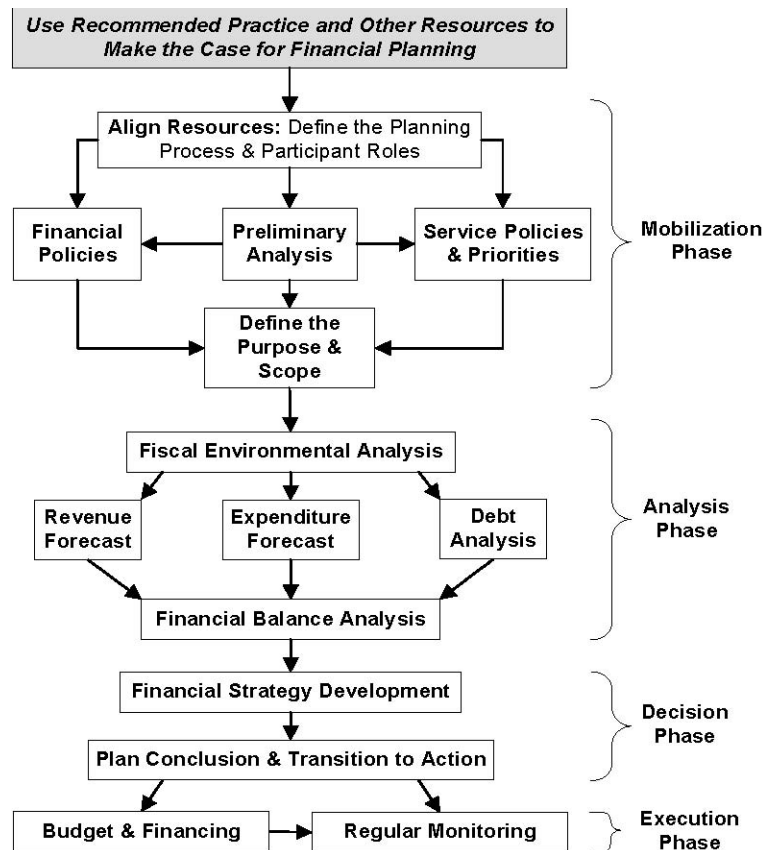
A long-term financial plan should include these steps.

- (1) *Mobilization Phase.* The mobilization phase prepares the organization for long-term planning by creating consensus on what the purpose and results of the planning process should be. The mobilization phase includes the following items.
 - a. *Alignment of Resources.* This step includes determining the composition of the project team, identifying the project sponsor, and formulating a strategy for involving other important stakeholders. This step also involves the creation of a high-level project plan to serve as a roadmap for the process.
 - b. *Preliminary Analysis.* This step helps raise awareness of special issues among planning participants, such as the board or non-financial executive staff. A scan of the financial environment is common at this point.
 - c. *Identification of Service Policies and Priorities.* Service policies and priorities have important implications on how resources will be spent and how revenues will be raised. A strategic plan or a priority setting session with elected officials could be useful in identifying service policies and priorities.
 - d. *Validation and Promulgation of Financial Policies.* Financial policies set baseline standards for financial stewardship and perpetuate structural balance, so a planning process must corroborate policies in place (as well as the organization's compliance with those policies) and also identify new policies that may be needed.
 - e. *Definition of Purpose and Scope of Planning.* The purpose and scope of the planning effort will become clear as a result of the foregoing activities, but the process should include a forum for developing and recognizing their explicit purpose and scope.

- (2) *Analysis Phase.* The analysis phase is designed to produce information that supports planning and strategizing. The analysis phase includes the projections and financial analysis commonly associated with long-term financial planning. The analysis phase involves information gathering, trend projection, and analysis as follows:
 - a. *Information Gathering.* This is where the government analyzes the environment in order to gain a better understanding of the forces that affect financial stability. Improved understanding of environmental factors should lead to better forecasting and strategizing.
 - b. *Trend Projection.* After the environment has been analyzed, the planners can project various elements of long-term revenue, expenditure, and debt trends.
 - c. *Analysis.* The forecasts can then be used to identify potential challenges to fiscal stability (e.g., "imbalances"). These could be fiscal deficits (e.g., expenditures outpacing revenues), environmental challenges (e.g., unfavorable trends in the environment), or policy weaknesses (e.g., weaknesses in the financial policy structure). Scenario analysis can be used to present both optimistic, base, and pessimistic cases.

- (3) *Decision Phase.* After the analysis phase is completed, the government must decide how to use the information provided. Key to the decision phase is a highly participative process that involves elected officials, staff, and the public. The decision phase also includes a culminating event where the stakeholders can assess the planning process to evaluate whether the purposes for the plan described in the mobilization phase were fulfilled and where a sense of closure and accomplishment can be generated. Finally, the decision phase should address the processes for executing the plan to ensure tangible results are realized.

(4) *Execution Phase*. After the plan is officially adopted, strategies must be put into action (e.g. funding required in achieving goals). The execution phase is where the strategies become operational through the budget, financial performance measures, and action plans. Regular monitoring should be part of this phase. The following diagram highlights the various long-term financial planning phases discussed in this recommended practice.



References

- GFOA Best Practice, “Financial Forecasting in the Budget Preparation Process,” 1999.
- GFOA Best Practice, “Adoption of Financial Policies,” 2001.
- GFOA Best Practice, “*Establishment of Strategic Plans*,” 2005.
- GFOA Best Practice, “*Budgeting for Results and Outcomes*,” 2007.
- GFOA Best Practice, “*Performance Management: Using Performance Measurement for Decision Making*,” 2002 and 2007.
- *Financing the Future Long-Term Financial Planning for Local Government*; GFOA, 2007.
- <http://www.gfoa.org/ltfp>. GFOA Web site containing a wealth of supporting materials for financial planning.
- <http://www.gfoa.org/services/nacslb/>. Best Practices in Budgeting Web site. See Element 9 –Develop and Evaluate Financial Options.

Approved by the GFOA’s Executive Board, February 22, 2008.

Comments by Jeffrey Kightlinger, General Manager, Metropolitan Water District of Southern California, during a public workshop held in San Diego on MWD's Integrated Resources Plan, Aug. 10, 2010.

“A quick comment on contracts. That is an interesting point. Metropolitan and all the State Water Contractors agreed to what are commonly referred to as ‘take-or-pay’ contracts. I’ve never understood the word ‘or,’ because the reality is, you pay regardless of what you take, to be honest. So it’s more like ‘pay’ and ‘sometimes take.’ But, these ‘take-or-pay’ Contractors, we have made a firm commitment to the State of California that we are going to pay half of the fixed costs of the State Water Project every single year, regardless of whether we get one drop of water from the project. There has been debate within Metropolitan that perhaps Member Agencies should do that same kind of commitment as well, so there is a certain base-load of funding and financing available for our projects. Because Member Agencies develop local resources on their own, and start using less and less of Metropolitan water. To date, that while staff thinks contracts are a terrific idea, to date, most of our board members have said ‘we’re not so sure about that.’ And, most of our Member Agencies have said ‘No. Thanks, but no thanks, because we prefer this the way it is.’ We do try to, though, keep a certain amount of our revenue stream in fixed costs, and a certain amount of our revenue stream in the water supply. But, right now it’s about 80% or more comes from the sale of water. We have about 15% in property taxes, and we’ve slowly but surely added to a fixed fee that everybody pays every single year. But that’s an ongoing debate within Metropolitan. Should people make those firm commitments going into the future? So far, the Member Agencies have opted not to. They prefer it the way it is. I think we’re going to continue to have that discussion at Metropolitan, particularly as costs increase. “Oh, and we’ll definitely take that into consideration, I definitely want to make sure that’s put into the Integrated Resources Plan.¹ Because I do believe, if we are successful – and this is something I keep telling people - if we are successful on the State Water Project – and success means a very expensive eco-system rehab project the size of what we’ve done in the Florida Everglades, and success means building a new tunnel or canal that we’re looking in the eight- to 12-billion-dollar range with the State of California - and Metropolitan coming on board to pay 25% of that cost – that’s a significant new cost that Metropolitan, the next generation of Metropolitan ratepayers will be paying. And we need to take a look at different financing mechanisms that everyone is comfortable with region-wide.”

¹Requirement for firm contractual commitments by Member Agencies to pay MWD’s State Water Project costs was not included in MWD’s adopted 2010 Integrated Resources Plan.



San Diego County Water Authority

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April 8, 2014

Jeff Kightlinger, General Manager and
Members of the Board of Directors
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

MEMBER AGENCIES

Carlsbad
Municipal Water District

City of Del Mar

City of Escondido

City of National City

City of Oceanside

City of Poway

City of San Diego

Fallbrook
Public Utility District

Helix Water District

Lakeside Water District

Olivenhain
Municipal Water District

Otay Water District

Padre Dam
Municipal Water District

Camp Pendleton
Marine Corps Base

Rainbow
Municipal Water District

Ramona
Municipal Water District

Rincon del Diablo
Municipal Water District

San Dieguito Water District

Santa Fe Irrigation District

South Bay Irrigation District

Vallecitos Water District

Valley Center
Municipal Water District

Vista Irrigation District

Yuima
Municipal Water District

OTHER REPRESENTATIVE

County of San Diego

RE: April 8, 2014 Board Meeting Board Memo 8-1 – Approve proposed biennial budget for fiscal years 2014/15 and 2015/16, proposed ten-year forecast, proposed revenue requirements for fiscal years 2014/15 and 2015/16, and recommended water rates and charges to be effective on January 1, 2015 and January 1, 2016; adopt resolutions fixing and adopting water rates and charges for 2015 and 2016; and transmit the General Manager’s Business Plan Strategic Priorities for FY 2014/15 and 2015/16 – **REQUEST TO CONTINUE BOARD ACTION ONE MONTH, UNTIL THE MAY BOARD MEETING, TO ALLOW AN OPPORTUNITY FOR REVIEW OF INFORMATION PROVIDED TO THE BOARD OF DIRECTORS ON APRIL 4, 2014, AT 4:03 PM; IN THE ALTERNATIVE – OPPOSE**

Dear Mr. Kightlinger and Board Members:

We have reviewed Board Memo 8-1 and the supplemental information that was provided by MWD via Ms. Scully’s March 19, 2014 letter to Dan Hentschke and DVD, as the basis of its proposed rates and charges for 2015 and 2016. The Water Authority has not had an opportunity to review the additional information that was provided by Ms. Scully last Friday afternoon in her letter dated April 4, 2014 and an attached DVD, which states that it is in response to the Water Authority’s February 28, 2014 Public Records Act request.

Request to continue Board action one month, until the May Board meeting, to allow an opportunity for review of information provided to the Board of directors on April 4, 2014 at 4:03 PM

The information provided to the Water Authority last Friday afternoon was first requested more than two months ago, on January 27, 2014. Based upon a cursory review, there does not appear to be any reason why this information could not have been provided in a timely manner, which would have allowed for meaningful review and consideration of the information by MWD Board members, agency staff and the public. For this reason, we request that the Board continue action on the 2015 and 2016 rates (“the 2015/16 rates”) until the May 13 Board meeting.

Leaving aside for the moment that Judge Karnow has already ruled that Government Code § 54999.7 *does* apply to MWD, and leaving aside that your delivery of the data today is *not timely under the Public Records Act*, we do not understand why the MWD staff and Board of Directors would *not* want to make available all of the data and methodology MWD relies upon in setting its rates and charges. As stated earlier, in Mr. Hentschke's February 28, 2014 letter to Ms. Scully (RE: Renewed written request for data and proposed methodology for establishing rates and charges (Government Code §§54999.7 and 6250 et seq.)), we believe the "financial planning model" computer program MWD uses in setting its rates and charges should be provided in the interest of making review of the data and methodology easier to understand and more transparent. This would be a great service to the MWD member agencies and public we serve and enable it to meet the burden it now has under Proposition 26. Based upon the information that has been provided, it is not possible for MWD to meet its burden because there is insufficient data to determine the cause of the costs MWD is incurring or the relative benefits each of its member agencies and ratepayers is receiving.

The cost-of-service methodology used by MWD in support of its rates and charges violates Proposition 26, the California wheeling statute, Government Code § 54999.7 (a) and the common law

The cost-of-service methodology used to establish water rates and charges under the three rate options presented by MWD (which do not vary substantively but only provide for varying percentage increases in the proposed 2015/16 rates) in Board Memo 8-1 ("the Board Memo") is based on the very same rate structure and cost-of-service methodology that was at issue in the recent trial in San Francisco challenging the 2010-2014 rates and charges ("the rate litigation"). We are disappointed that the MWD Board has not taken a closer look at the issues and tentative decision by Judge Karnow in the rate litigation, as well as the reasons for his decision. MWD has not changed how it allocates State Water Project and Water Stewardship Rate costs; as a result, unless the trial court's ruling is reversed on appeal, the 2015/16 rates will suffer from exactly the same deficiencies as have already been determined to be unlawful in the rate litigation.

Although MWD has once again provided a lot of *paperwork* relating to the proposed rates and charges for 2015/16, it fails to present relevant or timely *factual data*, or, follow a cost-of-service process that allows costs to be allocated based on cost causation and according to the benefits received by its member agencies and ratepayers. Although the MWD Board has been told during this process that staff has allocated costs consistent with cost-of-service requirements, MWD has argued in court that *none of these requirements even applies to MWD*. This includes state constitution Article XIII C (Proposition 26), Government Code Section 54999.7 and the common law. In other words, MWD argues that all these legal requirements – *intended to ensure that ratepayers are charged fair rates for government services* – simply do not apply to MWD.

MWD's claim of immunity from cost causation requirements exposes its cost-of-service report for what it is – a pretense that portrays the impression that MWD follows cost causation principles, when it does not. Perhaps that is why MWD refuses to release its financial planning model, which would allow member agencies and the public to understand how MWD has allocated its costs. MWD's position is that its actions are subject only to the requirement that uniform rates be charged and approved by a majority of the MWD Board of Directors. This should be a cause of concern for all MWD Board members and the millions of ratepayers they collectively serve. MWD has offered no explanation why it would be in the public interest to allow MWD to charge ratepayers more than the actual cost of the services it provides.

MWD's newly created "full service exchange cost" is based on litigation strategies and "labels," not cost-of service requirements

MWD has added – without any substantive explanation or analysis – a new line item to its schedule of rates and charges for the 2015/16 rates, namely, a "Full Service Exchange Cost" (Table 2. Rates and Charges by Option, at page 5 of the Board Memo). MWD has not supported this new "rate" by any cost-of-service analysis, because none exists or could exist. In fact, until MWD's Board Memo was distributed, there was no such thing as a "Full Service Exchange Cost" rate.

The full service exchange cost rate is yet another litigation-driven invention designed to be consistent with MWD's most recent litigation theory, advanced for the first time in the objections to the court's tentative decision that MWD filed on March 27, 2014. MWD is now saying that its individual rates – which it had previously claimed were adopted for more transparency and were based on cost of service – are in fact, nothing more than "labels." It doesn't matter, MWD now argues, whether a dollar of costs or a hundred dollars of costs is assigned to any particular rate component. While obviously intended to salvage its position in the rate litigation, this argument by MWD actually supports what the Water Authority has been saying all along – that MWD's rates are arbitrary and capricious and not based on data or cost-of-service requirements.

MWD's "revenue requirements" are based on a false set of assumptions and purposely underestimate revenues, rather than on facts and data available to MWD

In the current budget and rate-setting process, MWD staff has abandoned any effort to estimate MWD's real revenue requirements. Instead, the budget and long term "projections" are based on an artificial water sales assumption of 1.75 million acre feet, which staff has said would be exceeded three out of every four years. In years when high demands are anticipated – such as during the current drought – this artificial assumption purposely under-estimates projected revenues. MWD has also purposely over-stated its costs by, for example, including costs associated with assumed delivery of State Water

Project water in volumes that MWD itself projects will not be delivered.

These budget and rate-setting practices do not conform to any industry or agency standard. To the contrary, these practices are purposely designed to put MWD in the same position it has been in over the last budget cycle: collecting hundreds of millions of dollars in revenues without any basis in cost of service and making budget and spending decisions ex post facto. The Board's budget and rate-setting process is broken. MWD should set its rates based on rational projections, rather than assumptions it knows are incorrect and will result in hundreds of millions of dollars in over- and under-collections.

Board Memo 8-1 shows on its face that suspension of the tax rate restriction is not now, and will not in August be "essential to the fiscal integrity of MWD"

Section 124.5 permits MWD to suspend the limitation on property tax collections if the MWD Board finds that tax revenue in excess of the restriction is "essential to the fiscal integrity" of MWD. The Board Memo states that, "if the Board decides to not suspend the tax rate restriction in August, any reduction in revenues will be made up from the R&R Fund, and projected rate increases in FY 2016/17 and 2017/18 will be 2 percent higher." Given this explanation and the massive over-collection of revenues MWD continues to plan for and impose on ratepayers through the adoption of the proposed budget and rates, suspension of the tax rate restriction cannot plausibly be "essential to the fiscal integrity" of MWD.

The General Manager's "Business Plan Strategic Priorities" include large spending priorities that have not been presented to policy committees or even to the Board as part of the budget deliberations

The Board should bring back the General Manager's "Business Plan Strategic Priorities," for discussion and deliberation by the Board of Directors. The Board has not yet voted on key issues that would be foundational to moving forward with the "priorities" being declared by the General Manager, for example, "developing procedures and structures to handle the mechanics and logistics of managing a mega-construction project." The General Manager's priorities should not exist separate and apart from the priorities that the Board establishes during the budget deliberations and in other long-range planning processes that have not yet occurred.

MWD's "10-year forecast" lacks the essential elements of long-term planning and does not constitute a long range finance plan

MWD's "10-year rate forecast" lacks both the substance and process of a long-range finance plan. The 10-year "forecast" is not based on any *data*, and does not include any planning scenarios, risk analysis or input and data from its member agencies. Instead, it describes a set of *assumed, static conditions*.

Mr. Kightlinger and Members of the Board of Directors

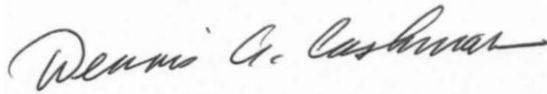
April 8, 2014

Page 5

Long range finance planning is a dynamic, fact-based process of aligning financial capacity with long-term service objectives. Forecasts of future financial capacity are used so strategies can be developed to achieve long-term sustainability in light of the stated *service objectives and financial challenges*. None of these key issues are discussed in the “projection” included in the budget, which has been unilaterally prepared and presented by MWD staff without any involvement whatsoever by the MWD Board of Directors or input or participation by the member agencies. Neither does the purported long term plan contain any scenarios and risk analyses that a real long range finance plan includes. The 10-year rate forecast that MWD labels a long range finance plan has the same attribute as its budget process – it is based on assumptions, rather than engaging in the more difficult and important process of financial planning based on best available data and articulation of service objectives.

In closing, MWD’s Board of directors is being asked by its staff to adopt a budget based upon data and assumptions it knows are incorrect, and two more years of rates based upon the same defective methodology that the court has ruled violates Proposition 26, the wheeling statutes, Government Code §54999.7 and the common law.

Sincerely,

A handwritten signature in cursive script, appearing to read "Dennis A. Cushman".

Dennis A. Cushman
Assistant General Manager

SUPERIOR COURT OF THE STATE OF CALIFORNIA
COUNTY OF SAN FRANCISCO
BEFORE THE HONORABLE CURTIS E. A. KARNOW
DEPARTMENT 304

SAN DIEGO WATER AUTHORITY,)
)

Petitioner and Plaintiff,) Case No.
) CPF-10-510830 &
vs.) CPF-12-512466
)

METROPOLITAN WATER DISTRICT OF)
SOUTHERN CALIFORNIA; ALL)
PERSONS INTERESTED IN THE)
VALIDITY OF THE RATES ADOPTED BY)
THE METROPOLITAN WATER DISTRICT)
OF SOUTHERN CALIFORNIA ON APRIL)
10, 2012 TO BE EFFECTIVE JANUARY)
1, 2013 AND JANUARY 1, 2014, and)
DOES 1-10,) Pages 1 - 182
)

Respondents and Defendants.)
)

REPORTER'S TRANSCRIPT OF PROCEEDINGS
San Francisco Superior
San Francisco, California
Thursday, April 2, 2015

Reported By:
TARA SANDFORD, RPR, CSR #3374

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(resumed)

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STAPLETON, Maureen 91 168 --

EXHIBITS

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302	7/3/06 email (EC54-547)	17 17

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1 San Francisco, California
 2 Thursday, April 2, 2015
 3 10:00 a.m.
 4 Department 304 Hon. Curtis E. A. Karnow, Judge
 5
 6 THE COURT: Good morning.
 7 I had a chance to look at Metropolitan's motion
 8 brought at the conclusion of the Plaintiff's case. And
 9 I am going to defer this until the end of trial. I
 10 think I understand the differences in approaches here.
 11 We've got two views as to how it is proper to
 12 establish a breach and how it is proper to measure
 13 damages. I think the wisest course is to defer ruling
 14 until the end of this trial.
 15 So let's proceed with our witnesses.
 16
 17 JEFF KIGHTLINGER,
 18 resumed the stand and testified further as follows:
 19
 20 THE COURT: You recall you are still under
 21 oath?
 22 THE WITNESS: Yes, sir.
 23 /
 24 //
 25 ///

5

1 Q. I think you testified that San Diego during
 2 that five years didn't try to persuade Metropolitan to
 3 change the cost allocations that went into its rate
 4 structure; correct?
 5 A. Yes.
 6 MR. PURCELL: All right. I'd like to read from
 7 Brian Thomas's deposition again, the person most
 8 knowledgeable for Metropolitan, pages 144, line 18, to
 9 145, line 21.
 10 THE COURT: Is that something that I have?
 11 MR. PURCELL: We can get it up on the screen.
 12 THE COURT: Let's follow along on the screen.
 13 You don't have that?
 14 THE WITNESS: I am not aware if I have it.
 15 THE COURT: Let's follow along on the screen.
 16 You don't have that?
 17 THE WITNESS: I am not aware I have it. Maybe
 18 it is in one of these binders.
 19 MR. KEKER: 144, yes.
 20 MR. PURCELL: This is in evidence as PTX 516.
 21 May I proceed, your Honor?
 22 THE COURT: Please.
 23 MR. PURCELL: (Reading:)
 24 Starting at page 144, line 18 and going to page
 25 145 at line 21.

7

1 CROSS-EXAMINATION (resumed)
 2 BY MR. PURCELL:
 3 Q. Good morning, Mr. Kightlinger.
 4 A. Good morning, sir.
 5 Q. I would just like to clear one thing up to
 6 start with. There's a lot of testimony yesterday about
 7 the Metropolitan rate structure; correct?
 8 A. Yes.
 9 Q. Now, the rate structure is the buckets that Met
 10 arranges for the rates; right? There is a supply
 11 bucket; there's a power bucket, and there is a system
 12 access bucket?
 13 A. Yes.
 14 Q. San Diego's objections aren't to the buckets,
 15 really; they are to the allocation of costs that go into
 16 the buckets; correct?
 17 A. That is how I understand their objections, yes.
 18 Q. Okay, good.
 19 So I am going to talk about in terms of cost
 20 allocations, really, rather than the rate structure, and
 21 if there is any confusion, please let me know.
 22 You testified yesterday about the five-year
 23 period following the execution of the exchange
 24 agreement; correct?
 25 A. Yes.

6

1 "Q Okay. The Water Authority
 2 waited until beyond that
 3 five-year period before it
 4 filed this lawsuit; correct?
 5 "A Yes.
 6 "Q During the -- during the
 7 time between the filing of the
 8 exchange agreement or, rather,
 9 the signing of the exchange
 10 agreement and the filing of
 11 this lawsuit, the Water
 12 Authority participated in
 13 various Metropolitan processes
 14 related to the setting of Met's
 15 rates; right?
 16 "A Yes.
 17 "Q The Water Authority
 18 continued to advocate for
 19 changes to Met's rates in the
 20 boardroom and in committee
 21 meetings; right?
 22 "A Yes.
 23 "Q That was part of the rate
 24 -- for example, the rate
 25 refinement process?

8

1 "A Yes. Staff, as well. In
 2 staff meetings, as well.
 3 "Q And in staff meetings, as
 4 well.
 5 "And likewise, there was a cost
 6 of service review process that
 7 the Water Authority
 8 participated in during that
 9 process?
 10 "A Yes.
 11 "Q And as part of the cost of
 12 service review process, the
 13 Water Authority again advocated
 14 in the boardroom, and in
 15 committee meetings and in staff
 16 meetings for changes to
 17 Metropolitan's rates?
 18 "A Yes."
 19 Q. Mr. Kightlinger, was Mr. Thomas wrong?
 20 A. No.
 21 Q. We talked yesterday a little bit about the
 22 dispute resolution process in Section 11.1 of the
 23 exchange agreement.
 24 Do you remember that discussion?
 25 A. Yes.

9

1 Q. Prior to the Water Authority filing this
 2 lawsuit, the Water Authority invoked that dispute
 3 resolution process; correct?
 4 A. Yes, they sent us a letter at some point,
 5 around 2010, I believe.
 6 Q. And Metropolitan responded with a letter of its
 7 own?
 8 A. I believe so. I don't think you showed it to
 9 me yesterday. I think we did respond.
 10 Q. I would just like to do that now and hopefully
 11 we can do it quickly. Can I get PTX 169 up on the
 12 screen?
 13 Mr. Kightlinger, is this the letter the Water
 14 Authority sent to you invoking paragraph 11.1?
 15 A. Yes.
 16 MR. PURCELL: I would like to move PTX 169 into
 17 evidence, your Honor.
 18 MR. EMANUEL: I really don't understand the
 19 point of this.
 20 THE COURT: What's your objection?
 21 MR. EMANUEL: The objection is relevance, your
 22 Honor.
 23 THE COURT: Overruled.
 24 PTX 169 is admitted.
 25 (Exhibit PTX 169 was received into evidence.)

10

1 MR. PURCELL: Can I get PTX 175 up on the
 2 screen?
 3 Q. Mr. Kightlinger, is this a subsequent letter to
 4 the Water Authority sent to Karen Tachiki, your
 5 successor as Metropolitan general counsel, involving the
 6 resolution dispute process in paragraph 11.1?
 7 A. Yes, it looks like it.
 8 Q. Did you get a copy of this letter when it was
 9 sent to Ms. Tachiki?
 10 A. Probably.
 11 MR. PURCELL: Your Honor, I would like to move
 12 PTX 175 into evidence.
 13 MR. EMANUEL: I have an objection. This was
 14 not part of Plaintiff's exhibit list in advance of
 15 trial. I will not object to it being admitted, but I do
 16 want it noted that it is not really playing by the
 17 rules.
 18 MR. PURCELL: It is on our list, your Honor.
 19 We are happy to provide a copy of the list.
 20 THE COURT: We can take care of that at one of
 21 the convenient breaks today. In the meantime, PTX 175
 22 is admitted.
 23 (Exhibit 175 was received into evidence.)
 24 MR. PURCELL: Can I have PTX 207 up on the
 25 screen?

11

1 Q. Mr. Kightlinger, is this a letter that the
 2 Water Authority sent to Metropolitan, to you
 3 specifically, stating that all payments made to the
 4 water stewardship rate after June 23, 2011, are made
 5 under protest?
 6 A. Yes.
 7 MR. PURCELL: I would like to move PTX 207 into
 8 evidence.
 9 MR. EMANUEL: No objection, your Honor.
 10 THE COURT: I am looking at the record. It
 11 clearly reflects your position.
 12 PTX 207 is admitted.
 13 (PTX 207 was received into evidence.)
 14 MR. PURCELL: Can I have PTX 225 up on the
 15 screen?
 16 Q. Mr. Kightlinger, is this a letter you sent in
 17 response to the Water Authority's request for a
 18 negotiation under paragraph 11.1 of the exchange
 19 agreement?
 20 A. I can't see the bottom. I don't know if I
 21 signed it or Karen signed it, but this is certainly a
 22 letter in response from Metropolitan, yes.
 23 Q. I think PTX 225 is in the new binder I gave you
 24 this morning, if you want to confirm that fact. It is
 25 in fact.

12

1 Actually, Mr. Kightlinger, you can see on the
 2 screen, I pulled up the signature block.
 3 **A. That is my signature, yes.**
 4 MR. PURCELL: I would like to move 225 into
 5 evidence.
 6 MR. EMANUEL: No objection.
 7 THE COURT: PTX 225 is admitted.
 8 (Exhibit PTX 225 was received in evidence.)
 9 Q. BY MR. PURCELL: Mr. Kightlinger, Metropolitan
 10 has never contended that the Water Authority failed to
 11 satisfy the dispute resolution obligation in paragraph
 12 11.1 of the exchange agreement; correct?
 13 **A. That's correct.**
 14 Q. Similarly, there's a procedure under the
 15 exchange agreement for Metropolitan to set aside
 16 disputed amounts of payments under the exchange
 17 agreement when there's a price dispute; correct?
 18 **A. Yes.**
 19 Q. And the Water Authority sent some
 20 correspondence to Metropolitan invoking that set-aside
 21 procedure?
 22 **A. Yes.**
 23 Q. And Metropolitan responded to the Water
 24 Authority's letters?
 25 **A. Yes, they did.**

13

1 Q. In fact, money was set aside?
 2 **A. Yes, it was.**
 3 MR. PURCELL: I would like to show you a few
 4 letters on that. PTX 189, please.
 5 Q. Mr. Kightlinger, is this a letter that the
 6 Metropolitan general counsel sent to Dan Hentschke, San
 7 Diego general counsel, regarding payments under protest
 8 under the exchange agreement?
 9 **A. Yes, it is.**
 10 MR. PURCELL: I would like to move PTX 189 into
 11 evidence.
 12 MR. EMANUEL: No objection, your Honor,
 13 although the copy that is on the screen doesn't have a
 14 number on it. Is it there someplace else?
 15 MR. PURCELL: It is at the top.
 16 MR. EMANUEL: That's all I needed.
 17 THE COURT: PTX 189 is admitted.
 18 (Exhibit 189 is received in evidence.)
 19 MR. PURCELL: I am happy to do this one by one.
 20 We invited Metropolitan to stipulate to admission of
 21 these letters between the parties. I don't think there
 22 is any objection to the authenticity of any of them.
 23 MR. EMANUEL: I am a little put off that they
 24 asked for a stipulation. That is not really appropriate
 25 to argue in front of the Court. Right now I am just

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1 asking they lay a foundation and let's go through it.
 2 THE COURT: All right. Let's go.
 3 MR. PURCELL: Let's just do it.
 4 PTX 229, next, please. I would like to move
 5 PTX 229 in evidence, your Honor.
 6 THE COURT: Any objection?
 7 MR. EMANUEL: No objection.
 8 THE COURT: PTX 229 is admitted.
 9 (Exhibit 229 was received in evidence.)
 10 MR. PURCELL: PTX 230 is the next exhibit. I
 11 would like to move PTX 230 into evidence.
 12 MR. EMANUEL: No objection.
 13 THE COURT: PTX 230 is admitted.
 14 (Exhibit 230 was received in evidence.)
 15 MR. PURCELL: PTX 232. I would like to move
 16 PTX 232 into evidence.
 17 MR. EMANUEL: No objection.
 18 THE COURT: PTX 232 is admitted.
 19 MR. PURCELL: PTX 234. I would like to move
 20 PTX 234 into evidence.
 21 MR. EMANUEL: No objection.
 22 THE COURT: PTX 234 is admitted.
 23 MR. PURCELL: PTX 243. I would like to move
 24 PTX 243 into evidence.
 25 THE COURT: I would like to ask whether these

15

1 are coming in to try to prove any disputed fact?
 2 MR. PURCELL: Your Honor, these are trying --
 3 these are being submitted for the purpose of proving the
 4 amounts that were set aside -- under the set-aside
 5 provision of the contract. We don't think there's a
 6 dispute about it.
 7 THE COURT: Is it part of your case that X
 8 dollars were set aside or that money was set aside?
 9 MR. PURCELL: It relates to the availability of
 10 interest under the damages calculation.
 11 THE COURT: Okay.
 12 MR. EMANUEL: Your Honor, if I may, these don't
 13 go to the amount that has been set aside.
 14 THE COURT: How many of these are there?
 15 MR. PURCELL: One more.
 16 THE WITNESS: This letter is about a bond.
 17 THE COURT: We will wait for a question. Is
 18 there an objection to PTX 243?
 19 MR. EMANUEL: No.
 20 THE COURT: PTX 243 is admitted.
 21 MR. PURCELL: The last one is DTX 624.
 22 THE COURT: This last one only is a D; correct?
 23 MR. EMANUEL: No objection, your Honor.
 24 THE COURT: DTX 624 is admitted.
 25 /

16

1 (Exhibits 232, 234, 243 and 624 were
 2 received in evidence.)
 3 Q. BY MR. PURCELL: Mr. Kightlinger, getting back
 4 to the substance of the case here for a second, one of
 5 the issues that San Diego objected to, I think you
 6 testified yesterday, was the inclusion of State Water
 7 Project costs in Metropolitan's transportation rates;
 8 correct?
 9 A. Yes. Going back to the late '90s, they
 10 protested that when we were doing the unbundling
 11 process.
 12 Q. Mr. Kightlinger, the State Water Project is not
 13 the start of the Metropolitan's facilities and
 14 infrastructure; correct?
 15 A. It is owned by the State of California.
 16 Q. I would like to put up PTX 302. Is this an
 17 e-mail that you sent to your board of directors in July
 18 of 2006 about the LADWP AVEK turnout agreement?
 19 A. It appears to be. I don't recall the issue.
 20 MR. PURCELL: I move Exhibit 302 into evidence.
 21 MR. EMANUEL: No objection.
 22 THE COURT: PTX 302 is admitted.
 23 (Exhibit 302 was received in evidence.)
 24 Q. BY MR. PURCELL: Going to the last paragraph on
 25 page one, the second sentence says, "Distilled to its

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1 essence, this agreement permits AVEK to transport non
 2 State Water Project, SWP water, through the California
 3 aqueduct, and to deliver such water to LADWP at a
 4 turnout to be constructed within AVEK's service area."
 5 A. Yes.
 6 Q. This refers to the agreement that permits LADWP
 7 to obtain non State Water Project water through the
 8 State Water Project facilities without needing to move
 9 through Metropolitan's facilities; correct?
 10 A. Yes.
 11 Q. I would like to highlight the first paragraph
 12 under Authority for the turnout agreement, page three.
 13 This paragraph reads, "Another question that
 14 has been raised is whether the former CEO had the
 15 authority to execute the turnout agreement without
 16 obtaining prior approval from the board of directors.
 17 "As I explained at the meeting, Mr. Gastelum
 18 posed this question to me, as then general counsel, and
 19 it was my conclusion it was within his authority to
 20 execute the turnout agreement because it is, "one, was
 21 consistent with enforcement of Metropolitan's rights
 22 under the State water contract; two, did not require the
 23 use of Metropolitan's facilities or infrastructure;
 24 three, did not require any expenditure of Metropolitan's
 25 funds; and, four, did not conflict with any applicable

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1 provisions of the Metropolitan Water District Act,
 2 Administrative Code or adopted board policies."
 3 Do you see that?
 4 A. I do.
 5 Q. One of the reasons that this agreement was
 6 within the authority of Mr. Gastelum to execute without
 7 submitting to the Metropolitan board of directors was
 8 because LADWP moving non State Water Project water
 9 through the State Water Project did not require the use
 10 of any Metropolitan facilities or infrastructure;
 11 correct?
 12 A. That's right.
 13 Q. Mr. Kightlinger, you are familiar with the rate
 14 structure integrity program; correct?
 15 A. Yes.
 16 Q. That was a program where Metropolitan included
 17 certain language within local resource program
 18 contracts; correct?
 19 A. Yes.
 20 Q. And that language that Metropolitan included in
 21 contracts permitted Metropolitan to terminate the
 22 contract if the recipient member agency mounted a
 23 challenge to Metropolitan's current rate structure;
 24 correct?
 25 A. Yes.

19

1 Q. It did not permit Metropolitan to terminate the
 2 contract if Metropolitan were to change its rate
 3 structure and then the agency were to mount a challenge
 4 to the new rate structure; correct?
 5 A. I don't recall that twist on it. That sounds
 6 right. I would have to take a look at it.
 7 Q. We can show you the documents and hopefully
 8 refresh you.
 9 Can we have PTX 80 to put on the screen. This
 10 is in evidence.
 11 This is a little bit of background. This is a
 12 memo, June 18, 2004, from Ron Gastelum, who was then the
 13 CEO and general manager of Metropolitan; correct?
 14 A. Yes.
 15 Q. Your predecessor. Not your immediate
 16 predecessor, but one of them in that role?
 17 A. Exactly.
 18 Q. It's the job you have today?
 19 A. Yes.
 20 Q. The first paragraph says, "For years we have
 21 been discussing the continuing financial risk to
 22 Metropolitan and the member agencies from the threat of
 23 legal or legislative actions undermining our rate
 24 structure. As in the past, some entities for their own
 25 gain may challenge the rate structure in order to convey

20

1 water at a lesser cost than as required to properly
 2 maintain the system's integrity and reliability. This
 3 challenge is not presented by deficiencies in the rate
 4 structure but by continuing economic attraction of lower
 5 cost based agricultural transfer water, if it can be
 6 conveyed into our service area at marginal cost."
 7 Do you see that?
 8 **A. I do.**
 9 Q. That accurately summarizes why Metropolitan
 10 wanted to put the rate structure integrity into place;
 11 correct?
 12 **A. Yes.**
 13 Q. And then in the second paragraph Mr. Gastelum
 14 writes: "One indication that such concern is still
 15 valid was the San Diego Water Authority's position in
 16 the QSA agreement reserving their right to challenge
 17 Metropolitan's uniform wheeling rates after five years
 18 from the date of execution of the QSA."
 19 Do you see that?
 20 **A. Yes.**
 21 Q. Mr. Gastelum is specifically referring to San
 22 Diego as a member agency that might litigate in the
 23 future; correct?
 24 **A. Yes.**
 25 Q. That reference to five years, that's a

21

1 reference to the five-year provision in paragraph 5.2 of
 2 the exchange agreement?
 3 **A. Yes.**
 4 Q. Mr. Gastelum doesn't say anything there about
 5 San Diego reserving its right only to challenge new cost
 6 allocations to Met's rate structure, does he?
 7 **A. No. He certainly knew what the intent was, but**
 8 **he also had his suspicions.**
 9 Q. There is nothing in this language that limits
 10 the concern about San Diego litigating -- to litigation
 11 over new rate structures; correct?
 12 **A. Not in this sentence, no.**
 13 Q. And let's take a look at DTX 909. This is a
 14 month-and-a-half later, July 30th, 2004. This is a
 15 letter from Mr. Gastelum to Miss Stapleton, his
 16 counterpart at the Water Authority.
 17 Do you see that?
 18 **A. Yes.**
 19 MR. PURCELL: I would like to move DTX 909 into
 20 evidence?
 21 MR. EMANUEL: No objection.
 22 THE COURT: 909 is admitted.
 23 (Exhibit 909 was received in evidence.)
 24 Q. BY MR. PURCELL: In the first paragraph
 25 Mr. Gastelum writes Miss Stapleton, "Thank you for

22

1 clarifying at our July member agency managers' meeting
 2 that the San Diego County Water Authority has no plans
 3 to challenge Metropolitan's rate structure. At the same
 4 time, you suggested a meeting with me would be useful to
 5 address the reservation by the authority in the
 6 quantification settlement agreement, QSA, to challenge
 7 Metropolitan's rate structure after five years."
 8 Do you see that?
 9 **A. I do.**
 10 Q. Mr. Gastelum is summarizing a meeting he had
 11 with Miss Stapleton; correct?
 12 **A. Yes, I think so. A phone call, meeting,**
 13 **something.**
 14 Q. Mr. Gastelum is stating what his impression is
 15 of what Miss Stapleton told him; correct?
 16 **A. That's my understanding of this.**
 17 Q. Mr. Gastelum, when he talks about the
 18 reservation by the authority to challenge Metropolitan's
 19 rate structure after five years, he doesn't say anything
 20 about a new rate structure, does he?
 21 **A. Not in this sentence, no.**
 22 Q. He doesn't limit his understanding of San
 23 Diego's right to challenge Metropolitan's rate structure
 24 as to some material change in the cost allocation?
 25 **A. He doesn't go into that detail, no.**

23

1 Q. I would like to show you PTX 95.
 2 Is this an August 17, 2004, fax from you to
 3 your then counterpart at the Water Authority, Dan
 4 Hentschke, the general counsel?
 5 **A. It looks like it, yes.**
 6 MR. PURCELL: I would like to move PTX 95 into
 7 evidence.
 8 MR. EMANUEL: Can we see all the pages?
 9 THE COURT: Of course. This is a one-page
 10 document?
 11 MR. PURCELL: I'm sorry. No, your Honor. It
 12 is a three-page letter attached to the cover page.
 13 MR. EMANUEL: Now they have handed me -- wait a
 14 minute. Part of the problem, it wasn't on the exhibit
 15 list. I am looking at it for the first time now.
 16 Can I have a minute?
 17 THE COURT: Of course.
 18 MR. EMANUEL: Your Honor, because it wasn't on
 19 the exhibit list and I haven't had a chance to prepare,
 20 I am going to object to its use and admission.
 21 THE COURT: Do you know if it was on the list
 22 or not?
 23 MR. PURCELL: I believe it was inadvertently
 24 omitted. It was on our Phase 1 exhibit list.
 25 MR. EMANUEL: It wasn't omitted in the Phase 1;

24

1 is that correct?
 2 THE COURT: PTX 95 is admitted.
 3 (Exhibit 95 was received in evidence.)
 4 Q. BY MR. PURCELL: If we could turn to page two
 5 of the letter itself, which is the third page of the
 6 document, the paragraph starting "likewise."
 7 This paragraph reads: "Likewise, member
 8 agencies are not being asked to forfeit any fundamental
 9 First Amendment rights in exchange for such funding.
 10 They are merely being asked to forego commencing a legal
 11 or legislative action challenging the district's
 12 existing rate structure. See Section 7, rate structure
 13 integrity language.
 14 "Paragraph 2: "Member agencies who accept such
 15 finding remain free to challenge Metropolitan's existing
 16 rate structure via the normal board process and
 17 challenge any material changes to the existing rate
 18 structure via whatever means are available. Such member
 19 agencies also remain free to commence a legal action
 20 against Metropolitan, quote, should Metropolitan in
 21 setting rates under existing rate structure fail to
 22 comply with public notice, open meeting or other legal
 23 requirements associated with the process of setting
 24 water rates and related taxes, fees and charges."
 25 Do you see that, Mr. Kightlinger?

25

1 MR. EMANUEL: I will object. The question was
 2 confusing. Could I ask it be rephrased?
 3 THE COURT: Could you start that again?
 4 Q. BY MR. PURCELL: You testified yesterday under
 5 the exchange agreement the intention of that, the
 6 bargain between the parties, was San Diego gave up the
 7 right to challenge the existing cost allocations in
 8 Metropolitan's rate structure; correct?
 9 A. **Within the term of the exchange agreement.**
 10 Q. Within the 45 years of the exchange agreement?
 11 A. **(Nods head affirmatively.)**
 12 Q. For 45 years they were agreeing not to
 13 challenge the existing cost allocations in the rate
 14 structure; correct?
 15 A. **Correct.**
 16 Q. And the rate structure integrity program only
 17 applies to the existing rate structure and not any
 18 future rate structures; correct?
 19 A. **That's right.**
 20 Q. You read Mr. Gastelum's e-mail or memo from
 21 June, which said that one of the reasons the rate
 22 structure integrity program was being adopted was
 23 because San Diego might sue later on?
 24 A. **I think he said that San Diego had expressly**
 25 **reserved a right to bring actions, as one of his reasons**

27

1 A. **Yes.**
 2 Q. This is your letter; correct?
 3 A. **Yes.**
 4 Q. You wrote this to Mr. Hentschke at the Water
 5 Authority?
 6 A. **And to Jerry Shoal at -- counsel, I believe at**
 7 **this time, to Eastern MWD, as well.**
 8 Q. This was in response to a letter they had
 9 written to you objecting to the rate structure integrity
 10 language as unconstitutional and objectionable in
 11 various other ways?
 12 A. **I don't remember exactly all their objections,**
 13 **but I do know they were upset with it.**
 14 Q. This accurately reflected your understanding of
 15 what the language covered; correct?
 16 A. **Yes.**
 17 Q. And you say pretty clearly there that "member
 18 agencies remain free to challenge any material change to
 19 the existing rate structure under the RSI language."
 20 Correct?
 21 A. **Yes.**
 22 Q. So if the RSA language limited only changes to
 23 the existing rate structure, your testimony yesterday
 24 was under the exchange agreement San Diego gave up the
 25 right to challenge the existing rate structure; correct?

26

1 **that we should be concerned about this.**
 2 Q. But if San Diego had already given up its right
 3 to challenge the existing rate structure under the
 4 exchange agreement, there would be no need to impose the
 5 RSI language on San Diego, would there?
 6 A. **As a need -- we have 26 member agencies. This**
 7 **letter came from two agencies. A number of agencies had**
 8 **concerns. When we adopted the rate structure. It was**
 9 **actually not 25 member agencies for it and San Diego**
 10 **against it. It was a fairly split vote.**
 11 **And a number of agencies had concerns. The**
 12 **whole point of the RSI language was that we were signing**
 13 **long-term program agreements. Some of these agreements**
 14 **would be we would provide subsidies to projects that**
 15 **would be 20 to 30 to 40 years. And the idea was to make**
 16 **sure there was some commitment to be able to collect**
 17 **those funds before we would sign those contracts. And**
 18 **that is what this was intended to address.**
 19 Q. Mr. Kightlinger, do you know the only agency
 20 being called out by name in Gastelum's memos in San
 21 Diego; correct?
 22 A. **He calls out entities. He calls out one of the**
 23 **basins that were attempted to sue -- if you go through**
 24 **the memo, he really talks about it is really a broad**
 25 **policy issue. There are a number of people that are**

28

1 **seeking low-cost water he does call out by name, but he**
2 **does talk about other entities and organizations.**

3 Q. He doesn't call out any other Met member agency
4 by name other than San Diego?

5 **A. Not in that memo, no.**

6 Q. As regarding San Diego, if San Diego had really
7 given up its right to sue under the exchange agreement
8 over the existing rate structure, there would be no need
9 for the rate structure integrity provision as against
10 San Diego, would there?

11 **A. That was the intent, yes.**

12 MR. PURCELL: Nothing further.

13 THE COURT: Thank you.

14 Redirect, sir?

15 MR. EMANUEL: Thank you.

16 THE COURT: If you need a break because of this
17 new document, let me know.

18 MR. EMANUEL: I appreciate that. I have my
19 team looking at it.

20 THE COURT: In a situation like that, if there
21 is something I can do to ameliorate the situation, let
22 me know.

23 MR. EMANUEL: I apologize. It got the better
24 of me. It is such a long document, single space, it was
25 a lot.

29

1 two organizations?

2 **A. Yes.**

3 Q. Which side of the equation would you say
4 Mr. Gastelum was on, trusting, not trusting, or trust
5 and verifying; how would you describe him?

6 **A. I would say I'm in the trust-but-verify mode as**
7 **the counsel. Mr. Gastelum was -- he came out of the**
8 **landfill industry, and he was a very not trusting person**
9 **in general.**

10 Q. You had involvement in creating this RSI
11 clause; correct?

12 **A. Yes. I went through and worked through with**
13 **Mr. Gastelum on the actual language of it, but the**
14 **policy proposal was his to the board.**

15 Q. Was it your understanding this RSI clause would
16 be a disincentive to file suit; right?

17 **A. Yes.**

18 MR. BRAUNIG: Objection. Leading.

19 THE COURT: I won't sustain the objection on
20 that one because it is so obvious. If we could avoid
21 leading questions.

22 MR. EMANUEL: Thank you. I will, your Honor.

23 THE COURT: That one is overruled.

24 Q. BY MR. EMANUEL: Would it apply to all
25 lawsuits?

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1 THE COURT: I understand.

2
3 REDIRECT EXAMINATION

4 BY MR. EMANUEL:

5 Q. Let's go back. Let's start with that last
6 point about there is an agreement under the exchange
7 that the -- limiting what San Diego could sue on.

8 Sir, isn't it true, or in your experience, San
9 Diego has found any number of reasons to sue
10 Metropolitan, isn't that true?

11 **A. In the last 15 years we've had probably four or**
12 **five different lawsuits over various issues with the**
13 **Water Authority.**

14 Q. Would it be accurate to say that your
15 understanding of the exchange agreement isn't a
16 guarantee that suit still couldn't be filed?

17 **A. No. It only dealt with the existing rate**
18 **structure. Their rate structure integrity language is**
19 **intended to sweep in all our member agencies as well,**
20 **but we've had lawsuits over the applicability of the**
21 **Brown Act. We've had lawsuits over preferential rights.**
22 **We've had lawsuits over point-to-point versus postage**
23 **stamp rates. So we had other challenges.**

24 Q. How can I put this question? It seems fair to
25 say that there is a certain lack of trust between these

30

1 **A. No. Simply challenges to the existing rate**
2 **structure.**

3 Q. Would it apply to ill-conceived or
4 non-meritorious lawsuits?

5 **A. I assume they were challenging the existing**
6 **rate structure, it would apply to that.**

7 Q. I want to go back to some exhibits that were
8 shown you yesterday.

9 Could you put up PTX 56, please. Zoom this on
10 the date.

11 Mr. Kightlinger, do you see the date on this?

12 **A. Yes.**

13 Q. You see how it is "for your information, San
14 Diego's latest proposal," do you see that?

15 **A. Yes.**

16 Q. Based on the date, would this proposal have
17 been the one we talked about yesterday, Option-1 and
18 Option-2?

19 **A. No. This predated that by some months.**

20 Q. Can you give me an estimate of when Option-1
21 and Option-2 was proposed?

22 **A. The late July, early August time frame of 2003.**
23 **No. This preceded that by some months.**

24 Q. Can you give me an estimate of when Option-1
25 and Option-2 was proposed?

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1 **A. The late July, early August time frame of 2003.**
 2 Q. Close enough. Give me PTX 57.
 3 Do you see the date?
 4 **A. Yes.**
 5 Q. Do you see the subject line?
 6 **A. "Getting to yes."**
 7 Q. This originated with an email from Mr. Slater;
 8 correct?
 9 **A. Yes.**
 10 Q. Was this part of that process after Option-1,
 11 Option-2, to work out the points and reach an agreement?
 12 **A. That's correct.**
 13 Q. I take it as of this point, just by the phrase
 14 "getting to yes," what was your understanding as to
 15 whether you had in fact reached yes?
 16 **A. No. We had a number of deal points that still**
 17 **had not yet been worked out.**
 18 Q. Can we go down to the bottom of this exhibit,
 19 item number five. Do you see that?
 20 **A. I do.**
 21 Q. Was that literally true?
 22 MR. PURCELL: Objection. Vague.
 23 THE COURT: I am not sure what that question
 24 means. The record will be a little bit easier if you
 25 just read that line into the record.

33

1 THE WITNESS: Certainly. "Item five, San Diego
 2 will draft an 'I love you MWD' reso." Reso meaning
 3 resolution.
 4 Q. BY MR. EMANUEL: How did you understand that?
 5 **A. We had talked about the intent was if we got to**
 6 **yes and our agencies agreed on this, that this was**
 7 **intended to start a new page and peace and harmony, et**
 8 **cetera, between our two agencies and put aside the**
 9 **lawsuits and the rancor. So they were going to draft a**
 10 **resolution to that effect.**
 11 Q. You were asked about the State Water Project?
 12 **A. Yes.**
 13 Q. Does Metropolitan consider it part of its
 14 conveyance system? Do you remember that question?
 15 **A. Yes.**
 16 Q. I think your answer didn't answer the question.
 17 You said, "The state owns it."
 18 The question was, sir, as asked by Mr. Purcell,
 19 does Metropolitan consider it part of its conveyance
 20 system?
 21 **A. We do not consider it part of our conveyance**
 22 **system, but we do consider our agency as having an**
 23 **ownership interest in the State Water Project based on**
 24 **the contract we entered into with the State of**
 25 **California and the way in which we make our payments on**

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1 **that project.**
 2 Q. Please explain why you consider it to be a part
 3 owner of that system?
 4 **A. We have certain rights to use that facility.**
 5 **We have transportation rights. We have to pay for it**
 6 **every year, so a significant sum. But with that, even**
 7 **if we don't -- aren't getting water just from the State**
 8 **of California, if we wish to move water within it, we**
 9 **have capacity rights that enable us to move water,**
 10 **Metropolitan transfer water, in our ownership capacity**
 11 **rights. And in fact we can do so on behalf of our**
 12 **member agencies, and we have done so, including San**
 13 **Diego.**
 14 **They have purchased transfers in the past and**
 15 **they have moved that water within Metropolitan's**
 16 **capacity rights in the State Water Project system.**
 17 Q. When San Diego moved non-State Water Project,
 18 non-Metropolitan water through the conveyance system,
 19 did San Diego have to pay a wheeling rate to
 20 Metropolitan?
 21 **A. Only when it reached our system and then they**
 22 **had the ability to use the State system through our**
 23 **ownership capacity.**
 24 Q. Did they have to pay a wheeling rate through
 25 the State or could they use Metropolitan's?

35

1 **A. The latter. They used Metropolitan's capacity.**
 2 Q. Are you aware of any litigation involving
 3 whether the payments to the State for the State Water
 4 Project are payment of costs of the State or costs of
 5 the State water contract?
 6 MR. PURCELL: Objection. Vague.
 7 THE COURT: Do you understand that question?
 8 THE WITNESS: I understood the question. I
 9 believe I understand the question.
 10 THE COURT: We are going with this witness'
 11 understanding. This may be a legal issue, but go ahead
 12 and answer it.
 13 THE WITNESS: There were early validation
 14 actions to establish the rights under the -- and
 15 payments of the State Water Project. And so in that
 16 validation action it was determined these were
 17 obligations of the contractors for the State of
 18 California.
 19 Q. BY MR. EMANUEL: And Metropolitan is a State
 20 water contractor; correct?
 21 **A. Yes, sir.**
 22 Q. And it makes payments to the State that the
 23 State -- for the conveyance system and for the supply
 24 water; is that correct?
 25 **A. That's correct.**

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1 Q. What I'm asking you, have you ever heard or
 2 have an understanding that the payments to the State is
 3 the State's mere conduit?
 4 MR. PURCELL: Objection. Vague.
 5 THE COURT: Has he ever heard it? That's not
 6 vague.
 7 Have you ever heard that?
 8 THE WITNESS: I've not heard it actually
 9 expressed that way.
 10 MR. EMANUEL: Can you pull up the 2003 exchange
 11 agreement. Would you go to the paragraph just before
 12 5.2?
 13 THE COURT: For the record, the exhibit number
 14 is --
 15 MR. KEKER: 65 PTX and DTX 51, but they have 51
 16 up, I think.
 17 THE COURT: PTX 65 we will call it.
 18 Q. BY MR. EMANUEL: Do you see paragraph 5.1 and
 19 that deals with pricing? Do you see that, sir?
 20 A. I do.
 21 Q. Would you go to the paragraph above that? You
 22 see paragraph 4.2?
 23 A. I do.
 24 Q. Let's back up. So 4.1 deals with
 25 characterization of exchange water. Do you see that?

37

1 A. Yes.
 2 Q. And for some purpose it is characterized as
 3 local water; is that right?
 4 A. Yes.
 5 Q. That has certain financial implications?
 6 A. Yes. **This is something San Diego wanted. It**
 7 **doesn't fit within the typical meaning of the word**
 8 **"local." It is coming from several hundred miles away.**
 9 **In our parlance, in our structure within Metropolitan,**
 10 **local water has certain benefits, how we do our drought**
 11 **management planning.**
 12 **Local water is not considered regional water to**
 13 **be shared. It is their own water, so it doesn't fit**
 14 **into something that we would then pull back in a**
 15 **drought, as part of drought management. So it is**
 16 **important to them that it becomes an independent local**
 17 **supply. It is also how we calculate a**
 18 **readiness-to-serve charge. If it's a local supply, it**
 19 **doesn't go into that calculation. So those were**
 20 **benefits, how they wanted this water, the IID transfer**
 21 **water to be treated.**
 22 Q. Let's look at 4.2., the entire paragraph,
 23 please.
 24 Notwithstanding provisions of 4.1, "The water
 25 delivered to SDCWA shall be characterized as

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1 Metropolitan water and not as local water."
 2 Do you see that?
 3 A. I do.
 4 Q. What is your understanding of that?
 5 A. **Notwithstanding for the purposes of drought**
 6 **management and the readiness-to-serve charges, at the --**
 7 **the way the exchange worked is that when the water hits**
 8 **our intake, it's Metropolitan's water. And then we take**
 9 **it and then what we exchange with San Diego is**
 10 **Metropolitan water.**
 11 Q. And when does it hit your intake?
 12 A. **In theory, when it's made available by IID to**
 13 **us, we order from the Bureau of Reclamation, and it**
 14 **comes to Lake Havasu, and that is where our intake is**
 15 **and that is where we pump the water.**
 16 Q. You are still on the Colorado River?
 17 A. Yes.
 18 Q. The location is the Colorado River?
 19 A. **Yes, it is a location on the Colorado River,**
 20 **yes.**
 21 MR. EMANUEL: Your Honor, if I could have a
 22 minute?
 23 THE COURT: Of course
 24 MR. QUINN: Would it be possible for us to have
 25 five minutes?

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1 THE COURT: See everybody in five minutes.
 2 (Recess.)
 3 THE COURT: Sir.
 4 MR. PURCELL: Your Honor, before we get
 5 started, we have a motion to strike.
 6 THE COURT: All right.
 7 MR. PURCELL: We move to strike
 8 Mr. Kightlinger's testimony about Metropolitan having an
 9 ownership interest in the State Water Project as being
 10 directly contrary to Metropolitan's response to Request
 11 for Admission 44, which is in evidence as PTX 237A.
 12 THE COURT: How does that read?
 13 MR. PURCELL: It reads, Request for Admission
 14 Number 44, "Admit that Metropolitan does not own the
 15 State Water Project."
 16 Response to Request for Admission Number
 17 44, "Admit."
 18 THE COURT: I will tell you that I actually
 19 made a note and he used the phrase "ownership interest"
 20 but I don't think -- I didn't interpret the answer
 21 actually to be that he says he has interest to certain
 22 rights. My sense is that Metropolitan is not contending
 23 they actually have any literal ownership interest in the
 24 State Water Project. Right?
 25 MR. EMANUEL: Right. And the witness said

40

1 that.
 2 THE COURT: I think it was a shorthand for --
 3 it's like having rights to a license more than anything
 4 else or rights to use, and that's how I interpreted it.
 5 I will deny the motion to strike with that
 6 understanding, that he really did not mean ownership in
 7 the literal sense. RFA 44 actually governs here, and
 8 let's proceed.
 9 MR. EMANUEL: Would the Court permit I get that
 10 on the record from the witness?
 11 THE COURT: You don't have to. RFA 44 is
 12 preclusive.
 13 MR. EMANUEL: Not that. I meant what he was
 14 referring to as those interests.
 15 THE COURT: If you think it matters. I think I
 16 understand that Metropolitan has certain rights to use
 17 the State Water Project. I understand that. We went
 18 through some of that in the first trial.
 19 MR. EMANUEL: Very well.
 20 THE COURT: And I recall that.
 21 Q. BY MR. EMANUEL: In that case, then, I'll go
 22 back to Exhibit DTX 51.
 23 Mr. Kightlinger, we were discussing this
 24 exception and --
 25 THE COURT: Again, this has also been named PTX

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1 56.
 2 MR. KEKER: Sixty-five.
 3 THE COURT: Sixty-five.
 4 Q. BY MR. EMANUEL: Unfortunately, it has two
 5 numbers.
 6 "The exchange water delivered to SDCWA shall be
 7 characterized as Metropolitan and not as local water
 8 only for the limited purposes of paragraph 5.2."
 9 Do you see that?
 10 A. I do.
 11 Q. Let's -- let's look at 5.2 so we know what
 12 we're talking about here.
 13 5.2 is the price that the Water Authority would
 14 pay; is that correct?
 15 A. That is correct.
 16 Q. Would you please explain, then, how 4.2 relates
 17 to 5.2?
 18 A. Yes. The Water Authority wanted this water to
 19 be considered local water, the water they were getting
 20 from IID, for purposes of how it would be dealt with in
 21 terms of drought and calculation of our
 22 readiness-to-serve charges.
 23 But for the purpose of the pricing, it was
 24 going to be treated as Metropolitan water and governed
 25 by 5.2, the pricing terms.

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1 Q. Was there an advantage to the Water Authority
 2 for the water to be considered Metropolitan water?
 3 A. Yes. One of the complications in their
 4 transfer with IID is the water from IID is Colorado
 5 River water. The only parties that can receive Colorado
 6 River water are parties that have what's called a
 7 Section 5 contract with the Bureau of Reclamation under
 8 the Boulder Canyon Project Act.
 9 The Water Authority, not being a Colorado River
 10 contractor, technically, unless it got such a contract
 11 with the United States, could not receive Colorado River
 12 water. So Metropolitan, by receiving that water as
 13 Metropolitan and then exchanging it, solved the issue of
 14 how to get delivery from the United States Bureau of
 15 Reclamation.
 16 Q. But explain, how did that solve that problem?
 17 A. It was deemed Metropolitan's water. And so we
 18 have a contract for delivery of Colorado River water
 19 with the United States and, therefore, the Water
 20 Authority wasn't deemed -- they were not getting a
 21 delivery of Colorado River water. Metropolitan was.
 22 Q. Thank you very much.
 23 Let's turn back to this rate structure
 24 integrity clause. I believe you testified this was a
 25 subject that was discussed at the board level of

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1 Metropolitan; is that correct?
 2 A. Yes.
 3 Q. And were there agencies in favor of it,
 4 agencies against it?
 5 A. Yes.
 6 No. It was a controversial proposal, and my
 7 recollection there were a number of amendments proposed
 8 by various board members on behalf of their agencies to
 9 be made to the policy before it was adopted.
 10 Q. Was the Water Authority for or against it?
 11 A. They were flat-out opposed to it from the
 12 get-go.
 13 Q. Do you have a recollection whether or not the
 14 Water Authority made an amendment that the rate
 15 structuring integrity clause should only be triggered if
 16 someone sued and lost?
 17 A. I don't recall the Water Authority proposing
 18 any suggested amendments to it. They felt it shouldn't
 19 be adopted at all. The amendments I recall being
 20 proposed were from agencies such as Orange County
 21 agencies and the Riverside County agencies having a
 22 number of concerns and proffering a number of
 23 amendments.
 24 MR. EMANUEL: Nothing more, your Honor.
 25 MR. PURCELL: No recross.

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1 THE COURT: Thank you very much, sir.
 2 You are excused.
 3 THE WITNESS: Thank you.
 4
 5 DEVENDRA UPADHYAH,
 6 called as a witness by the Defendant, was sworn and
 7 testified as follows:
 8
 9 THE COURT: You are calling?
 10 MR. EMANUEL: Mr. Upadhyah.
 11 THE WITNESS: I do.
 12 THE CLERK: Go ahead and be seated. Would you
 13 please state and spell your full name for the record.
 14 THE WITNESS: Devendra Upadhyah, and it's
 15 D-E-V-E-N-D-R-A, U-P-A-D-H-Y-A-H.
 16
 17 DIRECT EXAMINATION
 18 BY MR. EMANUEL:
 19 Q. By whom are you employed?
 20 A. **The Metropolitan Water District of Southern**
 21 **California.**
 22 Q. What is your position?
 23 A. **My position is the group manager for the water**
 24 **resources management group.**
 25 Q. What programs fall within the water resources

45

1 management group?
 2 A. **Water resource management group manages demand**
 3 **management programs, conservation programs that provide**
 4 **incentives to consumers in Southern California, local**
 5 **resources program aimed at helping to develop supplies**
 6 **among the customer member agencies.**
 7 **We have a group that looks at forecasting for**
 8 **the needs of Southern California out in the future. We**
 9 **also manage our contracts with the State Water Project,**
 10 **the Department of Water Resources and with the U.S.**
 11 **Bureau of Reclamation for supplies that we receive on**
 12 **the Colorado River along with many other partners we**
 13 **have. We manage the contracts for those supplies.**
 14 MR. EMANUEL: In advance, and according to the
 15 Court's deadline, we prepared a declaration for
 16 Mr. Upadhyah that had been submitted to the other side
 17 and filed with the Court.
 18 Does the Court want a copy? I am not going to
 19 direct him on those questions.
 20 THE COURT: I would appreciate it if you have a
 21 spare copy.
 22 MR. EMANUEL: I will leave one for the witness
 23 in case it comes up on cross.
 24 Q. Sir, a topic not covered in your declaration
 25 has to do with the demand management programs.

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1 Can you tell me what's under those programs?
 2 A. **Sure. Demand management programs consist**
 3 **really of two different programs that Metropolitan runs.**
 4 **One of them is a conservation program. That program**
 5 **provides incentives through throughout Southern**
 6 **California for consumers to purchase water-efficient**
 7 **devices, things like, for example would be,**
 8 **high-efficiency clothes washers or high-efficiency**
 9 **toilets that reduce demands for water. We provide**
 10 **incentives that buy down the costs of those things for**
 11 **consumers. That's the conservation program.**
 12 **Another program is the local resources program.**
 13 **That program provides financial incentives for our local**
 14 **agencies to develop projects that fall into three major**
 15 **categories: Wastewater recycling, groundwater recovery**
 16 **and seawater desalination at some point in the future.**
 17 **These would be projects that would produce supplies that**
 18 **those local agencies are able to use to meet their**
 19 **customers' needs.**
 20 Q. You referred to incentives. Did you mean
 21 financial incentives? Are there other kinds of
 22 incentives?
 23 A. **Financial incentives.**
 24 Q. How long have you been the manager of the water
 25 resources management group?

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1 A. **Since the beginning of 2010.**
 2 Q. How long have you been an employee of
 3 Metropolitan?
 4 A. **I started with Met back in 1995, and there was**
 5 **a period for about three years there where I was working**
 6 **for another agency.**
 7 Q. Going back to the local resources program, who
 8 receives the dollars that are part of these financial
 9 incentives?
 10 A. **The local agencies, the member agencies and**
 11 **their subagencies that actually develop the projects.**
 12 Q. What are the benefits to local agencies for
 13 these local resource programs?
 14 A. **They are receiving a financial incentive from**
 15 **Metropolitan. But ultimately the benefit of those**
 16 **projects is that those projects produce supplies that**
 17 **they are able to use to meet the needs of their**
 18 **customers and they are able to sell those supplies to**
 19 **their customers.**
 20 Q. You used the word "they."
 21 A. **They receive supplies.**
 22 Q. What are the benefits to local agencies for
 23 these local resource programs?
 24 A. **They are receiving a financial incentive from**
 25 **Metropolitan. But ultimately the benefit of those**

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1 **projects is that those projects produce supplies that**
 2 **they are able to use to meet the needs of their**
 3 **customers and they are able to sell those supplies to**
 4 **their customers.**
 5 Q. You used the word "they." They receive
 6 supplies. Who is "they" referring to?
 7 **A. The member agencies or the local agency that**
 8 **develop the project.**
 9 Q. Is that also true for other demand management
 10 programs that these supply? Who owns the supplies that
 11 were produced through those other demand management
 12 programs?
 13 **A. That's correct. There are supplies that are**
 14 **produced by the local agencies. They are their**
 15 **supplies. They are able to use those to meet their**
 16 **customers' demands.**
 17 Q. What I am asking, there are conservation
 18 programs and there are other kinds of programs, all of
 19 which produce water, I take it?
 20 **A. Either produce water or reduce demand for**
 21 **water, right.**
 22 Q. And my point is, whose supply is it?
 23 **A. It's those local agencies.**
 24 Q. When this water is produced through these
 25 demand management programs, who has the title to that

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1 water? I'm just speaking loosely. I don't know what
 2 the word is in water law. Who owns the water?
 3 MR. BRAUNIG: I am going to object to the
 4 extent it calls for a legal conclusion.
 5 THE COURT: We will get his understanding. Do
 6 you know?
 7 THE WITNESS: To the extent it is water
 8 supplied that they are able to use through that project,
 9 it's theirs to sell to their customers.
 10 Q. BY MR. EMANUEL: From Metropolitan's point of
 11 view, does Metropolitan consider whether or not this is
 12 part of Metropolitan's supply?
 13 **A. It is not part of Metropolitan's supply. These**
 14 **aren't supplies that we have access to. It doesn't come**
 15 **into our system. We don't sell them to our member**
 16 **agencies. At no point is it a supply that Metropolitan**
 17 **has to provide to our customers. Rather, it is at the**
 18 **local level.**
 19 Q. Why does Metropolitan have these demand
 20 management programs?
 21 **A. These demand management programs provide a**
 22 **benefit to Metropolitan in that it reduces the demand**
 23 **for water to move through our system.**
 24 **But there's also a piece of legislation that**
 25 **was passed in 1999, we refer to it as Senate Bill 60,**

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1 **that requires that Metropolitan increase or focus on**
 2 **conservation, water recycling and groundwater recovery**
 3 **recharge.**
 4 Q. Are you familiar with the phrases "upstream"
 5 and "downstream"?
 6 **A. Yes, I am.**
 7 Q. Would you explain what "upstream" means and
 8 "downstream" means in the context of what we've been
 9 talking, conservation?
 10 **A. Sure. Metropolitan has service connections**
 11 **that demark the point of delivery between Metropolitan's**
 12 **distribution system into our member agencies'**
 13 **distribution systems. And so we refer to anything that**
 14 **is downstream of those service connections, that are**
 15 **then within our member agencies and their local**
 16 **agencies, as downstream.**
 17 **Anything that is above those service**
 18 **connections in Met's system and beyond is considered to**
 19 **be upstream.**
 20 Q. The demand management programs that you
 21 referred to, are they upstream or downstream?
 22 **A. They are downstream.**
 23 Q. What rate at Metropolitan generates the income
 24 that pays for demand management programs?
 25 **A. The cost of the demand management programs is**

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1 **recovered through our water stewardship rate.**
 2 Q. Are you aware of whether any part of that water
 3 stewardship rate -- let me back up.
 4 Does the entirety of the water stewardship rate
 5 go upstream, downstream or split between the two
 6 streams?
 7 MR. BRAUNIG: Objection. Vague.
 8 THE COURT: Overruled.
 9 THE WITNESS: Can you please restate the
 10 question?
 11 Q. BY MR. EMANUEL: Let me take it one at a time.
 12 So the costs that are paid through the water
 13 stewardship rate, are they paid to downstream users or
 14 upstream users or some combination?
 15 **A. It is all downstream.**
 16 Q. Has that been true -- how long has that been
 17 true?
 18 **A. To my knowledge, it's been true since the**
 19 **beginning of the water stewardship rate.**
 20 Q. Does Metropolitan have -- strike that.
 21 What benefits -- what benefits, if any, do
 22 wheelers enjoy because of demand management programs?
 23 **A. Demand management programs that we run reduce**
 24 **the need for water to move through Metropolitan's**
 25 **system. And as a result of that it is creating capacity**

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1 **within Metropolitan's system to move supplies, to the**
 2 **extent that a wheeler is acquiring a supply from another**
 3 **entity and moving that water through Metropolitan's**
 4 **system. Part of the reason the capacity is available to**
 5 **do that is because of the demand management programs.**
 6 Q. Mr. Upadhyah, are you aware of whether or not
 7 Metropolitan purchases back the supplies generated --
 8 purchases back from the local agencies the supplies
 9 generated by the demand management program?
 10 A. I'm not aware of a situation where that
 11 happens, no.
 12 Q. I would like to show you what has been marked
 13 for identification as DTX 979.
 14 Can you tell the Court what this is?
 15 A. Yes. This is the February 2011 version of what
 16 we refer to as our SB-60 report. I had mentioned
 17 earlier Senate Bill 60 that placed some requirements on
 18 Metropolitan, and one of those requirements was filing a
 19 report to the State legislature each year that showed
 20 some of the actions that we had taken in the areas of
 21 conservation, recycling, groundwater recovery and
 22 recharge.
 23 Q. Is the production of this report one of your
 24 duties and responsibilities, at least, to oversee?
 25 A. Yes, it is.

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1 Q. If you would turn to page 7 of this report,
 2 tell us what this achievement scorecard represents.
 3 A. This -- what you see on the screen is the
 4 scorecard that we include in the report that shows both
 5 the acre-feet associated with the demand management
 6 programs and the dollars associated with the demand
 7 management programs.
 8 This is a part of what we're reporting to the
 9 legislature that we've been able to do in combination
 10 with the member and local agencies.
 11 Q. If we look at the very first line under
 12 conservation, would you explain what that 15,500
 13 acre-feet are?
 14 A. Okay. So as part of the demand management
 15 programs, I mentioned one of the programs we run is a
 16 conservation program where we're providing incentives
 17 for consumers, businesses, residents in our service area
 18 to purchase devices that save water, are more efficient.
 19 That line is showing that in fiscal year
 20 2009-'10, which was the period that we were reporting on
 21 for this year in this report, those new conservation
 22 devices that were installed and funded by that program
 23 saved 15,500 acre-feet. That is the new savings from
 24 those actions.
 25 Q. How is that line different from the line below

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1 it?
 2 A. The line below it is showing that we've
 3 actually been doing this program for a number of years,
 4 and that devices that were installed in previous years
 5 are also still saving water.
 6 The first line is showing just the new things
 7 that were installed that year and their savings. But
 8 the next -- the second line, 147,000 acre-feet, depicts
 9 the savings associated with things that had been
 10 installed before that are still saving water in that
 11 year.
 12 Q. Now, if we look at the third line, what does
 13 that represent?
 14 A. The third line is showing that since the
 15 program's inception in the early 1990s, the cumulative
 16 water savings across all of those things that have been
 17 installed is estimated to be about 1.4 million
 18 acre-feet.
 19 Q. Let's move down the chart to under "recycled
 20 water." Look at the first line there.
 21 Please explain what that represents.
 22 A. The first line under "recycled water" is
 23 similarly showing for 2009-'10 the acre-feet that was
 24 produced in that year by wastewater recycling facilities
 25 that were funded, in part, by this program.

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1 Q. Could you give us an example of a wastewater
 2 recycling program or type of program?
 3 A. Sure. The -- an example there, and there are
 4 many different facilities that are funded that are
 5 producing as part of this, but an example would be an
 6 agency would take wastewater that is coming from the
 7 wastewater plant and treat that wastewater to a higher
 8 grade of treated supply, and then would pipe that to, as
 9 an example, outdoor irrigation on a park or on a golf
 10 course, so that they are able to use that treated
 11 wastewater to meet the needs of that irrigated
 12 territory.
 13 Q. If we look two lines below that, see where it
 14 says, "cumulative production." Please explain what that
 15 represents.
 16 A. The cumulative production line is showing that
 17 since this program's inception, the projects that were
 18 partially funded by these incentives for Metropolitan
 19 are producing or have produced about 1.3 million
 20 acre-feet.
 21 Q. Move down to "groundwater recovery," and
 22 looking at the first line. What is an example of a
 23 groundwater recovery program?
 24 A. Groundwater recovery refers to a situation
 25 where there is groundwater that is contaminated in some

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1 way or may have salt content that is high enough that in
2 order to be able to use that water, you have to put some
3 measure of treatment to be able to get rid of that
4 contaminant.

5 So groundwater recovery are programs where
6 we're providing incentives similar to the wastewater
7 recycling to be able to help an agency develop a
8 project, to help them pay for that project, so they can
9 clean up that groundwater and be able to use it to meet
10 their customers' demands.

11 Q. Does the 50,000 acre-feet represent the amount
12 of water produced through this program for that
13 particular fiscal year?

14 A. Right. For 2009-'10 the production for those
15 facilities was 50,000 acre-feet.

16 Q. And two lines below that, "the cumulative
17 production," is that the same as what you explained
18 before, the life of these programs, this is your
19 estimate?

20 A. That's correct. Over the life of the program,
21 it's produced 515,000 acre-feet.

22 Q. Let me ask you to turn in this document to page
23 8. Do you see that sentence?

24 A. I do.

25 Q. To whom is conserved water a source of supply?

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1 A. This statement is showing that it is a source
2 of supply for Southern California. Specifically, it's a
3 source of supply for the local agencies that produce it
4 and they are able to take that supply and meet their
5 customers' demands.

6 Q. Would it be accurate to say not only -- when
7 you say use it, do they give it away or do they sell it
8 to their users?

9 A. To my knowledge, it's always sold to their
10 users. I'm not aware of a situation where it is simply
11 given away.

12 Q. Can you tell the Court whether or not conserved
13 water downstream is a source of supply for Metropolitan?

14 A. So, this -- these programs, they're not a
15 source of supply for Metropolitan. At no point are they
16 producing water that Metropolitan is able to take into
17 our system. We are not able to sell that water to our
18 customers. Rather, they are supplies that our member
19 agencies and local agencies are able to use to meet
20 their customer demands.

21 MR. EMANUEL: Thank you, your Honor. No more
22 questions.

23 THE COURT: Cross-examination. It looks like
24 maybe one more question.

25 MR. EMANUEL: I will move it into evidence.

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1 THE COURT: Exhibit 979.

2 MR. EMANUEL: DTX 979, your Honor, we move it
3 into evidence.

4 THE COURT: Are there more pages than the ones
5 we talked about that I'll be reading?

6 MR. EMANUEL: There are certainly more pages.
7 I don't know that you need to read them. Maybe we
8 should do a redacted.

9 THE COURT: Yes. Then remind me later on to
10 admit it as redacted.

11 (Exhibit 979 was marked for identification.)

12 THE COURT: Cross-examination.

13
14 CROSS-EXAMINATION

15 BY MR. BRAUNIG:

16 Q. Good morning, Mr. Upadhyah.

17 A. Good morning.

18 Q. I am Warren Braunig and we met at your
19 deposition.

20 You testified that the primary benefit of
21 the -- of the water stewardship rate in the demand
22 management programs is the creation of local supply for
23 use by -- by the local member agencies; correct?

24 A. The primary benefit to the local agencies is
25 the supply.

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1 Q. It is also a benefit to Metropolitan, that
2 Metropolitan, by investing in these demand management
3 programs, doesn't have to import or buy supplies of its
4 own; correct?

5 A. The benefit to Metropolitan is the reduced
6 demand on our system.

7 Q. And that's a supply benefit?

8 A. I would not argue that's a supply benefit.

9 Q. Met's investments in local water grow the
10 supply of water for Metropolitan in the region; correct?

11 A. That's not correct.

12 Q. You have Tab 1 of your deposition, Tab 1 of the
13 binder one, Volume I is your deposition, and I would ask
14 you to turn to page 109, line 16.

15 MR. EMANUEL: It's Tab 2, Volume I.

16 THE COURT: The page is 109?

17 MR. BRAUNIG: Yes.

18 (Reading:)

19 "Q And my question is does
20 Metropolitan invest in local
21 resources in order to grow the
22 pie of supply?

23 "A That's -- yes, that's one
24 of the benefits we're investing
25 for, yes."

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1 MR. EMANUEL: Where were we?
 2 THE COURT: Sixteen through 20.
 3 Q. BY MR. BRAUNIG: That's correct, that's true
 4 testimony that you gave?
 5 **A. That's correct.**
 6 Q. The demand management programs also create a
 7 benefit for Metropolitan by not having to spend money on
 8 imported water supplies; correct?
 9 **A. The demand management programs reduce the need**
 10 **for the movement of water through the Metropolitan**
 11 **system. It may not be Metropolitan's imported supplies.**
 12 MR. BRAUNIG: Your deposition, page 109, line
 13 21 through page 110, line one.
 14 THE COURT: Go ahead.
 15 MR. BRAUNIG: (Reading:)
 16 "Q Okay. Is metropolitan's
 17 -- is one of the benefits that
 18 you articulated of these
 19 programs, that it creates a
 20 benefit of not having to spend
 21 money on other imported
 22 supplies?
 23 "A Yeah. That's part of the
 24 basis for the incentive."
 25 Q. That's true testimony?

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1 **A. Correct.**
 2 Q. Would you agree -- you testified in addition to
 3 creating local supplies, the demand management programs
 4 have regional benefits for Metropolitan; correct?
 5 **A. Correct.**
 6 Q. Met has never calculated the regional benefit
 7 of the aggregate group of water supply projects and
 8 desalination projects and conservation programs funded
 9 in a given calendar year, has it?
 10 **A. Metropolitan calculates the benefit of the**
 11 **water that's produced, and we report that each year in**
 12 **the SB-60 report.**
 13 Q. You calculate the number of acre-feet created?
 14 **A. Right.**
 15 Q. Met does not calculate the regional benefit
 16 beyond the calculation of acre-feet; it does not
 17 calculate the regional benefit of the group of programs
 18 that were funded in 2011, does it?
 19 **A. The SB-60 report we are producing is showing**
 20 **the supplies that are benefiting the local agencies as a**
 21 **result of those programs. It is a characterization of**
 22 **what's produced through those programs.**
 23 Q. I am asking you a specific question. I am
 24 asking you about the regional benefit. Met has not
 25 calculated the regional benefit of the programs Met

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1 invested in in 2011?
 2 MR. EMANUEL: I am going to object. It is
 3 ambiguous. We need to know what regional benefit.
 4 THE COURT: Aside from the calculation of
 5 conserved acre-feet, there is some other regional
 6 benefit that you have calculated?
 7 THE WITNESS: On an annual basis we are not
 8 calculating a separate benefit from what's being
 9 reported in SB-60. Although the development of the
 10 programs initially was based on a calculation of
 11 benefits to the region overall, and we continue those
 12 programs as a result of that.
 13 Q. BY MR. BRAUNIG: To be clear, just so the
 14 record is clear, for the programs that Met invested in
 15 through the water stewardship rate in 2011, Met has not
 16 gone in and said, here's what the -- in dollar terms --
 17 here's what the regional benefits are to the region?
 18 **A. No. I don't believe we've done it in dollar**
 19 **terms.**
 20 Q. You didn't do that in 2012, '13 or '14 either?
 21 **A. Not to my knowledge.**
 22 Q. Met doesn't do any regular calculation of the
 23 benefits to Metropolitan in terms of avoided capital or
 24 transportation costs associated with these programs,
 25 does it?

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1 **A. We did that initially when the program was set**
 2 **up, but we're not doing that on an annual basis, no.**
 3 Q. And you didn't do that for the money that was
 4 invested in 2011?
 5 **A. Not to my knowledge.**
 6 Q. Or 2012 through '14?
 7 **A. Again, not to my knowledge.**
 8 Q. On an ongoing basis the only thing that Met
 9 keeps track of is how many acre-feet of water are we
 10 creating for these programs?
 11 **A. The acre-feet that are produced by the local**
 12 **agencies and used by the local agencies.**
 13 Q. You don't know what percentage of the benefits
 14 to Metropolitan associated with these demand management
 15 programs are associated with avoiding supply costs
 16 versus what percentage are attributable to avoiding any
 17 other costs, do you?
 18 **A. We know that these programs are reducing the**
 19 **demand for water moving through our system, so we know**
 20 **that there is a benefit associated with that reduced**
 21 **flow in our system.**
 22 MR. BRAUNIG: I am going to use the deposition
 23 again. Page 126, lines four through ten.
 24 THE COURT: I really should do this the right
 25 way, which is to ask if there is any objection.

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1 MR. EMANUEL: I am reading it right now.
 2 Thank you, your Honor.
 3 No objection.
 4 THE COURT: Go ahead.
 5 MR. BRAUNIG: (Reading:)
 6 "Q Of the investment that
 7 Metropolitan is making in LRP
 8 programs, what percentage of
 9 the benefits are attributable
 10 to avoiding water supply costs
 11 and what percentage are
 12 attributable to avoiding some
 13 of these other costs that you
 14 described?
 15 "A I don't know."
 16 Q. That's true testimony?
 17 A. Yes.
 18 Q. When Met is deciding whether to invest in
 19 specific demand management programs, Met doesn't
 20 consider whether those specific programs will help Met
 21 avoid some future transportation or facility costs, does
 22 it?
 23 A. **The basis for the program is the avoidance of**
 24 **those costs and the reduced demand on our system and the**
 25 **specific programs we're trying to implement in order to**

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1 **meet that overall objective.**
 2 Q. On a project-by-project basis Met doesn't
 3 evaluate whether a specific project it invests in will
 4 have a transportation or facility benefit, does it?
 5 A. No.
 6 **Rather, we have overarching goals for the**
 7 **programs. They are articulated in our integrated**
 8 **resource plan in terms of goals. We are trying to put**
 9 **programs together that meet those goals.**
 10 Q. Water stewardship is not a service that is
 11 inherent to the delivery of water, is it?
 12 A. **A service that is inherent to the delivery of**
 13 **water?**
 14 Q. Met could supply and deliver water to its
 15 member agencies without charging for water stewardship;
 16 correct?
 17 A. **If by that you mean we could exist without**
 18 **running these programs, I think that's true.**
 19 Q. Met has made a policy decision that it wants to
 20 fund these demand management programs?
 21 A. **That's correct.**
 22 Q. And Met collects money from the water
 23 stewardship rate to fund the programs; correct?
 24 A. **That's correct. And one thing we're also doing**
 25 **is complying with SB-60. We are carrying out these**

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1 **duties.**
 2 Q. Met then, after it takes the money, after it
 3 collects the money, then distributes -- then distributes
 4 the demand management subsidies to its member agencies;
 5 right?
 6 A. **The conservation programs largely do not go**
 7 **directly to the member agencies. They are benefit to**
 8 **the consumers throughout Southern California. The local**
 9 **resources program financial incentives are provided to**
 10 **local agencies that enter into a contract with**
 11 **Metropolitan and produce supplies for their customers**
 12 **through those projects.**
 13 Q. Met makes the decision, though, about how those
 14 subsidies are going to be distributed out to the member
 15 agents; right?
 16 A. **To the extent member agencies are applying for**
 17 **or consumers are applying for those rebates, then they**
 18 **are ultimately going to be getting those benefits.**
 19 **There isn't a pre-decision distribution of funds.**
 20 Q. The decision about how these funds are going to
 21 be distributed out is a decision made by Met in response
 22 to applications made by the member agencies?
 23 A. **That's correct.**
 24 Q. That's created situations where some large
 25 member agencies receive a lot more in demand management

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1 subsidies than they pay into the water stewardship rate;
 2 right?
 3 A. **I'm not sure.**
 4 Q. You are not sure because Met hasn't done that
 5 analysis?
 6 A. **Because I know the projects that are pursued,**
 7 **but I can't say as to whether that compares with the**
 8 **amounts that agencies are paying in.**
 9 Q. So Met has the data to determine how much each
 10 agency contributes to the water stewardship rate; right?
 11 A. **Probably, yes.**
 12 Q. As far as you know, they would?
 13 A. **As far as I know.**
 14 Q. And Met also possesses data about how much it
 15 pays out in subsidies to each member agency; correct?
 16 A. **Correct.**
 17 Q. Met has never compiled that data in order to
 18 determine whether there's a proportional relationship
 19 between the amount of water stewardship rate monies that
 20 are contributed and the amount of subsidies that are
 21 going out to those member agencies?
 22 A. **Not to my knowledge, and, frankly, that's not**
 23 **the way our programs are measured. Our programs are**
 24 **measured against overall regional goals.**
 25 Q. But Met has never done that; Met has never

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1 tried to see if there is a proportional relationship
 2 between the funds that are created -- funds that are
 3 received through these charges and the benefits to the
 4 member agencies from the distribution of those funds as
 5 subsidies?
 6 **A. Not to my knowledge. And the reason for that**
 7 **is, frankly, these are programs meant to provide**
 8 **regional benefits. It's not designed to provide a**
 9 **specific amount of benefit to any specific agency.**
 10 Q. But they do provide a local benefit, don't
 11 they?
 12 **A. They do provide local benefit.**
 13 Q. That local benefit is cash in the form of
 14 subsidies; correct?
 15 **A. There is a financial incentive Metropolitan is**
 16 **providing.**
 17 Q. There is also the water created that is a
 18 benefit to the local member agency that is generated
 19 through these subsidies; right?
 20 **A. That is correct.**
 21 Q. You don't measure what the benefits are that
 22 are specific to those agencies compared to how much they
 23 are contributing through the water stewardship rate?
 24 **A. Not to my knowledge.**
 25 Q. You're familiar with the rate structuring

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1 integrity provision?
 2 **A. I am familiar with it, yes.**
 3 Q. Because of the rate structure integrity
 4 provision, San Diego isn't allowed to receive any new
 5 contracts for local resource projects or conservation;
 6 correct?
 7 **A. Can you rephrase it? I didn't catch the last**
 8 **part.**
 9 Q. Since 2011, when rate structure integrity was
 10 invoked, San Diego has not been allowed to participate
 11 in new local resource projects or conservation programs;
 12 correct?
 13 **A. That's not correct.**
 14 Q. Met has not entered into new contracts with San
 15 Diego for local resource projects since 2011, has it?
 16 **A. For local resources projects, I believe you're**
 17 **correct. The conservation program continues to provide**
 18 **incentives for consumers throughout Met's service area,**
 19 **including the water authorities.**
 20 Q. San Diego is no longer allowed to participate
 21 in the local resource programs since 2011? Or into new
 22 contracts?
 23 **A. Since 2011 the County Water Authority has taken**
 24 **actions that triggered the RSI provisions in the**
 25 **agreements we've had.**

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1 Q. And the actions that have been triggered are
 2 because San Diego filed this lawsuit, they are not
 3 allowed to participate in new local resource program
 4 projects?
 5 **A. That is a follow-on action that has occurred as**
 6 **a result of San Diego's litigation.**
 7 Q. That means no matter how good a program San
 8 Diego might have to generate supply of water, no matter
 9 how cost effective it is, no matter how shovel-ready it
 10 is, Met is not going to fund it because San Diego filed
 11 this lawsuit; correct?
 12 MR. EMANUEL: I am going to object. The
 13 question is argumentative and the Court may recall this
 14 was the subject of a motion in limine, as well.
 15 THE COURT: It is a little argumentative. I
 16 will allow it.
 17 Go ahead.
 18 THE WITNESS: What was the question?
 19 Q. BY MR. BRAUNIG: The question is no matter how
 20 good the project is that San Diego might have, Met is
 21 not going to fund it because of rate structure
 22 integrity?
 23 **A. To the extent that San Diego has a project, and**
 24 **I can't speak to how good a project is or isn't, a**
 25 **project that would be part of the LRP program, that**

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1 **contract would contain rate structure integrity language**
 2 **that would be triggered by the action San Diego has**
 3 **taken with this litigation.**
 4 Q. And therefore, Met wouldn't fund it?
 5 **A. Ultimately, our board would have to consider**
 6 **that but, yes, it would likely trigger that clause and**
 7 **until that's settled, we wouldn't be funding it.**
 8 Q. There have been some questions that have been
 9 asked about whether San Diego at any point tried to get
 10 Met to change the RSI provisions. In fact, San Diego
 11 did try to change the provisions at one point in time
 12 and Met said no. Correct?
 13 **A. I actually don't recall that.**
 14 Q. Can we go to Tab 17, please, PTX 120.
 15 Do you recognize Tab 17, PTX 120, as a letter
 16 from Metropolitan to San Diego County Water Authority
 17 about the rate structure integrity on August 2, 2005?
 18 **A. Yes, I recognize this as that letter.**
 19 MR. BRAUNIG: We would move PTX 120 into
 20 evidence.
 21 MR. EMANUEL: No objection.
 22 THE COURT: PTX 120 has the proposal as an
 23 attachment and you are moving that in, as well?
 24 MR. BRAUNIG: Yes.
 25 THE COURT: PTX 120 is admitted.

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1 (Exhibit 120 was received in evidence.)
 2 Q. BY MR. BRAUNIG: I want to draw your attention,
 3 please, to the second line of that first paragraph.
 4 "Metropolitan is unable to execute your agreement
 5 because your modified version departs from the uniform
 6 rate structure integrity provision required by
 7 Metropolitan's board of directors for all new incentive
 8 program agreements with the member agencies."
 9 Does this refresh your recollection that when
 10 attempted to modify the rate structure language, Met
 11 told you it can't enter into a program that doesn't have
 12 that specific language?
 13 MR. EMANUEL: I don't think there was a
 14 failure --
 15 THE COURT: Sustained.
 16 Q. BY MR. BRAUNIG: For member agencies the rate
 17 structure integrity language is nonnegotiable; right?
 18 **A. The process that we would consider or our board**
 19 **would consider would be their own board process to take**
 20 **a look at whether changes to the rate structure**
 21 **integrity provision are things they would want to**
 22 **undertake.**
 23 Q. The RSI language is nonnegotiable; correct?
 24 **A. Once the board has adopted the language, they**
 25 **then gave us direction to include that in all of our**

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1 **contracts.**
 2 THE COURT: Does that mean it's nonnegotiable?
 3 THE WITNESS: The negotiation that could occur
 4 would be at a board level.
 5 MR. BRAUNIG: I am going to use his deposition,
 6 please, your Honor.
 7 Page 34, line 21, through 35, line four.
 8 MR. EMANUEL: Give me a second, your Honor.
 9 THE WITNESS: This was Tab 2.
 10 MR. BRAUNIG: Tab 2. It will come up on the
 11 board for you.
 12 THE COURT: Any objection?
 13 MR. EMANUEL: No objection.
 14 MR. BRAUNIG: (Reading:)
 15 "Q Is it negotiable?
 16 "A No.
 17 "Q So as a member agency your
 18 choice is to sign an agreement
 19 that includes the rate
 20 structure integrity language or
 21 you're not eligible to obtain
 22 certain incentive benefits for
 23 local resources or conservation
 24 or desalination?
 25 "A You need to sign an

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1 agreement that has standard
 2 provisions."
 3 MR. EMANUEL: To be fair, you should read the
 4 question and answer above that.
 5 THE COURT: The question and answer above that,
 6 starting at line 13?
 7 MR. EMANUEL: Starting at line seven.
 8 THE COURT: Starting at line seven?
 9 MR. BRAUNIG: I think it is a different
 10 question. If he wants to read it in and spend his time
 11 doing it, he can do that.
 12 THE COURT: I don't think it changes the
 13 meaning. Let's go ahead at this time and read that in,
 14 line seven and ending at line 12.
 15 MR. EMANUEL: Yes.
 16 THE COURT: We can do that now.
 17 MR. BRAUNIG: (Reading:)
 18 "Q What if an agency -- what
 19 if a member agency refuses to
 20 sign an agreement with that
 21 language?
 22 "A To the extent that it's
 23 part of the standard language
 24 that the board has instructed
 25 to have in all of these

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1 contracts, then the agency
 2 would be agreeing to not
 3 participate in those programs."
 4 Q. You testified earlier when this program was
 5 initiated, the demand management programs were initiated
 6 back in the mid-1990s or so, Metropolitan evaluated the
 7 regional benefits or the benefits associated with doing
 8 these programs; correct?
 9 **A. That's correct.**
 10 Q. Metropolitan has never done a backward-looking
 11 analysis to determine if demand management programs are
 12 actually avoiding particular costs, has it?
 13 **A. Not to my knowledge.**
 14 Q. Since the mid-1990s Metropolitan has never done
 15 another forward look to see if additional demand
 16 management spending would avoid transportation facility
 17 costs, has it?
 18 **A. Additional demand management spending itself**
 19 **may not be analyzed, but I do believe we looked at the**
 20 **projected capital investment program at Metropolitan in**
 21 **the, maybe, mid-2000s to see if reductions in demand**
 22 **would help reduce the expenditures to our capital**
 23 **program in the future. But I don't think it was**
 24 **directly related to the incentive program itself.**
 25 Q. Changing gears a little bit, when a member

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1 agency chooses to wheel water, that fact, the wheeling,
 2 doesn't cause Met to need to spend more money on demand
 3 management programs, does it?
 4 **A. Does the wheeling itself cause Metropolitan to**
 5 **spend more money on demand management?**
 6 Q. That's right.
 7 **A. I don't think so.**
 8 Q. Likewise, the entry into the exchange agreement
 9 by San Diego and Metropolitan, that didn't cause
 10 Metropolitan to need to spend more money on local
 11 resource projects and conservation, did it?
 12 **A. That individual agreement may not, but when**
 13 **Metropolitan is looking at our programs, as I said**
 14 **before, you're looking back, say, the 1990s, we were**
 15 **considering in the future the needs for the system to be**
 16 **determined to be able to move water to meet customer**
 17 **demands.**
 18 **And that includes both supplies that**
 19 **Metropolitan is providing but supplies that would be**
 20 **wheeled by other parties through the system.**
 21 Q. You're not able to identify any specific
 22 wheeling transactions that are attributable to spending
 23 on demand management programs, are you?
 24 **A. What do you mean by attributable to spending?**
 25 **I'm not sure I understand.**

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1 Q. Your testimony is that spending this money
 2 frees up space that then makes wheeling possible; is
 3 that right?
 4 **A. It reduces demand for deliveries in our system.**
 5 Q. But you're not able to identify any specific
 6 wheeling transaction that's attributable to the spending
 7 that's been made on demand management programs, are you?
 8 **A. Again, I'm not sure what you mean by**
 9 **"attributable."**
 10 Q. It had been caused by or as a result of.
 11 **A. I don't know why a wheeling transaction would**
 12 **be caused by demand management programs.**
 13 Q. You have been a Met staffer for more than a
 14 decade; correct?
 15 **A. That's true.**
 16 Q. And you have been involved in a number of
 17 different rate refinement or rate-related initiatives;
 18 correct?
 19 **A. Yes, sir.**
 20 Q. Since 2003, when Met unbundled its rates, Met
 21 has not presented any rate structures to its board other
 22 than the one it's using today, has it?
 23 **A. Not to my knowledge.**
 24 Q. Met has not presented to its board any
 25 different cost allocations that would move all of the

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1 State Water Project costs off of transportation, has it?
 2 **A. Over the course of the years since the rate**
 3 **structure was adopted, we have discussed many different**
 4 **potential things with the board, but we've never made a**
 5 **recommendation for a wholesale rate structure change, if**
 6 **that's what you're getting at.**
 7 Q. There has never been presented to the board an
 8 option that would move State Water Project costs off of
 9 transportation?
 10 **A. In a -- as an option that the board would take**
 11 **action on, I'm not sure.**
 12 Q. You're not sure, or no?
 13 **A. Well, we've had many discussions over the years**
 14 **about different things that could be done. We've had**
 15 **board workshops related to what we called our long-range**
 16 **finance plans and things like that.**
 17 **So there were concepts that were discussed, but**
 18 **I don't know that there was ever a specific action to**
 19 **make significant changes to the rate structure that the**
 20 **board would have acted on.**
 21 Q. The same goes for the demand management
 22 programs, there's never been an option presented to the
 23 board that would take those demand management programs
 24 off of transportation and put them somewhere else?
 25 **A. Not to my knowledge.**

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1 Q. Over the years that you've been working on
 2 these rate initiatives, San Diego has frequently
 3 complained about the fact that State Water Project costs
 4 are on transportation, haven't they?
 5 **A. San Diego has voiced that opinion in many**
 6 **meetings.**
 7 Q. Over the course of many years?
 8 **A. That's correct.**
 9 Q. Since 2003?
 10 **A. I can't say the exact years, but yes.**
 11 Q. Likewise, with the demand management programs,
 12 they've been complaining for a decade or more that those
 13 programs shouldn't be on Metropolitan's transportation
 14 rates; correct?
 15 **A. I can't say a decade or more, but I do know**
 16 **that they have voiced that desire.**
 17 Q. You can't say that they have voiced that
 18 desire?
 19 **A. I can say that they have.**
 20 Q. Okay, thank you.
 21 And they've voiced that desire repeatedly?
 22 **A. Yes.**
 23 Q. Over the course of many years?
 24 **A. Yes.**
 25 Q. In your declaration that was submitted into --

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1 as part of your testimony, you note that Metropolitan
 2 and its member agencies have the right to wheel
 3 third-party water on the State Water Project; do you
 4 recall that?
 5 **A. Yes.**
 6 Q. Met has never attempted to put a financial
 7 value on the right of Metropolitan or its member
 8 agencies to wheel water on the State Water Project, has
 9 it?
 10 **A. A financial value on our right to wheel water?**
 11 Q. Uh-huh.
 12 **A. Metropolitan's right to wheel water?**
 13 Q. That's right.
 14 **A. Not to my knowledge. It is one of the benefits**
 15 **we get as State water contractor and part of the fees we**
 16 **pay under our State water contract allow us part of that**
 17 **right.**
 18 Q. But you've never attempted to put a financial
 19 value on that right, Metropolitan hasn't?
 20 **A. I don't believe that we put a financial value**
 21 **on it other than the fact that the bill we pay for the**
 22 **State Water Project is broken up into**
 23 **conservation/supply and transportation from the**
 24 **Department of Water Resources. We are getting that**
 25 **value for the transportation.**

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1 Q. Is it your opinion that the disaggregation of
 2 the DWR bill into conservation and conveyance that has
 3 -- that has legal meaning, that that -- that that,
 4 therefore, means that's the value to Metropolitan?
 5 MR. EMANUEL: I will object to the question.
 6 THE COURT: It is two different questions. I
 7 think you mean the latter.
 8 MR. BRAUNIG: I'll re-ask the question.
 9 Q. Your -- you were present during the first phase
 10 of this trial; correct?
 11 **A. Correct.**
 12 Q. Have you read the Court's statement of decision
 13 on the issue of whether or not DWR -- the fact that DWR
 14 disaggregates its bill means those are Met's
 15 transportation costs?
 16 **A. I have.**
 17 Q. You have, okay.
 18 Since 2013, since December of 2013, has the
 19 structure of DWR's billing to Met changed?
 20 **A. Not to my knowledge.**
 21 Q. DWR still breaks up its bill in the same way?
 22 **A. Correct.**
 23 Q. Met still doesn't own the State Water Project,
 24 does it?
 25 **A. Correct.**

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1 Q. Met still doesn't operate the State Water
 2 Project, does it?
 3 **A. We don't operate the State Water Project, to my**
 4 **knowledge.**
 5 Q. And the State Water Project still is not part
 6 of Met's conveyance system, is it?
 7 **A. It is included in our conveyance rates.**
 8 Q. With respect to this idea of State Water
 9 Project wheeling, there are many years where Met doesn't
 10 wheel any third-party water on the State Water Project;
 11 correct?
 12 **A. That's correct.**
 13 Q. And there are many years where Metropolitan
 14 member agencies don't wheel any water on the State Water
 15 Project; correct?
 16 **A. Correct.**
 17 Q. In fact, isn't it true that of the water that's
 18 been moved on the State Water Project over the last
 19 decade, less than five percent of that is wheeling by
 20 Metropolitan or its member agencies?
 21 **A. I think that's probably right. I don't know**
 22 **the exact statistic, but I would imagine that is a very**
 23 **small amount.**
 24 Q. Met makes decisions about whether a member
 25 agency like San Diego can stand in Met's shoes and wheel

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1 water on the State Water Project, doesn't it?
 2 **A. Can stand in Metropolitan's shoes and wheel**
 3 **water? If -- in a scenario where San Diego wants to**
 4 **execute a transfer that's purchasing supply from another**
 5 **entity?**
 6 Q. Right.
 7 **A. Then they could enter into an arrangement with**
 8 **Metropolitan to wheel the water, yes.**
 9 Q. And Metropolitan would have the discretion to
 10 decide whether or not San Diego is allowed to do that;
 11 correct?
 12 **A. Well, there are wheeling provisions that would**
 13 **apply in terms of the ability to move the water.**
 14 Q. Can we bring up PTX 358, please.
 15 This is Tab 24 in your binder. It's in the
 16 binder that's in the binder one.
 17 This is PTX 358. This is a letter from
 18 Metropolitan to San Diego concerning a proposed wheeling
 19 transaction?
 20 **A. Okay.**
 21 Q. The answer is yes, that's what this is?
 22 **A. Yes, it appears that way, yes.**
 23 MR. BRAUNIG: We would move PTX 358 into
 24 evidence.
 25 MR. EMANUEL: No objection.

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1 THE COURT: PTX 358 is admitted.
 2 (Exhibit 358 was received in evidence.)
 3 Q. BY MR. BRAUNIG: In PTX 357 San Diego had
 4 requested wheeling service on the State Water Project
 5 for water it was getting from the San Juan Water
 6 District? That's what is in the first paragraph.
 7 A. **That appears to be, yes.**
 8 Q. If you look on the third paragraph,
 9 Metropolitan was refusing to consent to wheel this water
 10 or to allow the State Water Project to wheel this water
 11 on San Diego's behalf; correct?
 12 A. **It -- yes, it appears we are not consenting to**
 13 **it.**
 14 Q. That is a decision that Metropolitan can make?
 15 A. **Right. There would be many considerations**
 16 **behind that, but yes.**
 17 MR. BRAUNIG: We are five minutes from noon and
 18 it is a good time.
 19 THE COURT: Do you have more questions after
 20 lunch?
 21 MR. BRAUNIG: I might have a little more.
 22 THE COURT: Why don't we get together again at
 23 1:30. Thank you very much.
 24 (Noon recess.)
 25

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1 San Francisco, California
 2 Thursday, April 2, 2015
 3 1:30 p.m.
 4 Department No. 304 Hon. Curtis E.A. Karnow, Judge
 5
 6 DEVENDRA UPADHYAH,
 7 resumed the stand and testified further as follows:
 8
 9 THE COURT: Shall we continue. Do we have a
 10 witness?
 11 Sir, if you'll join us.
 12
 13 MR. BRAUNIG: Your Honor, counsel for Met had
 14 sought to move in DTX 979, which is the SB-60 report, a
 15 30-page document, and you had asked them to prepare an
 16 excerpted version. We think for purposes of
 17 completeness the entire 979 should come in, and we don't
 18 object to it. Since he sought to move it in, we don't
 19 object, if the Court would allow it.
 20 MR. EMANUEL: I am withdrawing 979. I would
 21 ask to enter evidence 979A which is only the two pages
 22 we used. I think that would be more efficient.
 23 MR. BRAUNIG: Your Honor, I think, that putting
 24 in two pages of a 30-page document, it's not an enormous
 25 document.

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1 THE COURT: Is there something else that when
 2 you write the post-trial briefs you will be pointing me
 3 to some of the other pages?
 4 MR. BRAUNIG: Possibly. We would like to have
 5 the opportunity to do that.
 6 THE COURT: One of the requests -- I'll make it
 7 now -- when we finish the exhibits, you are going to be
 8 providing to me the courtesy copies, you are going to
 9 take everything out of this room and you are going to be
 10 providing me only the pages you will be relying on and
 11 you think I need to read afterwards.
 12 If you want the entire 979 in, I will admit the
 13 entire 979. It is hereby admitted. And I apologize to
 14 counsel for having gone to the trouble of doing what I
 15 asked you to do.
 16 MR. EMANUEL: No apologies necessary.
 17 MR. BRAUNIG: Your Honor, also there is some
 18 discrepancy as to whether or not I moved PTX 358 in.
 19 THE COURT: I have an indication that you did.
 20 MR. BRAUNIG: It's admitted.
 21 THE COURT: That's my indication. The clerk
 22 confirms.
 23 THE CLERK: I do not. I do confirm now that
 24 you saw it.
 25 THE COURT: Now he does.

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1 MR. BRAUNIG: With that, your Honor, I have
 2 nothing further.
 3 THE COURT: Any further questions of this
 4 witness, redirect?
 5
 6 REDIRECT EXAMINATION
 7 BY MR. EMANUEL:
 8 Q. We are going to look again at PTX 358.
 9 Mr. Upadhyah, do you have that in front of you?
 10 THE COURT: The July 7, 2010, letter under Tab
 11 24.
 12 THE WITNESS: Yes, I do.
 13 Q. BY MR. EMANUEL: Let's look into the third
 14 paragraph, and specifically, I think, to the third
 15 sentence of the third paragraph.
 16 For the record, "If SDCWA possesses a change in
 17 place of use from the State Water Resources Control
 18 Board for CVP supplies from SJWD, then Metropolitan will
 19 provide transportation for this water as non-SWP
 20 supplies."
 21 Sir, would you explain to us what that means?
 22 A. **Sure. When San Diego was proposing this**
 23 **transfer at the time, it was with a party that has**
 24 **rights on the Central Valley project, which in this**
 25 **paragraph is referred to as CVP. And there is a certain**

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1 **place of use defined for the Central Valley Project and**
 2 **contractors that are on the Central Valley Project, that**
 3 **is separate from the place of use for the State Water**
 4 **Project and contractors on the State Water Project.**
 5 Q. Let's stop you right there. Would you explain
 6 the importance of place of use?
 7 **A. Sure. It's defined that permanent operations**
 8 **of the CVP is for the benefit of contractors on the CVP**
 9 **and its use of water in the CVP area, that place of use,**
 10 **which is completely different than the State Water**
 11 **Project and the place of use within the State Water**
 12 **Project area.**
 13 **So what we were saying there is there is a**
 14 **process that is used to go to the State board and**
 15 **request a change in place of use. There was risk from**
 16 **Metropolitan if we were to agree to a wheeling**
 17 **arrangement for a transfer that does not have that**
 18 **approval, so we were saying if you are able to process**
 19 **that change in place of use through the State board then**
 20 **we'll move the water as nonproject water.**
 21 THE COURT: Do you need the permission of the
 22 State board to do any wheeling deal?
 23 THE WITNESS: If it's in this situation where
 24 there's the risk of not -- the State board not
 25 acknowledging the change of place of use, then there is

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1 a risk that, for example, if we had done that without
 2 that change in place of use, the State Board could look,
 3 after the fact, could look and say, you took delivery of
 4 your State Water Project allocation, we are not
 5 acknowledging that it was a transfer.
 6 Q. BY MR. EMANUEL: We were talking about the
 7 conservation and the demand management program.
 8 Do you have an estimate of how much water was
 9 produced through these demand management programs?
 10 **A. The number changes as we go through time, as**
 11 **the benefits increase. It is more than three million**
 12 **acre-feet over the life of the programs.**
 13 MR. EMANUEL: Thank you. Nothing more, your
 14 Honor.
 15 MR. BRAUNIG: Nothing further.
 16 THE COURT: Thank you. You are excused.
 17 MR. KEKER: Let me get Miss Stapleton who is
 18 next, your Honor.
 19 THE COURT: Thank you.
 20 MR. EMANUEL: Can we do administrative
 21 housekeeping? Do you remember there was the
 22 Administrative Code, the Court asked that only some
 23 portion of it, so we have -- what was the number --
 24 1149A, Metropolitan moves into evidence, your Honor.
 25 THE COURT: Does San Diego have a copy of that?

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1 MR. EMANUEL: Yes, I gave that at the break.
 2 MR. BRAUNIG: No objection.
 3 (Exhibit 1149A was received into evidence.)
 4 THE COURT: 1149A is admitted.
 5 MR. QUINN: Metropolitan calls Maureen
 6 Stapleton.
 7
 8 MAUREEN STAPLETON,
 9 called as a witness by the Defendant, was sworn and
 10 testified as follows:
 11
 12 THE WITNESS: I do.
 13 THE CLERK: Please be seated. Maureen
 14 Stapleton. M-A-U-R-E-E-N. S-T-A-P-L-E-T-O-N.
 15
 16 DIRECT EXAMINATION
 17 BY MR. QUINN:
 18 Q. Good afternoon, Miss Stapleton.
 19 **A. Good afternoon.**
 20 Q. My name is John Quinn. You are the general
 21 manager of the Water Authority in San Diego?
 22 **A. Correct.**
 23 Q. How long have you been the general manager?
 24 **A. Nineteen-and-a-half years.**
 25 Q. Did you work for the Water Authority before you

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1 became general manager?
 2 **A. No, I did not.**
 3 Q. What are the scope of your responsibilities as
 4 general manager of the San Diego Water Authority?
 5 **A. I am responsible for the overall management of**
 6 **the Water Authority and its 260 employees.**
 7 Q. Do you recall back in 2001 that Metropolitan
 8 went through a process of unbundling its rates?
 9 **A. Yes.**
 10 Q. Do you recall those unbundled rates went into
 11 effect January 1, 2003?
 12 **A. Yes.**
 13 Q. As early as 2001, when Metropolitan was
 14 considered unbundling its rates, you folks at the San
 15 Diego Water Authority understood that the system access
 16 rate was a component of the conveyance charges that Met
 17 was implementing for these unbundled rates; correct?
 18 **A. Yes.**
 19 Q. And certainly you knew that power was another
 20 component?
 21 **A. Yes.**
 22 Q. You knew the water stewardship rate was another
 23 component of this unbundled conveyance rate?
 24 **A. Yes.**
 25 MR. QUINN: If we could look at Defense Exhibit

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1 767. There has been no objection to this, your Honor,
 2 and I would offer it into evidence.
 3 MR. KEKER: No objection.
 4 MR. QUINN: You should have a binder up there
 5 that will have copies of all the exhibits I will refer
 6 to.
 7 THE COURT: Exhibit 767, I take it that's a
 8 DTX?
 9 MR. QUINN: DTX 767.
 10 THE COURT: It is admitted.
 11 (Exhibit 767 was received in evidence.)
 12 Q. BY MR. QUINN: Could you please identify this
 13 document for us?
 14 **A. It appears to be a PowerPoint presentation by**
 15 **the Water Authority, or it's referenced as the Water**
 16 **Authority.**
 17 Q. And it bears a date that we see on the first
 18 page of October 11, 2001?
 19 **A. Yes.**
 20 Q. And do you recall participating in a San Diego
 21 Water Authority workshop concerning Met's unbundling
 22 proposal back in October of 2001?
 23 **A. Yes. I don't remember this specific meeting**
 24 **per se, but I attended all of these workshops.**
 25 Q. This exhibit appears to be a PowerPoint

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1 presentation that was used in connection with one of
 2 those workshops in San Diego where you were considering
 3 this unbundled rate proposal?
 4 **A. It does.**
 5 Q. If you could turn to, I think it is, slide
 6 number five. It is page 28 of the document. It is the
 7 page entitled "Wheeling." We've got it up on the
 8 screen. If it is easier for you to look at the screen
 9 there, there is a screen -- you can also see it right in
 10 front of you on the left-hand side.
 11 **A. Oh, yes. Thank you.**
 12 Q. This slide, of course, shows that under this
 13 unbundled proposal for wheeling there be a system access
 14 rate and a water stewardship rate, an incremental power
 15 cost, and there is a question mark there. You see that?
 16 **A. Yes.**
 17 Q. San Diego knew that these components were going
 18 to be on this unbundled conveyance rate and also got
 19 information about what the charges would be?
 20 **A. Yes.**
 21 Q. In fact, San Diego received cost of service
 22 reports that specified, for example, the amount of the
 23 State Water Project costs that would go into, for
 24 example, the system access rate; do you recall that?
 25 **A. Yes.**

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1 MR. QUINN: If you could look, please, at DTX
 2 475. This has not been admitted, at least as marked,
 3 your Honor. It was previously part of the administrative
 4 record. There is no objection to it, as I understand
 5 it, and we will offer Defense Exhibit 475.
 6 MR. KEKER: No objection.
 7 THE COURT: DTX 475 is admitted.
 8 (Exhibit 475 was received into evidence.)
 9 THE COURT: If we could put that up on the
 10 screen.
 11 MR. KEKER: Again, this is a 200-page document.
 12 THE COURT: I think we're just going to have a
 13 general conversation about this at the end Of the trial.
 14 Q. BY MR. QUINN: Do you recognize this document,
 15 Miss Stapleton?
 16 **A. I do not.**
 17 Q. But you did -- you did get information -- you
 18 do recall receiving information from time to time about
 19 specifically -- prior to January 1, 2003, when these
 20 unbundled rates went into effect, you had very specific
 21 information about what the particular charges would be
 22 and what is contained in those charges.
 23 Is that fair to say?
 24 **A. Yes.**
 25 Q. And in March of 2002, the specific rates for

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1 the unbundled rate structure, including the conveyance
 2 rate, were considered and approved by the Met. But you
 3 did -- you did get information -- you do recall
 4 receiving information from time to time about
 5 specifically -- prior to January 1, 2003, when these
 6 unbundled rates went into effect, you had very specific
 7 information about what the particular charges would be
 8 and what was contained in those charges.
 9 Is that fair to say?
 10 **A. Yes.**
 11 Q. And in March of 2002 the specific rates for the
 12 unbundled rate structure, including the conveyance rate,
 13 were considered and approved by the Met board.
 14 Do you recall that?
 15 **A. Yes.**
 16 Q. If we can look at Defense Exhibit 129, which I
 17 understand is in evidence. This document is entitled
 18 "Delegate Votes at a Glance."
 19 Do you see that?
 20 **A. Yes, I do.**
 21 Q. This is a document you can see in the lower
 22 right-hand corner, depending -- if you hold it this way,
 23 the long way, it's in the lower right-hand corner, you
 24 can see a Bates number SDCWA, et cetera, which indicates
 25 this is a document that came from San Diego's files.

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1 You understand that?
 2 **A. Yes.**
 3 Q. Can you tell us what this document is?
 4 **A. This is an at-a-glance voting record of our MWD**
 5 **delegates from the Water Authority.**
 6 Q. So is it true, then, that in this document we
 7 can see how the delegates from the San Diego Water
 8 Authority, who sit on the Metropolitan board, how they
 9 vote on various issues?
 10 **A. Yes.**
 11 MR. QUINN: That's what this reflects. And
 12 then if we could turn, please, to Defense Exhibit 772,
 13 DTX 772, not yet admitted, your Honor. As I understand
 14 there is no objection to it. I am going to offer this,
 15 as well.
 16 (Exhibit 772 was received into evidence.)
 17 MR. KEKER: No objection.
 18 THE COURT: DTX 772 is admitted.
 19 Q. BY MR. QUINN: You see this exhibit, 772, these
 20 are minutes of a San Diego Water Authority board meeting
 21 on February 28, 2002?
 22 **A. Yes.**
 23 Q. And if you turn, please, to page 11, that's
 24 page 11 on the lower right-hand side. You can also see
 25 that on the screen. You see there in the first

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1 paragraph, but I would like to read that to you. The
 2 first paragraph under 1B it says, "Director of imported
 3 water has provided reasons why CWA staff --"
 4 What is CWA?
 5 **A. County Water Authority. That's our agency.**
 6 Q. -- "had recommended that the board take a
 7 position on MWD's proposed rates and charges. He
 8 reviewed the proposed rate structure and described rate
 9 structure components. He showed potential impact to CWA
 10 member agencies. Mr. Hess compared existing and
 11 proposed MWD rates and charges, and said the IID
 12 transfer would provide a benefit to the proposed MWD
 13 rate structure."
 14 You see that?
 15 **A. Yes, I do.**
 16 Q. The second paragraph says, "After a lengthy
 17 discussion, the staff recommendation was revised to
 18 read: "The board direct the Met delegates to support
 19 the proposed Met rates and charges for 2003, with the
 20 statement and understanding that the action is without
 21 prejudice to the continuation of the preferential rights
 22 lawsuit."
 23 You see that?
 24 **A. Yes, I do.**
 25 Q. Apparently there was some lawsuit then going on

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1 between San Diego and who?
 2 **A. And Metropolitan Water District.**
 3 Q. About this preferential rights issues?
 4 **A. Yes.**
 5 Q. After a discussion at San Diego about the
 6 unbundled rate structure and the components of it, the
 7 San Diego board, after looking at this, directed the San
 8 Diego delegates on the Met board to vote for the rates
 9 that went into effect January 1, 2003; is that correct?
 10 **A. Yes. To support the rate structure, correct.**
 11 Q. And to vote, you understand that?
 12 **A. Yes, to vote affirmative.**
 13 Q. The only reservation related to this other
 14 issue, which was the subject of a pending lawsuit
 15 regarding preferential rights, at least as reflected in
 16 the minutes?
 17 **A. Yes.**
 18 Q. There was no reservation, at least as reflected
 19 in the minutes, in terms of the vote on these unbundled
 20 rates with respect to either State Water Project costs
 21 or the water stewardship rate; correct?
 22 **A. Correct.**
 23 Q. In fact, San Diego delegates, if we go back and
 24 look at Defense Exhibit 129, San Diego's members on the
 25 Met board did, in fact, vote in favor of those unbundled

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1 rates; correct?
 2 **A. They voted in favor of the rate structure,**
 3 **correct.**
 4 Q. And those rates and that rate structure and the
 5 components of it, that's the same structure which San
 6 Diego maintains in this case is a breach of the 2003
 7 exchange agreement?
 8 **A. Yes.**
 9 Q. You are aware Mr. Slater has been -- Mr. Scott
 10 Slater was designated by San Diego as the person most
 11 knowledgeable to testify on various issues relating to
 12 damages, breach and mistake. You are aware of that?
 13 **A. Yes, I am. I would like to read to you from**
 14 **Mr. Slater's deposition as the person most**
 15 **knowledgeable, from page 216 to 217, 12.**
 16 MR. KEKER: No objection.
 17 Q. BY MR. QUINN: I will read to you Mr. Slater's
 18 testimony as the person most knowledgeable.
 19 "Q. You knew that at the time
 20 the October 2003 agreement was
 21 signed, that that \$235 charge
 22 included charges, costs
 23 relating to the State Water
 24 Project that were included in
 25 the system access rate, that

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1 were rolled up into the
 2 wheeling rate. You knew that?
 3 "A Yes, I did.
 4 "Q And you thought it was
 5 inappropriate to include those
 6 charges; correct?
 7 "A Correct.
 8 "Q And you believe that was actually not
 9 lawful to do that; correct?
 10 "A Agreed.
 11 "Q And, similarly, if I ask
 12 you the same questions about
 13 the costs associated with power
 14 and the State Water Project,
 15 you knew those were included,
 16 too, and you thought it was
 17 illegal to include those in
 18 that rate; correct?
 19 "A That's correct.
 20 "Q And -- but you knew they were
 21 in that 235-dollar rate?
 22 "A That's correct."
 23 Now, back in 2003, you heard Mr. Slater
 24 emphatically express that opinion at the time the
 25 exchange agreement was being negotiated; correct?

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1 **A. Yes. We believed that they were not lawfully**
 2 **to be included.**
 3 Q. And you heard him express that opinion and you
 4 believed that also, even before the exchange agreement
 5 was signed up; correct?
 6 **A. Correct.**
 7 Q. When, Miss Stapleton, did you first reach the
 8 conclusion that the inclusion of State Water Project
 9 costs in the unbundled conveyance rate was unlawful?
 10 When did you first reach that conclusion?
 11 **A. When Metropolitan started talking about**
 12 **unbundling of the rates and of the cost allocation of**
 13 **the State Water Project. That's when we believed that**
 14 **was a misinterpretation of what was allowed by law.**
 15 Q. You had that belief when you first heard that
 16 Metropolitan had proposed to include those costs in the
 17 unbundled conveyance rate?
 18 **A. Correct.**
 19 Q. That could have been in 2001, 2002, but
 20 certainly by 2003; correct?
 21 **A. Correct.**
 22 Q. You believed that it was unlawful, based upon
 23 the law as it existed then in 2003; correct?
 24 **A. Yes. We believed that the interpretation by**
 25 **Metropolitan was not correct.**

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1 Q. My point is you believed it was unlawful under
 2 the law, as it existed in 2003, the existing law at that
 3 time?
 4 **A. Yes.**
 5 Q. Now, on occasion over the years, you haven't
 6 been bashful about writing to Metropolitan to express
 7 concerns that the San Diego Water Authority had about
 8 various issues. Would that be fair to say?
 9 **A. Yes. That is fair to say. I am not a bashful**
 10 **woman.**
 11 Q. And if an issue is important enough, you would
 12 put those concerns in writing?
 13 **A. It depends on what forum we would be at and it**
 14 **depends on what we're trying to achieve. So I wouldn't**
 15 **say wholesale I would put something like that in**
 16 **writing.**
 17 Q. What I'm saying is, without regard to the
 18 forum, you wouldn't wait -- if you had a particular
 19 concern you thought it was important enough -- you
 20 wouldn't necessarily wait until the next board meeting.
 21 You might send off a letter or an email and document
 22 your strongly held views?
 23 **A. Or make a phone call to let my views be known;**
 24 **correct.**
 25 Q. And if an issue was important enough that you

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1 thought it ought to be documented, you wouldn't hesitate
 2 to put San Diego's views in writing; is that fair to
 3 say?
 4 **A. I guess I am hesitating on documented. I am**
 5 **not sure I understand the question.**
 6 Q. Let me withdraw it again.
 7 I am saying if you thought it was important
 8 enough, if you thought an issue was important enough, I
 9 mean, you've been a general manager for, you told me, 19
 10 years?
 11 **A. Correct.**
 12 Q. And you understand the value sometimes of
 13 negotiating things, of documenting things when it
 14 relates to issues that are important; correct?
 15 **A. Correct.**
 16 Q. Including issues about illegal conduct?
 17 **A. Yes.**
 18 Q. So if an issue is important enough --
 19 **A. Uh-huh.**
 20 Q. -- to you, you wouldn't hesitate to put San
 21 Diego's concerns in writing; correct?
 22 **A. Yes. I would put them in writing from time to**
 23 **time, if it was appropriate. Again, depending upon what**
 24 **venue I'm using to try to make a change.**
 25 Q. So in particular, in 2003, after Metropolitan

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1 unbundled its rates, and after the new rates went into
 2 effect, you wrote Mr. Gastelum --
 3 **A. Yes.**
 4 Q. -- your counterpart at Metropolitan at the
 5 time, about those rates and documented your concerns.
 6 Do you recall that?
 7 **A. Yes, I do.**
 8 Q. Let's take a look at DTX 794. This is in
 9 evidence.
 10 And you say in the first line of your letter
 11 that you have identified some issues in the setting and
 12 the adoption of Metropolitan's proposed rates.
 13 Do you see that?
 14 **A. I do see that.**
 15 Q. And then it goes on -- and I am not going to
 16 take the time to go through your three-page
 17 single-spaced letter -- but continuing in the second
 18 paragraph there, and on to the second paragraph, you
 19 list certain of these issues; correct?
 20 **A. Yes.**
 21 Q. And these include something called
 22 "pay-as-you-go funding." I'm not even going to ask you
 23 what that is.
 24 **A. Yes.**
 25 Q. "Excess revenue collection. The use of

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1 reserved funds."
 2 Do you see all that?
 3 **A. I do see that.**
 4 Q. And then on page two there is a -- you reach --
 5 in the first full paragraph on page two, in the last
 6 sentence, you refer to "rate stability." Do you see
 7 that?
 8 THE COURT: Can you say that one more time,
 9 Mr. Quinn?
 10 MR. QUINN: Yes.
 11 Q. On page two, last sentence of the first full
 12 paragraph on page two, if you look at the second-to-last
 13 maybe you can highlight that, "rate stability."
 14 This is in the second-to-last line of the
 15 paragraph.
 16 **A. Yes, I see it now.**
 17 Q. And that was an issue. You thought that rate
 18 stability was something that was important to
 19 Metropolitan's members, including San Diego. Fair to
 20 say?
 21 **A. Yes, it was the use of reserves.**
 22 Q. Okay. But the rate stability was something
 23 that you thought was important; correct?
 24 **A. Yes. That the use of the planned increase of**
 25 **reserves could be more properly applied to maintaining**

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1 **existing rates, in this case, system access and water**
 2 **stewardship. And that would provide rate stability to**
 3 **the member agency, right.**
 4 Q. So you say, "Thus providing overall rate
 5 stability to agencies."
 6 Just reading that I got the impression you
 7 thought that was a useful thing to do?
 8 **A. Yes.**
 9 Q. Further, further down the page, you actually
 10 discuss the system power rate. Do you see that? You
 11 have a numbered paragraph.
 12 **A. I do.**
 13 Q. What you say there about the system power rate,
 14 the only thing you say about it there is it is kind of
 15 positive. Would you agree?
 16 **A. Yes. It was the first time that we were able**
 17 **to distinguish with specificity the system power rate in**
 18 **its detail, so we thought that was -- we wanted to give**
 19 **kudos where we could for doing that.**
 20 Q. The answer to my question was, yes, it was a
 21 positive thing?
 22 **A. Yes, it was.**
 23 Q. You say, "it is an excellent example of rate
 24 component transparency." Is what you wrote?
 25 **A. Yes.**

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1 Q. You don't -- you didn't actually hear, say, by
 2 the way, we think it is unlawful; you don't see that in
 3 that paragraph?
 4 **A. Not in that paragraph.**
 5 Q. Or anywhere in that letter. You don't say that
 6 use of power, inclusion of power in the rate is
 7 unlawful?
 8 **A. Yes, that's true. We kind of reference State**
 9 **Water Project in the next section.**
 10 Q. Sure. We will come to that.
 11 You did not request or even suggest that the
 12 State Water Project costs come out of the power rate?
 13 **A. Not in this paragraph, no.**
 14 Q. In the next paragraph you write about water
 15 delivery costs. Do you see that?
 16 **A. Yes, I do.**
 17 Q. There you do say that, "San Diego objects to
 18 the inclusion of significant water supply costs, e.g.,
 19 State Water Project costs, as a component in
 20 Metropolitan's system access rate."
 21 Do you see that?
 22 **A. Yes, I do.**
 23 Q. That is part of what we're talking about, what
 24 this lawsuit is about; right?
 25 **A. Correct.**

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1 Q. You go on to explain why San Diego objects.
 2 You say, and I quote, "The inclusion of supply costs in
 3 the system access rate creates subsidies for
 4 Metropolitan's supplies and increased costs for water
 5 delivery. This result sends inappropriate economic
 6 signals on both the costs of alternative supplies and
 7 appropriate delivery costs."
 8 Do you see that?
 9 **A. I do.**
 10 Q. At that time you thought that those costs,
 11 actually, that it was unlawful, it was illegal?
 12 **A. Yes, we believed it was unlawful.**
 13 Q. But you decided not to put that in the letter?
 14 **A. Not in this letter.**
 15 Q. Well, let me ask you: Before this lawsuit was
 16 filed, are you aware of any written communication that
 17 you wrote to anyone at Metropolitan saying that any of
 18 these challenged rates were illegal or unlawful?
 19 **A. I cannot recall offhand a written letter that**
 20 **says, hello, these rates are unlawful.**
 21 Q. Are you aware of any written communication,
 22 prior to the filing of this lawsuit, at any time, where
 23 anybody at San Diego tells anybody at Metropolitan that
 24 the inclusion of these State Water Project costs and the
 25 water stewardship rate in the unbundled conveyance rate

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1 is illegal?
 2 **A. In writing?**
 3 Q. Yes.
 4 **A. No.**
 5 Q. That would be a pretty important thing,
 6 wouldn't it? I mean, these contracts involve millions
 7 and millions of -- the conveyance of water in these
 8 charges involve tens of millions of dollars, don't they?
 9 **A. Yes, sir, they do.**
 10 Q. If somebody thought it was illegal, they are
 11 illegally being charged tens of millions of dollars, or
 12 that a proposal was on the table that would contemplate
 13 illegally charging tens of millions of dollars, that
 14 would be something significant, wouldn't you agree?
 15 **A. It is something significant, yes.**
 16 Q. And there is nothing in this letter where you
 17 say that --
 18 Let me turn now to the water stewardship rate
 19 and what you write there. The last paragraph on that
 20 page, "The Water Authority" -- it says, "The Water
 21 Authority supports the goal of increasing the production
 22 of recycled water and increasing support for economic
 23 water conservation programs, requiring an increase in
 24 the water stewardship rate. The Water Authority would
 25 like to continue to support local resource management

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1 and development programs," and it goes on. You can read
 2 ahead and read it to yourself.
 3 There is nothing there where you say the water
 4 stewardship rate should not be included in the water
 5 delivery costs or the costs of conveyance, is there?
 6 **A. Well, it references that the Water Authority**
 7 **believes that these goals could be met without**
 8 **unnecessarily increasing the system access charge in the**
 9 **water stewardship rate this year.**
 10 **So that was our reference to they should not be**
 11 **in the transportation rates.**
 12 Q. There is nothing there where you indicate or
 13 even suggest that you thought that the inclusion of the
 14 water stewardship rate charges was actually unlawful or
 15 illegal?
 16 **A. Correct.**
 17 Q. Did you have any role in the negotiation and
 18 approval of the exchange agreement that ended up being
 19 signed in October of 2003?
 20 **A. Yes, I did.**
 21 Q. And what was your role?
 22 **A. I was the team leader of the negotiating team.**
 23 Q. And do you recall that, just kind of jumping
 24 into the middle of that, that around August of 2003, San
 25 Diego proposed to Metropolitan two different ways of

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1 entering into this conveyance arrangement for the water
 2 that San Diego had contracted to get; do you recall?
 3 **A. I do.**
 4 Q. And if we could take a look at DTX 8- -- just a
 5 second. DTX 829.
 6 MR. QUINN: This is not in evidence but there
 7 isn't an objection to it and I would offer this, your
 8 Honor.
 9 MR. KEKER: No objection.
 10 THE COURT: DTX 829 is admitted.
 11 (exhibit 829 was received into evidence.)
 12 Q. BY MR. QUINN: You are in the e-mail string
 13 down at the bottom, between you and Mr. Campbell, and
 14 Mr. Campbell refers it up to Lee Miller, I guess.
 15 **A. Yes.**
 16 THE COURT: Willer, W-I-L-L-E-R.
 17 MR. QUINN: Thank you, your Honor.
 18 Q. Who is Lee Willer?
 19 **A. She was an employee of the Water Authority who**
 20 **was a subordinate of Campbell.**
 21 Q. This is dated in -- your email is dated
 22 September 8. This is, I guess, kind of early on, not
 23 too long after the idea of these two different options
 24 have been put on the table; is that right?
 25 **A. Correct.**

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1 Q. In your email you ask Mr. Campbell to develop
 2 some written material for San Diego's board concerning
 3 the potential deal points for this exchange agreement?
 4 **A. Yes.**
 5 Q. Mr. Campbell then writes to Mr. Willer asking
 6 also, "How are you doing on the last canal lining
 7 analysis? We talked about comparing the exchange
 8 agreement versus wheeling rate differential and
 9 spreading the difference over canal lining water for 75
 10 years. I would like to do some escalation sensitivities
 11 on the MWD wheeling rate, two percent, three percent,
 12 four percent, to see the per AF" --
 13 I have come to learn that's acre-foot.
 14 **A. Yes, it is.**
 15 Q. -- "on the canal lining water."
 16 Do you see that?
 17 **A. I do.**
 18 Q. What was requested here was an analysis of the
 19 assumption that the MWD conveyance or wheeling rate
 20 would escalate over a 75-year period; correct?
 21 **A. Right. We were doing a range of escalations.**
 22 Q. Among the ranges you did, do you ever recall
 23 being a range of escalations done where you only looked
 24 at a five-year period, and assume those rates would only
 25 be in effect for five years?

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1 **A. No. We actually did it on a worst-case**
 2 **scenario.**
 3 Q. If you look at your e-mail, the second at the
 4 bottom, in the second sentence in the first paragraph,
 5 where it says, "The handout needs to articulate the deal
 6 points and identify the canal lining projects and its
 7 water as an alternative path that is at the sole
 8 discretion of the authority."
 9 Do you see that?
 10 **A. Yes.**
 11 Q. Do you recall that Metropolitan, when these two
 12 options were put on the table by San Diego, Metropolitan
 13 came back to San Diego and said, "They look roughly the
 14 same to us from an economic standpoint. San Diego, you
 15 can choose which one. You choose, Option-1 or
 16 Option-2." Do you recall that?
 17 **A. I do recall that Metropolitan said that they**
 18 **were okay with either Option-1 or Option-2.**
 19 Q. Right. I was interested in an answer you gave
 20 a moment ago. Are you telling us the reason you didn't
 21 run the numbers, the projections for five years, is
 22 you're only interested in a worst-case analysis?
 23 **A. Yes, a worst-case scenario to present to my**
 24 **board, so that they knew if, in fact, we were**
 25 **unsuccessful in negotiating what we thought was the**

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1 **lawful wheeling rate, that they knew what their exposure**
 2 **would be.**
 3 Q. You didn't think the board would be interested
 4 in knowing what the future scenarios might look like if
 5 the rate structure was only in place for five years?
 6 **A. No. They want to know what the worst case is.**
 7 **You hope for the best but you plan for the worst.**
 8 **So we did the worst-case scenario in a two to**
 9 **five percent, I believe it was, escalation, so we knew**
 10 **what our maximum exposure would be.**
 11 Q. So that's your experience in the business world
 12 when you're looking at a particular potential deal. You
 13 don't look at -- you only look at a worst case. You
 14 don't run the numbers for what the case is, for what you
 15 hope to achieve, it's not the worst case; you don't run
 16 those numbers?
 17 **A. We did not. We were under a very short time**
 18 **period. We were talking about a huge risk that we were**
 19 **taking on, and I would rather tell my board what I**
 20 **believed was the worst-case scenario so they wouldn't**
 21 **come back and say, why didn't you tell me what that**
 22 **maximum exposure was.**
 23 Q. I understand, ma'am, why you -- the board would
 24 want to know worst case, and I understand why you would
 25 want to tell them worst case. My question is a little

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1 different.
 2 Isn't it your experience in the business world,
 3 that decision makers also want to see a projection based
 4 on what you realistically think you can achieve,
 5 something that is not the worst case?
 6 MR. KEKER: Objection. Argumentative. No
 7 foundation. And I move to strike the speech at the
 8 beginning.
 9 THE COURT: Overruled.
 10 Go ahead.
 11 THE WITNESS: We had been on a monthly or twice
 12 or three times a month been talking to our board about
 13 the various options. The All-American Canal option was
 14 a new option, and that was the focus of what my board
 15 needed to look at, was whether to take Option-1, which
 16 was already out there, or Option-2, which was new. And,
 17 therefore, I directed staff to take the number that
 18 Metropolitan had, escalate it out, and assuming that it
 19 would not change over that 45 years, what was our
 20 exposure based on the escalation of two to five percent.
 21 That is what I wanted the board to know, what the
 22 maximum exposure would be so they could make the most
 23 informed decision.
 24 The worst thing for a manager is to have a
 25 board member come back and say why didn't you tell me

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1 that was possible.
 2 Q. You know with respect, I don't think that
 3 answered my question, which was directed to, in the real
 4 world, if you want to give them, I think you just said,
 5 you want to give them the best information, don't you
 6 also want to give them a projection, based not just on
 7 the worst case but by what you hoped to achieve in
 8 negotiating the agreement? Don't you want them also to
 9 have that information?
 10 **A. No. Because the exposure would be less than**
 11 **that maximum that you provided to the board. It would**
 12 **be nothing but better than what you gave to the board as**
 13 **the worst-case scenario. That would be a positive.**
 14 **They would be happy. So, no.**
 15 Q. So the way it works at San Diego is the board
 16 only wants to hear worst-case scenarios. They are not
 17 interested in hearing what you think is actually
 18 realistic or what you can achieve? Is that your
 19 experience at San Diego?
 20 **A. In this case it is.**
 21 Q. Is it your testimony that you had some
 22 discussion with some board members where they said to
 23 you, "No, don't present us with any scenarios reflecting
 24 what you really intend to achieve in this agreement or
 25 what you can think you can realistically do. We are not

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1 interested in that. All we want to see is the absolute
 2 worst case?" Did you have a conversation like that with
 3 anybody on the San Diego board?
 4 **A. No, I did not.**
 5 MR. QUINN: Let's take a look at DTX 830.
 6 I understand this is not in evidence and I
 7 understand there is no objection.
 8 THE COURT: The PowerPoint slides.
 9 MR. KEKER: No objection, your Honor.
 10 MR. QUINN: We have offered this.
 11 THE COURT: DTX 830 is admitted.
 12 (Exhibit 830 was received into evidence.)
 13 Q. BY MR. QUINN: Just so you know where I'm
 14 going, ma'am, I want to walk through the written records
 15 that exist leading up to the execution of the exchange
 16 agreement in October.
 17 What we're looking at here, the cover note is
 18 an e-mail from Amy Chen to some people, including
 19 yourself, and it is dated September 10, 2003; correct?
 20 **A. Correct.**
 21 Q. Who is Amy Chen?
 22 **A. She is one of my staff members who is assigned**
 23 **the MWD program and she's located in Los Angeles in the**
 24 **MWD building.**
 25 Q. She lives in enemy territory. It's a joke.

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1 I'm sorry.
 2 Does this appear to be -- maybe you can tell me
 3 what that presentation, these PowerPoints seem to
 4 reflect?
 5 **A. Right. Based upon the cover memo of Gil Ivey,**
 6 **who is an employee of Metropolitan was, sending to my**
 7 **staff member the presentation that was made at the MWD**
 8 **water planning quality and resources committee meeting**
 9 **on the QSA.**
 10 Q. This is a document generated by Metropolitan,
 11 to your understanding?
 12 **A. Yes.**
 13 Q. Do you have any understanding why it was sent
 14 to the folks at San Diego?
 15 **A. I don't have any specific knowledge. We were**
 16 **trying to keep each agency informed of what the other**
 17 **one was doing.**
 18 Q. If you thumb through, I think, four or five
 19 pages, you will see one slide that is entitled at the
 20 top "peace treaties." You see that?
 21 **A. Yes.**
 22 Q. It says, "Wheeling laws, no legislative change
 23 by San Diego and MWD."
 24 **A. Yes.**
 25 Q. Do you see that?

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1 **A. I do.**
 2 Q. And then if you skip forward a couple of pages
 3 there is a heading that says, "Alternate SDCWA
 4 Pathways." Two bullets. "Two options available. SDCWA
 5 to choose by October 1."
 6 **A. Yes.**
 7 Q. That is probably referring to that San Diego
 8 can choose which option?
 9 **A. Correct.**
 10 Q. The next slide at the top, it says, "SDCWA
 11 Option-1."
 12 And the second bullet there is "SDCWA pays
 13 discount wheeling rate for 35 years or 5.1 MAF."
 14 **A. Million acre-feet.**
 15 Q. So Option-1, that was -- this is we are going
 16 to continue just to go -- we will continue under that
 17 exchange agreement that we negotiated a few years ago;
 18 right?
 19 **A. Correct.**
 20 Q. Which had a discounted wheeling rate in it?
 21 **A. We would argue it's not discounted.**
 22 Q. If you look at the next slide on the top, SDCWA
 23 Option-2, the second option, what Met is saying is here,
 24 "SDCWA pays full wheeling rate for IID, SDCWA transfer
 25 water and canal lining conserved water."

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1 Do you see that?
 2 **A. I do.**
 3 Q. And you understood that was Met's position
 4 about what the proposal was?
 5 **A. Yes. It doesn't reference a year on this one.**
 6 **So I can't tell how long they thought that would be.**
 7 Q. It just says full wheeling rate?
 8 **A. Yes.**
 9 Q. You understood that was their understanding and
 10 expectation?
 11 **A. No, I did not know that full wheeling rate --**
 12 **it's not the same language we used, but I presume it**
 13 **referenced the \$253 rate.**
 14 Q. And that's what ultimately ended up going into
 15 the agreement?
 16 **A. It did.**
 17 MR. QUINN: And then if we could look at DTX
 18 837, which has not been admitted. I understand there is
 19 no objection to it. We would offer it, your Honor.
 20 MR. KEKER: No objection.
 21 THE COURT: DTX 837 is admitted.
 22 (Exhibit 837 was received into evidence.)
 23 MR. KEKER: It is also 846. You're right. No
 24 objection.
 25 Q. BY MR. QUINN: The top document is an email

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1 from you dated September 16, 2003?
 2 **A. Yes.**
 3 Q. And you sent this to all board members --
 4 **A. Yes.**
 5 Q. -- is that right? Concerning QSA update and
 6 attached fact sheet and Campbell memorandum, you
 7 attached those two documents; right?
 8 **A. I did.**
 9 Q. The first attachment, if we could look at that,
 10 the first page, it says, "Fact Sheet, September 16,
 11 2003." And this is a fact sheet that was prepared at
 12 San Diego outlining the two options; right?
 13 **A. Yes.**
 14 Q. And the second attachment is the memorandum
 15 from Bob Campbell outlining the financial analysis of
 16 the two options; correct?
 17 **A. Yes.**
 18 Q. So if we could just look first at the fact
 19 sheet.
 20 And if we could go to the second page, which
 21 says, "Option-2" at the top. If we would just enlarge,
 22 say, the top third. The second bullet, in describing
 23 the Option-2, it says "MWD assigns its canal lining
 24 rights to SDCWA. Canal lining water rights to SDCWA.
 25 Project yields 77,700 acre-feet annually for 110 years.

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1 8.5 million acre-feet of water." That's a lot of water?
 2 **A. It's a lot of water.**
 3 Q. Worth a lot?
 4 **A. Worth a lot.**
 5 Q. Worth billions, with a B, of dollars; correct?
 6 **A. I don't know. But it is worth a lot of -- it**
 7 **has high value.**
 8 Q. It is certainly worth -- 77,700 acre-feet
 9 annually for 110 years is certainly worth more than
 10 \$100 million?
 11 **A. Absolutely.**
 12 Q. Absolutely. Certainly worth more than
 13 \$500 million?
 14 **A. I don't know.**
 15 Q. You don't know?
 16 **A. I'd have to do a calculation of what it would**
 17 **be worth compared to other transfers.**
 18 Q. Would you dispute that that quantity of water
 19 is worth -- I understand you don't know whether it's
 20 worth billions. Are you in a position to dispute that?
 21 Would you dispute -- if somebody said that was worth \$2
 22 billion, with a B, would you dispute that?
 23 **A. I would not, no.**
 24 Q. You just don't know?
 25 **A. I wouldn't know what, you know, what the costs**

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1 **would be over 110 years and how to present value the**
 2 **cost of that water.**
 3 Q. How about just the current cost? Let's talk in
 4 terms of today. If you could get that much water
 5 today -- let's not worry about for now the
 6 discounting -- that would be worth billions of dollars?
 7 **A. Yes, it would be worth a lot of money.**
 8 Q. Billions?
 9 **A. Sir, I don't want to say what it's worth unless**
 10 **I had the ability to spend some time to calculate its**
 11 **value.**
 12 Q. Certainly anyone who said it might only be
 13 worth \$100,000, that would be flat-out wrong?
 14 **A. I would say it's worth much more than that.**
 15 Q. Let's go to the second attachment, the
 16 memorandum from Mr. Campbell. And I assume you would
 17 read this memo before you sent it -- before you attached
 18 it to your email to your board of directors?
 19 **A. Yes, I would have read it.**
 20 Q. And insofar as you know, everything that's in
 21 this memo is accurate?
 22 **A. Yes.**
 23 Q. And the description of Option-2, in this memo,
 24 there in that first paragraph, it says, "The assignment
 25 of Met's canal lining project water rights to SDCWA, in

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1 consideration for SDCWA's paying Met's wheeling rate, in
 2 lieu of the exchange agreement to transport the
 3 IID/SDCWA transfer water and canal lining water.
 4 Currently the Met wheeling rate is set at \$253 per
 5 acre-foot, including the system access and water
 6 stewardship rates and power cost."
 7 Do you see that?
 8 **A. I do.**
 9 Q. And then it says, where it says, "In
 10 consideration," what you understood that to mean was
 11 that Met would get what's stated there, Met's wheeling
 12 rate, instead of the rate under the 1998 exchange
 13 agreement, which is what the existing exchange agreement
 14 provided for; right?
 15 **A. Yes. That we would pay the \$253 instead of**
 16 **that 90-dollar rate.**
 17 Q. So you were going to pay a lot more?
 18 **A. Yes.**
 19 Q. You understood that \$253, probably beating the
 20 dead horse here, but it included that system access
 21 rate, the power rate with the State Water Project costs
 22 built into both of them, and the water stewardship rate;
 23 correct?
 24 **A. Yes. That would be included in that \$253 that**
 25 **we would pay for a minimum of the five years.**

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1 Q. In the next full paragraph Mr. Campbell writes
 2 about how the staff used two different approaches to
 3 evaluate the costs of the two options.
 4 **A. Yes.**
 5 Q. And in both approaches he assumed that under
 6 Option-2 Met's wheeling rate would escalate over the
 7 term of the contract; correct?
 8 **A. Correct.**
 9 Q. In the last paragraph on page one, third
 10 sentence he writes, "The Met wheeling rate is
 11 established annually by the Met board of directors and
 12 is assumed to escalate over time." Correct?
 13 **A. Correct.**
 14 Q. In this memorandum that you sent, you said we
 15 are anticipating that the wheeling rate, at least for
 16 purposes of trying to value this option, we assume the
 17 wheeling rate will include these components, will be
 18 starting at \$253, and there will be a factor for
 19 inflation over time; correct?
 20 **A. That -- I'm not sure about the way we would**
 21 **value this option. But that -- what the potential costs**
 22 **could be for this option.**
 23 Q. Right.
 24 **A. It would be done in this manner.**
 25 Q. Thank you. You are trying to compare the two,

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1 and in looking at the potential costs of the second
 2 option, the staff is looking at these two different
 3 ways, but they are assuming it is going to start at 253
 4 and escalate up over time; right?
 5 **A. Right. In this calculation or analysis, that**
 6 **is exactly what we're doing.**
 7 Q. Again, there is no numbers here run on just a
 8 five-year scenario. This only --
 9 **A. No.**
 10 Q. -- the 253 and escalator is only for five
 11 years?
 12 **A. No. Because the canal lining was for 110**
 13 **years.**
 14 Q. A week after that you helped prepare and
 15 approved a memorandum to the water policy committee?
 16 **A. Yes.**
 17 MR. QUINN: And let's take a look at DTX 856.
 18 Not admitted yet. No objection, as I understand it.
 19 We'd offer this, your Honor.
 20 MR. KEKER: No objection.
 21 THE COURT: DTX 856 is admitted.
 22 (Exhibit 856 was received into evidence.)
 23 Q. BY MR. QUINN: What is the water policy
 24 committee?
 25 **A. It is a committee made up of approximately 14**

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1 **members of my board of directors.**
 2 Q. If you go to the last page, you will see an
 3 indication there, I think it's the last lines on the
 4 page, this is a memorandum that was -- that you prepared
 5 and approved?
 6 **A. Yes.**
 7 Q. Also prepared by Mr. Campbell and
 8 Mr. Hentschke, the general counsel?
 9 **A. Correct.**
 10 Q. If you turn to page two in this memo that you
 11 wrote, you describe Option-1 and Option-2?
 12 **A. Yes.**
 13 Q. In particular to Option-2, if we can enlarge
 14 that paragraph, you wrote, "In consideration for Met's
 15 assignment of All-American and Coachella canal lining
 16 water rights to the authority, the authority would pay
 17 Met's lawful wheeling rate in lieu of the exchange
 18 agreement. The Met's current published wheeling rate is
 19 \$253 per acre-foot and is comprised of the system access
 20 charge, water stewardship charge and power cost."
 21 Do you see that?
 22 **A. I do.**
 23 Q. In this memo, at any point, do you tell the
 24 water policy committee when you're laying this out that
 25 you think those charges are unlawful?

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1 **A. In the public sessions we did not.**
 2 Q. Go back to my question. In this memo.
 3 **A. In the memo, no, we did not.**
 4 Q. Did you ever write a memo to your board, did
 5 you, considering these various proposals and leading up
 6 to the execution of the agreement, did you personally
 7 write a memo to your board at any point which indicates
 8 that any of these charges are unlawful?
 9 **A. We never provided any written documentation to**
 10 **our board related to this. It was never in writing.**
 11 Q. Related to this --
 12 **A. Related to our belief that Met's wheeling rate**
 13 **at that time was not lawful. We did not provide**
 14 **anything in writing to the board on that.**
 15 Q. It wasn't important enough to include in any of
 16 the documents?
 17 **A. Oh, not in the documents. It was absolutely**
 18 **important for the board to know that what our concerns**
 19 **were about Met's rates not being lawful and those -- and**
 20 **those discussions, and there were many of those**
 21 **discussions were held with our board.**
 22 Q. You don't have anything in writing that you can
 23 share with us?
 24 **A. We do not provide any written documentation to**
 25 **the board for closed session items.**

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1 Q. So this is something that -- this view about
 2 the illegality is something you wanted to keep in closed
 3 session?
 4 **A. Absolutely.**
 5 Q. You regarded that as something that was
 6 confidential?
 7 **A. Absolutely.**
 8 Q. You didn't want that to be publicly known, that
 9 you thought these rates were --
 10 **A. The discussions, it was not appropriate to have**
 11 **those discussions in open session.**
 12 THE COURT: Ma'am, you have to just let him
 13 finish his question. Just give it a beat and then
 14 answer.
 15 Q. BY MR. QUINN: I am not asking about the
 16 discussions. I am focusing on your view that these
 17 rates were illegal. You didn't want that to be publicly
 18 known.
 19 **A. No, that is not true.**
 20 Q. If you look at pages five and six, there is a
 21 discussion of the staff, two approaches to the analysis
 22 of the cost of Option-1 and -2.
 23 Do you see that?
 24 **A. Yes, I do.**
 25 Q. And, again, each of those approaches assumes

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1 the \$253 rate will escalate over time, using inflation
 2 factors ranging from two to five percent?
 3 **A. Yes.**
 4 Q. And, again, if we look in here, there's nothing
 5 in here about proposed -- any other proposed alternative
 6 scenario, like a five-year period, in terms of length of
 7 the wheeling deal?
 8 **A. There is not.**
 9 Q. At the bottom of page six there is a beginning
 10 of a summary in which you present various factors to
 11 assist the board in assessing the risks and benefits of
 12 Option-2. Do you see that?
 13 **A. I do.**
 14 Q. On the next page, page 7, you discuss supply
 15 reliability, saying "There is no other readily available
 16 water supply with the priority level, cost amount and
 17 duration of water supply resulting from the canal
 18 lining." Do you see that?
 19 **A. I do.**
 20 Q. How did you know that, that there wasn't other
 21 similar available water supply?
 22 **A. Because we had been negotiating for so long and**
 23 **were very familiar with the Colorado River and the**
 24 **availability of various supplies on the river.**
 25 Q. On page 7 you indicate how the marginal cost of

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1 the canal lining water compares favorably to other water
 2 transfers that range in supply costs alone --
 3 **A. Yes.**
 4 Q. -- between \$250 and \$300; do you see that?
 5 **A. I do see that.**
 6 Q. On page 8 under "Supply risks are significantly
 7 lower," you write, and I quote, "While choosing Option-2
 8 exposes the authority to higher wheeling costs,
 9 comprised of Met rate components and system access
 10 charge, stewardship and fluctuations of power costs, it
 11 protects the authority from even greater exposure
 12 associated with securing an alternative imported supply,
 13 whether or not that supply" -- I'm sorry -- "securing an
 14 alternative imported supply, whether or not that supply
 15 comes from Met or another seller."
 16 Did you believe that to be true at the time?
 17 **A. Yes.**
 18 Q. And you recommended that Option-2 be approved;
 19 right?
 20 **A. I did.**
 21 Q. Notwithstanding your view that these rates are
 22 illegal; correct?
 23 **A. Correct.**
 24 Q. And you concluded that this was a good deal for
 25 San Diego, to start with the wheeling rate -- it was a

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1 good deal even if, worst-case scenario, if you had to
 2 pay this illegal wheeling rate of \$253, with an
 3 inflation factor of up to five percent over the life of
 4 the contract, even at that scenario you were
 5 recommending that this was a good deal for San Diego?
 6 **A. Yes.**
 7 MR. QUINN: If we could turn now to DTX 221,
 8 which is not yet admitted, and to which the Plaintiff
 9 has objected on the grounds of relevance.
 10 THE COURT: Are you offering it now?
 11 MR. QUINN: I am offering it, your Honor.
 12 THE COURT: I am trying to figure out if you
 13 are going to ask the witness some questions to lay a
 14 foundation. Why don't you tell me what the relevance is
 15 and then they can tell me why it's not.
 16 MR. QUINN: This raises -- this addresses the
 17 same issues, your Honor, about the risk, the wheeling
 18 rate, the proposed exchange deal. It talks also about
 19 the other related agreements, the allocation, the
 20 quantification settlement agreement and identifies the
 21 various risks of Option-2.
 22 MR. KEKER: Your Honor, I think our
 23 objection -- I know our objection as to relevance is
 24 based on that portion that talks about everything but
 25 what this trial about, which is the terms of the

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1 exchange agreement. And this going back to the motive,
 2 the other benefits and so on is a complete red herring
 3 to the issue of what the parties agreed to in 2003 and
 4 5.2 of the agreement. We said before, we are all over
 5 the place with parole evidence; we get it. But our
 6 argument is going to be read the contract and follow it,
 7 and none of this atmosphere and the earth cooled and
 8 then land was formed and canals were dug and so on is
 9 useful to making that decision.
 10 So that's our objection, and I'll sit down.
 11 THE COURT: I understand. I do understand your
 12 position, you should look at the other contracts. And
 13 part of the defense is that we should, and so it is
 14 admissible on that basis. DTX 221 is admitted.
 15 (Exhibit 221 was received in evidence.)
 16 Q. BY MR. QUINN: Do you recall this -- we are now
 17 up to September 25, 2003, just a few days, a couple of
 18 weeks before the exchange agreement is actually signed?
 19 **A. Yes, a few days before the deadline, where we**
 20 **had to make a decision.**
 21 Q. It actually was signed -- somebody help me --
 22 do you remember the date of the exchange agreement?
 23 **A. I want to say October 10.**
 24 Q. I am hearing a chorus of October 10, so I think
 25 you're right.

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1 You recall this PowerPoint presentation here,
 2 DTX 221, was presented to the board at San Diego?
 3 **A. Yes. This is our public PowerPoint**
 4 **presentation.**
 5 Q. You thought this was accurate?
 6 **A. Yes.**
 7 Q. You wouldn't have submitted it otherwise?
 8 **A. Yes.**
 9 Q. If you turn, please, to slide 2.
 10 Fair to say that this shows that San Diego --
 11 this pie here shows that San Diego was fairly dependent
 12 on Metropolitan for their water supply?
 13 **A. In 1991 we were 95 percent dependent.**
 14 Q. Do you know what that was in 2003?
 15 **A. In 2003 we had reduced it to maybe -- I am**
 16 **going to say maybe 75 percent or so, 80 percent.**
 17 Q. Would it be true to say that San Diego had, for
 18 a long time, sought to secure its own independent supply
 19 of water?
 20 **A. Yes.**
 21 Q. And if you turn, please, to slide 21, the
 22 heading at the top is "Option-2, Financial
 23 Risk/Benefit."
 24 Here you identify the risk under Option-2,
 25 risk: "Exposure to MWD wheeling rate."

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1 Do you see that?
 2 **A. Yes.**
 3 Q. Under that exchange agreement that had already
 4 been in place, which would have been Option-1, for at
 5 least 30 years you knew what the wheeling charges were
 6 going to be; correct?
 7 **A. Correct.**
 8 Q. Because there was -- that starts out at a
 9 certain number, \$80 and \$90, and then an index to
 10 increases; right?
 11 **A. Yes.**
 12 Q. But you didn't have that under the proposal
 13 under Option-2?
 14 **A. Correct.**
 15 Q. The risk was, it says here, "Exposure to the
 16 MWD wheeling rate." You mean for the term of the
 17 contract; right?
 18 **A. Certainly for the first five years we were**
 19 **exposed to it -- to Met's wheeling rate. And then after**
 20 **five years, depending on what the Water Authority chose**
 21 **to do, we were exposed to the lawful wheeling rate.**
 22 Q. I mean, even under San Diego's interpretation,
 23 if we look at that exchange agreement, we won't see
 24 anything in there specifying what the price would be for
 25 any year, you know, years two to five or after five?

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1 **A. We have -- yes, there's nothing in the**
 2 **agreement that talks about what a specific dollar amount**
 3 **would be after year five.**
 4 Q. Or what the increases would be?
 5 **A. Correct.**
 6 Q. There was no index, in other words, like there
 7 was under the previous exchange agreement?
 8 **A. Correct.**
 9 THE COURT: Whenever you get to a good point in
 10 the next five minutes or so, just pick a time and take a
 11 break.
 12 MR. QUINN: Why don't I finish this exhibit.
 13 It won't take long.
 14 THE COURT: Sure.
 15 Q. BY MR. QUINN: And then you say, you describe
 16 here the cost for benefit received from canal lining.
 17 You describe that as, "The present value difference
 18 between the 1998 exchange agreement cost and the MWD
 19 wheeling rate cost for 35 years." Do you see that?
 20 **A. I do.**
 21 Q. And it refers there, below that, to "Inflation
 22 sensitivity for the wheeling rate." Do you see that?
 23 **A. I do.**
 24 Q. That is something that needs to be considered?
 25 **A. Yes.**

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1 Q. So it is still anticipated that San Diego would
 2 pay the MWD wheeling rate for 35 years and that rate
 3 would increase over time; correct?
 4 **A. Yes. As I explained earlier, we had a range of**
 5 **escalations that we used to determine what we felt was**
 6 **the maximum wheeling rate that we would be exposed to.**
 7 Q. So if we look at the present value analysis
 8 that's done here, and you are kind of summarizing here,
 9 that present value analysis, again, was based on an
 10 assumption that the Met wheeling rate would escalate
 11 over the existing rate of the life term of the contract?
 12 **A. Correct.**
 13 Q. If we turn to slide 22, "Option-2, financial
 14 risk analysis," that identifies what we have been
 15 talking about, the price under the 1998 agreement as \$97
 16 an acre-foot for 2003. Do you see that?
 17 **A. Yes.**
 18 Q. It goes on to say, "Risk is in difference
 19 between Met wheeling rate cost and wheeling rate cost
 20 under the exchange agreement." And using the numbers in
 21 the slide the risk was the difference between \$253 and
 22 \$97 per acre-foot or \$156 per acre-foot with an
 23 inflation factor for each?
 24 **A. Yes.**
 25 Q. That was the important information that you

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1 were presenting to the board in making this decision;
 2 correct?
 3 **A. Absolutely.**
 4 Q. It says, "The present value of differential is
 5 the cost of getting the canal lining water benefit."
 6 Right?
 7 **A. Right.**
 8 Q. So the board understood that the canal lining
 9 water was a trade-off for the payment of the existing
 10 Met wheeling rate plus an inflation factor?
 11 **A. I don't think that's exactly correct.**
 12 **I think that they felt that the canal lining**
 13 **project was a trade for giving up the 1998 exchange**
 14 **agreement for the exchange agreement that was proposed**
 15 **in -- that now is the 2003. It is not correct that we**
 16 **traded absolutely the canal lining project for the Met**
 17 **determined wheeling rate for 45 years.**
 18 Q. In terms of the analysis that was presented to
 19 the board --
 20 **A. Yes. In terms of the analysis, yes.**
 21 Q. -- it was presented to the board, and what you
 22 were asking the board to make its decision based on, you
 23 were presenting them this present value analysis and
 24 comparing the cost.
 25 In terms of the analysis that was presented to

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1 the board --
 2 **A. Yes. In terms of the analysis, yes.**
 3 Q. It was presented to the board, and what you
 4 were asking the board to make its decision based on, you
 5 were presenting them this present value analysis and
 6 comparing the cost; correct?
 7 **A. Right. We were comparing the costs and the**
 8 **maximum exposure of costs.**
 9 Q. And we looked earlier at Mr. -- is it
 10 Campbell's memorandum? -- where he talked in terms
 11 about the consideration for the canal lining water
 12 paying the wheeling rate; do you recall that?
 13 **A. Yes.**
 14 Q. You understand that -- I mean, you don't have
 15 any disagreement with that? That was part of the
 16 consideration, forgetting this huge volume of water for
 17 110 years was agreeing to pay this much increased
 18 wheeling rate; correct?
 19 **A. Yes, yes. For that five years.**
 20 Q. And that was -- those were key points in the
 21 deal; fair?
 22 **A. Yes.**
 23 Q. They are reflected in the -- that deal, those
 24 key points of this deal are reflected in different
 25 documents, the exchange agreement and the allocation

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1 agreement; correct?
 2 **A. Yes.**
 3 Q. You can't just read one of those documents to
 4 have an understanding of what the deal was; correct?
 5 **A. The total deal?**
 6 Q. Yes.
 7 **A. It would be -- you would have to look at all**
 8 **30-some documents in the QSA to actually understand the**
 9 **total deal, not just one or two.**
 10 Q. So, again, after considering all this and the
 11 risk and benefits described in the information you gave
 12 the board, the San Diego board approved Option-2;
 13 correct?
 14 **A. Yes.**
 15 MR. QUINN: This would be a good time, your
 16 Honor.
 17 THE COURT: I will see everybody in 15 minutes.
 18 Thank you very much.
 19 (Recess.)
 20 MR. KEKER: Your Honor, could I raise a point
 21 that I was going to raise at the end of the day but I am
 22 afraid if I wait it will be in a rush for 4:00 and we
 23 should do it now. And that is the question of time.
 24 When we -- we have used about four hours to
 25 present our direct case, as promised. Your order says

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1 we get nine hours and they get 12 hours, and just
 2 basically we don't think that's fair. We had three
 3 witnesses. They've got seven witnesses. I'm not sure
 4 our clocks and your chess clock are a little bit
 5 different. The clerk let us look at your chess clock.
 6 We basically used, we think, us about 4:45 and
 7 them about 5:14. What I am suggesting is you give us
 8 equal time and we use three days in the week that you
 9 set aside four days, and we get in 12 hours of testimony
 10 split evenly with the rest of the witnesses, rather than
 11 have us at a three-hour disadvantage, for what we don't
 12 think there is any good reason.
 13 THE COURT: Would you like to be heard?
 14 MR. QUINN: If the Court is going to consider
 15 that, yes. Otherwise we -- we want some more time, too.
 16 Remember, they were telling us this could all be done
 17 this week. We cut witnesses. Told them to send Amy
 18 Chen home, for example. We scrambled and cut
 19 examinations and tried to squeeze in the time we had.
 20 They just had a damages case to put on. They say
 21 everything else has been decided. We have affirmative
 22 defenses. I think the Court had good reasons for not
 23 giving both sides, at this point, the same amount of
 24 time.
 25 THE COURT: I have actually already -- I spent

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1 quite a bit of time trying to figure this out, coming up
 2 with some rules of thumb about how to deal with the
 3 amount of time people need on direct and cross. I don't
 4 think anything's changed. So I'm not going to grant the
 5 motion. I am just going to live with the time we set.
 6 MR. KEKER: The second request, your Honor, is
 7 that in the back of the courtroom Jessica Fromm, who is
 8 an 8th grade teacher from Denver, is here and she wanted
 9 to take a picture of the courtroom to show her students,
 10 and we wondered if you had any objection to her doing
 11 that.
 12 THE COURT: Of course not.
 13 MR. QUINN: I object. Mr. Kecker is going to be
 14 in the photo.
 15 THE COURT: That I understand. I appreciate it
 16 if you don't take pictures of someone who is on the
 17 witness stand. We will arrange the room. Because the
 18 witness might object to that. You can always take a
 19 picture of everybody after the witness has stepped down,
 20 if you want. If anybody else has any objection to being
 21 in a picture, please just make that known and move when
 22 the picture is being taken.
 23 Let's proceed.
 24 Q. BY MR. QUINN: Miss Stapleton, I would like to
 25 read to you again some testimony from Mr. Slater, San

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1 Diego's person most knowledgeable. And this will be
 2 from page 64 of his deposition, lines 14 to 25.
 3 "Q I want to jump back to the
 4 2003 agreement for a second.
 5 I'm jumping back here like
 6 Marty McFly. I'm jumping
 7 between time frames here.
 8 "A I'm not Marty McFly.
 9 "Q Okay. Get that on the
 10 record. 2003, the negotiations
 11 for the 2003 agreement, was it
 12 ever discussed excluding -- did
 13 any party ever propose
 14 excluding State Water Project
 15 costs from the price -- from
 16 the price, the contract price
 17 to be charged under that
 18 agreement?
 19 "A I do not recall that, no."
 20 Was Mr. Slater wrong about that?
 21 **A. He was not. We did not propose a lower price.**
 22 Q. And you also -- at no point did San Diego in
 23 negotiations for that agreement, Mr. Slater, the person
 24 most knowledgeable testified, never proposed taking out
 25 the State Water Project costs from the wheeling rate, in

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1 connection with the negotiation of that agreement;
 2 correct?
 3 **A. For the price that started, that we started**
 4 **within the exchange agreement?**
 5 Q. At no point, did any party ever propose
 6 excluding State Water Project costs from the price, the
 7 contract price to be charged under that agreement; is
 8 that true?
 9 **A. That is true.**
 10 Q. So is it your testimony, just reading between
 11 the lines, Miss Stapleton, are you saying that you
 12 brought up with Met excluding State Water Project costs
 13 in year two?
 14 **A. No.**
 15 Q. Year three?
 16 **A. No.**
 17 Q. Four?
 18 **A. No.**
 19 Q. For any year?
 20 **A. Yes.**
 21 Q. What year did you propose backing out the State
 22 Water Project costs on, you personally?
 23 **A. Yes. In year six or beyond, that we had to**
 24 **come to some agreement in that we believed the State**
 25 **water projects were not lawfully included in the rates.**

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1 Q. And who did you propose that to on the Met
 2 side?
 3 **A. Dennis Underwood.**
 4 Q. Anyone else?
 5 **A. I believe it was referenced among the group,**
 6 **which would be the Met team and the Water Authority**
 7 **team.**
 8 Q. I am trying to find out who, other than
 9 Mr. Underwood, you say you proposed taking State Water
 10 Project costs out after the five years you identified --
 11 **A. I personally?**
 12 Q. Yes.
 13 **A. I personally?**
 14 Q. Yes.
 15 **A. No. It would be just Mr. Underwood.**
 16 Q. And sadly he's deceased?
 17 **A. Yes, unfortunately.**
 18 Q. By 2005 the 2003 exchange agreement had been in
 19 effect for over a year?
 20 **A. Correct.**
 21 Q. Met initially billed San Diego for conveyance
 22 charges at that initial price of \$253?
 23 **A. Yes.**
 24 Q. And over the next five years that price
 25 escalated, just as San Diego had anticipated in those

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1 projections that you presented to the board?
 2 **A. It escalated. I can't tell you if it escalated**
 3 **between the two and five percent. I do not recall.**
 4 Q. But it did escalate every year?
 5 **A. Yes, it did.**
 6 Q. In 2005, it's true to say that San Diego did
 7 not write to Metropolitan saying that the rates were
 8 unlawful?
 9 **A. Correct.**
 10 Q. And in 2005, San Diego did not make any claim
 11 with Met that charging a price based on these unlawful
 12 rates was a breach of contract?
 13 **A. Correct.**
 14 Q. And San Diego, in 2005, did not object in
 15 writing to the price or to any invoice; true?
 16 **A. Correct.**
 17 Q. And that would be true if I asked you those
 18 same questions for 2006, 2007, 2008, 2009, your answers
 19 would be the same? Do you want me to go through them?
 20 **A. I believe we started some dialogue and there**
 21 **may be in writing some references to us beginning --**
 22 **wanting to talk about the negotiations for the wheeling**
 23 **rate.**
 24 Q. Is there any writing that you can point us to
 25 in any of those years where San Diego wrote to Met,

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1 prior to 2010, stating that the rates being charged were
 2 unlawful?
 3 **A. I cannot go to any specific document. I cannot**
 4 **recall any right now.**
 5 Q. You cannot recall, can't identify for us any
 6 document in any of those years where San Diego made a
 7 claim with Met that it was charging a price that was in
 8 breach of contract?
 9 **A. No.**
 10 Q. Or even objecting in writing to the price being
 11 charged or to any invoice before 2010?
 12 **A. I don't recall any.**
 13 Q. If you'd look at -- if we could turn to the
 14 exchange agreement itself, DTX 55, PTX 65, and turn to
 15 page 26, there is a Section 12.4(c), if you would take a
 16 look at that.
 17 And you recall this provision here that says,
 18 "In the event of a dispute over the price, SDCWA shall
 19 pay, whenever due, the full amount claimed by
 20 Metropolitan, provided, however, during the pendency of
 21 the dispute, Metropolitan shall deposit . . ."
 22 You know the provision I'm referring to?
 23 **A. I do.**
 24 Q. Unless you want me to, I won't read the whole
 25 paragraph.

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1 **A. I do know that provision.**
 2 Q. You understood since -- at any time after 2003,
 3 if San Diego disputed a price, it could deposit money
 4 with Met and Met would have to keep that money in an
 5 account until the dispute was resolved?
 6 **A. Yes.**
 7 Q. The first time that San Diego did that was in
 8 February of 2011; right?
 9 **A. Yes.**
 10 MR. QUINN: Let's look at DTX 624, not yet
 11 admitted. I understand there is no objection, and I
 12 would offer it, February 10, 2010, letter from
 13 Mr. Hentschke to Mr. Kightlinger.
 14 MR. KEKER: No objection.
 15 THE COURT: DTX 624 is admitted.
 16 (Exhibit 624 was received in evidence.)
 17 Q. BY MR. QUINN: You recognize this as a letter
 18 from San Diego's general counsel to Mr. Kightlinger?
 19 **A. Yes.**
 20 Q. This is the first time San Diego asked Met to
 21 set aside money under that Section 12.4 (c); correct?
 22 **A. Correct.**
 23 Q. There is nothing in that five-year provision,
 24 sometimes referred to as a standstill or year of good
 25 feelings, whatever -- there is nothing in that that

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1 prevented San Diego during that time from invoking this
 2 deposit procedure under 12.4 (c), was there?
 3 **A. I believe we could not challenge the rate for**
 4 **the first five years. So unless they were charging more**
 5 **than the Met established rate, we could not -- we**
 6 **couldn't dispute it.**
 7 Q. Let's take a look at that section and see what
 8 it provides that you couldn't do in the first five
 9 years, Section 5.2, pages 16 and 17.
 10 I think you will see in the second line there,
 11 it says, "For the term of this agreement neither San
 12 Diego nor Met shall seek or support in any legislative,
 13 administrative or judicial forum any change in the form,
 14 substance or interpretation of any applicable law or
 15 regulation."
 16 Do you see that?
 17 **A. I do.**
 18 Q. It refers to not taking actions in legislative,
 19 administrative or judicial forums; correct?
 20 **A. Yes.**
 21 Q. Does that refresh your recollection there was
 22 nothing that prevented San Diego from invoking this 12.4
 23 (c) procedure even during the first five years?
 24 **A. I see that.**
 25 Q. You are aware that from 2000 -- during this

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1 time frame, 2005 through 2009, Met every single year,
 2 Metropolitan's conveyance rates were submitted for
 3 approval by the Met board every year; correct?
 4 **A. Yes.**
 5 Q. You recall, if we can look at DTX 129, I think
 6 we looked at this already, in 2005 San Diego's members
 7 of the Met board voted for the wheeling rate which
 8 included the State Water Project costs and the water
 9 stewardship rate; correct?
 10 **A. Correct.**
 11 Q. As we discussed earlier, San Diego's delegates
 12 to the Met board received direction from the San Diego
 13 board as to how to vote on certain matters; right?
 14 **A. Only -- the only one I see is the one you**
 15 **referenced earlier. That's the only one that I have**
 16 **seen.**
 17 Q. Let me ask, is it generally a custom and
 18 practice on the issue of rates that San Diego's
 19 delegates will be instructed how to vote?
 20 **A. No. It's actually opposite of that. They are**
 21 **not instructed by our board of directors on how to vote.**
 22 Q. In any event, we can see here, this is a record
 23 of how in fact they did vote; right?
 24 **A. Yes.**
 25 Q. And as part of that, you know that when these

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1 rates and rate structures come up for vote, there's a
 2 whole package that goes to the whole members of the
 3 board to support the requested action; correct?
 4 **A. Correct.**
 5 Q. And that includes a cost of service breakdown
 6 which specifically identifies the components of the
 7 rates that the delegates are being asked to vote on;
 8 correct?
 9 **A. Correct.**
 10 Q. So it would not be true to say, would it, that
 11 when these things come up for vote at the Met board, the
 12 only thing the board members can vote on is whether the
 13 rates should be increased?
 14 **A. That is the primary issue. But in addition, it**
 15 **is they are aware of how the costs are allocated.**
 16 Q. Ma'am, it would not be true to say, that when
 17 these packages come up for review, that the only thing
 18 the board members have an opportunity to approve is an
 19 increase in the rates; that they have no ability to
 20 address the rate structures?
 21 **A. I do not know what that specific package is. I**
 22 **don't know what the resolution is. So I don't believe I**
 23 **can answer that accurately.**
 24 Q. As far as you know --
 25 **A. I do not know.**

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1 THE COURT: She's still talking, Mr. Quinn.
 2 MR. QUINN: Sorry.
 3 THE WITNESS: I just don't know. I haven't
 4 viewed it.
 5 Q. BY MR. QUINN: You attend some of the
 6 Metropolitan board meetings?
 7 A. Rarely.
 8 Q. You know that those -- there are recordings
 9 made of those meetings?
 10 A. Yes.
 11 Q. As there are recordings made of the San Diego
 12 meetings; right?
 13 A. Correct.
 14 Q. So far as you are aware, did any of the San
 15 Diego delegates to the Met board ever disclose to the
 16 Met board that San Diego believed any of these rates
 17 that were being voted on were unlawful?
 18 A. During what period of time?
 19 Q. Prior to the filing of this lawsuit.
 20 A. I believe that they did indicate that they did
 21 not support, did not believe that the costs were
 22 allocated correctly.
 23 Q. At any time -- my question -- I'm not sure --
 24 I might have misspoken and maybe you misheard
 25 my question.

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1 My question is, when these votes -- when these
 2 rates came up annually, at any time did any -- so far as
 3 you know, did any of the San Diego delegates inform the
 4 Met board that the rates on the table submitted for
 5 voting were illegal or unlawful?
 6 A. No.
 7 Q. Is it your understanding the board members have
 8 fiduciary duties to other board members?
 9 A. To other board members?
 10 Q. To the board. To the board as a whole.
 11 A. To the agency, yes.
 12 Q. As members of the board they are fiduciaries?
 13 A. Yes.
 14 Q. It is true, isn't it, that San Diego's
 15 delegates to the Met board also voted to approve these
 16 conveyance rates in 2006, 2007, 2008 and 2009?
 17 A. Yes.
 18 Q. During the period we've been talking about,
 19 prior to 2010, San Diego requested, on occasion, that
 20 Met wheel water, wheel water on San Diego's behalf,
 21 isn't that correct?
 22 A. Yes.
 23 Q. And San Diego wanted water wheeled through the
 24 State Water Project facilities under Met's contract with
 25 the State; correct?

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1 A. Yes.
 2 Q. For example, if we could look at DTX 75 -- this
 3 is in evidence -- December 1, 2008, letter to
 4 Mr. Kightlinger from you, this is an example of a -- one
 5 instance where San Diego was requesting that water be
 6 wheeled through Met -- through State Water Project
 7 facilities under Met's contract with the State; is that
 8 correct?
 9 A. That is correct.
 10 Q. And San Diego requested that Met -- San Diego
 11 knew that Met had this ability, this right to use the
 12 State Water Project facilities for that purpose; right?
 13 A. Yes.
 14 Q. And San Diego knew that Met pays for those
 15 facilities through its contract with the State; correct?
 16 A. Yes.
 17 Q. And San Diego, when it did that, when it
 18 wheeled water through the State Water Project
 19 facilities, it would pay the full Met wheeling rate for
 20 those services without objection; correct?
 21 A. I don't know.
 22 Q. You don't know whether or not the wheeling rate
 23 that San Diego was charged for wheeling through the
 24 State Water Project facilities included the system
 25 access rate, power rate and including the State water

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1 costs, you just don't know?
 2 A. I am aware that they included that. I am not
 3 aware if it included other costs.
 4 Q. Okay. You are aware when you request wheeling,
 5 transportation of water, you are going to be paying
 6 system access rate, power rate, including the State
 7 Water Project costs; correct?
 8 A. Correct.
 9 Q. And San Diego pays those charges without
 10 objections?
 11 A. Correct.
 12 Q. No objection to paying those costs when you are
 13 wheeling water through the State Water Project?
 14 A. We did not object when we moved this water in,
 15 it looks like, probably 2009 when we moved this water.
 16 Q. Similarly, if the State Water Project was being
 17 used to perform under the exchange agreement, San Diego
 18 would have no objection to paying those costs related to
 19 use of the State Water Project?
 20 A. Could you explain what "objection" is?
 21 Q. San Diego would have no issue with being
 22 charged for use of State Water Project facilities if
 23 they had to be used to perform the exchange agreement;
 24 correct?
 25 A. I don't know.

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1 Q. Well, the use of -- it's true, isn't it, that
 2 the use of the State Water Project facilities was
 3 essential to Met's performance under the exchange
 4 agreement; it had to be done? Correct?
 5 **A. Not necessarily.**
 6 Q. Is it your understanding that Met could perform
 7 the exchange agreement simply by using the Colorado
 8 River Aqueduct exclusively?
 9 **A. Yes.**
 10 Q. Well, you knew, in fact, that the State Water
 11 Project facilities would be used to deliver water under
 12 the exchange agreement; you knew that at the time the
 13 exchange agreement was negotiated and signed; correct?
 14 **A. No. I knew it could be used, but I did not**
 15 **know it would be used.**
 16 Q. In fact, San Diego understood, at the time that
 17 the agreement was negotiated and signed, that even a
 18 temporary inability to use the State Water Project
 19 facilities could cause a change in the delivery of water
 20 to San Diego under the exchange agreement?
 21 **A. Yes, it could.**
 22 Q. So if we look at DTX 51, Section -- this is the
 23 exchange agreement -- Section 3.3, pages 13 to 14. You
 24 see where it says, "SDCWA understands that any number of
 25 factors, including emergencies, inspection, maintenance

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1 or repair of Metropolitan facilities or the State Water
 2 Project facilities may result in a temporary and
 3 incidental modification of the delivery schedule
 4 contemplated in paragraph 3.2." Correct?
 5 **A. Correct.**
 6 Q. The parties clearly contemplated that the use
 7 of the State Water Project facilities were an essential
 8 aspect under the exchange agreement?
 9 **A. I don't see that. "They may result." It**
 10 **doesn't say "they shall result."**
 11 Q. You understood if there were a shutdown of the
 12 State Water Project facilities, that might have certain
 13 consequences for the schedule of the deliveries?
 14 **A. Yes, it might.**
 15 Q. So you understood from that that Met might well
 16 be using the State Water Project facilities to perform
 17 under the exchange agreement?
 18 **A. Yes, they might.**
 19 Q. And as a historical fact, you know that a large
 20 portion of the water that has been delivered under the
 21 exchange agreement has come through the State Water
 22 Project; you know that?
 23 **A. Yes.**
 24 Q. Do you know how much?
 25 **A. I do not.**

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1 Q. Is it more than 50 percent of the water that's
 2 been exchanged?
 3 **A. I don't believe so.**
 4 Q. Is it more than a third of the water that's
 5 been exchanged?
 6 **A. I don't know.**
 7 Q. Can you give us an order of magnitude?
 8 **A. I cannot. Sorry.**
 9 MR. QUINN: I would like to read you another
 10 passage of Mr. Slater's deposition, Volume II, page 243,
 11 line 20, to 244, eight.
 12 MR. KEKER: No objection, your Honor.
 13 THE COURT: Go ahead, please.
 14 MR. QUINN: (Reading:)
 15 "Q So would it be true to say
 16 that, as of 2007, San Diego
 17 would sue if Met did not change
 18 the way it calculated its
 19 wheeling rate upon -- it would
 20 sue upon the exp- -- sometime
 21 between the expiration of the
 22 five-year period and ten years
 23 after that?
 24 "A Correct.
 25 "Q And that was San Diego's

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1 state of mind as of 2007?
 2 "A Yes.
 3 "Q And that if I ask you that
 4 same question about 2006, 2005,
 5 2004, your answer would be the
 6 same"
 7 "A Yes.
 8 "Q And 2008?
 9 "A Yes."
 10 Q. That is flatly not true, isn't it? Correct?
 11 **A. No. We had every intention to negotiate an**
 12 **acceptable rate with Met and knew if we were unable to**
 13 **do so that our only alternative was lawsuit.**
 14 Q. Mr. Slater says as of 2007 they intend -- there
 15 would be an intention to sue.
 16 That is simply not true as of 2007?
 17 **A. An intention to sue, no. We did not in 2007**
 18 **intend to sue.**
 19 Q. When he says that San Diego's state of mind as
 20 of 2007 that it intended to sue upon expiration of the
 21 five-year period, that's simply wrong?
 22 MR. KEKER: Objection, your Honor.
 23 THE COURT: Sustained.
 24 Q. BY MR. QUINN: Let's take a look at DTX 555,
 25 which is admitted. This is an April 18, 2007, memo to

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1 the imported water committee.
 2 **A. Yes.**
 3 Q. On the second page, this is a memorandum
 4 prepared by Daniel Hentschke?
 5 **A. Yes.**
 6 Q. Approved by you?
 7 **A. Yes.**
 8 Q. The last sentence reads, "The Water Authority
 9 does not intend to litigate Met's current rate structure
 10 but it cannot know what future actions the Met board may
 11 take since the Met rates are established annually and
 12 are subject to change by Met's board of directors."
 13 Do you see that?
 14 **A. I do.**
 15 Q. That is language you approved?
 16 **A. Yes.**
 17 Q. In 2007 there was no intention to sue; correct?
 18 **A. Correct. We did not intend to litigate.**
 19 Q. And this was --
 20 Q. It was 2008 that five-year period expired?
 21 **A. Yes.**
 22 MR. QUINN: And then if we can look at DTX
 23 1114. This is not yet admitted and I understand there
 24 is no objection. I would offer it.
 25 MR. KEKER: No objection.

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1 THE COURT: DTX 1114 is admitted.
 2 (Exhibit 1114 was received into evidence.)
 3 Q. BY MR. QUINN: Can you identify this document?
 4 **A. This is a PowerPoint related to the MWD's work**
 5 **plan.**
 6 Q. If you turn to page 11, there is a reference to
 7 "Transportation Issues re SDCWA Transfers."
 8 **A. Yes.**
 9 Q. And it says, "Approval of canal lining option
 10 brought additional reliable water supplies for 110
 11 years."
 12 Do you see that?
 13 **A. Yes.**
 14 Q. After that it says, "No expectation of
 15 litigation."
 16 Do you see that?
 17 **A. I do.**
 18 Q. If you turn to page 12, "2007 Objectives," do
 19 you see, "work in partnership with MWD" and below that
 20 "peace treaty' expired - no litigation"?
 21 Do you see that?
 22 **A. Yes.**
 23 Q. Again, as of 2007, the state of mind at San
 24 Diego is there is no intention to sue?
 25 **A. Correct.**

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1 Q. Since 2003 San Diego has received the benefits
 2 it expected to get under the exchange agreement?
 3 **A. Yes.**
 4 Q. It has received that assignment of the water
 5 and the water -- you have no criticisms of Met's
 6 performance other than these charges which are the
 7 subject of this case; is that true?
 8 **A. That's true.**
 9 Q. And San Diego has received and accepted the
 10 benefits and Met has performed; correct?
 11 **A. Correct.**
 12 Q. Option-2 had that initial price of \$253 which
 13 was assumed to escalate from there?
 14 **A. Yes.**
 15 Q. And the price that San Diego contends it should
 16 pay for 2011, for example, according to your expert,
 17 Mr. Denham is \$136 per square foot?
 18 **A. Per acre-foot.**
 19 Q. Per acre-foot.
 20 **A. Yes.**
 21 Q. So is it your understanding of the exchange
 22 agreement San Diego is entitled to the benefits of
 23 Option-2, the canal lining water, for 110 years and the
 24 \$235 million, and the other thing it gets but should pay
 25 about half of what San Diego assumed it would pay under

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1 option two when it was running those analyses?
 2 **A. No. We assumed we would pay a lawful wheeling**
 3 **rate, and we would get the benefit of the exchange**
 4 **agreement by a lawful wheeling rate.**
 5 Q. If I understand correctly what you're telling
 6 us is you believe that Mr. Denham is right, that for
 7 2011, for example, you can get all those same benefits
 8 and only pay the \$136; correct?
 9 **A. The benefits derived were not directly related**
 10 **to the exchange agreement number. The benefits, the**
 11 **totality of benefits of the QSA related to the exchange**
 12 **agreement, the \$253.**
 13 Q. I mean, again, not to gild the lily, I hope,
 14 we've seen these memos that say the consideration for
 15 the canal lining water was the wheeling rate, which
 16 starts out \$238; right? I'm sorry. \$253?
 17 **A. Correct.**
 18 Q. And so San Diego's position now is it should be
 19 able to get all those benefits anticipated under the
 20 exchange agreement but actually it should only have to
 21 pay much, much less than what that initial year's price
 22 was?
 23 **A. We should only have to pay the lawful wheeling**
 24 **rate.**
 25 Q. Your testimony, Miss Stapleton, was -- I was

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1 asking about whether you brought up taking out the State
 2 Water Project costs, you personally brought it up with
 3 anyone on the Met side. And you said that you did that
 4 in -- I have 2009.
 5 **A. About the State Water Project costs?**
 6 Q. Yes.
 7 **A. We raised that issue way before 2009.**
 8 Q. I'm talking about the conversation with
 9 Mr. Underwood.
 10 **A. I raised that conversation with Dennis all the**
 11 **way back to -- I mean, we were having conversations in**
 12 **1999 or 2000, 2001, 2002, all the way up to the**
 13 **execution of the exchange agreement.**
 14 Q. I asked you what year did you propose backing
 15 out the State Water Project costs on, you personally,
 16 and you said, yes, in year six or beyond --
 17 **A. Right.**
 18 Q. Right?
 19 **A. After the execution of the exchange agreement.**
 20 Q. You did that with Mr. Underwood?
 21 **A. No, no. Mr. Underwood had passed since then.**
 22 Q. That is what I was going to ask. He passed in
 23 2005?
 24 **A. Yes. I'm sorry. I misunderstood.**
 25 **I had ongoing discussions with Dennis Underwood**

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1 **in 2000, 2001, 2002, 2003. The 2009 is when the Water**
 2 **Authority or I actually issued formal objections to the**
 3 **State Water Project costs being included in the Met**
 4 **rate.**
 5 Q. Wasn't it your testimony that you said that you
 6 did not bring -- you were asked, just reading between
 7 the lines:
 8 "Q Miss Stapleton, are you
 9 saying you brought up with Met
 10 excluding State Water Project
 11 costs in year two?
 12 "A No.
 13 "Q Year three?
 14 "A No.
 15 "Q Year four?
 16 "A. No.
 17 "Q For any year?
 18 "A Yes.
 19 "Q What year did you propose
 20 backing out the State Water
 21 Project costs on you
 22 personally?
 23 "A Yes. In year six or
 24 beyond. We had come to know --
 25 come to some agreement and that

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1 we believed the State Water
 2 Project costs were not lawfully
 3 included in the rates.
 4 "Q Who did you propose that
 5 to on the Met side?
 6 "A Dennis Underwood."
 7 Was that your testimony?
 8 **A. I'm sorry. I misunderstood then.**
 9 **Basically my conversations with Dennis were**
 10 **during the negotiations to 2003 and beyond, and I**
 11 **continued those conversations with Dennis until he**
 12 **passed in 2005.**
 13 **The issue about 2009 was when we had formal**
 14 **conversations about -- in 2009 we were raising the issue**
 15 **in a much more public way.**
 16 MR. QUINN: Can I have just a moment, your
 17 Honor?
 18 THE COURT: Of course.
 19 MR. QUINN: Nothing further.
 20
 21 CROSS-EXAMINATION
 22 BY MR. KEKER:
 23 Q. With speed, Miss Stapleton, because of time.
 24 When did San Diego raise with Met the problem
 25 with cost allocation of the State Water Project costs?

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1 **A. Our first concerns regarding wheeling were in**
 2 **1996 and they were -- we continued those dialogues for a**
 3 **number of years.**
 4 Q. Did -- did people that you talked to at Met
 5 understand that you believed it was improper to allocate
 6 State Water Project costs to the transportation rate?
 7 MR. QUINN: Objection. Speculation.
 8 Foundation.
 9 THE COURT: Sustained.
 10 Q. BY MR. KEKER: Did you talk to somebody at Met
 11 about your objection to including State Water Project
 12 costs in the transportation rates?
 13 MR. QUINN: Objection. Vague. Time, as to
 14 time.
 15 THE COURT: Overruled.
 16 THE WITNESS: Yes, I did.
 17 Q. BY MR. KEKER: When?
 18 **A. I had continuing conversations about this issue**
 19 **with Dennis Underwood beginning in about 2000 and**
 20 **continuing on.**
 21 Q. To your knowledge, did San Diego staff have
 22 similar conversations with people on Met staff objecting
 23 to the inclusion of State Water Project costs in the
 24 transportation rates?
 25 **A. Yes.**

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1 MR. QUINN: Objection. Foundation.
 2 Q. BY MR. KEKER: When --
 3 THE COURT: Overruled. Give me a shot to rule
 4 on it.
 5 MR. KEKER: Sorry.
 6 THE WITNESS: Yes, they did.
 7 Q. BY MR. KEKER: When? Starting when?
 8 MR. QUINN: Objection. Foundation.
 9 THE COURT: Overruled.
 10 THE WITNESS: In approximately 1997, '98, and
 11 it continued through the execution of the exchange
 12 agreement.
 13 Q. BY MR. KEKER: To your knowledge did anybody at
 14 the Water Authority ever stop saying that they believed
 15 the State Water Project costs should not be in the
 16 transportation rates?
 17 A. No.
 18 Q. What language did you use when you talked to
 19 Vice President Underwood at Met in these many
 20 conversations that you had about what was wrong with
 21 including State Water Project costs in the
 22 transportation rates?
 23 A. I indicated to Dennis that I didn't believe
 24 they were lawful, that it was improper to put the State
 25 Water Project costs on transportation in lieu of supply;

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1 that I thought it was inconsistent with the wheeling
 2 statute.
 3 Q. What wheeling statute are you referring to?
 4 A. The Katz wheeling statute.
 5 Q. Do you know if that has a Water Code
 6 designation?
 7 A. Yes. 1810.
 8 Q. Who is Mr. Katz?
 9 A. Mr. Katz was in the legislature and he was the
 10 author of the wheeling statute.
 11 Q. Was Mr. Katz the author of the wheeling statute
 12 involved in the negotiations -- in 2003, what was his
 13 role in 2003?
 14 A. In 2003 Richard Katz actually was a -- was on
 15 the Governor's staff and he and another individual on
 16 behalf of Governor Davis participated and facilitated
 17 the negotiations in 2003.
 18 Q. Did Mr. Katz, for example, understand there was
 19 a dispute between San Diego and Met about how to
 20 calculate the wheeling rate?
 21 A. Yes, he was aware.
 22 MR. QUINN: Objection. Foundation.
 23 THE COURT: I'll sustain. We are probably
 24 going off a little bit.
 25 Q. BY MR. KEKER: Just generally, had this been a

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1 subject of a great deal of discussion and objection and
 2 contention between San Diego and Met since the rates
 3 were unbundled?
 4 A. Yes. We had many, many conversations with Met
 5 staff and during this period of time trying to come to
 6 resolution.
 7 Q. Could anybody in these agencies or involved in
 8 this process not understand that there was a dispute
 9 about where to allocate these State Water Project costs?
 10 MR. QUINN: Objection. Foundation.
 11 THE COURT: Sustained. It is argumentative.
 12 Q. BY MR. KEKER: You mentioned something about
 13 closed sessions and so on. Was San Diego's position
 14 prior to 2003 about the proper allocation of State Water
 15 Project costs, was it public or private? Was it
 16 publicly known, publicly discussed?
 17 A. Yes. It was known by MWD and the member
 18 agencies at Metropolitan that we disputed the inclusion
 19 of the State Water Project in the wheeling rate.
 20 Q. When you talked about closed sessions during
 21 Mr. Quinn's examination, what was your point about the
 22 closed sessions?
 23 A. Was that we had repeated and frequent closed
 24 sessions with our board of directors during the
 25 negotiations of the QSA, and a huge amount of the

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1 information and the analysis were done in closed session
 2 with the board as we continued to try to reach
 3 agreement.
 4 Q. What about the water stewardship rate? When
 5 had you directly begun communicating your concern about
 6 the placement of the water stewardship rate costs on
 7 transportation to anybody at Met?
 8 A. In about the year 2000.
 9 Q. And to whom did you communicate that concern
 10 and what did you say about it?
 11 A. For me, it was to Dennis Underwood who was my
 12 counterpart on the negotiating team of Met. And, again,
 13 I indicated the water stewardship charge was directly
 14 related to supply development and it didn't belong on
 15 the transportation charge. I didn't believe it was
 16 consistent, again, with the wheeling law.
 17 Q. And did you say -- did you tell him it was
 18 improper, invalid or anything like that?
 19 A. Yes. The language I would use is it's improper
 20 or that it's not consistent with the law or that it --
 21 that is not a valid charge to the transportation or
 22 system access rate.
 23 Q. To your knowledge did Met staff -- excuse me.
 24 San Diego Water Authority staff communicate similar
 25 concerns to their contemporaries at Met?

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1 MR. QUINN: Objection; foundation.
 2 THE COURT: Did you overhear these
 3 communications?
 4 THE WITNESS: I did in some cases.
 5 THE COURT: Tell us about what you heard.
 6 THE WITNESS: I heard both Scott Slater, my
 7 special counsel, and Bob Campbell, one of my staff
 8 members, having discussions with either Brian Thomas,
 9 who was an employee of Metropolitan, or Jeff
 10 Kightlinger, the general counsel, about the wheeling
 11 rate and our objections to the inclusion of certain
 12 charges in that wheeling rate.
 13 Q. BY MR. KEKER: By the way, was Mr. Gastelum,
 14 who was the general manager in 2003, is he still around
 15 and available to Met as a witness?
 16 A. **Yes, he is around.**
 17 Q. Miss Stapleton why did the Water Authority
 18 agree -- let me back up. You said the \$253 wheeling
 19 rate made up of the current system access rate, water
 20 stewardship rate and system power rate, adding to \$253.
 21 You said you believed at the time of the exchange
 22 agreement that rate was not -- was illegal, was not
 23 properly calculated. Do you remember that?
 24 A. **Correct.**
 25 Q. Why did San Diego agree in the exchange

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1 agreement to pay that rate for the initial year?
 2 A. **For a couple reasons. We needed to make**
 3 **modifications in the exchange agreement from 1998. We**
 4 **had to solve some problems, which is the exchange**
 5 **agreement term was shorter than our water transfer term**
 6 **and we had 15 years of exposure.**
 7 **The second issue was there was some conditions**
 8 **precedent that we had been told by Ron Gastelum that**
 9 **would invalidate the 1998 agreement.**
 10 **So we decided if we could put boundaries on our**
 11 **exposure to Met's wheeling rate and had the opportunity**
 12 **to either negotiate something we both could live with**
 13 **and that it was lawful, that that was worth -- that was**
 14 **worth the risk.**
 15 Q. You said you agreed as part of the exchange
 16 agreement to pay Met's wheeling rate, whatever they
 17 said, for five years?
 18 A. **Correct.**
 19 Q. And thereafter, what wheeling rate did you
 20 agree to pay?
 21 A. **The lawful wheeling rate.**
 22 Q. Did you make sure that the agreement reflected
 23 that agreement?
 24 A. **Yes.**
 25 Q. Could we look at Plaintiff's 65 and put up 5.2,

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1 please?
 2 A. **I don't think I have 65.**
 3 Q. Sorry, Miss Stapleton, I am rushing. Let's put
 4 up 5.2 on the screen.
 5 This is an agreement for exchange water, and in
 6 5.2 it says the price on the date of execution is \$253;
 7 right?
 8 A. **Correct.**
 9 Q. At the time was there a dispute between Met and
 10 San Diego about whether or not that was a lawful
 11 wheeling rate?
 12 A. **Yes, that was.**
 13 Q. Did Mr. Underwood understand there was a
 14 dispute?
 15 A. **Absolutely.**
 16 Q. Did you understand there was a dispute?
 17 A. **Yes.**
 18 Q. Did anybody at Met not understand that there
 19 was a dispute?
 20 A. **No.**
 21 MR. QUINN: I object. Move to strike.
 22 THE COURT: Sustained.
 23 Q. BY MR. KEKER: And it says, "Thereafter, the
 24 price shall be equal to the charge or charges set by the
 25 Met board of directors pursuant to applicable law and

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1 regulation."
 2 What did that mean to you?
 3 A. **That meant thereafter Met -- that the price**
 4 **would be a lawful wheeling rate that was set by MWD.**
 5 Q. And had there been some discussion about how
 6 long San Diego would sit still if Met didn't change its
 7 ways about cost allocation?
 8 A. **Yes.**
 9 Q. And what did the discussion lead to?
 10 A. **It led to that we could not challenge the MWD**
 11 **established rate for the first five years.**
 12 Q. And what was the purpose for you, for San
 13 Diego, to agree to a wheeling rate that you thought was
 14 higher than the law permitted and to agree to it, to pay
 15 it for five years?
 16 A. **Because it provided an exchange agreement that**
 17 **matched our water transfer agreement in the length of**
 18 **time. And it got rid of the conditions precedent. So**
 19 **we knew we would have a firm capacity within the**
 20 **aqueduct in this exchange agreement, and we were willing**
 21 **to take the risk.**
 22 Q. During the negotiations, as Mr. Kightlinger
 23 told us, did Met say we want you to agree to whatever we
 24 say the wheeling rate is for the next 45 and maybe 75
 25 years?

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1 **A. That was their initial offer to us.**
 2 Q. And did San Diego agree to eat whatever they
 3 wanted to call the wheel rate, whatever number they
 4 wanted to put on it, for 45 to 75 years?
 5 **A. Absolutely not.**
 6 Q. What did the negotiation yield in that regard?
 7 **A. We finally got down to a five-year time period**
 8 **where we agreed to pay the MWD established rate, and**
 9 **after five years we had the opportunity to seek either**
 10 **administrative or judicial remedy.**
 11 Q. Let's look at the next term. It says, still in
 12 5.2, "For the term of this agreement neither San Diego
 13 nor Met shall seek or support in any legislative,
 14 administrative or judicial forum."
 15 Does administrative include Met?
 16 **A. Yes.**
 17 Q. So you are promising you are not going to go to
 18 Met, you are not going to go to the legislature and you
 19 are not going to go to court for the life of this
 20 agreement --
 21 **A. Yes.**
 22 Q. -- pertaining to the charge or charges set by
 23 the board of directors. That's what that says; right?
 24 **A. Correct.**
 25 Q. And then it comes down and it says, "Provided

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1 further that, A, after the conclusion of the first five
 2 years" --
 3 What are the next two words?
 4 **A. "Nothing herein."**
 5 Q. -- "shall preclude San Diego from contesting in
 6 an administrative or judicial forum," blah, blah, blah.
 7 What did you understand that to mean about this
 8 five-year period?
 9 **A. After five years, if we were unsuccessful**
 10 **reaching an agreement on what would be considered the**
 11 **lawful rate, the Water Authority had the ability to**
 12 **contest the wheeling rate that Met had established in**
 13 **either an administrative or judicial manner.**
 14 Q. After the five years with respect to what the
 15 subject matter of your lawsuit could be, did you
 16 understand that there was any condition about only
 17 procedural or only something that didn't exist when we
 18 started or anything, any limitation on that?
 19 **A. Absolutely not.**
 20 Q. Did you expect there was a possible -- did you
 21 anticipate there was a possibility the law might change
 22 or develop and make the wheeling situation work more
 23 plain over the next five years?
 24 **A. Yes. That there were some court cases**
 25 **regarding wheeling during this period of time, and we**

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1 **thought that there may be additional court decisions**
 2 **that might have an influence on -- an influence to help**
 3 **clarify what a lawful wheeling rate might be.**
 4 Q. In San Diego's mind did the term "lawful
 5 wheeling rate" have meaning?
 6 **A. It had essential meaning.**
 7 Q. Was there any part of California or
 8 constitutional law that was excluded from the term
 9 "lawful"?
 10 **A. No.**
 11 Q. And in your discussions with Mr. Underwood, did
 12 he seem to understand that, as well?
 13 **A. He did.**
 14 Q. Would you look at 11.1, please. 11.1 says you
 15 have to negotiate if you have a problem, but it also
 16 says, "San Diego shall not dispute whether the price
 17 determined pursuant to paragraph 5.2 for the first five
 18 years of this agreement was determined in accordance
 19 with applicable law or regulation ('a price dispute')."
 20 What price did you think they were talking
 21 about that you couldn't dispute for five years?
 22 **A. Met's wheeling rate as selected or as set by**
 23 **the board of directors.**
 24 Q. Where the parentheses are around "price
 25 dispute," look over at 12.4, please, and 12.4(c), which

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1 says, "In the event of a dispute over the price, San
 2 Diego shall pay when due. . ."
 3 And then it goes and talks about the escrow
 4 accounts?
 5 **A. Right.**
 6 Q. Was there anything in this agreement that
 7 limited San Diego's ability to complain about any aspect
 8 whatsoever of the price it was being charged by Met
 9 after five years were over?
 10 **A. No.**
 11 Q. Was that something that was negotiated for
 12 hard?
 13 **A. Very hard.**
 14 Q. And was that contrary to the position that Met
 15 wanted, which is you can never challenge our prices?
 16 **A. Yes.**
 17 Q. That was the compromise?
 18 **A. This was the compromise.**
 19 Q. For five years you couldn't challenge --
 20 THE COURT: I have to interrupt. I have
 21 another case coming in at 4:00. I have a ferocious
 22 amount of work to do.
 23 Can we pick this up on our next trial date?
 24 MR. KEKER: Yes, sir.
 25 THE COURT: I do have some other cases. Thank

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1 you. I will see you next time we get together.
2 (Evening recess was taken.)
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1 REPORTER'S CERTIFICATE
2

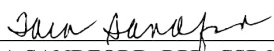
3 STATE OF CALIFORNIA,)
4) ss
5 COUNTY OF SANTA BARBARA.)

6 I, TARA ANN SANDFORD, CSR #3374, Certified Shorthand
7 Reporter, in the County of Santa Barbara, State of
8 California, hereby certify:

9 That the court proceedings were taken down by me in
10 stenotype at the time and place herein named and
11 thereafter reduced to typewriting by computer-aided
12 transcription under my direction.

13 I further certify that I am not interested in the
14 event of the action.

15 WITNESS my hand this 3rd day of April,
16 2015, at San Francisco, California.
17
18
19
20

21 
22 TARA SANDFORD, RPR, CSR No. 3374
23 Certified Shorthand Reporter
24 State of California
25

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San Diego County Water Authority

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(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

May 8, 2015

Randy Record and
Members of the Board of Directors
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

MEMBER AGENCIES

- Carlsbad Municipal Water District
 - City of Del Mar
 - City of Escondido
 - City of National City
 - City of Oceanside
 - City of Poway
 - City of San Diego
 - Fallbrook Public Utility District
 - Helix Water District
 - Lakeside Water District
 - Olivenhain Municipal Water District
 - Otay Water District
 - Padre Dam Municipal Water District
 - Camp Pendleton Marine Corps Base
 - Rainbow Municipal Water District
 - Ramona Municipal Water District
 - Rincon del Diablo Municipal Water District
 - San Dieguito Water District
 - Santa Fe Irrigation District
 - South Bay Irrigation District
 - Vallecitos Water District
 - Valley Center Municipal Water District
 - Vista Irrigation District
 - Yuima Municipal Water District
- OTHER REPRESENTATIVE**
- County of San Diego

RE: Board Memo 8-2: Authorize (1) \$150 million in additional funding for conservation incentives from the Water Stewardship Fund and the Water Management Fund; and (2) Implementation of modifications to the Turf Removal Program -- **OPPOSE**

Chair Record and Members of the Board:

As you know, the Water Authority and its member agencies have an outstanding record of leadership in water conservation planning, programs and implementation. The San Diego region's per capita water use has dropped by 22 percent since 2007. More than a year ago, in response to the current drought, the Water Authority launched its *When in Drought, Save Every Day, Every Way* campaign to further increase public awareness. Through our continuous efforts, a recent poll shows 87 percent of San Diegans believe saving water is a civic duty, 85 percent are aware the drought is very serious, and 81 percent have taken additional actions to reduce water use since mandatory water use restrictions were implemented in San Diego County last August. It is clear that San Diegans are doing our part to reduce water use, and we will continue to support the Governor's call for increased water conservation and strive to meet the State Board's newly adopted regulations. Against this backdrop, we must oppose staff's recommendation for the following reasons:

- **Lack of accountability.** In spite of repeated requests, MWD has failed to demonstrate actual near-term water savings resulting from the turf removal program. At an estimated cost of almost \$1,500 per acre-foot (AF), which staff has amortized over ten years, the near-term cost of any water savings would be substantially more than \$1,500/AF and well in excess of MWD's current spot market transfers. Short term, there has been no demonstration of meaningful water savings as a result of these subsidies, and certainly no demonstration of water savings that would not otherwise have occurred, either as a result of the high cost of water or state mandates limiting the amount of water retail agencies and their ratepayers may use on ornamental landscapes. Long term, MWD's program includes *no measures* to ensure that turf that someone is paid to remove today won't be reestablished in the future. *Without*

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such accountability, this program constitutes a waste of ratepayer dollars and a gift of public funds.

- ***Lack of transparency.*** MWD has not even provided an accounting of the participants who have received the more than \$77 million that has already been spent on the program. No further public rate dollars should be allocated or spent without an accounting of past expenditures. We renew our request for an immediate audit of this program, including identification of fund recipients, evidence of the turf removal or other "conservation" improvements that have been made with these public funds, and disclosure of any consultants or business entities that have benefitted from the implementation of this program by MWD.ⁱ
- ***Lack of available funding to pay for this massive, unbudgeted program expansion.*** It appears that there are insufficient funds available to pay for the staff recommendationⁱⁱ; and it is therefore highly probable that rate increases will be required for which there has been no public notice. In a PowerPoint presentation to the Finance and Insurance Committee last month, staff reported a Water Management Fund balance of \$32.2 million as of March 31, 2015.ⁱⁱⁱ This month, staff is requesting to use \$9.975 million of that remaining balance to purchase transfer supplies from Yuba County Water Agency, leaving only \$22.25 million available in the Water Management Fund.^{iv} This means that the rest of the funding - \$127.8 million - must come from the Water Stewardship Fund. But in order for the Water Stewardship Fund to generate that level of funding, *MWD would have to sell 3.12 million acre-feet of water (MWD must also make payments due on long term contracts paid for with Water Stewardship Rate dollars).* Since MWD's water sales are obviously going to be much lower than 3 million acre-feet, there is no identified source from which to generate the \$150 million needed for this program. MWD is running this program as an "open checkbook," but it has not planned or budgeted for these expenditures.
- ***The conservation program is being funded with rates the Superior Court has already ruled are illegal.*** MWD is continuing to collect the Water Stewardship Rate even though the Superior Court has already ruled that it is an illegal tax. In addition, San Diegans are being excluded from full participation in the member agency program as a result of MWD's inclusion of the "Rate Structure Integrity" clause, as to which the Court has also ruled substantively in San Diego's favor, subject only to the question of standing.
- ***The turf removal program is a regressive tax.*** Many low income ratepayers allowed their lawns to die many months if not years ago due to the cost of water. Now, they are being forced to subsidize turf replacement by private golf clubs and other commercial and residential high water users.

We have stated our deep concerns about the turf replacement program and MWD's water conservation programs generally, due to the absence of accountability actually measuring conservation results or accounting for the ratepayer dollars being spent on these programs. We have provided suggestions and made requests for information and for an audit on many prior occasions. A copy of our most recent letter dated December 8, 2014, is attached.

Instead of adopting staff's recommendation, we urge the board to: 1) order an immediate audit of the \$77 million that has been spent to date, including the information described above; and 2) request that staff bring back a detailed report including (a) data and an analysis demonstrating the near-term and long-term benefit of these programs, (b) a recommendation and firm budget cap for any proposed expanded conservation program, and (c) identify the source of available funding to pay for it. Staff should also report on the demand reduction impacts from permanent landscape ordinances and/or code changes limiting outdoor water use and how such changes should contribute to phasing out subsidies as a primary means to achieve water conservation.

For these reasons, we oppose staff's recommendations.

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
Director



Fern Steiner
Director



Yen C. Tu
Director

Attachments:

1. Water Authority's December 8, 2014 Letter to MWD Board re 8-1

ⁱ We have been asked, for example, what role MWD's past General Manager, Ron Gastelum, has played in the development and implementation of the turf removal program and whether he has benefitted financially from it on behalf of his client "Turf Terminators." In addition to his former role as General Manager of MWD, Mr. Gastelum also represents a number of MWD member agencies.

ⁱⁱ MWD's budgeted conservation program funding for fiscal years 2014/15 and 2015/16 totaled \$40 million; the staff recommendation in this month's Board Memo 8-2 will increase that budget more than six-fold to \$250 million.

ⁱⁱⁱ In this month's presentation, the projected balance of the Water Management Fund is shown as \$141.9 million as of June 30, 2015; no explanation is provided how the balance will increase by more than \$100 million from March to June 2015.

^{iv} This is all the money that is left in the Water Management Fund of the \$232 million transferred there from the almost **\$500 million MWD has over-collected from ratepayers since June 2013.**



San Diego County Water Authority

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April 13, 2015

Randy Record and
Members of the Board of Directors
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

MEMBER AGENCIES

Carlsbad
Municipal Water District
City of Del Mar
City of Escondido
City of National City
City of Oceanside
City of Poway
City of San Diego
Fallbrook
Public Utility District
Helix Water District
Lakeside Water District
Olivenhain
Municipal Water District
Otay Water District
Padre Dam
Municipal Water District
Camp Pendleton
Marine Corps Base
Rainbow
Municipal Water District
Ramona
Municipal Water District
Rincon del Diablo
Municipal Water District
San Dieguito Water District
Santa Fe Irrigation District
South Bay Irrigation District
Vallecitos Water District
Valley Center
Municipal Water District
Vista Irrigation District
Yuima
Municipal Water District
**OTHER
REPRESENTATIVE**
County of San Diego

RE: Board Memo 8-1: Approve resolutions fixing and adopting a Readiness-to-Serve Charge and a Capacity Charge for calendar year 2016 - OPPOSE

Chair Record and Members of the Board,

Copies of the following letters (without attachments) are attached:

- 1) April 8, 2014 letter from Dennis Cushman to Dawn Chin, Clerk of the Board RE: Board Memo 8-1 - Approve proposed biennial budget for fiscal years 2014/15 and 2015/16, proposed ten-year forecast, proposed revenue requirements for fiscal years 2014/15 and 2015/16, and recommended water rates and charges to be effective on January 1, 2015 and January 1, 2016; and transmit the General Manager's Business Plan Strategic Priorities for FY 2014/15 and 2015/16 - COMMENTS ON PROPOSED WATER RATES AND CHARGES (FOR 2015 AND 2016); and
- 2) April 8, 2014 letter from Dennis Cushman to Jeff Kightlinger RE: April 8, 2014 Board Meeting, Board Memo 8-1 - Approve proposed biennial budget for fiscal years 2014/15 and 2015/16, proposed ten-year forecast, proposed revenue requirements for fiscal years 2014/15 and 2015/16, and recommended water rates and charges to be effective on January 1, 2015 and January 1, 2016; and transmit the General Manager's Business Plan Strategic Priorities for FY 2014/15 and 2015/16 - REQUEST TO CONTINUE BOARD ACTION ONE MONTH, UNTIL THE MAY BOARD MEETING, TO ALLOW AN OPPORTUNITY FOR REVIEW OF INFORMATION PROVIDED TO THE BOARD OF DIRECTORS ON APRIL 4, 2014, AT 4:03 PM; IN THE ALTERNATIVE - OPPOSE.

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The Water Authority requests inclusion of this letter and the attached letters and each and every attachment provided to MWD on April 8, 2014, in the record of proceedings relating to the actions and resolutions to fix and adopt Readiness-to-Serve (RTS) Charge and a Capacity Charge effective January 1, 2016, based on the rates and charges adopted by the Board on April 8, 2014. MWD's Engineer's Report dated April 2015 and 2014 cost of service reports are lacking a reasonable basis to support the RTS and Capacity Charges being imposed on the Water Authority for calendar year 2016, in that they fail to identify either the benefit of each facility or project to be financed with RTS revenues or the recipient of that benefit. Declarations by the Chief Financial Officer and Board of Directors in resolutions are not a sufficient factual or legal basis for the assessment of the RTS and Capacity Charges and are, in fact, contrary to testimony provided by MWD itself in the Water Authority litigation presently pending against MWD, in which MWD's cost allocations and rates have already been determined to violate the common law, Govt. Code Section 54999.7(a), the Wheeling Statute and Proposition 26. The Water Authority also requests inclusion of the April 2, 2015 trial testimony of Devendra Upadhyay in the record of proceedings relating to the Board's actions and resolutions to fix and adopt the RTS and Capacity Charges.

For these reasons, we OPPOSE Board Memo 8-1.

Sincerely,



Michael T. Hogan
Director



Keith Lewinger
Director



Fern Steiner
Director



Yen C. Tu
Director

Attachments:

1. Letter to Dawn Chin re: Board Memo 8-1, dated April 8, 2014
2. Letter to Jeff Kightlinger re: Board Memo 8-1, dated April 8, 2014
3. Trial testimony of Devendra Upadhyay, dated April 2, 2015



San Diego County Water Authority

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HAND DELIVERED

April 8, 2014

Dawn Chin, Clerk of the Board
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

MEMBER AGENCIES

Carlsbad
Municipal Water District

City of Del Mar

City of Escondido

City of National City

City of Oceanside

City of Poway

City of San Diego

Fallbrook
Public Utility District

Helix Water District

Lakeside Water District

Oliverain
Municipal Water District

Otay Water District

Padre Dam
Municipal Water District

Camp Pendleton
Marine Corps Base

Rainbow
Municipal Water District

Ramona
Municipal Water District

Rincon del Diablo
Municipal Water District

San Dieguito Water District

Santa Fe Irrigation District

South Bay Irrigation District

Vallecitos Water District

Valley Center
Municipal Water District

Viata Irrigation District

Yuima
Municipal Water District

OTHER REPRESENTATIVE

County of San Diego

RE: April 7, 2014 Finance and Insurance Committee Meeting
Board Memo 8-1 – Approve proposed biennial budget for fiscal years 2014/15 and 2015/16, proposed ten-year forecast, proposed revenue requirements for fiscal years 2014/15 and 2015/16, and recommended water rates and charges to be effective on January 1, 2015 and January 1, 2016; adopt resolutions fixing and adopting water rates and charges for 2015 and 2016; and transmit the General Manager's Business Plan Strategic Priorities for FY 2014/15 and 2015/16 – **COMMENTS ON PROPOSED WATER RATES AND CHARGES (FOR 2015 AND 2016)**

Dear Ms. Chin:

Accompanying this letter are a CD containing a copy of all of the documents listed in the attached Index, "Documents San Diego County Water Authority Requests be Included in the Administrative Record for Setting of 2015-2016 MWD Rates, Part II" (a copy is marked as Attachment 1 to this letter). The documents on the CD are comprised solely of prior correspondence between the San Diego County Water Authority and MWD.

Also attached are copies of the following letters and information:

1. Letter from Marcia Scully to Dan Hentschke dated March 19, 2014 RE: Response to Request for Information Dated February 28, 2014 (a copy is marked as Attachment 2 to this letter).
2. Letter from Marcia Scully to Dan Hentschke dated April 4, 2014 RE: Further Response to Request for Information Dated February 28, 2014 (a copy is marked as Attachment 3 to this letter).
3. Email transmittal of the April 4, 2014 information to the MWD Board of Directors dated April 4, 2014, transmitted at 4:03 PM (a copy is marked as Attachment 4 to this letter).
4. Government Finance Officers Association, Best Practice, Long-Term Financial Planning (2008) (BUDGET) (a copy is marked as Attachment 5 to this letter) and Overview of the Characteristics of Effective Financial Planning Documents, which may be found at the following link:
http://www.gfoa.org/index.php?option=com_content&task=view&id=366.
5. Public meeting excerpt RE MWD's draft 2010 Integrated Resources Plan, August 10, 2010. (Attachment 6)

6. Audio files of the following MWD Finance and Insurance Committee (F&I) and Board meetings (Board), which may be found at the following links (discussions at the April 7 F&I and April 8 board meetings are not yet available from MWD but are requested to be made part of the record):
 - a. Feb 10, 2014 F&I meeting: Proposed biennial budget and rates; setting public hearings (8-1) http://mwdh2o.granicus.com/MediaPlayer.php?view_id=29&clip_id=3517
 - b. Feb 11, 2014 Board meeting: Proposed biennial budget and rates; setting public hearings (8-1) http://mwdh2o.granicus.com/MediaPlayer.php?view_id=12&clip_id=3515
 - c. Feb 25, 2014 F&I meeting: Proposed biennial budget and rates
http://mwdh2o.granicus.com/MediaPlayer.php?view_id=29&clip_id=3559
 - d. March 10, 2014 F&I meeting: Proposed biennial budget and rates
http://mwdh2o.granicus.com/MediaPlayer.php?view_id=29&clip_id=3620
 - e. March 11, 2014 Board meeting: public hearings
http://mwdh2o.granicus.com/MediaPlayer.php?view_id=12&clip_id=3583
 - f. April 7, 2014 F&I meeting: Approve biennial budget and rates (8-1)
 - g. April 8, 2014 Board meeting: Approve biennial budget and rates (8-1)

The Water Authority requests inclusion of this letter and its Attachments, including each and every document listed on the Index and included on the CD, in the record of the proceedings relating to the actions and resolutions for adoption and imposition of MWD's rates and charges for 2015 and 2016.

Sincerely,



Dennis A. Cushman
Assistant General Manager

Attachments

Documents San Diego County Water Authority Requests be Included in the Administrative Record for Setting of 2015-2016 MWD Rates, Part II

List of Contents

- Water Authority's Director Steiner letter re: Member Agency Willingness to Sign Take-or-Pay Contracts (August 16, 2011)
- Water Authority Delegation letter re: Board Memo 8-2: Authorize the execution and distribution of the Official Statement in connection with the issuance of the Water Revenue Refunding Bonds (April 9, 2012)
- Water Authority Delegation letter re: Agenda Item 8-8: Authorize the execution and distribution of Official Statements in connection with issuance of the Water Revenue Refunding Bonds (June 11, 2012)
- Water Authority Delegation letter re: Board Memo 8-1: Authorize the execution and distribution of the Remarketing Statement in connection with the remarketing of the Water Revenue Bonds (August 20, 2012)
- Water Authority's Director Wilson letter re: Comments on Appendix A and OS (August 29, 2012)
- Water Authority Delegation letter re: Your September 4, 2012 Letter - Comments on Appendix A to Remarketing Statement and Official Statement (October 8, 2012)
- Water Authority Delegation letter re: Board Memo 8-1: Authorize the Execution and Distribution of the Official Statement in Connection with the Issuance of the Water Revenue Refunding Bonds (November 5, 2012)
- Water Authority Delegation letter re: Board Memo 8-1: Authorize the execution and distribution of the Official Statement in connection with the issuance of the Water Revenue Refunding Bonds (February 11, 2013)
- Water Authority Delegation letter re: Board Memo 8-3: Authorize the execution and distribution of the Official Statement in connection with the issuance of the Special Variable Rate Water Revenue Refunding Bonds (May 13, 2013)
- Water Authority Delegation letter re: Board Memo 8-5: Authorize the execution and distribution of the Official Statement in connection with issuance of the Special Variable Rate Water Revenue Refunding Bonds (June 7, 2013)
- Water Authority Delegation letter re: Board Memo 8-1: Authorize the execution and distribution of Remarketing Statements in connection with the remarketing of the water Revenue Refunding Bonds (December 9, 2013)
- Water Authority letter re: Draft Long Range Finance Plan (January 5, 2011)
- Water Authority Delegation letter re: Update on Rate Refinement Discussions (Finance & Insurance Committee Item 7-a) (July 9, 2012)

- Water Authority's Director Wilson letter re: Rate Refinement Workshop (August 16, 2012)
- Water Authority Delegation letter re: Update on "Rate Refinement" (Board Information Item 7-b) (September 10, 2012)
- Water Authority Delegation letter re: Board Memo 8-3 – Approve the form of the amended and restated Purchase Order and authorize amendment of section 4122 of the Administrative Code (October 8, 2012)
- Water Authority letter re: Amended and Restated Purchase Order for System Water to be Provided by the Metropolitan Water District of Southern California ("Revised Purchase Order Form") (December 27, 2012)
- Water Authority letter re: Amended and Restated Purchase Order for System Water to be Provided by the Metropolitan Water District of Southern California (January 14, 2013)
- Water Authority Director Lewinger's letter re: Tracking Revenues from Rate Components Against Actual Expenditures (November 4, 2012)
- Water Authority Delegation letter re: Board Memo 8-1: Adopt resolutions imposing Readiness-to-Serve Charge and Capacity Charge effective January 1, 2014 – Request to Table or in the Alternative, Oppose (April 8, 2013)
- Water Authority Delegation letter re: Board Memo 8-1 – Set public hearing to consider suspending Section 124.5 of the Metropolitan Water District Act to maintain the current ad valorem tax rate (May 14, 2013)
- MWD letter re: Public Hearing scheduled pursuant to section 124.5 of the Metropolitan Water District Act (Stats. 1984, ch. 271) (May 29, 2013)
- MWD Board Memo 8-1 re: Mid-cycle Biennial Budget Review and Recommendations for Use of Reserves over Target signed by the general manager on May 30, 2013
- MWD Board Memo 8-2 re: Suspend the tax rate limitations in Section 124.5 of the Metropolitan Water District Act to maintain the ad valorem tax rate for fiscal year 2013/14 signed by the general manager on May 31, 2013
- Water Authority Delegation letter re 8-1 – Mid-cycle Biennial Budget Review and Recommendation for Use of Reserves over Target Water Rate Increases – Oppose and Request for Refund to Ratepayers of Excess Reserves and Board Memo 8-2 – Suspend the tax rate limitations in Section 124.5 of the Metropolitan Water District Act to maintain the ad valorem tax rate for fiscal years 2013/14 – Oppose (June 5, 2013)
- Water Authority Delegation letter re: Board Memo 5G-2: Adopt resolution maintaining the tax rate for fiscal year 2013/14 – Oppose (August 16, 2013)
- AFSCME letter re: October 8, 2013 Board Meeting (November 1, 2013)
- Water Authority letter re: Written Request for Notice Request for Data and Proposed Methodology for Establishing Rates and Charges (January 27, 2014)
- Mayors of 14 cities in San Diego Region letter re: MWD's calendar years 2015 and 2016 rate setting and fiscal years 2013 and 2014 over-collection (February 3, 2014)

- MWD's response letter re: Written Request for Notice Regarding Rate Setting (February 5, 2014)
- Water Authority response letter re: Renewed written request for data and proposed methodology for establishing rates and charges (February 28, 2014)
- Water Authority Delegation letter re: Metropolitan Water District Public Hearing on Suspension of Tax Rate Limitation (March 7, 2014)
- MWD response letter re: Response to Request for Information Dated February 28, 2014 (March 10, 2014)
- MWD letter re: Response to Request for Information Dated February 28, 2014 (March 19, 2014)
- MWD letter re: Further Response to Request for Information Dated February 28, 2014 (April 4, 2014)
- Water Authority Delegation letter re: KPMG Audit Report of MWD's Basic Statements for Years ended June 30, 2011 and 2010 (October 25, 2011)
- Water Authority letter re: San Diego County Water Authority's Annexation (March 13, 2012)
- Water Authority Delegation letter re: Adoption of 2010 Integrated Resources Plan - Oppose (October 11, 2010)
- Water Authority Delegation letter re: Board Memo 8-3 – Adjustments to Metropolitan's Water Supply Allocation Plan Formula; Request to Defer Action Pending Board Workshop (September 9, 2011)
- Water Authority Delegation letter re: Water Planning and Stewardship Committee items 6a, 6b, and 6d (October 7, 2011)
- Water Authority Delegation letter re: SB 60 Annual Public Hearing and Report to the Legislature Regarding Adequacy of MWD's Urban Water Management Plan; Request to Include Information in Report to Legislature (December 13, 2011)
- Water Authority Delegation letter re: Board Memo 7-2: Authorize execution of Memorandum of Understanding for the greater Los Angeles County Region Integrated Regional Water Management (IRWM) Plan leadership committee and join other IRWM groups in our service area if invited by member agencies (December 10, 2012)
- Water Authority Delegation Letter re: SB 60 Annual Public Hearing and Report to the Legislature Regarding Adequacy of MWD's UWMP; Request to Include Information in Report to Legislature (December 10, 2012)
- Water Authority Delegation Letter re: Board Item 9-1 – Proposed Foundational Actions Funding Program (March 7, 2013)
- Water Authority Delegation Letter re: Board Item 8-4: Approve Foundational Actions Funding Program -- OPPOSE (April 8, 2013)

- Water Authority Delegation letter re: Board Memo 7-3: Authorize entering into an exchange and purchase agreement with the San Gabriel Valley Municipal Water District (August 19, 2013)
- Water Authority Delegation letter re: Board Memo 8-2: Authorize staff to enter into funding agreements for Foundational Actions Funding Program proposals - Oppose (September 10, 2013)
- Residents for Sustainable Mojave Development letter re: Metropolitan Water District's Role in Approving the Cadiz Valley Water Conservation, Recovery and Storage Project (October 4, 2013)
- Water Authority Delegation letter re: Board Memo 8-3- Authorize (1) agreement with the State Water Contractors, Inc. to pursue 2014 Sacramento Valley water transfer supplies; and (2) \$5 per acre-foot initial administrative deposit not to exceed \$500,000 – Support with Reservation of Rights to object to cost allocation (October 4, 2013)
- Water Authority Delegation letter re : Board Letter 8-1 - Authorize amendment to Metropolitan's Cyclic Storage Agreement with Upper San Gabriel Valley Municipal Water District and the Main San Gabriel Basin Watermaster – Request to Table or in the Alternative to Oppose (October 8, 2013)
- Water Authority letter re: Foundational Actions Funding Program Agreement (November 13, 2013)
- Water Authority Delegation letter re: SB 60 Report – Water Planning and Stewardship Committee Public Hearing (December 9, 2013)
- Water Authority Delegation letter re: Board Memo 8-6 – Consolidated Agreement for Chino Basin Desalination Program – Oppose (June 13, 2011)
- Water Authority Delegation letter re: Board Item 8-3 –Oppose: Authorize entering into a Local Resources Program Agreement with Municipal Water District of Orange County and the city of San Clemente for the San Clemente Recycled Water System Expansion Project (June 11, 2012)
- Water Authority Delegation letter re: Board Item 7-1 –Oppose: Authorize entering into a Local Resources Program Agreement with Municipal Water District of Orange County and El Toro Water District for the El Toro Recycled Water System Expansion Project (August 20, 2012)
- Water Authority Delegation letter re: Board Item 7-1 –Oppose: Authorize entering into a Local Resources Program Agreement with Three Valleys Municipal Water District and California State Polytechnic University, Pomona, for the Cal Poly Pomona Water Treatment Plant (December 10, 2012)
- Water Authority Delegation letter re: Board Item 7-4 –Oppose: Authorize entering into a Local Resources Program Agreement with Calleguas Municipal Water District and Camrosa Water District for the Round Mountain Water Treatment Plant (February 11, 2013)

- Water Authority Delegation letter re: Board Item 7-2 –Oppose: Authorize entering into a Local Resources Program Agreement with the city of Long Beach and Water Replenishment District of Southern California for the Leo J. Vander Lands Water Treatment Facility Expansion Project (May 10, 2013)
- Water Authority Delegation letter re: Board Item 7-1 –Oppose: Authorize entering into a Local Resources Program Agreement with the city of Anaheim for the Anaheim Water Recycling Demonstration Project (July 5, 2013)
- Water Authority Delegation letter re: Board Item 7-4 –Oppose: Authorize entering into a Local Resources Program Agreement with Eastern Municipal Water District for the Perris II Brackish Groundwater Desalter (October 4, 2013)
- Water Authority Director Steiner letter re: August 2010 Board Memo 9-1, MWD Water Conservation Program (August 16, 2010)
- Water Authority letter re: Metropolitan’s Draft Long Term Conservation Plan (November 29, 2010)
- Water Authority letter re: Comments on Long Term Conservation Plan Working Draft Version 11 (July 20, 2011)
- Water Authority letter re: Turf Replacement Grant Programs (November 23, 2011)
- Water Authority Delegation letter re: Board Memo 8-4 – Oppose: Authorize changes to water conservation incentives (subsidies) as described (May 7, 2012)
- Water Authority Delegation statement re: Item 7-5: Adopt resolutions to (1) support applications and (2) authorize General manager to accept funding and enter into contracts with the Bureau of Reclamation for WaterSMART grant funding if awarded (February 11, 2013)
- Water Authority Delegation letter re: Board Memo 8-3 – Oppose: Authorization to implement New Conservation Program Initiatives (September 9, 2013)
- Water Authority Delegation letter re: Board Memo 8-2 – Authorize \$3 million for an On-Site Retrofit Pilot Program: Table Pending Development of Program Criteria and Cost of Service Analysis, or in the Alternative, Oppose and Board Memo 8-7 – Authorize an increase of \$20 million for conservation incentives and outreach: Oppose Unless Amended to Allow the Water Authority to Receive Program Benefits and Comply with Cost of Service Requirements (February 10, 2014)
- Water Authority Delegation letter re: Board Memo 8-3 – Table Pending Receipt of Additional Information or in the Alternative, Oppose: Authorize entering into a Water Savings Incentive Program (WSIP) Agreement with Altman’s Specialty Plants, Inc. to provide financial incentives for a water use efficiency project (March 10, 2014)
- Water Authority Delegation letter re: Board Memo 5-1 – Sale of discounted water Program (April 25, 2011)
- MWD response letter re: Response to April 25, 2011 letter on Board Memo 5-1 – Sale of Discounted Water (May 4, 2011)

- Water Authority Delegation letter re: Board Memo 5-1 Sale of Discounted Water (May 6, 2011)
- Water Authority Director Lewinger re: Comments and Questions on Board Memo 9-2 – Update on Replenishment Service Program (September 12, 2011)
- Water Authority Delegation letter re: Board Memo 8-8 - Approve Policy Principles for a Replenishment (Discounted Water) Program (November 4, 2011)
- Water Authority Delegation letter re: Board Memo 9-1 - Review Options for Updated Replenishment (Discounted Water) Program (December 12, 2011)
- Water Authority Delegation letter re: MWD Letters on Replenishment dated December 21, 2011 (January 5, 2012)
- MWD response letter re: Replenishment Workgroup Documentation (January 18, 2012)
- Water Authority Delegation letter re: Item 7-3 – Approve amendments to the Metropolitan Water District Administrative Code to current laws and practices and makes corrections (September 10, 2012)
- Testimony of Dennis Cushman, Water Authority assistant general manager, re: Water Planning and Stewardship Committee Item 6-c: oral report on QSA issues (October 9, 2012)
- Water Authority letter re: Record of September 10, 2013 Meeting of the Board of Directors of the Metropolitan Water District of Southern California - Item 8-2 (September 11, 2013)
- MWD response letter re: Record of September 10, 2013 MWD Board Meeting of the Board of Directors of the Metropolitan Water District of Southern California - Item 8-2 (September 16, 2013)
- MWD letter re: Responses to Director Questions re Ethics Workshops (November 14, 2013)
- Water Authority Delegation letter re: Applicability of MWD’s Administrative Code (December 9, 2013)
- MWD response letter re: Applicability of MWD’s Administrative Code (January 10, 2014)



THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

Office of the General Counsel

VIA FEDERAL EXPRESS

March 19, 2014

Daniel Hentschke, Esq.
San Diego County Water Authority
4677 Overland Avenue
San Diego, CA 92123-1233

Re: Response to Request for Information Dated February 28, 2014

Dear Dan:

Enclosed is a DVD containing Metropolitan records provided in response to San Diego County Water Authority's (SDCWA) February 28, 2014 Public Records Act request for the "database, inputs, outputs, spreadsheets, and reports used or prepared by Metropolitan staff or consultants in the development of the recommended rates, charges, surcharges, or fees," to the extent that such material has not already been provided to Metropolitan's Board of Directors, including SDCWA's delegates. Proprietary formulas and programming code have been removed from spreadsheets, and employee names and identifying employee numbers have been redacted.

As stated in my March 10 letter, although Metropolitan disagrees with SDCWA's assertion that Government Code Section 54999.7 is applicable to Metropolitan (and SDCWA has agreed in the past that the Section does not apply to Metropolitan), Metropolitan has fully complied with Government Code Section 54999.7's requirements through the proposed budget and rates information that has been provided and will continue to be provided to the Board, member agencies and the public. As part of its regular budget-setting and rate-setting process, Metropolitan provides to the Board, member agencies and the public the detailed data and proposed methodology for the proposed rates and charges, through the budget and rate Board letters, proposed budget, costs of services studies for various rate proposals, presentations and discussions at the multiple committee and Board meetings and workshops.

The DVD contains Metropolitan Finance staff's working materials that underlie this detailed, previously-provided material. This includes drafts and calculations, and also includes materials concerning potential rate scenarios that were not presented to the Board. Metropolitan's budget-setting and rate-setting process is still in progress. The DVD contains materials through the February 25, 2014 Board budget and rate workshop and some subsequent underlying materials. As the staff continues to work on rate scenarios in response to requests from the Board and

Daniel Hentschke, Esq.
March 19, 2014
Page 2

direction from management until final adoption of the budget and rates, we will provide one or more additional productions with later records as well.

As noted in my March 10 letter, we will post this material on-line so it is available to all Metropolitan Board members, member agency staff and the public. If any Board member requests, we will also provide the material on a DVD.

Very truly yours,



Marcia Scully
General Counsel

MS:jmm

Enclosure

cc (without enclosure):

Members of the Metropolitan Board of Directors
Member Agency Managers
Jeffrey Kightlinger
Maureen Stapleton



THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

Office of the General Counsel

April 4, 2014

Daniel Hentschke, Esq.
San Diego County Water Authority
4677 Overland Avenue
San Diego, CA 92123-1233

Re: Further Response to Request for Information Dated February 28, 2014

Dear Dan:

This follows up on my letter of March 19, 2014, which enclosed a DVD containing materials provided in response to San Diego County Water Authority's February 28, 2014 Public Records Act request. My March 19 letter noted that as Metropolitan's budget-setting and rate-setting process is still in progress, we would also provide one or more additional productions of later records. Enclosed is a DVD containing Metropolitan's second production of requested records. Proprietary formulas and programming code have been removed from spreadsheets.

As with Metropolitan's first production, we have posted this material on-line so it is available to all Metropolitan Board members, member agency staff and the public. If any Board member requests, we will also provide the material on a DVD.

Very truly yours,

A handwritten signature in cursive script that reads "Marcia".

Marcia Scully
General Counsel

MS:jmm

Enclosure

cc: (without enclosure)
Members of the Metropolitan Board of Directors
Member Agency Managers
Jeffrey Kightlinger
Maureen Stapleton

From: Office of the General Counsel
Sent: Friday, April 04, 2014 4:03:02 PM (UTC-08:00) Pacific Time (US & Canada)
Cc: Kightlinger, Jeffrey; Lichtenberger, Julia
Subject: Further Response to San Diego County Water Authority's Request for Information Dated February 28, 2014



*THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA*

Date: April 4, 2014
To: Board of Directors
Member Agency Managers
From: Marcia Scully, General Counsel
Subject: Further Response to San Diego County Water Authority's Request for Information Dated February 28, 2014

Attached is our further response to SDCWA's Request for Information dated February 28. If you have any questions, please feel free to contact me.

This communication, together with any attachments or embedded links, is for the sole use of the intended recipient(s) and may contain information that is confidential or legally protected. If you are not the intended recipient, you are hereby notified that any review, disclosure, copying, dissemination, distribution or use of this communication is strictly prohibited. If you have received this communication in error, please notify the sender immediately by return e-mail message and delete the original and all copies of the communication, along with any attachments or embedded links, from your system.



BEST PRACTICE

Long-Term Financial Planning (2008) (BUDGET)

Background. Long-term financial planning combines financial forecasting with strategizing. It is a highly collaborative process that considers future scenarios and helps governments navigate challenges. Long-term financial planning works best as part of an overall strategic plan.

Financial forecasting is the process of projecting revenues and expenditures over a long-term period, using assumptions about economic conditions, future spending scenarios, and other salient variables.

Long-term financial planning is the process of aligning financial capacity with long-term service objectives. Financial planning uses forecasts to provide insight into future financial capacity so that strategies can be developed to achieve long-term sustainability in light of the government's service objectives and financial challenges.

Many governments have a comprehensive long-term financial planning process because it stimulates discussion and engenders a long-range perspective for decision makers. It can be used as a tool to prevent financial challenges; it stimulates long-term and strategic thinking; it can give consensus on long-term financial direction; and it is useful for communications with internal and external stakeholders.

Recommendation. The Government Finance Officers Association (GFOA) recommends that all governments regularly engage in long-term financial planning that encompasses the following elements and essential steps.

A long-term financial plan should include these elements.

- (1) *Time Horizon.* A plan should look at least five to ten years into the future. Governments may elect to extend their planning horizon further if conditions warrant.
- (2) *Scope.* A plan should consider all appropriated funds, but especially those funds that are used to account for the issues of top concern to elected officials and the community.
- (3) *Frequency.* Governments should update long-term planning activities as needed in order to provide direction to the budget process, though not every element of the long-range plan must be repeated.
- (4) *Content.* A plan should include an analysis of the financial environment, revenue and expenditure forecasts, debt position and affordability analysis, strategies for achieving and maintaining financial balance, and plan monitoring mechanisms, such as scorecard of key indicators of financial health.
- (5) *Visibility.* The public and elected officials should be able to easily learn about the long-term financial prospects of the government and strategies for financial balance. Hence, governments should devise an effective means for communicating this information, through either separate plan documents or by integrating it with existing communication devices.

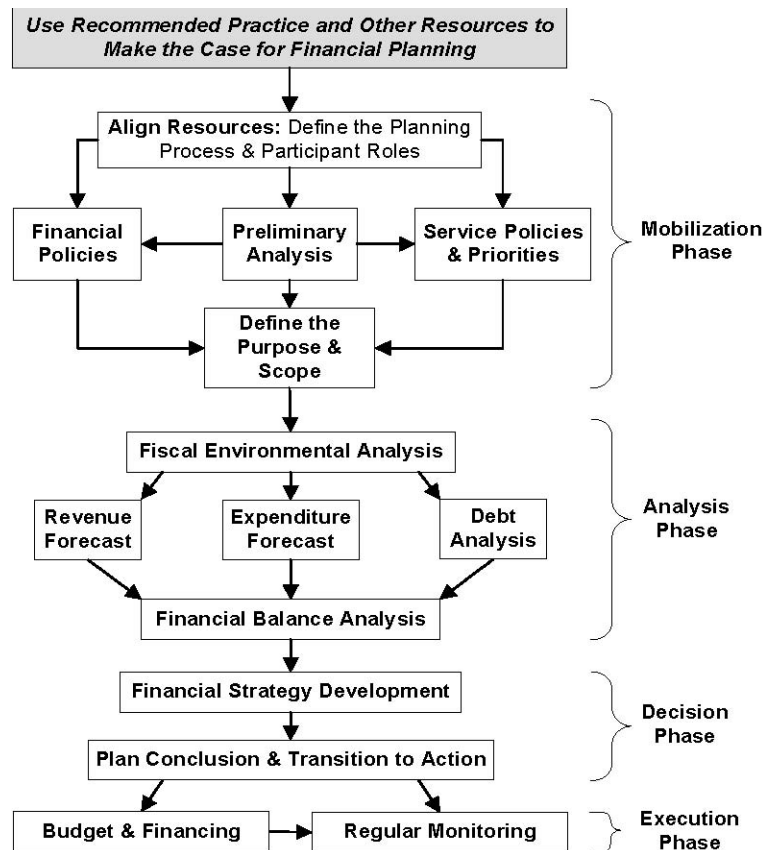
A long-term financial plan should include these steps.

- (1) *Mobilization Phase.* The mobilization phase prepares the organization for long-term planning by creating consensus on what the purpose and results of the planning process should be. The mobilization phase includes the following items.
 - a. *Alignment of Resources.* This step includes determining the composition of the project team, identifying the project sponsor, and formulating a strategy for involving other important stakeholders. This step also involves the creation of a high-level project plan to serve as a roadmap for the process.
 - b. *Preliminary Analysis.* This step helps raise awareness of special issues among planning participants, such as the board or non-financial executive staff. A scan of the financial environment is common at this point.
 - c. *Identification of Service Policies and Priorities.* Service policies and priorities have important implications on how resources will be spent and how revenues will be raised. A strategic plan or a priority setting session with elected officials could be useful in identifying service policies and priorities.
 - d. *Validation and Promulgation of Financial Policies.* Financial policies set baseline standards for financial stewardship and perpetuate structural balance, so a planning process must corroborate policies in place (as well as the organization's compliance with those policies) and also identify new policies that may be needed.
 - e. *Definition of Purpose and Scope of Planning.* The purpose and scope of the planning effort will become clear as a result of the foregoing activities, but the process should include a forum for developing and recognizing their explicit purpose and scope.

- (2) *Analysis Phase.* The analysis phase is designed to produce information that supports planning and strategizing. The analysis phase includes the projections and financial analysis commonly associated with long-term financial planning. The analysis phase involves information gathering, trend projection, and analysis as follows:
 - a. *Information Gathering.* This is where the government analyzes the environment in order to gain a better understanding of the forces that affect financial stability. Improved understanding of environmental factors should lead to better forecasting and strategizing.
 - b. *Trend Projection.* After the environment has been analyzed, the planners can project various elements of long-term revenue, expenditure, and debt trends.
 - c. *Analysis.* The forecasts can then be used to identify potential challenges to fiscal stability (e.g., "imbalances"). These could be fiscal deficits (e.g., expenditures outpacing revenues), environmental challenges (e.g., unfavorable trends in the environment), or policy weaknesses (e.g., weaknesses in the financial policy structure). Scenario analysis can be used to present both optimistic, base, and pessimistic cases.

- (3) *Decision Phase.* After the analysis phase is completed, the government must decide how to use the information provided. Key to the decision phase is a highly participative process that involves elected officials, staff, and the public. The decision phase also includes a culminating event where the stakeholders can assess the planning process to evaluate whether the purposes for the plan described in the mobilization phase were fulfilled and where a sense of closure and accomplishment can be generated. Finally, the decision phase should address the processes for executing the plan to ensure tangible results are realized.

(4) *Execution Phase*. After the plan is officially adopted, strategies must be put into action (e.g. funding required in achieving goals). The execution phase is where the strategies become operational through the budget, financial performance measures, and action plans. Regular monitoring should be part of this phase. The following diagram highlights the various long-term financial planning phases discussed in this recommended practice.



References

- GFOA Best Practice, “Financial Forecasting in the Budget Preparation Process,” 1999.
- GFOA Best Practice, “Adoption of Financial Policies,” 2001.
- GFOA Best Practice, “*Establishment of Strategic Plans*,” 2005.
- GFOA Best Practice, “*Budgeting for Results and Outcomes*,” 2007.
- GFOA Best Practice, “*Performance Management: Using Performance Measurement for Decision Making*,” 2002 and 2007.
- *Financing the Future Long-Term Financial Planning for Local Government*; GFOA, 2007.
- <http://www.gfoa.org/ltfp>. GFOA Web site containing a wealth of supporting materials for financial planning.
- <http://www.gfoa.org/services/nacslb/>. Best Practices in Budgeting Web site. See Element 9 –Develop and Evaluate Financial Options.

Approved by the GFOA’s Executive Board, February 22, 2008.

Comments by Jeffrey Kightlinger, General Manager, Metropolitan Water District of Southern California, during a public workshop held in San Diego on MWD's Integrated Resources Plan, Aug. 10, 2010.

“A quick comment on contracts. That is an interesting point. Metropolitan and all the State Water Contractors agreed to what are commonly referred to as ‘take-or-pay’ contracts. I’ve never understood the word ‘or,’ because the reality is, you pay regardless of what you take, to be honest. So it’s more like ‘pay’ and ‘sometimes take.’ But, these ‘take-or-pay’ Contractors, we have made a firm commitment to the State of California that we are going to pay half of the fixed costs of the State Water Project every single year, regardless of whether we get one drop of water from the project. There has been debate within Metropolitan that perhaps Member Agencies should do that same kind of commitment as well, so there is a certain base-load of funding and financing available for our projects. Because Member Agencies develop local resources on their own, and start using less and less of Metropolitan water. To date, that while staff thinks contracts are a terrific idea, to date, most of our board members have said ‘we’re not so sure about that.’ And, most of our Member Agencies have said ‘No. Thanks, but no thanks, because we prefer this the way it is.’ We do try to, though, keep a certain amount of our revenue stream in fixed costs, and a certain amount of our revenue stream in the water supply. But, right now it’s about 80% or more comes from the sale of water. We have about 15% in property taxes, and we’ve slowly but surely added to a fixed fee that everybody pays every single year. But that’s an ongoing debate within Metropolitan. Should people make those firm commitments going into the future? So far, the Member Agencies have opted not to. They prefer it the way it is. I think we’re going to continue to have that discussion at Metropolitan, particularly as costs increase. “Oh, and we’ll definitely take that into consideration, I definitely want to make sure that’s put into the Integrated Resources Plan.¹ Because I do believe, if we are successful – and this is something I keep telling people - if we are successful on the State Water Project – and success means a very expensive eco-system rehab project the size of what we’ve done in the Florida Everglades, and success means building a new tunnel or canal that we’re looking in the eight- to 12-billion-dollar range with the State of California - and Metropolitan coming on board to pay 25% of that cost – that’s a significant new cost that Metropolitan, the next generation of Metropolitan ratepayers will be paying. And we need to take a look at different financing mechanisms that everyone is comfortable with region-wide.”

¹Requirement for firm contractual commitments by Member Agencies to pay MWD’s State Water Project costs was not included in MWD’s adopted 2010 Integrated Resources Plan.



San Diego County Water Authority

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(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

April 8, 2014

Jeff Kightlinger, General Manager and
Members of the Board of Directors
Metropolitan Water District of Southern California
P.O. Box 54153
Los Angeles, CA 90054-0153

MEMBER AGENCIES

Carlsbad
Municipal Water District

City of Del Mar

City of Escondido

City of National City

City of Oceanside

City of Poway

City of San Diego

Fallbrook
Public Utility District

Helix Water District

Lakeside Water District

Olivenhain
Municipal Water District

Otay Water District

Padre Dam
Municipal Water District

Camp Pendleton
Marine Corps Base

Rainbow
Municipal Water District

Ramona
Municipal Water District

Rincon del Diablo
Municipal Water District

San Dieguito Water District

Santa Fe Irrigation District

South Bay Irrigation District

Vallecitos Water District

Valley Center
Municipal Water District

Vista Irrigation District

Yuima
Municipal Water District

OTHER REPRESENTATIVE

County of San Diego

RE: April 8, 2014 Board Meeting Board Memo 8-1 – Approve proposed biennial budget for fiscal years 2014/15 and 2015/16, proposed ten-year forecast, proposed revenue requirements for fiscal years 2014/15 and 2015/16, and recommended water rates and charges to be effective on January 1, 2015 and January 1, 2016; adopt resolutions fixing and adopting water rates and charges for 2015 and 2016; and transmit the General Manager’s Business Plan Strategic Priorities for FY 2014/15 and 2015/16 – **REQUEST TO CONTINUE BOARD ACTION ONE MONTH, UNTIL THE MAY BOARD MEETING, TO ALLOW AN OPPORTUNITY FOR REVIEW OF INFORMATION PROVIDED TO THE BOARD OF DIRECTORS ON APRIL 4, 2014, AT 4:03 PM; IN THE ALTERNATIVE – OPPOSE**

Dear Mr. Kightlinger and Board Members:

We have reviewed Board Memo 8-1 and the supplemental information that was provided by MWD via Ms. Scully’s March 19, 2014 letter to Dan Hentschke and DVD, as the basis of its proposed rates and charges for 2015 and 2016. The Water Authority has not had an opportunity to review the additional information that was provided by Ms. Scully last Friday afternoon in her letter dated April 4, 2014 and an attached DVD, which states that it is in response to the Water Authority’s February 28, 2014 Public Records Act request.

Request to continue Board action one month, until the May Board meeting, to allow an opportunity for review of information provided to the Board of directors on April 4, 2014 at 4:03 PM

The information provided to the Water Authority last Friday afternoon was first requested more than two months ago, on January 27, 2014. Based upon a cursory review, there does not appear to be any reason why this information could not have been provided in a timely manner, which would have allowed for meaningful review and consideration of the information by MWD Board members, agency staff and the public. For this reason, we request that the Board continue action on the 2015 and 2016 rates (“the 2015/16 rates”) until the May 13 Board meeting.

Leaving aside for the moment that Judge Karnow has already ruled that Government Code § 54999.7 *does* apply to MWD, and leaving aside that your delivery of the data today is *not timely under the Public Records Act*, we do not understand why the MWD staff and Board of Directors would *not* want to make available all of the data and methodology MWD relies upon in setting its rates and charges. As stated earlier, in Mr. Hentschke's February 28, 2014 letter to Ms. Scully (RE: Renewed written request for data and proposed methodology for establishing rates and charges (Government Code §§54999.7 and 6250 et seq.)), we believe the "financial planning model" computer program MWD uses in setting its rates and charges should be provided in the interest of making review of the data and methodology easier to understand and more transparent. This would be a great service to the MWD member agencies and public we serve and enable it to meet the burden it now has under Proposition 26. Based upon the information that has been provided, it is not possible for MWD to meet its burden because there is insufficient data to determine the cause of the costs MWD is incurring or the relative benefits each of its member agencies and ratepayers is receiving.

The cost-of-service methodology used by MWD in support of its rates and charges violates Proposition 26, the California wheeling statute, Government Code § 54999.7 (a) and the common law

The cost-of-service methodology used to establish water rates and charges under the three rate options presented by MWD (which do not vary substantively but only provide for varying percentage increases in the proposed 2015/16 rates) in Board Memo 8-1 ("the Board Memo") is based on the very same rate structure and cost-of-service methodology that was at issue in the recent trial in San Francisco challenging the 2010-2014 rates and charges ("the rate litigation"). We are disappointed that the MWD Board has not taken a closer look at the issues and tentative decision by Judge Karnow in the rate litigation, as well as the reasons for his decision. MWD has not changed how it allocates State Water Project and Water Stewardship Rate costs; as a result, unless the trial court's ruling is reversed on appeal, the 2015/16 rates will suffer from exactly the same deficiencies as have already been determined to be unlawful in the rate litigation.

Although MWD has once again provided a lot of *paperwork* relating to the proposed rates and charges for 2015/16, it fails to present relevant or timely *factual data*, or, follow a cost-of-service process that allows costs to be allocated based on cost causation and according to the benefits received by its member agencies and ratepayers. Although the MWD Board has been told during this process that staff has allocated costs consistent with cost-of-service requirements, MWD has argued in court that *none of these requirements even applies to MWD*. This includes state constitution Article XIII C (Proposition 26), Government Code Section 54999.7 and the common law. In other words, MWD argues that all these legal requirements – *intended to ensure that ratepayers are charged fair rates for government services* – simply do not apply to MWD.

MWD's claim of immunity from cost causation requirements exposes its cost-of-service report for what it is – a pretense that portrays the impression that MWD follows cost causation principles, when it does not. Perhaps that is why MWD refuses to release its financial planning model, which would allow member agencies and the public to understand how MWD has allocated its costs. MWD's position is that its actions are subject only to the requirement that uniform rates be charged and approved by a majority of the MWD Board of Directors. This should be a cause of concern for all MWD Board members and the millions of ratepayers they collectively serve. MWD has offered no explanation why it would be in the public interest to allow MWD to charge ratepayers more than the actual cost of the services it provides.

MWD's newly created "full service exchange cost" is based on litigation strategies and "labels," not cost-of service requirements

MWD has added – without any substantive explanation or analysis – a new line item to its schedule of rates and charges for the 2015/16 rates, namely, a "Full Service Exchange Cost" (Table 2. Rates and Charges by Option, at page 5 of the Board Memo). MWD has not supported this new "rate" by any cost-of-service analysis, because none exists or could exist. In fact, until MWD's Board Memo was distributed, there was no such thing as a "Full Service Exchange Cost" rate.

The full service exchange cost rate is yet another litigation-driven invention designed to be consistent with MWD's most recent litigation theory, advanced for the first time in the objections to the court's tentative decision that MWD filed on March 27, 2014. MWD is now saying that its individual rates – which it had previously claimed were adopted for more transparency and were based on cost of service – are in fact, nothing more than "labels." It doesn't matter, MWD now argues, whether a dollar of costs or a hundred dollars of costs is assigned to any particular rate component. While obviously intended to salvage its position in the rate litigation, this argument by MWD actually supports what the Water Authority has been saying all along – that MWD's rates are arbitrary and capricious and not based on data or cost-of-service requirements.

MWD's "revenue requirements" are based on a false set of assumptions and purposely underestimate revenues, rather than on facts and data available to MWD

In the current budget and rate-setting process, MWD staff has abandoned any effort to estimate MWD's real revenue requirements. Instead, the budget and long term "projections" are based on an artificial water sales assumption of 1.75 million acre feet, which staff has said would be exceeded three out of every four years. In years when high demands are anticipated – such as during the current drought – this artificial assumption purposely under-estimates projected revenues. MWD has also purposely over-stated its costs by, for example, including costs associated with assumed delivery of State Water

Project water in volumes that MWD itself projects will not be delivered.

These budget and rate-setting practices do not conform to any industry or agency standard. To the contrary, these practices are purposely designed to put MWD in the same position it has been in over the last budget cycle: collecting hundreds of millions of dollars in revenues without any basis in cost of service and making budget and spending decisions ex post facto. The Board's budget and rate-setting process is broken. MWD should set its rates based on rational projections, rather than assumptions it knows are incorrect and will result in hundreds of millions of dollars in over- and under-collections.

Board Memo 8-1 shows on its face that suspension of the tax rate restriction is not now, and will not in August be "essential to the fiscal integrity of MWD"

Section 124.5 permits MWD to suspend the limitation on property tax collections if the MWD Board finds that tax revenue in excess of the restriction is "essential to the fiscal integrity" of MWD. The Board Memo states that, "if the Board decides to not suspend the tax rate restriction in August, any reduction in revenues will be made up from the R&R Fund, and projected rate increases in FY 2016/17 and 2017/18 will be 2 percent higher." Given this explanation and the massive over-collection of revenues MWD continues to plan for and impose on ratepayers through the adoption of the proposed budget and rates, suspension of the tax rate restriction cannot plausibly be "essential to the fiscal integrity" of MWD.

The General Manager's "Business Plan Strategic Priorities" include large spending priorities that have not been presented to policy committees or even to the Board as part of the budget deliberations

The Board should bring back the General Manager's "Business Plan Strategic Priorities," for discussion and deliberation by the Board of Directors. The Board has not yet voted on key issues that would be foundational to moving forward with the "priorities" being declared by the General Manager, for example, "developing procedures and structures to handle the mechanics and logistics of managing a mega-construction project." The General Manager's priorities should not exist separate and apart from the priorities that the Board establishes during the budget deliberations and in other long-range planning processes that have not yet occurred.

MWD's "10-year forecast" lacks the essential elements of long-term planning and does not constitute a long range finance plan

MWD's "10-year rate forecast" lacks both the substance and process of a long-range finance plan. The 10-year "forecast" is not based on any *data*, and does not include any planning scenarios, risk analysis or input and data from its member agencies. Instead, it describes a set of *assumed, static conditions*.

Mr. Kightlinger and Members of the Board of Directors

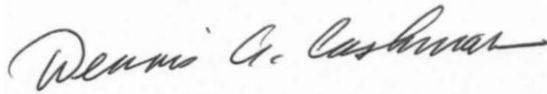
April 8, 2014

Page 5

Long range finance planning is a dynamic, fact-based process of aligning financial capacity with long-term service objectives. Forecasts of future financial capacity are used so strategies can be developed to achieve long-term sustainability in light of the stated *service objectives and financial challenges*. None of these key issues are discussed in the “projection” included in the budget, which has been unilaterally prepared and presented by MWD staff without any involvement whatsoever by the MWD Board of Directors or input or participation by the member agencies. Neither does the purported long term plan contain any scenarios and risk analyses that a real long range finance plan includes. The 10-year rate forecast that MWD labels a long range finance plan has the same attribute as its budget process – it is based on assumptions, rather than engaging in the more difficult and important process of financial planning based on best available data and articulation of service objectives.

In closing, MWD’s Board of directors is being asked by its staff to adopt a budget based upon data and assumptions it knows are incorrect, and two more years of rates based upon the same defective methodology that the court has ruled violates Proposition 26, the wheeling statutes, Government Code §54999.7 and the common law.

Sincerely,

A handwritten signature in cursive script, appearing to read "Dennis A. Cushman". The signature is written in black ink on a light-colored background.

Dennis A. Cushman
Assistant General Manager

SUPERIOR COURT OF THE STATE OF CALIFORNIA
COUNTY OF SAN FRANCISCO
BEFORE THE HONORABLE CURTIS E. A. KARNOW
DEPARTMENT 304

SAN DIEGO WATER AUTHORITY,)
)

Petitioner and Plaintiff,) Case No.
) CPF-10-510830 &
vs.) CPF-12-512466
)

METROPOLITAN WATER DISTRICT OF)
SOUTHERN CALIFORNIA; ALL)
PERSONS INTERESTED IN THE)
VALIDITY OF THE RATES ADOPTED BY)
THE METROPOLITAN WATER DISTRICT)
OF SOUTHERN CALIFORNIA ON APRIL)
10, 2012 TO BE EFFECTIVE JANUARY)
1, 2013 AND JANUARY 1, 2014, and)
DOES 1-10,) Pages 1 - 182
)

Respondents and Defendants.)
)

REPORTER'S TRANSCRIPT OF PROCEEDINGS
San Francisco Superior
San Francisco, California
Thursday, April 2, 2015

Reported By:
TARA SANDFORD, RPR, CSR #3374

JAN BROWN & ASSOCIATES
WORLDWIDE DEPOSITION & VIDEOGRAPHY SERVICES
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(resumed)

UPADHYAH, Devendra 45 59 88 --

STAPLETON, Maureen 91 168 --

EXHIBITS

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175	6/30/10 letter	11 11
189	2/24/11 letter	14 14
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EXHIBITS (continued)

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1 San Francisco, California
 2 Thursday, April 2, 2015
 3 10:00 a.m.
 4 Department 304 Hon. Curtis E. A. Karnow, Judge
 5
 6 THE COURT: Good morning.
 7 I had a chance to look at Metropolitan's motion
 8 brought at the conclusion of the Plaintiff's case. And
 9 I am going to defer this until the end of trial. I
 10 think I understand the differences in approaches here.
 11 We've got two views as to how it is proper to
 12 establish a breach and how it is proper to measure
 13 damages. I think the wisest course is to defer ruling
 14 until the end of this trial.
 15 So let's proceed with our witnesses.
 16
 17 JEFF KIGHTLINGER,
 18 resumed the stand and testified further as follows:
 19
 20 THE COURT: You recall you are still under
 21 oath?
 22 THE WITNESS: Yes, sir.
 23 /
 24 //
 25 ///

5

1 Q. I think you testified that San Diego during
 2 that five years didn't try to persuade Metropolitan to
 3 change the cost allocations that went into its rate
 4 structure; correct?
 5 A. Yes.
 6 MR. PURCELL: All right. I'd like to read from
 7 Brian Thomas's deposition again, the person most
 8 knowledgeable for Metropolitan, pages 144, line 18, to
 9 145, line 21.
 10 THE COURT: Is that something that I have?
 11 MR. PURCELL: We can get it up on the screen.
 12 THE COURT: Let's follow along on the screen.
 13 You don't have that?
 14 THE WITNESS: I am not aware if I have it.
 15 THE COURT: Let's follow along on the screen.
 16 You don't have that?
 17 THE WITNESS: I am not aware I have it. Maybe
 18 it is in one of these binders.
 19 MR. KEKER: 144, yes.
 20 MR. PURCELL: This is in evidence as PTX 516.
 21 May I proceed, your Honor?
 22 THE COURT: Please.
 23 MR. PURCELL: (Reading:)
 24 Starting at page 144, line 18 and going to page
 25 145 at line 21.

7

1 CROSS-EXAMINATION (resumed)
 2 BY MR. PURCELL:
 3 Q. Good morning, Mr. Kightlinger.
 4 A. Good morning, sir.
 5 Q. I would just like to clear one thing up to
 6 start with. There's a lot of testimony yesterday about
 7 the Metropolitan rate structure; correct?
 8 A. Yes.
 9 Q. Now, the rate structure is the buckets that Met
 10 arranges for the rates; right? There is a supply
 11 bucket; there's a power bucket, and there is a system
 12 access bucket?
 13 A. Yes.
 14 Q. San Diego's objections aren't to the buckets,
 15 really; they are to the allocation of costs that go into
 16 the buckets; correct?
 17 A. That is how I understand their objections, yes.
 18 Q. Okay, good.
 19 So I am going to talk about in terms of cost
 20 allocations, really, rather than the rate structure, and
 21 if there is any confusion, please let me know.
 22 You testified yesterday about the five-year
 23 period following the execution of the exchange
 24 agreement; correct?
 25 A. Yes.

6

1 "Q Okay. The Water Authority
 2 waited until beyond that
 3 five-year period before it
 4 filed this lawsuit; correct?
 5 "A Yes.
 6 "Q During the -- during the
 7 time between the filing of the
 8 exchange agreement or, rather,
 9 the signing of the exchange
 10 agreement and the filing of
 11 this lawsuit, the Water
 12 Authority participated in
 13 various Metropolitan processes
 14 related to the setting of Met's
 15 rates; right?
 16 "A Yes.
 17 "Q The Water Authority
 18 continued to advocate for
 19 changes to Met's rates in the
 20 boardroom and in committee
 21 meetings; right?
 22 "A Yes.
 23 "Q That was part of the rate
 24 -- for example, the rate
 25 refinement process?

8

1 "A Yes. Staff, as well. In
 2 staff meetings, as well.
 3 "Q And in staff meetings, as
 4 well.
 5 "And likewise, there was a cost
 6 of service review process that
 7 the Water Authority
 8 participated in during that
 9 process?
 10 "A Yes.
 11 "Q And as part of the cost of
 12 service review process, the
 13 Water Authority again advocated
 14 in the boardroom, and in
 15 committee meetings and in staff
 16 meetings for changes to
 17 Metropolitan's rates?
 18 "A Yes."
 19 Q. Mr. Kightlinger, was Mr. Thomas wrong?
 20 A. No.
 21 Q. We talked yesterday a little bit about the
 22 dispute resolution process in Section 11.1 of the
 23 exchange agreement.
 24 Do you remember that discussion?
 25 A. Yes.

9

1 Q. Prior to the Water Authority filing this
 2 lawsuit, the Water Authority invoked that dispute
 3 resolution process; correct?
 4 A. Yes, they sent us a letter at some point,
 5 around 2010, I believe.
 6 Q. And Metropolitan responded with a letter of its
 7 own?
 8 A. I believe so. I don't think you showed it to
 9 me yesterday. I think we did respond.
 10 Q. I would just like to do that now and hopefully
 11 we can do it quickly. Can I get PTX 169 up on the
 12 screen?
 13 Mr. Kightlinger, is this the letter the Water
 14 Authority sent to you invoking paragraph 11.1?
 15 A. Yes.
 16 MR. PURCELL: I would like to move PTX 169 into
 17 evidence, your Honor.
 18 MR. EMANUEL: I really don't understand the
 19 point of this.
 20 THE COURT: What's your objection?
 21 MR. EMANUEL: The objection is relevance, your
 22 Honor.
 23 THE COURT: Overruled.
 24 PTX 169 is admitted.
 25 (Exhibit PTX 169 was received into evidence.)

10

1 MR. PURCELL: Can I get PTX 175 up on the
 2 screen?
 3 Q. Mr. Kightlinger, is this a subsequent letter to
 4 the Water Authority sent to Karen Tachiki, your
 5 successor as Metropolitan general counsel, involving the
 6 resolution dispute process in paragraph 11.1?
 7 A. Yes, it looks like it.
 8 Q. Did you get a copy of this letter when it was
 9 sent to Ms. Tachiki?
 10 A. Probably.
 11 MR. PURCELL: Your Honor, I would like to move
 12 PTX 175 into evidence.
 13 MR. EMANUEL: I have an objection. This was
 14 not part of Plaintiff's exhibit list in advance of
 15 trial. I will not object to it being admitted, but I do
 16 want it noted that it is not really playing by the
 17 rules.
 18 MR. PURCELL: It is on our list, your Honor.
 19 We are happy to provide a copy of the list.
 20 THE COURT: We can take care of that at one of
 21 the convenient breaks today. In the meantime, PTX 175
 22 is admitted.
 23 (Exhibit 175 was received into evidence.)
 24 MR. PURCELL: Can I have PTX 207 up on the
 25 screen?

11

1 Q. Mr. Kightlinger, is this a letter that the
 2 Water Authority sent to Metropolitan, to you
 3 specifically, stating that all payments made to the
 4 water stewardship rate after June 23, 2011, are made
 5 under protest?
 6 A. Yes.
 7 MR. PURCELL: I would like to move PTX 207 into
 8 evidence.
 9 MR. EMANUEL: No objection, your Honor.
 10 THE COURT: I am looking at the record. It
 11 clearly reflects your position.
 12 PTX 207 is admitted.
 13 (PTX 207 was received into evidence.)
 14 MR. PURCELL: Can I have PTX 225 up on the
 15 screen?
 16 Q. Mr. Kightlinger, is this a letter you sent in
 17 response to the Water Authority's request for a
 18 negotiation under paragraph 11.1 of the exchange
 19 agreement?
 20 A. I can't see the bottom. I don't know if I
 21 signed it or Karen signed it, but this is certainly a
 22 letter in response from Metropolitan, yes.
 23 Q. I think PTX 225 is in the new binder I gave you
 24 this morning, if you want to confirm that fact. It is
 25 in fact.

12

1 Actually, Mr. Kightlinger, you can see on the
 2 screen, I pulled up the signature block.
 3 **A. That is my signature, yes.**
 4 MR. PURCELL: I would like to move 225 into
 5 evidence.
 6 MR. EMANUEL: No objection.
 7 THE COURT: PTX 225 is admitted.
 8 (Exhibit PTX 225 was received in evidence.)
 9 Q. BY MR. PURCELL: Mr. Kightlinger, Metropolitan
 10 has never contended that the Water Authority failed to
 11 satisfy the dispute resolution obligation in paragraph
 12 11.1 of the exchange agreement; correct?
 13 **A. That's correct.**
 14 Q. Similarly, there's a procedure under the
 15 exchange agreement for Metropolitan to set aside
 16 disputed amounts of payments under the exchange
 17 agreement when there's a price dispute; correct?
 18 **A. Yes.**
 19 Q. And the Water Authority sent some
 20 correspondence to Metropolitan invoking that set-aside
 21 procedure?
 22 **A. Yes.**
 23 Q. And Metropolitan responded to the Water
 24 Authority's letters?
 25 **A. Yes, they did.**

13

1 Q. In fact, money was set aside?
 2 **A. Yes, it was.**
 3 MR. PURCELL: I would like to show you a few
 4 letters on that. PTX 189, please.
 5 Q. Mr. Kightlinger, is this a letter that the
 6 Metropolitan general counsel sent to Dan Hentschke, San
 7 Diego general counsel, regarding payments under protest
 8 under the exchange agreement?
 9 **A. Yes, it is.**
 10 MR. PURCELL: I would like to move PTX 189 into
 11 evidence.
 12 MR. EMANUEL: No objection, your Honor,
 13 although the copy that is on the screen doesn't have a
 14 number on it. Is it there someplace else?
 15 MR. PURCELL: It is at the top.
 16 MR. EMANUEL: That's all I needed.
 17 THE COURT: PTX 189 is admitted.
 18 (Exhibit 189 is received in evidence.)
 19 MR. PURCELL: I am happy to do this one by one.
 20 We invited Metropolitan to stipulate to admission of
 21 these letters between the parties. I don't think there
 22 is any objection to the authenticity of any of them.
 23 MR. EMANUEL: I am a little put off that they
 24 asked for a stipulation. That is not really appropriate
 25 to argue in front of the Court. Right now I am just

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1 asking they lay a foundation and let's go through it.
 2 THE COURT: All right. Let's go.
 3 MR. PURCELL: Let's just do it.
 4 PTX 229, next, please. I would like to move
 5 PTX 229 in evidence, your Honor.
 6 THE COURT: Any objection?
 7 MR. EMANUEL: No objection.
 8 THE COURT: PTX 229 is admitted.
 9 (Exhibit 229 was received in evidence.)
 10 MR. PURCELL: PTX 230 is the next exhibit. I
 11 would like to move PTX 230 into evidence.
 12 MR. EMANUEL: No objection.
 13 THE COURT: PTX 230 is admitted.
 14 (Exhibit 230 was received in evidence.)
 15 MR. PURCELL: PTX 232. I would like to move
 16 PTX 232 into evidence.
 17 MR. EMANUEL: No objection.
 18 THE COURT: PTX 232 is admitted.
 19 MR. PURCELL: PTX 234. I would like to move
 20 PTX 234 into evidence.
 21 MR. EMANUEL: No objection.
 22 THE COURT: PTX 234 is admitted.
 23 MR. PURCELL: PTX 243. I would like to move
 24 PTX 243 into evidence.
 25 THE COURT: I would like to ask whether these

15

1 are coming in to try to prove any disputed fact?
 2 MR. PURCELL: Your Honor, these are trying --
 3 these are being submitted for the purpose of proving the
 4 amounts that were set aside -- under the set-aside
 5 provision of the contract. We don't think there's a
 6 dispute about it.
 7 THE COURT: Is it part of your case that X
 8 dollars were set aside or that money was set aside?
 9 MR. PURCELL: It relates to the availability of
 10 interest under the damages calculation.
 11 THE COURT: Okay.
 12 MR. EMANUEL: Your Honor, if I may, these don't
 13 go to the amount that has been set aside.
 14 THE COURT: How many of these are there?
 15 MR. PURCELL: One more.
 16 THE WITNESS: This letter is about a bond.
 17 THE COURT: We will wait for a question. Is
 18 there an objection to PTX 243?
 19 MR. EMANUEL: No.
 20 THE COURT: PTX 243 is admitted.
 21 MR. PURCELL: The last one is DTX 624.
 22 THE COURT: This last one only is a D; correct?
 23 MR. EMANUEL: No objection, your Honor.
 24 THE COURT: DTX 624 is admitted.
 25 /

16

1 (Exhibits 232, 234, 243 and 624 were
 2 received in evidence.)
 3 Q. BY MR. PURCELL: Mr. Kightlinger, getting back
 4 to the substance of the case here for a second, one of
 5 the issues that San Diego objected to, I think you
 6 testified yesterday, was the inclusion of State Water
 7 Project costs in Metropolitan's transportation rates;
 8 correct?
 9 A. Yes. Going back to the late '90s, they
 10 protested that when we were doing the unbundling
 11 process.
 12 Q. Mr. Kightlinger, the State Water Project is not
 13 the start of the Metropolitan's facilities and
 14 infrastructure; correct?
 15 A. It is owned by the State of California.
 16 Q. I would like to put up PTX 302. Is this an
 17 e-mail that you sent to your board of directors in July
 18 of 2006 about the LADWP AVEK turnout agreement?
 19 A. It appears to be. I don't recall the issue.
 20 MR. PURCELL: I move Exhibit 302 into evidence.
 21 MR. EMANUEL: No objection.
 22 THE COURT: PTX 302 is admitted.
 23 (Exhibit 302 was received in evidence.)
 24 Q. BY MR. PURCELL: Going to the last paragraph on
 25 page one, the second sentence says, "Distilled to its

17

1 essence, this agreement permits AVEK to transport non
 2 State Water Project, SWP water, through the California
 3 aqueduct, and to deliver such water to LADWP at a
 4 turnout to be constructed within AVEK's service area."
 5 A. Yes.
 6 Q. This refers to the agreement that permits LADWP
 7 to obtain non State Water Project water through the
 8 State Water Project facilities without needing to move
 9 through Metropolitan's facilities; correct?
 10 A. Yes.
 11 Q. I would like to highlight the first paragraph
 12 under Authority for the turnout agreement, page three.
 13 This paragraph reads, "Another question that
 14 has been raised is whether the former CEO had the
 15 authority to execute the turnout agreement without
 16 obtaining prior approval from the board of directors.
 17 "As I explained at the meeting, Mr. Gastelum
 18 posed this question to me, as then general counsel, and
 19 it was my conclusion it was within his authority to
 20 execute the turnout agreement because it is, "one, was
 21 consistent with enforcement of Metropolitan's rights
 22 under the State water contract; two, did not require the
 23 use of Metropolitan's facilities or infrastructure;
 24 three, did not require any expenditure of Metropolitan's
 25 funds; and, four, did not conflict with any applicable

18

1 provisions of the Metropolitan Water District Act,
 2 Administrative Code or adopted board policies."
 3 Do you see that?
 4 A. I do.
 5 Q. One of the reasons that this agreement was
 6 within the authority of Mr. Gastelum to execute without
 7 submitting to the Metropolitan board of directors was
 8 because LADWP moving non State Water Project water
 9 through the State Water Project did not require the use
 10 of any Metropolitan facilities or infrastructure;
 11 correct?
 12 A. That's right.
 13 Q. Mr. Kightlinger, you are familiar with the rate
 14 structure integrity program; correct?
 15 A. Yes.
 16 Q. That was a program where Metropolitan included
 17 certain language within local resource program
 18 contracts; correct?
 19 A. Yes.
 20 Q. And that language that Metropolitan included in
 21 contracts permitted Metropolitan to terminate the
 22 contract if the recipient member agency mounted a
 23 challenge to Metropolitan's current rate structure;
 24 correct?
 25 A. Yes.

19

1 Q. It did not permit Metropolitan to terminate the
 2 contract if Metropolitan were to change its rate
 3 structure and then the agency were to mount a challenge
 4 to the new rate structure; correct?
 5 A. I don't recall that twist on it. That sounds
 6 right. I would have to take a look at it.
 7 Q. We can show you the documents and hopefully
 8 refresh you.
 9 Can we have PTX 80 to put on the screen. This
 10 is in evidence.
 11 This is a little bit of background. This is a
 12 memo, June 18, 2004, from Ron Gastelum, who was then the
 13 CEO and general manager of Metropolitan; correct?
 14 A. Yes.
 15 Q. Your predecessor. Not your immediate
 16 predecessor, but one of them in that role?
 17 A. Exactly.
 18 Q. It's the job you have today?
 19 A. Yes.
 20 Q. The first paragraph says, "For years we have
 21 been discussing the continuing financial risk to
 22 Metropolitan and the member agencies from the threat of
 23 legal or legislative actions undermining our rate
 24 structure. As in the past, some entities for their own
 25 gain may challenge the rate structure in order to convey

20

1 water at a lesser cost than as required to properly
 2 maintain the system's integrity and reliability. This
 3 challenge is not presented by deficiencies in the rate
 4 structure but by continuing economic attraction of lower
 5 cost based agricultural transfer water, if it can be
 6 conveyed into our service area at marginal cost."
 7 Do you see that?
 8 **A. I do.**
 9 Q. That accurately summarizes why Metropolitan
 10 wanted to put the rate structure integrity into place;
 11 correct?
 12 **A. Yes.**
 13 Q. And then in the second paragraph Mr. Gastelum
 14 writes: "One indication that such concern is still
 15 valid was the San Diego Water Authority's position in
 16 the QSA agreement reserving their right to challenge
 17 Metropolitan's uniform wheeling rates after five years
 18 from the date of execution of the QSA."
 19 Do you see that?
 20 **A. Yes.**
 21 Q. Mr. Gastelum is specifically referring to San
 22 Diego as a member agency that might litigate in the
 23 future; correct?
 24 **A. Yes.**
 25 Q. That reference to five years, that's a

21

1 reference to the five-year provision in paragraph 5.2 of
 2 the exchange agreement?
 3 **A. Yes.**
 4 Q. Mr. Gastelum doesn't say anything there about
 5 San Diego reserving its right only to challenge new cost
 6 allocations to Met's rate structure, does he?
 7 **A. No. He certainly knew what the intent was, but**
 8 **he also had his suspicions.**
 9 Q. There is nothing in this language that limits
 10 the concern about San Diego litigating -- to litigation
 11 over new rate structures; correct?
 12 **A. Not in this sentence, no.**
 13 Q. And let's take a look at DTX 909. This is a
 14 month-and-a-half later, July 30th, 2004. This is a
 15 letter from Mr. Gastelum to Miss Stapleton, his
 16 counterpart at the Water Authority.
 17 Do you see that?
 18 **A. Yes.**
 19 MR. PURCELL: I would like to move DTX 909 into
 20 evidence?
 21 MR. EMANUEL: No objection.
 22 THE COURT: 909 is admitted.
 23 (Exhibit 909 was received in evidence.)
 24 Q. BY MR. PURCELL: In the first paragraph
 25 Mr. Gastelum writes Miss Stapleton, "Thank you for

22

1 clarifying at our July member agency managers' meeting
 2 that the San Diego County Water Authority has no plans
 3 to challenge Metropolitan's rate structure. At the same
 4 time, you suggested a meeting with me would be useful to
 5 address the reservation by the authority in the
 6 quantification settlement agreement, QSA, to challenge
 7 Metropolitan's rate structure after five years."
 8 Do you see that?
 9 **A. I do.**
 10 Q. Mr. Gastelum is summarizing a meeting he had
 11 with Miss Stapleton; correct?
 12 **A. Yes, I think so. A phone call, meeting,**
 13 **something.**
 14 Q. Mr. Gastelum is stating what his impression is
 15 of what Miss Stapleton told him; correct?
 16 **A. That's my understanding of this.**
 17 Q. Mr. Gastelum, when he talks about the
 18 reservation by the authority to challenge Metropolitan's
 19 rate structure after five years, he doesn't say anything
 20 about a new rate structure, does he?
 21 **A. Not in this sentence, no.**
 22 Q. He doesn't limit his understanding of San
 23 Diego's right to challenge Metropolitan's rate structure
 24 as to some material change in the cost allocation?
 25 **A. He doesn't go into that detail, no.**

23

1 Q. I would like to show you PTX 95.
 2 Is this an August 17, 2004, fax from you to
 3 your then counterpart at the Water Authority, Dan
 4 Hentschke, the general counsel?
 5 **A. It looks like it, yes.**
 6 MR. PURCELL: I would like to move PTX 95 into
 7 evidence.
 8 MR. EMANUEL: Can we see all the pages?
 9 THE COURT: Of course. This is a one-page
 10 document?
 11 MR. PURCELL: I'm sorry. No, your Honor. It
 12 is a three-page letter attached to the cover page.
 13 MR. EMANUEL: Now they have handed me -- wait a
 14 minute. Part of the problem, it wasn't on the exhibit
 15 list. I am looking at it for the first time now.
 16 Can I have a minute?
 17 THE COURT: Of course.
 18 MR. EMANUEL: Your Honor, because it wasn't on
 19 the exhibit list and I haven't had a chance to prepare,
 20 I am going to object to its use and admission.
 21 THE COURT: Do you know if it was on the list
 22 or not?
 23 MR. PURCELL: I believe it was inadvertently
 24 omitted. It was on our Phase 1 exhibit list.
 25 MR. EMANUEL: It wasn't omitted in the Phase 1;

24

1 is that correct?
 2 THE COURT: PTX 95 is admitted.
 3 (Exhibit 95 was received in evidence.)
 4 Q. BY MR. PURCELL: If we could turn to page two
 5 of the letter itself, which is the third page of the
 6 document, the paragraph starting "likewise."
 7 This paragraph reads: "Likewise, member
 8 agencies are not being asked to forfeit any fundamental
 9 First Amendment rights in exchange for such funding.
 10 They are merely being asked to forego commencing a legal
 11 or legislative action challenging the district's
 12 existing rate structure. See Section 7, rate structure
 13 integrity language.
 14 "Paragraph 2: "Member agencies who accept such
 15 finding remain free to challenge Metropolitan's existing
 16 rate structure via the normal board process and
 17 challenge any material changes to the existing rate
 18 structure via whatever means are available. Such member
 19 agencies also remain free to commence a legal action
 20 against Metropolitan, quote, should Metropolitan in
 21 setting rates under existing rate structure fail to
 22 comply with public notice, open meeting or other legal
 23 requirements associated with the process of setting
 24 water rates and related taxes, fees and charges."
 25 Do you see that, Mr. Kightlinger?

25

1 MR. EMANUEL: I will object. The question was
 2 confusing. Could I ask it be rephrased?
 3 THE COURT: Could you start that again?
 4 Q. BY MR. PURCELL: You testified yesterday under
 5 the exchange agreement the intention of that, the
 6 bargain between the parties, was San Diego gave up the
 7 right to challenge the existing cost allocations in
 8 Metropolitan's rate structure; correct?
 9 A. **Within the term of the exchange agreement.**
 10 Q. Within the 45 years of the exchange agreement?
 11 A. **(Nods head affirmatively.)**
 12 Q. For 45 years they were agreeing not to
 13 challenge the existing cost allocations in the rate
 14 structure; correct?
 15 A. **Correct.**
 16 Q. And the rate structure integrity program only
 17 applies to the existing rate structure and not any
 18 future rate structures; correct?
 19 A. **That's right.**
 20 Q. You read Mr. Gastelum's e-mail or memo from
 21 June, which said that one of the reasons the rate
 22 structure integrity program was being adopted was
 23 because San Diego might sue later on?
 24 A. **I think he said that San Diego had expressly**
 25 **reserved a right to bring actions, as one of his reasons**

27

1 A. **Yes.**
 2 Q. This is your letter; correct?
 3 A. **Yes.**
 4 Q. You wrote this to Mr. Hentschke at the Water
 5 Authority?
 6 A. **And to Jerry Shoal at -- counsel, I believe at**
 7 **this time, to Eastern MWD, as well.**
 8 Q. This was in response to a letter they had
 9 written to you objecting to the rate structure integrity
 10 language as unconstitutional and objectionable in
 11 various other ways?
 12 A. **I don't remember exactly all their objections,**
 13 **but I do know they were upset with it.**
 14 Q. This accurately reflected your understanding of
 15 what the language covered; correct?
 16 A. **Yes.**
 17 Q. And you say pretty clearly there that "member
 18 agencies remain free to challenge any material change to
 19 the existing rate structure under the RSI language."
 20 Correct?
 21 A. **Yes.**
 22 Q. So if the RSA language limited only changes to
 23 the existing rate structure, your testimony yesterday
 24 was under the exchange agreement San Diego gave up the
 25 right to challenge the existing rate structure; correct?

26

1 **that we should be concerned about this.**
 2 Q. But if San Diego had already given up its right
 3 to challenge the existing rate structure under the
 4 exchange agreement, there would be no need to impose the
 5 RSI language on San Diego, would there?
 6 A. **As a need -- we have 26 member agencies. This**
 7 **letter came from two agencies. A number of agencies had**
 8 **concerns. When we adopted the rate structure. It was**
 9 **actually not 25 member agencies for it and San Diego**
 10 **against it. It was a fairly split vote.**
 11 **And a number of agencies had concerns. The**
 12 **whole point of the RSI language was that we were signing**
 13 **long-term program agreements. Some of these agreements**
 14 **would be we would provide subsidies to projects that**
 15 **would be 20 to 30 to 40 years. And the idea was to make**
 16 **sure there was some commitment to be able to collect**
 17 **those funds before we would sign those contracts. And**
 18 **that is what this was intended to address.**
 19 Q. Mr. Kightlinger, do you know the only agency
 20 being called out by name in Gastelum's memos in San
 21 Diego; correct?
 22 A. **He calls out entities. He calls out one of the**
 23 **basins that were attempted to sue -- if you go through**
 24 **the memo, he really talks about it is really a broad**
 25 **policy issue. There are a number of people that are**

28

1 **seeking low-cost water he does call out by name, but he**
2 **does talk about other entities and organizations.**

3 Q. He doesn't call out any other Met member agency
4 by name other than San Diego?

5 **A. Not in that memo, no.**

6 Q. As regarding San Diego, if San Diego had really
7 given up its right to sue under the exchange agreement
8 over the existing rate structure, there would be no need
9 for the rate structure integrity provision as against
10 San Diego, would there?

11 **A. That was the intent, yes.**

12 MR. PURCELL: Nothing further.

13 THE COURT: Thank you.

14 Redirect, sir?

15 MR. EMANUEL: Thank you.

16 THE COURT: If you need a break because of this
17 new document, let me know.

18 MR. EMANUEL: I appreciate that. I have my
19 team looking at it.

20 THE COURT: In a situation like that, if there
21 is something I can do to ameliorate the situation, let
22 me know.

23 MR. EMANUEL: I apologize. It got the better
24 of me. It is such a long document, single space, it was
25 a lot.

29

1 two organizations?

2 **A. Yes.**

3 Q. Which side of the equation would you say
4 Mr. Gastelum was on, trusting, not trusting, or trust
5 and verifying; how would you describe him?

6 **A. I would say I'm in the trust-but-verify mode as**
7 **the counsel. Mr. Gastelum was -- he came out of the**
8 **landfill industry, and he was a very not trusting person**
9 **in general.**

10 Q. You had involvement in creating this RSI
11 clause; correct?

12 **A. Yes. I went through and worked through with**
13 **Mr. Gastelum on the actual language of it, but the**
14 **policy proposal was his to the board.**

15 Q. Was it your understanding this RSI clause would
16 be a disincentive to file suit; right?

17 **A. Yes.**

18 MR. BRAUNIG: Objection. Leading.

19 THE COURT: I won't sustain the objection on
20 that one because it is so obvious. If we could avoid
21 leading questions.

22 MR. EMANUEL: Thank you. I will, your Honor.

23 THE COURT: That one is overruled.

24 Q. BY MR. EMANUEL: Would it apply to all
25 lawsuits?

31

1 THE COURT: I understand.

2
3 REDIRECT EXAMINATION

4 BY MR. EMANUEL:

5 Q. Let's go back. Let's start with that last
6 point about there is an agreement under the exchange
7 that the -- limiting what San Diego could sue on.

8 Sir, isn't it true, or in your experience, San
9 Diego has found any number of reasons to sue
10 Metropolitan, isn't that true?

11 **A. In the last 15 years we've had probably four or**
12 **five different lawsuits over various issues with the**
13 **Water Authority.**

14 Q. Would it be accurate to say that your
15 understanding of the exchange agreement isn't a
16 guarantee that suit still couldn't be filed?

17 **A. No. It only dealt with the existing rate**
18 **structure. Their rate structure integrity language is**
19 **intended to sweep in all our member agencies as well,**
20 **but we've had lawsuits over the applicability of the**
21 **Brown Act. We've had lawsuits over preferential rights.**
22 **We've had lawsuits over point-to-point versus postage**
23 **stamp rates. So we had other challenges.**

24 Q. How can I put this question? It seems fair to
25 say that there is a certain lack of trust between these

30

1 **A. No. Simply challenges to the existing rate**
2 **structure.**

3 Q. Would it apply to ill-conceived or
4 non-meritorious lawsuits?

5 **A. I assume they were challenging the existing**
6 **rate structure, it would apply to that.**

7 Q. I want to go back to some exhibits that were
8 shown you yesterday.

9 Could you put up PTX 56, please. Zoom this on
10 the date.

11 Mr. Kightlinger, do you see the date on this?

12 **A. Yes.**

13 Q. You see how it is "for your information, San
14 Diego's latest proposal," do you see that?

15 **A. Yes.**

16 Q. Based on the date, would this proposal have
17 been the one we talked about yesterday, Option-1 and
18 Option-2?

19 **A. No. This predated that by some months.**

20 Q. Can you give me an estimate of when Option-1
21 and Option-2 was proposed?

22 **A. The late July, early August time frame of 2003.**
23 **No. This preceded that by some months.**

24 Q. Can you give me an estimate of when Option-1
25 and Option-2 was proposed?

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1 **A. The late July, early August time frame of 2003.**
 2 Q. Close enough. Give me PTX 57.
 3 Do you see the date?
 4 **A. Yes.**
 5 Q. Do you see the subject line?
 6 **A. "Getting to yes."**
 7 Q. This originated with an email from Mr. Slater;
 8 correct?
 9 **A. Yes.**
 10 Q. Was this part of that process after Option-1,
 11 Option-2, to work out the points and reach an agreement?
 12 **A. That's correct.**
 13 Q. I take it as of this point, just by the phrase
 14 "getting to yes," what was your understanding as to
 15 whether you had in fact reached yes?
 16 **A. No. We had a number of deal points that still**
 17 **had not yet been worked out.**
 18 Q. Can we go down to the bottom of this exhibit,
 19 item number five. Do you see that?
 20 **A. I do.**
 21 Q. Was that literally true?
 22 MR. PURCELL: Objection. Vague.
 23 THE COURT: I am not sure what that question
 24 means. The record will be a little bit easier if you
 25 just read that line into the record.

33

1 THE WITNESS: Certainly. "Item five, San Diego
 2 will draft an 'I love you MWD' reso." Reso meaning
 3 resolution.
 4 Q. BY MR. EMANUEL: How did you understand that?
 5 **A. We had talked about the intent was if we got to**
 6 **yes and our agencies agreed on this, that this was**
 7 **intended to start a new page and peace and harmony, et**
 8 **cetera, between our two agencies and put aside the**
 9 **lawsuits and the rancor. So they were going to draft a**
 10 **resolution to that effect.**
 11 Q. You were asked about the State Water Project?
 12 **A. Yes.**
 13 Q. Does Metropolitan consider it part of its
 14 conveyance system? Do you remember that question?
 15 **A. Yes.**
 16 Q. I think your answer didn't answer the question.
 17 You said, "The state owns it."
 18 The question was, sir, as asked by Mr. Purcell,
 19 does Metropolitan consider it part of its conveyance
 20 system?
 21 **A. We do not consider it part of our conveyance**
 22 **system, but we do consider our agency as having an**
 23 **ownership interest in the State Water Project based on**
 24 **the contract we entered into with the State of**
 25 **California and the way in which we make our payments on**

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1 **that project.**
 2 Q. Please explain why you consider it to be a part
 3 owner of that system?
 4 **A. We have certain rights to use that facility.**
 5 **We have transportation rights. We have to pay for it**
 6 **every year, so a significant sum. But with that, even**
 7 **if we don't -- aren't getting water just from the State**
 8 **of California, if we wish to move water within it, we**
 9 **have capacity rights that enable us to move water,**
 10 **Metropolitan transfer water, in our ownership capacity**
 11 **rights. And in fact we can do so on behalf of our**
 12 **member agencies, and we have done so, including San**
 13 **Diego.**
 14 **They have purchased transfers in the past and**
 15 **they have moved that water within Metropolitan's**
 16 **capacity rights in the State Water Project system.**
 17 Q. When San Diego moved non-State Water Project,
 18 non-Metropolitan water through the conveyance system,
 19 did San Diego have to pay a wheeling rate to
 20 Metropolitan?
 21 **A. Only when it reached our system and then they**
 22 **had the ability to use the State system through our**
 23 **ownership capacity.**
 24 Q. Did they have to pay a wheeling rate through
 25 the State or could they use Metropolitan's?

35

1 **A. The latter. They used Metropolitan's capacity.**
 2 Q. Are you aware of any litigation involving
 3 whether the payments to the State for the State Water
 4 Project are payment of costs of the State or costs of
 5 the State water contract?
 6 MR. PURCELL: Objection. Vague.
 7 THE COURT: Do you understand that question?
 8 THE WITNESS: I understood the question. I
 9 believe I understand the question.
 10 THE COURT: We are going with this witness'
 11 understanding. This may be a legal issue, but go ahead
 12 and answer it.
 13 THE WITNESS: There were early validation
 14 actions to establish the rights under the -- and
 15 payments of the State Water Project. And so in that
 16 validation action it was determined these were
 17 obligations of the contractors for the State of
 18 California.
 19 Q. BY MR. EMANUEL: And Metropolitan is a State
 20 water contractor; correct?
 21 **A. Yes, sir.**
 22 Q. And it makes payments to the State that the
 23 State -- for the conveyance system and for the supply
 24 water; is that correct?
 25 **A. That's correct.**

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1 Q. What I'm asking you, have you ever heard or
 2 have an understanding that the payments to the State is
 3 the State's mere conduit?
 4 MR. PURCELL: Objection. Vague.
 5 THE COURT: Has he ever heard it? That's not
 6 vague.
 7 Have you ever heard that?
 8 THE WITNESS: I've not heard it actually
 9 expressed that way.
 10 MR. EMANUEL: Can you pull up the 2003 exchange
 11 agreement. Would you go to the paragraph just before
 12 5.2?
 13 THE COURT: For the record, the exhibit number
 14 is --
 15 MR. KEKER: 65 PTX and DTX 51, but they have 51
 16 up, I think.
 17 THE COURT: PTX 65 we will call it.
 18 Q. BY MR. EMANUEL: Do you see paragraph 5.1 and
 19 that deals with pricing? Do you see that, sir?
 20 A. I do.
 21 Q. Would you go to the paragraph above that? You
 22 see paragraph 4.2?
 23 A. I do.
 24 Q. Let's back up. So 4.1 deals with
 25 characterization of exchange water. Do you see that?

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1 A. Yes.
 2 Q. And for some purpose it is characterized as
 3 local water; is that right?
 4 A. Yes.
 5 Q. That has certain financial implications?
 6 A. Yes. **This is something San Diego wanted. It**
 7 **doesn't fit within the typical meaning of the word**
 8 **"local." It is coming from several hundred miles away.**
 9 **In our parlance, in our structure within Metropolitan,**
 10 **local water has certain benefits, how we do our drought**
 11 **management planning.**
 12 **Local water is not considered regional water to**
 13 **be shared. It is their own water, so it doesn't fit**
 14 **into something that we would then pull back in a**
 15 **drought, as part of drought management. So it is**
 16 **important to them that it becomes an independent local**
 17 **supply. It is also how we calculate a**
 18 **readiness-to-serve charge. If it's a local supply, it**
 19 **doesn't go into that calculation. So those were**
 20 **benefits, how they wanted this water, the IID transfer**
 21 **water to be treated.**
 22 Q. Let's look at 4.2., the entire paragraph,
 23 please.
 24 Notwithstanding provisions of 4.1, "The water
 25 delivered to SDCWA shall be characterized as

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1 Metropolitan water and not as local water."
 2 Do you see that?
 3 A. I do.
 4 Q. What is your understanding of that?
 5 A. **Notwithstanding for the purposes of drought**
 6 **management and the readiness-to-serve charges, at the --**
 7 **the way the exchange worked is that when the water hits**
 8 **our intake, it's Metropolitan's water. And then we take**
 9 **it and then what we exchange with San Diego is**
 10 **Metropolitan water.**
 11 Q. And when does it hit your intake?
 12 A. **In theory, when it's made available by IID to**
 13 **us, we order from the Bureau of Reclamation, and it**
 14 **comes to Lake Havasu, and that is where our intake is**
 15 **and that is where we pump the water.**
 16 Q. You are still on the Colorado River?
 17 A. Yes.
 18 Q. The location is the Colorado River?
 19 A. **Yes, it is a location on the Colorado River,**
 20 **yes.**
 21 MR. EMANUEL: Your Honor, if I could have a
 22 minute?
 23 THE COURT: Of course
 24 MR. QUINN: Would it be possible for us to have
 25 five minutes?

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1 THE COURT: See everybody in five minutes.
 2 (Recess.)
 3 THE COURT: Sir.
 4 MR. PURCELL: Your Honor, before we get
 5 started, we have a motion to strike.
 6 THE COURT: All right.
 7 MR. PURCELL: We move to strike
 8 Mr. Kightlinger's testimony about Metropolitan having an
 9 ownership interest in the State Water Project as being
 10 directly contrary to Metropolitan's response to Request
 11 for Admission 44, which is in evidence as PTX 237A.
 12 THE COURT: How does that read?
 13 MR. PURCELL: It reads, Request for Admission
 14 Number 44, "Admit that Metropolitan does not own the
 15 State Water Project."
 16 Response to Request for Admission Number
 17 44, "Admit."
 18 THE COURT: I will tell you that I actually
 19 made a note and he used the phrase "ownership interest"
 20 but I don't think -- I didn't interpret the answer
 21 actually to be that he says he has interest to certain
 22 rights. My sense is that Metropolitan is not contending
 23 they actually have any literal ownership interest in the
 24 State Water Project. Right?
 25 MR. EMANUEL: Right. And the witness said

40

1 that.
 2 THE COURT: I think it was a shorthand for --
 3 it's like having rights to a license more than anything
 4 else or rights to use, and that's how I interpreted it.
 5 I will deny the motion to strike with that
 6 understanding, that he really did not mean ownership in
 7 the literal sense. RFA 44 actually governs here, and
 8 let's proceed.
 9 MR. EMANUEL: Would the Court permit I get that
 10 on the record from the witness?
 11 THE COURT: You don't have to. RFA 44 is
 12 preclusive.
 13 MR. EMANUEL: Not that. I meant what he was
 14 referring to as those interests.
 15 THE COURT: If you think it matters. I think I
 16 understand that Metropolitan has certain rights to use
 17 the State Water Project. I understand that. We went
 18 through some of that in the first trial.
 19 MR. EMANUEL: Very well.
 20 THE COURT: And I recall that.
 21 Q. BY MR. EMANUEL: In that case, then, I'll go
 22 back to Exhibit DTX 51.
 23 Mr. Kightlinger, we were discussing this
 24 exception and --
 25 THE COURT: Again, this has also been named PTX

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1 56.
 2 MR. KEKER: Sixty-five.
 3 THE COURT: Sixty-five.
 4 Q. BY MR. EMANUEL: Unfortunately, it has two
 5 numbers.
 6 "The exchange water delivered to SDCWA shall be
 7 characterized as Metropolitan and not as local water
 8 only for the limited purposes of paragraph 5.2."
 9 Do you see that?
 10 A. I do.
 11 Q. Let's -- let's look at 5.2 so we know what
 12 we're talking about here.
 13 5.2 is the price that the Water Authority would
 14 pay; is that correct?
 15 A. That is correct.
 16 Q. Would you please explain, then, how 4.2 relates
 17 to 5.2?
 18 A. Yes. The Water Authority wanted this water to
 19 be considered local water, the water they were getting
 20 from IID, for purposes of how it would be dealt with in
 21 terms of drought and calculation of our
 22 readiness-to-serve charges.
 23 But for the purpose of the pricing, it was
 24 going to be treated as Metropolitan water and governed
 25 by 5.2, the pricing terms.

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1 Q. Was there an advantage to the Water Authority
 2 for the water to be considered Metropolitan water?
 3 A. Yes. One of the complications in their
 4 transfer with IID is the water from IID is Colorado
 5 River water. The only parties that can receive Colorado
 6 River water are parties that have what's called a
 7 Section 5 contract with the Bureau of Reclamation under
 8 the Boulder Canyon Project Act.
 9 The Water Authority, not being a Colorado River
 10 contractor, technically, unless it got such a contract
 11 with the United States, could not receive Colorado River
 12 water. So Metropolitan, by receiving that water as
 13 Metropolitan and then exchanging it, solved the issue of
 14 how to get delivery from the United States Bureau of
 15 Reclamation.
 16 Q. But explain, how did that solve that problem?
 17 A. It was deemed Metropolitan's water. And so we
 18 have a contract for delivery of Colorado River water
 19 with the United States and, therefore, the Water
 20 Authority wasn't deemed -- they were not getting a
 21 delivery of Colorado River water. Metropolitan was.
 22 Q. Thank you very much.
 23 Let's turn back to this rate structure
 24 integrity clause. I believe you testified this was a
 25 subject that was discussed at the board level of

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1 Metropolitan; is that correct?
 2 A. Yes.
 3 Q. And were there agencies in favor of it,
 4 agencies against it?
 5 A. Yes.
 6 No. It was a controversial proposal, and my
 7 recollection there were a number of amendments proposed
 8 by various board members on behalf of their agencies to
 9 be made to the policy before it was adopted.
 10 Q. Was the Water Authority for or against it?
 11 A. They were flat-out opposed to it from the
 12 get-go.
 13 Q. Do you have a recollection whether or not the
 14 Water Authority made an amendment that the rate
 15 structuring integrity clause should only be triggered if
 16 someone sued and lost?
 17 A. I don't recall the Water Authority proposing
 18 any suggested amendments to it. They felt it shouldn't
 19 be adopted at all. The amendments I recall being
 20 proposed were from agencies such as Orange County
 21 agencies and the Riverside County agencies having a
 22 number of concerns and proffering a number of
 23 amendments.
 24 MR. EMANUEL: Nothing more, your Honor.
 25 MR. PURCELL: No recross.

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1 THE COURT: Thank you very much, sir.
 2 You are excused.
 3 THE WITNESS: Thank you.
 4
 5 DEVENDRA UPADHYAH,
 6 called as a witness by the Defendant, was sworn and
 7 testified as follows:
 8
 9 THE COURT: You are calling?
 10 MR. EMANUEL: Mr. Upadhyah.
 11 THE WITNESS: I do.
 12 THE CLERK: Go ahead and be seated. Would you
 13 please state and spell your full name for the record.
 14 THE WITNESS: Devendra Upadhyah, and it's
 15 D-E-V-E-N-D-R-A, U-P-A-D-H-Y-A-H.
 16
 17 DIRECT EXAMINATION
 18 BY MR. EMANUEL:
 19 Q. By whom are you employed?
 20 A. **The Metropolitan Water District of Southern**
 21 **California.**
 22 Q. What is your position?
 23 A. **My position is the group manager for the water**
 24 **resources management group.**
 25 Q. What programs fall within the water resources

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1 management group?
 2 A. **Water resource management group manages demand**
 3 **management programs, conservation programs that provide**
 4 **incentives to consumers in Southern California, local**
 5 **resources program aimed at helping to develop supplies**
 6 **among the customer member agencies.**
 7 **We have a group that looks at forecasting for**
 8 **the needs of Southern California out in the future. We**
 9 **also manage our contracts with the State Water Project,**
 10 **the Department of Water Resources and with the U.S.**
 11 **Bureau of Reclamation for supplies that we receive on**
 12 **the Colorado River along with many other partners we**
 13 **have. We manage the contracts for those supplies.**
 14 MR. EMANUEL: In advance, and according to the
 15 Court's deadline, we prepared a declaration for
 16 Mr. Upadhyah that had been submitted to the other side
 17 and filed with the Court.
 18 Does the Court want a copy? I am not going to
 19 direct him on those questions.
 20 THE COURT: I would appreciate it if you have a
 21 spare copy.
 22 MR. EMANUEL: I will leave one for the witness
 23 in case it comes up on cross.
 24 Q. Sir, a topic not covered in your declaration
 25 has to do with the demand management programs.

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1 Can you tell me what's under those programs?
 2 A. **Sure. Demand management programs consist**
 3 **really of two different programs that Metropolitan runs.**
 4 **One of them is a conservation program. That program**
 5 **provides incentives through throughout Southern**
 6 **California for consumers to purchase water-efficient**
 7 **devices, things like, for example would be,**
 8 **high-efficiency clothes washers or high-efficiency**
 9 **toilets that reduce demands for water. We provide**
 10 **incentives that buy down the costs of those things for**
 11 **consumers. That's the conservation program.**
 12 **Another program is the local resources program.**
 13 **That program provides financial incentives for our local**
 14 **agencies to develop projects that fall into three major**
 15 **categories: Wastewater recycling, groundwater recovery**
 16 **and seawater desalination at some point in the future.**
 17 **These would be projects that would produce supplies that**
 18 **those local agencies are able to use to meet their**
 19 **customers' needs.**
 20 Q. You referred to incentives. Did you mean
 21 financial incentives? Are there other kinds of
 22 incentives?
 23 A. **Financial incentives.**
 24 Q. How long have you been the manager of the water
 25 resources management group?

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1 A. **Since the beginning of 2010.**
 2 Q. How long have you been an employee of
 3 Metropolitan?
 4 A. **I started with Met back in 1995, and there was**
 5 **a period for about three years there where I was working**
 6 **for another agency.**
 7 Q. Going back to the local resources program, who
 8 receives the dollars that are part of these financial
 9 incentives?
 10 A. **The local agencies, the member agencies and**
 11 **their subagencies that actually develop the projects.**
 12 Q. What are the benefits to local agencies for
 13 these local resource programs?
 14 A. **They are receiving a financial incentive from**
 15 **Metropolitan. But ultimately the benefit of those**
 16 **projects is that those projects produce supplies that**
 17 **they are able to use to meet the needs of their**
 18 **customers and they are able to sell those supplies to**
 19 **their customers.**
 20 Q. You used the word "they."
 21 A. **They receive supplies.**
 22 Q. What are the benefits to local agencies for
 23 these local resource programs?
 24 A. **They are receiving a financial incentive from**
 25 **Metropolitan. But ultimately the benefit of those**

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1 **projects is that those projects produce supplies that**
 2 **they are able to use to meet the needs of their**
 3 **customers and they are able to sell those supplies to**
 4 **their customers.**
 5 Q. You used the word "they." They receive
 6 supplies. Who is "they" referring to?
 7 **A. The member agencies or the local agency that**
 8 **develop the project.**
 9 Q. Is that also true for other demand management
 10 programs that these supply? Who owns the supplies that
 11 were produced through those other demand management
 12 programs?
 13 **A. That's correct. There are supplies that are**
 14 **produced by the local agencies. They are their**
 15 **supplies. They are able to use those to meet their**
 16 **customers' demands.**
 17 Q. What I am asking, there are conservation
 18 programs and there are other kinds of programs, all of
 19 which produce water, I take it?
 20 **A. Either produce water or reduce demand for**
 21 **water, right.**
 22 Q. And my point is, whose supply is it?
 23 **A. It's those local agencies.**
 24 Q. When this water is produced through these
 25 demand management programs, who has the title to that

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1 water? I'm just speaking loosely. I don't know what
 2 the word is in water law. Who owns the water?
 3 MR. BRAUNIG: I am going to object to the
 4 extent it calls for a legal conclusion.
 5 THE COURT: We will get his understanding. Do
 6 you know?
 7 THE WITNESS: To the extent it is water
 8 supplied that they are able to use through that project,
 9 it's theirs to sell to their customers.
 10 Q. BY MR. EMANUEL: From Metropolitan's point of
 11 view, does Metropolitan consider whether or not this is
 12 part of Metropolitan's supply?
 13 **A. It is not part of Metropolitan's supply. These**
 14 **aren't supplies that we have access to. It doesn't come**
 15 **into our system. We don't sell them to our member**
 16 **agencies. At no point is it a supply that Metropolitan**
 17 **has to provide to our customers. Rather, it is at the**
 18 **local level.**
 19 Q. Why does Metropolitan have these demand
 20 management programs?
 21 **A. These demand management programs provide a**
 22 **benefit to Metropolitan in that it reduces the demand**
 23 **for water to move through our system.**
 24 **But there's also a piece of legislation that**
 25 **was passed in 1999, we refer to it as Senate Bill 60,**

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1 **that requires that Metropolitan increase or focus on**
 2 **conservation, water recycling and groundwater recovery**
 3 **recharge.**
 4 Q. Are you familiar with the phrases "upstream"
 5 and "downstream"?
 6 **A. Yes, I am.**
 7 Q. Would you explain what "upstream" means and
 8 "downstream" means in the context of what we've been
 9 talking, conservation?
 10 **A. Sure. Metropolitan has service connections**
 11 **that demark the point of delivery between Metropolitan's**
 12 **distribution system into our member agencies'**
 13 **distribution systems. And so we refer to anything that**
 14 **is downstream of those service connections, that are**
 15 **then within our member agencies and their local**
 16 **agencies, as downstream.**
 17 **Anything that is above those service**
 18 **connections in Met's system and beyond is considered to**
 19 **be upstream.**
 20 Q. The demand management programs that you
 21 referred to, are they upstream or downstream?
 22 **A. They are downstream.**
 23 Q. What rate at Metropolitan generates the income
 24 that pays for demand management programs?
 25 **A. The cost of the demand management programs is**

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1 **recovered through our water stewardship rate.**
 2 Q. Are you aware of whether any part of that water
 3 stewardship rate -- let me back up.
 4 Does the entirety of the water stewardship rate
 5 go upstream, downstream or split between the two
 6 streams?
 7 MR. BRAUNIG: Objection. Vague.
 8 THE COURT: Overruled.
 9 THE WITNESS: Can you please restate the
 10 question?
 11 Q. BY MR. EMANUEL: Let me take it one at a time.
 12 So the costs that are paid through the water
 13 stewardship rate, are they paid to downstream users or
 14 upstream users or some combination?
 15 **A. It is all downstream.**
 16 Q. Has that been true -- how long has that been
 17 true?
 18 **A. To my knowledge, it's been true since the**
 19 **beginning of the water stewardship rate.**
 20 Q. Does Metropolitan have -- strike that.
 21 What benefits -- what benefits, if any, do
 22 wheelers enjoy because of demand management programs?
 23 **A. Demand management programs that we run reduce**
 24 **the need for water to move through Metropolitan's**
 25 **system. And as a result of that it is creating capacity**

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1 **within Metropolitan's system to move supplies, to the**
 2 **extent that a wheeler is acquiring a supply from another**
 3 **entity and moving that water through Metropolitan's**
 4 **system. Part of the reason the capacity is available to**
 5 **do that is because of the demand management programs.**
 6 Q. Mr. Upadhyah, are you aware of whether or not
 7 Metropolitan purchases back the supplies generated --
 8 purchases back from the local agencies the supplies
 9 generated by the demand management program?
 10 A. I'm not aware of a situation where that
 11 happens, no.
 12 Q. I would like to show you what has been marked
 13 for identification as DTX 979.
 14 Can you tell the Court what this is?
 15 A. Yes. This is the February 2011 version of what
 16 we refer to as our SB-60 report. I had mentioned
 17 earlier Senate Bill 60 that placed some requirements on
 18 Metropolitan, and one of those requirements was filing a
 19 report to the State legislature each year that showed
 20 some of the actions that we had taken in the areas of
 21 conservation, recycling, groundwater recovery and
 22 recharge.
 23 Q. Is the production of this report one of your
 24 duties and responsibilities, at least, to oversee?
 25 A. Yes, it is.

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1 Q. If you would turn to page 7 of this report,
 2 tell us what this achievement scorecard represents.
 3 A. This -- what you see on the screen is the
 4 scorecard that we include in the report that shows both
 5 the acre-feet associated with the demand management
 6 programs and the dollars associated with the demand
 7 management programs.
 8 This is a part of what we're reporting to the
 9 legislature that we've been able to do in combination
 10 with the member and local agencies.
 11 Q. If we look at the very first line under
 12 conservation, would you explain what that 15,500
 13 acre-feet are?
 14 A. Okay. So as part of the demand management
 15 programs, I mentioned one of the programs we run is a
 16 conservation program where we're providing incentives
 17 for consumers, businesses, residents in our service area
 18 to purchase devices that save water, are more efficient.
 19 That line is showing that in fiscal year
 20 2009-'10, which was the period that we were reporting on
 21 for this year in this report, those new conservation
 22 devices that were installed and funded by that program
 23 saved 15,500 acre-feet. That is the new savings from
 24 those actions.
 25 Q. How is that line different from the line below

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1 it?
 2 A. The line below it is showing that we've
 3 actually been doing this program for a number of years,
 4 and that devices that were installed in previous years
 5 are also still saving water.
 6 The first line is showing just the new things
 7 that were installed that year and their savings. But
 8 the next -- the second line, 147,000 acre-feet, depicts
 9 the savings associated with things that had been
 10 installed before that are still saving water in that
 11 year.
 12 Q. Now, if we look at the third line, what does
 13 that represent?
 14 A. The third line is showing that since the
 15 program's inception in the early 1990s, the cumulative
 16 water savings across all of those things that have been
 17 installed is estimated to be about 1.4 million
 18 acre-feet.
 19 Q. Let's move down the chart to under "recycled
 20 water." Look at the first line there.
 21 Please explain what that represents.
 22 A. The first line under "recycled water" is
 23 similarly showing for 2009-'10 the acre-feet that was
 24 produced in that year by wastewater recycling facilities
 25 that were funded, in part, by this program.

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1 Q. Could you give us an example of a wastewater
 2 recycling program or type of program?
 3 A. Sure. The -- an example there, and there are
 4 many different facilities that are funded that are
 5 producing as part of this, but an example would be an
 6 agency would take wastewater that is coming from the
 7 wastewater plant and treat that wastewater to a higher
 8 grade of treated supply, and then would pipe that to, as
 9 an example, outdoor irrigation on a park or on a golf
 10 course, so that they are able to use that treated
 11 wastewater to meet the needs of that irrigated
 12 territory.
 13 Q. If we look two lines below that, see where it
 14 says, "cumulative production." Please explain what that
 15 represents.
 16 A. The cumulative production line is showing that
 17 since this program's inception, the projects that were
 18 partially funded by these incentives for Metropolitan
 19 are producing or have produced about 1.3 million
 20 acre-feet.
 21 Q. Move down to "groundwater recovery," and
 22 looking at the first line. What is an example of a
 23 groundwater recovery program?
 24 A. Groundwater recovery refers to a situation
 25 where there is groundwater that is contaminated in some

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1 way or may have salt content that is high enough that in
2 order to be able to use that water, you have to put some
3 measure of treatment to be able to get rid of that
4 contaminant.

5 So groundwater recovery are programs where
6 we're providing incentives similar to the wastewater
7 recycling to be able to help an agency develop a
8 project, to help them pay for that project, so they can
9 clean up that groundwater and be able to use it to meet
10 their customers' demands.

11 Q. Does the 50,000 acre-feet represent the amount
12 of water produced through this program for that
13 particular fiscal year?

14 A. Right. For 2009-'10 the production for those
15 facilities was 50,000 acre-feet.

16 Q. And two lines below that, "the cumulative
17 production," is that the same as what you explained
18 before, the life of these programs, this is your
19 estimate?

20 A. That's correct. Over the life of the program,
21 it's produced 515,000 acre-feet.

22 Q. Let me ask you to turn in this document to page
23 8. Do you see that sentence?

24 A. I do.

25 Q. To whom is conserved water a source of supply?

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1 A. This statement is showing that it is a source
2 of supply for Southern California. Specifically, it's a
3 source of supply for the local agencies that produce it
4 and they are able to take that supply and meet their
5 customers' demands.

6 Q. Would it be accurate to say not only -- when
7 you say use it, do they give it away or do they sell it
8 to their users?

9 A. To my knowledge, it's always sold to their
10 users. I'm not aware of a situation where it is simply
11 given away.

12 Q. Can you tell the Court whether or not conserved
13 water downstream is a source of supply for Metropolitan?

14 A. So, this -- these programs, they're not a
15 source of supply for Metropolitan. At no point are they
16 producing water that Metropolitan is able to take into
17 our system. We are not able to sell that water to our
18 customers. Rather, they are supplies that our member
19 agencies and local agencies are able to use to meet
20 their customer demands.

21 MR. EMANUEL: Thank you, your Honor. No more
22 questions.

23 THE COURT: Cross-examination. It looks like
24 maybe one more question.

25 MR. EMANUEL: I will move it into evidence.

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1 THE COURT: Exhibit 979.

2 MR. EMANUEL: DTX 979, your Honor, we move it
3 into evidence.

4 THE COURT: Are there more pages than the ones
5 we talked about that I'll be reading?

6 MR. EMANUEL: There are certainly more pages.
7 I don't know that you need to read them. Maybe we
8 should do a redacted.

9 THE COURT: Yes. Then remind me later on to
10 admit it as redacted.

11 (Exhibit 979 was marked for identification.)

12 THE COURT: Cross-examination.

13
14 CROSS-EXAMINATION

15 BY MR. BRAUNIG:

16 Q. Good morning, Mr. Upadhyah.

17 A. Good morning.

18 Q. I am Warren Braunig and we met at your
19 deposition.

20 You testified that the primary benefit of
21 the -- of the water stewardship rate in the demand
22 management programs is the creation of local supply for
23 use by -- by the local member agencies; correct?

24 A. The primary benefit to the local agencies is
25 the supply.

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1 Q. It is also a benefit to Metropolitan, that
2 Metropolitan, by investing in these demand management
3 programs, doesn't have to import or buy supplies of its
4 own; correct?

5 A. The benefit to Metropolitan is the reduced
6 demand on our system.

7 Q. And that's a supply benefit?

8 A. I would not argue that's a supply benefit.

9 Q. Met's investments in local water grow the
10 supply of water for Metropolitan in the region; correct?

11 A. That's not correct.

12 Q. You have Tab 1 of your deposition, Tab 1 of the
13 binder one, Volume I is your deposition, and I would ask
14 you to turn to page 109, line 16.

15 MR. EMANUEL: It's Tab 2, Volume I.

16 THE COURT: The page is 109?

17 MR. BRAUNIG: Yes.

18 (Reading:)

19 "Q And my question is does
20 Metropolitan invest in local
21 resources in order to grow the
22 pie of supply?

23 "A That's -- yes, that's one
24 of the benefits we're investing
25 for, yes."

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1 MR. EMANUEL: Where were we?
 2 THE COURT: Sixteen through 20.
 3 Q. BY MR. BRAUNIG: That's correct, that's true
 4 testimony that you gave?
 5 **A. That's correct.**
 6 Q. The demand management programs also create a
 7 benefit for Metropolitan by not having to spend money on
 8 imported water supplies; correct?
 9 **A. The demand management programs reduce the need**
 10 **for the movement of water through the Metropolitan**
 11 **system. It may not be Metropolitan's imported supplies.**
 12 MR. BRAUNIG: Your deposition, page 109, line
 13 21 through page 110, line one.
 14 THE COURT: Go ahead.
 15 MR. BRAUNIG: (Reading:)
 16 "Q Okay. Is metropolitan's
 17 -- is one of the benefits that
 18 you articulated of these
 19 programs, that it creates a
 20 benefit of not having to spend
 21 money on other imported
 22 supplies?
 23 "A Yeah. That's part of the
 24 basis for the incentive."
 25 Q. That's true testimony?

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1 **A. Correct.**
 2 Q. Would you agree -- you testified in addition to
 3 creating local supplies, the demand management programs
 4 have regional benefits for Metropolitan; correct?
 5 **A. Correct.**
 6 Q. Met has never calculated the regional benefit
 7 of the aggregate group of water supply projects and
 8 desalination projects and conservation programs funded
 9 in a given calendar year, has it?
 10 **A. Metropolitan calculates the benefit of the**
 11 **water that's produced, and we report that each year in**
 12 **the SB-60 report.**
 13 Q. You calculate the number of acre-feet created?
 14 **A. Right.**
 15 Q. Met does not calculate the regional benefit
 16 beyond the calculation of acre-feet; it does not
 17 calculate the regional benefit of the group of programs
 18 that were funded in 2011, does it?
 19 **A. The SB-60 report we are producing is showing**
 20 **the supplies that are benefiting the local agencies as a**
 21 **result of those programs. It is a characterization of**
 22 **what's produced through those programs.**
 23 Q. I am asking you a specific question. I am
 24 asking you about the regional benefit. Met has not
 25 calculated the regional benefit of the programs Met

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1 invested in in 2011?
 2 MR. EMANUEL: I am going to object. It is
 3 ambiguous. We need to know what regional benefit.
 4 THE COURT: Aside from the calculation of
 5 conserved acre-feet, there is some other regional
 6 benefit that you have calculated?
 7 THE WITNESS: On an annual basis we are not
 8 calculating a separate benefit from what's being
 9 reported in SB-60. Although the development of the
 10 programs initially was based on a calculation of
 11 benefits to the region overall, and we continue those
 12 programs as a result of that.
 13 Q. BY MR. BRAUNIG: To be clear, just so the
 14 record is clear, for the programs that Met invested in
 15 through the water stewardship rate in 2011, Met has not
 16 gone in and said, here's what the -- in dollar terms --
 17 here's what the regional benefits are to the region?
 18 **A. No. I don't believe we've done it in dollar**
 19 **terms.**
 20 Q. You didn't do that in 2012, '13 or '14 either?
 21 **A. Not to my knowledge.**
 22 Q. Met doesn't do any regular calculation of the
 23 benefits to Metropolitan in terms of avoided capital or
 24 transportation costs associated with these programs,
 25 does it?

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1 **A. We did that initially when the program was set**
 2 **up, but we're not doing that on an annual basis, no.**
 3 Q. And you didn't do that for the money that was
 4 invested in 2011?
 5 **A. Not to my knowledge.**
 6 Q. Or 2012 through '14?
 7 **A. Again, not to my knowledge.**
 8 Q. On an ongoing basis the only thing that Met
 9 keeps track of is how many acre-feet of water are we
 10 creating for these programs?
 11 **A. The acre-feet that are produced by the local**
 12 **agencies and used by the local agencies.**
 13 Q. You don't know what percentage of the benefits
 14 to Metropolitan associated with these demand management
 15 programs are associated with avoiding supply costs
 16 versus what percentage are attributable to avoiding any
 17 other costs, do you?
 18 **A. We know that these programs are reducing the**
 19 **demand for water moving through our system, so we know**
 20 **that there is a benefit associated with that reduced**
 21 **flow in our system.**
 22 MR. BRAUNIG: I am going to use the deposition
 23 again. Page 126, lines four through ten.
 24 THE COURT: I really should do this the right
 25 way, which is to ask if there is any objection.

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1 MR. EMANUEL: I am reading it right now.
 2 Thank you, your Honor.
 3 No objection.
 4 THE COURT: Go ahead.
 5 MR. BRAUNIG: (Reading:)
 6 "Q Of the investment that
 7 Metropolitan is making in LRP
 8 programs, what percentage of
 9 the benefits are attributable
 10 to avoiding water supply costs
 11 and what percentage are
 12 attributable to avoiding some
 13 of these other costs that you
 14 described?
 15 "A I don't know."
 16 Q. That's true testimony?
 17 A. Yes.
 18 Q. When Met is deciding whether to invest in
 19 specific demand management programs, Met doesn't
 20 consider whether those specific programs will help Met
 21 avoid some future transportation or facility costs, does
 22 it?
 23 A. **The basis for the program is the avoidance of**
 24 **those costs and the reduced demand on our system and the**
 25 **specific programs we're trying to implement in order to**

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1 **meet that overall objective.**
 2 Q. On a project-by-project basis Met doesn't
 3 evaluate whether a specific project it invests in will
 4 have a transportation or facility benefit, does it?
 5 A. No.
 6 **Rather, we have overarching goals for the**
 7 **programs. They are articulated in our integrated**
 8 **resource plan in terms of goals. We are trying to put**
 9 **programs together that meet those goals.**
 10 Q. Water stewardship is not a service that is
 11 inherent to the delivery of water, is it?
 12 A. **A service that is inherent to the delivery of**
 13 **water?**
 14 Q. Met could supply and deliver water to its
 15 member agencies without charging for water stewardship;
 16 correct?
 17 A. **If by that you mean we could exist without**
 18 **running these programs, I think that's true.**
 19 Q. Met has made a policy decision that it wants to
 20 fund these demand management programs?
 21 A. **That's correct.**
 22 Q. And Met collects money from the water
 23 stewardship rate to fund the programs; correct?
 24 A. **That's correct. And one thing we're also doing**
 25 **is complying with SB-60. We are carrying out these**

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1 **duties.**
 2 Q. Met then, after it takes the money, after it
 3 collects the money, then distributes -- then distributes
 4 the demand management subsidies to its member agencies;
 5 right?
 6 A. **The conservation programs largely do not go**
 7 **directly to the member agencies. They are benefit to**
 8 **the consumers throughout Southern California. The local**
 9 **resources program financial incentives are provided to**
 10 **local agencies that enter into a contract with**
 11 **Metropolitan and produce supplies for their customers**
 12 **through those projects.**
 13 Q. Met makes the decision, though, about how those
 14 subsidies are going to be distributed out to the member
 15 agents; right?
 16 A. **To the extent member agencies are applying for**
 17 **or consumers are applying for those rebates, then they**
 18 **are ultimately going to be getting those benefits.**
 19 **There isn't a pre-decision distribution of funds.**
 20 Q. The decision about how these funds are going to
 21 be distributed out is a decision made by Met in response
 22 to applications made by the member agencies?
 23 A. **That's correct.**
 24 Q. That's created situations where some large
 25 member agencies receive a lot more in demand management

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1 subsidies than they pay into the water stewardship rate;
 2 right?
 3 A. **I'm not sure.**
 4 Q. You are not sure because Met hasn't done that
 5 analysis?
 6 A. **Because I know the projects that are pursued,**
 7 **but I can't say as to whether that compares with the**
 8 **amounts that agencies are paying in.**
 9 Q. So Met has the data to determine how much each
 10 agency contributes to the water stewardship rate; right?
 11 A. **Probably, yes.**
 12 Q. As far as you know, they would?
 13 A. **As far as I know.**
 14 Q. And Met also possesses data about how much it
 15 pays out in subsidies to each member agency; correct?
 16 A. **Correct.**
 17 Q. Met has never compiled that data in order to
 18 determine whether there's a proportional relationship
 19 between the amount of water stewardship rate monies that
 20 are contributed and the amount of subsidies that are
 21 going out to those member agencies?
 22 A. **Not to my knowledge, and, frankly, that's not**
 23 **the way our programs are measured. Our programs are**
 24 **measured against overall regional goals.**
 25 Q. But Met has never done that; Met has never

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1 tried to see if there is a proportional relationship
 2 between the funds that are created -- funds that are
 3 received through these charges and the benefits to the
 4 member agencies from the distribution of those funds as
 5 subsidies?
 6 **A. Not to my knowledge. And the reason for that**
 7 **is, frankly, these are programs meant to provide**
 8 **regional benefits. It's not designed to provide a**
 9 **specific amount of benefit to any specific agency.**
 10 Q. But they do provide a local benefit, don't
 11 they?
 12 **A. They do provide local benefit.**
 13 Q. That local benefit is cash in the form of
 14 subsidies; correct?
 15 **A. There is a financial incentive Metropolitan is**
 16 **providing.**
 17 Q. There is also the water created that is a
 18 benefit to the local member agency that is generated
 19 through these subsidies; right?
 20 **A. That is correct.**
 21 Q. You don't measure what the benefits are that
 22 are specific to those agencies compared to how much they
 23 are contributing through the water stewardship rate?
 24 **A. Not to my knowledge.**
 25 Q. You're familiar with the rate structuring

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1 integrity provision?
 2 **A. I am familiar with it, yes.**
 3 Q. Because of the rate structure integrity
 4 provision, San Diego isn't allowed to receive any new
 5 contracts for local resource projects or conservation;
 6 correct?
 7 **A. Can you rephrase it? I didn't catch the last**
 8 **part.**
 9 Q. Since 2011, when rate structure integrity was
 10 invoked, San Diego has not been allowed to participate
 11 in new local resource projects or conservation programs;
 12 correct?
 13 **A. That's not correct.**
 14 Q. Met has not entered into new contracts with San
 15 Diego for local resource projects since 2011, has it?
 16 **A. For local resources projects, I believe you're**
 17 **correct. The conservation program continues to provide**
 18 **incentives for consumers throughout Met's service area,**
 19 **including the water authorities.**
 20 Q. San Diego is no longer allowed to participate
 21 in the local resource programs since 2011? Or into new
 22 contracts?
 23 **A. Since 2011 the County Water Authority has taken**
 24 **actions that triggered the RSI provisions in the**
 25 **agreements we've had.**

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1 Q. And the actions that have been triggered are
 2 because San Diego filed this lawsuit, they are not
 3 allowed to participate in new local resource program
 4 projects?
 5 **A. That is a follow-on action that has occurred as**
 6 **a result of San Diego's litigation.**
 7 Q. That means no matter how good a program San
 8 Diego might have to generate supply of water, no matter
 9 how cost effective it is, no matter how shovel-ready it
 10 is, Met is not going to fund it because San Diego filed
 11 this lawsuit; correct?
 12 MR. EMANUEL: I am going to object. The
 13 question is argumentative and the Court may recall this
 14 was the subject of a motion in limine, as well.
 15 THE COURT: It is a little argumentative. I
 16 will allow it.
 17 Go ahead.
 18 THE WITNESS: What was the question?
 19 Q. BY MR. BRAUNIG: The question is no matter how
 20 good the project is that San Diego might have, Met is
 21 not going to fund it because of rate structure
 22 integrity?
 23 **A. To the extent that San Diego has a project, and**
 24 **I can't speak to how good a project is or isn't, a**
 25 **project that would be part of the LRP program, that**

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1 **contract would contain rate structure integrity language**
 2 **that would be triggered by the action San Diego has**
 3 **taken with this litigation.**
 4 Q. And therefore, Met wouldn't fund it?
 5 **A. Ultimately, our board would have to consider**
 6 **that but, yes, it would likely trigger that clause and**
 7 **until that's settled, we wouldn't be funding it.**
 8 Q. There have been some questions that have been
 9 asked about whether San Diego at any point tried to get
 10 Met to change the RSI provisions. In fact, San Diego
 11 did try to change the provisions at one point in time
 12 and Met said no. Correct?
 13 **A. I actually don't recall that.**
 14 Q. Can we go to Tab 17, please, PTX 120.
 15 Do you recognize Tab 17, PTX 120, as a letter
 16 from Metropolitan to San Diego County Water Authority
 17 about the rate structure integrity on August 2, 2005?
 18 **A. Yes, I recognize this as that letter.**
 19 MR. BRAUNIG: We would move PTX 120 into
 20 evidence.
 21 MR. EMANUEL: No objection.
 22 THE COURT: PTX 120 has the proposal as an
 23 attachment and you are moving that in, as well?
 24 MR. BRAUNIG: Yes.
 25 THE COURT: PTX 120 is admitted.

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1 (Exhibit 120 was received in evidence.)
 2 Q. BY MR. BRAUNIG: I want to draw your attention,
 3 please, to the second line of that first paragraph.
 4 "Metropolitan is unable to execute your agreement
 5 because your modified version departs from the uniform
 6 rate structure integrity provision required by
 7 Metropolitan's board of directors for all new incentive
 8 program agreements with the member agencies."
 9 Does this refresh your recollection that when
 10 attempted to modify the rate structure language, Met
 11 told you it can't enter into a program that doesn't have
 12 that specific language?
 13 MR. EMANUEL: I don't think there was a
 14 failure --
 15 THE COURT: Sustained.
 16 Q. BY MR. BRAUNIG: For member agencies the rate
 17 structure integrity language is nonnegotiable; right?
 18 **A. The process that we would consider or our board**
 19 **would consider would be their own board process to take**
 20 **a look at whether changes to the rate structure**
 21 **integrity provision are things they would want to**
 22 **undertake.**
 23 Q. The RSI language is nonnegotiable; correct?
 24 **A. Once the board has adopted the language, they**
 25 **then gave us direction to include that in all of our**

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1 **contracts.**
 2 THE COURT: Does that mean it's nonnegotiable?
 3 THE WITNESS: The negotiation that could occur
 4 would be at a board level.
 5 MR. BRAUNIG: I am going to use his deposition,
 6 please, your Honor.
 7 Page 34, line 21, through 35, line four.
 8 MR. EMANUEL: Give me a second, your Honor.
 9 THE WITNESS: This was Tab 2.
 10 MR. BRAUNIG: Tab 2. It will come up on the
 11 board for you.
 12 THE COURT: Any objection?
 13 MR. EMANUEL: No objection.
 14 MR. BRAUNIG: (Reading:)
 15 "Q Is it negotiable?
 16 "A No.
 17 "Q So as a member agency your
 18 choice is to sign an agreement
 19 that includes the rate
 20 structure integrity language or
 21 you're not eligible to obtain
 22 certain incentive benefits for
 23 local resources or conservation
 24 or desalination?
 25 "A You need to sign an

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1 agreement that has standard
 2 provisions."
 3 MR. EMANUEL: To be fair, you should read the
 4 question and answer above that.
 5 THE COURT: The question and answer above that,
 6 starting at line 13?
 7 MR. EMANUEL: Starting at line seven.
 8 THE COURT: Starting at line seven?
 9 MR. BRAUNIG: I think it is a different
 10 question. If he wants to read it in and spend his time
 11 doing it, he can do that.
 12 THE COURT: I don't think it changes the
 13 meaning. Let's go ahead at this time and read that in,
 14 line seven and ending at line 12.
 15 MR. EMANUEL: Yes.
 16 THE COURT: We can do that now.
 17 MR. BRAUNIG: (Reading:)
 18 "Q What if an agency -- what
 19 if a member agency refuses to
 20 sign an agreement with that
 21 language?
 22 "A To the extent that it's
 23 part of the standard language
 24 that the board has instructed
 25 to have in all of these

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1 contracts, then the agency
 2 would be agreeing to not
 3 participate in those programs."
 4 Q. You testified earlier when this program was
 5 initiated, the demand management programs were initiated
 6 back in the mid-1990s or so, Metropolitan evaluated the
 7 regional benefits or the benefits associated with doing
 8 these programs; correct?
 9 **A. That's correct.**
 10 Q. Metropolitan has never done a backward-looking
 11 analysis to determine if demand management programs are
 12 actually avoiding particular costs, has it?
 13 **A. Not to my knowledge.**
 14 Q. Since the mid-1990s Metropolitan has never done
 15 another forward look to see if additional demand
 16 management spending would avoid transportation facility
 17 costs, has it?
 18 **A. Additional demand management spending itself**
 19 **may not be analyzed, but I do believe we looked at the**
 20 **projected capital investment program at Metropolitan in**
 21 **the, maybe, mid-2000s to see if reductions in demand**
 22 **would help reduce the expenditures to our capital**
 23 **program in the future. But I don't think it was**
 24 **directly related to the incentive program itself.**
 25 Q. Changing gears a little bit, when a member

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1 agency chooses to wheel water, that fact, the wheeling,
 2 doesn't cause Met to need to spend more money on demand
 3 management programs, does it?
 4 **A. Does the wheeling itself cause Metropolitan to**
 5 **spend more money on demand management?**
 6 Q. That's right.
 7 **A. I don't think so.**
 8 Q. Likewise, the entry into the exchange agreement
 9 by San Diego and Metropolitan, that didn't cause
 10 Metropolitan to need to spend more money on local
 11 resource projects and conservation, did it?
 12 **A. That individual agreement may not, but when**
 13 **Metropolitan is looking at our programs, as I said**
 14 **before, you're looking back, say, the 1990s, we were**
 15 **considering in the future the needs for the system to be**
 16 **determined to be able to move water to meet customer**
 17 **demands.**
 18 **And that includes both supplies that**
 19 **Metropolitan is providing but supplies that would be**
 20 **wheeled by other parties through the system.**
 21 Q. You're not able to identify any specific
 22 wheeling transactions that are attributable to spending
 23 on demand management programs, are you?
 24 **A. What do you mean by attributable to spending?**
 25 **I'm not sure I understand.**

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1 Q. Your testimony is that spending this money
 2 frees up space that then makes wheeling possible; is
 3 that right?
 4 **A. It reduces demand for deliveries in our system.**
 5 Q. But you're not able to identify any specific
 6 wheeling transaction that's attributable to the spending
 7 that's been made on demand management programs, are you?
 8 **A. Again, I'm not sure what you mean by**
 9 **"attributable."**
 10 Q. It had been caused by or as a result of.
 11 **A. I don't know why a wheeling transaction would**
 12 **be caused by demand management programs.**
 13 Q. You have been a Met staffer for more than a
 14 decade; correct?
 15 **A. That's true.**
 16 Q. And you have been involved in a number of
 17 different rate refinement or rate-related initiatives;
 18 correct?
 19 **A. Yes, sir.**
 20 Q. Since 2003, when Met unbundled its rates, Met
 21 has not presented any rate structures to its board other
 22 than the one it's using today, has it?
 23 **A. Not to my knowledge.**
 24 Q. Met has not presented to its board any
 25 different cost allocations that would move all of the

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1 State Water Project costs off of transportation, has it?
 2 **A. Over the course of the years since the rate**
 3 **structure was adopted, we have discussed many different**
 4 **potential things with the board, but we've never made a**
 5 **recommendation for a wholesale rate structure change, if**
 6 **that's what you're getting at.**
 7 Q. There has never been presented to the board an
 8 option that would move State Water Project costs off of
 9 transportation?
 10 **A. In a -- as an option that the board would take**
 11 **action on, I'm not sure.**
 12 Q. You're not sure, or no?
 13 **A. Well, we've had many discussions over the years**
 14 **about different things that could be done. We've had**
 15 **board workshops related to what we called our long-range**
 16 **finance plans and things like that.**
 17 **So there were concepts that were discussed, but**
 18 **I don't know that there was ever a specific action to**
 19 **make significant changes to the rate structure that the**
 20 **board would have acted on.**
 21 Q. The same goes for the demand management
 22 programs, there's never been an option presented to the
 23 board that would take those demand management programs
 24 off of transportation and put them somewhere else?
 25 **A. Not to my knowledge.**

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1 Q. Over the years that you've been working on
 2 these rate initiatives, San Diego has frequently
 3 complained about the fact that State Water Project costs
 4 are on transportation, haven't they?
 5 **A. San Diego has voiced that opinion in many**
 6 **meetings.**
 7 Q. Over the course of many years?
 8 **A. That's correct.**
 9 Q. Since 2003?
 10 **A. I can't say the exact years, but yes.**
 11 Q. Likewise, with the demand management programs,
 12 they've been complaining for a decade or more that those
 13 programs shouldn't be on Metropolitan's transportation
 14 rates; correct?
 15 **A. I can't say a decade or more, but I do know**
 16 **that they have voiced that desire.**
 17 Q. You can't say that they have voiced that
 18 desire?
 19 **A. I can say that they have.**
 20 Q. Okay, thank you.
 21 And they've voiced that desire repeatedly?
 22 **A. Yes.**
 23 Q. Over the course of many years?
 24 **A. Yes.**
 25 Q. In your declaration that was submitted into --

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1 as part of your testimony, you note that Metropolitan
 2 and its member agencies have the right to wheel
 3 third-party water on the State Water Project; do you
 4 recall that?
 5 **A. Yes.**
 6 Q. Met has never attempted to put a financial
 7 value on the right of Metropolitan or its member
 8 agencies to wheel water on the State Water Project, has
 9 it?
 10 **A. A financial value on our right to wheel water?**
 11 Q. Uh-huh.
 12 **A. Metropolitan's right to wheel water?**
 13 Q. That's right.
 14 **A. Not to my knowledge. It is one of the benefits**
 15 **we get as State water contractor and part of the fees we**
 16 **pay under our State water contract allow us part of that**
 17 **right.**
 18 Q. But you've never attempted to put a financial
 19 value on that right, Metropolitan hasn't?
 20 **A. I don't believe that we put a financial value**
 21 **on it other than the fact that the bill we pay for the**
 22 **State Water Project is broken up into**
 23 **conservation/supply and transportation from the**
 24 **Department of Water Resources. We are getting that**
 25 **value for the transportation.**

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1 Q. Is it your opinion that the disaggregation of
 2 the DWR bill into conservation and conveyance that has
 3 -- that has legal meaning, that that -- that that,
 4 therefore, means that's the value to Metropolitan?
 5 MR. EMANUEL: I will object to the question.
 6 THE COURT: It is two different questions. I
 7 think you mean the latter.
 8 MR. BRAUNIG: I'll re-ask the question.
 9 Q. Your -- you were present during the first phase
 10 of this trial; correct?
 11 **A. Correct.**
 12 Q. Have you read the Court's statement of decision
 13 on the issue of whether or not DWR -- the fact that DWR
 14 disaggregates its bill means those are Met's
 15 transportation costs?
 16 **A. I have.**
 17 Q. You have, okay.
 18 Since 2013, since December of 2013, has the
 19 structure of DWR's billing to Met changed?
 20 **A. Not to my knowledge.**
 21 Q. DWR still breaks up its bill in the same way?
 22 **A. Correct.**
 23 Q. Met still doesn't own the State Water Project,
 24 does it?
 25 **A. Correct.**

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1 Q. Met still doesn't operate the State Water
 2 Project, does it?
 3 **A. We don't operate the State Water Project, to my**
 4 **knowledge.**
 5 Q. And the State Water Project still is not part
 6 of Met's conveyance system, is it?
 7 **A. It is included in our conveyance rates.**
 8 Q. With respect to this idea of State Water
 9 Project wheeling, there are many years where Met doesn't
 10 wheel any third-party water on the State Water Project;
 11 correct?
 12 **A. That's correct.**
 13 Q. And there are many years where Metropolitan
 14 member agencies don't wheel any water on the State Water
 15 Project; correct?
 16 **A. Correct.**
 17 Q. In fact, isn't it true that of the water that's
 18 been moved on the State Water Project over the last
 19 decade, less than five percent of that is wheeling by
 20 Metropolitan or its member agencies?
 21 **A. I think that's probably right. I don't know**
 22 **the exact statistic, but I would imagine that is a very**
 23 **small amount.**
 24 Q. Met makes decisions about whether a member
 25 agency like San Diego can stand in Met's shoes and wheel

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1 water on the State Water Project, doesn't it?
 2 **A. Can stand in Metropolitan's shoes and wheel**
 3 **water? If -- in a scenario where San Diego wants to**
 4 **execute a transfer that's purchasing supply from another**
 5 **entity?**
 6 Q. Right.
 7 **A. Then they could enter into an arrangement with**
 8 **Metropolitan to wheel the water, yes.**
 9 Q. And Metropolitan would have the discretion to
 10 decide whether or not San Diego is allowed to do that;
 11 correct?
 12 **A. Well, there are wheeling provisions that would**
 13 **apply in terms of the ability to move the water.**
 14 Q. Can we bring up PTX 358, please.
 15 This is Tab 24 in your binder. It's in the
 16 binder that's in the binder one.
 17 This is PTX 358. This is a letter from
 18 Metropolitan to San Diego concerning a proposed wheeling
 19 transaction?
 20 **A. Okay.**
 21 Q. The answer is yes, that's what this is?
 22 **A. Yes, it appears that way, yes.**
 23 MR. BRAUNIG: We would move PTX 358 into
 24 evidence.
 25 MR. EMANUEL: No objection.

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1 THE COURT: PTX 358 is admitted.
 2 (Exhibit 358 was received in evidence.)
 3 Q. BY MR. BRAUNIG: In PTX 357 San Diego had
 4 requested wheeling service on the State Water Project
 5 for water it was getting from the San Juan Water
 6 District? That's what is in the first paragraph.
 7 A. **That appears to be, yes.**
 8 Q. If you look on the third paragraph,
 9 Metropolitan was refusing to consent to wheel this water
 10 or to allow the State Water Project to wheel this water
 11 on San Diego's behalf; correct?
 12 A. **It -- yes, it appears we are not consenting to**
 13 **it.**
 14 Q. That is a decision that Metropolitan can make?
 15 A. **Right. There would be many considerations**
 16 **behind that, but yes.**
 17 MR. BRAUNIG: We are five minutes from noon and
 18 it is a good time.
 19 THE COURT: Do you have more questions after
 20 lunch?
 21 MR. BRAUNIG: I might have a little more.
 22 THE COURT: Why don't we get together again at
 23 1:30. Thank you very much.
 24 (Noon recess.)
 25

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1 San Francisco, California
 2 Thursday, April 2, 2015
 3 1:30 p.m.
 4 Department No. 304 Hon. Curtis E.A. Karnow, Judge
 5
 6 DEVENDRA UPADHYAH,
 7 resumed the stand and testified further as follows:
 8
 9 THE COURT: Shall we continue. Do we have a
 10 witness?
 11 Sir, if you'll join us.
 12
 13 MR. BRAUNIG: Your Honor, counsel for Met had
 14 sought to move in DTX 979, which is the SB-60 report, a
 15 30-page document, and you had asked them to prepare an
 16 excerpted version. We think for purposes of
 17 completeness the entire 979 should come in, and we don't
 18 object to it. Since he sought to move it in, we don't
 19 object, if the Court would allow it.
 20 MR. EMANUEL: I am withdrawing 979. I would
 21 ask to enter evidence 979A which is only the two pages
 22 we used. I think that would be more efficient.
 23 MR. BRAUNIG: Your Honor, I think, that putting
 24 in two pages of a 30-page document, it's not an enormous
 25 document.

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1 THE COURT: Is there something else that when
 2 you write the post-trial briefs you will be pointing me
 3 to some of the other pages?
 4 MR. BRAUNIG: Possibly. We would like to have
 5 the opportunity to do that.
 6 THE COURT: One of the requests -- I'll make it
 7 now -- when we finish the exhibits, you are going to be
 8 providing to me the courtesy copies, you are going to
 9 take everything out of this room and you are going to be
 10 providing me only the pages you will be relying on and
 11 you think I need to read afterwards.
 12 If you want the entire 979 in, I will admit the
 13 entire 979. It is hereby admitted. And I apologize to
 14 counsel for having gone to the trouble of doing what I
 15 asked you to do.
 16 MR. EMANUEL: No apologies necessary.
 17 MR. BRAUNIG: Your Honor, also there is some
 18 discrepancy as to whether or not I moved PTX 358 in.
 19 THE COURT: I have an indication that you did.
 20 MR. BRAUNIG: It's admitted.
 21 THE COURT: That's my indication. The clerk
 22 confirms.
 23 THE CLERK: I do not. I do confirm now that
 24 you saw it.
 25 THE COURT: Now he does.

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1 MR. BRAUNIG: With that, your Honor, I have
 2 nothing further.
 3 THE COURT: Any further questions of this
 4 witness, redirect?
 5
 6 REDIRECT EXAMINATION
 7 BY MR. EMANUEL:
 8 Q. We are going to look again at PTX 358.
 9 Mr. Upadhyah, do you have that in front of you?
 10 THE COURT: The July 7, 2010, letter under Tab
 11 24.
 12 THE WITNESS: Yes, I do.
 13 Q. BY MR. EMANUEL: Let's look into the third
 14 paragraph, and specifically, I think, to the third
 15 sentence of the third paragraph.
 16 For the record, "If SDCWA possesses a change in
 17 place of use from the State Water Resources Control
 18 Board for CVP supplies from SJWD, then Metropolitan will
 19 provide transportation for this water as non-SWP
 20 supplies."
 21 Sir, would you explain to us what that means?
 22 A. **Sure. When San Diego was proposing this**
 23 **transfer at the time, it was with a party that has**
 24 **rights on the Central Valley project, which in this**
 25 **paragraph is referred to as CVP. And there is a certain**

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1 **place of use defined for the Central Valley Project and**
 2 **contractors that are on the Central Valley Project, that**
 3 **is separate from the place of use for the State Water**
 4 **Project and contractors on the State Water Project.**
 5 Q. Let's stop you right there. Would you explain
 6 the importance of place of use?
 7 **A. Sure. It's defined that permanent operations**
 8 **of the CVP is for the benefit of contractors on the CVP**
 9 **and its use of water in the CVP area, that place of use,**
 10 **which is completely different than the State Water**
 11 **Project and the place of use within the State Water**
 12 **Project area.**
 13 **So what we were saying there is there is a**
 14 **process that is used to go to the State board and**
 15 **request a change in place of use. There was risk from**
 16 **Metropolitan if we were to agree to a wheeling**
 17 **arrangement for a transfer that does not have that**
 18 **approval, so we were saying if you are able to process**
 19 **that change in place of use through the State board then**
 20 **we'll move the water as nonproject water.**
 21 THE COURT: Do you need the permission of the
 22 State board to do any wheeling deal?
 23 THE WITNESS: If it's in this situation where
 24 there's the risk of not -- the State board not
 25 acknowledging the change of place of use, then there is

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1 a risk that, for example, if we had done that without
 2 that change in place of use, the State Board could look,
 3 after the fact, could look and say, you took delivery of
 4 your State Water Project allocation, we are not
 5 acknowledging that it was a transfer.
 6 Q. BY MR. EMANUEL: We were talking about the
 7 conservation and the demand management program.
 8 Do you have an estimate of how much water was
 9 produced through these demand management programs?
 10 **A. The number changes as we go through time, as**
 11 **the benefits increase. It is more than three million**
 12 **acre-feet over the life of the programs.**
 13 MR. EMANUEL: Thank you. Nothing more, your
 14 Honor.
 15 MR. BRAUNIG: Nothing further.
 16 THE COURT: Thank you. You are excused.
 17 MR. KEKER: Let me get Miss Stapleton who is
 18 next, your Honor.
 19 THE COURT: Thank you.
 20 MR. EMANUEL: Can we do administrative
 21 housekeeping? Do you remember there was the
 22 Administrative Code, the Court asked that only some
 23 portion of it, so we have -- what was the number --
 24 1149A, Metropolitan moves into evidence, your Honor.
 25 THE COURT: Does San Diego have a copy of that?

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1 MR. EMANUEL: Yes, I gave that at the break.
 2 MR. BRAUNIG: No objection.
 3 (Exhibit 1149A was received into evidence.)
 4 THE COURT: 1149A is admitted.
 5 MR. QUINN: Metropolitan calls Maureen
 6 Stapleton.
 7
 8 MAUREEN STAPLETON,
 9 called as a witness by the Defendant, was sworn and
 10 testified as follows:
 11
 12 THE WITNESS: I do.
 13 THE CLERK: Please be seated. Maureen
 14 Stapleton. M-A-U-R-E-E-N. S-T-A-P-L-E-T-O-N.
 15
 16 DIRECT EXAMINATION
 17 BY MR. QUINN:
 18 Q. Good afternoon, Miss Stapleton.
 19 **A. Good afternoon.**
 20 Q. My name is John Quinn. You are the general
 21 manager of the Water Authority in San Diego?
 22 **A. Correct.**
 23 Q. How long have you been the general manager?
 24 **A. Nineteen-and-a-half years.**
 25 Q. Did you work for the Water Authority before you

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1 became general manager?
 2 **A. No, I did not.**
 3 Q. What are the scope of your responsibilities as
 4 general manager of the San Diego Water Authority?
 5 **A. I am responsible for the overall management of**
 6 **the Water Authority and its 260 employees.**
 7 Q. Do you recall back in 2001 that Metropolitan
 8 went through a process of unbundling its rates?
 9 **A. Yes.**
 10 Q. Do you recall those unbundled rates went into
 11 effect January 1, 2003?
 12 **A. Yes.**
 13 Q. As early as 2001, when Metropolitan was
 14 considered unbundling its rates, you folks at the San
 15 Diego Water Authority understood that the system access
 16 rate was a component of the conveyance charges that Met
 17 was implementing for these unbundled rates; correct?
 18 **A. Yes.**
 19 Q. And certainly you knew that power was another
 20 component?
 21 **A. Yes.**
 22 Q. You knew the water stewardship rate was another
 23 component of this unbundled conveyance rate?
 24 **A. Yes.**
 25 MR. QUINN: If we could look at Defense Exhibit

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1 767. There has been no objection to this, your Honor,
 2 and I would offer it into evidence.
 3 MR. KEKER: No objection.
 4 MR. QUINN: You should have a binder up there
 5 that will have copies of all the exhibits I will refer
 6 to.
 7 THE COURT: Exhibit 767, I take it that's a
 8 DTX?
 9 MR. QUINN: DTX 767.
 10 THE COURT: It is admitted.
 11 (Exhibit 767 was received in evidence.)
 12 Q. BY MR. QUINN: Could you please identify this
 13 document for us?
 14 **A. It appears to be a PowerPoint presentation by**
 15 **the Water Authority, or it's referenced as the Water**
 16 **Authority.**
 17 Q. And it bears a date that we see on the first
 18 page of October 11, 2001?
 19 **A. Yes.**
 20 Q. And do you recall participating in a San Diego
 21 Water Authority workshop concerning Met's unbundling
 22 proposal back in October of 2001?
 23 **A. Yes. I don't remember this specific meeting**
 24 **per se, but I attended all of these workshops.**
 25 Q. This exhibit appears to be a PowerPoint

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1 presentation that was used in connection with one of
 2 those workshops in San Diego where you were considering
 3 this unbundled rate proposal?
 4 **A. It does.**
 5 Q. If you could turn to, I think it is, slide
 6 number five. It is page 28 of the document. It is the
 7 page entitled "Wheeling." We've got it up on the
 8 screen. If it is easier for you to look at the screen
 9 there, there is a screen -- you can also see it right in
 10 front of you on the left-hand side.
 11 **A. Oh, yes. Thank you.**
 12 Q. This slide, of course, shows that under this
 13 unbundled proposal for wheeling there be a system access
 14 rate and a water stewardship rate, an incremental power
 15 cost, and there is a question mark there. You see that?
 16 **A. Yes.**
 17 Q. San Diego knew that these components were going
 18 to be on this unbundled conveyance rate and also got
 19 information about what the charges would be?
 20 **A. Yes.**
 21 Q. In fact, San Diego received cost of service
 22 reports that specified, for example, the amount of the
 23 State Water Project costs that would go into, for
 24 example, the system access rate; do you recall that?
 25 **A. Yes.**

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1 MR. QUINN: If you could look, please, at DTX
 2 475. This has not been admitted, at least as marked,
 3 your Honor. It was previously part of the administrative
 4 record. There is no objection to it, as I understand
 5 it, and we will offer Defense Exhibit 475.
 6 MR. KEKER: No objection.
 7 THE COURT: DTX 475 is admitted.
 8 (Exhibit 475 was received into evidence.)
 9 THE COURT: If we could put that up on the
 10 screen.
 11 MR. KEKER: Again, this is a 200-page document.
 12 THE COURT: I think we're just going to have a
 13 general conversation about this at the end Of the trial.
 14 Q. BY MR. QUINN: Do you recognize this document,
 15 Miss Stapleton?
 16 **A. I do not.**
 17 Q. But you did -- you did get information -- you
 18 do recall receiving information from time to time about
 19 specifically -- prior to January 1, 2003, when these
 20 unbundled rates went into effect, you had very specific
 21 information about what the particular charges would be
 22 and what is contained in those charges.
 23 Is that fair to say?
 24 **A. Yes.**
 25 Q. And in March of 2002, the specific rates for

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1 the unbundled rate structure, including the conveyance
 2 rate, were considered and approved by the Met. But you
 3 did -- you did get information -- you do recall
 4 receiving information from time to time about
 5 specifically -- prior to January 1, 2003, when these
 6 unbundled rates went into effect, you had very specific
 7 information about what the particular charges would be
 8 and what was contained in those charges.
 9 Is that fair to say?
 10 **A. Yes.**
 11 Q. And in March of 2002 the specific rates for the
 12 unbundled rate structure, including the conveyance rate,
 13 were considered and approved by the Met board.
 14 Do you recall that?
 15 **A. Yes.**
 16 Q. If we can look at Defense Exhibit 129, which I
 17 understand is in evidence. This document is entitled
 18 "Delegate Votes at a Glance."
 19 Do you see that?
 20 **A. Yes, I do.**
 21 Q. This is a document you can see in the lower
 22 right-hand corner, depending -- if you hold it this way,
 23 the long way, it's in the lower right-hand corner, you
 24 can see a Bates number SDCWA, et cetera, which indicates
 25 this is a document that came from San Diego's files.

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1 You understand that?
 2 **A. Yes.**
 3 Q. Can you tell us what this document is?
 4 **A. This is an at-a-glance voting record of our MWD**
 5 **delegates from the Water Authority.**
 6 Q. So is it true, then, that in this document we
 7 can see how the delegates from the San Diego Water
 8 Authority, who sit on the Metropolitan board, how they
 9 vote on various issues?
 10 **A. Yes.**
 11 MR. QUINN: That's what this reflects. And
 12 then if we could turn, please, to Defense Exhibit 772,
 13 DTX 772, not yet admitted, your Honor. As I understand
 14 there is no objection to it. I am going to offer this,
 15 as well.
 16 (Exhibit 772 was received into evidence.)
 17 MR. KEKER: No objection.
 18 THE COURT: DTX 772 is admitted.
 19 Q. BY MR. QUINN: You see this exhibit, 772, these
 20 are minutes of a San Diego Water Authority board meeting
 21 on February 28, 2002?
 22 **A. Yes.**
 23 Q. And if you turn, please, to page 11, that's
 24 page 11 on the lower right-hand side. You can also see
 25 that on the screen. You see there in the first

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1 paragraph, but I would like to read that to you. The
 2 first paragraph under 1B it says, "Director of imported
 3 water has provided reasons why CWA staff --"
 4 What is CWA?
 5 **A. County Water Authority. That's our agency.**
 6 Q. -- "had recommended that the board take a
 7 position on MWD's proposed rates and charges. He
 8 reviewed the proposed rate structure and described rate
 9 structure components. He showed potential impact to CWA
 10 member agencies. Mr. Hess compared existing and
 11 proposed MWD rates and charges, and said the IID
 12 transfer would provide a benefit to the proposed MWD
 13 rate structure."
 14 You see that?
 15 **A. Yes, I do.**
 16 Q. The second paragraph says, "After a lengthy
 17 discussion, the staff recommendation was revised to
 18 read: "The board direct the Met delegates to support
 19 the proposed Met rates and charges for 2003, with the
 20 statement and understanding that the action is without
 21 prejudice to the continuation of the preferential rights
 22 lawsuit."
 23 You see that?
 24 **A. Yes, I do.**
 25 Q. Apparently there was some lawsuit then going on

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1 between San Diego and who?
 2 **A. And Metropolitan Water District.**
 3 Q. About this preferential rights issues?
 4 **A. Yes.**
 5 Q. After a discussion at San Diego about the
 6 unbundled rate structure and the components of it, the
 7 San Diego board, after looking at this, directed the San
 8 Diego delegates on the Met board to vote for the rates
 9 that went into effect January 1, 2003; is that correct?
 10 **A. Yes. To support the rate structure, correct.**
 11 Q. And to vote, you understand that?
 12 **A. Yes, to vote affirmative.**
 13 Q. The only reservation related to this other
 14 issue, which was the subject of a pending lawsuit
 15 regarding preferential rights, at least as reflected in
 16 the minutes?
 17 **A. Yes.**
 18 Q. There was no reservation, at least as reflected
 19 in the minutes, in terms of the vote on these unbundled
 20 rates with respect to either State Water Project costs
 21 or the water stewardship rate; correct?
 22 **A. Correct.**
 23 Q. In fact, San Diego delegates, if we go back and
 24 look at Defense Exhibit 129, San Diego's members on the
 25 Met board did, in fact, vote in favor of those unbundled

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1 rates; correct?
 2 **A. They voted in favor of the rate structure,**
 3 **correct.**
 4 Q. And those rates and that rate structure and the
 5 components of it, that's the same structure which San
 6 Diego maintains in this case is a breach of the 2003
 7 exchange agreement?
 8 **A. Yes.**
 9 Q. You are aware Mr. Slater has been -- Mr. Scott
 10 Slater was designated by San Diego as the person most
 11 knowledgeable to testify on various issues relating to
 12 damages, breach and mistake. You are aware of that?
 13 **A. Yes, I am. I would like to read to you from**
 14 **Mr. Slater's deposition as the person most**
 15 **knowledgeable, from page 216 to 217, 12.**
 16 MR. KEKER: No objection.
 17 Q. BY MR. QUINN: I will read to you Mr. Slater's
 18 testimony as the person most knowledgeable.
 19 "Q. You knew that at the time
 20 the October 2003 agreement was
 21 signed, that that \$235 charge
 22 included charges, costs
 23 relating to the State Water
 24 Project that were included in
 25 the system access rate, that

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1 were rolled up into the
 2 wheeling rate. You knew that?
 3 "A Yes, I did.
 4 "Q And you thought it was
 5 inappropriate to include those
 6 charges; correct?
 7 "A Correct.
 8 "Q And you believe that was actually not
 9 lawful to do that; correct?
 10 "A Agreed.
 11 "Q And, similarly, if I ask
 12 you the same questions about
 13 the costs associated with power
 14 and the State Water Project,
 15 you knew those were included,
 16 too, and you thought it was
 17 illegal to include those in
 18 that rate; correct?
 19 "A That's correct.
 20 "Q And -- but you knew they were
 21 in that 235-dollar rate?
 22 "A That's correct."
 23 Now, back in 2003, you heard Mr. Slater
 24 emphatically express that opinion at the time the
 25 exchange agreement was being negotiated; correct?

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1 **A. Yes. We believed that they were not lawfully**
 2 **to be included.**
 3 Q. And you heard him express that opinion and you
 4 believed that also, even before the exchange agreement
 5 was signed up; correct?
 6 **A. Correct.**
 7 Q. When, Miss Stapleton, did you first reach the
 8 conclusion that the inclusion of State Water Project
 9 costs in the unbundled conveyance rate was unlawful?
 10 When did you first reach that conclusion?
 11 **A. When Metropolitan started talking about**
 12 **unbundling of the rates and of the cost allocation of**
 13 **the State Water Project. That's when we believed that**
 14 **was a misinterpretation of what was allowed by law.**
 15 Q. You had that belief when you first heard that
 16 Metropolitan had proposed to include those costs in the
 17 unbundled conveyance rate?
 18 **A. Correct.**
 19 Q. That could have been in 2001, 2002, but
 20 certainly by 2003; correct?
 21 **A. Correct.**
 22 Q. You believed that it was unlawful, based upon
 23 the law as it existed then in 2003; correct?
 24 **A. Yes. We believed that the interpretation by**
 25 **Metropolitan was not correct.**

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1 Q. My point is you believed it was unlawful under
 2 the law, as it existed in 2003, the existing law at that
 3 time?
 4 **A. Yes.**
 5 Q. Now, on occasion over the years, you haven't
 6 been bashful about writing to Metropolitan to express
 7 concerns that the San Diego Water Authority had about
 8 various issues. Would that be fair to say?
 9 **A. Yes. That is fair to say. I am not a bashful**
 10 **woman.**
 11 Q. And if an issue is important enough, you would
 12 put those concerns in writing?
 13 **A. It depends on what forum we would be at and it**
 14 **depends on what we're trying to achieve. So I wouldn't**
 15 **say wholesale I would put something like that in**
 16 **writing.**
 17 Q. What I'm saying is, without regard to the
 18 forum, you wouldn't wait -- if you had a particular
 19 concern you thought it was important enough -- you
 20 wouldn't necessarily wait until the next board meeting.
 21 You might send off a letter or an email and document
 22 your strongly held views?
 23 **A. Or make a phone call to let my views be known;**
 24 **correct.**
 25 Q. And if an issue was important enough that you

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1 thought it ought to be documented, you wouldn't hesitate
 2 to put San Diego's views in writing; is that fair to
 3 say?
 4 **A. I guess I am hesitating on documented. I am**
 5 **not sure I understand the question.**
 6 Q. Let me withdraw it again.
 7 I am saying if you thought it was important
 8 enough, if you thought an issue was important enough, I
 9 mean, you've been a general manager for, you told me, 19
 10 years?
 11 **A. Correct.**
 12 Q. And you understand the value sometimes of
 13 negotiating things, of documenting things when it
 14 relates to issues that are important; correct?
 15 **A. Correct.**
 16 Q. Including issues about illegal conduct?
 17 **A. Yes.**
 18 Q. So if an issue is important enough --
 19 **A. Uh-huh.**
 20 Q. -- to you, you wouldn't hesitate to put San
 21 Diego's concerns in writing; correct?
 22 **A. Yes. I would put them in writing from time to**
 23 **time, if it was appropriate. Again, depending upon what**
 24 **venue I'm using to try to make a change.**
 25 Q. So in particular, in 2003, after Metropolitan

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1 unbundled its rates, and after the new rates went into
 2 effect, you wrote Mr. Gastelum --
 3 **A. Yes.**
 4 Q. -- your counterpart at Metropolitan at the
 5 time, about those rates and documented your concerns.
 6 Do you recall that?
 7 **A. Yes, I do.**
 8 Q. Let's take a look at DTX 794. This is in
 9 evidence.
 10 And you say in the first line of your letter
 11 that you have identified some issues in the setting and
 12 the adoption of Metropolitan's proposed rates.
 13 Do you see that?
 14 **A. I do see that.**
 15 Q. And then it goes on -- and I am not going to
 16 take the time to go through your three-page
 17 single-spaced letter -- but continuing in the second
 18 paragraph there, and on to the second paragraph, you
 19 list certain of these issues; correct?
 20 **A. Yes.**
 21 Q. And these include something called
 22 "pay-as-you-go funding." I'm not even going to ask you
 23 what that is.
 24 **A. Yes.**
 25 Q. "Excess revenue collection. The use of

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1 reserved funds."
 2 Do you see all that?
 3 **A. I do see that.**
 4 Q. And then on page two there is a -- you reach --
 5 in the first full paragraph on page two, in the last
 6 sentence, you refer to "rate stability." Do you see
 7 that?
 8 THE COURT: Can you say that one more time,
 9 Mr. Quinn?
 10 MR. QUINN: Yes.
 11 Q. On page two, last sentence of the first full
 12 paragraph on page two, if you look at the second-to-last
 13 maybe you can highlight that, "rate stability."
 14 This is in the second-to-last line of the
 15 paragraph.
 16 **A. Yes, I see it now.**
 17 Q. And that was an issue. You thought that rate
 18 stability was something that was important to
 19 Metropolitan's members, including San Diego. Fair to
 20 say?
 21 **A. Yes, it was the use of reserves.**
 22 Q. Okay. But the rate stability was something
 23 that you thought was important; correct?
 24 **A. Yes. That the use of the planned increase of**
 25 **reserves could be more properly applied to maintaining**

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1 **existing rates, in this case, system access and water**
 2 **stewardship. And that would provide rate stability to**
 3 **the member agency, right.**
 4 Q. So you say, "Thus providing overall rate
 5 stability to agencies."
 6 Just reading that I got the impression you
 7 thought that was a useful thing to do?
 8 **A. Yes.**
 9 Q. Further, further down the page, you actually
 10 discuss the system power rate. Do you see that? You
 11 have a numbered paragraph.
 12 **A. I do.**
 13 Q. What you say there about the system power rate,
 14 the only thing you say about it there is it is kind of
 15 positive. Would you agree?
 16 **A. Yes. It was the first time that we were able**
 17 **to distinguish with specificity the system power rate in**
 18 **its detail, so we thought that was -- we wanted to give**
 19 **kudos where we could for doing that.**
 20 Q. The answer to my question was, yes, it was a
 21 positive thing?
 22 **A. Yes, it was.**
 23 Q. You say, "it is an excellent example of rate
 24 component transparency." Is what you wrote?
 25 **A. Yes.**

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1 Q. You don't -- you didn't actually hear, say, by
 2 the way, we think it is unlawful; you don't see that in
 3 that paragraph?
 4 **A. Not in that paragraph.**
 5 Q. Or anywhere in that letter. You don't say that
 6 use of power, inclusion of power in the rate is
 7 unlawful?
 8 **A. Yes, that's true. We kind of reference State**
 9 **Water Project in the next section.**
 10 Q. Sure. We will come to that.
 11 You did not request or even suggest that the
 12 State Water Project costs come out of the power rate?
 13 **A. Not in this paragraph, no.**
 14 Q. In the next paragraph you write about water
 15 delivery costs. Do you see that?
 16 **A. Yes, I do.**
 17 Q. There you do say that, "San Diego objects to
 18 the inclusion of significant water supply costs, e.g.,
 19 State Water Project costs, as a component in
 20 Metropolitan's system access rate."
 21 Do you see that?
 22 **A. Yes, I do.**
 23 Q. That is part of what we're talking about, what
 24 this lawsuit is about; right?
 25 **A. Correct.**

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1 Q. You go on to explain why San Diego objects.
 2 You say, and I quote, "The inclusion of supply costs in
 3 the system access rate creates subsidies for
 4 Metropolitan's supplies and increased costs for water
 5 delivery. This result sends inappropriate economic
 6 signals on both the costs of alternative supplies and
 7 appropriate delivery costs."
 8 Do you see that?
 9 **A. I do.**
 10 Q. At that time you thought that those costs,
 11 actually, that it was unlawful, it was illegal?
 12 **A. Yes, we believed it was unlawful.**
 13 Q. But you decided not to put that in the letter?
 14 **A. Not in this letter.**
 15 Q. Well, let me ask you: Before this lawsuit was
 16 filed, are you aware of any written communication that
 17 you wrote to anyone at Metropolitan saying that any of
 18 these challenged rates were illegal or unlawful?
 19 **A. I cannot recall offhand a written letter that**
 20 **says, hello, these rates are unlawful.**
 21 Q. Are you aware of any written communication,
 22 prior to the filing of this lawsuit, at any time, where
 23 anybody at San Diego tells anybody at Metropolitan that
 24 the inclusion of these State Water Project costs and the
 25 water stewardship rate in the unbundled conveyance rate

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1 is illegal?
 2 **A. In writing?**
 3 Q. Yes.
 4 **A. No.**
 5 Q. That would be a pretty important thing,
 6 wouldn't it? I mean, these contracts involve millions
 7 and millions of -- the conveyance of water in these
 8 charges involve tens of millions of dollars, don't they?
 9 **A. Yes, sir, they do.**
 10 Q. If somebody thought it was illegal, they are
 11 illegally being charged tens of millions of dollars, or
 12 that a proposal was on the table that would contemplate
 13 illegally charging tens of millions of dollars, that
 14 would be something significant, wouldn't you agree?
 15 **A. It is something significant, yes.**
 16 Q. And there is nothing in this letter where you
 17 say that --
 18 Let me turn now to the water stewardship rate
 19 and what you write there. The last paragraph on that
 20 page, "The Water Authority" -- it says, "The Water
 21 Authority supports the goal of increasing the production
 22 of recycled water and increasing support for economic
 23 water conservation programs, requiring an increase in
 24 the water stewardship rate. The Water Authority would
 25 like to continue to support local resource management

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1 and development programs," and it goes on. You can read
 2 ahead and read it to yourself.
 3 There is nothing there where you say the water
 4 stewardship rate should not be included in the water
 5 delivery costs or the costs of conveyance, is there?
 6 **A. Well, it references that the Water Authority**
 7 **believes that these goals could be met without**
 8 **unnecessarily increasing the system access charge in the**
 9 **water stewardship rate this year.**
 10 **So that was our reference to they should not be**
 11 **in the transportation rates.**
 12 Q. There is nothing there where you indicate or
 13 even suggest that you thought that the inclusion of the
 14 water stewardship rate charges was actually unlawful or
 15 illegal?
 16 **A. Correct.**
 17 Q. Did you have any role in the negotiation and
 18 approval of the exchange agreement that ended up being
 19 signed in October of 2003?
 20 **A. Yes, I did.**
 21 Q. And what was your role?
 22 **A. I was the team leader of the negotiating team.**
 23 Q. And do you recall that, just kind of jumping
 24 into the middle of that, that around August of 2003, San
 25 Diego proposed to Metropolitan two different ways of

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1 entering into this conveyance arrangement for the water
 2 that San Diego had contracted to get; do you recall?
 3 **A. I do.**
 4 Q. And if we could take a look at DTX 8- -- just a
 5 second. DTX 829.
 6 MR. QUINN: This is not in evidence but there
 7 isn't an objection to it and I would offer this, your
 8 Honor.
 9 MR. KEKER: No objection.
 10 THE COURT: DTX 829 is admitted.
 11 (exhibit 829 was received into evidence.)
 12 Q. BY MR. QUINN: You are in the e-mail string
 13 down at the bottom, between you and Mr. Campbell, and
 14 Mr. Campbell refers it up to Lee Miller, I guess.
 15 **A. Yes.**
 16 THE COURT: Willer, W-I-L-L-E-R.
 17 MR. QUINN: Thank you, your Honor.
 18 Q. Who is Lee Willer?
 19 **A. She was an employee of the Water Authority who**
 20 **was a subordinate of Campbell.**
 21 Q. This is dated in -- your email is dated
 22 September 8. This is, I guess, kind of early on, not
 23 too long after the idea of these two different options
 24 have been put on the table; is that right?
 25 **A. Correct.**

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1 Q. In your email you ask Mr. Campbell to develop
 2 some written material for San Diego's board concerning
 3 the potential deal points for this exchange agreement?
 4 A. Yes.
 5 Q. Mr. Campbell then writes to Mr. Willer asking
 6 also, "How are you doing on the last canal lining
 7 analysis? We talked about comparing the exchange
 8 agreement versus wheeling rate differential and
 9 spreading the difference over canal lining water for 75
 10 years. I would like to do some escalation sensitivities
 11 on the MWD wheeling rate, two percent, three percent,
 12 four percent, to see the per AF" --
 13 I have come to learn that's acre-foot.
 14 A. Yes, it is.
 15 Q. -- "on the canal lining water."
 16 Do you see that?
 17 A. I do.
 18 Q. What was requested here was an analysis of the
 19 assumption that the MWD conveyance or wheeling rate
 20 would escalate over a 75-year period; correct?
 21 A. Right. We were doing a range of escalations.
 22 Q. Among the ranges you did, do you ever recall
 23 being a range of escalations done where you only looked
 24 at a five-year period, and assume those rates would only
 25 be in effect for five years?

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1 A. No. We actually did it on a worst-case
 2 scenario.
 3 Q. If you look at your e-mail, the second at the
 4 bottom, in the second sentence in the first paragraph,
 5 where it says, "The handout needs to articulate the deal
 6 points and identify the canal lining projects and its
 7 water as an alternative path that is at the sole
 8 discretion of the authority."
 9 Do you see that?
 10 A. Yes.
 11 Q. Do you recall that Metropolitan, when these two
 12 options were put on the table by San Diego, Metropolitan
 13 came back to San Diego and said, "They look roughly the
 14 same to us from an economic standpoint. San Diego, you
 15 can choose which one. You choose, Option-1 or
 16 Option-2." Do you recall that?
 17 A. I do recall that Metropolitan said that they
 18 were okay with either Option-1 or Option-2.
 19 Q. Right. I was interested in an answer you gave
 20 a moment ago. Are you telling us the reason you didn't
 21 run the numbers, the projections for five years, is
 22 you're only interested in a worst-case analysis?
 23 A. Yes, a worst-case scenario to present to my
 24 board, so that they knew if, in fact, we were
 25 unsuccessful in negotiating what we thought was the

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1 lawful wheeling rate, that they knew what their exposure
 2 would be.
 3 Q. You didn't think the board would be interested
 4 in knowing what the future scenarios might look like if
 5 the rate structure was only in place for five years?
 6 A. No. They want to know what the worst case is.
 7 You hope for the best but you plan for the worst.
 8 So we did the worst-case scenario in a two to
 9 five percent, I believe it was, escalation, so we knew
 10 what our maximum exposure would be.
 11 Q. So that's your experience in the business world
 12 when you're looking at a particular potential deal. You
 13 don't look at -- you only look at a worst case. You
 14 don't run the numbers for what the case is, for what you
 15 hope to achieve, it's not the worst case; you don't run
 16 those numbers?
 17 A. We did not. We were under a very short time
 18 period. We were talking about a huge risk that we were
 19 taking on, and I would rather tell my board what I
 20 believed was the worst-case scenario so they wouldn't
 21 come back and say, why didn't you tell me what that
 22 maximum exposure was.
 23 Q. I understand, ma'am, why you -- the board would
 24 want to know worst case, and I understand why you would
 25 want to tell them worst case. My question is a little

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1 different.
 2 Isn't it your experience in the business world,
 3 that decision makers also want to see a projection based
 4 on what you realistically think you can achieve,
 5 something that is not the worst case?
 6 MR. KEKER: Objection. Argumentative. No
 7 foundation. And I move to strike the speech at the
 8 beginning.
 9 THE COURT: Overruled.
 10 Go ahead.
 11 THE WITNESS: We had been on a monthly or twice
 12 or three times a month been talking to our board about
 13 the various options. The All-American Canal option was
 14 a new option, and that was the focus of what my board
 15 needed to look at, was whether to take Option-1, which
 16 was already out there, or Option-2, which was new. And,
 17 therefore, I directed staff to take the number that
 18 Metropolitan had, escalate it out, and assuming that it
 19 would not change over that 45 years, what was our
 20 exposure based on the escalation of two to five percent.
 21 That is what I wanted the board to know, what the
 22 maximum exposure would be so they could make the most
 23 informed decision.
 24 The worst thing for a manager is to have a
 25 board member come back and say why didn't you tell me

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1 that was possible.
 2 Q. You know with respect, I don't think that
 3 answered my question, which was directed to, in the real
 4 world, if you want to give them, I think you just said,
 5 you want to give them the best information, don't you
 6 also want to give them a projection, based not just on
 7 the worst case but by what you hoped to achieve in
 8 negotiating the agreement? Don't you want them also to
 9 have that information?
 10 A. No. Because the exposure would be less than
 11 that maximum that you provided to the board. It would
 12 be nothing but better than what you gave to the board as
 13 the worst-case scenario. That would be a positive.
 14 They would be happy. So, no.
 15 Q. So the way it works at San Diego is the board
 16 only wants to hear worst-case scenarios. They are not
 17 interested in hearing what you think is actually
 18 realistic or what you can achieve? Is that your
 19 experience at San Diego?
 20 A. In this case it is.
 21 Q. Is it your testimony that you had some
 22 discussion with some board members where they said to
 23 you, "No, don't present us with any scenarios reflecting
 24 what you really intend to achieve in this agreement or
 25 what you can think you can realistically do. We are not

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1 interested in that. All we want to see is the absolute
 2 worst case?" Did you have a conversation like that with
 3 anybody on the San Diego board?
 4 A. No, I did not.
 5 MR. QUINN: Let's take a look at DTX 830.
 6 I understand this is not in evidence and I
 7 understand there is no objection.
 8 THE COURT: The PowerPoint slides.
 9 MR. KEKER: No objection, your Honor.
 10 MR. QUINN: We have offered this.
 11 THE COURT: DTX 830 is admitted.
 12 (Exhibit 830 was received into evidence.)
 13 Q. BY MR. QUINN: Just so you know where I'm
 14 going, ma'am, I want to walk through the written records
 15 that exist leading up to the execution of the exchange
 16 agreement in October.
 17 What we're looking at here, the cover note is
 18 an e-mail from Amy Chen to some people, including
 19 yourself, and it is dated September 10, 2003; correct?
 20 A. Correct.
 21 Q. Who is Amy Chen?
 22 A. She is one of my staff members who is assigned
 23 the MWD program and she's located in Los Angeles in the
 24 MWD building.
 25 Q. She lives in enemy territory. It's a joke.

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1 I'm sorry.
 2 Does this appear to be -- maybe you can tell me
 3 what that presentation, these PowerPoints seem to
 4 reflect?
 5 A. Right. Based upon the cover memo of Gil Ivey,
 6 who is an employee of Metropolitan was, sending to my
 7 staff member the presentation that was made at the MWD
 8 water planning quality and resources committee meeting
 9 on the QSA.
 10 Q. This is a document generated by Metropolitan,
 11 to your understanding?
 12 A. Yes.
 13 Q. Do you have any understanding why it was sent
 14 to the folks at San Diego?
 15 A. I don't have any specific knowledge. We were
 16 trying to keep each agency informed of what the other
 17 one was doing.
 18 Q. If you thumb through, I think, four or five
 19 pages, you will see one slide that is entitled at the
 20 top "peace treaties." You see that?
 21 A. Yes.
 22 Q. It says, "Wheeling laws, no legislative change
 23 by San Diego and MWD."
 24 A. Yes.
 25 Q. Do you see that?

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1 A. I do.
 2 Q. And then if you skip forward a couple of pages
 3 there is a heading that says, "Alternate SDCWA
 4 Pathways." Two bullets. "Two options available. SDCWA
 5 to choose by October 1."
 6 A. Yes.
 7 Q. That is probably referring to that San Diego
 8 can choose which option?
 9 A. Correct.
 10 Q. The next slide at the top, it says, "SDCWA
 11 Option-1."
 12 And the second bullet there is "SDCWA pays
 13 discount wheeling rate for 35 years or 5.1 MAF."
 14 A. Million acre-feet.
 15 Q. So Option-1, that was -- this is we are going
 16 to continue just to go -- we will continue under that
 17 exchange agreement that we negotiated a few years ago;
 18 right?
 19 A. Correct.
 20 Q. Which had a discounted wheeling rate in it?
 21 A. We would argue it's not discounted.
 22 Q. If you look at the next slide on the top, SDCWA
 23 Option-2, the second option, what Met is saying is here,
 24 "SDCWA pays full wheeling rate for IID, SDCWA transfer
 25 water and canal lining conserved water."

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1 Do you see that?
 2 **A. I do.**
 3 Q. And you understood that was Met's position
 4 about what the proposal was?
 5 **A. Yes. It doesn't reference a year on this one.**
 6 **So I can't tell how long they thought that would be.**
 7 Q. It just says full wheeling rate?
 8 **A. Yes.**
 9 Q. You understood that was their understanding and
 10 expectation?
 11 **A. No, I did not know that full wheeling rate --**
 12 **it's not the same language we used, but I presume it**
 13 **referenced the \$253 rate.**
 14 Q. And that's what ultimately ended up going into
 15 the agreement?
 16 **A. It did.**
 17 MR. QUINN: And then if we could look at DTX
 18 837, which has not been admitted. I understand there is
 19 no objection to it. We would offer it, your Honor.
 20 MR. KEKER: No objection.
 21 THE COURT: DTX 837 is admitted.
 22 (Exhibit 837 was received into evidence.)
 23 MR. KEKER: It is also 846. You're right. No
 24 objection.
 25 Q. BY MR. QUINN: The top document is an email

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1 from you dated September 16, 2003?
 2 **A. Yes.**
 3 Q. And you sent this to all board members --
 4 **A. Yes.**
 5 Q. -- is that right? Concerning QSA update and
 6 attached fact sheet and Campbell memorandum, you
 7 attached those two documents; right?
 8 **A. I did.**
 9 Q. The first attachment, if we could look at that,
 10 the first page, it says, "Fact Sheet, September 16,
 11 2003." And this is a fact sheet that was prepared at
 12 San Diego outlining the two options; right?
 13 **A. Yes.**
 14 Q. And the second attachment is the memorandum
 15 from Bob Campbell outlining the financial analysis of
 16 the two options; correct?
 17 **A. Yes.**
 18 Q. So if we could just look first at the fact
 19 sheet.
 20 And if we could go to the second page, which
 21 says, "Option-2" at the top. If we would just enlarge,
 22 say, the top third. The second bullet, in describing
 23 the Option-2, it says "MWD assigns its canal lining
 24 rights to SDCWA. Canal lining water rights to SDCWA.
 25 Project yields 77,700 acre-feet annually for 110 years.

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1 8.5 million acre-feet of water." That's a lot of water?
 2 **A. It's a lot of water.**
 3 Q. Worth a lot?
 4 **A. Worth a lot.**
 5 Q. Worth billions, with a B, of dollars; correct?
 6 **A. I don't know. But it is worth a lot of -- it**
 7 **has high value.**
 8 Q. It is certainly worth -- 77,700 acre-feet
 9 annually for 110 years is certainly worth more than
 10 \$100 million?
 11 **A. Absolutely.**
 12 Q. Absolutely. Certainly worth more than
 13 \$500 million?
 14 **A. I don't know.**
 15 Q. You don't know?
 16 **A. I'd have to do a calculation of what it would**
 17 **be worth compared to other transfers.**
 18 Q. Would you dispute that that quantity of water
 19 is worth -- I understand you don't know whether it's
 20 worth billions. Are you in a position to dispute that?
 21 Would you dispute -- if somebody said that was worth \$2
 22 billion, with a B, would you dispute that?
 23 **A. I would not, no.**
 24 Q. You just don't know?
 25 **A. I wouldn't know what, you know, what the costs**

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1 **would be over 110 years and how to present value the**
 2 **cost of that water.**
 3 Q. How about just the current cost? Let's talk in
 4 terms of today. If you could get that much water
 5 today -- let's not worry about for now the
 6 discounting -- that would be worth billions of dollars?
 7 **A. Yes, it would be worth a lot of money.**
 8 Q. Billions?
 9 **A. Sir, I don't want to say what it's worth unless**
 10 **I had the ability to spend some time to calculate its**
 11 **value.**
 12 Q. Certainly anyone who said it might only be
 13 worth \$100,000, that would be flat-out wrong?
 14 **A. I would say it's worth much more than that.**
 15 Q. Let's go to the second attachment, the
 16 memorandum from Mr. Campbell. And I assume you would
 17 read this memo before you sent it -- before you attached
 18 it to your email to your board of directors?
 19 **A. Yes, I would have read it.**
 20 Q. And insofar as you know, everything that's in
 21 this memo is accurate?
 22 **A. Yes.**
 23 Q. And the description of Option-2, in this memo,
 24 there in that first paragraph, it says, "The assignment
 25 of Met's canal lining project water rights to SDCWA, in

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1 consideration for SDCWA's paying Met's wheeling rate, in
 2 lieu of the exchange agreement to transport the
 3 IID/SDCWA transfer water and canal lining water.
 4 Currently the Met wheeling rate is set at \$253 per
 5 acre-foot, including the system access and water
 6 stewardship rates and power cost."
 7 Do you see that?
 8 **A. I do.**
 9 Q. And then it says, where it says, "In
 10 consideration," what you understood that to mean was
 11 that Met would get what's stated there, Met's wheeling
 12 rate, instead of the rate under the 1998 exchange
 13 agreement, which is what the existing exchange agreement
 14 provided for; right?
 15 **A. Yes. That we would pay the \$253 instead of**
 16 **that 90-dollar rate.**
 17 Q. So you were going to pay a lot more?
 18 **A. Yes.**
 19 Q. You understood that \$253, probably beating the
 20 dead horse here, but it included that system access
 21 rate, the power rate with the State Water Project costs
 22 built into both of them, and the water stewardship rate;
 23 correct?
 24 **A. Yes. That would be included in that \$253 that**
 25 **we would pay for a minimum of the five years.**

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1 Q. In the next full paragraph Mr. Campbell writes
 2 about how the staff used two different approaches to
 3 evaluate the costs of the two options.
 4 **A. Yes.**
 5 Q. And in both approaches he assumed that under
 6 Option-2 Met's wheeling rate would escalate over the
 7 term of the contract; correct?
 8 **A. Correct.**
 9 Q. In the last paragraph on page one, third
 10 sentence he writes, "The Met wheeling rate is
 11 established annually by the Met board of directors and
 12 is assumed to escalate over time." Correct?
 13 **A. Correct.**
 14 Q. In this memorandum that you sent, you said we
 15 are anticipating that the wheeling rate, at least for
 16 purposes of trying to value this option, we assume the
 17 wheeling rate will include these components, will be
 18 starting at \$253, and there will be a factor for
 19 inflation over time; correct?
 20 **A. That -- I'm not sure about the way we would**
 21 **value this option. But that -- what the potential costs**
 22 **could be for this option.**
 23 Q. Right.
 24 **A. It would be done in this manner.**
 25 Q. Thank you. You are trying to compare the two,

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1 and in looking at the potential costs of the second
 2 option, the staff is looking at these two different
 3 ways, but they are assuming it is going to start at 253
 4 and escalate up over time; right?
 5 **A. Right. In this calculation or analysis, that**
 6 **is exactly what we're doing.**
 7 Q. Again, there is no numbers here run on just a
 8 five-year scenario. This only --
 9 **A. No.**
 10 Q. -- the 253 and escalator is only for five
 11 years?
 12 **A. No. Because the canal lining was for 110**
 13 **years.**
 14 Q. A week after that you helped prepare and
 15 approved a memorandum to the water policy committee?
 16 **A. Yes.**
 17 MR. QUINN: And let's take a look at DTX 856.
 18 Not admitted yet. No objection, as I understand it.
 19 We'd offer this, your Honor.
 20 MR. KEKER: No objection.
 21 THE COURT: DTX 856 is admitted.
 22 (Exhibit 856 was received into evidence.)
 23 Q. BY MR. QUINN: What is the water policy
 24 committee?
 25 **A. It is a committee made up of approximately 14**

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1 **members of my board of directors.**
 2 Q. If you go to the last page, you will see an
 3 indication there, I think it's the last lines on the
 4 page, this is a memorandum that was -- that you prepared
 5 and approved?
 6 **A. Yes.**
 7 Q. Also prepared by Mr. Campbell and
 8 Mr. Hentschke, the general counsel?
 9 **A. Correct.**
 10 Q. If you turn to page two in this memo that you
 11 wrote, you describe Option-1 and Option-2?
 12 **A. Yes.**
 13 Q. In particular to Option-2, if we can enlarge
 14 that paragraph, you wrote, "In consideration for Met's
 15 assignment of All-American and Coachella canal lining
 16 water rights to the authority, the authority would pay
 17 Met's lawful wheeling rate in lieu of the exchange
 18 agreement. The Met's current published wheeling rate is
 19 \$253 per acre-foot and is comprised of the system access
 20 charge, water stewardship charge and power cost."
 21 Do you see that?
 22 **A. I do.**
 23 Q. In this memo, at any point, do you tell the
 24 water policy committee when you're laying this out that
 25 you think those charges are unlawful?

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1 **A. In the public sessions we did not.**
 2 Q. Go back to my question. In this memo.
 3 **A. In the memo, no, we did not.**
 4 Q. Did you ever write a memo to your board, did
 5 you, considering these various proposals and leading up
 6 to the execution of the agreement, did you personally
 7 write a memo to your board at any point which indicates
 8 that any of these charges are unlawful?
 9 **A. We never provided any written documentation to**
 10 **our board related to this. It was never in writing.**
 11 Q. Related to this --
 12 **A. Related to our belief that Met's wheeling rate**
 13 **at that time was not lawful. We did not provide**
 14 **anything in writing to the board on that.**
 15 Q. It wasn't important enough to include in any of
 16 the documents?
 17 **A. Oh, not in the documents. It was absolutely**
 18 **important for the board to know that what our concerns**
 19 **were about Met's rates not being lawful and those -- and**
 20 **those discussions, and there were many of those**
 21 **discussions were held with our board.**
 22 Q. You don't have anything in writing that you can
 23 share with us?
 24 **A. We do not provide any written documentation to**
 25 **the board for closed session items.**

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1 Q. So this is something that -- this view about
 2 the illegality is something you wanted to keep in closed
 3 session?
 4 **A. Absolutely.**
 5 Q. You regarded that as something that was
 6 confidential?
 7 **A. Absolutely.**
 8 Q. You didn't want that to be publicly known, that
 9 you thought these rates were --
 10 **A. The discussions, it was not appropriate to have**
 11 **those discussions in open session.**
 12 THE COURT: Ma'am, you have to just let him
 13 finish his question. Just give it a beat and then
 14 answer.
 15 Q. BY MR. QUINN: I am not asking about the
 16 discussions. I am focusing on your view that these
 17 rates were illegal. You didn't want that to be publicly
 18 known.
 19 **A. No, that is not true.**
 20 Q. If you look at pages five and six, there is a
 21 discussion of the staff, two approaches to the analysis
 22 of the cost of Option-1 and -2.
 23 Do you see that?
 24 **A. Yes, I do.**
 25 Q. And, again, each of those approaches assumes

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1 the \$253 rate will escalate over time, using inflation
 2 factors ranging from two to five percent?
 3 **A. Yes.**
 4 Q. And, again, if we look in here, there's nothing
 5 in here about proposed -- any other proposed alternative
 6 scenario, like a five-year period, in terms of length of
 7 the wheeling deal?
 8 **A. There is not.**
 9 Q. At the bottom of page six there is a beginning
 10 of a summary in which you present various factors to
 11 assist the board in assessing the risks and benefits of
 12 Option-2. Do you see that?
 13 **A. I do.**
 14 Q. On the next page, page 7, you discuss supply
 15 reliability, saying "There is no other readily available
 16 water supply with the priority level, cost amount and
 17 duration of water supply resulting from the canal
 18 lining." Do you see that?
 19 **A. I do.**
 20 Q. How did you know that, that there wasn't other
 21 similar available water supply?
 22 **A. Because we had been negotiating for so long and**
 23 **were very familiar with the Colorado River and the**
 24 **availability of various supplies on the river.**
 25 Q. On page 7 you indicate how the marginal cost of

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1 the canal lining water compares favorably to other water
 2 transfers that range in supply costs alone --
 3 **A. Yes.**
 4 Q. -- between \$250 and \$300; do you see that?
 5 **A. I do see that.**
 6 Q. On page 8 under "Supply risks are significantly
 7 lower," you write, and I quote, "While choosing Option-2
 8 exposes the authority to higher wheeling costs,
 9 comprised of Met rate components and system access
 10 charge, stewardship and fluctuations of power costs, it
 11 protects the authority from even greater exposure
 12 associated with securing an alternative imported supply,
 13 whether or not that supply" -- I'm sorry -- "securing an
 14 alternative imported supply, whether or not that supply
 15 comes from Met or another seller."
 16 Did you believe that to be true at the time?
 17 **A. Yes.**
 18 Q. And you recommended that Option-2 be approved;
 19 right?
 20 **A. I did.**
 21 Q. Notwithstanding your view that these rates are
 22 illegal; correct?
 23 **A. Correct.**
 24 Q. And you concluded that this was a good deal for
 25 San Diego, to start with the wheeling rate -- it was a

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1 good deal even if, worst-case scenario, if you had to
 2 pay this illegal wheeling rate of \$253, with an
 3 inflation factor of up to five percent over the life of
 4 the contract, even at that scenario you were
 5 recommending that this was a good deal for San Diego?
 6 **A. Yes.**
 7 MR. QUINN: If we could turn now to DTX 221,
 8 which is not yet admitted, and to which the Plaintiff
 9 has objected on the grounds of relevance.
 10 THE COURT: Are you offering it now?
 11 MR. QUINN: I am offering it, your Honor.
 12 THE COURT: I am trying to figure out if you
 13 are going to ask the witness some questions to lay a
 14 foundation. Why don't you tell me what the relevance is
 15 and then they can tell me why it's not.
 16 MR. QUINN: This raises -- this addresses the
 17 same issues, your Honor, about the risk, the wheeling
 18 rate, the proposed exchange deal. It talks also about
 19 the other related agreements, the allocation, the
 20 quantification settlement agreement and identifies the
 21 various risks of Option-2.
 22 MR. KEKER: Your Honor, I think our
 23 objection -- I know our objection as to relevance is
 24 based on that portion that talks about everything but
 25 what this trial about, which is the terms of the

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1 exchange agreement. And this going back to the motive,
 2 the other benefits and so on is a complete red herring
 3 to the issue of what the parties agreed to in 2003 and
 4 5.2 of the agreement. We said before, we are all over
 5 the place with parole evidence; we get it. But our
 6 argument is going to be read the contract and follow it,
 7 and none of this atmosphere and the earth cooled and
 8 then land was formed and canals were dug and so on is
 9 useful to making that decision.
 10 So that's our objection, and I'll sit down.
 11 THE COURT: I understand. I do understand your
 12 position, you should look at the other contracts. And
 13 part of the defense is that we should, and so it is
 14 admissible on that basis. DTX 221 is admitted.
 15 (Exhibit 221 was received in evidence.)
 16 Q. BY MR. QUINN: Do you recall this -- we are now
 17 up to September 25, 2003, just a few days, a couple of
 18 weeks before the exchange agreement is actually signed?
 19 **A. Yes, a few days before the deadline, where we**
 20 **had to make a decision.**
 21 Q. It actually was signed -- somebody help me --
 22 do you remember the date of the exchange agreement?
 23 **A. I want to say October 10.**
 24 Q. I am hearing a chorus of October 10, so I think
 25 you're right.

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1 You recall this PowerPoint presentation here,
 2 DTX 221, was presented to the board at San Diego?
 3 **A. Yes. This is our public PowerPoint**
 4 **presentation.**
 5 Q. You thought this was accurate?
 6 **A. Yes.**
 7 Q. You wouldn't have submitted it otherwise?
 8 **A. Yes.**
 9 Q. If you turn, please, to slide 2.
 10 Fair to say that this shows that San Diego --
 11 this pie here shows that San Diego was fairly dependent
 12 on Metropolitan for their water supply?
 13 **A. In 1991 we were 95 percent dependent.**
 14 Q. Do you know what that was in 2003?
 15 **A. In 2003 we had reduced it to maybe -- I am**
 16 **going to say maybe 75 percent or so, 80 percent.**
 17 Q. Would it be true to say that San Diego had, for
 18 a long time, sought to secure its own independent supply
 19 of water?
 20 **A. Yes.**
 21 Q. And if you turn, please, to slide 21, the
 22 heading at the top is "Option-2, Financial
 23 Risk/Benefit."
 24 Here you identify the risk under Option-2,
 25 risk: "Exposure to MWD wheeling rate."

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1 Do you see that?
 2 **A. Yes.**
 3 Q. Under that exchange agreement that had already
 4 been in place, which would have been Option-1, for at
 5 least 30 years you knew what the wheeling charges were
 6 going to be; correct?
 7 **A. Correct.**
 8 Q. Because there was -- that starts out at a
 9 certain number, \$80 and \$90, and then an index to
 10 increases; right?
 11 **A. Yes.**
 12 Q. But you didn't have that under the proposal
 13 under Option-2?
 14 **A. Correct.**
 15 Q. The risk was, it says here, "Exposure to the
 16 MWD wheeling rate." You mean for the term of the
 17 contract; right?
 18 **A. Certainly for the first five years we were**
 19 **exposed to it -- to Met's wheeling rate. And then after**
 20 **five years, depending on what the Water Authority chose**
 21 **to do, we were exposed to the lawful wheeling rate.**
 22 Q. I mean, even under San Diego's interpretation,
 23 if we look at that exchange agreement, we won't see
 24 anything in there specifying what the price would be for
 25 any year, you know, years two to five or after five?

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1 **A. We have -- yes, there's nothing in the**
 2 **agreement that talks about what a specific dollar amount**
 3 **would be after year five.**
 4 Q. Or what the increases would be?
 5 **A. Correct.**
 6 Q. There was no index, in other words, like there
 7 was under the previous exchange agreement?
 8 **A. Correct.**
 9 THE COURT: Whenever you get to a good point in
 10 the next five minutes or so, just pick a time and take a
 11 break.
 12 MR. QUINN: Why don't I finish this exhibit.
 13 It won't take long.
 14 THE COURT: Sure.
 15 Q. BY MR. QUINN: And then you say, you describe
 16 here the cost for benefit received from canal lining.
 17 You describe that as, "The present value difference
 18 between the 1998 exchange agreement cost and the MWD
 19 wheeling rate cost for 35 years." Do you see that?
 20 **A. I do.**
 21 Q. And it refers there, below that, to "Inflation
 22 sensitivity for the wheeling rate." Do you see that?
 23 **A. I do.**
 24 Q. That is something that needs to be considered?
 25 **A. Yes.**

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1 Q. So it is still anticipated that San Diego would
 2 pay the MWD wheeling rate for 35 years and that rate
 3 would increase over time; correct?
 4 **A. Yes. As I explained earlier, we had a range of**
 5 **escalations that we used to determine what we felt was**
 6 **the maximum wheeling rate that we would be exposed to.**
 7 Q. So if we look at the present value analysis
 8 that's done here, and you are kind of summarizing here,
 9 that present value analysis, again, was based on an
 10 assumption that the Met wheeling rate would escalate
 11 over the existing rate of the life term of the contract?
 12 **A. Correct.**
 13 Q. If we turn to slide 22, "Option-2, financial
 14 risk analysis," that identifies what we have been
 15 talking about, the price under the 1998 agreement as \$97
 16 an acre-foot for 2003. Do you see that?
 17 **A. Yes.**
 18 Q. It goes on to say, "Risk is in difference
 19 between Met wheeling rate cost and wheeling rate cost
 20 under the exchange agreement." And using the numbers in
 21 the slide the risk was the difference between \$253 and
 22 \$97 per acre-foot or \$156 per acre-foot with an
 23 inflation factor for each?
 24 **A. Yes.**
 25 Q. That was the important information that you

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1 were presenting to the board in making this decision;
 2 correct?
 3 **A. Absolutely.**
 4 Q. It says, "The present value of differential is
 5 the cost of getting the canal lining water benefit."
 6 Right?
 7 **A. Right.**
 8 Q. So the board understood that the canal lining
 9 water was a trade-off for the payment of the existing
 10 Met wheeling rate plus an inflation factor?
 11 **A. I don't think that's exactly correct.**
 12 **I think that they felt that the canal lining**
 13 **project was a trade for giving up the 1998 exchange**
 14 **agreement for the exchange agreement that was proposed**
 15 **in -- that now is the 2003. It is not correct that we**
 16 **traded absolutely the canal lining project for the Met**
 17 **determined wheeling rate for 45 years.**
 18 Q. In terms of the analysis that was presented to
 19 the board --
 20 **A. Yes. In terms of the analysis, yes.**
 21 Q. -- it was presented to the board, and what you
 22 were asking the board to make its decision based on, you
 23 were presenting them this present value analysis and
 24 comparing the cost.
 25 In terms of the analysis that was presented to

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1 the board --
 2 **A. Yes. In terms of the analysis, yes.**
 3 Q. It was presented to the board, and what you
 4 were asking the board to make its decision based on, you
 5 were presenting them this present value analysis and
 6 comparing the cost; correct?
 7 **A. Right. We were comparing the costs and the**
 8 **maximum exposure of costs.**
 9 Q. And we looked earlier at Mr. -- is it
 10 Campbell's memorandum? -- where he talked in terms
 11 about the consideration for the canal lining water
 12 paying the wheeling rate; do you recall that?
 13 **A. Yes.**
 14 Q. You understand that -- I mean, you don't have
 15 any disagreement with that? That was part of the
 16 consideration, forgetting this huge volume of water for
 17 110 years was agreeing to pay this much increased
 18 wheeling rate; correct?
 19 **A. Yes, yes. For that five years.**
 20 Q. And that was -- those were key points in the
 21 deal; fair?
 22 **A. Yes.**
 23 Q. They are reflected in the -- that deal, those
 24 key points of this deal are reflected in different
 25 documents, the exchange agreement and the allocation

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1 agreement; correct?
 2 **A. Yes.**
 3 Q. You can't just read one of those documents to
 4 have an understanding of what the deal was; correct?
 5 **A. The total deal?**
 6 Q. Yes.
 7 **A. It would be -- you would have to look at all**
 8 **30-some documents in the QSA to actually understand the**
 9 **total deal, not just one or two.**
 10 Q. So, again, after considering all this and the
 11 risk and benefits described in the information you gave
 12 the board, the San Diego board approved Option-2;
 13 correct?
 14 **A. Yes.**
 15 MR. QUINN: This would be a good time, your
 16 Honor.
 17 THE COURT: I will see everybody in 15 minutes.
 18 Thank you very much.
 19 (Recess.)
 20 MR. KEKER: Your Honor, could I raise a point
 21 that I was going to raise at the end of the day but I am
 22 afraid if I wait it will be in a rush for 4:00 and we
 23 should do it now. And that is the question of time.
 24 When we -- we have used about four hours to
 25 present our direct case, as promised. Your order says

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1 we get nine hours and they get 12 hours, and just
 2 basically we don't think that's fair. We had three
 3 witnesses. They've got seven witnesses. I'm not sure
 4 our clocks and your chess clock are a little bit
 5 different. The clerk let us look at your chess clock.
 6 We basically used, we think, us about 4:45 and
 7 them about 5:14. What I am suggesting is you give us
 8 equal time and we use three days in the week that you
 9 set aside four days, and we get in 12 hours of testimony
 10 split evenly with the rest of the witnesses, rather than
 11 have us at a three-hour disadvantage, for what we don't
 12 think there is any good reason.
 13 THE COURT: Would you like to be heard?
 14 MR. QUINN: If the Court is going to consider
 15 that, yes. Otherwise we -- we want some more time, too.
 16 Remember, they were telling us this could all be done
 17 this week. We cut witnesses. Told them to send Amy
 18 Chen home, for example. We scrambled and cut
 19 examinations and tried to squeeze in the time we had.
 20 They just had a damages case to put on. They say
 21 everything else has been decided. We have affirmative
 22 defenses. I think the Court had good reasons for not
 23 giving both sides, at this point, the same amount of
 24 time.
 25 THE COURT: I have actually already -- I spent

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1 quite a bit of time trying to figure this out, coming up
 2 with some rules of thumb about how to deal with the
 3 amount of time people need on direct and cross. I don't
 4 think anything's changed. So I'm not going to grant the
 5 motion. I am just going to live with the time we set.
 6 MR. KEKER: The second request, your Honor, is
 7 that in the back of the courtroom Jessica Fromm, who is
 8 an 8th grade teacher from Denver, is here and she wanted
 9 to take a picture of the courtroom to show her students,
 10 and we wondered if you had any objection to her doing
 11 that.
 12 THE COURT: Of course not.
 13 MR. QUINN: I object. Mr. Kecker is going to be
 14 in the photo.
 15 THE COURT: That I understand. I appreciate it
 16 if you don't take pictures of someone who is on the
 17 witness stand. We will arrange the room. Because the
 18 witness might object to that. You can always take a
 19 picture of everybody after the witness has stepped down,
 20 if you want. If anybody else has any objection to being
 21 in a picture, please just make that known and move when
 22 the picture is being taken.
 23 Let's proceed.
 24 Q. BY MR. QUINN: Miss Stapleton, I would like to
 25 read to you again some testimony from Mr. Slater, San

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1 Diego's person most knowledgeable. And this will be
 2 from page 64 of his deposition, lines 14 to 25.
 3 "Q I want to jump back to the
 4 2003 agreement for a second.
 5 I'm jumping back here like
 6 Marty McFly. I'm jumping
 7 between time frames here.
 8 "A I'm not Marty McFly.
 9 "Q Okay. Get that on the
 10 record. 2003, the negotiations
 11 for the 2003 agreement, was it
 12 ever discussed excluding -- did
 13 any party ever propose
 14 excluding State Water Project
 15 costs from the price -- from
 16 the price, the contract price
 17 to be charged under that
 18 agreement?
 19 "A I do not recall that, no."
 20 Was Mr. Slater wrong about that?
 21 **A. He was not. We did not propose a lower price.**
 22 Q. And you also -- at no point did San Diego in
 23 negotiations for that agreement, Mr. Slater, the person
 24 most knowledgeable testified, never proposed taking out
 25 the State Water Project costs from the wheeling rate, in

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1 connection with the negotiation of that agreement;
 2 correct?
 3 **A. For the price that started, that we started**
 4 **within the exchange agreement?**
 5 Q. At no point, did any party ever propose
 6 excluding State Water Project costs from the price, the
 7 contract price to be charged under that agreement; is
 8 that true?
 9 **A. That is true.**
 10 Q. So is it your testimony, just reading between
 11 the lines, Miss Stapleton, are you saying that you
 12 brought up with Met excluding State Water Project costs
 13 in year two?
 14 **A. No.**
 15 Q. Year three?
 16 **A. No.**
 17 Q. Four?
 18 **A. No.**
 19 Q. For any year?
 20 **A. Yes.**
 21 Q. What year did you propose backing out the State
 22 Water Project costs on, you personally?
 23 **A. Yes. In year six or beyond, that we had to**
 24 **come to some agreement in that we believed the State**
 25 **water projects were not lawfully included in the rates.**

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1 Q. And who did you propose that to on the Met
 2 side?
 3 **A. Dennis Underwood.**
 4 Q. Anyone else?
 5 **A. I believe it was referenced among the group,**
 6 **which would be the Met team and the Water Authority**
 7 **team.**
 8 Q. I am trying to find out who, other than
 9 Mr. Underwood, you say you proposed taking State Water
 10 Project costs out after the five years you identified --
 11 **A. I personally?**
 12 Q. Yes.
 13 **A. I personally?**
 14 Q. Yes.
 15 **A. No. It would be just Mr. Underwood.**
 16 Q. And sadly he's deceased?
 17 **A. Yes, unfortunately.**
 18 Q. By 2005 the 2003 exchange agreement had been in
 19 effect for over a year?
 20 **A. Correct.**
 21 Q. Met initially billed San Diego for conveyance
 22 charges at that initial price of \$253?
 23 **A. Yes.**
 24 Q. And over the next five years that price
 25 escalated, just as San Diego had anticipated in those

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1 projections that you presented to the board?
 2 **A. It escalated. I can't tell you if it escalated**
 3 **between the two and five percent. I do not recall.**
 4 Q. But it did escalate every year?
 5 **A. Yes, it did.**
 6 Q. In 2005, it's true to say that San Diego did
 7 not write to Metropolitan saying that the rates were
 8 unlawful?
 9 **A. Correct.**
 10 Q. And in 2005, San Diego did not make any claim
 11 with Met that charging a price based on these unlawful
 12 rates was a breach of contract?
 13 **A. Correct.**
 14 Q. And San Diego, in 2005, did not object in
 15 writing to the price or to any invoice; true?
 16 **A. Correct.**
 17 Q. And that would be true if I asked you those
 18 same questions for 2006, 2007, 2008, 2009, your answers
 19 would be the same? Do you want me to go through them?
 20 **A. I believe we started some dialogue and there**
 21 **may be in writing some references to us beginning --**
 22 **wanting to talk about the negotiations for the wheeling**
 23 **rate.**
 24 Q. Is there any writing that you can point us to
 25 in any of those years where San Diego wrote to Met,

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1 prior to 2010, stating that the rates being charged were
 2 unlawful?
 3 **A. I cannot go to any specific document. I cannot**
 4 **recall any right now.**
 5 Q. You cannot recall, can't identify for us any
 6 document in any of those years where San Diego made a
 7 claim with Met that it was charging a price that was in
 8 breach of contract?
 9 **A. No.**
 10 Q. Or even objecting in writing to the price being
 11 charged or to any invoice before 2010?
 12 **A. I don't recall any.**
 13 Q. If you'd look at -- if we could turn to the
 14 exchange agreement itself, DTX 55, PTX 65, and turn to
 15 page 26, there is a Section 12.4(c), if you would take a
 16 look at that.
 17 And you recall this provision here that says,
 18 "In the event of a dispute over the price, SDCWA shall
 19 pay, whenever due, the full amount claimed by
 20 Metropolitan, provided, however, during the pendency of
 21 the dispute, Metropolitan shall deposit . . ."
 22 You know the provision I'm referring to?
 23 **A. I do.**
 24 Q. Unless you want me to, I won't read the whole
 25 paragraph.

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1 **A. I do know that provision.**
 2 Q. You understood since -- at any time after 2003,
 3 if San Diego disputed a price, it could deposit money
 4 with Met and Met would have to keep that money in an
 5 account until the dispute was resolved?
 6 **A. Yes.**
 7 Q. The first time that San Diego did that was in
 8 February of 2011; right?
 9 **A. Yes.**
 10 MR. QUINN: Let's look at DTX 624, not yet
 11 admitted. I understand there is no objection, and I
 12 would offer it, February 10, 2010, letter from
 13 Mr. Hentschke to Mr. Kightlinger.
 14 MR. KEKER: No objection.
 15 THE COURT: DTX 624 is admitted.
 16 (Exhibit 624 was received in evidence.)
 17 Q. BY MR. QUINN: You recognize this as a letter
 18 from San Diego's general counsel to Mr. Kightlinger?
 19 **A. Yes.**
 20 Q. This is the first time San Diego asked Met to
 21 set aside money under that Section 12.4 (c); correct?
 22 **A. Correct.**
 23 Q. There is nothing in that five-year provision,
 24 sometimes referred to as a standstill or year of good
 25 feelings, whatever -- there is nothing in that that

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1 prevented San Diego during that time from invoking this
 2 deposit procedure under 12.4 (c), was there?
 3 **A. I believe we could not challenge the rate for**
 4 **the first five years. So unless they were charging more**
 5 **than the Met established rate, we could not -- we**
 6 **couldn't dispute it.**
 7 Q. Let's take a look at that section and see what
 8 it provides that you couldn't do in the first five
 9 years, Section 5.2, pages 16 and 17.
 10 I think you will see in the second line there,
 11 it says, "For the term of this agreement neither San
 12 Diego nor Met shall seek or support in any legislative,
 13 administrative or judicial forum any change in the form,
 14 substance or interpretation of any applicable law or
 15 regulation."
 16 Do you see that?
 17 **A. I do.**
 18 Q. It refers to not taking actions in legislative,
 19 administrative or judicial forums; correct?
 20 **A. Yes.**
 21 Q. Does that refresh your recollection there was
 22 nothing that prevented San Diego from invoking this 12.4
 23 (c) procedure even during the first five years?
 24 **A. I see that.**
 25 Q. You are aware that from 2000 -- during this

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1 time frame, 2005 through 2009, Met every single year,
 2 Metropolitan's conveyance rates were submitted for
 3 approval by the Met board every year; correct?
 4 **A. Yes.**
 5 Q. You recall, if we can look at DTX 129, I think
 6 we looked at this already, in 2005 San Diego's members
 7 of the Met board voted for the wheeling rate which
 8 included the State Water Project costs and the water
 9 stewardship rate; correct?
 10 **A. Correct.**
 11 Q. As we discussed earlier, San Diego's delegates
 12 to the Met board received direction from the San Diego
 13 board as to how to vote on certain matters; right?
 14 **A. Only -- the only one I see is the one you**
 15 **referenced earlier. That's the only one that I have**
 16 **seen.**
 17 Q. Let me ask, is it generally a custom and
 18 practice on the issue of rates that San Diego's
 19 delegates will be instructed how to vote?
 20 **A. No. It's actually opposite of that. They are**
 21 **not instructed by our board of directors on how to vote.**
 22 Q. In any event, we can see here, this is a record
 23 of how in fact they did vote; right?
 24 **A. Yes.**
 25 Q. And as part of that, you know that when these

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1 rates and rate structures come up for vote, there's a
 2 whole package that goes to the whole members of the
 3 board to support the requested action; correct?
 4 **A. Correct.**
 5 Q. And that includes a cost of service breakdown
 6 which specifically identifies the components of the
 7 rates that the delegates are being asked to vote on;
 8 correct?
 9 **A. Correct.**
 10 Q. So it would not be true to say, would it, that
 11 when these things come up for vote at the Met board, the
 12 only thing the board members can vote on is whether the
 13 rates should be increased?
 14 **A. That is the primary issue. But in addition, it**
 15 **is they are aware of how the costs are allocated.**
 16 Q. Ma'am, it would not be true to say, that when
 17 these packages come up for review, that the only thing
 18 the board members have an opportunity to approve is an
 19 increase in the rates; that they have no ability to
 20 address the rate structures?
 21 **A. I do not know what that specific package is. I**
 22 **don't know what the resolution is. So I don't believe I**
 23 **can answer that accurately.**
 24 Q. As far as you know --
 25 **A. I do not know.**

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1 THE COURT: She's still talking, Mr. Quinn.
 2 MR. QUINN: Sorry.
 3 THE WITNESS: I just don't know. I haven't
 4 viewed it.
 5 Q. BY MR. QUINN: You attend some of the
 6 Metropolitan board meetings?
 7 A. Rarely.
 8 Q. You know that those -- there are recordings
 9 made of those meetings?
 10 A. Yes.
 11 Q. As there are recordings made of the San Diego
 12 meetings; right?
 13 A. Correct.
 14 Q. So far as you are aware, did any of the San
 15 Diego delegates to the Met board ever disclose to the
 16 Met board that San Diego believed any of these rates
 17 that were being voted on were unlawful?
 18 A. During what period of time?
 19 Q. Prior to the filing of this lawsuit.
 20 A. I believe that they did indicate that they did
 21 not support, did not believe that the costs were
 22 allocated correctly.
 23 Q. At any time -- my question -- I'm not sure --
 24 I might have misspoken and maybe you misheard
 25 my question.

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1 My question is, when these votes -- when these
 2 rates came up annually, at any time did any -- so far as
 3 you know, did any of the San Diego delegates inform the
 4 Met board that the rates on the table submitted for
 5 voting were illegal or unlawful?
 6 A. No.
 7 Q. Is it your understanding the board members have
 8 fiduciary duties to other board members?
 9 A. To other board members?
 10 Q. To the board. To the board as a whole.
 11 A. To the agency, yes.
 12 Q. As members of the board they are fiduciaries?
 13 A. Yes.
 14 Q. It is true, isn't it, that San Diego's
 15 delegates to the Met board also voted to approve these
 16 conveyance rates in 2006, 2007, 2008 and 2009?
 17 A. Yes.
 18 Q. During the period we've been talking about,
 19 prior to 2010, San Diego requested, on occasion, that
 20 Met wheel water, wheel water on San Diego's behalf,
 21 isn't that correct?
 22 A. Yes.
 23 Q. And San Diego wanted water wheeled through the
 24 State Water Project facilities under Met's contract with
 25 the State; correct?

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1 A. Yes.
 2 Q. For example, if we could look at DTX 75 -- this
 3 is in evidence -- December 1, 2008, letter to
 4 Mr. Kightlinger from you, this is an example of a -- one
 5 instance where San Diego was requesting that water be
 6 wheeled through Met -- through State Water Project
 7 facilities under Met's contract with the State; is that
 8 correct?
 9 A. That is correct.
 10 Q. And San Diego requested that Met -- San Diego
 11 knew that Met had this ability, this right to use the
 12 State Water Project facilities for that purpose; right?
 13 A. Yes.
 14 Q. And San Diego knew that Met pays for those
 15 facilities through its contract with the State; correct?
 16 A. Yes.
 17 Q. And San Diego, when it did that, when it
 18 wheeled water through the State Water Project
 19 facilities, it would pay the full Met wheeling rate for
 20 those services without objection; correct?
 21 A. I don't know.
 22 Q. You don't know whether or not the wheeling rate
 23 that San Diego was charged for wheeling through the
 24 State Water Project facilities included the system
 25 access rate, power rate and including the State water

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1 costs, you just don't know?
 2 A. I am aware that they included that. I am not
 3 aware if it included other costs.
 4 Q. Okay. You are aware when you request wheeling,
 5 transportation of water, you are going to be paying
 6 system access rate, power rate, including the State
 7 Water Project costs; correct?
 8 A. Correct.
 9 Q. And San Diego pays those charges without
 10 objections?
 11 A. Correct.
 12 Q. No objection to paying those costs when you are
 13 wheeling water through the State Water Project?
 14 A. We did not object when we moved this water in,
 15 it looks like, probably 2009 when we moved this water.
 16 Q. Similarly, if the State Water Project was being
 17 used to perform under the exchange agreement, San Diego
 18 would have no objection to paying those costs related to
 19 use of the State Water Project?
 20 A. Could you explain what "objection" is?
 21 Q. San Diego would have no issue with being
 22 charged for use of State Water Project facilities if
 23 they had to be used to perform the exchange agreement;
 24 correct?
 25 A. I don't know.

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1 Q. Well, the use of -- it's true, isn't it, that
 2 the use of the State Water Project facilities was
 3 essential to Met's performance under the exchange
 4 agreement; it had to be done? Correct?
 5 A. **Not necessarily.**
 6 Q. Is it your understanding that Met could perform
 7 the exchange agreement simply by using the Colorado
 8 River Aqueduct exclusively?
 9 A. **Yes.**
 10 Q. Well, you knew, in fact, that the State Water
 11 Project facilities would be used to deliver water under
 12 the exchange agreement; you knew that at the time the
 13 exchange agreement was negotiated and signed; correct?
 14 A. **No. I knew it could be used, but I did not**
 15 **know it would be used.**
 16 Q. In fact, San Diego understood, at the time that
 17 the agreement was negotiated and signed, that even a
 18 temporary inability to use the State Water Project
 19 facilities could cause a change in the delivery of water
 20 to San Diego under the exchange agreement?
 21 A. **Yes, it could.**
 22 Q. So if we look at DTX 51, Section -- this is the
 23 exchange agreement -- Section 3.3, pages 13 to 14. You
 24 see where it says, "SDCWA understands that any number of
 25 factors, including emergencies, inspection, maintenance

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1 or repair of Metropolitan facilities or the State Water
 2 Project facilities may result in a temporary and
 3 incidental modification of the delivery schedule
 4 contemplated in paragraph 3.2." Correct?
 5 A. **Correct.**
 6 Q. The parties clearly contemplated that the use
 7 of the State Water Project facilities were an essential
 8 aspect under the exchange agreement?
 9 A. **I don't see that. "They may result." It**
 10 **doesn't say "they shall result."**
 11 Q. You understood if there were a shutdown of the
 12 State Water Project facilities, that might have certain
 13 consequences for the schedule of the deliveries?
 14 A. **Yes, it might.**
 15 Q. So you understood from that that Met might well
 16 be using the State Water Project facilities to perform
 17 under the exchange agreement?
 18 A. **Yes, they might.**
 19 Q. And as a historical fact, you know that a large
 20 portion of the water that has been delivered under the
 21 exchange agreement has come through the State Water
 22 Project; you know that?
 23 A. **Yes.**
 24 Q. Do you know how much?
 25 A. **I do not.**

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1 Q. Is it more than 50 percent of the water that's
 2 been exchanged?
 3 A. **I don't believe so.**
 4 Q. Is it more than a third of the water that's
 5 been exchanged?
 6 A. **I don't know.**
 7 Q. Can you give us an order of magnitude?
 8 A. **I cannot. Sorry.**
 9 MR. QUINN: I would like to read you another
 10 passage of Mr. Slater's deposition, Volume II, page 243,
 11 line 20, to 244, eight.
 12 MR. KEKER: No objection, your Honor.
 13 THE COURT: Go ahead, please.
 14 MR. QUINN: (Reading:)
 15 "Q So would it be true to say
 16 that, as of 2007, San Diego
 17 would sue if Met did not change
 18 the way it calculated its
 19 wheeling rate upon -- it would
 20 sue upon the exp- -- sometime
 21 between the expiration of the
 22 five-year period and ten years
 23 after that?
 24 "A Correct.
 25 "Q And that was San Diego's

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1 state of mind as of 2007?
 2 "A Yes.
 3 "Q And that if I ask you that
 4 same question about 2006, 2005,
 5 2004, your answer would be the
 6 same"
 7 "A Yes.
 8 "Q And 2008?
 9 "A Yes."
 10 Q. That is flatly not true, isn't it? Correct?
 11 A. **No. We had every intention to negotiate an**
 12 **acceptable rate with Met and knew if we were unable to**
 13 **do so that our only alternative was lawsuit.**
 14 Q. Mr. Slater says as of 2007 they intend -- there
 15 would be an intention to sue.
 16 That is simply not true as of 2007?
 17 A. **An intention to sue, no. We did not in 2007**
 18 **intend to sue.**
 19 Q. When he says that San Diego's state of mind as
 20 of 2007 that it intended to sue upon expiration of the
 21 five-year period, that's simply wrong?
 22 MR. KEKER: Objection, your Honor.
 23 THE COURT: Sustained.
 24 Q. BY MR. QUINN: Let's take a look at DTX 555,
 25 which is admitted. This is an April 18, 2007, memo to

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1 the imported water committee.
 2 **A. Yes.**
 3 Q. On the second page, this is a memorandum
 4 prepared by Daniel Hentschke?
 5 **A. Yes.**
 6 Q. Approved by you?
 7 **A. Yes.**
 8 Q. The last sentence reads, "The Water Authority
 9 does not intend to litigate Met's current rate structure
 10 but it cannot know what future actions the Met board may
 11 take since the Met rates are established annually and
 12 are subject to change by Met's board of directors."
 13 Do you see that?
 14 **A. I do.**
 15 Q. That is language you approved?
 16 **A. Yes.**
 17 Q. In 2007 there was no intention to sue; correct?
 18 **A. Correct. We did not intend to litigate.**
 19 Q. And this was --
 20 Q. It was 2008 that five-year period expired?
 21 **A. Yes.**
 22 MR. QUINN: And then if we can look at DTX
 23 1114. This is not yet admitted and I understand there
 24 is no objection. I would offer it.
 25 MR. KEKER: No objection.

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1 THE COURT: DTX 1114 is admitted.
 2 (Exhibit 1114 was received into evidence.)
 3 Q. BY MR. QUINN: Can you identify this document?
 4 **A. This is a PowerPoint related to the MWD's work**
 5 **plan.**
 6 Q. If you turn to page 11, there is a reference to
 7 "Transportation Issues re SDCWA Transfers."
 8 **A. Yes.**
 9 Q. And it says, "Approval of canal lining option
 10 brought additional reliable water supplies for 110
 11 years."
 12 Do you see that?
 13 **A. Yes.**
 14 Q. After that it says, "No expectation of
 15 litigation."
 16 Do you see that?
 17 **A. I do.**
 18 Q. If you turn to page 12, "2007 Objectives," do
 19 you see, "work in partnership with MWD" and below that
 20 "peace treaty' expired - no litigation"?
 21 Do you see that?
 22 **A. Yes.**
 23 Q. Again, as of 2007, the state of mind at San
 24 Diego is there is no intention to sue?
 25 **A. Correct.**

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1 Q. Since 2003 San Diego has received the benefits
 2 it expected to get under the exchange agreement?
 3 **A. Yes.**
 4 Q. It has received that assignment of the water
 5 and the water -- you have no criticisms of Met's
 6 performance other than these charges which are the
 7 subject of this case; is that true?
 8 **A. That's true.**
 9 Q. And San Diego has received and accepted the
 10 benefits and Met has performed; correct?
 11 **A. Correct.**
 12 Q. Option-2 had that initial price of \$253 which
 13 was assumed to escalate from there?
 14 **A. Yes.**
 15 Q. And the price that San Diego contends it should
 16 pay for 2011, for example, according to your expert,
 17 Mr. Denham is \$136 per square foot?
 18 **A. Per acre-foot.**
 19 Q. Per acre-foot.
 20 **A. Yes.**
 21 Q. So is it your understanding of the exchange
 22 agreement San Diego is entitled to the benefits of
 23 Option-2, the canal lining water, for 110 years and the
 24 \$235 million, and the other thing it gets but should pay
 25 about half of what San Diego assumed it would pay under

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1 option two when it was running those analyses?
 2 **A. No. We assumed we would pay a lawful wheeling**
 3 **rate, and we would get the benefit of the exchange**
 4 **agreement by a lawful wheeling rate.**
 5 Q. If I understand correctly what you're telling
 6 us is you believe that Mr. Denham is right, that for
 7 2011, for example, you can get all those same benefits
 8 and only pay the \$136; correct?
 9 **A. The benefits derived were not directly related**
 10 **to the exchange agreement number. The benefits, the**
 11 **totality of benefits of the QSA related to the exchange**
 12 **agreement, the \$253.**
 13 Q. I mean, again, not to gild the lily, I hope,
 14 we've seen these memos that say the consideration for
 15 the canal lining water was the wheeling rate, which
 16 starts out \$238; right? I'm sorry. \$253?
 17 **A. Correct.**
 18 Q. And so San Diego's position now is it should be
 19 able to get all those benefits anticipated under the
 20 exchange agreement but actually it should only have to
 21 pay much, much less than what that initial year's price
 22 was?
 23 **A. We should only have to pay the lawful wheeling**
 24 **rate.**
 25 Q. Your testimony, Miss Stapleton, was -- I was

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1 asking about whether you brought up taking out the State
 2 Water Project costs, you personally brought it up with
 3 anyone on the Met side. And you said that you did that
 4 in -- I have 2009.
 5 **A. About the State Water Project costs?**
 6 Q. Yes.
 7 **A. We raised that issue way before 2009.**
 8 Q. I'm talking about the conversation with
 9 Mr. Underwood.
 10 **A. I raised that conversation with Dennis all the**
 11 **way back to -- I mean, we were having conversations in**
 12 **1999 or 2000, 2001, 2002, all the way up to the**
 13 **execution of the exchange agreement.**
 14 Q. I asked you what year did you propose backing
 15 out the State Water Project costs on, you personally,
 16 and you said, yes, in year six or beyond --
 17 **A. Right.**
 18 Q. Right?
 19 **A. After the execution of the exchange agreement.**
 20 Q. You did that with Mr. Underwood?
 21 **A. No, no. Mr. Underwood had passed since then.**
 22 Q. That is what I was going to ask. He passed in
 23 2005?
 24 **A. Yes. I'm sorry. I misunderstood.**
 25 **I had ongoing discussions with Dennis Underwood**

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1 **in 2000, 2001, 2002, 2003. The 2009 is when the Water**
 2 **Authority or I actually issued formal objections to the**
 3 **State Water Project costs being included in the Met**
 4 **rate.**
 5 Q. Wasn't it your testimony that you said that you
 6 did not bring -- you were asked, just reading between
 7 the lines:
 8 "Q Miss Stapleton, are you
 9 saying you brought up with Met
 10 excluding State Water Project
 11 costs in year two?
 12 "A No.
 13 "Q Year three?
 14 "A No.
 15 "Q Year four?
 16 "A. No.
 17 "Q For any year?
 18 "A Yes.
 19 "Q What year did you propose
 20 backing out the State Water
 21 Project costs on you
 22 personally?
 23 "A Yes. In year six or
 24 beyond. We had come to know --
 25 come to some agreement and that

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1 we believed the State Water
 2 Project costs were not lawfully
 3 included in the rates.
 4 "Q Who did you propose that
 5 to on the Met side?
 6 "A Dennis Underwood."
 7 Was that your testimony?
 8 **A. I'm sorry. I misunderstood then.**
 9 **Basically my conversations with Dennis were**
 10 **during the negotiations to 2003 and beyond, and I**
 11 **continued those conversations with Dennis until he**
 12 **passed in 2005.**
 13 **The issue about 2009 was when we had formal**
 14 **conversations about -- in 2009 we were raising the issue**
 15 **in a much more public way.**
 16 MR. QUINN: Can I have just a moment, your
 17 Honor?
 18 THE COURT: Of course.
 19 MR. QUINN: Nothing further.
 20
 21 CROSS-EXAMINATION
 22 BY MR. KEKER:
 23 Q. With speed, Miss Stapleton, because of time.
 24 When did San Diego raise with Met the problem
 25 with cost allocation of the State Water Project costs?

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1 **A. Our first concerns regarding wheeling were in**
 2 **1996 and they were -- we continued those dialogues for a**
 3 **number of years.**
 4 Q. Did -- did people that you talked to at Met
 5 understand that you believed it was improper to allocate
 6 State Water Project costs to the transportation rate?
 7 MR. QUINN: Objection. Speculation.
 8 Foundation.
 9 THE COURT: Sustained.
 10 Q. BY MR. KEKER: Did you talk to somebody at Met
 11 about your objection to including State Water Project
 12 costs in the transportation rates?
 13 MR. QUINN: Objection. Vague. Time, as to
 14 time.
 15 THE COURT: Overruled.
 16 THE WITNESS: Yes, I did.
 17 Q. BY MR. KEKER: When?
 18 **A. I had continuing conversations about this issue**
 19 **with Dennis Underwood beginning in about 2000 and**
 20 **continuing on.**
 21 Q. To your knowledge, did San Diego staff have
 22 similar conversations with people on Met staff objecting
 23 to the inclusion of State Water Project costs in the
 24 transportation rates?
 25 **A. Yes.**

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1 MR. QUINN: Objection. Foundation.
 2 Q. BY MR. KEKER: When --
 3 THE COURT: Overruled. Give me a shot to rule
 4 on it.
 5 MR. KEKER: Sorry.
 6 THE WITNESS: Yes, they did.
 7 Q. BY MR. KEKER: When? Starting when?
 8 MR. QUINN: Objection. Foundation.
 9 THE COURT: Overruled.
 10 THE WITNESS: In approximately 1997, '98, and
 11 it continued through the execution of the exchange
 12 agreement.
 13 Q. BY MR. KEKER: To your knowledge did anybody at
 14 the Water Authority ever stop saying that they believed
 15 the State Water Project costs should not be in the
 16 transportation rates?
 17 A. No.
 18 Q. What language did you use when you talked to
 19 Vice President Underwood at Met in these many
 20 conversations that you had about what was wrong with
 21 including State Water Project costs in the
 22 transportation rates?
 23 A. I indicated to Dennis that I didn't believe
 24 they were lawful, that it was improper to put the State
 25 Water Project costs on transportation in lieu of supply;

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1 that I thought it was inconsistent with the wheeling
 2 statute.
 3 Q. What wheeling statute are you referring to?
 4 A. The Katz wheeling statute.
 5 Q. Do you know if that has a Water Code
 6 designation?
 7 A. Yes. 1810.
 8 Q. Who is Mr. Katz?
 9 A. Mr. Katz was in the legislature and he was the
 10 author of the wheeling statute.
 11 Q. Was Mr. Katz the author of the wheeling statute
 12 involved in the negotiations -- in 2003, what was his
 13 role in 2003?
 14 A. In 2003 Richard Katz actually was a -- was on
 15 the Governor's staff and he and another individual on
 16 behalf of Governor Davis participated and facilitated
 17 the negotiations in 2003.
 18 Q. Did Mr. Katz, for example, understand there was
 19 a dispute between San Diego and Met about how to
 20 calculate the wheeling rate?
 21 A. Yes, he was aware.
 22 MR. QUINN: Objection. Foundation.
 23 THE COURT: I'll sustain. We are probably
 24 going off a little bit.
 25 Q. BY MR. KEKER: Just generally, had this been a

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1 subject of a great deal of discussion and objection and
 2 contention between San Diego and Met since the rates
 3 were unbundled?
 4 A. Yes. We had many, many conversations with Met
 5 staff and during this period of time trying to come to
 6 resolution.
 7 Q. Could anybody in these agencies or involved in
 8 this process not understand that there was a dispute
 9 about where to allocate these State Water Project costs?
 10 MR. QUINN: Objection. Foundation.
 11 THE COURT: Sustained. It is argumentative.
 12 Q. BY MR. KEKER: You mentioned something about
 13 closed sessions and so on. Was San Diego's position
 14 prior to 2003 about the proper allocation of State Water
 15 Project costs, was it public or private? Was it
 16 publicly known, publicly discussed?
 17 A. Yes. It was known by MWD and the member
 18 agencies at Metropolitan that we disputed the inclusion
 19 of the State Water Project in the wheeling rate.
 20 Q. When you talked about closed sessions during
 21 Mr. Quinn's examination, what was your point about the
 22 closed sessions?
 23 A. Was that we had repeated and frequent closed
 24 sessions with our board of directors during the
 25 negotiations of the QSA, and a huge amount of the

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1 information and the analysis were done in closed session
 2 with the board as we continued to try to reach
 3 agreement.
 4 Q. What about the water stewardship rate? When
 5 had you directly begun communicating your concern about
 6 the placement of the water stewardship rate costs on
 7 transportation to anybody at Met?
 8 A. In about the year 2000.
 9 Q. And to whom did you communicate that concern
 10 and what did you say about it?
 11 A. For me, it was to Dennis Underwood who was my
 12 counterpart on the negotiating team of Met. And, again,
 13 I indicated the water stewardship charge was directly
 14 related to supply development and it didn't belong on
 15 the transportation charge. I didn't believe it was
 16 consistent, again, with the wheeling law.
 17 Q. And did you say -- did you tell him it was
 18 improper, invalid or anything like that?
 19 A. Yes. The language I would use is it's improper
 20 or that it's not consistent with the law or that it --
 21 that is not a valid charge to the transportation or
 22 system access rate.
 23 Q. To your knowledge did Met staff -- excuse me.
 24 San Diego Water Authority staff communicate similar
 25 concerns to their contemporaries at Met?

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1 MR. QUINN: Objection; foundation.
 2 THE COURT: Did you overhear these
 3 communications?
 4 THE WITNESS: I did in some cases.
 5 THE COURT: Tell us about what you heard.
 6 THE WITNESS: I heard both Scott Slater, my
 7 special counsel, and Bob Campbell, one of my staff
 8 members, having discussions with either Brian Thomas,
 9 who was an employee of Metropolitan, or Jeff
 10 Kightlinger, the general counsel, about the wheeling
 11 rate and our objections to the inclusion of certain
 12 charges in that wheeling rate.
 13 Q. BY MR. KEKER: By the way, was Mr. Gastelum,
 14 who was the general manager in 2003, is he still around
 15 and available to Met as a witness?
 16 A. **Yes, he is around.**
 17 Q. Miss Stapleton why did the Water Authority
 18 agree -- let me back up. You said the \$253 wheeling
 19 rate made up of the current system access rate, water
 20 stewardship rate and system power rate, adding to \$253.
 21 You said you believed at the time of the exchange
 22 agreement that rate was not -- was illegal, was not
 23 properly calculated. Do you remember that?
 24 A. **Correct.**
 25 Q. Why did San Diego agree in the exchange

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1 agreement to pay that rate for the initial year?
 2 A. **For a couple reasons. We needed to make**
 3 **modifications in the exchange agreement from 1998. We**
 4 **had to solve some problems, which is the exchange**
 5 **agreement term was shorter than our water transfer term**
 6 **and we had 15 years of exposure.**
 7 **The second issue was there was some conditions**
 8 **precedent that we had been told by Ron Gastelum that**
 9 **would invalidate the 1998 agreement.**
 10 **So we decided if we could put boundaries on our**
 11 **exposure to Met's wheeling rate and had the opportunity**
 12 **to either negotiate something we both could live with**
 13 **and that it was lawful, that that was worth -- that was**
 14 **worth the risk.**
 15 Q. You said you agreed as part of the exchange
 16 agreement to pay Met's wheeling rate, whatever they
 17 said, for five years?
 18 A. **Correct.**
 19 Q. And thereafter, what wheeling rate did you
 20 agree to pay?
 21 A. **The lawful wheeling rate.**
 22 Q. Did you make sure that the agreement reflected
 23 that agreement?
 24 A. **Yes.**
 25 Q. Could we look at Plaintiff's 65 and put up 5.2,

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1 please?
 2 A. **I don't think I have 65.**
 3 Q. Sorry, Miss Stapleton, I am rushing. Let's put
 4 up 5.2 on the screen.
 5 This is an agreement for exchange water, and in
 6 5.2 it says the price on the date of execution is \$253;
 7 right?
 8 A. **Correct.**
 9 Q. At the time was there a dispute between Met and
 10 San Diego about whether or not that was a lawful
 11 wheeling rate?
 12 A. **Yes, that was.**
 13 Q. Did Mr. Underwood understand there was a
 14 dispute?
 15 A. **Absolutely.**
 16 Q. Did you understand there was a dispute?
 17 A. **Yes.**
 18 Q. Did anybody at Met not understand that there
 19 was a dispute?
 20 A. **No.**
 21 MR. QUINN: I object. Move to strike.
 22 THE COURT: Sustained.
 23 Q. BY MR. KEKER: And it says, "Thereafter, the
 24 price shall be equal to the charge or charges set by the
 25 Met board of directors pursuant to applicable law and

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1 regulation."
 2 What did that mean to you?
 3 A. **That meant thereafter Met -- that the price**
 4 **would be a lawful wheeling rate that was set by MWD.**
 5 Q. And had there been some discussion about how
 6 long San Diego would sit still if Met didn't change its
 7 ways about cost allocation?
 8 A. **Yes.**
 9 Q. And what did the discussion lead to?
 10 A. **It led to that we could not challenge the MWD**
 11 **established rate for the first five years.**
 12 Q. And what was the purpose for you, for San
 13 Diego, to agree to a wheeling rate that you thought was
 14 higher than the law permitted and to agree to it, to pay
 15 it for five years?
 16 A. **Because it provided an exchange agreement that**
 17 **matched our water transfer agreement in the length of**
 18 **time. And it got rid of the conditions precedent. So**
 19 **we knew we would have a firm capacity within the**
 20 **aqueduct in this exchange agreement, and we were willing**
 21 **to take the risk.**
 22 Q. During the negotiations, as Mr. Kightlinger
 23 told us, did Met say we want you to agree to whatever we
 24 say the wheeling rate is for the next 45 and maybe 75
 25 years?

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1 **A. That was their initial offer to us.**
 2 Q. And did San Diego agree to eat whatever they
 3 wanted to call the wheel rate, whatever number they
 4 wanted to put on it, for 45 to 75 years?
 5 **A. Absolutely not.**
 6 Q. What did the negotiation yield in that regard?
 7 **A. We finally got down to a five-year time period**
 8 **where we agreed to pay the MWD established rate, and**
 9 **after five years we had the opportunity to seek either**
 10 **administrative or judicial remedy.**
 11 Q. Let's look at the next term. It says, still in
 12 5.2, "For the term of this agreement neither San Diego
 13 nor Met shall seek or support in any legislative,
 14 administrative or judicial forum."
 15 Does administrative include Met?
 16 **A. Yes.**
 17 Q. So you are promising you are not going to go to
 18 Met, you are not going to go to the legislature and you
 19 are not going to go to court for the life of this
 20 agreement --
 21 **A. Yes.**
 22 Q. -- pertaining to the charge or charges set by
 23 the board of directors. That's what that says; right?
 24 **A. Correct.**
 25 Q. And then it comes down and it says, "Provided

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1 further that, A, after the conclusion of the first five
 2 years" --
 3 What are the next two words?
 4 **A. "Nothing herein."**
 5 Q. -- "shall preclude San Diego from contesting in
 6 an administrative or judicial forum," blah, blah, blah.
 7 What did you understand that to mean about this
 8 five-year period?
 9 **A. After five years, if we were unsuccessful**
 10 **reaching an agreement on what would be considered the**
 11 **lawful rate, the Water Authority had the ability to**
 12 **contest the wheeling rate that Met had established in**
 13 **either an administrative or judicial manner.**
 14 Q. After the five years with respect to what the
 15 subject matter of your lawsuit could be, did you
 16 understand that there was any condition about only
 17 procedural or only something that didn't exist when we
 18 started or anything, any limitation on that?
 19 **A. Absolutely not.**
 20 Q. Did you expect there was a possible -- did you
 21 anticipate there was a possibility the law might change
 22 or develop and make the wheeling situation work more
 23 plain over the next five years?
 24 **A. Yes. That there were some court cases**
 25 **regarding wheeling during this period of time, and we**

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1 **thought that there may be additional court decisions**
 2 **that might have an influence on -- an influence to help**
 3 **clarify what a lawful wheeling rate might be.**
 4 Q. In San Diego's mind did the term "lawful
 5 wheeling rate" have meaning?
 6 **A. It had essential meaning.**
 7 Q. Was there any part of California or
 8 constitutional law that was excluded from the term
 9 "lawful"?
 10 **A. No.**
 11 Q. And in your discussions with Mr. Underwood, did
 12 he seem to understand that, as well?
 13 **A. He did.**
 14 Q. Would you look at 11.1, please. 11.1 says you
 15 have to negotiate if you have a problem, but it also
 16 says, "San Diego shall not dispute whether the price
 17 determined pursuant to paragraph 5.2 for the first five
 18 years of this agreement was determined in accordance
 19 with applicable law or regulation ('a price dispute')."
 20 What price did you think they were talking
 21 about that you couldn't dispute for five years?
 22 **A. Met's wheeling rate as selected or as set by**
 23 **the board of directors.**
 24 Q. Where the parentheses are around "price
 25 dispute," look over at 12.4, please, and 12.4(c), which

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1 says, "In the event of a dispute over the price, San
 2 Diego shall pay when due. . ."
 3 And then it goes and talks about the escrow
 4 accounts?
 5 **A. Right.**
 6 Q. Was there anything in this agreement that
 7 limited San Diego's ability to complain about any aspect
 8 whatsoever of the price it was being charged by Met
 9 after five years were over?
 10 **A. No.**
 11 Q. Was that something that was negotiated for
 12 hard?
 13 **A. Very hard.**
 14 Q. And was that contrary to the position that Met
 15 wanted, which is you can never challenge our prices?
 16 **A. Yes.**
 17 Q. That was the compromise?
 18 **A. This was the compromise.**
 19 Q. For five years you couldn't challenge --
 20 THE COURT: I have to interrupt. I have
 21 another case coming in at 4:00. I have a ferocious
 22 amount of work to do.
 23 Can we pick this up on our next trial date?
 24 MR. KEKER: Yes, sir.
 25 THE COURT: I do have some other cases. Thank

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1 you. I will see you next time we get together.
2 (Evening recess was taken.)
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1 REPORTER'S CERTIFICATE
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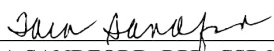
3 STATE OF CALIFORNIA,)
4) ss
5 COUNTY OF SANTA BARBARA.)

6 I, TARA ANN SANDFORD, CSR #3374, Certified Shorthand
7 Reporter, in the County of Santa Barbara, State of
8 California, hereby certify:

9 That the court proceedings were taken down by me in
10 stenotype at the time and place herein named and
11 thereafter reduced to typewriting by computer-aided
12 transcription under my direction.

13 I further certify that I am not interested in the
14 event of the action.

15 WITNESS my hand this 3rd day of April,
16 2015, at San Francisco, California.
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22 TARA SANDFORD, RPR, CSR No. 3374
23 Certified Shorthand Reporter
24 State of California
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