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15
16 SUPERIOR COURT OF THE STATE OF CALIFORNIA
17 COUNTY OF SAN FRANCISCO

18 SAN DIEGO COUNTY WATER
AUTHORITY,

19 Petitioner and Plaintiff,

20 v.

21 METROPOLITAN WATER DISTRICT OF
22 SOUTHERN CALIFORNIA; et al.,

23 Respondents and Defendants.
24
25
26
27
28

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

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

Date: November 4, 2013

Time: 9:00 a.m.

Dept.: 304

Judge: Hon. Curtis E. A. Karnow

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

Trial Date: December 17, 2013

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1 **I. INTRODUCTION**

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

12 Accordingly, Respondent and Defendant Metropolitan Water District of Southern
13 California (“MWD”) submits its First Pretrial Brief in advance of the November 4, 2013 pretrial
14 hearing. Below, MWD discusses each of the San Diego County Water Authority’s (“SDCWA”)
15 claims in the *2010 Action* (Case No. CPF-10-510830) and the *2012 Action* (Case No. CPF-12-
16 512466) other than the breach of contract claims, and sets forth the standard of review, burden of
17 proof, and appropriate evidence for each claim.

18 **II. FACTUAL OVERVIEW**

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

27 **A. Factual Background Relevant to the Rate Challenges**

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

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

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

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

14 **1. The 1997 Wheeling Rate**

15 In January 1997, MWD’s Board of Directors voted to adopt a “postage stamp” wheeling
16 rate, effective January 15, 1997, applicable to member agencies that convey non-MWD water
17 through MWD’s water conveyance system in transactions of one year or less. A postage stamp
18 rate for wheeling a given quantity of water, as its name indicates, is the same regardless of how
19 far the water is transported. The postage stamp nature of the wheeling rate substantially benefits
20 SDCWA, because water must travel a longer distance to get to it as compared to most other
21 member agencies. The Board developed this rate in consultation and cooperation with MWD’s
22 26 member agencies, of which SDCWA is one. As a general matter, MWD’s wheeling rate
23 applies to the conveyance of non-MWD water through MWD’s system. It consists of certain
24 system-wide costs (*i.e.*, costs of capital, operation, and/or maintenance of MWD’s interconnected
25 facilities, as opposed to just those portions of the system used in the wheeling transactions).

26 This wheeling rate included, among other things, both MWD’s conveyance costs under
27
28

1 its “take-or-pay” contract¹ with DWR for SWP, water and costs to assist funding of water
2 conservation and other water demand management programs. Both of those cost allocations are
3 inconsistent with the allegations SDCWA now asserts—more than 15 years later—that all SWP
4 costs, including conveyance and power costs, and water conservation and demand management
5 program costs, must be allocated solely to MWD’s water supply rate. This wheeling rate was
6 assessed on any member agency engaged in a wheeling transaction of one year or less since
7 January 15, 1997, until it was modified in 2003 by the “unbundling” of MWD’s rate structure,
8 which unbundling is discussed in more detail below.

9 **2. The Unbundling of MWD’s Water Rates**

10 In the late 1990s, MWD began a revision of its overall water rates and charges, in
11 consultation and cooperation with SDCWA and MWD’s other member agencies. On October
12 16, 2001, MWD’s Board of Directors voted to adopt a revised rate structure, effective January 1,
13 2003. Among other things, this rate structure unbundled water rates and charges to reflect the
14 different services provided by MWD and to more transparently allocate costs to operation
15 functions.

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

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

27 ¹ The SWP contract is “take or pay” because MWD must pay a certain amount under the contract
28 regardless of how much water it gets from the SWP.

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

3 3. The Rate-Setting Process

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

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

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

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

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

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

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

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

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

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

15 Despite SDCWA's allegations, MWD has never "colluded" with any member agency or
16 group of member agencies. No member agency or member agency group exerts unlawful
17 influence over MWD. SDCWA's claims that MWD has made decisions, including regarding its
18 rate structure, rates, "dry year peaking," and awards of "subsidy contracts" to intentionally
19 discriminate against SDCWA are untrue, and, as this court has held, are irrelevant to the claims
20 alleged in SDCWA's Third Amended Petition/Complaint ("TAC") in the *2010 Action* and
21 SDCWA's Petition/Complaint in the *2012 Action* ("2012 Complaint"). 7/2/2012 Tr. at 40:26-
22 43:1 and 62:27-63:6 (the Court ruled that SDCWA's allegations of a "cabal" are "not part of this
23 case.")

24 **4. The Rates at Issue**

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

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

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

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

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

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

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

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

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

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

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

3 In every year since 2003, MWD has maintained a System Access Rate, System Power
4 Rate, Water Stewardship Rate, Readiness-to-Serve Charge, and Capacity Charge, and has used a
5 consistent methodology for allocating costs to these rates and charges and for apportioning the
6 rates and charges among member agencies. Indeed, when MWD’s Board considered and
7 reaffirmed its cost allocation methodology on November 10, 2009, SDCWA voted in the
8 affirmative. Likewise, SDCWA proposed and voted in favor of a 3% rate increase for the
9 2013/14 years based on this same rate structure that it is now challenging for those years.

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

12 **1. MWD’s Integrated Resources Plan and Statutory Mandates**
13 **Provide the Foundation for MWD’s Water Demand**
14 **Management Programs**

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

1 achieved by the year 2035: (1) an annual savings of 2,168,000 acre-feet³ of water through water
2 use efficiency efforts, including conservation and recycling; and (2) the production of an
3 additional 2,025,000 acre-feet annually through local resources.

4 Furthermore, these commitments are essential to meeting statutory mandates that require
5 an increased focus on conservation and local resource development. In 1999, the California
6 Legislature passed Senate Bill 60, which amended the MWD Act to require that MWD place an
7 “increased emphasis on sustainable, environmentally sound, and cost-effective water
8 conservation, recycling, and groundwater storage and replenishment measures.” MWD Act
9 § 130.5. In 2009, the Legislature added a provision to the California Water Code that requires
10 the state to reduce its per capita water use by 20% by 2020. Cal. Water Code § 10608.16. The
11 Legislature requires MWD to provide yearly reports outlining its progress toward these
12 conservation goals. These “SB60 reports” detail MWD’s achievements in promoting
13 conservation, recycling, and groundwater recharge, and quantify the number of acre-feet of water
14 developed and/or conserved by various projects and programs implemented throughout MWD’s
15 service region.

16 **2. MWD’s Water Demand Management Programs are**
17 **Implemented Through Contracts with Member Agencies**

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

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

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

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

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

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

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

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

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

21 These benefits are further demonstrated by the sheer number of acre-feet of water
22 developed and/or conserved on an annual basis through these programs. These benefits are
23 reflected in MWD’s yearly SB60 Reports to the Legislature. For example, in fiscal year 2011-
24 2012, MWD-assisted conservation programs saved approximately 156,000 acre-feet of water—
25 enough to provide water for more than 750,000 to 1 million people for a full year. In that same
26 year, LRP programs contributed an additional 171,000 acre-feet of recycled water for non-
27 potable uses and another 40,000 acre-feet of recovered groundwater for municipal use. Since
28 1991, these programs have produced almost 4 million acre-feet of water for the residents of

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

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

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

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

23 **4. MWD Adopted and Implemented the RSI Provision**

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

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

6 Moreover, the threat of future litigation was made explicit by SDCWA in the context of
7 negotiating its 35-year water exchange agreement (“Exchange Agreement”) with MWD in late
8 2003. Under the Exchange Agreement, SDCWA makes available water it purchases from the
9 Imperial Irrigation District to MWD at the intake to MWD’s Colorado River Aqueduct on Lake
10 Havasu, and MWD, in turn, delivers an equivalent amount of Exchange Water to SDCWA. In
11 negotiating the Exchange Agreement’s Price provision, SDCWA agreed not to challenge
12 MWD’s water rates for a period of five years after its execution. Thereafter, SDCWA reserved
13 its right to challenge the validity of MWD’s rates “in an administrative or judicial forum.” In
14 that context, SDCWA openly threatened to litigate over MWD’s existing rate structure and
15 destabilize MWD’s rates.

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

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

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

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

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

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

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

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

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

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

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

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

3 **6. SDCWA Filed Suit, Triggering the RSI Provision**

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

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

17 As part of its decision to initiate the termination process of existing project contracts,
18 MWD’s Board also voted to defer the execution of three pending project contracts with
19 SDCWA. These contracts had not yet been finalized and were in various stages of negotiation.
20 Two of these deferred agreements provided funding for water conservation—one for an
21 agricultural conservation program and the other for research regarding flow control valves. The
22 third deferred contract was for a proposed Seawater Desalination Project in Carlsbad, California.
23 This project was designed to produce 56,000 acre-feet of potable water a year from desalinated
24 seawater. Under the proposal, SDCWA requested from MWD up to \$350 million for
25 approximately 1.4 million acre-feet of water over the span of 25 years. Ultimately, the Carlsbad
26 project went forward without MWD’s participation. SDCWA has admitted that this project will
27 provide region-wide benefits.
28

1 **C. Factual Background Relevant to the Preferential Rights Claim**

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

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

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

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

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

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

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

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

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

1 the “purchase of water” under section 135, particularly as that provision has been interpreted by
2 the Court of Appeal in prior litigation that SDCWA initiated on the issue. *See SDCWA v. MWD*,
3 117 Cal. App. 4th 13 (2004). MWD thus properly excludes those payments from the preferential
4 rights calculation. SDCWA’s own documents repeatedly admit that the “[c]urrent Preferential
5 Rights Formula does not include any component of the water rate.” SDCWA admits that this
6 statement constitutes its paraphrasing of section 135. SDCWA’s internal documents further
7 acknowledge: “Section 135 does not include revenue collected through water rates in the
8 preferential rights calculations.”

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

12 The rate challenges in the first three causes of action in both the *2010* and *2012 Actions*
13 consist of a writ of mandate (first cause of action), request for declaratory relief (second cause of
14 action), and request for determination of invalidity of the rates (third cause of action). Each of
15 these causes of action in both actions alleges that MWD’s rates violate the following five laws:
16 the MWD Act, common law, Government Code Section 54999.7(a), Water Code Section 1810,
17 *et seq.*, and Proposition 13. In addition, in the *2012 Action* only, SDCWA alleges MWD’s rates
18 also violate Proposition 26. As the Court has previously recognized, stated in simplest terms
19 under all laws the Court is to assess whether the rates are reasonable. *See 3/27/2013 Tr. at*
20 *15:10-16* (Court stating that whether evaluating MWD’s rates and charges under Proposition 26
21 or any other law, “the substantive issue, of course, as we all know, will be exactly the same,
22 which is the reasonableness of the rates.”).

23 **A. Standard of Review Generally Applicable to Challenges to Quasi-**
24 **Legislative Decisions Such As MWD’s Rate-Setting**

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

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

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

9 This standard requires that a challenge to an agency action be denied unless that action
10 was “entirely lacking in evidentiary support.” *Brydon*, 24 Cal. App. 4th at 196 (“Given the
11 quasi-legislative nature of the District’s enactment of the rate structure design, review is
12 appropriate only by means of ordinary mandate where the court is limited to a determination of
13 whether District’s actions were arbitrary, capricious or entirely lacking in evidentiary support.”)
14 (citations omitted); *see also Am. Coatings*, 54 Cal. 4th at 460 (“In assessing the validity of a
15 quasi-legislative [decision] in an action for mandamus under Code of Civil Procedure section
16 1085, our inquiry necessarily is confined to the question whether the classification is ‘arbitrary,
17 capricious, or without reasonable or rational basis.’”) (citations omitted).⁴

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

21 _____
22 ⁴ The arbitrary and capricious standard of review applies equally to SDCWA’s causes of action
23 for declaratory relief and determinations of invalidity. The standard for mandamus review
24 applies regardless of how the case is captioned or how the plaintiff articulates its requested relief;
25 the relevant inquiry is whether the action challenges a quasi-legislative agency decision, not
26 whether plaintiff seeks its relief in the form of a writ, declaratory judgment, or statement of
27 decision. *See generally Bunnett v. Regents of the University of California*, 35 Cal. App. 4th 843,
28 848 (1995) (regardless of how denominated, “the causes of action are no more than challenges to
the administrative decision of a state agency,” and therefore the standards applicable to “a writ of
mandate” apply); *Le Strange v. City of Berkeley*, 210 Cal. App. 2d 313, 320 (1962) (“[t]he
appropriate method of reviewing the decisions or orders of local administrative agencies . . . is
by mandamus,” and when the complaint is captioned otherwise, “it may be regarded as a petition
for a writ of mandate”).

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

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

24 While the arbitrary and capricious standard is even “*more* deferential to agency
25 decisionmaking” than the highly deferential substantial evidence standard (*see Am. Coatings*, 54
26 Cal. 4th at 461 (emphasis added)), courts often utilize the substantial evidence test to determine
27 if an agency’s decision is arbitrary and capricious. *See Golden Drugs Co., Inc. v. Maxwell-Jolly*,
28 179 Cal. App. 4th 1455, 1467 (2009) (“We recognize that not everyone acknowledges a

1 distinction between ‘devoid of evidentiary support’ and ‘substantial evidence’”) (citations
2 omitted). Indeed, the arbitrary and capricious standard “generally means that a court cannot
3 disturb the agency’s decision if substantial evidence in the administrative record supports the
4 decision.” *Plastic Pipe and Fittings Ass’n v. California Bldg. Standards Comm’n*, 124 Cal. App.
5 4th 1390, 1406 (2004).

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

12 Therefore, any allegations of bias SDCWA has or may make are irrelevant to the
13 reasonableness inquiry. *Wilson v. Hidden Valley Mun. Water Dist.*, 256 Cal. App. 2d 271, 286
14 (1967) (it is well established that “[a]ny claim of prejudgment, bias or prejudice” on the part of
15 an agency “is beside the point” in reviewing the legality of quasi-legislative decisions).⁵ The
16 California Supreme Court has held that “the validity of a legislative act does not depend on the
17 subjective motivation of its draftsmen but rests instead on the objective effect of the legislative
18 terms.” *Cnty. of Los Angeles v. Super. Ct.*, 13 Cal. 3d 721, 727 (1975). A duly enacted rate
19 supported by substantial evidence in the record cannot be invalidated because it was alleged to
20 have “resulted from” subjective feelings or purposes that the court found impure or distasteful.
21 *San Francisco v. Cooper*, 13 Cal. 3d 898, 905 (1975) (“the judiciary has no authority to
22 withdraw the legislative prerogative on the basis of allegedly improper influences brought to
23 bear upon individual legislators”). Indeed, courts have rejected allegations that water districts
24 are biased that are similar to those SDCWA has made in this matter:

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

27 ⁵ As noted, this Court has ruled that SDCWA’s allegations of a “cabal” are “not part of the case.”
28 7/2/2012 Tr. at 40:26-43:1 and 62:27-63:6.

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

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

6 Accordingly, under an arbitrary and capricious review, this Court should uphold MWD's
7 2011/12 and 2013/14 water rates and charges if there is substantial evidence supporting their
8 reasonableness in the administrative record.⁶

9 **B. SDCWA's MWD Act Claim**

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

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

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

1 **1. Standard of Review**

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

7 Where there is any dispute over the meaning or interpretation of MWD Act Section 134,
8 MWD’s interpretation is entitled to substantial deference. In *SDCWA v. MWD*, where SDCWA
9 challenged MWD’s compliance with a different section of the MWD Act, the Court of Appeal
10 stated that it must “accord[] great weight and respect to [MWD’s] construction.” 117 Cal. App.
11 4th at 22. This is in keeping with the long-standing rule that courts “give deference to an
12 agency’s interpretation” of a statute “by its implementing agency.” *Kern Cnty. Water Agency v.*
13 *Watershed Enforcers*, 185 Cal. App. 4th 969, 982 (2010); *see also San Bernardino Valley*
14 *Audubon Soc’y v. City of Moreno Valley*, 44 Cal. App. 4th 593, 603 (1996) (“[W]e give great
15 deference to an agency’s interpretation of its governing statutes.”); *City of Long Beach v. Dep’t*
16 *of Indus. Relations*, 34 Cal. 4th 942, 956 (2004) (“In construing an ambiguous statute, courts
17 generally defer to the views of an agency charged with administering the statute.”).

18 **2. Burden of Proof**

19 SDCWA bears the burden of establishing that MWD’s water rates violate the MWD Act.
20 Common law dictates that MWD’s rates must be presumed reasonable and the “burden of
21 overcoming this presumption is on the assailant.” *Boynton v. City of Lakeport Mun. Sewer Dist.*
22 *No. 1*, 28 Cal. App. 3d 91, 95 (1972). Specifically, the burden of proof first falls on the plaintiff
23 to establish that the rates are different for like classes of people, and then it “shifts to defendants
24 to establish that the rates were fixed by a lawful rate-fixing body.” *Elliott v. City of Pac. Grove*,
25 54 Cal. App. 3d 53, 60 (1975). “Upon such a showing an assumption of fact is required to be
26 made that the rates fixed are reasonable, fair and lawful.” *Id.* Finally, “[t]he burden then shifts
27 back to plaintiff to establish . . . that the rates fixed are unreasonable, unfair or unlawful.” *Id.*

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

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

8 **3. Evidence the Court Is Required to Evaluate**

9 **a. Scope of Allowable Evidence**

10 The California Supreme Court has stated the “well settled” rule that “extra-record
11 evidence is generally not admissible in . . . traditional mandamus actions challenging quasi-
12 legislative administrative decisions.” *Western States*, 9 Cal. 4th at 574. In other words, a court
13 should “consider *only* the administrative record” (which excludes extra-record documents, as
14 well as fact and expert witness testimony) in determining whether a quasi-legislative decision
15 was reasonable. *Id.* at 573 (emphasis added); *see also Am. Coatings*, 54 Cal. 4th at 460 (when
16 evaluating the validity of a quasi-legislative decision, courts “consider only the administrative
17 record before the agency at that time [the decision was made]”); *Plastic Pipe & Fittings Ass’n.*,
18 124 Cal. App. 4th at 1406 (review of quasi-legislative action was limited to determining whether
19 agency action was arbitrary, capricious, or “entirely without evidentiary support,” which
20 “generally means that a court cannot disturb the agency’s decision if . . . evidence in the
21 administrative record supports the decision”).

22 The Courts of Appeal have unanimously followed the rule in *Western States* on this
23 point: “An unbroken line of cases holds that, in traditional mandamus actions challenging quasi-
24 legislative administrative decisions, . . . ‘extra-record evidence’ is not admissible.” *Carrancho*,
25 111 Cal. App. 4th at 1269 (citations omitted); *see also San Joaquin*, 162 Cal. App. 4th at 163,
26 167 (granting writ petition to quash discovery on this basis).⁷

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

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

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

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

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

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

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

27 ⁸ This Court has ruled that SDCWA’s allegations of a “cabal” are “not part of the case.”
28 7/2/2012 Tr. at 40:26-43:1 and 62:27-63:6.

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

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

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

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

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

1 legislative decision “if a reasonable trier of fact could conclude that the evidence is reasonable,
2 credible, and of solid value.” *Id.* at 1407; *see also id.* at 1407-08 (court found that an agency’s
3 reliance on a single comment letter in the record constituted substantial evidence to support its
4 decision); *Associated Builders & Contractors, Inc. v. San Francisco Airports Com.*, 21 Cal.4th
5 352, 374-75 (1999) (concluding that substantial evidence supported an agency decision based on
6 a record consisting of only two public meetings to hear evidence and argument on the
7 desirability of the agreement at issue as well as a declaration submitted by the Commission in
8 opposition to the agreement).

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

12 **b. Pertinent Administrative Record Documents**

13 Documents in each action’s administrative record shows that SDCWA’s challenge under
14 the MWD Act fails at the outset under the plain language of the statute. As stated, SDCWA
15 relies on section 134 of the MWD Act, which provides that MWD’s rates must be “uniform for
16 like classes of service throughout the district.” To have a claim under section 134, SDCWA
17

18 ¹⁰ The rule limiting review of the legality of MWD’s rates to the administrative record applies to
19 all causes of action that challenge MWD’s rate structure and rates—whether styled as a petition
20 for writ of mandate, a claim for declaratory relief, or a validation action under Code of Civil
21 Procedure §§ 860 *et seq.* Regardless of how a cause of action is styled, the relevant inquiry is
22 whether the action challenges a quasi-legislative agency decision. *See, e.g., Voss v. Super. Ct.*,
23 46 Cal. App. 4th 900, 922-23 (1996) (stating that both mandamus and declaratory relief are
24 available “to challenge the quasi-legislative actions of the [agency]” and that such actions are
25 reviewed “within the bounds of the standards applicable to judicial review of such [actions]”);
26 *Poway Royal Mobilehome Owners Ass’n v. City of Poway*, 149 Cal. App. 4th 1460, 1478-79
27 (2007) (holding that in validation actions “[t]he scope of judicial review of a legislative type
28 activity is limited to an examination of the record before the authorized decision makers to test
for sufficiency with legal requirements”); *Kucharczyk Regents of Univ. of Cal.*, 946 F. Supp.
1419, 1434 (N.D. Cal. 1996) (“Plaintiffs contend that mandamus does not apply at all in this
action, which they characterize as a breach of contract action. However, the plaintiff’s
characterization of his cause of action is not determinative.”); *see also Western States*, 9 Cal. 4th
at 576 (as a result of the deference afforded to quasi-legislative decisions, the California
Supreme Court held “that extra-record evidence is generally not admissible” even on claims
“that the agency has not proceeded in a manner required by law”).

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

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

8 The documents in the administrative record show that MWD’s current rate structure,
9 including the rates challenged here, is the result of a lengthy and reasoned analysis of the
10 propriety of recouping expenses from related operation functions, through the application of
11 MWD’s Cost of Service (“COS”) methodology. A rates consultant engaged by MWD, a well-
12 respected and nationally recognized expert in the field,¹¹ concluded in his April 6, 2010 report
13 that the rates are “consistent with water industry best practices, and [comply] with COS and rate
14 guidelines in the American Water Works Association’s (‘AWWA’) Manual M-1, *Principles of*
15 *Water Rates, Fees, and Charges.*” See 2010/2012 Administrative Records (“2010 Record” and
16 “2012 Record”, respectively) Document No. 591.¹² The review further determined that MWD’s
17 “rate methodology is reasonable”, “consistent with Board policies and, more specifically, with
18 the 2001 Rate Structure Framework” and “accurate and consistent with the 2001 COS.” *Id.*

19 **(1) Allocation of SWP Transportation Costs**

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

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

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

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

1 Under its contract with DWR, MWD pays to DWR separate supply and transportation
2 charges. Article 22 of the contract establishes a supply charge (called the “Delta Water
3 Charge”), which is “for project water.” 2010/2012 Records Document No. 1. Article 23
4 establishes the transportation charge “to *deliver* project water” and states that it consists of
5 “capital, operation, maintenance, power and replacement costs.” *Id.* (emphasis added). Article
6 24 describes the capital cost component of the transportation charge, which “shall return to the
7 State . . . those costs of all project transportation facilities necessary to deliver project water to
8 [MWD].” *Id.* Article 25 sets forth a minimum transportation charge for “operation,
9 maintenance, power and replacement” of DWR’s transportation facilities “irrespective of the
10 amount of project water delivered to the contractor.” *Id.* This charge covers such expenses as
11 operating and repairing the California Aqueduct, a transportation facility necessary for water to
12 be transported to MWD and its member agencies. The transportation charge also contains a
13 variable charge for operation, maintenance, power and replacement costs, which is dependent
14 upon the amount of water delivered to MWD. *Id.* This variable transportation charge is
15 principally composed of the power cost to pump water through the aqueduct and over the
16 Tehachapi Mountains to transport water to MWD and its member agencies.

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

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

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

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

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

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

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

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

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

24 (2) Allocation of the Water Stewardship Rate

25 The administrative record also supports MWD's contention that including the Water
26 Stewardship Rate in transportation charges is reasonable because development of local water
27 resources decreases the need for additional conveyance facilities, and thus reduces conveyance
28

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

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

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

17 MWD classified both Conveyance and Aqueduct and Distribution costs into its demand
18 and commodity categories (and also allocated Conveyance and Aqueduct to its standby
19 category), and conducted an analysis to determine the appropriate allocation to each category.
20 This included determining the percentage of available capacity used to meet peak monthly and
21 daily deliveries to its member agencies (which falls into the demand classification). 2010/2012
22 Records Document No. 599; 2012 Record Document No. 944. MWD then allocated the demand
23 and standby cost classifications to its Readiness-to-Serve Charge, Capacity Charge, and
24 Treatment Surcharge. 2010/2012 Records Document No. 599; 2012 Record Document No. 944.
25 MWD allocated its drought storage operation function to its fixed commodity classification, and
26 finally to its supply rates. 2010/2012 Records Document No. 599; 2012 Record Document No.
27 944.

28 Administrative record evidence shows that allocating costs associated with satisfying

1 peak demand in this manner is reasonable.

2 The Readiness-to-Serve Charge recovers SWP-related conveyance costs associated with
3 peak demand as well as emergency and peak-related storage costs and standby costs. *See*
4 2010/2012 Records Document No. 599; 2012 Record Document No. 944. MWD calculates the
5 Readiness-to-Serve Charge for each member agency by using a ten-year rolling average of that
6 member agency's past total consumption, *i.e.*, all firm deliveries including water transfers and
7 exchanges that use MWD capacity. 2010/2012 Records Document No. 599; 2012 Record
8 Document No. 944. This calculation leads to a relatively stable Readiness-to-Serve Charge that
9 reasonably represents an agency's potential long-term need for standby services and access to
10 MWD's facilities under different demand conditions, including peak demand. 2010/2012
11 Records Document No. 599; 2012 Record Document No. 944. MWD allows its member
12 agencies to choose whether or not to pay a Standby Charge (a property tax) as a way to offset
13 their Readiness-to-Serve Charge. 2010/2012 Records Document No. 599; 2012 Record
14 Document No. 944.

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

23 The capital facilities the Readiness-to-Serve Charge funds benefit all system users as
24

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

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

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

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

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

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

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

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

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

14 C. SDCWA’s Common Law Claim

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

18 1. Standard of Review

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

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

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

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

11 **2. Burden of Proof**

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

19 **3. Evidence the Court Is Required to Evaluate**

20 **a. Scope of Allowable Evidence**

21 Because this claim challenges the lawfulness of the quasi-legislative act of rate setting
22 (like SDCWA’s MWD Act claim discussed above), the Court’s review of evidence is limited to
23 the administrative records in the *2010* and *2012 Actions* and should exclude extra-record
24

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

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

4 **b. Pertinent Administrative Record Documents**

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

11 **D. SDCWA’s Government Code Section 54999.7 Claim**

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

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

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

26 _____
27 ¹⁶ Where a quasi-legislative agency action is being reviewed, courts “consider only the
28 administrative record” in determining whether a quasi-legislative decision was reasonable.
Western States, 9 Cal. 4th at 573.

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

3 To further explain SDCWA’s concession, Government Code section 54999 was enacted
4 in response to the California Supreme Court’s decision in *San Marcos Water Dist. v. San Marcos*
5 *Unified Sch. Dist.*, 42 Cal. 3d 154 (1986). *San Marcos* involved a sewer capacity right fee that a
6 retail water district had imposed onto its end-user customers, including a school district. *Id.* at
7 157-58. The Supreme Court held that the capacity fee amounted to a special assessment or tax
8 and under the California Constitution and public entities are generally excepted from liability for
9 such charges absent specific statutory authorization. *Id.* at 168. In response, the California
10 Legislature passed Government Code section 54999 providing that, under certain circumstances,
11 such charges were not assessments, but capacity fees that could be levied against public entities.
12 Cal Gov. Code § 54999(b) (“The Legislature . . . finds that the holding in [*San Marcos*] should be
13 revised to authorize payment and collection of capital facilities fees . . .”). There is no reasonable
14 claim that MWD’s rates and charges are special assessments that cannot be levied against other
15 public entities unless they conform to the requirements set out in the *San Marcos* legislation.

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

22 1. Standard of Review

23 Even assuming *arguendo* that Section 54999.7 applied to wholesale water charges at all,
24 or applied to components of charges for water services as opposed to water service as a whole, or
25 applied where all customers are public agencies, the standard of review for SDCWA’s claim
26 would be the same as the standard described above under common law. *See* Section III.B.1. The
27 Government Code does not provide for a particular standard of review for claims under section
28 54999.7 and MWD is not aware of any case law specifying the standard of review for such

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

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

9 Likewise, section 54999.7(c) delegates to the public entity the task of determining rates
10 in the first instance that it will charge to public schools by using “appropriate industry
11 ratemaking principles” for “public agencies providing public utility service.” Cal. Gov. Code §
12 54999.7(c) (“A public agency providing public utility service shall complete a cost of service
13 study at least once every 10 years that addresses the cost of providing public utility service to
14 public schools. The study shall describe the methodology for the determination of cost
15 responsibility, which may be identified by reference to appropriate industry ratemaking
16 principles . . . [such as guidance] issued by the American Water Works Association or guidance
17 associated with other comparable industry principles recognized by public agencies providing
18 public utility service.”). Although the reference to “public schools” makes it obvious that this
19 statute has no application to wholesale providers such as MWD, the generalized reference to
20 “appropriate industry ratemaking principles” is another indicator that the traditional standard of
21 review applicable to public entities engaged in rate-setting is appropriate.

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

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

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

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

21 **2. Burden of Proof**

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

1 42 Cal.3d at 1180-81 (reasonableness “is the beginning and end of the judicial inquiry”).

2 **3. Evidence the Court Is Required to Evaluate**

3 **a. Scope of Allowable Evidence**

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

12 **b. Pertinent Administrative Record Documents**

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

21 **E. SDCWA’s California Water Code Claim (the “Wheeling Statute”)**

22 SDCWA alleges that MWD’s 2011/12 and 2013/14 water rates violate California’s
23 Wheeling Statute (Cal. Water Code §§ 1810-14) “because the rates [MWD] charges for
24 conveyance to [SDCWA] exceed ‘fair compensation’ for use of [MWD’s] system.” TAC ¶ 96;
25 2012 Complaint ¶ 98; *see also* TAC ¶¶ 72, 101; 2012 Complaint ¶ 73. The Wheeling Statute
26 govern the rates an agency sets for “wheeling,” which is a term for the conveyance of non-
27 agency water through the agency’s system. *See MWD v. IID*, 80 Cal. App. 4th at 1407.

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

1 transport (1) *non-MWD water*; (2) to *MWD’s member agencies*; (3) for a period of up to one
2 year. MWD Administrative Code §§ 4119, 4405.¹⁷

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

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

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

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

24
25 ¹⁷ The price for other wheeling transactions – wheeling for a duration of more than one year,
26 and/or wheeling to a party other than a MWD member agency – are negotiated on a one-to-one
27 contractual basis.

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

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

5 Third, the Wheeling Statute only allows bona fide transferors of water the right to use
6 70% of an agency’s conveyance facilities’ “*unused capacity*, for the period of time for which that
7 capacity is available.” Cal. Water Code §§ 1810, 1814 (emphasis added). This means that if an
8 agency, such as MWD, has no available capacity in its facilities, it is not obligated to provide
9 wheeling service. Under the Exchange Agreement, service to SDCWA is *uninterruptible*; MWD
10 is *obligated* to exchange IID water for Exchange Water and convey this Exchange Water to
11 SDCWA regardless of whether there is unused capacity or its level. And the Exchange
12 Agreement requires MWD to dedicate sufficient capacity in its facilities for the exchange for at
13 least 35 years, not just for the short term of a specific wheeling transaction. *See* TAC, Ex. A.

14 **1. Standard of Review**

15 The Wheeling Statute has a “substantial evidence” standard of review. Cal. Water Code
16 § 1813. Under the Wheeling Statute, no “public agency may deny a bona fide transferor of water
17 the use of a water conveyance facility which has unused capacity, for the period of time for
18 which that capacity is available, if fair compensation is paid for that use” Cal. Water Code §
19 1810. “Fair compensation” is defined as “the reasonable charges incurred by the owner of the
20 conveyance system, including capital, operation, maintenance, and replacement costs, increased
21 costs from any necessitated purchase of supplemental power” *Id.* § 1811(c). In making the
22 determinations required by the Wheeling Statute, the “public agency shall act in a reasonable
23 manner consistent with the requirements of law to facilitate the voluntary sale, lease, or exchange
24 of water and shall support its determinations by written findings.” *Id.* § 1813. “[T]he court shall
25 sustain the determination of the public agency if it finds that the determination is supported by
26 substantial evidence.” *Id.* Therefore, in sum, the Wheeling Statute inquiry is reasonableness.

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

1 81 Cal. App. 4th 1044, 1051 (2000) (under the Wheeling Statute, determination of fair
2 compensation constitutes an act of discretion and “[m]andate may not order the exercise of
3 discretion in a particular manner unless discretion can be lawfully exercised only one way under
4 the facts.”); *MWD v. IID*, 80 Cal. App. 4th at 1425, 1428 (“The water conveyance facility owner,
5 in this case the Metropolitan Water District, is specifically authorized to determine what is ‘fair
6 compensation’ provided the determination is made in a timely and reasonable manner” and
7 “[t]he construction of the Wheeling Statute by the Metropolitan Water District is entitled to great
8 weight and respect.”) (citations omitted).

9 As with the arbitrary and capricious standard, the substantial evidence standard is “highly
10 deferential.” *Western States*, 9 Cal.4th at 572. Indeed, the two standards are nearly identical in
11 practice; they both require a reasonable basis for an agency decision. *See id.*(under substantial
12 evidence standard a court’s review is limited to evaluating an administrative decision based on
13 whether it was “rational in light of the evidence before the agency” and not “whether it was the
14 wisest decision given all the available scientific data”); *Golden Drugs Co., Inc.*, 179 Cal. App.
15 4th at 1467 (“we recognize that not everyone acknowledges a distinction between ‘devoid of
16 evidentiary support’ and ‘substantial evidence’”) (citations omitted); *Warmington Old Town*
17 *Assocs. v. Tustin Unified Sch. Dist.*, 101 Cal. App. 4th 840, 850 (2002) (upon reviewing a quasi-
18 legislative action of the School District, court held that “the inquiry into arbitrariness or
19 capriciousness is like substantial evidence review in that both require a reasonable basis for the
20 decision.”); *Balch Enters. v. New Haven Unified Sch. Dist.*, 219 Cal. App. 3d 783, 792 (1990)
21 (court could see “no way, however, that [the arbitrary and capricious] determination can be
22 distinguished from application of the substantial evidence rule as applied in administrative
23 mandamus actions — in either case the question is whether there was a reasonable basis for the
24 decision”).

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

1 **2. Burden of Proof**

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

10 **3. Evidence the Court Is Required to Evaluate**

11 **a. Scope of Allowable Evidence**

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

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

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

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

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

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

5 **b. Pertinent Administrative Record Documents**

6 The Water Code requires only that MWD’s charges for wheeling be “reasonable charges”
7 that MWD set in a “reasonable manner” supported by written findings. Cal. Water Code §§
8 1811, 1813. As discussed, no specific wheeling transaction is at issue here. When MWD
9 adopted its general wheeling rate, it made written findings that supported that rate’s
10 reasonableness. *See e.g.*, 2010/2012 Records Document No. 82. MWD’s wheeling rate in the
11 abstract consists of the System Access Rate and Water Stewardship Rate (which, as explained
12 previously, were adopted in 2001 and first implemented in 2003), and the actual cost of power
13 for a particular wheeling transaction (if the party does not provide its own power). MWD
14 Administrative Code § 4405(b). The evidence in the administrative record, discussed above in
15 Section III.B.3.b demonstrates that MWD’s allocation of SWP costs to MWD’s System Access
16 Rate, and the calculation of that rate and the Water Stewardship Rate based on quantities of
17 water conveyed, took years of reasoned analysis, and was reasonable.

18 **F. SDCWA’s Constitutional Claims**

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

22 **1. Article XIII A (Proposition 13)**

23 SDCWA alleges that MWD’s 2011/12 and 2013/14 water rates violate Article XIII A and
24 Proposition 13’s implementing statute, Government Code section 50076, because those rates do
25 not charge the “reasonable cost of providing the service . . . for which the fee is charged” and,
26 accordingly, are taxes and required a two-thirds vote in order to be enacted. *See, e.g.*, TAC ¶¶
27 69; 82, 95; 2012 Complaint ¶¶ 68, 96. Proposition 13 added Article XIII A to the California
28 Constitution for the purpose of limiting rising property taxes. Section 4 of Proposition 13

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

9 As with SDCWA’s Government Code claim, its Proposition 13 claim fails at the outset
10 because MWD’s water rates fall outside the scope of Proposition 13. *See Brydon*, 24 Cal. App.
11 4th at 194 (“[I]f the fee is not the type of exaction which article XIII A was designed to reach,
12 then resort to sections 50075-50077, the enabling legislation for the article, is unnecessary.”)
13 Two courts have held that water rates fall outside Proposition 13. *See Brydon*, 24 Cal. App. 4th
14 at 194-95; *Rincon*, 121 Cal. App. 4th at 822. And SDCWA cannot plausibly deny this, although
15 it has attempted to do so in these actions. SDCWA itself successfully argued before the Court of
16 Appeal that Proposition 13 does not apply to water rates, and obtained a published opinion with
17 that holding that is now conclusive here. *See Rincon*, 121 Cal. App. 4th at 821-22.¹⁹

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

25
26 _____
27 ¹⁹ Remarkably, in response to this definitive impediment, SDCWA’s counsel previously told this
28 Court that merely that it was entitled to take different positions in different cases. *See 7/2/2012*
Tr. at 57:4-13 (SDCWA contended that MWD is “wrong” in asserting that by making “one
argument in the *Rincon* case in 2004. . . now [SDCWA] can’t make a different argument”).

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

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

13 The specific question in *Rincon* was whether SDCWA could have a “postage stamp”
14 transportation rate, like MWD does, *i.e.*, a flat dollar rate for each acre-foot of water transported,
15 regardless of distance or which portions of the transportation infrastructure available to MWD
16 were used. *Id.* at 816. In answering this question, the court recognized the traditional distinction
17 between water rates (which are a commodity charge) and special assessments (which are a tax).
18 Under California case law, “water rates are considered user or commodity charges because they
19 are based on the actual consumption of water.” *Id.* at 819. The court explained that “user rates
20 are functionally distinct from special assessments, which are compulsory charges levied against
21 certain properties for public improvements that directly or indirectly benefit the property owner
22 and are not related to the use of the public improvement.” *Id.* “It also reasoned that “the power
23 to set water rates comes from the public agency’s proprietary and quasi-public capacity, while
24 the power to impose special assessments or other capital charges derives from the taxing power.”
25

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

1 *Id.* (citations omitted).

2 The court then addressed Proposition 13 directly. The plaintiff challenging SDCWA’s
3 transportation rate argued that the rates covering certain capital costs had to be deemed a special
4 tax rather than a user fee “in order to adhere to the spirit of Proposition 13.” *Id.* at 821. The
5 court rejected that argument, *holding that Proposition 13 does not apply to water rates. Id.* at
6 821-22. The court quoted at length from *Brydon*, and reasoned that “[a]lthough the
7 transportation rate is a postage stamp rate rather than a block rate . . . we find the analysis in
8 *Brydon* compelling. *The transportation rate was not designed to replace property tax revenue*
9 *lost due to Proposition 13 nor is there any indication the Legislature intended to revise the*
10 *statutory scheme governing water rates.” Id.* at 822 (emphasis added).²¹

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

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

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

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

7 **a. Standard of Review**

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

17 In determining whether a fee exceeds the reasonable cost of the service, California courts
18 ignore whether the fee charged to the user is proportional to the benefit received by that user or
19 the burden that user’s conduct imposes on the system. A “fee does not become a tax simply
20 because the fee may be disproportionate to the service rendered to individual payors. The
21 question of proportionality is not measured on an individual basis. Rather, it is measured
22 collectively, considering *all* rate payors.” *Id.* (emphasis added); *see also Rincon*, 121 Cal. App.
23 4th at 823 (holding that water rates need not be proportionate to the specific burden caused by
24 particular rate payors, because “when the Legislature intends a fee be based upon a particular
25 user’s burden on the facility, it has stated that intention clearly”); *Griffith v. Pajaro Valley Water*
26 *Mgmt. Agency*, Nos. H038087, H038264, 2013 Cal. App. LEXIS 822, at *26-27 (Cal. App. 6th

1 Dist. Oct. 15, 2013) (in the Proposition 218 context²², Court of Appeal stated that
2 “[a]pportionment is not a determination that lends itself to precise calculation” and a
3 proportionality requirement does not compel a “parcel-by-parcel proportionality analysis.”). In
4 *Griffith*, the Court held that where, as here, a proposition prescribes no particular method for
5 apportioning a fee other than that the amount shall not exceed the proportional cost of the
6 service, grouping similar users together for the same rate and charging them according to usage
7 is a reasonable way to apportion the cost of service. *Griffith*, 2013 Cal. App. LEXIS 822, at *27
8 (“That there may be other methods favored by plaintiffs does not render defendant’s method
9 unconstitutional.”).

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

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

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

1 **b. Burden of Proof**

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

20 **c. Evidence the Court Is Required to Evaluate**

21 **(1) Scope of Allowable Evidence**

22 As with the other rate challenges claims discussed above, because SDCWA’s Proposition
23 13 claim challenges the quasi-legislative act of rate setting, the Court’s review of evidence is
24 limited to the administrative records in the *2010* and *2012 Actions* and should exclude extra-
25 record documents and fact and expert witness testimony. *See* Section III.B.3.a.

26 **(2) Pertinent Administrative Record Documents**

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

1 reasonable relationship to the costs they recover.

2 As noted above, charges can be considered “taxes” subject to Proposition 13 only when
3 the revenue they generate exceeds the reasonable cost of the service, for which they were
4 imposed in the aggregate, or in other words, measuring all rate payors together. MWD’s rate-
5 setting process ensures that this does not happen. The evidence shows that MWD’s rates are set
6 at a level designed to recover costs. When determining the amounts of the water rate elements,
7 MWD first estimates its revenue requirements for the coming fiscal year, which it then allocates
8 to different operation functions. *See, e.g.*, 2010/2012 Records Document No. 599; 2012 Record
9 Document No. 944. MWD’s allocation of costs to operation functions makes sure that MWD’s
10 rates generate revenue to pay for related expenses. *See* 2010/2012 Records Document No. 599;
11 2012 Record Document No. 944 (MWD uses functional allocation to “correlate charges for
12 different types of service with the costs of providing those different types of service”). Then
13 MWD uses these operation functions to assign costs to various cost classifications, and finally
14 the rate components to which they relate. 2010/2012 Records Document No. 599; 2012 Record
15 Document No. 944. MWD’s rate component allocations are designed to “fully recover” the cost
16 of service for that fiscal year. 2010/2012 Records Document No. 599; 2012 Record Document
17 No. 944.²³

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

25 ²³ California case law specifically sanctions this approach. *See Griffith*, 2013 Cal. App. LEXIS
26 822, at *24-25 (Court rejected plaintiff’s argument that defendant “improperly ‘worked
27 backwards’” by following a revenue-requirement model like the one MWD follows. Further, the
28 court stated that following this approach was recommended by the American Water Works
Association Manual, which does not offend the proportionality requirement in Proposition 218.).

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

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

3 SDCWA alleges that MWD's 2013/14 water rates²⁴ violate Article XIII C, Section 1
4 because they meet that section's definition of "tax" and were not approved by a two-thirds vote.
5 *See, e.g.*, 2012 Complaint ¶ 56. It is SDCWA's position that MWD's 2013/14 water rates are
6 special taxes because they exceed the costs MWD bears to provide services to its member
7 agencies and because MWD allegedly misclassifies various supply-related costs as
8 transportation. *Id.* at ¶ 58. Article XIII C defines the "tax" that requires two-thirds voter
9 approval as "any levy, charge, or exaction of any kind imposed by a local government," and
10 states seven exceptions to its application. *See* Cal. Const. art. XIII C, § 1(e)(1)-(7).

11 As MWD explained in its recent briefing on Article XIII C, the provisions added by
12 Proposition 26 are inapplicable to MWD's water rates because MWD's rates are not taxes
13 subject to Proposition 26 for two separate reasons: (1) the rates are not "imposed"; and (2) even
14 if they were, MWD's rates fall within two exceptions to Proposition 26. Moreover, as also
15 previously briefed, even assuming *arguendo* that MWD's rates were subject to Proposition 26,
16 Proposition 26 has been satisfied because the rates were approved by 2/3 of the relevant
17 electorate. *See generally* Memorandum of Points and Authorities in Support of MWD's Motion
18 for Judgment on the Pleadings; MWD's Reply in Support of its Motion for Judgment on the
19 Pleadings. While the Court denied MWD's motion, it did so on procedural grounds and because
20 it found that the applicability of Proposition 26 depends on factual issues. *See* September 19,
21 2013 Order at 3; 9/18/2013 Tr. at 9:9-15 ("[T]here are a lot of factual issues that still remain. . .
22 and it's very possible that Metropolitan will win on some of these or all of these issues. But
23 there are factual issues. . . so I can't grant the motion today."). While MWD believes the
24 inapplicability of Proposition 26 and the fact that MWD satisfied the requisite vote are legal
25 questions based on judicially noticeable facts, as set forth in MWD's prior briefing, MWD will

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

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

4 **a. Standard of Review and Burden of Proof**

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

15 At trial, MWD intends to prove (a) that its water rates do not fall under the definition of
16 taxes because they are not “imposed,”; and (b) even if the water rates were imposed, the rates are
17 excepted from the definition of taxes for two separate reasons: because they are charges for the
18 purchase or use of “local government property” (Cal. Const. art. XIII C, § 1(e)(4)) and because
19 they are charges imposed for a specific government service provided directly to the payor and
20 which do not exceed the reasonable costs of providing the service (Cal. Const. art. XIII C, §
21 1(e)(2)). Moreover, at trial MWD intends to prove that even assuming *arguendo* its rates are
22 considered a tax under Proposition 26 (which they are not), its rates satisfy Proposition 26
23 because they were approved by 2/3 of the relevant electorate: the MWD Board of Directors.
24 Pursuant to Article XIII C, Section 1, it is only under exception (e)(2) that MWD is required to
25 prove its water rates are reasonable by a preponderance of the evidence.

26 An unnumbered paragraph of Article XIII C, § 1(e) which provides the preponderance of
27 the evidence burden has *no effect* on the exceptions that do not contain a reasonableness
28

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

10 To establish the exception provided in Article XIII C section 1(e)(2), MWD must prove
11 by a preponderance of the evidence that the “fees are imposed to cover the cost of performing
12 [the service provided].” *Griffith*, 207 Cal. App. 4th at 997; *see also* Cal. Const. art. XIII C, §
13 1(e)(2) (under this exception, MWD bears the burden of proving by a preponderance of the
14 evidence that its water rates (1) are no more than necessary to recover the reasonable costs of
15 providing the service and (2) that the manner in which the costs were allocated bears a fair or
16 reasonable relationship to the burden on or benefits received from the service provided).

17 In *Griffith*, a landlord filed a petition for writ of mandate seeking to invalidate an
18 ordinance enacted by the City of Santa Cruz which called for annual inspections of residential
19 rental properties, arguing, among other things, that the ordinance imposed a tax in violation of
20 Proposition 26. *Id.* at 987. In evaluating the ordinance under Proposition 26, the court applied
21 the holdings in *Cal. Farm Bureau Federation v. State Water Resources Control Bd.* (“*Cal. Farm*
22 *Bureau*”), 51 Cal.4th 421 (2011), which addressed Proposition 13. *Id.* at 996-97. While *Cal.*
23 *Farm Bureau* did not concern Proposition 26 directly, the *Griffith* court found its analysis
24

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

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

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

11 California case law “suggest[s] a flexible assessment of proportionality within a broad
12 range of reasonableness in setting fees.” *Equilon Enters. LLC v. State Bd. of Equalization*, 189
13 Cal. App. 4th 865, 882 (2010) (citations omitted). It does not matter for purposes of the
14 apportionment requirement that a challenger can propose an alternative better suited to a fee’s
15 purposes as long as an agency’s apportionment of costs among payers is reasonable in light of
16 the fee’s purpose. *Id.* at 882-86 (Court rejected plaintiff gasoline company’s argument that its
17 allocation of a lead program fee was unreasonable because the majority of childhood lead
18 poisoning comes from paint, not gasoline, because the fee allocation was directed at addressing
19 childhood lead exposure, not just poisoning, and thus the fee did not need to be allocated based
20 on responsibility for lead contamination.); *see also Griffith v. City of Santa Cruz*, 207 Cal. App.
21 4th 982, 997 (2012) (court found city satisfied the reasonableness requirements of Proposition 26
22 because fees imposed on rental property owners pursuant to a new ordinance were equal to or
23 less than the cost of implementing the ordinance); *Griffith*, 2013 Cal. App. LEXIS 822, at *26-27
24 (court of appeal stated that “[a]pportionment is not a determination that lends itself to precise
25 calculation” and a proportionality requirement does not compel a “parcel-by-parcel
26 proportionality analysis.”).

1 **b. Evidence the Court Is Required to Evaluate**

2 **(1) Scope of Allowable Evidence**

3 The Court is limited to review of solely the administrative record when addressing
4 whether MWD’s rates and charges comply with Proposition 26. As discussed, it is well
5 established that the Court’s inquiry into the reasonableness of MWD’s rates and charges is
6 limited to review of the administrative record because, as with SDCWA’s other rate challenges,
7 SDCWA’s Proposition 26 claim challenges the quasi-legislative act of rate setting through a
8 mandamus proceeding. *See, e.g., Western States*, 9 Cal. 4th at 573, 576; *Coachella Valley Unif.*
9 *Sch. Dist. v. State of Cal.*, 176 Cal. App. 4th 93, 117 (2009); *Shapell Indus.*, 1 Cal. App. 4th at
10 233-34. Although Proposition 26 changed the traditional rule concerning which party bears the
11 burden of proof under certain circumstances (as relevant here, the determination regarding the
12 applicability of exception (e)(2)), the Proposition says nothing about altering the rule that review
13 of a quasi-legislative agency decision is limited to the administrative record. Where, as here,
14 there is no clear indication that a new law was meant to change an established rule, the existing
15 rule should stand. *See Aryeh v. Canon Business Solutions, Inc.*, 55 Cal. 4th 1185, 1193 (2013)
16 (laws “should not be interpreted to alter the common law, and should be construed to avoid
17 conflict with common law rules . . . unless [a law’s] language clearly and unequivocally
18 discloses an intention to depart from, alter, or abrogate the common-law rule”) (citations
19 omitted).

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

24 **(2) Pertinent Administrative Record Documents**

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

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

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

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

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

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

22 **IV. STANDARD OF REVIEW, BURDEN OF PROOF, AND**
23 **ADMISSIBLE EVIDENCE FOR THE RATE STRUCTURE**
24 **INTEGRITY PROVISION CLAIM (FIFTH CAUSE OF ACTION IN**
25 **2010 ACTION)**

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

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

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

19 **A. Standard of Review and Burden of Proof**

20 SDCWA’s fifth cause of action asserts civil claims for declaratory relief regarding the
21 RSI provision included in project contracts between MWD and SDCWA. As such, it does not
22 involve any separate standard of review. Rather, the burden of proof that applies to SDCWA’s
23 RSI provision challenge is the same as with regard to any civil claim: as the plaintiff, SDCWA
24 bears the burden of proving its claims by a preponderance of the evidence. Cal. Evid. Code
25 §§ 115 & 500.

26 **1. Legal Standard Applicable to SDCWA’s Unconstitutional Conditions**
27 **Claim**

28 SDCWA bears the burden of establishing that the unconstitutional conditions doctrine

1 applies to the RSI provision and to SDCWA. Specifically, SDCWA must show that (1) it is a
2 potential recipient of a “public benefit” to which the unconstitutional conditions doctrine applies;
3 (2) the RSI provision implicates a constitutional right enjoyed by SDCWA; and (3) the RSI
4 provision impinges on that constitutional right. *See Sanchez v. Cnty. of San Diego*, 464 F.3d
5 916, 930-31 (9th Cir. 2006) (“A plaintiff alleging a violation of the unconstitutional conditions
6 doctrine, however, must first establish that a constitutional right is infringed upon.”) (citing
7 *Parrish v. Civil Service Comm’n of the County of Alameda*, 66 Cal. 2d 260 (1967)).

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

18 2. Legal Standard Applicable to SDCWA’s Section 1668 Claim

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

24 B. Evidence the Court Is Required to Evaluate

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

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

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

10 **1. The Unconstitutional Conditions Doctrine Does Not Apply Here**

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

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

17 It is undisputed that SDCWA is a public agency. As such, it does not enjoy a
18 constitutional right to petition the courts.²⁶ As the California Supreme Court has held, certain
19 provisions of the state and federal constitutions confer “fundamental rights on individual
20 citizens,” not on units of the government. *Star-Kist Foods, Inc. v. Cnty. of Los Angeles*, 42 Cal.
21 3d 1, 8 (1986) (quoting *San Diego Unified Port Dist. v. Gianturco*, 457 F. Supp. 283, 290
22 (1978)). These types of constitutional rights, “which are intended to limit governmental action
23 vis-à-vis individual citizens,” cannot be asserted by political subdivisions, such as SDCWA. *Id.*
24 Indeed, Article I, section 3, of the California Constitution explicitly provides, “The *people* have
25 the right to instruct their representatives, petition government for redress of grievances, and
26 assemble freely to consult for the common good.” Cal. Const. Art. I, § 3(a) (emphasis added).
27 Neither this section nor any other section within Article I makes any reference to government

28 ²⁶See MWD’s Motion for Summary Adjudication, at 7-9.

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

4 **b. Payments Made by MWD Under the Project Contracts Are**
5 **Not “Public Benefits” to Which the Unconstitutional**
6 **Conditions Doctrine Applies**

7 Payments by MWD to its member agencies pursuant to LRP, CCP, and SDP project
8 contracts are not “public benefits” protected by California’s unconstitutional conditions
9 doctrine.²⁸ These payments are distinguishable from the “public benefits” at issue in California’s
10 unconstitutional conditions cases. As the California Supreme Court has recognized, the
11 unconstitutional conditions doctrine is implicated when the government “implements a general
12 public benefit program.” *Comm. to Defend Reproductive Rights v. Myers*, 29 Cal. 3d 252, 269-
13 70 (1981). Specifically, the Court has held that the doctrine applies to such public benefits as
14 “access to a public forum, public employment, welfare benefits, public housing, unemployment
15 benefits, or the use of public property.” *Id.* at 264.²⁹ There is no comparable “general public

16 ²⁷See *Star-Kist Foods*, 42 Cal. 3d at 5-9 (discussing cases); *Native Am. Heritage Comm’n v. Bd.*
17 *of Trustees*, 51 Cal. App. 4th 675, 683 (1996) (rejecting first amendment claim asserted by one
18 state agency against another); *San Miguel Consol. Fire Prot. Dist. v. Davis*, 25 Cal. App. 4th
19 134, 143-45 (1994) (holding special fire and municipal improvement districts had no standing to
20 challenge provisions of revenue and tax code on equal protection, due process, or other
21 constitutional grounds); *Bd. of Supervisors v. McMahon*, 219 Cal. App. 3d 286, 296-97 (1990)
22 (dismissing county’s due process challenge to state welfare statute); see also *S. Lake Tahoe v.*
23 *Cal. Tahoe Reg’l Planning Agency*, 625 F.2d 231, 233 (9th Cir. 1980) (holding city had no
24 standing to assert takings and due process challenge to regional transportation plan); *Santa*
25 *Monica Cmty. Coll. Dist. v. Pub. Emp’t Relations Bd.*, 112 Cal. App. 3d 684, 690 (1980) (citing
26 “long line of cases” holding that a public entity, being a creature of the state, is not a “person”
27 within the meaning of the due process clause); *Cnty. of Los Angeles v. Super. Ct. of Alameda*
28 *Cnty*, 128 Cal. App. 522, 526 (1933) (“the county is not a ‘person’ within the meaning of either
the federal or the state Constitution”); *Riley v. Stack*, 128 Cal. App. 480, 484 (1933) (same).

²⁸See MWD’s Motion for Summary Adjudication, at 9-11.

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

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

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

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

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

28 ³⁰*See* MWD’s Motion for Summary Adjudication, at 11-13.

1 Cal. App. 3d 739, 753-54, (1980); *Saret-Cook v. Gilbert, Kelly, Crowley & Jennett*, 74 Cal. App.
2 4th 1211, 1226 (1999) (“[V]oluntary acceptance of the benefit of a transaction is equivalent to a
3 consent of all the obligations arising from it.”). Purported constitutional rights, including the
4 right to petition, may be waived upon clear and convincing evidence that the waiver was
5 knowing, voluntary, and intentional. *D. H. Overmyer Co. v. Frick Co.*, 405 U.S. 174 (1972);
6 *Miller*, 100 Cal. App. 3d at 753-54 (“Waiver is the voluntary and intentional relinquishment of a
7 known right.”).³¹

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

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

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

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

8 **2. The Evidence Demonstrates the Validity of the RSI Provision Under**
9 **California’s Unconstitutional Conditions Doctrine**

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

13 Not all restrictions on a constitutional right rise to the level of an “unconstitutional
14 condition.” *See, e.g., Lee*, 129 Cal. App. 3d at 13-14; *Norton v. City of Santa Ana*, 15 Cal. App.
15 3d 419, 426-27 (1971). Indeed, courts have consistently recognized that the “government may,
16 when circumstances inexorably so require, impose conditions upon the enjoyment of publicly
17 conferred benefits despite a resulting qualification of constitutional rights.” *Lee*, 129 Cal. App.
18 3d at 13-14; *Norton*, 15 Cal. App. 3d at 426-27. In particular, restrictions on the exercise of
19 constitutional rights in the context of a commercial transaction, where the relinquishment of
20 rights constitutes consideration under the associated contract, are fundamentally different from
21 restrictions in other contexts. As the evidence will demonstrate, the elements of California’s
22 unconstitutional conditions test are satisfied here.

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

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

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

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

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

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

1 protect the very existence of those programs.

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

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

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

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

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

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

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

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

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

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

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

16 This is precisely the kind of condition California courts have found permissible. *See Lee*,
17 129 Cal. App. 3d at 13-14. *Lee* is instructive. There, a civil service worker employed by the
18 county department of public social services decided to run for state senate and was fired as a
19 result. *Id.* at 10-11. The county fired Lee because, under the Hatch Act (5 U.S.C. § 1501 *et*
20 *seq.*), his participation in the election threatened the department's continued federal funding. *Id.*
21 Specifically, the Hatch Act provides that a local agency may be faced with a withdrawal of
22 federal funds unless it discharges an employee found to be in violation of the Act. *Id.* Because
23 Lee's participation in the election threatened the department's funding, the benefit of the
24 condition was found to manifestly outweigh the restriction imposed on Lee's right to run for
25 office. *Id.* at 13-14. As the court explained, California courts have "recognized the right of
26 governmental agencies to preserve their harmonious operation by restricting such political
27 activities as directly threaten administrative disruption or loss of integrity." *Id.*

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

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

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

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

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

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

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

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

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

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

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

23 As more fully briefed in conjunction with MWD’s Motion for Summary Adjudication,
24 SDCWA’s claim that the RSI provision violates California Civil Code section 1668 is entirely
25 without merit. Section 1668 “invalidates contracts that purport to *exempt* an individual or entity
26 from liability” for certain tortious or unlawful acts. *Frittelli, Inc. v. 350 N. Canon Drive, LP*,
27 202 Cal. App. 4th 35, 43 (2011) (emphasis added). Accordingly, courts have routinely voided
28 express contractual provisions discharging a party from liability. *See City of Santa Barbara v.*

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

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

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

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

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

1 regarding MWD’s “preferential rights” calculations under section 135 of the MWD Act. (TAC
2 ¶¶ 112-115.) SDCWA alleges that MWD has improperly calculated its preferential right because
3 MWD does not include SDCWA’s payment of volumetric water rates for the purchase of
4 water—which is expressly excluded from the preferential rights calculation by section 135—
5 under the 2003 Exchange Agreement. According to SDCWA, these payments do not constitute
6 payments for the “purchase of water” and should therefore be included in calculating its
7 preferential right. SDCWA seeks a judicial declaration that MWD’s current method for
8 calculating SDCWA’s preferential right violates section 135, and an order directing MWD to
9 include in the calculation SDCWA’s payments under the 2003 Exchange Agreement. (TAC,
10 Prayer for Relief at ¶ 6.)

11 **A. Standard of Review and Burden of Proof**

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

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

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

9 **B. Evidence the Court Is Required to Evaluate**

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

19 **1. MWD’s Method of Calculating Preferential Rights Is Valid, and**
20 **SDCWA Is Collaterally Estopped from Arguing Otherwise**

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

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

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

5 After an extensive interpretive analysis of section 135, including review of section 135’s
6 text, purpose, statutory context, and Legislative history³³ and intent, the Court of Appeal
7 interpreted section 135 to mean that all components of MWD’s “charge for the ‘purchase of
8 water’ to its members may include amounts allocated for capital costs and operating expenses.”
9 *SDCWA v. MWD*, 117 Cal. App. 4th at 26. The court held that “the statute excludes from the
10 preference formula any amount of capital costs and operating expenses which might be included
11 as part of the ‘purchase of water.’” *Id.* The court specifically “reject[ed] San Diego’s
12 interpretation of the phrase ‘purchase of water’ as being intended to mean only ‘the cost of the
13 water resource,’ and not the ‘bundled’ charge for water inclusive of capital costs and operating
14 expenses.” *Id.* at 17, 26. The court rejected SDCWA’s “attempt to draw any meaningful
15 distinction between the Water Code’s use of the alternative phrases ‘water rates’ (which
16 [SDCWA] argues can include capital and operating costs) and the ‘purchase of water.’” *Id.* at 26
17 n.6. The court further held that “the Legislature’s inclusion of the language ‘excepting purchase
18 of water’ supports the evident purpose of *excluding any portion of water rates* used to pay capital
19 costs and operating expenses from the formula for calculating preferential rights.” *Id.* at 28
20 (emphasis added). In short, *SDCWA v. MWD* adopted MWD’s interpretation and application of
21 section 135, which is the same interpretation at issue here.

22 **b. SDCWA’s “Water Rate” Payments Under the Exchange**
23 **Agreement Are Properly Excluded in Calculating Its**
24 **Preferential Right**

25 SDCWA will be unable to establish that MWD’s method for calculating preferential
26 rights is invalid. SDCWA admits that it pays MWD’s “water rates,” specifically three

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

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

5 SDCWA contends, however, that its payments for Exchange Water under the 2003
6 Exchange Agreement should be included in calculating its preferential right because it is not
7 purchasing the “supply” of water from MWD and is paying only the transportation rate MWD
8 charges its member agencies for transportation in its unbundled rate structure. *See* TAC ¶¶ 61-
9 63, 113. But SDCWA’s fallacy is its attempt to equate “purchase of water” under section 135
10 with MWD’s “supply” rates. *Id.* (referring to “purchase of water’ (i.e., supply)”). *SDCWA v.*
11 *MWD* expressly rejected that interpretation. “[P]urchase of water” in section 135 is not limited
12 to payments for the “direct purchase of water”; rather, it includes all portions of “water rates”—
13 regardless of whether the rate is used to pay for “supply” or for MWD’s other capital costs and
14 operating expenses. For purposes of section 135 under *SDCWA v. MWD*, whether SDCWA’s
15 water rate payments pay for “supply” costs, *i.e.*, the cost of the water resource, or the costs of
16 conveying water, *does not matter*: Any payment by SDCWA of “water rates” constitutes
17 “purchase of water” under section 135. SDCWA’s interpretation of section 135 is wrong as a
18 matter of law and has already been rejected by *SDCWA v. MWD*.

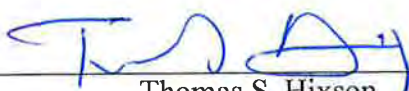
19 There is no material difference between *SDCWA v. MWD* and this action.³⁴ To the extent
20 SDCWA argues that its claim here involves payments for the “transportation” of Exchange
21 Water under the Exchange Agreement rather than payments for the purchase of MWD water,
22 that is a distinction without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

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

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

7
8 DATED: October 18, 2013

Bingham McCutchen LLP

9
10 By: 
11 Thomas S. Hixson
12 Attorneys for Respondent and Defendant
13 Metropolitan Water District of Southern
14 California
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28

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

3 **PROOF OF SERVICE**

4 I am over eighteen years of age, not a party in this action, and employed in San
5 Francisco County, California at Three Embarcadero Center, San Francisco, California 94111-
6 4067. I am readily familiar with the practice of this office for collection and processing of
7 correspondence for mail/fax/hand delivery/next business day Federal Express delivery, and they
8 are deposited that same day in the ordinary course of business.

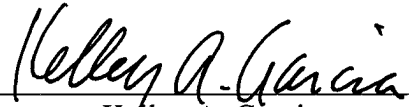
9 On October 18, 2013, I served the attached:

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

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

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

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

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21 Kelley A. Garcia

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3 **PROOF OF SERVICE**

4 I am over eighteen years of age, not a party in this action, and employed in San
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