KEKER & VAN NEST LLP
JOHN W. KEKER - # 49092
jkeker@kvn.com
DANIEL PURCELL - # 191424
dpurcell@kvn.com
DAN JACKSON - # 216091
djackson@kvn.com
WARREN A. BRAUNIG - # 243884
wbraunig@kvn.com
633 Battery Street
San Francisco, CA 94111-1809
Telephone: 415 391 5400
Facsimile: 415 397 7188

DANIEL S. HENTSCHKE - # 76749
General Counsel
SAN DIEGO COUNTY WATER AUTHORITY
4677 Overland Avenue
San Diego, CA 92123-1233
Telephone: (858) 522-6791
Facsimile: (858) 522-6566

Attorneys for Petitioner and Plaintiff
SAN DIEGO COUNTY WATER AUTHORITY

EXEMPT FROM FILING FEES
[GOVERNMENT CODE § 6103]

SUPERIOR COURT OF THE STATE OF CALIFORNIA

IN AND FOR THE COUNTY OF SAN FRANCISCO

SAN DIEGO COUNTY WATER AUTHORITY,

Petitioner and Plaintiff,

v.

METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA; ALL PERSONS INTERESTED IN THE VALIDITY OF THE RATES ADOPTED BY THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA ON APRIL 13, 2010 TO BE EFFECTIVE JANUARY 2011; and DOES 1-10,

Respondents and Defendants.

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

SAN DIEGO'S POST-TRIAL BRIEF

Date: January 23, 2014
Time: 9:00 a.m.
Dept.: 304
Judge: Hon. Curtis E.A. Karnow

Dates Filed: June 11, 2010
June 8, 2012
Trial Held: December 17-23, 2013

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

Federal Cases

State Cases

State Statutes and Other Authorities

I. INTRODUCTION

As San Diego indicated in its pretrial briefs, and the trial confirmed, the issues in this case can be distilled to one fundamental question: Is rate stability a lawful justification for Met's inclusion of water-supply and drought-insurance costs in its transportation rates, even though those costs are unrelated to the service of transporting water?[1] That is precisely the justification Met offered in its so-called "written findings," its January 1997 Board Resolution in support of its wheeling rates, in which it declared that it is "reasonable" to charge State Water Project ("SWP") supply costs to wheelers "in order to protect Metropolitan's member agencies from financial injury by avoiding the shifting of those costs from a wheeling party to Metropolitan's other member agencies." AR2010-2446 at 2449-50.[2] Especially after trial, it is undisputed that this is still Met's basis for the transportation rates it adopted in 2010 and 2012, which are the subject of this case. At trial, Met's counsel repeatedly emphasized that Met's allocation of SWP costs to its transportation rates dates back to the 1997 wheeling rate ***and is still based on the 1997***

[1] Like Met, San Diego uses the term "transportation rates" to refer to the System Access Rate, System Power Rate, and Water Stewardship Rate, which are purportedly "designed to recover the cost of transporting water to MWD's member agencies." Met's 2nd Pretrial Br. at 1. Because Met's wheeling rate, as defined in section 4405 of its Administrative Code, includes two of these "transportation rates" (the System Access and Water Stewardship rates), and because wheeling is the transportation of water, San Diego also uses "transportation rates" collectively to encompass the wheeling rate along with the other disputed rates. The price San Diego pays under the Exchange Agreement also consists of what Met calls its "transportation rates": the System Access, System Power and Water Stewardship rates. That much about the Exchange Agreement is undisputed. *See, e.g.*, Presentation filed Dec. 16, 2013 ("Met's Opening Slides") at 45. That said, San Diego agrees with Met that the Court should put the Exchange Agreement "aside" for present purposes because "the breach of contract action has been severed," Tr. at 134:8-18 (Hixson), though Met's counsel honored that principle in the breach more than the observance.

[2] Note that the phrase "shifting … costs," as Met uses it, is simply the inverse of "rate stability." In Met's idiosyncratic usage, the term "cost shifting" does not mean shifting costs from those who cause them to those who do not. On the contrary, Met's "findings" allocate self-described "supply" costs to the wheeling rate, though such costs admittedly are not caused by wheeling, in order to preserve rate stability in complete disregard of cost causation. AR2010-2446 at 2449. Met also refers to rate stability as the "hold harmless requirement." *See* AR2010-1222 at 1234.

Note also that "AR2010" and "AR2012" indicate that the document at issue is in the administrative record for the 2010 or 2012 case, respectively, and the numbers following the dash are the significant digits of the bates number. Because all of the documents in the 2010 record are also in the 2012 record, "AR2010-" citations refer to the administrative records for both cases; "AR2012-" citations are generally reserved herein for documents that are only found in the 2012 record. The bates number also discloses whether a document is in the 2012 record only or in both the 2010 and the 2012 records: documents with bates number 11575 and higher are only in the 2012 record; everything below that is in both.

"findings." *See* Presentation filed Dec. 23, 2013 ("Met's AR Slides") at 60-65, 126-29.

Met's reliance on its 1997 Board Resolution as "findings" to support its transportation rates is utterly misplaced. "This conclusory resolution, which does not contain any evidence or factual information, does not constitute substantial evidence" to support Met's rates. *City of Livermore v. Local Agency Formation Com.*, 184 Cal. App. 3d 531, 542 (1986). It constitutes the ***opposite***: dispositive evidence ***invalidating*** Met's transportation rates under every claim in this case, because it shows that those rates were—and, as Met concedes, still are—based on legal conclusions that are wrong as a matter of established law. *City of Palmdale v. Palmdale Water Dist.*, 198 Cal. App. 4th 926 (2011), held that rate stability is not a lawful basis for imposing rates that are disproportionate to the actual service provided. *See id.* at 937-38. And *San Luis Coastal Unified Sch. Dist. v. City of Morro Bay*, 81 Cal. App. 4th 1044 (2000), held that rate stability is an illegal justification for discouraging wheeling, as Met's wheeling rate indisputably does. *See id.* at 1050; *see also*, *e.g.*, AR2010-1222 at 1244-54 (Dec. 1995 RMI). Met simply ignored these dispositive cases, both in setting its rates and at trial.

At trial, as in the record, Met also appealed to rate stability as purported justification for including its so-called "Water Stewardship Rate"—which is really just a tax—in its transportation rates: "Placing WSR In Supply Would Permit Users That Only Use Transportation Services To Avoid These Costs." Met's AR Slides at 87. Met's singular and unlawful focus on rate stability is further shown by its "Rate Structure Integrity" clause, which it used to punish San Diego for filing this case by depriving it of any future "Water Stewardship" benefits, while still charging for those benefits on all water, even water San Diego buys from third parties. *See* AR2012-13083 at 13089. Met's only reason for this draconian measure was, again, rate stability—though, as this Court held, "there is no reason to see that as any sort of substantial benefit, and certainly not a *public* benefit." Dec. 4, 2013 Order at 19 (emphasis in original). Just as the Court found that Met's rate-stability argument "proves too much" in the context of San Diego's constitutional petitioning rights (given standing to assert them), *id.*, it also proves too much in the context of San Diego's constitutional, statutory and common-law rights to be charged rates that comport with the benefits it receives. *See Palmdale*, 198 Cal. App. 4th at 937-38; *Morro Bay*, 81 Cal.

App. 4th at 1050. Because San Diego has been banned from receiving any future "Water Stewardship" funds, its "benefits" are actually negative and going deeper into the hole by tens of millions of dollars every year.

Rate stability is also the reason for Met's unlawful refusal to even consider the disparate costs imposed by some member agencies' disproportionate reliance on Met water in dry years. The administrative record shows beyond any reasonable dispute that Met spends billions of dollars in order to accommodate dry-year peaking, and that some member agencies benefit far more than others from the drought insurance Met provides. Yet Met has refused to take even the smallest steps, recommended by its own staff, to ameliorate the disconnect between its transportation rates and the "dry year supply benefit[s]" that are charged to those rates even though they should be "assigned to the Supply function and recovered through Metropolitan's supply rates." AR2010-10753 at 10756-57. That change would have saved San Diego "less than $0.6M per year due to their wheeled and exchanged water," whereas "[o]ther agencies could pay more on the Supply rate." *Id.* at 10761. But Met's Board refused to reallocate even those relatively modest dry-year supply costs—a drop in the dry-year peaking bucket—to the supply rates, instead "directing staff to make no changes to the Cost-of-Service methodology…." AR2010-10779 at 10786. Again, rate stability prevailed—and continues to prevail—over the legal requirements that rates must not exceed the reasonable cost of service, must fairly apportion costs according to their causes and the benefits provided, and must facilitate wheeling.

In any event, whatever Met's reasons and regardless of its motives, its transportation rates are unlawful. No evidence supports Met's decision to allocate the vast majority of its SWP costs to its transportation rates. Met simply asserts, *ipse dixit*, that the SWP, owned and operated by the Department of Water Resources ("DWR"), is actually ***Met's conveyance system***, which is wrong as a matter of law and fact. Nor does the record in any way support Met's inclusion of 100% of its "Water Stewardship" costs for conservation and local water supply development programs in its transportation rates. Indeed, all documentary evidence and testimony indicates those programs generate primarily supply benefits. And, given the overwhelming record evidence that the costs of dry-year peaking are real, enormous, and disproportionately caused by

some member agencies, which thus enjoy drought insurance without paying the actual costs of it, Met's refusal to even try to allocate those costs to the member agencies that cause and benefit from them violates the constitution, numerous statutory provisions, and the common law.

For these reasons, and others proven at trial and explained further below, Met's transportation rates—*i.e.*, its System Access Rate, System Power Rate, Water Stewardship Rate, and wheeling rates—are illegal and this Court should invalidate them.

II. BACKGROUND

In its pretrial briefs, San Diego described the history of Met's rates and this lawsuit and discussed much of the relevant evidence, as well as the legal issues—some now resolved by the Court's pretrial rulings, but others that still remain to be decided. San Diego hopes those briefs will continue to be helpful to the Court, yet recognizes that the exhibits the briefs originally referred to, from San Diego's Appendix and Motion to Augment, have been superseded by trial exhibits and, in several instances, by Met's subsequent agreement to correct the 2012 administrative record. Accordingly, San Diego now provides updated versions of those briefs, changing the form of the citations but nothing else, as Attachments A & B to this brief.

Rather than repeat what is in those attachments, San Diego will focus here on what Met's presentation of the administrative record at trial confirms as the basis for its transportation rates. It is clear now that Met's rates are not based on its consultant George Raftelis's made-for-litigation 2010 "cost-of-service" report. Met's counsel was forced to admit that the crucial passage in Raftelis's report has ***no evidentiary value*** because June Skillman admitted that ***she***, not Raftelis, wrote that language in an attempt to justify the fateful decisions Met made back in 1997. *See* Tr. at 123:25-124:9. Thus, the actual basis for Met's decisions is found in the 1997 Resolution Met calls its "written findings." *See* AR2010-2446-51 (Resolution 8520). Met wholeheartedly agrees. Its counsel took pains to demonstrate that Met's decision to include SWP costs in its transportation rates dates back to those "findings," and that Met continues to rely on those "findings" for the transportation rates it adopted in 2010 and 2012, which are the subject of this case. *See* Met's AR Slides at 60-65, 126-29; *see also, e.g.*, Answer ¶ 3; Met's 1st Pretrial Br. at 53; Met's Reply Pretrial Br. at 15; Met's 2nd Pretrial Br. at 28-30. San Diego agrees that those

so-called "findings," and the record documents that underlie and explain them, are not merely historical background, but constitute the most direct evidence of the actual basis for the transportation rates at issue in this case: Met's "hold harmless" requirement that wheeling must not be allowed to have any "adverse impact upon rates and charges to any other member agency, now or in the future." AR2010-1069 at 1070.

This "hold harmless" requirement first appears in the administrative record in a September 26, 1995 "Board letter," which makes clear that this is the first, foremost, and ultimate "condition" for any "wheeling policy" Met might adopt. *See id.* Met asserted—incorrectly, as *Morro Bay* makes clear—that "[t]his is consistent with the statutory language providing that mandated water transfers may not result in injury (economic) to any legal user of water." *Id.* at 1072 (misquoting Water Code § 1810(d)); *see Morro Bay*, 81 Cal. App. 4th at 1050 ("the rate increase it claims its other customers will have to bear" because of wheeling is ***not*** "the sort of injury to a legal user of water the Legislature had in mind"). Attachment A to the Board letter went on to describe the "Equivalent Margin Method," which would ensure that "member agencies are protected from undesirable rate impacts by providing the same level of revenues to Metropolitan that a water sale would provide, less the avoided costs associated with not providing an increment of water. Since the cost of water to Metropolitan is essentially zero,"—which, by the way, is obviously false, as the record abundantly proves[3]—"avoided costs are basically electricity for pumping and some small charges on the SWP." *Id.* at 1081.

The next document in the record is the October 1995 RMI report. AR2010-1101-35. RMI also recommended the equivalent margin method, but left detailed discussion of it for its December report. *See id.* at 1107. In its October report, RMI recognized that the cost of water Met purchases "from other sources ***such as the State Water Project***" is a supply cost. *Id.* at 1104 (emphasis added); *see also id.* at 1112. RMI also recognized that "conservation costs" cannot simply be attributed to the transportation function; they should be attributed to "Source of

[3] *See, e.g.*, AR2010-1406 at 1491-92 ("Metropolitan may have to expend as much as $105 million in a single year to purchase up to 300,000 acre-feet of water transfers," and agrees to pay $250 per acre-foot for recycled water); AR2010-11245 at 11257 ("Available Water Supply Is Now the Limiting Force").

Supply" where that is "the nature of their primary benefits." *Id.* at 1106. "For example, the Ultra-Low Flush toilet program was primarily designed to achieve annual water savings, so the costs associated with that program would be treated as commodity-related and functionalized to Source of Supply." *Id.* at 1115; *cf.* Tr. at 94:14-24 (Met's counsel conceding that Met allocates those costs to its transportation rates instead). RMI also noted that, "[a]s a supplemental water supplier, Metropolitan's demands vary significantly from year to year and season to season, depending on weather." AR2010-1101 at 1126. This is a recurring theme, and lies at the heart of the dry-year peaking problem—Met's counterfactual suggestion that the problem is something San Diego invented for this litigation notwithstanding.

RMI's December 1995 report explained that Met's self-imposed "hold harmless" requirement—that wheeling "'**must not negatively impact the rates or charges to any other Member Agencies**'"—is "perhaps the single most important constraint on the pricing of wheeling services." AR2010-1222 at 1234 (emphasis in original). Indeed, of the four wheeling-rate options RMI analyzed—two of which resulted in what "[c]ould be perceived as a very reasonable rate for wheeling service"—RMI was forced to recommend the one yielding a wheeling rate that "could be perceived as excessive" because that was "the only rate method evaluated that would not give Member Agencies an economic incentive" to wheel, and thus was "the only rate method examined that would satisfy the requirement … that Member Agencies be 'held harmless' from any cost shifting due to wheeling." *Id.* at 1249-54. Notably, Met continues to rely on that reasoning, having quoted this very language from RMI's December 1995 Report in its Second Pretrial Brief as purported support for its "inclusion of SWP costs in MWD's general rate for wheeling service." Met's 2nd Pretrial Br. at 28-29.

The "rate method" Met cited approvingly in its Second Pretrial Brief as complying with the "hold harmless" principle, *id.*, is the one RMI referred to as "Option I." *See* AR2010-1222 at 1244-54. This is an "equivalent margin" rate because it would enable Met "to earn the same amount of fixed costs (or 'margin')" from wheelers—who, by definition, would not be purchasing a water supply from Met—as from member agencies purchasing both a Met water supply and the service of transporting it. *Id.* at 1225. Option I set the wheeling rate at the full-service water rate,

plus the Readiness to Serve ("RTS") charge, minus avoided costs. AR2010-1222 at 1244-45. Wheelers would therefore be charged all unavoidable costs, including "costs not incurred to provide wheeling service." *Id.* at 1249. This includes, in particular, "***fixed SWP costs***," "***Water Management/Conservation***" costs, and "***the cost of acquiring new dry-year water supplies***." *Id.* at 1245 n.15 & 1249 (emphases added). In other words, RMI recognized that ***all three categories of costs that San Diego is complaining about in this case are unrelated to wheeling, and are only included in the wheeling rate in order to satisfy Met's "hold harmless" requirement***. *See id.* Option I is essentially the rate Met adopted in 1997, except that the RTS charge is omitted from the adopted wheeling rate.[4]

Option II was to subtract "all SWP and CRA [Colorado River Aqueduct] supply costs from the firm sales rate." *Id.* at 1245. Note that—contrary to Met's contention at trial—this is not limited to the Delta Water Charge; it includes ***all*** SWP costs, including what DWR itemizes as its own transportation costs. *See id.* at 1234; AR2012-16288_1796 at 1893 (RMI May 1996 showing that the costs allocated as ***Met's*** supply costs in December 1995 include all SWP costs, including ***DWR's*** transportation costs); Tr. at 793:6-796:22 (same). Option III was the "very reasonable" incremental rate. AR2010-1222 at 1252. And Option IV was to charge that incremental rate "during periods when Metropolitan declared a supply shortage." *Id.* at 1247. As RMI recognized in connection with Option IV, it makes no sense at all for Met to charge wheelers for its fixed costs when wheeling is effectively compelled by a shortage in Met's own supplies. Because Met "would presumably have set its water rates to recover fixed and nonvariable costs based on expected deliveries"—which it has already made or committed, hence the shortage—"[a]dditional deliveries of non-Metropolitan water obtained by Member Agencies

[4] This distinction, which Met emphasized at trial, makes no difference to the issues in this case. Brian Thomas made this explicit in discussing two versions of the equivalent margin method wheeling rate. The first included the RTS charge and the second excluded it as "a true fixed charge," but both were equivalent-margin rates, and both failed to encourage wheeling, as his "Evaluation Matrix" shows. *See* AR2012-17126_103 at 106, 111. RMI's Option I, Brian Thomas's equivalent-margin wheeling rates, and the wheeling rate Met actually adopted all share the essential characteristic of an equivalent-margin rate: "all unavoidable costs, including unavoidable supply costs, are included in calculating the firm wheeling rate." AR2010-2173 at 2174; *see also* AR2010-1069 at 1081; AR2010-1222 at 1225; AR2010-2446 at 2449.

to offset deficient Metropolitan supplies would not need to contribute to the same fixed and nonvariable costs." *Id.* at 1248.

It is also important to note that RMI did not advise Met against adopting an incremental wheeling rate (Option III or IV). Rather, RMI recognized that Met's self-imposed "hold harmless" requirement, combined with its insistence on retaining "the current volumetric rate design," left no option but the equivalent-margin wheeling rate. *Id.* at 1225-26. But, consistent with exemplars in the gas and electricity industries, RMI suggested that Met only adopt such an equivalent margin rate—which, as RMI freely conceded, intentionally discourages wheeling—in order "to gain experience with these services while the detailed analyses required to develop a permanent wheeling policy are underway." *Id.* at 1243. For example, CPUC briefly utilized an equivalent margin rate, but only while it developed a new rate structure based on cost-causation principles—including the recognition of distinct costs caused by "cold-year demand," the gas-industry equivalent of dry-year peaking. *Id.* at 1242 n.12. "This produced stable, cost-based transportation rates that made the utilities indifferent as to whether the customer elected utility procurement or purchased gas direct from suppliers." *Id.* Similarly, as RMI recognized, Met could have "established a fixed monthly or annual demand charge to recover the bulk of its fixed costs," enabling it to set a reasonable wheeling rate and to encourage wheeling as the law requires. *Id.* at 1226. There would be no *actual* cost shifting, because costs would finally be assigned where they always belonged. *See id.* at 1242 n.12, 1226. Met ignored this point.

Met also ignored the analysis of its proposed wheeling rate provided by NBS/Lowry—experts hired by Los Angeles ("LA") and the Municipal Water District of Orange County ("MWDOC"). *See* AR2010-1659-1791. NBS/Lowry bluntly stated that Met's equivalent margin approach "is, according to our legal analysis, probably illegal and incorrectable. In addition, it would … have an adverse impact on water transfers and an adverse impact on Southern California water resource efficiency … [and] would not be acceptable to state and federal officials." *Id.* at 1757. Nevertheless, Met continued to assert its "hold harmless" requirement as a justification for including SWP costs in its transportation rates. *See*, *e.g.*, AR2010-1406 at 1514; AR2010-2173-226; AR2010-2237-40; AR2010-2350-407; AR2010-2430-36.

Met's "hold harmless" requirement was enshrined in the 1997 "findings" on which Met still relies. *See* AR2010-2446-51 (Resolution 8520); Met's AR Slides at 60-65, 126-29; Met's 2nd Pretrial Br. at 29-30. In that document, before Met gets to what it calls "findings," it lists a series of "WHEREAS" clauses. Two are of particular note. ***First***, Met simply declares that Met's own conveyance system ***and*** DWR's separately-owned conveyance system—the SWP—"are hereafter referred to as the 'conveyance system.'" AR2010-2446. Humpty Dumpty might approve,[5] but the California Supreme Court does not: "The district does not obtain ownership of any facilities, ownership by the state being expressly provided for. Nothing in the contract indicates that the state shall hold title as a trustee or that the district shall be an equitable owner." *MWD v. Marquardt*, 59 Cal. 2d 159, 201-02 (1963) (citations omitted). In fact, Met's contract "FOR A WATER SUPPLY" from the SWP expressly provides:

> The District [Met] may provide funds to the State in such amounts and at such times as may be necessary for the State to complete construction of such uncompleted portion or portions of the project transportation facilities to the extent necessary for the transport and delivery of water to the District as provided for in this contract: Provided, That ***the State shall be and remain the owner of such project transportation facilities or portions thereof constructed in whole or in part with funds provided by the District***, and shall be and remain obligated to operate, maintain, repair and replace such facilities to the full extent contemplated in this contract.…

AR2010-1 at 59 § 17(f)(1) (underlining in original, other emphases added); *see also id.* at § 13 (Met does not control or distribute SWP water until after it is delivered); AR2010-173 at 205, 216 (same). Indeed, Met has conclusively admitted that it does not own the SWP, operate the SWP, or transport or pump SWP water before it reaches the terminal reservoirs at Castaic Lake and Lake Perris. PTX237-A (RFA) Nos. 44-47.[6] ***Second***, Met asserts—again, wrongly—that the

---

[5] "When ***I*** use a word," Humpty Dumpty said, in rather a scornful tone, "it means just what I choose it to mean—neither more nor less." "The question is," said Alice, "whether you ***can*** make words mean so many different things." "The question is," said Humpty Dumpty, "which is to be master—that's all." — LEWIS CARROLL, THROUGH THE LOOKING GLASS.

[6] These are Met's responses to San Diego's requests for admissions ("RFAs"), which are judicial admissions just like those "made in a pleading" or "by stipulation during trial." *Barsegian v. Kessler & Kessler*, 215 Cal. App. 4th 446, 451 (2013) (citations and quotation marks omitted). Indeed, RFAs "serve a function similar to the pleadings" and "differ fundamentally from other forms of discovery. Rather than seeking to uncover information, they seek to eliminate the need for proof." *Murillo v. Superior Court*, 143 Cal. App. 4th 730, 735-36 (2006) (citations and quotation marks omitted). Unlike extra-record evidence, which San Diego indicates with an asterisk, Met's judicial admissions are "not treated procedurally as evidence," but as "a *waiver of*

Wheeling Statutes preclude "financial injury" to non-wheelers. AR2010-2446 at 2447; *but see Morro Bay*, 81 Cal. App. 4th at 1050.

Met's "findings" are the sum of these legal errors. Met "finds" that its own conveyance system includes its "rights in the State Water Project system," which it erroneously equates to ownership of the SWP. *See* AR2010-2446 at 2449. Met "finds" that including "unavoidable costs," including SWP costs, "in the wheeling rate is necessary in order to protect Metropolitan's member agencies from financial injury by avoiding the shifting of those costs from a wheeling party to Metropolitan's other member agencies." *Id.* And Met "finds that such charges are reasonable and consistent with all applicable requirements of law, including any requirement to facilitate the voluntary sale, lease or exchange of water, while ensuring that the use of Metropolitan's conveyance system is fairly compensated and does not injure any other legal user of Metropolitan's water and conveyance system." *Id.* at 2450.

Since those 1997 "findings," the parties have generated a lot more paper, yet nothing has really changed. Met tried to validate its 1997 wheeling rate, but ultimately abandoned that case to "unbundle" its rates instead. *See MWD v. Imperial Irrigation Dist. (IID)*, 80 Cal. App. 4th 1403, 1433-36 (2000). The unbundling also failed to change anything that matters in this case, other than the names of the rates; it's old wine in new bottles, and San Diego isn't complaining about the bottles. As San Diego has always contended, while Met's unbundling created "a new series of 'labels,'" it did not solve the underlying problems—in particular, Met's misallocation of SWP, "Water Stewardship" and dry-year peaking costs. AR2010-4698 at 4764. The administrative record shows, again and again, that Met recognized those problems, but refused to solve them—in the unbundling process, or ever since—because it perseverates on rate stability. *See, e.g.*, AR2010-3802-06; AR2010-6463 at 6486 ("Rate structure should not place any member agency in

---

proof of a fact by conceding its truth." *Valerio v. Andrew Youngquist Constr.*, 103 Cal. App. 4th 1264, 1271 (2002) (emphasis in original). Accordingly, they are not "extra-record" evidence, and should be freely considered—along with Met's admissions in its answers and its arguments in briefs and at trial—with respect to all causes of action. *See, e.g., Rodriguez v. Mun. Court*, 25 Cal. App. 3d 521, 526-27 (1972) (in a mandamus case, the court may consider judicial admissions as well as "the arguments of counsel"); *see also* Code Civ. Proc. § 1089 (answers are filed in ordinary mandamus cases, which would be pointless if the Court could not consider judicial admissions).

a position of significant economic disadvantage."); AR2010-10667 at 10691-97 (Met's staff recognizes that dry-year peaking costs should be reallocated to supply, and that other costs now allocated to transportation should be recovered through the RTS and Capacity charges, but this will "shift some costs among agencies"); AR2012-13546 at 13562 (increased fixed charges risk "revenue volatility to member agencies" and "could trigger Proposition 218 notice processes"); AR2012-16583 at 16588-90 (Met refuses to reallocate SWP, Water Stewardship and dry-year peaking costs because if it did, some member agencies "would avoid costs that other member agencies were paying" and "avoid providing revenues" necessary for rate stability); *PTX171 (in a naked appeal to rate stability rather than cost-of-service principles, controlling member agencies warned Met in 2010 that reallocating SWP and Water Stewardship costs alone would save San Diego nearly $3 billion dollars by the end of the QSA with "a corresponding increase in cost shared by Metropolitan's other member agencies").

Again, Met agrees—and emphasizes—that the issues in this case predate the unbundling, and remain the same after the unbundling. *See* Met's AR Slides at 60-65 ("This Practice of Allocating SWP Transportation Costs to Transportation Rates Pre-dates the Unbundling"). While there is a huge amount of evidence in this case—none of which supports Met, and much of which further proves its rates invalid, as discussed in the Argument below—Met's "hold harmless" requirement is really both the beginning and end of this case. Met chose, and continues to choose, rate stability over anything else, and that original sin is the source of the fatal defects in Met's transportation rates—in particular, their improper inclusion of SWP costs, "Water Stewardship" costs, and dry-year peaking costs. *See, e.g.*, AR2010-1222 at 1245 n.15 & 1249.

As the Court knows, after Met unbundled its rates, the parties agreed to a five-year litigation standstill. When that time ran out in 2008, San Diego spent two years working within the Met boardroom, trying to get Met to adopt legal rates as part of its "rate refinement" initiatives and the discussion of a long-range finance plan. *Tr. at 221:7-222:3 (Cushman). But San Diego never got the boulder to the top of the hill; Met "abandoned all efforts to develop a long-range finance plan. And ultimately, no changes came out of any of the rate refinement processes that they undertook, and there's no activity on those today." *Id.* at 161:22-162:17. In

2010, Met adopted its transportation rates for 2011-12. Met agreed that San Diego had exhausted its administrative remedies, and San Diego timely filed the 2010 case in this Court. *See* *PTX177. The 2012 case followed after Met adopted its rates for 2013-14. Both cases were tried together on December 17-23, 2013.

III. ARGUMENT

A. Met's transportation rates violate Proposition 26.

Under its pretrial rulings, the Court will decide whether Met's 2012 transportation rates comply with the constitutional requirements of Proposition 26 based on the Court's *de novo* review of the administrative record. Nov. 5, 2013 Pretrial Rulings at 12-13. While San Diego preserves for appeal its arguments that Proposition 26 also applies in the 2010 case, and that the Court's review should not be limited to the administrative record, San Diego will confine the present discussion to the 2012 case and the administrative record. Again, however, this does not, nor should it, prevent San Diego from relying on Met's judicial admissions for all of the asserted claims. Judicial admissions are "not treated procedurally as evidence," but as "a *waiver of proof*." *Valerio*, 103 Cal. App. 4th at 1271 (emphasis in original).

Under Proposition 26, Met bears the burden of proving three things "by a preponderance of the evidence." Cal. Const. art. 13C, § 1. ***First***, Met must prove by a preponderance of the evidence that its transportation rates are not taxes, regardless of which exception Met relies on. *See id.*; Pretrial Rulings at 14 ("Metropolitan bears the burden of proving that its charge is not a tax under *any* of the seven exceptions. Metropolitan has not provided authority for its alternative reading.") (emphasis in original). ***Second***, Met must prove "that the amount is no more than necessary to cover the reasonable costs of the governmental activity." Cal. Const. art. 13C, § 1. ***Third***, Met must prove "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 governmental activity." *Id.* Met has not carried any of these burdens, much less all of them.

1. There is no merit to Met's attempt to avoid Proposition 26 entirely by arguing that it does not "impose" its transportation rates, or that Met's own Board of Directors is the "electorate."

Indeed, rather than really even attempt to carry its burdens, Met continues to argue, albeit

cursorily, that Proposition 26 does not apply at all. In particular, Met's counsel asserted at trial that Proposition 26 does not apply because "Met's rates aren't imposed in the legal sense of that term, meaning that Met is a voluntary cooperative of member agencies that have chosen to join." Tr. at 500:17-19. Aside from the fact that this favorite phrase of Met's—"voluntary collective"—never appears anywhere in the Met Act, the Court already rejected Met's legal argument in denying its motion for judgment on the pleadings ("MJOP"). *See* Sept. 19, 2013 Order Denying MJOP at 3 (citing *Bighorn-Desert View Water Agency v. Verjil*, 39 Cal. 4th 205 (2006)). The Court allowed the possibility "that ***facts*** adduced at trial will reveal the extent to which the rates are or are not 'imposed,' such as the choices available to San Diego for water and water transport." *Id.* at 3 (emphasis added). But Met did not adduce any such facts, whether from the administrative record, to which this claim is limited at Met's insistence, or otherwise.[7] And the facts in the record refute Met's argument that it does not "impose" its rates. The record actually contains numerous references to the fact that Met will "***IMPOSE*** RATES AND CHARGES." AR2010-6159-162 (emphasis added; capitalization in original); *see also, e.g.*, AR2010-6166-222; AR2010-6223-239; AR2010-6945-7029. And, more substantively, the 2012 Official Statement to Met's bondholders explains that "No facilities exist to deliver water directly from IID to SDCWA. Accordingly, Metropolitan and SDCWA entered into an exchange contract.…" AR2012-16429 at 16509.[8] That's the barrel Met had San Diego over, and the reason independent judicial review is so important here: San Diego had no choice but to either forego the IID transfer

[7] If the Court were to consider any extra-record evidence Met might proffer, which it should not, it should also consider Mr. Cushman's testimony directly on point: when San Diego tried to opt out of the Water Stewardship Rate after Met barred San Diego from receiving any benefits from it, "Metropolitan's response to that was no, that's not optional, you pay." Tr. at 170:6-20; *see also id.* at 166:19-167:3. Likewise, Mr. Upadhyay and Ms. Skillman testified that the only way for San Diego to get imported water is through Metropolitan's facilities. *See id.* at 604:25-605:9 (Upadhyay); *PTX391 at 29:5-18 (Skillman). Mr. Upadhyay's testimony, moreover, established that Met's Water Stewardship Rate is a tax. Met collects that rate for general purposes and puts the funds into its general revenues; when the Water Stewardship Rate generates a surplus, that is used for general revenues; when it has a deficit, that is paid from general revenues. *See* Tr. at 599:9-24, 640:24-641:16. Thus, the Water Stewardship Rate is a general tax that Met could not impose even with voter approval, or a special tax without voter approval; either way, it's invalid. *See* Cal. Const. art. 13C, §§ 1-2.

[8] At trial, the parties discussed at some length a June 2013 bond statement (*PTX-244; *PTX-352)—but much of the same information in that extra-record document is also found in the April 2012 Official Statement that Met included in the 2012 record. AR2010-16429-573.

and continue buying that amount of water from Met at its full-service rates, or pay Met to deliver the IID water. *See id.* Either way, San Diego would be paying Met; the idea that San Diego could simply choose not to do so is absurd and unsupported by any evidence in the record.

Met also may argue, as it did in its MJOP, that its own Board constitutes the "electorate." If Met has not abandoned that argument, which it never mentioned at trial, it should. As the Court held in denying the MJOP, "it would be an odd reading indeed of the Proposition—designed to provide taxpayers with certain guarantees that no additional taxes be imposed by local governmental agencies—that it permits the rate-makers (the utilities' governing body) to unilaterally decide to impose the asserted tax." Sept. 19, 2013 Order at 4; *see also* San Diego's Opp'n MJOP (Aug. 26, 2013) at 12-15; Attach. B § III.A. Further, Met refutes its own argument in its Official Bond Statements, which show that nothing but its mantra of rate stability prevents Met from seeking the approval of the "voters in Metropolitan's service area," because that is what Met did "at a special election held on June 4, 1974" for approval of its revenue bonds. AR2012-16429 at 16441; *see also* AR2010-11443 at 11511; 2012-16594 at 16806; Section III.B, *infra*.

Thus, Met's efforts to avoid Proposition 26 are unavailing.

2. Met has not proven by a preponderance of the evidence that its transportation rates are not taxes.

The only exceptions to Proposition 26's broad definition of "taxes" that Met has argued its rates might fall under are Exception 2 for government services and products and Exception 4 for entrance to or use of local government property. *See, e.g.*, Met's First Pretrial Br. at 62; Cal. Const. art. 13C, § 1(e)(2) & (4). Met has not carried its burdens with respect to either.

a. Met has not met its burden to prove that Exception 2 applies.

Exception 2 applies to a "charge imposed for a specific government service or product provided directly to the payor that is not provided to those not charged, and which does not exceed the reasonable costs to the local government of providing the service or product." Cal. Const. art. 13C, § 1(e)(2). Met has not carried its burden of proving by a preponderance of the evidence that its transportation rates are "for a specific government service or product provided directly to the payor that is not provided to those not charged." *Id.* Met also has not carried its

burden with respect to the second, cost-of-service, clause, but that issue is discussed separately below. *See* Section III.A.3, *infra*.

First, Met's inclusion of SWP costs in its transportation rates makes those rates invalid taxes rather than allowable charges under Exception 2 because, like all the others, that exception applies only to "activities undertaken ***directly by the local government***." *Schmeer v. Cnty. of LA*, 213 Cal. App. 4th 1310, 1327 n.5 (2013) (emphasis added). Yet Met has conclusively admitted that it does not own, operate, or "directly" undertake any "activities" on the SWP. *See* PTX237-A (RFA) Nos. 44-47.

Met tried to get around that fatal admission at trial by arguing that occasionally, in dry years when its own SWP supplies have run out, it pays an incremental wheeling rate for DWR to transport non-SWP water through the SWP. Met has never explained how that could constitute an activity undertaken "directly" by Met—it isn't, because DWR still owns and operates the SWP. *See id.* As Bartle Wells explained in 2010, "[t]he fact that MET wheels a small amount of water across the SWP does not change the fundamental nature of its relationship to the SWP. Indeed, the terms and conditions of MET's right to wheel water through the SWP is also determined by its contract with DWR," which establishes that Met "does not own or control the State Water Project." AR2010-11393 at 11397-98; *see also* AR2010-001 at 59 & AR2010-173 at 216 § 17(f)(1); *Marquardt*, 59 Cal. 2d at, 201-02; PTX237-A (RFA) Nos. 44-47; Tr. at 86:1-3 ("THE COURT: That's owned by the state? MR. HIXSON: That is owned by the state, correct.").

Even if Met had some basis for claiming that this extracurricular wheeling is its own "direct" activity—which it doesn't—the costs of wheeling of ***non-SWP*** water when Met has a water shortage are entirely distinct from Met's costs for ***SWP*** water, which are the vast majority of the SWP costs, and the only ones at issue in this case. RMI explained this in December 1995: "Additional deliveries of non-Metropolitan water obtained by Member Agencies to offset deficient Metropolitan supplies ***would not need to contribute to the same fixed and nonvariable costs***" because Met sets "its water rates to recover fixed and nonvariable costs based on expected deliveries"—as distinct from the unexpected ones it separately contracts with DWR for on an

incremental wheeling rate. AR2010-1222 at 1248 (emphasis added). The only relevance here of DWR's wheeling rate is that it shows what a wheeling rate that complies with Proposition 26 would look like. As far as the SWP goes, Met should simply pass through DWR's incremental wheeling rate—nothing more and nothing less, and only when Met incurs it, which is very rarely. And Met should adopt a similar wheeling rate for the CRA, taking into account—as DWR does—the fact that Met's member agencies, and ultimately their rate payers, financed and continue to finance that aqueduct. *See* Met's AR Slides at 58 (Met does not pay a facilities charge to wheel on SWP reaches that Met—and hence San Diego—helped pay for).

In any event, the Court is spared the effort of trying to penetrate Met's *non sequitur* about non-SWP water because *Bay Area Cellular Tel. Co. v. City of Union City*, 162 Cal. App. 4th 686 (2008), directly refutes it. There, the defendant City imposed a fee on telephone lines to fund its 911 emergency system. The court held that the fee was a special tax, not a charge for a "service" as that term is used under Propositions 13 and 218, and in Exception 2 to Proposition 26. *See id.* at 698; Cal. Const. art. 13C, § 1(e)(2). "The Fee must be paid by all nonexempt telephone service subscribers in the City—encompassing virtually all nonexempt households and businesses—whether or not they ever use 911 services. A fee for *access* to a governmental service is not the same as a fee for *use* of that service." 162 Cal. App. 4th at 698 (emphases in original). "Indeed, if it were, Proposition 218 could easily become meaningless. Taxes paid by the public to fund police or fire services available to all could be renamed 'public safety access fees' and be exempt from the voter approval requirements. Taxes paid to maintain city streets could be renamed 'road access fees.' The list of possibilities is endless." *Id.* n.11; *see also id.* at 699 (same conclusion follows "under the reasoning of the cases decided under Proposition 13").

Met's argument takes exactly the same form as the "road access fee" argument *Bay Area Cellular* recognized as absurd on its face. According to Met, simply because it provides "access" to the SWP for wheeling of non-SWP water, it can include all SWP costs—the vast majority of which are for SWP water supply—in its transportation rates. But "*access*" is not the same as "*use*." *Id.* at 698 (emphases in original). Because Met includes SWP charges in its transportation rates without regard to whether, and to what extent, the member agencies paying those rates "*use*"

the SWP, its transportation rates are invalid taxes. *See id.* (emphasis in original).

Second, Met failed to carry its burden of proving by a preponderance of the evidence that its Water Stewardship Rate is "for a specific government service or product provided directly to the payor that is not provided to those not charged." Cal. Const. art. 13C, § 1(e)(2). Met admitted as much at trial. The Water Stewardship Rate, Met's counsel explained, operates "at a higher level of generality, asking what are the general types of expenses that could result in cost being deferred or avoided." Tr. at 435:15-24. Met claims that this is appropriate because it is "looking at hundreds of millions or billions of dollars of expenses in capital facilities." The Court asked Met's counsel, "Your view is that you shouldn't have to be forced to justify each one?" "Right." The Court asked again, "Your view is this 50,000 foot view which is that you've got to look at these programs as a group or as a whole?" "Yes, exactly." *Id.* at 442:5-11.

Putting aside the ridiculous suggestion that Proposition 26's restrictions on taxation should be ignored or relaxed because Met taxes ***a lot***, Met's 50,000-foot approach plainly takes the Water Stewardship Rate outside of Exception 2. Met does not charge its Water Stewardship Rate for "a ***specific*** government service or product provided ***directly to the payor*** that is ***not provided to those not charged***." Cal. Const. art. 13C, § 1(e)(2) (emphases added). This is abundantly clear from Met's Integrated Resources Plan ("IRP"), the document Met's counsel cited as the primary exemplar of its 50,000-foot approach, and the basis for "what Metropolitan actually did in terms of capital planning." Tr. at 436:2-10; *see* AR2010-1406-1519. The IRP explains that Met decided to spend billions of dollars to "improve the region's water supply" because otherwise "some type of water shortage could occur in every other year," which "would be devastating to Southern California's $450 billion economy, affecting half the state's population and jobs." AR2010-1406 at 1427. Saving Southern California's economy and avoiding negative impacts on people and their jobs is a laudable goal. But it's not a "specific government service or product." Cal. Const. art. 13C, § 1(e)(2). And it's not provided "directly" to member agencies paying the rate to the exclusion of "those not charged." *Id.* Nor is the need to promote conservation any justification for ignoring the constitutional requirements of Proposition 26. *See* Met's AR Slides at 90 (citing S.B. 60). *Palmdale* rejected that argument in

the related context of Proposition 218. While the law favors conservation, there is no reason why conservation cannot be harmonized with the constitutional "mandate for proportionality." *Palmdale*, 198 Cal. App. 4th at 936-37.

Indeed, in the Proposition 218 context, the California Supreme Court has rejected the 50,000-foot approach, holding that the defendant's "proportionality analysis fails to satisfy Proposition 218 largely because the special assessment is based on [defendant's] projected annual budget of $8 million for its open space program rather than on a calculation or estimation of the cost of the ***particular public improvement*** to be financed by the assessment." *Silicon Valley Taxpayers Ass'n, Inc. v. Santa Clara Cnty. Open Space Auth.*, 44 Cal. 4th 431, 457 (2008) (emphasis added). *Bay Area Cellular* is also directly on point here. Met's "Water Stewardship Rate" is just like the facially invalid "public safety access fees" and "road access fees" the *Bay Area Cellular* court warned against, and much less defensible than the 911 fee the court actually invalidated. "Water Stewardship," as Met uses that term at the 50,000-foot level, does not correspond to a "service" or "product," but to a general concept like "public safety," which "inures to the benefit of the public as a whole, not to any particular group within the public." 162 Cal. App. 4th at 696, 698 n.11. Again, Met's IRP makes this clear. *See, e.g.*, AR2010-1406 at 1427. But under long-established common law, under Proposition 13, and now even more clearly under Proposition 26, Met must prove that it provides a ***specific service*** and that its charges do not exceed the reasonable costs of that service, and must prove it with ***specific evidence***. *See* Cal. Const. art. 13C, § 1(e)(2); *Bay Area Cellular*, 162 Cal. App. 4th at 696, 698 n.11. Hand waving at 50,000 feet about vague and ***non***specific public benefits fails at every level of the analysis—not least because, as discussed further below, it is a complete abdication of cost-of-service requirements. *See id.*; Section III.A.3, *infra*.

Furthermore, like the 911 fee, the Water Stewardship Rate "must be paid by all" member agencies "whether or not they ever" receive project funding. *Bay Area Cellular*, 162 Cal. App. 4th at 698. Indeed, in San Diego's case, the Water Stewardship Rate cannot even be said to provide "*access* to a governmental service." *Id.* (emphasis in original). As the Court knows, Met has ***banned*** San Diego from receiving any new funding for conservation or local water projects in

retaliation for challenging Met's rate stability. *See* AR2012-13083 at 13089. San Diego thus receives ***no*** "specific … service or product," Cal. Const. art. 13C, § 1(e)(2), even if Met's "Water Stewardship" could be considered a "service or product," which it cannot. Imagine if, in *Bay Area Cellular*, the plaintiff had been banned from dialing 911 but still had to pay for it. The fee would have been an invalid tax *a fortiori*. So, therefore, is the Water Stewardship Rate. *See id.*; *Bay Area Cellular*, 162 Cal. App. 4th at 698-99 & n.11.

b. Met has not met its burden to prove that Exception 4 applies.

Met's argument with respect to Exception 4, which applies to charges "imposed for entrance to or use of local government property, or the purchase, rental, or lease of local government property," can be dispatched quickly. Cal. Const. art. 13C, § 1(e)(4). Indeed, Met's own counsel, in five days of trial, devoted only a single sentence to it. *See* Tr. at 500:21-501:3. Exception 4 is inapplicable here for the reasons the Court already indicated in its order denying Met's MJOP; those stated in San Diego's August 26, 2013 opposition to that motion, which is incorporated here by reference; and those in San Diego's reply to Met's first pretrial brief (Attach. B at 5-8). Certainly Met has not carried its burden of proving that the ***SWP*** is Met's "local government property." Cal. Const. art. 13C, § 1(e)(4). Again, the SWP contract on which Met relies for this contention says exactly the opposite, as the California Supreme Court has expressly held. *See* AR2010-001 at 59 & AR2010-173 at 216 § 17(f)(1); *Marquardt*, 59 Cal. 2d at, 201-02. Moreover, Met judicially admitted that it does not own the SWP, *see* PTX237-A (RFA) No. 44, so even if there were evidence that might contradict that admission—which there isn't—"no contradictory evidence may be introduced." *Murillo*, 143 Cal. App. 4th at 736. Met also has not carried its burden of proving that the Water Stewardship Rate is imposed for "use of local government property," and cannot do so because that rate is imposed for nothing but the use of money itself, money in a general fund that San Diego pays into but gets little or nothing from—it's a tax, and a blatantly unfair one.

3. Met has not proven by a preponderance of the evidence that its transportation rates do not exceed the reasonable costs of providing water transportation services.

Met also cannot carry its burden of proving by a preponderance of the evidence, under

both Article 13C, § 1(e)(2) and the final paragraph of § 1, that its transportation rates charge no more than the reasonable cost of service. Both parties agree that the standard for the otherwise nebulous concept of "reasonableness" is whether the rates "reflect cost causation." Met's Opening Slides at 39; *see also* AR2010-1101 at 1125 (RMI Oct. 1995) ("Cost allocation should occur on a cost causation basis."); AR2010-3865 at 3997 (AWWA) ("A cost-of-service approach to setting water rates allocates costs to each customer or customer class based on the theory of cost causation."). "Cost causation" means that "***rates are established so that users generally pay an amount equal or proportional to the costs the system incurs to provide them service***." AR2010-3865 at 4185-86 (AWWA) (emphasis added). Met's transportation rates fail that test—and it certainly has not carried its burden of proving otherwise—because the transportation rates include SWP, "Water Stewardship," and dry-year peaking costs that are not only disproportionate but are ***not causally related*** to the service of transporting water. *See Cal. Farm Bureau Fed'n v. SWRCB*, 51 Cal. 4th 421, 437 (2011) ("A valid fee may not be imposed for unrelated revenue purposes.").

a. SWP costs are not caused by the transportation of water on *Met's* system.

Met does not dispute that its System Access Rate and System Power Rate include SWP costs. *See, e.g.*, Met's AR Slides at 41. Met also does not dispute that it could adopt transportation rates that exclude SWP costs—indeed, as Met's counsel indicated in answer to a question posed by the Court, that is what Met has done with its incremental power charge for wheeling; it simply refuses to adopt a consistent approach with respect to its System Access Rate and System Power Rate. *See* Tr. at 416:9-418:11. Nor does Met dispute that historically, Met allocated all SWP costs to supply, and none to transportation, including the SWP costs that ***DWR*** bills as its own transportation costs, because those are not ***Met's*** transportation costs. That is what the 1969 Study shows, AR2012-16288_1723 at 1743-46, as Met's counsel frankly conceded at trial:

> Brown and Caldwell did look at the functional cost allocation and they defined the supply system. And for Met, they did define the supply system as inclusive of the State Water Project facilities, including the terminal reservoirs of that system.… And beneath that is State of California, Delta water charge and transportation.

> And you can see that in the functional categories, it is true that the 1969 study looked at that and put them all into supply.

Tr. at 469:23-470:12.

Other than that straightforward admission, all Met's counsel said about the 1969 Study is that "it's so old, that it precedes the unbundling by so many decades. There's no indication that Met was even thinking or contemplating about drawing a distinction between supply and transportation rates and even evaluating the question of what would go into each rate." *Id.* at 471:2-7. That is sophistry. In the same trial presentation, Met's counsel presented an entire series of slides under the heading "This Practice of Allocating SWP Transportation Costs to Transportation Rates Pre-dates the Unbundling," referring back to the 1997 "findings." Met's AR Slides at 60-65. Met's own presentation also makes clear that costs should be functionalized without regard to "what would go into each rate," which is only evaluated later. *See id.* at 13-27. Met's problem with the 1969 Study is not that it precedes the unbundling, but that it precedes the "hold harmless" principle. But that's why the 1969 Study is valid—unlike everything Met did after adopting its illegal "hold harmless" principle. *See Palmdale*, 198 Cal. App. 4th at 937-38; *Morro Bay*, 81 Cal. App. 4th at 1050.[9] In any event, the 1969 Study simply confirms as a matter of historical fact what is equally proven by the more recent evidence, including RMI's December 1995 study—the whole point of which was "contemplating about drawing a distinction between supply and transportation rates" (Tr. at 471:2-7)—as well as the 2010 and 2012 Bartle Wells and FCS studies. *See* AR2010-1222-55 (RMI Dec. 1995); AR2010-11207-14 (Bartle Wells Mar. 5, 2010); AR2010-11393-400 (Bartle Wells Apr. 12, 2010); AR2012-16215-16 (Bartle Wells Mar. 8, 2012); AR2012-16156-91 (FCS Mar. 12, 2012).

Met, on the other hand, has ***no*** substantial evidence, much less "a preponderance of the evidence," to the contrary. Cal. Const. art. 13C, § 1. In its pretrial brief, Met touted as an

[9] Moreover, after the trial, it's clear that the older the Met document, the more trustworthy it is. The 1969 Report and the first two RMI reports in 1995 all straightforwardly state that SWP costs are supply costs; then in May 1996 the experts began to change their tune at the insistence of Met's staff; and then, in 2010, Met's staff wrote the key language from Raftelis's "independent" report, which Met's counsel then had to backpedal away from at trial. *See* Tr. at 123:25-124:9. The later "evidence" is just Met's "litigating position," which is "of little worth." *Yamaha Corp. of Am. v. SBE*, 19 Cal. 4th 1, 8-9 (1998). The 1969 Study is at the opposite end of the spectrum.

independent expert conclusion the language from the Raftelis report claiming that it is "'appropriate'" to characterize SWP costs as Met's transportation costs because "'DWR invoices in a very detailed manner.'" Met's 1st Pretrial Br. at 33. Yet in Met's opening argument at trial, Met's counsel conceded that "it is true that Met staff contributed" that language, and went on to ***deny that it's any kind of evidence at all***: it's just a "description of what Met does;" it doesn't "mirror[] the entire Raftelis report;" "Section 5 of the Raftelis report was Raftelis's independent review. They set forth the evidence." Tr. at 123:25-124:9. But Section 5 doesn't contain any evidence either, just bare conclusions, devoid of facts or analysis, declaring that Met's rates comply with law and industry standards and what Met has done before, which is just turtles all the way down.[10] *See* AR2010-11309 at 11321-23. It is precisely "the conclusory type of jargon courts have criticized as making no attempt at any specificity; the reasons appear to have emerged from the consultants' word processor without any thought…." *Friends of Mammoth v. Town of Mammoth Lakes Redevelopment Agency*, 82 Cal. App. 4th 511, 557-58 (2000) (quotation marks omitted); *accord Gonzales v. City of Santa Ana*, 12 Cal. App. 4th 1335, 1346 (1993); *see also Livermore*, 184 Cal. App. 3d at 542. And, in any event, Section 5 of Raftelis's report says nothing at all to support Met's allocation of SWP costs to its transportation rates. *See* AR2010-11309 at 11321-23.

While Met's counsel argued at trial that expert evidence "is highly relevant to the question of whether there is substantial evidence that the board's decision was reasonable," Tr. at 454:22-24, Met's disavowal of Raftelis's statement about the SWP as any kind of evidence, *id.* at 123:25-124:9, means that ***the only expert opinions on the issue in the administrative record are the ones offered by Bartle Wells and FCS***.[11] This "highly relevant" (*id.* at 454:22) expert evidence

[10] "The allusion is to a classic story told in different forms and attributed to various authors. In our favored version, an Eastern guru affirms that the earth is supported on the back of a tiger. When asked what supports the tiger, he says it stands upon an elephant; and when asked what supports the elephant he says it is a giant turtle. When asked, finally, what supports the giant turtle, he is briefly taken aback, but quickly replies 'Ah, after that it is turtles all the way down.'" *Rapanos v. United States*, 547 U.S. 715, 754 n.14 (2006) (citation omitted). Here, of course, it's not turtles; it's rate stability.

[11] Met might contend that RMI's May 1996 report qualifies, but Met's reliance on that report is both untimely and misplaced. RMI's 1996 report is not in the 2010 record at all, because Met never relied on it in 2010. And it wasn't in the 2012 record that Met filed on March 19, 2013,

proves that there is no substantial evidence to support Met's decision, only substantial evidence proving that Met's inclusion of SWP costs in its transportation rates violates cost-of-service and industry standards. *See* AR2010-11207-14; AR2010-11393-400; AR2012-16215-16; AR2012-16156-91.

Bartle Wells found that SWP costs are for a water supply that is delivered to Met "through facilities owned, maintained, and operated by the State of California, not through facilities MET owns, maintains and operates," yet Met's financial tables show "that rather than allocating all of these costs to Supply, MET's proposed rate plan allocates $429 million (85%) of such cost to MET's Conveyance and Aqueduct service function," which is "inconsistent with proper cost of service allocation. The portion of SWP costs currently collected by the System Access rate and the System Power rate should instead be assigned to the Supply service function and recovered with the Supply rates." AR2010-11207 at 11208. Likewise, "SWP power costs should be allocated to the Supply service function and recovered through the Supply rates, because they are a supply-related cost," which is not only mandated by industry practice, but also would be "consistent with how MET allocates power costs related to water treatment to the Treatment Surcharge." *Id.* at 11209. Further, Bartle Wells "reviewed information from three other SWP contracting agencies and all of them allocate SWP costs as supply costs. We are aware of no other agency that benefits from the SWP that allocates SWP costs the way MET does. BWA finds MET's cost-of-service allocation is not consistent with proper cost of service allocation, and is not consistent with industry practice." *Id.*

Met responded with two letters. The first was a single page by Met's CFO Brian Thomas with nothing but the bald conclusion that Met follows the AWWA guidelines. AR2010-11303-04. The second was a letter from Met's General Counsel and General Manager, setting out Met's

---

because Met didn't rely on it in 2012, either. Met only added it to the 2012 record right before trial, on December 11, 2013, in response to San Diego's motion to correct the record. And, as discussed at trial, the May 1996 report impeaches itself because RMI originally functionalized all SWP costs to supply, as in the 1969 Study, and only changed course when Met told it what to say, just as Met later did to Raftelis. *See* AR2012-16288_1796 at 1875-76. Met's eleventh-hour and circular reliance on its own conclusory arguments as parroted by RMI is not substantial evidence. *See id.*; *Yamaha*, 19 Cal. 4th at 8-9; *Friends of Mammoth*, 82 Cal. App. 4th at 557-58; *Gonzales*, 12 Cal. App. 4th at 1346; *Livermore*, 184 Cal. App. 3d at 542.

litigating positions and legal conclusions. AR201011305-08. Neither is substantial evidence. *See Yamaha*, 19 Cal. 4th at 8-9; *Friends of Mammoth*, 82 Cal. App. 4th at 557-58; *Gonzales*, 12 Cal. App. 4th at 1346; *Livermore*, 184 Cal. App. 3d at 542. And Met's conclusions are wrong in any case, as Bartle Wells explained. *See* AR2010-11393-400. The AWWA guidelines require a cost-causation approach that "'recognizes differences in the costs of providing service to different types of customers.' If MET were to follow this principle as it claims, it would not ascribe sums paid to the DWR for an imported water supply to the cost of water transportation via facilities in Southern California." *Id.* at 11395. Nor is there any merit to Met's assertion—now directly stated by Met's General Counsel rather than through the mouth of a purportedly "independent" expert—that it is "appropriate" for Met to functionalize SWP costs to transportation because those costs are itemized as DWR's transportation costs:

> This amounts to a statement that MET may deviate from industry standards requiring all Supply costs to be characterized as such because it has received an itemized billing statement of costs incurred by its water supplier or perhaps just because it is possible to do so. MET's approach is incorrect. Industry standards require the MET's financial obligations to the DWR to be accounted as Supply costs as demonstrated by the very authorities upon which MET's rate consultants claim to rely.

Id. at 11394. Furthermore, as already explained above, the "fact that MET wheels a small amount of water across the SWP does not change the fundamental nature of its relationship to the SWP. Indeed, the terms and conditions of MET's right to wheel water through the SWP is also determined by its contract with DWR," which establishes that Met "does not own or control the State Water Project." *Id.* at 11397-98; *see also* AR2012-16215-16 (Bartle Wells reaffirming its opinions for the 2012 record).

Likewise, FCS concluded (among other things) that all SWP costs should be allocated to Met's supply rates, not its transportation rates:

> There is no reasonable relationship between the cost of acquiring that water and the use of MWD's internal transmission facilities. The fact that [DWR] breaks out its own 'supply' and 'transportation' costs in invoices provided to MWD does not warrant charging users of MWD's facilities *for transportation services* a portion of the costs for MWD's purchase of State Water Project water.

AR2012-16156 at 16161 (emphasis in original). Met again responded, not with evidence, but with legal argument from its General Counsel and General Manager. *See* AR2012-16583-93.

The only evidentiary value of that letter is that it shows that Met's 2012 rates, just like its 2010 rates, its 1997 wheeling rate, and everything in between, are ultimately grounded on nothing but Met's desire for rate stability. *See* AR2012-16583-92.

Met's allocation of the costs of its SWP water supply to its transportation rates is illegal because wheelers do not ***use*** Met's SWP water supply and, as the evidence described above makes clear, they do not ***cause*** Met to incur the costs associated with that water supply, including the costs DWR bills as its own transportation costs. *See* AR2012-16288_1723 at 1743-46; AR2010-11207-14; AR2010-11393-400; AR2012-16156-91; *see also* Cal. Const. art. 13C, § 1(e)(2); *Schmeer*, 213 Cal. App. 4th 1327 n.5 (Proposition 26's exceptions are limited to charges for "activities undertaken directly by the local government"); *Palmdale*, 198 Cal. App. 4th at 937 (water rates invalid because district failed to carry its burden of proving a causal link between the water rates and "the cost of providing water to these customers"); *Bay Area Cellular*, 162 Cal. App. 4th at 698-99 & n.11 (charges for "service" must be based on "use," not merely "access").

The lack of the requisite causal connection between wheeling and SWP costs is true of Met's entire system, and it is particularly obvious with respect to wheeling on the CRA, which isn't even connected to the SWP except in the sense that, for example, the Golden Gate Bridge is "connected" to the 405 Freeway. Just because some drivers may make it from one to the other doesn't mean, for example, that drivers crossing the Golden Gate Bridge caused the need for the billion dollar "Carmegeddon" repairs on the 405 such that those costs can be funded by Golden Gate Bridge tolls.[12] Likewise, just because some molecules of water from the SWP may end up in wheeled water—which happens for Met's own convenience and is neither controlled nor mandated by wheelers—doesn't mean that CRA wheeling causes SWP costs. Met certainly has not carried its burden of proving by a preponderance of the evidence that SWP costs are caused by wheeling in the "specific" and "direct[]" sense that Proposition 26 requires. *See* Cal. Const. art. 13C, § 1(e)(2).

[12] http://www.ibtimes.com/interstate-405-carmageddon-history-myth-trivia-299287

b. "Water Stewardship" costs are not caused by the transportation of water.

Met has judicially admitted that it does not calculate the proportional benefits that individual member agencies receive from its Water Stewardship Rate or the programs it funds, neither on the basis of individual programs, nor in the aggregate. PTX237-A (RFA) Nos. 20, 32. Met has further judicially admitted that it "has never calculated the ***regional*** benefit to MWD created by the aggregate group of local water supply projects, seawater desalination projects, or conservation programs funded or subsidized with revenue collected through the Water Stewardship Rate in a given calendar year." *Id.* No. 38 (emphasis added). These admissions are fatal, because Met must carry the burden of proving that it recovers no more than its reasonable costs and allocates those costs fairly according to the costs caused by, and benefits received directly from, "a specific government service." Cal. Const. art. 13C, § 1(e)(2) & final ¶.

Trying to evade the inevitable, Met's argument at trial was that it is allowed to take the 50,000-foot approach, but that is wrong as a matter of law as discussed above, *see* Cal. Const. art. 13C, § 1(e)(2); *Bay Area Cellular*, 162 Cal. App. 4th at 698-99 & n.11, as well as industry practice. As Bartle Wells explained, to "simply say, 'all customers benefit and must therefore pay' essentially admits MET has not done the cost-accounting and rate-design tasks required by industry practice.…" AR2010-11393 at 11398; *see also* AR2010-11203 at 11209-10 (Bartle Wells); AR2012-16156 at 16161-62, 16173-74 (FCS). Proper cost causation analysis is simply not done at the 50,000-foot level. *See id.*

Furthermore, even at the 50,000-foot level, Met has not carried its burden of proving that water transportation needs—as opposed to supply needs—cause Met to incur the costs of the conservation, desalination, recycling, and groundwater recovery and storage programs funded by the Water Stewardship Rate. Met certainly has not carried its burden to prove that ***all*** of these costs are caused by transportation needs, and ***none*** of them by supply needs, such that it is appropriate to allocate 100% of the Water Stewardship Rate to Met's transportation rates, as it does. Met said the opposite in its Official Bond Statement:

> The central objective of Metropolitan's water conservation program is to help ensure adequate, reliable and affordable water supplies for Southern California by

> actively promoting efficient water use. The importance of conservation to the region has increased in recent years because of drought conditions in the State Water Project watershed and court-ordered restrictions on Bay-Delta pumping, as described under "METROPOLITAN'S WATER SUPPLY—State Water Project" in this Appendix A under "METROPOLITAN'S WATER SUPPLY."

AR2012-16429 at 16519. Notably, the referenced discussion of the SWP under the heading of "WATER SUPPLY" is explicitly distinguished from Met's discussion of its "WATER DELIVERY SYSTEM." *Compare id.* at 16496-505 *with id.* at 16526. Thus, the "central objective" of the Water Stewardship Programs is to address Met's "SUPPLY" problems and expressly ***not*** issues of "WATER DELIVERY." *Id.*

Indeed, as discussed above, the animating concern of the IRP—on which Met bases its 50,000-foot approach—is that if "nothing is done to improve the region's water supply," it "would be devastating to Southern California's $400 billion economy." AR2010-1406 at 1427. Conservation helps solve that problem by reducing the demand for water, and "during the IRP, conservation was also considered as a supply option much like any other traditional supply project." *Id.* at 1448. In other words, if Met could take the 50,000-foot level approach—which, as a matter of law, it cannot, as discussed above—then it would have to treat its entire conservation program "like any other traditional supply project," and allocate the costs of it to supply. *Id.*[13] To be clear, Met should not and, under the law and cost-of-service standards, cannot simply do that, either; it cannot simply trade its baseless allocation of all conservation and

[13] At trial, Met also relied on *DTX-18, a 1996 "issue paper" about the economic benefits of local resource programs. But Met did not think this document was even relevant enough to include in the administrative record, and Met was right. It is just another 50,000-foot approach, which is untethered to the actual local resource programs Met has funded with the Water Stewardship Rate, and which addresses supply and storage projects whose costs are not caused by the need to transport water. *See* *DTX-18 at 9; Tr. at 631:22-632:21, 567:25-568:21 (Upadhyay). Further, because *DTX-18 is not in the record, Met—at its own strenuous insistence—can use it only in connection with the wheeling claim, to which it is completely irrelevant. It never mentions wheeling and has nothing to do with costs caused by wheeling. Although Met speculated at trial—at an even higher level than this document, call it the 100,000-foot level—that local resource programs might free up conveyance capacity that might benefit wheelers, there is no ***evidence***, in this document or anywhere else, to support that assertion, which by itself "cannot rise to the dignity of substantial evidence." *Roddenberry v. Roddenberry*, 44 Cal. App. 4th 634, 651 (1996). Anyway, Met's speculation is based on the counterfactual assumption that Met does not have sufficient capacity to accommodate wheeling, which is false, *see* *PTX-244 at A-46, and even if true, still would not prove that Met incurred any such costs ***because*** of wheeling. Indeed, as discussed below, the only relevant record evidence shows that Met incurred such costs to accommodate dry-year peaking. *See, e.g.*, AR2010-1520 at 1591.

local-water-supply costs to transportation, for a baseless allocation of all of them to supply. Met must do a proper and specific cost-benefit analysis. The point is that there is absolutely no basis in evidence, logic or law for Met's allocation of all such costs to transportation.

Indeed, Raftelis's own textbook unambiguously states that "conservation costs" should be functionalized to "Source of supply." AR2012-16288_5282 at 5291. Even when hired to try to justify Met's contrary approach, Raftelis could not bring himself to claim that all such costs should be functionalized to transportation. Instead, he wrote that "all or at least a portion" of programs for local "conservation, water recycling, and the recovery of contaminated groundwater" should be functionalized as "***supply costs***." AR2012-16288_2114 at 2179 (emphasis added). To figure out what "portion," other than none, to allocate to some other rate, Raftelis suggested that Met should "conduct a detailed cost benefit analysis" of each program to determine how it "defers or eliminates future investments in additional transmission and or treatment capacity or supply yield." *Id.* at 2217. Because Met hadn't—and admittedly still hasn't—conducted any sort of cost-benefit analysis at all, Raftelis gamely suggested a "simple" division of costs, based on nothing more sophisticated than the proverbial splitting of the baby: half to supply, half to transportation. But Met took it even further: where Raftelis redefined "all or at least a portion to supply" to mean "50% to supply," Met redefined it beyond all recognition—"***none*** to supply"—and still does.

Aside from Raftelis's plainly arbitrary approach, the only suggestions in the evidence for assigning ***any*** of these costs to ***any*** rate other than supply would—like Proposition 26 itself—require Met to descend from 50,000 feet and prove its case. RMI's October 1995 report is a good example. RMI "proposed that the conservation cost be disaggregated, to the extent realistic and reasonable, and treated in accordance with the objective of the program." AR2010-1101 at 1115. Based on that approach, Met's programs for ultra-low-flush toilets, water reclamation, and groundwater recovery would all be "treated as supply related costs" because they "provide benefits in the form of increased water supplies." *Id.* Other programs might be "functionalized to Transmission/Distribution." *Id.* But that functionalization of costs was not done at the 50,000-foot level, but at the level of particular programs, "depending on the nature of their primary

benefits." *Id.* at 1106.

In fact, Met's own Engineers' Reports concede that Met should not be recovering many of these costs through uniform volume rates at all, and that such costs would "more equitably be paid in part by assessments on land that in part derives its value from the availability of water." AR2010-11443 at 11512; *accord* 2012-16594 at 16807. This is true because Met only charges its rates when it delivers water, but benefits derived "from the ***availability*** of water," *id.* (emphasis added), obtain even when no water is delivered and no rates are charged. There can be no dispute that this is true of the benefits Met claims to justify its Water Stewardship Rate, because ***the benefits that would "more equitably be paid in part by assessments" are exactly the same as what Met elsewhere describes as the purported "Water Stewardship" benefits***: "Investments in demand side management programs like conservation, water recycling and groundwater recovery reduce the need to provide additional imported water supplies and help defer the need for additional conveyance, distribution and storage facilities." AR2010-11443 at 11510-11.

This further disproves Met's already-disproven contention that there is a causal connection between ***wheeling*** and the costs Met incurs to provide "additional conveyance [and] distribution" facilities. *Id.* The Engineers' Reports concede that Met could recover for those benefits through the RTS charge, which—as Met's counsel emphasized at trial—is not part of the wheeling rate. And it is not part of the wheeling rate because wheelers do not cause Met to incur the costs of "additional conveyance [and] distribution" facilities. *Id.* On the contrary, as the Engineers' Reports established and is proven further in the following section on dry-year peaking, those costs are caused by "agencies that only occasionally purchase water from Metropolitan but receive the reliability benefits of Metropolitan's system," including "replenishment of groundwater basins and reservoir storage as reserves against shortages due to droughts." *Id.* at 11513. Indeed, even if there might be some incidental benefit to wheelers resulting from additional conveyance capacity—which Met has neither proven nor tried to prove—the costs of that capacity cannot be causally attributed to wheelers because, ***first***, the Engineers' Reports and the other evidence discussed below shows that those costs are caused by dry-year peaking; and ***second***, wheelers cannot depend on such additional conveyance capacity in any case. Wheeling

under Met's Administrative Code is expressly "[s]ubject to the General Manager's determination of available system capacity." Admin. Code § 4405(a). Thus, if conveyance capacity is already spoken for by the dry-year peakers that caused Met to incur the costs of providing it, or is unavailable for any other reason, wheelers are out of luck. In sum, Met has no substantial, let alone preponderant, evidence to show that water transportation causes ***any***, much less ***all***, of its Water Stewardship costs; the evidence, in fact, conclusively proves the opposite.

Met's Water Stewardship Rate is an illegal tax that must be invalidated.

c. Dry-year peaking costs are real, and not caused by the transportation of water.

As the Court has already noted, Met judicially admits that it does not "make a separate allocation for dry peaking years." Dec. 10, 2013 Order at 4. Even at the 50,000-foot level, Met simply doesn't consider the costs it incurs because of dry-year peaking, or the disparate benefits its member agencies receive in the form of drought insurance. Nor does Met even try to argue that dry-year peaking costs are caused by, or should be attributed to, transportation. On the contrary, Met's own staff explicitly states that "dry year supply benefit[s]" should be "assigned to the Supply function and recovered through Metropolitan's supply rates." AR2010-10753 at 10756-57; *but see* AR2010-10779 at 10786 (Met Board refusing to do so).

Met's only defense of its improper inclusion of dry-year peaking costs in its transportation rates is to assert that dry-year peaking doesn't exist; that San Diego just made it up; or if it exists, it's in the nature of a rounding error that can just be ignored. The truth is quite the opposite, as the administrative record—and even Met's own presentation of it at trial—makes clear. In fact, far from being a side issue or niggling complaint of San Diego's invention, dry-year peaking is at the heart of everything Met does and all of its problems: it's a big reason ***why*** Met has its huge take-or-pay contract for SWP water; it's ***why*** DWR occasionally wheels non-SWP water to Met over the SWP in dry years when Met's allocation of SWP water proves insufficient; it's a big reason ***why*** Met spends billions of dollars on reservoirs and groundwater storage; it's a big reason ***why*** Met invests so much in conservation; and it's ***why*** Met talks about needing additional conveyance capacity—***not*** because of wheeling, but to have "the conveyance capacity required to

deliver water to storage in wet and normal periods so ***dry year demands*** could be met, as well as the capacity required in a ***dry year*** to deliver available supplies." AR2010-1520 at 1591 (emphases added). Met incurs all of these costs in order to provide reliable ***dry-year water supplies***.

In fact, that is the essential point of the IRP, on which Met so heavily, yet wrongly, relies. "In order to develop a resources plan to reliably meet the future water needs for the region, it is necessary to provide an accurate assessment of the existing firm supplies available ***during dry years***." AR2010-1406 at 1440 (emphasis added).[14] Accordingly, the IRP defined a "design year," which is "referred to in the IRP as 'dry year.'" *Id.*; *see also* AR2010-5189 at 5194 ("Need for IRP" is based on "dry year"). The IRP then compared "existing supplies to the projected hot/dry weather retail demands" to identify "potential water supply shortages," which became "the overall resource target to be developed during the IRP process." AR2010-1406 at 1442. Everything in the IRP ties back to this fundamental objective of meeting its member agencies' variable ***dry year supply demands***:

- "Simply put, storage provides a means of storing surplus water during normal and wet weather years for later use during dry years, when imported supplies are limited. Like water transfers, storage is a flexible supply. However, unlike many transfers, it can require large capital investments." *Id.* at 1466. For example, "about 220,000 acre-feet of storage in these DWR terminal reservoirs can now be used by Metropolitan during dry years (carryover supply)," which is one reason why Met's huge fixed-cost, take-or-pay contract with DWR is not only a supply cost, but largely a dry-year supply cost. Met's "800,000 acre-feet Eastside Reservoir Project [now called Diamond Valley Lake] will be used to meet Southern California's remaining storage requirements, with 400,000 acre-feet dedicated to emergency purposes and 400,000 acre-feet dedicated to drought carryover," at a "cost of $2.0 billion." *Id.* at 1509-10, 1493; *see also* AR2010-5558 at 5564 (Diamond Valley Lake, SWP storage, and others are "Dry-Year Storage"). "Metropolitan manages its storage portfolio to capture surplus supplies to meet future dry-year demands." AR2012-13875 at 13902.
- Met maintains nearly six million acre-feet of storage capacity, at great expense, which it

[14] This shows why Met's continued insistence that peaking is only relevant to hourly, daily or weekly peaking is meritless. The costs Met incurs are not only related to peaking on that scale, but also—and on a grander scale—to dry-year peaking, as the IRP makes clear. *See* AR2010-1406 at 1440. Met's Engineers' Reports also prove this: "agencies that only occasionally purchase water from Metropolitan but receive the reliability benefits" impose costs of insuring "against shortages due to droughts," which volumetric rates do not equitably recover. AR2010-11443 at 11511-13. The relevant timeframe for droughts is years, not hours, days, or weeks.

fills with SWP water (among other sources). AR2012-16429 at 16516-19. In particular, Met is able to fill its reservoirs when "large quantities of surplus water from the SWP" are available, AR2010-1406 at 1476, which also explains why SWP costs are largely dry-year supply costs. "Existing SWP supply available to Metropolitan during a dry year is estimated to be about 650,000 acre-feet. The Preferred Resource Mix calls for an increased utilization of SWP supplies of about 700,000 acre-feet during a dry year by the year 2020." *Id.* at 1510. Met also wheels non-SWP water "in order to avoid a shortage in a drought situation." *Id.* at 1491.

- "In addition to supplying a basic source of water, groundwater basins provide a critical storage function that allows for reduced dependency on imported water during dry years and droughts, as well as during peak periods of demand during the summer season." AR2010-1406 at 1450. "The Preferred Resource Mix identifies the potential for 200,000 acre-feet of additional groundwater production during dry years. To accomplish this additional dry year production, about one million acre-feet of dedicated storage capacity within the local basins is required." *Id.* at 1510. Conservation efforts likewise improve supply reliability "during a drought." *Id.* at 1452. In other words, Water Stewardship costs are dry-year supply costs.

Nor is there any merit to Met's suggestion at trial that all of its member agencies contribute equally, or anything like equally, to the huge cost burdens just discussed. Met's Official Bond Statement explains why. "Some agencies depend on Metropolitan to supply 100 percent of their water needs, regardless of the weather. Other agencies, with local surface reservoirs or aqueducts that capture rain or snowfall, rely on Metropolitan more in dry years than in years with heavy rainfall, while others, with ample groundwater supplies, purchase Metropolitan water only to supplement their local supplies or to recharge groundwater basins." AR2012-16429 at 16521. The Engineers' Reports also make clear that distinct costs are imposed by "agencies that only occasionally purchase water from Metropolitan but receive the reliability benefits of Metropolitan's system," including insurance "against shortages due to droughts" that "might more equitably be paid in part by assessments" because member agencies receive special benefits from the "availability of water" whether they pay any water rates or not. AR2012-16594 at 16807-08.

Furthermore, the differences in benefits provided to different member agencies are very significant. At one end of the spectrum are agencies that depend on Met for most of their water; at the other is LA, which has taken as little as ***13%*** of its water supply when "the Los Angeles Aqueduct and local groundwater supplies have been nearly sufficient," yet can rely on fully "***82***

percent of its dry year supplies" from Met. AR2012-16429 at 16523 (emphasis added). Likewise, Met's IRP explains that "because demands and supplies can vary substantially from year to year due to weather and hydrology," and "because Metropolitan's supplies are the swing supply for the region as a whole, this variation in demand alone translates into a ± 14 percent change in Metropolitan's water sales," much of which is attributed to the fact that "below-normal runoff in the Owens Valley increases [LA's] need for Metropolitan's deliveries." AR2010-1406 at 1486-88 (charting LA's dry-year peaking).

Raftelis's 1999 report confirms that dry-year peaking is a very real, very expensive, and very disproportionate phenomenon caused by the fact that "agencies with local resources" use Met as the "'swing supply.'" AR2012-16288_2114 at 2189-92. In fact, Raftelis quantified the differences between member agencies in their "need for system capacity" related to this phenomenon. *Id.* at 2192. The differences are huge, and all out of proportion to the amounts the various member agencies pay Met. For example, based on LA's demand characteristics from 1988-1998, it needed 507.5 cubic feet per second (CFS) of connected capacity, reflecting the fact that it relies on Met "during droughts" to "provide additional supplies." *Id.* at 2190-92. At the end of that period, in 1998, LA paid a mere 5.64% of Met's revenues. *Id.* at 2190. On the other hand, based on San Diego's demand characteristics in that same decade, it needed only 489.5 CFS—***less*** connected capacity than LA—yet at the end of the period paid fully 26.26% of Met's revenue—***far more*** than LA. *See id.* at 2190, 2192. More generally, Met's member agencies show great variability in their demand characteristics—from the 5.5 CFS that San Fernando needed, to the 821 CFS that MWDOC required. *See id.* at 2192.

As FCS explained, "MWD's volumetric rate structure allows agencies to 'roll on and off' the system with little financial cost to those individual member agencies." AR2012-16156 at 16178. The "minimal amount of additional revenues through the current Tier 2 water rate" do not come close to recovering the dry-year peaking costs. *Id.* "In effect, MWD spends billions of dollars on drought insurance, but does not require the beneficiaries of that insurance to pay for it until they actually use it," and only for as long as they actually do so. *Id.* This requires "other customers, whose demand is more stable, to subsidize those whose use of the MWD system is

highly variable. This disproportionately burdens member agencies with proportionally level annual demands." *Id.*; *see also* AR2010-3865 at 4117 ("Properly designed rates should recover the cost, as nearly as is practicable, of providing service to a customer, or class of customers, with minimal cross-subsidizing among customer classes."). ***Met has no evidence even disputing FCS's conclusion, much less disproving it by a preponderance of the evidence.***

Contrary to Met's suggestion at trial, its RTS charge does not come close to solving the problem. In the first place, as Bartle Wells showed, and Met has no substantial evidence to contradict, let alone disprove, the RTS charge is "arbitrary and lacking proper foundation." AR2010-4744-48. And, in any event, Met judicially admits that the RTS charge does not reflect "a separate allocation for dry peaking years." Dec. 10, 2013 Order at 4. It mostly relates to emergency storage—earthquakes, not droughts (*see* AR2010-1406 at 1466)—and doesn't even recover those costs. "The estimated potential benefits that could be paid by an RTS charge in fiscal year 2012/13 exceed $322 million," but for no apparent reason other than rate stability, the charge "only recover[s] a portion of the total potential benefit"—a maximum of $146 million, or less than half. AR2012-16594 at 16807.

At trial, the Court asked whether member agencies end up paying for their drought insurance through the volumetric rates. *See* Tr. at 828:1-829:15. The answer is No. ***First***, Met presented no ***evidence*** of that and admits it has no such evidence because it pretends dry-year peaking doesn't exist, even though the phenomenon is fundamental to the IRP, and Raftelis partially quantified (but then ignored) it. *See* AR2010-1406 at 1486-89; AR2012-16288_2114 at 2189-92. ***Second***, Met cannot carry its burden because the evidence shows that member agencies that buy more water in dry years ***do not*** thereby "make up" for what they do not buy in wet years. This is explained in the AWWA guidelines, which Met falsely claims to follow. As Met emphasized at trial, all of its rates are what AWWA calls "uniform volume rates." *See* AR2010-3865 at 4120; Met's AR Slides at 32-35. It is inappropriate to collect the vast majority of revenues through uniform volume rates, as Met does, unless "all increments of water provided are associated with the same unit cost of service." *Id.* at 3969. That is certainly ***not*** the case where some customers are buying relatively consistent volumes of water while others are proportionally

buying far greater volumes of water in dry years. The cost of dry-year supplies includes not only the costs of delivered water, but also all the costs of acquiring and storing the water for dry years. Thus, the fact that dry-year peakers buy a lot of water at "uniform volume rates" in dry years does not solve the problem, but completes it. *See id.*

This is why AWWA states that uniform volume rates are only appropriate "[w]here demand characteristics do not significantly differ among individual wholesale customers." AR2010-3865 at 4121. As we have seen, however, the member agencies' demand characteristics differ very significantly, which is inherent in Met's role as a supplemental wholesale water provider, combined with the fact that "its member agencies receive water from hydrologically diverse and geographically widespread areas." AR2010-1406 (IRP) at 1440; *see also, e.g.*, AR2012-16288_2114 at 2189-92 (Raftelis). Nor can Met claim that it has no other options, because AWWA, which Met falsely claims to follow, offers at least two.

First, "[w]here the wholesale purchaser has other supply options, a minimum-purchase (take-or-pay) requirement may be added … to discourage a customer from using the utility system as a supplemental source of supply to meet peak requirements." AR2010-3865 at 4121. But rather than implement such a requirement, as DWR does, Met's rates actually ***encourage*** its member agencies to do exactly what AWWA says it should ***discourage***, by making supplemental supplies available to dry-year peakers without requiring them to make any commitment, or to otherwise pay the costs Met incurs in order to have water supplies and the necessary infrastructure ready to serve them in dry years.

Second, Met could adopt a demand rate: a "fixed charge per month to cover demand or extra capacity-related costs," which is appropriate where—as here—"peak demand is a major determinant of system capacity and the need for system expansion," because, as already discussed, uniform volume rates do not equitably recover costs that "are related to peak demand." AR2010-3865 at 4121-23 (emphases added). Met has the express statutory authority to impose such a charge. Water Code § 109-134.5; *see also* Cal. Const. art. 13D, § 4; Gov't Code § 53753. If Met properly followed those statutory and constitutional procedures—which it has not, and refuses to do—it would satisfy Proposition 26. Cal. Const. art. 13C, § 1(e)(7).

What exactly Met does to fix its rates, assuming the Court invalidates them, is up to Met, but it cannot claim that it has no other options; nor that it has the option of continuing to impose its illegal rates in the name of "rate stability." *See id.*; *Palmdale*, 198 Cal. App. 4th at 937-38. Proposition 26 makes absolutely clear that Met's transportation rates—which never had any support in, but instead are plainly inequitable under, the AWWA guidelines Met falsely purports to follow—are now simply and straightforwardly ***illegal***. *See* Cal. Const. art. 13C, § 1; *see also id.* § 1(e)(2). Met has not come close—or even really attempted—to carry its burden of proving the contrary by the preponderance of the evidence. *See id.*

4. Met has not proven by a preponderance of the evidence that its transportation rates allocate costs commensurate with the burdens member agencies impose or the benefits they receive.

Finally, Met has not carried its burden of proving that "the manner in which [its] costs are allocated to [member agencies] bear a fair or reasonable relationship to the [member agencies'] burdens on, or benefits received from, the governmental activity." Cal. Const. art. 13C, § 1. This requirement is violated if some member agencies "are effectively subsidizing special benefits received by" others. *Town of Tiburon v. Bonander*, 180 Cal. App. 4th 1057, 1087-88 (2009) (discussing similar proportionality requirement of Proposition 218, Cal. Const. art. 13D, § 4). That is precisely the effect of all of the misallocations discussed above.

In particular, the Water Stewardship Rate is ***nothing but*** a tax to fund an illegal subsidy program. Other member agencies receive tens of millions of dollars annually in subsidies that San Diego is forced to pay for even after being banned from receiving any new program benefits or subsidies itself. *See* AR2012-13083 at 13089. It is hard to imagine a more clear-cut violation of Proposition 26. *See* Cal. Const. art. 13C, § 1. By way of contrast, the record includes an analysis by another of Met's member agencies, Western Municipal Water District, showing that it received a "Net Benefit" of $23.2 million. 2012AR-17126_15 at 23. The record evidence thus shows beyond any doubt that the way Met allocates its Water Stewardship Rate to its member agencies—charging them the same whether they benefit the same or even at all—does not "bear a fair or reasonable relationship" to the highly disproportionate benefits they receive. Cal. Const. art. 13C, § 1. Nothing in the record supports Met's naked assertion to the contrary, and Met

certainly has not proven it by a preponderance of the evidence.

San Diego is also subsidizing special benefits that other member agencies receive in the form of artificially low water supply rates. This is true across the board, because Met's misallocation of SWP costs to its transportation rates forces member agencies paying those rates to subsidize the supply rates, where SWP costs belong. And the illegal subsidy is aggravated by dry-year peaking, the substantial costs of which Met refuses to even acknowledge, let alone allocate according to their causes, or the special benefits dry-year peakers enjoy in the form of drought insurance.

Met's rates are thus invalid for the independent reason that it has not carried its burden of proof by a preponderance of the evidence that its transportation rates fairly allocate costs based on the burdens caused, and benefits received, by its member agencies. *See* Cal. Const. art. 13C, § 1.

B. Met's transportation rates violate Proposition 13.

Met's transportation rates also violate Proposition 13. Met has previously argued that Proposition 13 does not apply, relying on *Brydon v. E. Bay Mun. Util. Dist.*, 24 Cal. App. 4th 178 (1994), and *Rincon Del Diablo Mun. Water Dist. v. SDCWA*, 121 Cal. App. 4th 813 (2004). But those cases provide no support for Met's attempt to avoid the constitutional requirements of Proposition 13. *See* Attachs. A & B § III.B. Among several other grounds of distinction San Diego explained in its pretrial briefs, *see id.*, both *Brydon* and *Rincon* held that the water rates at issue were not taxes because they were "not designed to replace property tax monies lost in consequence of the enactment of California Constitution, article XIII A." *Brydon*, 24 Cal. App. 4th at 194; *accord Rincon,* 121 Cal. App. 4th at 822. But here, ***Met's Engineers' Reports explicitly say the opposite about Met's rates***:

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

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

Met's Engineer thus makes clear that Met's rates, unlike those at issue in *Brydon* and *Rincon*, ***were*** designed to avoid compliance with Proposition 13. *See id.* Nor is it the case that it is "necessar[y]" for Met to use uniform volume water rates to recover the bulk of its revenues even though, as the Engineer expressly concedes, assessments would be a more equitable way to collect for benefits that derive from the availability of water, not just its actual delivery, which is how Met's water rates are charged. *See id.* The Legislature expressly permits Met to "impose a water standby or availability service charge," for an "amount of revenue … as determined by the board," subject to the notice, protest, and hearing procedures in Section 53753 of the Government Code," which implements Proposition 218's procedures for assessments. Water Code § 109-134.5; *see also* Cal. Const. art. 13D, § 4; Gov't Code § 53753. Provided Met imposed such charges "in accordance with the provisions of Article XIII D," they would not violate Propositions 13 and 26. *See* Cal. Const. art. 13C, § 1(e)(7).

Met knows this, but refuses to adopt equitable charges because that "could trigger Proposition 218 notice processes" and lead to "revenue volatility to member agencies." AR2012-13546 at 13562; *see also* AR2012-11575-81 (discussing Proposition 218); AR2012-16429 at 16547 (discussing Propositions 26, 13 and 218). Again, however, Met's overarching desire for rate stability is no basis for its refusal to follow the law. *See* Cal. Const. art. 13C, § 1; *Palmdale*, 198 Cal. App. 4th at 937-38; *Morro Bay*, 81 Cal. App. 4th at 1050.

In its pretrial rulings, the Court held that once San Diego carries its prima facie burden of coming forward with evidence that Met's transportation rates violate Proposition 13, the burden of production shifts to Met "to show that the challenged components of its rates bear a fair or reasonable relationship to the costs of the service Metropolitan provides." Pretrial Rulings at 15; *see also Cal. Farm Bureau*, 51 Cal. 4th at 436-37 ("Thus, once plaintiffs have made their prima facie case, the state bears the burden of production and must show (1) the estimated costs of the service or regulatory activity, and (2) the basis for determining the manner in which the costs are apportioned, so that charges allocated to a payor bear a fair or reasonable relationship to the payor's burdens on or benefits from the regulatory activity.") (quotation marks omitted).

San Diego presented more than enough evidence at trial to make out a prima facie case under Proposition 13. As discussed above, the administrative record proves that Met's transportation rates are invalid, and is certainly adequate to shift the burden of production to Met. *See Cal. Farm Bureau*, 51 Cal. 4th at 440-42 (plaintiff carried prima facie burden by arguing that the fees at issue were disproportionate, requiring defendant to make an "evidentiary showing that the associated costs of the regulatory activity were reasonably related to the fees assessed on the payors").[15]

Thus, the burden of production shifts to Met. For all the reasons already discussed with respect to Proposition 26, Met has not carried its burden of production to show that the challenged components of its rates—the System Access Rate, System Power Rate, Water Stewardship Rate, and wheeling rate—bear a fair or reasonable relationship to the costs of the service Metropolitan provides. Nor has Met carried its acknowledged burden of "producing evidence demonstrating the manner in which it accounts for peaking bears a fair or reasonable relationship to its member agencies' burden on, and benefits from, MWD's system." Met's 1st Pretrial Br. at 59 (citing *Beaumont Investors v. Beaumont-Cherry Valley Water Dist.*, 165 Cal. App. 3d 227, 235 (1985)). On the contrary, Met has admitted to this Court that it does not do anything to specifically account for dry-year peaking. *See* Dec. 10, 2013 Order at 4. Met's failure to produce the requisite evidence is total, for both the 2010 and the 2012 case.

Thus, all of Met's transportation rates violate Proposition 13 and must be invalidated.

C. Met's wheeling rates violate the Wheeling Statutes.

Under the Wheeling Statutes, "[n]otwithstanding any other provision of law, neither the state, nor any regional or local public agency may deny a bona fide transferor of water the use of a water conveyance facility which has unused capacity, for the period of time for which that capacity is available, if fair compensation is paid for that use," subject to certain exceptions.

[15] Further, if Met contends that San Diego has not made a prima facie case, it should have moved for nonsuit after San Diego rested. *See Cal. Farm Bureau*, 51 Cal. 4th at 436 (consequence of failure to make a prima facie case is that plaintiff "risks nonsuit"); Code Civ. Proc. § 581c (motion for nonsuit must be made before defendant offers evidence); *Ziegler v. Ohio Farmers Ins. Co.*, 23 Cal. App. 2d 138, 140 (1937) (same).

Water Code § 1810. The only exception that Met has relied on is that "[t]his use of a water conveyance facility is to be made without injuring any legal user of water and without unreasonably affecting fish, wildlife, or other instream beneficial uses and without unreasonably affecting the overall economy or the environment of the county from which the water is being transferred." *Id.* 1810(d). "'Fair compensation' means the reasonable charges incurred by the owner of the conveyance system, including capital, operation, maintenance, and replacement costs,[16] increased costs from any necessitated purchase of supplemental power, and including reasonable credit for any offsetting benefits for the use of the conveyance system." *Id.* § 1811(c). In determining fair compensation, Met "shall act in a reasonable manner consistent with the requirements of law to facilitate the voluntary sale, lease, or exchange of water and shall support its determinations by written findings." *Id.* § 1813. Likewise, "the court shall give due consideration to the purposes and policies of this article." Water Code § 1813.

In its pretrial rulings, the Court held that, as the statute states, the Court will "consider *all* relevant evidence." Pretrial Rulings at 18 (emphasis in original). San Diego bears the burden of proof but, as under Proposition 13, once San Diego makes out a prima facie case, the burden of production shifts to Met. *See id.* at 17. The Court also held that it "should review *de novo* whether the statute applies or bars the inclusion of any component in a rate," but to the extent the Court must "review Metropolitan's factual 'fair compensation' determination, the statute requires [the Court] to do so under the substantial evidence standard." *Id.*

This leads to the question whether Met made any "***factual*** 'fair compensation' determination." *Id.* (emphasis added). Met did not, which means that the "substantial evidence" standard does not apply here—the only issues presented are for *de novo* review. *See id.* In the "findings" on which Met relies, it asserted the doubly erroneous legal conclusion that "pursuant to Sections 1810 and 1812 of the Water Code, the use of Metropolitan's water conveyance system"—which it simply declared and redefined to include the SWP—"is to be made without

[16] "'Replacement costs' mean the reasonable portion of costs associated with material acquisition for the correction of irreparable wear or other deterioration of conveyance facility parts that have an anticipated life that is less than the conveyance facility repayment period and which costs are attributable to the proposed use." Water Code § 1811(d).

injuring any legal user of water from that system, including financial injury." AR2010-2446 at 2446-47. Then Met "found" that including its unavoidable costs, including SWP supply costs, "in the wheeling rate is necessary in order to protect Metropolitan's member agencies from financial injury by avoiding the shifting of those costs from a wheeling party to Metropolitan's other member agencies"—Met's "hold harmless" principle. *Id.* at 2449. Met's ultimate "finding" is "that such charges are reasonable and consistent with all applicable requirements of law, including any requirement to facilitate the voluntary sale, lease or exchange of water, while ensuring that the use of Metropolitan's conveyance system is fairly compensated and does not injure any other legal user of Metropolitan's water and conveyance system." *Id.* at 2450. "This conclusory resolution, which does not contain any evidence or factual information, does not constitute substantial evidence." *Livermore*, 184 Cal. App. 3d at 542. It consists of nothing but legal conclusions and Met's unsupported assertions, and those conclusions and assertions are ***wrong***. *See Marquardt*, 59 Cal. 2d at, 201-02; *Palmdale*, 198 Cal. App. 4th at 937-38; *Morro Bay*, 81 Cal. App. 4th at 1050.

First, there is no evidentiary or legal value whatsoever to Met's *ipse dixit* that "Metropolitan's conveyance system, and its rights to the use of the SWP conveyance system are hereafter referred to as the 'conveyance system.'" AR2010-2446. This is a transparent bid to redefine "conveyance system" to get around the statutory limitation of "fair compensation" to "reasonable charges ***incurred by the owner of the conveyance system***." Water Code § 1811(c) (emphasis added). Met's solipsism cannot change the fact that Met does ***not*** own the SWP—DWR does. PTX237-A (RFA) Nos. 44-47; AR2010-001 at 59 & AR2010-173 at 216 § 17(f)(1); *Marquardt*, 59 Cal. 2d at, 201-02; Tr. at 86:1-3. This is simply not subject to dispute. *See Murillo*, 143 Cal. App. 4th at 736 (where, as here, facts are judicially admitted, "no contradictory evidence may be introduced"). This is game, set, and match on the issue of SWP costs, independent of the other arguments and evidence on that issue discussed above, and the further extra-record evidence on it, as discussed below. *See* Section III.C.2.a, *infra*.

Second, Met's effort to redefine "injur[y]" in section 1810(d) to mean "financial injury" is equally unavailing. *See* AR2010-2446 at 2447, 2449. The word "financial" does not appear

anywhere in the statute. And *Morro Bay* rejected Met's argument. *See* 81 Cal. App. 4th at 1046-51. In *Morro Bay*, a school district that had been buying water from Morro Bay entered into an agreement for a supply of water from the SWP, and proposed to wheel it through Morro Bay's conveyance system for $121 per acre-foot. Morro Bay rejected the proposal because the loss of water supply sales to the school district "would require an immediate community-wide water rate increase." *Id.* at 1047. Morro Bay argued that "it cannot let the school district use its conveyance facility without injuring other legal users of water within the city. Morro Bay's argument is based on the rate increase it claims its other customers will have to bear if it loses the school district as a customer." *Id.* at 1050. The court made short work of that: "***we do not believe the loss of income from a customer is the sort of injury to a legal user of water the Legislature had in mind***.… ***Although loss of a customer can cause financial difficulties, it does not amount to an injury***." *Id.* (emphasis added).

Morro Bay's holding directly refutes the basis for Met's alleged "findings"—its "hold harmless" principle. The *Morro Bay* holding is also independently supported by the legislative history, which refutes Met's argument that the prohibition of "injury" is a mandate for rate stability. After that language was added, opponents continued to argue that the statute ***would not*** preserve rate stability. *See* Req. for Jud. Not. (Dec. 22, 2013) Ex. 1 at LH-315, 353-354. Indeed, Met can effectively be counted among them because, in 1998, ***Met sought, unsuccessfully, to amend § 1810(d) to prohibit "shifting costs."*** AR2010-3093 at 3095. As NBS/Lowry explained, based on their review of the legislative history for LA and MWDOC, the language at issue is not about rates or cost shifting but "refers to the loss of appropriation rights owned by the transferor by reason of the transfer." AR2010-1659 at 1724; *see also* Attach. A § III.C.

Morro Bay also provides important guidance about the relationship between wheeling and storage, which is important to the dry-year peaking issue as discussed above. The court held that storage facilities might be considered part of the "conveyance system," but only to the extent "***necessary for the transportation of water***. Such ***necessary*** and incidental use of integrated storage facilities must be considered to be within the scope of the statutory scheme for the conveyance of water," but ***not*** "over a period of time greater than that ***necessary to convey the***

water through the system." 81 Cal. App. 4th at 1049 (emphases added).

Met's so-called "findings" prove that Met did not "act in a reasonable manner consistent with the requirements of law to facilitate the voluntary sale, lease, or exchange of water," Water Code § 1813, when it "found" that fair compensation should include costs that are ***not*** "necessary for the transportation of water." *Morro Bay*, 81 Cal. App. 4th at 1049; *see* AR2010-2446-51. It is important to understand that the Court of Appeal in *MWD v. IID* never reached this issue; it never sustained Met's 1997 "findings;" and Met's wheeling rate was never validated. Instead, the Court of Appeal remanded for the trial court to rule under section 1813, rather than as an abstract question of law, but that never happened because Met abandoned the case and unbundled its rates. *See* 80 Cal. App. 4th at 1433-36. Section 1813 not only requires Met to facilitate wheeling, it mandates that, in reviewing whether Met did so, and whether it charged more than fair compensation, "the court shall give due consideration to the purposes and policies of this article." Water Code § 1813. Giving due consideration to those purposes and policies, it is impossible to conclude anything except that Met's rates frustrate them, in fact and by design, and that the resulting wheeling rates far exceed fair compensation.

1. Met's wheeling rates illegally discourage wheeling.

As discussed above, the Court need not look any further than the 1997 Resolution Met cites in purported satisfaction of the requirement that it "shall support its determinations by written findings," Water Code § 1813, to find that Met's wheeling rates violate the Wheeling Statutes. The "findings" are expressly based on the very contention that *Morro Bay* rejected as a matter of law: that section 1810(d) allows Met to "protect" its other member agencies "from financial injury" rather than adopt a wheeling rate that is limited to "fair compensation," and nothing more. *See Morro Bay*, 81 Cal. App. 4th at 1046-51; AR2010-2446 at 2449.

RMI's December 1995 report further confirms that Met's illegal "hold harmless" requirement was "perhaps the single most important constraint on [its] pricing of wheeling services," AR2010-1222 at 1234, and that it required Met to actively ***discourage*** wheeling: "By removing any economic incentive to displace Metropolitan's sales, the potential for revenue losses due to wheeling are reduced significantly." *Id.* at 1249. Although the wheeling rate "could

be perceived as excessive," it would "prevent displacement of Metropolitan's sales and ensure full recovery of Metropolitan's fixed costs," and "is the only rate method examined that would not give Member Agencies an economic incentive to displace Metropolitan's sales under certain water market conditions." *Id.* at 1249, 1254. Far from facilitating water transfers, Met's wheeling rates were designed to discourage them. *See id.*

RMI's conclusion that Met's wheeling rates would, and were designed to, discourage wheeling was not disputed; everyone who analyzed the wheeling rate came to the same conclusion. For example, another consultant hired by Met warned that "it is ***virtually unthinkable*** that there is ***any remotely acceptable wheeling rate*** that could in fact be imposed ***that would hold MWD and the other agencies harmless***." AR2012-17126_68 at 78 (emphases added).[17] NBS/Lowry also found that Met's equivalent margin wheeling rate would "have an adverse impact on water transfers" and is "probably illegal and incorrectable." AR2010-1659 at 1757. Likewise, the "Evaluation Matrix" in a memorandum by Met's CFO Brian Thomas shows that Met's Equivalent Margin Method wheeling rate does not encourage wheeling. The only option that does, while meeting all other criteria—including that it would not cause wheelers to pay for costs caused by non-wheelers, ***or vice versa***—is San Diego's "Commitments" proposal:[18]

[17] With respect to the Wheeling Statute, the distinction between the 2010 and 2012 records is unimportant because all of the evidence San Diego cites here is "relevant" to both cases, which is the standard under section 1813. *See* Water Code § 1813; Pretrial Rulings at 18.

[18] San Diego's "Commitments" proposal was for Met to enter into contracts with each member agency whereby each agency would agree to pay its share of Met's costs pursuant to a formula that "would establish a direct connection between the costs of facilities, supplies and programs and the benefits of such facilities, supplies and programs to each member agency." AR2010-4330 at 4331. This is consistent with the AWWA guidelines. *See* AR2010-3865 at 4121-23.

Evaluation Matrix

Strategy:	Encourages Wheeling?	Cost Shifting?	Same Treatment?	SWP Cost Recovery?	Others?
Equivalent Margin Method	-	+	+	+	
Commitments	+, at incremental cost	+	+	+	
Infrastructure Bank	maybe	+	+	+	
MWDOC Proposal	+	-	-	-	
Fully Distributed Cost	-	maybe (storage issue)	+	+	
Point-to-Point	+	-	-	-	
Bidding	?	?	?	?	
Incremental Cost	+	-	-	-	
Others?					

+ = meets criteria, - = does not meet criteria

AR2012-17126_103 at 109; *see also id.* at 106-09.

Nor has the conclusion that Met's wheeling rate discourages wheeling changed as a result of Met's unbundling of its rates. The Evaluation Matrix shows this, as well, because the Fully Distributed Cost strategy—which, as shown in the matrix, also fails to encourage wheeling—was based on unbundled rates. *See id.* at 107. Likewise, in a March 2000 memorandum explaining Met's soon-to-be adopted unbundled rates, Met's Senior Resources Specialist Shane Chapman explained that Met includes the Water Stewardship Rate in the wheeling rate in order to maintain rate stability and, as a necessary consequence, discourage wheeling. *See* *PTX-41 at 18394. As Mr. Chapman explained, Met cannot "charge the cost of developing local resources as 'Metropolitan supply costs'" and still be equally "competitive with a supplier that does not have to pay these costs." *Id.* This is RMI's basic point, reformulated for the unbundled rates: "By removing any economic incentive to displace Metropolitan's sales, the potential for revenue losses due to wheeling are reduced significantly." AR2010-1222 at 1249.

Further, San Diego's Assistant General Manager Dennis Cushman testified that Met's wheeling rate, by including the bulk of its SWP costs and all conservation and local water development costs, has discouraged San Diego from engaging in more wheeling, and other member agencies from engaging in any significant amount of wheeling. Tr. at 222:8-22

(Cushman). This is confirmed by Met's sales data, which show that San Diego is the only member agency that has engaged in any significant wheeling or exchanges with Met since it first adopted its wheeling rate in 1997. *See* *PTX-299; *PTX-300; *PTX-301; *PTX-203A (compare data in Sales_AF tab, which includes wheeling, with data in Sales_AF-wheeling tab, which excludes wheeling).

In the face of this proof—far beyond a prima facie case—Met has no substantial evidence at all that it met the requirements of section 1813. Met's own pretrial briefs effectively concede its failure of proof. According to Met, "when conducting the substantial evidence review, the Court must weigh the evidence in the administrative record," but "the Court may not weigh extra-record evidence against the evidence in the administrative record." Met Reply at 16. So be it. Most of San Diego's evidence discussed above is from the administrative record. What does Met have from the administrative record? Nothing. On Met's own theory, it has not carried its burden of production. *See id.*

Rather than offer proof that its rates reasonably facilitate wheeling from anywhere in its administrative record—much less from its so-called "findings" that are supposed to contain such proof—at trial, Met introduced *en masse* 76 agreements that it contends show a vibrant market for Met wheeling services. But even a cursory review of these agreements deflates that thesis. Many are from the 1960's and 1970's, almost none of them involve Met member agencies, and many are not even wheeling agreements.[19] Met's purported evidence that its rate facilitates wheeling thus shows nothing of the kind, and certainly does not outweigh San Diego's direct and overwhelming evidence to the contrary. This is not substantial evidence showing that Met acted "in a reasonable manner consistent with the requirements of law to facilitate" wheeling. Water Code § 1813. In fact, Met's extra-record evidence actually proves San Diego's point. San Diego

[19] *See, e.g.*, *DTX-156, *DTX-190, *DTX-203, *DTX-216. Twenty-seven of the agreements (*DTX-150-176) are just documentation of a decades-long agreement between Met and two other SWP contractors (Desert Water Agency, and the Coachella Valley Water District) that lack a physical connection to the CRA and exchange their SWP supplies for Met water from the Colorado River. Of the nine agreements that even mention a Met member agency other than San Diego, two (*DTX-199 and *DTX-200) are minor wheeling transactions (less than 3000 acre-feet total) from more than a decade ago. *DTX-143 is a 1975 exchange to refill a groundwater basin, and *DTX-179-182, 195-196 are storage agreements, not wheeling agreements.

is the only member agency that wheels a substantial amount of water through Met's conveyance system, and it only does so based on Met's agreement that "Metropolitan shall forthwith pay the disputed amount, plus all interest," to San Diego if it prevails on its contract claim. Compl. Ex. A § 12.4(c).[20] No other member agencies have such an agreement. And none of them wheel a significant amount of water. That's no surprise; it's exactly what Met intended.

Met's wheeling rates are illegal and the Court should invalidate them under section 1813.

2. Met's wheeling rates exceed "fair compensation."

Met's wheeling rates also illegally exceed "fair compensation" ***by definition*** because they do not include a "reasonable credit for any offsetting benefits for the use of the conveyance system." Water Code § 1811(c); *see* Met Admin. Code § 4405. This is particularly illogical and unfair given that Met actually pays ***up to $250 per acre-foot*** for the development of other water supplies, without any basis for subsidizing one form of supply and penalizing the other. *See* AR2010-1165-66. The fact that water transfers provide offsetting benefits cannot be denied, not only because the Water Code says such benefits exist and must be calculated and credited, but also because Met's own documents show the significant—yet ***uncredited***—benefits to Met and its member agencies provided by San Diego's transfer agreement with IID. Met's Shane Chapman calculated those benefits at $65 per acre-foot, while unreasonably trying to keep that secret from San Diego. *See* *PTX-25. Met's negotiating committee for the Exchange Agreement concluded that Met could offer San Diego "a discount of more than 50%" on its wheeling rate and that would still leave Met in "substantially the same position" as if it acquired and stored the water itself. *PTX-26 at MWD2010-00264791. And Brian Thomas stated that "**Metropolitan's member agencies** benefit from a full Colorado River Aqueduct," and "the additional supplies of surplus water at near zero cost." *PTX-30 at MWDPRA014981 (emphasis in original); *see also In re Quantification Settlement Agreement Cases*, 201 Cal. App. 4th 758, 785 (2011) (but for the

[20] This refutes Met's argument that the Exchange Agreement is somehow evidence that Met's wheeling rate must be fair compensation or else San Diego would not have agreed to pay it. Met is ignoring the escrow account, the fact that San Diego only consented not to sue Met over its rates for the first five years of the Exchange Agreement, and that San Diego has always maintained that Met's wheeling rates exceed fair compensation. *See* Compl. Ex. A § 12.4(c).

IID-San Diego transfer, "Metropolitan would feel the brunt of the shortfall," leaving the CRA "over half empty"). Met does not give any "reasonable credit," Water Code § 1811(c), or ***any credit at all***, to San Diego or any other wheeler for these significant and indisputable offsetting benefits. *See* Met Admin. Code § 4405. Met's wheeling rates are thus invalid by definition. Water Code § 1811(c).

Met's wheeling rate also exceeds fair compensation for the reasons already discussed above based on the administrative record: the System Access Rate and Water Stewardship Rate, which are included in the wheeling rate, improperly include SWP, demand-management, and dry-year peaking costs that are not "necessary for the transportation of water." *Morro Bay*, 81 Cal. App. 4th at 1049. The extra-record evidence, discussed below, further confirms what the administrative record already proves: Met's wheeling rates exceed fair compensation.

a. The extra-record evidence further proves that SWP costs are not caused by wheeling on Met's system.

As a simple physical and geographical fact—in addition to the judicial admissions already discussed—Met's conveyance system is distinct from the SWP. *See, e.g.*, *PTX-348A. Met does not control the SWP or physically take possession of SWP water until it arrives in the terminal reservoirs at Castaic Lake and Lake Perris; it is only then that Met can treat the water, move the water through Met's distribution system, and potentially blend it with other water sources. Tr. at 536:4-537:2 (Yamasaki); *PTX-392 (Thomas Depo.) at 153:6-19.

To try to overcome these facts and its own admissions, Met simply adopts ***DWR's*** itemization of costs on ***DWR's*** invoices as if they were ***Met's*** own costs—*i.e.*, asserting *de facto* ownership of the system it admittedly does not actually own. Met formerly relied on Raftelis's 2010 report as supposed evidence that this violation of both logic and law is somehow nonetheless consistent with industry standards. As discussed above, however, Met's counsel had to abandon that position at trial, disavowing Raftelis's statement about DWR's itemization of costs. *See* Tr. at 123:25-124:9. The extra-record evidence shows why: that language—the only sentence in Raftelis's entire report that even addresses Met's purported basis for allocating SWP costs to the wheeling rate—was written by Met's budget manager, June Skillman, along with

Met's assistant general counsel, Sydney Bennion. *See* *PTX-167. At trial, Ms. Skillman admitted not only that she personally wrote Raftelis's justification for Met's rates, but also that it was her idea to add the language about the functionalization being "appropriate;" that she did so with the understanding that San Diego was likely to file this lawsuit; and that she did not disclose her authorship of this critical language to Met's Board. *See* Tr. at 722:11-723:1; 712:21-713:1, 718:20-719:3, 719:25- 722:10, 727:2-9. Met's counsel was right to concede that Raftelis's supposed statement—really Ms. Skillman's—about Met's claiming DWR's costs as if they were Met's own is not substantial evidence, and indeed not evidence at all. *See* Tr. at 123:25-124:9.

Ms. Skillman also admitted that Met's allocation of SWP costs is ***inconsistent with NARUC guidance***, which ***requires SWP costs to be allocated wholly to supply***. *See* Tr. at 732:22-733:6, 735:1-736:6.[21] Indeed, when Met staff falsely suggested to the Board in April 2010 that Met's rates follow NARUC standards, Met did not even possess a copy of the NARUC guidelines. *See* *PTX-255; Tr. at 695:21-696:11. Ms. Skillman suggested at trial that the NARUC standards are inapplicable to Met because Met is not a regulated utility, Tr. at 696:12-697:22, but that not only contradicts what Met staff previously told its Board—and San Diego—it's beside the point, given that AWWA, which Met also claimed, and still claims, to follow, employs the NARUC standards. *Id.* at 730:9-18; *see also* AR2010-3865-4226.

Met also tries to justify its inclusion of SWP costs in the wheeling rate for ***Met's*** system by arguing that Met occasionally pays DWR an incremental wheeling rate to wheel non-SWP water through the SWP. Tr. at 99:3-7, 105:15-25. As discussed above, this is a *non-sequitur* that does nothing to justify Met's misallocation of SWP costs. *See* Section III.A.2.a, *supra*; *Bay Area Cellular*, 162 Cal. App. 4th at 698-99 & n.11. And, in any event, the extra-record evidence confirms that Met's use of the SWP to wheel or transport non-SWP water is *de minimis*. *PTX-328 through *PTX-340 and *PTX-380 include, for calendar years 1995 through 2009, DWR

[21] NARUC refers to guidelines by the National Association of Regulatory Utility Commissioners. As Bartle Wells explained in undisputed evidence in the administrative record—as now definitively conceded by Ms. Skillman, as discussed above—under NARUC section 610, costs associated with the purchase of a water supply, ***including Met's SWP costs***, must be allocated to supply rates rather than transportation or wheeling rates. *See* AR2010-11393 at 11394; *see also* AR2012-16288_1754 at 1757 (NARUC § 610).

schedules showing, for each SWP contractor, DWR's annual deliveries of SWP water supplies (including SWP water sent to storage), the amount of SWP water obtained by that contractor through transfers or exchanges with other SWP contractors, and that contractor's deliveries of ***non-SWP*** water, including wheeling. *See* *PTX-328A, *PTX-329A, *PTX-330A, *PTX-331A, *PTX-332A, *PTX-333A, *PTX-334A, *PTX-335A, *PTX-336A, *PTX-337A, *PTX-338A, *PTX-339A, *PTX-340A, *PTX-341A, *PTX-380A. The upshot is that wheeling non-SWP water accounts for less than ***two percent*** of water Met received from DWR in that time.

For the Court's convenience, San Diego has assembled this data, all of which is in evidence, into a packet of the Bulletin 132 schedules and a spreadsheet capturing the consolidated information. *See* Braunig Decl., Exs. A, B. The data confirms, as San Diego represented at trial, that Met's wheeling of non-project water represents less than 2% of all water Met received through the State Water Project from 1995 through 2009. *See id.* Ex. C. Indeed, in nine of the fifteen years, Met did not engage in any wheeling of non-Project water on the State Water Project. *Id.* Ex. B.[22] Met's only dispute with these numbers at trial was that they did not include so-called "Water Bank Recovery" water listed in the DWR Bulletins for 2007-2009. But even if the water Met took out of water banks were "wheeled water" from third parties—which it is not, and which Met did not establish at trial—Met's wheeling of water would still constitute only 4.6% of all Met water received through the SWP during that same fifteen-year period. *See id.*, Ex. D. That cannot justify Met's misallocation of 85% of its SWP supply costs to its transportation rates.

Lastly, there is no merit to Met's nonsensical contention that it can allocate most of its SWP supply costs to the wheeling rates because member agencies wheeling water on the CRA may ultimately receive water that includes molecules of water from the SWP, a justification found nowhere in the administrative record but that Met repeatedly emphasized at trial. Met

[22] Dennis Cushman testified that, over the past decade, San Diego has wheeled only 33,000 acre-feet of water through the SWP, compared to roughly 5 million acre-feet that San Diego purchased from MWD, and over 1 million acre-feet that it acquired from IID and the Canal Lining Projects and paid MWD to convey through the Colorado River Aqueduct, over that same period. Tr. at 191:14-25 (Cushman).

provides whatever blend it provides either because the Legislature has directed it to do so independent of and unrelated to wheeling, *see* Water Code § 109-136, or for its own convenience. Met alone controls the blend of water; San Diego has neither physical control over the blending nor contractual or legal control over it. *See* Tr. at 539:22-24, 540:25-541:2, 541:8-14. In any case, if Met wants to try to account for the benefits of a blended water supply in a proper cost-of-service analysis, it is free to do so—yet never has. But Met may not use the *post hoc* rationalization that it blends water to shoehorn the bulk of its SWP costs into its wheeling rates.

b. Water Stewardship costs are not caused by wheeling.

The extra-record evidence also confirms that Met's wheeling rate exceeds fair compensation because the Water Stewardship Rate has nothing to do with "reasonable charges incurred by the owner of the conveyance system, including capital, operation, maintenance, and replacement costs, increased costs from any necessitated purchase of supplemental power." Water Code § 1811(c). The funds collected through the Water Stewardship Rate do not pay for operations or maintenance or any of the other categories listed in Section 1811—they are used to pay for conservation programs or projects that generate local water ***supplies*.** *PTX 392 (Thomas Depo.) at 77:8-19; *PTX 389 (Arakawa) at 91:2-13; *PTX-244 at A-30 ("While local water resources are non-Metropolitan sources of water supply, Metropolitan has provided incentives for local supply development as described below," including groundwater storage, recycled water and seawater desalination.). Although Met assigns 100% of these costs to its transportation rates, including the wheeling rate, Met's Manager of Water Resources Deven Upadhyay admitted repeatedly at trial that the WSR-funded programs create a "supply benefit" for Met. *See* Tr. at 578:10-21, 584:10-24, 598:23-599:8, 624:21-626:10 (Upadhyay). Even at the 50,000-foot level, these programs are intended to reduce the need for Met to imported water supplies, either by creating substitute local supply or by creating "reduced demand" for imported water. *Id.* at 624:21-626:10. As discussed above, however, that is not the proper level for a cost of service analysis, which is no different under the Wheeling Statutes. *See* Water Code § 1811(c); *Morro Bay*, 81 Cal. App. 4th at 1049.

While Met paid lip-service at trial to supposed "transportation" or "capacity" benefits

associated with the programs funded by the WSR, it has made zero effort to calculate or track those benefits. Indeed, in 2007, Met's board specifically rejected an approach that would have incorporated "regional water supply and facility benefits" into the evaluation criteria for selecting WSR programs to fund; instead Met chose an "open program" that awards money primarily based on whether local water development projects are "ready to proceed"—a criterion that has nothing to do with, and indeed effectively precludes analysis of, project benefits. *See* *PTX-123 at 466156, 157; Tr. at 197:21-199:8, 200:4-7 (Cushman). Indeed, Mr. Upadhyay confirmed that Met evaluates and tracks the programs only by measuring the number of acre-feet of water that the programs conserve or replace—solely a measure of supply. Tr. at 624:8-16 (Upadhyay); *see also id.* at 200:25-201:7, 200:8-15 (Cushman); *PTX-119 at 456046; *PTX-199 at 462004; *PTX-227 at 251245. According to Mr. Upadhyay, Met has never had a "business need" to calculate any of the supposed regional benefits of its Water Stewardship programs, other than the number of acre-feet of water supply created, and does nothing to ensure that its member agencies receive proportionate benefits—which, in fact, they do not. *See* Tr. at 627:10-629:15 (Upadhyay); *PTX-392 (Upadhyay Depo.) at 53:4-19; Tr. at 201:9-207:4 (Cushman); *PTX-179; *PTX-201; *PTX-214; *see also* AR2012-17126_15 at 23. Given the cost-of-service requirements inherent in every constitutional and statutory obligation against which Met's rates are judged—including section 1811(c) of the Wheeling Statutes—Met's cavalier refusal even to perform this analysis beggars belief.

Met's inclusion of these supply costs in its wheeling rate is particularly inappropriate because wheelers don't need any supply benefits—the whole point of wheeling is that the wheeler already has a supply, and has the legal right to move or exchange it through another's conveyance system for no more than fair compensation. What's more, the supply wheelers bring into the Met system is a benefit to Met and its other member agencies, as discussed above. *See, e.g.*, *PTX-25; *PTX-26 at MWD2010-00264791; *PTX-30 at MWDPRA014981. In other words, ***Met charges wheelers for "Water Stewardship" <u>supply</u> costs that wheelers don't cause and don't benefit from, while simultaneously failing to give any credit to wheelers for the actual, undeniable, and offsetting supply benefits from wheeling***. This is unfair, inequitable,

unreasonable, arbitrary, capricious—in short, ***illegal*** under any imaginable standard, and certainly under the Wheeling Statutes, which require Met to "act in a reasonable manner consistent with the requirements of law to facilitate" wheeling, and charge no more than fair compensation, giving "reasonable credit for any offsetting benefits." Water Code §§ 1811(c), 1813.

Nor is there any basis for Met's contention at trial that the programs funded by the Water Stewardship Rate free up capacity that wheelers need, let alone cause. Not only has Met failed to produce any ***evidence*** of that, it is simply counterfactual. Mr. Upadhyay testified that, in recent years, Met has been operating at well below full system capacity. Tr. at 648:20-649:8, 652:19-654:3 (Upadhyay); *PTX-386. And, other than San Diego's wheeling under the Exchange Agreement, Met has no current demand for wheeling services for which it needs to "free up" capacity—Met's artificially inflated wheeling rate has intentionally and undeniably discouraged any significant wheeling through Met's system, as discussed above. *See* Section III.C.1, *supra*.

Furthermore, as Met's 1992 Revenue Design Study Report made clear, yet Met ignored, one of the best ways to promote conservation—the purported goal of its Water Stewardship Rate—is to eliminate the kind of distortions in the price of water supplies that the Water Stewardship Rate, combined with Met's misallocation of SWP and dry-year peaking costs, helps to create. Efficient use of resources follows when the price "reflects the total cost of that resource and supply and demand are brought into balance," which is why DWR "and many public and environmental interest groups, believe water should be priced to reflect its total cost in order to promote efficient use of that resource." *PTX15 at 35. Met does the opposite—indeed the acknowledged basis of the 1997 "findings" that Met continues to cite as the basis for its 2010 and 2012 wheeling rates is that "the cost of water to Metropolitan is essentially zero." AR2010-1069 at 1081. Met's imposition of the Water Stewardship Rate on wheeling is as lacking in any evidentiary foundation as that transparent falsehood.

c. Dry-year peaking costs are real, and not caused by wheeling.

As already discussed, the *Morro Bay* court recognized that storage facilities may only be considered part of the "conveyance system," as that term is used in the Wheeling Statutes, to the extent "***necessary for the transportation of water***." *Morro Bay*, 81 Cal. App. 4th at 1049

(emphasis added). As also discussed above, drought storage is a huge component of Met's dry-year peaking costs. And Met admits that it includes such costs in its System Access Rate, which is a component of Met's wheeling rate. PTX-235A at pp. 14-15; *see also* Tr. at 210:12-213:10, 214:4-24 (Cushman). Yet Met has not shown and cannot show that drought-storage costs, or any other dry-year peaking costs, are necessary for the wheeling of water. It has not even tried.

For example, Ms. Skillman testified that nothing in Met's rates accounts for benefits and burdens on member agencies as a result of dry-year peaking. *See* Tr. at 738:6-16. The costs of dry-year peaking are not allocated to each member agency in proportion to the benefit each member agency receives from Met's purchase and storage of water to accommodate dry-year peaking. *See id.* at 740:6-11. Met does not even attempt to identify in its cost-of-service process the benefits to some member agencies from their ability to roll onto Met's system in dry years and roll off of Met's system in wet years, *id.* at 738:23-739:2, nor has Met tried to calculate the specific costs of the dry-year peaking benefits it provides, *id.* at 739:15-19. Indeed, when asked whether LA benefits more than others, Ms. Skillman said, "Well, I actually just testified that we don't do a calculation of the benefits, so I don't know how I would know that." *Id.* at 741:3-7. But there is no doubt that Met does know about the huge drought-insurance benefits it provides to LA. *See, e.g.*, AR2012-16288_2114 (Raftelis 1999) at 2189-92; AR2010-1406 (IRP) at 1486-88; AR2012-16429 (2012 Bond Statement) at 16521-23; *PTX-244 (2013 Bond Statement) at p. A-30. Nor is there any dispute that Met could account and charge for those costs. As Ms. Skillman acknowledged in an October 12, 2011 email: "We could charge LA based on what they ***aren't buying from us*** due to high flows off the LA Aqueduct." PTX-211 (emphasis added). Yet Met has steadfastly refused to account for and proportionally recover the costs of dry-year peaking.

Instead, Met suggested at trial that dry-year peaking is not a real phenomenon, or that it is insignificant. *See, e.g.*, Tr. 707:23-708:17. The record evidence already discussed disproves that assertion, and the extra-record evidence further disproves it. Although Met refused to include the entire 1969 Study in the administrative record, all of it is in evidence, and it proves that Met has always known about dry-year peaking, which is fundamental to its existence as a supplemental water supplier: "normal variations of consumer demand are amplified in their effect on a

supplemental supply system. This effect is apparent both with respect to seasonal (month to month) variations, ***and variations from year to year***." *PTX-6 at 206441 (emphasis added). This is "not surprising; variations of demand on a supplemental supply system are usually much greater than variations of total community demand because of the tendency of customer-purveyors to use their own systems at uniform rates if it is permissible to do so. ***This phenomenon is well known to the MWD staff***…." *Id.* at 206446 (emphasis added).

Met's 1992 Revenue Design Study Report, commissioned at the insistence of the Legislature after Met's disastrous response to the 1987-1992 drought, also makes clear that dry-year peaking is not some construct of San Diego's invention; on the contrary, it is central to any effort to "understand the variability of Metropolitan's water demands." *PTX15 at 1604. When "Metropolitan deliveries were compared against other data to find a relationship between deliveries and other explanatory factors," the "strongest long term relationship found was between the total monthly rainfall measured at Los Angeles Civic Center and the total deliveries." *Id.* at 1604-06. The reason is dry-year peaking:

> Two mechanisms combine to define the amount of water that Metropolitan wil1 be able to deliver in any given situation. During normal or wet years, Metropolitan is limited by the amount of water that member agencies are wil1ing to purchase. In those years, Metropolitan has sufficient supplies available to meet all the demands made by its member agencies. In this situation, it would be expected that there is a strong negative correlation between rainfall and the demand for water deliveries from Metropolitan. Normal or above normal rainfall increases local supplies, reduces local demands, and reduces the demand for water deliveries from Metropolitan. In these years, the sales by Metropolitan are limited by demand only.
>
> However, during drought years, Metropolitan is not able to meet demands due to limitations on supplies. If population growth and its associated increases in demands for water continues to increase, these types of supply driven limitations may become more prevalent unless additional sources of supply are obtained. In these years, sales by Metropolitan will be limited by supply, and not demand as has generally been the case historically.

Id. at 1606. As AWWA explained in the record document cited above (AR2010-3865 at 1421-23)—and the 1992 Study makes even more clear, and explicitly directed at Met—Met's uniform volumetric rates do not equitably recover these dry-year peaking costs because they "do not distinguish between a customer with a very steady and predictable load factor and one which only peaks on the system. Customers only peaking on a system require considerable investment in

capital facilities and related operating costs to meet those peak requirements, yet may not use sufficient quantities of water to recover those costs." *PTX15 at 1686; *see also id.* at 1576. This is a problem of inequitable rates in every year, and becomes a "major problem" for Met's own revenue stability "in years when the entire region is subjected to cool, wet weather, or required to reduce purchases due to limited supplies." *Id.* at 1687. Thus, the authors recommended that "Metropolitan should explore implementation of a rate form which recognizes both the volume of water purchased and the peak demand placed on its system by member agencies. Such a rate form would enhance overall equity and improve revenue stability.… A detailed cost allocation study should be undertaken to determine appropriate cost based commodity-demand rate structures." *Id.* at 1577-78.

Met has never done a "detailed cost allocation study." *Id.* As Ms. Skillman explained, "We don't perform the cost of service study based on benefits." *Id.* at 739:78. That simply means that what Met calls a "cost of service study" does not attempt to allocate costs according to cost-causation, but instead to maximize rate stability. That is illegal, as discussed above, and for Met to try to justify it by claiming, as Ms. Skillman did, that it "had not heard the concept dry year peaking until it was raised by the Water Authority in March of 2012," Tr. 707:23-708:17, is to deny reality and contradict the undisputed evidence. *See*, *e.g.*, *PTX-6 at 206441-46 (1969 Study); *PTX15 at 1604-06 (1992 Study); AR2010-1406 at 1440, 1486-88 (IRP); AR2012-16288_2114 at 2189-92 (Raftelis 1999).

More recent evidence shows the same thing. Met's sales can swing from 1.5 million to 2.5 million per year depending on whether it is a wet or dry year or a wet-year. *See* *PTX-208, at 64948; *see also* *PTX-101 at MWDPRA1072655. But some member agencies are more responsible than others for these swings. For example, San Diego expert Dan Denham measured—for LA, for San Diego, and for a composite of all other member agencies—annual purchases from Met against a baseline average of seven years (1994-2000). The resulting chart, in evidence as *PTX-384, demonstrates that while all member agencies peak to some degree, LA's annual peaking is far more dramatic. San Diego, and the composite of other member agencies, have increased sales by as much as 40% or 50%, relative to the baseline, in dry years; but LA, in

dry years, buys 200% or even 300% more water than it did in the baseline period. This is consistent with the information about LA's annual variation in purchases detailed in Met's official bond statements, one of which is in the 2012 administrative record (AR2012-16429-573), and another of which (for 2013) was presented by San Diego at trial (*PTX-244 at p. A-30). These bond statements explain that, both in the past decade and over the next 25 years, LA's purchases from Met can vary by as much as 250,000 acre-feet from one year to the next, depending on whether it is a wet year or a dry year.

Met objected at trial that San Diego should have used a longer baseline, through 2003, when Met unbundled its rates. Tr. at 341-344 (Denham cross). It is not clear what unbundling could possibly have to do with dry-year peaking—given that Met freely admits that it refused to account for dry-year peaking in any way, in unbundling its rates or otherwise—but in any event, re-doing the analysis as Met advocated does not alter the results. As San Diego showed the Court in rebuttal at trial, using the raw data from *PTX-383, if one shifts the "baseline index" period to cover the period 1994-2003, the scope of LA's peaking appears less dramatic, but is still far greater than that of San Diego or the composite of other member agencies. *See* Braunig Decl., Ex. E. The same story is revealed by comparing agencies' annual sales against an index of average MWD purchases over the entire 20-year period 1994-2013. *See* Braunig Decl., Ex. F.[23] For San Diego and the composite of other member agencies, sales rise and fall within a plus-or-minus 20% range from the average. By contrast, LA's sales fall to 70% or more below the average in wet-years, or years when flows from the Owens Valley are high, and rise to more than 60% above the average in dry-years. *Id.*

Met's emphasis on the fact that San Diego peaks as well misses the point. San Diego's argument is simply that annual, or dry-year, peaking is a real phenomenon and one that is not consistent across all member agencies. Given the fact that dry-year peaking imposes costs on Met, especially in terms of the need to buy and store additional water, as a simple matter of cost-

[23] San Diego attempted to move these two exhibits, which were marked as *PTX-387 and *PTX-388, into evidence. The Court sustained Met's objection to them as demonstratives, but "encourage[d] San Diego if it wants, to include these as part of its argument in the argument submission, for example post-trail brief if you wish." Tr. at 823:17-20.

of-service, Met is required to account for those costs and recover them in proportion to which member agencies benefit from the dry-year storage. Mr. Denham's analysis suggested, by way of example, that LA's unusual peaking profile provides it with a unique 60,000 acre-foot per year benefit, the costs of which are spread across all Met member agencies. Tr. at 329:22-334:6 (Denham). LA should pay for the costs of this dry-year insurance that Met provides—not only in the years LA uses that insurance but, even more importantly, in the years it does not. If other member agencies—including San Diego—rely on Met for dry-year services at an above-average level, they too should bear the costs. That is the definition of reasonableness in rate-making: everyone must pay in proportion to the costs they cause and the benefits they receive.

Extra-record evidence also provided further explanation of what the costs of dry-year peaking are, and how Met recovers them. Met retains more than three million acre-feet of storage, a large portion of which is bought and stored as insurance for use in dry years. Tr. at 543:6-544:8 (Yamasaki). In addition to the costs of obtaining this extra water, Met incurs capital costs to store and utilize this water in dry years. *Id.*; see also *id.* at 505:11-15. When Met prepared its Long Range Finance Plan in 2004, it was spending $10 million to $15 million per year for storage in groundwater basins off the SWP "for future use during dry years." *PTX-101 at 1072659; *see also* *PTX-37 at MWDPRA43; Tr. at 512:1-15 (Yamasaki) (describing how Met uses its investment in groundwater storage programs to support its operations in dry years). Because these costs are not caused by—or even related to—wheeling, their inclusion in Met's wheeling rate both exceeds "fair compensation" and violates the Wheeling Statute's requirement that Met act reasonably to facilitate wheeling. Water Code §§ 1811(c), 1813.

d. Met's misallocation of costs to its wheeling rate is significant.

Testimony at trial further established the financial consequences of Met's decision to place "rate stability" over cost-of-service. Dan Denham testified that Met's inclusion of SWP costs, conservation and water-supply development costs in its transportation and wheeling rates resulted in an overcharge to transportation of $236 per acre-foot in 2011, $232 per acre-foot in 2012, and $315 per acre-foot in 2013, and will result in a $302 per acre-foot overcharge in 2014. Tr. at 311:11-314:25. Mr. Denham was able to identify in Met's revenue requirements Met's

costs associated with the SWP and those associated with its "demand management program." *Id.* at 304:17-307:11. He then traced those costs to specific Met transportation rates and re-calculated Met's transportation rates if those costs were not included. *Id.* at 307:12-308:13. For example, for calendar year 2011, Mr. Denham testified that, without SWP costs, the System Access Rate would have fallen from $204 per acre-foot to $103 per acre-foot, a $101/af difference; the System Power Rate would have fallen from $127 per acre-foot to $33 per acre-foot, a $94/af difference. *Id.* at 309:7-310:22. Were the Water Stewardship Rate not treated as a transportation rate, Met's 2011 transportation rates would have fallen by another $41 per acre-foot. *Id.* at 310:23-311:6. In recent years, San Diego has been wheeling more than 150,000 acre-feet per year through Met's facilities. *See* *PTX-299, *PTX-300, *PTX-301. San Diego loses tens of millions of dollars per year because of Met's misallocation of SWP and Water Stewardship costs. Indeed, in a naked appeal to rate stability over the legal requirements of facilitating wheeling and charging no more than "fair compensation" for it, Met's controlling member agencies demanded, in June 2010, that Met not reallocate these costs to its supply rates because doing so would save San Diego nearly ***$3 billion dollars by the end of the QSA*** with "a corresponding increase in cost shared by Metropolitan's other member agencies." *PTX-171. By bowing to that pressure, Met violated the law. *See Morro Bay*, 81 Cal. App. 4th at 1050.

D. Met's transportation rates violate Government Code sections 54999.7(a) and 66013.

Section 54999.7(a) of the Government Code prohibits Met from imposing rates that "exceed the reasonable cost of providing the public utility service." Gov't Code § 54999.7(a). Similarly, section 66013 provides that "when a local agency imposes fees for water connections or sewer connections, or imposes capacity charges, those fees or charges shall not exceed the estimated reasonable cost of providing the service for which the fee or charge is imposed," unless approved by a popular two-thirds vote. Gov't Code § 66013. Although Met previously argued that it is not bound by the cost-of-service requirements of Government Code Sections 54999.7(a) and 66013 in setting its rates, Met's counsel made no mention of that argument at trial. In any event, San Diego disposed of Met's arguments in the pretrial briefing. *See* Attachs. A & B §

III.D. For the reasons demonstrated at length above based on the administrative record, Met's rates violate these cost-of-service requirements. The Court, therefore, should invalidate Met's rates because they violate Government Code sections 54999.7(a) and 66013.

E. Met's transportation rates violate the Met Act.

The Met Act requires that rates "be uniform for like classes of service throughout the district." Water Code § 109-134. As the Court recognized in its pretrial rulings, one way "to establish a MWD Act violation is to prove different classes of entities." Pretrial Rulings at 21 n.18. Once San Diego has made a prima facie case that Met charges its "uniform" rates to "different classes of entities," *id.*, rather than "like classes of service throughout the district," Water Code § 109-134, the burden to produce contrary evidence shifts to Met. *See* Pretrial Rulings at 20-21. San Diego has more than carried its initial prima facie burden, yet Met has not come close to carrying its burden of production.

First, it is beyond dispute that wheeling is a distinct class of service—that is what Met's Administrative Code expressly provides. *See* Met Admin. Code §§ 4401, 4405. Because the wheeling rate does not include the supply rates, wheeling is among Met's "***other classes of service***." *Id.* § 4401(a)(1) (emphasis added). Yet Met's wheeling rate includes costs that are not caused by wheeling, with the result that the wheeling "class[] of service" subsidizes "other classes of service," *id.*—in particular, those that obtain a Met water supply without paying the full cost of it because supply costs are improperly loaded onto the wheeling rate. As the AWWA guidelines, which are undisputedly authoritative, make clear, this violates fundamental cost-of-service principles. "Properly designed rates should recover the cost, as nearly as is practicable, of providing service to a customer, or a class of customers, ***with minimal cross-subsidizing among customer classes***." AR2010-3865 at 4117 (emphasis added). Met's rates do the opposite, as proven at trial and demonstrated throughout this brief.

Second, the AWWA guidelines also make clear that Met's member agencies fall into different classes because "demand characteristics … significantly differ among individual wholesale customers." *Id.* at 4121. Cost causation—which Met agrees is the applicable standard (*see, e.g.*, Met's Opening Slides at 39)—"recognizes differences in the costs of providing service

to different types of customers. For example, a customer with a higher than average peak rate of use requires larger capacity pumps, pipes, and other system facilities than a customer with an equal total volume of use who takes water at a uniform rate." AR2010-3865 at 3993. Thus, "cost allocation procedures should recognize the particular service requirements of the customers for total volume of water, peak rates of use, and other factors," *id.*, and if "peak demand is a major determinant of system capacity and the need for system expansion," the water agency should not, as Met does, recover the bulk of those costs through uniform volume rates. *See id.* at 4123. "To the extent that costs of providing service are related to peak demand, a uniform volume rate by itself may be less equitable than one with a demand rate," *id.*, or "a minimum-purchase (take-or-pay) requirement." *Id.* at 4121.

As discussed at length above, the demand characteristics of Met's member agencies differ dramatically with respect to the dry-year peaking costs they cause Met to incur. *See, e.g.*, AR2012-16288_2114 (Raftelis 1999) at 2189-92; AR2012-16156 (FCS) at 16176-78; AR2010-1406 (IRP) at 1440, 1486-88; AR2012-16429 (Bond Statement) at 16521-23; AR2010-11443 (2010 Engineer's Report) at 11512-13; AR2012-16594 (2012 Engineers' Report) at 16807-08. Met acknowledges that those costs are recovered through its uniform rates, including the transportation rates. *See*, *e.g.*, Met's AR Slides at 147. But because of the large variations in member agencies' dry-year peaking, Met's "uniform" rates are ***not*** charged to "like classes of service throughout the district." Water Code § 109-134.

Note that San Diego is not claiming, and the AWWA guidelines do not recommend, that Met must have different uniform volume rates for a class of "dry-year peakers." The point is that that such benefits would—as Met's own Engineers' Reports point out—be "more equitably be paid in part by assessments on land that in part derives its value from the availability of water;" or—as AWWA points out—by take-or-pay requirements or demand rates, or in some other reasonable manner. *See* AR2010-11443 at 11512-13; AR2012-16594 at 16806-07; AR2010-3865 at 1421-23. But Met cannot refuse to account for, or even analyze, the significant differences among its member agencies' dry-year peaking characteristics, yet assert—as it does with an admitted lack of any evidentiary support whatsoever, *see, e.g.*, PTX237-A (RFA)—that its rates

are nevertheless "uniform for like classes of service." Water Code § 109-134.

Third, if the Water Stewardship Rate could be considered a water rate at all—as opposed to a tax, which is what it is—the Water Stewardship Rate does not constitute a uniform rate for "like classes of service." *Id.* As the administrative record shows, different member agencies receive very different benefits from the Water Stewardship Rate and the programs it funds, despite paying the rate uniformly. *See* AR2012-13083 at 13089; AR2012-17126_15 at 23. Met admits that it cannot prove otherwise. *See* PTX237-A (RFA) Nos. 17-20, 22, 24, 26, 28, 30, 32, 34, 36, 38, 40, 42. And San Diego, having been excluded from receiving any further Water Stewardship subsidies, is not even eligible for those benefits, plainly putting it into a distinct, and highly inequitable, "class of service." *See* AR2012-13083 at 13089.

San Diego submits that the evidence just cited, combined with all the other record evidence discussed at further length above, more than shifts the burden, requiring Met to produce record evidence showing that it does not, in fact, have "different classes of entities." Pretrial Rulings at 21 n.18. Met has not carried that burden. On the contrary, ***Met's responses to San Diego's RFAs constitute binding judicial admissions of its complete failure of proof***. *See generally* PTX237-A (RFA). Thus, Met's transportation rates violate the Met Act and are invalid.

F. Met's transportation rates violate the common law.

Finally, water rates are invalid under the common law if they are not based "on the cost of service or some other reasonable basis." *Cnty. of Inyo v. Pub. Utilities Com.*, 26 Cal. 3d 154, 159 n.4 (1980). Met does not rely on any other supposedly "reasonable basis" for its rates; the parties agree that the relevant standard is cost causation—*i.e.*, rates must be "established so that users generally pay an amount equal or proportional to the costs the system incurs to provide them service." AR2010-3865 at 4185-86 (AWWA). For all the reasons set forth above, however, Met fails that standard. It has no cost of service basis for its water rates—they are based, instead, on rate stability at the ***expense*** of proper cost-of-service allocation. Met's rates violate the common law and should be invalidated for this reason, as well.

///

///

IV. CONCLUSION

For the foregoing reasons, the Court should invalidate Met's transportation rates—*i.e.*, its System Access Rate, System Power Rate, Water Stewardship Rate, and wheeling rates.

Respectfully submitted,

Dated: January 17, 2014

KEKER & VAN NEST LLP

/s/ Dan Jackson

By: JOHN KEKER
DANIEL PURCELL
DAN JACKSON
WARREN A. BRAUNIG

Attorneys for Petitioner and Plaintiff
SAN DIEGO COUNTY WATER AUTHORITY

PROOF OF SERVICE BY ELECTRONIC TRANSMISSION AND EMAIL VIA PDF FILE

I am employed in the City and County of San Francisco, State of California in the office of a member of the bar of this court at whose direction the following service was made. I am over the age of eighteen years and not a party to the within action. My business address is Keker & Van Nest LLP, 633 Battery Street, San Francisco, CA 94111-1809.

On January 17, 2014, I served the following documents described as:

SAN DIEGO'S POST-TRIAL BRIEF

by serving a true copy of the above-described documents in the following manner:

BY LEXIS NEXIS® FILE & SERVE

On the date executed below, I electronically served the documents described above via Lexis Nexis® File & Serve on the recipients designated on the Transaction Receipt located on the via Lexis Nexis® File & Serve website.

Executed on January 17, 2014, at San Francisco, California.

I declare under penalty of perjury under the laws of the State of California that the above is true and correct.

Maureen L. Stone