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SUPERIOR COURT OF THE STATE OF CALIFORNIA

COUNTY OF SAN FRANCISCO

SAN DIEGO COUNTY WATER AUTHORITY,

Petitioner and Plaintiff,

v.

METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA; et al.,

Respondents and Defendants.

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

RESPONDENT/DEFENDANT METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA'S OBJECTIONS TO THE COURT'S TENTATIVE DETERMINATION AND PROPOSED STATEMENT OF DECISION ON RATE SETTING CHALLENGES

Dept.: 304
Judge: Hon. Curtis E. A. Karnow

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

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I. INTRODUCTION

Pursuant to Code of Civil Procedure section 634 and rule 3.1590(g) of the California Rules of Court, Respondent and Defendant Metropolitan Water District of Southern California ("MWD") objects to the Court's Tentative Determination and Proposed Statement of Decision on Rate Setting Challenges ("Tentative") issued on February 25, 2014.[1] MWD also requests a hearing on its objections pursuant to rule 3.1590(k). MWD's objections present an important opportunity for the Court to correct the factual and legal errors in its Tentative. *In re Marriage of Ditto*, 206 Cal. App.3d 643, 647 (1988) ("court is not bound by its statement of intended decision and may enter a wholly different judgment than that announced"); rule 3.1590(b) ("the tentative decision does not constitute a judgment and is not binding on the court").

MWD's adoption of the rates at issue is unquestionably a quasi-legislative action. *20th Century Ins. Co. v. Garamendi*, 8 Cal. 4th 216, 277 (1994). The law is clear that quasi-legislative actions are entitled to the highest level of judicial deference and cannot be set aside absent the most extraordinary circumstances. *See Brydon v. East Bay Mun. Util. Dist.*, 24 Cal. App. 4th 178, 196 (1994) ("it *must be presumed* the [agency] did not act arbitrarily or unreasonably . . . but that it was guided by sound discretion and a conscientious and intelligent judgment") (emphasis added). The scope of a court's review is limited, out of deference to the agency's authority and presumed expertise, and the court "may not reweigh the evidence or substitute its judgment for that of the agency." *Exxon Mobil Corp. v. OEHHA*, 169 Cal. App. 4th 1264, 1277 (2009). Simply put, this Court is prohibited from substituting its judgment for that of MWD's Board of Directors or reweighing the evidence before MWD's Board when it adopted the rates. The Court's Tentative violates these fundamental principles.

Ratemaking embodies the complexity of quasi-legislative decision making and involves balancing many competing economic and policy objectives. It is well-established that the "process of selecting the most appropriate rate structure for a particular utility is not simple. The selection is complex because there are so many types of rate structures. No one rate structure

[1] All rule references are to the California Rules of Court.

meets all utility objectives equally, and not all objectives are valued the same by the utility or its customers." DTX-030 at AR2012-003963 (American Water Works Association's ("AWWA") Manual M-1, *Principles of Water Rates, Fees, and Charges* (5th Ed.); JTX-1 at AR2010-003963.

Even under the most stringent standard of review that the Court stated it would apply in this case, the Court is not permitted to choose the "best" rate structure, or the structure that any one entity or person might prefer. "That there may be other methods favored by plaintiffs does not render a defendant's method[s] [unlawful]," and courts should not prescribe a particular method, *or disturb the defendant's method of setting rates*, as long as the defendant's method is reasonable. *Griffith v. Pajaro Valley Water Mgmt. Agency*, 220 Cal. App. 4th 586, 601 (2013) ("*Griffith II*") (emphasis added). California's courts recognize that a reasonableness inquiry requires a flexible assessment, and thus have refused to invalidate charges where a plaintiff's suggested method is not the "*only* reasonable manner" in which the defendant could have allocated its fee. *Equilon Enter. v. State Bd. of Equalization*, 189 Cal. App. 4th 865, 882-86 (2010) (emphasis added); *see also Brydon*, 24 Cal. App. 4th at 200 (rejecting plaintiffs' arguments for alternative water rates for failing to overcome the presumption that defendant's rates are reasonable); *Hansen v. City of San Buenaventura*, 42 Cal.3d 1172, 1181 (1986) (because reasonableness "is the beginning and end of the judicial inquiry," courts will not overturn water rate if there is a reasonable basis for its design such as "the cost of [providing] service or some other reasonable basis").

The fact that SDCWA has suggested alternative rate designs, and has presented evidence to support its assertion that those rate designs could be considered *more reasonable* or preferable by some, does not render MWD's rates unreasonable or unlawful. The existence of other reasonable rate structures is irrelevant to the Court's inquiry, and the Court should not have taken such evidence into account when it made its tentative determination. As demonstrated at the final hearing, MWD's rate-making decisions are supported by substantial evidence and comply with applicable law. The Court's Tentative nevertheless second guesses MWD's complex rate structure that was carefully designed over a decade ago to balance the varying objectives of its 26 member public agencies, and invalidates MWD's rate structure in favor of a structure the

Court deems more reasonable. In so doing, the Tentative improperly exceeds the proper scope of judicial review. *Durant v. City of Beverly Hills*, 39 Cal. App. 2d 133, 139 (1940) ("The universal rule is that . . . the court is not a rate-fixing body").

Accordingly, MWD respectfully asks the Court to reconsider its Tentative based on the legal and factual errors discussed below.

II. SUMMARY OF ISSUES

The Tentative is flawed for the following reasons:

First, it misapplies the standards of review governing SDCWA's rate challenges. Throughout, the Tentative fails to address, misinterprets, or mischaracterizes the evidence MWD presented to support its rate for full service water and rate for wheeling service, and impermissibly re-weighs MWD's evidence against SDCWA's evidence.

Second, the Tentative fails to analyze the validity of MWD's rate for *full service water*. The Tentative's analysis concerns only *wheeling*. Yet, the Tentative's conclusion suggests that it invalidates not only the rate for wheeling service, but also the full service rate. Because the Tentative does not analyze the overall cost of providing full service water in order to determine whether MWD's rate for full service water is appropriate, its invalidation of that rate is unfounded.

Third, the Tentative's analysis of MWD's rate for wheeling service is based on factual and legal errors. Regarding MWD's allocation of State Water Project ("SWP") transportation costs, the Tentative (a) does not apply the law governing facial challenges (applicable to SDCWA's challenge to MWD's rate for wheeling service); (b) fundamentally misconstrues MWD's relationship with the state Department of Water Resources ("DWR"); and (c) improperly re-weighs the evidence presented during the rate-setting process. Regarding MWD's allocation of demand management costs through its Water Stewardship Rate, the Tentative finds that the expenditures "primar[ily]" confer a supply benefit (Tentative at 58-59), but absent from the administrative record and final hearing record is evidence establishing a significant and quantifiable "primary" supply benefit to MWD. In contrast, there was substantial evidence presented of significant and quantifiable transportation benefits, of avoided infrastructure costs

and increased capacity. Further, the Tentative requires MWD to conduct an analysis calibrating the precise transportation and supply-related benefits of its demand management programs that is not required under the law. MWD's Board has determined that its demand management programs provide a significant transportation-related benefit, and it is thus reasonable for its Board to decide to allocate those program costs to the transportation component of its rate for full service water and its rate for wheeling service. The Tentative relies on unsupported assertions and impermissibly re-weighs the evidence in order to reach a contrary determination.

Fourth, the Tentative states, incorrectly, that the Court had previously decided the issue of whether Proposition 26 applies has been satisfied. In fact, the Court did not previously decide that issue. As a result, the Court failed to consider evidence MWD presented at the final hearing to show that Proposition 26 either does not apply, or has been satisfied. Consequently, the Tentative's finding that Proposition 26 applies and was violated is wrong as a matter of law.

Fifth, the Tentative's finding that Government Code section 54999.7 applies and was violated is wrong as a matter of law.

III. OMISSIONS, AMBIGUITIES, AND ERRORS IN THE TENTATIVE DETERMINATION

A. The Tentative misapplies the standards of review.

Although the Tentative identifies the various standards of review governing the different causes of action in SDCWA's rate challenge (Tentative at 17-23), the Tentative fails to properly apply these standards. As the Tentative finds, the default arbitrary and capricious standard applies to SDCWA's common law and Government Code claims. *Id.* at 21-23. This standard requires that a challenge to an agency action be denied unless that action was "entirely lacking in evidentiary support." *Brydon*, 24 Cal. App. 4th at 196. The crux of the Court's inquiry is whether the agency can "cite[] a legitimate reason" for its action. *San Joaquin Local Agency Formation Comm'n v. Super. Ct.*, 162 Cal. App. 4th 159, 170 (2008). Under an arbitrary and capricious standard, quasi-legislative decisions are entitled to significant deference for two important reasons: first, to guarantee that courts will not "usurp legislative power and thereby violate the separation of powers," and, second, because agencies such as MWD "develop a high

degree of expertise" in their subject areas. *Western States Petroleum Ass'n v. Super. Ct.*, 9 Cal. 4th 559, 572 (1995); *see also Pitts v. Perluss*, 58 Cal. 2d 824, 834-35 (1962) ("The substitution of the judgment of a court . . . in quasi-legislative matters would effectuate neither the legislative mandate nor sound social policy"); *Carrancho v. California Air Resources Bd.*, 111 Cal. App. 4th 1255, 1272 (2003) ("A court passing on the means employed by an agency to effectuate a statutory purpose will not substitute its judgment for that of the agency in the absence of arbitrary and capricious action."); *Brydon*, 24 Cal. App. 4th at 196.

The substantial evidence standard applies to SDCWA's Wheeling Statute claim. Tentative at 19-21. While the arbitrary and capricious standard is even "*more* deferential to agency decisionmaking" than the highly deferential substantial evidence standard (*see American Coatings Ass'n., Inc. v. South Coast Air Quality Dist.*, 54 Cal.4th 446, 461 (2012) (emphasis added)), courts often utilize the substantial evidence test to determine if an agency's decision is arbitrary and capricious. *See Golden Drugs Co., Inc. v. Maxwell-Jolly*, 179 Cal. App. 4th 1455, 1467 (2009) ("We recognize that not everyone acknowledges a distinction between 'devoid of evidentiary support' and 'substantial evidence'") (citations omitted). Both standards are highly deferential, require a reasonable basis for the decision, and generally mean that "a court cannot disturb the agency's decision if substantial evidence in the administrative record supports the decision." *Plastic Pipe & Fittings Ass'n v. California Bldg. Standards Comm'n*, 124 Cal. App. 4th 1390, 1406 (2004); *Warmington Old Town Assocs. v. Tustin Unified Sch. Dist.*, 101 Cal. App. 4th 840, 850 (2002).

"Substantial evidence" does not refer to a substantial amount of evidence, but rather evidence of legal significance or evidence adequate to support a conclusion. *United Professional Planning, Inc. v. Super. Ct.*, 9 Cal. App. 3d 377, 392-93 (1970) (substantial evidence means "such relevant evidence as a reasonable man might accept as adequate to support a conclusion"); *Toyota Motor Sales U.S.A. v. Super. Ct.*, 220 Cal. App. 3d 864, 871 (1990) (substantial evidence includes a focus on the quality, not the quantity, of evidence); *In re Estate of Teed*, 112 Cal. App. 2d 638, 644-45 (1952) (court reasoning that if the word "substantial" means anything, it clearly implies that such evidence must be of ponderable legal significance).

Under the proper standard, the Court may invalidate MWD's rates only if the record is bereft of evidence supporting the reasonableness of those rates. *See Brydon*, 24 Cal. App. 4th at 196 (A challenge to an agency action must be denied unless that action was "*entirely lacking* in evidentiary support") (emphasis added). As explained below (Sections III.B-C, *infra*), MWD presented substantial evidence that its rates are reasonable, most of which the Tentative fails to address, misinterprets, or mischaracterizes. For example:

- The Tentative does not mention, let alone consider, a 2010 Raftelis Financial Consulting report that determined (1) that MWD's cost of service methodology is reasonable; (2) that MWD's cost of service and rate methodology is consistent with industry best practices, including the rate guidelines in the AWWA M1 Manual; (3) that MWD's rates are consistent with the rate structure framework MWD adopted in 2001; and (4) that MWD's cost of service is also consistent with the rate structure framework. DTX-088 at AR2012-011321-011323; JTX-1 at AR2010-011321-011323. This omission is prejudicial error because this report alone could support MWD's rates as reasonable. *Plastic Pipe and Fittings Ass'n v. California Bldg. Standards Comm'n*, 124 Cal. App. 4th 1390, 1407-08 (2004) (under an arbitrary and capricious standard of review, an agency has discretion to rely on a single item of evidence from a credible source experienced in the particular subject matter).

- When assessing the reasonableness of allocating SWP transportation costs to the rate for wheeling service, the Tentative ignores MWD's evidence that SWP transportation costs are MWD's own transportation costs, because DWR defines which SWP costs are for transportation and then *legally allocates* these to MWD in its contract with MWD. Tentative at 45, fn. 68. In making the determination whether a "good basis" for this allocation appears in the record" (Tentative at 53), the Tentative should have considered this evidence. *Brydon*, 24 Cal. App. 4th at 196. The DWR Contract alone could support MWD's SWP transportation allocations. *Plastic Pipe and Fittings Ass'n*, 124 Cal. App. 4th at 1407-08; *United Professional Planning, Inc.*, 9 Cal. App. 3d at 392.

- When the Tentative discusses the facts of *Metropolitan Water Dist. of Southern California v. Imperial Irrigation District*, 80 Cal. App. 4th 1403 (2000) (Tentative at 23-26), it focuses on only a portion of MWD's rationale for placing system-wide costs in its rate for wheeling service (along with its full service rate). And although the Tentative focuses on MWD's desire to avoid putting costs solely on its full service customers, it misses the pivotal point—MWD placed these costs in its rate for wheeling service (along with its full service rate) because wheelers are partially *responsible* for them, and if they did not pay these costs too, "member agencies as well as the taxpayers would in effect be forced to subsidize in material part the wheeling transactions." 80 Cal. App. 4th at 1421; s*ee also id.* at 1432-33 (Legislature did not intend the Wheeling Statute to require subsidized wheeling transfers). Thus, MWD's allocation of these costs to wheelers is not a deviation

from, but is consistent with, cost causation principles.

- The Tentative states that RMI's October 1995 study is not evidence supporting MWD's allocation of fixed SWP costs to its rate for wheeling service because this study states only that the costs associated with operating the Colorado River Aqueduct are arguably classifiable as transportation costs. Tentative at 53-54. This is wrong. RMI included the cost of operating and maintaining *both* aqueducts—MWD's Colorado River Aqueduct *and* DWR's California Aqueduct—in the Transmission Function, not the Supply Function. DTX-013 at AR2012-001112; JTX-1 at AR2010-001112. The Tentative's misinterpretation of this study results in a decision that disregards evidence supporting the validity of MWD's rate for wheeling service.

- The Tentative incorrectly states that the purpose of the SB-60 reports is to document how much water MWD was able to "avoid *selling*." Tentative at 13 (emphasis added). In fact, the evidence demonstrates that the SB-60 reports document the decreased demand on MWD's system—*i.e.*, the number of acre-feet MWD was able to avoid *transporting*, whether from decreased sales or decreased wheeling. MWD Closing Brief at 64-65.

- The Tentative states that although MWD calculated it would be able to save $2 billion in capital infrastructure costs as a result of its demand management programs in its Integrated Resources Plan ("IRP"), it "is unclear the extent to which the demand management programs contemplated in the [IRP] are in existence." Tentative at 14. Whether MWD's demand management programs are as the IRP contemplated is not the correct inquiry; the issue is whether MWD has, in fact, been able to avoid these costs. As Mr. Upadhyay, the Manager of MWD's Water Resources Management Group, testified at the final hearing, MWD has been able to defer building the facilities that formed the basis of MWD's calculation. 12/20/2013 Tr. at 573:6-574:3.

Furthermore, the Tentative repeatedly weighs the evidence supporting MWD's rate allocations against SDCWA's evidence —an approach that is contrary to the standard governing review of agency actions. *Exxon*, 169 Cal. App. 4th at 1277 (the scope of a court's review is limited, out of deference to the agency's authority and presumed expertise, and the court may not *reweigh* the evidence or substitute its judgment for that of the agency). This limited judicial review is further constrained by the fact that, in "technical matters requiring the assistance of experts and the study of marshaled [technical] data, courts will permit administrative agencies to work out their problems with *as little judicial interference as possible*.'" *Id.* (emphasis added); *see also Western States*, 9 Cal.4th at 572 (quasi-legislative agency determinations and findings

are entitled to significant deference because the agencies often develop a high degree of expertise in their subject areas and governing law); *San Diego County Water Authority v. Metropolitan Water Dist.*, 117 Cal.App.4th 13, 23 n. 4 (2004) ("[s]ubstantial deference must be given to [Metropolitan's] Board's determination of its rate design").

It is well-established that "[u]rban water pricing is a vastly complex [and technical] mechanism depending greatly upon the source and use of the water." *Brydon*, 24 Cal. App. 4th at 201; DTX-030 at AR2012-003963 ("The process of selecting the most appropriate rate structure for a particular utility is not simple. The selection is complex."); JTX-1 at AR2010-003963. Because MWD has developed considerable expertise in water issues, and because rate-making is technical and complex, MWD's rate determinations are entitled to deference. MWD's Board already weighed the evidence regarding the proper allocation of its SWP and demand management costs during the rate-setting process. By re-weighing that evidence, the Tentative effectively, and impermissibly, substitutes the Court's judgment for MWD's Board's judgment. For example:

- When determining whether MWD reasonably allocates its SWP costs to its rate for wheeling service, the Tentative weighs a May 1996 RMI report that treated MWD's fixed SWP costs as its transportation costs against a Bartle Wells report that "vigorously dispute[s] the propriety of this treatment of SWP costs." Tentative at 54. Without justification, the Tentative finds that SDCWA's Bartle Wells opinion is more persuasive than RMI's opinion. Under an arbitrary and capricious standard of review, it is irrelevant that the evidence supporting the agency's decision was "vigorously dispute[d]" (Tentative at 54). *See Western States*, 9 Cal. 4th at 574 ("A court's task is not to weigh conflicting evidence and determine who has the better argument" but instead whether the "quasi-legislative decision was supported by substantial evidence").

- Although the Tentative says it will not determine whether the San Pedro principles are generally appropriate, it nevertheless adopts SDCWA's argumentative characterization of those principles without giving credence to MWD's explanation of its own stated principles. Tentative at 57. Specifically, the Tentative chooses SDCWA's explanation that MWD places its fixed, unavoidable costs in its rate for wheeling service solely to prevent increasing its rates for full service water customers over MWD's explanation that it includes these costs in its rate for wheeling service, as well as in its full service rate, (1) because cost causation supports such an inclusion, and (2) in order to prevent full service customers from subsidizing the cost of wheeling service. *Id.* The

Tentative then determines that the principles are "not supportable" here. *Id.*

- The Tentative adopts SDCWA's unsupported argument that *supply* is the primary benefit of the demand management programs without any basis for disregarding MWD's evidence that *transportation* is a significant benefit. Tentative at 58-59. For example, the Tentative impermissibly relies on an excerpt of Mr. Upadhyay's deposition testimony (which explained that "one" benefit of the demand management programs is supply-related), and disregarded Mr. Upadhyay's final hearing testimony (which expanded on and explained this deposition testimony). *Compare* 9/13/2013 Tr. at 52:11-53:19, 109:16-111:19 *with* 12/20/2013 Tr. at 589:3-11; 608:3-11. At the final hearing, Mr. Upadhyay testified that although the demand management programs may confer a supply benefit, they are not *primarily* supply-related because they do not develop water supplies for *MWD*, but rather for the *member agencies*. 12/20/2013 Tr. at 589:3-11; 608:3-11. Instead, for MWD, the "ultimate" benefit of these programs is "the reduced need" to transport water through MWD's system. *Id.*

- The Tentative says "it does not matter that Met generally delivers a blend of water to wheelers. . . . The blend might be useful but the benefit is gratuitous." Tentative at 53. First, there was no evidence that in wheeling transactions, MWD delivers only a blend. Second, as to full service water, which is generally blended, this characterization completely disregards MWD's evidence that this blend is both *mandated by law*, and that SDCWA "depends" on MWD blending its SWP and non-SWP water to save millions of dollars from the harmful effects of salinity. MWD Closing Brief at 53-55.

- The Tentative states that Raftelis suggested a 50-50 allocation of demand management costs between supply and transportation "out of frustration," without basis. Tentative at 60. This is an impermissible adoption of SDCWA's unsupported argument about the 1999 Raftelis Report—there is no evidence that Raftelis suggested any allocation out of "frustration."

B. The Tentative's finding on the validity of MWD's full service water rate fails to analyze that rate.

The Tentative's conclusion purports to resolve SDCWA's rate challenges by invalidating MWD's transportation rate components (*i.e.*, the System Access Rate, System Power Rate, and Water Stewardship Rate). Tentative at 65 (there "is no substantial evidence in the record to support Met's inclusion in its transportation rates, and hence in its wheeling rate, of 100% of (1) [MWD's SWP transportation costs recovered through the System Access Rate and System Power Rate]; and (2) the costs for conservation and local water supply development programs recovered through the Water Stewardship Rate"). However, this ruling cannot stand because the Tentative's analysis that leads to this conclusion concerns only MWD's *rate for wheeling*

service. MWD's *other* service—*full service*—was swept into the conclusion, perhaps inadvertently, without any analysis applicable to it.

The Tentative correctly states that MWD provides two separate services: (1) full service water, where MWD delivers MWD water to its customers, and (2) wheeling service, where MWD transports third-party water on behalf of its customers. Tentative at 9. SDCWA challenges the transportation rate components in *both* the full service water rate and the rate for wheeling service. 12/18/13 Tr. at 222:23-223:12 (SDCWA stating that it challenges both the rate for wheeling service as well as the transportation rate component of MWD's full service water rate). The Tentative also states that under all of SDCWA's claims, the essential inquiry is whether the rate bears a reasonable relationship to the cost *of the service* being provided. Tentative at 47, 52. But although the Tentative's conclusion invalidating rates addresses both the "transportation rates" and MWD's "wheeling rate," its entire analysis of MWD's transportation-related SWP and demand management costs (*i.e.*, the System Access Rate, System Power Rate, and Water Stewardship Rate) is based on whether MWD's rate for wheeling service properly recovers the overall cost of providing wheeling service. Tentative at 1-2 (finding that the result of MWD allegedly misallocating its fixed SWP and demand management costs "is that parties who use Met's *wheeling services* pay an inflated rate for that service") (emphasis added). At no point does the Tentative analyze whether allocating MWD's SWP and demand management costs to the transportation component of its *rate for full service water* is proper given the overall cost of providing *that full service*.

This is a huge flaw. Ninety-five percent of the time that MWD charges its System Access Rate and Water Stewardship Rate transportation rate components—two of the three transportation rate components the Tentative declares unlawful—it does so as part of the sale of *full service water*. JTX-2 (AR2012-016429) at AR2012-016539, AR2012-016545 (showing that 95 percent of MWD's water revenues are for full service water and 5 percent are for wheeling). The third transportation rate component the Tentative strikes down—the System Power Rate—is not part of the rate for wheeling service at all, and so it is part of the sale of full service water 100 percent of the time. Yet, the Tentative's conclusion strikes down all three transportation

rates for all purposes.

All of the Tentative's analysis concerning the allocation of SWP and demand management costs relates to fairness to wheelers, and there is no analysis of whether the allocation of these costs to the transportation rate components causes the rate for full service water to somehow become unreasonable. For example, the Tentative finds that MWD's use of the SWP to "move some of its water" is insufficient to merit placing 100 percent of MWD's SWP transportation costs in its transportation rates because the record "does not establish whether it is necessary [to use the SWP] for *wheeling* at all." Tentative at 53 (emphasis added). Additionally, the Tentative finds that MWD's use of the SWP to provide a blend of water to its customers does not support placing MWD's SWP transportation costs in its transportation rate components because that blend is "not required for *wheeling* agreements." *Id.* (emphasis added). Similarly, the Tentative's ruling on the Water Stewardship Rate is based on an analysis of only the propriety of *wheelers* paying that rate. The Tentative finds it is improper for MWD to "treat[] the *entirety* of the Water Stewardship Rate as a 'transportation' rate *that is then incorporated into the wheeling rate*" because the costs attributable to the demand management programs "relate to the transportation needs to provide purchased [*i.e.,* full service] water [and not *wheeled water*]." Tentative at 60-61 (emphasis added); *see also id.* at 2, 52-61, 64-65 (invalidating the System Access Rate, System Power Rate, and Water Stewardship Rate based on an analysis of the overall cost of providing wheeling services).

The Tentative impermissibly divorces its analysis from the rates at issue and the evidence MWD has provided to support those rates. Although at times the *evidence* the Tentative cites refers to MWD's rationale for allocating its transportation costs to the transportation components of its *rate for full service water*,[2] the Tentative's analysis is based solely on the propriety of including those costs in MWD's rate for wheeling service. See Tentative at 53-54 (analyzing

[2] MWD presented evidence that it uses the SWP to convey non-project water in order to provide *full service water*, and to blend SWP and Colorado River water in order to provide a blend to its *full service customers*. *See* MWD Closing Brief at 49-55.

MWD's use of the SWP to move non-project water and provide a blend to the member agencies in relation to the rate for wheeling service). This is improper because the Tentative's analysis regarding the propriety of MWD's rate for wheeling service has no bearing on the validity of MWD's rate for full service water. While the two rates may share some of the same components—*i.e.*, both include the System Access Rate and Water Stewardship Rate—they are charges for two entirely different services. DTX-090 at AR2010-011491; JTX-2 at AR2012-011491; DTX-110 at AR2012-016638; MWD Admin. Code, §§ 4401, 4405. An analysis of the propriety of charging certain costs for providing one service does not bear on the propriety of charging similar costs when providing an entirely separate service.

Nowhere is this demonstrated more clearly than the Tentative's treatment of the System Power Rate, which the Tentative invalidates based on an analysis of the overall cost of providing wheeling service—notwithstanding that the System Power Rate is ***not part of*** MWD's rate for wheeling service. Tentative at 1-2, 64-65; MWD Admin. Code § 4405. In other words, the Tentative impermissibly determines the "sufficiency of evidence" supporting MWD's allocation of SWP-related power costs to its System Power Rate *based solely on an analysis of a rate for wheeling service that does not recover those costs at all*.

Moreover, there are different considerations regarding whether MWD may properly allocate its costs to its rate for full service water versus its rate for wheeling service.[3] Indeed, the Tentative itself recognizes the distinction between the rates for the two different services: including MWD's system-wide costs in the price SDCWA pays for the *water it buys from MWD* may well be proper, but "that does not necessarily mean that San Diego as a *wheeler* must have those same financial obligations." Tentative at 58 (emphasis added). MWD provided substantial evidence during the final hearing and in its briefing that allocating its SWP transportation and demand management costs to the transportation component of its full service water rate is

[3] To the extent that the Tentative rules on the validity of MWD's full service water rate, the Wheeling Statute, and the standard of review thereunder, is inapplicable. By definition, the Wheeling Statute applies only to a charge for wheeling (conveying third-party water). Wat. Code §§ 1810-1811.

reasonable (MWD Closing Brief at 45-74), and this evidence must *separately be evaluated* before the Court can rule on MWD's rate for full service water.

Under the proper analysis, SDCWA's challenge to MWD's full service water rate must be rejected. That analysis requires only that "permissible fees must be related to the *overall* cost of the governmental [service]." *Cal. Farm Bureau Fed'n v. State Water Res. Control Bd.*, 51 Cal.4th 421, 438 (2011) (emphasis added); *Griffith v. City of Santa Cruz*, 207 Cal. App. 4th 982, 997 (2012) ("*Griffith I*").

MWD's full service water rate is lawful if the overall fees for the cost of providing that service—including, but not limited to, MWD's transportation rate components—are related to MWD's overall costs of providing full service water. There is no evidence that MWD's overall full service water rate is not reasonably related to its costs of providing full service water, and the Tentative does not state otherwise. Thus, SDCWA's challenge to MWD's full service water rate should be rejected. A decision invalidating MWD's full service water rate based on a review of the System Access Rate and Water Stewardship Rate only in the context of wheeling, and based on no review of the System Power Rate, would violate the rule obligating the Court to consider the *overall cost* of providing full service water. It would instead improperly focus on the label MWD assigns to its rate components.

In 2003, MWD unbundled the various costs of providing full service water into rate components—*i.e.*, the Tier 1 and 2 supply rates, the System Access Rate, System Power Rate, and Water Stewardship Rate. DTX-042 at AR2012-006439-006441; JTX-1 at AR2010-006439-006441; DTX-045 at AR2012-006473; JTX-1 at AR2010-006473; DTX-132 at AR2012-006462_01; DTX-034 at AR2012-005545-005546; JTX-1 at AR2010-005545-005546. Although MWD has unbundled its rates to more transparently show how it charges for each service, the individual components of MWD's rates do not constitute separate services. For example, MWD does not provide a separate "demand management" service, or a "supply" service, or a "power" service. And the manner in which MWD labels its rate components does not affect the price of MWD's water service. The overall cost of providing full service water includes both MWD's supply and transportation-related SWP costs, as well as its supply and

transportation-related Colorado River costs, its demand management costs, and its other costs. DTX-090 at AR2010-011488, 011490; JTX-2 at AR2012-011488, 011490.; DTX-110 at AR2012-016693, 016695. This was true both before and after the unbundling. The only thing that changed in 2003 is that MWD identified the different components that make up the full service rate—MWD's full service customers have *always* paid for the entirety of these costs. *Id.* The allocation of costs between different components of the full service water rate cannot cause those components to somehow become unlawful because it does not affect the rate. For example, if MWD charged $300 per acre-foot for full service water, that could take the form of one bundled charge of $300, or a $1 supply charge and a $299 transportation charge, or a $299 supply charge and a $1 transportation charge. Those different options would all result in the same $300 rate for the same service, which is full service water.

The Tentative's legal analysis is only about wheeling, but its conclusion sweeps broadly past that. Tentative at 65. It is as though the Tentative started out only to invalidate MWD's rate for wheeling service but then inadvertently in the conclusion struck down MWD's transportation rate components generally, thus invalidating the full service rate as well. It is not correct to invalidate a full service rate based on a rationale applicable only to wheeling. And, it is not proper to invalidate a full service rate, which applies 95 percent of the time, based on a rationale that applies only 5 percent of the time when wheeling occurs. Finally, it is not correct to invalidate the System Power Rate based on a wheeling rationale, when that rate is *never* part of the rate for wheeling service.

Accordingly, the Tentative is at best ambiguous, and at worst erroneous, with regard to MWD's rate for full service water because the Tentative does not have *any substantive analysis of that rate*. *Raisola v. Flower Street Ltd.*, 205 Cal. App. 3d 1004, 1009 (1988) (trial court's determination "clearly erroneous" because it failed to analyze a factual issue before it).

C. The Tentative's finding that MWD's rate for wheeling service is unreasonable is wrong as a matter of law and fact.

1. The Tentative's analysis of MWD's allocation of SWP costs is flawed because it does not apply the law governing facial challenges.

Because SDCWA did not challenge MWD's rate for wheeling service with regard to any particular wheeling transaction, its claim is only a facial challenge to MWD's pre-established rate for wheeling service. This rate applies only to member agencies, for transactions of one year or less. MWD Admin. Code §§ 4119, 4405. When evaluating a facial challenge to the validity of an agency action, a court must consider only the act itself, "not its application to the particular circumstances of an individual." *California Teachers Ass'n v. State of California*, 20 Cal.4th 327, 338 (1999). In other words, a party pursuing a facial challenge cannot prevail by suggesting that, in some future hypothetical situation, problems may possibly arise as to the particular *application* of the agency action. *Id.* Rather, the party must demonstrate that the action *inevitably* poses a *present total and fatal conflict* with applicable legal prohibitions. *Id.* This means that unless it is inevitably improper to include SWP transportation costs in the rate for wheeling service, SDCWA's facial challenge must fail. Accordingly, the Tentative should have—but does not—evaluate MWD's rate for wheeling service in the abstract. As discussed below, the Tentative instead analyzes MWD's rate for wheeling service based on *particular hypothetical situations* in which the rate for wheeling service may apply. This is legal error.

The Tentative acknowledges that MWD's system-wide transportation costs are eligible for inclusion in MWD's rate for wheeling service because the Court of Appeal has established that MWD may include these costs in its rate for wheeling service. Tentative at 56-58 (citing *MWD v. IID*, 80 Cal. App. 4th 1403, 1433 (2000). But the Tentative states that inclusion of SWP transportation costs in MWD's rate for wheeling service is inappropriate here because such an allocation does not satisfy the cost causation requirement, "that is, whether the costs of the services (*e.g.*, wheeling) are reasonably related to the costs of providing those services." Tentative at 52, 56-58.

There is, however, a *direct* relationship between the SWP transportation costs that MWD incurs and the rate MWD charges for wheeling. MWD's payment of SWP transportation costs,

pursuant to its contract with DWR, gives MWD the right to wheel water through the SWP on behalf of its member agencies. When MWD uses the SWP to wheel water on behalf of its member agencies, it does so without having to pay an otherwise applicable facilities fee because it *has already paid for this service* by paying the fixed Transportation Charges under the DWR Contract. *See* DTX-055 at AR2012-000153 (Art. 55(b)-(c)); JTX-1 at AR2010-000153 (Art. 55(b)-(c)); DTX-087 at AR2012-011307 (MWD does not pay an additional facilities fee under the DWR Contract to wheel water on behalf of member agencies because it "has already paid costs of using [the SWP facilities] in the Transportation Charge invoiced under its Statement of Charges"); JTX-1 at AR2010-011307; *see also* DTX-109 at AR2012-016588; 12/19/2013 Tr. at 505:23-506:9 (Yamasaki testimony). SDCWA has repeatedly acknowledged that MWD's wheeling service includes MWD's right to wheel through the SWP, and SDCWA has taken advantage of this right. DTX-086 at *SDCWA2010-2012_00082035 (SDCWA stating that since MWD's "wheeling service includes the member agency *privilege* to use [MWD's] rights to State Water Project facilities, [SDCWA] requests that you provide the necessary coordination to ensure all issues, including delivery schedules, through-delta conveyance capacity, and any other operational matters are timely addressed with the [DWR]") (emphasis added).[4]

While SDCWA could directly approach DWR to wheel water on its behalf, it instead requests this service of MWD, on the basis of MWD's "rights to State Water Project facilities." DTX-086 at *SDCWA2010-2012_00082035; DTX-075 at *MWDPRA044184. Presumably, SDCWA has asked to use MWD's rights, rather than making the request of DWR, because the option is less expensive for SDCWA than it would be if it had to pay DWR a facilities fee (rendering MWD's charge for wheeling less expensive than DWR's). SDCWA recognizes that in the context of using the SWP transportation facilities for wheeling, MWD's rights to the system are equivalent to DWR's. *Id.*

[4] *See also* DTX-075 at *MWDPRA044184 (SDCWA stating that since MWD's "wheeling service includes the right of a member agency to use [MWD's] rights to [SWP] facilities, I also ask that you provide the necessary coordination with DWR . . . to ensure all issues, including . . . operational matters are timely addressed").

Indeed, *every example* MWD provided of wheeling on SDCWA's behalf involved the use of SWP transportation facilities for those wheeling transactions. DTX-185* (2009 agreement between MWD and SDCWA for conveyance of water SDCWA purchased from Placer County Water Agency through SWP transportation facilities); DTX-201* (2008 agreement between MWD and SDCWA for conveyance of water SDCWA purchased from Butte Water District and Sutter Extension Water District through SWP transportation facilities). MWD also presented evidence that it uses the SWP transportation facilities to wheel water on behalf of its other member agencies. DTX-200* (Agreement whereby MWD wheeled non-project water through the SWP transportation facilities on behalf of the Municipal Water District of Orange County, for ultimate delivery to the Santa Margarita Water District). SDCWA, in fact, offered no evidence of any wheeling transaction that occurred anywhere *other* than the SWP transportation facilities.[5]

The only reason MWD has this right to use SWP transportation facilities for wheeling on behalf of its member agencies is because it entered into a contract with the state. Under this contract, MWD agreed to pay its allocated share of the costs of the SWP facilities, whether MWD receives water or not, and whether it wheels water for its member agencies or not. MWD's right to use the SWP facilities to wheel water exists under Article 55 of the DWR Contract (DTX-055 at AR2012-000153 (Art. 55(b)-(c)); JTX-1 at AR2010-000153 (Art. 55(b)-(c))) which contract, as discussed below, requires MWD to pay its *legally allocated* share of SWP transportation costs. *See infra* Section III.C.2. Under the DWR Contract, DWR assesses

[5] Although the Tentative acknowledges evidence that MWD uses the SWP to transport non-project water, the cited evidence actually describes situations where MWD purchases non-project water that it transports through the SWP in order to provide *full service water* to its customers. *E.g.*, Tentative at 54 (citing DTX-87 and DTX 109). As previously explained, these are not wheeling transactions, and this evidence does not bear on whether MWD's inclusion of system-wide SWP costs in its rate for wheeling service is reasonable. Furthermore, the Tentative's discussion of whether MWD must use the SWP to blend water for wheelers suggests a misunderstanding. Tentative at 53. MWD presented evidence regarding the blend of SWP and Colorado River Aqueduct water in order to justify including SWP transportation costs in the transportation components of its rate for full service water, *not* its rate for wheeling service. MWD Closing Brief at Section V.A.3.

the SWP costs and determines which of these costs are transportation-related. DTX-055 at AR2012-000153 (Art. 55(b)-(c)); JTX-1 at AR2010-000153 (Art. 55(b)-(c)). Its disaggregated invoices identify those costs. DTX-087 at AR2012-011307; JTX-1 at AR2010-011307; DTX-109 at AR2012-016588; 12/19/2013 Tr. at 505:23-506:9 (Yamasaki testimony); DTX-137 at *MWD2010-00007219. MWD uses this information to allocate these costs to its rate for wheeling service through its System Access Rate, as well as to its full service rate through its System Access Rate and System Power Rate. DTX-090 at AR2010-011492; JTX-2 at AR2012-011492; DTX-110 at AR2012-016697; MWD Admin. Code § 4405. Because member agencies that purchase full service water pay the System Access Rate, as well as the System Power Rate, on a volumetric basis, each full service purchaser pays a portion of MWD's system-wide SWP transportation costs in direct proportion to the amount of water that it buys. *Id.* Also, because every member agency that wheels water also pays the System Access Rate on a volumetric basis, each wheeler pays a portion of MWD's system-wide SWP costs in direct proportion to the amount of water that MWD wheels to that agency. *Id.*

There is thus a direct relationship between the SWP costs MWD incurs, and the costs it charges for wheeling. MWD uses SWP transportation facilities to provide wheeling services to its member agencies, and MWD has to pay SWP transportation costs in order to be able to provide that service. MWD passes on those transportation costs to wheelers, through its System Access Rate, which includes the SWP transportation costs that MWD is required to pay (and also passes on SWP transportation costs to its full service customers).

This is entirely appropriate under the Wheeling Statute. As laid out in MWD's Resolution 8520 (DTX-680), because wheelers were responsible for MWD *incurring* a portion of its fixed SWP costs, they should thus be responsible for *paying* a portion of those costs when they elect to wheel. DTX-680 at AR2012-002457-58, 002466, 002473; JTX-1 at AR2010-002457-58, 002466, 002473; *see also MWD v. IID*, 80 Cal. App. 4th at 1431 ("the 'fair compensation' (§ 1810) to which a water conveyance system owner is entitled for wheeling water includes reasonable capital, maintenance, and operation costs occasioned, caused, or brought about by 'the use of the conveyance system.'"). These costs are shared fairly by both

full service customers and wheelers, in relation to their requested volumetric use. Accordingly, the Tentative's finding that MWD "inappropriately focuses on the identity of the customer as opposed to the cost of the service being rendered" (Tentative at 58) is wrong.

The Tentative appears to conclude that it would be appropriate to include SWP costs in the rate for wheeling service only to the extent that MWD can specifically identify those SWP costs as being caused by specific wheeling transactions. Tentative at 53 (the fact that MWD uses the SWP to move non-project water on some occasions "does not support the reasonableness of including **all** the state's transportation costs as part of Met's transportation costs") (emphasis in original). This suggests a fundamental misunderstanding of how the DWR Contract works. As discussed in more detail below, MWD does not pay its allocated share of SWP transportation costs *only* when it uses the SWP to wheel water. Instead, MWD must pay those costs continuously—year in and year out, in advance, regardless of how much water it gets, and regardless of whether it wheels water through the SWP—in order to exercise its right to wheel through the SWP when member agencies like SDCWA ask it to do so. Section III.C.2, *infra*. It would therefore not be reasonable for MWD to calculate the number of times it uses the SWP to wheel water and include only those costs in its rate for wheeling service.

The law, moreover, does not require MWD to undertake this unreasonable task. A party—such as SDCWA here—bringing a facial challenge to a rate for wheeling service "must demonstrate that the [action] *inevitably* pose[s] a present total and fatal conflict with applicable [legal] prohibitions." *California Teachers Ass'n*, 20 Cal. 4th at 338 (emphasis added). Thus, to invalidate MWD's rate for wheeling service, SDCWA was required to prove that, in *all* cases, it would be inappropriate for MWD to include its allocated SWP transportation costs in its rate for wheeling service. SDCWA has not done that here.

The Tentative, if adopted, would produce some remarkable—and incorrect—results. As noted, MWD uses SWP transportation facilities to wheel water on SDCWA's behalf *at SDCWA's request*. MWD is able to do so only because it agreed to, and does, pay the costs associated with the SWP transportation facilities. Under the Tentative, even in cases like those where the water is wheeled *through SWP transportation facilities*, MWD would not be able to

include its allocated share of SWP transportation costs—which pay to build and maintain those facilities—in its rate for wheeling service. That simply cannot be right.

The negative ramifications of the Tentative are even more severe when one considers that member agencies are not obligated to buy any water from MWD. Thus, member agencies could buy no full service water and, through MWD, use the SWP transportation facilities to wheel non-MWD water to them. Under the Tentative, MWD could not charge those member agencies for the SWP transportation costs that MWD has to incur under its DWR Contract in order for the SWP to be available to convey both water for full service sales and wheeled water. Full service water purchasers would thus be directly subsidizing wheelers. *MWD v. IID*, 80 Cal. App. 4th at 1421, 1433 ("member agencies as well as the taxpayers would in effect be forced to subsidize in material part the wheeling transactions"). MWD's rate for wheeling service ensures that no one is subsidizing anyone else. Every user of the conveyance system—wheelers and full service purchasers—pays the same per acre-foot volumetric System Access Rate. Full service purchasers also pay the per-acre foot volumetric System Power Rate, whereas wheelers only pay their actual power costs or may choose to supply their own power. As laid out in MWD's Resolution 8520, MWD includes its fixed SWP transportation costs in its rate for wheeling service in order to prevent this very subsidy. DTX-680 at AR2012-002457-58, 002466; JTX-1 at AR2010-002457-58, 002466. This is entirely appropriate under the Wheeling Statute:

> There is no indication the Legislature ever intended that the water conveyance system owner should suffer potential or actual financial loss as a result. Rather, the Legislature took repeated steps to enact compensatory language that would enable water conveyance system owners to provide the desired wheeling service while recovering their costs. In short, the Legislature did not intend that the impact of the Wheeling Statutes should be to cause a water conveyance system owner to lose money or to subsidize wheeling transfers.

MWD v. IID, 80 Cal. App. 4th at 1433.

The Tentative's conclusion rests largely on the possibility that SWP transportation facilities may not be necessary for a *particular wheeling transaction*. Tentative at 53 (the record does not establish whether use of the state systems for MWD's transportation is *necessary* for

wheeling at all). That MWD may not use SWP transportation facilities in some wheeling transactions is not sufficient grounds upon which to invalidate MWD's rate for wheeling service in a facial challenge. *California Teachers Ass'n*, 20 Cal.4th at 338 (a party bringing a facial challenge cannot prevail by suggesting that in some future hypothetical situation "problems may possibly arise" as to the particular *application* of the agency action).

The fact that MWD uses SWP transportation facilities to wheel water is dispositive under the standard applicable to facial challenges, and requires rejection of SDCWA's challenge to the inclusion of SWP transportation costs in MWD's rate for wheeling service.

2. The Tentative misconstrues MWD's relationship with DWR.

The Tentative states that only if "there is any reasonable basis to conclude [that SWP transportation charges] are ***Met's*** [transportation] charges" is it appropriate for MWD to collect those charges through its own wheeling or transportation rates. Tentative at 54. The Tentative finds there was no such basis, stating that SWP transportation costs are not MWD's transportation costs "any more than the overhead and payroll costs of Ford Motor Company are the overhead and payroll costs of a customer who buys a Ford car." Tentative at 53. According to the Tentative, it is inappropriate for MWD to include SWP transportation costs in the transportation rate component of its full service water rate, or its rate for wheeling service. *Id.*

There is, however, much more than a reasonable basis to conclude that SWP transportation charges are MWD's transportation charges. In fact, overwhelming evidence establishes that these costs are MWD's costs, primarily evidence of the contract between MWD and DWR, and MWD and DWR's conduct pursuant to that contract. MWD's relationship to SWP costs is nothing like the relationship of a Ford buyer to Ford's overhead and payroll costs. Indeed, the Tentative's Ford analogy helps illustrate why the SWP transportation costs that MWD pays are MWD's transportation costs.

The DWR Contract is not a purchase and sale agreement, under which MWD pays DWR for a certain quantity of water. Instead, under the contract, MWD agreed to assume a legal obligation for certain SWP costs, including SWP transportation costs, which costs MWD must pay even if it receives no water. In addition, under the contract, MWD and other State Water

Contractors assumed a legal obligation to fund the decade-long construction of the SWP. This is set forth in the contract's terms. Article 23 of the DWR Contract sets out a "Transportation Charge" which consists of "those costs of all project transportation facilities necessary to deliver project water to [MWD]." DTX-055 at AR2012-000071 (Art. 23); JTX-1 at AR2010-000071 (Art. 23). Without doubt, these costs are transportation costs because they reflect the costs of transporting water. *Id.* DWR identifies which of its costs are transportation costs, and charges these to MWD as transportation costs in its invoices. DTX-055 at AR2012-000071-000087, 000153 (Arts. 23-26, Art. 55); JTX-1 at AR2010-000071-000087, 000153 (Arts. 23-26, Art. 55); DTX-137 at *MWD2010-00007219.

Moreover, these costs are *MWD's* transportation costs. Under the contract, those transportation costs are "allocated to the contractor"—MWD—meaning MWD is legally responsible for them. DTX-055 at AR2012-000071 (Art. 23); JTX-1 at AR2010-000071 (Art. 23). Subsequent articles—Articles 24 through 26—break down the specific cost components of the Transportation Charge, and provide that these specific costs are "allocated" to MWD (that is, that MWD is legally responsible for them).[6] Articles 23 through 26 demonstrate that DWR is *not* legally responsible at all for these costs—they all provide that the amounts MWD must pay will cover *all of the costs* associated with transporting water to MWD. *Id.*

Costs "belong" to the party who is legally obligated to pay them. Under the DWR

[6] Article 24 recovers the capital costs associated with the aqueducts necessary to transport water to MWD, and sets forth the capital cost component of the Transportation Charge which "shall return to the State those [ ] costs of the project transportation facilities necessary to deliver [project] water to [MWD]," which are "allocated" to MWD. DTX-055 at AR2012-000074 (Art. 24(a)); JTX-1 at AR2010-000074 (Art. 24(a)).

Article 25 pays for operation and maintenance of those aqueducts, and sets forth a minimum charge for the costs of "operation, maintenance, power and replacement" of DWR's transportation facilities which costs are also "allocated to [MWD]." DTX-055 at AR2012-000083 (Art. 25(a)); JTX-1 at AR2010-000083 (Art. 25(a)).

Article 26 recovers power costs required to pump water through transportation facilities to MWD, and sets forth the variable charge component of the Transportation Charge for operation, maintenance, and power and replacement costs. This charge is dependent upon the amount of water delivered to MWD and is also "allocated" to MWD. DTX-055 at AR2012-000086-87 (Art. 26(a)); JTX-1 at AR2010-000086-87 (Art. 26(a)).

Contract, MWD—not DWR—is legally obligated to pay these transportation costs, no matter what.

This is not the same as the relationship between a Ford buyer and Ford Motor Company. A Ford buyer has no legal obligation to pay Ford's overhead and payroll costs, let alone fund the decade-long construction of the Ford factory that will build the cars. A Ford buyer does no more than agree to pay the purchase price. His contract to purchase the car does not provide that Ford's ongoing overhead and payroll costs are legally allocated to him, and it does not obligate him to pay the costs. To be sure, a seller's sale price *can*, and often does, recover the seller's costs.[7] But that does not mean the buyer is *obligated*, as MWD is here, to pay those costs, and the buyer is certainly not obligated to pay those costs before and after the sale of the car.

In other ways, the DWR Contract confirms that the SWP transportation costs allocated to MWD are MWD's own transportation costs. For example, not only does the contract provide that MWD, not DWR, is ultimately responsible for those transportation costs, but also that DWR *never* has to pay those costs. The Transportation Charges are set and paid by MWD prospectively, so MWD pays these costs before DWR incurs them, and before MWD gets any water. DTX-055; JTX-1 and 2 at AR2010/2012-007880 (SWP "charges are derived from estimates made by DWR for the upcoming year. Because DWR then issues invoices based on its estimates, corrections for over or under payments are made in subsequent years after actual costs are determined"). Indeed, DWR's construction of the SWP was contingent upon contractors like MWD agreeing to pay all of the SWP construction costs. DTX-055 at AR2012-000045-000047, 000056-000060, 000095-000097 (Arts. 6, 17, 29); JTX-1 at AR2010-000045-000047, 000056-

[7] Moreover, buyers do not always pay sellers' costs. In an extremely competitive market or when the seller misperceives demand, the price can be below the seller's costs (*A.A. Poultry Farms, Inc. v. Rose Acre Farms, Inc*., 881 F.2d 1396, 1400 (7th Cir. 1989)), and in an uncompetitive market the sale price can be far above—and have a negligible relationship to—the seller's costs. *United States v. LSL Biotechnologies*, 379 F.3d 672, 697 (9th Cir. 2004). And in cases where a seller *cannot* sell his inventory, the seller (not any potential buyer) must absorb all of the costs associated with bringing a product to market. In short, in a typical seller-buyer relationship—like Ford's relationship to Ford buyers—there is at most a *potential* relationship between the seller's costs and the sale price.

000060, 000095-000097 (Arts. 6, 17, 29). And MWD was contractually required to, and did, start paying the capital component of the Transportation Charges during construction of the SWP facilities, which was nearly *ten years before* MWD ever received any SWP water. *Id.*; *see also* DTX-135 at *98-99.

Again, this distinguishes MWD's relationship with DWR from the typical buyer-seller relationship. Ford is not assured by contract that it will never have to pay overhead and payroll costs, and that it has a guarantee that future Ford buyers will absorb the cost of the Ford factory's construction, and Ford's overhead and payroll costs, years before they get their cars. This is because those costs are Ford's, not the buyers'.

The DWR Contract similarly confirms that the SWP transportation costs allocated to MWD are MWD's, not DWR's, by providing that MWD is responsible for paying those costs *regardless of whether it gets any water from the SWP*. JTX-2 (AR2012-016429) at AR2012-016559 ("under the State Water Contract, [MWD] is obligated to pay allocable portions of the costs of construction of the system and ongoing operating and maintenance costs through at least 2035, *regardless of quantities of water available from the project*") (emphasis added); DTX 135 (Bulletin 132-64) at 171 ("The capital and minimum components [of the Transportation Charge] will be collected irrespective of the annual amounts of water received").

More specifically, the contract provides that MWD has a particular amount of water that it *may* get from the SWP in a given year, called its "maximum annual entitlement." DTX-055 at AR2012-000039; JTX-1 at AR2010-000039. This amount is not a guarantee—the contract says that entitlement is "not be interpreted to mean that in each year the State will be able to make that quantity of project water available to" MWD, but that there is instead an "expectation that under certain conditions only a lesser amount . . . may be made available." *Id.* The contract further provides that due to "drought or any other cause whatsoever," DWR may make less water available to MWD, and that DWR will have no liability to MWD if it does so. *Id.* at AR2012-000061 (Art. 18); JTX-1 at AR2010-000061 (Art. 18). Relying on these provisions, DWR has in the past dropped the amount of water MWD was allocated in a given year to near zero. DTX-102 *SDCWA2010-2012_00136906 (noting that, due to a drought, the initial "SWP allocation

[in 2010] was only five percent [of MWD's annual entitlement], the lowest initial SWP allocation in history").

Even if DWR makes little or no water available to MWD, MWD still must pay its share of SWP transportation costs, since nothing in the contract reduces MWD's obligation for those costs if little or no SWP water is made available to it. 61 Ops. Cal. Atty. Gen. 373, 376 (Cal. AG 1978) (under the DWR Contract, "whether or not a [water] district takes or sells water, it must make payments according to its maximum annual entitlement and the portions of the State Water Project required to supply that entitlement"). Only some of those costs may be *less* if little or no water is made available. In particular, power costs associated with pumping water, which are allocated to MWD under Article 26 of the DWR Contract, do not exist if there is no water to pump, and thus MWD does not have to pay those costs if it gets no water. DTX-055 at AR2012-000086-87 (Art. 26(a)); JTX-1 at AR2010-000086-87 (Art. 26(a)). But MWD still must pay all other transportation costs—such as capital costs for building the SWP aqueducts necessary to deliver water to MWD—even if it gets no SWP water through those facilities. DTX-055 at AR2012-000074 (Art. 24(a)); JTX-1 at AR2010-000074 (Art. 24(a)). And if for some reason water *is* made available to MWD, but MWD chooses not to, or is unable to, take it, MWD must still pay its contractually-allocated share of SWP transportation costs. DTX-055 at Art. 33.AR2012-000098 (Art. 33); JTX-1 at AR2010-000098 (Art. 33).

This too distinguishes MWD's relationship with DWR from a typical buyer-seller relationship. A Ford customer is certainly not legally obligated to fund the factory's construction and pay Ford's ongoing overhead and payroll costs if Ford is unable to sell (or the customer chooses not to buy) a Ford car—because those costs are Ford's, not the customer's.

In sum, the DWR Contract provides that MWD's share of SWP transportation costs are legally allocated to MWD, and that DWR is not ultimately responsible for those costs. The contract obligates MWD to pay these costs before DWR ever incurs any SWP transportation costs, and provides that MWD is responsible for these costs even if DWR makes no water available, or if MWD decides to take no water. A party's legal relationship to costs determines whether it "owns" those costs — *i.e.*, whether the costs are theirs, as opposed to someone else's.

And under the terms of the DWR Contract, which establishes MWD's relationship to SWP transportation costs, there can be no reasonable dispute that those transportation costs are MWD's.

MWD submits that a more fitting analogy, if one is needed, is that MWD can be compared to a renter who sublets his apartment (where subletting is allowed). Although the renter (MWD) does not own the apartment, he has a contract that commits him to paying rental (transportation) costs or he loses his occupancy right. If he sublets to another, he may charge his legally incurred rental costs to his subtenant (a full service water purchaser or wheeler) because these are costs the renter incurs under his lease with the landlord and must pay in order to retain his right to occupy the apartment. Lack of ownership of the building does not change the fact that the renter's costs are his own and he may charge them to a subtenant.

The Tentative incorrectly suggests that if (and only if) MWD owned the SWP transportation facilities—presumably, in fee simple—would it be appropriate for MWD to treat SWP transportation costs as *its* transportation costs. Tentative at 53. No law cited in the Tentative or by SDCWA says that MWD may treat as its transportation costs (and include in its full service water or wheeling rates) only those costs associated with transportation facilities owned in fee simple by MWD.

The Tentative's focus on ownership of the SWP is also flawed because it fails to recognize the legally-sanctioned method by which MWD sets its rates. At the final hearing MWD showed that through the cost of service process, it allocates its expenses to different rate elements based on *operation functions*, not ownership. *See* DTX-090 at AR2010-011472, 011474-011482; JTX-2 at AR2012-011472, 011474-011482; DTX-110 at AR2012-016679, 016681-016687. Industry guidelines sanction MWD's allocation of costs according to operation function; there is no support in industry guidelines for relying solely on ownership as the basis for cost allocation, as the Tentative does. *See* DTX-030 at AR2012-003934 (AWWA M-1 Manual sanctioning MWD's functionalization method); JTX-1 at AR2010-003934 (same); DTX-088 at AR2012-011317-321 (2010 Raftelis Report stating that MWD's "[cost of service] and rate methodology is consistent with AWWA's [cost of service] principles," including allocation of

costs by functions); JTX-1 at AR2010-011317-321 (same). Each of MWD's operation functions is designed to generate revenue to pay for expenses related to that function. DTX-090 at AR2010-011474; JTX-2 at AR2012-011474; DTX-110 at AR2012-016681. MWD's relevant operation functions consist of supply, transportation (conveyance and aqueduct and distribution), storage, and demand management. *See* DTX-090 at AR2010-011474-011475; JTX-2 at AR2012-011474-011475; DTX-110 at AR2012-016681-016682.

Transportation-related costs associated with bringing water to MWD's service area—mainly costs associated with the Colorado River Aqueduct and the SWP transportation facilities—are functionalized as conveyance and aqueduct (*i.e. transportation*) costs. *Id.* Similarly, *transportation-related* costs associated with MWD's internal distribution system are functionalized as distribution (*i.e. transportation*) costs. *Id.* MWD's conveyance and aqueduct and distribution costs are ultimately placed in MWD's transportation rate components (*i.e.*, the System Access Rate, System Power Rate, and Water Stewardship Rate) which are incorporated into the rate for full service water, and partially incorporated into the rate for wheeling service (since the System Power Rate is not included). *See generally* DTX-090 at AR2010-011490-92; JTX-2 at AR2012-011490-92; DTX-110 at AR2012-016695-97. These volumetric rates then apply on a per-acre foot basis only to the extent a customer purchases full service water or wheels. DTX-090 at AR2010-011492; JTX-2 at AR2012-011492; DTX-110 at AR2012-016697; MWD Admin. Code § 4405. MWD's Administrative Code explains that "'Wheeling service' shall mean the use of Metropolitan's facilities, including its rights to use State Water Project facilities." MWD Admin. Code § 4119. It is entirely reasonable for MWD to collect its SWP *transportation* costs through its *transportation* rate components, regardless of who owns the SWP. Under relevant industry guidelines, the issue is not ownership, but which function these costs relate to. The Tentative's focus on ownership wrongly substitutes well-established rate-making principles for an unsubstantiated policy determination that ownership determines proper cost allocations.

Moreover, the Tentative's focus on ownership is inconsistent with the law. The pertinent inquiry in considering a property right is not the label assigned, but rather the rights and duties

that the parties' contract grants and imposes:

> Ultimately, the label given to [the party's] "interest" is of little importance. Arrangements between landowners and those who conduct commercial operations upon their land are so varied that it is increasingly difficult and correspondingly irrelevant to attempt to pigeonhole these relationships as "leases," "easements," "licenses," "profits," or some other obscure interest in land devised by the common law in far simpler times. Little practical purpose is served by attempting to build on this system of classification.
>
> The agreement here granted certain rights and imposed certain duties on the parties. Our task is to determine the scope of these rights and duties. To say we cannot do so without first determining whether the agreement is a lease, an easement, or some other interest in land ignores modern commercial realities. The contractual relationship between the parties must be analyzed based on the evidence and findings without regard to its classification under traditional common law concepts.

Golden W. Baseball Co. v. City of Anaheim, 25 Cal. App. 4th 11, 36-37 (1994) (citations omitted). As detailed above, the DWR Contract grants rights to, and imposes duties on, MWD that establish that the SWP transportation costs are MWD's transportation costs. This contractual relationship between DWR and MWD is what is relevant, not the label of ownership of the SWP. Further, here, SDCWA has recognized that in the context of using the SWP transportation system for wheeling, MWD's "rights to State Water Project facilities" are equivalent to DWR's, so ownership is beside the point. DTX-086 at *SDCWA2010-2012_00082035; DTX-075 at *MWDPRA044184.

SDCWA claimed that, under the Wheeling Statute, MWD may not charge in wheeling transactions for costs associated with facilities it does not own. This argument is unsupported. There is nothing in the Wheeling Statute that contradicts the above law that the rights and duties in the parties' contract control. The Wheeling Statute allows MWD to recover costs associated with its "conveyance system." Wat. Code, § 1811 (defining "fair compensation" to mean the "reasonable charges incurred by the owner of the conveyance system" for capital, operation, maintenance, and replacement costs, among other things). In *MWD v. IID*, the Court of Appeal held that fair compensation includes charges MWD "*becomes subject to or liable for* in using the 'conveyance system.'" 80 Cal. App. 4th at 1431 (emphasis added). Such costs are not limited to those costs associated with facilities that MWD owns in fee simple. For example, the Wheeling

Statute specifically permits facility owners such as MWD to recover power costs. Wat. Code, § 1811. MWD does so by charging wheelers the actual power costs incurred in the wheeling transaction (unless the wheelers provide their own power). MWD Admin. Code § 4405. It cannot be the case that only those facilities owners who owned power plants can recover power costs they incur in connection with providing wheeling services.

Moreover, the notion that MWD may treat as *its* transportation costs only those costs associated with facilities it owns in fee simple conflicts with common experience. For example, homes and businesses have power costs even if they do not own power plants. Businesses have transportation costs whether they transport their products in trucks they own, lease the truck fleet, or ship their products via common carrier. Costs are yours when you are legally required to pay them, not only when you own all the facilities associated with them.

Citing a 1969 study, the Tentative finds that MWD previously recognized that ownership of the SWP is dispositive because MWD previously allocated its "SWP costs to supply, and none to transportation (including the SWP costs that DWR bills as its own transportation costs)." Tentative at 53. This finding misses a key point. The 1969 study was commissioned almost 50 years ago when MWD did not yet have a rate for wheeling service, and had not yet unbundled its rates to charge separately for transportation and supply expenses; the study did not purport to analyze the proper allocation of such expenses. *See generally* JTX-2 at AR2012-016288_1723. Indeed, the study noted that "[t]here are essentially two steps in a cost of service study. The first is separation of total costs into cost segments. . . . The second step is assignment of these cost segments to appropriate cost components for rate formulation." *Id.* at AR2012-016288_1739. The study separated supply from other costs in step one, but combined "the cost[s] of producing and delivering water" in step two *because* MWD had a single "commodity component of a water rate" and not separate supply and transportation rates. *Id.* at AR2012-016288_1739, 1750. MWD first set a wheeling rate in 1997, which is the first time it separately allocated transportation costs. DTX-026 at AR2012-002497-002499; JTX-1 at AR2010-002497-002499; DTX-680 at AR2012-002446-002489; JTX-1 at AR2010-002446-002489. MWD first unbundled its full service rate to reflect its different components, but still charged the same

overall price, in 2003. DTX-045 at AR2012-006517; JTX-1 at AR2010-006517. Furthermore, the 1969 study advocated allocating all of MWD's Colorado River Aqueduct expenses to supply as well. JTX-2 at AR2012-01688_1744. No one has argued that MWD's transportation expenses associated with moving water through the Colorado River Aqueduct are not properly allocated to the transportation components of MWD's rate for full service water or its rate for wheeling service.

The Court of Appeal in *MWD v. IID* found that using system-wide costs, and not just charges for use of particular facilities, to establish a wheeling rate is consistent with the Wheeling Statute: "Section 1811, subdivision (c) makes no reference to point-to-point costs or any similar concepts. In similar vein, section 1811, subdivision (c) makes no reference to actual, increased, incremental, or marginal expenditures in terms of 'capital, operation, [and] maintenance . . . costs.'" 80 Cal. App. 4th at 1428. MWD's inclusion of its SWP transportation costs in its rate for wheeling service is consistent with its inclusion of its Colorado River Aqueduct and distribution system transportation costs. All constitute MWD's system-wide transportation costs. Tellingly, SDCWA has not challenged MWD's inclusion of its Colorado River Aqueduct and distribution system transportation costs, regardless of which point to which water is wheeled. SDCWA has no issue with paying Colorado River Aqueduct costs when it asks MWD to wheel its water only on the SWP, or paying for part of the distribution system that its wheeled water does not travel through. SDCWA has not challenged the inclusion of these costs because that would be inconsistent with *MWD v. IID*'s approval of including system-wide costs. Because the SWP transportation costs also are MWD's transportation costs, the analysis is no different.

As the Tentative finds, MWD's allocation of SWP transportation costs to its rate for wheeling service is appropriate if there is "any reasonable basis to conclude that [SWP transportation charges] are Met's [transportation] charges." Tentative at 54. The DWR Contract, standing alone, provides that basis.

3. The Tentative's analysis of MWD's allocation of SWP costs to its rate for wheeling service impermissibly reweighs the evidence and for that reason is flawed. Moreover, no case holds that rate stability is an improper objective.

The Tentative impermissibly reweighs the evidence considered by MWD's Board when it made its rate-setting determination (*Exxon*, 169 Cal. App. 4th at 1277), which was a quasi-legislative decision (*20th Century Ins. Co.*, 8 Cal. 4th at 277). The Tentative's reliance on evidence presented by SDCWA establishes this error.

For example, the Tentative incorrectly finds that MWD includes fixed SWP costs in its rate for wheeling service to achieve rate stability for its full service customers. Tentative at 55-58. No evidence was presented during the final hearing that MWD's rate for wheeling service is based on rate stability; to the contrary, this determination directly contradicts MWD's evidence showing that it includes these costs in its rate for wheeling service (1) because cost causation supports such an inclusion, and (2) to prevent full service customers from subsidizing the cost of wheeling service. MWD Closing Brief at Section V.C.1. The Tentative states that "[w]ho is subsidizing whom is the core dispute," but improperly relies on SDCWA's conclusory claim that "wheelers such as itself subsidize the other member agencies" while disregarding MWD's evidence that under the current rate for wheeling service *no one is subsidizing anyone.* Tentative at 55. Because MWD's quasi-legislative findings are supported by substantial evidence, that evidence—not SDCWA's views—should be the basis for the Tentative's findings.

As discussed above, MWD's rate for wheeling service is designed specifically to *prevent* either its full service or wheeling customers from subsidizing the cost of the other's service, and it is designed to charge customers only their proper per acre-foot conveyance costs. *See generally* DTX-680 at AR2012-002446-002489; JTX-1 at AR2010-002446-002489; MWD Admin. Code §§ 4401, 4405; DTX-090 at AR2010-011492; JTX-2 at AR2012-011492; DTX-110 at AR2012-016697. Because credible evidence supports MWD's rate-making determinations, those determinations must be accepted by the Court. *Exxon*, 169 Cal. App. 4th at 1277. And contrary to SDCWA's assertions, no case holds that a rate stability objective is illegal or even improper. *San Luis Coastal Unified Sch. Dist. v. City of Morro Bay*, 81 Cal. App. 4th

1044 (2000) ("*Morro Bay*"); *City of Palmdale v. Palmdale Water Dist*., 198 Cal. App. 4th 926 (2011) ("*Palmdale*").

In *Morro Bay*, the City denied a school district's request to wheel third-party water through the City's distribution system because the City feared losing the school district as a customer. 81 Cal. App. 4th at 1047. The school district challenged the denial, contending it was improper under the Wheeling Statute, specifically Water Code section 1810. The principal issue was whether the Wheeling Statute applied to the transaction; in a split decision, the Court of Appeal found that the Wheeling Statute likely applied. *Id*. at 1046-1054. The majority went on to hold that an agency cannot deny a wheeling transaction request on the sole grounds of loss of income (*id*. at 1050),[8] but refused to disrupt the City's fair compensation determination under section 1812. *Id.* at 1051. The Court did not hold that fiscal health and revenue stability cannot be considered in setting "fair compensation" under the Wheeling Statute, and no court has ever relied on *Morro Bay* for such a proposition.

Had the *Morro Bay* Court intended a rule prohibiting consideration of overall operational needs and fiscal integrity in setting "fair compensation" under the Wheeling Statute, it likely would have addressed *MWD v. IID*, which was issued only weeks earlier from another division of the same district of the Court of Appeal. The *MWD v. IID* Court noted that MWD included system-wide costs in its wheeling rate in order "to maintain its operational and financial integrity and to avoid adverse impact upon rates and charges to other member agencies," then held that an agency could include such costs in its "fair compensation" calculation. *See* 80 Cal. App. 4th at 1420-1421, 1426-1433. *MWD v. IID*, not *Morro Bay*, is the relevant authority.

In *Palmdale*, a water district attempted to restructure its rates to provide for revenue stability. 198 Cal. App. 4th at 928-29. On appeal, the Court did not criticize this goal, but simply held that the District's tiered-rate method failed because it imposed different water rates for similar users without "identify[ing] *any support in the record* for the inequality" and did not even attempt to provide "*any explanation* for this disparity." *Id.* at 936-38 (emphasis added).

[8] Here, there is no evidence that MWD has ever denied a wheeling transaction request.

MWD's rate for wheeling service does not unreasonably discriminate between similar MWD customers, and in any event, MWD fully justified the rate in its 1997 Resolution and elsewhere in the administrative record. DTX-680 at AR2012-002446-002489; JTX-1 at AR2010-002446-002489.

The Tentative's finding that MWD's rate for wheeling service unlawfully employs a rate stability objective unconnected to cost causation (Tentative at 55-58) is wrong. Rate stability is not an unlawful objective, and the evidence shows that MWD's rate for wheeling service is based on cost causation considerations.

4. The Tentative would require MWD to conduct an analysis of the Water Stewardship Rate that is not required under any law.

The Tentative's ruling that MWD must quantify the transportation-related benefits wheelers receive from MWD's demand management programs in order to appropriately include these costs in its rate for wheeling service contradicts controlling law on this issue. Tentative at 60 (because MWD has not specifically quantified the transportation-related benefit wheelers receive from demand management programs, MWD has not shown that it is reasonable to treat "the *entirety* of the Water Stewardship Rate as a 'transportation' rate that is then incorporated into the wheeling rate"). As explained, MWD's rate for wheeling service must "be related to the *overall* cost of the governmental [service]," and "need not be finely calibrated to the precise benefit each individual fee payor might derive." *Cal. Farm Bureau*, 51 Cal.4th at 438 (emphasis added); *Griffith II*, 220 Cal. App. 4th at 601 ("[a]pportionment is not a determination that lends itself to precise calculation" and a "parcel-by-parcel proportionality analysis" is not required).

In *Griffith II*, a regional water management agency imposed increased groundwater augmentation charges to fund delivery of water resources to coastal users in response to saltwater intrusion. 220 Cal. App. 4th at 600-02. Inland rate-payors challenged the fee increase, claiming the amount they were charged was disproportionate under Proposition 218 because they did not use the services the charges were intended to provide (that is, that the inland users did not receive the water resources the groundwater augmentation charge was used to fund). *Id.* at 597-602. On appeal, the Court rejected the rate payors' arguments that only rate payors actually *receiving*

water should be charged, because it determined that delivery of these water resources was part of an *overall system objective* of managing saltwater intrusion, which provided the benefit of less salty water to "all water users." *Id.*at 602. *Griffith II* did *not require the agency to quantify the system-wide benefit* of its water delivery efforts before it could legally allocate those costs equally among all system users, but simply upheld the groundwater augmentation charges "borne [equally] by all users" because the benefit of less salty well water was provided to all fee payors — no matter how far they were located from the coast. *Id.* at 590, 602.

Here, as in *Griffith II*, MWD has shown that its demand management programs provide a transportation-related benefit to all users, including wheelers, and the Tentative recognizes this. Tentative at 61 ("wheelers would benefit as a general matter by reason of [the] increased capacity [that MWD's demand management programs create] in that they might be able to wheel more water"). Indeed, although all system users benefit from this increased capacity, wheelers receive an even *greater* benefit because they are *dependent* on available capacity in order to wheel at all. Wat. Code, § 1810 *et seq.* Therefore, MWD's Board has determined that all system users should pay the Water Stewardship Rate in equal proportion because they all benefit from the increased capacity resulting from the demand management programs.[9] This analysis is sufficient under the law.

This does not mean that MWD failed to design a rate for wheeling service that proportionately allocates wheelers their fair share of the Water Stewardship Rate. As SDCWA itself has acknowledged, MWD's demand management programs "result in a one-for-one offset in the use of imported water." DTX-383 at *MWD2010-00525693. A one-for-one offset means that for every acre-foot of water that MWD does not need to transport through its system because

[9] *E.g.*, 12/20/2013 Tr. at 593:10-594:6 (Upadhyay testimony); DTX-045 at AR2012-006519 ("Investments in [demand management programs] decrease the region's overall dependence on imported water supplies . . . Similar to public benefit charges in the electric industry, the regional and state-wide benefits of demand management programs are assessed to all users of the [MWD] system . . ."); JTX-1 at AR-2010-006519; DTX-109 at AR2012-016590 ("All users . . . benefit from the system capacity made available by investments in demand management programs. . . These projects and programs provide regional benefits to improve regional reliability. It is fair and reasonable to assess the [Water Stewardship Rate] to all users of the [MWD] system.").

of the program, "then other agencies would . . . have the access to the capacity in the system if they wanted to purchase supplies from *other sources* and move that water through [MWD's] system." 12/20/2013 Tr. at 587:19-588:13 (Upadhyay testimony) (emphasis added). Like the System Access Rate, the Water Stewardship Rate is charged on a volumetric basis. DTX-090 at AR2010-011492; JTX-2 at AR2012-011492; DTX-110 at AR2012-016697. This means that wheelers (1) receive a one-for-one capacity-related benefit as a result of the demand management programs, and (2) pay the Water Stewardship Rate only if they choose to wheel, and only based on the number of acre-feet of water MWD wheels at their request. This is both fair and proportional.

The Tentative suggests that MWD must "calculate the proportional benefits that individual member agencies receive from its Water Stewardship Rate or the programs it funds" (Tentative at 59), a nearly impossible pursuit and one that is not required by the law. Local supply development and conservation expenditures—the expenditures made under the Water Stewardship Rate—were among the system-wide costs at issue in *MWD v. IID* and, there, the Court of Appeal never suggested that MWD would have to make such a substantial showing to justify this allocation, which was appropriate on its face. *See MWD v. IID*, 80 Cal. App. 4th at 1422-23, 1428, 1433. To the contrary, the Court of Appeal found that the "compensatory language" of the Wheeling Statute demonstrates that the Legislature intended to allow conveyance owners to "recove[r] their costs," including system-wide costs not necessarily directly associated with a specific wheeling transaction. *Id*. at 1433.

As for legal standards other than the Wheeling Statute, California case law recognizes that there may be an imperfect link between rates and cost recovery because agencies may legally set rates based on estimated future costs. Specifically, *Griffith II* rejected the plaintiff's claim that the defendant "improperly 'worked backwards'" by following a prospective revenue-requirement model similar to MWD's model, noting that this approach—which was recommended by the AWWA Manual—does not offend the proportionality requirement in the similar context of Proposition 218. 220 Cal. App. 4th at 600-01; *see also Griffith I*, 207 Cal. App. 4th at 996 (revenue requirements can be "estimated" or determined prospectively); *Cal.*

Farm Bureau, 51 Cal. 4th at 437-38 (same).

MWD lawfully sets its rates at a level designed to recover its costs by prospectively estimating its revenue requirements for the coming fiscal year. DTX-090 at AR2010-011467, 011472-011482; JTX-2 at AR2012-011467, 011472-011482; DTX-110 at AR2012-016674, 016679-016687. Although the Tentative recognizes that MWD cannot be faulted "for not providing a transportation benefit number for *each* of the demand management programs" (Tentative at 60), it would be equally impossible to quantify the specific transportation-related benefits *in the aggregate* given the prospective nature of MWD's rate-setting process. This is because MWD cannot know in advance whether demand management programs will lead to its member agencies *purchasing less* full service water, or *wheeling less* third-party water. In either case, MWD's transportation capacity will be affected. However, only if member agencies purchase less water from MWD will MWD receive an arguably supply-related benefit from the demand management programs. And, in any event, the true "supply" benefit from the programs is not to MWD, it is to the member agencies that develop the local supplies and conserve water. 12/20/2013 Tr. at 589:3-11; 608:3-11 (Upadhyay testimony). MWD does not receive any water supply through the demand management programs. *Id.* In other words, while there is clear evidence that demand management programs funded by the Water Stewardship Rate reduce the member agencies' need to use MWD's system to *transport* water, it is not clear that absent such demand management programs MWD would have to *supply* more water, nor is there a true supply benefit to MWD at all.

In any event, the Tentative's finding that "the record does not show correlation" between MWD's avoided transportation costs and the Water Stewardship Rate and that "the best we can do with this record [is] to conclude that to some unspecified extent, some portion of the WSR is causally linked to some avoided transportation costs" (Tentative at 60) is wrong. MWD established at the final hearing that it can and does document the reduced transportation costs directly resulting from its demand management programs. MWD Closing Brief at 64-65. For example, on an annual basis MWD is required to report to the Legislature its progress in achieving demand management programs goals. MWD Act § 130.5(e); DTX-454* (Senate Bill

60 (SB-60) Report for fiscal year 2011/12); 12/20/2013 Tr. at 601:5-18 (Upadhyay testimony). These reports quantify the number of acre-feet of water MWD was able to avoid transporting to its member agencies in a particular year as a result of its demand management programs, and thus the number of acre-feet of avoided demand on MWD's transportation system. *See, e.g.*, DTX-454 at *MWD2010-00310322; 12/20/2013 Tr. at 601:19-603:15 (Upadhyay testimony).

The Tentative's finding that the demand management programs provide a primarily supply-related benefit is not based on the evidence. Tentative at 58 ("Obviously" demand management programs serve a supply-related purpose for MWD by allowing MWD to "in turn reduce its purchases"); *see also id.* at 58-59 (the record shows that "at least the primary benefit of these programs is the creation of new water 'supply'"). This part of the Tentative relies on deposition testimony by Mr. Upadhyay explaining that "one" benefit of the demand management programs is supply-related. 9/13/2013 Tr. at 52:11-53:19, 109:16-111:19. During the final hearing, Mr. Upadhyay testified that while the demand management programs occasionally may confer a supply benefit, they are not primarily supply-related because they do not develop supplies that MWD is able to move through its system; rather, the "ultimate" benefit of these programs is "the reduced need" to transport water through MWD's system. 12/20/2013 Tr. at 589:3-11; 608:3-11.

Moreover, the Tentative inappropriately accepts at face value SDCWA's conclusory assertion that MWD's brief, witnesses, and documents "all confirm that the primary purpose of these programs is to 'incentivize the development of ***local*** water ***supplies***.'" Tentative at 59. To state the obvious, it is error to rely on a party's mischaracterization of its opponent's evidence. The quote from MWD's brief referring to the development of local water supplies pertains to the supplies that the *member agencies* participating in such programs receive. As explained, the fact that demand management programs produce supply for the *member agencies* does ***not*** mean that *MWD* necessarily receives a supply-related benefit from these programs. Moreover, MWD's evidence definitively shows that the primary benefit of the demand management programs is transportation-related. MWD Closing Brief at Section V.B.1 (MWD providing nine pages of evidence supporting its contention that the primary benefit of the demand management programs

is transportation-related). The evidence cited by the Tentative includes MWD's responses to SDCWA's Requests for Admissions Numbers 17 through 43 (Tentative at 59, fns. 86, 88), which suggests reliance on SDCWA's incorrect assertions regarding the content of MWD's responses—because nowhere does MWD ever admit that the primary benefit of its demand management programs is supply-related. PTX-237-A* Nos. 17-43.[10]

The Tentative helps make the point. The evidence that the Tentative relies on to show that the Water Stewardship Rate provides a substantial supply-related benefit demonstrates only that the expenditures the rate funds reduce the need for *imported* water. Tentative at 59. An expenditure that reduces the need for imported water reduces transportation costs, because transportation infrastructure is how imported water gets to MWD's service area. Such evidence says nothing significant about supply costs. To prove a significant supply benefit, SDCWA would have had to identify evidence that, for example, shows that Water Stewardship Rate expenditures provide a supply benefit to *MWD*. But as stated, the member agencies that develop the local supplies or conserve water receive a supply benefit from the expenditures, not MWD. Given the evidence of MWD's avoided and reduced transportation costs through the demand management programs, an unsubstantiated assertion regarding the Water Stewardship Rate's supply benefit to MWD is an inadequate basis upon which to invalidate MWD's rates.

It is undisputed that MWD must facilitate and promote responsible water management and conservation. MWD Act § 130.5; Wat. Code §§ 10608.16, 10608.36; *see also* DTX-045 at AR2012-006519-006520; JTX-1 at AR2010-006519-006520; 12/20/2013 Tr. at 564:4-565:4 (Upadhyay testimony). The Tentative finds that allocating 100 percent of MWD's Water Stewardship Rate to its rate for wheeling service is "wholly arbitrary" (Tentative at 60), ignoring

[10] None of SDCWA's Requests for Admissions Numbers 17 through 43 ask MWD to admit or deny whether the primary benefit of the demand management programs is supply or transportation related. Instead, they ask whether MWD: provides funds for demand management programs in an amount proportional to each member agency's Water Stewardship Rate contribution, calculates numerically the proportional benefit to each member agency from each program individually or in the aggregate, or calculates numerically the regional benefit from each program individually or in the aggregate.

the fact that, given the nature of the rate-setting process, the quasi-legislative body may make policy decisions about its rates. And, the law does not require the precision the Tentative assumes is required; it requires only a reasonable relationship between MWD's costs and the rates it charges. MWD has demonstrated that such a reasonable relationship exists.

The Tentative's failure to acknowledge this aspect of ratemaking law creates a conundrum—the Tentative finds that demand management programs funded by the Water Stewardship Rate reduce transportation costs, but also finds that MWD cannot allocate the costs of funding its demand management programs to the transportation rate component of its full service water rate, or its rate for wheeling service, because it cannot quantify those reduced transportation costs. Compounding the problem, the Tentative also finds that the evidence shows that demand management programs must reduce supply costs—notwithstanding that not even SDCWA claimed that such cost reductions have been, or can be, quantified. Under the Tentative as it stands, allocating the Water Stewardship Rate to supply would not be allowed, and MWD would not be allowed to split the costs 50/50 between supply and transportation. Tentative at 60 (finding Raftelis's suggested 50-50 allocation arbitrary). Short of a complex and backward-looking analysis of the history of MWD's demand management programs, plus a continual complex analysis of the programs on an on-going basis—analyses that no one contends are even possible, and that if possible would be ever-shifting—to finely calibrate the respective transportation and supply benefits of MWD's demand management programs, MWD cannot allocate the cost of those programs to *either* transportation or supply, or a combination of both, under the Tentative as drafted. This would mean MWD cannot fund these programs, even though it is legally required to do so. MWD Act § 130.5; Wat. Code §§ 10608.16, 10608.36.

The law does not require MWD to conduct such an analysis. MWD's Board determined that the demand management programs provide a significant transportation-related benefit to MWD, and allocated the Water Stewardship Rate accordingly. This is reasonable.

That there may be other ways MWD could have allocated the costs of funding its demand management programs is irrelevant here. As explained, a court's review of MWD's rate making activity is limited to a determination whether there is substantial evidence to support the rate

structure developed by MWD, not to determine the best way MWD *could* develop water rates or the way that is most preferable to the reviewer. *Griffith II*, 220 Cal. App .4th at 601 ("That there may be other methods favored by plaintiffs does not render defendant's method[s] [unlawful]"); *Hansen v. City of San Buenaventura*, 42 Cal.3d 1172, 1181 (1986) (because "[r]easonableness . . . is the beginning and end of the judicial inquiry," courts will not overturn a water rate if there is a reasonable basis for its design such as "the cost of providing service, or some other reasonable basis").

MWD has provided substantial evidence that allocating the costs of funding demand management programs to its rate for wheeling service, as well as to its full service rate on the same volumetric basis, through the Water Stewardship Rate charges fair compensation and is reasonable. That determination is entitled to deference. *Morro Bay*, 81 Cal. App. 4th at 1051 (under the Wheeling Statute, determination of fair compensation constitutes an act of discretion and "[m]andate may not order the exercise of discretion in a particular manner unless discretion can be lawfully exercised only one way under the facts"); *MWD v. IID*, 80 Cal.App.4th at 1425, 1428 ("The water conveyance facility owner, in this case the Metropolitan Water District, is specifically authorized to determine what is 'fair compensation' provided the determination is made in a timely and reasonable manner" and "[t]he construction of the Wheeling Statute by the Metropolitan Water District is entitled to great weight and respect").

D. The Tentative does not consider evidence presented at the final hearing that demonstrates that Proposition 26 either does not apply or, if it does, has been satisfied.

The Tentative's finding that Proposition 26 applies to MWD's rates, and that Proposition 26 has not been satisfied through a two-thirds majority vote of MWD's electorate (Tentative at 48) is erroneous because the Tentative failed to consider MWD's evidence on that issue presented at the final hearing. It appears the Court believes it had earlier ruled on this issue when, in fact, it had not done so.

MWD filed a motion for judgment on the pleadings concerning SDCWA's Proposition 26 claim in the *2012 Action*. In its September 19, 2013 Order, the Court denied the motion on the procedural ground that an entire cause of action was not being adjudicated. 9/19/13 Order at

2, 4. The Court also stated, "Nor do I think it wise, as a matter of discretion, to eliminate the Proposition 26 issues without reviewing the evidence for other claims in this case." *Id.* at 2. The Court further stated: "*the fact that Metropolitan does not today convince me that the Proposition 26 issues must be excluded from the case does not imply Metropolitan will not convince me of that at trial*." *Id.* at 3 (emphasis added).

Accordingly, at the time of the final hearing on the rate issues, there was no ruling on the question about whether Proposition 26 applies and, if so, whether MWD has satisfied it. In other words, the Court was required to evaluate the evidence presented during the final hearing to determine whether Proposition 26 applies and whether MWD has complied with it. From the Tentative, it appears the Court did not do so, but simply concluded without analysis that "Met did not adduce any [] facts" regarding the applicability of Proposition 26 at the final hearing. Tentative at 48. As the Court's record will show, this conclusion is unfounded. Although the motion for judgment on the pleadings was limited to the facts alleged in the pleadings, at the final hearing MWD relied on *evidence*, including over 20,000 pages of the administrative record for the 2012 Action, to show that Proposition 26 does not apply here and that even if it did, MWD satisfied it through the requisite vote of its Board of Directors.

1. The evidence establishes that MWD's rates are not "imposed" within the meaning of Proposition 26.

Citing *Bighorn-Desert View Water Agency v. Verjil*, 39 Cal. 4th 205 (2006), the Tentative finds that MWD's wholesale water rates are "imposed." Tentative at 48. The Tentative recites an improper definition of "imposed" under Proposition 26. *Bighorn* holds that retail domestic water charges are property-related fees under Article XIII D, section 6 of the California Constitution and, therefore, "fees" within the meaning of Article XIII C, Section 3's initiative rule. 39 Cal. 4th at 221. Whether MWD's rates are fees as *Bighorn* defined them is not the issue here. SDCWA is not claiming that MWD's rates are property-related fees under Article XIII D, or that an initiative measure applies to those rates. Instead, SDCWA contends MWD's rates are "taxes" for purposes of Article XIII C, section 2, which *Bighorn* did not address. Indeed, *Bighorn* expressly states that it has *no bearing* on Article XIII C's "definitions of the terms

'general tax' and 'special tax.'" *Id.* at 213. MWD presented a preponderance of evidence and legal analysis to prove its rates are not "imposed."

First, MWD's rates are not "imposed" because they are not traditional taxes. As explained in *Schmeer v. County of Los Angeles*, taxes within the ambit of Proposition 26 are defined as money paid to the government by private parties: "The term 'tax' in ordinary usage refers to a compulsory payment made to the government or remitted to the government." 213 Cal. App. 4th 1310, 1326 (2013). In contrast, MWD's evidence established that all of MWD's member agencies *are* the government, as is MWD. MWD is a government agency formed by the voluntary union of other government entities that set the rates themselves via their representatives on the MWD Board of Directors.[11] DTX-029 at AR2012-003848; JTX-1 at AR2010-003848 (MWD "is a voluntary cooperative of member public agencies created for the purpose of 'developing, storing and distributing water'"). MWD's water rates do not fall within the ordinary use of the word "tax" because they are not paid by private parties to the government.

Second, a tax is a compulsory payment imposed by the government without the consent of the payor, which MWD's rates are not. *Cal. Farm Bureau*, 51 Cal. 4th at 437 (distinguishing taxes, which are "compulsory," from fees, which involve "a voluntary decision to develop or seek other government benefits or privileges"); *Ponderosa Homes, Inc. v. City of San Ramon*, 23 Cal. App. 4th 1761, 1770 (1994) ("impose[d]" means "to establish or apply by authority or force"). In contrast to traditional taxes where private parties are compelled to pay money to the government without a say in the design of those charges, the entities that pay MWD's rates collectively "[have] discretion to add or change [MWD's] rates and charges, or the allocation of Metropolitan's costs among its rates and charges and among its member agencies, so long as cost-of-service requirements are met." *2012 Action* Pet./Compl. ¶ 33. A rate for wheeling service in particular is not imposed. The decision to wheel third-party water is entirely a

[11] An agency cannot join MWD unless its governing body applies for membership and receives the approval of the qualified electors in the agency's service area. MWD Act §§ 350-56. SDCWA's electorate voted to join MWD in 1946. PTX-006 at SDCWA2010-2012_00206422.

voluntary, non-compulsory act.

Third, MWD's evidence established that it is a supplemental supplier of water, which means that, unlike a retail water agency, MWD has no exclusive right to serve in its service area. DTX-109 at AR2012-016587; MWD Act § 130. To the degree a member agency has local resources, develops local resources, implements conservation, or otherwise reduces demands, that member agency is not required to use MWD water or water services in the way it would be required to use services from a local retail water agency; the member agency is free to opt out fully or partially from MWD's services. DTX-109 at AR2012-016587 (MWD's "member agencies are free to acquire supplies from other sources," and MWD's "Board has adopted the concept of 'direct access,' or customer choice for supplier, to accommodate a water transfer market"); JTX-2 (AR2012-016429) at AR2012-016538 ("No member agency of Metropolitan is obligated to purchase water from Metropolitan. However, twenty-four of Metropolitan's 26 member agencies have entered into voluntary 10-year water supply purchase orders for water purchases through December 31, 2012").

Fourth, SDCWA, like all of MWD's member agencies, has other choices regarding where it purchases its water, and as SDCWA itself alleges, it purchases a large share of supplies from third party sources. *2012 Action* Pet./Compl. ¶ 3 (SDCWA "purchases conserved Colorado River water from [Imperial Irrigation District and] . . . has also obtained conserved water from the lining of the All American and Coachella Canals"); DTX-185* (2009 agreement between MWD and SDCWA for conveyance of water SDCWA purchased from Placer County Water Agency); DTX-201* (2008 agreement between MWD and SDCWA for conveyance of water SDCWA purchased from Butte Water District and Sutter Extension Water District); DTX-177* (2003 agreement between MWD and SDCWA for conveyance of water SDCWA purchased from Fallbrook Public Utility District). SDCWA also has access to local sources of water. JTX-2 (AR2012-016429) at AR2012-016523 (Member agencies have "independently funded and developed additional local supplies [of] water"); 12/20/2013 Tr. at 594:7-596:10 (SDCWA continues to receive demand management funding through MWD's Local Resources Program. Approximately 14 of SDCWA's Local Resources Programs are currently active, and are eligible

to receive around $7 million a year in funding).

Fifth, notwithstanding the Tentative's finding to the contrary (Tentative at 48), MWD's evidence at the final hearing established that SDCWA *does* have a choice about involving MWD in its obtaining water from the Imperial Irrigation District ("IID") and the lining of the All-American and Coachella Canals ("IID/Canal Lining Water"). Although it would take planning, time, and money as all water infrastructure projects do, SDCWA could have constructed, and still can construct, its own conveyance system to connect to the Colorado River, the All-American Canal, and/or the Coachella Canal. JTX-2 (AR2012-012589) at AR2012-012594; DTX-109 at AR2012-016584. Portions of the Exchange Agreement between MWD and SDCWA rest on the assumption that SDCWA may, in fact, construct its own conveyance facilities to move IID water to SDCWA's service area, as opposed to exchanging that water for MWD water. In the Exchange Agreement, SDCWA reserved the right, "in its sole discretion," to permanently reduce the amount of IID/Canal Lining Water that it exchanges with MWD "to the extent SDCWA decides continually and regularly to transport [IID/Canal Lining Water] . . . through Alternative Facilities," which are defined as facilities that are not "owned and operated by MWD." Ex. A to *2010 Action* Third Amended Pet./Compl. ("TAC") and *2012 Action* Pet./Compl. (Arts. 1.1(c) and 3.7). Ten years have passed since the 2003 Exchange Agreement was executed, reserving SDCWA's right to use Alternative Facilities to move its IID/Canal Lining Water. MWD planned and built the Colorado River Aqueduct, and the state of California planned and built the California Aqueduct, in the same or less time — and both were far more extensive projects covering significantly more ground than a SDCWA connection to the Colorado River, the All-American Canal, and/or the Coachella Canal would be. DTX-055 at AR2012-000001-000172; JTX-1 at AR2010-000001-000172; DTX-019 at AR2012-001421-001422, 001460; JTX-1 at AR2010-001421-001422, 001460. Such a SDCWA conveyance system would not run parallel to, be duplicative of, or even be near MWD's Colorado River Aqueduct or other conveyance/distribution systems.

Moreover, the Tentative's reliance on the word "imposed" in several of MWD's official documents (Tentative at 48) does not change the reality that SDCWA is not obligated to use

MWD's system to transport water.

2. The evidence establishes that MWD's rates are covered by Proposition 26's (e)(4) exception.

One of Proposition 26's exceptions, contained in subsection (e)(4), provides that charges are not "taxes" subject to the proposition when the charge is for the use or purchase of local government property. The Tentative's statement that the Court previously rejected, and thus cannot reconsider, MWD's argument that its rates are covered by this exception is incorrect. 9/19/13 Order at 2-3.

Article XIII C, section 1, subdivision (e)(4) of the California Constitution excludes from Proposition 26's scope "a charge imposed for . . . use of local government property, or the purchase . . . of local government property." At the final hearing, MWD presented evidence that whether the rates at issue are for the use of the MWD water system (real property) or the purchase of water (personal property), MWD's rates for wheeling service and for full service water fall within this property exception because they are charges for use or purchase of local government property.

"Where pipes are laid in real estate for the purpose of carrying water to the lands to which they extend, the pipes, while imbedded in the soil, constitute real property both before the water is carried therein and after the use for that purpose has ceased." *Robinson v. City of Glendale*, 182 Cal. 211, 213 (1920). As MWD demonstrated, its water rates and charges are charges for use of MWD's own distribution and conveyance pipes and other transportation facilities, as well as MWD's contractual right to use the SWP pipes and other SWP transportation facilities. JTX-2 (AR2012-016429) at AR2012-016492. As discussed *supra* (Section III.C.1 and III.C.2), MWD's contract with DWR sets forth rights and duties that give MWD a property right in the SWP facilities to use these facilities for transportation. DTX-055 at AR2012-000074-000089, 000153 [Arts. 24-26, 55]; JTX-1 at AR2010-000074-000089, 000153 (Arts. 24-26, 55); *Golden West Baseball Co.*, 25 Cal. App. 4th at 36-37. At a minimum, this property right is equivalent to a lease, although the contract terms rather than the property interest label is what is relevant. *Golden W. Baseball Co.*, 25 Cal. App. 4th at 36-37.

Importantly, SDCWA recognizes that in the context of wheeling, MWD's "rights to State Water Project facilities" are equivalent to DWR's, and SDCWA has preferred to use MWD's rights over DWR's. DTX-086 at *SDCWA2010-2012_00082035; DTX-075 at *MWDPRA044184.

Charges to use either MWD's facilities, or facilities in which MWD has a property right, are for the "use of local government property" under the (e)(4) exception. It does not matter for purposes of this section what rate components comprise MWD's rates for full service water or for wheeling (the Water Stewardship Rate, System Access Rate, and System Power Rate/actual cost of power) because Proposition 26 looks only at the *purpose* for which the charge is collected. Cal. Const., art. XIII C, § 1, subd. (e)(4). Whether for full service water or for wheeling, MWD's customers pay for the use of local government property to convey water.

To the extent the Court has determined that SDCWA's challenge is only to MWD's rate for wheeling service, then Proposition 26's (e)(4) exception completely resolves the Proposition 26 claim. By *definition*, a wheeling rate is a charge for "use of a water conveyance facility." Wat. Code § 1810. MWD's Administrative Code defines wheeling service as "the use of Metropolitan's facilities, including its rights to use State Water Project facilities." MWD Admin. Code § 4119. MWD's rate for wheeling service is nothing more than a charge for the use of property, *i.e.* the pipes and other transportation infrastructure through which water is wheeled.

Additionally, to the extent the Court has determined that SDCWA also challenges the full service rate, then purchases of water fall under this exception too, because the water MWD sells to its member agencies is MWD's property and thus "local government property." *Santa Clarita Water Co. v. Lyons*, 161 Cal. App. 3d 450, 461 (1984) ("When severed from the realty, reduced to possession and placed in containers, [water] becomes *personal property*") (emphasis in original); *Watts Industries, Inc. v. Zurich American Ins., Co.*, 121 Cal. App. 4th 1029, 1043 (2004) ("Containers" includes "artificial watercourses or conduits through which water flows"). The Tentative should not look to the underlying components of MWD's full service water rate, but rather to the purpose of that rate. Because MWD's full service customers pay the full service water rate in order to *purchase MWD's water*, MWD's full service water rate is a charge for the purchase of local government property.

Accordingly, the Tentative's finding that MWD's rates do not fall within the (e)(4) exception is contrary to governing law and the evidence presented during the final hearing.

3. The evidence establishes that MWD's rates are covered by Proposition 26's (e)(2) exception.

One of Proposition 26's other exceptions provides that charges are not "taxes" subject to the proposition when the charge reasonably recovers the cost of performing the service in the aggregate, or in other words, measuring all rate payors together. As discussed in Sections III.B and III.C, *supra* (contesting the substantive bases for the Tentative's ruling invalidating MWD's rate for full service water and rate for wheeling service), the Tentative's finding that Proposition 26's (e)(2) exception does not apply to MWD's rates is wrong because MWD proved by a preponderance of evidence that it collects the costs estimated to meet its revenue requirements, and that its rates in aggregate do not exceed the overall costs of providing its services.

4. The evidence establishes that MWD satisfied Proposition 26's voting requirement.

As noted above, the Tentative mistakenly states that the Court previously rejected MWD's claim that its rates satisfy Proposition 26's voting requirement. At the final hearing, MWD presented sufficient evidence establishing that even if Proposition 26 applied to MWD, it satisfied the approval requirement with regard to its 2013-2014 rates because all entities that pay the rates were given a vote, and the rates were approved by more than two-thirds of that electorate of payors. DTX-111 at AR2012-016997-017001 (the rates and charges at issue in the *2012 Action* were passed by a 76 percent majority of MWD's Board of Directors); MWD Act §§ 57, 130, 133 (under state law, the MWD Board is the body required to vote on MWD's rates). MWD also provided additional evidence and analysis concerning why the "electorate" was MWD's Board and could not legally or logically be individual voters across MWD's 19 million-person service area, none of whom pay MWD's rates, or any group other than MWD's own customers. MWD Closing Brief at 100-108. The Court's failure to consider this evidence and analysis is in error.

E. The Tentative's determination that Government Code section 54999.7 applies is wrong as a matter of law.

The Tentative's ruling that Government Code section 54999.7, subdivision (a), applies to MWD's water rates is based on the conclusory statement that because MWD and SDCWA are both public agencies, MWD charges rates for a public utility service. Tentative at 50. This ruling fails to substantively respond to MWD's legal arguments that section 54999.7 is not meant to apply to wholesale water service providers.

As MWD established at the final hearing, Government Code section 54999 was enacted in response to the decision in *San Marcos Water District v. San Marcos Unified Sch. Dist.*, 42 Cal. 3d 154 (1986). San Marcos involved a retail utility's capital-project capacity fee charged to all agency customers, whether public or private. *Id*. at 157-58. The Supreme Court held that utility charges for capital improvements are special assessments, not user fees, under the California Constitution, and public entities are impliedly exempt from such charges, unless the Legislature directs otherwise. *Id*. at 160-165. In response, the Legislature passed the San Marcos legislation seeking to ensure that public-entity customers pay a share of capital costs. *See Utility Cost Mgmt. v. East Bay Municipal Utility Dist*., 79 Cal. App. 4th 1242, 1246-47 (2000); *see also* Gov't Code § 54999(b) ("The Legislature . . . finds that the holding in [*San Marcos*] should be revised to authorize payment and collection of capital facilities fees . . ."). Under the legislation, if a capacity fee bears certain key fee characteristics, such as a foundational cost of service analysis, then the utility may levy the charge against public entities. *See* Gov't Code, § 54999 *et seq.* The narrow focus on retail capacity fees is manifest in the text, for example, by requiring parity for public and private customers and identifying specific requirements for public entity customers, namely schools. *See* Gov. Code §§ 54999.7(a), (c). There is no reasonable claim that MWD's rates and charges amount to special assessments from which public entities are impliedly exempt.

Moreover, the statute cannot apply to MWD because, on its face, it requires that rates charged to public agencies be the same as those charged to *non-public* agencies. Section 54999.7(b) provides: "A fee, including a rate, charge, or surcharge, for any product, commodity,

or service provided to a public agency, shall be determined on the basis of the same objective criteria and methodology applicable to comparable nonpublic users." MWD's 26 customers are all public agencies. DTX-029 at AR2012-003848; JTX-1 at AR2010-003848; MWD Act §§ 12, 50, 51, 55, 350-56. MWD's rates and charges have long been applied to public entities, and only public entities. DTX-029 at AR2012-003848; JTX-1 at AR2010-003848; MWD Act §§ 50, 51, 55, 350-56.

Also, the statute further provides that it applies only to charges that are "impose[d]." Gov't Code § 54999.7(a). MWD provided evidence and legal analysis that its rates and charges are not imposed. MWD Closing Brief at 29, 38-41; Section III.D.1, *supra*. The Tentative failed to address this evidence and analysis.

Finally, SDCWA has conceded that Government Code section 54999 does not apply to MWD: stating the section "is a provision of the San Marcos legislation governing the applicability of water service and other public utility rates to schools and other public agencies" and it "does not apply to a water wholesaler like [MWD]." TAC, Ex. D at 7 (JTX-1 (AR2010-011333) at 011339; JTX-2 (AR 2012-011333) at 011339). SDCWA chose to submit this statement to MWD's Board of Directors during MWD's rate-setting process. *Id.* SDCWA had no reason to state section 54999 does not apply to MWD other than the fact it is clearly true.

IV. CONCLUSION

For the reasons stated above, MWD respectfully asks the Court to revise its Tentative invalidating MWD's rate for wheeling service, and to either clarify that its Tentative does not apply to MWD's full service water rate, or revise its Tentative to reject SDCWA's challenge to the transportation components of MWD's full service rate.

DATED: March 27, 2014

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San Francisco County Superior Court Case Nos. CPF-10-510830 & CPF-12-512466

PROOF OF SERVICE

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

On March 27, 2014, I served the attached:

RESPONDENT/DEFENDANT METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA'S OBJECTIONS TO THE COURT'S TENTATIVE DETERMINATION AND PROPOSED STATEMENT OF DECISION ON RATE SETTING CHALLENGES

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

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

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct and that this declaration was executed on March 27, 2014, at San Francisco, California.

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