Case No. S243500

In the

Supreme Court

of the

State of California

SAN DIEGO COUNTY WATER AUTHORITY,
Plaintiff and Appellant,

v.

METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA et al.,
Defendants and Appellants.

OF A PUBLISHED DECISION OF THE FIRST APPELLATE DISTRICT, DIVISION 3
CASE NOS. A146901, A148266, AFFIRMING-IN PART AND REVERSING-IN PART A JUDGMENT OF THE 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

ANSWER TO PETITION FOR REVIEW

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To the Honorable Chief Justice and Associate Justices of the California Supreme Court:

Defendant and Appellant Metropolitan Water District of Southern California ("Metropolitan") respectfully submits this Answer to the Petition for Review filed by Plaintiff and Appellant San Diego County Water Authority ("San Diego").

Counterstatement Of The Issue

Whether substantial evidence supports a public agency's inclusion in its volumetric transportation rates of water transportation costs it incurs for its integrated system.

Introduction

Stripped of rhetoric and misleading characterizations, the Petition presents only the sole, narrow issue of whether substantial evidence supports Metropolitan's allocation of a specific cost it incurs to a specific water rate it charges, which then forms the price in a unique two-party contract. The Court of Appeal correctly answered that question "Yes" in a considered, unanimous 48-page published opinion (Pollak, J., joined by McGuiness and Siggins, JJ.). That narrow and fact-specific decision correctly applies settled law and creates no conflict with other decisions. The cases the Petition tries to portray as inconsistent simply involved differing underlying facts. And the Court of Appeal's decision in fact threatens none of the dramatic policy implications conjured by the Petition. For all these reasons, the decision does not merit this Court's review.

First, in correctly upholding Metropolitan's ratemaking determination as supported by substantial evidence, the Court of Appeal applied "basic" existing precedent that neither San Diego nor the superior court questioned. (Opn. at pp. 21-22.) The court followed the well-settled rule that "the courts do not weigh competing methodologies to determine the best water rates" but rather "determine only whether substantial evidence supports the [] determination made by the rate-setting agency." (*Id.* at p. 27.) Applying that rule, the court reviewed a massive administrative record for substantial evidence supporting Metropolitan's cost allocation and, finding such evidence, reversed a superior court decision that had ignored the record. Whether the Court of Appeal correctly evaluated the record evidence is not an issue meriting review. (See Cal. Rules of Court, rule 8.500(b).)

Moreover, the Court of Appeal's substantial evidence holding is correct. The costs at issue are transportation-related costs Metropolitan incurs each year to construct, maintain, operate, and repair the State Water Project transportation infrastructure, whether or not Metropolitan obtains any State Water Project water. The Court of Appeal correctly determined that the State Water Project infrastructure is part of Metropolitan's integrated water delivery system, a crucial finding that San Diego all but ignores in its Petition. While the State Water Project is owned by the State, the State pays none of its costs; Metropolitan and other State Water

Project contractors pay all of those costs under long-term contracts with the State Department of Water Resources even if they receive no project water. Metropolitan's payment of those costs enables it to provide water to its member agencies through a single, integrated system that includes both the State Water Project's facilities (such as the California Aqueduct, which carries water from Northern California to Metropolitan's Southern California service area), and the transportation facilities Metropolitan owns (such as the Colorado River Aqueduct, which conveys water from Eastern California to Metropolitan's Southern California service area).

Just as the State itemizes the water transportation costs and water supply costs it bills to Metropolitan (and other contractors), so Metropolitan distinguishes the water transportation costs and water supply costs it bills to its own customers. Metropolitan allocates its share of the State Water Project's transportation costs to the rates it charges its customers for transporting water, and it allocates its share of the State Water Project's supply costs to the rates it charges its customers for a supply of water.

San Diego's insistence that "Metropolitan's transportation-only customers are forced to pay a rate that includes charges for a supply of Project water" (Pet. at p. 18) simply ignores the Court of Appeal's key holdings concerning Metropolitan's legal and factual relationship to the State Water Project. As the Court of Appeal correctly found, "[t]he California Aqueduct unquestionably is an

integral part of the system by which Metropolitan transports water to its member agencies." (Opn. at pp. 22-23.) And in response to San Diego's argument that Metropolitan does not "own" the State Water Project facilities, the Court of Appeal correctly held that "this heavy reliance on ownership is misplaced because the State Water Project owner does not bear its costs—Metropolitan and other contracting agencies do." (*Id.* at p. 27.) The Court of Appeal therefore correctly found substantial evidence in the administrative record to support Metropolitan's allocation of its State Water Project transportation costs to its transportation rates: "As these costs are incurred by Metropolitan, so too must they be recovered by it." (*Id.* at pp. 23-24.)

Second, the Court of Appeal did not "split" with other Court of Appeal decisions. That other decisions, considering other facts, have concluded that other rates did not reflect the reasonable costs of other services provided does not equate to a split of authority that warrants this Court's intervention. The Court of Appeal's decision is consistent with other cases rejecting efforts to apply the impossibly-strict proportionality that San Diego claims is required under Proposition 26, and the supposedly conflicting authorities identified by San Diego are easily reconciled when the facts of those cases—not discussed by San Diego—are considered.

Third, the Petition's overheated appeals to public policy concerns are baseless. For example, the Petition makes

sensationalist claims (Pet. at p. 3) about the supposedly "exorbitant rates" San Diego must pay under its water exchange agreement with Metropolitan and suggests that this will somehow discourage other water transfers in the State. But these claims are highly misleading. San Diego conspicuously fails to mention that it was *San Diego* that proposed Metropolitan's transportation rates rather than a lower fixed rate as the price term in the exchange agreement, and that San Diego received from Metropolitan as consideration state funding and future water supplies worth *well over a billion dollars*. And in suggesting that the transportation rates upheld here supposedly "inflate [San Diego's] cost of using conserved Imperial Valley water to almost *double* the cost of using water sold by Metropolitan" (*ibid.*), San Diego remarkably fails to mention that its conserved Imperial Valley water supply costs essentially *quadruple* the price of Metropolitan's water supply before Metropolitan's transportation rates even come into play. In 2015, for example, had Metropolitan charged San Diego *nothing* to exchange its water under the contract, using conserved Imperial Valley water still would have cost *$42 per acre-foot more* than using Metropolitan water. San Diego's buyer's remorse over the terms of a unique water exchange agreement—terms that San Diego itself proposed and elected—does not warrant this Court's intervention.

The other speculative policy consequences San Diego invokes find no basis in the record. They cannot transform a correct and

unremarkable decision on a fact-specific challenge to a water ratemaking cost allocation into an issue worthy of the Court's review.

The Petition should be denied.

Statement Of The Case

A. The Metropolitan Water District Of Southern California

Metropolitan is a regional water wholesaler. It operates as a voluntary cooperative of 26 member agencies (including San Diego) servicing an area with 19 million residents. (Opn. at p. 4.) It was created in 1928 to "combine the financial resources of cities and communities in Southern California and to bring supplemental water to the area." (*Metropolitan Water Dist. of So. Cal. v. Imperial Irrigation Dist.* (2000) 80 Cal.App.4th 1403, 1415 (*Imperial*).)

The member agencies govern Metropolitan through their representatives on its Board of Directors, with each agency appointing its own representatives. (Opn. at p. 4.) Representation is proportional based on the taxable property value in each member agency's service area, although each agency is entitled to a minimum of one Board seat. (*Ibid*.) The City of Los Angeles has the most directors, with San Diego—itself a water wholesaler—"close behind." (*Id.* at pp. 4-5.)

B. Metropolitan's Integrated Conveyance System

Metropolitan imports water from two principal sources: the Colorado River via the Colorado River Aqueduct and the State

Water Project in Northern California via the California Aqueduct. (Opn. at pp. 5-7.) Metropolitan built the Colorado River Aqueduct to take delivery of Colorado River water at Arizona's Lake Havasu and transport it to Southern California. (*Id.* at p. 6.) Metropolitan participates in the State Water Project through a contract with the State of California's Department of Water Resources, which gives it the right to use the Project's conveyance system and to an annual proportional allocation of available State Water Project water, if any. (*Ibid.*; *Goodman v. County of Riverside* (1983) 140 Cal.App.3d 900, 905 (*Goodman*); 2-AR2010-000175-563 [contract].)[1]

The State Water Project was initially financed in part by state bonds pursuant to the Burns-Porter Act, which was confirmed by voters in November 1960. (*Goodman*, *supra*, 140 Cal.App.3d 900, 903.) The Burns-Porter Act enacted a unified system of financing the State Water Project, including authorization for initial financing by public bonds, and also directed the Department of Water Resources to enter into contracts with local governmental entities for the sale, delivery, or use of water, power, or other services or facilities of the system. (*Id.* at pp. 903-904.) Pursuant to the Burns-Porter Act and "contracting principles" published by the Department of Water Resources, "[t]he entire cost of the [State Water] Project was to be

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[1] Record citations identify volume and page of the appellants' appendix ("AA"), appellants' reply appendix ("ARA"), administrative record ("AR2010" or "AR2012"), and reporter's transcript ("RT").

met by the proceeds of these contracts" with local agencies. (*Id.* at p. 909.) The payments under those contracts both pay for the State Water Project's costs and repay the public bonds issued to construct it. (*Id*. at p. 905.)

In 1960, Metropolitan entered into a State Water Project contract with the Department of Water Resources. (*See, e.g.*, *Goodman*, *supra*, 140 Cal.App.3d at p. 905.) Since the State Water Project's inception, such contracts have required Metropolitan and other State Water Project contractors to assume full financial responsibility for the State Water Project's capital construction and operation costs—whether or not the contracting agency receives any State Water Project water in any given year. (*Id.* at p. 904; Opn. at p. 22.) In exchange for its yearly payments, Metropolitan has the right to use the State Water Project's transportation network for transportation of both project and nonproject water. Metropolitan's member agencies may transport nonproject water through the State Water Project by paying Metropolitan's wheeling rate, with no additional payment to the State of California for use of the State Water Project facilities. (*See* Opn. at p. 23.)

The Colorado River Aqueduct, State Water Project, and Metropolitan's regional distribution system are integrated and interconnected, and have been since each portion's inception, providing Metropolitan capacity and flexibility that benefits all users. (*See* Opn. at p. 29.) The integration of these facilities allows

Metropolitan to comply with the legislative mandate that Metropolitan deliver State Water Project water to the extent reasonable and practical, and that, where it delivers a blend, aim for a blend that is at least 50% State Water Project water. (Wat. Code. appen., § 109-136.) Blending reduces the damaging salinity of water from other sources. San Diego relies on Metropolitan's blending efforts to achieve its own salinity goal. State Water Project water comprised approximately 41% of the water that Metropolitan provided to San Diego under the contract at issue in this case. (Opn. at p. 29.)

C. Metropolitan's Ratemaking Process

Metropolitan is required by statute to establish rates that will generate sufficient revenue to pay its expenses. (Opn. at p. 11; Wat. Code appen., § 109-134.) In setting rates, which requires a majority vote of Metropolitan's Board of Directors following a period for public comment, Metropolitan categorizes Metropolitan's costs as serving supply, transportation, or other functions, and allocates those categorized costs to volumetric rates (*i.e.*, rates charged per acre-foot of water Metropolitan delivers to the member agency) and fixed charges. (*See* Opn. at p. 12.) This cost of service methodology is endorsed in the compendium of rate-setting guidelines, concepts and options for consideration set forth in the American Water Works Association Manual M-1, *Principles of Water Rates, Fees, and Charges*.

D. Metropolitan's Rate Components

To replace an earlier single, bundled water rate, Metropolitan's Board of Directors voted to adopt an unbundled rate structure effective January 2003 allocating charges to separate components, including supply and transportation. (Opn. at p. 11.) Thus, "Metropolitan's water service rates are now a combination of component rates calculated to recover its costs incurred in purchasing and transporting water to its member agencies." (*Id*. at p. 12.) All rates relevant to this case are volumetric and charged as a dollar amount per acre-foot of water. (*Ibid*.)

Metropolitan's supply rates recover Metropolitan's costs of obtaining water supply from the State Water Project and Colorado River and maintaining and developing additional water supplies through transfers and other transactions. (Opn. at p. 12.)

"Metropolitan's transportation rates are designed to recover the costs of operating and maintaining its vast water conveyance infrastructure." (Opn. at p. 12.) Two such transportation rates are relevant to the Petition:

> A "system access rate" is designed to recover the capital, operating, and maintenance costs associated with transportation facilities, including "conveyance" facilities that transport water from the State Water Project and Colorado River Aqueduct and "distribution" facilities that transport water within Metropolitan's service area. A "system

> power rate" recovers the cost of pumping water through the State Water Project and Colorado River Aqueduct to Southern California.

(*Ibid.*, internal citation omitted.)[2] Like first-class postage stamps, Metropolitan's transportation rates are the same no matter how far the water is transported or which transportation facilities are used. (*Id.* at pp. 12-13.) The use of "postage stamp" rates has long been upheld and indeed one Court of Appeal decision specifically upheld Metropolitan's use of such "postage stamp" rates. (*Imperial*, *supra*, 80 Cal.App.4th 1403, 1433.)

E. Metropolitan's Service Rates

Metropolitan provides two services to its member agencies for which it charges established rates: (1) full-service water service, in which it both supplies and transports water to a member agency, and (2) "wheeling" service, in which it transports water supplied by others. (Opn. at p. 13.) Metropolitan's wheeling rate applies only to wheeling by member agencies for up to one year; the charges for other wheeling transactions are negotiated. (*Ibid*., fn. 6.)

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[2] The transportation rates also include a "water stewardship rate" whose allocation to transportation the Court of Appeal held was not supported by substantial evidence in the record before it as related to the wheeling rate and the exchange price. (Opn. at pp. 27-30.) That rate is not at issue in the Petition and Metropolitan has not petitioned for review on this issue.

Metropolitan establishes its full-service water rate and its wheeling rate based on the relevant component rates. (Opn. at p. 13.) The rate for full-service water includes the supply rates and transportation rates. (*Ibid.*) The wheeling rate includes the system access rate but not the system power rate or any supply rates. (*Ibid.*) The allocation between supply and transportation makes no difference to the total full-service rate.

F. Metropolitan's Exchange Agreement With San Diego

The agreement at issue in this case is not a wheeling agreement but rather a unique agreement for the exchange of water at a negotiated price in exchange for valuable consideration. In 1998, the Imperial Irrigation District ("Imperial") agreed to transfer up to 200,000 acre-feet of water per year to San Diego, contingent upon San Diego obtaining Metropolitan's agreement to accept delivery of the "transfer water" from Imperial at Lake Havasu and wheel it to San Diego. (*In re Quantification Settlement Agreement Cases* (2011) 201 Cal.App.4th 759, 788 (*QSA Cases*); *see also* 21-AA-05882, 5906 at § 3.1 [contract].) After San Diego and Metropolitan were unable to agree to terms for a wheeling agreement, San Diego and Metropolitan instead entered into a 30-year Exchange Agreement (the "1998 Exchange Agreement"). (Opn. at p. 9.)

Although both wheeling and exchange agreements facilitate water transfers, they "are not the same":

> A wheeling agreement calls for the transportation of water when there is

> available capacity in the water conveyance system. An exchange agreement promises the delivery of a specified quantity of water. Water is not wheeled unless available, but an exchange agreement requires delivery of an agreed-upon quantity of water every month. Recipients under a wheeling agreement receive less than the transfer amount due to evaporation and other transit losses, but the conveyance system operator bears transit losses under an exchange agreement.

(Opn. at pp. 9-10.)

Under the 1998 Exchange Agreement, San Diego was required to pay Metropolitan only $90 per acre-foot of water Metropolitan delivered to San Diego, with limited yearly increases, in the first 20 years of the contract, with a reduction in years 21 through 30. (11-AA-02839 § 5.2.) The agreement was conditioned upon the State Legislature's appropriation of $235 million to Metropolitan to line the earthen All-American and Coachella Valley Canals, which Metropolitan estimated would conserve 70,000-80,000 acre-feet per year of water supplies that would be available to Metropolitan. (*See* 11-AA-02847 § 8.1, subd. (d).) The State Legislature allocated the funding to Metropolitan. (*See, e.g.*, Wat. Code, § 12562.)

Between 1998 and 2003, San Diego obtained no water from Imperial because of an ongoing dispute that affected Imperial's entitlement to Colorado River water. (Opn. at p. 10.) In 2003,

various stakeholders entered into a series of agreements (collectively, the "Quantification Settlement Agreement") to quantify all parties' rights to Colorado River water, making it possible for Imperial to transfer water to San Diego as contracted. (*QSA Cases*, *supra*, 201 Cal.App.4th at pp. 773-774.)

In mid-2003, to address certain requirements of the Quantification Settlement Agreement, San Diego and Metropolitan amended the 1998 Exchange Agreement. Although there was no need to change the price term, San Diego proposed two price options to Metropolitan. Under "Option 1," the existing price term would not change. Under "Option 2," Metropolitan would assign to San Diego its $235 million legislative appropriation for canal lining and other projects, as well as Metropolitan's rights to 77,700 acre-feet of the resulting conserved canal lining water per year for 110 years—rights worth well over $1 billion. (14-AA-03849-50; 41-RT-2661:1-11; 32-AA-09031 § 4A.1.) In exchange, San Diego would pay a higher price per acre-foot for the water it obtained from Metropolitan under the Exchange Agreement. Instead of $90 per acre-foot (adjusted over time), San Diego would pay Metropolitan's unbundled transportation rates which, on the date of execution, totaled $253 per acre-foot. (14-AA-03849-50.) Thereafter, the price would be "equal to the charge or charges set by Metropolitan's Board of Directors pursuant to applicable law and regulation and generally applicable to the conveyance of water by Metropolitan on

behalf of its member agencies." (22-AA-06137-38 § 5.2.) This price would also apply to the delivery of water in exchange for the conserved canal lining water. (22-AA-06126 § 1.1, subd. (m).)

After Metropolitan's Board of Directors allowed San Diego to choose between the two price options, San Diego selected Option 2. Metropolitan assigned to San Diego its rights to the legislative appropriations for canal lining and other projects and to the 110 years of conserved canal lining water (32-AA-09017-93), in consideration for the amended Exchange Agreement between San Diego and Metropolitan (the "Exchange Agreement"). (22-AA-06122-24.) As a result, San Diego received $235 million and 77,700 acre-feet of water per year for 110 years, worth well over $1 billion, in return for its promise to pay a contract price equal to Metropolitan's transportation rates.

G. San Diego's Challenge To Metropolitan's Transportation Rates And Breach Of Contract Action

In 2010 and 2012, San Diego brought actions against Metropolitan alleging that Metropolitan's transportation rates were invalid and that Metropolitan therefore had breached the Exchange Agreement, whose price term uses rates "generally applicable to the conveyance of water" set "pursuant to applicable law and regulation."

Specifically, as relevant to the Petition, San Diego alleged that Metropolitan's allocation of its State Water Project transportation

costs to the system access rate and system power rate it charges violates Water Code Sections 1810-1814 (the "Wheeling Statutes"), Proposition 26 (California Constitution, Article XIIIC, Section 1), Government Code Section 54999.7(a), and the common law. (Opn. at pp. 14-16.)[3]

The superior court informally coordinated the 2010 and 2012 cases and bifurcated the bench trial, trying the rate challenges first and contract claim second. (Opn. at p. 15.)

H. The Superior Court's Decision And Award Of Contract Damages

Following a court trial on San Diego's rate challenges in December 2013, the superior court issued its "Statement of Decision on Rate Setting Challenges" on April 24, 2014. (*See generally* Pet. at Ex. C.)[4] As relevant here, the superior court held it unlawful for Metropolitan to include in its transportation rates (through the system access rate and the system power rate), "and hence in its wheeling rate," 100% of Metropolitan's State Water Project transportation costs, deeming these costs applicable to supply and not transportation of water. (Pet. Ex. C at p. 65.) The superior court

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[3] The 2010 case challenged Metropolitan's 2011-2012 rates; the 2012 action challenged Metropolitan's 2013-2014 rates. (Opn. at p. 14.)

[4] The Petition attaches the superior court's 66-page statement of decision in violation of Rules of Court 8.504, subd. (e)(1) and (2), which impose a 10-page limit on such attachments.

concluded that "the System Access Rate, System Power Rate, … and [the] wheeling rate—therefore violate Proposition 26 (2013-14 rates only), the Wheeling statute, Govt. Code § 54999.7(a), and the common law." (*Ibid.*)

After separately trying San Diego's breach-of-contract claim, the superior court found that Metropolitan had breached the price term of the Exchange Agreement and awarded San Diego damages equal to the total amount it had paid under the Exchange Agreement from 2011 through 2014 for all the disputed transportation costs. (Opn. at p. 16 & fn. 9.) This amount totaled $188,295,602, and together with the superior court's award of prejudgment interest of $46,637,180 resulted in a total judgment of $234,932,782 plus almost $9 million in attorney fees. (*Id.* at p. 16.)

I. The Court Of Appeal's Opinion

Both San Diego and Metropolitan appealed from the judgment. The parties filed 460-plus pages of briefing, a 23,000-plus page administrative record, 12,700-plus pages of appendices, and three requests for judicial notice. The Court of Appeal heard over an hour of oral argument, including extensive argument on the issue raised by the Petition. In a 48-page unanimous, published opinion, the Court of Appeal found that Metropolitan's allocation of its State Water Project transportation costs to its transportation rates was supported by substantial evidence. Specifically, the Court of Appeal concluded that Metropolitan's recoupment of these costs in its

wheeling rate did not exceed the "fair compensation" Metropolitan is allowed to collect under the Wheeling Statutes. (Opn. at pp. 21-27.) The Court of Appeal further held that, "[w]hile there are some differences among the legal standards, … the 'core' issue as determined under the wheeling statutes does, as a practical matter, dictate the conclusion that must be reached under the other provisions of law." (Opn. at p. 19.) After considering the specific requirements of each law, the Court of Appeal held that the recoupment of these costs in Metropolitan's transportation rates does not offend Proposition 26, Government Code 54999.7(a), or the common law because it does not cause Metropolitan's transportation rates to exceed the reasonable costs to Metropolitan to providing water conveyance. (Opn. at pp. 19, 29-32.) The Court of Appeal's analysis is discussed in detail below.

Reasons For Denying Review

I. THE COURT OF APPEAL'S DECISION CORRECTLY APPLIED WELL-SETTLED LAW

The Petition gives conspicuously short shrift to identifying any error of law or fact made by the Court of Appeal below. Instead, San Diego simply presumes the correctness of its erroneous assertion that the State Water Project transportation facilities are "supply" facilities and then repeatedly argues the Court of Appeal's decision must be reviewed because it upheld Metropolitan's contrary conclusion. The Court of Appeal, however, correctly

applied well-settled law to conclude that Metropolitan's allocation of its State Water Project transportation costs was proper and its transportation rates do not exceed the reasonable costs of the provided services.

A. The Court Of Appeal Correctly Concluded That Allocating Metropolitan's State Water Project Transportation Costs To Its Transportation Rates Complies With The Wheeling Statutes

1. The Law Applied By The Court Of Appeal Is Well-Settled

The Wheeling Statutes provide that a public agency with unused capacity in its water conveyance system generally may not deny a water transferor the use of the conveyance facility for wheeling "if fair compensation is paid for that use" (Wat. Code, § 1810), with "fair compensation" defined as 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)). In any judicial proceeding challenging whether a wheeling rate exceeds "fair compensation," "the court shall consider all relevant evidence, and the court shall give due consideration to the purposes and policies of [the Wheeling Statutes]" and "shall sustain the determination of the

public agency if it finds that the determination is supported by substantial evidence." (Wat. Code, § 1813.)

It has long been settled that wheeling rates may include system-wide transportation costs and need not be limited to the marginal cost of transporting water over the portion of the system utilized in a particular transaction by, for example, charging on a "point-to-point" basis. (*Imperial*, *supra*, 80 Cal.App.4th 1403, 1407-1408, 1433.) Since *Imperial*, this "postage stamp" rate principle has been confirmed many times, including in *San Diego's* favor as applied to its own "postage stamp" transportation rate. (*Rincon del Diablo Mun. Water Dist. v. San Diego County Water Authority* (2004) 121 Cal.App.4th 813, 816-818, 824 [upholding flat "postage stamp" rate]; *see also Central San Joaquin Water Conservation Dist. v. Stockton East Water Dist.* (2016) 7 Cal.App.5th 1041, 1052-55 [wheeling statutes do not limit "fair compensation" to incremental marginal costs and wheeling rates for member agencies may be based on pro rata share of total costs].) As the Court of Appeal noted below, "[n]either [San Diego] nor the trial court question[ed] th[is] basic premise." (Opn. at p. 21.)

2. <u>The Court Of Appeal's Application Of The Law To The Record In This Case Is Correct And Non-Controversial</u>

Holding that the State Water Project is "an integral part of the system by which Metropolitan transports water to its member

agencies" (Opn. at p. 23), the Court of Appeal correctly concluded that Metropolitan's inclusion of its State Water Project transportation payments in the calculation of its wheeling rate is "well supported by the record" and "does not violate the wheeling statutes." (*Id.* at p. 27.) The Court of Appeal rejected San Diego's "heavy reliance" on the fact that Metropolitan does not own the State Water Project, finding this argument "misplaced because the State Water Project[']s title] owner does not bear its costs—Metropolitan and other contracting agencies do" (*ibid*.)—a legal and factual relationship long ago acknowledged in *Goodman*, *supra*, 140 Cal.App.3d at p. 910 (cited in Opn. at p. 23).[5]

In support of its sound and unremarkable conclusion that Metropolitan's allocation was "well supported by the record," the Court of Appeal recited in detail numerous pieces of evidence from the administrative record. (Opn. at pp. 22-26.)[6] The Petition largely

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[5] The Petition misplaces reliance on the definition of "fair compensation" as "the reasonable charges incurred by the owner of the conveyance system" (Wat. Code, § 1811, subd. (c)). Section 1810 states that a public agency cannot deny a wheeler the use of a water conveyance facility "if fair compensation is paid"; it does not limit payment of fair compensation to "owners."

[6] For example, the court cited record evidence that (i) Metropolitan's State Water Project contract requires it "to pay its pro rata share of the capital, operation and maintenance costs of the conveyance system" regardless of receipt of any project water (Opn. at pp. 22-23); (ii) Metropolitan has wheeled nonproject water through the State Water Project on San Diego's behalf (*id.* at p. 23); (iii) a 1969 rate consultant study showed that Metropolitan had

disregards the Court of Appeal's recital of the substantial evidence, instead insisting (Pet. at p. 24) that *all* of Metropolitan's costs related to the State Water Project are "quintessential supply costs" because Metropolitan's financial responsibility for the State Water Project was occasioned by its efforts to import water supplies. Such a claim is absurd. San Diego tellingly does not suggest that all of Metropolitan's transportation-related costs for the Colorado River Aqueduct must be allocated entirely to supply simply because Metropolitan built that facility to import water supplies from the east. And rightly so, for San Diego's theory that costs of transportation facilities built to import water supplies cannot be included in transportation rates would prohibit owners and operators from charging *any* transportation costs to wheelers for the use of *any* facility that was not constructed solely for the purpose of enabling wheeling—as no facility in California ever has been.

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begun to differentiate transportation and supply costs but did *not* show that Metropolitan had reclassified State Water Project transportation costs from supply to transportation (*id*. at p. 24) as San Diego contends; (iv) a 1996 rate study had concluded that "state charges for capital, operation and maintenance charges for project facilities" were "'clearly transmission-related' and properly allocated to Metropolitan's…transportation costs" (*id*. at pp. 24-25); (v) Metropolitan had made written findings explaining its basis for including its State Water Project transportation costs in a "postage stamp" wheeling rate (*id*. at p. 25); and (vi) a 2010 consultant study found Metropolitan had properly assigned the itemized State Water Project supply and transportation costs invoices to their "'respective functional categories'" in its own rates (*id*. at p. 26).

San Diego's attempt (Pet. at p. 25) to analogize Metropolitan's State Water Project transportation costs to a florist's transportation costs for exotic lilies is baseless. Unlike Metropolitan's relationship with the State Water Project, the florist in San Diego's analogy did not have to pay to build the lily farm years before she received any lilies, does not have to continue paying to maintain the farm even if she does not buy any lilies, cannot grow her own exotic lilies on the farm simply because she buys lilies, and does not deliver a blend of exotic lilies and wildflowers to customers seeking wildflower delivery service. The flaws in San Diego's contrived analogy only underscore the unique nature of the transportation costs under the State Water Contract, which the Court of Appeal correctly identified.

B. The Court Of Appeal Correctly Concluded The System Access Rate And System Power Rate Comply With Proposition 26

The Court of Appeal also was correct in holding that Metropolitan had met its burden of proving by a preponderance of the evidence that its system access rate and system power rate are not taxes under Proposition 26 because they fall within Proposition 26's exclusion from the definition of a tax of a charge for "a specific government service or product provided directly to the payor that is not provided to those not charged, and which does not exceed the reasonable costs to the local government of providing the service or product." (Cal. Const., art. XIII C, § 1, subd. (e)(2); Opn. at pp. 30-

31.) As the Court of Appeal explained, "Metropolitan provides a specific service (use of the conveyance system) directly to the payor (a member agency) that is not provided to those not charged and which does not exceed the reasonable costs to Metropolitan of providing the service." (Opn. at p. 31.)

Although San Diego would prefer to define transportation services more narrowly (*e.g.*, in terms of specific facilities used or the source of the water before it enters Metropolitan's system), courts have repeatedly rejected San Diego's view that rates must be so particularized even under the more exacting requirements of Proposition 218.[7] (*See, e.g.*, *Capistrano Taxpayers Assn., Inc. v. City of San Juan Capistrano* (2015) 235 Cal.App.4th 1493, 1502 [charging all retail water users for costs of recycled water did not violate Proposition 218, even though ratepayers who required potable water would be unable to use recycled water, because "providing each kind of water is providing the *same* service," emphasis in

[7] Unlike Proposition 26, Proposition 218 explicitly references proportionality. (Cal. Const., art. XIIID, § 6(b)(3) ["The amount of a fee or charge imposed upon any parcel or person as an incident of property ownership shall not exceed the *proportional* cost of the service *attributable to the parcel*," emphasis added].) The (e)(2) exception to Proposition 26's definition of a "tax," applied by the Court of Appeal, lacks parallel language: 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 *proportional* costs to the local government of providing the service or product *to the payor.* (Cal. Const., art. XIIIC, § 1, subd. (e)(2).)

original]; *Griffith v. Pajaro Valley Water Management Agency* (2013) 220 Cal.App.4th 586, 600-602 [rejecting argument that, under Proposition 218, only property owners actually receiving water from a new pipeline should be charged for its costs, reasoning that the pipeline provided system-wide benefits]; *see also Jacks v. City of Santa Barbara* (2017) 3 Cal.5th 248, 259-260 [Proposition 218 was intended to limit property assessments to "proportionate" special benefits; Proposition 26, in adding definition of tax, exempted fees that do not exceed the reasonable costs of certain benefits, products, services, and regulatory activity].)[8]

Asserting that the Court of Appeal's holding nevertheless offends Proposition 26, San Diego contends that Proposition 26 "bars Metropolitan from characterizing *the entirety* of the State Water Project 'transportation charges' as costs that Metropolitan incurs in transporting third party water." (Pet. at p. 27, emphasis in original.) This argument is not only baseless but materially misleading.

First, Metropolitan charges its transportation rates not only for wheeling, but for any transportation of water through Metropolitan's integrated system, including for full-service water

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[8] Requiring exacting proportionality would be unworkable. (Hanak et al., *Paying for Water in California* (Mar. 2014) p. 31, Public Policy Institute of California <http://www.ppic.org/content/pubs/report/R_314EHR.pdf> [as of Aug. 21, 2017] ["[F]ragmented interpretation of water service costs threatens to undermine one of the hallmarks of contemporary water management, which recognizes that water service is an integrated endeavor"].)

service, which makes up the vast majority of Metropolitan's water rate revenues. In fact, only a very small percentage (not "*the entirety*" or "*100%*" as San Diego repeatedly and misleadingly contends (*e.g.*, Pet. at pp. 27, 28, emphasis in original) of Metropolitan's conveyance system costs are recouped from rates charged for wheeling.

Second, because Metropolitan's transportation rates are volumetric, they are inherently proportional, charged based on the amount of water being transported through Metropolitan's conveyance system. Thus, contrary to San Diego's suggestion, wheelers pay only an inherently proportional share of the costs of Metropolitan's conveyance system, which properly includes the State Water Project. And the volumetric nature of all rates refutes San Diego's assertion (Pet. at p. 29) that it is being double charged because it pays for transportation as part of both its full-service rates and the price it pays under the exchange agreement.

Third, San Diego argues that Metropolitan should allocate its State Water Project transportation costs only to supply, but tellingly does *not* suggest the same for Metropolitan's Colorado River Aqueduct transportation costs. San Diego can give no explanation for this distinction other than title ownership, a distinction the Court of Appeal rightly rejected. (Opn. at p. 27 [San Diego's "heavy reliance on ownership is misplaced"].)

San Diego's Petition thus boils down—for Proposition 26 as for the Wheeling Statutes—to its disagreement with the Court of Appeal's finding that the State Water Project is part of Metropolitan's single, integrated conveyance system.[9] That narrow and fact-specific finding cannot possibly warrant this Court's review.

II. THIS CASE CREATES NO "SPLIT" OF AUTHORITY WARRANTING THIS COURT'S REVIEW

Although the sole enumerated ground for review San Diego invokes is the need to secure uniformity of decision, San Diego devotes only slightly more than two pages of its single-issue Petition to describing the purported split of authority it contends necessitates this Court's review. It identifies no pronouncement of legal principle in the Court of Appeal's opinion that it contends is incorrect or inconsistent with the decisions of other courts of appeals. Rather, the sole basis for its argument is San Diego's belief that, despite applying the correct law, the Court of Appeal reached an incorrect result on the specific facts of this case, thereby "undermin[ing]" the legal principles. (Pet. at p. 18.) San Diego then speculates that the courts of appeal that decided *Newhall County Water District v. Castaic Lake Water Agency* (2016) 243 Cal.App.4th

[9] This case in any event would be a poor vehicle for review of any Proposition 26 issue because there are alternative grounds not reached by the Court of Appeal (Opn. at p. 30) on which to find Proposition 26 inapplicable here.

1430 (*Newhall*) and *City of Palmdale v. Palmdale Water District* (2011) 198 Cal.App.4th 926 (*Palmdale*) "plainly would have reached a different result." (*Ibid.*) That argument is incorrect because both cases are clearly distinguishable on their facts.

San Diego provides no analysis of the facts or reasoning of *Newhall* in support of its speculative claim, stating only that "the [*Newhall*] court invalidated a rate under Proposition 26 because it did not 'bear[] a reasonable relationship *to the payor's burdens on or benefits from the Agency's activity.*'" (Pet. at p. 18., emphasis in original; *see also id.* at p. 17 [citing *Newhall*].) As the Court of Appeal below noted, however, *Newhall* "presents a far different factual situation." (Opn. at p. 31.)

In *Newhall*, the rate challenge arose when the defendant, a wholesale water supplier, switched from charging water retailers "on a per acre-foot basis for the imported water sold" (*Newhall*, *supra*, 243 Cal.App.4th at p. 1437), to a new rate structure that charged each water retailer based in part on its "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)" (*id.* at pp. 1437-38, emphasis in original). *Newhall* rightly concluded that the new rates violated Proposition 26 because 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,

as the fee was in significant part based on demand for groundwater—a product the Agency *does not supply*. (*Id.* at p. 1441.)

That conclusion on the extreme facts of *Newhall* has no bearing here, where Metropolitan unquestionably does provide the conveyance of water. Given the substantial evidence in the record supporting Metropolitan's allocation of its State Water Project transportation costs to its transportation rates, there is no basis to conclude that the Court of Appeal in *Newhall* would have decided the fact-specific issue in this case any differently than the decision below did.

As for *Palmdale*—a case applying Proposition 218, not Proposition 26—San Diego also omits any discussion of its facts, focusing instead on its holding that "a set of water rates was unconstitutional because there was a disparity between the prices the utility's customers paid, and the cost of the services they received." (Pet. at pp. 17-18.) Unlike Metropolitan, the water agency in *Palmdale* did not base its rates on a cost-of-service analysis. In *Palmdale*, a water agency considered two options for a new rate structure, one based on "cost of service," which its consultants described as "Defensible—Prop 218" and "Consistent with industry standards," and one that recovered a large percentage of revenues from fixed fees based on the size of the customer's meter. (*Palmdale*, *supra,* 198 Cal.App.4th at pp. 929-930.) The agency in *Palmdale* adopted the latter approach. Whatever disagreements San Diego

may have with Metropolitan's cost-of-service analysis, there is no basis to conclude that the *Palmdale* court would reach any different conclusion than the Court of Appeal did here on the determinative, fact-specific issue of the reasonableness of Metropolitan's specific cost-of-service allocation in this case.

Finally, San Diego contends that the Court of Appeal's decision conflicts with *San Luis Coastal Unified School District v. City of Morro Bay* (2000) 81 Cal.App.4th 1044, arguing that, under *Morro Bay*, "the [Court of Appeal] should have unequivocally condemned Metropolitan's plainly unlawful purpose" in structuring its rates, citing "Metropolitan's *own written findings*." (Pet. at p. 19, emphasis in original.) As an initial matter, *Morro Bay* did not concern ratemaking at all, but rather a public agency's denial of access to a wheeler to avoid "loss of income" from that wheeler as a customer. Here, in contrast, the Court of Appeal reviewed whether system-wide costs are properly allocated to a wheeling rate and concluded, in accordance with well-established law, that they are. Moreover, San Diego misplaces emphasis (*id.*) on *Morro Bay*'s supposed implications for Metropolitan's written findings, but it is Metropolitan's wheeling rate determination—not its findings—that is reviewed for compliance with the Wheeling Statutes based on all relevant evidence. (Wat. Code, § 1813.)

The Court of Appeal's decision below is not in conflict with *Newhall*, *Palmdale*, or *Morro Bay* and, accordingly, there is no need to grant review to secure uniformity.

III. THE SUPPOSED "DANGER[S]" POSITED BY THE PETITION ARE SPECULATIVE AND FIND NO BASIS IN THE COURT OF APPEAL'S DECISION

A. The Court Of Appeal's Decision Poses No Threat To Any Policy Favoring Water Transfers Or Conservation

Although San Diego contends that "[t]his case is about…the State's keen focus on the efficient allocation and conservation of the State's water supply" (Pet. at p. 1), this case is in fact about something much more mundane: San Diego's desire to pay less money than it owes under a *sui generis* exchange agreement whose price term San Diego itself proposed and chose, in exchange for over $1 billion in assets that the Petition conspicuously fails to mention. Indeed, other than vague platitudes, the only specific consequence of the Court of Appeal's decision claimed by San Diego is that the decision "approved transportation rates that inflate [San Diego's] cost of using conserved Imperial Valley water to almost *double* the cost of using water sold by Metropolitan" and require it to pay "exorbitant rates." (*Id*. at p. 3, emphasis in original.)

San Diego's claim is highly misleading for at least two reasons. *First*, San Diego's cost of using conserved Imperial Valley water is greater than the cost of purchasing Metropolitan's water

because of the high price San Diego pays Imperial for the water supply, not the price it pays Metropolitan to exchange the water. In 2014 and 2015, San Diego paid Imperial $594 and $624 per acre-foot for conserved Imperial Valley water, respectively. (21-AA-5988, *cited in* Pet. at p. 21.) Metropolitan's first-tier untreated water supply rates (*i.e.*, without transportation costs) in 2014 and 2015 were $148 and $158 per acre-foot, respectively. (The Metropolitan Water Dist. of So. Cal., Annual Report 2016, Table 7-1, p. 132 <http://www.mwdh2o.com/PDF_Who_We_Are/2016_AnnualReport .pdf> [as of Aug. 13, 2017].) Thus, the cost of Imperial's water supply alone was essentially *quadruple* the cost of Metropolitan's water supply, without considering transportation costs at all. Metropolitan's *total* full-service rate for first-tier untreated water, *including* transportation rates, was $593 and $582 in 2014 and 2015, respectively. (*Ibid.*) Thus, Metropolitan could have charged San Diego *nothing* to exchange its conserved Imperial Valley water and the Imperial Valley water would still have cost San Diego between $1 and $42 more than purchasing Metropolitan's full-service water in those years. Unless *Metropolitan* were to start paying *San Diego* for exchanging water under the Exchange Agreement, Metropolitan's full-service water will be more economically attractive than conserved Imperial Valley water. San Diego chose to pay Imperial's high price for its conserved water out of a professed interest in diversifying its sources of supply. Nothing in the

Wheeling Statutes or any policy favoring water transfers requires Metropolitan to subsidize that choice.

Second, San Diego fails to disclose that it had previously contracted to pay Metropolitan only $90 per acre-foot, with limited yearly increases and reductions over the life of the contract, to exchange its conserved Imperial Valley water. In 2003, San Diego elected to amend the original price term in favor of paying $253 per acre-foot (the total of Metropolitan's transportation rates in 2003) and Metropolitan's lawfully set transportation rates thereafter in exchange for $235 million in State appropriations to Metropolitan for canal lining and Metropolitan's rights to 77,700 acre-feet of the resulting conserved canal lining water per year for 110 years, an amount worth over $1 billion. Thus, under the Exchange Agreement, San Diego is not paying Metropolitan's transportation rates only for Metropolitan to exchange water; San Diego is paying Metropolitan to exchange water *and* to give San Diego $235 million plus well over $1 billion in water rights. San Diego chose the rates it now criticizes, and it received lucrative consideration in return. San Diego's buyer's remorse over a unique contract term—even if it were credible despite San Diego's touting of the exchange agreement as a "great deal" for San Diego (41-RT-2594:15-17)—presents no policy reason for this Court to intervene.[10]

[10] To the extent the financial effect of the Court of Appeal's decision on San Diego is relevant, San Diego also fails to note that

San Diego also improperly attempts to make this case more appealing for review by making new arguments about the environmental health of the Sacramento-San Joaquin Delta. (*E.g.*, Pet. at pp. 20-21.) This speculative new argument is not based on any facts in the record and should be rejected for that reason alone. Further, there is no basis for the assertion that the Court of Appeal's decision regarding the unique Exchange Agreement or Metropolitan's wheeling rate applicable only to short-term wheeling by member agencies will have any effect on water transfers or conservation efforts by others. In any event, the argument makes no sense: if the Court of Appeal's decision did make water transfers and exchanges more costly, as San Diego asserts, that only encourages local resource development and conservation efforts—a result in accord with San Diego's professed concern for the region's environment.

B. The Court Of Appeal's Decision Will Not Spur Government Waste Or Unreasonable Rates

Finally, the Petition makes a series of overheated assertions that the Court of Appeal's decision will "open[] the door to increasingly tenuous relationships between services and costs,"

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any reallocation of Metropolitan's State Water Project transportation rates to Metropolitan's supply rates will increase the amount San Diego pays for Metropolitan's full-service water and, as San Diego notes, it is Metropolitan's largest customer of full-service water. (Pet. at p. 29.)

"remove[] an important incentive for agencies to manage their costs," encourage agencies to avoid "trim[ming] costs" in favor of "[c]ost-spreading…to obscure the impact of waste and inefficiency," and "permit[] government entities to shift costs from politically influential or favored clients to…communities or individuals less likely to be able to vindicate their rights in court." (Pet. at pp. 21-22.) Notably, there has never been any allegation in this case that Metropolitan engaged in government waste and the Court of Appeal's decision in no way endorses waste or cost-shifting to the disenfranchised.[11] Moreover, the Court of Appeal's recognition that an agency may recover system-wide costs is hardly novel; any agency wishing to find support for system-wide cost recovery need look no further than precedent San Diego itself established in *Rincon*. (*See* p. 19, *supra.*) In any event, the same concerns could be raised in support of *any* petition for review of an unsuccessful rate challenge,

[11] Equally baseless and transparent is San Diego's reference to its provision of water to local agencies that supply military facilities, "including the First Marine Division at Camp Pendleton." In fact, although Camp Pendleton is one of San Diego's member agencies, it generates its own "self-sustaining water supply" (*see* "Marine Corps Base Camp Pendleton" <http://www.pendleton.marines.mil/About/Facilities/> [as of Aug. 5, 2017]) and purchased only 59 acre-feet of water from San Diego in 2016, accounting for only 0.015% of San Diego's water sales. (*See* "Comprehensive Annual Financial Report" at 116 <https://www.sdcwa.org/sites/default/files/files/finance-investor/CAFR/Final%20BOOKCAFR2016.pdf> [as of Aug 5, 2017].)

and San Diego fails to identify any specific reasons that this case realistically poses any such concerns.

IV. SAN DIEGO'S CLAIM THAT INTERVENTION IS REQUIRED TO CLARIFY THE MANDATE ON REMAND IS MERITLESS

Finally, San Diego argues that this Court's "intervention is…urgently needed" because the Court of Appeal did not direct the superior court to consider "offsetting benefits" in recalculating San Diego's contract damages on remand. (Pet. at p. 30.) This argument fails for at least two reasons:

First, San Diego makes clear that it intends to pursue this argument, first raised in its petition for rehearing, in the superior court. This Court's intervention at this stage thus would be premature: San Diego can press its interpretation of the Court of Appeal's mandate in the superior court upon remand in the first instance.

Second, there is no basis to apply the Wheeling Statute's requirement that *wheelers* be given a "reasonable credit for any offsetting benefits" of wheeling transactions to the transaction under the Exchange Agreement. As San Diego has repeatedly represented to multiple tribunals, including the State Water Resources Control Board, the Sacramento Superior Court, and the Third District Court of Appeal, San Diego's Exchange Agreement with Metropolitan "is radically different than a wheeling agreement." (1-ARA-0111-12; *see*

also 1-ARA-240-41 [San Diego's statement: "[T]he [] Exchange Agreement falls outside the scope of the Wheeling Law….The Wheeling Law does not apply to the [] Exchange Agreement."]; 1-ARA-0281 [San Diego's statement: "[T]he Exchange Agreement… [is] clear on [its] face[] that [it]…do[es] not trigger application of the Wheeling Statutes."].) As aptly expressed by San Diego, "the parties' actions under the Exchange Agreement are governed by the contract between the parties and not limitations under the Wheeling Law." (1-ARA-0242.) This Court's intervention is not "urgently needed" to clarify that San Diego should be able to pursue a meritless and inconsistent argument upon remand to the superior court.

Conclusion

The Petition presents no proper ground for Supreme Court review. Accordingly, Metropolitan respectfully requests this Court deny the Petition.

DATED: August 21, 2017

Respectfully submitted,

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Certificate Of Word Count

The undersigned counsel certifies that pursuant to California Rule of Court 8.504(d)(1)-(2) of the California Rules of Court, the foregoing Answer to Petition to Review is one-and-a-half spaced and printed in proportionally-spaced 13 point Palatino Linotype typeface. It contains 8357 words (excluding the table of contents, table of authorities, this certificate, and the proof of service). In preparing this certificate, I relied upon the word count generated by Microsoft Word 2011.

Executed on August 21, 2017 at Redwood Shores, California.

/s/ Kathleen M. Sullivan
Kathleen M. Sullivan

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