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17 SUPERIOR COURT OF THE STATE OF CALIFORNIA

18 COUNTY OF SAN FRANCISCO

19 SAN DIEGO COUNTY WATER  
AUTHORITY,

20 Petitioner and Plaintiff,

21 v.

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

24 Respondents and Defendants.

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

**RESPONDENT AND DEFENDANT  
METROPOLITAN WATER DISTRICT  
OF SOUTHERN CALIFORNIA'S  
MEMORANDUM OF POINTS AND  
AUTHORITIES IN SUPPORT OF ITS  
MOTION TO REOPEN EXPERT  
DISCOVERY FOR LIMITED PURPOSE**

Date: August 6, 2014

Time: 3:00 p.m.

Dept.: 304

Judge: Hon. Curtis E. A. Karnow

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Trial Date: Phase II trial date not yet set

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1 **MEMORANDUM OF POINTS AND AUTHORITIES**

2 **Preliminary Statement**

3 This Court's April 24, 2014 Statement of Decision on Rate Setting Challenges (“Decision”)  
4 wreaks havoc on the water rate structure utilized by Respondent and Defendant Metropolitan  
5 Water District of Southern California (“MWD”) since 2003. By this motion, MWD seeks to  
6 reopen expert discovery for a limited purpose in light of the Decision.

7 If the Parties are required to proceed with litigating the breach of contract claims, then  
8 MWD seeks to present damages evidence that was only possible to develop after the Decision was  
9 issued. The proper measure of damages here is the difference between the rates that SDCWA paid  
10 and the replacement rates that MWD’s Board of Directors adopts. The alternative rate structures  
11 available, and the related facts, must be considered by the Court in evaluating whether SDCWA  
12 can establish damages and, if so, the proper amount. These alternatives and facts were not  
13 previously subject to discovery, because the Decision was required first. A reopening of expert  
14 discovery to enable MWD to augment its list of damages experts and to provide supplemental  
15 expert reports concerning damages, so that it may present this information at trial, is required if the  
16 breach of contract action claims are litigated.

17 **Factual Background**

18 The second stage of this phased trial considers whether MWD has breached its 2003  
19 Exchange Agreement with SDCWA (along with considering SDCWA’s preferential rights claim).  
20 A necessary element of breach of contract that SDCWA must establish is damages. Civ. Code §  
21 3300; *CDF Firefighters v. Maldonado*, 158 Cal. App. 4<sup>th</sup> 1226, 1239 (2008). Contract damages  
22 serve to put the party in as good a position as it would have been had performance been rendered  
23 as promised. *State v. Pac. Indem. Co.*, 63 Cal. App. 4<sup>th</sup> 1535, 1551 (1998). To prove damages in  
24 an adjudication at this time, SDCWA must show that the amount it paid under the 2003 Exchange  
25 Agreement was greater than the amount that MWD could have lawfully charged. MWD needs to  
26 put forward expert opinion, in the form of supplemental expert reports, in order to inform what  
27 rates it could have charged SDCWA in light of the rulings set forth in the Decision.

1 This Court, in its Decision, would invalidate MWD’s rate for wheeling service and three  
2 primary rates utilized by MWD in its rate structure: the System Access Rate, the System Power  
3 Rate, and the Water Stewardship Rate. The latter three rates are the transportation or conveyance  
4 rates within MWD’s full service rate. They are the conveyance charges that SDCWA pays under  
5 the 2003 Exchange Agreement’s price term. The System Access Rate and Water Stewardship  
6 Rate (along with actual power costs) also comprise MWD’s pre-established rate for wheeling  
7 service.

8 This Court itself has recognized that conditions exist which would benefit from additional  
9 expert evidence. In the Decision, the Court left open the possibility that at least some of the  
10 payments made to the State could be included in MWD’s System Access Rate, System Power  
11 Rate, and rate for wheeling service by stating “[a]nd while Met may from time to time use the  
12 state’s transport capability to move some its water, that does not support the reasonableness of  
13 including **all** the state’s transportation costs as part of Met’s transportation costs.” Decision at 53  
14 (internal citations omitted) (emphasis in original). Similarly, the Court, while finding the Water  
15 Stewardship Rate invalid, did not conclude that all costs of the demand management programs  
16 would be excluded. The Court stated that “the central problem here is that Met treats the *entirety*  
17 of the Water Stewardship Rate as a ‘transportation’ rate that is then incorporated into the wheeling  
18 rate.” *Id.* at 60 (emphasis in original).

19 No Party’s experts opined as to what percentage of costs associated with these rates could  
20 be allocated to the conveyance rates in a manner that complies with the Court’s ruling. As the  
21 Court recognized, “While I cannot fault Met for not providing a transportation benefit number for  
22 *each* of the specific demand management programs, the best we can do with this record is to  
23 conclude that to some unspecified extent, some portion of the Water Stewardship Rate is causally  
24 linked to some avoided transportation costs.” *Id.* (emphasis in original). The Court also noted that  
25 “[a]side from the Wheeling statute, I have been required to confine my review to the  
26 administrative record.” *Id.* at 64. *See also* Joint Case Management Conference Statement for July  
27 19, 2013 CMC at 12:10-21. Furthermore, rates are inter-related. If one rate is reduced, others

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1 must be increased to recoup MWD's costs. See MWD Act § 134; *Mission Springs Water Dist. v.*  
2 *Verjil*, 218 Cal. App. 4<sup>th</sup> 892, 920-921 (2013); Baxter Decl. Ex. B (Woodcock Expert Rep.), at 25.

3 MWD needs to be able to put forward considered evidence as to what fair and reasonable  
4 rates, lawful under the Decision, could have been charged in the absence of the System Power  
5 Rate, System Access Rate, and Water Stewardship Rate struck down by the Court.

6 Several examples can make the point of the new evidence required. First, although the  
7 Court struck down the System Power Rate, it is beyond doubt that MWD could set generally  
8 applicable replacement conveyance rates that charge customers for the actual power costs to move  
9 and deliver full service Metropolitan water or to wheel third-party water. MWD should be  
10 permitted to establish, under the Decision, what a replacement power charge consisting of actual  
11 costs is, as well as what SDCWA would have been charged for marginal incremental power costs  
12 between 2011 and 2014 under this replacement rate. Interestingly, these actual power costs will  
13 likely be higher than what SDCWA was charged with application of the System Power Rate.  
14 Further evidence of incremental power costs must be identified and considered in evaluating  
15 damages.

16 Second, a number of fair and reasonable different cost structures or architectures are  
17 possible in light of the Court's Decision, which would invalidate the cost structure actually  
18 selected by MWD's Board in 2001 and implemented in 2003. These cost structures or  
19 architectures are open to MWD's Board for selection, as a quasi-legislative policy decision, in the  
20 future if the Court's Decision withstands appeal. Further expert testimony is required to  
21 demonstrate both the possible choices and that the choices are fair and reasonable. MWD, in  
22 making this case, is not limited by the existing cost structure. That approach was struck down by  
23 the Court, and that decision reaches the entirety of the rates MWD charges to all its customers, not  
24 just SDCWA. MWD's Board, in this regard, would need to reshape its rates to avoid requiring  
25 any of its customers to subsidize others, and this requires that system-wide infrastructure costs be  
26 properly apportioned to cost objectives. MWD should be permitted to present expert evidence of  
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1 available options in light of the Decision and what, if any, damages would be proper under the  
2 Exchange Agreement as a result of each.

3 Third, another example of required additional expert evidence pertains to the Water  
4 Stewardship Rate. Even SDCWA concedes that some of the costs in this category benefit  
5 wheelers because the programs funded by the Water Stewardship Rate reduces or defers required  
6 expansion of the system-wide infrastructure and resulting capital costs – costs that the Court of  
7 Appeal recognizes do benefit and should be apportioned to those users wheeling water through the  
8 MWD system. *Metro. Water Dist. of S. California v. Imperial Irr. Dist.*, 80 Cal. App. 4<sup>th</sup> 1403,  
9 1427-30 (2000). (The Water Stewardship Rate, indeed, has always been apportioned to both full  
10 service and wheeling users based on volumetric (per acre-foot) conveyance and thus wheelers  
11 have been charged less than 5% of the costs.)

12 In sum, the limited supplemental expert discovery sought by this motion is highly relevant,  
13 as it goes to the heart of SDCWA’s claim for damages if the Court determines that breach of  
14 contract should be litigated. And, before the Court issued its Decision that would invalidate  
15 certain rates but not others, and explaining the Court’s grounds for doing so, it was impossible to  
16 perform an analysis of potential replacement rates that would be permissible to the Court.  
17 SDCWA will not be prejudiced by this submission, and there is ample time to fully consider any  
18 additional expert discovery prior to the trial date on breach of contract—which has not yet been  
19 set. The proposed additional discovery will assist the Court in providing a full and fair  
20 determination on breach of contract.

### 21 **Procedural Background**

22 Discovery in these cases is now closed. The Parties completed fact discovery – written  
23 discovery, document productions, and depositions – in Fall 2013, prior to expert discovery.  
24 SDCWA and MWD each served a demand for exchange of expert witness information pursuant to  
25 Code of Civil Procedure § 2034.210 in October 2013. Pursuant to the demands, SDCWA and  
26 MWD exchanged lists of expert witnesses, expert reports, and document productions. The Parties  
27 thereafter took expert depositions. Expert discovery concluded in November 2013.

1 MWD's expert exchange included the report of Christopher Woodcock regarding the rate-  
2 setting procedures and reasonableness of rates set by MWD, as well as their interrelated nature.  
3 Mr. Woodcock's expert opinion further explained that it was impossible to determine the  
4 appropriate amount of damages for any alleged breach of the Exchange Agreement without the  
5 guidance to be provided by the Court in its rate determination:

6 "In my opinion, until the Court rules, it is impossible to determine what the  
7 damages are, if any. At least three charges could be impacted by the Court's ruling  
8 . . . . MWD's rates and charges are inter-related. If the Court invalidated one or  
9 more parts of MWD's rate structure, it would be reasonable for MWD's Board to  
10 consider whether changes should be made to other parts of MWD's rate structure.  
11 Until the Court rules, it is impossible to know what actions the Board might take,  
12 and therefore, what SDCWA's damages are, if any."

10 Baxter Decl. Ex. B (Woodcock Expert Rep.), at 25. Mr. Woodcock further explained that MWD  
11 may have to re-set supply tiers, or re-examine its policy to provide options for purchase orders for  
12 member agencies. Mr. Woodcock also noted the agreement of SDCWA's person most  
13 knowledgeable on Exchange Agreement damages, SDCWA Assistant General Manager Dennis  
14 Cushman, that calculating damages prior to the Court's determination would not be possible.<sup>1</sup>

15 On April 24, 2014, the Court issued its Decision on the validity of MWD's rates for full  
16 service water and wheeling service. The Court determined that the System Access Rate, System  
17 Power Rate, Water Stewardship Rate, and rate for wheeling service were invalid. The Court  
18 rejected SDCWA's "dry-year peaking" claim.

19 \_\_\_\_\_  
20 <sup>1</sup> Mr. Cushman agreed that the Board has "a number of different ways [it] could develop a  
21 rate structure and a system of rates that lawfully recover rates." Baxter Decl. Ex. C (Dep. of  
22 Dennis Cushman) at 422:7-10. Mr. Cushman further agreed that the Board must determine the  
23 rates before damages could be calculated:

23 Presuming the Water Authority prevails [in the litigation], the judge will invalidate  
24 Metropolitan's rates, and Metropolitan will have to go back and set and adopt lawful rates.  
25 How Metropolitan goes back and adopts lawful rates and charges is at this point unknown.  
26 So how it might affect the Water Authority's payments is unknown.

25 *Id.* at 422:7-10; 443:20-444:2. Mr. Cushman also agreed that he did not know whether SDCWA  
26 would be better off under re-set rates (*id.* at 422:14-19), i.e., whether there would be damages even  
27 if SDCWA prevailed on the rate challenge.

1 ARGUMENT

2 The Court should reopen expert discovery, pursuant to California Civil Code of Procedure  
3 § 2024.050(a), for the limited purpose of allowing MWD to augment its list of experts and serve  
4 supplemental expert reports on the question of damages.

5 **A. Legal Standard**

6 The Court may grant a motion to reopen discovery on its discretion. Code Civ. Proc. §  
7 2024.050(a). In determining whether to do so, the Court shall take into account all relevant  
8 matters, including:

9 (1) The necessity and the reasons for the discovery.

10 (2) The diligence or lack of diligence of the party seeking the discovery or the  
11 hearing of a discovery motion, and the reasons that the discovery was not  
12 completed or that the discovery motion was not heard earlier.

13 (3) Any likelihood that permitting the discovery or hearing the discovery motion  
14 will prevent the case from going to trial on the date set, or otherwise interfere with  
15 the trial calendar, or result in prejudice to any other party.

16 (4) The length of time that has elapsed between any date previously set, and the  
17 date presently set, for the trial of the action.

18 *Id.*, § 2024.050(b).

19 **B. The Requested Expert Discovery is Critical to a Full and Fair Evaluation of**  
20 **Contract Damages**

21 SDCWA’s breach of contract claims hinge on its assertion that MWD failed to set water  
22 rates in accordance with applicable law in California. MWD’s and SDCWA’s 2003 Exchange  
23 Agreement provides for the exchange of water between SDCWA and MWD for, among other  
24 consideration, SDCWA’s payment of a “Price” set in two phases: (1) an agreed initial numeric  
25 price and (2) subsequent prices “equal to the charge or charges set by Metropolitan’s Board of  
26 Directors pursuant to applicable law and regulation and generally applicable to the conveyance of  
27 water by Metropolitan on behalf of its member agencies.” (Baxter Decl. Ex. A (2003 Exchange  
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1 Agreement) § 5.2.) Of course, damages for such a breach of contract should do no more than put  
2 SDCWA in the position it *would have been in* if MWD had set rates in a manner consistent with  
3 the Court’s Decision. Civ. Code § 3300. If the breach of contract claim will be litigated, then this  
4 requires a determination of what charge or charges *could have been set* by MWD’s Board, with  
5 the benefit of the Court’s ruling and reasoning. SDCWA can recover no more than the difference  
6 between that amount and the amount it actually paid.

7 Courts have recognized that rate-setting is a vastly complex process (*Brydon v. E. Bay*  
8 *Mun. Util. Dist.*, 24 Cal. App. 4th 178, 201 (1994)) that may not be engaged in by a court when it  
9 determines that a current rate is invalid under the law (*Durant v. City of Beverly Hills*, 39 Cal.  
10 App. 2d 133, 139-140 (1940)). As the Court of Appeal explained in *Durant*, “[t]he universal rule  
11 is that in these circumstances the court is not a rate-fixing body . . . and that the limit of its  
12 function and jurisdiction is to find, upon a proper showing, that the rates fixed are unreasonable  
13 and unfair. If upon such finding it is adjudged that the established rates shall not be collected, the  
14 court is not permitted to fix another and different rate, but this function must be left with the  
15 proper rate-fixing body.” *Id.* at 139-40 (citation omitted). Furthermore, “mandate may compel an  
16 exercise of discretion, but may not control it. Mandate may not order the exercise of discretion in  
17 a particular manner unless discretion can be lawfully exercised only one way under the facts.”  
18 *San Luis Coastal Unified School Dist. v. City of Morro Bay*, 81 Cal. App. 4th 1044, 1051 (2d Dist.  
19 2000). The legally required rate-fixing body here is the Board of MWD. MWD Act §§ 50, 133,  
20 134. Moreover, even as a contractual matter, the 2003 Exchange Agreement’s price term requires  
21 MWD’s Board, rather than any other body, to set the charges on which the price term is based.  
22 Baxter Decl. Ex. A (2003 Exchange Agreement), § 5.2. Setting new, compliant conveyance rates  
23 is a task that legally and contractually *must* be left to MWD’s Board to undertake, and there are  
24 many ways that it can determine and set that rate.

25 Expert opinion is therefore required to analyze the myriad potential rate structures that  
26 MWD’s Board would be permitted to choose to comply with the Court’s Decision. It is not as  
27 simple a matter as directing that charges previously allocated to transportation rates be instead  
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1 allocated to supply rates. As Mr. Woodcock explained, MWD may have to restructure all of its  
2 water rates, including changing the tiered rates that it currently charges for supply, and may have  
3 to consider entirely new methodologies of recovering its costs. Baxter Decl. Ex. B (Woodcock  
4 Expert Rep.), at 25. A full explanation of MWD’s options, and the costs thereto that would apply  
5 to SDCWA under the 2003 Exchange Agreement’s price term, requires expert opinion, and the  
6 Court should reopen expert discovery on a limited basis so that MWD may provide it. Code Civ.  
7 Proc. § 2024.050(b)(1).

8 **C. MWD Has Exercised Diligence In Requesting This Discovery**

9 The Court issued its Decision on the validity of MWD’s rates on April 24, 2014—less  
10 than three months ago. The Case Management Conference to discuss setting trial in the breach of  
11 contract (and preferential rights) phase of this litigation has not yet occurred. Prior to the Court’s  
12 Decision, producing expert reports analyzing all possible ways in which MWD could have set its  
13 rates in compliance with the Decision and its reasoning would not have been possible. It would  
14 not have been feasible for an expert to consider all possible rulings with all possible rationales that  
15 the Court could have issued as to the various rates’ validity—this would have been at best grossly  
16 inefficient and more likely flatly impossible. Accordingly, there is no lack of diligence in seeking  
17 to reopen discovery for issues that were impossible to complete prior to the Court’s Determination  
18 after the first phase of trial. Code Civ. Proc. § 2024.050(b)(2).

19 **D. Reopening Expert Discovery On a Limited Basis Will Not Prejudice**  
20 **SDCWA or Delay Trial**

21 There is no chance of prejudice to SDCWA by MWD augmenting its expert list and  
22 producing supplemental expert reports on damages. The second phase of trial has not been  
23 calendared. Accordingly, there is ample time to complete any discovery matters related to  
24 MWD’s augmented expert list and supplemental expert reports, including any deposition or  
25 responsive report, as the Court deems necessary. Further, trial will not be delayed as it has not yet  
26 been scheduled. These factors do not weigh against reopening discovery. Code Civ. Proc.  
27 § 2024.050(b)(3).

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**E. Contemplated Expert Discovery**

The limited reopening of expert discovery will allow experts to be retained by MWD to analyze potential rate structures consistent with the Court's April 24, 2014 Decision and report their findings as to available alternative fair and reasonable rate structures to be used in measuring contract damages, if any, under those available structures. MWD presently intends to utilize two experts at trial: one to present the overall accounting logic required to structure the rates consistent with generally accepted accounting principles, and the second to present specific alternative rate structures and resulting charges to SDCWA under the 2003 Exchange Agreement, consistent with the proper accounting structure. Both experts will have to analyze existing financial records at MWD in order to undertake and support their reports to be submitted to the Court.

**Conclusion**

For the foregoing reasons, MWD respectfully submits the Court should reopen expert discovery pursuant to Code Civ. Proc. § 2024.050(a) for the limited purpose of allowing MWD to augment its expert witness list and to serve supplemental expert reports on the calculation of damages in the event SDCWA's breach of contract claims are litigated.

DATED: July 1, 2014

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