No. A146901

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA
FIRST APPELLATE DISTRICT, DIVISION THREE

SAN DIEGO COUNTY WATER AUTHORITY,
Respondent and Cross-Appellant,
v.
METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA,
Appellant and Cross-Respondent.

Appeal From Judgments And Peremptory Writs of Mandate After Court Trials
Superior Court for the County of San Francisco, Nos. CFP-10-510830 and CFP-12-512466
The Honorable Richard A. Kramer and Curtis E.A. Karnow

APPELLANTS' OPENING BRIEF

JOHN B. QUINN (S.B. No. 90378)
ERIC J. EMANUEL (S.B. No. 102187)
VALERIE RODDY (S.B. No. 235163)
QUINN EMANUEL URQUHART
& SULLIVAN, LLP
865 South Figueroa Street, 10th Floor
Los Angeles, CA 90017
Telephone: (213) 443-3000
Facsimile: (213) 443-3100
johnquinn@quinnemanuel.com
ericemanuel@quinnemanuel.com
valerieroddy@quinnemanuel.com

*COLIN C. WEST (S.B. No. 184095)
THOMAS S. HIXSON (S.B. No. 193033)
MORGAN LEWIS & BOCKIUS LLP
One Market, Spear Street Tower
San Francisco, California 94105
Telephone: (415) 442-1000
Facsimile: (415) 442-1001
colin.west@morganlewis.com
thomas.hixson@morganlewis.com

*KATHLEEN M. SULLIVAN (S.B. No. 242261)
QUINN EMANUEL URQUHART
& SULLIVAN, LLP
555 Twin Dolphin Drive, 5th Floor
Redwood Shores, CA 94065
Telephone: (650) 801-5000
Facsimile: (650) 801-5100
kathleensullivan@quinnemanuel.com

*MARCIA SCULLY (S.B. No. 80648)
HEATHER C. BEATTY (S.B. No. 161907)
JOSEPH VANDERHORST (S.B. No. 106441)
JOHN D. SCHLOTTERBECK (S.B. No. 169263)
THE METROPOLITAN WATER DISTRICT OF
SOUTHERN CALIFORNIA
700 North Alameda Street
Los Angeles, CA 90012-2944
Telephone: (213) 217-6000
Facsimile: (213) 217-6980
mscully@mwdh2o.com
hbeatty@mwdh2o.com
jvanderhorst@mwdh2o.com
jschlotterbeck@mwdh2o.com

Attorneys for Appellant and Cross-Respondent
Metropolitan Water District of Southern California

MICHAEL N. FEUER, CITY ATTORNEY (S.B. No. 111529)
JOSEPH A. BRAJEVICH, GENERAL COUNSEL (S.B. NO. 156144)
*JULIE C. RILEY, DEPUTY CITY ATTORNEY (S.B. No. 197407)
MELANIE TORY, DEPUTY CITY ATTORNEY (S.B. No. 252387)
111 N. Hope Street, Room 340
Los Angeles, California 90012
Telephone: (213) 367-4513
Facsimile: (213) 241-1430
joseph.brajevich@ladwp.com
julie.riley@ladwp.com
melanie.tory@ladwp.com

*AMRIT S. KULKARNI (S.B. No. 202786)
GREGORY J. NEWMARK (S.B. No. 190488)
MEYERS, NAVE, RIBACK, SILVER & WILSON
555 12th Street, Suite 1500
Oakland, California 94607
Telephone: (510) 808-2000
Facsimile: (510) 444-1108
akulkarni@meyersnave.com
gnewmark@meyersnave.com

Attorneys for Appellant and Real Party in Interest The City of Los Angeles Acting By and Through the Los Angeles Department of Water and Power

*STEPHEN R. ONSTOT (S.B. No. 139319)
ALESHIRE & WYNDER, LLP
18881 Von Karman Avenue, Suite 1700
Irvine, California 92612
Telephone: (949) 223-1170
Facsimile: (949) 223-1180
sonstot@awattorneys.com

Attorneys for Appellant and Real Party in Interest Municipal Water District of Orange County

JOHN L. FELLOWS III, CITY ATTORNEY (S.B. No. 103968)
*PATRICK Q. SULLIVAN, ASSISTANT CITY ATTORNEY (S.B. No. 179922)
3031 Torrance Boulvard 3/F
Torrance, California 90503-5059
Telephone: (310) 618-5810
Facsimile: (310) 618-5813
psullivan@torranceca.gov

Attorneys for Appellant and Real Party in Interest City of Torrance

*STEVEN P. O'NEILL (S.B. No. 143075)
MICHAEL SILANDER (S.B. NO. 202609)
LEMIEUX & O'NEILL
4165 East Thousan Oaks Boulevard, Suite 350
Westlake Village, California 91362
Telephone: (805) 495-2787
Facsimile: (805) 495-2787
steve@lemieux-oneill.com
michael@lemieux-oneill.com

Attorneys for Appellants and Real Parties in Interest Las Virgenes Municipal Water District, Eastern Municipal Water District, Western Municipal Water District, Foothill Municipal Water District, and West Basin Municipal Water District

*STEVEN M. KENNEDY (S.B. No. 141061)
BRUNICK, MCELHANEY & KENNEDY
1839 Commercenter West
San Bernardino, California 92408
Telephone: (909) 889-8301
Facsimile: (909) 388-1889
skennedy@bmklawplc.com

Attorneys for Appellant and Real Party in Interest Three Valleys Municipal Water District

CERTIFICATE OF INTERESTED PARTIES

(Cal. Rule of Court 8.208)

Counsel is aware of no entities or persons required to be listed under California Rule of Court 8.208(e)(1) or (2).

DATED: May 5, 2016

By: /s/ *Kathleen M. Sullivan*
Kathleen M. Sullivan
Attorneys for Appellant and Cross-Respondent Metropolitan Water District of Southern California

DATED: May 5, 2016

By: /s/ *Amrit S. Kulkarni*
Amrit S. Kulkarni
Attorneys for Appellant The City of Los Angeles Acting By and Through the Los Angeles Department of Water and Power

DATED: May 5, 2016

By: /s/ *Stephen R. Onstot*
Stephen R. Onstot
Attorneys for Appellant Municipal Water District of Orange County

DATED: May 5, 2016

By: /s/ *Patrick Q. Sullivan*

Patrick Q. Sullivan
Attorneys for Appellant City of Torrance

DATED: May 5, 2016

By: /s/ *Michael Silander*

Michael Silander
Attorneys for Appellants Las Virgenes Municipal Water District, Eastern Municipal Water District, Western Municipal Water District, Foothill Municipal Water District, and West Basin Municipal Water District

DATED: May 5, 2016

By: /s/ *Steven M. Kennedy*

Steven M. Kennedy
Attorneys for Appellant Three Valleys Municipal Water District

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page

Cases

Constitutional Provisions

Statutes

Other Authorities

Introduction

This appeal arises from decisions of the San Francisco County Superior Court (Karnow, J.) invalidating certain rates charged by appellant/cross-respondent Metropolitan Water District of Southern California ("Metropolitan"), and holding Metropolitan breached a contract incorporating those rates in the price term on the ground that the rates were not set "pursuant to applicable law and regulation" as the contract requires. As damages for that breach, the superior court awarded respondent/cross-appellant San Diego County Water Authority ("San Diego") $188.3 million in damages, plus interest and attorneys' fees for a total award of more than $240 million.

The rate ruling should be reversed and the breach-of-contract award vacated, for the superior court should not have second-guessed Metropolitan's reasonable ratemaking choices. Quasi-legislative choices made by agencies are entitled to deference unless arbitrary and capricious. Metropolitan presented ample evidence that its challenged rates were consistent with its obligations, real-world uses, and recommendations of rate-setting experts. The superior court was not free to substitute its own rate-setting formula for Metropolitan's own reasonable exercise of its discretion.

Specifically, the superior court invalidated Metropolitan's allocation of two types of costs to its rates for the *transportation* of water as opposed to the *supply* of water. The first are the costs

Metropolitan incurs for participation in the State Water Project, a system of reservoirs, aqueducts, and other water storage and delivery facilities that supplies water to Metropolitan via the California Aqueduct. The second are the costs Metropolitan incurs for water stewardship, *i.e.*, demand-management programs that promote local water conservation and development. The superior court's rate rulings warrant this Court's reversal on de novo review based on any or all of five legal errors:

First, the superior court erred in failing to dismiss San Diego's rate challenge as untimely. Metropolitan's rate structure was validated by operation of law in connection with a pledge backing a 2002 bond issue, and challenges to public agency actions relating to such bond issues must be brought within 60 days.

Second, the superior court erred in declining to defer to Metropolitan's reasonable treatment of the above costs as transportation costs recoverable through transportation rates. To begin with, the court erred in holding that Metropolitan must not treat as transportation costs the costs it must pay for the State Water Project conveyance facilities—costs Metropolitan must pay whether or not it obtains any State Water Project water. State Water Project facilities are integrated with Metropolitan's facilities into a single system that enables Metropolitan to blend different sources of water as required by law and transport water for the benefit of all of its member agencies. Thus, just as Metropolitan may reasonably

recoup through transportation rates the costs of constructing, maintaining and operating its own conveyance facilities, it may reasonably recoup through transportation rates the costs it pays for the construction, maintenance, and operation of State Water Project conveyance facilities.

Moreover, the superior court erred in concluding that Metropolitan may not recoup the costs of demand-management programs through transportation rates. The court concluded that programs to conserve and develop local water supplies are supply-related rather than transportation-related. But conservation and development of local water supplies necessarily relate to transportation because they reduce demands on Metropolitan's transportation system; they do not create water supply for Metropolitan.

Third, the superior court erred in holding that Proposition 26 applies to Metropolitan's wholesale water rates, for those rates are not imposed and in any event are permitted by express exceptions to Proposition 26. The court erred further in holding that Proposition 26, if applicable, was not satisfied by the vote of Metropolitan's Board of Directors, which is the relevant rate-paying electorate.

Fourth, the superior court made an additional error of law in holding that Government Code Section 54999.7(a)—a section which applies only to *retail* utility agencies—applies to Metropolitan, a *wholesale* water agency.

Fifth, the superior court erred in issuing writs of mandate purporting to govern all future Metropolitan ratemaking, in violation of the separation of powers.

In addition to the above rate-ruling errors, the superior court erred in awarding San Diego over $240 million for breach of contract. Because the contract rulings depend upon the rate rulings, these errors need not be separately reached if the rate rulings are reversed. If they are reached, they warrant reversal or vacatur for five reasons: *First*, the court abused its discretion in refusing to allow new expert damages calculations in light of its rate rulings. *Second*, it erred in finding breach. *Third*, it erred in rejecting the affirmative defense of illegality. *Fourth*, it adopted an improper damages measure. And *fifth*, it awarded excessive interest.

Finally, the superior court separately erred in holding that San Diego's payments to Metropolitan under the contract at issue are not payments for the "purchase of water," and thus may be included in calculating San Diego's "preferential rights" to Metropolitan's available water supplies. The court incorrectly rewrote the "preferential rights" formula Metropolitan has used for its member agencies since 1931.

The superior court should not have substituted its own rate-setting preferences for Metropolitan's reasonable exercise of its discretion and expertise. The decision below should be reversed or vacated.

Statement Of Appealability

This appeal is taken from final judgments and peremptory writs of mandate of the San Francisco County Superior Court that dispose of all issues between the parties, and is authorized by Code of Civil Procedure Section 904.1(a)(1).

Statement of Facts and Procedural History

A. The Metropolitan Water District Of Southern California

Metropolitan today is a voluntary cooperative of 26 member agencies (2-AR2010-000173; 14-AR2010-003848; Wat. Code appen., §§ 109-351 – 109-354) serving an area with nearly 19 million residents (58-AR2012-016583). It was created in 1928 by the voters of several southern California cities who sought to "provide a supplemental supply of water for domestic and municipal uses and purposes at wholesale rates to its member public agencies." (58-AR2012-016440; Wat. Code appen., §§ 109-25, 109-130; 27-AA-07455.)[1]

---

[1] Record citations identify volume and page of the appellants' appendix ("AA"), administrative record in Case No. CFP-10-510830 (the "2010 Action") ("AR2010"), administrative record in Case No. CFP-12-512466 (the "2012 Action") ("AR2012"); and reporter's transcript ("RT"). Because the administrative record in the 2012 case incorporates the administrative record in the 2010 case in its entirety,

The member agencies govern Metropolitan through their representatives on its Board of Directors, with each agency appointing its own representatives. (*See* Wat. Code appen., §§ 109-50, 109-51, 109-55.) Representation is proportional based on the taxable property value in each member agency's service area, although each agency is entitled to a minimum of one Board seat. (*Id*. §§ 109-51, 109-52.) San Diego controls approximately 18% of Metropolitan's Board of Directors. (*See, e.g.*, 40-AR2010-011569-71; 60-AR2012-016997-7003.)

B. Metropolitan's Water Sources: The Colorado River And The State Water Project

Metropolitan imports water from two principal sources, the Colorado River via the Colorado River Aqueduct, which Metropolitan owns and operates (58-AR2012-016505), and the State Water Project in Northern California via the California Aqueduct. (58-AR2012-016440.) Metropolitan has access to the State Water Project conveyance system and an annual allocation of State Water Project water through a contract with the State of California's Department of Water Resources. (1-AR2010-000001-172; 58-AR2012-

---

a citation to AR2010 indicates that the same evidence is also part of AR2012. (*See* 27-AA-07456 at n.2.)

016496-97.)

The State Water Project was initially financed in part by state bonds pursuant to the Burns-Porter Act, which was confirmed by voters in November 1960. (*See, e.g.*, *Goodman v. Cty. of Riverside* (1983) 140 Cal.App.3d 900, 903 (*Goodman*); Wat. Code, § 12931 et seq.)[2] The Burns-Porter Act enacted a unified system of financing the State Water Project, including authorization for initial financing by public bonds, and also directed the Department of Water Resources to enter into contracts for the sale, delivery, or use of water or power, or for other services or facilities of the system, which it has done with various local governmental entities. (*Goodman*, *supra*, at p. 903; Wat. Code, § 12937, subd. (b).) The payments under those contracts pay for all the State Water Project's costs and repay the public bonds issued to construct it. (*Goodman*, *supra,* at p. 903.)

In 1960, Metropolitan entered into a State Water Project contract with the Department of Water Resources ("the State Water Project Contract"). (*See, e.g.*, *Goodman*, *supra*, 140 Cal.App.3d 900,

---

[2] For details of the origins of the State Water Project, see Department of Water Resources' Bulletin No. 132-63, *The California State Water Project in 1963* (*see generally* 17-AA-4676-817, 18-AA-04820-4994) and *Goodman*, *supra*, 140 Cal.App.3d 900.

905; 2-AR2010-000175-563.) Since the State Water Project's inception, such contracts have required Metropolitan and other State Water Project contractors to assume full financial responsibility for the State Water Project's capital construction and operation costs—whether or not the contracting agency receives any State Water Project water in any given year. (1-AR-2010-000065-89; 22-AA-6238; 22-AA-6253; 23-AA-6392-93.) In exchange for its yearly payments, Metropolitan has access to the State Water Project's conveyance network, and Metropolitan's member agencies can transport non-Project water through the State Water Project by paying the applicable Metropolitan rates, with no additional payment to the State of California for use of the State Water Project facilities. (*See* Section I.B.3(a), *infra*.)

The Colorado River Aqueduct, State Water Project, and Metropolitan's in-basin distribution system are integrated and interconnected, providing capacity and flexibility that benefit all users. (*See, e.g.*, 9-AR2012-002455-56; 58-AR2012-016583-87.) Moreover, the integration of these facilities allows Metropolitan to blend State Water Project water with water from other sources. (*See* 9-AR2012-002455-56; 58-AR2012-016586.) Legislation mandates that Metropolitan blend its water sources, to the extent reasonable and practical, with an objective of reaching a blend that is at least 50% State Water Project water. (Wat. Code. appen., § 109-136; *see also* 29-RT-1398:12-20; 1443:24-1444:3; 30-RT-1735:13-1739:14.) Blending

reduces the damaging salinity of water from other sources. (*See, e.g.*, 16-AA-04497; 29-RT-1460:8-17.) San Diego relies on Metropolitan's blending efforts to achieve its own salinity goal. (19-AA-5154 at 53:44-54:32; 29-RT-1460:18-1461:2.) State Water Project water comprised approximately 40% of the water that Metropolitan provided to San Diego under the contract at issue in this case. (43-RT-3002:22-28; 33-AA-9323.)

C. Metropolitan's Rate-Setting Process

Metropolitan's enabling statute (the Metropolitan Water District Act) authorizes Metropolitan to set rates that recover the revenue necessary to pay its expenses (Wat. Code appen., § 109-134) by a majority vote of its Board (*id.* § 109-57). Prior to each rate-setting Board meeting, Metropolitan's staff sets forth Metropolitan's revenue requirements, the methodology for establishing Metropolitan's rates, and the proposed rates and charges. (*E.g.*, 23-AR2010-006166-222; 36-AR2010-009962-010046; 48-AR2012-013788-013868.) Based on discussion at public meetings and noticed public hearings, Metropolitan's staff may develop additional rate options and presents the Board with proposed rate options and a staff recommendation. (*See* Metropolitan Admin. Code, §§ 2109, subd.

(c), 4304 [7-AA-01890, 01931-32];[3] Gov. Code, § 54954.3 ; 23-AR2010-006294-6430; 40-AR2010-011443-542; 59-AR2012-016594-844.)

The rate proposals explain how Metropolitan assigns certain expenses to related operation functions. (*E.g.*, 40-AR2010-0011467-502; 59-AR2012-016616-789; Admin. Code, § 4304 [7-AA-01931-32].) Metropolitan follows a four-step cost of service process that (1) forecasts Metropolitan's revenue requirements for the given fiscal year; (2) functionalizes its costs (as relevant here) to supply, transportation, storage, or demand management; (3) categorizes those functionalized costs based on their causes (*e.g.*, average demand, peak usage, or emergency standby needs) and behavioral characteristics (*e.g.*, fixed or variable costs); and (4) allocates those categorized costs to volumetric rates (*i.e.*, rates charged per acre-foot[4] of water Metropolitan delivers to the member agency) and fixed charges. (*See, e.g.*, 40-AR2010-011467, 011470-89; 59-AR2012-016674, 016677-94.) This four-step cost of service process is endorsed by ratemaking experts and is the rate methodology

---

[3] The superior court took judicial notice of all sections of Metropolitan's Administrative Code ("Admin. Code") cited herein. (7-AA-01837-38; 9-AA-02269-70.)

[4] An acre-foot of water is enough water to cover an acre in one foot of water (or 325,851 gallons).

prescribed by the American Water Works Association Manual M-1, *Principles of Water Rates, Fees, and Charges*. (*See, e.g.*, 40-AR2010-011321-23.)

D. Metropolitan's Rates And Rate Structure

Metropolitan provides both full-service water service, by which it supplies and delivers its *own* imported water supplies to a member agency, and "wheeling" service, by which it transports *non*-Metropolitan water through Metropolitan's facilities and State Water Project facilities to which Metropolitan has access rights. (Admin. Code § 4119 [7-AA-01921]; 9-AR2010-002455-56; 58-AR2012-016583-87.) "'Wheeling' refers to '[t]he use of a water conveyance facility by someone other than the owner or operator to transport water.'" (*In re Quantification Settlement Agreement Cases* (2011) 201 Cal.App.4th 758, 838, fn. 51 (*QSA Cases*).) California law mandates that the owner or operator of a water conveyance facility allow others to use up to 70% of the facility's unused capacity to transport water in exchange for "fair compensation." (Wat. Code, §§ 1810, 1814; *QSA Cases*, *supra*, at p. 758, 838, fn. 5.)

1. Metropolitan's Component Rates

To replace an earlier single, bundled water rate for each service (*see, e.g.*, 23-AR2010-006166-70; 24-AR2010-006496), Metropolitan's Board of Directors voted on October 16, 2001 to adopt an unbundled rate structure allocating charges to separate components, including transportation and supply. (21-AR2010-

005737-42, at § 44644.) On March 12, 2002, after public hearings, Metropolitan's Board approved the first rates and charges under the new structure, to go into effect January 1, 2003. (23-AR2010-006166-70; 23-AR2010-006439-41, at § 44812; 24-AR2010-006470.)

(a) Supply-Rate Components

Metropolitan's "Supply Rates" include a "Tier 1 Supply Rate," recovering costs of obtaining water supply from the State Water Project and Colorado River and costs related to maintaining and developing additional water supplies through transfers and other transactions (27-AA-07460-61; 40-AR2010-011474-75; 40-AR2010-011499-500; 59-AR2012-016681-82); and a "Tier 2 Supply Rate," applicable to water purchases that exceed a certain volume (27-AA-07460-61; 24-AR2010-006535-36; 40-AR2010-011499-500; 59-AR2012-016700; Admin. Code § 4121 [7-AA-01922].)

(b) Transportation-Rate Components

Metropolitan's "Transportation Rates" include (i) a "System Access Rate," which recovers the capital, operating, maintenance, and overhead costs associated with transportation facilities, including "distribution" facilities that transport water within Metropolitan's service area and "conveyance" facilities that transport water from the State Water Project and Colorado River Aqueduct to that area (27-AA-07461; 24-AR2010-006518; 59-AR2012-016697; Admin. Code § 4123 [7-AA-01923]); (ii) a "System Power Rate," which recovers the melded (average) costs of power

necessary to pump water through the State Water Project transportation facilities and Colorado River Aqueduct to the distribution facilities within Metropolitan's service area, and from those facilities to the member agencies (27-AA-07462; 24-AR2010-006520; 40-AR2010-011492; 59-AR2012-016697; Admin. Code § 4125 [7-AA-01924]); and (iii) a "Water Stewardship Rate," which recovers the costs of demand-management programs such as local water resource development programs and water conservation programs that "reduce and defer [Metropolitan's] system capacity expansion costs…and create available capacity to be used to complete water transfers" (27-AA-07462; 24-AR2010-006519; 40-AR2010-011492; 59-AR2012-016697; Admin. Code § 4124 [7-AA-01924]). Metropolitan's Transportation Rates are the same no matter how far the water is transported or which transportation facilities are used. The Court of Appeal upheld Metropolitan's use of such "postage stamp" rates in *Metropolitan Water District of Southern California v. Imperial Irrigation District* (2000) 80 Cal.App.4th 1403 (*Imperial*).

2. Metropolitan's Service Rates

Metropolitan establishes its full-service water rate and its wheeling rate based on different configurations of its component rates: (i) the "Full-Service Water Rate" includes all Supply Rates and all Transportation Rates; (ii) the "Wheeling Rate" includes the System Access Rate, the Water Stewardship Rate, the actual power costs incurred to convey water, and an administration fee. (27-AA-

07460; Admin. Code, §§ 4119, 4401, 4405, subd. (b) [7-AA-01921, 01933-35, 01938].) The wheeling rate does not include the System Power Rate or the Supply Rates. (Admin. Code, § 4405 [7-AA-01938].) Metropolitan's wheeling rate applies only to wheeling by member agencies for up to one year; the charges for other wheeling transactions are negotiated. (Admin. Code. §§ 4119, 4405 [7-AA-01921, 01938].) Thus, in summary, the full-service rates and wheeling rate overlap as follows:

Full Service Water Rate

Tiered Supply Rates
Costs of imported water supplies, capital financing, operating, maintenance, and overhead costs for storage in Metropolitan's reservoirs

System Access Rate
Capital, operating, maintenance, and overhead costs associated with the transportation facilities (*e.g.*, aqueducts and pipelines); recovers costs of distribution facilities (internal facilities) and conveyance (State Water Project and Colorado River Aqueduct)

System Power Rate
Costs of power to transport water through State Water Project, Colorado River Aqueduct, and Metropolitan's facilities

Water Stewardship Rate
Recovers costs of funding demand-management programs (local water resource development programs and water conservation programs)

Wheeling Rate

System Access Rate, *supra.*

Water Stewardship Rate, *supra.*

Actual Power Costs
Recovers the power cost of moving the wheeled water

Administration Fee

E. The 1998 Exchange Agreement

In 1998, the Imperial Irrigation District ("Imperial") agreed to transfer up to 200,000 acre-feet of water per year to San Diego, contingent upon San Diego obtaining Metropolitan's agreement to accept delivery of the "transfer water" from Imperial at Lake Havasu and wheel it to San Diego. (*See* 21-AA-05882-992; 21-AA-05893 ¶¶ A-B, E-H; 21-AA-05906 § 3.1; 21-AA-05934-35 § 7.1, subd. (e).) But San Diego and Metropolitan were unable to agree to terms for a wheeling agreement. (41-RT-2643:22-2644:7.)

Instead, San Diego and Metropolitan entered into a 30-year Exchange Agreement (the "1998 Exchange Agreement"). (11-AA-02824; 11-AA-02844 § 7.1.)[5] Under that agreement, San Diego was required to pay Metropolitan only $90 per acre-foot of water it

---

[5] Unlike a wheeling agreement, the 1998 Exchange Agreement obligated Metropolitan: (1) to deliver "exchange water" to San Diego whether or not Metropolitan had available capacity to accept or transport Imperial's transfer water, (2) to deliver water in equal monthly installments, regardless of when or if transfer water was made available at Lake Havasu; and (3) to deliver like amounts of exchange water in San Diego as San Diego delivered transfer water at Lake Havasu, without deducting for transit losses (*e.g.*, loss through evaporation). (*See*, *e.g.*, 11-AA-02828 § 1.1(q); 11-AA-02833 § 3.1(a); 11-AA-02835 § 3.2(d); 11-AA-02836-37 § 3.4; *cf.* Wat. Code, § 1814.)

delivered to San Diego, with limited yearly increases, in the first 20 years of the contract, with a reduction in years 21 through 30. (11-AA-02839 § 5.2; 11-AA-02865.) The agreement was conditioned upon the State Legislature's appropriation of $235 million to Metropolitan to line the earthen All-American and Coachella Valley Canals, which Metropolitan estimated would conserve 70,000-80,000 acre-feet per year of water supplies. (11-AA-02847 § 8.1, subd. (d); 11-AA-02865; 41-RT-2657:15-2659:5; 41-RT-2645:17-2647:2.) The State Legislature allocated the funding to Metropolitan. (*See, e.g.*, 32-AA-09031 § 4A.1; Wat. Code, §§ 12561, 12562.)

F. The 2003 Amended Exchange Agreement

Between 1998 and 2003, San Diego obtained no water from Imperial because of an ongoing dispute that affected Imperial's entitlement to Colorado River water. (*See* 41-RT-2647:5-2649:23.) In 2003, state and national government agencies, Native American tribes, water agencies, irrigation districts, and local governments entered into a series of agreements (collectively, the "Quantification Settlement Agreement") to quantify all parties' rights to Colorado River water, making it possible for Imperial to transfer water to San Diego as contracted. (*See, e.g.*, *QSA Cases*, *supra*, at p. 773; 41-RT-2649:19-2650:2.)

In mid-2003, to address certain requirements of the Quantification Settlement Agreement, San Diego and Metropolitan amended the 1998 Exchange Agreement. (41-RT-2650:3-2651:1; 41-

RT-2656:19-2657:14.) Although there was no need to change the price term, San Diego proposed two price options to Metropolitan. (41-RT-2660:1-5.)

Under "Option 1," the existing price term would not change. (14-AA-03849-50.) Under "Option 2," Metropolitan would assign to San Diego its $235 million legislative appropriation for canal lining and other projects, as well as Metropolitan's rights to 77,000 acre-feet of the resulting conserved canal lining water per year for 110 years. (14-AA-03849-50; 41-RT-2661:1-11; 32-AA-09031 § 4A.1.) In exchange, San Diego would pay a higher price per acre-foot for the water it obtained from Metropolitan under the Exchange Agreement. Instead of $90 per acre-foot (adjusted over time), San Diego would pay Metropolitan's unbundled Transportation Rates (System Access Rate, System Power Rate, and Water Stewardship Rate) which, on the date of execution, totaled $253 per acre-foot. (42-RT-2821:22-28.) Thereafter, the price would 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." (22-AA-06137-38 § 5.2.) San Diego understood that future prices would be based on the same rate structure, starting at $253 and escalating over the life of the Exchange Agreement. (*See* 42-RT-2809:18-2811:10; 42-RT-2823:14-2824:16; 42-RT-2826:8-21; 42-RT-2830:2-7; 42-RT-2832:10-2833:24; 43-RT-2925:17-2927:28; 41-RT-

2594:26-2597:27; 40-RT-2429:24-28; 14-AA-03849-50; 32-AA-09114-43; 32-AA-09144; 32-AA-09145-53; 33-AA-09200-36.) This price would also apply to the delivery of water in exchange for the conserved canal lining water. (22-AA-06126 § 1.1, subd. (m).)[6]

Metropolitan's Board of Directors allowed San Diego to choose between the two options. (41-RT-2661:12-2662:5; 42-RT-2811:19-26.) San Diego provided its own Board of Directors with a financial analysis of the two options, which made clear that the price term in Option 2 was the sum of Metropolitan's Transportation Rates. (14-AA-03849-50.) San Diego selected Option 2. (*See generally* 22-AA-06122-56.) Metropolitan assigned to San Diego its rights to the legislative appropriations for canal lining and other projects and to the conserved canal lining water (32-AA-09017-93), in consideration for the amended Exchange Agreement between San Diego and Metropolitan (the "Exchange Agreement"). (22-AA-06122-24.) As a result, San Diego received $235 million and 77,700 acre-feet of water per year for 110 years, worth well over $1 billion, in return for its promise to pay a contract price equal to

---

[6] The price term also included a provision that the superior court interpreted to prevent San Diego from challenging Metropolitan's Transportation Rates for the first five years of the contract. (*See, e.g.*, 22-AA-06137-38 § 5.2; 27-AA-07457-58.)

Metropolitan's Transportation Rates. San Diego began receiving Imperial transfer water in 2003 and conserved canal lining water in 2006. (40-RT-2410:2-2411:4.)

G. The Proceedings Below

In 2010 and 2012, San Diego brought two actions against Metropolitan, alleging that Metropolitan's Transportation Rates and wheeling rate are invalid and unconstitutional. (1-AA-00043-235; 1-AA-00236-44; 4-AA-00981-01105; 5-AA-01332-33.) Case No. CFP-10-510830 (the "2010 Action") challenges Metropolitan's 2011-2012 water rates; Case No. CFP-12-512466 (the "2012 Action") challenges Metropolitan's 2013-2014 water rates. The superior court informally coordinated the 2010 and 2012 actions for most purposes, including trial. (*See, e.g.*, 17-RT-679:5-16.)

The operative complaint in the 2010 Action alleged three causes of action challenging Metropolitan's rates for the years 2011-2012: (1) writ of mandate, (2) declaratory relief, and (3) "reverse validation." (6-AA-01389-96.) These causes of action challenged the validity of two aspects of Metropolitan's Transportation Rates: (1) the allocation of Metropolitan's State Water Project transportation costs to the System Access Rate and System Power Rate; and (2) the inclusion of the Water Stewardship Rate in Metropolitan's Transportation Rates instead of Supply Rates. Relevant here, San Diego alleged that these allocations violated California common law; Proposition 26 (California Constitution,

Article XIIIC, Section 1); Government Code Section 54999.7(a); and Water Code Sections 1810-1814 (the "Wheeling Statutes"). (6-AA-01394-96.) San Diego also brought a claim for breach of the Exchange Agreement (based on its challenge to the validity of Metropolitan's Transportation Rates) and a declaratory relief claim seeking a declaration that Metropolitan improperly calculates "preferential rights" (*i.e.*, rights to purchase a certain percentage of Metropolitan's available water supply). (6-AA-01396-1400.)

On June 8, 2012, after Metropolitan's next rate-setting cycle, San Diego filed the 2012 Action, which repeated in substantial part the claims and allegations in the 2010 Action. (4-AA-01050-13; 5-AA-01332-33.)

The superior court bifurcated adjudication of San Diego's claims into two phases: (1) claims challenging Metropolitan's rates; and (2) the breach-of-contract and preferential rights claims. (*See, e.g.*, 34-AA-09463-65.)

Other Metropolitan member agencies answered San Diego's rate challenges in one or both cases below, including appellants Municipal Water District of Orange County, City of Torrance, Las Virgenes Municipal Water District, West Basin Municipal Water District, Foothill Municipal Water District, City of Los Angeles, Three Valleys Municipal Water District, Eastern Municipal Water District and Western Municipal Water District. (34-AA-09584.)

H. The Superior Court's Phase I Decision

Following a court trial on San Diego's rate challenges in December 2013, the superior court issued its "Statement of Decision on Rate Setting Challenges" (the "Phase I Decision") on April 24, 2014. (*See generally* 27-AA-07452-518.) In that decision, the court held it unlawful for Metropolitan to include in its Transportation Rates "and hence in its wheeling rate," 100% of Metropolitan's State Water Project transportation costs (through the System Access Rate and the System Power Rate) and 100% of Metropolitan's demand-management-program costs (through the Water Stewardship Rate) as "unfair to wheelers." (27-AA-07503-12, 07516.) Reasoning that certain costs that were allocated to Metropolitan's Transportation Rates should have been allocated to its Supply Rates, the superior court concluded that "these rates—the System Access Rate, System Power Rate, Water Stewardship Rate, and [the] wheeling rate—therefore violate Proposition 26 (2013-14 only), the Wheeling statute, Gov. Code § 54999.7(a), and the common law." (27-AA-07516.)

I. The Superior Court's Phase II Decision

Following a second court trial on San Diego's breach-of-contract and preferential-rights claims, the superior court issued a second Statement of Decision on August 28, 2015 (the "Phase II Decision"). The court found that Metropolitan had breached the price term of the Exchange Agreement because it charged San Diego Transportation Rates that were not "consistent with law and

regulation." (34-AA-09470.) The superior court rejected Metropolitan's affirmative defenses to breach, including illegality, mistake of law, consent, waiver and estoppel. (*See, e.g.*, 34-AA-09478-84.)

The superior court awarded San Diego the entirety of its requested damages—$188,295,602—which equaled the total amount San Diego paid under the Exchange Agreement from 2011-2014 for (1) State Water Project transportation costs included in the System Access Rate and System Power Rate; and (2) the Water Stewardship Rate. (34-AA-09476-78.) Although the superior court acknowledged that the award "may overcompensate San Diego," it found that "[i]t asks too much of San Diego to require it to recalculate Met[ropolitan]'s rates with any useful degree of precision." (*Ibid.*) The superior court additionally awarded San Diego prejudgment interest in the later-calculated amount of $46,637,180. (34-AA-09478; 34-AA-09587.)

The superior court also held that Metropolitan's formula for calculating preferential rights must give San Diego credit for amounts it paid under the Exchange Agreement, reasoning that those payments were not for the "purchase of water," which would be excluded from that calculation. (34-AA-09489.)

Metropolitan moved for a new trial on November 16, 2015, arguing, among other things, that the superior court awarded excessive damages. (34-AA-09499-502; 34-AA-09580-81) The

superior court denied Metropolitan's motion in its entirety on December 23, 2015. On November 18, 2015, the superior court entered final judgment and a peremptory writ of mandate in the 2010 Action and 2012 Action. This appeal followed. (34-AA-09658-67.)[7]

Argument

I. THE SUPERIOR COURT'S INVALIDATION OF METROPOLITAN'S RATES RESTED ON A SERIES OF LEGAL ERRORS

A. The Superior Court Erred In Failing To Dismiss San Diego's Rate Challenges As Untimely Because They Were Brought After Metropolitan's Rate Structure Was Validated By Operation Of Law

The superior court erred by overruling Metropolitan's demurrer to San Diego's rate challenges, attacking only

[7] The superior court awarded San Diego $320,084 in costs and $8,910,354.20 in attorneys' fees on January 21, 2016 and March 24, 2016, respectively. (34-AA-09700-06; 34-AA-09624-25; 34-AA-09710-13.) On April 11, 2016, Metropolitan filed a separate notice of appeal as to the attorneys' fee award. Because the superior court's errors require reversal of the judgments below, the costs and fee awards must also be set aside. (*See, e.g.*, *Allen v. Smith* (2002) 94 Cal.App.4th 1270, 1284.) Metropolitan does not assert any separate or additional points of error related to these post-trial decisions.

Metropolitan's rate *structure*, based on their untimeliness—an error dispositive of all of the issues on Metropolitan's appeal except the ruling on preferential rights. Metropolitan argued that (1) its rate structure was validated by operation of law in 2002, long before San Diego filed its claims; and (2) as to all non-constitutional challenges, any defects in Metropolitan's rate structure were cured by legislative validation acts in 2003. The superior court overruled Metropolitan's demurrer without analysis, stating merely that "[n]either the statute of limitations nor the validating statute bar the allegations in the Second Amend[ed] Complaint." (13-RT-484:24-26; 485:28-486:4 .)[8]

This Court reviews the overruling of a demurrer de novo. (*Big Valley Band of Pomo Indians v. Superior Court* (2005) 133 Cal.App.4th 1185, 1190.) Reversal is warranted here.

1. <u>The Validation Statutes Require Challenges To Public Agency Actions Relating To Bonds To Be Brought Within 60 Days</u>

California's validation statutes (Code Civ. Proc., §§ 860 et seq.) provide for the prompt resolution of the validity of acts involving

---

[8] In light of the superior court's ruling, Metropolitan did not demur to San Diego's complaint in the 2012 Action, but preserved this affirmative defense in its answer. (*See, e.g.*, 5-AA-01346-47, 01349-50; 27-AA-07602-03, 07605-06.)

public agencies' issuance of bonds. Accordingly, those statutes allow 60 days for (1) an agency to file a validation action in rem to obtain a conclusive determination that such an act is valid, and (2) any "reverse validation actions" challenging such agency acts. (*See, e.g.*, Code Civ. Proc., § 860; *id.* § 863; *McLeod v. Vista Unified Sch. Dist.* (2008) 158 Cal.App.4th 1156, 1166 [describing framework].)

"[A]n agency may indirectly but effectively 'validate' its action by doing nothing to validate it; unless an 'interested person' brings an action of his own…within the 60-day period [to challenge the validity of an agency action], the agency's action will become immune from attack whether it is legally valid or not." (*Cal. Commerce Casino, Inc. v. Schwarzenegger* (2007) 146 Cal.App.4th 1406, 1420 (*Commerce Casino*), quoting *City of Ontario v. Superior Court* (1970) 2 Cal.3d 335, 341-42.) "As to matters 'which have been or which could have been adjudicated in a validation action, such matters—including constitutional challenges—must be raised within the statutory limitations period in section 860 et seq. [*i.e.*, 60 days] or they are waived.'" (*Commerce Casino*, *supra*, 146 Cal.App.4th 1406, 1420, quoting *Friedland v. City of Long Beach* (1998) 62 Cal.App.4th 835, 851 (*Friedland*) [finding limitations period "not unreasonable" "[g]iven the policies underlying the validation statutes"].)

The validation statutes "serve[] to fulfill the important objective of 'facilitat[ing] a public agency's financial transactions with third parties by quickly affirming their legality.' In particular,

'the fact that litigation may be pending or forthcoming drastically affects the marketability of public bonds[.]'" (*Commerce Casino*, *supra*, 146 Cal.App.4th 1416, 1421, quoting *Friedland*, *supra*, 62 Cal.App.4th 835, 843.) Thus, one type of agency action that is commonly subject to the validation provisions of the Code of Civil Procedure is the issuance of public bonds. (*See, e.g.*, Gov. Code, § 53511; *id.* § 6516.6, subd. (e); Wat. Code appen., § 109-163.)

The Court of Appeal has held that the validation procedures applicable to public bonds extend also to the method of financing that a public agency pledges for the bonds' repayment. In *Aughenbaugh v. Board of Supervisors* (1983) 139 Cal.App.3d 83 (*Aughenbaugh*), the plaintiff challenged the collection of certain water standby charges on the basis that they exceeded the amounts allowable by statute. (*Id.* at p. 87.) *Aughenbaugh* concluded that this statutory violation "was cured by the Legislature's adoption of validating statutes enacted after the fixing of the charges" because the standby charges had been pledged to repay certain bonds and

thus had become "part of the bond contract" that had been immunized by the validation legislation. (*Id.* at p. 86.)[9]

Aughenbaugh specifically rejected the plaintiff's arguments that the charges at issue "were not contractually made a part of the bonds because the bond contract d[id] not *require* [the agency] to levy *any* standby charges" and that the charges were not "pledged" because the bond contract permitted the agency "either to raise or lower the standby charges." (*Aughenbaugh*, *supra*, 139 Cal.App.3d 83, 89-90, original emphasis added.) The Court of Appeal explained that it was irrelevant whether the *amount* of the standby charges was fixed by the bond contract:

> Whatever the amount of the water standby charge prescribed under the 1971 resolution…, the total revenue from the standby charges is pledged to pay the principal and interest on the bonds.… [T]he standby charges are part of the district's revenues and whatever amount is fixed by the district is pledged to pay off the bonds. Thus, the entire revenue from standby charges, including the amount needed to pay the operating and

---

[9] Although *Aughenbaugh* considered curative validation legislation, its reasoning applies with equal force to the validation statutes in the Code of Civil Procedure.

> maintenance costs of the facility, is part of the bond contract.

(*Ibid.*) Thus, the Court of Appeal "uph[e]ld the validity of the water standby charges as part of the bond contract" because any statutory violation had been cured by the same legislation that operated to validate the bond contract itself. (*Id.* at p. 92.)

Similarly, in *Graydon v. Pasadena Redevelopment Agency* (1980) 104 Cal.App.3d 631 (*Graydon*), the Court of Appeal held that the Code of Civil Procedure's validation statutes applied to the award of a construction contract because the contract "was an integral part of the whole method of financing" the repayment of public bonds. (*Id.* at p. 645.) In *Graydon*, the agency issued bonds to finance the construction of a retail center that included a subterranean garage, and pledged the incremental taxes it would collect once the retail center was completed for repayment of the bonds. (*Ibid.*) The agency awarded the challenged contract for the construction of the subterranean garage without a competitive bidding process to avoid a detrimental delay to the project. (*Id.* at pp. 645-46.) The Court of Appeal found that "[t]he ability of the Agency to pay its bonds, dependent in large part upon the flow of tax increment monies resulting from the completion of the retail center, was thus directly linked to the award of the questioned contract" and the challenged contract was therefore subject to the validation statutes' requirement that challenges be brought within 60 days. (*Ibid.*)

As *Aughenbaugh* and *Graydon* make clear, the certainty provided by the Code of Civil Procedure's validation framework extends to "the whole method of financing" and other "part[s] of the bond contract." *Graydon*, *supra*, 104 Cal.App.3d at 645; *Aughenbaugh*, *supra,* 139 Cal.App.3d at 92.

2. Metropolitan Pledged The Challenged Rate Structure To The Repayment Of Its Bonds, Validating It By Operation Of Law In 2002

As San Diego admitted in its pleadings, the validation statutes apply because Metropolitan has pledged its rates to the repayment of its public bonds:

> *Metropolitan has pledged [its] rates… to the payment or security of its general obligation bonds*, as it is permitted to under Government Code Section 53502. *Government Code Section 53511, in turn, authorizes the filing of a validation action or reverse validation action "to determine the validity of its bonds, warrants, contracts, obligations or evidences of indebtedness."*

(6-AA-01394 ¶ 92 [asserting reverse validation claim], emphasis added; *accord* Wat. Code appen., § 109-163.) The Legislature has empowered Metropolitan to raise revenue through the issuance of public water bonds, subject to approval of the electorate, to fund various public works. (*See* Wat. Code appen., § 109-200.) These water revenue bonds are "secured by a pledge of…and shall be payable, as to the principal and…interest thereon…solely from and

secured by a lien upon…[Metropolitan's] Net Operating Revenues," which include "all revenues received by [Metropolitan] from charges for the sale and availability of water, including…[Metropolitan's] water rates." (3-AA-00572 § 5.01(A); 3-AA-00557; 3-AA-00579 art. VI, § 6.01.) [10] This pledge of Metropolitan's water rate revenues as security is "irrevocable until there are no Bonds Outstanding." (3-AA-00572 § 5.01(A).)

Importantly, and as in *Aughenbaugh* and *Graydon*, Metropolitan expressly pledged the very rate structure San Diego now challenges to the repayment of its bonds in 2002. On September 12, 2002, six months after Metropolitan approved its unbundled rate structure to take effect January 2003, Metropolitan issued its 2002 Series A Water Revenue Refunding Bond (the "2002 Water Revenue Bonds"). (3-AA-00638-643.) These bonds state that they are a "contract between [Metropolitan] and the registered owner [of the bond]," "payable as to both principal and interest exclusively from the Net Operating Revenues and other funds pledged," which, as defined in the Official Bond Statement, include "all revenues received by Metropolitan from charges for the sale and

---

[10] The superior court took judicial notice of the bond documents cited in this section without objection. (13-RT-427:24-428:13.)

availability of water, including, without limitation, Metropolitan's water rates…." (3-AA-00693; 3-AA-00686.)

Metropolitan's Official 2002 Bond Statement expressly describes its newly enacted rate structure—including the Transportation Rates challenged in this lawsuit—and identifies these rate components as generating the revenue Metropolitan pledged as security for the bonds. (*See, e.g.*, 3-AA-00686-87; 3-AA-00692-94 ["New Rate Structure"].) For each unbundled rate component, Metropolitan's Official 2002 Bond Statement described: (1) the dollar amount of the rate in 2003; (2) the type of costs it was intended to recoup; and (3) whether it would be charged for Metropolitan's wheeling service, full service water, or both. (*See, e.g.*, 3-AA-00693-94.) For example, the 2002 Official Bond Statement itemized the Water Stewardship Rate as follows:

> *Water Stewardship Rate* — This rate will be $23 per acre-foot. The Water Stewardship Rate will be charged on a dollar per acre-foot basis to collect revenues to support Metropolitan's financial commitment to conservation, water recycling, groundwater recovery and other water management programs approved by the Board. The Water Stewardship Rate will be charged for every acre-foot of water conveyed by Metropolitan.

(3-AA-00693.) Thus, Metropolitan's rate structure was pledged as security for its revenue bonds in 2002, and again in 2003. (5-AA-

01119; 5-AA-01230-40; 5-AA-01305-07.)[11] That rate structure has remained unchanged with each new rate cycle.

Under *Aughenbaugh* and *Graydon*, Metropolitan's rate structure—part of the "whole method of financing" Metropolitan's bonds—was validated by operation of law in 2002 under the validation statutes, rendering untimely challenges filed (as here) more than 60 days thereafter.

3. San Diego's Non-Constitutional Challenges Were Further Barred By The Enactment Of Subsequent Validation Legislation

San Diego's non-constitutional challenges to Metropolitan's rate structure (*i.e.*, all but its claim that Metropolitan's 2013-2014 rates are invalid under Proposition 26, *see infra* Section I.C) are also barred by the Legislature's subsequent validation of the rate structure. Under California law, the Legislature can "cure irregularities or omissions to comply with provisions of a statute which could have been omitted in the first instance." (*Miller v.*

---

[11] San Diego argued below that the 2002 Water Revenue Bonds were fully paid off and therefore were somehow no longer relevant. Metropolitan pledged the same rates in support of its 2003 Series A Water Revenue Refunding Bond, which are still outstanding. (5-AA-01119; 5-AA-01230-40; 5-AA-01305-07.)

McKenna (1944) 23 Cal.2d 774, 781-82; *see also City of Venice v. Lawrence* (1914) 24 Cal.App.350, 353 ["It has been repeatedly held that the legislature may validate past transactions when it could in advance, without contravening constitutional provisions, have authorized the proceedings"].) Each year, the Legislature passes validating acts for the purpose of curing non-constitutional defects in agency actions or proceedings conducted in connection with bond issuances. (*See, e.g., Aughenbaugh, supra*, 139 Cal.App.3d at p. 90.)

After Metropolitan pledged its newly-adopted rate structure to the repayment of the 2002 Water Revenue Bonds on September 12, 2002, the California Legislature passed the "First Validating Act of 2003" ("2003 Validating Act") which was approved by the Governor and became effective immediately on April 30, 2003. (*See* 3-AA-00532-38.) This act validated "[a]ll acts and proceedings…taken by…any public body…*for, or in connection with,* the authorization, *issuance, sale,* execution, delivery, or exchange of *bonds*…." (3-AA-00536-37 § 6, emphasis added.) Under *Aughenbaugh,* the rate structure San Diego now challenges was a part of the bond contract in 2002 because it was part of the "whole method of financing" the bonds and was therefore validated by the 2003 Validating Act. Thus, the superior court erred by overruling Metropolitan's demurrer to San Diego's non-constitutional rate challenges for this additional reason.

B. The Superior Court Erred In Finding Metropolitan's Reasonable Ratemaking Decisions Unlawful

On the merits of San Diego's rate challenges, the superior court erred in finding that Metropolitan's System Access Rate, System Power Rate, Water Stewardship Rate and wheeling rate are illegal under four different sources of law asserted by San Diego: (1) the common law; (2) Government Code section 54999.7, subdivision (a); (3) the "Wheeling Statutes" (Wat. Code, §§ 1810 et seq.);[12] and, as to Metropolitan's 2013-2014 rates only, (4) Proposition 26. This Court reviews challenges to Metropolitan's quasi-legislative ratemaking decisions as a pure question of law, subject to de novo review and without reference to the superior court's findings. (*See, e.g.*, *Western States Petroleum Ass'n v. Super. Ct.* (1995) 9 Cal.4th 559, 573 (*Western States*); *Friends of the Old Trees v. Department of Forestry & Fire Protection* (1997) 52 Cal.App.4th 1383, 1393 (*Friends of the Old Trees*) ["[W]e review the matter without reference to the trial court's

---

[12] The Wheeling Statutes provide that, subject to certain exceptions, "neither the state, nor any regional or local public agency may deny a bona fide transferor of water the use of a water conveyance facility which has unused capacity, for the period of time for which that capacity is available, if fair compensation is paid for that use[.]" (Wat. Code, § 1810.)

actions. In mandamus actions, the trial court and appellate court perform the same function"].)

1. Metropolitan's Quasi-Legislative Ratemaking Decisions Are Entitled To Substantial Deference And Cannot Be Disturbed If They Are Reasonable

Challenges to the lawfulness of quasi-legislative decisions of an agency—including water rate-setting—are reviewed under the "arbitrary and capricious" standard of review. (*See Brydon v. East Bay Mun. Util. Dist.* (1994) 24 Cal.App.4th 178, 196 (*Brydon*) [enactment of a water rate structure design is "quasi-legislative [in] nature"].[13] This standard requires courts to reject challenges to agency actions that are not "entirely lacking in evidentiary support." (*Ibid*.) "[W]here the [agency] had the legislatively delegated authority to enact the regulatory means in dispute, it must be presumed the board did not act arbitrarily or unreasonably…but that it was guided by sound discretion and a conscientious and intelligent judgment." (*Brydon*, *supra*, 24 Cal.App.4th 178, 196; *accord*

[13] Although Article XIII C of the California Constitution, as most recently amended by Proposition 26, imposes a burden of proof on the government in certain rate challenges, it has no impact on San Diego's statutory or common law rate-challenge theories and, as demonstrated in Section I.C, *infra*, Proposition 26 does not apply to the challenged rates.

San Diego Co. Water Auth. v. Metropolitan Water Dist. of So. Cal. (2004) 117 Cal.App.4th 13, 23 fn. 4 (*San Diego*) ["Substantial deference must be given to the [Metropolitan] Board's determination of its rate design"].)[14]

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 like Metropolitan "develop a high degree of expertise" in their subject areas. (*Western States, supra,* 9 Cal.4th 559, 572; *see also Pitts v. Perluss* (1962) 58 Cal.2d 824, 834-35 ["The substitution of the judgment of a court…in quasi-legislative matters would effectuate neither the legislative mandate nor sound social policy"].)

Contrary to the superior court's erroneous conclusion that it "should review de novo whether the [Wheeling Statutes]…bar[] the inclusion of any component in a rate" (27-AA-07471), the Wheeling

---

[14] The "arbitrary and capricious" mandamus standard applies regardless of whether a cause of action seeks a writ of mandate, declaratory judgment, or reverse validation decision (all sought by San Diego below) so long as the action challenges a quasi-legislative agency decision. (*Bunnett v. Regents of the University of California* (1995) 35 Cal.App.4th 843, 848; *Le Strange v. City of Berkeley* (1962) 210 Cal.App.2d 313, 320.)

Statutes also provide for a highly deferential "substantial evidence" standard of review. (*See* Wat. Code, § 1813 ["In any judicial action challenging any determination made [under the Wheeling Statutes]…the court shall sustain the determination of the public agency if it finds that the determination is supported by substantial evidence"].)[15] Both the arbitrary and capricious and substantial evidence standards of review generally require "that a court cannot

---

[15] The superior court applied de novo review to the inclusion of specific components in Metropolitan's wheeling rate under the Wheeling Statutes based on a misreading of *Imperial*, *supra*, 80 Cal.App.4th 1403, reasoning that "the Court [in *Imperial*] afforded no deference to [Metropolitan's] position" in assessing the inclusion of system-wide costs in a wheeling rate. (27-AA-07471.) In fact, the Court of Appeal in *Imperial* reviewed the *superior court's* decision de novo because it presented an issue of statutory interpretation, *i.e.*, whether the Wheeling Statutes preclude the inclusion of system-wide costs in a wheeling rate, as the superior court had found in that case. (*Imperial*, *supra*, 80 Cal.App.4th 1403, 1422, 1426.) Finding that the Wheeling Statutes do not prohibit the inclusion of system-wide costs as a matter of law, the Court of Appeal reversed and remanded the case for consideration of, among other things, "[w]hether [Metropolitan] properly included specific costs in its wheeling rate calculation." (*Id.* at p. 1436.) The Court of Appeal instructed the superior court to consider these questions "in full compliance with Section 1813" (*ibid.*), which expressly provides that "the court shall sustain the determination of the public agency if it finds that the determination is supported by substantial evidence." (Wat. Code, § 1813.)

disturb the agency's decision if substantial evidence in the administrative record supports the decision." (*Plastic Pipe and Fittings Ass'n v. California Bldg. Standards Comm'n* (2004) 124 Cal.App.4th 1390, 1406.) "Substantial evidence" does not refer to a substantial amount of evidence, but rather evidence of legal significance or evidence adequate to support a conclusion. (*See United Professional Planning, Inc. v. Super. Ct.* (1970) 9 Cal.App.3d 377, 392 [substantial evidence means "such relevant evidence as a reasonable man might accept as adequate to support a conclusion"].)

The superior court was thus correct to state that the "core inquiry" here is "whether the costs of the services (e.g. wheeling) are reasonably related to the costs of providing those services." (27-AA-07503; *see also* Wat. Code, §§ 1811, subd. (c), 1812.) But the court erred in failing to find that "[r]easonableness…is the beginning and end of the judicial inquiry." (*Hansen v. City of San Buenaventura* (1986) 42 Cal.3d 1172, 1181; *see Griffith v. Pajaro Valley Water Mgmt. Agency* (2013) 220 Cal.App.4th 586, 601 (*Pajaro Valley*) ["[C]ourts will not prescribe a particular method, or disturb the defendant's method of setting rates, as long as the defendant's method is reasonable."]; *Equilon Enter. v. State Bd. of Equalization* (2010) 189 Cal.App.4th 865, 882-86 [reasonableness inquiry requires a "flexible assessment"]; *Brydon*, *supra*, 24 Cal.App.4th 178, 200 [rejecting plaintiffs' arguments for alternative water rates for failing to overcome the presumption that defendant's rates are reasonable].)

2. The Superior Court Engaged In The Wrong Inquiry By Evaluating Rate Components Instead Of Service Rates

Under the above standards, Metropolitan's System Access Rate, System Power Rate, and Water Stewardship Rate should plainly have been found reasonable (*see infra* Sections I.B.3-4), but as a threshold matter, the superior court should not have reviewed those rates in the first place because each is a rate *component* rather than a service rate. Metropolitan does not provide "System Access" service, "System Power" service, "Water Stewardship" service, or even "Transportation" service. Rather, Metropolitan provides full-service water and wheeling service; those are the only two service rates Metropolitan charges. (*See* Admin. Code §§ 4119, 4401, 4405 [7-AA-01921, 01933-35, 01938].) The only way a member agency would pay any of Metropolitan's Transportation Rates standing alone is by contract (as San Diego agreed to do in the Exchange Agreement here).

Under each of San Diego's facial rate-challenge theories, the reasonableness of rates is properly measured at the service-rate level rather than at the individual-component level. (*See Durant v. Beverly Hills* (1940) 39 Cal.App.2d 133, 138 [under common law, the "fundamental theory of rate making…is that there shall be but one rate for a *particular service*," emphasis added; Gov. Code, § 54999.7, subd. (a) ["a fee for public utility *service*, other than electricity or gas,

shall not exceed the reasonable cost of providing the public utility *service*," emphasis added); *Griffith v. City of Santa Cruz* (2012) 207 Cal.App.4th 982, 997 (*Griffith*) ["permissible fees must be related to the *overall cost of the governmental [service]*"], emphasis added; Cal. Const., art. XIIIC, § 1, subd. (e)(2) [Proposition 26 exemption for charges "imposed for a *specific government service*…which does not exceed the reasonable costs to the local government of providing *the service*"], emphasis added; *id.* § 1, subd. (e)(1) [similar].) The superior court thus erred in reviewing the rate components individually.

That error in turn created additional errors. Rather than analyze Metropolitan's wheeling service rate, the superior court instead focused on whether Metropolitan's component Transportation Rates are unfair to wheelers.[16] Concluding that certain costs that were allocated to Metropolitan's Transportation

[16] (*See, e.g.*, 27-AA-07452-53 [invalidating System Access Rate, System Power Rate, Water Stewardship Rate because "parties who use [Metropolitan's] wheeling services pay an inflated rate for that service"]; 27-AA-07506 [describing "core dispute" as "whether, under the current rate structure, wheelers were subsidizing water purchasers"]; 27-AA-07511 ["central problem" regarding allocation of demand management costs to transportation is that it "is then incorporated into the wheeling rate"]; 27-AA-07516 [Metropolitan's "rates over-collect from wheelers"].)

Rates should have been allocated to its Supply Rates, the superior court invalidated Metropolitan's Transportation Rates "and hence…its wheeling rate." (27-AA-07516.)

The superior court's conclusion is obviously erroneous as to the System Power Rate. That rate component is not part of Metropolitan's wheeling rate at all; wheelers pay only the "actual cost (not system average) of power." (Admin. Code § 4405 [7-AA-01938]; 27-AA-07460; *supra* at p. 33.) Thus the System Power Rate *cannot* be unfair to wheelers; it does not apply to them.

But the court's purported invalidation of the System Access Rate and Water Stewardship Rate is also erroneous, even though those two rate components are charged as part of the wheeling service rate. That is because those rate components are also charged as components of the full-service water rate. (*See supra* at p. 33.) And the superior court's holding that Metropolitan's State Water Project transportation costs and demand-management costs should have been allocated to supply rather than transportation can have no effect on Metropolitan's full-service water rate, for that rate includes *both* Transportation Rates and Supply Rates, making the allocation between them immaterial at the service-rate level. (*See, e.g.*, 23-AR2010-006295; Admin. Code § 4401 [7-AA-01933].) San Diego has never contended, and the superior court never found, that Metropolitan's Transportation Rates, insofar as charged as components of the full-service water rate, are invalid as to full-

service water purchasers. And the full-service rate *cannot* be unfair to wheelers; it does not apply to them. For these reasons alone, the Court should at the very minimum reverse the judgment to the extent it purports to invalidate Metropolitan's Transportation Rates as they are applied to rate-payers other than wheelers (34-AA-09585:20-22).

Because the superior court's invalidation of Metropolitan's three component Transportation Rates and its wheeling rate (containing two of these Transportation Rates) was based entirely on these rates' purported unfairness to wheelers, Metropolitan frames the remainder of its analysis of its Transportation Rates and wheeling rate in the context of their application to wheelers.

3. Metropolitan's Allocation Of Its State Water Project Transportation Costs To Its Transportation Rates And Wheeling Rate Should Be Upheld As Reasonable

Even if it were proper to review Metropolitan's component Transportation Rates standing alone, the superior court erred in declining to defer to Metropolitan's allocation. The administrative record contains ample evidence supporting Metropolitan's allocation of 100% of its State Water Project transportation costs to its Transportation Rates and wheeling rate. The superior court improperly substituted its own judgment for the reasonable ratemaking decision made by Metropolitan. Further, although this

Court reviews the reasonableness of Metropolitan's rates without reference to the superior court's decision (*Friends of the Old Trees*, *supra*, 52 Cal.App.4th 1383, 1393), a review of the superior court's analysis demonstrates that the superior court's conclusion is contrary to Court of Appeal precedent.

(a) The Record Supports Including State Water Project Transportation Costs In The Transportation Rates And Wheeling Rate

The law is clear that Metropolitan is allowed to recover from wheelers "charges incurred…for the use of [its] conveyance system." (*See* Wat. Code, § 1811, subd. (c); *see also Imperial*, *supra*, 80 Cal.App.4th 1403, 1430-31 ("'[F]air compensation'…includes charges the owner, in this case the Metropolitan Water District, becomes subject to or liable for in using the `conveyance system'…to wheel water when it has unused capacity"). Because the State Water Project conveyance system is an integrated extension of Metropolitan's system for which Metropolitan is financially responsible whether or not it purchases any State Water Project water, Metropolitan may reasonably allocate to its own Transportation Rates the transportation costs it pays to the State Water Project.

In 1960, Metropolitan entered into the State Water Project Contract with the Department of Water Resources. (*See supra* at

p. 25.) The State Water Project Contract is not a typical purchase or supply contract. Among other things, it:

- Required Metropolitan to pay the capital cost component of the State Water Project transportation facilities, and required Metropolitan to start paying these costs during the construction of the State Water Project's facilities, years before Metropolitan ever received any supply of State Water Project water (1-AR2010-000045-47, 000056-60, 000065-89, 000095-97 at Arts. 6, 17, 22-26, 29.)
- Requires Metropolitan to pay both the allocable portions of the costs of construction of the transportation system and minimum fixed ongoing operating and maintenance costs through at least 2035, regardless of the quantities of water available from the project (58-AR2012-016559; *accord* 2-AR2010-000402]);
- Requires Metropolitan, along with the other contractors, to assume full financial responsibility for the State Water Project's transportation costs, and provides that the State shall have no financial responsibility for those costs (1-AR2010-000071-74, 000083, 000086-87 at Arts. 23, 24(a), 25(a), 26(a)); and
- Requires Metropolitan to pay for the cost of building out additional State Water Project conveyance

infrastructure (*see* 1-AR2010-000112; *see also* 58-AR2012-016561 [discussing East Branch expansion of State Water Project conveyance system]; 31-RT-1784:24-1785:10.)

Thus, as a participant in the State Water Project, Metropolitan and the other state water contractors are responsible for the costs of building, operating, and maintaining the Project's transportation facilities.

In exchange for paying those costs, Metropolitan has a right to use the State Water Project transportation facilities as its own to transport non-Project water (1-AR2010-000153 at Art. 55(a); *see also* Admin. Code § 4119 [7-AA-01921].) Metropolitan also has the right to use State Water Project facilities for "interim storage" of non-Project water. (*Ibid.*; 40-AR2010-011307; 58-AR2012-016588.) Metropolitan pays no additional charges to transport or store non-Project water because, through its participation in the State Water Project, Metropolitan already pays for these rights through its reimbursement to the State of the State Water Project's transportation charges. (1-AR2010-000153 at Art. 55(b)-(c)); 40-AR2010-011307; 58-AR2012-016588; *accord* 27-AA-07457-58; 30-RT-1712:23-1713:9.)

Metropolitan exercises these rights under the State Water Project Contract for the benefit of its member agencies like San Diego. (*See, e.g.*, 40-AR2010-011307; 58-AR2012-016514-16; *accord* 30-

RT-1715:12-1717:15; 30-RT-1715:18-1716:6; 30-RT-1719:1-1721:17; 9-AA-02275-76, 02279-80, 02282.) Indeed, in two wheeling transactions as to which evidence was presented at trial, Metropolitan wheeled water through State Water Project facilities on San Diego's behalf. (*See generally* 18-AA-05077-105 [agreement to wheel water from Placer County]; 19-AA-05108-05153 [agreement to wheel water from Butte and Sutter Counties]; *see also* 15-AA-04032-45; 15-AA-04025-31.) As a Metropolitan member agency, San Diego did not have to pay any additional fees to the State to access the State Water Project facilities for these wheeling transactions because the transportation charges that Metropolitan pays as a participant in the State Water Project entitle it to use the facilities for transactions of this nature.

All Metropolitan's member agencies benefit from its contractual right to use the State Water Project's conveyance facilities as its own and from the operational flexibility provided by the integration of the State Water Project facilities, Colorado River facilities, and Metropolitan's in-basin distribution system. (58-AR2012-016583-89; 9-AR2010-002455-56; *accord* 30-RT-1717:14-25 [flexibility is an "important water management tool"]). The integration of Metropolitan's conveyance system with the State Water Project system also allows for a desirable and legally required blending of water supplies that would otherwise not occur. (*See supra* pp. 26-27.)

State Water Project costs are disaggregated between supply and transportation in both the State Water Project Contract and the bills Metropolitan receives. Metropolitan is accordingly able to precisely allocate the State Water Project supply and transportation costs to the proper functions in its own water rates. (*See, e.g.*, 1-AR2010-000065 at Art. 22(a) ["Delta Water Charge" for supply of State Water Project water]; 1-AR2010-000071-72 at Art. 23 ["Transportation Charge" consisting of "those costs of all project transportation facilities necessary to deliver project water to [Metropolitan]"]; 18-AA-05029 [invoice disaggregating costs for water supplies from costs for transportation facilities].)

The State Water Project Transportation Charge is further broken down into three components: capital costs associated with the aqueducts (1-AR2010-000074 at Art. 24(a)); a minimum cost for the operation, maintenance, power, and replacement of the aqueducts (1-AR2010-000083 at Art. 25(a)); and variable power costs, *i.e.*, costs that are dependent upon the amount of water actually delivered to Metropolitan (1-AR2010-000086-87 at Art. 26(a).) Metropolitan allocates the capital costs and minimum costs for operation to its System Access Rate and the variable power costs—the only cost that is variable depending on the amount of water Metropolitan actually receives—to the System Power Rate (a rate that is not part of Metropolitan's wheeling rate). (*See, e.g.*, 1-AR2010-000086 (Art. 26(a).)

The resulting rate allocation between transportation and supply conforms with industry guidelines. For example, Research Management International ("RMI") performed a study for Metropolitan in October 1995 that functionalized costs of operating and maintaining both Metropolitan's Colorado River Aqueduct and the State Water Project's California Aqueduct to the "Transmission Function," *not* the "Supply Function." (4-AR2010-001112.) The Supply Function includes the costs of purchasing water from wholesale water suppliers (*e.g.*, the State Water Project); Metropolitan categorizes these costs as supply costs by allocating the Delta Water Charge to its supply rates. (*Ibid.*) Metropolitan's practice is consistent with RMI's cost of service allocations. (*Accord* 62-AR2012-016288_1876 [1996 RMI study finding that "two categories [of Metropolitan's State Water Project costs] are clearly transmission-related, namely the capital charges for transmission facilities and the operations and maintenance charges for transmission facilities"]; 62-AR2012-016288_1904 [allocating State Water Project Delta Water Charge to supply and Transportation Charges to transmission].) Metropolitan's allocation of its State Water Project transportation costs to its Transportation Rates was also endorsed by Raftelis Financial Corporation, a premier consultant on water rate-setting, in a 2010 report that concluded, after a thorough evaluation, that Metropolitan's rates and cost-of-service methodology are reasonable and consistent with industry

best practices, including the rate guidelines in the AWWA M1 Manual. (40-AR2010-011321-23; *see also* 24-AR-2010-006489-90.)

The record thus contains ample, and certainly substantial, evidence supporting Metropolitan's rate-making decision to allocate the State Water Project Transportation Charges to the System Access Rate and System Power Rate. The superior court erred in ignoring or discounting this evidence.

(b) The Superior Court's Findings Are Contrary To Court Of Appeal Precedent

The superior court further erred in departing from established legal precedent in invalidating Metropolitan's System Access Rate and System Power Rate as unfair to wheelers. The superior court gave two reasons for its decision: (1) in its view, "[n]o reasonable basis appears in the record" for Metropolitan to allocate the transportation costs it pays for the State Water Project as its own transportation costs (27-AA-07504-05); and (2) there was no basis to allocate all of the State Water Project transportation costs to Transportation Rates that are paid in part by wheelers. (27-AA-07505-07.)[17] Both reasons are incorrect.

---

[17] That 100% of a cost is allocated to Transportation Rates does not mean that it will be borne 100% by wheelers. Rather, if the

The superior court's first reason rests on a fallacy: the court opined that the fact that the state disaggregates and displays State Water Project transportation costs on bills to Metropolitan "does not suggest those are also (or instead?) *Met[ropolitan]'s* transportation costs, any more than the overhead or payroll costs of Ford Motor Company are the overhead or payroll costs of a customer who buys a Ford car." (27-AA-07504, original emphasis included.) The record and Metropolitan's State Water Contract (*see* Section I.B.3(a), *supra*) show the error of the analogy: If Metropolitan is like a car purchaser and the Department of Water Resources is like the Ford Motor Company, then Metropolitan paid to build the Ford factory years in advance, agreed to pay for a car whether it received one or not, pays to add factory lines if demand for Fords increases, and has contractual rights to use the factory to build Toyotas (*i.e.*, transport non-Project water). In other words, contrary to the superior court's faulty analogy, the costs of constructing, operating and maintaining State Water Project transportation facilities are not internalized to

---

cost is allocated to the System Access Rate or the Water Stewardship Rate, it is paid by wheelers and full-service water purchasers alike at a volumetric rate. Full-service water purchasers, the source of 95% of Metropolitan's water rate revenues, thus bear the vast majority of the cost. (58-AR2012-016539, 016545.) Wheelers do not pay the System Power Rate at all.

the price of Project water supply as payroll and overhead costs are internalized to the price of a car; to the contrary, they are separately charged as transportation costs borne by Metropolitan and the 27 other contracting agencies whether they buy Project water or not.

The superior court's conclusion that Metropolitan may not recover its State Water Project costs through its Transportation Rates because it does not "own" the State Water Project is also contrary to the *Goodman* decision. In *Goodman*, *supra*, 140 Cal.App.3d 900, the Court of Appeal established that the State Water Project's costs are the contractors', not the State's. There, the Court of Appeal considered whether property taxes levied by a retail water agency to pay its State Water Project costs came within an exception to Proposition 13 for indebtedness approved by the voters before 1978. The issue turned in part on whether the costs of State Water Project construction, operation, maintenance and replacement, for which the taxes were assessed, were the State's costs or the agency's costs. (*Id*. at pp. 903, 910-11.) The Court of Appeal explained that, although the State Water Project was funded by state bonds, the funding was pursuant to legislation that directed the Department of Water Resources to enter into contracts with local governmental agencies requiring each to pay according to their entitlement, even though an agency may not "actually receive water." (*Id.* at pp. 904-05.)

The *Goodman* plaintiffs argued that "the state is the debtor" and that the local water agency "never assumed any part of the debt." (*Goodman*, *supra*, 140 Cal.App.3d 900, 907, 909.) The Court of Appeal disagreed:

> The entire cost of the [State Water Project] 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 p. 909, emphasis added [concluding that the local agency had the debt obligation].) The costs of "building, operating, maintaining, and replacing the [State Water Project]" were—by voter approval—to be "met by payments from local agencies." (*Id.* at p. 910.) It is thus the State Water Project contractors (like Metropolitan) that have "ultimate responsibility for the indebtedness" and therefore own the cost obligations. (*Id.* at p. 909.) In voting that the *State* may build the State Water Project, issue debt to do so, and enter into the State Water Contracts, the Court of Appeal reasoned, the voters also "intended that the costs were to be met by payments from local agencies with water contracts" and approved the contracting agencies' obligations. (*Id.* at pp. 909-10.)

The superior court suggested that *Goodman* merely means that revenue from *property taxes* can be used to pay an agency's State Water Project costs. (34-AA-09660.) *Goodman* is not so narrow. Although *Goodman* involved challenged property taxes, its holding

was premised on its conclusion that State Water Project costs are the agency's costs. State Water Project costs cannot be the agency's for property-tax purposes, but the State's for transportation cost-allocation purposes.

Goodman accordingly supports reversal here. Under Metropolitan's State Water Project Contract, Metropolitan—not the Department of Water Resources—is obligated to pay its share of all costs necessary for the State Water Project, including capital maintenance and repair costs for facilities for the conveyance of water. (1-AR2010-00065-89; 2-AR2010-000198, 000236, 000239, 000244, 000252-53, 000256, 000260, 000273.) Because the Department of Water Resources disaggregates its "transportation charges," Metropolitan is able to specifically identify the portion of its State Water Project costs that relate to water transportation (rather than water supply) and then accurately allocate those transportation costs to its System Access Rate and System Power Rate components. (18-AA-05029-33; 1-AR2010-000071-72.)

The superior court's conclusion that Metropolitan cannot allocate 100% of its State Water Project transportation costs to Transportation Rates is also inconsistent with the Court of Appeal's decision in *Imperial*, *supra*, 80 Cal.App.4th 1403. There, the Court of Appeal held that Metropolitan could adopt a "postage stamp" wheeling rate (*i.e.*, a wheeling rate that, like of the price of a U.S. domestic postage stamp, does not depend on the distance traveled).

In doing so, the Court of Appeal rejected the argument that "there must be a 'nexus…between the wheeling rate charged and the actual path specific facilities used in conveying water.'" (*Id*. at p. 1429.) The superior court did recognize that, "[i]n [*Imperial*], the Court endorsed certain kinds of system-wide costs as properly part of the wheeling charges—those that relate to the conveyance system" (27-AA-07507), but the superior court nonetheless decided that rule did not apply here because it "found no reasonable basis in the record" for Metropolitan's determination that "the state's…conveyance facilities are a part of Met[ropolitan]'s conveyance facilities." (27-AA-07508-09.)

That ruling is incorrect, for as shown above, Metropolitan's conveyance facilities *do* include the State Water Project conveyance facilities. While Metropolitan does not have legal title to those facilities, Metropolitan (along with the other State Water Project contractors) is financially responsible for the State Water Project's conveyance system, has contractual rights to use the State Water Project facilities, and can wheel water through State Water Project facilities on behalf of its member agencies without paying separate or additional amounts to the State.

Indeed, the superior court seemed to recognize that the State Water Project was part of Metropolitan's conveyance system for purposes of full-service water. (*See* 27-AA-07509 ["San Diego as a purchaser of water may well have a variety of system-wide financial

obligations" that would include the State Water Project conveyance system].) Of course, Metropolitan has *one* conveyance system; it does not have one conveyance system for full-service water purchasers and one conveyance system for wheelers. There is no question under *Imperial* that, as part of its entitlement to "fair compensation" for wheeling, Metropolitan can require wheelers to contribute to the "reasonable capital, maintenance, and operation costs occasioned, caused, or brought about by 'the use of the conveyance system" (*Imperial*, *supra*, 80 Cal.App.4th 1403, 1431; *accord* 27-AA-07507), or that Metropolitan is not required to apportion those costs to wheelers based only on segments of the system wheelers most often use (*Imperial*, *supra*, at pp. 1433-34).

Metropolitan's decision to allocate its State Water Project transportation costs to Transportation Rates and its wheeling rate thus was reasonable on the record and consistent with both *Goodman* and *Imperial*. The superior court erred in holding otherwise.

4. Metropolitan's Allocation Of The Water Stewardship Rate To Transportation Should Be Upheld As Reasonable

The superior court recognized that demand-management programs benefit wheelers by reducing transportation capacity needs, but held nevertheless that Metropolitan may not allocate the Water Stewardship Rate that recovers those costs to transportation. (27-AA-07511-12.) Specifically, the court held that Metropolitan did

not "show correlation between Met[ropolitan]'s avoided transportation costs and [the Water Stewardship Rate.]" (27-AA-07511.) That is error.

(a) The Water Stewardship Rate Recoups Costs Of Programs That Benefit All Users of Metropolitan's System, Including Wheelers

Metropolitan's Water Stewardship Rate recovers the costs of funding demand-management programs that further Metropolitan's legislative mandate to expand and incentivize the development of local water supplies and water conservation within its service area. Those programs include the Local Resources Program, which provides incentives for recycled water and groundwater recovery facilities, and the Conservation Credits Program, through which Metropolitan encourages installation of water-efficient devices and other conservation measures. (Wat. Code appen., § 109-130.5; Wat. Code, §§ 10608.16, 10608.36; *see also* 24-AR2010-006519-20; 31-RT-1772:4-1773:10; 40-AR2010-011492; 11-AR2010-002868-73; 58-AR2012-016495-6; 58-AR2012-016519.) As a Transportation Rate, the Water Stewardship Rate is charged to *both* full-service water purchasers and wheelers per acre-foot of water purchased or wheeled. As established by the administrative record (and further supported by evidence adduced at trial), Metropolitan's allocation of the Water Stewardship Rate to transportation is reasonable because the demand-management programs it funds create several

transportation-related benefits. (*See, e.g.*, 28-RT-1356:18-24, 1360:11-13.)

First, demand-management programs enable Metropolitan to avoid, reduce, or defer transportation-related capital expenditures. (*See, e.g.*, 40-AR2010-011511 ["Investments in demand side management programs like conservation, water recycling and groundwater recovery…help defer the need for additional conveyance, distribution, and storage facilities"].) The lower the regional demand for water, the less Metropolitan needs to spend on capital costs to expand and maintain its conveyance and distribution network.

This conclusion is amply supported by the record. In 1996, Metropolitan conducted an extensive study to determine its future demand scenarios and corresponding infrastructure requirements. (*See generally* 6-AR2010-001406-1519; 6-AR2010-001520-1657; 9-AA-02335-62; 10-AA-02708-2821; 9-AA-02363-501.) Specifically, Metropolitan compared a "base case" without demand-management programs to a "preferred case" with such programs. (9-AA-02343-45, 02348-53; 31-RT-1774:13-1755:24.) Under the base case, Metropolitan identified several distribution facilities for which it would need to incur capital costs to create or expand, including the

Central Pool Augmentation Project, San Diego Pipeline No. 6, and the West Valley Interconnection. (*See* 9-AA-02345; 31-RT-1776:1-21; *see also* 6-AR2010-001652-001657.)[18] Metropolitan determined that the preferred case with demand-management programs would save approximately $2 billion in capital infrastructure costs. (9-AA-02353; 31-RT-1776:22-1777:12.)

Also, as part of its 1996 Integrated Resources Plan (*see generally* 6-AR2010-001520-1657), Metropolitan assessed how changes in future demand would affect the need for additional or expanded distribution facilities. (6-AR2010-001655-001657; 31-RT-1779:25-1780:10.) The analysis revealed that as little as a 5% increase or decrease in demand had a significant effect on projected infrastructure capital costs. (6-AR2010-001655-57; 31-RT-1779:25-1781:16.) For example, Metropolitan determined that if anticipated demand decreased by 5%, it could defer building the San Diego Pipeline No. 6 and the Central Pool Augmentation Project, both of which are distribution facilities. (6-AR2010-001655-57; 31-RT-1781:6-16.) Metropolitan has in fact been able to defer both those

---

[18] As the largest purchaser of Metropolitan's water, San Diego would pay the highest percentage of these capital costs, which are recouped in the volumetric System Access Rate. (*See* 40-AR2010-011492; 59-AR2012-016697; 29-RT-1553:21-22.)

infrastructure projects because demand-management programs have effectively decreased demand on its distribution system. (31-RT-1781:17-1782:3.)

As these studies demonstrate, Metropolitan's ability to defer or avoid capital expenditures is directly related to reducing demand on its distribution system. (24-AR2010-006519 ("Investments in conservation and recycling decrease the region's overall dependence on imported water supplies"); 31-RT-1796:24-1797:1); 11-AR2010-002870 [first key goal of Metropolitan's Local Resources Program is to "avoid or defer [Metropolitan] capital expenditures"]; 31-RT-1786:22-1788:11; 10-AA-02564 [identifying regional benefits associated with the Local Resources Program, including reduction in capital investments due to deferral and downsizing of regional infrastructure and reduction in operating costs for distribution of imported supplies); 31-RT-1788:17-1789:21; 31-RT-1791:16-1793:1.)[19]

Even San Diego has acknowledged the regional, transportation-related benefits of Metropolitan's demand-

---

[19] The reduced demand resulting from these programs is documented. In fiscal year 2011/12, for example, Metropolitan would have had to transport over 20% more water through its system without its demand-management programs. (*See, e.g.*, 10-AA-2526-62; 31-RT-1809:5-18; 10-AA-02534; 31-RT-1809:19-1813:19.)

management programs. When San Diego proposed a seawater desalination facility to be funded under Metropolitan's Seawater Desalination Program, it cited as a benefit of the project "deferral of the Authority's need for Pipeline 6, thereby reducing or deferring Metropolitan's capital expenditures." (10-AA-02629; *see also* 9-AA-02508-09 [in seeking project approval in 2010, representing that the desalination program would help avoid "distribution system expansion"].)

Second, Metropolitan's demand-management programs create transportation-related benefits by increasing available capacity for system use, including by wheelers and other water transferors. The Wheeling Statutes require public agencies to make their water conveyance facilities available only when there is a certain amount of unused capacity. (Wat. Code, §§ 1810, 1811, subd. (e), § 1814.) "[T]he fact that there is a reduced need to move the water through the system means that there is net capacity to the system that wouldn't have been there otherwise." (31-RT-1815:17-24; *see also* 24-AR2010-006519 (due to Metropolitan's demand-management programs, "more capacity is available in existing facilities for a longer period of time. The capacity made available by conservation and recycling is open to all system users and can be used to complete water transfers"); 58-AR2012-016519 ["All users of Metropolitan's system benefit from the system capacity made available by investments in demand management programs"].) This

is not a hypothetical benefit; "portions of [Metropolitan's] system, even in [the] period since 2008 [] were operated at capacity for times of the year." (31-RT-1857:11-13; *see also* 30-RT-1733:11-1734:6 [examples of capacity constraints, including San Diego Pipeline 3 and 5, which deliver untreated water to San Diego and the Riverside area].) For all these reasons, Metropolitan acts reasonably in allocating the Water Stewardship Rate to transportation because that rate recovers the costs of programs that provide extensive transportation-related benefits.

The superior court, moreover, erred in finding that Metropolitan's Water Stewardship Rate recovers a supply-related rather than a transportation-related cost. Demand-management programs conserve and develop local water supplies; they do not create any water supplies for Metropolitan to sell. "[D]emand management programs do not *produce supply* that Met[ropolitan] is able to move through its system. In fact, what [Metropolitan is] paying for is a reduction in demand in [its] imported system." (31-RT-1816:3-11, emphasis added.) The court erred in reading Metropolitan's statement that "'[t]he central objective of Metropolitan's water conservation program is to help ensure adequate, reliable and affordable water supplies for Southern California'" as an admission that "Met[ropolitan] itself knows that the *primary* benefit is not for transportation, but for supply" (27-AA-07510, emphasis in original). "Supplies" in the quoted statement

refers to the local member agencies' water supplies, not a supply-related cost or benefit for Metropolitan. Conserving and developing the local member agencies' water supplies has nothing to do with Metropolitan's water supplies, which are imported from outside its service area. The superior court erred in confusing the two. (*See, e.g.*, 27-AA-07510 & at fn. 87.)

Because demand-management programs benefit *all* of Metropolitan's member agencies, Metropolitan's decision to charge the Water Stewardship Rate to all users is reasonable. (*See* 31-RT-1801:10-1802:6; 24-AR2010-006519 ["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 Metropolitan system"]; 58-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 Metropolitan system."); *accord* 31-RT-1797:3-11.) Metropolitan's allocation of this rate component to transportation is reasonable and supported by the record.

(b) The Superior Court Erred In Requiring A Precise Allocation Of A System-Wide Cost That Provides A System-Wide Benefit

Despite conceding that "some portion of the Water Stewardship Rate is causally linked to some avoided transportation costs," the superior court held that Metropolitan had not shown that it is reasonable to treat "the *entirety* of the Water Stewardship Rate as a 'transportation' rate." (27-AA-07511, emphasis in original). In so holding, the court faulted Metropolitan for failing to "show correlation between those avoided costs and water stewardship rates" and to quantify the transportation-related benefit *wheelers* receive from demand-management programs. (*Ibid.*)

But the key inquiry for a court in determining whether particular system-wide costs are properly included in a water rate is whether system users benefit *at all* from those costs—not whether the rate is "finely calibrated to the precise benefit each individual fee payor might derive." (*Cal. Farm Bureau Fed'n v. State Water Res. Control Bd.* (2011) 51 Cal.4th 421, 438 (*Cal. Farm Bureau*); *Pajaro Valley*, *supra*, 220 Cal.App.4th 586, 601 ["[a]pportionment is not a determination that lends itself to precise calculation" and a "parcel-by-parcel proportionality analysis" is not required for Proposition 218].) Indeed, as the Court of Appeal noted in *Imperial*, the Legislature, in defining "fair compensation" for purposes of the Wheeling Statutes, intentionally omitted references to "marginal,

pro rata, and incremental capital, operation, or maintenance costs in favor of a broader reference to reasonable such charges incurred." (*Imperial*, *supra*, 80 Cal.App.4th 1403, 1432.)

California law allows for charges that take into consideration system-wide benefits even under the stricter proportionality language of Proposition 218 than that which applies here, as demonstrated in *Pajaro Valley, supra,* 220 Cal.App.4th 586. There, citizens sued a regional water-management agency to challenge an ordinance that increased groundwater-augmentation charges for the operation of wells. pursuant to Proposition 218, which calls for per parcel proportionality for property-related fees. (*Id.* at pp. 589-90.) The Court of Appeal rejected the citizens' argument that only property owners actually receiving water from the wells should be charged for their operation because it determined that operation of the wells was part of an overall system objective of managing water resources, which provided a benefit to "all water users." (*Id.* at pp. 600-02.) Notably, *Pajaro Valley* 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 was enjoyed by all fee payors. (*Id.* at pp. 590, 602; *accord Imperial*, *supra*, 80 Cal.App.4th 1403, 1433 ["compensatory language" of the Wheeling Statutes demonstrates that the Legislature intended to allow conveyance

owners to "recove[r] their costs," including system-wide costs]; *Brydon*, *supra*, 24 Cal.App.4th 178, 193 ["In pursuing a constitutionally and statutorily mandated conservation program, cost allocations for services provided are to be judged by a standard of reasonableness with some flexibility permitted to account for system-wide complexity"].)

The degree of precision the superior court required is not only contrary to these precedents, but also creates an impossible rate-making quandary for Metropolitan. The superior court found that allocating 100 percent of Metropolitan's demand-management costs to the Water Stewardship Rate component is "wholly arbitrary" because Metropolitan only demonstrated the transportation-related nature of the demand-management programs "to some unspecified extent." (27-AA-07511.) By the same reasoning, it would be "wholly arbitrary" to allocate 100 percent of the Water Stewardship Rate to supply. The superior court also rejected a 50-50 allocation between transportation and supply as "wholly arbitrary." (*Ibid*.) Short of a complex and backward-looking historical analysis of Metropolitan's demand-management programs, plus a continuous complex ongoing analysis of the programs, Metropolitan cannot allocate the cost of those programs to *either* its transportation or supply rate components, or a combination of both. Even then, because Metropolitan sets its rates prospectively, it is doubtful it could ever achieve the precise allocation the superior court demanded.

In sum, the superior court erred by improperly requiring a *pro rata* allocation of costs to fund programs that are mandated by law and benefit all system users. Metropolitan demonstrated a reasonable correlation between demand-management program costs and the system-wide benefits those programs confer on all users of the system, including wheelers. And Metropolitan reasonably recovers those costs from all users, including wheelers via the Water Stewardship Rate. Accordingly, the superior court's ruling invalidating the Water Stewardship Rate should be reversed.

C. The Superior Court Committed Legal Error By Finding That Metropolitan's 2013-14 Transportation And Wheeling Rates Violate Proposition 26

Apart from the errors above, the superior court independently erred by invalidating Metropolitan's 2013-2014 System Access Rate, System Power Rate, Water Stewardship Rate and wheeling rate under Article XIIIC, Section 1 of the California Constitution, as amended by Proposition 26. By granting San Diego's Proposition 26 claim (4-AA-01005 ¶ 68), the superior court treated those rates as "taxes" as defined by Proposition 26 and therefore as invalid absent approval by a two-thirds vote of registered voters. The superior court erred as a matter of law in rejecting Metropolitan's arguments that (1) Proposition 26 does not apply because Metropolitan's wholesale water rates are not "imposed"; (2) Metropolitan's water rates are exempted by enumerated exceptions to the definition of a

local "tax" in Proposition 26; and (3) even if Proposition 26 applies, the appropriate electorate (Metropolitan's Board) approved those rates. (27-AA-07499, 07503, 07512.) Those rulings require reversal.

By way of background, Proposition 26 is the third of three relevant voter amendments to the California Constitution designed to curb increases in state and local taxation. In 1978, California voters adopted Proposition 13, which added Article XIIIA to the California Constitution and "impos[ed] important limitations upon the assessment and taxing powers of state and local governments" by (1) limiting ad valorem real property tax rates; (2) limiting increases in real property value assessments; (3) requiring that state tax increases be approved by two-thirds of the Legislature; and (4) requiring that special taxes imposed by cities, counties, or special districts be approved by a two-thirds vote of electors. (*See, e.g.*, *Amador Valley Joint Union High Sch. Dist. v. State Bd. of Equalization* (1978) 22 Cal.3d 208, 218; *Schmeer v. Cty. of Los Angeles* (2013) 213 Cal.App.4th 1310, 1317 (*Schmeer*).)

In 1996, California voters passed Proposition 218, adding Articles XIIIC and XIIID to the California Constitution to "limit[] the power of local governments to impose taxes." (*See, e.g.*, *Pajaro Valley Water Mgmt. Agency v. Amrhein* (2007) 150 Cal.App.4th 1364, 1378 (*Amrhein*).) Relevant to this appeal, Article XIIIC provides that no local government (including "any special district, or any other local or regional governmental authority" (Cal. Const., art. XIIIC, § 1,

subd. (b)), may "impose, extend or increase any special tax" (*i.e.*, a "tax imposed for specific purposes" without two-thirds voter approval. (Cal. Const., art. XIIIC § 2, subd. (d).) Proposition 218 included an express directive for liberal interpretation in favor of taxpayers that was absent from Proposition 13. (*See, e.g.*, *Silicon Valley Taxpayers Ass'n, Inc. v. Santa Clara County Open Space Authority* (2008) 44 Cal.4th 431, 448.)

In *Sinclair Paint Co.* v. *State Board of Equalization* (1997) 15 Cal.4th 866 (*Sinclair Paint*), the California Supreme Court held that regulatory fees not exceeding the "reasonable cost" of providing the service for which the regulatory fees are charged are not "special taxes" subject to the voting requirements of Proposition 13 or 218; rather, they serve a regulatory purpose and represent an exercise of an agency's police power, rather than its taxing power. (*Id*. at p. 877.) Extensive litigation followed over whether various fees and charges were "regulatory fees" or "special taxes" subject to a two-thirds voting requirement. (*See, e.g., Barratt American, Inc. v. City of Rancho Cucamonga* (2005) 37 Cal.4th 685, 700-01; *In re Attorney Discipline System* (1998) 19 Cal.4th 582, 587-90.)

In 2010, the voters passed Proposition 26. "[L]argely a response to *Sinclair Paint"* and subsequent cases relating to the distinction between regulatory fees and taxes, Proposition 26 was adopted "to close perceived loopholes in Proposition 13 and 218." (*Schmeer, supra*, 213 Cal.App.4th 1310, 1322.) Proposition 26

accomplished this goal in two ways. *First*, it provided a constitutional definition of "taxes" subject to voter approval, broadly defining a local "tax" to include any fee or charge imposed by a local government unless it falls into one of seven exempted categories. (Cal. Const., art. XIIIC, § 1, subd. (e).) *Second*, Proposition 26 gave the government the burden to prove, by a preponderance of evidence, that any revenue measure not approved by voters is not a "tax" as defined by Article XIIIC. (*E.g.*, Cal. Const., art. XIIIC, § 1(unnumbered para.).) Unlike Proposition 218, Proposition 26 does not expressly require liberal interpretation in favor of taxpayers.

Whether a charge is a "tax" within the meaning of Proposition 26 is a question of law that this Court reviews de novo. (*Cal. Farm Bureau*, *supra*, 51 Cal.4th 421, 436 ["Whether [a statute authorizing collection of fees] imposes a tax or a fee [under Article XIIIC] is a question of law decided upon an independent review of the record"]; *accord Sinclair Paint*, *supra*, 15 Cal.4th 866, 873-74 ["whether impositions are 'taxes' or 'fees' is a question of law for the appellate courts to decide on independent review of the facts"]. This Court also reviews the interpretation of a constitutional initiative's voting requirements de novo. (*See, e.g.*, *Greene v. Marin County Flood Control & Water Conservation Dist.* (2010) 49 Cal.4th 277, 287.) The Court reviews any factual findings under the substantial evidence standard. (*See, e.g.*, *Schmeer*, *supra*, 213 Cal.App.4th 1310, 1316.)

1. Proposition 26 Does Not Apply To Metropolitan's Rates Because They Are Not Compulsory

Proposition 26 defines a "tax" as "any levy, charge, or exaction of any kind *imposed* by a local government," subject to certain enumerated exceptions. (*See* Cal. Const., art. XIIIC, § 1(e), emphasis added.) The superior court erred when it found that Metropolitan's 2013-2014 wholesale water rates or rate components are "taxes." Metropolitan does not "impose[]" its water rates within the meaning of Proposition 26 because the representatives of Metropolitan's member agencies—Metropolitan's only rate payers—adopt Metropolitan's rate structure and rates, thereby deciding the rates they will pay for themselves. (Wat. Code appen., § 109-57; *cf. California Cannabis Coalition v. City of Upland* (2016) 199 Cal.Rptr.3d 805, 817 ["Taxation imposed by initiative is not taxation imposed by local government"]; 99 Ops. Cal. Atty. Gen. 1, 4-5 (2016) [franchise fee charged as condition for voluntary franchise not "imposed" under Article XIIIC].)

Moreover, Metropolitan is a supplemental, wholesale, supplier of water. Member agencies participate in Metropolitan voluntarily. (*See, e.g.*, 14-AR2010-003848 [Metropolitan is a "voluntary cooperative of member public agencies"].) An agency cannot join Metropolitan unless its governing body applies for membership and receives the approval of the qualified electors in the agency's service area. (*See* Wat. Code appen., §§ 109-350 et seq.)

San Diego's electorate voted to join Metropolitan in 1946. (20-AA-05600.) Metropolitan does not "impose" its rates on its member agencies because the member agencies voluntarily participate in Metropolitan and consider, amend, and vote on Metropolitan's rates through a public process. (*Cf. Cal. Farm Bureau, supra,* 51 Cal.4th 421, 437 ["Most taxes are compulsory rather than imposed in response to a voluntary decision to develop or to seek other government benefits or privileges"]; *Ponderosa Homes, Inc. v. City of San Ramon* (1994) 23 Cal.App.4th 1761, 1770 ["The phrase 'to impose' is generally defined to mean to establish or apply by authority or force, as in 'to impose a tax'"], quoting Webster's Third New Int'l Dictionary 1136 (1970)].)

Unlike a local retail water agency, Metropolitan has no exclusive right to provide water in its service area. (58-AR2012-016587.) Rather, its member agencies are free to acquire water from other sources and are not required to purchase water from Metropolitan. Indeed, San Diego obtains a large share of its supplemental water supplies from third party sources, including the Imperial Irrigation District and the conserved water from the lining of the All American and Coachella Canals. (*See, e.g.*, 6-AA-01364-65.) San Diego also has access to local sources of water.

Certainly, Metropolitan uses its conveyance system to exchange this third-party water with Metropolitan water it delivers in San Diego, but it does so *by contract*. (*See generally* 11-AA-02824-03115.) By definition, contractual price terms are not "imposed."

(*See, e.g.*, *Robinson v. Magee* (1858) 9 Cal. 81, 83 ["A contract is a *voluntary* and lawful agreement, by competent parties, for a good consideration, to do or not to do a specified thing"].)

San Diego argued below that Metropolitan's rates are nevertheless compulsory as to it because, although it can obtain water from alternative sources, it lacks any other means to convey third-party water to its local distribution system. (*See, e.g.*, 26-AA-07299 ["That is the barrel Met[ropolitan] had San Diego over"].) But that is not correct for two reasons:

First, the record evidence demonstrates that San Diego was not "over a barrel." In the 1998 Exchange Agreement, for example, San Diego was not required to pay Metropolitan's Transportation Rates at all; it agreed to specific dollar amounts for 30 years. (11-AA-02839.) San Diego—*not* Metropolitan—elected an amended price term based on Metropolitan's Transportation Rates. (*See* pp. 35-38, *supra*.)

Second, San Diego *could* build alternative conveyance systems to transport its third-party water—unlike retail water customers that cannot individually build out local distribution networks to avoid paying retail water rates. (*Compare* 44-AR2012-012594 with 58-AR2012-016584.) Reflecting this possibility, San Diego reserved the right, "in its sole discretion," to permanently reduce the amount of Imperial transfer water and conserved canal lining water that it exchanges with Metropolitan under the Exchange Agreement "to

the extent [San Diego] decides continually and regularly to transport [transfer and canal lining water]...through Alternative Facilities," which are defined as facilities that are not "owned and operated by Metropolitan." (22-AA-06124, 06136 §§ 1.1, subd. (c) and 3.7.) San Diego has had more than a decade to build "Alternative Facilities" and more than 15 years to build its own conveyance system since it contracted with Imperial Irrigation District for surplus water. Metropolitan 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 would a San Diego connection to the Colorado River, the All-American Canal, and/or the Coachella Canal. (*See generally* 1-AR2010-000001-172; 6-AR2010-001421-22, 001460.)

Despite all of this evidence that Metropolitan's rates are not compulsory, the superior court nevertheless concluded that Metropolitan's rates are "imposed," relying on *Bighorn-Desert View Water Agency v. Verjil* (2006) 39 Cal.4th 205 (*Bighorn*). (27-AA-07499; 6-AA-01639.) *Bighorn*, however, merely held that *retail* domestic water charges are "property-related" charges for purposes of Article XIIID, section 6 of the California Constitution (part of Proposition 218) and, therefore, "fees" within the meaning of Article XIIIC, Section 3's voter initiative provision (allowing voter initiatives to reduce or repeal "any local tax, assessment, fee or charge").

(*Bighorn*, *supra*, 39 Cal.4th 205, 218, 220-21 .) *Bighorn* did not consider whether the retail water agency's charges were "taxes" at all and, as demonstrated above, retail and wholesale water are very different creatures. Metropolitan's member agency customers (retail water agencies and other wholesalers) can opt out of Metropolitan's rates by obtaining water locally or from another source or building out their own conveyance network (58-AR2012-016587); a retail agency's customers (residents and businesses) can obtain water only from the retail water agency that operates the system to which their properties connect. Thus, even to the extent *Bighorn* could be read to address the meaning of a "tax" instead of a charge, the compulsory nature of a water retailer's charges makes *Bighorn* clearly distinguishable.

Because Metropolitan's full-service water rate, wheeling service rate, and component Transportation Rates are not "imposed," they cannot be taxes within the meaning of Proposition 26 (*see* Cal. Const., art. XIIIC, § 1, subd. (e)), and the inquiry can and should end there.

2. Metropolitan's Rates Fall Within Proposition 26's Express Exceptions To The Definition Of A "Tax"

Metropolitan's Transportation Rates and wheeling rate cannot violate Proposition 26 for the additional reason that they fall within one or more of three of its seven enumerated exceptions to the definition of a "tax":

(a) Metropolitan's Rates Are Reasonable Payor-Specific Charges For A "Product Or Service" or "Benefit or Privilege"

First, Metropolitan's rates are not "taxes" because they fall within Proposition 26's (e)(1) and (e)(2) exceptions. The (e)(1) exception excludes any "charge imposed for a specific benefit conferred or privilege granted directly to the payor that is not provided to those not charged, and which does not exceed the reasonable costs to the local government of conferring the benefit or granting the privilege." (Cal. Const., art. XIIIC, § 1, subd. (e)(1).) The (e)(2) exception excludes any "charge imposed for a specific government service or product provided directly to the payor that is not provided to those not charged, and which does not exceed the reasonable costs to the local government of providing the service or product." (Cal. Const., art. XIIIC, § 1, subd. (e)(2).)

The (e)(1) and (e)(2) exceptions are very similar, with both requiring only that the charge is for a benefit, privilege, service, or product that is not provided to those not charged and that the charge not exceed "the reasonable costs to the local government" of conferring or providing the benefit, privilege, service, or product.

(Cal. Const., art. XIIIC, § 1, subd. (e)(1), (2).)[20] There was no dispute below that the subsection (e)(2) exemption applies to Metropolitan's rates so long as they do not exceed the reasonable costs to Metropolitan "of providing the service or product." (*See, e.g.*, 6-AA-01389 ¶ 69.) Although the superior court's Phase I Statement of Decision does not expressly address either the (e)(1) or (e)(2) exception, the superior court did find that "the issue on the merits" with respect to the application of Proposition 26 to Metropolitan's rates was whether the rates were reasonable (27-AA-07499) and implicitly found the exceptions did not apply when it held that Metropolitan's Transportation Rates and wheeling rate violate Proposition 26. (*See, e.g.*, 34-AA-09661.)

---

[20] The only difference between the (e)(1) and (e)(2) exceptions is that (e)(1) applies to "benefit[s] or privilege[s]" and (e)(2) applies to "government service[s] or product[s]." (Art. XIIIC § 1, subds. (e)(1), (2).) Although Metropolitan relied on the (e)(2) exception in its Phase I post-trial briefing (26-AA-07179-82), Metropolitan also requested that the superior court consider the (e)(1) exception in its motion for new trial. The superior court found the (e)(1) exception waived (34-AA-09660) and, in any event, inapplicable. (34-AA-09659-62.) Metropolitan continues to assert the (e)(1) exception on appeal, but rather than parse whether its water conveyance and sale is a "benefit or privilege" or "product or service," for simplicity it limits its analysis above to the (e)(2) exception. This analysis applies equally to the (e)(1) exception.

The superior court did not specifically discuss the legal standard it was required to apply in determining whether Metropolitan's rates are "taxes" or exempted payor-specific charges within the meaning of Proposition 26. The Phase I Statement of Decision makes clear, however, that the superior court erroneously applied a too-exacting "strict proportionality" standard. The "reasonableness" inquiry under the Proposition 26 exceptions does not consider the relative costs and benefits to individual fee payors but rather the relationship between the revenue generated by the fee and the overall cost of service:

> [P]ermissible fees must be related to the overall cost of the governmental regulation. They need not be finely calibrated to the precise benefit each individual fee payor might derive. What a fee cannot do is exceed the reasonable cost of regulation with the generated surplus used for general revenue collection. An excessive fee that is used to generate general revenue becomes a tax.

(*Griffith, supra,* 207 Cal.App.4th 982, 997 [applying Proposition 26 exception], quoting *Cal. Farm Bureau*, *supra*, 51 Cal.4th 421, 438, quotations omitted.)

Courts applied this standard before Proposition 26, and indeed, the drafters of Proposition 26 adopted the same language in the payor-specific exceptions to the definition of a "tax," including the (e)(2) exception. (*Griffith*, *supra*, 207 Cal.App.4th 982, 996; *compare* Cal. Const., art. XIIIC § 1, subd. (e)(1), (2), & (3) *with San*

Diego Gas & Electric Co. v. San Diego County Air Pollution Control Dist. (1988) 203 Cal.App.3d 1132, 1145-46 ["A 'special tax' under [Article XIIIA, § 4] does not embrace fees charged in connection with regulatory activities *which do not exceed the reasonable cost of providing services* necessary to the activity for which the fee is charged"], emphasis added; *see also Rincon del Diablo Mun. Water Dist. v. San Diego Co. Water Auth.* (2004) 121 Cal.App.4th 813, 823 [holding San Diego's rates did not "exceed the estimated reasonable cost of providing the service"].)

Rather than apply the collective reasonableness analysis set forth in *California Farm Bureau* and *Griffith,* the superior court found that Metropolitan's rates were not reasonable because they "over-collect from wheelers." (27-AA-07516.) The superior court's focus on individualized burden is more consistent with the real property provisions in Article XIIID—added by Proposition 218—which expressly refer to proportionality. (*See, e.g.*, Cal. Const., art. XIIID, § 6(b)(3) ["The amount of a fee or charge imposed upon any parcel or person as an incident of property ownership shall not exceed the proportional cost of the service attributable to the parcel"].)[21] Even

---

[21] Despite the clear differences between Propositions 26 and 218, some courts have nevertheless failed to distinguish between the

under this inapplicable standard, however, proportionality does not limit rates to the costs of providing a specific service or benefit to a specific user.

For example, applying Proposition 218 in *Capistrano Taxpayers Ass'n, Inc. v. City of San Juan Capistrano* (2015) 235 Cal.App.4th 1493, 1502 (*Capistrano*), the Court of Appeal held, reversing the trial court, that charging all retail water users for the costs of recycled water did not violate Proposition 218 even though ratepayers who required potable water would be unable to use recycled water. *Capistrano* explained:

> [T]he trial court assumed that providing recycled water is a fundamentally different kind of service from providing traditional potable water. We think not. When each kind of water is provided by a single local agency that provides water to different kinds of users, some of whom can make use of recycled water (for example, cities irrigating park land) while others, such as private residences, can only make use of traditional potable water, providing each kind of water is providing the *same* service.

---

two in reviewing the reasonableness of rates under Proposition 26. (*See, e.g., Newhall County Water Dist. v. Castaic Lake Water Agency* (2016) 243 Cal.App.4th 1430, 1446.)

> Both are getting water that meets their needs.

(*Id.* at p. 1502 [remanding for further findings].)

As in *Capistrano*, Metropolitan provides its full-water service and wheeling service through a single, integrated conveyance system, on which water purchasers and wheelers alike place demands. A strict allocation of costs among individual users is neither required nor desirable. (*See ibid.*; *see also Moore v. City of Lemon Grove* (2015) 237 Cal.App.4th 363, 368] [applying Proposition 218 to sanitation fees and charges and noting that "courts afford agencies a reasonable degree of flexibility 'to apportion the costs of regulatory programs in a variety of reasonable financing schemes'"], citation omitted; *Pajaro Valley*, *supra*, 220 Cal.App.4th 586, 601 [applying Proposition 218 and quoting *California Farm Bureau* for proposition that "[t]he question of proportionality is not measured on an individual basis"]; Hanak et al., *Paying for Water in California* (Mar. 2014) p. 31, Public Policy Institute of California <http://www.ppic.org/content/pubs/report/R_314EHR.pdf> [as of May 3, 2016] ["[F]ragmented interpretation of water service costs threatens to undermine one of the hallmarks of contemporary water management, which recognizes that water service is an integrated endeavor"]; *cf. id.* at Tech. Appen., p. 37 <http://www.ppic.org/content/pubs/other/314EHR_appendix.pdf> [as of May 3, 2016] ["Judicial insistence that public water agencies establish a tight fit between the aggregate costs and benefits of their water supply

portfolios and how they allocate those costs and benefits to individual water users…would place an impossible burden on the agencies"].)

In addition to being contrary to law, the superior court's grafting of a strict proportionality requirement onto Article XIIIC § 1(e)(1) and (2)—which apply to a vast array of government fees—would create unworkable precedent. It is one matter to ensure that fees and charges only collect reasonable costs of service to curb hidden taxes; it is quite another to subject the minutiae of ratemaking to a constitutional challenge whenever a constituent disagrees with it. Proposition 26 ensures the former; a variety of non-constitutional remedies that give appropriate deference to the ratemaking agency (including those pursued by San Diego in this case) enable constituents to assert more detailed challenges.

As demonstrated in Sections I.B.3 & I.B.4, *supra*, Metropolitan's allocation of the costs challenged below is collectively reasonable. Thus, the superior court's conclusion that Metropolitan's Transportation Rates and wheeling rate for 2013-2014 violate Proposition 26 based on exacting proportionality was contrary to law.

(b) Metropolitan's Rates Are Charges For The Use Or Purchase Of Local Government Property

Metropolitan's rates also fall within Proposition 26's (e)(4) exception from the definition of "tax" for charges "imposed for entrance to or use of local government property, or the purchase, rental, or lease of local government property." (Cal. Const., art. XIIIC, § 1, subd. (e)(4).) Unlike the (e)(1) and (e)(2) exceptions, the (e)(4) exception requires no inquiry into the reasonableness of the charge.

Prior to the Phase I court trial, Metropolitan moved for judgment on the pleadings that Proposition 26 did not apply to Metropolitan's rates because they fall within the (e)(4) exception. (6-AA-01614-16.) The superior court deferred ruling on Proposition 26's application to Metropolitan's 2013-2014 rates so that it could evaluate the evidence presented at the final hearing. In the Phase I Statement of Decision, however, the superior court simply concluded without analysis that "Metropolitan did not adduce any [] facts" regarding the applicability of this enumerated exception at the final hearing. (27-AA-07499.) Whether analyzed on the pleadings and judicially noticeable facts alone or on the basis of the full administrative record admitted at trial, the superior court's finding that Metropolitan's water rates are not charges for the use or purchase of local government property was error.

By legislative definition, a wheeling rate is a charge for "use of a water conveyance facility." (Wat. Code, § 1810; *QSA Cases*, *supra*, 201 Cal.App.4th 758, 838, fn. 51.) Moreover, Metropolitan's Administrative Code defines wheeling service as "the use of Metropolitan's facilities, including its rights to use State Water Project facilities." (Admin. Code, § 4119 [7-AA-01921].) Indeed, Metropolitan's wheeling service rate is a charge for the use of government property, *i.e.*, the pipes and other transportation infrastructure through which water is wheeled, to get water from point A to point B, just as a driver is required to pay a toll to use a bridge to get from point A to point B.

Metropolitan's full-service water rate (and its component Transportation Rates) also falls under the government-property exception because water, "severed from the realty, reduced to possession and placed in containers," is property. (*Santa Clarita Water Co. v. Lyons* (1984) 161 Cal.App.3d 450, 461; *Watts Industries, Inc. v. Zurich American Ins., Co.* (2004) 121 Cal.App.4th 1029, 1043 ("[c]ontainers" includes "artificial watercourses or conduits through which water flows"].) Additionally, the pipes and other facilities Metropolitan uses to transport full-service water to its member agencies constitute government property for purposes of this exception. (*Robinson v. City of Glendale* (1920) 182 Cal. 211, 213 ["Where pipes are laid in real estate for the purpose of carrying water to the lands to which they extend, the pipes…constitute real

property"].) It is undisputed that Metropolitan's full-service water rate recovers (among other costs) costs for use of its own distribution and conveyance pipes and other transportation facilities (27-AA-07460-61, as well as Metropolitan's contractual right to use State Water Project pipes and other transportation facilities—all of which costs are necessary for transporting full-service water.

Because Metropolitan's rates are charges for the use of Metropolitan's water conveyance facilities and State Water Project facilities for which Metropolitan owns the costs or purchase of Metropolitan's full-service water, the superior court's conclusion that Metropolitan's water rates do not fall within the Proposition 26 government property exception is contrary to law.

3. Even If Proposition 26 Applies, Its Electorate Approval Requirement Was Satisfied

Finally, even if the challenged water rates could be deemed a "tax," the voter requirements of Proposition 26 were satisfied because Metropolitan's full-service water and wheeling service rates (and their component Transportation Rates) were approved by more than two-thirds of the relevant electorate: Metropolitan's Board of Directors. Specifically, on April 10, 2012, after public comment and votes on three other rate options, the proposed 2013-2014 rates were submitted to Metropolitan's Board of Directors for a vote of its member agencies' Board representatives. (60-AR2012-016997-017003

at § 49026.) The challenged rates were approved by 76% of the vote. (*Ibid.*)[22]

Regarding its voting requirement, Article XIIIC states only that "[n]o local government may impose, extend, or increase any special tax unless and until that tax is submitted to the electorate and approved by a two-thirds vote." (Cal. Const., art. XIIIC, § 2(d).) Although the superior court acknowledged that "electorate" is not defined and that there was no direct authority interpreting the required "electorate," it relied on a reference to the "electorate residing in the affected area" in Article XIIID—applicable only to property-based taxes—to hold that Metropolitan's rates must be approved by a two-thirds majority of voters in its service area if they do not fall within one of the seven enumerated exceptions to Proposition 26's definition of a local "tax." (*See* 27-AA-07499; 6-AA-01639-40, quoting Article XIIID § 6(c).) That was error.

An "electorate" is "a body of people entitled to vote." (*See, e.g.*, Merriam-Webster Dict. <http://www.merriam-webster.com/dictionary/electorate> [as of Apr. 25, 2016]; *see also* American Heritage Dict. <https://ahdictionary.com/word/search.html?q=

[22] Notably, San Diego itself voted for Metropolitan's 2003 and 2006-2010 rates, which were no different in structure to the rates challenged here. (*See* 26-AA-07351-78.)

electorate> [as of Apr. 25, 2016] [defining electorate as "[a] body of qualified voters"].) By mandate of the California Legislature, the only body of people entitled or qualified to vote on Metropolitan's rates are the member agencies' representatives on Metropolitan's Board of Directors, and a majority of their votes is *sufficient* to approve any Board action. (Wat. Code appen., § 109-133 ["The board shall fix the rate or rates at which water shall be sold"]; § 109-57 ["The affirmative votes of members representing more than 50 percent of the total number of votes of all the members shall be necessary and, except as otherwise expressly provided, shall be sufficient to carry any order, resolution or ordinance coming before the board"].)

Requiring the voters in Metropolitan's service area to vote on Metropolitan's rates would repeal these statutory directives by implication. But it is well-established that a subsequent law—whether a statute or a constitutional amendment—will not be found to have impliedly repealed a pre-existing, more specific law absent legislative or voter intent to do so. (*See, e.g.*, *People v. Super. Ct. (Cooper)* (2003) 114 Cal.App.4th 713, 720 ["[A]ll presumptions are against a repeal by implication"], internal quotation marks omitted; *Metropolitan Water Dist. of So. Cal. v. Dorff* (1979) 98 Cal.App.3d 109, 114 ("[T]he presumption is against [implied] repeal, especially where the prior statute has been generally understood and acted upon"); *see also Barratt American, Inc. v. City of San Diego* (2004) 117

Cal.App.4th 809, 817 ["'The same standards apply in determining whether a constitutional amendment impliedly repealed a statutory provision'"], citation omitted.) An intent to repeal may be found only where (1) "the two acts are so inconsistent that there is no possibility of concurrent operation," or (2) "the later provision gives undebatable evidence of an intent to supersede the earlier" provision. (*Hays v. Wood* (1979) 25 Cal.3d 772, 784.)

There was no basis for the superior court to find an implied repeal of the Legislature's mandate that Metropolitan's Board of Directors—and *only* its Board of Directors—vote on Metropolitan's rates, particularly where, as here, Metropolitan's only direct ratepayers are its member agencies, not the voters in its service area.

Notably, if Metropolitan were a *retail* water supplier rather than a wholesale water agency, its charges for water service would be property-related fees that are *not* subject to voter approval at all pursuant to Article XIIID, the same article on which the superior court relied to define "electorate" to mean the voters in Metropolitan's service area. (Cal. Const., art. XIIID, § 6(c).) Thus, the superior court's holding that millions of voters in Metropolitan's service area must vote on Metropolitan's water rates to satisfy the voting requirements of Article XIIIC perversely imposes more burdensome voter approval requirements on Metropolitan as a wholesale supplier than are imposed on Metropolitan's retail member agencies or their retail sub-agencies, which directly provide

water service to and impose rates on the public. This result is particularly nonsensical given that an increase or decrease in Metropolitan's rates will not necessarily result in an increase or decrease in the rates the registered voters in Metropolitan's service area pay, because Metropolitan's wholesale and retail member agencies—and, where applicable, their retail sub-agencies—include other water-related costs (*e.g.*, costs for local water supplies or infrastructure) or may structure their rates differently.[23]

---

[23] In denying certain member agencies' motion for a new trial, the superior court concluded that a case decided after it entered its Phase I Statement of Decision, *City of San Diego v. Shapiro* (2014) 228 Cal.App.4th 756 (*Shapiro*), held that "electorate," as used in Article XIIIC, § 2(d), means registered voters. (34-AA-09663.) In *Shapiro*, the City of San Diego passed an ordinance limiting the electorate eligible to vote on a tax on hotel room revenue to owners of real property on which a hotel was located or lessees of government-owned property on which a hotel was located. (*Shapiro*, *supra*, at p. 761.) *Shapiro* merely held that a city (which, unlike Metropolitan, *has* a constituency of registered voters who vote on city issues) cannot define the electorate more narrowly to vote on special taxes. *Shapiro* does not require that registered voters—rather than Metropolitan's actual constituents, the member agencies—vote on Metropolitan's rates. Moreover, unlike the city in *Shapiro*, Metropolitan has not defined its electorate; the Legislature has.

Because Metropolitan's rates were approved by more than two-thirds of the statutorily-mandated electorate, the superior court erred by finding those rates violated Article XIIIC § 2(d).

D. The Superior Court Erred In Concluding That Government Code Section 54999.7(a) Applies To Metropolitan

The superior court made an additional error of law in holding that Section 54999.7, subdivision (a) of the Government Code—a section that applies only to *retail* utility agencies—applies to Metropolitan, a *wholesale* water agency. (27-AA-07501.) Whether that section applies to Metropolitan is a question of statutory interpretation that is a pure question of law and is reviewed by this Court de novo. (*Ailanto Properties, Inc. v. City of Half Moon Bay* (2006) 142 Cal.App.4th 572, 582.)

Section 54999.7 of the Government Code provides that:

> Any public agency providing *public utility service* may impose a fee, including a rate…for any product, commodity, or service provided to a public agency.…Such a fee for public utility service, other than electricity or gas, shall not exceed the reasonable cost of providing the public utility service.

(Gov. Code, § 54999.7, subd. (a), emphasis added.)[24] By its express terms, it applies only to public agencies that provide a "public utility service." *Ibid.* "Public utility service" is defined for purposes of this statute as "service for water, light, heat, communications, power, or garbage, or for flood control, drainage or sanitary purposes, or sewage collection, treatment, or disposal, provided by a public agency." (Gov. Code, § 54999.1, subd. (h).) Although "water" standing alone could refer to both retail and wholesale service, the majority of the listed services are necessarily retail services (e.g., light, heat, communications, garbage, drainage, and sanitation services), suggesting that "water" means only retail water. (*See e.g.*,

---

[24] Sections 54999 et seq. of the Government Code—including Section 54999.7—were enacted in response to *San Marcos Water District v. San Marcos Unified School District* (1986) 42 Cal.3d 154 (*San Marcos*), which held that public entities were exempt from paying the same fees for capital improvements that private parties were required to pay. (*San Marcos*, *supra*, at pp. 157-58, 168 .) In response to this disparity of treatment between public and private entities, the Legislature passed Section 54999.7 to ensure that public-entity customers also pay a share of capital improvement costs by requiring that rates charged to non-public customers be the same as rates charges to public agencies. (*See* Gov. Code, § 54999, subd. (b) [legislative findings]; *Utility Cost Mgmt. v. East Bay Municipal Utility Dist*. (2000) 79 Cal.App.4th 1242, 1246-47; *see also* Gov. Code, § 54999.7, subd. (b).)

Moore v. California State Bd. of Accountancy (1992) 2 Cal.4th 999, 1011-12 ["[W]hen a statute contains a list or catalogue of items, a court should determine the meaning of each by reference to the others, giving preference to an interpretation that uniformly treats items similar in nature and scope….A court will adopt a restrictive meaning of a listed item if acceptance of a more expansive meaning…would otherwise make the item markedly dissimilar to the other items in the list, " internal citations omitted].) Notably, even San Diego agreed with this interpretation until it sued Metropolitan, previously admitting that Section 54999.7 "*does not apply to a water wholesaler like [Metropolitan].*" (6-AA-01467-75, emphasis added.)[25]

Moreover, Government Code, § 54999.7, subdivision (c), which requires that every public agency providing a "public utility service" complete a decennial study that addresses the cost of providing public utility service to public schools, helps to confirm that "public utility service" does not include wholesale water agencies, because only retail utility agencies could meaningfully comply with this statutory requirement. (*See, e.g., People ex rel.*

[25] Additionally, for the reasons stated in Section I.C.1, *supra*, Metropolitan cannot violate Section 54999.7 because it does not "impose" its fees.

Lungren v. Superior Court (1996) 14 Cal.4th 294, 301 ["'[W]ords must be read in context, considering the nature and purpose of the statutory enactment.'"], citations and alterations omitted.) The superior court missed the point in disregarding this provision because San Diego did not allege that Metropolitan violated it. (27-AA-07501.) This Court should reverse the superior court's determination that section 54999.7 of the Government Code applies to Metropolitan's wholesale water rates.[26]

E. The Superior Court Improperly Issued Overbroad Writs Of Mandate

In a final error epitomizing the superior court's violation of the clear separation of powers between the judiciary and public agencies, the superior court issued identical peremptory writs of

---

[26] If, for the reasons set forth in Section I.B, *supra*, the Court reverses under the arbitrary and capricious standard of review that applies to challenges brought under Section 54999.7, Metropolitan nonetheless respectfully requests that the Court address this discrete point of error because the superior court's holding could have important ramifications beyond this litigation. (*See, e.g.*, *Keitel v. Heubel* (2002) 103 Cal.App.4th 324, 332 ["appellate courts have discretion to determine unnecessary issues of great importance to the parties which may serve to avoid future litigation when the issue presented is one of continuing public interest and likely to recur," internal citations omitted].)

mandate in the 2010 and 2012 Actions that improperly exceed the superior court's jurisdiction and reflect an extraordinary judicial usurpation of Metropolitan's ratemaking authority. By issuing writs that purport to mandate how Metropolitan must exercise its discretion under any circumstances and for all time, the superior court committed clear legal error.

First, "[m]andate is never granted to compel performance of an act upon a merely anticipated refusal." (*Regents of Univ. of California v. State Bd. of Equalization* (1977) 73 Cal.App.3d 660, 669.) Rather, "[m]andate lies only to compel the performance of an act which the law specifically enjoins." (*Ibid*.) Absent a statutory requirement that the agency do (or not do) the specific acts at issue in the action, mandate is improper because courts "anticipate that when th[e] decision becomes final, [the agency] will do whatever is required by law." (*Id.* at p. 669; *accord Northridge Park County Water Dist. v. McDonnell* (1958) 158 Cal.App.2d 123, 128-29].)

Second, the law is clear that a "court [in mandate proceedings] may not control the exercise of discretion on the part of the [agency] and may not substitute its own discretion for the discretion vested in the [agency]. A writ of mandate will not issue to force the exercise of discretion in a particular manner." (*Allen v. Bowron* (1944) 64 Cal.App.2d 311, 313 []; *accord San Luis Coastal Unified School Dist. v. City of Morro Bay* (2000) 81 Cal.App.4th 1044, 1051 ["Mandate may not order the exercise of discretion in a particular manner unless

discretion can be lawfully exercised only one way under the facts"], internal quotations and citations omitted; *City and County of San Francisco v. Superior Court of City and County of San Francisco* (1959) 53 Cal.2d 236, 244 ["[mandate] will not lie to control discretion within the area lawfully entrusted to an administrative board"]; *Gong v. City of Fremont* (1967) 250 Cal.App.2d 568, 572 [same].)

Under these settled authorities, the writs of mandate issued by the superior court are unlawful. The writs command Metropolitan not to include certain costs "in setting its transportation and wheeling rates *in the future.*" (34-AA-09589, emphasis added.) The writs also purport to require Metropolitan "to henceforth set its rates based on cost causation" (34-AA-09589-90 ¶¶ 1, 3), even though the superior court did not state the intended meaning of the term (used differently by the parties) and there are other possible reasonable bases for setting rates, none of which were before the superior court in this rate challenge. The superior court has no power to direct how Metropolitan sets rates in future rate-setting cycles on the basis of different facts and different administrative records than were before it in this case. (*See, e.g.*, *McGinnis v. City of San Jose* (1908) 153 Cal. 711, 715 ["The act which will be compelled by mandamus must be one to the performance of which the complaining party is entitled at the institution of his proceeding"].)

Further, the writs command Metropolitan "not to include in its future transportation or wheeling rates costs that are not

attributable to [Metropolitan's] own conveyance system or to its actual costs in conveying water," and specifically not to include *any* of its State Water Project costs (34-AA-09589 ¶ 2), even though the superior court held only that it was unreasonable to allocate *all* of Metropolitan's State Water Project transportation costs to conveyance on the basis of the evidence before it at the time. (27-AA-07516.) The superior court impermissibly crossed the threshold between ordering Metropolitan to not do a specific act it had determined to be illegal (*i.e.*, allocating 100% of its State Water Project transportation costs or Water Stewardship Rate to its Transportation Rates) and ordering Metropolitan to exercise its discretion in a specific way (*i.e.*, setting rates based on cost causation or allocating 0% of its State Water Project transportation costs to its Transportation Rates).

For these reasons, the peremptory writs are unlawful and should be vacated.

II. THE SUPERIOR COURT ERRED IN AWARDING SAN DIEGO MORE THAN $240 MILLION FOR BREACH OF THE EXCHANGE AGREEMENT

Having improperly declared Metropolitan's Transportation Rates and wheeling rate invalid in Phase I, the superior court erred in the Phase II trial by finding breach of contract and awarding San Diego $188.3 million in damages and more than $46 million in prejudgment interest. The court found breach of the Exchange

Agreement's provision setting the price "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…." (22-AA-06137-38 § 5.2; 34-AA-09466.) But the court's rationale that the rates are unfair to wheelers does not apply to the Exchange Agreement. Moreover, the court denied Metropolitan the opportunity to develop evidence as to what alternative lawful Transportation Rates might exist and whether San Diego paid more or less than such rates under the Exchange Agreement—a comparison bearing on both the existence of breach and the measure of damages. Then, having denied discovery concerning the amount of lawful rates, the superior court relied on Metropolitan's resulting lack of proof regarding the amount of lawful rates to justify its finding of breach and its excessive damages award to San Diego—an award untethered to any finding as to what a lawful rate would be.

This Court need not reach these Phase II issues if it reverses on all claims underlying the Phase I ruling invalidating Metropolitan's challenged rates. If reached, however, the breach-of-contract judgment should be reversed.

A. The Superior Court Abused Its Discretion By Refusing To Reopen Expert Discovery Regarding Alternative Lawful Transportation Rates

After the superior court issued its Phase I Statement of Decision, Metropolitan moved for leave to reopen expert discovery for the limited purpose of developing supplemental evidence regarding a range of lawful rates in light of the superior court's findings that Metropolitan's Transportation Rates were invalid because they recouped 100% of Metropolitan's State Water Project transportation costs and demand management costs. (*See* 27-AA-07519-32.) Metropolitan noted that the parties could not have adduced expert testimony regarding the amount of a lawful rate for purposes of calculating San Diego's contract damages during the initial expert discovery period—which concluded before the Phase I trial—until the parties knew if, why, and to what extent the superior court deemed Metropolitan's Transportation Rates invalid. (27-AA-07529-31; *see also* 27-AA-07565.)

The superior court denied the motion solely on the ground that Metropolitan had questioned the superior court's jurisdiction to determine the amount of a lawful rate and had moved to dismiss without prejudice on that basis. The superior court had denied Metropolitan's motion to dismiss on this basis nearly two months before the Phase II trial began (*see* 27-AA-07653-54.) In denying Metropolitan's motion to reopen expert discovery, the court stated:

> I reiterated…my oral request that a party not ask me to conduct a trial on a theory of damages which it contends I have no power or jurisdiction to do. Nevertheless, Metropolitan has done that, and it is in aid of that effort that it desires me to re-open expert discovery….Metropolitan makes it clear (as it has done many times in the past, orally and in writing) that it contends this court has no power to award contract damages in this case, because the only way those could possibly be calculated would be through, in effect, a rate setting procedure as to which this court lacks 'jurisdiction.' But it is to this that the proposed expert would testify.

(27-AA-07633.) This Court reviews such determination for abuse of discretion. (*See, e.g., Hernandez v. Superior Court* (2004) 115 Cal.App.4th 1242, 1246.)

By denying Metropolitan's motion to reopen expert discovery for a limited purpose, the superior court left Metropolitan extremely restricted in the expert testimony it could present regarding lawful rates or alternative contractual damages measures. For example, because Metropolitan could not supplement its expert disclosures, the superior court precluded Metropolitan's ratemaking expert from testifying at trial regarding "[t]he fair and reasonable alternatives available to [Metropolitan] to recover proper costs for exchange water, including fixed infrastructure costs, power costs and costs associated with conservation"; the "[r]easonable and fair rates

[Metropolitan] could have charged [San Diego] under the 2003 amended and restated exchange agreement"; and "what [Metropolitan] could properly have charged [San Diego] in light of the rulings in Phase I." (43-RT-2880:27-2881:27 .)

The superior court abused its discretion by refusing to reopen expert discovery for limited purposes simply because Metropolitan had also challenged its jurisdiction to set rates. Parties have the legal right to argue mutually inconsistent defenses or theories in the alternative. (*See, e.g.*, *Lynch & Freytag v. Copper* (1990) 218 Cal.App.3d 603, 613 [inconsistent contract defenses have long been recognized and permitted]; *Radinsky v. T.W. Thomas, Inc.* (1968) 264 Cal.App.2d 75, 81 ["Inconsistent defenses may be pleaded"].) "Tolerance for [pleading mutually inconsistent bases of defense] rests on the principle that uncertainty as to factual details or their legal significance should not force a pleader to gamble on a single formulation of his claim if the facts ultimately found by the court, though diverging from those the pleader might have considered most likely, still entitle him to relief." (*Blickman Turkus, LP v. MF Downtown Sunnyvale, LLC* (2008) 162 Cal.App.4th 858, 886.).[27] For

---

[27] In denying Metropolitan's motion for a new trial, the superior court stated: "Met[ropolitan] *was* allowed to make inconsistent

example, a party that unsuccessfully challenges personal jurisdiction may still pursue merits discovery, and a party that contests liability may pursue damages discovery. The superior court's holding was therefore a clear abuse of discretion. (*See, e.g.*; *City of Sacramento v. Drew* (1989) 207 Cal.App.3d 1287, 1297-98 ["Action that transgresses the confines of the applicable principles of law is outside the scope of discretion"].)[28]

---

allegations and arguments, but it failed to offer proof to support them." (34-AA-09664, original emphasis included.) But Metropolitan's "fail[ure] to offer proof" at trial resulted from the superior court's denial of expert discovery and order precluding Metropolitan's ratemaking expert from testifying to reasonable alternative rate structures, and the superior court made those rulings only because it would not permit Metropolitan to argue in the alternative.

[28] As argued in Section II.C, *infra*, in the event this Court does not reverse on grounds that dispose of San Diego's contract claims in their entirety, the Court should reverse and remand for a retrial on damages. Such a decision would automatically reopen discovery. (*See, e.g.*, *Fairmont Ins. Co. v. Superior Court* (2000) 22 Cal.4th 245, 250; *Hirano v. Hirano* (2007) 158 Cal.App.4th 1, 6-7.) Metropolitan separately asserts this point of error, however, because it explains in part how the superior court ultimately arrived at its excessive damages award.

B. The Superior Court Erred By Finding An Actionable Breach

The superior court also erred by equating its Phase I determination that Metropolitan's Transportation Rates are unlawful with conclusive proof of all of the elements of San Diego's breach of contract claim, including the requirements that San Diego establish breach of the Exchange Agreement's price term and that it was, in fact, injured by that breach. (*See, e.g., Richman v. Hartley* (2014) 224 Cal.App.4th 1182, 1186 [elements].) The superior court stated:

> In Phase I, I held that Met[ropolitan]'s [Transportation Rates] were unlawful. There is no dispute that those rates are the rates generally applicable to Met[ropolitan]'s member agencies for the conveyance of water. Because Met[ropolitan]'s charges were not consistent with law and regulation, Metropolitan breached § 5.2 of the Exchange Agreement.
>
> …
>
> San Diego has proven by a preponderance of the evidence that it was in fact damaged by paying conveyance rates that were higher than Met[ropolitan] could have set pursuant to applicable law and regulation.

(34-AA-09470, 09474-76, citations omitted.) The superior court's finding that Metropolitan's Transportation Rates were unlawful *as to wheelers* cannot translate into a breach of the Exchange Agreement

because the Exchange Agreement does not concern wheeling. (*See* fn. 5, *supra*.) Moreover, the superior court's mere assumption that there was a breach and that San Diego was injured does not amount to substantial evidence and should be reversed. (*See e.g., JMR Construction Corp. v. Environmental Assessment & Remediation Management, Inc.* (2015) 243 Cal.App.4th 571 [198 Cal.Rptr.3d 47, 59] ["The question of whether a plaintiff was, in fact, damaged by the defendant's breach of contract is reviewed for substantial evidence"].)

The Exchange Agreement provides that the price "shall be *equal* to the charge or charges set by Metropolitan's Board of Directors pursuant to applicable law and regulation… ." (22-AA-06137-38 § 5.2, emphasis added.) Therefore, to establish breach or actual damages, San Diego was required to prove that it was charged an amount greater than the amount of lawful rates. (*Behnke v. State Farm Gen. Ins. Co.* (2011) 196 Cal.App.4th 1443, 1468.)

Ratemaking is a delicate science, and an adjustment to one rate requires adjustments elsewhere. It is far from clear that San Diego paid more than it otherwise would have if Metropolitan had alternative lawful Transportation Rates, as San Diego's "person most knowledgeable" regarding San Diego's damages, Dennis Cushman, candidly admitted:

> Q. …[Y]ou don't know whether San Diego would necessarily be better off under some of those alternative rate

structures that Metropolitan could lawfully adopt, correct?

A. Correct.

Q. There might be other lawful rate structures, as far as you know, that Met[ropolitan] could adopt for conveying water where San Diego would be worse off, correct?

A. Possibly.

[Objection; overruled.]

Q. You just don't know?

A. We don't know.

(40-RT-2446:18-2447:5.) Even though San Diego admitted it did not know if it had actually been harmed by the rate structure the superior court had invalidated, the superior court found that San Diego had established it was, in fact, harmed solely because the Transportation Rates were found invalid in the inapplicable context of wheeling. This result is contrary to the "well settled [law] that the party claiming the damage must prove that he has suffered damage and prove the elements thereof with reasonable certainty." (*Mendoyoma, Inc. v. Cty. of Mendocino* (1970) 8 Cal.App.3d 873, 880-81; *see also Allen v. Gardner* (1954) 126 Cal.App.2d 335, 340 ["The law requires, and properly so, that the fact of damage be proved with reasonable certainty. Uncertainty as to the fact of damage, that is, as to the nature, existence or cause of the damage, is fatal"], citation omitted; Civ. Code, § 3301 ["No damages can be recovered for a breach of contract which are not clearly ascertainable in both their

nature and origin"].) Because there was no substantial evidence that San Diego suffered any injury as a result of any breach of the Exchange Agreement, the superior court's judgment in favor of San Diego on its breach of contract should be reversed.[29]

C. The Superior Court Erred In Enforcing A Contract That, Based On Its Phase I Findings, Was Illegal

The superior court also erred in rejecting Metropolitan's affirmative defense of illegality. In Phase I, the superior court concluded that Metropolitan's Transportation Rates are unlawful, but those rates have been structured the same way since the Exchange Agreement's inception. In Phase II, however, the superior court rejected Metropolitan's affirmative defense of illegality, even though the Exchange Agreement price term that San Diego

---

[29] The superior court noted that San Diego had relied on testimony by two witnesses that San Diego had been damaged by the inclusion of State Water Project transportation costs and the Water Stewardship Rates in Metropolitan's Transportation Rates, but did not appear itself to rely on this testimony. (*See* 34-AA-09473, fn. 17.) In both instances, however, the witnesses were addressing the *amount* of San Diego's damages as calculated by simply subtracting out 100% of those costs from the Transportation Rates, and this testimony does nothing to establish that San Diego was in *fact* damaged by any breach of the Exchange Agreement. (*See* 40-RT-2396:9-24; 45-RT-3196:21-3197:3.)

proposed as consideration was deemed illegal.

A contract is void for illegality if it provides for unlawful consideration. (*See* Civ. Code, § 1608 [if any part of consideration for contract is unlawful, contract is void]; Civ. Code, § 1667 [contract is unlawful if contrary to express law or policy of express law].) Where, as here, the pertinent facts are undisputed, whether a contract is illegal is a pure question of law that this Court reviews de novo. (*Timney v. Lin* (2003) 106 Cal.App.4th 1121, 1126.)

The superior court summarily rejected Metropolitan's illegality defense, finding that "the parties did not agree the setting of charges was legal or illegal" and that "[f]ixing a $253 price is not illegal." (34-AA-09483.) Of course, contracting parties do not have to agree in advance that a contract is illegal for it to be unenforceable, and a usurious contract is no less usurious simply because the interest due is stated in a dollar figure rather than as a percentage of the principal.

In any event, San Diego's general manager testified at trial that San Diego believed the $253 initial price term was unlawful, and the evidence uniformly confirmed that $253 was simply the equivalent of the Metropolitan's already-established Transportation Rates for 2003. (42-RT-2865:24-2866:10; 41-RT-2585:10-2586:20, 2590:5-8, 2591:5-2594:1, 2599:23-2601:4, 2604:28-2606:2; 42-RT-2821:22-28, 2824:7-16; 43-RT-2896:12-2897:11, 2898:14-16, 2922:26-2923:6, 2922:20-2923:19; 40-RT-2430:27-2432:5; 41-RT-2661:1-11,

2663:2-2665:10; 14-AA-03849-50; 33-AA-09200-36.)[30]

Moreover, at the time San Diego proposed its "Option 2" price term (*i.e.*, Metropolitan's Transportation Rates)—and certainly by the time the Exchange Agreement was executed—San Diego knew both the amount and composition of Metropolitan's Transportation Rates for 2004 because those rates had already been adopted. (*Compare* 26-AA-07364 *with* 14-AA-03849-50.) Thus, even if San Diego believed that the initial price of $253 per acre-foot on the execution date was legal because it was simply a dollar amount, San Diego knew it was agreeing to pay what it believed to be an unlawful rate for 2004.

Metropolitan's Transportation Rates are either lawful or they are not; if they are not, San Diego cannot enforce a contract that was void *ab initio* because it provided for unlawful consideration. (Civ. Code § 1596 [contract must be lawful "when the contract is made"]; *Kashani v. Tsann Kuen China Enter. Co., Ltd.* (2004) 118 Cal.App.4th 531, 541-42 [illegal contract "may not serve as the foundation of any action, either in law or in equity"].) In addition to being illegal (under the superior court's Phase I findings), the Exchange

---

[30] San Diego had not previously informed Metropolitan that San Diego believed the rates were illegal since inception.

Agreement is also void because it is contrary to public policy (*see* Civ. Code, § 1667); San Diego should not be permitted to contract for what it believes is an unlawful price that it will in some manner charge to its downstream constituents in its own rates. The judgment for San Diego on its breach of contract claim should be reversed on this additional ground.

D. The Superior Court Adopted An Improper Measure Of Damages To Give San Diego A Massive Windfall

The superior court further erred by awarding San Diego $188,295,602 plus interest in contractual damages based on an improper measure of damages. (34-AA-09478.) Whether a plaintiff is entitled to a particular measure of damages is a question of law subject to de novo review. (*Toscano v. Greene Music* (2004) 124 Cal.App.4th 685, 691.)

To establish its damages—*i.e.*, the difference between what San Diego paid and what it should have paid under the Exchange Agreement—San Diego was required to establish an amount Metropolitan could have lawfully charged for conveyance. (*See, e.g.*, Civ. Code, § 3358 ["Except as expressly provided by statute, no person can recover a greater amount in damages for the breach of an obligation, than he could have gained by the full performance thereof on both sides"].) Yet San Diego did not submit any evidence regarding the amount of a lawful rate, and instead simply instructed its damages expert to assume San Diego would not have to pay *any*

portion of the State Water Project transportation costs or Water Stewardship Rate charges to calculate its damages. (40-RT-2524:26-2525:5, 2526:11-19, 2527:4-20.)

The superior court reasoned that if including 100% of Metropolitan's State Water Project transportation costs and Water Stewardship Rate in Metropolitan's Transportation Rates made those rates unlawful, it could simply award 100% of those amounts between 2011 and 2014 ($188,295,602) to San Diego as its damages. (34-AA-09476.) Thus, the superior court subtracted *all* State Water Project transportation costs and the entire Water Stewardship Rate from Metropolitan's Transportation Rates and deemed the resulting amount the lawful rate to which San Diego was entitled.

But the resulting amount could not be a lawful rate because, as the superior court recognized in Phase I, it is likely that at least some percentage of the costs it subtracted *should* be allocated to Metropolitan's Transportation Rates. (*See, e.g.*, 27-AA-07504, 07511 ["[T]he central problem here is that Met[ropolitan] treats the *entirety* of the Water Stewardship Rate as a 'transportation' rate"], emphasis in original.) Thus, just as the superior court found Metropolitan's Transportation Rates illegal because they allocated 100% of these costs to transportation, these rates would also be illegal if they allocated 100% of these costs to supply. San Diego was entitled only to a price equal to lawful rates for conveyance. The superior court erred by awarding San Diego damages based on the amount of an

unlawful rate to which San Diego was not entitled. A plaintiff should not be placed in a better position than if the promise had been performed. (*See, e.g.*, Civ. Code, § 3358; *Brandon & Tibbs v. George Kevorkian Accountancy Corp.* (1990) 226 Cal.App.3d 442, 468; *Glendale Fed. Sav. & Loan Ass'n v. Marina View Heights Dev. Co.*, (1977) 66 Cal.App.3d 101, 123.)

The superior court justified awarding this improper measure of damages by again faulting Metropolitan for having contested jurisdiction earlier in the case and for failing to present the same expert evidence the superior court had denied it an opportunity to develop and then precluded at trial:

> On the matter of stating or fixing damages through some sort of analysis of counterfactual arguably legal rates, Met[ropolitan] has repeatedly tried to have its cake and eat it too, as it were. It has told me both that (i) only a new rate setting procedure may be used in this case to fix lawful rates which in turn must be done before damages can be ascertained, and (ii) superior courts may not do this.
>
> …
>
> This logical twist got to the point where I had to instruct Met[ropolitan] not to press a damages theory which Met[ropolitan] at the same time maintained I had no jurisdiction to entertain…I allowed the parties, and Met[ropolitan] specifically to introduce evidence of a "lawful spectrum

> of rates" to estimate damages. In the event, Met[ropolitan] did not do so.

(34-AA-09474 at fn. 20; *see also* 34-AA-09665 ["Met[ropolitan] refused to present a damages calculation or methodology because it hoped that its reasoning would actually lead to a dismissal."].)

In fact, even though Metropolitan's ability to put on any alternative damages theory was gravely restricted by the superior court's rulings, Metropolitan showed at the Phase II trial that San Diego's damages were excessive. Metropolitan presented evidence that (1) San Diego would have had to pay more for supply during the same time period if the disputed costs were all allocated to supply (*see, e.g.*, 45-RT-3182:13-3183:1, 3202:6-3203:1; 45-RT-3183:9-13; 45-RT-3198:19-27; 40-RT-2526:11-19; 40-RT-2536:18-28); (2) approximately 40% of the water Metropolitan provided to San Diego under the Exchange Agreement between 2011 and 2014 was State Water Project Water, such that Metropolitan's inclusion of State Water Project transportation costs was appropriate as to that 40% of the water under the superior court's own Phase I determinations (43-RT-2991:5-2992:11; 33-AA-09237-322; 43-RT-3002:5-11; 43-RT-3002:22-28; 45-RT-3188:25-3189:18; 33-AA-09337-42); and (3) at the very least, the record supported calculating San Diego's damages based on the last rate under the Exchange Agreement ($253 per acre-foot) deemed lawful by the superior court, which would yield damages of only $114,376,896 (*see* 34-AA-09449.)

It was not Metropolitan's burden, however, to establish a lawful rate; it was San Diego's burden to come forward with the proof required for a legally tenable measure of damages. The superior court's award of the entirety of the challenged rates when San Diego failed to do so was error and the damages award should be set aside.

E. The Superior Court Awarded Excessive Interest

On top of the inflated damages award, the superior court erroneously awarded San Diego more than $46 million in prejudgment interest at the statutory 10% per annum rate. (*See* 34-AA-09498; 34-AA-09523-24; 34-AA-09586 ¶ 2.) This interest award was contrary to law because the 10% prejudgment interest rate for breach of contract cases applies only where a contract is silent regarding interest (Civ. Code, § 3289), and therefore cannot apply to the Exchange Agreement, which included an express stipulation regarding interest. Whether the superior court applied the proper interest rate is a question of law that this Court reviews de novo. (*See, e.g.*, *Chodos v. Borman* (2015) 239 Cal.App.4th 707, 712.)

Civil Code Section 3289 provides only two potential rates of prejudgment interest in contract actions. If there is a stipulated interest provision in the contract, that stipulated rate applies. (Civ. Code, § 3289, subd. (a).) In the absence of a stipulated interest provision, the Civil Code sets a default 10% rate. (*Id.*, subd. (b).) A stipulated legal rate of interest does not have to be a fixed

percentage; contracting parties may agree to any manner of calculating the rate, including a formula or reference outside of the contract. (*See, e.g.*, *Resolution Trust Corp. v. First American Bank* (9th Cir. 1998) 155 F.3d 1126, 1129 [contractual provision setting the interest rate at "the average equivalent coupon-issue yield on the United State [sic] Treasury's thirteen (13)-week Treasury Bill at the Auction held immediately prior to the beginning of each calendar quarter," as "adjusted quarterly," was valid interest rate stipulation for purposes of section 3289(a)].) So long as the stipulated means of calculating interest is not illegal (for example, under usury laws), it is error to set an agreed interest provision aside for the default statutory interest rate. (*See, e.g.*, *id.* at p. 1129; *see also Granite Construction Co. v. American Motorists Ins. Co.* (1994) 29 Cal.App.4th 658, 670-71; Civ. Code, § 3289, subd. (a).)

Section 12.4(c) of the Exchange Agreement is a clear stipulation that, in the event of a price dispute: (1) San Diego would continue to pay, and Metropolitan would set aside, any disputed amount; and (2) the interest payable on an award resulting from a price dispute would be the interest actually earned in an interest bearing account:

> In the event of a dispute over the Price, [San Diego] shall pay when due the full amount claimed by Metropolitan; provided, however, that, during the pendency of the dispute, Metropolitan shall deposit the difference between the Price

> asserted by [San Diego] and the Price claimed by Metropolitan *in a separate interest bearing account*. If [San Diego] prevails in the dispute, Metropolitan shall forthwith pay the disputed amount, *plus all interest earned thereon*, to [San Diego]. If Metropolitan prevails in the dispute, Metropolitan may then transfer the disputed amount, *plus all interest earned thereon*, into any other fund or account of Metropolitan.

(22-AA-06147 § 12.4(c), emphasis added.)

San Diego's own pleadings confirmed that it, like Metropolitan, understood that Section 12.4(c) established the prejudgment interest due under the Exchange Agreement. (*See, e.g.*, 2-AA-00250 ¶ 4 [praying for interest "as a result of the express term in section 12.4(c) of the [Exchange Agreement]"]; 06-AA-01366 ¶ 4 [same]; 4-AA-00983 ¶ 4 [same].)

The superior court nevertheless reasoned that Section 12.4(c) is merely a security provision designed to ensure that proceeds would be available to pay any judgment. In doing so, it relied heavily on its prior decision rejecting San Diego's argument that Section 12.4(c) was a liquidated damages provision, finding that "[t]he same logic applies to the interest clause here." (*See* 34-AA-09493; *see also* 27-AA-07624.) The superior court's conclusion, however, overlooks the key distinction between *liquidated* damages and stipulated interest on an *unliquidated* damages amount: As a

liquidated damages provision, Section 12.4(c) would allow San Diego to increase its damages award exponentially simply by disputing a greater amount of the price, even if it ultimately only prevailed on a tiny portion of its rate challenge. As a stipulated interest provision, Section 12.4(c) simply provides the formula for calculating the interest due on an amount of compensatory damages determined at trial. That Section 12.4(c) was "not intended to fix *the amount of damages* in price disputes" (27-AA-07623, emphasis added), does not mean that its provision regarding interest is not a stipulated interest provision. The superior court erred when it awarded San Diego statutory prejudgment interest under Civil Code Section 3289(a).

III. THE SUPERIOR COURT ERRED IN FINDING THAT EXCHANGE WATER PAYMENTS MUST BE INCLUDED IN THE CALCULATION OF SAN DIEGO'S PREFERENTIAL RIGHTS

Finally, the superior court erred in concluding that Metropolitan's methodology for calculating preferential water rights violates Section 135 of the Metropolitan Water District Act because it does not include San Diego's payments under the Exchange Agreement in its calculation. (34-AA-09485-89.) Preferential rights give a member agency the right to a percentage of Metropolitan's available water supplies based on "the ratio of that member's total accumulated payments toward Metropolitan's capital costs and

operating expenses when compared to the total of all member agencies' payments toward those costs, excluding amounts paid by the member for 'purchase of water.'" (Wat. Code appen., § 109-135; *San Diego, supra,* 117 Cal.App.4th 13, 17.) The superior court found that the Exchange Agreement transaction between San Diego and Metropolitan is not a "purchase of water" within the meaning of Section 135, and therefore that San Diego's payments under the Exchange Agreement must be included in the calculation of San Diego's preferential rights ratio.

This holding should be reversed. It (1) is inconsistent with Court of Appeal precedent, (2) ignores the language and structure of the Exchange Agreement, (3) fails to give appropriate deference to Metropolitan's agency expertise, and (4) creates a rule that is unjustifiably favorable to San Diego at the expense of Metropolitan's other member agencies. Whether a payment is a "purchase of water" that can lawfully be excluded from the preferential rights calculation under Section 135 is a question of statutory construction that this Court reviews de novo and without deference to the superior court. (*See, e.g.*, *People ex rel. Lockyer v. Shamrock Foods Co.* (2000) 24 Cal.4th 415, 432.) This Court accords "great weight and respect" to Metropolitan's interpretation of its implementing act, including the preferential rights statute. (*San Diego*, *supra,* 117 Cal.App.4th 13, 22.)

Metropolitan has calculated preferential rights using the same formula for all of its member agencies since 1931. (*See, e.g.*, 45-RT-3139:21-3140:7.) This formula credits various charges and fees paid by the member agencies (*e.g.*, certain fixed fees) but does not credit in the calculation any volumetric charges in its full-service water rate, including the Transportation Rates. (45-RT-3138:27-3139:9.)

In a previous challenge by San Diego to Metropolitan's preferential rights calculation, this Court upheld Metropolitan's exclusion of *all* payments for water, even though those rates included conveyance costs. (*See San Diego, supra*, 117 Cal.App.4th 13, 27-28.) The Court rejected San Diego's argument that only the cost of the water supply itself should be excluded from the preferential rights calculation. (*Id.* at p. 23.) It framed the question as follows: "[W]here 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 p. 25, emphasis added.) 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.

(*Id.* at pp. 27-28.) This Court also rejected San Diego's contention that it "must read the phrase 'purchase of water' literally, with an insistence upon precise and uniform terminology." (*Id.* at pp. 24, 26.)

Here too, it is irrelevant for purposes of calculating preferential rights that the price San Diego pays under the Exchange Agreement—*i.e.*, Metropolitan's Transportation Rates—recoups costs attributable to capital or operating expenses. (*San Diego, supra*, 117 Cal.App.4th 13, 26.) San Diego's payments are volumetric rates for water and thus ineligible for inclusion in the preferential rights calculation. This should have been the end of the inquiry.

The superior court nevertheless concluded that San Diego's Exchange Agreement payments cannot be excluded from Metropolitan's calculation of San Diego's preferential rights because these payments are for the "exchange" rather than the "purchase" of water. (*See, e.g.*, 34-AA-09488.) To reach this conclusion, however, the superior court had to ignore the express language and structure of the Exchange Agreement itself.

*Firs*t, the Exchange Agreement expressly provides that the exchange water will be characterized as Metropolitan water—not "Local Water" (*i.e.*, "water supplies not served by Metropolitan")—for purposes of the contract's price term. (*See* 22-AA-06126, 06137

§§ 1.1, subd. (q), 4.1, 4.2, 5.2.) Thus, the parties agreed that San Diego was purchasing Metropolitan water.

Second, the structure of the Exchange Agreement also confirms that San Diego was purchasing water from Metropolitan, not merely transporting its own water through Metropolitan's conveyance system. Under the Exchange Agreement, Metropolitan delivers an agreed upon quantity of water every month regardless of the amount, if any, San Diego has made available. (*See* 41-RT-2679:10-2680:18.) On at least one occasion, San Diego did not make the agreed amount of water available at the intake point, but Metropolitan still performed its promise to deliver exchange water. (*See, e.g.*, 9-AA-02522-23; 40-RT-2489:14-2490:8; 41-RT-2679:10-2680:18; 45-RT-3228:7-16.) Moreover, San Diego's payments under the Exchange Agreement are structured like a water purchase in which San Diego pays partly with cash and partly in-kind with the water it supplies to Metropolitan at Lake Havasu. Even San Diego's person-most-knowledgeable regarding the Exchange Agreement acknowledged that the transaction operates like a trade-in; Metropolitan charges San Diego for all water it delivers—including full-service water and exchange water—and gives San Diego a credit for the water supply San Diego is deemed to have made available. (40-RT-2489:7-11; 28-AA-07824 – 32-AA-09016; 28-AA-07919.)

In finding that San Diego's payments under the Exchange Agreement do not constitute a purchase of water, the superior court

contravened this Court's teaching that it should not "read the phrase 'purchase of water' literally, with an insistence upon precise and uniform terminology." (*San Diego*, *supra*, at pp. 24, 26.) Under a correct reading of the law and the agreement, Metropolitan is not required to credit San Diego's payments under the Exchange Agreement in its preferential rights calculation.

Finally, the superior court's ruling unfairly prejudices full-service water purchasers that pay Metropolitan's Transportation Rates as part of the full-service water rate. The Transportation Rates recoup the same costs, whether charged as part of the full-service water rate or as the price term for the Exchange Agreement. The law is clear under *San Diego* that the portions of full-service water rates attributable to capital costs and operating expenses—such as Metropolitan's Transportation Rates—do not have to be credited in the preferential rights calculation. It would be arbitrary and unfair to credit San Diego, but not others, for its payment of the same rates in calculating preferential rights.

Conclusion

For all of the foregoing reasons, Metropolitan respectfully requests that the Court vacate the judgments and peremptory writs below in their entirety and remand for entry of judgment in Metropolitan's favor.

DATED: May 5, 2016

Respectfully submitted,

QUINN EMANUEL URQUHART & SULLIVAN, LLP

By: */s/ Kathleen M. Sullivan*
Kathleen M. Sullivan
Attorneys for Appellant and Cross-Respondent Metropolitan Water District of Southern California

DATED: May 5, 2016

MEYERS, NAVE, RIBACK, SILVER & WILSON

By: */s/ Amrit S. Kulkarni*
Amrit S. Kulkarni
Attorneys for Appellant The City of Los Angeles Acting By and Through the Los Angeles Department of Water and Power

DATED: May 5, 2016

ALESHIRE & WYNDER LLP

By: */s/ Stephen R. Onstot*
Stephen R. Onstot
Attorneys for Appellant Municipal Water District of Orange County

DATED: May 5, 2016 CITY OF TORRANCE

By: */s/ Patrick Q. Sullivan*
Patrick Q. Sullivan
Attorneys for Appellant City of Torrance

DATED: May 5, 2016 LEMIEUX & O'NEILL

By: */s/ Michael Silander*
Michael Silander
Attorneys for Appellants Las Virgenes Municipal Water District, Eastern Municipal Water District, Western Municipal Water District, Foothill Municipal Water District, and West Basin Municipal Water District

DATED: May 5, 2016 BRUNICK, MCELHANEY & KENNEDY

By: */s/ Steven M. Kennedy*
Steven M. Kennedy
Attorneys for Appellant Three Valleys Municipal Water District

Certificate of Compliance

Pursuant to California Rule of Court 8.204, the foregoing Opening Brief of Appellant and Cross-Respondent Metropolitan Water District of Southern California is one-and-a-half spaced and printed in proportionally spaced 13-point Palatino Linotype typeface. It is 140 pages long and contains 24,954 words (excluding the table of contents and table of authorities, this certificate, and the proof of service). In preparing this certificate, I relied upon the word count generated by Microsoft Word 2011.

Executed on May 5, 2016 at New York, New York.

/s/ Kathleen M. Sullivan
Kathleen M. Sullivan

State of California)
County of Los Angeles)
)

Proof of Service by:
✓ US Postal Service
Federal Express

I, Kirstin Largent , declare that I am not a party to the action, am over 18 years of age and my business address is: 631 S Olive Street, Suite 600, Los Angeles, California 90014.

On 05/05/2016 declarant served the within: Appellants' Opening Brief **upon:**

Copies FedEx USPS

Electronically Served via TrueFiling on each person listed on the attached Service List.

1 Copies FedEx ✓ USPS

Clerk for the Honorable Curtis Karnow
Superior Court of California
County of San Francisco
Civic Center Courthouse
400 McAllister Street
San Francisco, California 94102-4514

Trial Court Judge

Copies FedEx USPS

Electronically Served:

Supreme Court of California,
per Rule 8.212(c)(2)

Copies FedEx USPS

the address(es) designated by said attorney(s) for that purpose by depositing **the number of copies indicated above,** of same, enclosed in a postpaid properly addressed wrapper in a Post Office Mail Depository, under the exclusive custody and care of the United States Postal Service, within the State of California, or properly addressed wrapper in an Federal Express Official Depository, under the exclusive custody and care of Federal Express, within the State of California

I further declare that this same day the **original and** copies has/have been hand delivered for filing OR the **original and** copies has/have been filed by third party commercial carrier for next business day delivery to:

ELECTRONICALLY FILED VIA TRUEFILING:

CALIFORNIA COURT OF APPEAL
First Appellate District, Division Three

I declare under penalty of perjury that the foregoing is true and correct:

Signature: /s/ Kirstin Largent (Appellate Paralegal, Counsel Press Inc

SERVICE LIST

John W. Keker Daniel Purcell Daniel E. Jackson Keker & Van Nest LLP 633 Battery Street San Francisco, California 94111-1809 jkeker@kvn.com dpurcell@kvn.com djackson@kvn.com *Attorneys for Petitioner and Appellant, San Diego County Water Authority*	Daniel S. Hentschke San Diego County Water Authority 4677 Overland Avenue San Diego, California 92123-1233 dhentschke@sdcwa.org *Attorney for Petitioner and Appellant, San Diego County Water Authority*