Nos. A146901 and A148266

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

APPELLANT'S REPLY AND CROSS-RESPONDENT'S RESPONDING 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)
CHRISTINE M. CARSON (S.B. No. 188603)
ALESHIRE & WYNDER, LLP
18881 Von Karman Avenue, Suite 1700
Irvine, California 92612
Telephone: (949) 223-1170
Facsimile: (949) 223-1180
sonstot@awattorneys.com
ccarson@awattoreys.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

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Introduction

San Diego's responding/cross-appeal opening brief fails to defend the cascading series of errors below. San Diego devotes more effort to disparaging Metropolitan than it does to the merits of the appeal, and when it does confront the merits, San Diego fails to overcome any of Metropolitan's five independent grounds for reversal of the superior court's rulings invalidating Metropolitan's rates:

First, the superior court erred by considering San Diego's rate challenges at all because Metropolitan's rate structure was validated by operation of law, making San Diego's challenge untimely. Metropolitan fully preserved this argument, contrary to San Diego's suggestion. And in arguing that rates cannot be "perpetually validated," San Diego misses the point: Metropolitan's rate *amounts* are subject to challenge each time they are enacted, but San Diego challenges Metropolitan's rate *structure*, not its rate *amounts*, and Metropolitan's rate *structure*, because it is the method of financing Metropolitan pledged to the repayment of its bonds, was validated by operation of law 60 days after the bond issue. The rates rulings thus should be reversed in their entirety.

Second, on the merits of San Diego's rate challenges, the superior court improperly substituted its judgment for Metropolitan's. San Diego erroneously argues that the superior court's ratemaking rulings are "findings of fact" that cannot be set

aside by this Court if supported by substantial evidence. That turns the standard of review on its head: The reasonableness of Metropolitan's quasi-legislative ratemaking decisions is a pure question of law, and it is *Metropolitan's* decisions that cannot be set aside if they find support in the record. San Diego fails in seeking to discredit the ample record evidence supporting the Metropolitan Board's ratemaking decisions.

Third, the superior court erred in finding that Metropolitan's rates are special taxes violating Proposition 26 because (1) Metropolitan's rates are not "imposed"; (2) they fall within exceptions to Proposition 26's definition of a "special tax"; and (3) they were approved by Metropolitan's relevant electorate as defined by the Legislature. San Diego fails to overcome these errors. Metropolitan's rates are not "imposed" because they are set by the payors themselves, who voluntarily participate in Metropolitan. Metropolitan's rates fall within enumerated Proposition 26 exceptions, including those for reasonable charges for benefits or services not charged nonusers, and San Diego misplaces reliance on *Newhall County Water District v. Castaic Lake Water Agency* (2016) 243 Cal.App.4th 1430 (*Newhall*) in arguing otherwise. *Newhall* rejected as unreasonable a fixed charge for consumption of a product or service that the agency *did not even provide*. Metropolitan, in sharp contrast, reasonably charges the challenged costs to users of its services volumetrically based on consumption. San Diego errs in arguing for

individually-tailored rates based only on the specific portions of a system used in specific transactions; it is beyond dispute in California that agencies may recover system-wide costs through "postage-stamp" rates. And if Proposition 26 applies (it does not), it was satisfied, because Metropolitan's wholesale rates were approved by its electorate: its Board of Directors, comprised of representatives of its member agencies.

Fourth, as San Diego has previously admitted, Section 54999.7(a) of the Government Code does not apply to Metropolitan at all.

Fifth, the writs must be vacated. In addition to pressing another frivolous waiver argument, San Diego argues that courts may issue writs without offending the separation of powers, but this is beside the point: *these* writs are improperly overbroad and violate the separation of powers because they purport to dictate how Metropolitan must exercise its discretion in the future.

The superior court's errors with respect to San Diego's breach of contract claim need not be reached if the invalidation of Metropolitan's rates is reversed. If these errors *are* reached, they warrant reversal or vacatur for five reasons: *First*, the superior 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 and excessive measure of

damages. And *fifth*, it awarded excessive interest. San Diego's response to these arguments repeats the superior court's erroneous findings.

As to the superior court's erroneous declaration that Metropolitan must give San Diego preferential rights credit for payments under the Exchange Agreement, San Diego again wrongly urges deference to the superior court on a predominantly legal question. As this Court's analysis of legislative history in *San Diego County Water Authority v. Metropolitan Water District of Southern California* (2004) 117 Cal.App.4th 13 (*San Diego*) makes clear, San Diego's payments are properly excluded from preferential rights. San Diego makes no compelling argument to the contrary.

Finally, San Diego's cross-appeal presents no basis for reversal:

First, the superior court correctly granted summary adjudication denying San Diego's challenge to the Rate Structure Integrity ("RSI") provision that Metropolitan includes in its demand management program contracts with member agencies. Contrary to San Diego's argument, the RSI provision is not an unconstitutional condition on its right to petition. The superior court correctly held that San Diego lacks standing to pursue that claim and, in any event, Metropolitan's demand management contracts are not a public benefit as required for the unconstitutional conditions doctrine to apply. Moreover, the doctrine does not apply to a sophisticated

public agency's voluntary waiver of a right by contract. Nor does the RSI provision violate Civil Code section 1668 because it does not "exempt" Metropolitan from liability, directly or indirectly.

Second, the superior court correctly determined that San Diego was not entitled to attorneys' fees as the prevailing party on the Phase II portion of the case. The Exchange Agreement clearly limits attorneys' fees to rate challenges such as those that were resolved in Phase I. This argument, too, need not be reached if the Court reverses the judgment invalidating Metropolitan's rates.

Appellants' Reply in Support of Their Appeal

Argument

I. SAN DIEGO FAILS TO DEFEND THE SUPERIOR COURT'S INVALIDATION OF METROPOLITAN'S RATES

A. San Diego's Rate Challenges Were Untimely Because Metropolitan's Rate Structure Was Validated By Operation Of Law

Contrary to San Diego's argument, Metropolitan did not waive the argument that San Diego's challenges should have been dismissed because they were filed years after Metropolitan's rate

structure was validated by operation of law. (ROB 7, 92-93.)[1] To the contrary, Metropolitan's validation argument was rejected on demurrer after full briefing below. By statute, "an order…overruling a demurrer" is "deemed excepted to." (Code Civ. Proc., § 647; *see also McCauley v. Howard Jarvis Taxpayers Assn.* (1998) 68 Cal.App.4th 1255, 1264 ["Raising an issue by an unsuccessful demurrer is enough to preserve the issue for appeal....Having made the statute of limitations argument by demurrer and lost, [defendants] can hardly be faulted for not re-beating the dead horse as trial approached."].) Metropolitan was not required to seek additional findings in the superior court's Statements of Decision to preserve this purely legal argument on appeal.

The authorities cited by San Diego do not help its argument. Section 634 of the Code of Civil Procedure and *In re Marriage of Arceneaux* (1990) 51 Cal.3d 1130, 1133-34, concern only implied

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[1] Citations to San Diego's Responding and Opening Brief, San Diego's Responding Appendix, and Appellants' Reply Appendix are identified by "ROB, "RA," and "ARA," respectively. Citations to Appellants' Opening Brief are identified by "AOB," and in references to that brief, "Metropolitan" is used for convenience to denote both Metropolitan and the member agencies who join its arguments.

factual findings, and do not apply to legal errors. (*United Services Auto. Assn. v. Dalrymple* (1991) 232 Cal.App.3d 182, 185-86; *Planning and Conservation League v. Castaic Lake Water Agency* (2009) 180 Cal.App.4th 210, 251-52.) *DeCelle v. City of Alameda* (1963) 221 Cal.App.2d 528 (*DeCelle*), which San Diego cites as the sole support for its claim that "a party waives an affirmative defense by failing to pursue it after the trial court overrules a demurrer" (ROB 93), says no such thing: In *DeCelle*, the defendants asserted an inapplicable statute of limitations on demurrer, pleaded a non-specific "Statute of Limitations" defense in their answer, and asserted a different statute of limitations for the first time on appeal. (*DeCelle, supra,* 221 Cal.App.2d 528, 533.) Metropolitan asserts the same argument on appeal that it fully briefed on demurrer in the superior court. San Diego's waiver argument is therefore frivolous.

San Diego fares no better in relying on the Supreme Court's decision in *Barratt American, Inc. v. City of Rancho Cucamonga* (2005) 37 Cal.4th 685 (*Barratt*). (ROB 90-92.) *Barratt* held that the reenactment of a building permit fee schedule even at the same fee amount was "an ordinance, resolution, or motion adopting a new fee or service charge, or modifying or amending an existing fee or service charge" within the meaning of Government Code § 66022, subdivision (a). (*Barratt*, *supra*, 37 Cal.4th 685, 702-04.) *Barratt* reflected a concern that, absent the possibility of challenge to reenacted fee *amounts*, local agencies might simply readopt fees that

exceed the actual costs of services. (*Ibid.*) But San Diego does not contest the *amount* of Metropolitan's rates; it challenges only the *structure* of Metropolitan's rates, which has not changed since they were unbundled in 2003. *Barratt* in no way suggests that San Diego may challenge the validity of an already-validated rate *structure* years after it was adopted.[2] Moreover, under Government Code section 53511 (applicable here, as San Diego admitted in its complaint (6-AA-01394 ¶ 92) and does not dispute on appeal), Metropolitan's rate structure was expressly pledged to the repayment of the agency's bonds; section 66022, applicable in *Barratt*, in contrast, says nothing about bonds. Thus, there was no reason for the Court to consider in *Barratt* whether the method of financing bonds was validated with the bond issue itself, as in *Aughenbaugh v. Board of Supervisors* (1983) 139 Cal.App.3d 83 (*Aughenbaugh*).

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[2] Indeed, as a San Diego witness later testified at trial, "[i]f a majority of the Metropolitan board were to vote against a rate increase for a particular year," it would *not* "have any effect on the underlying rate structure." (40-RT-2405:4-15.)

The other cases San Diego cites (ROB 91 fn. 17) likewise do not aid its cause. For example, *Arcadia Development Co. v. City of Morgan Hill* (2008) 169 Cal.App.4th 253 (*Arcadia*) held that the time for challenging a land use restriction began to run anew when the restriction was extended because whether the restriction was appropriate "had to [be] decided upon the circumstances as they existed when the law was extended." (*Id.* at p. 264.) Here, in contrast, Metropolitan's rate *structure* does not depend on any variable circumstances that change yearly. *Arcadia*, like *Barratt*, at most stands for the undisputed proposition that the opportunity to challenge the *amount* of Metropolitan's rates renews with each rate-setting.

San Diego also cites *Fontana Redevelopment Agency v. Torres* (2007) 153 Cal.App.4th 902, 913 (*Fontana*), presumably for the court's statement that "courts cannot validate ongoing illegality." But *Fontana* held only that validation of a redevelopment plan with specified debt limitations did not immunize a later bond issue that *exceeded* those limitations; it assumed validation would immunize attacks on the plan as adopted. (*Ibid.*) *Fontana* thus *supports* Metropolitan's argument, for there is no allegation in this case that Metropolitan has deviated from its previously validated rate structure. It would nullify the entire purpose of validation to read *Fontana*'s statement that "courts cannot validate ongoing illegality"

to mean that courts may revisit a validated agency action anytime a challenger contends it is illegal.[3]

San Diego's attempt to distinguish the authorities cited by Metropolitan also fails. San Diego argues that *Aughenbaugh* and *Friedland v. City of Long Beach* (1998) 62 Cal.App.4th 835 (*Friedland*) are distinguishable because the plaintiffs there sought refunds for past charges. But San Diego fails to explain why an untimely challenge can be asserted to a validated rate structure so long as no

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[3] The other cases cited by San Diego are inapposite. *Travis v. County of Santa Cruz* (2004) 33 Cal.4th 757, 770 found that the time for challenging as-applied challenges to conditions on a development permit (unlike facial challenges to the ordinance governing such permits) runs from the issuance of the permit. But San Diego does not dispute that its rate challenges here are facial challenges, and even if this were an as-applied challenge, Metropolitan's rate structure has been applied to San Diego in the same way since 2003. *City of Ontario v. Superior Court* (1970) 2 Cal.3d 335, 340 (*Ontario*) affirmed the superior court's excusal of non-compliance with the validation statutes' service requirements and has no discernible relevance. *Miller v. McKenna* (1944) 23 Cal.2d 774, 782 (*Miller*) held that curative legislation does not cure constitutional defects, but this limitation does not apply to validation or reverse validation under Code Civ. Pro. §§ 860 *et seq.*, which immunizes subject agency actions from *all* untimely subsequent challenges. (*See California Commerce Casino, Inc. v. Schwarzenegger* (2007) 146 Cal.App.4th 1406, 1420.)

refund is sought. A prospective challenge can be just as disruptive as a refund action to a method of financing an agency's bonds (*see* AOB 44-48), and thus can equally undermine the very purpose of validation.[4]

Finally, San Diego contends that *Graydon v. Pasadena Redevelopment Agency* (1980) 104 Cal.App.3d 631 (*Graydon*) does not apply because there, "the relief the plaintiff sought would have decreased revenues the defendant pledged to its bonds," whereas Metropolitan represented in 2012 that any relief would raise costs to Metropolitan's other member agencies but not reduce net revenues. (ROB 91-92; *see* 5-AA-1118.) Such *ex post* statements, however, are irrelevant to Metropolitan's rightful expectations based on validation by operation of law of its rate structure in 2002. And whether an agency action has been validated cannot depend on the future, unpredictable ramifications of the untimely challenge.

Thus, under *Aughenbaugh* and *Graydon* (and, as to non-constitutional challenges, curative legislation [*see* AOB 51-52]),

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[4] San Diego also contends that *Friedland* is distinguishable because there the city had pursued a successful validation action to judgment, but that is irrelevant: Rates validated by operation of law resulting from non-action are just as valid as affirmatively validated rates. (*Ontario, supra,* 2 Cal.3d 335, 341-42; AOB 44.)

Metropolitan's rate structure was validated by operation of law in 2002, rendering San Diego's challenges untimely and warranting reversal on all issues in Metropolitan's appeal except preferential rights.

B. Metropolitan's Ratemaking Decisions Were Reasonable And Not Unlawful Under The Common Law, Section 54999.7(a), And The Wheeling Statutes

1. San Diego Misstates The Standard Of Review For Its Non-Constitutional Rate Challenges

San Diego fails in its repeated efforts to rewrite or confuse the relevant standards of review on the issues in Metropolitan's appeal.

(a) The Standard Of Review Applicable To Quasi-Legislative Ratemaking Requires Deference To Metropolitan, Not The Superior Court

Contrary to San Diego's suggestion (ROB 37 & fn. 3, 67, 73), whether Metropolitan's quasi-legislative ratemaking decisions are arbitrary and capricious is not a factual determination requiring deference to the superior court but rather a "question of law" requiring deference to Metropolitan, the expert agency. (*Delaware Tetra Techs., Inc. v. County of San Bernardino* (2016) 247 Cal.App.4th 352, 359, internal quotations omitted; *see also Western States Petroleum Association v. Superior Court* (1995) 9 Cal.4th 559, 573 (*Western States*) ["[T]he factual bases of quasi-legislative administrative decisions are

entitled to the same deference as the factual determinations of trial courts [and] the substantiality of the evidence supporting such administrative decisions is a question of law."];[5] *Citizens for East Shore Parks v. California State Lands Com.* (2011) 202 Cal.App.4th 549, 572 [where issue is whether agency "took action that is 'arbitrary, capricious, contrary to public policy, unlawful, or procedurally unfair,' the appellate court faces a 'question of law' which is reviewed de novo"], citations omitted; *California Bldg. Industry Assn. v. San Joaquin Valley Air Pollution Control Dist.* (2009) 178 Cal.App.4th 120, 129-30 ["In reviewing quasi-legislative actions, the authority of the trial court 'is limited to determining whether the decision of the agency was arbitrary [and] capricious, entirely lacking in

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[5] San Diego fails to distinguish *Western States* and *Friends of the Old Trees v. Department of Forestry & Fire Protection* (1997) 52 Cal.App.4th 1383, 1389 (*Friends of the Old Trees*). (ROB 37 fn. 3.) Although the issue in *Western States* was whether extra-record discovery was allowable in a particular mandate proceeding, the Supreme Court's analysis was mainly premised on the standard of review. (*Western States*, *supra*, 9 Cal.4th 559, 572-74.) Similarly, although *Friends of the Old Trees* ultimately concluded that the issue before it was properly resolved by administrative mandate instead of traditional mandate, it resolved that question by analyzing in depth both standards of review. (*Friends of the Old Trees*, *supra*, 52 Cal.App.4th 1383, 1389.)

evidentiary support, or unlawfully or procedurally unfair.'…The appellate court reviews the trial court's decision de novo under the same standard."], citations omitted; *City of South Gate v. Los Angeles Unified Sch. Dist.* (1986) 184 Cal.App.3d 1416, 1422 (*City of South Gate*) ["The ultimate question[], whether the agency's decision was arbitrary, capricious or entirely lacking in evidentiary support…[is] essentially [a] question[] of law."].)

San Diego mistakenly relies on *Kreeft v. City of Oakland* (1998) 68 Cal.App.4th 46, 53 and *Wong v. Ohlone College* (2006) 137 Cal.App.4th 1379, 1382, for their statements that the substantial evidence test applies to the superior court's factual findings on a petition for ordinary mandate. (ROB 3-4, 39, 67, 73, 75.) But neither case reflects any "factual findings" by the superior court to which the court of appeal actually afforded any deference. Importantly, ordinary mandate is appropriate to challenge not only quasi-legislative administrative decisions (as here), in which the record is typically limited to the administrative record, but also ministerial or informal administrative actions, in which extra-record evidence may be admissible. (*Western States, supra,* 9 Cal.4th 559, 575.) The cited statements regarding deference to the superior court's factual findings on ordinary mandate apply in the latter context; they do not suggest the Court of Appeal defers to the superior court when reviewing an agency's quasi-legislative determinations.

Nor can the standard of review for factual determinations even apply here. The superior court has no authority to make factual determinations as to San Diego's non-constitutional rate challenges in the first place: "A court reviewing a quasi-legislative act cannot reweigh the evidence or substitute its own judgment for that of the agency." (*Plastic Pipe & Fittings Assn. v. California Building Standards Com.* (2004) 124 Cal.App.4th 1390, 1406.) Yet, the superior court did just that—it substituted its own judgment for that of Metropolitan's Board.

(b) The Wheeling Statutes Expressly Provide For Deference To Metropolitan, Not The Superior Court

San Diego does not dispute that the superior court improperly reviewed de novo, instead of for substantial evidence, the inclusion of specific costs in Metropolitan's wheeling rate under the Wheeling Statutes. (*See* AOB 56 fn. 15.) Instead, it argues that the deference expressly afforded Metropolitan under the Wheeling Statutes must be replaced with deference to the superior court on appeal. (ROB 38-39, 67.) This too is wrong.

Section 1813 of the Wheeling Statutes expressly provides that, "[i]n any judicial action challenging any determination made under this article…the court shall sustain the determination of the public agency if it finds that the determination is supported by substantial evidence." (Wat. Code, § 1813.) "When administrative agency

action is judicially reviewable under a substantial evidence standard, the rule for the reviewing trial court and appellate court is the same." (*California Assn. of Medical Products Suppliers v. Maxwell-Jolly* (2011) 199 Cal.App.4th 286, 303; *see also Lewin v. St. Joseph Hospital of Orange* (1978) 82 Cal.App.3d 368, 386 ["If the proper scope of review in the trial court was whether the administrative decision was supported by substantial evidence, the function of the appellate court on appeal is the same as that of the trial court, that is, it reviews the administrative decision to determine whether it is supported by substantial evidence."].)

San Diego suggests that the Legislature chose the substantial evidence standard over the arbitrary and capricious standard "in response to Met[ropolitan]'s efforts to serve its own self-interest in setting wheeling rates." (ROB 68-69.) The legislative history in fact reflects no such motive (*see ibid.*, citing 5-RA-1171, 1229), and in any event is irrelevant, for Metropolitan does not dispute that its wheeling rate is reviewed under the Wheeling Statutes under the substantial evidence standard of review (*e.g.*, AOB 56 fn. 15).

Finally, San Diego suggests that Metropolitan's ratemaking decisions are not entitled to deference under the Wheeling Statutes

because its written findings were "slovenly." (ROB 69.) This is not only untrue,[6] but also irrelevant. It is the "determination," not the "written findings," that is reviewed, "consider[ing] all relevant evidence" (Wat. Code, § 1813), which in this case includes a 20,000-plus page administrative record. Notably, *Yamaha Corp. of America v. State Board of Equalization* (1998) 19 Cal.4th 1, 14-15 (*Yamaha*), from which San Diego borrows liberally (ROB 53, 69), actually defeats San Diego's position; *Yamaha* discussed the deference afforded agencies on matters of statutory interpretation, not quasi-legislative decisions, which it carefully and expressly distinguished. (*Yamaha, supra*, 19 Cal.4th 1, 10-11 ["Because an interpretation is an agency's *legal opinion*, however 'expert,' rather than the exercise of a delegated

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[6] Resolution 8520 bears no resemblance to the resolutions or findings at issue in San Diego's cited cases. (*Compare* 9-AR2010-02446-51 [Resolution 8520] *with City of Livermore v. Local Agency Formation Com.* (1986) 184 Cal.App.3d 531, 541-42 [resolution was "conclusory" and did "not contain any evidence or factual information"] *and California Hotel & Motel Assn. v. Indus. Welfare Com.* (1979) 25 Cal.3d 200, 214 [invalidating order fixing minimum wage, which required notice and circulation of findings, because it contained only "recitation of the commission's authority and of the [statutorily-prescribed] procedures"].)

legislative power to make law, *it commands a commensurably lesser degree of judicial deference*"], second emphasis added.)

(c) Proposition 26 Did Not Replace The Standard Of Review For San Diego's Non-Constitutional Rate Challenges

San Diego suggests that Proposition 26 eliminated the deferential standard of review applicable when agency actions are challenged on non-constitutional grounds (ROB 37, 40)—even in cases where Proposition 26 does not apply.[7] There is no support for San Diego's novel and erroneous assertion. Metropolitan's ratemaking decisions must be upheld under the common law and Government Code section 54999.7(a) if they are not arbitrary and capricious, and must be upheld under the Wheeling Statutes if they are supported by substantial evidence—well-established standards of review that even the superior court acknowledged. (*See* 27-AA-07468-69 ["arbitrary and capricious" standard applies by default]; 27-AA-7471-72, 07474 [deference to Metropolitan's factual findings

[7] San Diego has abandoned any claim that Proposition 26 retroactively applies to Metropolitan's 2011-2012 rates. And Proposition 26 does not apply to Metropolitan's rates at all (*see* Section I.C, *infra*).

required under the Wheeling Statutes and section 54999.7 of the Government Code]; *accord* ROB 9-10.) San Diego misplaces reliance on *Silicon Valley Taxpayers Association v. Santa Clara County Open Space Authority* (2008) 44 Cal.4th 431, 443-50. (ROB 40.) That decision merely discusses the standard of review under Proposition 218 as it applies to a challenge under Proposition 218; it does not suggest that Proposition 218 (or Proposition 26) has replaced the standard of review for non-constitutional challenges.

San Diego's many efforts to require deference to the superior court's erroneous findings should be rejected.

2. Metropolitan's Allocation Of Its State Water Project Transportation Costs To Its Transportation Rates And Wheeling Rate Is Reasonable

San Diego opens its brief with the misleading assertion that "[t]he central question here is whether Met[ropolitan] overcharged San Diego to transport San Diego's water through Met[ropolitan]'s Colorado River Aqueduct." (ROB 1.) To the contrary, however, the rate challenges here concern the reasonableness of the Transportation Rates and wheeling rate that Metropolitan charges *all of its member agencies*. San Diego never contracted for a rate for transporting its water through the Colorado River Aqueduct. San Diego contracted to pay a price to exchange water based on Metropolitan's Transportation Rates. Those rates are postage-stamp

rates that apply no matter how far or through which facilities Metropolitan moves water. Nor is Metropolitan's wheeling rate—the other rate challenged by San Diego—a rate for transporting water through the Colorado River Aqueduct; it too is a postage-stamp rate that applies regardless of the distance the water travels or the facilities through which it is wheeled. (*See* AOB 31.)

It is irrelevant that the Exchange Agreement may involve Metropolitan using the Colorado River Aqueduct to deliver blended Metropolitan water from any source in exchange for the transfer and canal lining water made available at Lake Havasu, or that a wheeler may wish to wheel water along the Colorado River Aqueduct only. *First*, San Diego asserted only facial challenges to Metropolitan's rates, making the specifics of particular transactions irrelevant. (*See, e.g.*, *Avenida San Juan P'ship v. City of San Clemente* (2011) 201 Cal.App.4th 1256, 1277.) *Second*, San Diego has already litigated—and lost—any argument that Metropolitan's postage-stamp rates are unlawful (*Metropolitan Water Dist. of Southern California v. Imperial Irrigation Dist.* (2000) 80 Cal.App.4th 1403, 1407-08, 1428-29 (*Imperial*)), and it has even successfully defeated a challenge to its own postage-stamp transportation rates. (*Rincon Del Diablo Mun. Water Dist. v. San Diego County Water Auth.* (2004) 121 Cal.App.4th 813, 824 (*Rincon*).)

The "central question" here thus is whether the superior court should have found, based on substantial evidence in the

administrative record, that Metropolitan acted reasonably in including its State Water Project transportation costs and its demand management costs in the Transportation Rates it charges to *all of its member agencies* within its full service rate and its wheeling rate. (27-AA-07452-53, 07496, 07516; 34-AA-09585-86; 34-AA-09589-90.) The answer to that question is "Yes."

(a) San Diego Has Not Refuted Metropolitan's Responsibility For Its State Water Project Transportation Costs

The State Water Project is part of Metropolitan's integrated conveyance system, and Metropolitan is responsible for its costs whether or not it obtains any State Water Project water. (*See, e.g.*, AOB 24-27, 61-74, 93-108; *see also* 58-AR2012-016583-87.) San Diego fails to show that Metropolitan is not responsible for these costs or that these costs are not reasonably allocated to transportation.

Misplacing reliance on *Metropolitan Water District of Southern California v. Marquardt* (1963) 59 Cal.2d 159 (*Marquardt*), San Diego argues that Metropolitan has no "ownership interest" in the State Water Project and thus no basis to allocate its State Water Project transportation costs to its Transportation Rates. (ROB 4.) But legal title is irrelevant here: Metropolitan "owns" its State Water Project transportation costs (independent of its State Water Project supply costs) because of its long-term contractual obligations. (*See* AOB 62-64, 69-74.)

San Diego mistakenly attributes to *Marquardt* the holding Metropolitan's State Water Project contract "is actually 'a contract for the furnishing of continued water service.'" (ROB 55, quoting *Marquardt*, *supra*, 59 Cal.2d 159 201.) In fact, *Marquardt* observed only that the contract "has a much greater resemblance to a contract for the furnishing of continued water service in the future" than an "agreement for the purchase of an interest in a water system on the installment plan." (*Marquardt, supra,* at pp. 201-02.) This statement in no way negates the clear differences between Metropolitan's State Water Project contract and a water supply contract—perhaps most strikingly that Metropolitan must pay State Water Project transportation costs *even if it receives no water*. (58-AR2012-016559, *accord* 2-AR2010-000402; AOB 63-65.)

Nor did *Marquardt* reject "as 'unsound' and 'unrealistic'" Metropolitan's argument that it owns the costs of the State Water Project, as San Diego erroneously suggests. (ROB 55.) *Marquardt* merely found it "unrealistic" and "unsound" to treat Metropolitan's State Water Project indebtedness as "the aggregate amount of all payments to be made throughout the entire term of the contract." (*Marquardt, supra,* 59 Cal.2d 159, 200-02.) *Marquardt* thus is fully consistent with Metropolitan's argument that it is responsible for the cost of the State Water Project's transportation facilities. *Goodman v. County of Riverside* (1983) 140 Cal.App.3d 900 (*Goodman*), confirms as much, for it acknowledged the unique financial responsibility that

State Water Project contractors like Metropolitan have for the cost of the State Water Project's transportation facilities (*id.* at pp. 909-10), but also expressly cited *Marquardt* (*id.* at p. 908).

San Diego offers no effective response to *Goodman*. *First*, San Diego suggests that Metropolitan waived reliance on *Goodman.* San Diego is wrong. (*See Giraldo v. California Department of Corrections and Rehabilitation* (2008) 168 Cal.App.4th 231, 251 ["We are aware of no prohibition against citation of new authority in support of an issue that was…raised below"], emphasis omitted.) Here, Metropolitan raised *Goodman* below in Phase II and in its motion for a new trial (34-AA-09500), and pressed the *precise* argument *Goodman* supports in the Phase I trial on San Diego's rate challenges. (*See, e.g.*, 26-AA-07184 ["[I]t is reasonable for [Metropolitan] to consider [State Water Project] transportation costs its *own* transportation costs"], emphasis in original.)

Second, on the merits, San Diego errs in contending that *Goodman* at most "means that Met[ropolitan] must pay its [State Water Project] bills to ensure continued water service." (ROB 55.) *Goodman* in fact recognizes that the State Water Project's contracts "require regular payments to the state in return for participation in the System" and that "[n]ot all the districts actually receive water, but all must make payments[.]" (*Goodman*, 140 Cal.App.3d 900, 904.) Indeed, San Diego offers no legal authority that would explain the relevance it attributes to legal title in light of *Goodman's*

interpretation of the State Water Contract. No authority exists that requires an agency to hold legal title to recover costs it incurs in connection with participation in a facility.

(b) The Factual Record Does Not Support San Diego Or The Superior Court's Findings

San Diego asserts six primary arguments based on the administrative record and other evidence, but none shows that Metropolitan's allocation of its State Water Project transportation costs to its Transportation Rates and wheeling rate was arbitrary and capricious or unsupported by substantial evidence:

(i) The RMI Reports

San Diego wrongly accuses Metropolitan of "resort[ing] to misrepresentation" regarding a series of reports prepared in 1995-1996 by Resource Management International, Inc. ("RMI"). (ROB 51-52.) As Metropolitan correctly stated in its opening brief, the October 1995 RMI report 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":

> Supply Function – Costs of operating and maintaining *water supply facilities, such as dams and associate reservoirs, wells, and desalination plants, and costs of purchasing water* from wholesale water suppliers.

> Transmission Function – *Costs of operating and maintaining the aqueducts to move water from sources of supply to major centers of demand*.

(4-AR2010-001112, emphasis added; AOB 67.) Nevertheless, San Diego contends that Metropolitan's characterization is "false" (ROB 52), claiming that the October 1995 report "allocated all of Met[ropolitan]'s [State Water Project] costs to the 'Supply Function.'" (ROB 21.) But San Diego's sole support for this claim is a section of the report that has nothing to do with how costs should be functionalized but rather describes the "major types of data" required to perform a cost-of-service analysis. (4-AR2010-001104 [including "Customer Sales and Billing Data," "Financial and Accounting Data," "Rate Schedules and Regulations," and "Policy Guidelines" as other "major types of data"].) And this section lists no transmission-related data at all—even though it is undisputed that Metropolitan incurs transmission-related costs—further confirming that the portion of the report San Diego is relying on has nothing to do with how costs should be functionalized.

San Diego also contends that a different RMI report issued in December 1995 "confirmed that all [State Water Project] costs…are 'Supply Costs.'" (ROB 52, emphasis omitted; *id.* at pp. 21-22.) But unlike the October 1995 RMI report, this report is not focused on a cost-of-service analysis, and the chart cited by San Diego is included to illustrate the allocation of Metropolitan's costs between fixed and

variable costs, not their functionalization in a cost-of-service analysis. (5-AR2010-1233-34.)[8]

Thus, RMI did not "conveniently change[] its tune" in May 1996 because of the announcement of San Diego's Transfer Agreement with the Imperial Irrigation District, as San Diego wrongly speculates. (ROB 52.) The May 1996 RMI report is fully consistent with the October 1995 RMI report. Just as the October 1995 RMI report functionalized "[c]osts of operating and maintaining the aqueducts to move water from sources of supply to major centers of demand" to transmission (4-AR2010-001112), so the May 1996 RMI report allocated Metropolitan's State Water Project transportation charges to Metropolitan's transmission function. (62-AR2012-016288_1904.) The RMI reports thus support Metropolitan's ratemaking decision and do not assist San Diego.

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[8] San Diego's selective quotation of the December 1995 RMI report as stating that State Water Project costs are "not incurred to provide wheeling service" (ROB 22) is misleading. The report actually states that *"[m]ember [a]gencies will likely argue that* the rate includes costs not incurred to provide wheeling service" if Metropolitan were to include such costs in one of the hypothetical wheeling rates considered in the report. (5-AR2010-001249, emphasis added.) RMI was not itself opining on the merits of that argument.

(ii) The 1969 Brown & Caldwell "Water Pricing Policy Study"

As it did in the superior court, San Diego relies heavily on a 1969 "Water Pricing Policy Study" by outside consultant Brown & Caldwell that it injected into the administrative record for the 2013-2014 rates (but not the 2011-2012 rates). San Diego contends this 47-year old study shows that Metropolitan "formerly allocated all of [its State Water Project transportation] costs to its 'Supply System' because the 'function of making water available' to Met[ropolitan] is a 'supply' function for Met[ropolitan]." (ROB 11-12, 21, citing 62-AR2012-16288_1743-46.) This 1969 study was a key basis for the superior court's erroneous decision. (27-AA-7504 [concluding that "[p]reviously, Met[ropolitan] allocated [State Water Project] costs to supply, and none to transportation (including the [State Water Project] costs that [the Department of Water Resources] bills as its own transportation costs). No reasonable basis appears in the record as to why this has changed"].)

Both San Diego and the superior court misinterpret and overstate the significance of this dated cost-of-service study. *First*, nothing in the Brown & Caldwell document suggests that Metropolitan ever allocated its State Water Project transportation costs to "supply rates" in lieu of "transportation rates"; Metropolitan did not have separate supply and transportation rates until nearly 35

years after Brown & Caldwell authored its report. (*See, e.g.*, 4-AR2010-0001133.)

Second, San Diego and the superior court in any event are making an apples-to-oranges comparison because Brown & Caldwell used different functional cost categories than Metropolitan was using three decades later when it unbundled its rates:

Brown & Caldwell used only four functional cost categories in its 1969 report: "Supply System," "Distribution System," "Water Treatment Facilities," and "Administrative and General Costs." (62-AR2012-016288_1744.) "Supply System" costs covered "facilities whose function is the delivery of water from the sources of supply to the [Metropolitan] distribution system," including the Colorado River Aqueduct and the State Water Project (excluding its terminal reservoirs). (*Ibid.*) The "Distribution System" picked up where the "Supply System" left off, moving water from Metropolitan's major conduits to the localized member agencies. (*Ibid.*)

Almost a quarter of a century later, however, a 1993 textbook by the leading expert on water rates, George A. Raftelis, endorsed additional functional cost categories. In addition to "Source of supply" and "Distribution," the Raftelis textbook included "Pumping and conveyance" and "Transmission" categories, which it described as follows:

> *Pumping and conveyance:* costs associated with pumping raw water from the source

> of supply and transferring it through a piping network for treatment
>
> *Transmission:* costs associated with transporting water from the point of treatment through a major trunk to major locations within the service area

(62-AR2012-016288_5291-92.) Thus, whereas Brown & Caldwell's categories lumped all costs of "facilities whose function is the delivery of water from the sources of supply to the [Metropolitan] distribution system" with "Supply System" costs, excluding only localized distribution costs (62-AR2012-016288_1744), costs related to the conveyance of water through "major trunk[s] to major locations within the service area" were properly allocated to the "Transmission" functional cost category recognized by at least 1993. (62-AR2012-016288_5291-92.) Supply costs now ended at the *source* of supply, and supply *system* costs—*i.e.*, the costs for the transportation system, excluding the localized distribution network—were now allocated to "Pumping and conveyance" and "Transmission." (*Ibid.*)[9]

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[9] San Diego claims that the Raftelis textbook "explained…that 'water right purchases' are *'supply'* costs" but fails to mention the "Pumping and conveyance" or "Transmission"

By 2010, when Metropolitan enacted the first rates challenged below, Metropolitan's functionalized cost categories included "Supply," "Conveyance and Aqueduct," "Storage," "Treatment," "Distribution," "Demand Management," "Administrative and General," and "Hydroelectric." (40-AR2010-011474-75.) The "Conveyance and Aqueduct" category hews closely to the "Transmission" category described in the 1993 Raftelis textbook, encompassing costs related to the water source facilities (i.e., the State Water Project and Colorado River Aqueduct facilities) "that convey water to Metropolitan's internal distribution system." (*Ibid.*)

Thus, it simply is not true that the record reflects "[n]o reasonable basis" for costs that were allocated to "Supply System" by Brown & Caldwell in 1969 to later be allocated to "Conveyance and Aqueduct" and, consequently, Metropolitan's Transportation Rates and wheeling rate. The functionalized cost categories themselves had changed.

Indeed, it was not only the State Water Project transportation costs that shifted from Brown & Caldwell's "Supply System"

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categories. (ROB 22.) When these three categories are considered together, it is clear that "water right purchase" costs stop at the supply source.

category to the "Conveyance and Aqueduct" category in Metropolitan's later cost-of-service studies: The 1969 Brown & Caldwell study allocated to the "Supply System" category 90% of operating expenses (excluding water purchases) for the Colorado River Aqueduct in 1967-1968, and 100% of 1979-1980 and 1989-1990 estimated expenses (62-2012-AR-16288_1745-46); these are now all also functionalized as "Conveyance and Aqueduct" costs and are thus allocated to Metropolitan's Transportation Rates and wheeling rate. Not even San Diego contends this is improper. Metropolitan's State Water Project transportation costs and its Colorado River Aqueduct transportation costs were functionalized similarly by Brown & Caldwell in 1969; it only makes sense that they are functionalized similarly today.

(iii) NARUC Accounting Guidance

San Diego also cites to "accounting standards" from the National Association of Regulatory Utility Commissioners ("NARUC"), contending that it "dictate[s] that the category for supply costs 'shall include the cost at the point of delivery of water purchased for resale,'" and that this "'includes charges for readiness to serve and…payments for the right to divert water at the source of supply.'" (ROB 22, citing 62-AR2012-16288_1757, 1-RA-60.) Thus, San Diego claims, "Met[ropolitan]'s litigating position is inconsistent with the NARUC accounting standards Met[ropolitan] purports to follow." (ROB 54.)

NARUC has developed a uniform system of accounts to be used by regulated utilities, primarily retail utilities. In fact, Metropolitan does not claim to strictly follow NARUC accounting guidance, but rather explains that, "[b]ecause all water utilities are not identical, the rate structure reflects Metropolitan's unique physical, financial, and institutional characteristics." (40-AR2010-11474.) Indeed, NARUC accounting guidance is not applicable to *public* water agencies in California like Metropolitan, which is governed by its Board and applicable law; NARUC's accounting guidance applies to regulated utilities and is a tool that "allows regulators to distinguish capital expenditures from operating and maintenance expenses and to separate utility activities from nonutility operations." (3-ARA-0755-56; 15-AR2010-003904 [noting NARUC accounting system "can be modified" for government-owned utilities]; 31-RT-1904:12-1905:1.) In any event, "rates should reflect cost causation and not be determined by replication of the fixed and variable nature of costs from an accounting or budgeting perspective." (4-ARA-1021; *see also* 15-AR2010-003997-3998.)[10]

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[10] Consistent with various rate-setting authorities, Metropolitan uses the term "cost causation" to refer to the functionalization of costs—not to a requirement that all costs be

(iv) The State Water Project Contract

Ignoring all of the aspects of Metropolitan's State Water Project contract that confirm the reasonableness of Metropolitan's allocation of its State Water Project transportation costs to its Transportation Rates and wheeling rate (*see* AOB 62-65), San Diego argues that the State Water Project contract confirms the contrary because, under the contract, the Department of Water Resources "only charges Met[ropolitan] 'incremental costs' for wheeling.'" (ROB 51.) But this is incorrect. Pursuant to Article 55 of the contract, the Department of Water Resources only charges *contractors* for the "incremental costs" for wheeling within those portions of the State Water Project transportation facilities from which they would normally receive deliveries. But that is specifically because those contractors already pay for the other transportation-related costs associated with these facilities, such as capital, under Articles 23-29 of the contract. (*See, e.g.*, 1-AR2010-000074-89, 000153 [Arts. 23-28, Art. 55, subd. (a), (b)].) Metropolitan's member agencies, including San Diego, are not

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individually allocated to each specific user *proven* to cause each specific cost, as San Diego suggests. (*See* Section I.C.2(a)(ii), *infra*.)

contractors and receive access to State Water Project water and facilities through Metropolitan. (*See* AOB 65.)

(v) The 2010 Raftelis Report

San Diego urges the Court to ignore a 2010 report by Raftelis Financial Consulting that endorses Metropolitan's allocation of its State Water Project transportation costs to its Transportation Rates and its wheeling rate (*see* AOB 67-68), contending that it was "suborned" by Metropolitan's June Skillman. (ROB 35.) This attack is unfounded. Ms. Skillman provided Raftelis background information regarding how Metropolitan conducts its cost-of-service analyses and sets its rates, including that it functionalizes its State Water Project costs in the same way they are itemized on the invoices Metropolitan receives from the State.[11] That language was

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[11] It is common practice for agency staff to provide background information to independent rate consultants for the preparation of a rate study. (*See Morgan v. Imperial Irrigation Dist.* (2014) 223 Cal.App.4th 892, 916 [court validated water rates, supported by independent rate study that "relied on the District's data when preparing the Cost of Service Study"]; *see also Moore v. City of Lemon Grove* (2015) 237 Cal.App.4th 363, 374 (*Moore*) [court validated sewer rates, supported by independent rate study that used revenue, expenditures, and past and projected expenditure information prepared by city staff].)

included in part in Section IV of the report ("Overview of FY 2010/11 Cost of Service ('COS') and Rate Setting Process"), which simply explains how Metropolitan functionalizes its costs and arrives at its rates. (1-RA-278-79; 31-RT-1907:4-1910:24; 40-AR2012-011317-18, 011322-23.) Neither Ms. Skillman, nor anyone else at Metropolitan, provided language for Section V, which sets forth opinions finding Metropolitan's methodologies and rates are consistent with the law and industry guidelines. (40-AR2012-011322-23; 31-RT-1907:4-1910:24.)

(vi) San Diego's Litigation-Driven Expert Opinions

Finally, San Diego relies on various letters from Bartle Wells Associates that it commissioned just months before filing suit and a report drafted in March 2012 for San Diego by FCS Group, which repeat nearly verbatim San Diego's litigation position. (*See* ROB 22, citing 39-AR2010-11208-09.) San Diego contends these litigation-driven reports show that "[t]he 'other [State Water Project] contracting agencies'… allocate [State Water Project] costs as supply costs." (*Ibid*.) But San Diego's experts reviewed the cost allocations of only three of *dozens* of State Water Project contractors, which may be very differently situated than Metropolitan. Because the experts did not identify or provide any details regarding the three they did consider, there is no foundation for any conclusion that those selected contractors are representative of the whole. (39-AR2010-

011209.) Whatever weight these reports merit given the paucity of the sample and the circumstances in which the report was created, the existence of some contradictory data in the record is not helpful to San Diego.

For all these reasons, San Diego fails to negate the substantial evidence supporting Metropolitan's inclusion of its State Water Project transportation costs in its Transportation Rates and wheeling rate.[12]

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[12] San Diego's misplaced reliance on extra-record and irrelevant sources requires little response. For example, San Diego cites the extra-record and concededly "'opinionated'" *Cadillac Desert* (ROB 18, quoting *Capistrano Taxpayers Assn., Inc. v. City of San Juan Capistrano* (2015) 235 Cal.App.4th 1493, 1497 (*Capistrano*)), solely for purported facts regarding Metropolitan's prior opposition to the State Water Project, which has no bearing on any fact in this case. Similarly, San Diego criticizes Metropolitan for failing to cite *Arizona v. California* (1963) 373 U.S. 546 (*Arizona*), which it contends "is essential for understanding this case." (ROB 20.) But the superior court did not mention *Arizona* once in 95 pages of Statements of Decision (27-AA-07452-7518; 34-AA-09461-09490), and San Diego devoted scant attention to *Arizona* in its Phase I pre- and post-trial briefing (*e.g.*, 7-AA-001743-82; 26-AA-07282-349). Nothing in *Arizona* suggests that Metropolitan's allocation of its State Water Project transportation costs is unreasonable.

(c) San Diego's "Protectionism" Arguments Are Irrelevant And Unsupported

San Diego's insinuations that Metropolitan engages in "protectionism" by allocating its State Water Project transportation costs to its Transportation Rates and wheeling rate are meritless. (ROB 12-13.) Metropolitan has a legitimate concern to ensure that its member agencies do not bear a disproportionate share of Metropolitan's costs in the construction, operation, and maintenance of its vast conveyance system. Metropolitan's water purchasers should not be forced to absorb *all* of the costs of the conveyance system's facilities, while wheelers wheel up and down the California Aqueduct for nothing more than the price of the power used. To the contrary, a court has expressly rejected the notion of such a forced cross-subsidy in the context of rates subject to Proposition 218. (*Green Valley Landowners Assn. v. City of Vallejo* (2015) 241 Cal.App.4th 425, 439 [Proposition 218's proportionality requirement "prohibits a rate structure… that requires one group of customers to essentially subsidize another"].)

Even if San Diego's accusations of protectionist motivations were relevant,[13] they are factually baseless, as examination of San Diego's misleading quotation of the record illustrates. For example, San Diego quotes from a wheeling work plan to suggest Metropolitan adopted "'a far different strategy'" because "San Diego was 'the only 'likely' wheeler." (ROB 12, citing 62-AR2012-17126_0070, 73.) But the quoted work plan is actually discussing a strategy for an upcoming internal Metropolitan working group meeting on December 4, 1995, not wheeling generally. (62-AR2012-17126_0068, 73.) Similarly, San Diego quotes from the work plan to argue that Metropolitan had adopted a "'strategy'" to "'assign[] all system and financial risk to potential wheeling parties.'" (ROB 12). But the work plan did not reflect that Metropolitan had adopted any "strategy" for wheeling; its purpose was to consider different strategies, and the internal quotes are from a draft position paper merely advancing a policy "proposal." (62-AR2012-17126_0070.)

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[13] They are not. "So long as a reasonable basis" exists for an agency's quasi-legislative determination, "the motivating factors considered in reaching the decision are immaterial." (*Stauffer Chem. Co. v. Air Resources Bd.* (1982) 128 Cal.App.3d 789, 794-95; *see Davies v. Contractors' State License Bd.* (1978) 79 Cal.App.3d 940, 951 [court may not inquire into the reasoning process of the Board members].)

San Diego similarly distorts Metropolitan's Resolution 8520, suggesting that it "'finds' that it is 'necessary' to include 'unavoidable costs attributable to Metropolitan's supply,' *including [State Water Project] costs*, in its wheeling rate" for supposedly protectionist reasons. (ROB 26, emphasis added.) But Resolution 8520 did *not* determine that State Water Project transportation costs were *supply* costs; to the contrary, it noted that its allocation of costs

> to Metropolitan's transmission function accurately reflects the capital, operation, maintenance and replacement costs incurred by Metropolitan to convey water to its member agencies, through Metropolitan's conveyance system, including Metropolitan's rights in the State Water Project system, and that including those costs in Metropolitan's wheeling rate is necessary to insure recovery of fair compensation for the use of that conveyance system.

(9-AR2010-02449 § 5.)

3. Metropolitan's Allocation Of The Water Stewardship Rate To Its Transportation Rates And Wheeling Rate Is Reasonable

San Diego argues for the first time on appeal that the Water Stewardship Rate may not be charged to transportation *or* supply because it generates general revenue and is thus an unconstitutional tax. (ROB 55-59.)[14] This argument is baseless.

To begin with, San Diego misrepresents *California Farm Bureau Federation v. State Water Resources Control Board* (2011) 51 Cal.4th 421, 438 (*Cal. Farm Bureau*). That decision does not hold that "a rate 'used to generate general revenue becomes a tax.'" (ROB 56.) To the contrary, *California Farm Bureau* in fact states only that an *excessive* fee becomes a tax:

> Thus, permissible 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

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[14] This is not surprising: San Diego is the largest purchaser of Metropolitan's full service water (29-RT-1553:6-22), and it would undoubtedly prefer not to pay the Water Stewardship Rate at all.

> used for general revenue collection. *An excessive fee* that is used to generate general revenue becomes a tax.

(*Cal. Farm Bureau, supra,* 51 Cal.4th 421, 438 [emphasis added].) San Diego's reference to "general revenue" in the abstract is meaningless without consideration of the *cost of the service* for which the rate is charged. (*See ibid*.)

Metropolitan charges two rates for two services: the full service rate for full service water and the wheeling rate for wheeling service. (27-AA-07460.) The full service rate includes the three Transportation Rates (the System Access Rate, System Power Rate, and Water Stewardship Rate) along with the Supply Rates. The wheeling rate includes two of the Transportation Rates (the System Access Rate and Water Stewardship Rate).[15] Metropolitan cannot be

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[15] Metropolitan's wheeling rate applies only to member agencies, for wheeling transactions up to one year. (AOB 32.) Third-party wheeling, and wheeling to member agencies for more than a year, are governed by individual contracts between Metropolitan and the wheeling party.

found to charge an "excessive fee" for "water stewardship" services, which it does not separately offer.[16]

The relevant inquiry for purposes of San Diego's new "excessive fee" argument is thus whether it is reasonable to allocate water stewardship costs to the full service rate that member agencies pay to purchase full service water and to the wheeling rate that member agencies pay to purchase wheeling service. The answer to that question is "Yes" as to both services. Metropolitan has quantified that its demand management programs avoid, reduce, and defer transportation-related expenses that would otherwise be passed onto purchasers of full service water and wheeling service through the cost of conveyance. (AOB 76-79.) Demand

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[16] In any event, even if considered on a standalone basis, any accusation that the Water Stewardship Rate is an "excessive fee" is factually baseless. The Water Stewardship Rate does not exceed demand management program costs and revenues from that rate are not treated as general revenues. To the contrary, revenues from the Water Stewardship Rate are earmarked for the "Water Stewardship Fund," as made clear in the exhibits Metropolitan's Mr. Upadhyay was discussing in the testimony cited by San Diego. (5-ARA-1298-99; 31-RT-1805:19-1808:14, 1848:24-1849:16; *see also, e.g.*, 3-ARA-0677-78 ["Water Stewardship Rate revenues exceeded costs by $1,617,848 during 2010/11. This amount should be transferred to the Water Stewardship Fund"].)

management programs reduce the need to import water into the service area and increase capacity for system use by wheelers and other water transferors (AOB 79-80), which if anything benefits wheelers more than full service purchasers, since wheeling occurs only when there is availability in the conveyance system. Thus, by functionalizing the Water Stewardship Rate as a volumetric Transportation Rate, Metropolitan ensures that member agencies pay the Water Stewardship Rate in direct proportion to the benefit they receive from using Metropolitan's infrastructure.

San Diego does not refute this record evidence. It simply quotes the superior court's conclusions, which showed no deference to Metropolitan's Board and which are all premised on the superior court's erroneous finding that demand management programs have supply-related benefits to Metropolitan.[17]

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[17] San Diego misleadingly cites references to the Water Stewardship Rate or demand management programs in general proximity to the word "supply," without explaining that the reference is not to *Metropolitan's* water supply, but to local supplies. (ROB 57 fn. 6, citing, *e.g.*, 39-AR2010-11207-14 [Water Stewardship Rate "provid[es] subsidies for development of *local water supplies and conservation programs*…."], emphasis added; 25-AA-6932:3-22 [similar]; 40-AR2010-11393-400 [similar]; 57-AR2012-16215-16 [Water Stewardship Rate incentivizes local water supply development]; 22-

As to San Diego's glancing references to Metropolitan's allocation of water stewardship costs between the Transportation Rates and the Supply Rates, that allocation makes no difference for full service water because each member agency pays the total full service rate if it purchases water. The allocation between the transportation and supply functions is relevant only to the wheeling rate, since the Supply Rates are not part of the wheeling rate. But when member agencies pay the Water Stewardship Rate as one component of both the full service rate and the wheeling rate, they do so only in direct proportion to the full service water they purchase or the amount of non-Metropolitan water they wheel through Metropolitan's system, because each rate is charged on a volumetric basis. Thus the allocation provides no basis for San Diego's new argument.

San Diego also lambasts the Water Stewardship Rate as funding a discretionary "slush fund" that Metropolitan uses to reward or, in San Diego's case, punish member agencies. (ROB 56.)

AA-6157-64, emphasis included [noting purpose of Local Resources Program agreement was to "increase regional water supply reliability by replacing demand for imported water supplies and increasing groundwater production…."].)

But this is fiction. Facilitating demand management is not discretionary: Metropolitan has a legislative mandate to "expand water conservation, water recycling, and groundwater recovery efforts." (Wat. Code appen., § 109-130.5, subd. (a)(2); 10-AA-02526-62.) Moreover, there is no basis for San Diego's claim that it "has only been getting the stick" instead of the "carrot" because of the Rate Structure Integrity ("RSI") provision in Metropolitan's demand management program contracts. For example, in 2007, 2008, and 2010, San Diego was the *third* highest recipient of demand management program funding; and in 2009, it was the *second* highest recipient. (22-AA-06192.) Even after San Diego triggered the RSI provision by challenging Metropolitan's rates, Metropolitan terminated only two of its six contracts with San Diego containing this provision, and it continued to fund those programs that provide incentives to residents and businesses in San Diego's service area. (31-RT-1802:11-1804:10.) As of June 2013, San Diego had received approximately $114 million in demand management program funding. (31-RT-1802:7-13.)

Finally, San Diego argues that Metropolitan "cannot possibly carry its burden of proving that its Water Stewardship Rate bears 'a fair or reasonable relationship' to…San Diego's 'burdens on, or benefits received from,' Met[ropolitan]'s transportation of water under the Exchange Agreement," under Proposition 26. (ROB 56-

57.) Metropolitan addresses this argument further in Section I.C.2(a), *infra.*

4. Metropolitan's Transportation Rates And Wheeling Rate Do Not Violate The Wheeling Statutes, Government Code Section 54999.7(a), Or The Common Law

San Diego contends that Metropolitan does not contest the superior court's "factual findings" under the Wheeling Statutes and, thus that these findings are "'conclusive' and 'binding' on appeal." (ROB 67.) It makes the same argument with respect to the superior court's findings under section 54999.7, subdivision (a) of the Government Code. (*Id.* at 73.) Both arguments are frivolous. Metropolitan *did* challenge the superior court's findings that it was not reasonable to allocate Metropolitan's State Water Project transportation costs or demand management program costs to its Transportation Rates and wheeling rate—under the Wheeling Statutes, the common law, Section 54999.7(a), and Proposition 26.

(AOB 61-85, 94-100.) In any event, these are legal findings, not factual findings, and accordingly are subject to de novo review.[18]

San Diego errs in contending that *San Luis Coastal Unified School District v. City of Morro Bay* (2000) 81 Cal.App.4th 1044, 1050 (*Morro Bay*) supports its challenge to Metropolitan's wheeling rate under the Wheeling Statutes. San Diego argues that *Morro Bay* conclusively rejected Metropolitan's premise, expressed in Resolution 8520, that it could protect its member agencies "from financial injury" caused by "the shifting of [unavoidable] costs from a wheeling party to Metropolitan's other member agencies." (ROB 70-73.) San Diego is wrong for two reasons:[19]

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[18] In contrast, the "binding" factual determination in *City of South Gate*, cited by San Diego (ROB 67), was a "*foundational* matter of fact" relating to the requirements for an environmental impact review under the California Environmental Quality Act (CEQA). *City of South Gate, supra*, 184 Cal.App.3d 1416, 1422, 1426-27.)

[19] San Diego is also wrong about the chronology: although it contends that Metropolitan unbundled its rates and dismissed the *Imperial* case in response to *Morro Bay* (ROB 27), *Morro Bay* issued in June 2000, so it could not have caused unbundling that was already underway in February 2000, before it issued. (*See, e.g.*, 17-AR2010-004399-4409; 17-AR2010-004771.)

First, *Morro Bay* is inapposite. In *Morro Bay*, the defendant denied the plaintiff school district access to its conveyance system to wheel third party water because it did not want to lose the school district as a water supply customer, which would drive up rates for the defendant's other water customers. (*Morro Bay*, *supra,* 81 Cal.App.4th 1044, 1050.) The defendant argued that it was not required to permit wheeling because the loss of sales would injure its other customers in violation of Water Code section 1810(d), which provides that wheeling under the statute "is to be made without injuring any legal user of water and…without unreasonably affecting the overall economy or the environment of the county from which the water is being transferred." (*Ibid.*, quoting Wat. Code, § 1810, subd. (d).) The court of appeal rejected this argument, finding that "the loss of income from a customer is [not] the sort of injury to a legal user of water the Legislature had in mind." (*Ibid.*) Thus, "[n]othing in the statutory scheme gives [defendant] the right to *deny* the school district the use of its water conveyance system because it wants more money." (*Ibid.*, emphasis added.)

Here, by contrast, Metropolitan is not *denying* any wheeler access to its conveyance system, it is merely seeking the "fair compensation" for the use of the system that section 1810 requires. "Fair compensation" includes "the reasonable charges incurred by the owner of the conveyance system, including capital, operation, maintenance, and replacement costs, increased costs from any

necessitated purchase of supplemental power, and including reasonable credit for any offsetting benefits for the use of the conveyance system." (Wat. Code, § 1811, subd. (c).) *Morro Bay* did not address whether any specific costs were properly recovered under this broad definition of "fair compensation," and instead remanded to permit the defendant to make the factual determinations required by the Wheeling Statutes that it had not previously made in light of its outright denial of access. (*Morro Bay, supra,* 81 Cal.App.4th 1044, 1050-51.) *Morro Bay* certainly did not hold that system-wide costs may not be included in a wheeling rate or that water purchasers must subsidize wheelers. (*Accord Imperial, supra,* 80 Cal.App.4th 1403, 1428-31 [system-wide costs recoverable under Wheeling Statutes].)

Second, as noted above, it is Metropolitan's wheeling ratemaking determination—not Resolution 8520 in isolation—that is reviewed for compliance with the Wheeling Statutes based on all relevant evidence. (Wat. Code, § 1813.) For the reasons set forth in Sections I.B.2 & I.B.3, *supra*, Metropolitan's wheeling rate is "fair compensation" for wheeling and not invalid under the Wheeling Statutes.

C. Proposition 26 Does Not Apply And, Even If It Did, Its Requirements Have Been Satisfied

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

San Diego contends that the superior court's determination that Metropolitan's rates are "imposed" within the meaning of Proposition 26 is binding because it was "based on findings of fact." (ROB 59.) That is incorrect. Whether Metropolitan's rates are "imposed" within the meaning of Proposition 26 is a question of constitutional construction, which is a question of law reviewed de novo. (*Cal. Farm Bureau, supra*, 51 Cal.4th 421, 436.)

The law does not support San Diego's argument. *Williams Communications, LLC v. City of Riverside* (2003) 114 Cal.App.4th 642 (*Williams*), does not "explicitly reject" Metropolitan's argument that its rates are not imposed. (ROB 62.) In that case, the court never sought to interpret the meaning of the word "imposed" in the context of Proposition 26, or in the context of "taxes" generally. Instead, the court rejected the defendant city's contention that it "could charge rent or an easement or license fee" for the plaintiff telephone company's use of its streets to install infrastructure, even though a law prohibited any charge or fee for use of streets for telephone service. (*Williams, supra,* 114 Cal.App.4th 642, 655-56.)

Bighorn-Desert View Water Agency v. Verjil (2006) 39 Cal.4th 205, 214-17 (*Bighorn-Desert*) is similarly inapposite. *Bighorn-Desert*

concerned retail water, so its holding did not turn on whether retail water service rates were "imposed" but rather on whether they were "a user fee or charge for a property related service"—an issue specific to Proposition 218.

Finally, *Newhall*, *supra*, 243 Cal.App.4th 1430 does not "confirm" that Proposition 26 applies to all wholesale water rates. The defendant in *Newhall* did not argue that its fees were not "imposed" within the meaning of Proposition 26. (*Newhall, supra,* 243 Cal.App.4th 1430, 1433-1434.) Nor was the defendant agency in *Newhall* a voluntary cooperative. (*See id.* at p. 1434.)[20]

Even if treated as a question of fact, Metropolitan's rates are not "imposed" within the meaning of Proposition 26. The superior court ignored all evidence elicited by Metropolitan demonstrating that its rates were not imposed. (*See* ROB 60, quoting 27-AA-7499; *see also* AOB 89-90 [Metropolitan's rates are set by its rate payors and participation is voluntary].) Instead, the court relied on a statement in the 2012 Official Statement to Metropolitan's bondholders that

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[20] *Robinson v. Magee* (1858) 9 Cal.81 also does not assist San Diego. That contract rights are constitutionally guaranteed and protect against "savagery" (ROB 61) has nothing to do with whether Metropolitan's rates are "imposed" for purposes of Proposition 26.

"[n]o facilities exist to deliver water directly from [the Imperial Irrigation District] to [the San Diego County Water Authority]" to conclude that Metropolitan "imposes" its rates. (27-AA-7499, citing 58-AR-2012-16509; *see also* ROB 60, citing 28-RT-1371:20-1372:4.)[21] But just because Metropolitan currently has the only existing facilities San Diego could use to exchange its transfer water from Imperial and its canal lining water does not mean that Metropolitan "imposes" rates on its 26 member agency customers. That is a question determined by Metropolitan's statutory governance structure—not the specific options San Diego had open once it voluntarily joined that cooperative. (*See Griffith v. Pajaro Valley Water Mgmt. Agency* (2013) 220 Cal.App.4th 586, 597-598 (*Pajaro*

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[21] The superior court also relied on resolutions and other materials in the record that used the word "impose" in relation to Metropolitan's rates. But the use of "impose" in Metropolitan's documents is not determinative for purposes of construing the same term as it appears in Proposition 26. (*Cf. Weekes v. City of Oakland* (1978) 21 Cal.3d 386, 392 [character of tax "ascertained from its incidents, not its label"].) The portion of the State Assembly Committee on Water's report quoted by San Diego in further support of the superior court's erroneous conclusion (ROB 61) is merely a plea for more data and "an understanding of the long-term, future pricing problems of the District" that sheds no light on any relevant issue. (20-AA-5564.)

Valley)[22] [reviewing agency's enabling act to determine scope of agency's service and reasonableness of its fees]; *see also Newhall*, *supra*, 243 Cal.App.4th 1430, 1441-1442 [same].) Moreover, San Diego made other voluntary choices after joining Metropolitan: it could have chosen to build its own means of conveying water from Imperial or to develop other local water sources (e.g., desalination), so that it would not have to rely on Metropolitan at all. Emphasizing that San Diego was not without options, San Diego expressly reserved the right to permanently reduce the amount of water it exchanged under the Exchange Agreement by any amount it chose to transport through "Alternative Facilities," i.e., non-Metropolitan facilities. (22-AA-06124, 06136 §§ 1.1(c), 3.7.) Unlike a retail water service, Metropolitan has no exclusive right to serve in its service area. (58-AR2012-016587; Wat. Code appen., § 109-130.)

The Exchange Agreement—a voluntary contract between San Diego and Metropolitan—further shows that Metropolitan's rates were not "imposed" in that transaction. San Diego proposed and

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[22] Although this case is sometimes referred to as "*Griffith II*," Metropolitan refers to it as *Pajaro Valley* in order to distinguish it from the earlier decision in *Griffith v. Santa Cruz* (2012) 207 Cal.App.4th 982 (*Griffith*). (AOB 12.)

selected the price term in the 2003 Exchange Agreement, based on Metropolitan's Transportation Rates. The price did not need to be based on Metropolitan's rates at all; the 1998 Exchange Agreement used a fixed dollar amount not based on rates, which adjusted over time and would have remained in place for decades. Yet San Diego voluntarily sought to and succeeded in changing the price to one based on Metropolitan's rates in 2003.[23]

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[23] San Diego negotiated Metropolitan's exchange of its transfer water from Imperial to San Diego for $90 per acre-foot, with limited yearly increases and subsequent reductions, regardless of the amounts of Metropolitan's rates. (11-AA-02839 § 5.2; 11-AA-02865.) It was *San Diego* that proposed changing this price term to one based on Metropolitan's Transportation Rates in exchange for Metropolitan's $235 million legislative appropriation for canal lining and other projects and its rights to 77,000 acre-feet per year of conserved canal lining water for 110 years, and it was *San Diego* that ultimately elected to change the price term when Metropolitan left the final decision to it. (14-AA-03849-50; 41-RT-2660:1-2662:5; 32-AA-09031 § 4A.1.) Although San Diego now attempts to portray the change in price term as a mutual decision (*e.g.*, ROB 31-33), it admits that it *requested and chose* to pay Metropolitan's rates as the contract price rather than maintain the 1998 price term.

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

(a) Metropolitan's Rates Are Reasonable Payor-Specific Charges Under The (e)(2) Exception

(i) San Diego's Waiver Argument Is Frivolous

San Diego contends that Metropolitan waived any argument that its rates fall within the subdivision (e)(2) exception for payor-specific government services or products because Metropolitan failed to raise it at trial, exploiting imprecise language in the superior court's order on Metropolitan's motion for new trial. (ROB 62-63.) San Diego knows this is not true: San Diego devoted nearly 5 pages of its Phase I post-trial brief to a section entitled "Met[ropolitan] has not met its burden to prove that Exception 2 applies." (26-AA-7300-7305; *see also* 26-AA-07179-81; 7-AA-01714; 6-AA-01633 fn. 6; 27-AA-07499.) San Diego's waiver argument is frivolous.[24]

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[24] As in its opening brief, Metropolitan limits its analysis to the (e)(2) exception, but its analysis applies equally to the (e)(1) exception for government "benefit[s] or privilege[s]." Metropolitan

(ii) Proposition 26's (e)(2) Exception Does Not Require Payor-By-Payor Proportionality

Proposition 26 provides an exception for payor-specific charges for government products and services so long as they are provided directly to the payor but not to those not charged and they do not "exceed the reasonable costs to the local government of providing the service or product." (Cal. Const., art. XIIIC, § 1, subd. (e)(2).) San Diego contends that, under *Newhall*, *supra,* 243 Cal.App.4th 1430, *Capistrano, supra,* 235 Cal.App.4th 1493, and other cases, the cost of service must be allocated proportionally to the benefit obtained by each particular rate payor. That is wrong. To the contrary, cost of service requires only that rates be reasonable as to rate payors collectively (*see* AOB 96-100).[25]

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has already acknowledged that it first raised this exception in its motion for a new trial. (AOB 95 fn. 20). Because this Court "review[s] de novo the question whether the challenged rates comply with constitutional requirements" (*Newhall*, *supra*, 243 Cal.App.4th 1430, 1440) this Court may consider it on appeal. (*See, e.g., Hoffman-Haag v. Transamerica Ins. Co.* (1991) 1 Cal.App.4th 10, 15-16.)

[25] Metropolitan has consistently argued that the subdivision (e)(1)-(e)(3) exceptions (Cal. Const., art. XIIIC, §1, subd. (e)(1)-(3)) are

Newhall: San Diego misplaces reliance on the Second District's decision in *Newhall*, which involved facts that were "extreme" and "unusual." (*See* Appellants' Request for Judicial Notice, Ex. A, at 1.) *Newhall* is at best *sui generis* and, if its analysis were applied more broadly, wrongly decided. (*See* Respondent's Request for Judicial Notice, Ex. A, at 1-2.) In any event, *Newhall* is not binding on this Court. (*Jessen v. Mentor Corp.* (2008) 158 Cal.App.4th 1480, 1490 fn. 10.)

In *Newhall*, the defendant was a wholesale water supplier formed under its own specific enabling act that served four retail agencies in the Santa Clarita Valley: the plaintiff, two retailers that the defendant wholesaler owned and/or operated, and a fourth retailer that accounted for less than 2% of the water demand. (*Newhall*, *supra*, 243 Cal.App.4th 1430, 1433-34, citing Wat. Code

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limited by cost of service, which "is viewed in the aggregate, or in other words, measuring all rate payors together." (*See, e.g.*, 26-AA-07174-75; 27-AA-07431-34.) Metropolitan has also consistently stated that the common law, applicable to Metropolitan's rates, requires no more than reasonableness, with cost of service being one but not the only reasonable approach. (*See, e.g.*, 7-AA-01693-94; *Hansen v. City of San Buenaventura* (1986) 42 Cal.3d 1172, 1180-81 (*Hansen*); *County of Inyo v. Pub. Utilities Comm'n* (1980) 26 Cal.3d 154, 159 (*Inyo*).)

appen., § 103-15.) The defendant wholesaler supplied 83% of water demand through its two retailers, and its "stated vision [wa]s to manage all water sales in the Santa Clarita Valley, both wholesale and retail." (*Ibid.*) The plaintiff received 30% of its water supplies from the defendant and the rest from local groundwater sources. (*Id.* at pp. 1435-36.) The retailers operated by the defendant were more dependent on imported water supplies. (*Ibid.*)

The challenge arose after the defendant switched from a "'100 percent variable' rate structure" for its sale of imported water, under which the defendant "charged on a per acre-foot basis for the imported water sold" (*id.* at p. 1437), to a new rate structure under which the defendant imposed (1) a fixed charge "based on each retailer's three-year rolling average of total water demand (that is, its demand for the Agency's imported water *and* for groundwater not supplied by the Agency)"; and (2) a volumetric charge based on a per acre-foot charge for imported water only (*id.* at pp. 1437-38, emphasis in original).

Newhall concluded that the new rates violated Proposition 26. The court held that a fixed fee based on the retail agency's consumption of water bore no reasonable cost-of-service relationship to the defendant's supply of imported water because it was in significant part based on "demand for a product the Agency does not supply—groundwater." (*Id.* at p. 1442.) *Newhall* did not need to go any further.

But *Newhall* did go further, and imposed an additional "proportionality requirement": namely, that rates be set pursuant to a "method of allocation" that "bear[s] a fair or reasonable relationship to the payor's burdens on, or benefits received from,' the Agency's activity." (*Id.* at 1441, citing art. XIII C, § 1, subd. (e), final par.)

This "proportionality requirement" derives not from subdivision (e)(2), but rather from an unnumbered paragraph that appears in Proposition 26 after the seven enumerated exceptions to the definition of a special tax:

> The local government bears the burden of proving by a preponderance of the evidence [i] that a levy, charge, or other exaction is not a tax, [ii] that the amount is no more than necessary to cover the reasonable costs of the governmental activity, and [iii] that the manner in which those costs are allocated to a payor bear a fair or reasonable relationship to the payor's burdens on, or benefits received from, the governmental activity.

(Cal. Const., art. XIIIC, § 1, subd. (e) [bracketed numerals added for ease of reference].) But this unnumbered paragraph merely establishes the burden of proof for various elements of the exceptions; it does not graft substantive requirements onto all of the exceptions listed above it.

Clause [iii] does not apply to the (e)(2) exception, as *Newhall* erroneously held. Proposition 26 incorporated "nearly verbatim" specific language from prior case law and statutory law. (*See Griffith, supra,* 207 Cal.App.4th 982, 996.) Pre-Proposition 26 judicial interpretations of language tracking the language of the Proposition 26 exceptions are binding for purposes of interpreting Proposition 26. (*See Southern California Edison Co. v. Public Utilities Com.* (2014) 227 Cal.App.4th 172, 197-198].) Under this principle, not all the clauses in the unnumbered paragraph apply to each of the exceptions.

To be sure, the general language in clause [i] requiring an agency to prove that "a levy, charge, or other exaction is not a tax" applies to all seven exceptions. But the language in clause [ii], which requires an agency to prove that a charge is "no more than necessary to recover the reasonable costs of the governmental activity," tracks language previously used only to determine the reasonableness of user fees—the subject of the (e)(2) exception. (*See Rincon, supra,* 121 Cal.App.4th 813, 823 [applying requirement of Gov. Code, § 66013, subd. (a) that "fees or charges shall not exceed the estimated reasonable cost of providing the service for which the fee is imposed"].) And the language in clause [iii], which requires an agency to prove "that the manner in which those costs are allocated to a payor bear a fair or reasonable relationship to the payor's burdens on, or benefits received from, the governmental activity,"

tracks language previously used only to determine the reasonableness of regulatory fees—the subject of the (e)(3) exception. (*See Griffith, supra,* 207 Cal.App.4th 982, 996 [noting that Proposition 26's (e)(3) exception tracks the pre-Proposition 26 reasonableness test for regulatory fees].)

Clause [iii] of the unnumbered paragraph thus does not apply to all the exceptions, including the (e)(2) exception. For example, it would be nonsensical if clause [iii] was read to require an agency to prove that the amount of "a fine, penalty, or other monetary charge imposed by the judicial branch of government or a local government, as a result of a violation of law"—the subject of the (e)(5) exception—"is no more than necessary to cover the reasonable costs of the governmental activity, and that the manner in which those costs are allocated to a payor bear a fair or reasonable relationship to the payor's burdens on, or benefits received from, the governmental activity." (Cal. Const., art. XIIIC, § 1, subd. (e).) Even *Newhall* noted there are some differences between regulatory fees exempted under the (e)(3) exception and user fees exempted under the (e)(2) exception, which would not be relevant if the final paragraph required the local government to prove all of the requirements in the unnumbered paragraph for all of the exceptions. (*Newhall, supra,* 243 Cal.App.4th 1430, 1442-43 [distinguishing *Griffith, supra,* 207 Cal.App.4th 982 as involving subd. (e)(3) exception].)

Newhall did not explain its reasoning in importing clause [iii] of the unnumbered paragraph as a "proportionality" requirement for user fees exempted under subdivision (e)(2), nor did it explain what is required to meet this improperly imported requirement in the context of user fees. Instead, *Newhall* attempted to distinguish *Griffith* on the basis that it concerned a regulatory fee under the (e)(3) exception that was imposed on "numerous payors," noting that a collective reasonableness test applied there because "it would be impossible to assess such fees based on the individual payor's precise burden on the regulatory program." (*Newhall, supra,* 243 Cal.App.4th 1430, 1443.) *Newhall* explained that, in the specific circumstance involving the allocation of costs "among only four payors," a collective reasonableness standard "simply does not apply." (*Id.* at pp. 1443-1444.) It did not state that a collective reasonableness standard is inapplicable to *all* user fees, or to *all* wholesale water rates.

San Diego seizes upon *Newhall*'s distinction between the small number of rate payors there and the large number of rate payors in *Griffith.* (ROB 43-44.) But that distinction finds no support in article XIIIC's text. And San Diego's attempt to equate four agencies (two of which were owned and/or operated by the wholesaler) with the 26 member agencies that comprise Metropolitan (all of which are separate from the wholesaler, but collectively govern it) is unpersuasive. Neither *Newhall* nor Proposition 26 provides a

rational place to draw the line between so few payors that individualized rates are required and so many payors that they are not.

Moreover, unlike in *Newhall*, Metropolitan's rates are not based at all on groundwater use, and member agencies pay volumetrically based on their purchase of full service water or wheeling service. Thus it is beside the point for San Diego to note "variations" among the member agencies in terms of their relative access to local groundwater and dependence on Metropolitan. (ROB 44.) Such variations are irrelevant to Metropolitan's rate structure.

Rather, Metropolitan's challenged rates are more like the fee in *Griffith* that the *Newhall* court considered sufficiently "proportional" to pass muster under Proposition 26. Member agencies that are more dependent on Metropolitan—whether for the purchase and conveyance of Metropolitan's imported water or to wheel third party water—pay more by paying Metropolitan's volumetric full service rate (including the Transportation Rates) or its volumetric wheeling rate, respectively. Water purchasers and wheelers pay different total rates because water supply costs are excluded from the wheeling rate, and wheelers pay actual power costs for the wheeling transaction rather than the System Power Rate. Thus, here as in *Griffith*, rates are proportional because they "*were* allocated by categories of payor, and were based on the

burden on the inspection program, with higher fees where more [] work was required." (*Newhall*, *supra*, 243 Cal.App.4th 1439, 1443.)

Thus, even if *Newhall* were binding on this court and correct on the law (it is not), Metropolitan's rates are sufficiently proportional as to be valid under *Newhall*. *Newhall*'s rejection of the collective measure of reasonableness stemmed from the agency's inability to connect *any* costs to a service (groundwater) the court found the agency did not provide. That is simply not the case with Metropolitan's Transportation Rates. Metropolitan's challenged rates are not invalid under *Newhall* because they recoup transportation costs based on the amount of water each member agency transports.

Capistrano: San Diego fares no better in relying upon *Capistrano*, which construed Proposition 218's requirement that 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 that parcel*." (Cal. Const., art. XIIID, § 6, subd. (b)(3), emphasis added.) As San Diego notes (ROB 45), *Capistrano* seized upon the final four words to conclude that Proposition 218 required the retail water agency there to ascertain the cost of service to particular parcels if "'attributable to the parcel' is to mean anything." (*Capistrano, supra*, 235 Cal.App.4th 1493, 1405.)

San Diego errs in asserting that "[t]hat analysis applies *a fortiori*" to Proposition 26's (e)(2) exception. (ROB 45.) The (e)(2) exception conspicuously lacks language parallel to Proposition 218: It requires that the payor-specific charge "not exceed the reasonable costs to the local government of providing the service or product"; it does not require that the payor-specific charge "not exceed the reasonable costs to the local government of providing the service or product" *to the payor.* (Cal. Const., art. XIIIC, § 1, subd. (e)(2).) San Diego's position requires that the Court improperly read additional words into Proposition 26—words the voters enacted into Proposition 218 for property-related fees, but did not enact into Proposition 26.

Notably, even under *Capistrano*'s proportionality requirement, the court required the retail water agency only to correlate its tiered prices with the actual cost of providing water at those tiered levels; it did *not* find that the retail water agency had to tailor its rate to *each parcel*. *Palmdale v. Palmdale Water District* (2011) 198 Cal.App.4th 926, 936-37, cited by San Diego, similarly found that Proposition 218 barred a tiered rate structure that treated different classes of users differently based on considerations other than cost of service. In sharp contrast, Metropolitan's Transportation Rates and wheeling rate were set in accordance with cost of service principles. (*See, e.g.*, 40-AR2010-011467, 011470-89.) "That there may be other methods favored by [San Diego] does not render [Metropolitan's] method

unconstitutional." (*See Pajaro Valley, supra,* 220 Cal.App.4th 586, 601.)

Ultimately, San Diego seeks—and the superior court required—far more individualized tailoring of rates than contemplated in *Newhall* or *Capistrano*. Metropolitan's volumetric rates pass muster under *Newhall* because they are inherently proportional use fees. San Diego repeatedly ignores this fact, as emphasized by its reliance on the holding in *Bay Area Cellular Telephone Co. v. City of Union City* (2008) 162 Cal.App.4th 686, 698 that a "fee for *access* to a governmental service is not the same as a fee for *use* of that service." (ROB 47, emphasis in original.) Contrary to San Diego's assertion (*see ibid.*), Metropolitan does not "charge[] for *access* to the [State Water Project] and to 'water stewardship.'" The challenged rates here—whether viewed at the service level or as individual rate components—are plainly *use* fees, not access fees. They are only charged when a member agency purchases water or wheels water,[26] and in both cases they are charged in proportion to

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[26] Exchanges of water are matters of contract; Metropolitan's rate structure does not include a generally applicable rate for "exchange service." The 2003 Exchange Agreement's price, at San

the amount of water conveyed. Metropolitan's member agencies do not pay for Metropolitan's transportation function without paying the Transportation Rates within the full service rate or the wheeling rate. If Metropolitan's State Water Project transportation costs and demand management costs are reasonably allocated to transportation (and, as demonstrated *supra*, they are), those costs are being recovered in proportion to the amount of water each member agency conveys.

San Diego's suggestion that rates must be more specifically tailored on a payor-by-payor basis to the benefit from the service or burden on the system is in any event impractical—one of the reasons why it is so well-settled that system-wide costs may be recovered through "postage-stamp" rates without regard to specific distances traveled and specific facilities used. (*Imperial*, *supra*, 80 Cal.App.4th 1403, 1433; *see also* AOB 83-84; *Rincon, supra,* 121 Cal.App.4th 813, 822-823; *cf. Moore, supra,* 237 Cal.App.4th 363, 369 [fees appropriately charged for "all the required costs of providing service, short-term and long-term, including operation, maintenance, financial, and

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Diego's request, is based on the Transportation Rates, but solely as a contractual matter between the parties.

capital expenditures"]; *Pajaro Valley*, *supra*, 220 Cal.App.4th 586, 590-91, 602.)

For all these reasons, Metropolitan's Transportation Rates and wheeling rate are reasonable, payor-specific charges and fall within Proposition 26's (e)(2) exception.

(b) Metropolitan's Rates Are Charges For The Use Or Purchase Of Local Government Property Under The (e)(4) Exception

Metropolitan's rates are also not special taxes under Proposition 26 because they are charged "for entrance to or use of local government property, or the purchase, rental, or lease of local government property." (AOB 101-03; Cal. Const., art. XIIIC, § 1, subd. (e)(4).) Unlike the (e)(1) and (e)(2) exceptions, the (e)(4) exception for use or purchase of local government property does not require any showing regarding reasonableness. (*Ibid.*) That does not mean, of course, that Metropolitan's rates do not have to be reasonable; the common law requires as much. (*Inyo, supra,* 26 Cal.3d 154, 159 fn. 4 [rates invalid if not based "on cost of service or some other reasonable basis"]; *accord Hansen, supra,* 42 Cal.3d 1172, 1180-81.) It does mean, however, that the reasonableness of Metropolitan's rates is not a constitutional issue.

San Diego mistakenly argues that the (e)(4) exception does not apply because neither State Water Project transportation costs nor water stewardship costs are imposed for the use of Metropolitan's

"property." (ROB 63-64.)[27] But San Diego wrongly focuses on individual *costs* instead of the actual *charge* for service. (Cal. Const., art. XIIIC, § 1, subd. (e)(4) [excepting from definition of special tax "[a] *charge* imposed for entrance to or use of local government property, or the purchase of local government property"], emphasis added.) Viewed properly at the service charge level, Metropolitan charges its full service water rate (including its Transportation Rates) for the purchase of local government property: Metropolitan's water. That purchase includes the transportation of the water that is purchased. The Transportation Rates of the full service rate recover the costs of the transportation function. The wheeling rate is charged for use of Metropolitan's conveyance system, not specifically that portion of it that is part of the State Water Project. Both the full service rate and the wheeling rate charge the Water Stewardship Rate for use of Metropolitan's conveyance system, reflecting the reduction of the cost of the conveyance system from lower demand. A member agency that does not purchase

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[27] San Diego's response based only on "use" does not address Metropolitan's position that the subdivision (e)(4) exception also applies to the *purchase* of its water.

Metropolitan water or use Metropolitan's conveyance system does not pay any of these charges.

Focusing on individual costs instead of the charge, as San Diego attempts to do, is not only contrary to the language of the exception, but it would also yield absurd results: Under San Diego's approach, public transportation fares would have to be precisely calibrated to the exact distance traveled to avoid becoming an unconstitutional special tax. An admission fee to a local government-owned botanical garden would become an unconstitutional tax if it recouped any costs for portions of the garden that a park-goer does not visit or any operational costs that only had an indirect benefit on the park-goer's experience. For the (e)(4) exception to have any application at all, it must be applied at the service level, not the individual cost level as San Diego urges.

Contrary to San Diego's suggestion, Metropolitan's full service and wheeling rates were *not* the types of fees the Legislative Analyst addressed in its statements noting examples of regulatory fees that were likely to be affected by the passage of Proposition 26. (ROB 64.) Far from telling voters that Proposition 26 would invalidate all funding sources for "recycling incentives," the Legislative Analyst said only that "oil recycling fee[s]," that are used in part to fund "recycling incentives," would likely be affected, as would "hazardous materials fee[s]" and "fees on alcohol retailers."

(2-RA-404-05) None of those fees is charged for access to or use of local government property; rather, they are charged for transactions that do not involve local government property at all, such as changing motor oil, replacing a battery, or selling wine.

With respect to *use* fees, the Legislative Analyst noted: "*Some Fees and Charges Are Not Affected.* The change in the definition of taxes would not affect most user fees…because these fees and charges…are exempt from its provisions." (2-RA-405, emphasis in original.) Metropolitan's full service rate and wheeling rate are user fees. (*See, e.g., Bighorn-Desert, supra,* 39 Cal.4th 205, 217 ["Consumption-based water delivery charges also fall within the definition of user fees, which are 'amounts charged to a person using a service where the amount of the charge is generally related to the value of the services provided'"], citations omitted.)

For the same reasons discussed above in connection with the (e)(2) exception, San Diego errs in suggesting that unnumbered paragraph at the end of subsection (e) grafts a strict proportionality requirement onto the (e)(4) exception. (ROB 64-65.) San Diego's construction of the unnumbered paragraph is wrong, and hence San Diego misplaces reliance on *Newhall*. (*See* Section I.C.2(a)(ii), *supra.*) *Schmeer*, also cited by San Diego, construed "governmental activity" in the unnumbered paragraph "as a shorthand reference for the activities described in the exceptions," but it did not consider whether all requirements of the unnumbered paragraph apply to all

of the exceptions. (*Schmeer v. County of Los Angeles* (2013) 213 Cal.App.4th 1310, 1327 fn. 5.) Nor did the superior court here endorse construing subsection (e)'s final paragraph to impose a proportionality requirement on all seven of the enumerated exceptions as San Diego suggests; the superior court held only that Metropolitan bore the burden of proving that a charge is not a tax under any of the exceptions. (*Compare* ROB 64 *with* 7-AA-1796-97.)

Because Metropolitan's full service rate, including the Transportation Rates, is charged for the purchase of local government property (water) and use of Metropolitan's conveyance system, and the wheeling rate is charged for the use of local government property (Metropolitan's conveyance system), these rates are not special taxes under Proposition 26 under the (e)(4) exception.

3. Metropolitan's Rates Were Approved By Two-Thirds Of The Relevant Electorate

Even if the challenged water rates could be deemed a "tax," the voting requirement of Proposition 26 was satisfied because Metropolitan's rates were approved by more than two-thirds of Metropolitan's Board of Directors which, by statute, is the relevant

electorate. (AOB 103-08; Wat. Code appen., § 109-133; *id.* § 109-55.)[28] San Diego contends that *City of San Diego v. Shapiro* (2014) 228 Cal.App.4th 756 (*Shapiro*), is dispositive of this argument. *Shapiro* is distinguishable for two reasons.

First, in *Shapiro*, the City of San Diego created its own electorate by adopting an ordinance limiting "qualified electors" to a specific group (*Shapiro*, *supra,* 228 Cal.App.4th 756, 761); here, Metropolitan was merely following the Legislature's directive in its implementing statute that Metropolitan's Board of Directors vote on Metropolitan's rates. Whether or not the superior court believed it was doing so (ROB 65-66), it impliedly repealed this statutory mandate by changing Metropolitan's relevant electorate. (*See* AOB 106.)

Second, *Shapiro* concerned a special property tax levied on hotel properties and did not involve Proposition 26 or water rates at all. This is a critical distinction: Applying *Shapiro* to Proposition 26

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[28] San Diego argues that this "is circular because it simply assumes what Met[ropolitan] must prove: that Met[ropolitan] charges proper rates rather than improper taxes." (ROB 65.) But this makes no sense: No electorate approval at all is required under Proposition 26 *unless* the rates are determined to be special taxes. (Cal. Const., art. XIIIC, § 2(d).)

in the context of wholesale water rates would be inconsistent with Proposition 218's voting requirements for retail water rates. Proposition 218 does not require a two-thirds vote of all registered voters for water rates. (Cal. Const., art. XIIID, § 6, subd. (c); *Richmond v. Shasta Cmty. Services Dist.* (2004) 32 Cal.4th 409, 426-27.) Proposition 26 also exempts retail water rates from its voting requirement by expressly excluding from its definition of a "special tax" all "[a]ssesments and property-related fees imposed in accordance with the provisions of Article XIIID." (Cal. Const., art. XIIIC, § 1, subd. (e)(7).) San Diego cites no legislative history suggesting the voters who approved Proposition 26 intended its voting requirement to apply to wholesale water rates like Metropolitan's, nor does it attempt to defend the absurdity that would result of having registered voters vote on *wholesale* water rates, but not *retail* water rates. (*See* AOB 106-07.)[29] Thus,

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[29] Indeed, because San Diego itself is a wholesale water supplier, applying Proposition 26's voting requirement to wholesale water rates would result in duplicative and potentially inconsistent voting: A super-majority of registered voters in Metropolitan's service area could approve a rate, only for registered voters in San Diego's service area to disapprove San Diego's downstream rate.

Metropolitan's implementing statute and not *Shapiro* is dispositive of the scope of Metropolitan's relevant electorate for water rates.

4. San Diego's Reliance On Proposition 13 Is Unavailing

San Diego's claim that Proposition 13 provides an alternate ground for affirmance is meritless. San Diego makes no attempt to explain how Metropolitan's rates, if they pass muster under Proposition 26, might run afoul of Proposition 13, which is narrower in scope. San Diego did not appeal the superior court's Proposition 13 ruling (34-AA-09627) and there is no reason for this Court to reach this issue.

Moreover, San Diego's claim that Metropolitan "effectively concedes on appeal that Proposition 13 applies" by citing *Goodman* (ROB 66), a Proposition 13 case, is specious. Metropolitan cited *Goodman* for its discussion of the State Water Project and its contractors' responsibility for its costs (AOB 25, 70-72, 74) and did not concede Proposition 13's applicability.

In any event, Proposition 13 does not apply to wholesale "postage stamp" water transportation rates, as San Diego itself persuaded a court of appeal in *Rincon, supra,* 121 Cal.App.4th 813. (2-ARA-0509, 0550-51; 9-AA-02269-70; *see also Brydon v. East Bay Mun. Util. Dist.,* 24 Cal.App.4th 178, 193-94.) *Rincon* held that Proposition 13 did not apply to a postage-stamp transportation rate (like the rates at issue here) because it was "not designed to replace

property tax revenue lost due to Proposition 13 nor is there any indication [that] the Legislature intended to revise the statutory scheme governing water rates." (*Rincon*, *supra*, 121 Cal.App.4th 813, 822.)[30]

Proposition 13 is not an alternate ground for affirmance.

D. Government Code Section 54999.7(a) Does Not Apply To Metropolitan's Wholesale Water Rates

As demonstrated in Section I.B, *supra*, San Diego's rate challenge under section 54999.7(a) of the Government Code fails

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[30] The authorities cited by San Diego do not compel an opposite conclusion. In *Beaumont Investors v. Beaumont-Cherry Valley Water District* (1985) 165 Cal.App.3d 227, 234, the parties stipulated that Proposition 13 applied to the facilities fee in question and the court never independently analyzed Proposition 13's applicability. The analysis in *Capistrano, supra,* 235 Cal.App.4th 1493, 1512-13, is limited to Proposition 218's effect on *how* Proposition 13 is applied, not *whether* it applies to water rates. Finally, the testimony of a single non-lawyer witness (Metropolitan's Mr. Thomas) that Proposition 13 applies to Metropolitan's rates (24-AA-6886:13-18; 25-AA-06917:17-22), does not make it so. And San Diego fails to note that the same witness subsequently clarified that he was referring to other charges, such as Metropolitan's standby charge, readiness-to-serve charge, or property taxes (none of which are at issue in this case) and that neither he nor Metropolitan had concluded that it does. (25-AA-07014:15-07015:5.)

because Metropolitan's challenged ratemaking decisions were not arbitrary or capricious. This rate challenge also fails, however, because this statute—which expressly applies only to public agencies providing "public utility service[s]"—is not applicable to Metropolitan's wholesale water rates. (*See* AOB 108-11 [explaining why "public utility service" is limited to retail utilities].) San Diego asserts three arguments in response. None has merit.

First, San Diego suggests that wholesale water rates are subject to Section 54999.7(a) because they were found to be subject to Proposition 26 in *Newhall*. (ROB 73.) But, just as *Newhall* did not actually consider whether Proposition 26 applied to a voluntary cooperative's wholesale water rates because the defendant there did not challenge its applicability on that ground (*see* Section I.C.1, *supra*), *Newhall* did not purport to reach whether Section 54999.7(a) applied to wholesale water rates either. (*Newhall*, *supra*, 243 Cal.App.4th 1430, 1451.) Rather, like Proposition 26, section 54999.7—a statute designed to ensure public agencies bear public utilities' costs of capital improvements just as non-public users do (*see, e.g.*, Gov. Code, § 54999.7, subd. (a), (b))—is an awkward fit to

wholesale water agencies that serve only other non-end user, public agencies.[31]

Second, San Diego dismisses Metropolitan's argument that the other examples of "public utility service[s]" listed in the statutory definition of that term suggest that its inclusion of "service for water" is limited to retail water service only. (ROB 74.) According to San Diego, the statute's inclusion of "flood control" indicates that "public utility service[s]" are not limited to retail utility services. (*Ibid.*) But this misses the point: None of the other "public utility service[s]" consists *exclusively* of wholesale services that are *never* charged to the end user, whether a private citizen or a public school. Indeed, "flood control" charges—unlike wholesale water rates—are routinely borne by property owners directly. (*See, e.g.*, *Greene v.*

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[31] San Diego denies its express admission that section 54999.7(a) does not apply to Metropolitan's rates, claiming that "San Diego's counsel noted that the reference to decennial studies in section 54999.7(c) is beside the point because Met[ropolitan]'s rates violate section 54999.7(a)." (ROB 74 fn. 8, citing 6-AA-1473.) San Diego's words speak for themselves: "[T]he cited statute [section 54999.7] is a provision of the *San Marcos* legislation governing the application of water service…to schools and other public agencies, which does not apply to a water wholesaler like Metropolitan." (6-AA-1473.)

Marin County Flood Control and Water Conservation Dist. (2010) 49 Cal.4th 277, 281.)

Third, San Diego argues that excluding wholesale water service from "public utility service(s)" "also contradicts the broad definition of 'public agency'" in the statute (ROB 74), apparently contending that an entity is not a "public agency" under the statute unless it offers a "public utility service." But this argument ignores the statutory text: "[P]ublic agency" is used in the statute to describe not only providers of public utilities, but also *recipients* of public utilities—including public agencies that plainly do not provide utilities, like schools. (*See, e.g.*, Gov. Code, § 54999.7, subd. (a) ["Any public agency providing public utility service may impose a fee, including a rate, charge, or surcharge, for any product, commodity, or service provided to a public agency, and any public agency receiving service from a public agency providing public utility service shall pay that fee so imposed."].) Construing "public utility service" to exclude wholesale water service would not narrow the definition of "public agency" to exclude wholesale water suppliers like Metropolitan or San Diego in any way. Metropolitan does not provide a "public utility service," and section 54999.7(a) is inapplicable.

E. The Writs Are Improperly Overbroad And This Error Was Not Waived

As set forth in Metropolitan's opening brief (AOB 111-114) the peremptory writs of mandate issued in this case are improper because they purport to dictate to Metropolitan how to exercise its discretion in future ratemaking cycles. San Diego responds with yet another waiver argument and, on the merits, cites authorities that in fact confirm the writs are improper.

San Diego's waiver argument (ROB 87-88) is frivolous. Metropolitan consistently registered its objections to the form of the writ—including to its impermissible overbreadth and purported applicability to future rate-setting—as the superior court acknowledged. (*E.g.*, 5-ARA-1330-36; 6-RA-1507; 47-RT-3335:5-18.) By statute, these errors are preserved for appeal. (Code Civ. Proc., § 647 ["final decision[s]" deemed excepted to even without objection, and all "orders, rulings, actions or decisions" deemed excepted to "[i]f the party, at the time when the order, ruling, action

or decision is sought or made, or within a reasonable time thereafter, makes known his position thereon, by objection or otherwise"].)[32]

Turning to the merits, San Diego defends the unremarkable proposition that writs do not necessarily offend the separation of powers. (ROB 88 & fn. 13.) But Metropolitan does not contend otherwise; it contends that *these* writs offend the separation of powers because they purport to dictate how Metropolitan must exercise its discretion in the future. (AOB 111-114.) Specifically, the writs command Metropolitan not to include certain costs "in setting its transportation and wheeling rates *in the future*" (34-AA-09589, emphasis added), and require Metropolitan "to henceforth set its rates based on cost causation" in future rate-setting cycles. (34-AA-09589-90 ¶¶ 1, 3.)[33] And the writs further impinge on Metropolitan's

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[32] *Mesecher v. County of San Diego* (1992) 9 Cal.App.4th 1677, 1686-87, the only authority San Diego cites in support of its waiver argument, does not suggest that a party waives promptly-asserted objections to the form of a writ or order by not submitting an alternatively-worded counter-proposal. (*See ibid.* [objection to inconsistent verdicts was waived by party that invited possibility in jointly-proposed verdict form].)

[33] The parties agree that writ relief with respect to Metropolitan's 2011-2014 rates is unnecessary because San Diego

discretion by ordering Metropolitan 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.)[34]

The cases cited by San Diego itself confirm that the writs here are improper for these reasons. In *Carmel Valley Fire Protection District v. State of California* (1987) 190 Cal.App.3d 521, 539-40 (*Carmel Valley*), the court of appeal held that the writ before it did not violate

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was already compensated for any injury as a result of its contract claim. (47-RT-3339:21-25.)

[34] San Diego contends the writs' mandate that Metropolitan include no State Water Project costs in its future Transportation Rates is appropriate because the superior court concluded that "[n]o reasonable basis appears in the record" for Metropolitan's purported change from allocating all of its State Water Project costs "to supply, and none to transportation." (ROB 89-90.) Aside from the inaccuracy of this finding (*see* Section I.B.2(b), *supra*), the cited finding makes clear on its face why the writ is overbroad; the finding was made on the basis of the record before the superior court in the 2011-2014 rate challenges, not the record that will determine the reasonableness of any challenges to Metropolitan's future rates.

the separation of powers specifically because it only compelled the State to reimburse funds that had *already* been appropriated by the Legislature for the specified purpose and there was "absolutely no language purporting to require the Legislature to enact appropriations or perform any other act that might violate separation of powers principles." (*Ibid.*) Like the language *Carmel Valley* indicated *would* cause the writ to violate the separation of powers, the writs in this case command Metropolitan to exercise its discretion in future ratemaking cycles in specific ways.

Similarly, in *Conlan v. Bonta* (2002) 102 Cal.App.4th 745, 763-64 (*Conlan*), the court of appeal held that the trial court should have entered a peremptory writ of mandate because the agency failed to adopt any measures to ensure prompt reimbursement for certain Medi-Cal claims. (*Ibid.*) The court went on to state:

> The manner in which the Department [of Health Services] chooses to meet its obligations is within the discretion of the Department. Thus, we do not decide what form such procedures must take….While the method of accommodating such considerations is within the discretion of the Department, we decide only that…doing nothing is not an option.

(*Ibid.*, internal citations omitted.) Thus, a writ can compel an agency to act, but it cannot dictate how an agency should exercise its discretion.

In *California Association for Health Services v. State Department of Health Care Services* (2012) 204 Cal.App.4th 676, 689-90, the court of appeal ordered the Department of Health Services to revisit prior rate reviews after finding them wanting. Here too, although the court of appeal issued a writ of mandate requiring the Department to try again, it "decline[d] plaintiffs' invitation to dictate to the Department how it performs its rate review." (*Id.* at 687.)

Finally, San Diego cites *Graham v. State Board of Control* (1995) 33 Cal.App.4th 253, 261 (*Graham*) and *49er Chevrolet v. New Motor Vehicle Board* (1978) 84 Cal.App.3d 84, 93 (*49er Chevrolet*) for the proposition that courts can order agencies to proceed in a manner consistent with their opinions. But in both cases, the courts of appeal determined that the agencies had committed some error of law—in *Graham*, by following a regulation that conflicted with a statute, and in *49er Chevrolet*, by statutory misinterpretation—and the contemplated writs simply ordered the agencies to comport with the opinions in the specific cases before them. In none of the cases cited by San Diego did a court order the agency to act in a specific way in other, future proceedings. Rather, the courts "anticipate[d] that when th[e] decision becomes final, [the agency] will do whatever is required by law" in exercising its discretion going forward. (*Regents of Univ. of California v. State Bd. of Equalization* (1977) 73 Cal.App.3d 660, 669.) By dictating how Metropolitan must

exercise its discretion in all future rate-settings, the writs in this case are impermissibly overbroad and must be set aside.

II. SAN DIEGO FAILS TO DEFEND THE SUPERIOR COURT'S ERRONEOUS AWARD OF MORE THAN $240 MILLION FOR BREACH OF THE EXCHANGE AGREEMENT

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

The superior court's refusal to reopen expert discovery for the limited purpose of allowing additional disclosures regarding the amount of lawful rates (and, hence, the measure of damages) is not "binding" on this Court (ROB 82) if it was an abuse of discretion. (*Hernandez v. Superior Court* (2004) 115 Cal.App.4th 1242, 1246-48.) The superior court's discretion is "subject to the limitations of legal principles governing the subject of its action, and to reversal on appeal where no reasonable basis for the action is shown." (*Westside Cmty. for Independent Living, Inc. v. Obledo* (1983) 33 Cal.3d 348, 355, in bank, citations omitted.) The superior court abused its discretion when it expressly denied Metropolitan's motion for the sole reason that Metropolitan had also argued that the superior court lacked jurisdiction to determine a lawful rate. (27-AA-07632-33.)

San Diego makes two meritless arguments in support of the superior court's decision:

First, San Diego quotes the superior court's order on Metropolitan's motion for a new trial, but the relevant passage is entirely circular:

> Met[ropolitan] claims my decision [not to reopen discovery] prevented it from pursuing expert discovery necessary to rebut San Diego's claimed damages, and was therefore inconsistent with well-recognized principles that a party can argue in the alternative. But this isn't true. Met[ropolitan] *was* allowed to make inconsistent allegations and arguments, but it failed to offer proof to support them….

(34-AA-09664-65, emphasis in original, internal citations omitted.) Allowing Metropolitan to argue in the alternative *at trial* is meaningless without allowing Metropolitan to engage in discovery and offer proof in support of its alternative theories. And the superior court cannot fault Metropolitan for "fail[ing]" to offer such proof (*ibid.*) when its own rulings had *precluded* Metropolitan from offering any expert testimony at trial regarding "[t]he fair and reasonable alternatives available to [Metropolitan]"; "[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 precluded this expert testimony because it was not disclosed during expert discovery which, although it had concluded before the

Phase I trial took place, the superior court refused to reopen because Metropolitan had argued in the alternative that the court lacked jurisdiction to determine a lawful rate.[35]

Second, San Diego argues that Metropolitan's failure to submit a meet-and-confer declaration pursuant to section 2016 of the Code of Civil Procedure is an alternate ground for affirmance, but this is wrong. Even an insufficient meet-and-confer effort—much less a lack of a declaration regarding the meet-and-confer effort—is generally not a ground for denial of a discovery motion; rather, courts should consider requiring additional meet-and-confer efforts or monetary sanctions. (*Obregon v. Superior Court* (1998) 67 Cal.App.4th 424, 434-35.) Moreover, San Diego never raised this procedural deficiency below and the superior court accordingly did

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[35] There is no record support for the implication that Metropolitan pursued a strategy to dismiss for lack of jurisdiction and, only when that did not succeed, belatedly sought to present a damages case. After the superior court issued its Phase I Statement of Decision, Metropolitan sought to augment its expert disclosures, *nine months before* the breach of contract trial and *concurrently* with contending that the court could not determine lawful rates as necessary to find damages, if any. (*See, e.g.*, 27-AA-07519-32; 34-RT-2183-2208; 27-AA-07636-40.)

not rely on it. (27-AA-7634 fn. 1.) The lack of a meet-and-confer declaration does not excuse the superior court's abuse of discretion.

B. The Superior Court's Finding That The Exchange Agreement Was Breached Is Not Supported By Substantial Evidence And San Diego's Attempts To Obtain A Different Price Term Should Be Rejected

Metropolitan argued in its opening brief that the superior court erred in finding a breach of the Exchange Agreement's price term because (1) the superior court invalidated Metropolitan's Transportation Rates and wheeling rate "as to wheelers" (27-AA-07503-12, 07516), but the Exchange Agreement is not a wheeling agreement; and (2) San Diego admitted that it did not know if it suffered any injury from Metropolitan's breach because an alternative lawful rate may not have been lower than the rates it was charged. (*See* AOB 34 fn. 5, 120-23.)

In response to these arguments, San Diego fails to show that the superior court's finding of an actionable breach is supported by substantial evidence. The superior court erred in simply assuming that San Diego had suffered an actionable injury. As San Diego admitted, an alternative lawful rate may have been just as high or higher as the rate San Diego was charged. (AOB 121-23.) San Diego responds to this argument by citing the same testimony Metropolitan addressed in its opening brief—testimony that relates only to the *amount* of damages as calculated by simply subtracting

100% of the challenged costs and that does not address whether San Diego was in *fact* damaged by any breach of the price term. (*Compare* ROB 80 *with* AOB 123 fn. 29.)

Rather than grappling with the deficient evidence of breach, San Diego devotes most of its argument to an improper attempt to modify the price term on appeal. San Diego seeks a finding that "[t]he 'applicable law' governing Met[ropolitan]'s charges under section 5.2 of the Exchange Agreement includes…the Wheeling Statutes" (ROB 77-79) and that the price term means Metropolitan's wheeling rate rather than Metropolitan's Transportation Rates. This effort to rewrite the agreement contradicts San Diego's own past statements,[36] is contrary to the superior court's findings, and finds no support in the record.

None of the evidence San Diego cites suggests that the Wheeling Statutes apply to the Exchange Agreement or that the price term requires a wheeling rate. Mr. Thomas—the Metropolitan

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[36] San Diego has successfully argued before the court of appeal, the Sacramento Superior Court, and the State Water Resources Control Board that the Exchange Agreement (or its 1998 predecessor) is not a wheeling agreement and the Wheeling Statutes do not apply to it. (*See, e.g.,* 1-ARA-0111-12; 1-ARA-0240-42; 1-ARA-0281; *see also* 1-ARA-0254.)

non-lawyer witness San Diego repeatedly cites for legal conclusions (*see, e.g.*, ROB 67, 77, 107)—did not identify the Wheeling Statutes among the "applicable law[s]" he believed applied to the Exchange Agreement's price term, nor did San Diego's Mr. Slater. (*See* ROB 77, citing 25-AA-6916:10-6917:22; *see also* 41-RT-2557:22-2558:25, 2559:20-2563:28.)

Likewise, for the proposition that the parties "plainly intended 'applicable law'" to include the Wheeling Statutes, which are all about 'the conveyance of water'" (ROB 77), San Diego cites only the price term of the Exchange Agreement itself. Wheeling is one type of conveyance; the terms are not synonymous.

And San Diego's claim that the Legislature enacted the Wheeling Statutes "with the transaction consummated in the Exchange Agreement specifically in mind" (ROB 78) *twelve years* beforehand is also unsupported: The Oakland Tribune article San Diego cites discusses water transfers generally and mentions that Mr. Katz had introduced legislation "to require public water conveyance facilities, wherever possible, to carry water exchanged by contract" (5-RA-1216) and the "County of San Diego Legislative Analysis" mentions only a hypothetical agreement with Imperial, as well as potential agreements that contemplated wheeling on the State Water Project. (5-RA-1258-59.)

Both parties understood, and the superior court found, that "charges…generally applicable to the conveyance of water by

Metropolitan on behalf of its member agencies" meant Metropolitan's Transportation Rates (the System Access Rate, the System Power Rate, and the Water Stewardship Rate), not the wheeling rate. (34-AA-09470 & fn. 15 ["There is no dispute that [the System Access Rate, System Power Rate, and Water Stewardship Rate] are the rates generally applicable to Met[ropolitan]'s member agencies for the conveyance of water"].) San Diego now argues that the parties understood that San Diego was negotiating for a wheeling rate, but San Diego cites no evidence that supports its claim. The evidence is undisputed that the parties attempted to negotiate a wheeling agreement, were unable to do so, and consequently entered into the 1998 Exchange Agreement *instead* (followed by the 2003 Exchange Agreement). (41-RT-2643:22-2644:7.) San Diego has admitted that the contracted-for exchange of water has very different features from wheeling. (1-ARA-0111-12 [1998 Exchange Agreement is "radically different" from wheeling because it not subject to availability of space in Metropolitan's conveyance system]; 1-ARA-0240-42; 1-ARA-0281.) Consequently, San Diego's detailed narrative about events preceding a wheeling agreement that never came to fruition (ROB 27-30) is irrelevant. San Diego's attempt to modify the price term on appeal should be rejected.

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

San Diego does not dispute that it entered into the Exchange Agreement believing Metropolitan's rate structure was illegal. Nor does San Diego dispute that it entered into the Exchange Agreement believing that the rates Metropolitan would charge it in 2004—the first year 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"—were illegal; when it signed the agreement, the 2004 rates had already been adopted. Despite having responsibilities to its own member agencies, San Diego knowingly agreed to pay a price based on what it believed to be an illegal rate. If Metropolitan's rates are in fact illegal, so too is the Exchange Agreement.

Rather than dispute these facts, and for the first time on appeal, San Diego contends that Metropolitan is barred from contesting the legality of the Exchange Agreement because it was validated "at Met[ropolitan]'s own request, in the *QSA* litigation." (ROB 84.) In fact, as made clear in the motion for summary adjudication referenced by San Diego—in which San Diego also joined—the Exchange Agreement was validated by operation of law because no one took action to validate it within the 60-day period allowed for such actions, i.e., as Metropolitan and San Diego

referred to it, by "the 'do nothing' method." (1-ARA-0238-40, 243.) Thus, section 870 of the Code of Civil Procedure, which applies only to judgments on validation actions, does not apply as San Diego contends.

Rather, section 869 of the Code of Civil Procedure, which provides that "[n]o contest *except by the public agency or its officer or agent* of any thing or matter under this chapter shall be made other than within the time and the manner herein specified," applies. (Code Civ. Proc., § 869, emphasis added.) Under this provision, an agency contract can still be contested by the agency itself after validation by the "do nothing" method. (*Ibid.*; *California-American Water Co. v. Marina Coast Water District* (2016) 2 Cal.App.5th 748, 754; *Friedland, supra*, 62 Cal.App.4th 835, 851 ["Section 869 states that an interested person *must* bring such an action within the statutory time limits or be forever barred from contesting the validity of the agency's action in court[;] the public agency is not so limited"], emphasis in original; *Ontario, supra,* 2 Cal.3d 335, 341 ["[N]o such [60-day restriction to act on validity] is placed on the agency itself, which is in effect authorized by section 869 to disregard the 60-day

statute of limitations imposed by section 860"].) [37] Thus, Metropolitan is not precluded from asserting the illegality of the Exchange Agreement and, in any event, San Diego waived this argument by asserting it for the first time on appeal on an undeveloped factual record. (*Dacey v. Taraday* (2011) 196 Cal.App.4th 962, 978.)

The cases cited by San Diego enforcing illegal contracts are inapposite. San Diego quotes *Marshall v. La Boi* (1954) 125 Cal.App.2d 253, 268 (*Marshall*) for the proposition that "it would be a strange doctrine that would hold, in an action between the guilty party and the innocent parties, that the innocent parties are barred from affirmative relief because of such innocent participation," casting itself in the role of the innocent parties. (ROB 84.) But in *Marshall*, the "guilty part[ies]" were the parties that knew the

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[37] Section 869 does *not* allow *any* public agency to avoid the 60-day limitations period of the validation statutes; rather, it must be the agency that took the validated action. Thus, San Diego cannot challenge Metropolitan's already-validated rates (*see* Section I.A, *supra*) merely because it is a public agency. (*Millbrae School Dist. v. Superior Court* (1989) 209 Cal.App.3d 1494, 1499.) Metropolitan is a party, not a third party, to the Exchange Agreement and can therefore still challenge its legality under section 869 (as could San Diego). (Code Civ. Proc., § 869.)

contract was illegal at the time it was entered. (*Marshall, supra,* 125 Cal.App.2d 253, 268.) San Diego is hardly an "innocent party" given that it induced the price it believed was illegal.

San Diego also notes that the court in *South Tahoe Gas Co. v. Hofmann Land Improvement Co.* (1972) 25 Cal.App.3d 750 (*South Tahoe*) did not void a contract that had an illegal price term where the contract "expressly, as well as impliedly" referred to the legal rate, arguing the same is true here. (ROB 54.) But the contract that was not voided in *South Tahoe* did not simply refer to a legal rate in the abstract: The contract referred numerous times to the regulation setting forth the schedule of maximum rates the utility could charge. (*South Tahoe, supra,* 25 Cal.App.3d 750, 753-54.) Moreover, the party seeking to avoid the contract in *South Tahoe* was the purchaser, and the court noted that the purchaser, having contracted to pay $3.35 per foot for gas main extensions, would have agreed to pay $2.00 per foot, which is the price the court enforced when the defendant developer contended it was required to pay nothing because the contract was illegal. (*Id.* at 765.)

Metropolitan contends, of course, that its rates are not illegal, but if they are, so too is the Exchange Agreement. Here, assuming illegality *arguendo*, San Diego had a contract with a legal price term ($90 per acre-foot with adjustments); it induced Metropolitan to amend the contract to obtain a price term it understood at the time was illegal as enacted by Metropolitan, obtaining additional

consideration in the form of a $235 million legislative appropriation and 110 years of valuable water rights in the process; it knowingly paid an illegally high price for seven years, despite being a public agency; and then used the illegality of the price term to obtain a better deal than it negotiated on a contract that, unlike the terminated or completed contracts in *Marshall* and *South Tahoe*, requires continued performance for *at least* 35 years (San Diego could elect to extend the term to 45 years) for the exchange of transfer water, and for 110 years for the exchange of canal lining water. (22-AA-06140 § 7.1(a); 32-AA-09030 § 4.2.) The courts in *Marshall* and *South Tahoe* observed that voiding the illegal contracts would result in non-payment of innocent parties. Here, *not* voiding the contract will perpetuate a contract that is illegal and contrary to public policy if the Transportation Rates are illegal. The superior court erred by enforcing the Exchange Agreement.

D. The Superior Court's Excessive Damages Award Was Erroneous And Not Justified By Waiver

As demonstrated in Metropolitan's opening brief, the superior court's award of excessive damages was the predictable but erroneous result of its refusal to reopen expert discovery and its subsequent exclusion of expert testimony regarding alternative lawful rates. (*See* AOB 126-130.) San Diego's primary response to Metropolitan's argument that the superior court awarded excessive damages is another waiver argument. (*E.g.*, ROB 16

["Met[ropolitan] waived its [damages] arguments by failing to assert them before, during, or even after trial, until it moved for a new trial"], citing 34-AA-9658-66; *id.* at pp. 3, 80-81.) But this is plainly not true: Metropolitan *did* assert competing damages models based on trial evidence (as best it could given the superior court's rulings) before moving for a new trial. (*See, e.g.*, 33-AA-09395 [arguing in closing brief that 40% of Metropolitan's State Water Project costs should not be included in damages because San Diego received 40% State Water Project water in its blend]; 34-AA-09449 [arguing in objection to statement of decision that damages should be difference between last lawful rate ($253 per acre-foot) and rates charged].) Contrary to the superior court's and San Diego's assertion, there *were* "viable alternative methodolog[ies] available." (ROB 81, citing 34-AA-09477.) San Diego fails to offer any argument on appeal that any of these alternative methodologies were improper.

San Diego next quotes the superior court's conclusion that it "asks too much of San Diego to require it to recalculate Met[ropolitan]'s rates with any useful degree of precision" and an "approximation of damages" is therefore acceptable. (ROB 81, citing 34-AA-9478.) But requiring San Diego to establish that it was entitled to $188 million instead of nothing (*see* AOB 120-123) is not demanding much precision.

None of the authorities cited by San Diego suggests that backing out 100% of the challenged costs was appropriate. In *MCI*

Telecommunications Corp. v. Federal Communications Commission (D.C. Cir. 1995) 59 F.3d 1407, 1416, the method of approximation endorsed by the court "yield[ed] a conservative estimate" of damages because "[t]he actual reasonable rate would, if anything, …be lower than the rate derived by the [petitioners]." In *Meister v. Mensinger* (2014) 230 Cal.App.4th 381, 401 the court remanded for additional expert evidence to determine damages, supporting Metropolitan's argument the court's disallowance of meaningful expert testimony resulted in unjust and excessive damages.

Scheenstra v. California Dairies, Inc. (2013) 213 Cal.App.4th 370, 397, 402 also supports Metropolitan: There, the court determined that the defendant dairy cooperative imposed a milk supply quota that was too low on the plaintiff dairy farmer, thereby breaching its contract. The "correct measure of damages was the difference between what [plaintiff] actually received for milk deliveries made while the quota system was in effect, and what he would have received with a proper, uniform supply reduction program." The trial court determined what an "equitable and uniform quota" would have been in order to calculate damages (*ibid.*); it did not simply assume the plaintiff would have had *no* quota at all as the superior court effectively did here.

In *Kashmiri v. Regents of University of California* (2007) 156 Cal.App.4th 809, 849, the appellant advanced a new theory of damages on appeal for which no factual record had been developed;

here, in contrast, Metropolitan developed what record it could and asserted viable damages theories at trial. (AOB 129-130.)[38]

E. The Superior Court Awarded Excessive Interest

San Diego defends the superior court's excessive prejudgment interest award (ROB 83) by again confusing the standards of review for questions of law and factual findings. The applicable 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), which San Diego does not dispute except to argue that, because the superior court considered extrinsic evidence, its conclusions are binding. (ROB 83.)

Section 12.4(c) of the Exchange Agreement is clear that the prejudgment interest that will be paid is the interest earned on the disputed amount in an interest-bearing account during the course of the dispute. (22-AA-06147 § 12.4(c).) That this was an

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[38] San Diego's other cited authorities are equally distinguishable. (*See, e.g.*, *DePalma v. Westland Software House* (1990) 225 Cal.App.3d 1534, 1544-46 [tax consequences should not be considered mitigating factor in contract damages, in part because federal law limits risk of excess recovery based on tax consequences]; *Benard v. Walkup* (1969) 272 Cal.App.2d 595, 605-06 [defendant did not pursue excessive damages argument]; *Allen v. Gardner* (1954) 126 Cal.App.2d 335, 340 [plaintiff offered proof of value of full performance].)

unambiguous stipulation regarding interest is confirmed by San Diego's own pleading in its complaint, praying for interest "as a result of the express term in section 12.4(c) of the [Exchange] Agreement." (2-AA-00250 ¶ 4, 00285-86; 6-AA-01366 ¶ 4, 01402; 4-AA-00983 ¶ 4, 01015.) San Diego makes no effort to explain why its own pleading does not confirm that Section 12.4(c) is a stipulated interest provision.

Although the superior court used extrinsic evidence to determine that Section 12.4(c) of the Exchange Agreement was a security provision rather than a liquidated damages provision, it was improper to ignore the plain language of the contract with respect to the stipulated interest provision. The consideration of extrinsic evidence does not insulate a flawed legal determination from review and reversal. (*Tahoe Nat'l Bank v. Phillips* (1971) 4 Cal.3d 11, 23-24.)

III. SAN DIEGO FAILS TO DEFEND THE SUPERIOR COURT'S ERRONEOUS FINDING THAT SAN DIEGO IS ENTITLED TO PREFERENTIAL RIGHTS CREDIT FOR ITS PAYMENTS UNDER THE EXCHANGE AGREEMENT

As set forth in Metropolitan's opening brief (AOB 135-36), Section 135 of the Metropolitan Water District Act (Wat. Code appen., § 109-135) gives each of Metropolitan's member agencies preferential rights to supplemental water supplies in proportion to "the total accumulation of amounts paid by such agency to the

district on tax assessments and otherwise, excepting purchase of water, toward the capital cost and operating expense of the district's works." Metropolitan's interpretation of "purchase of water" to include payments under the Exchange Agreement is both correct and entitled to deference. (*San Diego, supra,* 117 Cal.App.4th 13, 23 & fn. 4.) San Diego offers no compelling argument to the contrary.

As a preliminary matter, San Diego again confuses the standard of review. Although San Diego suggests that deference to the superior court's determination is required by describing it as supported by "substantial evidence" three times in three pages (ROB 85-87), the correct standard of review is de novo. As the Supreme Court has made clear, the presence of factual issues does not change the standard of review for a primarily legal issue:

> If the pertinent inquiry requires application of experience with human affairs, the question is predominantly factual and its determination is reviewed under the substantial-evidence test. If, by contrast, the inquiry requires a critical consideration, in a factual context, of legal principles and their underlying values, the question is predominantly legal and its determination is reviewed independently.

(*See, e.g., Crocker Nat'l Bank v. City and County of San Francisco* (1989) 49 Cal.3d 881, 888, in bank.) Whether San Diego's payments under the Exchange Agreement are entitled to preferential rights credit is a question of statutory and, potentially, contract interpretation and

"requires a critical consideration, in a factual context, of legal principles and their underlying values." (*Ibid.*) Thus, the superior court's preferential rights analysis is entitled to no deference. Rather, it is *Metropolitan's* interpretation of its implementing act that must be accorded "great weight and respect." (*San Diego*, *supra*, 117 Cal.App.4th 13, 22.)

Turning to the legal question, San Diego first attempts to dismiss the relevance of this Court's prior decision in *San Diego*—which directly addresses the preferential rights statute and the meaning of "purchase of water"—merely because it "had nothing to do with the Exchange Agreement." (ROB 85.) Although the Exchange Agreement was not at issue, Metropolitan's volumetric rates—including volumetric charges for conveyance—were, and *San Diego* is dispositive.

In concluding that portions of Metropolitan's volumetric rates that recovered costs of conveyance were amounts paid for the "purchase of water," this Court reviewed the statutory framework and legislative history and concluded that, although the Legislature expected that Metropolitan would ultimately recoup its capital costs and operating expenses from its water rates, it consciously excluded these payments from the preferential rights formula: "The legislative history [of the preferential rights statute], when coupled with the nature of the amendments to the statutory scheme over the years, reveals a legislative awareness and expectation that water rates

would eventually generate sufficient revenues to pay the bulk of Metropolitan's capital and operating expenses," in lieu of reliance on Metropolitan's other means of paying for capital and operating expenses, such as property taxes (Wat. Code appen., §§ 109-305, 307), benefit assessments (*id.* at §§ 109-134.6 *et seq.*), bond indebtedness (*id.* at §§ 109-200 *et seq.*), or standby and availability charges (*id.* at § 109-134.5). (*San Diego, supra,* 117 Cal.App.4th 13, 26-28.)

Nevertheless, this Court concluded, the statutory wording "supports the evident purpose of excluding *any portion of water rates used to pay capital costs and operating expenses* from the formula for calculating preferential rights." (*Id.* at p. 28, emphasis added.) Thus, *San Diego* recognizes that section 109-135 contemplates excluding Metropolitan's volumetric rates used to pay capital costs and

operating expenses[39]—like the Transportation Rates charged in the Exchange Agreement—from the preferential rights calculation.[40]

Finally, San Diego selectively excerpts Metropolitan's brief to argue that "[i]t is not, as Met[ropolitan] contends, 'arbitrary and unfair to credit San Diego, but not others,' for payments that are made by 'San Diego, but not others.'" (ROB 87.) But this is the very opposite of what Metropolitan contends: Metropolitan's other member agencies make the same payments—*i.e.*, the Transportation

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[39] This dichotomous treatment of amounts paid through water rates on the one hand and other charges on the other hand is further supported by Section 109-135's explicit identification of "tax assessments" in describing the touchstone of the preferential rights formula. (Wat. Code appen., § 109-135; *accord* 2-RA-567:11-568:1.)

[40] Metropolitan disputes that the judgment below requires wheeling payments to be credited under the preferential rights calculation. Metropolitan did not challenge the superior court's purported finding to the contrary on appeal (ROB 86) because it is at most dicta. After Metropolitan alerted the superior court that San Diego had not sought declaratory relief with respect to preferential rights credit for wheeling payments and the matter had not been litigated (34-AA-09456-57; 6-AA-01403), the superior court deleted this "finding" from the ultimate conclusion of its tentative decision (*compare* 5-ARA-1328 *with* 34-AA-09489), and no declaration concerning the preferential rights treatment of wheeling payments was included in the judgment. (34-AA-09585-86.)

Rates—as part of the full service water rate. San Diego and Metropolitan's member agencies are paying for the delivery of water using Metropolitan's conveyance system. There is no principled reason why San Diego should receive credit when the other member agencies do not.

Metropolitan's Response to San Diego's Cross-Appeal

Counter-Statement of Facts

A. Metropolitan's Demand Management Programs And RSI Provision

As part of its legislative mandate to "expand water conservation, water recycling, and groundwater recovery efforts" (Wat. Code appen., § 109-130.5; 10-AA-02526-62), Metropolitan enters into demand management project contracts with its member agencies that are designed to develop and conserve local water resources. (3-RA-0641 ¶ 3.) Metropolitan does not enter into these contracts with individual members of the general public. (*Ibid*.) Member agencies are not guaranteed contracts; rather, they must apply for these contracts by submitting proposals, which Metropolitan's Board of Directors approves at its discretion. (*Id.* ¶ 4.)

Under these contracts, Metropolitan pays for every acre-foot of water produced or conserved locally, using revenues from the Water Stewardship Rate. (*Id.* at ¶¶ 3, 5.) These project contracts are not grants (1-ARA-0017:4-7); rather, they are payments made by Metropolitan as consideration for the development or conservation of local water.

In 2004, after considering comments from member agencies, including San Diego, Metropolitan's Board of Directors voted to include a Rate Structure Integrity ("RSI") provision in all such

project contracts going forward. (*See generally* 3-RA-0644-47.) The RSI provision requests that a contracting member agency address "any and all future issues, concerns and disputes relating to [Metropolitan's existing rate structure] through administrative opportunities available to [it] pursuant to Metropolitan's public board process." (3-RA-822 § 8.2, subd. (a).) If the contracting party instead challenges the rate structure which funds the demand management projects, through litigation and/or legislation, Metropolitan's Board has the discretion to terminate project payments. (*Id.* at 823 § 8.4.) The RSI provision does not prohibit litigation or limit or exempt Metropolitan from liability. (1-ARA-0023:2-6, 0024:6-14.)

B. San Diego's Demand Management Contracts

San Diego established a policy not to enter into any contracts containing the RSI provision and abided by its policy for three years. (1-ARA-0029:14-30:13.) Beginning in 2007, however, San Diego entered into six demand management project contracts with Metropolitan that contained the RSI provision. (3-RA-642 ¶ 9.) After considering whether it was waiving its legal rights by entering into these project contracts and seeking legal counsel during the negotiations for these contracts, San Diego entered into these contracts without any purported reservation of rights. (1-ARA-0019:3-12, 0038:15-395, 0040:12-41:23, 0045:9-48:19, 0049:2-50:6, 0051:15-52:24; 3-RA-642 ¶ 9.) Metropolitan paid San Diego for its

performance under the contracts until San Diego triggered the RSI provision by filing the 2010 Case. (3-RA-822-23 §§ 8.2, 8.4.)

Argument

I. THE SUPERIOR COURT CORRECTLY DISMISSED SAN DIEGO'S RATE STRUCTURE INTEGRITY CLAIM

A. San Diego Lacks Standing To Challenge The RSI Provision Under The Unconstitutional Conditions Doctrine

The superior court correctly entered judgment in favor of Metropolitan on San Diego's claim that the RSI provision imposes an unconstitutional condition on its right to petition. As the superior court correctly concluded, San Diego lacks standing. San Diego "does not have an independent constitutional right to petition the legislature or the courts…because that is an inherently individual right." (7-AA-1821.)

This holding is amply supported by precedent. Political subdivisions of the state "cannot assert constitutional rights which are intended to limit governmental action vis-à-vis individual citizens." (*Star-Kist Foods, Inc. v. County of Los Angeles* (1986) 42 Cal.3d 1, 8-9 (*Star-Kist*); *Santa Monica Community College Dist. v. Public Employment Relations Bd.* (1980) 112 Cal.App.3d 684, 690 [acknowledging "the long line of cases which hold that a public entity, being a creature of the state, is not a 'person' within the meaning of the due process clause, and is not entitled to due process

from the state"]; *County of Los Angeles v. Super. Ct.* (1933) 128 Cal.App. 522, 526 (*Los Angeles*) ["[T]he county is not a 'person' within the meaning of either the federal or the state Constitution…."].) A state or its political subdivisions may only assert structural constitutional rights like the commerce clause or the supremacy clause. (*Star-Kist*, *supra*, 42 Cal.3d 1, 8-9.)

The right to petition asserted by San Diego is not a structural right but an individual right. (*See, e.g.*, *Wolfgram v. Wells Fargo Bank* (1997) 53 Cal.App.4th 43, 50-52 [noting that "[t]he right to petition for redress of grievances is the right to complain *about* and complain *to the government*" derives from the Magna Carta and is a "simple, primitive, and natural right"], emphasis added.) As a political subdivision of the state, San Diego therefore lacks standing under *Star-Kist* to assert a right to petition.

San Diego seeks reversal on three grounds, none of which has merit:

First, San Diego urges the Court to ignore *Star-Kist*, claiming it applies only to the "enforceability of federal rights." (ROB 99.) But San Diego articulates no reason why the same rule should not apply to the enforceability of rights afforded by the California Constitution. Nor is there one. These standing rules have equal force to claims brought under the California Constitution. (*See Native American Heritage Com. v. Bd. of Trustees* (1996) 51 Cal.App.4th 675, 683 (*Native American Heritage*) [discussing standing of state

entities in the context of the California Constitution]; *Los Angeles*, 128 Cal.App. 522, 526 ["[T]he county is not a 'person' within the meaning of either the federal or the *state* Constitution…."], emphasis added; *Bd. of Supervisors v. McMahon* (1990) 219 Cal.App.3d 286, 296 [rejecting attempt to distinguish between claims brought under federal and state constitutions and reiterating general rule that political subdivisions cannot assert constitutional protections intended to limit government encroachment on individual citizens' rights].)

Second, San Diego argues that its RSI claim falls within the limited exception to the rule for the assertion of structural rights. To the extent San Diego is contending the right to petition is a structural right, it is wrong. The Constitution gives "[t]he *people*…the right to…petition government for redress of grievances[.]" (Cal. Const. art. I, § 3, emphasis added.) Moreover, California's Constitution, like the United States Constitution, divides its Constitution between "rights" and "powers": the right to petition is situated in Article I, the Declaration of Rights, which is intended to provide and protect the rights of the people, as opposed to defining and limiting the powers of the government. (*Compare* Cal. Const., art. I *with id.* art. XI [prescribing scope of powers and duties of local government].)

To the extent San Diego seeks to broaden this exception to reach individual rights, this argument too must be rejected. As *Star-Kist* makes clear, the limited exception for structural rights is

necessary only because these rights "define[] the relative powers of states and the federal government." (*Star-Kist*, *supra,* 42 Cal.3d 1, 9.) The exception does not apply anytime "there is a real possibility" a wrong would go "unchecked," as San Diego argues by cobbling together cherry-picked phrases from *Star-Kist*. (ROB 100.)

Third, San Diego argues that because Metropolitan's member agencies' constituents may have an interest in pursuing claims against Metropolitan, San Diego should have standing to assert those constituents' interests on their behalf. (ROB 101.) A state entity has third-party standing only if (i) the constituents' rights are inextricably bound up with the state entity's rights; and (ii) there are genuine obstacles preventing the constituents from asserting their own rights. (*Native American Heritage*, *supra,* 51 Cal.App.4th 675, 684; *see also Sanchez v. City of Modesto* (2006) 145 Cal.App.4th 660, 675-77.) San Diego fails to fulfill either requirement.

The rights of San Diego's constituents are not inextricably bound with San Diego's because San Diego's constituents have no rights at all in these private contracts between San Diego and Metropolitan. The contracts encourage San Diego to develop or conserve local water supplies in exchange for payments from Metropolitan. (3-RA-0641 ¶ 3.) Metropolitan does not enter into any of these contracts with the general public and no member of the general public is a signatory to any of these contracts on his or her own behalf. (*Ibid.*) Merely having an ancillary or attenuated benefit

does not amount to having a vested interest in a contract between two parties; rather, a third-party beneficiary must be expressly identified. (*H.N. and Frances C. Berger Foundation v. Perez* (2013) 218 Cal.App.4th 37, 43-44 [private citizens had no third-party standing to enforce a government contract relating to improvements of roads affecting their property]; *City and County of San Francisco v. Western Air Lines, Inc.* (1962) 204 Cal.App.2d 105, 120 [airline was not third-party beneficiary in contracts between federal government and local government just because "[it] may also be incidentally benefitted…with longer runways, brighter beacons, or larger loading ramps…."].) Nor are there any genuine obstacles preventing the constituents from asserting their own rights; they simply have no rights to assert with respect to contracts between Metropolitan and its member agencies. San Diego cannot borrow standing from constituents who lack it themselves.

In any event, San Diego failed to raise its third-party standing argument in its pleadings, as the superior court noted when rejecting it. (7-AA-1818; 1821 & fn. 51, citing *Bostrom v. County of San Bernardino* (1995) 35 Cal.App.4th 1654, 1664.) San Diego's passing reference to rate payors in justifying its request for declaratory relief hardly equates to asserting third-party standing. For this additional reason, San Diego's third-party standing argument fails.

B. Even If San Diego Had Standing, It Does Not "Win[] On The Merits"

As an alternate ground for affirmance, San Diego's unconstitutional conditions claim would fail on the merits even if San Diego had standing to assert it (which it does not). Other than parroting the superior court's conclusions on the merits—which, given San Diego's lack of standing, was dicta—San Diego does not discuss the merits at all, even though this Court's review is de novo. As demonstrated below, San Diego's unconstitutional conditions claim fails on the merits for two additional reasons: (1) there was no public benefit being conditioned; and (2) San Diego made a knowing and voluntary waiver of any petitioning rights.[41] In any event, San Diego does not "win[] on the merits" (ROB 97) because, even if it had standing, summary adjudication in its favor would have been improper.

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[41] New facts or theories San Diego raises on reply to support its conclusory arguments should not be considered by the Court. (*Benach v. County of Los Angeles* (2007) 149 Cal.App.4th 836, 852 & fn. 10 ["It would be unfair to permit an appellant to wait to argue his substantive points until after the respondent exhausts its only opportunity to address an issue on appeal"].)

(a) No Public Benefit Is Being Conditioned

San Diego's unconstitutional conditions claim fails because there is no "publicly-conferred benefit" being conditioned. (*Parrish v. Civil Service Comm'n of Alameda County* (1967) 66 Cal.2d 260, 271 (*Parrish*) [unconstitutional conditions doctrine applies to "publicly-conferred benefit[s]"].) On summary judgment, Metropolitan argued that "the 'public benefits' at issue in California's unconstitutional conditions cases are made generally available by the government, in its capacity as sovereign, *to private citizens*." (3-RA-0606, emphasis added; *accord Robbins v. Superior Court*, (1985) 38 Cal.3d 199, 203, 206-07 (*Robbins*) [welfare benefits]; *Parrish, supra,* 66 Cal.2d 260, 271 [welfare benefits]; *Danskin v. San Diego Unified School Dist.* (1946) 28 Cal.2d 536, 538-39 [access to public fora]; *Bagley v. Washington Twp. Hosp. Dist.* (1966) 65 Cal.2d 499, 505 [government employment benefits]; *Binet-Montessori, Inc. v. San Francisco Unified Sch. Dist.* (1979) 98 Cal.App.3d 991, 994 [use of public property].)

In contrast, the RSI provision conditions contracts between two government agencies. The "benefits" at issue here are payments made by Metropolitan to San Diego as consideration for San Diego's performance of its obligation of conserving water or producing local water. (3-RA-0641 ¶ 3.) Because Metropolitan's payments to San Diego are not "publicly-conferred benefits," the unconstitutional conditions doctrine does not apply.

In concluding that Metropolitan's payments to San Diego *are* publicly-conferred benefits, the superior court (in dicta) erroneously focused on the public or private nature of the party conferring, rather than receiving, the benefit, to conclude that *any* benefit conferred by the government is publicly-conferred. (7-AA-01822-23.) The superior court reasoned that because the unconstitutional conditions doctrine has been applied to benefits that are afforded to small numbers of people (e.g., government employment contracts), publicly-conferred must refer to the public nature of the conferring party rather than a benefit that is conferred on the public at large. (7-AA-01823.)

The superior court's focus on the entity conferring the benefit was simply wrong: The unconstitutional conditions doctrine applies even to benefits conferred by private entities if government action caused the imposition of the condition. (*See, e.g., Koveleskie v. SBC Capital Mkts., Inc.* (7th Cir. 1999) 167 F.3d 361, 368 ["The unconstitutional conditions doctrine prohibits a private entity, acting pursuant to government mandate, from conditioning a worker's employment upon a waiver of that worker's constitutional rights"].) Further, the superior court's interpretation would

improperly extend this doctrine to *any* benefit conferred by the government, regardless of how attenuated from the citizenry, as the superior court recognized. (7-AA-1822; *see also* 26-RT-1104:19-25.)[42]

(b) There Was A Voluntary And Knowing Waiver

San Diego's unconstitutional conditions claim also fails on the merits because it knowingly and voluntarily waived its right to petition. Constitutional rights may be contractually waived through knowing and voluntary consent. (*Leonard v. Clark* (9th Cir. 1993) 12 F.3d 885, 890 (*Leonard*) [union's consent to labor agreement was voluntary and intelligent waiver of its members' First Amendment rights]; *Lake James Cmty. Volunteer Fire Dept., Inc. v. Burke County, N.C.* (4th Cir. 1998) 149 F.3d 277, 282 (*Lake James*) [volunteer fire

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[42] The requirement of a direct relationship between the state and the private citizen is also important because it implicates disparate bargaining power concerns. The purpose of the doctrine is to prohibit the government (or a private entity pursuant to government mandate) from inducing waivers of constitutional rights through oppression. (*See e.g., Parrish*, 66 Cal.2d at 270 [noting waiver requested by government employees "whom the beneficiaries knew to possess virtually unlimited power over their very livelihood"].) There are no such concerns here, where Metropolitan and San Diego are both state agencies.

department's decision to waive its right to petition was "made knowingly and voluntarily"]; *D.H. Overmyer Co. Inc. v. Frick Co.* (1972) 405 U.S. 174, 187 (*Overmyer*) [waiver of Fourteenth Amendment right to prejudgment notice and hearing was enforceable because party did so "voluntarily, intelligently, and knowingly…with full awareness of the legal consequences in exchange for the benefit of relief from delinquent payments"].)

In a similar vein, other courts have rejected the application of the unconstitutional conditions doctrine entirely when a sophisticated party knowingly and voluntarily enters into a contract with the government. (*Barden Detroit Casino, L.L.C. v. City of Detroit* (E.D. Mich. 1999) 59 F.Supp.2d 641, 648-49, 661-62 [declining to apply doctrine to "Consent and Release" agreement preventing casino from challenging ordinance as condition of submitting bid in city's and state's application process]; *West Chelsea Bldgs., LLC v. United States* (2013) 109 Fed.Cl. 5, 27-28 [declining to apply the doctrine of unconstitutional conditions to "voluntary agreement" not to sue because it was "negotiated over long periods of time between sophisticated business people represented by counsel in connection with a complex plan for development…executed as part of an overall deal in which benefits were given in exchange for certain obligations by all parties."]; *Lake James, supra,* 149 F.3d 277, 282 [finding waiver and, alternatively, that condition was proper].)

Lake James is instructive. There, the court held that an agreement not to sue between a volunteer fire department and the government was not a violation of the unconstitutional conditions doctrine because "[t]hat principle . . . does not categorically preclude parties from negotiating contractual relationships that include waiver of constitutional rights such as a covenant not to sue." (*Lake James, supra*, 149 F.3d 277, 282.) The volunteer fire department in *Lake James* had sought out legal counsel, agreed to the terms and signed the contract, and had also submitted a letter objecting that the agreement violated the department's right to petition. (*Id.* at pp. 279-80.) The court found this agreement enforceable despite the volunteer fire department's objections. It noted that the volunteer fire department "protested the difficult choice…[but nevertheless] voluntarily executed the contract….By executing and returning the contract, it clearly made that difficult choice. But making a choice rendered difficult because of a weak bargaining position of its own creation does not render the execution of the contract involuntary." (*Id.* at p. 281.) Here, as in *Lake James*, the unconstitutional conditions doctrine is inapplicable because it does not prevent sophisticated parties like Metropolitan and San Diego, with advice from legal counsel, "from negotiating contractual relationships that include waivers of constitutional rights such as a covenant not to sue." (*Id.* at p. 282.) San Diego considered its choices, sought legal counsel's advice, and subsequently made the choice to enter into contracts

with Metropolitan containing the RSI provision. (1-ARA-0019:3-12, 0038:15-395, 0040:12-41:23, 0045:9-48:19, 0049:2-50:6, 0051:15-52:24.)

The superior court incorrectly rejected (in dicta) Metropolitan's waiver and consent argument, finding that a beneficiary's (presumably unwilling) waiver is assumed if he or she has accepted the public benefit, relying on *Robbins* and *Parrish* to reject Metropolitan's waiver and consent argument. (7-AA-01824.) *Robbins* and *Parrish*, however, both involved indigent individuals whose welfare benefits or housing were conditioned on the surrender of constitutional rights. (*Robbins*, 38 Cal.3d 199, 207 [noting that plaintiffs would be subjected to personal sacrifices, psychological impact, physical danger, and loss of control over personal decisions]; *Parrish*, 66 Cal.2d 260, 270-71 [noting that knowing and fully voluntary waiver was insufficient "in this case" given that individuals could be "submit[ted] to random, exploratory searches of their homes from inception"].) These concerns are not present for a contract (as here) between two sophisticated and willing parties, one of whom has received enormous consideration while covenanting not to sue.

Although not explicitly implicating the unconstitutional conditions doctrine, *Leonard* is instructive because, unlike *Parrish* and *Robbins*, it involved no imbalance of power or fear of undue coercion from the state. In *Leonard*, the court affirmed the district court's ruling that a labor union's collective bargaining agreement

with the City of Portland was enforceable even though conditioned on a waiver of its right to petition. (*Leonard*, 12 F.3d 885, 886.) In concluding that the union had made a voluntary and knowing waiver of its "full and unrestricted exercise of those rights," the court noted that the union was advised by competent counsel, and had voluntarily signed the agreement despite its objections that it was "unconstitutional, illegal, and unenforceable." (*Id.* at 889-90.) The court further noted that, if the union believed its constitutional rights were burdened, "it should not have bargained them away and signed the agreement" in a contract between "parties of relatively equal bargaining strength." (*Id.* at p. 890.)

It is undisputed that San Diego knowingly and voluntarily entered into the contracts that included the RSI provision. San Diego was fully aware of the ramifications of that provision, having voiced objections to the RSI provision before Metropolitan adopted its policy of including it in this type of contract as well as having been advised by competent legal counsel in negotiating contracts containing the RSI provision. (1-ARA-0017:17-18:12.) Like the union in *Leonard*, San Diego "bargained…away" any right it otherwise had to challenge Metropolitan's rates and still reap the benefits of those rates, having knowingly entered into the contracts as a sophisticated, represented party "of relatively equal bargaining strength" to Metropolitan. (*Leonard*, 12 F.3d 885, 890; *see also Lake James*, 149 F.3d 277, 281; *Sanchez v. County of San Bernardino* (2009)

176 Cal.App.4th 516, 528-30; *Navellier v. Sletten* (2002) 29 Cal.4th 82, 97-98 [noting that "[m]any preexisting legal relationships may properly limit a party's right to petition, including enforceable contracts in which parties waive rights to otherwise legitimate petitioning"].) San Diego's unconstitutional conditions claim fails for this reason also.

(c) The Superior Court Could Not Find For San Diego On The Merits On Summary Adjudication

Finally, San Diego contends it "win[s] on the merits" if it has standing because the superior court so stated in *dicta*. That is incorrect. The superior court's dicta, if regarded as "findings," would have to be reviewed de novo in an appeal from a judgment. And here, triable issues of material fact preclude any summary adjudication of San Diego's unconstitutional conditions claim in its favor.

Even if San Diego had standing and had successfully established that the RSI provision conditioned receipt of a public benefit upon the waiver of a constitutional right, Metropolitan still could prevail against San Diego's unconstitutional conditions claim. Metropolitan would have been required to "establish that: (1) the condition reasonably relates to the purposes of the legislation which confers the benefit; (2) the value accruing to the public from imposition of the condition manifestly outweighs any resulting

impairment of the constitutional right; and (3) there are no available alternative means that could maintain the integrity of the benefits program without severely restricting a constitutional right." (*Robbins, supra*, 38 Cal.3d 199, 213; *accord* 7-AA-01824.) In applying this factual balancing test, the superior court improperly purported to resolve material disputes of fact without a trial.

In opposing San Diego's cross-motion for summary adjudication of its RSI claim, Metropolitan proffered evidence that the RSI provision reasonably relates to its demand management programs because it protects the stability of Metropolitan's rate structure that funds the programs and guards against the destabilizing effect of external challenges to that structure;[43] San Diego contended that this contention was "demonstrably false." (*Compare, e.g.*, 3-RA-681-83 *with* 3-RA-866-68.) The superior court weighed conflicting evidence in concluding that the RSI provision's "benefit [is] insubstantial." (7-AA-1827.) The superior court similarly weighed competing evidence regarding whether the RSI provision is narrowly tailored. (7-AA-01827-28.) Because factual

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[43] Metropolitan's own motion for summary adjudication of San Diego's RSI claim was not based on the balancing test because of its inherently factual nature. (3-RA-0603-09.)

questions remain as to whether the benefit is substantial or the provision is narrowly tailored, the superior court could not properly resolve them on summary adjudication. (*See Aguilar v. Atlantic Richfield Co.* (2001) 25 Cal.4th 826, 856 ["the court may not weigh the plaintiff's evidence or inferences against the defendants'" on summary judgment].) San Diego could not "win on the merits" on summary adjudication.

C. The Superior Court Correctly Dismissed San Diego's Challenge to the RSI Provision Under Section 1668

As the superior court correctly concluded, the RSI provision does not violate section 1668 of the Civil Code because it does not exempt Metropolitan from liability, either directly or indirectly, which is all that is barred by the statute. (7-AA-1829-30.)

California courts have invalidated contracts under section 1668 when the contracts purport to exempt or absolve a party from liability. (*City of Santa Barbara v. Super. Ct.* (2007) 41 Cal.4th 747, 757-58; *see also Frittelli, Inc. v. 350 N. Canon Drive, LP* (2011) 202 Cal.App.4th 35, 43; *Tunkl v. Regents of Univ. of Cal.* (1963) 60 Cal.2d 92, 94 [invalidating provision that required patients to "release []…the hospital from any and all liability"].) But courts caution that "exemption" under section 1668 should be construed narrowly, and if a provision does not "totally exempt" a party from liability, then section 1668 is inapplicable. (*See e.g., Farnham v. Super. Ct.* (1997) 60 Cal.App.4th 69, 73-74, 78 [upholding contract provision under

section 1668 that limited liability to a "sole remedy" as opposed to "exemptions from *all* liability…[which] have been consistently invalidated…"], emphasis in original; *Lagatree v. Luce, Forward, Hamilton & Scripps LLP* (1999) 74 Cal.App.4th 1105, 1136-37 [upholding arbitration clause under section 1668, rejecting argument that it "lessen[ed] an employer's liability for its future wrongful conduct" because its substantive rights are not foregone, only diverted to an arbitral forum].)

Thus, the RSI provision does not violate section 1668 because, as the superior court found, it "does not bar suit. It does not on its face exempt Metropolitan from any sort of liability at all." (7-AA-1829.) Rather, the RSI provision merely provides that, if San Diego challenges Metropolitan's rates through litigation or legislation, then it cannot simultaneously monetarily benefit from contracts funded by the very rates it is challenging. (*See, e.g.*, 3-RA-822-23, §§ 8.2, 8.4.)

Without acknowledging the absurdity of contending that the RSI provision exempts Metropolitan from liability at the same time it attempts to defend its $240 million judgment on appeal, San Diego argues, contrary to the plain language of the statute, that "[c]omplete exemption from liability is not required. Even the 'indirect' object of avoiding responsibility for violating the law is prohibited." (ROB 104.) Even setting aside that "indirect" does not mean "partial," the RSI provision does not *exempt* liability at all, partially or completely. (7-AA-1829-30.) Even San Diego describes

the RSI provision as having the "clear purpose of deterring lawsuits." (ROB 104.) But "deterring" lawsuits "in the sense of reducing the odds one will be filed" (*ibid.*; 7-AA-1829) does not *exempt* liability.

San Diego mischaracterizes the law on which it relies. *Health Net of California, Inc. v. Dept. of Health Services* (2003) 113 Cal.App.4th 224 (*Health Net*), the primary basis for San Diego's argument, involved a contractual provision that *did* prohibit any recovery of damages. *Health Net* rejected the notion that Section 1668 applies *only* to exculpatory provisions that implicate public interests. (*Id.* at pp. 234-35.) *Health Net* noted, *arguendo*, that the exculpatory provision in that case would violate Section 1668 even under the more narrow view that it had rejected. (*Id.* at p. 236.) *Health Net* does not suggest that a provision that does not excuse liability can be invalid under section 1668 any time a public interest is present. Because the RSI provision does not exempt Metropolitan from liability, it does not violate section 1668.

II. THE SUPERIOR COURT CORRECTLY APPLIED THE EXCHANGE AGREEMENT'S ATTORNEYS' FEES PROVISION

San Diego's second argument on cross-appeal should also be rejected. The superior court correctly interpreted the attorneys' fee provision in the Exchange Agreement to cover only disputes

challenging Metropolitan's rates. The fee provision is included in the price term, which states in relevant part:

> ...[N]othing herein shall preclude [San Diego] from *contesting in an administrative or judicial forum whether such charge or charges have been set in accordance with applicable law and regulation*….In the event that [San Diego] contests a matter pursuant to the foregoing sentence, the prevailing Party shall be entitled to recovery of reasonable costs and attorneys fees incurred in prosecuting or defending against such contest.

(22-AA-6137-38, § 5.2, emphasis added.) The attorneys' fees term expressly provides for attorneys' fees for contests of whether Metropolitan's rates "have been set in accordance with applicable law and regulation" such as the rate challenges decided in Phase I. (*Ibid.*) It does not provide for attorneys' fees for any other disputes, nor does any other provision in the Exchange Agreement. (*See generally* 22-AA-6122-56.)

California courts routinely enforce narrow fee provisions. (*See, e.g.*, *Paul v. Schoellkopf* (2005) 128 Cal.App.4th 147, 153-54 [where fee provision provided recovery for actions involving escrow holder but was silent on other actions, fees on other claims were not recoverable]; *Hasler v. Howard* (2004) 120 Cal.App.4th 1023, 1027 [enforcing fee provision limited to actions pertaining to obligation to

"pay compensation" to preclude recovery of attorneys' fees for other claims].)

Even though Phase II involved claims by San Diego other than its rate challenges, San Diego argues that the superior court had "'no discretion'" to deny its Phase II attorneys' fees because it obtained a "'simple, unqualified win,'" quoting *Hsu v. Abbara* (1995) 9 Cal.4th 863 (*Hsu*). (ROB 106.) But *Hsu* stands only for the proposition that section 1717 of the Civil Code eliminates discretion to enforce a contractual attorneys' fees position where there is an undisputed prevailing party. (*Hsu*, 9 Cal.4th 863, 878-88.) It does not suggest that the superior court was required—or even permitted—to depart from the plain language of the fee provision.[44] And nothing in section 1717 suggests that the superior court must award San Diego fees in excess of what the parties agreed to; rather, section 1717 respects contractual intent by applying only to the extent the parties have agreed to attorneys' fees. (*See* Civ. Code, § 1717.)

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[44] *Hsu, supra,* 9 Cal.4th 863, 866 involved a broad fee provision that applied to "any action between [the parties] arising out of [the] agreement," making any consideration of the scope of the fee provision unnecessary.

San Diego also argues that it is entitled to its Phase II attorneys' fees because San Diego "contested 'such charge or charges'" in that phase too by suing for breach and damages. (ROB 106.) But the fee provision is not so broad, and applies only to contests of "whether such charge or charges have been set in accordance with applicable law and regulation." (22-AA-6137-38, § 5.2.) Mr. Thomas's testimony that "Section 5.2 allows [San Diego] to do what it has done in this case," cited by San Diego (ROB 107), has nothing to do with attorneys' fees and was solicited in response to questioning about whether and when San Diego could "file a lawsuit to challenge [Metropolitan's] rates." (25-AA-6954:6-55:1.)

Throughout the case, the superior court consistently characterized Phase I as pertaining to the rates challenge and Phase II as pertaining to preferential rights and San Diego's breach of contract claims. (*See* 34-AA-09463-65; 27-AA-7454.) Phase I was a "contest" of whether Metropolitan's Transportation Rates and wheeling rate "have been set in accordance with applicable law." Phase II did not re-litigate the lawfulness of the rates; indeed, San Diego repeatedly argued that the unlawfulness of Metropolitan's rates had been fully determined in Phase I. (40-RT-2380:5-2381:18; 45-RT-3164:14-20, 3167:17-3168:15, 3169:13-28; 35-RT-2227:3-11, 2228:19-2229:10.) There was no error in the superior court's conclusion that the Exchange Agreement's attorneys' fee provision applied only to Phase I.

Conclusion

For all of the foregoing reasons, Metropolitan respectfully requests that the Court vacate the judgments and peremptory writs below in their entirety, except for the denial of San Diego's requests for declaratory relief regarding the RSI provision and for attorneys' fees for Phase II, and remand for entry of judgment in Metropolitan's favor.

DATED: September 23, 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: September 23, 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: September 23, 2016 ALESHIRE & WYNDER LLP

By: */s/ Christine M. Carson*
Christine M. Carson
Attorneys for Appellant Municipal Water District of Orange County

DATED: September 23, 2016 CITY OF TORRANCE

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

DATED: September 23, 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: September 23, 2016 BRUNICK, MCELHANEY, BECKETT, DOLEN & 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 Appellants' Reply and Cross-Respondent's Responding Brief has line-spacing of one-and-a-half space and is printed in proportionally spaced 13-point Palatino Linotype typeface. It is 146 pages long and contains 26,577 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.

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/s/ Kathleen M. Sullivan
Kathleen M. Sullivan

State of California)
County of Los Angeles)
)

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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 Mark J. Hattam San Diego County Water Authority 4677 Overland Avenue San Diego, California 92123-1233 dhentschke@sdcwa.org mhattam@sdcwa.org *Attorneys for Petitioner and Appellant, San Diego County Water Authority*