MORGAN LEWIS & BOCKIUS LLP
Colin C. West (Bar No. 184095)
Thomas S. Hixson (Bar No. 193033)
Three Embarcadero Center
San Francisco, California 94111-4067
Telephone: (415) 393-2000
Facsimile: (415) 393-2286

QUINN EMANUEL URQUHART & SULLIVAN, LLP
John B. Quinn (Bar No. 090378)
Eric J. Emanuel (Bar No. 102187)
865 South Figueroa Street, 10th Floor
Los Angeles, California 90017-2543
Telephone: (213) 443 3000
Facsimile: (213) 443 3100

THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA
Marcia Scully (Bar No. 80648)
Heather C. Beatty (Bar No. 161907)
Joseph Vanderhorst (Bar No. 106441)
John D. Schlotterbeck (Bar No. 169263)
700 North Alameda Street
Los Angeles, California 90012-2944
Telephone: (213) 217-6000
Facsimile: (213) 217-6980

Attorneys for Respondent and Defendant
Metropolitan Water District of Southern
California

SUPERIOR COURT OF THE STATE OF CALIFORNIA

FOR THE COUNTY OF SAN FRANCISCO

SAN DIEGO COUNTY WATER AUTHORITY,

Petitioner and Plaintiff,

vs.

METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA; ALL PERSONS INTERESTED IN THE VALIDITY OF THE RATES ADOPTED BY THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA ON APRIL 10, 2012 TO BE EFFECTIVE JANUARY 1, 2013 AND JANUARY 1, 2014; and DOES 1-10,

Respondents and Defendants.

CASE NO. CPF-10-510830
CASE NO. CPF-12-512466

DEFENDANT METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA'S TRIAL BRIEF

Hon. Curtis E.A. Karnow
Dept.: 304
Trial Date: March 30, 2015
Trial Time: 9:00 a.m.

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

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page

Cases

WHY DID SDCWA AGREE TO PAY ALMOST THREE TIMES MORE?

The evidence will show – and it will be undisputed – that SDCWA and MWD had an agreement in 1998 to exchange water for $90 per acre-foot with annual increases limited to a fixed 1.55% for 20 years, and then the price would lower to $80 per acre-foot with annual increases limited to 1.44% for years 21 through 30. And yet in 2003 that agreement was amended to sharply increase the price SDCWA had to pay to $253 per acre-foot, with no cap on annual increases. Why would SDCWA agree to pay 2.8 times more for each acre-foot? Common sense suggests SDCWA must have received something substantial in exchange, and indeed it did. That something was promised in a related agreement, the "Allocation Agreement," and that Allocation Agreement was expressly part of the consideration for the 2003 Exchange Agreement.

This brief is not a summary of the law, although it will mention some key statutes and Court of Appeal rulings. It is not intended to preview or argue each element of each cause of action or affirmative defense, although it will discuss some of the key facts upon which those defenses are based. Rather, this brief is mostly "big picture" background to explain the interrelationship between the Allocation Agreement and the Exchange Agreement and to show how it is possible for MWD to have defenses that are not inconsistent with the Court's ruling in Phase I.

I. SDCWA ACQUIRED IMPERIAL IRRIGATION DISTRICT WATER AND NEEDED A WHEELING AGREEMENT

To understand why the Exchange Agreement was amended, it is necessary to understand how the original agreement came to be.

A. SDCWA's Agreement to Acquire "Transfer Water" From IID

The negotiations and multiple agreements described in the following pages originate out of SDCWA's efforts to obtain water from the Imperial Irrigation District (IID), which has a high priority right to the Colorado River. IID's agricultural use was so profligate that runoff from irrigation was raising the level of the Salton Sea, flooding the surrounding property. When the

California State Water Resources Control Board concluded that IID was wasting water in violation of the California Constitution, IID sought to market its water for transfer from agricultural use to urban use.

IID entered a contract with SDCWA in 1998 to transfer up to 200,000 acre-feet per year. (The water subject to this agreement is known as "IID Transfer Water.") The transaction was at the time (and remains today) one of the largest transfers of water ever from agricultural to urban use. That deal was contingent on SDCWA reaching an agreement with MWD to wheel the water to San Diego.

B. SDCWA and MWD Fail to Agree on a Wheeling Agreement

As it turned out, MWD and SDCWA never agreed to wheeling. One of the stumbling blocks was MWD's "postage stamp" wheeling rate, which included the cost of the State Water Project (SWP). SDCWA had long objected to the inclusion of the SWP in the cost of conveyance. But to understand why it was included, some background about the SWP is necessary.

1. By Law, MWD Is Responsible for the Cost of Construction, Operation, Maintenance and Replacement of the SWP

The SWP is a complex system of reservoirs, canals, tunnels, pipelines and pumping facilities that captures, stores, moves and delivers water from the Feather River in Northern California to urban and agricultural users throughout the State. It includes the 444-mile-long California Aqueduct. The SWP was first authorized by the Legislature in 1951; however, it was not until 1960 that the funds needed to construct the SWP were approved. In that year, the California voters approved the Burns Porter Act, which allowed the State to issue bonds to build the main features of the SWP.

The enabling statutes created a unique arrangement between California's Department of Water Resources (DWR) and water agencies, known as the "State Water Contractors" (SWCs), that receive water from the SWP. The agreements between the DWR and SWCs have no analogy to typical business or consumer transactions. The statutes required the DWR to enter into water supply contracts with each of the SWCs that imposed on the SWCs the obligation to pay for all construction, operation, maintenance, and replacement costs allocated to the purpose of water

supply and delivery. Even though the DWR would have title to the SWP, and would manage the construction, operate the SWP, and handle the money, including issuing bonds, the financial burden fell on the SWCs. MWD was the first SWC.

In return for paying the costs, the SWCs were not and are not guaranteed any water whatsoever. Although the peculiar phrase "take or pay" is used to describe the obligations of SWCs, the more accurate phrase would be that SWCs must "pay no matter what." Although each SWC has a contractual right to a specified amount of water, that right is contingent on the availability of enough water for a "100% allocation." Since SWP water deliveries commenced, MWD has received less than its full allocation 40% of the time. From 2000 to 2014, the allocation reached 100% only once. The 2014 allocation was, for example, only 5%, or 95,575 acre-feet of MWD's 1,911,500 acre-foot allocation. Nevertheless, in 2014 MWD paid 100% of its contract payment of $412,484,373.

As a SWC, MWD does not purchase water. It owns a "participation right" in the SWP, which provides it an entitlement to a contractually established share of available water. But regardless of the quantity of water received or not, SWCs must pay their proportionate share of the costs of the SWP. Even if no water were delivered at all, the bondholders and other costs of the SWP simply must still be paid. There are no similar arrangements in the business world where the buyer is directly responsible for paying the capital, operating and maintenance costs of a product prior to – and even in the absence of – delivery of any product. That is the unique, legislatively-mandated arrangement between the DWR and the SWCs.

In addition to their participation right, SWCs also have the right to use the SWP to convey third party water. That is, in the event MWD acquires water in Northern California independent of the DWR, MWD has the right to convey it down the California Aqueduct subject to certain conditions. This conveyance benefit extends through MWD to its member agencies. Thus, if SDCWA acquires water in Northern California, as has happened from time to time, it relies upon MWD to coordinate the use of the California Aqueduct to deliver to SDCWA the water SDCWA has bought.

MWD began making principal and interest payments for the bonds used for construction of the SWP in 1963 and had paid more than $190 million when the first water arrived in 1972.

2. The Court of Appeal Held that SWP Costs Are SWC Costs

The question whether the costs of the SWP are properly considered the state's costs or the SWCs' costs was decided in 1983. After the passage of Proposition 13, two taxpayers challenged the taxes they were assessed by the Mojave Water Agency, a retail water agency that is also a SWC, to pay for the SWP. The issues confronting the Court of Appeal in *Goodman v. County of Riverside*, 140 Cal. App. 3d 900 (1983), were whether the tax assessment was an "indebtedness approved by the voters" before July 1, 1978, so as to come within an exception to Proposition 13; and importantly, whether the costs of construction, operation, maintenance and replacement, for which the property taxes were assessed, were the State's costs or costs of the SWCs. *Id.* at 903, 910-11. After reviewing the law and the history, the court explained that although the SWP was funded by state bonds, the funding was pursuant to legislation that directed the DWR to enter into contracts with local governmental entities requiring each to pay according to their entitlement, even though an agency may not "actually receive water." *Id.* at 904. The Court noted that a typical contract between the State and the SWC was "entered into *for the direct benefit of the holders and owners of all general obligation bonds*" issued for the construction of the SWP. *Id.* at 905 (emphasis added) (internal quotation marks omitted).

The plaintiffs argued that "the state is the debtor" and that the local water agency "never assumed any part of the debt." *Id.* at 907, 909. The Court of Appeal, however, held that the debt obligations were the local agency's and the state was merely a "conduit" and "guarantor":

> The entire cost of the [SWP] was to be met by the proceeds of these contracts. *The State's General Fund was clearly nothing more than a conduit for the contract payments*, with the state, practically speaking, serving as a guarantor . . . .

Id. at 909 (emphasis added).

The court concluded that the costs of "building, operating, maintaining, and replacing the [SWP]" were – by voter approval – to be "met by payments from local agencies":

> [W]e conclude, when the state's voters approved the Act, that they approved an indebtedness in the amount necessary for building, operating, maintaining, and replacing the [SWP], and that they intended that the costs were to be met by payments from local agencies with water contracts.

Id. at 910 (emphasis added).

MWD's allocation of costs in determining a wheeling rate was consistent with the Court of Appeal's conclusion. Payments to the state for the costs of construction, operation, maintenance and replacement of the SWP were not payment of the state's costs. They were MWD's own infrastructure costs.

3. MWD Uses a "Postage Stamp" Rate that Includes Allocation of SWP Costs to Conveyance of Both MWD and Third-Party Water

MWD has charged wheelers, as well as member agencies conveying MWD water, a "Postage Stamp" rate rather than a "Point to Point" rate. The postage stamp rate, as its name suggests, is one price per acre-foot no matter which part of the system is used or for what length. It is like the 49-cent stamp for a one-ounce, first-class letter; the cost is the same whether the letter goes across town or across the nation. Similarly, the fixed rate per acre-foot (plus the power actually used) is the same regardless of the distance the wheeled or conveyed water travels. Thus, any one of MWD's member agencies may move water from the uppermost reaches of the SWP project in Northern California to the most distant point in MWD's system for the same price per acre-foot.

Because a member agency may use any part of MWD's conveyance system, including the SWP for which MWD has paid and continues to pay, MWD's postage stamp wheeling rate and conveyance rates included a portion of the SWP's costs that are attributable to the construction, maintenance and operation of the conveyance system.

4. The Court of Appeal Held that Postage Stamp Rates Based on System-Wide Costs Are Valid

SDCWA disputed whether MWD could properly charge a postage stamp rate and could properly include the cost of its entire state-wide conveyance system – including its share of the

costs for the SWP – in its calculation of the wheeling rate. To resolve this dispute, MWD filed a validation action. That action resulted in a published Court of Appeal decision.

In *Metropolitan Water District v. Imperial Irrigation District*, 80 Cal. App. 4th 1403 (2000), the Court of Appeal decided that (1) a postage stamp rate was proper, and (2) system-wide costs could be properly included. *Id.* at 1427, 1433. The appellate court reasoned that pre-set postage stamp rates, and the use of system-wide costs, had advantages that made them fair and reasonable. *Id.* at 1433-34.

Although the case was remanded, *id.* at 1437, it was subsequently voluntarily dismissed. By then, MWD was changing its rate structure, and SDCWA and MWD had already abandoned efforts to form a wheeling agreement by entering into the 1998 Exchange Agreement instead.

5. In 2001 MWD "Unbundled" Its Costs

In 2001 MWD unbundled its rates to provide greater transparency and for the first time allocated costs between supply and conveyance. The components of the rates were all publically disclosed, subjected to significant public discussion, and voted upon in meetings open to the public. The disclosures included the fact that SWP costs for infrastructure were allocated to conveyance. Notably, although SDCWA's representatives on MWD's Board of Directors initially voted against the new rate structure and the allocation between supply and conveyance, in 2002 they voted in favor of the rates effective in 2003 that were based on this rate structure. The components of the rate structure, including the allocation between supply and conveyance, has not changed, and MWD then – as well as now – has continued to include a portion of SWP costs in conveyance in accordance with the DWR's allocation of costs between supply and conveyance. SDCWA's representatives have voted in favor of those rates based on the unbundled rate structure in 2003, 2005, 2006, 2007, 2008, 2009 and 2012.

II. SDCWA AND MWD AGREE TO EXCHANGE WATER

A. The 1998 Exchange Agreement Provided for $90 per Acre-Foot

In 1998 SDCWA and MWD entered into a long-term Exchange Agreement, in which SDCWA would pay only $90 per acre-foot, with yearly increases limited to 1.55% per year, in the

first 20 years of the contract. In years 21 through 30, SDCWA would pay only $80 per acre-foot, with yearly increases limited to 1.44%. One condition of that agreement was that the State Legislature appropriate $235 million to MWD for MWD to use in substantial part to line the earthen All-American and Coachella Valley Canals, creating a water supply that otherwise would seep into the soil, and for groundwater projects. Upon completion of the canal lining project, MWD would have the rights to most of the water thus conserved ("Canal Lining Water") – 77,700 acre-feet per year for 110 years. The California Legislature did in fact appropriate the funds.

B. The Differences Between Wheeling Water and Exchanging Water

SDCWA has characterized exchange agreements as "transportation" or "wheeling" agreements. They are not.[1] Two crucial features distinguish an exchange agreement from a wheeling agreement, even though, at first glance, each appears to perform the same general function. If the water is wheeled, a wheeler can only use the conveyance system if the system has excess capacity. When the Colorado River Aqueduct is full, therefore, a wheeler cannot move its water. Only when flows are 70% or less of capacity is a wheeler entitled to use the aqueduct.

The 1998 Exchange Agreement promised delivery, regardless of capacity. Even if the Colorado River Aqueduct were full, with no room for exchange water, MWD would still be required to deliver the agreed-upon quantities. That is not a wheeling transaction. MWD is obligated to make deliveries of water at SDCWA's point of delivery from MWD's system even if the Colorado River Aqueduct were at full capacity.

Another crucial difference between a wheeling agreement and an exchange agreement is that the quantity and timing of water delivered need not correspond each month to the quantity and timing of water made available for exchange. The title of the agreement – Exchange Agreement – might suggest that the water SDCWA receives in San Diego County is the same water – or at least

---

[1] Another reason that the Exchange Agreements here are logically not wheeling agreements is that, as explained above, the parties had tried and failed to reach a wheeling agreement. The Exchange Agreement is obviously something different, otherwise the parties would have had a wheeling agreement.

the same quantity of water – SDCWA made available at Lake Havasu. But, in fact, that is not the case. The agreement requires MWD to deliver water in twelve equal, monthly installments and simply "deems" exchange water to have been made available at Lake Havasu whether or not a like quantity was in fact made available. SDCWA only has IID Transfer Water to exchange if IID has conserved the requisite quantity by fallowing sufficient acres of agricultural land. Moreover, fallowing conserves water only during those times when crops would otherwise have been irrigated, which is not necessarily in equal amounts every month.

It may happen (and has happened) that insufficient farm land is fallowed and therefore the amount IID can deliver to SDCWA – and in turn the amount SDCWA could exchange with MWD – is substantially less than agreed. In fact, in any given month, SDCWA may have no IID water to exchange at all, or the Colorado River Aqueduct may be entirely shut down for repairs or maintenance. Nonetheless, MWD still delivers per month the quantity specified. When IID water is not made available, the only way MWD can fulfill its obligations is to draw water from other sources, including SWP water.

Accordingly, the economic reality of an exchange agreement is the same as the purchase of water with one immaterial twist – a partial credit. Preliminarily, with respect to the water delivered to SDCWA, there is no distinction – nor could there be – between "exchange water" and "full service water." The only difference is an accounting one. SDCWA is charged the full-service rate for all the MWD water delivered to it in each billing period – both its full service water and its exchange water – just like any purchaser of water. SDCWA receives a credit for the amount of water it makes available for exchange or will be making available in the future. And when SDCWA has not made available to MWD all the water it was obligated to, even though MWD had already delivered the agreed quantity of exchange water, then SDCWA has had to pay additional cash instead of receiving the water credit. In other words, SDCWA pays for its purchases partly in cash and partly in goods, which is hardly different from trading in a car for a new one plus cash to boot. When the trade-in car is not provided as agreed, then more cash is paid. Whether all cash, or part cash and trade-in, the transaction is the purchase of a car.

C. The 1998 Exchange Agreement Provided for Blending Colorado River Water and SWP Water

Because of the differences between wheeling water and exchanging water, an important provision in the 1998 Exchange Agreement was MWD's right to provide water from any source. This provision was essential for both contractual and statutory reasons. With respect to legal obligations, the law requires MWD to deliver to its member agencies SWP and Colorado River water that is blended in equal proportion, provided sufficient SWP water is available. MWD Act, § 136. This provision is the Legislature's recognition of the fact that SWP water is generally higher quality with lower salinity and is therefore more desirable.

Moreover, because MWD must deliver an agreed-upon quantity of water each month, it must necessarily use other available supplies, including SWP water, when the Colorado River Aqueduct has insufficient flows or is shut down.

Therefore, in the 2003 Exchange Agreement, SDCWA agreed that MWD could provide water from any source and in any blend, provided it was no worse than Colorado River water. That provision was not gratuitous, but essential for both MWD and SDCWA. SDCWA would obviously want water even if the Colorado River Aqueduct were not operational. To meet its delivery obligations, MWD had to have the right to supply water from all available sources, including the SWP.

During the period in question, the proportion of SWP water that MWD has delivered to the SDCWA pipelines has varied from 0% to 89%, and averaged nearly 40%.

III. SDCWA PROPOSES OPTION 1 AND OPTION 2

A. SDCWA Participates in the Quantification Settlement Agreement

Although California's Legislature in 1929 agreed that the annual allocation of Colorado River water to California would be limited to 4.4 million acre-feet, California in fact was drawing more than this amount for decades, often exceeding 5 million acre-feet. Eventually the other six Colorado River Basin States, as well as the federal government, demanded California live within its limits. All California users of Colorado River faced the uncertainty of reduced rights to water.

In order for IID to transfer water to SDCWA, IID's rights to the water had to be ascertained and quantified.

In 2003 a series of agreements were reached – over 30 in all – that involved state and national government agencies, Native American tribes, water agencies, irrigation districts, and local governments to quantify the applicable parties' rights to Colorado River water and related rights and obligations. These agreements, called collectively the Quantification Settlement Agreement (QSA), were crucial to the resolution of the dispute. In that the goal was to settle every entity's disputed interests, the failure of any party to agree would likely have caused the entire effort to collapse. IID's transfer to SDCWA was among the issues resolved.

B. SDCWA Did Not Need a New Exchange Agreement and Proposed, as "Option 1," the Then-Existing 1998 Exchange Agreement

Upon the quantification of IID's right to Colorado River water, it could fulfill its contract with SDCWA to transfer a portion of the water to SDCWA under specified conditions. There was little that needed to change with regard to the existing Exchange Agreement to enable SDCWA to receive its IID Transfer Water because SDCWA and MWD already had their 1998 agreement in place, with a multi-decade term. Nevertheless SDCWA presented two options to MWD: Option 1 was simply to continue the existing 1998 Exchange Agreement along with the related agreements dealing with appropriations and other issues that had been worked out years earlier, with some minor changes. That option would have continued the fixed price of $90 per acre-foot and thereafter $80 per acre-foot, together with its fixed formula for annual price increases. Neither the price nor the formula for price increases was tied to MWD's rates.

C. SDCWA Proposed "Option 2," Which Would Provide SDCWA With Substantially More Water and $235 Million in Exchange for a Higher Price

As an alternative option, SDCWA proposed Option 2, which was dramatically different from Option 1. Under Option 2, MWD would assign to SDCWA MWD's rights to the $235 million appropriated by the California Legislature for canal lining and groundwater projects, as well as MWD's rights to the Canal Lining Water. In exchange, SDCWA agreed to pay a higher

price per acre-foot for both the IID Transfer Water and the Canal Lining Water. Instead of $90 and then $80 per acre-foot, it agreed to pay $253, which was the conveyance rate that SDCWA's representatives had recently voted for. That rate was the sum of three component rates: the System Access Rate, the System Power Rate and the Water Stewardship Rate. Two of those component rates included a portion of MWD's costs of the SWP, and SDCWA knew it. Indeed, its representatives had voted for it.

Furthermore, future conveyance rate increases were tied to future changes in the conveyance rate and were not limited to the 1.55% and 1.44% increases provided in the existing 1998 Exchange Agreement. The only limitation was that "the Price shall be equal to the charge or charges set by Metropolitan's Board of Directors pursuant to applicable law and regulation and generally applicable to the conveyance of water by Metropolitan on behalf of its member agencies." 2003 Exchange Agreement, ¶ 5.2.

The MWD Board considered Option 1 and Option 2 and put the ball back in SDCWA's court. MWD told SDCWA that both Option 1 and Option 2 were acceptable to MWD, and SDCWA could choose.

SDCWA provided its Board of Directors with a financial analysis of the two options. Three features leap off the page in reviewing the presentation to the SDCWA Board. First, the SDCWA Board was clearly informed of the differences in price and that the price term in Option 2 was the conveyance rate and that the conveyance rate consisted of the System Power Rate, the Water Stewardship Rate and the System Access Rate.

Second, the SDCWA Board was told that there was a risk of increases of the net conveyance rate above the original $253 per acre-foot. One of the scenarios projected increases as high as 5% annually – which is several times larger than the fixed price in Option 1.

The final feature of the materials presented to the Board was telling by its absence. No information, disclosure or suggestion was made that (1) the existing rates were illegal; or (2) the deal would be revised, renegotiated or subjected to litigation if the rate or rate structure were not changed in the next five years.

D. SDCWA Chose "Option 2," and Entered Into the Related Contracts to Implement Option 2

SDCWA selected Option 2 and that required SDCWA's participation in the Allocation Agreement that was already negotiated. That agreement had to be renegotiated among the many parties because, *inter alia,* it required MWD to agree to transfer the state appropriation of $235 million to SDCWA; MWD to transfer Canal Lining Water to SDCWA; and the federal government to approve that transfer.

Obviously, the purchase of water does SDCWA little good without means to convey it to San Diego. Notably, it could (and did) consider the option of digging its own aqueduct, but that would have taken years and billions of dollars after protracted environmental impact studies and the inevitable delays of probable litigation. Instead, SDCWA concluded the 2003 Exchange Agreement with MWD within a couple of weeks. Among the provisions of the 2003 Exchange Agreement are the identification of related agreements, including the Allocation Agreement.[2] The agreement provides that these other agreements are part of the consideration of the 2003 Exchange Agreement. 2003 Exchange Agreement at 3.

SDCWA started receiving IID Transfer Water in 2003 and started receiving Canal Lining Water in 2006.

In sum, SDCWA received $235 million and 77,700 acre-feet of water per year for 110 years in return for its promise to pay a contract price that included the Water Stewardship Rate, the System Power Rate and the System Access Rate, the latter two components including a portion of the SWP costs that the DWR had allocated to infrastructure.

---

[2] In addition to the Allocation Agreement, the 2003 Exchange Agreement refers to (1) the earlier November 10, 1998 Exchange Agreement between MWD and SDCWA and provides that the 2003 Exchange Agreement "amends and restates" that agreement, Recital E; (2) the April 29, 1998 "Agreement for Transfer of Conserved Water" between SDCWA and IID, amended October 10, 2003, Recital D; and (3) the Quantification Settlement Agreement dated as of October 10, 2003, as well as reference to "several agreements" also executed the same date "which settles a variety of long-standing disputes," Recital F.

IV. SDCWA MUST ACCEPT THE BURDENS TO WHICH IT AGREED IN EXCHANGE FOR THE BENEFITS IT ACCEPTED

The foregoing history should, in broad outline (detailed further evidence will be presented at trial), answer the Court's inquiry as to what the affirmative defenses are based on. The law simply does not permit a party to accept the benefits of a bargain while rejecting the burdens. Here, SDCWA knew exactly what the conveyance rate was based on. It knew it included components of the SWP. This is undisputed; after all, the parties had litigated that very issue less than three years previously, and SDCWA's representatives on MWD's Board had in fact voted to include those costs in the rates.

Moreover, SDCWA had in hand a long-term contract with a price of $90 per acre-foot, which would later become $80 per acre-foot. Nonetheless SDCWA proposed a contract for a nearly 300% increase (based on those included components). It did so in order to induce MWD to assign to SDCWA very substantial benefits. When a party, knowing all the facts, agrees to a term, it is deemed to have consented to it. There is no breach when MWD has used the same methodology and components to calculate future conveyance rates that it used to calculate the one to which SDCWA agreed.

Alternatively, assuming SDCWA believed that SWP costs could not properly be included, SDCWA knowingly and voluntarily waived that contention by executing an agreement that included those costs, and it did so to obtain benefits ($235 million and 77,700 acre-feet of water per year for 110 years) that it otherwise would not have received.

Further, having induced MWD to part with hundreds of millions of dollars and many millions of acre-feet of water over the life of the contracts, SDCWA is estopped to deny its consent to the inclusion of SWP costs in the conveyance rate.

Finally, if SDCWA is right that the parties agreed to an illegal price term, then MWD was mistaken and SDCWA knew it and/or two governmental entities entered into a contract that was illegal. In either case, the 2003 Exchange Agreement would be void.

Returning to the question at the beginning of this brief, why would SDCWA ever agree to the much higher conveyance rate price as provided in the 2003 Exchange Agreement? Answer: to obtain from MWD $235 million and 77,700 acre-feet of Canal Lining Water for 110 years.

PREFERENTIAL RIGHTS: WHAT DOES SDCWA RECEIVE UNDER THE EXCHANGE AGREEMENT?

Preferential rights is an entirely separate issue. Member agencies are entitled to a percentage of water in proportion to the amounts they have contributed to the construction and financing of the system. *See* MWD Act, § 135.[3] The Legislature determined that preferential rights would be measured based on financial contributions, "*excluding the purchases of water*." *Id.* (emphasis added). When SDCWA previously challenged MWD's calculation of preferential rights, the Court of Appeal determined that the exclusion of payments for water was fair and correct, and upheld MWD's exclusion of all payments for water, even though those rates included conveyance costs. In *San Diego County Water Authority v. Metropolitan Water District*, 117 Cal. App. 4th 13 (2004), the Court asked the question, "But where the operating expenses and capital costs of Metropolitan are included in the rate charged for the water, is a member entitled to receive preferential rights credits for that amount of the water charges attributable to these costs and expenses?" *Id.* at 23. The answer was no. *Id.* at 26. After examining the legislative history and the preferential rights statute in context, the Court concluded:

> [W]e have uncovered nothing in section 135, its legislative history, or the overall statutory scheme supporting San Diego's argument that the Legislature intended the phrase "excepting purchase of water" to impose a requirement that Metropolitan break down its water rate into component parts thereby giving preferential rights credit for "amounts . . . applied to the categories or classifications of capital costs and operating expenses." On the contrary, we conclude that the express legislative intention indicates just the opposite.

---

[3] Preferential rights have been on the books in their current form since 1931, but they have never been implemented. MWD's member agencies have always chosen to follow other plans for water allocation.

Id. at 27-28.

Here, there is a water rate charged for the exchange of water. That the rate has components attributable to capital or operating expenses is irrelevant for purposes of preferential rights. It is a water rate and thus ineligible for inclusion in the preferential right calculation.

Yet SDCWA contends that its payments for exchange water should increase its preferential rights. SDCWA asserts that the exchange of water is the mere conveyance of water. Based on that (incorrect) assumption, SDCWA reasons that when it pays to convey water, its payments should increase its preferential rights. But SDCWA seeks an illogical result. Other member agencies also pay for conveyance and yet their preferential rights do not increase. When member agencies purchase water from MWD, so called full service water, the price includes the cost of the conveyance of that water. Yet the payments of those other member agencies – even though paying the same conveyance rates for the same conveyance -- do not count toward preferential rights. On its face, it makes no sense to treat one member agency using the conveyance system better than all other members using the same system. Under SDCWA's logic, the more *non*-MWD water it conveys, the greater its entitlement to *MWD* water, and correspondingly other member agencies' rights to MWD water would proportionately decrease because they pay to convey MWD water, which does not count toward preferential rights. All parties paying to convey water should be treated alike.

Moreover, under the Exchange Agreement, the economic reality is that SDCWA is not merely conveying water but is purchasing MWD water, which is excluded by statute in calculating preferential rights. The water MWD delivers to SDCWA as exchange water is different water from what was made available. In fact, often SDCWA does not make available to MWD any water –and cannot make any available – until long after MWD has already delivered the agreed volume of exchange water to SDCWA. And sometimes SDCWA never makes available all the exchange water it promised. The Exchange Agreement is in substance a purchase of water at MWD's full-service rate, less the credit for water that is or in the future will be provided in kind.

In other words, SDCWA is purchasing water, partly in cash and partly with a credit. The preferential rights statute excludes the purchase of water. *See* MWD Act, § 135.

CONCLUSION

Obviously there are many other issues in this case – extremely important ones like the measure of damages – which are not touched upon in this brief. MWD respectfully submits it will be more useful to discuss those issues in depth in post-trial briefing based on the evidence actually proffered at trial.

DATED: March 23, 2015

QUINN EMANUEL URQUHART & SULLIVAN, LLP

By */s/ Eric J. Emanuel*
Eric J. Emanuel
Attorneys for Respondent and Defendant Metropolitan Water District of Southern California

PROOF OF SERVICE

STATE OF CALIFORNIA, COUNTY OF LOS ANGELES

I am employed in the County of Los Angeles, State of California. I am over the age of eighteen years and not a party to the within action; my business address is 865 South Figueroa Street, 10th Floor, Los Angeles, California 90017-2543.

On March 23, 2015, I served true copies of the following document(s) described as

DEFENDANT METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA'S TRIAL BRIEF

on the interested parties in this action as follows:

SEE ATTACHED LIST

BY FILE & SERVEXPRESS: by causing a true and correct copy of the documents(s) listed above to be sent via electronic transmission through File & ServeXpress to the person(s) at the address(es) set forth below.

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

Executed on March 23, 2015, at Los Angeles, California.

Pamela S. Davis

SERVICE LIST

VIA E-SERVICE

John W. Keker, Esq.
Daniel Purcell, Esq.
Dan Jackson, Esq.
Warren A. Braunig, Esq.
Keker & Van Nest LLP
633 Battery Street
San Francisco, CA 94111-1809
Telephone: (415) 391-5400
Facsimile: (415) 397-7188
Email: jkeker@kvn.com
dpurcell@kvn.com
djackson@kvn.com
wbraunig@kvn.com

Counsel for Petitioner and Plaintiff San Diego County Water Authority

VIA E-SERVICE

Daniel S. Hentschke, Esq.
San Diego County Water Authority
4677 Overland Avenue
San Diego, CA 92123-1233
Telephone: (858) 522-6790
Facsimile: (858) 522-6566
Email: dhentschke@sdcwa.org

Counsel for Petitioner and Plaintiff San Diego County Water Authority

VIA E-SERVICE

Dorine Martirosian, Deputy City Attorney
Glendale City Attorney's Office
613 E. Broadway, Suite 220
Glendale, CA 91206
Telephone: (818) 548-2080
Facsimile: (818) 547-3402
Email: DMartirosian@ci.glendale.ca.us

Counsel for City of Glendale

VIA E-SERVICE

John L. Fellows III, City Attorney
Patrick Q. Sullivan, Assistant City Attorney
Office of the City Attorney
3031 Torrance Blvd.
Torrance, CA 90503
Telephone: (310) 618-5817
Facsimile: (310) 618-5813
Email: PSullivan@TorranceCA.Gov
JFellows@TorranceCA.Gov

Counsel for the City of Torrance

VIA E-SERVICE

Steven M. Kennedy, Esq.
Brunick, McElhaney Beckett, Dolen & Kennedy,PLC
1839 Commercenter West
San Bernardino, CA 92408-3303
Telephone: (909) 889-8301
Facsimile: (909) 388-1889
Email: skennedy@bmblawoffice.com

Counsel for Three Valleys Municipal Water District

VIA E-SERVICE

Patricia J. Quilizapa, Esq.
Aleshire & Wynder, LLP
18881 Von Karman Avenue, Suite 1700
Irvine, CA 92612
Telephone: (949) 223-1170
Facsimile: (949) 223-1180
Email: pquilizapa@awattorneys.com

Counsel for Municipal Water District of Orange County

SERVICE LIST (Continued)

VIA E-SERVICE

Michael N. Feuer, City Attorney
Richard M. Brown, General Counsel
Julie Conboy Riley, Deputy City Attorney
Tina P. Shim, Deputy City Attorney
Melanie A. Tory, Deputy City Attorney
City of Los Angeles
111 North Hope Street, Room 340
Los Angeles, CA 90012
Telephone: (213) 367-4500
Facsimile: (213) 367-1430
Email: tina.shim@ladwp.com
julie.riley@lawp.com
melanie.tory@ladwp.com

Counsel for The City of Los Angeles, Acting by and Through The Los Angeles Department of Water and Power

VIA E-SERVICE

Amrit S. Kulkarni, Esq.
Julia L. Bond, Esq.
Dawn A. McIntosh, Esq.
Edward Grutzmacher, Esq.
Meyers, Nave, Riback, Silver & Wilson
555 12th Street, Suite 1500
Oakland, CA 94607
Telephone: (510) 808-2000
Facsimile: (510) 444-1108
Email: akulkarni@meyersnave.com
jbond@meyersnave,com
dmcintosh@meyersnave.com
egrutzmacher@meyersnave.com

Counsel for The City of Los Angeles, Acting by and Through The Los Angeles Department of Water and Power

VIA E-SERVICE

Steven P. O'Neill, Esq.
Michael Silander, Esq.
Christine M. Carson, Esq.
Lemieux and O'Neill
4165 E. Thousand Oaks Blvd., Suite 350
Westlake Village, CA 91362
Telephone: (805) 495-4770
Facsimile: (805) 495-2787
Email: steve@lemieux-oneill.com
michael@lemieux-oneill.com
christine@lemieux-oneill.com
kathi@lemieux-oneill.com

Counsel for Eastern Municipal Water District, Foothill Municipal Water District, Las Virgenes Municipal Water District, West Basin Municipal Water District, and Western Municipal Water District

VIA E-SERVICE (Case No. 10-510830 only)

Donald Kelly, Esq.
Utility Consumers' Action Network
3405 Kenyon Street, Suite 401
San Diego, CA 92110
Telephone: (619) 696-6966
Facsimile: (619) 696-7477
Email: dkelly@ucan.org

Counsel for Utility Consumers' Action Network