

1 KEKER & VAN NEST LLP  
JOHN W. KEKER - # 49092  
2 jkeker@kvn.com  
DANIEL PURCELL - # 191424  
3 dpurcell@kvn.com  
DAN JACKSON - # 216091  
4 djackson@kvn.com  
WARREN A. BRAUNIG - # 243884  
5 wbraunig@kvn.com  
6 633 Battery Street  
San Francisco, CA 94111-1809  
Telephone: (415) 391-5400  
7 Facsimile: (415) 397-7188

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ORIGINAL FILED  
SUPERIOR COURT OF CALIFORNIA  
COUNTY OF LOS ANGELES

JUN 08 2012

John A. Clarke, Executive Officer/Clerk  
BY Regina Juliano Deputy

8 DANIEL S. HENTSCHKE  
General Counsel  
9 SAN DIEGO COUNTY WATER AUTHORITY  
4677 Overland Avenue  
10 San Diego, CA 92123-1233  
Telephone: (858) 522-6791  
11 Facsimile: (858) 522-6566

12 Attorneys for Petitioner and Plaintiff  
13 SAN DIEGO COUNTY WATER AUTHORITY

14 SUPERIOR COURT OF THE STATE OF CALIFORNIA  
15 IN AND FOR THE COUNTY OF LOS ANGELES

16 SAN DIEGO COUNTY WATER  
17 AUTHORITY,

Case No. **BS137830**

18 Petitioner and Plaintiff,

**SAN DIEGO COUNTY WATER  
AUTHORITY'S PETITION FOR WRIT  
OF MANDATE AND COMPLAINT FOR  
DETERMINATION OF INVALIDITY,  
DAMAGES AND DECLARATORY  
RELIEF**

19 v.

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

25 Respondents and Defendants.

1 Petitioner San Diego County Water Authority (“Petitioner” or “Water Authority”) brings  
2 this Petition for Writ of Mandate, and Complaint for Determination of Invalidity, Damages and  
3 Declaratory Relief (“Complaint”), alleging as follows:

4 **I. INTRODUCTION**

5 1. The Water Authority brings this action for a writ of mandate, declaratory  
6 judgment, and determination of invalidity, challenging water rates adopted by Respondent and  
7 Defendant Metropolitan Water District of Southern California (“Metropolitan”) on April 10, 2012  
8 to be effective January 1, 2013 and January 1, 2014. The Water Authority also brings an  
9 independent claim for breach of a contract between Metropolitan and the Water Authority.

10 2. A similar and related lawsuit by the Water Authority challenging Metropolitan’s  
11 2011 and 2012 water rates is currently pending in San Francisco Superior Court, styled *San Diego*  
12 *County Water Authority v Metropolitan Water District of Southern California et al.*, Case No.  
13 CPF-10-510830. The Water Authority will seek to transfer this new case to San Francisco,  
14 pursuant to Code of Civil Procedure § 394, and to have the two cases consolidated.

15 3. The Water Authority is one of Metropolitan’s 26 member agencies and is  
16 Metropolitan’s single largest customer, purchasing more than 250,000 acre-feet of water supply  
17 annually from Metropolitan. The Water Authority, however, is unique among Metropolitan’s  
18 member agencies in that it both purchases a very large, steady volume of water from  
19 Metropolitan, year in and year out, and also pays Metropolitan to transport more than 150,000  
20 acre-feet per year of water purchased from third party sources. In particular, the Water Authority  
21 purchases conserved Colorado River water from the Imperial Irrigation District (“IID Water”).  
22 The Water Authority has also obtained conserved water from the lining of the All American and  
23 Coachella Canals (“Canal Lining Water”). To transport this IID and Canal Lining Water to its  
24 facilities, the Water Authority entered into an agreement with Metropolitan, the 2003 Amended  
25 and Restated Agreement for the Exchange of Water (“Transportation Agreement”), under which  
26 the Water Authority pays Metropolitan to deliver the water to the Water Authority. (A copy of  
27 the Transportation Agreement is attached hereto as Exhibit A.)  
28

1           4.       Metropolitan is obligated by statute, the California Constitution, and common law  
2 to set rates that do not exceed the reasonable costs of providing the particular service for which  
3 the rate is charged, and that are equitable, fair and non-discriminatory. The Transportation  
4 Agreement separately requires Metropolitan to set a price for the transportation of the Water  
5 Authority's purchased IID and Canal Lining Water that is consistent with California law and its  
6 contractual obligations. Per the Transportation Agreement, the Water Authority pays a price for  
7 the delivery of IID and Canal Lining Water that consists only of Metropolitan's "transportation"  
8 rates.

9           5.       On April 10, 2012, Metropolitan adopted water rates to be charged for calendar  
10 years 2013 and 2014. As used in this complaint, the term "rates" includes all rates and other  
11 levies, charges, fees, or exactions for the sale of water or provision of services by Metropolitan to  
12 its member public agencies. The rates challenged here violate common law, California statutory  
13 law and the California Constitution. Metropolitan also has breached the Transportation  
14 Agreement with the Water Authority by setting a price for the transportation of water that is  
15 inconsistent with California law and thus violates the express terms of the parties' contract.

16           6.       Metropolitan's rates violate California law, and breach the Transportation  
17 Agreement, in multiple ways.

18           7.       *First*, Metropolitan has allocated the costs of obtaining an imported water supply  
19 to the rates it charges for "transportation." Metropolitan purchases about half of the water supply  
20 it sells to its member agencies from the California Department of Water Resources ("DWR"),  
21 pursuant to a long-term "take-or-pay" supply contract that requires Metropolitan to pay a fixed  
22 amount per year regardless of how much water DWR is able to provide to Metropolitan.  
23 Metropolitan does not own or operate facilities to transport this water; instead, DWR transports  
24 the water to Metropolitan's delivery points and facilities via DWR's state-owned State Water  
25 Project facilities. In other words, the money Metropolitan pays to DWR is to obtain a water  
26 supply that Metropolitan then furnishes to its customers. Despite this, Metropolitan reallocates  
27 most of these supply costs to two of its "transportation" rates, specifically, the System Access  
28 Rate and System Power Rate. As a result, the price Metropolitan charges to the Water Authority

1 for delivery of the IID Water and Canal Lining Water—that Metropolitan accomplishes using  
2 only Metropolitan-owned pipelines and facilities—includes the completely unrelated costs  
3 Metropolitan incurs when it purchases water supply from DWR.

4 8. *Second*, Metropolitan allocates to another of its “transportation” rates, the Water  
5 Stewardship Rate, the costs of subsidizing member agencies’ water conservation and local water  
6 supply projects. These conservation and local supply development subsidies are payments by  
7 Metropolitan to enable member agencies—except the Water Authority, which Metropolitan has  
8 barred from the program—to develop or enhance their own local water supplies. Although these  
9 subsidies have nothing to do with the transportation of water, Metropolitan improperly  
10 characterizes them as part of its “transportation” rate, which is then charged on the Water  
11 Authority’s transportation of IID and Canal Lining Water. Accordingly, Metropolitan’s  
12 misallocation of these supply costs to its Water Stewardship Rate penalizes the Water Authority  
13 and subsidizes all other Metropolitan member agencies in two ways: (1) a direct subsidy from  
14 Metropolitan to all member agencies *other than* the Water Authority when Metropolitan writes  
15 the member agency a subsidy check; and (2) an indirect subsidy to the other member agencies  
16 because treating these costs as “transportation” rather than “supply” artificially raises costs for the  
17 Water Authority and artificially lowers costs for all other Metropolitan member agencies.

18 9. *Third*, Metropolitan systematically avoids identifying the true cost of standing  
19 ready as a standby, supplemental water supplier for its member agencies whose water demands  
20 are highly variable from year to year, depending on the availability of their own local water  
21 sources, annual precipitation or other factors. Metropolitan maintains excess capacity available in  
22 its Colorado River Aqueduct and other transportation facilities to accommodate this “dry year  
23 peaking,” and it also purchases and stores water so that it will be available in dry years. “Standby  
24 service” is expensive to provide, because the water supplies, storage and other facilities require  
25 high fixed costs to develop yet remain unused in during many years. And the benefits of  
26 Metropolitan’s standby service accrue disproportionately—while some member agencies purchase  
27 more or less the same volume of water every year, other member agencies’ purchases of  
28 Metropolitan Water vary dramatically from one year to the next. For example, the City of Los

1 Angeles, one of the Metropolitan member agencies that benefits the most from from this standby  
2 service, has increased its purchase of Metropolitan Water by as much as 200,000 acre-feet in dry  
3 years. Yet Metropolitan does not calculate the full costs associated with providing “standby  
4 service,” nor does it evaluate the relationship between the costs of these services and the benefit  
5 of the services provided. Instead, these costs are hidden in Metropolitan’s other rates. The result,  
6 once more, is a subsidy to a handful of member agencies, paid at the expense of steady purchasers  
7 like the Water Authority.

8 10. The fact that these various cost allocation decisions consistently work to the  
9 detriment of one member agency, the Water Authority, is no accident. Rather, it is the product of  
10 concerted action by Metropolitan staff, and a group of member agencies whose appointees  
11 constitute a voting majority of the Metropolitan board of directors. These member agencies,  
12 working hand-in-glove with top current and former Metropolitan executives, have established a  
13 “shadow government” that meets in secret to dictate water rates and other important issues  
14 pending before the Metropolitan board. Metropolitan’s adoption of the 2013/2014 water rates  
15 was not based on a cost-of-service study, or any lawful or reasonable grounds for allocating the  
16 cost of Metropolitan services, but rather, with the purpose and effect of enriching a subset of  
17 member agencies at the expense of the Water Authority and the San Diego County citizens it  
18 serves. Metropolitan’s coordination with, and effective delegation to, this shadow government  
19 further demonstrates that Metropolitan’s decisions vis-a-vis the Water Authority and its  
20 constituents are unlawful, discriminatory and invalid.

21 11. Accordingly, the Water Authority brings this action, requesting relief as set forth  
22 in the remainder of this Complaint.

## 23 II. PARTIES

24 12. Petitioner and Plaintiff San Diego County Water Authority is, and at all times  
25 mentioned herein was, a county water authority organized under the laws of the State of  
26 California and located in the County of San Diego, California.

27 13. Respondent and Defendant Metropolitan is, and at all times mentioned herein was,  
28 a public agency of the State of California organized pursuant to the Metropolitan Water District

1 Act [Stats. 1969, ch. 209 as amended; West's California Water Code Append. §§ 109-134  
2 (2010)], the principal offices of which are located in Los Angeles, California.

3 14. The true names and capacities of the Respondents and Defendants identified as  
4 DOES 1-10 are unknown to Petitioner, and Petitioner will amend this Complaint to insert the true  
5 names and capacities of those fictitiously named Respondents when they are ascertained.  
6 Petitioner is informed and believes, and on that basis alleges, that at all times relevant to this  
7 action, each of the Respondents and Defendants, including those fictitiously named, was the agent  
8 or employee of each of the other Respondents and Defendants, and while acting within the course  
9 and scope of such employment or agency, took part in either the acts or omissions alleged in this  
10 Complaint.

### 11 III. SERVICE OF PROCESS

12 15. Petitioner will serve Metropolitan and all other defendants/respondents in the  
13 manner provided by law for the service of summons in a civil action.

14 16. The Water Authority will publish notice of this action in newspapers of general  
15 circulation published in the six counties served by Metropolitan, as this is the method most likely  
16 to give notice to the person interested in these proceedings. Those counties are Ventura, Los  
17 Angeles, Riverside, San Bernardino, Orange, and San Diego. The Water Authority will seek an  
18 order *ex parte* ordering:

19 a. Publication of the summons in newspapers of general circulation in these  
20 counties pursuant to Code of Civil Procedure Section 861; and,

21 b. That notice be given by mailing a copy of the summons and complaint to  
22 those persons, if any, or their attorneys, who have notified Petitioner's attorneys of record  
23 in writing of their interest in the matter not later than the date on which publication of the  
24 summons is complete or such other time as the Court may order.

25 17. If Metropolitan agrees, as an alternative to an *ex parte* application, the Water  
26 Authority will present the Court with a stipulation and proposed order for publication of the  
27 summons as set forth above.

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IV. JURISDICTION AND VENUE

18. This court has jurisdiction over this matter pursuant to Code of Civil Procedure Section 1085, Code of Civil Procedure Section 410.10, and, with respect to the Third Cause of Action, Code of Civil Procedure Sections 860 *et seq.*, and Government Code § 66022.

19. Venue is proper in this court as Respondent is located within the County of Los Angeles and the acts and events giving rise to the claims occurred in part in the County of Los Angeles. This suit, however, is subject to transfer of venue to a neutral county pursuant to Code of Civil Procedure Section 394(a).

V. FACTUAL ALLEGATIONS

**A. Metropolitan, its roles, and its duties.**

20. Metropolitan is a wholesale water agency that imports, stores, transports and treats water throughout the Southern California counties of Ventura, Los Angeles, Riverside, San Bernardino, Orange, and San Diego. Metropolitan has 26 member agencies, including the Water Authority. These member agencies in turn sell water they obtain from Metropolitan to sub-agencies and utilities or directly to consumers. In addition to obtaining and delivering imported water for sale to its member agencies, Metropolitan has also chosen to subsidize member agencies' conservation and local water supply development projects.

21. Metropolitan obtains water for sale to its member agencies from two principal sources: first, from a water purchase contract with the California DWR; and, second, from Metropolitan's allocation of water from the Colorado River. The State Water Project water is delivered by DWR via State Water Project facilities directly to Metropolitan's distribution facilities located in Southern California, where it is mixed with other sources of Metropolitan Water and distributed to member agencies. Metropolitan transports its Colorado River water via the Metropolitan-owned and operated Colorado River Aqueduct ("CRA"). In this Complaint, water from these two principal sources of imported water will be referred to collectively as "Metropolitan Water," and water acquired from other third-party sources will be referred to generally as "Non-Metropolitan Water."

1           22.     Metropolitan’s operations are largely paid for by volumetric (per-acre-foot) rates it  
2 imposes for purchases of Metropolitan Water; fixed charges imposed on its 26 member agencies;  
3 and contractual payments by the Water Authority for its transportation of IID and Canal Lining  
4 Water. The MWD Act, which defines the powers and responsibilities of both Metropolitan and  
5 its Board, obligates Metropolitan to set rates that “shall be uniform for like classes of service  
6 throughout the district.” Metropolitan is further obligated by various state statutes, the California  
7 Constitution, and common law to set rates that are both consistent with cost-of-service principles  
8 (*i.e.*, the rates charged to a member agency must not exceed the cost of providing services to that  
9 agency) and non-discriminatory.

10           23.     Metropolitan has a board of directors, which includes at least one representative  
11 appointed by each member agency. Additional seats on the Board and weighted votes are  
12 allocated according to each member agency’s percentage share of the total assessed property  
13 value within the Metropolitan service area.

14           24.     Although Section 50 of the MWD Act requires that Metropolitan act exclusively  
15 through its board of directors, as detailed below, a group of self-interested member agencies has  
16 come to dominate and control Metropolitan. In recent years and likely earlier, a group of more  
17 than fifteen Metropolitan member agencies—led by the Municipal Water District of Orange  
18 County, the City of Los Angeles and its Department of Water and Power (“LADWP”), the  
19 Western Municipal Water District and the West Basin Municipal Water District—has met in  
20 secret, in concert with Metropolitan’s senior management, to ensure adoption by the Metropolitan  
21 board of water rates and charges, and cost allocation decisions, that further this group’s self-  
22 interests, while systematically disadvantaging the interests of the Water Authority and its  
23 ratepayers. This organized group of member agency managers, described by its own participants  
24 as the “Secret Society” and the “anti-San Diego Coalition,” meets outside the public view, retains  
25 former Metropolitan executives as consultants to further its goals, and engages in wide-ranging  
26 *sub rosa* activities to coordinate Metropolitan board votes and outcomes. Their shadow  
27 government has captured Metropolitan’s governance, with the full knowledge and complicity of  
28 Metropolitan’s top management and several members of its Board of Directors.



1           **B.     The Water Authority is Metropolitan’s largest steady customer.**

2           25.     Unlike the other Southern California counties served by Metropolitan, San Diego  
3     County has little local groundwater. As a result, the Water Authority historically relied on  
4     Metropolitan for a much higher percentage of its total water supply than most other Metropolitan  
5     member agencies—in the early 1990s, Metropolitan Water constituted as much as 95% of San  
6     Diego County’s water supply.

7           26.     Even today, the Water Authority remains Metropolitan’s largest steady purchaser  
8     of Metropolitan Water. Between 2006 and 2011, the Water Authority purchased almost 2.6  
9     million acre-feet of Metropolitan Water. In addition, during that same period, the Water  
10    Authority paid Metropolitan to transport more than 600,000 acre-feet of its purchased IID and  
11    Canal Lining Water. As Metropolitan’s largest customer, and the only member agency dependent  
12    on Metropolitan’s transportation service to deliver a large volume of third-party water (due to  
13    Metropolitan’s effective monopoly on inter-regional water transportation in Southern California),  
14    the Water Authority is uniquely vulnerable to abusive conduct by Metropolitan and the self-  
15    interested member agencies that control Metropolitan’s board.

16           **C.     The Water Authority purchases water from outside of Metropolitan.**

17           27.     Historically, because Metropolitan’s imported water was cheap and plentiful, the  
18    Water Authority did not need (and thus did not seek out) third-party sources of water like IID.  
19    This all changed during the early 1990s, when California experienced a severe drought.  
20    Metropolitan cut San Diego’s water supply by more than 30% for 13 months, causing major  
21    economic disruptions and forcing San Diego to enact extreme water-use reduction measures. In  
22    the wake of that experience, the Water Authority began to look elsewhere for more reliable  
23    sources of water supply, to guard against future water supply shortages and rationing by  
24    Metropolitan.

25           28.     The Water Authority ultimately contracted with IID to purchase up to 200,000  
26    acre-feet per year of water from the Colorado River Water for a 45-year period. The Water  
27    Authority also obtained the right to water conserved by the lining of the All-American and  
28    Coachella Canals. Because the Water Authority does not have its own aqueduct linking the

1 Colorado River to the Water Authority's service area, the Water Authority and Metropolitan  
2 negotiated the 2003 Transportation Agreement, for delivery of water to the Water Authority's  
3 storage and distribution facilities.

4 29. Pursuant to section 5.2 of the Transportation Agreement, Metropolitan promised  
5 that the price for transporting this Non-Metropolitan Water to the Water Authority "shall be equal  
6 to the charge or charges set by Metropolitan's Board of Directors pursuant to applicable law and  
7 regulation and generally applicable to the conveyance of water by Metropolitan on behalf of its  
8 member agencies."

9 30. As part of the negotiations of the Transportation Agreement, Metropolitan also  
10 demanded a litigation time-out, during which the Water Authority would not challenge  
11 Metropolitan's water rates in any "administrative or judicial forum" for the first five years of the  
12 agreement, including contesting whether the price set by Metropolitan pursuant to the  
13 Transportation Agreement was "set in accordance with applicable law and regulation." That five-  
14 year time-out expired in 2008.

15 **D. Metropolitan's rates and charges.**

16 31. Prior to 2003, Metropolitan charged its member agencies a single "bundled" rate  
17 for water, which incorporated all of Metropolitan's costs of supply, transportation, power,  
18 treatment, and administration. Metropolitan's bundled water rate was charged on a per-acre-foot,  
19 volumetric basis, with water rates set on an annual basis.

20 32. In 1986, the California Legislature passed the Wheeling Statute, Cal. Water Code  
21 Section 1810 *et seq.*, which requires Metropolitan and other water agencies to make available any  
22 excess capacity in their aqueducts for the transportation of third-party water at a "fair  
23 compensation" price. With the Wheeling Statute taking effect, and with an eye toward the  
24 impending Water Authority-IID water transfer, in the late 1990's, Metropolitan began the process  
25 of unbundling its rates. In October 2001, the Metropolitan board approved an unbundled set of  
26 water rate categories, which nominally related to particular services that Metropolitan provides,  
27 including water supply, transportation, standby service, power and water treatment. The Water  
28

1 Authority opposed approval of this unbundled rate structure, in part because Metropolitan did not  
2 disclose at the time how its costs would be allocated among the new rates and charges.

3 33. Metropolitan sets its water rates annually or, more recently, biennially. In doing  
4 so, the Metropolitan board votes not only on the dollar amount of the rates, but on an allocation of  
5 costs to each unbundled rate component; and Metropolitan affirms that, in its view, that year's  
6 allocation of costs to particular rate components is consistent with the cost of the services it  
7 provides to its member agencies. In every rate-setting cycle, Metropolitan has discretion to add  
8 or change its rates and charges, or the allocation of Metropolitan's costs among its rates and  
9 charges and among its member agencies, so long as cost-of-service requirements are met; indeed,  
10 Metropolitan has made such changes from time to time. Metropolitan has acknowledged that  
11 each year's rate-setting decision is a unique agency action. Thus, each year's rates must meet all  
12 legal requirements and each year's rate may be independently challenged in court.

13 34. Metropolitan's current water rates and charges and classes of service include  
14 several that are relevant here: two different "Supply" rates (Tier 1 and Tier 2), a "System Access  
15 Rate," a "System Power Rate," and a so-called "Water Stewardship Rate." Metropolitan defines  
16 these water rates and charges as follows:

17 a. Metropolitan's "Supply" rates purport to recover Metropolitan's cost of  
18 obtaining water from various sources, and developing long-term firm supplies.

19 b. Metropolitan's "System Access Rate" is one of Metropolitan's  
20 "transportation" rates, and is charged on a per-acre foot basis. The System Access Rate  
21 purports to "recover the cost of providing conveyance and distribution capacity to meet  
22 average annual demands." This rate therefore recovers a large share of Metropolitan's  
23 costs to maintain and operate its distribution system within the Southern California region,  
24 along with Metropolitan's Colorado River Aqueduct. As discussed below, in the  
25 2013/2014 rates, Metropolitan has also elected to include in its System Access Rate a  
26 large share of Metropolitan's costs paid to DWR for water supply from the State Water  
27 Project, even though the State Water Project is neither owned nor operated by  
28

1 Metropolitan, and it is *DWR*, not Metropolitan, that transports State Water Project water  
2 from Northern California to Metropolitan's storage reservoirs and facilities.

3 c. Metropolitan's "System Power Rate" is another of Metropolitan's  
4 "transportation" rates, also charged on a per-acre foot basis. The System Power Rate  
5 purports to "recover the cost of pumping water to Southern California." In its 2013/2014  
6 rates, Metropolitan incorporates into the System Power Rate its costs for powering its own  
7 Colorado River Aqueduct and other distribution facilities. In addition, however,  
8 Metropolitan includes in that rate pumping and power costs on the State Water Project,  
9 even though those power costs are not incurred by, nor are the activities performed by,  
10 Metropolitan.

11 d. Metropolitan's "Water Stewardship Rate" is also treated as a  
12 "transportation" rate, in Metropolitan's 2013 and 2014 rates, charged on a per-acre foot  
13 basis. The Water Stewardship Rate purports to "recover the costs of providing financial  
14 incentives for existing and future investments in local resources including conservation  
15 and recycled water." Money collected through this rate is used by Metropolitan to  
16 subsidize water conservation and local water supply projects by Metropolitan's member  
17 agencies.

18 35. Unlike the other Metropolitan rates—*e.g.*, those charged for supply, use of  
19 transportation facilities, and power, which (even if calculated improperly) relate to services  
20 Metropolitan actually provides to its member agencies—"water stewardship" is a concocted  
21 concept that does not describe any service provided by Metropolitan, other than the redistribution  
22 of money from some Metropolitan member agencies to others. In any event, the costs of funding  
23 local projects—even if it were shown to increase the regional water supply to the benefit of all  
24 Metropolitan member agencies (something Metropolitan has failed to demonstrate)—are supply  
25 costs, not "transportation" costs. Metropolitan's own rate consultants previously have  
26 acknowledged that "water stewardship" costs properly should be categorized as "supply," not  
27 "transportation."  
28

1           36.     When a member agency is purchasing *Metropolitan Water*, the allocation of  
2 Metropolitan costs to “supply” versus “transportation” makes no difference, because the  
3 purchaser pays all of Metropolitan’s unbundled rates. But when the Water Authority uses  
4 Metropolitan’s facilities to transport *Non-Metropolitan Water* purchased from other sources, the  
5 rate breakdown is critically important, because it pays only the “transportation” rates. The price  
6 Metropolitan charges for “transportation” of IID and Canal Lining Water is comprised of the  
7 System Access Rate, the System Power Rate, and the Water Stewardship Rate, even though these  
8 rates for 2013 and 2014 include Metropolitan’s costs of obtaining a water supply from the  
9 California DWR and the costs of subsidizing local water supply projects.

10           37.     Metropolitan has also adopted a “wheeling rate,” which it charges for the  
11 transportation of Non-Metropolitan Water. Metropolitan’s Wheeling Rate is an aggregate of the  
12 System Access Rate, the Water Stewardship Rate, the Water Treatment Rate (if the water is  
13 treated), and the incremental power cost associated with that wheeling of water. It does not  
14 include the Supply Rate or other charges. Thus, how costs are allocated between “transportation”  
15 and “supply” rates also has a direct effect on the wheeling rate. Neither the wheeling rate nor the  
16 price charged to the Water Authority under the Transportation Agreement should lawfully include  
17 water supply costs. But because the Water Authority is the only Metropolitan member agency  
18 that uses Metropolitan facilities to transport significant quantities of Non-Metropolitan Water, the  
19 rest of Metropolitan’s member agencies have a financial incentive to characterize water supply  
20 costs as “transportation.” That is precisely what Metropolitan, controlled by the Secret Society of  
21 member agency managers, has done.

22           38.     Accordingly, Metropolitan’s rates as applied to the Water Authority far exceed the  
23 reasonable costs Metropolitan incurs in transporting its IID and Canal Lining Water, or the cost of  
24 wheeling water under the Wheeling Statutes. The rates Metropolitan imposes for “transportation”  
25 force the Water Authority to bear a disproportionate share of Metropolitan’s supply costs and to  
26 subsidize the water supply of other Metropolitan member agencies.

1           **E.     A majority group of Metropolitan member agencies forms a shadow**  
2           **government to unlawfully discriminate against the Water Authority and its**  
3           **ratepayers.**

3           39.     Over the past fifteen years, Metropolitan has had a sordid history of back-room  
4           dealing aimed at disadvantaging the Water Authority. In the late 1990's, Metropolitan was  
5           enmeshed in scandal when a California Senate Select Committee issued a report finding that  
6           Metropolitan staff, Board members and member agency managers had secretly been meeting, in  
7           circumvention of California's Ralph M. Brown Act, to plot strategies to derail the Water  
8           Authority-IID water transfer. Their improper activities included the creation of a front group  
9           called the "Partnership for Regional Water Reliability," which undertook "opposition research"  
10          against more than 150 state and local elected officials, including Governor Pete Wilson, in an  
11          effort to expose conflicts-of-interest that might force those officials to recuse themselves from  
12          consideration or approval of the transfer. The Select Committee found "inept and improper  
13          political dealings," "extensive violations of the Brown Act," and "serious flaws" in the way  
14          Metropolitan and some its member agencies conduct business. The problems with Metropolitan's  
15          governance were so severe, pervasive, and well-documented that the Legislature passed a bill  
16          (Senate Bill 60 – Hayden, 1999) requiring Metropolitan to create an Office of Ethics and  
17          forbidding Metropolitan or any of its member public agencies from using public funds to  
18          investigate public officials, or from creating any association that is likely to mislead the public as  
19          to the association's true identity, its source of funding or its purpose.

20          40.     History has a way of repeating itself. Unbeknownst to the Water Authority at the  
21          time, in or about October 2009, a group of Metropolitan member agencies, whose appointed  
22          board members control a majority of the voting power on the Metropolitan board, organized a  
23          secret group including the general managers or other representatives of those member agencies.  
24          Membership in this secret group was on an "invitation only" basis. The Water Authority learned  
25          of the purpose and extent of this group's activities through a series of Public Records Act requests  
26          sent to Metropolitan and member agencies in late 2011. Documents obtained through those PRA  
27          requests demonstrate that, from at least October 2009 to the present, this group—which has been  
28          referred to by its own participants as the "Secret Society" and the "Anti-San Diego Coalition"—

1 has functioned as a shadow government, working to direct and control Metropolitan Board votes  
2 on water rates, and other key decisions, for the enrichment of the majority member agencies and  
3 to the detriment of the Water Authority.

4 41. From its inception, this shadow government has been squarely focused on ensuring  
5 that Metropolitan's rates and cost allocations discriminate against the Water Authority and  
6 overcharge for transportation of IID and Canal Lining Water. The agendas, notes and meeting  
7 summaries for the early sessions of the Secret Society reflect its participants' intent to make sure  
8 that Metropolitan's State Water Project costs were allocated to transportation rather than  
9 supply—because properly treating these costs as supply would lower San Diego's rates and  
10 increase their own. More recent documents show that the Secret Society's focus on the Water  
11 Authority and maintaining a specific allocation of costs between "transportation" and "supply"  
12 rates has continued at least through 2011.

13 42. The Secret Society's actions to rig Metropolitan's water rates and cost  
14 allocations—for their own benefit and to the Water Authority's detriment—are the product of a  
15 well-organized, well-funded effort. The group has retained consultants, including Metropolitan's  
16 former General Manager Ron Gastelum, and former Metropolitan Assistant General Manager Ed  
17 Means, at a cost of more than \$15,000 per month. The member agency participants assign each  
18 other and their consultants detailed action items to ensure that their desired results are  
19 implemented, including reporting back on how their agencies' appointed board members will vote  
20 and drafting anti-San Diego "policy" proposals that Metropolitan staff members agree to pass off  
21 and introduce as their own. Most importantly, with the help of their paid consultants and  
22 lobbyists, the Secret Society has conveyed to Metropolitan board members the Secret Society's  
23 consensus view that Metropolitan's current, misallocated costs and water rates and charges should  
24 be maintained, not because they are consistent with the cost of service or are proportional to  
25 benefits received by each of Metropolitan's member agencies (which they are not), but because  
26 the unlawful misallocation of water supply costs as transportation rates provides the majority  
27 member agencies with an annual windfall estimated to be at least \$50 million a year in 2013 and  
28 2014. The votes and actions of Metropolitan's board and staff are consistent with the shadow

1 government's rigged outcomes concerning the allocation of costs and imposition of water rates  
2 and charges.

3 43. In addition to operating in secret and hiding its existence, this shadow government  
4 has engaged in other questionable public agency activities. To cite but one example, the Secret  
5 Society commissioned a \$50,000 "independent" economic study from the Los Angeles County  
6 Economic Development Corporation with the express aim of discrediting the Water Authority's  
7 purchase of IID and Canal Lining Water and its requests for water rates and charges that more  
8 accurately reflect Metropolitan's costs of service. The Secret Society released the economic  
9 study in April 2012, trumpeting its findings as "proof" that the Water Authority's rate challenges  
10 are merely an effort to shift its costs of purchasing IID water to other member agencies. But  
11 public records of Secret Society members reveal that the Secret Society dictated this conclusion  
12 to its paid economic consultant, and, indeed, rejected initial findings that indicated the Water  
13 Authority's IID transfer agreement was actually a "good deal."

14 44. At every step, this shadow government has both aided, and been aided by,  
15 Metropolitan. Metropolitan has hosted Secret Society meetings at its headquarters. Metropolitan  
16 staff have regularly attended Secret Society meetings and provided participants with exclusive  
17 briefings on matters pending before the Metropolitan board. Metropolitan has coordinated with  
18 the secret group to conduct anti-San Diego lobbying and outreach campaigns for Metropolitan  
19 board members and state legislators. And Metropolitan's General Manager Jeffrey Kightlinger  
20 has personally attended meetings of the shadow government, and met with a select group of its  
21 ringleaders, to coordinate strategy and to offer Metropolitan's continuing assistance to the Secret  
22 Society. Given that the Water Authority was the principal target of the shadow government, it is  
23 little wonder that Metropolitan's 2013-14 rates, and numerous other decisions by the  
24 Metropolitan Board, have consistently disfavored the Water Authority and the San Diego region  
25 it serves.

26 **F. The 2011/2012 rate lawsuit**

27 45. On June 11, 2010, the Water Authority filed a lawsuit for writ of mandate,  
28 declaratory relief, and reverse-validation of Metropolitan's 2011 and 2012 rates, approved in



1 April 2010. Pursuant to Code of Civil Procedure Section 394, that action, styled *San Diego*  
2 *County Water Authority v Metropolitan Water District of Southern California et al.*, Case No.  
3 CPF-10-510830, was transferred to a neutral venue, San Francisco Superior Court, and is  
4 proceeding before the Honorable Richard A. Kramer. The complaint in the 2011/2012 rate  
5 challenge has been amended to include a claim for breach of the Transportation Agreement, and  
6 two claims for declaratory relief pertaining to related agency actions. Discovery is ongoing in  
7 that case, and no trial date has been set.

8 **G. Metropolitan sets unlawful rates for 2013 and 2014.**

9 46. On January 10, 2012, Metropolitan's board set a March 12, 2012 public hearing of  
10 its Business & Finance Committee on Metropolitan's proposed rates and charges to become  
11 effective January 1, 2013 and January 1, 2014. On March 12, 2012, Metropolitan's Business and  
12 Finance Committee held that public hearing, at which the Water Authority provided written and  
13 oral testimony. The Water Authority's written testimony included the submission of more than  
14 5000 pages of documents, including a detailed report prepared by industry experts FCS Group  
15 that demonstrated how Metropolitan's proposed rates and charges violate industry standard cost-  
16 of-service principles; a letter to Metropolitan's board from the Water Authority's special counsel  
17 detailing why the proposed rates would violate the California Constitution, state statutes, and  
18 common law; historical cost-of-service studies and analyses that are relevant to the validity of the  
19 2013/2014 rates; and documents detailing the improper activities of the Secret Society with  
20 respect to ratemaking and cost-allocation decisions. These documents are all part of the  
21 administrative record for the setting of the rates challenged here; the FCS Report and the letter  
22 from the Water Authority's special counsel are attached hereto as Exhibit B.

23 47. Two business days prior to the Metropolitan board vote to adopt the 2013 and  
24 2014 water rates and charges and cost allocations, on April 5, 2012, Metropolitan's General  
25 Manager and General Counsel co-authored a letter to the Water Authority in response to its  
26 March board submittals ("Metropolitan's Cost of Service Letter"). In that letter, Metropolitan  
27 said that the Water Authority and its expert consultants failed to "appreciate" that Metropolitan is  
28 a regional rather than a local water supplier whose "interconnected regional system" is necessary

1 for “regional flexibility” and “regional reliability.” Metropolitan also stated that its use of  
2 “postage stamp” rates results in “lower costs for all of Metropolitan’s member agencies,” but  
3 offered no data, analysis or expert opinion to support that claim. This document is part of the  
4 administrative record for the setting of the rates challenged here.

5 48. Although the timing of Metropolitan’s Cost of Service Letter gave the Water  
6 Authority only two business days (discounting the Easter Weekend) to respond, on April 9, 2012,  
7 the Water Authority submitted additional materials for the board’s consideration, including  
8 additional public records, a response to Metropolitan’s Cost of Service Letter, and additional  
9 evidence and analysis offered by the Water Authority’s experts and special counsel. These  
10 documents are all part of the administrative record for the setting of the rates challenged here. On  
11 April 10, 2012, without any discussion of the issues and concerns raised by the Water Authority  
12 and its consultants, Metropolitan’s board formally voted to adopt the proposed water rates and  
13 charges and cost allocations for 2013 and 2014.

14 49. Metropolitan’s 2013 and 2014 rates unreasonably and unlawfully allocate supply  
15 costs to rates imposed for transportation services. These misallocations of cost by Metropolitan  
16 unreasonably and unlawfully discriminate against the Water Authority and result in a wheeling  
17 rate, and a price charged for the delivery of IID and Canal Lining Water under the Transportation  
18 Agreement, that far exceed the cost of providing those services.

19 50. Metropolitan also allocates to “transportation,” through the imposition of its Water  
20 Stewardship Rate, costs it incurs to subsidize local water supply projects, such as desalination,  
21 groundwater recovery and water conservation, for all member agencies except the Water  
22 Authority (which Metropolitan has barred from participating in the subsidy program). Since  
23 Metropolitan has failed to make, and cannot make, any showing that these expenditures are  
24 necessary to provide transportation capacity in Metropolitan facilities, and assuming that these  
25 costs provide a regional benefit (something that Metropolitan has failed to establish to justify  
26 collecting revenues from all of Metropolitan’s member agencies to pay them), these costs must be  
27 allocated to supply.

28

1           51.     Finally, Metropolitan's 2013 and 2014 rates fail to account for, and allocate costs  
2 to, the "standby service" that Metropolitan provides to its member agencies. In 2013 and 2014,  
3 Metropolitan will spend millions of dollars on water supply and facilities to accommodate  
4 member agencies who may choose to rely on Metropolitan as a supplemental water source if it is  
5 a dry year. While Metropolitan purports to recover some of these standby-related costs through  
6 its fixed Readiness to Serve Charge, the Readiness to Serve Charge does not recover all standby  
7 costs. Indeed, Metropolitan has never accounted for these standby costs in a cost-of-service  
8 study, nor has it developed a rate that accurately reflects those costs and allocates them  
9 proportionally according to the benefits they receive from Metropolitan's investments in standby  
10 service. Instead, those costs are largely hidden within Metropolitan's Supply Rate and its System  
11 Access Rate. As Metropolitan's biggest customer and a steady purchaser of Metropolitan Water,  
12 the Water Authority is particularly disadvantaged by Metropolitan's treatment of standby costs.  
13 The harm to the Water Authority is increased by the inclusion of some of these hidden costs in  
14 the price for transportation of its IID and Canal Lining Water, even though the Water Authority  
15 obtains no standby benefit in conjunction with its purchase of these transportation services.  
16 Metropolitan's actions create an indirect subsidy for member agencies like the City of Los  
17 Angeles that engage in substantial dry-year peaking, paid for by steady purchasers like the Water  
18 Authority that receive less benefit from Metropolitan's standby service.

19           52.     As a direct result of Metropolitan's unlawful and discriminatory water rates and  
20 cost allocations, the Water Authority estimates it will be overcharged by at least \$50 million per  
21 year if the 2013 and 2014 rates and charges challenged in this action remain in effect. This  
22 annual overcharge will grow larger each year so long as Metropolitan's rates continue to be based  
23 on such unlawful cost allocations.

24           53.     The Water Authority has exhausted all its administrative remedies, including the  
25 dispute resolution provisions of Section 11.1 of the Transportation Agreement. Pursuant to  
26 Section 11.1, the Water Authority requested that Metropolitan negotiate resolution of the price  
27 dispute by letter dated April 26, 2012. A copy of this letter is attached as Exhibit C. In that letter,  
28 the Water Authority also asked Metropolitan to identify any further action that it believed the

1 Water Authority needed to take in order to exhaust its non-litigation remedies. Metropolitan  
2 responded on May 4, 2012, declining to participate in negotiations. Metropolitan also confirmed  
3 that the Water Authority had fully exhausted its available remedies. A copy of Metropolitan's  
4 response letter is attached as Exhibit D.

5 54. On or about April 26, 2012, the Water Authority also presented a claim for breach  
6 of the Transportation Agreement pursuant to Metropolitan Administrative Code section 9300 *et*  
7 *seq.* and California Government Code section 900 *et seq.* The Water Authority informed  
8 Metropolitan that it explicitly reserved its rights to bring suit against Metropolitan relating to the  
9 imposition of the 2013 and 2014 rates. A copy of this letter presenting the claim is attached as  
10 Exhibit E. To date, Metropolitan has taken no further action on that claim and, therefore, it has  
11 been deemed denied by operation of law.

12 **H. Metropolitan's rates are invalid under Proposition 26.**

13 55. On November 2010, California voters approved Proposition 26, a ballot initiative  
14 that followed upon Propositions 13 and 218 to further restrict the ability of local governments to  
15 raise revenue to fund government services, facilities, and programs without demonstrating a  
16 benefit associated with the increased revenue, as defined. Proposition 26 amended provisions of  
17 articles XIII A and XIII C of the California Constitution by providing a new definition of the term  
18 "tax" applicable to state and local governments, respectively.

19 56. Under the new definition set forth in article XIII C, section 1, subdivision (e)—  
20 which applies to "local governments" and "special districts" such as Metropolitan—a "tax"  
21 includes any "levy, charge, or exaction of any kind" imposed by the government entity, with  
22 seven stated exceptions. A tax imposed by a local government or district to fund a specific  
23 service is invalid unless approved by two-thirds of qualified voters in that district. Cal. Const. art.  
24 XIII A § 4; *id.* art. XIII C § 2, subdivision (d). As relevant here, a charge imposed for a specific  
25 government service is a tax unless "the charge [is] imposed for a specific government service or  
26 product provided directly to the payor that is not provided to those not charged, and which does  
27 not exceed the reasonable costs to the local government of providing the service or product." Cal.  
28 Const., art. XIII C, § 1, subdivision (e)(2). Thus, the rates challenged here require two-thirds

1 voter approval as special taxes unless Metropolitan meets its burden to prove they are: (i) for  
2 services provided directly to the Water Authority, (ii) for services not provided to others not  
3 charged, and (iii) do not exceed the reasonable costs to Metropolitan to provide those services.  
4 As demonstrated above, Metropolitan can prove none of these and its rates are therefore illegal,  
5 non-voter-approved special taxes.

6 57. Proposition 26 places the burden on the government entity imposing a charge to  
7 prove that it is not a tax and is therefore exempt from voter approval requirements. Specifically,  
8 under the final, unnumbered paragraph of Article XIII C, § 1, subdivision (e), the local  
9 government “bears the burden of proving by a preponderance of the evidence that a levy, charge,  
10 or other exaction is not a tax, that the amount is no more than necessary to cover the reasonable  
11 costs of the government activity, and that the manner in which those costs are allocated to a payor  
12 bears a fair or reasonable relationship to the payor’s burdens on, or benefits received from, the  
13 governmental activity.” Cal. Const., art. XIII C, § 1(e).

14 58. Metropolitan’s 2013 and 2014 water rates and charges impose on the Water  
15 Authority rates that are “more than necessary” to cover the cost of the services Metropolitan  
16 provides to the Water Authority; and Metropolitan’s water rates and charges are not allocated  
17 among its member agencies such that they bear a “fair and reasonable relationship” to the burdens  
18 and benefits received. As explained above, Metropolitan misclassifies various supply-related  
19 costs as “transportation,” although these charges have no relationship to the service benefits the  
20 Water Authority actually receives or the amounts Metropolitan actually spends to transport water.  
21 Similarly, Metropolitan has not demonstrated that the so-called “Water Stewardship Rate”  
22 imposed on the Water Authority provides a commensurate, or even any, benefit to the Water  
23 Authority. On the contrary, the conservation and local water supply projects funded by  
24 Metropolitan through the Water Stewardship Rate benefit only the member agencies that receive  
25 subsidies from Metropolitan, and do not provide any benefit, let alone a proportional benefit, to  
26 the Water Authority. In fact, due to a July 2011 decision by the Metropolitan board—as  
27 promoted by the Secret Society—the Water Authority is formally disqualified from receiving  
28 most of the benefit from the Water Stewardship Rate as punishment for filing the lawsuit

1 referenced in paragraph 45 above—in spite of the fact that the Water Authority pays more in  
2 Water Stewardship rates than any other member agency.

3 59. Metropolitan's water rates have not been approved in accordance with the  
4 requirements of article XIII C of the California Constitution, including the requirement of two-  
5 thirds voter approval for imposition of special taxes. They are therefore unlawful and invalid.

6 **I. Metropolitan's 2013-14 rates unlawfully discriminate against the Water**  
7 **Authority.**

8 60. Metropolitan's calendar year 2013 and 2014 water rates and charges not only  
9 violate the California Constitution and numerous California statutes; they also violate the  
10 common law principle that a public agency may not set rates that unlawfully discriminate against  
11 a single customer or group of customers.

12 61. Under the domination and control of a shadow government led by certain large,  
13 self-interested Metropolitan member agencies, Metropolitan has enacted rates that improperly  
14 allocate Metropolitan's costs of purchasing DWR water, and its water supply costs paid for by the  
15 Water Stewardship Rate, to its transportation rates. Further, Metropolitan has failed to charge the  
16 Water Authority a rate commensurate with the cost of services provided directly to the Water  
17 Authority. In addition, Metropolitan has arbitrarily decided not to recover the known and true  
18 costs of providing standby service proportionally from the agencies that benefit from that service,  
19 instead burying those costs in other rates. Thus, the Water Authority is charged for services that  
20 others receive without charge, or at a discounted rate, in violation of Proposition 26.

21 62. As described throughout this Complaint, the Water Authority is uniquely  
22 vulnerable to abusive conduct by Metropolitan and its self-interested member agencies, because it  
23 is the only Metropolitan member agency that is both a high-volume, steady purchaser of  
24 Metropolitan water and also utilizes Metropolitan's regional facilities to transport a large volume  
25 of Non-Metropolitan Water. Metropolitan, and the self-interested member agencies whose  
26 appointees wield a majority of the voting power on the Metropolitan board, have taken a series of  
27 actions to intentionally ignore cost-of-service standards and shift costs to the Water Authority that  
28 they know ought to be borne proportionally by other agencies and ratepayers. The

1 misclassification of supply costs as transportation results in overcharges to the Water Authority of  
2 more than \$50 million per year for 2013 and 2014, which the Secret Society's own documents  
3 acknowledge will grow over time and amount to nearly \$3 billion in total over the remaining term  
4 of the Water Authority-IID Agreement.

5         63. In addition to being arbitrary, unreasonable and unjustified on cost-of-service  
6 grounds, Metropolitan's discriminatory rates and cost allocations result directly from the  
7 activities of the Secret Society. Upon information and belief, and based on information from  
8 public records recently obtained by the Water Authority, a majority voting bloc of more than  
9 fifteen Metropolitan member agencies—with Los Angeles, Municipal Water District of Orange  
10 County, Western Municipal Water District and West Basin Municipal Water District as its  
11 ringleaders—have created a shadow government, working with Metropolitan executives and  
12 former Metropolitan executives now acting as the group's paid consultants, to manipulate  
13 Metropolitan water rates and other key decisions regarding Metropolitan's cost allocations and  
14 other matters. Aware that allocating costs to accord with the proportional benefit of the services  
15 provided (as both law and industry practice require) would reduce the total rates paid by the  
16 Water Authority—and increase them for their own member agencies—this shadow government  
17 was formed to ensure continuation of discriminatory cost allocations. The *sub rosa* existence and  
18 actions of the Secret Society has resulted in procedural unfairness, and in biased, unfair and  
19 unreasonable water rates and charges that unlawfully discriminate against the Water Authority  
20 and the citizens of San Diego.

21         64. While Metropolitan's cost allocations and rates benefit the majority of  
22 Metropolitan's other member agencies generally by shifting their water supply costs to the Water  
23 Authority's ratepayers, the member agencies who organized and have led the Secret Society  
24 receive particular spoils from Metropolitan's rate decisions. First, Metropolitan and its Board,  
25 under the influence and control of the Secret Society, have unequally disbursed subsidy contracts  
26 to provide many millions of dollars in grants to participants in the Secret Society, even though  
27 those grants fail to provide any regional benefit throughout Metropolitan's service area. The  
28 agencies that do not receive Metropolitan's subsidies, or do not receive a roughly proportional

1 share of those subsidies, are thus forced to subsidize water supply projects that only benefit other  
2 Metropolitan member agencies. To take but one example, Western Municipal Water District  
3 (“Western”) has reported to its board that, between the time of Metropolitan’s adoption of its  
4 unbundled rates in 2003 through 2010, it paid Metropolitan approximately \$14.8 million in Water  
5 Stewardship Rate fees, while receiving \$38.1 million for “water stewardship” (local water supply)  
6 projects in return—a “net benefit” of more than \$23 million. Western’s “net benefit” is simply an  
7 illicit wealth transfer from the citizens of San Diego County to those of Riverside County. The  
8 other ringleaders of the Secret Society, including the Municipal Water District of Orange County  
9 and the West Basin Municipal Water District, have reaped similarly large benefits from  
10 Metropolitan’s local resources program at the Water Authority’s expense. By contrast, the Water  
11 Authority has been formally blackballed from this subsidy program for exercising its  
12 constitutional right to bring the suit challenging Metropolitan’s unlawful rates identified in  
13 paragraph 45 above. In short, the Water Authority is forced to pay millions of dollars each year  
14 to fund water supply programs of other Metropolitan member agencies but will get nothing in  
15 return, while a subset of member agencies pays in far less and gets a windfall.

16         65.       Second, as discussed above, Metropolitan fails to fully account for the costs of  
17 “dry-year peaking,” that is, buying more water from Metropolitan in dry years or when local  
18 water supplies are otherwise reduced or not available. The chief beneficiary of Metropolitan’s  
19 flawed approach is the City of Los Angeles and its Department of Water & Power (LADWP).  
20 LADWP’s water supply purchases from Metropolitan vary widely from year to year—they can  
21 increase by as much as 200,000 acre-feet in a year, depending on the water supply conditions in  
22 the Owens Valley that serves LADWP’s own Los Angeles Aqueduct. When its own water  
23 supplies are short, LADWP can simply pick up the telephone and order more water from  
24 Metropolitan—a supply of water Metropolitan holds “on call” for LADWP at little cost to  
25 LADWP during years it does not need more water, but at great cost to steady Metropolitan water  
26 purchasers like the Water Authority. Metropolitan has not conducted a cost of service study that  
27 would allow a proper allocation of the costs of this standby service to the member agencies that  
28 receive the benefit of that service. The failure to properly allocate the costs of standby service



1 provides an estimated financial benefit to LADWP, and corresponding annual detriment to the  
2 other Metropolitan member agencies, of as much as \$40 million each year. As Metropolitan's  
3 largest steady purchaser of water, the Water Authority bears the largest share of Metropolitan's  
4 subsidization of LADWP's dry-year water supply.

5 66. Taken together, Metropolitan's actions represent a pattern and practice of  
6 discrimination against the Water Authority and its ratepayers, and a naked redistribution of  
7 money to the ringleaders of the self-described Anti-San Diego Coalition, both of which the Water  
8 Authority is powerless to halt except through litigation.

9 **FIRST CAUSE OF ACTION**

10 **FOR WRIT OF MANDATE RE: ALLOCATION OF COSTS IN 2013/2014 RATES**

11 **(Against Respondent Metropolitan)**

12 67. Petitioner re-alleges paragraphs 1 through 66 as though set forth fully herein.

13 68. Metropolitan is under a clear and present duty, pursuant to Article XIII A, Section  
14 4 (adopted by Proposition 13) and Article XIII C, Section 1, subdivision (e) (adopted by  
15 Proposition 26) of the California Constitution, and Government Code Section 50076, to set rates  
16 and charges no greater than the reasonable cost of providing the service or product for which the  
17 fee is charged. Under that duty, Metropolitan's rates and charges must reasonably and fairly  
18 allocate its costs among its member agencies in accordance with the benefits and burdens borne  
19 by each agency. Otherwise, the rates and charges imposed for these services constitute special  
20 taxes, for which Proposition 13 and Proposition 26 require two-thirds voter approval.

21 Metropolitan did not obtain voter approval of the rates and charges challenged here.

22 69. Moreover, under Article XIII C, Section 1 of the California Constitution (adopted  
23 by Proposition 26), Metropolitan has the burden to prove that the amounts it charges for its  
24 services are "no more than necessary to cover the reasonable costs of the governmental activity,"  
25 and that these costs are allocated such that they "bear a fair or reasonable relationship to the  
26 payor's burdens on, or benefits received from, the governmental activity." In other words,  
27 Metropolitan must prove that it properly and proportionally assigns the costs of providing  
28

1 services to its member agencies in accordance with the needs of and benefits provided to each  
2 agency.

3 70. Additionally, Metropolitan is under a clear and present duty under the MWD Act  
4 to set rates and charges that “shall be uniform for like classes of service throughout the district.”  
5 (Stats. 1969, ch. 209 as amended; West’s California Water Code—Append. §§ 109-134 (2010)).  
6 Under this duty, Metropolitan’s rates and charges must also apportion costs equitably among its  
7 customers.

8 71. Metropolitan is further under a clear and present duty, pursuant to Government  
9 Code Section 54999.7(a), to set rates and charges that do “not exceed the reasonable costs of  
10 providing the public utility service.”

11 72. Metropolitan is further under a clear and present duty, pursuant to Government  
12 Code Section 66013, to set charges that do not “exceed the estimated reasonable cost of providing  
13 the service for which the fee or charge is imposed.”

14 73. Metropolitan also is under a clear and present duty, imposed by the Wheeling  
15 Statutes (Water Code § 1810 *et seq.*) to charge only “fair compensation” for the conveyance, or  
16 “wheeling,” of water through Metropolitan’s facilities. Above and beyond the Transportation  
17 Agreement, which requires that Metropolitan transport IID Water and Canal Lining Water at a  
18 price equal to Metropolitan’s rates set “pursuant to applicable law and regulation and generally  
19 applicable to the conveyance of water by Metropolitan,” the Water Authority has previously  
20 engaged, in the past, and intends to engage in the future, in “wheeling” of water from third-party  
21 sources through Metropolitan’s facilities.

22 74. Finally, Metropolitan also has a clear and present duty under California common  
23 law to set rates and charges that are fair, reasonable, and proportionate to the cost of service.  
24 Metropolitan also has a common law duty to make decisions and set rates that do not  
25 unreasonably discriminate among its customers.

26 75. Metropolitan has failed to perform these duties. Rates adopted by Metropolitan on  
27 or about April 10, 2012, including the System Access Rate, System Power Rate, and Water  
28 Stewardship Rate, comprise the price that the Water Authority is charged pursuant to the

1 Transportation Agreement, as well as the “wheeling rate” applicable to the conveyance of Non-  
2 Metropolitan Water through Metropolitan’s facilities. As described above, the 2013/2014 water  
3 rates include, in the rates for transportation, costs that bear no relationship to the costs  
4 Metropolitan incurs to convey water through Metropolitan’s facilities, nor do they properly assign  
5 costs among member agencies as required by the California Constitution.

6 76. First, the 2013 and 2014 rates challenged here allocate most of Metropolitan’s cost  
7 of obtaining a water supply from the State Water Project to the System Access Rate and System  
8 Power Rate, which the Water Authority is required to pay as part of its price for the transportation  
9 of IID and Canal Lining Water through Metropolitan’s own facilities (the System Access Rate is  
10 also included in Metropolitan’s wheeling rate). The cost the Water Authority is required to pay is  
11 not commensurate with the service benefits received by the Water Authority, nor is it  
12 commensurate with the cost burden placed on Metropolitan by the Water Authority for  
13 transportation of its IID and Canal Lining Water.

14 77. Second, Metropolitan includes the Water Stewardship Rate in its calculation of the  
15 price charged to the Water Authority under the Transportation Agreement, and in calculating a  
16 rate under the Wheeling Statute, even though the Water Stewardship Rate does not recover costs  
17 of transporting water. Instead, revenues from the Water Stewardship Rate subsidize some  
18 favored member agencies’ costs of water conservation and local water supply projects. Even had  
19 Metropolitan demonstrated a regional benefit from these subsidies (which it has not), these costs  
20 are clearly being incurred to increase water supply, not transportation.

21 78. Allocating water supply costs to Metropolitan’s “transportation” rate unlawfully  
22 overcharges the Water Authority for water transportation, while artificially undercharging  
23 Metropolitan’s member agencies for water supply costs. Metropolitan’s misallocation of these  
24 costs violates the duties described above to allocate its costs, and set rates and charges, in a  
25 manner that is fair, reasonable, and proportionate to the cost of service to each customer.

26 79. In addition, Metropolitan’s rates fail to account for the full cost of providing  
27 standby service, or to charge rates that reflect the varying benefits received by different member  
28 agencies for that standby service, in violation of various statutory and constitutional obligations.

1 Metropolitan does not properly assign the costs of standby service to the member agencies that  
2 actually benefit from the costs it incurs for standby water supply and facilities.

3 80. The Water Authority estimates that if Metropolitan's misallocation of its State  
4 Water Project costs and Water Stewardship Rate costs remains unchanged, the Water Authority  
5 will be overcharged by at least \$50 million annually in 2013 and 2014. The Water Authority  
6 further estimates that Metropolitan's failure to account for and properly charge the cost of  
7 standby service results in the Water Authority being overcharged by additional millions of dollars  
8 annually, in a precise amount to be determined according to proof. These annual overcharges will  
9 increase each year until a court orders Metropolitan to comply with its duties outlined above.

10 81. The Water Authority has no plain, speedy, and adequate remedy at law, other than  
11 the relief sought in this Complaint. The Water Authority is beneficially interested in the issuance  
12 of a Writ of Mandate to obtain judicial review of Metropolitan's illegal overcharges.

13 82. Accordingly, the Water Authority is entitled to issuance of a Peremptory Writ of  
14 Mandate as specified more fully below.

15 **SECOND CAUSE OF ACTION**

16 **DECLARATORY RELIEF RE: ALLOCATION OF COSTS**  
17 **IN 2013/2014 RATES**

18 **(Against Respondent Metropolitan)**

19 83. Petitioner re-alleges paragraphs 1 through 82 as though set forth fully herein.

20 84. An actual and present controversy now exists between the Water Authority, on the  
21 one hand, and Metropolitan, on the other. Petitioner contends that the rates and charges  
22 Metropolitan adopted over its objections on April 10, 2012 violate state constitutional, statutory,  
23 and common law, as set forth in the First Cause of Action. The challenged rates overcharge San  
24 Diego residents for water transportation, undercharge Metropolitan's member agencies for water  
25 supply, and do not comply with Metropolitan's duty to impose rates and charges that are fair,  
26 reasonable, and proportionate to the cost of service to each customer.

27 85. Moreover, Metropolitan's actions violate the common law principle that an agency  
28 may not set unduly discriminatory rates by classifying its constituents on an unreasonable basis.

1 Metropolitan has engaged in a pattern and practice of discriminatory and unreasonable rate-  
2 setting, including the setting of its 2013 and 2014 rates, which violates the well-established  
3 common law prohibition against such discrimination. Through a process that is unfair and  
4 corrupted, Metropolitan has deliberately singled out and targeted the Water Authority and,  
5 through it, the residents of San Diego by imposing upon them unreasonably high water costs.

6 86. Respondent Metropolitan disagrees with these allegations and asserts that the rates  
7 and charges challenged here are lawful in all respects. Metropolitan further contends that the  
8 existence and activities of the Secret Society—and Metropolitan’s own actions in working with  
9 this shadow government—constitute reasonable and acceptable public agency practices.

10 87. In the absence of declaratory relief, Metropolitan will continue to impose  
11 discriminatory rates and charges that are not fair, reasonable, and proportionate to the cost of  
12 serving its customers, including the Water Authority. The Water Authority estimates that if  
13 Metropolitan’s 2013-2014 rates remain unchanged, the misallocation of Metropolitan’s State  
14 Water Project costs and conservation and local supply development costs to the “transportation”  
15 rate will result in the Water Authority being overcharged by at least \$50 million annually in 2013  
16 and 2014. This overcharge will continue to increase as the amount of Non-Metropolitan Water  
17 transported through Metropolitan facilities increases and as Metropolitan continues to execute  
18 subsidy contracts.

19 88. In the absence of declaratory relief, Metropolitan also will continue to participate  
20 in and encourage the *sub rosa* activities of the Secret Society, which meets in secret to dictate  
21 Metropolitan decisions and works with Metropolitan and its board to ensure the enactment of  
22 discriminatory rates and other board policies that discriminate against the Water Authority.

23 89. The Water Authority desires and is entitled to a judicial declaration that, because  
24 of Metropolitan’s misallocation of its State Water Project, Water Stewardship Rate, and standby  
25 costs to its “transportation” rates, and because of their discriminatory effect on the Water  
26 Authority, Metropolitan’s rates and charges are contrary to law and violate constitutional,  
27 statutory and common law. The Water Authority further desires and is entitled to a judicial  
28 declaration that Metropolitan must end its practice of delegating its policymaking authority to,

1 and secretly coordinating with, a shadow government, including for the purpose of discriminating  
2 against the Water Authority and San Diego County ratepayers, and that Metropolitan must  
3 conduct its business in public view.

4 90. Such declaratory relief is necessary and appropriate now, because the Water  
5 Authority anticipates that Metropolitan will continue to impose rates and charges that violate  
6 constitutional, statutory and common law; and that Metropolitan will continue its pattern and  
7 practice of coordinating with, and relying improperly upon, a shadow government working  
8 outside of public view to discriminate against the Water Authority and the people it serves. A  
9 declaration is therefore necessary to protect the Water Authority and the San Diego region from  
10 these unlawful rates, charges, and practices.

11 91. Therefore, the Water Authority prays for declaratory relief as specified more fully  
12 below.

13 **THIRD CAUSE OF ACTION**

14 **DETERMINATION OF INVALIDITY OF RATES ADOPTED BY METROPOLITAN ON**  
15 **OR ABOUT APRIL 10, 2012**

16 **(CCP § 860 *et seq.*; Gov't Code § 66022)**

17 **(Against Respondent Metropolitan)**

18 92. Petitioner re-alleges paragraphs 1 through 91 as though set forth fully herein.

19 93. Petitioner is informed and believes, and on that basis alleges, that the rates and  
20 charges Metropolitan adopted on or about April 10, 2012 may include capacity charges as defined  
21 in Government Code Section 66013. Government Code Section 66022 authorizes the filing of a  
22 validation action or reverse-validation action pursuant to Code of Civil Procedure Sections 860 *et*  
23 *seq.* to challenge a public agency's adoption of rates that include capacity charges as defined in  
24 Government Code Section 66013.

25 94. Assuming that Metropolitan's rates are subject to validation pursuant to this  
26 provision, the Water Authority seeks a determination pursuant to Code of Civil Procedure  
27 sections 860 and 863 that the rates and charges described below are invalid.  
28

1           95. Code of Civil Procedure Section 863 provides that “any interested person may  
2 bring an action . . . to determine the validity of the matter” in situations where a public agency  
3 could bring a validation action. The Water Authority qualifies as an “interested person” within  
4 the meaning of Section 863 because the Water Authority pays Metropolitan’s inflated and  
5 improperly allocated rates for the services at issue.

6           96. The rates and charges Metropolitan adopted on or about April 10, 2012 are invalid  
7 under Art. XIII A, Section 4 of the California Constitution (adopted by Proposition 13), and  
8 Government Code Section 50076, because these rates and charges are not limited to the  
9 “reasonable cost of providing the service . . . for which the fee is charged.” (Gov. Code § 50076).  
10 The rates and charges Metropolitan adopted on or about April 10, 2012 are also invalid under  
11 Article XIII C, Section 1, subdivision (e) of the California Constitution (adopted by Proposition  
12 26), because such charges are greater “than necessary to cover the reasonable costs of the  
13 governmental activity,” and are not allocated in a manner that “bear[s] a fair or reasonable  
14 relationship to the payor’s burdens on, or benefits received from, the governmental activity.” The  
15 water rates and charges challenged here violate these provisions for three independent reasons,  
16 any one of which alone is sufficient to invalidate the rates:

17           a. The challenged rates, including any capacity charges, recover the bulk of  
18 Metropolitan’s costs of water from the State Water Project through the System Access  
19 Rate and the System Power Rate imposed on transportation, rather than Metropolitan’s  
20 Supply Rate. As a result, the challenged rates overcharge for water transportation and  
21 undercharge for water supply. Thus, these rates do not allocate to each customer the  
22 actual, reasonable and proportionate cost of serving that customer and instead are  
23 unreasonable, arbitrary, capricious, and discriminatory.

24           b. The challenged rates, including any capacity charges, include the Water  
25 Stewardship Rate in the rates Metropolitan imposes for water transportation. As a result,  
26 the challenged rates overcharge for water transportation and undercharge for water supply.

27           c. The challenged rates and charges, including any capacity charges, include a  
28 large portion of Metropolitan’s costs associated with maintaining, storing and delivering

standby dry-year water supplies. Metropolitan fails to allocate the costs for this standby service based on the proportional benefit it provides to each member agency. For this reason, too, these rates and charges fail to allocate to each customer the actual, reasonable and proportionate cost of serving that customer and instead are unreasonable, arbitrary, capricious, and discriminatory.

97. For these reasons, Metropolitan's rates constitute a tax. Because this tax was not approved by a two-thirds majority of qualified voters, it is invalid under Article XIII A, Section 4 and article XIII C, Section 2, subd. (d) of the California Constitution.

98. For the reasons set forth above, the rates and charges adopted by Metropolitan's board on or about April 10, 2012 are also invalid under: (a) Metropolitan's principal act, Stats. 1969; ch. 209 as amended; West's California Water Code—Append. §§ 109-134 (2010), which requires Metropolitan to set rates and charges that are "uniform for like classes of services throughout the district"; (b) California's Wheeling Statutes (Water Code Section 1810 *et seq.*), because the rates Metropolitan charges for conveyance to the Water Authority of Non-Metropolitan Water exceed "fair compensation" for use of Metropolitan's facilities; (c) Government Code Section 54999.7(a), which requires that its rates and charges "not exceed the reasonable cost of providing the public utility service;" (d) Government Code Section 66013, which requires that Metropolitan's charges not "exceed the estimated reasonable cost of providing the service for which the fee or charge is imposed;" and (e) California common law, which requires that Metropolitan impose rates and charges that are fair, reasonable, and proportionate to the actual cost of service.

99. The Water Authority is entitled to a declaration under the Validation Statutes that the rates and charges Metropolitan adopted on April 10, 2012 are invalid and must be set aside.

**FOURTH CAUSE OF ACTION**

**BREACH OF CONTRACT**

**(Against Respondent Metropolitan)**

100. Petitioner re-alleges paragraphs 1 through 99 as though set forth fully herein.





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- Water Project to charges for water transportation;
- Refrain from allocating any costs that does not bear a fair or reasonable relationship to the payor’s burdens on, or benefits received from, the governmental activity associated with the Water Authority’s transportation of Non-Metropolitan Water through Metropolitan facilities;
  - Refrain from allocating any water conservation or local water supply development costs associated with Metropolitan’s Water Stewardship Rate to charges for water transportation;
  - Conduct a cost-of-service study that will allow Metropolitan to allocate the costs for providing various services to member agencies based on the proportional benefit they receive from Metropolitan’s provision of that service, including Metropolitan’s provision of standby services, before recovering the costs of those services from rates.

2. As to the Second Cause of Action, a declaration that (a) the rates and charges adopted by Metropolitan on April 10, 2012 are discriminatory, invalid, and must be set aside; (b) Metropolitan cannot allocate any costs associated with obtaining water supplies from the State Water Project to Metropolitan’s charges for water transportation; (c) Metropolitan cannot allocate any water conservation or local water supply development costs associated with its Water Stewardship Rate to Metropolitan’s charges for water transportation; (d) Metropolitan must allocate its costs of maintaining and storing a standby supply of water to member agencies based on the proportional benefit they receive from Metropolitan’s provision of that service; (e) Metropolitan has engaged in a pattern and practice of unlawful discriminatory rate-setting; and (f) Metropolitan must end its practice of delegating its policymaking authority to and coordinating in secret with a shadow government, including for the purpose of discriminating against the Water Authority and San Diego County ratepayers, and must conduct the business of Metropolitan in public view.

3. As to the Third Cause of Action, an order that the rates and charges adopted by Metropolitan on April 10, 2012 are invalid and must be set aside.

1           4.       As to the Fourth Cause of Action, an award of compensatory and general damages  
2 against Metropolitan, in an amount to be determined according to proof, and an order of specific  
3 performance of the Transportation Agreement requiring Metropolitan to set the rates charged to  
4 the Water Authority under the Transportation Agreement in conformance with applicable laws  
5 and regulations. The Water Authority also prays for interest on any amounts paid to Metropolitan  
6 pursuant to Metropolitan's invalid and unlawful rates for 2013 and 2014, from the date of the  
7 Water Authority's payment of any amounts under those rates to the date of judgment. The Water  
8 Authority has a right to such interest both as a matter of general damages principles and as a  
9 result of the express term in section 12.4(c) of the Transportation Agreement, which requires  
10 Metropolitan, in the event of a rate challenge, to place all disputed amounts in an interest-bearing  
11 escrow account. To the Water Authority's knowledge, as of the date of this Petition,  
12 Metropolitan has failed to deposit funds in a separate interest-bearing account as it agreed to do in  
13 the Transportation Agreement.


14           5.       For reasonable attorneys' fees and costs of suit incurred herein.

15           6.       For such other and further relief as the Court deems proper.

16  
17 Dated: June 8, 2012

KEKER & VAN NEST LLP

18  
19 By:

  
\_\_\_\_\_  
JOHN W. KEKER

Attorneys Petitioner and Plaintiff  
SAN DIEGO COUNTY WATER  
AUTHORITY



AMENDED AND RESTATED AGREEMENT BETWEEN THE  
METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA  
AND THE SAN DIEGO COUNTY WATER AUTHORITY  
FOR THE EXCHANGE OF WATER

THIS AMENDED AND RESTATED AGREEMENT FOR THE EXCHANGE OF WATER ("Agreement") is made and entered into as of October 10, 2003, between The Metropolitan Water District of Southern California (hereinafter "Metropolitan") and the San Diego County Water Authority (hereinafter "SDCWA"). Metropolitan and SDCWA are sometimes referred to as the "Parties".

RECITALS

A. SDCWA is a county water authority incorporated under the California County Water Authority Act, Stats. 1943, c.545 as amended, codified at Section 45-1 *et seq.* of the Appendix to the California Water Code, for the purpose of providing its member agencies in San Diego County with a safe, reliable, and sufficient supply of imported water.

B. Metropolitan is a public agency of the State of California incorporated under the Metropolitan Water District Act, Stats. 1969, ch. 209, as amended, codified at Section 109.1 *et seq.* of the Appendix to the California Water Code, engaged in transporting, storing and distributing water in the counties of Los Angeles, Orange, Riverside, San Bernardino, San Diego and Ventura, within the State of California.

C. SDCWA is a member agency of Metropolitan.

D. On April 29, 1998, SDCWA and the Imperial Irrigation District ("IID") entered into an Agreement for Transfer of Conserved Water, as amended by the Revised Fourth Amendment dated as of October 10, 2003, between SDCWA and IID (as thereby amended, the "Transfer Agreement").

E. On November 10, 1998, SDCWA and Metropolitan executed a Contract for the Exchange of Water to be acquired by SDCWA under the Transfer Agreement; this Agreement amends and restates that Contract in its entirety.

F. This Agreement is one of several agreements executed and delivered as of the date hereof by the Parties and by other agencies, including IID, MWD and Coachella Valley Water District ("CVWD"), pursuant to the Quantification Settlement Agreement among IID, MWD and CVWD dated as of October 10, 2003 (the "QSA"), which settles a variety of long-standing disputes regarding the priority, use, and transfer of Colorado River water and establishes the terms for the further distribution of Colorado River water among these entities for up to seventy-five (75) years based upon the water budgets set forth therein.

G. Also, on October 10, 2003, as contemplated by the QSA, SDCWA entered into the Allocation Agreement with the United States of America, IID, CVWD, MWD and other parties named therein (the "Allocation Agreement") pertaining to the allocation and distribution of water to be conserved from the All-American Canal Lining Project and the Coachella Canal Lining Project (as such terms are defined therein).

## AGREEMENT

NOW THEREFORE, the Parties in consideration of the foregoing recitals and the representations, warranties, covenants and agreements contained in this Agreement and for other good and valuable consideration, the receipt and sufficiency of which the Parties hereby acknowledge, Metropolitan and SDCWA agree to the following terms and conditions of this Agreement:

### I.

#### DEFINITIONS AND RULES OF CONSTRUCTION

1.1 Definitions. As used in this Agreement these terms, including any grammatical variations thereof, have the following meanings:

- (a) "Administrative Code" means the Metropolitan Water District Administrative Code adopted on January 13, 1987, as amended from time to time thereafter, and as in existence on the date of this Agreement, subject to modification to the extent provided in Paragraph 13.12 of this Agreement.
- (b) "Allocation Agreement" is as defined in Recital G, subject to modification for purposes of this Agreement after the date hereof to the extent provided in Paragraph 13.13 of this Agreement.
- (c) "Alternative Facilities" means facilities other than facilities owned and operated by Metropolitan.
- (d) "Bureau" means the Bureau of Reclamation of the United States Department of the Interior.

(e) "California Plan" means the draft plan dated May 11, 2000, to ensure that California can live within the state's apportionment of Colorado River water; provided, however, if any final California Plan is approved by the Colorado River Board of California and all the public agencies represented on the Colorado River Board of California, "California Plan" means such final California Plan.

(f) "Canal Lining Water" means the quantity of Colorado River water allocated each Year to SDCWA in accordance with the Allocation Agreement.

(g) "Colorado River Aqueduct" means the aqueduct system owned and operated by Metropolitan and transporting water from Lake Havasu on the Colorado River to Lake Mathews in Riverside County, California.

(h) "Conserved Water" means Conserved Water as such term is defined in Section 1.1 of the QSA.

(i) "Drought Management Plan" means any plan for the allocation and management of water resources of Metropolitan during a water shortage, as adopted by Metropolitan and in effect at pertinent times during the term of this Agreement.

(j) "Early Exchange Water" means the Exchange Water to be delivered by Metropolitan to SDCWA in exchange for Early Transfer Water to be Made Available by SDCWA to Metropolitan under this Agreement.

(k) "Early Transfer Water" means the aggregate ten thousand (10,000) acre-foot of Conserved Water to be transferred to SDCWA by IID in accordance with Section 3.5 of the Transfer Agreement.



(l) "Effective Date" means the Effective Date as such term is defined in Section 1.1 of the QSA.

(m) "Exchange Water" means, for each Year, water that is delivered to SDCWA by Metropolitan at the Metropolitan Point(s) of Delivery in a like quantity as the quantity of water that SDCWA has Made Available to Metropolitan under the Transfer Agreement and/or the Allocation Agreement and this Agreement for the same Year. The Exchange Water may be from whatever source or sources and shall be delivered using such facilities as may be determined by Metropolitan, provided that the Exchange Water delivered in each Year is of like quality to the Conserved Water and/or the Canal Lining Water which is Made Available to Metropolitan at the SDCWA Point of Transfer in such Year.

(n) "IID" is as defined in Recital D.

(o) "Implementation Agreement" is as defined in Section 1.1 of the QSA.

(p) "Interim Agricultural Water Program" means the program by that name for delivery of water for agricultural uses regulated in Sections 4900 to 4906 of the Administrative Code, including any successor program established by Metropolitan.

(q) "Local Water" means water supplies not served by Metropolitan. Such Local Water includes, for example, ground water, surface water production, recycled water, desalinated water and other water acquired, owned or produced by any of Metropolitan's member agencies, water retailers or other local agencies within

Metropolitan's service area (including supplies from projects participating in Metropolitan's Local Projects Program).

(r) "Made Available," "Make Available" or "Making Available." As used herein, Conserved Water and Canal Lining Water will be deemed to have been Made Available to Metropolitan when (1) such water has been transferred to SDCWA pursuant to the Transfer Agreement and/or allocated to SDCWA pursuant to the Allocation Agreement, (2) valid and continuing authorization has been given by the Bureau legally entitling Metropolitan to divert, for the Year in question, Conserved Water and/or Canal Lining Water at the SDCWA Point of Transfer, in addition to the water that Metropolitan is otherwise authorized to divert from the Colorado River, and (3) all other necessary legal rights, entitlements, approvals and permissions, under the laws of the United States and the State of California for diversions from the Colorado River by Metropolitan, if any, have been obtained and are in full force and effect. "Make Available" and "Making Available" are grammatical variations of "Made Available."

(s) Metropolitan Point(s) of Delivery is as defined in Paragraph 3.5(b).

(t) "Price" means the applicable amount to be paid per acre-foot of Exchange Water delivered by Metropolitan to SDCWA at the Metropolitan Point(s) of Delivery under this Agreement.

(u) "Price Dispute" is as defined in Paragraph 11.1.

(v) "SDCWA Point of Transfer" is as defined in Paragraph 3.5(a).

(w) "Secretary" means the United States Secretary of the Interior.

(x) "Termination Date" means the termination date determined under Paragraph 7.1, subject to the provisions of Paragraph 7.2.

(y) "Transfer Agreement" is as defined in Recital D, subject to modification to the extent provided in Paragraph 13.13 hereof.

(z) "Treated Exchange Water" means Exchange Water that has been treated by filtration and disinfection at a Metropolitan water filtration facility for direct delivery to SDCWA.

(aa) "Treatment Surcharge" means the rate(s), charge(s) and/or other fee(s) as determined pursuant to the Administrative Code for the provision of treated water service.

(bb) "Year" means the period commencing on the Effective Date and ending on the immediately following December 31 (the first (1<sup>st</sup>) Year), and each consecutive calendar year thereafter during the term of this Agreement.

#### 1.2 Rules of Construction.

(a) Unless the context clearly requires otherwise:

- (i) The plural and singular forms include the other;
- (ii) "Shall," "will," "must," and "agrees" are each mandatory;
- (iii) "May" is permissive;
- (iv) "Or" is not exclusive;
- (v) "Includes" and "including" are not limiting; and
- (vi) "Between" includes the ends of the identified range.

(b) Headings at the beginning of Paragraphs and subparagraphs of this Agreement are solely for the convenience of the Parties, are not a part of this Agreement and shall not be used in construing it.

(c) The masculine gender shall include the feminine and neuter genders and vice versa.

(d) The word "person" shall include individual, partnership, corporation, limited liability company, business trust, joint stock company, trust, unincorporated association, joint venture, governmental authority, water district and other entity of whatever nature, except either Metropolitan or SDCWA or an officer or employee thereof.

(e) Reference to any agreement (including this Agreement), document, or instrument means such agreement, document, instrument as amended or modified and in effect from time to time in accordance with the terms thereof and, if applicable, the terms hereof.

(f) Except as specifically provided herein, reference to any law, statute, ordinance, regulation or the like means such law as amended, modified, codified or reenacted, in whole or in part, and in effect from time to time, including any rules and regulations promulgated thereunder.

II

REPRESENTATIONS AND WARRANTIES

2.1 Representations and Warranties of Metropolitan. As a material inducement to SDCWA to enter into this Agreement, Metropolitan represents and warrants as follows:

(a) Metropolitan is a metropolitan water district, duly organized, validly existing and in good standing under the laws of the State of California, and subject to satisfaction of Metropolitan's conditions precedent, as set forth in Paragraph 8.1 hereof, Metropolitan has all necessary power and authority to perform its obligations hereunder on the terms set forth in this Agreement, and the execution and delivery hereof by Metropolitan and the performance by Metropolitan of its obligations hereunder will not violate or constitute an event of default under the terms or provisions of any agreement, document or instrument to which Metropolitan is a party or by which Metropolitan is bound.

(b) Subject to the satisfaction of Metropolitan's conditions precedent, as set forth in Paragraph 8.1 hereof, this Agreement is a valid and binding obligation of Metropolitan, enforceable in accordance with its terms, subject to the requirements of applicable law.

2.2 Representations and Warranties of SDCWA. As a material inducement to Metropolitan to enter into this Agreement, SDCWA represents and warrants as follows:

(a) SDCWA is a county water authority, duly organized, validly existing and in good standing under the laws of the State of California, and subject to satisfaction of

SDCWA's conditions precedent as set forth in Paragraph 8.2 hereof, SDCWA has all necessary power and authority to perform its obligations hereunder on the terms set forth in this Agreement, and the execution and delivery hereof by SDCWA and the performance by SDCWA of its obligations hereunder will not violate or constitute an event of default under the terms or provisions of any agreement, document or instrument to which SDCWA is a party or by which SDCWA is bound.

(b) Subject to the satisfaction of SDCWA's conditions precedent, as set forth in Paragraph 8.2, this Agreement is a valid and binding obligation of SDCWA enforceable in accordance with its terms, subject to the requirements of applicable law.

(c) SDCWA will have obtained such approvals and permissions as may be necessary, under applicable laws of the United States and the State of California, to Make Available to Metropolitan Conserved Water and Canal Lining Water pursuant to this Agreement.

### III

#### QUANTITY, DELIVERY AND SCHEDULING

##### 3.1 Conserved Water and Canal Lining Water

(a) SDCWA will Make Available the Conserved Water and/or the Canal Lining Water to Metropolitan at the SDCWA Point of Transfer each Year, in the manner set forth below. The quantity of Conserved Water and/or Canal Lining Water Made Available to Metropolitan by SDCWA at the SDCWA Point of Transfer each Year shall be the lesser of: (1) the sum of the quantity of water which IID transfers to SDCWA

under the Transfer Agreement in such Year and the quantity of Canal Lining Water allocated to SDCWA under the Allocation Agreement in such Year; or (2) 277,700 acre feet. The Conserved Water and/or the Canal Lining Water Made Available in each Year shall be deemed to have been Made Available to Metropolitan in monthly installments, with one-twelfth (1/12) of such water deemed to have been Made Available in each calendar month of such Year (provided that, in the first Year, the quantity of such water deemed to have been Made Available in each month shall be determined by dividing the total quantity for that Year by the number of calendar months or portions thereof in that Year).

(b) SDCWA will also Make Available to Metropolitan, in the manner set forth in subparagraph (a) above, the Early Transfer Water, in three annual installments as follows:

In calendar year 2020	2,500 acre-feet.
In calendar year 2021	5,000 acre-feet
In calendar year 2022	2,500 acre-foot

(c) SDCWA will provide to Metropolitan annual written notice by November 1<sup>st</sup> each Year (or, in the case of the first Year, reasonable advance written notice) of the quantity of Conserved Water (including Early Transfer Water, if applicable) to be transferred to SDCWA in accordance with the Transfer Agreement, and of the quantity of Canal Lining Water to be allocated to SDCWA in accordance with the Allocation Agreement, and in each case to be Made Available to Metropolitan at the

SDCWA Point of Transfer during the immediately following Year. The Conserved Water and/or the Canal Lining Water will be Made Available to Metropolitan by SDCWA in a manner consistent with the Bureau's operations schedule and will be measured as provided in Paragraph 3.4.

3.2 Exchange Water.

(a) Provided that the Conserved Water (including Early Transfer Water, if applicable) and/or the Canal Lining Water has been Made Available to Metropolitan at the SDCWA Point of Transfer pursuant to Paragraph 3.1, Metropolitan shall deliver Exchange Water (including Early Exchange Water, if applicable) to SDCWA at the Metropolitan Point(s) of Delivery, in compliance with this Agreement, and in the manner and to the extent set forth below. In any Year, Metropolitan will not be required to deliver an amount of Exchange Water that is greater than the aggregate amount of Conserved Water (including Early Transfer Water, if applicable) and Canal Lining Water Made Available to Metropolitan in that Year pursuant to Paragraph 3.1, subject to the provisions of subparagraphs (b) and (c) of Paragraph 7.2.

(b) Metropolitan's delivery of Exchange Water at the Metropolitan Point(s) of Delivery shall be governed by its rules and regulations for delivery of water set forth in Chapter 5 of Division IV of the Administrative Code in the same manner as other water delivered by Metropolitan, except as may otherwise be provided in this Agreement.

(c) The Exchange Water to be delivered in any Year shall be delivered in approximately equal monthly installments over the Year so that at the end of the twelfth



month the aggregate quantity of Exchange Water delivered by Metropolitan will be equal to the aggregate quantity of Conserved Water (including Early Transfer Water, if applicable) and Canal Lining Water Made Available to Metropolitan at the SDCWA Point of Transfer for that Year, or at the times and in the amounts as the Parties may otherwise agree.

(d) In the event that the delivery of Exchange Water to the Metropolitan Point(s) of Delivery is temporarily suspended or interrupted during any Year pursuant to Paragraph 3.3 below, the remaining quantity of Exchange Water to be delivered for such Year will be delivered by Metropolitan ratably over the remainder of such Year or as otherwise agreed by the Parties.

(e) Metropolitan shall have the right to deliver Exchange Water utilizing such facilities and by such delivery path as shall be determined by Metropolitan at its sole discretion. Utilization of a particular delivery path for any such delivery shall not operate as or be deemed to be a commitment to utilize the same delivery path for any future delivery. Metropolitan has not dedicated and shall not be deemed or construed to have dedicated any particular facilities for delivery of the Exchange Water.

3.3 Temporary Shutdown of Metropolitan Facilities. Metropolitan's Chief Executive Officer shall have the right to control, curtail, interrupt or suspend the delivery of Exchange Water to SDCWA in accordance with the Administrative Code. SDCWA understands that any number of factors, including emergencies, inspection, maintenance or repair of Metropolitan facilities or the State Water Project facilities, may result in a temporary and incidental

modification of the delivery schedule contemplated in Paragraph 3.2. Metropolitan shall notify SDCWA of any control, curtailment, interruption or suspension of delivery of Exchange Water in accordance with and to the extent set forth in the Administrative Code, as if the Exchange Water were water served by Metropolitan. Metropolitan agrees that delivery of Exchange Water shall be resumed as soon as possible following any such curtailment, interruption or suspension of delivery. Unless Metropolitan is otherwise relieved of its obligations under the provisions of this Agreement, a curtailment, interruption or suspension of the delivery of Exchange Water pursuant to this Paragraph 3.3 shall not change the amount of Exchange Water Metropolitan is obligated to deliver during any Year.

3.4 Measurement of Deliveries. The quantity of Exchange Water delivered in each Year by Metropolitan at the applicable Metropolitan Point(s) of Delivery, which amount will be metered at such Point(s) of Delivery as provided in the Administrative Code, shall be equal to the aggregate quantity of Conserved Water (including Early Transfer Water, if applicable) and Canal Lining Water Made Available to Metropolitan in such Year at the SDCWA Point of Transfer. The Parties agree that they will be bound by such meter readings.

3.5. Points of Transfer or Delivery.

(a) The SDCWA Point of Transfer. As used herein, the "SDCWA Point of Transfer" shall be Metropolitan's intake at Lake Havasu.

(b) The Metropolitan Point(s) of Delivery. As used herein, the "Metropolitan Point(s) of Delivery" shall be any or all San Diego Pipelines One through Five (inclusive)

or at similar facilities that may be constructed in the future at a point near the San Luis Rey River in Northern San Diego County.

3.6 Quality of Exchange Water. Metropolitan in its sole discretion shall have the right to deliver Exchange Water of a quality which exceeds the quality of the Conserved Water and/or Canal Lining Water which Metropolitan receives, and such Exchange Water shall fully satisfy Metropolitan's obligation to deliver Exchange Water of like quality to such Conserved Water and Canal Lining Water. In such event, Metropolitan's election shall not operate as or be construed to be a commitment to deliver Exchange Water of better quality in the future, and in no event shall SDCWA be deemed to have any right to receive Exchange Water of better quality than the Conserved Water and/or Canal Lining Water.

3.7 Alternative Facilities. SDCWA may determine, in its sole discretion, permanently to reduce the aggregate quantity of Conserved Water and Canal Lining Water to be Made Available to Metropolitan under this Agreement to the extent SDCWA decides continually and regularly to transport Conserved Water and/or Canal Lining Water in an amount equal to such reduction in quantity to San Diego County through Alternative Facilities; provided, however, that SDCWA shall furnish to Metropolitan a minimum of five (5) years' advance written notice of such determination. The written notice shall confirm the quantity of Conserved Water and/or Canal Lining Water (if any) which SDCWA will continue to Make Available to Metropolitan. If SDCWA exercises its right under this Paragraph 3.7, Metropolitan's obligation to deliver Exchange Water shall be limited to that specified quantity of Conserved Water and/or

Canal Lining Water that SDCWA confirms to Make Available to Metropolitan pursuant to this Agreement.

#### IV.

##### CHARACTERIZATION OF EXCHANGE WATER

4.1 Exchange Water as an Independent Local Supply. The Exchange Water shall be characterized for the purposes of all of Metropolitan's ordinances, plans, programs, rules and regulations, including any then-effective Drought Management Plan, and for calculation of any Readiness-to-Serve Charge share, in the same manner as the Local Water of other Metropolitan member agencies, except as provided in Paragraphs 4.2 and 5.2.

4.2 Exception for Interim Agricultural Water Program and Determination of Price. Notwithstanding the provisions of Paragraph 4.1, the Exchange Water delivered to SDCWA shall be characterized as Metropolitan water and not as Local Water only for the limited purposes of Paragraph 5.2 and the Interim Agricultural Water Program.

#### V.

##### PRICING AND PAYMENTS

5.1 Payments. SDCWA shall pay the Price for each acre-foot of Exchange Water (including Early Exchange Water, if applicable) delivered by Metropolitan at the Metropolitan Point(s) of Delivery.

5.2 The Price. The Price on the date of Execution of this Agreement shall be Two Hundred Fifty Three Dollars (\$253.00). Thereafter, the Price shall be equal to the charge or charges set by Metropolitan's Board of Directors pursuant to applicable law and regulation and

generally applicable to the conveyance of water by Metropolitan on behalf of its member agencies. For the term of this Agreement, neither SDCWA nor Metropolitan shall seek or support in any legislative, administrative or judicial forum, any change in the form, substance or interpretation of any applicable law or regulation (including the Administrative Code) in effect on the date of this Agreement and pertaining to the charge or charges set by Metropolitan's Board of Directors and generally applicable to the conveyance of water by Metropolitan on behalf of its member agencies; provided, however, that Metropolitan may at any time amend the Administrative Code in accordance with Paragraph 13.12, and the Administrative Code as thereby amended shall be included within the foregoing restriction; and, provided, further, that (a) after the conclusion of the first five (5) Years, nothing herein shall preclude SDCWA from contesting in an administrative or judicial forum whether such charge or charges have been set in accordance with applicable law and regulation; and (b) SDCWA and Metropolitan may agree in writing at any time to exempt any specified matter from the foregoing limitation. In the event that SDCWA 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.

5.3 Billing and Payments. Metropolitan shall mail monthly invoices to SDCWA in accordance with the Administrative Code, and SDCWA shall make monthly payments of amounts due pursuant to Paragraph 5.1 in accordance with the Administrative Code. The amount of each monthly billing and payment pursuant to this Agreement shall be the quantity in acre-feet of Exchange Water to be delivered by Metropolitan at the Metropolitan Point(s) of

Delivery during the applicable Year, multiplied by the Price as of the commencement of that Year, divided by twelve (12);

5.4 Treatment Surcharge. SDCWA shall pay to Metropolitan an amount equal to the Treatment Surcharge, in addition to the Price, for each acre-foot of Treated Exchange Water.

## VI.

### ADDITIONAL NOTIFICATIONS

6.1 Confirmation of Water Conservation. SDCWA will provide a written report to Metropolitan, prior to March 31 of each Year, describing the method by which any Conserved Water (including Early Transfer Water, if applicable) that was Made Available to Metropolitan in the prior Year was conserved by IID, including a description of conservation projects resulting in the Conserved Water and the quantity of Conserved Water conserved by each project.

6.2 Notice of Developments.

(a) After the Effective Date, SDCWA agrees to give prompt notice to Metropolitan if it discovers that any of its own representations and warranties herein were untrue when made or determines that any of its own representations and warranties will be untrue as of any date during the term of this Agreement.

(b) After the Effective Date, Metropolitan agrees to give prompt notice to SDCWA if it discovers that any of its own representations and warranties herein were untrue when made or determines that any of its own representations and warranties will be untrue as of any date during the term of this Agreement.

VII.

TERM

7.1 Commencement and Expiration. This Agreement shall become effective on the Effective Date and shall expire on the Termination Date, which shall be the later of the dates determined pursuant to subparagraph (a) and (b) below.

(a) Metropolitan's and SDCWA's rights and obligations under this Agreement pertaining to Conserved Water Made Available to Metropolitan pursuant to the Transfer Agreement and this Agreement shall expire and shall thereupon terminate on December 31 of the thirty-fifth (35<sup>th</sup>) Year, unless SDCWA elects by written Notice to Metropolitan no later than the end of the fifteenth (15<sup>th</sup>) Year to extend this Agreement to December 31 of the forty-fifth (45<sup>th</sup>) Year, or shall terminate as otherwise provided in Paragraph 7.2.

(b) Metropolitan's and SDCWA's rights and obligations under this Agreement pertaining to the Canal Lining Water shall expire and shall thereupon terminate on December 31 of the same Year in which the Allocation Agreement terminates, or shall terminate as otherwise provided in Paragraph 7.2.

7.2 Force Majeure.

(a) If the performance, in whole or in part, of the obligations of the respective Parties, or either of them, to Make Available Conserved Water or Canal Lining Water or to deliver Exchange Water (as the case may be) under this Agreement is prevented by acts or failure to act of any agency, court or other government authority, or any other

person; by natural disaster (such as earthquake, fire, drought or flood), contamination or outbreak of a water borne disease, war, strikes, lockouts, act of God, or acts of civil or military authority; by the operation of applicable law; or by any other cause beyond the control of the affected Party or Parties, whether similar to the causes specified herein or not, then, in any such circumstance, the obligation of the affected Party or Parties to cause the delivery of the Conserved Water or Canal Lining Water or to deliver the Exchange Water (as the case may be) under this Agreement shall be suspended from the time and to the extent that the performance thereof is prevented, but reasonable diligence shall be observed by the affected Party or Parties, so far as it lies in their power, in performing such respective obligations in whole or in part under this Agreement. In the event such performance of either of the Parties under this Agreement is prevented as described above, then during the period of such prevention, performance by the non-affected Party under this Agreement shall be excused until such prevention ceases, at which time both the Parties shall become obligated to resume and continue performance of their respective obligations hereunder during the term of this Agreement.

Notwithstanding the foregoing, no such prevention shall suspend or otherwise affect any payment obligations for Exchange Water actually delivered or any obligation of either Party to indemnify the other pursuant to Paragraph 13.10, or shall extend the term of this Agreement beyond the Termination Date, except as provided in Paragraph 7.2(a) below.

(b) In the event the performance by Metropolitan or SDCWA is prevented as described above, the Parties agree actively to cooperate and use their reasonable best



efforts, without diminution of any storage or other rights Metropolitan or SDCWA may have, to support a request to the Bureau for emergency storage in Lake Mead or Lake Havasu for the Conserved Water and/or the Canal Lining Water, if it would avoid the waste or loss of the Conserved Water and/or the Canal Lining Water.

(c) In the event the delivery of Exchange Water by Metropolitan is prevented as described in Paragraph 7.2(a) above, and in the event Conserved Water and/or the Canal Lining Water has been stored as contemplated by Paragraph 7.2(b) above, and such stored Conserved Water and/or the Canal Lining Water is Made Available to Metropolitan, the term of this Agreement shall be extended, for a period not to exceed five Years, without the necessity for further action by either Party, if and to the extent necessary to permit Metropolitan to complete the delivery of Exchange Water in a quantity equal to such stored Conserved Water and/or the Canal Lining Water.

7.3 Survival. Notwithstanding the foregoing or anything to the contrary in this Agreement, any remaining payment obligation of SDCWA under Article V, and the provisions in Paragraphs 12.5, 13.2, 13.3, 13.8, 13.10 and 13.15 and Articles X and XI, shall survive the termination of this Agreement.

## VIII.

### CONDITIONS PRECEDENT

8.1 Metropolitan's Condition Precedent. Metropolitan's obligations under this Agreement are subject to the execution and delivery of the QSA and the Related Agreements (as defined in Section 1.1 of the QSA), and to the occurrence of the Effective Date.

8.2 SDCWA's Conditions Precedent. SDCWA's obligations under this Agreement are subject to the execution and delivery of the Revised Fourth Amendment to the Transfer Agreement, the Allocation Agreement and the Implementation Agreement, and to the occurrence of the Effective Date.

8.3 Failure of Conditions. If Metropolitan's conditions precedent under Paragraph 8.1 are not satisfied or waived in writing by Metropolitan, or if SDCWA's conditions precedent under Paragraph 8.2 are not satisfied or waived in writing by SDCWA, in each case on or before December 31, 2003, then this Agreement will be void, and all rights and obligations provided hereunder will be terminated.

#### IX.

#### COMPLIANCE WITH APPLICABLE LAWS

9.1 Applicable Laws. This Agreement and the activities described herein are contingent upon and subject to compliance with all applicable laws.

#### X.

#### ADDITIONAL COVENANTS

10.1 Impact on Transfer Agreement. Nothing in this Agreement shall be construed to amend the Transfer Agreement.

10.2 Implementation of Transfer Agreement. Insofar as the Transfer Agreement is consistent with and implemented in accordance with state and federal law and the California Plan, Metropolitan shall not oppose approval or implementation of that Agreement before the

California State Water Resources Control Board, the Bureau, the United States Department of the Interior or in any other judicial or administrative proceedings

10.3 Support for Surplus Criteria. SDCWA will use reasonable best efforts to support all reasonable efforts by Metropolitan to promote and secure surplus criteria on the Colorado River with the objective of maintaining a full Colorado River Aqueduct.

10.4 Report to Legislature. The Parties shall report as requested to the Legislature of the State of California on the implementation of this Agreement.

10.5 Covenants of Good Faith. This Agreement is subject to reciprocal obligations of good faith and fair dealing.

10.6 SDCWA Consent and Waiver. Notwithstanding any limitations set forth in the Transfer Agreement otherwise restricting IID's right to transfer water to Metropolitan, SDCWA hereby consents to IID's transfer of water to Metropolitan as provided in Articles 5 and 6 of the IID/MWD Acquisition Agreement (as defined in Section 1.1 of the QSA) and waives any right to object thereto. SDCWA shall provide to IID, and shall be bound by, a written acknowledgement of its consent and waiver set forth in the preceding sentence above in such form and to such effect as Metropolitan may reasonably request.

10.7 Allocation Agreement Responsibilities. SDCWA shall indemnify Metropolitan and defend and hold it harmless at SDCWA's sole cost and expense from and against any obligation, liability or responsibility of any kind assigned to SDCWA under and pursuant to the Allocation Agreement and any claim by any person that MWD has any continuing obligation,

liability or responsibility of any kind with respect to the matters assigned to SDCWA under the Allocation Agreement.

## XI.

### DISPUTE RESOLUTION

11.1 Reasonable Best Efforts to Resolve by Negotiation. The Parties shall exercise reasonable best efforts to resolve all disputes, including Price Disputes, arising under this Agreement through negotiation; provided, however, that SDCWA shall not dispute whether the Price determined pursuant to Paragraph 5.2 for the first five (5) Years of this Agreement was determined in accordance with applicable law or regulation (a "Price Dispute"). In the event negotiation is unsuccessful, then the Parties reserve their respective rights to all legal and equitable remedies.

## XII.

### EVENTS OF DEFAULT; REMEDIES

12.1 Events of Default by SDCWA. Each of the following constitutes an "Event of Default" by SDCWA under this Agreement if not cured within 30 days of receiving written notice from Metropolitan of such matter:

- (a) Subject to Paragraphs 7.2 and 9.1, SDCWA fails to Make Available to Metropolitan Conserved Water or Canal Lining Water, as required under this Agreement.
- (b) SDCWA fails to perform or observe any other term, covenant or undertaking that it is to perform or observe under this Agreement.

(c) Any representation, warranty or statement made by or on behalf of the SDCWA and contained in this Agreement or in any exhibit, certificate or other document furnished pursuant to this Agreement is on the date made or later proves to be false, misleading or untrue in any material respect.

12.2 Events of Default by Metropolitan. Each of the following constitutes an "Event of Default" by Metropolitan under this Agreement if not cured within 30 days of receiving written notice from SDCWA of such matter:

(a) Subject to Paragraphs 7.2 and 9.1, Metropolitan fails to deliver the Exchange Water as required under this Agreement.

(b) Metropolitan fails to perform or observe any other term, covenant or undertaking that it is to perform or observe under this Agreement.

(c) Any representation, warranty or statement made by or on behalf of Metropolitan and contained in this Agreement or in any exhibit, certificate or other document furnished pursuant to this Agreement is on the date made or later proves to be false, misleading or untrue in any material respect.

12.3 Remedies Generally. If an Event of Default occurs, the non-breaching Party will have all rights and remedies provided at law or in equity against the breaching Party.

12.4 Enforcement of Transfer and Exchange Obligations.

(a) Any Event of Default as defined in Paragraph 12.1(a) or 12.2(a) may be remedied by an order of specific performance.

(b) So long as no Event of Default as defined in Paragraph 12.1(a) has occurred and is continuing, and so long as SDCWA tenders to Metropolitan full payment of the Agreement Price when due, Metropolitan shall not suspend or delay, in whole or in part, delivery of Exchange Water as required under this Agreement on account of any breach, or alleged breach, by SDCWA unless first authorized to do so by a final judgment. So long as no Event of Default as defined in Paragraph 12.2(a) has occurred and is continuing, SDCWA shall not suspend or delay, in whole or in part, Making Available Conserved Water and/or Canal Lining Water as required under this Agreement on account of any breach, or alleged breach, by Metropolitan unless first authorized to do so by a final judgment. A violation of the provisions of this subparagraph (b) may be remedied by an order of specific performance.

(c) In the event of a dispute over the Price, SDCWA shall pay when due the full amount claimed by Metropolitan; provided, however, that, during the pendency of the dispute, Metropolitan shall deposit the difference between the Price asserted by SDCWA and the Price claimed by Metropolitan in a separate interest bearing account. If SDCWA prevails in the dispute, Metropolitan shall forthwith pay the disputed amount, plus all interest earned thereon, to SDCWA. If Metropolitan prevails in the dispute, Metropolitan may then transfer the disputed amount, plus all interest earned thereon, into any other fund or account of Metropolitan.

12.5 Cumulative Rights and Remedies. The Parties do not intend that any right or remedy given to a Party on the breach of any provision under this Agreement be exclusive; each

such right or remedy is cumulative and in addition to any other remedy provided in this Agreement or otherwise available at law or in equity. If the non-breaching Party fails to exercise or delays in exercising any such right or remedy, the non-breaching Party does not thereby waive that right or remedy. In addition, no single or partial exercise of any right, power, or privilege precludes any other or further exercise of a right, power, or privilege granted by this Agreement or otherwise.

12.6. Action or Proceeding Between the Parties. Each Party acknowledges that it is a "local agency" within the meaning of § 394(e) of the California Code of Civil Procedure ("CCP"). Each Party further acknowledges that any action or proceeding commenced by one Party against the other would, under § 394(a) of the CCP, as a matter of law be subject to

- (a) being transferred to a "Neutral County," or instead
- (b) having a disinterested judge from a Neutral County assigned by the

Chairman of the Judicial Council to hear the action or proceeding.

(c) A "Neutral County" is any county other than Imperial, Los Angeles, Orange, Riverside, San Bernardino, San Diego or Ventura. In the event an action is filed by either party against the other to enforce this Agreement and to obtain damages for its alleged breach, each Party hereby:

- (i) Stipulates to the action or proceeding being transferred to a Neutral County or to having a disinterested judge from a Neutral County assigned to hear the action;

- (ii) Waives the usual notice required under the law-and-motion provisions of Rule 317 of the California Rules of Court;
- (iii) Consents to having any motion under § 394(c) heard with notice as an ex parte matter under Rule 379 of the California Rules of Court; and
- (iv) Acknowledges that this Agreement, and in particular this section, may be submitted to the court as part of the moving papers.

(d) Nothing in this Paragraph 12.6, however, impairs or limits the ability of a Party to contest the suitability of any particular county to serve as a Neutral County, or operates to waive any other rights.

### XIII.

#### GENERAL PROVISIONS

13.1 No Third-Party Rights. This Agreement is made solely for the benefit of the Parties and their respective permitted successors and assigns (if any). Except for such a permitted successor or assign, no other person or entity may have or acquire any right by virtue of this Agreement.

13.2 Ambiguities. Each Party and its counsel have participated fully in the drafting, review and revision of this Agreement. A rule of construction to the effect that ambiguities are to be resolved against the drafting Party will not apply in interpreting this Agreement, including any amendments or modifications.



13.3 Governing Law. This Agreement shall be governed by and construed in accordance with the laws of the State of California, without giving effect to conflict of laws provisions; provided, however, that federal law shall be applied as appropriate to the extent it bears on the resolution of any claim or issue relating to the permissibility of the transfers or the Making Available of Colorado River water, as contemplated herein.

13.4 Binding Effect; No Assignment. This Agreement is and will be binding upon and will inure to the benefit of the Parties and, upon dissolution, the legal successors and assigns of their assets and liabilities. Neither Party may assign any of its rights or delegate any of its duties under this Agreement. Any assignment or delegation made in violation of this Agreement is void and of no force or effect.

13.5 Notices. All notices, requests, demands, or other communications under this Agreement must be in writing, and sent to both addresses of each Party. Notice will be sufficiently given for all purposes as follows:

- *Personal Delivery.* When personally delivered to the recipient. Notice is effective on delivery.
- *First-Class Mail.* When mailed first-class, postage prepaid, to the last address of the recipient known to the Party giving notice. Notice is effective five mail delivery days after it is deposited in a United States Postal Service office or mailbox.
- *Certified Mail.* When mailed certified mail, return receipt requested. Notice is effective on receipt, if a return receipt confirms delivery.

*Overnight Delivery.* When delivered by an overnight delivery service such as Federal Express, charges prepaid or charged to the sender's account. Notice is effective on delivery, if delivery is confirmed by the delivery service.

*Facsimile Transmission.* Notice is effective on receipt, provided that a copy is mailed by first-class mail on the facsimile transmission date.

Addresses for purpose of giving notice are as follows:

To Metropolitan: Metropolitan Water District of Southern California

Attn.: Chief Executive Officer

Address for U.S. mail: P.O. Box 54153

Los Angeles, CA 90054-0153

Address for personal or overnight delivery:

700 North Alameda Street

Los Angeles, CA 90012-2944

Telephone: 213-217-6000

Fax: 213-217-6950

With a copy delivered by the same means and at the same address to:

Metropolitan Water District of Southern California

Attn.: General Counsel

To SDCWA:

San Diego County Water Authority

Attn.: General Manager

4677 Overland Avenue  
San Diego, California 92123-1233  
Telephone: 858-522-6780  
Fax: 858-522-6262

With a copy to:

San Diego County Water Authority  
Attn.: General Counsel  
4677 Overland Avenue  
San Diego, California 92123-1233  
Telephone: 858-522-6790  
Fax: 858-522-6566

(a) A correctly addressed notice that is refused, unclaimed, or undeliverable because of an act or omission by the Party to be notified will be deemed effective as of the first date that notice was refused, unclaimed, or deemed undeliverable by the postal authorities, messenger, or overnight delivery service.

(b) A Party may change its address by giving the other Party notice of the change in any manner permitted by this Agreement.

13.6 Entire Agreement. This Agreement constitutes the final, complete, and exclusive statement of the terms of the Agreement between the Parties pertaining to its subject matter and supersedes all prior and contemporaneous understandings or agreements of the Parties. Neither Party has been induced to enter into this Agreement by, nor is either Party relying on, any representation or warranty outside those expressly set forth in this Agreement.

13.7 Time of the Essence. If the day on which performance of any act or the occurrence of any event hereunder (except the delivery of Exchange Water) is due is not a business day, the time when such performance or occurrence shall be due shall be the first business day (as defined in Section 4507 of the Administrative Code) occurring after the day on which performance or occurrence would otherwise be due hereunder. All times provided in this Agreement for the performance of any act will be strictly construed, time being of the essence of this Agreement.

13.8 Modification. This Agreement may be supplemented, amended, or modified only by the written agreement of the Parties. No supplement, amendment, or modification will be binding unless it is in writing and signed by both Parties.

13.9 Waiver. No waiver of a breach, failure of condition, or any right or remedy contained in or granted by the provisions of this Agreement is effective unless it is in writing and signed by the Party waiving the breach, failure, right, or remedy. No waiver of a breach, failure of condition, or right or remedy is or may be deemed a waiver of any other breach, failure, right or remedy, whether similar or not. In addition, no waiver will constitute a continuing waiver unless the writing so specifies.

13.10 Indemnification.

(a) SDCWA shall indemnify Metropolitan pursuant to Section 4502 of the Administrative Code against liability in connection with acts of SDCWA after Metropolitan's delivery of the Exchange Water, to the same extent as is required with respect to water supplied by Metropolitan to a member public agency. Such

indemnification shall be in addition to any indemnification rights available under applicable law and to any other remedy provided under this Agreement.

(b) Metropolitan shall indemnify SDCWA pursuant to Section 4502 of the Administrative Code against liability in connection with Metropolitan's delivery of the Exchange Water to the same extent as is required with respect to water supplied by Metropolitan to a member public agency. Such indemnification shall be in addition to any indemnification rights available under applicable law and to any other remedy provided under this Agreement.

(c) Notwithstanding anything in this Agreement to the contrary, each Party agrees to proceed with reasonable diligence and use reasonable good faith efforts to jointly defend any lawsuit or administrative proceeding by any person other than the Parties challenging the legality, validity, or enforceability of this Agreement.

13.11 Authority of the Legislature. Nothing in this Agreement will limit any authority of the Legislature of the State of California to allocate or reallocate water.

13.12 Right to Amend the Administrative Code. Notwithstanding anything to the contrary in this Agreement, express or implied, Metropolitan shall have the right to amend the Administrative Code at its sole discretion, except that, for the purposes of this Agreement, no such amendment shall have the effect of changing or modifying Paragraphs 8.1 and 8.2, or the obligation of Metropolitan to deliver Exchange Water hereunder, unless such effect is first approved by the Board of Directors of SDCWA.

13.13 Right to Amend Transfer Agreement and Allocation Agreement.

Notwithstanding anything to the contrary in this Agreement, express or implied, SDCWA shall have the right to amend the Transfer Agreement and/or the Allocation Agreement at its sole discretion, except that, for purposes of this Agreement, no such amendment shall have the effect of changing or modifying Paragraphs 8.1 and 8.2, the obligation of SDCWA to Make Available Conserved Water and/or Canal Lining Water hereunder, or the Price payable by SDCWA with respect to any Exchange Water, or be binding on Metropolitan, unless such effect is first approved by the Board of Directors of Metropolitan.

13.14 Counterparts. This Agreement may be executed in two or more counterparts, each of which, when executed and delivered, shall be an original and all of which together shall constitute one instrument, with the same force and effect as though all signatures appeared on a single document.

13.15 Audit. Each Party shall be responsible for assuring the accuracy of its books, records and accounts of billings, payments, metering of water, and other records (whether on hard copy or in electronic or other format) evidencing the performance of its obligations pursuant to this Agreement and shall maintain all such records for not less than three years. Each Party will have the right to audit the other Party's books and records relating to this Agreement for purposes of determining compliance with this Agreement during the term hereof and for a period of three years following termination of this Agreement. Upon reasonable notice, each Party shall

cooperate fully with any such audit and shall permit access to its books, records and accounts as may be necessary to conduct such audit.

IN WITNESS WHEREOF, the Parties have executed this Agreement as of the date first written above.

*Approved as to Form:*

The Metropolitan Water District of Southern California

By:

  
General Counsel

By:

  
Chief Executive Officer

*Approved as to Form:*

The San Diego County Water Authority

By:

  
General Counsel

By:

  
General Manager







# San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233  
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

HAND DELIVERED

MEMBER AGENCIES

- Carlsbad Municipal Water District
- City of Del Mar
- City of Escondido
- City of National City
- City of Oceanside
- City of Poway
- City of San Diego
- Fallbrook Public Utility District
- Hahn Water District
- Lakeside Water District
- Oliverhan Municipal Water District
- Olney Water District
- Padre Dam Municipal Water District
- Camp Pendleton Marine Corps Base
- Rainbow Municipal Water District
- Rimosa Municipal Water District
- Rincón del Diablo Municipal Water District
- San Dieguito Water District
- Santa Fe Irrigation District
- South Bay Irrigation District
- Valecitos Water District
- Valley Center Municipal Water District
- Vista Irrigation District
- Yuma Municipal Water District

March 12, 2012

Members of the Finance and Insurance Committee  
 Members of the Board of Directors  
 Metropolitan Water District  
 of Southern California  
 P.O. Box 54153  
 Los Angeles, CA 90054-0153

Re: Finance and Insurance Committee  
 Meeting with Board of Directors  
 March 12, 2012  
 Agenda Item 1 Public Hearing  
     Comments on proposed water rates and charges  
 Agenda Item 6 Other Board Items – Action  
     8-4B Adopt recommended water rates and charges, and  
     resolutions to impose water rates and charges, for 2013 and  
     2014

Dear Members of the Committee and Board of Directors,

This letter supplements the public hearing testimony of the San Diego County Water Authority's representatives regarding the above referenced matters and transmits the following documents demonstrating that Metropolitan's current and proposed rates do not comply with California law for inclusion in the public hearing record.

- Metropolitan Water District Cost of Service Rate Review by FCS Group dated March 2012;
- Michael G. Colantuono, Colantuono & Levin, letter dated March 10, 2012 addressed to Jack Foley, Chairman, and Members of the Board regarding Proposed Water Rates to be Effective January 1, 2013;

OTHER REPRESENTATIVE

County of San Diego

*A public agency providing a safe and reliable water supply to the San Diego region*

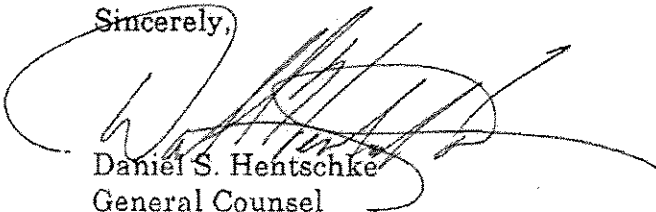
Members of the Finance and Insurance Committee  
Members of the Board of Directors  
Public Hearing  
March 12, 2012

- Bartle Wells Associates memorandum dated March 8, 2012 regarding Metropolitan Water District of Southern California Water Rates;
- San Diego County Water Authority letter dated March 8, 2012 addressed to Gary Breaux, Chief Financial Officer regarding Proposed Biennial Budgets and Associated Rates and Charges for 2012/13 and 2013/14;
- San Diego County Water Authority letter dated March 5, 2012 addressed to Jack Foley, Chairman, and Members of the Board of Directors, regarding Comments on Proposed Water Rates and Charges, including February 3, 2012 letter and other attachment thereto;
- San Diego County Water Authority letter dated March 8, 2010 addressed to Tim Brick, Chairman of the Board, regarding Comments on Proposed Water Rates and Charges, including all attachments thereto;
- San Diego County Water Authority letter dated April 12, 2010 addressed to Tim Brick, Chairman of the Board and Board of Directors, regarding adoption of recommended water rates and charges for 2011 and 2012, including all attachments thereto;
- Three inch, three-ring binder of documents including a San Diego County Water Authority PowerPoint presentation titled "Who Really Runs the Metropolitan Water District of Southern California? A Shadow Government Takes Control" dated March 12, 2012, public records organized under tabs A - Z, and a summary sheet.

The Water Authority respectfully requests inclusion of all these documents in the record of the proceedings relating to the actions and resolutions for adoption and imposition of water rates and charges for 2013 and 2014.

Further, the Water Authority has provided to Dawn Chin, Clerk of the Board the copies of documents identified in the letter dated March 12, 2012, a copy of which is also attached, and requests inclusion of all of those documents in the record of these proceedings.

Sincerely,



Daniel S. Hentschke  
General Counsel

# San Diego County Water Authority

Metropolitan Water District Cost of Service Rate Review

March 12, 2012



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## EXECUTIVE SUMMARY

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### A. STUDY OVERVIEW

The San Diego County Water Authority (the Water Authority) retained FCS Group to provide an objective and unbiased review of the Metropolitan Water District of Southern California's (MWD) 2013 and 2014 rate proposals in order to determine whether they are consistent with the equity and proportionality requirements of sound cost-of-service rate setting principles. While this review includes an analysis of the specific impacts of these rates on the Water Authority, the review is also intended to provide a broader review of MWD's rate setting methodology.

This study concludes that MWD's 2013 and 2014 water rates deviate from well-established cost of service principles; and unfairly discriminate against the Water Authority and against the transportation, or wheeling, of third-party sources of water through MWD's system.<sup>1</sup>

This analysis is based on data and records concerning the MWD system that have been made available to FCS Group, including the MWD staff cost allocation and rate analysis which MWD relies upon in establishing the proposed rates and charges. The costs presented in this report reflect the January 10, 2012 rate proposal developed by MWD staff. The conceptual findings presented within this report also apply to MWD's March 13, 2012 proposal of rate alternatives. FCS Group will update or amend its opinions as and if new information is made available to it. While this study provides some financial estimates of the amount of MWD's overcharges and the financial impact those overcharges will have on the Water Authority, a more detailed analysis would be required to refine the total direct and secondary impacts to the Water Authority of the proposed rates and charges.

### B. RATE SETTING AND COST OF SERVICE PRINCIPLES

Water rates and charges must illustrate a reasonable nexus between the service provided and the cost recovered to provide that service. A well crafted cost of service study should adhere to a number of basic principles:

- \* **Equitable** – Rates must equitably recover costs between custom classes proportionate to their respective cost impact to the system. Moreover, no one party may be advantaged at the expense of another class.
- \* **Legally Compliant** – Rates should adhere to all applicable statutory requirements and case law including the proportionality requirements of Proposition 26.
- \* **Administratively Feasible** – Equity and complexity should be balanced so as not to create an unreasonable cost burden to implement.

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<sup>1</sup> All references to rates are on a calendar basis, while budgets are on a fiscal year basis.

- ◆ **Understandable** – Rate structures and methodologies should be transparent and easily understood by system users.
- ◆ **Financially Affordable** – Rates should not place an unfair burden on ratepayers. As a large wholesaler serving local water purveyors, MWD should also attempt to provide rate smoothing and predictability as feasible.
- ◆ **Class Specific** – Rates should appropriately allocate and recover costs on a class specific basis in order to account for unique cost drivers that will differ by type of user. Moreover, rates should not place any class in a significant economic advantage or disadvantage.

### C. RATES & CHARGES REVIEW FINDINGS

We find that the proposed 2013 and 2014 rates and charges disproportionately burden the Water Authority and any other system users who engage in the transporting, or wheeling, of non-MWD water through MWD facilities. A summary of our review findings is as follows:

- ◆ MWD's costs for acquiring State Water Project water from the California Department of Water Resources should be recovered entirely through MWD's supply rate. There is no reasonable relationship between the cost of acquiring that water and the use of MWD's internal transmission facilities. The fact that the California Department of Water Resources (DWR) breaks out its own "supply" and "transportation" costs in invoices provided to MWD does not warrant charging users of MWD's facilities *for transportation services* a portion of the costs for MWD's purchase of State Water Project water.
- ◆ The fees imposed by MWD on the Water Authority to transport IID and canal lining supplies through the MWD facilities exceeds the cost of providing that service, violating cost of service and rate setting principles. Industry standard cost of service principles entitle MWD to charge those who wheel, or transport, water through its Colorado River Aqueduct a fair and reasonable charge for the use of that aqueduct and MWD's transmission facilities (including both fixed and variable cost components). MWD's rates for wheeling and transporting water should not include charges that bear no relation to the use of MWD's facilities.
- ◆ The allocation of DWR's power costs—associated with the moving of State Water Project water through DWR's state-owned facilities—to the rates charged for the conveyance and transportation of water through MWD's independently-owned internal facilities further deviates from cost of service principles and statutory proportionality requirements. It reclassifies a supply cost as a transportation cost and thus disproportionately charges member agencies relative to the services received from MWD for transportation of water through MWD facilities.
- ◆ Collecting MWD's cost of obtaining water from the State Water Project through MWD's transportation rate also creates an artificial economic barrier to achieving the MWD Board policy objectives of encouraging conservation, development of localized water supplies and an efficient water transfer market. Failing to collect these SWP costs consistently from other alternate supply sources such as local supply and conservation resource investments which also avoid SWP facility use, while imposing them on the wheeling of Water Authority transfers, further highlights the arbitrary nature and application of this practice.
- ◆ The Water Stewardship Rate (WSR) recovers MWD's costs associated with investments in local water supply, specifically MWD's funding—through financial incentives and direct subsidies—of member agencies' local resources projects such as conservation, recycled water, and seawater desalination. As a result, MWD's investment should be recovered through a supply charge. Investments in building, developing and conserving local water supplies should not be recovered through a charge on transportation through MWD's facilities, including third party supplied water that is transported through MWD's aqueduct and distribution system, unless, and only to the degree

that, offsetting transportation cost savings can be demonstrated. MWD's cost of service study lacks any evidence supporting the allocation of local supplies to transportation.

- ◆ MWD fails to demonstrate that the Water Stewardship Rate provides either a proportionate and direct benefit to the Water Authority or an indirect but tangible benefit. While the WSR is levied as a transportation rate, MWD has not demonstrated nor are we aware of any evidence that projects funded through the WSR have created or are necessary to create transportation capacity in MWD facilities. To the contrary, due to nearly a 40% reduction in water demands from its peak year, MWD has for some time had substantial excess pipeline capacity. It is reasonable to assume that MWD water demands will continue to remain low due to the SB X7-7 Water Conservation Act of 2009, local agency supply development, and increasing water rates. Finally, as of August 2010, MWD determined that the Water Authority is no longer eligible to receive funds collected through WSR, and therefore, there is no possibility of benefit to Water Authority customers. Denial of access to WSR highlights the arbitrary nature of the fee and its application.
- ◆ Industry standard rate setting principles and practices require that a cost of service analysis address class specific costs and benefits. In contrast, the MWD rate structure treats all member agencies as homogeneous in their use of and demand on the MWD facilities. This ignores numerous substantive and meaningful differences among system users, notably including the fact that a single member agency—the Water Authority—engages in the transportation of a substantial quantity of non-MWD water, an activity quite different (in terms of the resources it uses and costs it imposes) than the purchase of MWD water. The failure to account for these different costs results in a disproportionate shift of costs to member agencies that engage in significant transporting or wheeling of water through MWD facilities and creates an explicit subsidy for member agencies purchasing supplies directly from MWD.
- ◆ MWD staff has proposed suspending the replenishment rates as part of the 2013 and 2014 rate proposal. Ostensibly, it would not be reinstated until such time that a reasonable nexus could be established between the charge and cost causation. We were unable to find substantiating information for the cost basis for this existing discount. From a cost of service perspective, any such discount should be based on a transparent and traceable avoided cost. Absent such justification, it seems an unwarranted benefit to some customers at the expense of others.
- ◆ The current rate structure does not accurately reflect the cost of providing reserve capacity for fluctuations in annual demands. Revenues are primarily recovered through volumetric charges creating a revenue risk for MWD, as well as requiring users with stable demands to bear the cost to maintain excess supplies, storage programs, and facility capacity MWD bears on behalf of those users with sporadic annual and seasonal usage patterns.
- ◆ We do not believe that costs incurred due to seasonal peaking are adequately addressed by the current or proposed rates and charges. While the cost allocation plan, as proposed, considers collecting peak day cost through the capacity charge, this rate recovery is minimal and does not adequately reflect cost differentials or create a significant economic incentive to reduce peak day demands.
- ◆ MWD has taken an unduly simplified approach to the cost allocation process, in large part, based on the contention that data is not available to perform a more sophisticated analysis. As the largest water agency in the United States, MWD has significant access to the leading engineering, financial, and information technology firms. MWD does have a hydraulic model of its system that they should be able to use to evaluate capacity requirements for an individual customer based on average, peak year, and peak month usage patterns. MWD's own consultant, Rafelis Financial Consulting (RFC), concluded in 1999 that the accounting system did not provide adequate detail to develop a more sophisticated allocation. The decade lag has provided ample time to construct a more defensible approach. However, even with its current simplified approach, MWD should more appropriately allocate supply costs within its rates and charges. Changing usage patterns, including increasing



reliance on alternative supply sources, has increased the materiality of these inequities that are not accounted for by MWD's cost allocation process.

- ◆ While two independent consultants (Rafaelis Financial Consulting and Resource Management International) provided guidance through independent studies in the late 1990's, the existing rate structure and proposed allocation of costs and resulting rates and charges have been developed by internal staff. Due to the inconsistencies with statutory proportionality requirements and sound rate setting principles, we suggest that MWD and its members retain an outside expert to conduct a comprehensive and independent analysis and review in order to help staff establish equitable and defensible rates and charges. However, regardless of whether the final rates and charges are developed by MWD staff or an outside expert, all rates and charges should be well-documented and justified based on cost of service requirements.

## D. KEY RATE CONSIDERATIONS

The 2013 and 2014 MWD rate proposal contains a variety of rate components and charges to member agencies. Of specific concern is the misallocation of supply related costs and resulting overcharge to the Water Authority and other member agencies wishing to transport third party supplies using MWD facilities. We have summarized major issues as they relate to specific MWD rate and charge components below.

The **MWD Water Supply Rate** is intended to recover the cost of MWD's water supplies, including imported water supplies from the State Water Project and Colorado River. However, MWD proposes to reassign nearly \$1 billion in SWP related costs to the System Access Rate and System Power Rate between 2013 and 2014. These charges are imposed on transportation exclusively. MWD also fails to include \$136 million in its Supply Rate that MWD spends to develop local water supplies. The 2013 and 2014 rates instead propose to recover these costs through the Water Stewardship Rate, which is treated as a charge on transportation through MWD's facilities. All of these water supply costs should be recovered through the Water Supply Rate or another charge applied solely to supply customers.

The **MWD System Access Rate** is intended to recover the cost of conveyance and distribution. The charge is applied to all water that moves through MWD facilities on a per acre-foot basis, whether supplied by MWD or through a third party agreement. However, the System Access Rate, in the 2013 and 2014 water rates, also attempts to recover \$380 million of the nearly \$1 billion paid to the California DWR for water from the SWP. Indeed, this SWP cost comprises nearly 50% of the revenue collected through the System Access Rate.

The **MWD System Power Rate** is intended to recover the energy costs associated with pumping water through MWD facilities. The system power rate is applied to all water transported by MWD on a per acre-foot basis, including third party supplies wheeled using the MWD system. In the 2013 and 2014 System Power Rate, however, MWD also seeks to recover \$522 million of the nearly \$1 billion paid to the California DWR for water from the SWP. In other words, through the System Power Rate, MWD seeks to recover the cost for pumping that takes place in facilities that MWD does not operate nor own, are not incurred to move water through MWD facilities, and then charge those rates to customers that transport water only in facilities that MWD does own. This does not reflect industry or proper cost-allocation principles.

The **MWD Water Stewardship Rate** recovers the cost of providing financial incentives to MWD's member agencies for developing new local water supply projects, such as recycled water, desalination, conservation, and other new water supplies. There is no demonstration by MWD that the cost of these investments is based on a need for transportation capacity. However, MWD charges these water supply costs as a water transportation service. Because this rate pays for water supply development, it should be applied to the Water Supply Rate. The Water Stewardship Rate will

recover \$136 million in 2013 and 2014 through a transportation charge, again in deviation from proper cost-allocation principles.

The MWD Readiness-to-Serve Charge is intended to recover costs of providing standby service, such as emergency storage. The RTS is based on a ten-year year rolling average of annual firm demands and wheeled water, with the exception of the Water Authority exchange. A large portion of emergency storage and some SWP costs are recovered through the RTS. These costs should not be collected from member agencies wheeling water that do not share in the burden or benefit of those activities – transportation customers use transportation facilities, not emergency storage facilities; accordingly allocating the cost of emergency storage facilities to transportation deviates from industry cost-allocation principles.

The MWD Replenishment Rate is a discounted rate for surplus system supplies available for the purpose of replenishing local storage. MWD has not defined what supplies are considered “surplus” for purposes of a replenishment rate. The 2013 and 2014 rates and charges proposal suspends this rate discount. We were unable to find substantiating information for the cost basis for this existing discount. From a cost of service perspective, any such discount should be based on a transparent and traceable avoided cost. Absent a clear relationship, the charge would economically advantage one type of user while disadvantaging another.

**Other Significant Considerations** include system both annual and seasonal peaking costs. We do not believe seasonal nor sporadic annual peaking is adequately addressed by the current or proposed rates and charges. Moreover, while the cost allocation plan, as proposed, considers collecting peak day cost through the capacity charge, this rate recovery is minimal and does not create a significant economic incentive to reduce peak day demands. In addition, fluctuating annual peak demands create a significant revenue risk for MWD and force users with level demands to subsidize users with sporadic annual demands. Subsidizing fluctuating annual peak usage serves to incentivize it in exact contrast to MWD’s stated policies. We concur with RFC that establishing a sound peaking rate, whether for treatment or supply and distribution, would be appropriate based on MWD’s stated policy objectives.

## E. FINANCIAL IMPACTS

The 2013 and 2014 rate proposal places an undue financial burden on the Water Authority and its member agencies. The overpayments have both direct and secondary economic impacts to San Diego County. The 2013 and 2014 rate proposal also places an undue financial burden on other parties who might wish to transport water using MWD facilities. The current and proposed rates are obstacles to incentivizing conservation and to creating an environment for efficient use of water because they do not reflect the true cost of water and artificially increase the cost to transport water using MWD facilities and lower the apparent cost of MWD water.

## SECTION I: BACKGROUND INFORMATION

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The San Diego County Water Authority (the Water Authority) retained FCS Group to provide an objective and unbiased review of the Metropolitan Water District of Southern California's (MWD) 2013 and 2014 rate proposals for equity and proportionality requirements based on sound cost-of-service rate setting principles. While this review does address specific impacts and considerations relative to the Water Authority, it is also intended to provide a broader review of the rate setting methodology. As to the broader review of the rate setting methodology, we had limited time and access to data and records concerning the MWD system and thus the calculations presented within this report are intended to be illustrative and are not comprehensive. Moreover, the analysis relies on the MWD staff's own cost allocation and rate analysis. Even with these limitations, the analysis frames and defines critical issues and concerns and through this identifies specific features of MWD rates that do not comply with reasonable and appropriate standards for equitable and proportional allocation of costs. Finally, to provide context to what we believe is a misallocation of cost and resulting overcharge, we have provided order of magnitude impacts and considerations. While a reasonable quantification of impacts has been developed to identify the scale and significance of divergence, a more detailed analysis would be required to refine the total direct and secondary impacts to the Water Authority of the proposed rates and charges.

This chapter addresses basic rate setting and cost of service principles and discusses the findings from third party reviewers for the 2010 MWD rate setting proposal.

### A. RATE SETTING AND COST OF SERVICE PRINCIPLES

Water rates and charges must illustrate a reasonable nexus between the service provided and the cost recovered to provide that service. A well crafted cost of service study should adhere to a number of basic principles:

- B. **Equitable** – Rates must equitably recover costs between custom classes proportionate to their respective cost impact to the system. Moreover, no one party may be advantaged at the expense of another class.
- C. **Legally Compliant** – Rates should adhere to all applicable statutory requirements and case law including the proportionality requirements of Proposition 26.
- D. **Administratively Feasible** – Equity and complexity should be balanced so as not to create an unreasonable cost burden to implement.
- E. **Understandable** – Rate structures and methodologies should be transparent and easily understood by system users.
- F. **Financially Affordable** – Rates should not place an unfair burden on ratepayers. As a large wholesaler serving local water purveyors, MWD should also attempt to provide rate smoothing and predictability as feasible.
- G. **Class Specific** – Rates should appropriately allocate and recover costs on a class specific basis in order to account for unique cost drivers that will differ by type of user. Moreover, rates should not place any class in a significant economic advantage or disadvantage.

## B. 2010 THIRD PARTY RATE REVIEW

MWD has been recovering water supply and transmission related costs from its member agencies through a number of recovery mechanisms over its long history. Since 1995, there have been a number of studies addressing cost allocation issues. A detailed account of the rates and charges process is included in Appendix B of this report as summarized by the Water Authority. The authors of this study have reviewed that historical appendix and rely on it for purposes of historical background.

During the 2010 rate setting process, two outside experts, Raftelis Financial Consulting, Inc. (RFC) and Bartle Wells Associates, Inc. (BWA), provided opinions on MWD's 2010 rate proposals. RFC was retained by MWD. BWA was retained by the Water Authority. The findings of each review are summarized below.

### B.1 Raftelis Financial Consulting Review

Raftelis Financial Consulting (RFC) was retained by MWD to conduct an independent review of the 2010 cost of service analysis. RFC submitted four major findings as follows:

1. The 2010 cost-of-service study and rate methodology is reasonable, consistent with California law, specifically Government Code Section 54999.7, the Metropolitan Water District Act, and MWD Administrative Code.
2. The 2010 cost-of-service study and rate methodology is consistent with water industry best practices, and complies with COS and rate guidelines established in the American Water Works Association's Manual M-1, Principles of Water Rates, Fees, and Charges.
3. The 2010 proposed rates have been developed consistently with Board policies and the 2001 Rate Structure Framework.
4. The 2010 cost-of-service study is accurate and consistent with the 2001 study.

#### B.1.1 Review Findings

RFC provides the MWD Board adopted rate setting principles for the Strategic Planning Steering Committee as follows:

- The rate structure should be *fair*;
- It should be based on the *stability* of MWD's revenue and coverage of its costs;
- It should provide *certainty and predictability*;
- It should not place any class of customers at significant *economic disadvantage*;
- It should be reasonably *simple and easy to understand*; and
- Any dry-year allocation should be *based on need*.

The first five points specifically relate to the issues described in this document. We concur with these principles as standards of care. As described later in this report, we find that the MWD rate allocation itself deviates from reasonable cost of service principles and is based on over-simplifying assumptions. The RFC lists one of the central tenets of rate making as not placing any class of customer at a significant economic disadvantage. We concur with this statement. However, we find that the existing and proposed rates and charges create a significant economic disadvantage for the Water Authority and others wishing to transport third party or other non-MWD supplies using the MWD system.

As a future consideration, RFC offers the idea of charging a treated water peaking charge and revisiting of the Tier 1 and Tier 2 water allotments. We believe that this is a sound observation and offers MWD a cost-of-service rate approach for addressing peak usage and to equitably recover standby capacity and supply costs from users that use MWD facilities in a sporadic manner. This approach can be considered for all MWD facilities in order to reduce revenue risk and minimize subsidies for seasonal idle capacity, but also for year-to-year idle capacity resulting from hydrologic variations in local supply availabilities.

## B.2 Bartle Wells Associates Review

Bartle Wells Associates (BWA) was retained by the Water Authority to conduct an independent review of the 2010 cost-of-service analysis. BWA submitted two memorandums – the first submitted March 5, 2010; and the second submitted April 12, 2010. The major findings of the BWA memorandums are summarized as follows:

1. The 2010 rate study fails to properly allocate and recover State Water Project (SWP) costs deviating from standards guiding accounting for and allocating supply related costs by the American Water Works Association (AWWA) and the National Association of Regulatory Commissioners (NARUC). This contradicts MWD and RFC assertions that AWWA and NARUC guidelines were followed.
2. The 2010 rate study and methodology fail to achieve MWD's strategic objectives to support and encourage sound water resource management, accommodate a water transfer market, enhance fiscal stability, and to reflect cost-of-service principles.
3. The Water Stewardship Rate should only be applied to MWD supplied water, excluding water wheeled through the MWD system.
4. The 2010 rate study and methodology are inconsistent with the 2001 Rate Study, due to the fact that several components of the 2010 structure have changed in description and purpose since 2001.

### B.2.1 Review Findings

We concur with the BWA findings that the 2010 rate methodology does not achieve required reasonable allocations and fails to meet MWD's strategic objectives of promoting a water transfer market. While MWD is not subject to the Regulatory Commissioner's chart of accounts, the finding that State Water Project costs should be treated as supply costs is consistent with the MWD physical system and its supply costs. Moreover, there is no reasonable basis for spreading external supply power costs to internal distribution power costs or to charges for conveyance of water through the Colorado River Aqueduct.

In its April 2010 rate review, BWA writes, "The allocation of costs to unbundled rates and charges recovered from customers should be proportional to use and costs of service of each customer or customer class." Citing MWD's April 5, 2010 response to public comment, BWA disagreed that there would be no cost impact of recovering costs through either the supply component or the system access rate. BWA went on to write, "Because different member agencies take different water services and are not charged the same combination of unbundled rates and charges, the total cost of water differs by member agency." We concur with BWA's assertion. Because MWD's customers do not use the same bundle of services and do not have consistent base and peak water demands, the existing rate structure, which allocates supply costs to the System Access Rate (transportation rate) does not evenly impact all customers. Moreover, because MWD applies the System Access Rate and Water Stewardship Rate to both delivered supplies and wheeled water, the Water Authority is disproportionately charged for services.

BWA specifically addresses a key concern with the Water Stewardship Rate, stating that the recovery of these supply related costs through a transportation charge “neglects two key facts: (1) MET is not obligated to provide transportation services it cannot provide due to a lack of capacity, and (2) MET has had substantial available capacity in its facilities to deliver water and fully expects to have that capacity available in the future years it has forecasted.” MWD has not substantiated that the Water Stewardship Rate provides any capacity benefit for its transportation system nor provides a proportionate benefit to member agencies using MWD facilities to transport water.

## SECTION II: PROPOSED 2013 - 2014 RATES AND CHARGES PLAN

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As with the current rates, we do not believe that the proposed 2013 and 2014 rates and charges adhere to the equity and proportionality requirements as defined under Proposition 26 or to industry standard rate setting principles.

The following chapter briefly discusses the rate setting concepts presented by MWD staff in their rate proposal, addresses the allocation methods and approaches, and then provides commentary on each of the proposed rates and charges. Finally, the chapter also addresses system peaking costs.

### A. RATE SETTING CONCEPT

MWD delineates a four step rate setting process as follows:

- ♦ Step 1 – Development of Revenue Requirements
- ♦ Step 2 – Identification of Service Function Costs
- ♦ Step 3 – Classification of Costs
- ♦ Step 4 – Allocation of Costs to Rate Design Elements

These four steps as identified within the January 2012 Board Action report are reasonable and adhere to an appropriate rate setting process. However, the allocations and resulting rates do not adhere to appropriate rate setting rules, which will be delineated within this report.

### B. RATE ALLOCATION

The allocation process consists of two distinct parts: allocation to functional categories; and recovery of cost based on functional usage. The 2013 and 2014 rate proposal notes that a “key goal of functional allocation is to maximize the degree to which rates and charges reflect the costs of providing different types of service. For functional allocation to be of maximum benefit, two criteria must be kept in mind when establishing functional categories.

- ◆ The categories should correlate charges for different types of service with the costs of providing those different types of service; and
- ◆ Each function should include reasonable bases by which costs may be allocated.<sup>12</sup>

We concur with this conceptual standard and believe the philosophy is consistent with sound rate making principles. Moreover, we concur that the basic allocation functions, as presented by MWD, are also reasonable. We do not, however, believe that the actual allocations adhere to appropriate or reasonable allocations and cost recovery. Additionally, while the allocation specifically applies costs to fixed and volumetric categories, the rates and charges do not reflect this allocation, instead recovering cost primarily based on a per acre-foot (i.e., volumetric) charge.

As directly described and defined in the 2013 and 2014 rate proposals, MWD allocates costs to eight (8) categories as follows<sup>3</sup>:

- ◆ *Supply* – This function includes costs for those SWP and CRA facilities and programs that relate to maintaining and developing supplies to meet the member agencies' demands. For example, Metropolitan's supply related costs include investments in the Conservation Agreement with the Imperial Irrigation District and the Palo Verde Irrigation District (PVID) Program from the Colorado River supply programs. The SWP programs include transfer programs such as Kern Delta Program, Semitropic Water Storage Program, Yuba Accord Program, and the Arvin-Edison Water Storage Program. Costs for in-basin programs within Metropolitan's service area, such as Proposition 13 are also included.
- ◆ *Conveyance and Aqueduct* – This function includes the capital, operations, maintenance, and overhead costs for SWP and CRA facilities that convey water through Metropolitan's internal distribution system. Variable power costs for the SWP and CRA are also considered to be Conveyance and Aqueduct costs but are separately reported under a "power" sub-function. Conveyance and Aqueduct facilities can be distinguished from Metropolitan's other facilities primarily by the fact that they do not typically include direct connections to the member agencies. For purposes of this study, the Inland Feeder Project functions as an extension of the SWP East Branch and is therefore considered a Conveyance and Aqueduct facility as well.
- ◆ *Storage* – Storage costs include the capital financing, operating, maintenance, and overhead costs for Diamond Valley Lake, Lake Mathews, Lake Skinner, and five smaller regulatory reservoirs within the distribution system. Metropolitan's larger storage facilities are operated to provide (1) emergency storage in the event of an earthquake or similar system outage; (2) drought storage that produces additional supplies during times of shortage; and (3) regulatory storage to balance system demands and supplies and provide for operating flexibility. To reasonably allocate the costs of storage capacity among member agencies, the storage service function is categorized into sub-functions of emergency, drought, and regulatory storage.
- ◆ *Treatment* – This function includes capital financing, operating, maintenance, and overhead costs for Metropolitan's five treatment plants and is considered separately from other costs so that treated water service may be priced separately.
- ◆ *Distribution* – This function includes capital financing, operating, maintenance, and overhead costs for the "in-basin" feeders, canals, pipelines, laterals, and other appurtenant works. The "in-basin"

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<sup>2</sup> Metropolitan Water District of Southern California Fiscal Year 2012/13 Cost of Service, dated December 2011, Attachment 2, page 8.

<sup>3</sup> Metropolitan Water District of Southern California Fiscal Year 2012/13 Cost of Service, dated December 2011, Attachment 2, page 8 and 9.



*facilities are distinguished from Conveyance and Aqueduct facilities at the point of connection to the SWP, Lake Mathews, and other major turnouts along the CRA facilities.*

- ✦ *Demand Management – A separate demand management service function has been used to clearly identify the cost of Metropolitan’s investments in local resources like conservation, recycling, and desalination.*
- ✦ *Administrative and General (A&G) – These costs occur in each of the Groups’ departmental budgets and reflect overhead costs that cannot be directly functionalized. The cost-of-service process allocates A&G costs to the service functions based on the labor costs of non-A&G dollars allocated to each function.*
- ✦ *Hydroelectric – Hydroelectric costs include the capital financing, operating, maintenance, and overhead costs incurred to operate the 16 small hydroelectric plants located throughout the water distribution system.*

## B.1 Key Considerations

In its description of functions, MWD clearly distinguishes between “conveyance and aqueduct” and “distribution”. However, as illustrated below, the allocation calculations comingle these costs instead of distinguishing them.

MWD has taken an unduly simplified approach to the cost allocation process, in large part based on the contention that data is not available to perform a more sophisticated analysis. As the largest water agency in the United States, MWD has significant access to the leading engineering, financial, and information technology firms. MWD does have a hydraulic model of its system that they should be able to use to evaluate capacity requirements for an individual customer based on average, peak year, and peak month usage patterns. Raftelis Financial Consulting concluded in 1999 that the accounting system did not provide adequate detail to develop a more sophisticated allocation. The decade lag has provided ample time to construct a more defensible approach. However, even with its current simplified approach, MWD should more appropriately allocate supply costs within its rates and charges.

Finally, the cost allocation that is presented in the 2013 and 2014 rates and charges proposals is only partially followed. The rates are purported to use the following five classification categories:

- ✦ Fixed demand costs
- ✦ Fixed commodity costs
- ✦ Fixed standby costs
- ✦ Variable commodity costs
- ✦ Hydroelectric costs

While costs are allocated to these categories, the rates do not reflect distinctions between fixed and variable costs. Moreover, costs are almost exclusively recovered on a per acre-foot basis regardless of usage pattern or recognition of the cost to maintain system capacity for annual peak usage, which creates a significant revenue risk for MWD and requires users with more constant year-to-year demands to fund reserve capacity for users with sporadic annual demands that use the MWD facilities as a back-up supply source to meet their own peak year demand requirements. MWD is highly susceptible to revenue fluctuations because of this rate structure.

## C. RATES

The rate calculations are premised on MWD selling and wheeling 1.65 million acre-feet per year in 2013 and 2014. This is slightly lower than the stated 1.70 million acre-feet described in the introduction of the rate proposal. Additionally, the supply rates assume that 1.45 MAF of Tier 1 water will be sold. Finally, the MWD analysis assumes that approximately 0.95 MAF of water will be treated.

### C.1 Water Supply Rate

The supply rate purports to collect the total cost of MWD supplies, which include water imported from the State Water Project and through the Colorado River Aqueduct. The total allocated supply costs are ostensibly recovered over 1.45 MAF, net of the Water Authority water secured through the IID transfer.

The current 2012 rate is \$95 per acre-foot for Tier 1 water and \$290 for Tier 2 water. The Tier 1 rate also includes an additional \$69 per acre-foot Delta Supply Surcharge (DSS), for a total of \$164. MWD staff has proposed suspending or eliminating the DSS under the new rate structure. The proposed rate for 2013 would increase from its current level of \$95 per acre-foot to \$149 per acre-foot and then to \$157 per acre-foot in 2014, resulting in an overall decrease in MWD's supply charges with the sunset of the DSS. Additionally, the Tier 2 rate would remain constant over the next two years at \$290 per acre-foot.

#### Review Considerations

The water supply rate is intended to recover the cost of MWD's water supplies, including imported water supplies from the State Water Project and Colorado River. However, MWD proposes to reassign nearly \$1 billion in SWP related costs to the System Access Rate and System Power Rate between 2013 and 2014. These charges are imposed as a charge for transportation as applied to all water that flows through MWD facilities, including water wheeled or transported from third parties. MWD also proposes to recover approximately \$136 million through the Water Stewardship Rate during this same timeframe. While these Water Stewardship Rate revenues are earmarked for local water supply development, the charges are applied as a transportation rate and charged even for wheeling or transportation of third party water. We concur with the BWA 2010 findings that this constitutes the misallocation of supply charges and believe that this does not meet the proportionality requirement of sound rate making principles as required by the California Constitution, Article XIII C, § 1(e) (Proposition 26).

### C.2 System Access Rate (SAR)

The SAR is a volumetric system-wide rate levied on each acre-foot of water that moves through the MWD system, including both MWD supplied and wheeled water. The SAR purports to recover the cost of conveyance and MWD's distribution system, and supply related costs. The proposed rate for 2013 would increase from its current level of \$217 per acre-foot to \$228 per acre-foot and then to \$247 per acre-foot in 2014. Current estimates indicate that the SAR revenue requirement will be about \$374 million in 2013 and \$408 million in 2014.

#### Review Considerations

As with the System Power Rate (discussed below), the SAR recovers supply related costs in contradiction to the stated purpose of this rate, which is designed to recover costs to physically move water through MWD's system, net of its power costs. This creates a significant and disproportionate cost burden on the Water Authority and other agencies wishing to transport third party or local supplies using MWD facilities, because the charge is applied to all water moved in its system, not

just MWD provided water. Of the nearly \$1 billion dollars of the SWP supply costs that are applied to transportation charges in 2013 and 2014, \$380 million will be collected through the System Access Rate, representing nearly 50% of the revenue collected through that charge.

### C.3 Water Stewardship Rate (WSR)

The WSR recovers the cost of investments in conservation, water recycling, groundwater clean-up and other local resource programs. The program is a supply augmentation program that helps offset imported water supplies. However, the charge is applied as a transportation charge on all water that passes through MWD facilities, including third party water supplies purchased by member agencies and wheeled or transported through MWD facilities. MWD currently collects \$43 per acre-foot of water sold and wheeled through its system. This rate is projected to decrease to \$41 per acre-foot in 2013 and increase to \$42 per acre-foot in 2014, collecting \$67.5 million and \$70.0 million, respectively.

#### Review Considerations

As it is applied, the WSR is collected as a transportation rate, rather than a supply rate. We believe that the rate is inequitable and does not meet the proportionality requirements; first, because it is collected on all water that passes through MWD facilities, including wheeled or transported water; and second, because the funds collected through the WSR are dispersed to member agencies disproportionately. In other words, not all member agencies benefit proportionally from subsidies funded by the WSR and the Water Authority is excluded from them. The WSR is recovered based on the volume of water supplied to or wheeled on behalf of MWD's member agencies. As addressed in the Bartle Wells Associates' 2010 rate review, we also believe that recovering supply cost through a transportation rate deviates from sound rate making policy and disproportionately burden the Water Authority.

In order to demonstrate proportionality of a given rate, an agency must be able to illustrate a reasonable nexus between the charge and the service provided. The benefit can be both direct and indirect and can be achieved over a reasonable time period, but must be clearly shown. MWD fails to demonstrate either that the Water Stewardship Rate provides a proportionate and direct benefit to the Water Authority or that it provides an indirect, but tangible benefit. The WSR is levied as a transportation rate. We found no evidence in MWD's rate proposal that these investments in local water supplies create transportation related capacity or transportation cost savings through avoided capital investment in its distribution or conveyance facilities. Moreover, due to nearly 40% reduction in water demands from its peak annual demands, MWD currently has, and has for some time had, excess pipeline capacity. Absent evidence to the contrary, it is reasonable to assume that MWD water demands will continue to be impacted due to the SB X7-7 Water Conservation Act, local agency supply development, and increasing water rates. Major water providers throughout the western United States continue to experience water demand reductions. Finally, as of August 2010, MWD determined that the Water Authority is no longer eligible to receive funds collected through the WSR.<sup>4</sup> In spite of this action, MWD continues to collect the WSR charge on all water supplies to and wheeled on behalf of the Water Authority. Thus, the Water Authority and the region it serves is paying for a service it is barred from receiving. This violates industry practice, as summarized above.

Since the implementation of the WSR, MWD has maintained detailed audit records of the money collected and the program investments, including conducting periodic audits of local agencies receiving subsidy payments. The Water Authority's review of the payments concluded that they have

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<sup>4</sup> August 2010 Board action.

contributed significantly more money through the WSR than has been returned in program or other benefits. As such, MWD has not demonstrated that the WSR provides a fair and equitable relationship to the burden imposed on and benefits received by the Water Authority from WSR local supply investments.

#### C.4 System Power Rate (SPR)

The SPR purports to recover costs for pumping water through MWD facilities. The SPR is charged on each acre-foot of water delivered, including wheeled water. The charge aggregates water supply power costs and internal distribution costs. The fee is proposed to increase from \$136 per acre-foot to \$190 per acre-foot in 2013, then drop to \$164 per acre-foot in 2014.

##### Review Considerations

The System Power Rate recovers the costs of energy pumping water through the MWD facilities, as well as supply charges by the California Department of Water Resources for SWP supplied water delivered to MWD through a system that MWD does not operate nor own. SWP costs are exclusively supply related costs and should be recovered through a supply charge. The system power rate is applied to all water transported by MWD on a per acre-foot basis, including third party supplies wheeled using the MWD system. Of the nearly \$1 billion dollars of the SWP supply costs that are applied to transportation charges in 2013 and 2014, \$522 million will be collected through the System Power Rate.

It is important to note that, by securing third party supplied water that is transported through the CRA rather than importing more water through the SWP, the Water Authority has enabled MWD to avoid significant SWP power costs. However, based on the rate structure as proposed, the Water Authority is still burdened with paying for a portion of the remaining SWP power costs for which they do not receive any benefit.

#### C.5 Treatment Surcharge

MWD has proposed an increase in the treatment surcharge from \$234 per acre-foot in 2012 to \$260 per acre-foot in 2013 and \$302 per acre-foot in 2014. The treatment surcharge is a system-wide volumetric rate set to recover the cost of providing treated water service. As noted in the rate proposal, the treatment surcharge revenue requirement is expected to be about \$244 million in 2013, almost 18 percent of the total revenue requirement. The treatment surcharge is intended to recover all costs associated with providing treated water service, including commodity, demand and standby related costs. Significant capital improvements at Metropolitan's five treatment plants, such as the Ozone Retrofit Program and improvement programs at all five treatment plants result in additional capital financing costs being allocated to the treatment surcharge.

##### Review Considerations

The cost allocation plan attempts to isolate treatment related costs, including overhead and support costs, and to collect these costs on a volumetric basis. The limited information contained within the rate proposal and annual budget is insufficient to be able to validate the reported treatment plant costs. With the ozone retrofit program and other capital improvements, it appears reasonable that the treatment surcharge would continue to increase. As with the operation of other parts of the MWD system, treatment plant costs are substantially fixed, with minimal variable expenditures, such as the costs of power and chemicals.

## C.6 Capacity Charge

The capacity charge is assessed based on a three-year rolling average of peak day demands between May 1 and September 30. The charge is intended to pay for the cost to provide seasonal peak capacity in storage and distribution facilities. MWD intends this charge to encourage local agencies to increase local supplies to meet peak demands and to shift demands into lower usage months between October and April.

### Review Considerations

The capacity charge recovers a minimal cost. In concept, the capacity charge could be an effective mechanism to influence local agency behavior. However, only a small portion of the cost of providing this capacity is recovered. As noted in the peaking discussion below, MWD should price usage with respect to seasonal peaking and annual variability of water demands to fully account for the cost of standby supplies and capacity. Doing so would better serve MWD's stated goals and more closely adhere to industry-standard rate making practices.

## C.7 Readiness-to-Serve Charge

The costs of providing standby service, such as emergency storage, are recovered by the RTS. The RTS is based on a ten-year rolling average of annual firm demands and wheeled water, with the exception of the Water Authority exchange, the volume of which is excluded from the calculation.

### Review Considerations

MWD relies on a simplifying assumption and incorporates all annual firm demands including wheeling and exchange supplies. As noted, the readiness-to-serve charge is for emergency storage, not for the transportation of water through its facilities. Consequently, internal and external water supplies should be treated separately.

After review of the cost allocation, it is clear that a large portion of emergency storage and some SWP costs are recovered through the RTS. These costs should not be collected from member agencies wheeling or transporting third party water as those activities do not burden or impact and are unrelated to benefits associated with the benefits of the RTS. An appropriate charge would exclude these costs for wheeled or transported third party water.

## C.8 Replenishment Rate

The replenishment rate is a discounted rate for surplus system supplies available for the purpose of replenishing local storage. The 2013 and 2014 rates and charges proposal suspends this rate discount and states that staff will present options to the Board in the future.

### Review Considerations

All rates and charges for ongoing water services must demonstrate a cost of service foundation. We were unable to find substantiating information for the cost basis for this existing discount. From a cost of service perspective, any such discount should be based on a transparent and traceable avoided cost or benefit to users as defined and supported by an engineer's report. The 2013 and 2014 rates and charges proposal suspends this rate discount. Absent such justification, it seems an unwarranted benefit to some customers at the expense of others.

## D. WHEELING COSTS

MWD charges imposed on member agencies for wheeling or transportation of third party water far exceed the costs associated with providing those wheeling or transportation services, due to MWD's

incorporation of extraneous costs into the wheeling charge and thus violate statutory, policy and industry standards. Under the Exchange Agreement, the Water Authority transports third party water supplies through MWD facilities. As a result of the current rate allocation practice of recovering supply related costs through transportation rates and charges, the Water Authority, and any other agency receiving services from MWD for transportation of third party supplies, is overcharged and pays a rate that exceeds the cost of the service provided.

MWD could consider charging a fair and reasonable charge for the use of the Colorado River Aqueduct and transmission facilities. Pumping and other direct operational costs would also apply. The structure could contain both fixed and variable cost components, allowing MWD to recover a fair cost for facilities. Reasonable recovery would recognize facilities funded by Water Authority contributions made through ongoing rates and direct payments in order to ensure that there is no double-charging. This would enable all system users to benefit from the sharing of appropriate and related costs through a valid wheeling charge, while avoiding subsidy of those users through the inclusion of inappropriate costs in that charge.

## E. SYSTEM PEAKING AND EQUITABLE COST RECOVERY

MWD is highly dependent upon variable rate revenues for the operation of its system, while most of the annual expenditures are fixed and do not vary with consumption patterns. This creates revenue volatility and risk, as MWD has experienced over the past few years. Water demands on MWD continue to fluctuate and diminish due to conservation measures, price elasticity at the local retail level, mandatory water curtailments, weather patterns, member agencies' own local supply conditions and annual demand patterns, as well as other factors. These factors have caused MWD to sharply increase the unit cost of water in recent years.

It is clear from the consumption profiles over the past ten years that annual water demands by individual agency can vary widely. Moreover, the current rate structure does not adequately address annual peaking within the system, including 'roll-on/roll-off' users that use the MWD system as a supplemental source of supply in dry years or other times of need. Unaddressed, this constitutes a de facto subsidy of customers with significant demand peaks and annual fluctuations by those agencies with constant demands. This issue was raised during MWD's initial rate setting process, but not materially addressed as part of the proposed rate plan and is not addressed in the rates proposed for 2013 and 2014.

The following table illustrates average and peak water deliveries (including sales and wheeling) for the 10 year period between 2001 and 2010. Additionally, ratios of the peak year to average year water deliveries and standard deviation to average year water deliveries are shown in Table 1 in order to illustrate relative variability of member demands.

Table 1. Evaluation of Water Deliveries

Agency	Average Annual Deliveries (AF) <sup>1</sup>	Peak Deliveries (AF)	Peak Increase (AF)	Peak/Ave Sales Ratio	Standard Deviation/Ave Sales <sup>2</sup>
Anaheim	22,900	31,300	8,400	1.37	0.23
Beverly Hills	12,400	13,600	1,200	1.10	0.08
Burbank	13,400	16,000	2,600	1.19	0.13
Calleguas	118,400	131,400	13,000	1.11	0.07
Central Basin	84,900	119,200	34,300	1.40	0.26
Compton	3,000	3,900	900	1.30	0.18
Eastern	104,100	136,900	32,800	1.32	0.14
Foothill	12,000	14,800	2,800	1.23	0.11
Fullerton	12,500	17,800	5,300	1.42	0.32
Glendale	22,900	29,100	6,200	1.27	0.14
Inland Empire	76,500	96,800	20,300	1.27	0.12
Las Virgenes	23,200	27,100	3,900	1.17	0.09
Long Beach	40,900	47,500	6,600	1.16	0.15
Los Angeles	332,500	434,700	102,200	1.31	0.23
MWDOC	283,100	360,600	77,500	1.27	0.16
Pasadena	23,300	25,500	2,200	1.09	0.08
San Diego	603,300	667,900	64,600	1.11	0.09
San Fernando	300	900	600	3.00	1.16
San Marino	1,000	1,600	600	1.60	0.46
Santa Ana	15,600	22,000	6,400	1.41	0.35
Santa Monica	12,700	14,400	1,700	1.13	0.08
Three Valleys	75,200	89,700	14,500	1.19	0.13
Torrance	20,300	22,800	2,500	1.12	0.08
Upper San Gabriel	44,000	75,600	31,600	1.72	0.55
West Basin	140,100	150,400	10,300	1.07	0.07
Western MWD	92,300	115,100	22,800	1.25	0.19

<sup>1</sup> Values rounded to the nearest 100 AF

<sup>2</sup> Standard deviation of average annual deliveries (including sales and wheeling) divided by average sales

In response to the 2012 Remarketing Statement for the 2011 Series A-1 and A-3 Water Revenue Refunding Bonds, the Water Authority specifically noted its concern regarding the risk of unknown water demands and sales. These concerns centered on two factors – overall water demands relative to investment in redundant capacity; and unpredictable annual peak demands and resulting instabilities of revenues.

As a function of the rate setting process, MWD assigns costs to four cost classification categories as follows:

- ◆ **Commodity** – Costs generally associated with meeting average demands.
- ◆ **Demand** – Costs incurred to meet peak demands.
- ◆ **Standby** – Costs incurred to ensure system reliability during emergencies.
- ◆ **Hydroelectric** – Costs and revenues associated with hydroelectric production.

In an attempt to provide an order of magnitude estimate of the value of MWD's peak demand capacity, an allocation of the fixed asset records was developed. Based on this allocation, the investment is estimated to be roughly \$3 billion for peak demand capacity. The appropriate recovery of capital and operating costs related to these facilities could easily represent hundreds of millions of dollars per year.

An appropriate rate structure would allocate the full cost of this capacity to and recover it from those member agencies whose demand patterns require that MWD have this standby capacity available. In contrast to the magnitude of the investment in facilities and supplies to provide capacity for peak seasonal and annual demands, MWD's rates and charges will only recover between \$26 million in 2013 and \$31 million in 2014 through the capacity charge, for peak season demands, and a minimal amount of additional revenues through the current Tier 2 water rate. As a general construct, MWD's volumetric rate structure allows agencies to "roll on and off" the system with little financial cost to those individual member agencies, and instead requires all system users to bear the cost burden for standby capacity. In effect, MWD spends billions of dollars on drought insurance, but does not require the beneficiaries of that insurance to pay for it until they actually use it. It does so by requiring other customers, whose demand is more stable, to subsidize those whose use of the MWD system is highly variable. This disproportionately burdens member agencies with proportionally level annual demands.

## F. SUMMARY OF FINDINGS

As delineated within this report, we find that the proposed 2013 and 2014 rates and charges disproportionately burden the Water Authority and any other system users who engage in the transporting, or wheeling, of non-MWD water through MWD facilities. MWD has failed to demonstrate that State Water Project costs and costs related to its Water Stewardship program are anything other than supply related. Consequently, these costs are misallocated to MWD's transportation charges. Additionally, MWD's rates and charges do not adequately address the costs of standby peak capacity, spreading these costs amongst all member agencies rather than establishing a rate structure that equitably recovers costs from member agencies requiring standby capacity to meet peak annual and seasonal demands. MWD's failure to address these issues in its rates and charges also disproportionately burden the Water Authority due to the volume of water it buys on a level basis.



## SECTION III: FINANCIAL IMPACTS

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An agency may not, under California law, advantage one customer class over another. Based on the information presented above, we believe that the current and proposed rate structure does not adhere to sound and equitable rate setting principles. As this is the case, the Water Authority has overpaid for its share of services. The overpayments have both direct and secondary economic impacts to San Diego County.

In the June 2010 Petition for Writ of Mandate, the Water Authority estimated the annual overcharge resulting from the 2010 and 2011 adopted rates and charges at over \$30 million. With the proposed 2013 and 2014 increases in the MWD rates and charges, as well as increases in the Water Authority's transfer volumes, the prospective overcharges will correspondingly escalate.

### A. SECONDARY IMPACTS OF OVERPAYMENT

In order to provide a range of impacts, we have constructed a preliminary economic analysis using IMPLAN. This analysis software is widely used throughout the United States to evaluate the consequences of economic transactions in a given geographic region. A glossary of terms for this economic analysis is included in Appendix A of this report.

This analysis of secondary (additive) economic impacts is intended to provide a preliminary range. These impacts, resulting from overcharging San Diego County for water transportation services, are presented on a per \$1 million basis. Additionally, recognizing that the economic impacts will differ between residential customers and commercial and industrial customers, two separate analyses were conducted – impacts for each \$1 million overcharged to residences; and impacts for \$1 million overcharged to commercial customers. Finally, the secondary impacts are additive to the base overcharge amount. For example, for every \$1 million in overcharges for water services, dollars that would otherwise be available for residences in San Diego County, there is an additional \$932,000 of secondary economic activities and 6.92 jobs that would otherwise occur, creating a total primary and secondary impact of \$1.93 million.

This economic analysis is strictly illustrative in order to provide the reader with an order of magnitude of secondary economic impacts and is not intended to be a comprehensive economic analysis.

#### A.1 Overview

This memorandum provides a summary of the economic impact findings regarding the “opportunity cost” of the economic value to San Diego County residents and businesses when a portion of annual utility charges are changed from expenses to income. As part of this work task, FCS GROUP performed the following activities:

- ◆ Compiled economic and demographic data for San Diego County, using U.S., Census data and the IMPLAN model (see following paragraph);
- ◆ Applied the IMPLAN model to evaluate the annual economic impacts from a reallocation of \$1 million in household and business expenditures to income levels; and
- ◆ Summarized the results of the findings as a valuation of the “opportunity cost” to residents and businesses in San Diego County in terms of jobs and valued added (gross domestic product).


The IMPLAN (Impact analysis for Planning) model is an economic analysis model developed by MIG, Inc. that is used to quantify the direct and secondary (indirect and induced) economic effects of changes in investment on local and regional economies. The IMPLAN model was originally developed by the United States Department of Agriculture (USDA) Forest Service in cooperation with the United States Department of the Interior Bureau of Land Management to assist in land and resource management planning. The IMPLAN model has been in use since 1979 and has evolved into an interactive microcomputer program that has become the national standard for economic impact analysis. For more detailed information about the IMPLAN model, please visit [www.IMPLAN.com](http://www.IMPLAN.com).

The IMPLAN model applies national, regional and county data regarding business and household purchases and expenditures for estimating direct, indirect and induced demand and transfer payments, and economic activity measures. Selected economic activity measures include employment, value added, industry output, and tax payments to local, state and federal governments.

The IMPLAN data and accounts closely follow the accounting conventions used in the “Input-Output Study of the U.S. Economy” by the Bureau of Economic Analysis (1980) and the format recommended by the United Nations. The comprehensive and detailed data coverage of the entire United States by county, and the ability to incorporate user-supplied data and assumptions provide a high degree of flexibility in terms of geographic coverage and model formulation. A complete list of terms used in the IMPLAN model is provided in the appendix of this report.

The IMPLAN summary overview results for San Diego County are displayed in Table 3. As of 2010, San Diego County had a gross regional product (value added) amount of \$175.5 billion in 2010; and had 3,076,745 residents; 1,083,121 households; and 1,832,144 workers.

Table 3. IMPLAN Summary Output Results for San Diego County, 2010

 Model Information		Gross Regional Product		Export to Final
		Value Added	Final Demand	
Model Year:	2010	Employee Compensation:	Households:	\$118,479,284,075
Gross Regional Product:	\$175,468,136,958	Proprietor Income:	State/Local Government:	\$15,794,412,123
Total Personal Income:	\$142,843,560,000	Other Property Type Income:	Federal Government:	\$54,102,800,616
Total Employment:	1,832,144	Indirect Business Tax:	Capital:	\$23,290,023,234
Number of Industries:	385		Exports:	\$70,511,727,860
Land Area (Square Miles):	4,205		Imports:	(\$101,888,113,859)
Area Count:	1		Institutional Sales:	(\$4,821,996,921)
Population:	3,076,745		Total Final Demand:	\$175,468,137,129
Total Households:	1,063,127			
Average Household Income:	\$131,881			
Trade Flows Method:	Econometric RPC			
Model Status:	Multipliers			
Areas in the Model		Economic Indicators		
California	San Diego County	Shannon-Weaver Diversity Index:	0.71387	
		Top Ten Industries View By: Employment		
Sector	Description	Employment	Labor Income	Output
411	* Employment and payroll only federal go...	125,586	\$13,152,240,000	\$20,323,100,000
413	Food services and drinking places	116,228	\$2,644,009,000	\$7,101,322,000
438	* Employment and payroll only state & lo...	114,368	\$6,992,965,000	\$8,077,486,000
360	Real estate establishments	37,916	\$2,251,384,000	\$16,545,980,000
437	* Employment and payroll only (state & lo...	60,739	\$4,584,896,000	\$5,309,041,000
354	Offices of physicians, dentists, and other...	50,694	\$3,947,460,000	\$6,138,286,000
319	Wholesale trade businesses	49,993	\$3,847,202,000	\$8,751,588,000
376	Scientific research and development ser...	48,506	\$5,590,352,000	\$9,178,718,000
356	Securities, commodity contracts, investm...	45,961	\$1,045,292,000	\$6,391,893,000
439	* Employment and payroll only federal go...	41,462	\$4,841,992,000	\$5,305,583,000

### A.2 Economic Impact Analysis of the Opportunity Cost to Households

To better understand the annual economic impact from reduced household utility expenditures that would result from appropriate MWD rates, FCS Group utilized the 2010 IMPLAN model for San Diego County with adjusted 2012 dollar escalation estimates. The analysis was conducted as a sensitivity analysis to show the impact of \$1 million in annual spending increases that could occur if household income was redirected from local government (i.e., MWD) rates and charges to general spending categories.

The resulting economic opportunity analysis indicates that for every \$1 million in additional household income, San Diego County residents would spend approximately \$932,000 in the local and regional economy. This level of spending would likely generate approximately \$595,000 in value-added (sometimes referred to as gross domestic product) and \$319,000 in labor income. The labor income expenditures would support or create 6.92 jobs (full and part-time workers). As shown in Table 4, over 40 economic sectors would benefit from this level of increased spending.

**Table 4. Economic Impact Analysis of \$1M Opportunity Cost to San Diego County Households**

IMPLAN Sector	Description	Jobs Created <sup>1</sup>	Value Added (GDP) <sup>2</sup>
<b>Sorted by Number of Jobs</b>			
413	Food services and drinking places	0.74	\$26,942
394	Offices of physicians, dentists, and other health practitioners	0.46	\$38,767
360	Real estate establishments	0.28	\$48,144
426	Private household operations	0.25	\$2,434
397	Private hospitals	0.24	\$21,505
324	Retail Stores - Food and beverage	0.24	\$11,568
398	Nursing and residential care facilities	0.23	\$9,324
319	Wholesale trade businesses	0.23	\$32,289
329	Retail Stores - General merchandise	0.23	\$11,040
356	Securities, commodity contracts, investments, and related activities	0.20	\$5,226
392	Private junior colleges, colleges, universities, and professional schools	0.15	\$6,989
355	Nondepository credit intermediation and related activities	0.14	\$12,708
320	Retail Stores - Motor vehicle and parts	0.14	\$9,120
327	Retail Stores - Clothing and clothing accessories	0.13	\$4,888
331	Retail Nonstores - Direct and electronic sales	0.13	\$4,579
400	Individual and family services	0.13	\$3,540
330	Retail Stores - Miscellaneous	0.11	\$4,373
425	Civic, social, professional, and similar organizations	0.11	\$4,026
396	Medical and diagnostic labs and outpatient and other ambulatory care services	0.11	\$9,772
382	Employment services	0.10	\$3,642
419	Personal care services	0.09	\$3,671
367	Legal services	0.09	\$12,264
388	Services to buildings and dwellings	0.09	\$3,032
325	Retail Stores - Health and personal care	0.08	\$5,089

IMPLAN Sector	Description	Jobs Created <sup>1</sup>	Value Added (GDP) <sup>2</sup>
<b>Sorted by Number of Jobs</b>			
357	Insurance carriers	0.08	\$16,667
401	Community food, housing, and other relief services, including rehabilitation services	0.07	\$1,653
393	Other private educational services	0.07	\$2,547
414	Automotive repair and maintenance, except car washes	0.07	\$3,879
354	Monetary authorities and depository credit intermediation activities	0.07	\$14,547
399	Child day care services	0.06	\$1,895
409	Amusement parks, arcades, and gambling industries	0.06	\$4,002
424	Grantmaking, giving, and social advocacy organizations	0.06	\$2,481
323	Retail Stores - Building material and garden supply	0.06	\$3,767
391	Private elementary and secondary schools	0.06	\$1,581
328	Retail Stores - Sporting goods, hobby, book and music	0.06	\$2,333
395	Home health care services	0.06	\$2,391
411	Hotels and motels, including casino hotels	0.05	\$3,706
432	Other state and local government enterprises	0.05	\$4,119
	Other Misc. Sectors	1.31	\$234,708
	<b>Total</b>	<b>6.92</b>	<b>\$595,210</b>
<sup>1</sup> reflects full- and part-time employment			
<sup>2</sup> annual impacts include: employee compensation, proprietor income, other business income and state/local tax payments.			
Source: Minnesota IMPLAN Group, Inc.: 2010 IMPLAN model for San Diego County, analysis by FCS GROUP. Results shown are in 2012 dollars.			

### A.3 Economic Impact Analysis of the Opportunity Cost to Businesses

To better understand the annual economic impact from reduced business utility expenditures, FCS Group utilized the 2010 IMPLAN model for San Diego County with adjusted 2012 dollar escalation estimates. As with the residential analysis, an analysis was conducted to show the impact of \$1

million in annual spending increases that could occur if business income was redirected from local government (i.e., MWD) rates and charges to general spending categories.

The resulting economic opportunity analysis indicates that for every \$1 million in additional business employee and proprietor income, San Diego County employees and businesses would spend approximately \$763,000 in the local and regional economy. This level of spending would likely generate approximately \$491,000 in value-added (sometimes referred to as gross domestic product) and \$261,000 in labor income. The labor income expenditures would support or create 5.72 jobs (full and part-time workers). As shown in Table 5, over 60 economic sectors would benefit from this level of increased spending.

**Table 5. Economic Impact Analysis of \$1M Opportunity Cost to San Diego County Business Employees & Proprietors**

IMPLAN Sector	Description	Jobs <sup>1</sup>	Value Added (GDP) <sup>2</sup>
<b>Sorted by Number of Jobs</b>			
413	Food services and drinking places	0.62	\$22,537
394	Offices of physicians, dentists, and other health practitioners	0.37	\$31,007
426	Private household operations	0.22	\$2,123
324	Retail Stores - Food and beverage	0.21	\$10,059
360	Real estate establishments	0.20	\$34,773
319	Wholesale trade businesses	0.20	\$28,010
329	Retail Stores - General merchandise	0.20	\$9,600
397	Private hospitals	0.19	\$16,615
398	Nursing and residential care facilities	0.18	\$7,337
356	Securities, commodity contracts, investments, and related activities	0.17	\$4,361
320	Retail Stores - Motor vehicle and parts	0.12	\$7,927
355	Nondepository credit intermediation and related activities	0.12	\$10,698
327	Retail Stores - Clothing and clothing accessories	0.12	\$4,250
331	Retail Nonstores - Direct and electronic sales	0.12	\$3,982
400	Individual and family services	0.11	\$3,021
392	Private junior colleges, colleges, universities, and professional schools	0.10	\$4,711
330	Retail Stores - Miscellaneous	0.10	\$3,803
425	Civic, social, professional, and similar organizations	0.09	\$3,411

IMPLAN Sector	Description	Jobs <sup>1</sup>	Value Added (GDP) <sup>2</sup>
<b>Sorted by Number of Jobs</b>			
396	Medical and diagnostic labs and outpatient and other ambulatory care services	0.08	\$7,479
382	Employment services	0.08	\$2,965
325	Retail Stores - Health and personal care	0.07	\$4,425
367	Legal services	0.07	\$9,872
388	Services to buildings and dwellings	0.07	\$2,511
419	Personal care services	0.07	\$2,830
357	Insurance carriers	0.07	\$14,578
393	Other private educational services	0.07	\$2,303
401	Community food, housing, and other relief services, including rehabilitation services	0.06	\$1,412
391	Private elementary and secondary schools	0.06	\$1,603
414	Automotive repair and maintenance, except car washes	0.06	\$3,219
399	Child day care services	0.06	\$1,659
354	Monetary authorities and depository credit intermediation activities	0.06	\$11,735
409	Amusement parks, arcades, and gambling industries	0.05	\$3,332
323	Retail Stores - Building material and garden supply	0.05	\$3,273
424	Grantmaking, giving, and social advocacy organizations	0.05	\$2,124
328	Retail Stores - Sporting goods, hobby, book and music	0.05	\$2,029
	Other Misc. Sectors	1.21	\$205,728
	<b>Total</b>	<b>5.72</b>	<b>\$491,303</b>
<sup>1</sup> reflects full- and part-time employment			
<sup>2</sup> annual impacts include: employee compensation, proprietor income, other business income and state/local tax payments.			
Source: Minnesota IMPLAN Group, Inc.; 2010 IMPLAN model for San Diego County, analysis by FCS GROUP. Results shown are in 2012 dollars.			

#### A.4 Summary of Findings and Recommendations

This economic impact analysis is intended to provide a consistent method of comparing and measuring the economic benefits on the San Diego County economy as measured by employment, income, value added and economic output. A summary of the economic impacts of induced household and business spending on the local/regional economy is presented in Table 6.

**Table 6. Economic Impact of \$1M Additional Spending in San Diego County**

Metric	Annual Impact of \$1M in Additional Household Spending	Annual Impact of \$1M in Additional Business Employee & Proprietor Spending
Employment <sup>1</sup>	6.9	5.7
Labor Income	\$318,897	\$261,526
Value Added <sup>2</sup>	\$595,210	\$491,323
Output <sup>3</sup>	\$932,179	\$766,227
Notes:		
<sup>1</sup> reflects full- and part-time employment.		
<sup>2</sup> value added is commonly referred to as gross domestic product, and includes: employee compensation, proprietor income, other business income and state/local tax payments.		
Source: Minnesota IMPLAN Group, Inc.; 2010 IMPLAN model for San Diego County, analysis by FCS GROUP. Results shown are in 2012 dollars.		

As noted above, while the IMPLAN model provides a method to quantify economic impacts of additional household and business spending attributed to changes in spending patterns; it is recommended that the economic impact analysis be refined to also consider the following factors:

- ◆ Local/regional impacts in San Diego County associated with decreased revenues allocated to local/regional utility service providers; and
- ◆ Regional or state-level impacts associated with reallocating utility costs from San Diego County to other counties in California.



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Michael G. Colantuono  
MColantuono@CLLAW.US  
(530) 432-7359

Colantuono & Levin, PC  
300 S. Grand Avenue, Suite 2700  
Los Angeles, CA 90071  
Main: (213) 542-5700  
FAX: (213) 542-5710  
WWW.CLLAW.US

March 10, 2012

Mr. Jack Foley, Chairman and Members of the Board  
Metropolitan Water District of Southern California  
P.O. Box 54153  
Los Angeles, CA 90054-0153

Re: **Proposed Water Rates to be Effective January 1, 2013**

Dear Chairman Foley and Members of the Board:

**Introduction and Summary of Conclusions.** I write on behalf of the San Diego County Water Authority to express the basis of our conclusion that the proposed water rates that Metropolitan's staff recommends for Board adoption on March 12, 2010 do not comply with industry practice or California law. This opinion is based on our review of the rates, Board letters for the March 8<sup>th</sup> Board meeting and the January 24<sup>th</sup> workshop and attachments that purport to justify them, and an exchange of letters between Metropolitan and the Water Authority dated March 6<sup>th</sup> and 5<sup>th</sup>, respectively. We have also reviewed the Bartle Wells Associates memorandum dated March 8, 2012 as well as our April 12, 2010 letter and the materials referenced in that letter and the March 2012 Metropolitan Water District Cost of Service Rate Review report from FCS Group. For the reasons expressed below, we conclude the proposed rates do not reflect industry practice and are not consistent with the requirements of California law. In particular, the rates as proposed do not meet Metropolitan's legal obligation to adopt rates which reflect the actual, reasonable and proportionate cost of serving each customer of Metropolitan. Accordingly, we urge your Board to refrain from adopting these rates and to direct Metropolitan staff to revise the proposed rates to address the issues identified in the Bartle Wells memorandum, this letter, and correspondence and testimony provided by the Water Authority prior to your adoption in 2010 of the rates now in effect.

**Discussion.** Metropolitan is legally obligated to impose, and claims that it has imposed, a rate structure that reflects costs to serve its various customers that are real, reasonable, and proportionate to the cost of service. This obligation derives from Metropolitan's principal act, Proposition 13 and statutes implementing it, Government Code § 54999.7, the common law of utility rate-making developed by California courts and the requirements of Proposition 26, added to the California Constitution in November 2010.

METROPOLITAN'S PRINCIPAL ACT. Water Code Appendix § 109-134 (West's) states that Metropolitan's rates "shall be uniform for like classes of service throughout the district."

Metropolitan may not establish rates that discriminate between similarly situated customers. Rather, Metropolitan's rates must apportion costs equitably among its customers.

PROPOSITION 13 AND ITS IMPLEMENTING STATUTES. Prop. 13 requires two-thirds voter approval of "special taxes." Cal. Const., art XIII A, § 4. The Legislature implemented that section by adopting Government Code § 50076, which states:

As used in this article, "special tax" shall not include any fee which does not exceed the reasonable cost of providing the service or regulatory activity for which the fee is charged and which is not levied for general revenue purposes.

Unless Metropolitan intends to obtain voter approval of its rates as special taxes, those rates must comply with this exception to Proposition 13 and be limited to the "reasonable cost of providing the service ... for which the fee is charged." The courts have amplified this standard. *Beaumont Investors v. Beaumont-Cherry Valley Water District*, 165 Cal.App.3d 227, 234-35 (1985), involved a challenge to a water connection fee imposed by the defendant district on the plaintiff apartment developer. That court articulated the cost-limitation principle of Proposition 13 for water rates and charges as follows:

Both plaintiff and defendant agree that the facilities fee enacted by defendant, if reasonably related to the cost of the service for which it was imposed, would fall within the scope of the "service" fee defined by Government Code section 50076, and would thus lie outside of the definition of "special tax" as contemplated by Proposition 13. Both agree further that defendant, a statutorily created irrigation district, is within the ambit of Proposition 13.

Hence, the sole issue before us boils down to whether the record demonstrates that the facilities fee sought to be imposed by defendant does or does not "exceed the reasonable cost" of constructing the water system improvements contemplated by the District. Such a showing would require, at the minimum, evidence of (1) the estimated construction costs of the proposed water system improvements, and (2) the District's basis for determining the amount of the fee allocated to plaintiff, *i.e.*, the manner in which defendant apportioned the contemplated construction costs among the new users, **such that the charge allocated to plaintiff bore a fair or reasonable relation to plaintiff's burden on, and benefits from, the system.** (*Mills v. County of Trinity, supra*, 108 Cal.App.3d at pp. 659-660, 166 Cal.Rptr. 674; *County of Fresno v. Malmstrom* (1979) 94 Cal.App.3d 974, 983-985, 156 Cal.Rptr. 777.) (Emphasis added.)

Thus, Metropolitan's rates must not only be limited to the "reasonable cost" of providing services for which those rates are imposed, those rates must also "bear a fair or reasonable relation to [each customer's] burden on, and benefits from, the [water] system." Accordingly,

Proposition 13 requires that water rates be proportionate to the cost of service to each customer just as does Metropolitan's principal act. Other cases imposing this proportionate-cost standard include *San Diego Gas & Electric Company v. San Diego County Air Pollution Control District*, 203 Cal.App.3d 1132 (1988) (regulatory fees must be proportionate to cost of regulating each fee payor).

THE *SAN MARCOS* LEGISLATION. Adopted in the wake of *San Marco Water District v. San Marcos Unified School District* (1986) 42 Cal.3d 154, Government Code § 54999.7 applies to rates one public utility agency charges another "for any product, commodity or service." As relevant here, it has two principal requirements:

1. "Such a fee for public utility service ... shall not exceed the reasonable cost of providing the public utility service" *Id.*, subd. (a).
2. "A fee, including a rate, charge, or surcharge, for any product, commodity, or service provided to a public agency, shall be determined on the basis of the same objective criteria and methodology applicable to comparable nonpublic users, based on customer classes established in consideration of service characteristics, demand patterns, and other relevant factors. *Id.*, subd. (b).

Thus, Metropolitan bears the burden to prove, as discussed further below, that the rates it charges the Water Authority do not exceed the reasonable cost of the services provided and that its rates are determined on the basis of customer classes that reflect "service characteristics, demand patterns, and other relevant factors." This it has failed to do.

COMMON LAW OF UTILITY RATEMAKING. Even before the 1978 adoption of Proposition 13, California law required utility rates established by local governments like Metropolitan to be fair, reasonable, and proportionate to the cost of service. This body of judge-made, or common, law includes *Elliott v. City of Pacific Grove*, 54 Cal.App.3d 53, 59 (1975), which described the pre-Proposition 13 rate-making standard in rejecting a demurrer to a challenge to a differential sewer rate imposed on customers outside the defendant city:

[W]e conclude that plaintiffs have stated a cause of action. The complaint ... alleges sufficient facts warranting judicial relief if such facts can be established at trial. It is alleged therein that the ordinance in question sets a sewer service charge for plaintiffs, who are users outside the city limits, at four times the rate set inside the city limits without any proper basis for the differential. This is an allegation that the sewer charge imposed on plaintiffs is unreasonable. **There exists in plaintiffs, as users of a public utility's sewer service, a primary right that they cannot be charged an unreasonable rate for such service and there rests on the city, as a public utility, the corresponding duty not to charge plaintiffs an unreasonable rate for such service.** The complaint seeks to enforce

defendants' obligation to charge a reasonable rate. Having stated a cause of action it will be incumbent upon plaintiffs at trial to sustain **the burden of showing that the rates charged them are unreasonable and, therefore, discriminatory.** (Emphasis added.)

Similarly, in *Boynton v. City of Lakeport Mun. Sewer Dist. No. 1*, 28 Cal.App.3d 91, 94 (1972), the Court of Appeal reiterated that rates "must be reasonable, fair and equitable." In particular, they "must be proportional and not in excess of the benefits received." *Id.* at 95. "[I]f the difference in rates is based upon a reasonable and fair difference in conditions which equitably and logically justify a different rate, it is not an unjust discrimination." *Id.* at 97-98 quoting 12 McQuillin, *Municipal Corporations*, § 34.101, p. 231. Ultimately, the *Boynton* court found irrational and discriminatory the defendant district's practice of charging higher minimum rates to commercial users with the same number of meters as other users charged less. *Id.* at 98. Thus, the pre-Proposition 13 common law of utility rate-making also requires rates to be reasonable and non-discriminatory.

PROPOSITION 26. Unlike Proposition 218, Proposition 26 applies to water wholesalers, as well as retailers. It has significantly altered the legal standards applicable to Metropolitan's ratemaking, yet Metropolitan has made no effort to augment the evidentiary basis for its rates to acknowledge this new obligation. Thus the errors we pointed out in 2010 are more profoundly obvious now. In essence, Proposition 26, Article XIII C, § 1, subd. (e) of the California Constitution, defines all local government revenue measures as taxes requiring voter approval unless one of seven stated exceptions applies. The exception relevant here allows Metropolitan to act without voter approval to establish:

A charge imposed for a specific government service or product provided directly to the payor that is not provided to those not charged, and which does not exceed the reasonable costs to the local government of providing the service or product

Cal. Const. art. XIII C, § 1, subd. (e)(2). Thus, for every charge Metropolitan imposes on the Water Authority, it must show that it does not provide that same service or product "to those not charged" and that the charges do not exceed Metropolitan's "reasonable costs" to provide that service or product.

More importantly, Proposition 26 substantially alters Metropolitan's burden of proof in disputes adjudicated after the November 2010 effective date of the measure:

The local government bears the burden of proving by a preponderance of the evidence that a levy, charge, or other exaction is not a tax, that the amount 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. XIII C, § 1, subd. (e), unnumbered final paragraph. Thus, it is Metropolitan's burden to provide that the rates it charges the Water Authority:

1. Are not taxes on any legal theory;
2. Are not "more than necessary to cover the reasonable costs" of service; and,
3. "[T]he manner in which those costs are allocated to [the Water Authority] bear a fair or reasonable relationship to the [Water Authority's] burdens on, or benefits received from" Metropolitan's services.

In sum, Metropolitan's principal act, Proposition 13 and the statutes implementing it, Government Code § 54999.7, the common law of utility rate-making, and Proposition 26 all require Metropolitan to bear the burden to prove that its rates reflect costs of service that are:

1. actual;
2. reasonable;
3. proportionate to the cost of serving the customers which pay those rates and to those customers' benefits from or burdens on the service;
4. determined on the basis of customer classes that consider service characteristics, demand patterns and other relevant factors; and,
5. do not charge the Water Authority for services or facilities provided to those who are not charged.

**METROPOLITAN'S RATES VIOLATE THESE RULES, INDUSTRY PRACTICE AND PUBLIC POLICY.** Metropolitan's rates violates these legal requirements because, as opinions prepared by Bartle Wells & Associates dated March 5, 2010, April 12, 2010, and March 8, 2012 and by the FCS Group dated March 10, 2012 ("the Opinions") demonstrate, Metropolitan recovers most of its cost of obtaining a water supply via the State Water Project (SWP) from rates that are not charged solely in connection with obtaining Metropolitan's supplies. Instead these costs are allocated to Metropolitan's conveyance and aqueduct service function and recovered through rates imposed for the use Metropolitan's conveyance system. Similarly, the Water Stewardship Rate recovers costs that should be allocated to supply customers, but that are instead borne by all customers, including transportation customers like the Water Authority. These improper rates - have the effect of over-charging for transportation and undercharging for water supply. Accordingly, this proposed rate structure does not comply with the duty to impose rates that are

fair, reasonable, proportionate to the cost of service to each customer, determined on the basis of appropriate customer classes, and do not include charges for services or facilities provided to those who are not charged.

Though the California Public Utilities Commission does not regulate public agency water utilities like Metropolitan, its accounting guidelines for water utilities are nevertheless instructive as to the reasonableness of Metropolitan's allocation of its SWP costs, particularly in light of Metropolitan's claim that its rates have been peer-reviewed and reflect industry standard practices. *Uniform System of Accounts for Water Utilities* (Cal. Pub. Util. Comm'n, 1955). Those guidelines require a separate expense category for "Source of Supply Expenses," which includes an account for "purchased water." Section 704 of those guidelines provides as follows:

A. This [purchased water] account shall include the cost at the point of delivery of water purchased for resale. This includes charges for readiness to serve and the portion applicable to each accounting period of annual or more frequent payments for the right to divert water at the source of supply.

B. The records supporting this account shall be so kept as to show for each supplier from which water is purchased, point of delivery, quantity purchased, basis of charges, and the cost of water purchased.

Stated in essentially identical language is § 610 of the Uniform System of Accounts for Class A Water Utilities (1996) published by the National Association of Regulatory Utility Commissioners (NARUC), which requires separate cost accounting for water purchase costs, as follows:

610. Purchased Water

A. This account shall include the cost at the point of delivery of water purchased for resale.

B. The records supporting this account shall be so kept as to show for each supplier from which water is purchased, point of delivery, quantity purchased, basis of charges, and the cost of water purchased.

These NARUC standards are incorporated in the American Water Works Association's Manual M-1, Principles of Water Rates, Fees and Charges. Metropolitan claims to comply with both the NARUC standards and the AWWA Manual. Yet, as the Opinions note, rather than identifying its SWP costs as water supply costs, Metropolitan "functionalizes" purchased water costs into non-supply accounts in a manner which is not consistent with the AWWA Manual.

Given the terms of the "November 4, 1960 Contract Between the Metropolitan Water District of Southern California and the State of California Department of Water Resources for a Water Supply" as amended to date ("Metropolitan SWP agreement"), all the costs Metropolitan pays the Department of Water Resources (DWR) for a water supply under that agreement should be assigned to a "purchased water," or Supply, account. Indeed, the very title of the Metropolitan SWP Agreement suggests as much. Thus, Metropolitan's practice of including its SWP costs in its wheeling and exchange rates plainly deviates from industry standards.

Further evidence on this point is found in Raftelis, **Comprehensive Guide to Water and Wastewater Finance and Pricing**, 2<sup>nd</sup> Ed., 1993, pp. 168-69, in which Metropolitan's own cost-of-service consultant concludes that costs arising from water purchases, supply development, and conservation are "supply" costs and not conveyance, transmission or distribution costs.

In an April 5, 2010 memo, your General Manager and General Counsel admit that Metropolitan treats its costs under the Metropolitan SWP Agreement just as it does costs for maintaining and operating the Colorado River Aqueduct (CRA). The memo claims Metropolitan may do so because it wheels some water through the SWP and cites *Goodman v. County of Riverside*, 140 Cal.App.3d 900, 903-04 (1983), for the proposition that Metropolitan may differentiate transportation and supply costs for service over the SWP. While we do not address here the propriety of Metropolitan's charges for wheeling service across the SWP, we note the California Supreme Court's conclusion that Metropolitan is merely a customer of the SWP in *Metropolitan Water District v. Marquandt*, 59 Cal.2d 159, 201-202 (1963) ("The [Metropolitan] does not obtain ownership of any facilities, ownership by the state being expressly provided for [by the Metropolitan SWP Agreement].") Thus, Metropolitan's claims are unpersuasive and do not justify its treatment of the amounts it pays DWR for imported water service as a cost of transporting water across its own system within Southern California.

Charging some customers more than the cost of service determined under industry standards and generally accepted cost allocation principles, and concomitantly charging other customers less than the cost of service, amounts to a cross-subsidy between customers. Such cross-subsidies violate each of the legal authorities identified above.

As the Opinions note, overcharging for some services and undercharging for others also distorts customers' decisions to use imported water rather than reducing demand, conserving water, developing additional local supplies and pursuing water transfers from agricultural and other users. In so doing, Metropolitan's rate structure frustrates the policy objectives of the State



of California and the Metropolitan Board itself, as each has stated commitments to encourage conservation,<sup>1</sup> the development of local water sources,<sup>2</sup> and the development of a water market.<sup>3</sup>

COUNTER-ARGUMENTS OF STAFF AND RAFTELIS ARE UNPERSUASIVE. Metropolitan's rate consultant concluded in an April 6, 2010 Raftelis Report that Metropolitan's rates comply with California law because they are updated at least once every 10 years, as required by Government Code § 54999.7. April 6<sup>th</sup> Raftelis Report at pp. 1 and 10. This is not correct. The rate-setting standards of § 54999.7 and the *San Marcos* statute more generally require more than a once-a-decade review of costs.<sup>4</sup> As discussed above, these standards require that rates be actual, reasonable and proportionate to the cost of service. As the Opinions demonstrate, Metropolitan's proposed rates do not comply with these standards and the April 6<sup>th</sup> Raftelis Report's conclusion to the contrary is both unsupported and unpersuasive. Indeed, that report concedes Metropolitan's capacity and readiness-to-serve charges exceed Metropolitan's actual costs. April 6<sup>th</sup> Raftelis Report at pp. 2 and 14.

More generally, the April 6<sup>th</sup> Raftelis Report provides no explanation why Metropolitan's review of compliance with California law is limited to, "specifically Government Code § 54999.7 (requiring a COS study every 10 years)." The report thus suggests that compliance with § 54999.7's 10-year cost-of-service review requirement amounts to compliance with all relevant provisions of California law. As described above, California law demands more of Metropolitan than this.

Similarly, the April 6<sup>th</sup> Raftelis Report claims Metropolitan's rates comply with its principal act because those rates are sufficient to cover its costs,<sup>5</sup> reflect the costs of the District's major service functions and are uniform for like classes of service throughout the District. April 6<sup>th</sup> Raftelis Report at pp. 1 and 10. However, these bald statements are unsupported by

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<sup>1</sup> The State's commitment to promoting water conservation is stated at Water Code §§ 10608 and 10608.4, recently adopted to impose a 20% conservation standard on urban water providers. Metropolitan's commitment is stated in the justification for its 2001 rate structure. *See, e.g.*, January 8, 2002 Board Letter 9-1 at page 1.

<sup>2</sup> Water Code § 10608(c) states the Legislature's finding that "(c) Diverse regional water supply portfolios will increase water supply reliability and reduce dependence on the Delta." Metropolitan's commitment to the development of local water sources is stated in the October 16, 2001 Board Letter No. 9-6 at page 2.

<sup>3</sup> Water Code §§ 109(b) and 475 state the Legislature's support for water transfers and the development of a water market. Metropolitan support for these goals is stated in the October 16, 2001 Board Letter No. 9-6 at page 2.

<sup>4</sup> Nor is it clear that Metropolitan has satisfied even this limited view of California law given that the cost of service study on which Metropolitan claims to rely is based on a study performed in 1998 — some 14 years ago.

<sup>5</sup> This statement also appears to be false. As stated at note 5 on page 60 of the second attachment to your February 14, 2012 Board Letter 8-2, the Metropolitan's expenditures exceeded its revenues in three of the last four fiscal years. This fact, combined with Metropolitan's failure to track reserve use by rate component (with one exception) creates a significant likelihood of cross-subsidies in that rate reserves arise from rate components that disproportionately fall on certain customers — like the System Access Rate imposed on transportation services to the Water Authority — while the benefits accrue to others — like water supply customers of which the Water Authority is but one.

discussion or analysis and are rebutted by the Opinions. Moreover, the April 6<sup>th</sup> Raftelis Report concedes that Metropolitan treats SWP and CRA costs alike which, as demonstrated above, neither law nor industry practice permits. *Id.* at 7.

Your General Manager and General Counsel also claim that Metropolitan's Water Stewardship rate is appropriately applied to transportation rates because the demand management and local supply development efforts funded by that rate lower the capital costs of the Metropolitan system for the benefit of all its customers and it is therefore appropriate that all customers pay that rate. April 5<sup>th</sup> Memo at 3-4. This begs the question. It is not enough to show that particular costs Metropolitan incurs benefit its customers. To bear its burden to defend its rates, Metropolitan must also show what portion of that benefit accrues to each class of Metropolitan customers, that its customer classes are appropriately defined, and that Metropolitan's rates fairly apportion costs to those who benefit from them. Thus your Manager and Counsel essentially admitted in 2010 that Metropolitan has not done the cost-accounting and rate-design tasks required by industry practice and by law to support application of the Water Stewardship rate to rates for water transportation. Given that you propose to act on essentially the same record developed in 2010, with no effort to address the new requirements of Proposition 26, Metropolitan's failure to comply with the law is now all the more obvious.

Similarly, the April 6<sup>th</sup> Raftelis Report suggests that the water conservation and local water supply development efforts funded by the Water Stewardship rate are properly charged to water transportation customers because those efforts conserve capacity in distribution lines that can be used for transportation. This reasoning, however, neglects two facts: first, Metropolitan is not obligated to provide transportation services that it cannot provide due to a lack of capacity;<sup>6</sup> second, we understand that Metropolitan has not in recent years come close to its capacity to deliver water and does not expect to do so in the years it has forecasted; indeed demand for its product is falling steeply. Moreover, the Opinions demonstrate that the record now before you provides absolutely no basis to conclude that WSR programs have any benefit to Metropolitan's transportation function. Rather, Metropolitan has substantial excess capacity in its transportation systems and the dearth of demand which makes that so is likely to continue, both as Metropolitan better estimates its own future and as the Opinions suggest is likely due to State conservation mandates, higher water rates generally, and the increasingly high cost of Metropolitan water as compared to local alternatives.

Thus, Metropolitan need incur no costs to generate excess capacity in its system to facilitate transportation for the Water Authority and others and therefore ought not to assign costs to do so on the basis of water conservation efforts. Again, Metropolitan's counter-arguments are simply unpersuasive and insufficient to justify a rate structure that violates law, industry practice, and public policy.

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<sup>6</sup> Water Code § 1810.

Metropolitan Water District of Southern California  
March 10, 2012  
Page 10

**Conclusion.** As demonstrated above, Metropolitan's proposed rates violate the legal requirements of Metropolitan's principal act, Proposition 13 and the statutes implementing it, Government Code § 54999.7, the California common law of utility rate-making and Proposition 26. Those rates are also inconsistent with industry practice. The proposed rates fail to fairly apportion SWP costs and the costs recovered by the Water Stewardship rate to reflect the actual, reasonable and proportionate costs of the services for which those rates are imposed.

On behalf of the San Diego County Water Authority we urge your Board not to adopt the proposed rates, but to instruct Metropolitan staff to propose a revised rate structure that complies with California law and public policy as expressed by the Legislature and the Metropolitan Board. As was the case with our April 12, 2010 letter to your Board, the review reflected here is limited to the matters upon which an opinion is expressed.

Very truly yours,



Michael G. Colantuono

MGC:mgc

c: San Diego County Water Authority





## San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233  
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

April 26, 2012

Jeffrey Kightlinger, General Manager  
The Metropolitan Water District of Southern California  
P.O. Box 54153  
Los Angeles, CA 90054-0153

#### MEMBER AGENCIES

Carlsbad  
Municipal Water District

City of Del Mar

City of Escondido

City of National City

City of Oceanside

City of Poway

City of San Diego

Fairbrook  
Public Utility District

Helix Water District

Lakeside Water District

Clivenhain  
Municipal Water District

Otay Water District

Padre Dam  
Municipal Water District

Camp Pendleton  
Marine Corps Base

Rainbow  
Municipal Water District

Ramona  
Municipal Water District

Rincon del Diabla  
Municipal Water District

San Diego Water District

Santa Fe Irrigation District

South Bay Irrigation District

Vallecitos Water District

Valley Center  
Municipal Water District

Vista Irrigation District

Yuma  
Municipal Water District

#### OTHER REPRESENTATIVE

County of San Diego

Re: Request for Negotiation under Paragraph 11.1 of the Amended and Restated Agreement between the Metropolitan Water District of Southern California and the San Diego County Water Authority for the Exchange of Water dated October 10, 2003 ("Exchange Agreement").

Dear Mr. Kightlinger,

On April 10, 2012, the Board of Directors of the Metropolitan Water District of Southern California took final action to set water rates and charges, effective January 1, 2013 and January 1, 2014. As you know, the San Diego County Water Authority believes that the rates to be charged to the Water Authority under the Exchange Agreement for 2013 and 2014 are contrary to "cost of service" principles and applicable California law. The Water Authority presented oral testimony and documents for inclusion in the record of the March 12 and 13 and April 9 and 10, 2012 meetings of the Finance and Insurance Committee and Board of Directors, which testimony and documents stated the basis for the Water Authority's objections to these rates. The Water Authority has exhausted all administrative opportunities available to it pursuant to Metropolitan's public board process. The Water Authority is unaware of any further requirement or administrative opportunity available to it pursuant to Metropolitan's public board process to contest whether the action taken by Metropolitan's Board of Directors is lawful. Please advise us immediately if such a process exists.

Paragraph 5.2 of the above referenced 2003 Exchange Agreement provides that the "Price" paid by the Water Authority to Metropolitan under the Exchange Agreement "shall be equal to the charge or charges set by Metropolitan's Board of Directors pursuant to applicable law and regulation and generally applicable to the conveyance of water by Metropolitan on behalf of its member agencies." Metropolitan's 2013 and 2014 rates violate applicable law in breach of paragraph 5.2.

*A public agency providing a safe and reliable water supply to the San Diego region*

Jeffrey Kightlinger, General Manager  
Re: Request for Negotiation  
April 26, 2012  
Page 2

Paragraph 11.1 of the Exchange Agreement provides that Metropolitan and the Water Authority will use reasonable best efforts to resolve all disputes, including Price Disputes, arising under the agreement by negotiation, before resorting to legal or equitable remedies. To this end, the Water Authority requests a meeting between our respective staff and board leadership to see if there is any basis upon which we can resolve our disputes. Please provide your response by May 4, 2012. If Metropolitan agrees to participate in the requested negotiations, please identify dates in May when the appropriate personnel are available. If we do not receive a response by May 4, we will reasonably construe your failure to respond as Metropolitan's decision to decline our invitation to negotiate and as a knowing, intentional waiver of the provisions of paragraph 11.1. We will appreciate your prompt response so that the meeting can be scheduled.

Sincerely,

A handwritten signature in black ink, appearing to read "Maureen A. Stapleton". The signature is fluid and cursive, with a prominent initial "M" and "S".

Maureen A. Stapleton  
General Manager

Cc: Marcia Scully, General Counsel





THE METROPOLITAN WATER DISTRICT  
OF SOUTHERN CALIFORNIA

Office of the General Manager

May 4, 2012

Maureen A. Stapleton  
General Manager  
San Diego County Water Authority  
4677 Overland Avenue  
San Diego, CA 92123-1233

April 26, 2012 SDCWA Letter re Request for Negotiation under Paragraph 11.1 of the Amended and Restated Agreement between the Metropolitan Water District of Southern California and the San Diego County Water Authority for the Exchange of Water dated October 10, 2003 ("Exchange Agreement")

Dear Ms. Stapleton:

This letter responds to your letter of April 26, 2012 requesting a negotiation meeting under Paragraph 11.1 of the Exchange Agreement.

First, as is apparent from the Water Authority's pending litigation against Metropolitan, the Authority's dispute with respect to the Exchange Agreement and Metropolitan's rates solely concerns Metropolitan's rate structure that was approved by its Board of Directors in 2001 and took effect in 2003. The rates for 2013 and 2014 that the Board adopted in April 2012 are based on this rate structure. Pursuant to California law, the Board's rate-setting decisions are legislative acts that the Board determined by a majority vote in a publicly noticed, open session. The Board engaged in a months-long process, in which the Water Authority and many others fully participated, to set the 2013 and 2014 rates based on the existing rate structure. Indeed, your letter acknowledges:

"The Water Authority presented oral testimony and documents for inclusion in the record of the March 12 and 13 and April 9 and 10, 2012 meetings of the Finance and Insurance Committee and Board of Directors, which testimony and documents stated the basis for the Water Authority's objections to these rates. The Water Authority has exhausted all administrative opportunities available to it pursuant to Metropolitan's public board process."

There is no "meeting between our respective staff and board leadership," as you have requested, which could reverse the Board's majority vote.



Maureen A. Stapleton  
May 4, 2012  
Page 2

Second, as you know, the parties have already engaged in and completed dispute resolution under Paragraph 11.1. The Water Authority sent a nearly identical letter to Metropolitan on May 3, 2010, before the Water Authority filed its litigation. Metropolitan accepted the Water Authority's offer to engage in negotiations, and the Water Authority responded in a June 7, 2010 letter that "[t]he Water Authority team looks forward to beginning negotiations and hopes that we will be able to come to an agreement without the need for protracted litigation."

Representatives of Metropolitan and the Water Authority met and engaged in negotiations on June 23, 2010, despite the fact that the Water Authority had proceeded with filing a lawsuit on June 11, 2010. As the Water Authority subsequently stated in a June 30, 2010 letter: "the Water Authority and Metropolitan have satisfied the requirement of paragraph 11.1 of the 2003 exchange agreement to use reasonable best efforts to resolve all disputes, including Price Disputes, arising under the agreement by negotiation before resorting to legal or equitable remedies." The Water Authority also stated its opinion that "further negotiations [sic] would not be productive . . . ." Thereafter, in February 2011, the Water Authority requested and Metropolitan agreed to place the Authority's payments under the Exchange Agreement in a separate interest-bearing account.

Metropolitan is not aware of any areas of negotiation between the Water Authority and Metropolitan that were not already exhausted, and that are not legislative decisions that under California law only Metropolitan's Board can make through majority vote. However, if the Water Authority believes there are any areas of further negotiation that would be productive, please let us know.

Separately, your letter asks Metropolitan to confirm that there is not "any further requirement or administrative opportunity available to [the Water Authority] pursuant to Metropolitan's public board process to contest whether the action taken by Metropolitan's Board of Directors is lawful." You are correct that the Water Authority has fully engaged in Metropolitan's public Board process concerning its adoption of its 2013 and 2014 rates.

Accordingly, we see no need for a further meeting at this time pursuant to Paragraph 11.1 of our agreement, but feel free to contact us if you believe there are items that we could fruitfully discuss.

Very truly yours,

  
Jeffrey Kightlinger  
General Manager

cc: Marcia Scully, General Counsel, Metropolitan Water District of Southern California





## San Diego County Water Authority

4677 Overland Avenue • San Diego, California 92123-1233  
(858) 522-6600 FAX (858) 522-6568 www.sdcwa.org

April 26, 2012

Dawn Chin, Executive Secretary  
Metropolitan Water District of Southern California  
P.O. Box 54153  
Los Angeles, CA 90054-0153

#### MEMBER AGENCIES

Carlsbad  
Municipal Water District

City of Del Mar

City of Escondido

City of National City

City of Oceanside

City of Poway

City of San Diego

Fallbrook  
Public Utility District

Helix Water District

Lakeside Water District

Oliverain  
Municipal Water District

Otay Water District

Padre Dam  
Municipal Water District

Camp Pendleton  
Marine Corps Base

Rainbow  
Municipal Water District

Ramona  
Municipal Water District

Rincon del Diabla  
Municipal Water District

San Dieguito Water District

Santa Fe Irrigation District

South Bay Irrigation District

Vallecitos Water District

Valley Center  
Municipal Water District

Vista Irrigation District

Yuima  
Municipal Water District

#### OTHER REPRESENTATIVE

County of San Diego

Re: Claim for Breach of Contract Pursuant to Metropolitan Administrative Code § 9302 and California Government Code §§ 900 *et seq.*

Dear Ms. Chin:

The San Diego County Water Authority submits this claim for refund or damages for breach of contract pursuant to Metropolitan's Administrative Code sections 9300 *et seq.* and California Government Code sections 900 *et seq.* The Water Authority believes that Metropolitan has breached Paragraph 5.2 of the Amended and Restated Agreement between the Metropolitan Water District of Southern California and the San Diego County Water Authority for the Exchange of Water dated October 10, 2003, as described below. The Water Authority explicitly reserves its rights and hereby gives notice that it may bring suit for breach of contract against Metropolitan. Pursuant to Metropolitan Administrative Code section 9302 and Government Code section 910, the Water Authority provides the following information:

(a) Name and address:

San Diego County Water Authority  
4677 Overland Avenue  
San Diego, CA 92123-1233

(b) Address to which notices are to be sent:

Maureen A. Stapleton, General Manager  
Daniel S. Hentschke, General Counsel  
4677 Overland Avenue  
San Diego, CA 92123-1233

(c) Date, place, and other circumstances of the occurrence or transaction which gave rise to the claim asserted:

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Re: Claim for Breach of Contract  
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Adoption, imposition, billing, and collection of rates and other charges not established or imposed "pursuant to applicable law and regulation" from and after April 2012, including without limitation action taken on April 10, 2012, with respect to rates and charges to become effective January 1, 2013 and January 1, 2014. See attachments for further details.

(d) General description of indebtedness, obligation, injury, damage, or loss incurred.

Damages resulting from Metropolitan's breach of paragraph 5.2 of the Amended and Restated Agreement between the Metropolitan Water District of Southern California and the San Diego County Water Authority for the Exchange of Water dated October 10, 2003, including without limitation, damages caused by Metropolitan's unlawful adoption, determination, imposition, billing, and collection of the Price under that paragraph, which reads in part as follows: "the Price shall be equal to the charge or charges set by Metropolitan's Board of Directors pursuant to applicable law and regulation and generally applicable to the conveyance of water by Metropolitan on behalf of its member agencies."

(e) Amount claimed:

All damages caused by the breach, including without limitation attorney fees, expert fees, and litigation expenses, in an amount within the jurisdiction of the Superior Court, according to proof.

Please refer to the attached documents:

Letter dated February 10, 2011 to Jeffery Kightlinger and Karen Tachiki, including enclosure;

San Diego County Water Authority's Second Amended Petition for Writ of Mandate and Complaint for Damages and Declaratory Relief, San Francisco Superior Court Case No. CFP-10-510830;

Letter dated March 12, 2012 to Members of the Finance and Insurance Committee and Members of the Board of Directors, without attachments;

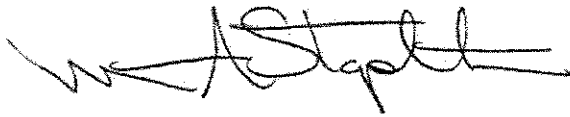
Letter dated March 12, 2012 to Dawn Chin, including attachments (but without the documents listed in attachments); and

Letter dated April 10, 2012 to Members of the Board of Directors, without attachments.

Dawn Chin, Executive Secretary  
Re: Claim for Breach of Contract  
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All attachments and other documents referenced in the above correspondence have previously been provided to Metropolitan and are in its possession. In addition, please see all other oral and written information submitted by the Water Authority for inclusion into the record of the 2012 proceedings for consideration and adoption of Metropolitan's 2013 and 2014 rates, which information is also in Metropolitan's possession.

Sincerely,

A handwritten signature in black ink, appearing to read "Maureen A. Stapleton". The signature is fluid and cursive, with a long horizontal line extending to the right.

Maureen A. Stapleton  
General Manager

Attachments