B119968

IN THE COURT OF APPEAL
OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT
DIVISION FIVE

THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA,

Plaintiff and Appellant,

vs.

ALL PERSONS INTERESTED IN THE MATTER OF THE FOURTH SUPPLEMENTAL RESOLUTION OF COMMERCIAL PAPER,

Defendants and Respondents.

APPEAL FROM THE SUPERIOR COURT FOR LOS ANGELES COUNTY
LAURENCE D. KAY, JUDGE
CASE NO. BC 164076

APPELLANT'S OPENING BRIEF

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INTRODUCTION

A. Background.

Water Code section 1810 prohibits the owner of a water conveyance system from denying a bona fide transferor of water the use of the system to deliver water, provided the system has unused capacity and the owner receives "fair compensation." The dispute here is what constitutes "fair compensation."

Plaintiff The Metropolitan Water District of Southern California (Metropolitan) is a regional water management agency that sells and delivers water to 27 member agencies who in turn serve 16 million residents of southern California. Metropolitan delivers the water through an extensive and costly water conveyance system, which it built and owns. Metropolitan's water rates are set at a level that enables it to recoup, among other costs, the substantial costs of building, operating, and maintaining its conveyance system.

As directed by statute, Metropolitan's Board of Directors, after years of investigation and study and after a public hearing, determined the "fair compensation" Metropolitan would require to allow other water sellers to "wheel" water, i.e., to use Metropolitan's system to deliver water to Metropolitan's member agencies. The Board set the wheeling rates on a uniform, per acre-foot (i.e., "postage-stamp") basis, at a level sufficient to enable Metropolitan to recoup the costs of its system. The Board reasoned that a member agency choosing to purchase water from a third party should pay the same transportation costs it would pay if it purchased the water from Metropolitan. Under this pricing scheme, the costs of Metropolitan's system are borne fairly and equally by all who use the system for water deliveries, based on the amount of water delivered.

Metropolitan pledged the anticipated revenues from wheeling transactions to support its commercial paper obligations. Metropolitan then filed the present action to validate the pledge.

Defendants contended Metropolitan's wheeling rates were unlawful, and the pledge was invalid, because (1) Metropolitan set the rates to recoup the capital costs of its entire water conveyance system, rather than just the capital costs of the specific facilities through which the water would flow in a wheeling transaction, and (2) Metropolitan set the rates on a postage-stamp basis that does not take into account the distance the water travels in Metropolitan's system or the facilities through which the water actually flows.

Metropolitan responded that its rate-setting methodology was lawful under Water Code sections 1810-1814, the statutes that govern wheeling transactions. Metropolitan further contended substantial evidence supported the Board's findings setting the wheeling rates.

The trial court never reached the question whether substantial evidence supported the Board's findings. Instead, it held that the wheeling statutes did not allow Metropolitan to recover either systemwide or capital costs but only the incremental or marginal cost of delivering wheeled water. The court further held that the statutes did not allow Metropolitan to set rates on a postage-stamp basis.

The trial court entered judgment in favor of defendants. In a post-judgment order, the court awarded attorney's fees to defendant Center for Public Interest Law (CPIL) pursuant to the "private attorney general" statute (Code of Civil Procedure section 1021.5) and costs to some of the other defendants. Metropolitan appeals from the adverse judgment and from the order awarding fees and costs.

B. Metropolitan's Contentions.

1. The judgment should be reversed because, contrary to the trial court's decision, the wheeling statutes permit Metropolitan to recover capital and systemwide costs through its wheeling rate.

With respect to capital, Water Code section 1811, subdivision (c), defines "fair compensation" to mean "the reasonable charges incurred by the owner of the conveyance system, including *capital*, operation, maintenance, and replacement costs, increased costs from any necessitated purchase of supplemental power, and including reasonable credit for any offsetting benefits for the use of the conveyance system." (Emphasis added.) The trial court construed the statute to allow recovery of only marginal costs, which by definition do not include capital costs. The court's construction is wrong because the statute specifically provides that "capital" costs may be recovered.

The legislative history confirms that recovery of capital costs was intended. The Legislature specifically rejected a proposal to limit recovery to marginal or incremental costs.

Equally flawed was the trial court's ruling that the wheeling statutes do not permit a system owner to recover systemwide costs but only costs related to specific facilities used in the wheeling transaction. The wheeling statutes distinguish between a conveyance *system* and a *facility* (which is part of a system), and they provide for recovery of reasonable costs incurred by the owner of the *system*. The statutes also define "unused capacity" to mean "space that is available within the operational limits of the conveyance *system*" which the owner is not using and which is sufficient to convey the water. (Wat. Code, § 1811, subd. (e), emphasis added.) Thus, the statutes contemplate that the entire system, not just one or two specific facilities, may be affected by a wheeling transaction.

Indeed, Metropolitan's system is an integrated web of pipes, aqueducts, pumping stations and other facilities that operate together for the benefit of system users. Metropolitan must maintain the entire system if it is to provide wheeling service through any part of the system. The wheeling rate must reflect these systemwide costs. Anything less would not be "fair compensation."

Metropolitan's rate-setting methodology comports with both the Legislature's intent to ensure "fair compensation" for conveyance system owners and the policy behind the wheeling statutes, which was to promote efficient use of water. Metropolitan calculated its wheeling rates to include the same transmission-related costs it includes in the rates for the water it sells. Thus, whether a member agency purchases water from Metropolitan or from a third party, the member pays Metropolitan the same transportation charge, a charge that compensates Metropolitan for its capital investments and systemwide costs.

Under this rate structure, Metropolitan and its member agencies are protected when wheeling transactions displace water sales (which happens whenever a member purchases water from a third party in lieu of purchasing water available from Metropolitan) because Metropolitan still recovers its costs.

If Metropolitan were required to charge a wheeling rate below the transportation charge its members pay when they purchase water from Metropolitan, Metropolitan would be compelled to raise its water rates to make up for the costs it could not recoup in its wheeling rate. For every 200,000 acre-feet of water that a member agency wheeled at marginal cost instead of purchasing full-service, delivered water from Metropolitan, approximately $52 million in costs would be shifted to those member agencies that pay for full service water. Under such a system, ever more member agencies would choose to purchase more expensive water from less efficient third parties because subsidized wheeling at an artificially low price would enable those third parties to undercut Metropolitan's price, which reflects the full cost of transportation. Metropolitan's financial integrity could be impaired, jeopardizing both its ability to fulfill its financial obligations and its ability to provide a reliable water supply for 16 million southern Californians. And who would be willing to make the investments necessary to improve and expand the system if "free riders" could use the system to wheel water at rates insufficient to repay the investments? Metropolitan's rate-setting methodology ensures its continuing viability by forestalling the "free rider" problem.

2. The judgment should be reversed for a second reason: the trial court erred by ruling Metropolitan could not set a uniform postage-stamp wheeling rate for its member agencies. Nothing in the statutes prohibits recovery of "fair compensation" through a uniform rate applicable on a per acre-foot basis as opposed to a "point-to-point" or per-mile basis.

Indeed, Metropolitan is required by law to sell water at a uniform rate. Since Metropolitan charges a postage-stamp rate for the water it *sells*, it is fair, appropriate, and consistent with the legislative rate-setting scheme for Metropolitan to charge a postage-stamp rate for wheeling service. Were Metropolitan to charge a wheeling rate on a point-to-point basis rather than on a uniform, postage-stamp basis, the wheeling rate would not be comparable to the water rate. It would be difficult for Metropolitan to assure its member agencies that they were paying a fair rate for wheeling compared to the rate for water. Moreover, agencies would end up paying dramatically different rates for essentially the same service.

3. The order awarding attorney fees to CPIL should be reversed because CPIL did not satisfy two prerequisites to a fee award under Code of Civil Procedure section 1021.5. CPIL did not establish that it conferred a

significant benefit on the public (the effect of the judgment will be simply to reallocate the cost of water delivery among the residents of Metropolitan's service area), and the trial court did not identify any important public right vindicated in this action.

STATEMENT OF FACTS

A. Overview Of Metropolitan.

Metropolitan is a regional water management agency that imports and provides water to much of southern California. (Exh. 207, p. 271.) Metropolitan sells and delivers the water to 27 member agencies, among which are cities, municipal water districts, and a county water authority. (Exh. 207, p. 272.) The member agencies in turn serve approximately 16 million customers in more than 145 cities and 94 unincorporated communities, a service area of about 5,200 square miles. (Exh. 207, pp. 271-272.) Metropolitan is not just a supplier of water; it also promotes water management through, for example, local resource development, conservation, and seasonal storage. (Exh. 207, p. 260.)

Metropolitan was formed in 1928 to create a financial base large enough to fund construction of the Colorado River Aqueduct.[1] (Exh. 207, p. 271; *City of Pasadena v. Chamberlain* (1928) 204 Cal. 653, 658.) Metropolitan serves a similar purpose to this day. A coordinated approach, beyond the financial capability of any single member agency, will be required

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1/ Metropolitan was formed under the predecessor to and is governed by the current Metropolitan Water District Act, Statutes 1969, chapter 209, as amended, West's Water Code – Appendix (1995 edition and 1999 supplement), sections 109-1 to 109-551. (See Exh. 207, p. 271.)

to ensure a reliable, low-cost water supply for southern California over the next 30 years. (Exh. 207, pp. 271-278, 340.)

Metropolitan is governed by a 51-member Board of Directors. All 27 member agencies are represented by at least one director. (Exh. 3, Exh. B, Att. 1, p. 1; see Stats. 1969, ch. 209, § 51, p. 497, as amended by Stats. 1985, ch. 1531, § 1, West's Wat. Code – App. (1995 ed.) § 109-51.) Defendant San Diego County Water Authority (San Diego), one of the largest of Metropolitan's member agencies, is represented by six directors. (CT p. 646.)[2]

B. Metropolitan's Integrated Water Delivery System.

Metropolitan imports water to Southern California from two sources: (1) the Colorado River; and (2) rivers of northern California tapped by the State Water Project.[3] (Exh. 3, Exh. B, Att. 1, p. 4.) Water from the Colorado

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2/ Two separate Clerk's Transcripts were prepared. The first, consisting of 20 volumes, was prepared for the appeal filed February 13, 1998. The second, consisting of 4 volumes, was prepared for the appeal filed May 5, 1998 (and related cross-appeals). We refer to the 20-volume transcript as "CT" and the 4-volume transcript as "CT2." Because the reporter's transcripts were not consecutively paginated, we refer to them by the dates of hearing.

3/ The State Water Project collects water in northern California and stores it in Lake Oroville. (Littleworth & Garner (1995) California Water p. 24.) From there, the water flows down the Sacramento River, into and across the Sacramento-San Joaquin Delta, and ultimately into the California Aqueduct, which carries the water south 444 miles to users in the Central Valley and southern California, including Metropolitan. (*Id.* at pp. 24, 26.)

Funding for the State Water Project is authorized in the Water Resources Development Bond Act, also known as the Burns-Porter Act (Water Code sections 12930-12944). (Littleworth & Garner, *supra,* pp. 23-24.) The Act authorized the issuance of $1.75 billion in general obligation bonds to assist in financing the State Water Project's construction. (Wat. Code, § 12935; Littleworth & Garner, *supra,* at pp. 23-24.) In order to repay these (continued...)

River flows westward to southern California via the Colorado River Aqueduct, which Metropolitan owns. (Exh. 207, p. 272.) Water from northern California flows southward via the State Water Project's California Aqueduct. (*Ibid.*; Exh. 3, Exh. B, Att. 1, p. 4; see *ante*, fn. 3.)

Once the water reaches southern California, Metropolitan transports and stores the water in its vast, integrated system of interconnecting pipelines, treatment plants, and reservoirs. (Exh. 3, Exh. B, Att. 1, pp. 4-5.) Page 167 of exhibit 206, reproduced on the next page, depicts portions of the Colorado River Aqueduct and the California Aqueduct, together with Metropolitan's water conveyance system.

3/ (...continued)
general obligation bonds, Metropolitan and other agencies (known as "contractors") contract with the Department of Water Resources, which operates the State Water Project, for a share of its water. (Wat. Code, § 12937, subd. (b); Littleworth & Garner, *supra,* at p. 24.) Revenues collected from the contractors repay the general obligation bonds. (Wat. Code, § 12937, subd. (b); Littleworth & Garner, *supra,* at p. 24.) Contractors pay all capital, operating, and maintenance costs, whether or not they actually take water. (Littleworth & Garner, *supra,* at p. 24.)

[INSERT COPY OF APPROPRIATE EXHIBIT.]

Because the facilities that comprise Metropolitan's conveyance system are interconnected, Metropolitan can send water from the California Aqueduct or the Colorado River Aqueduct along more than one route to most member agencies. (Exh. 3, Exh. B, Att. 1, pp. 4-5.) This system gives Metropolitan great flexibility in transporting and storing water. Metropolitan can compensate for an outage on one aqueduct by increasing the use of others. (*Ibid.*) In addition, the integrated system enables Metropolitan to manage water quality by blending waters from different sources. (*Ibid.*)

C. Metropolitan's Expenses And Revenues.

Metropolitan's integrated system has required and continues to require substantial capital investments. (Exh. 3, Exh. B, Att. 1, p. 6.) Metropolitan pays debt service on bonds and cash financing for capital projects. (Exh. 207, p. 346.)

Metropolitan pays for the operation and maintenance of its facilities, an annual expense budgeted in 1996 at $199.7 million. (Exh. 3, Exh. B, Att. 1, pp. 6, 8; Exh. 207, pp. 346-347.) It also pays for water management programs – programs that promote water conservation and recycling, groundwater storage and recovery, and local seasonal storage. (Exh. 207, pp. 341-343.) Its budget for water management was about $29 million in 1996, and Metropolitan expects the budget to increase to over $86 million by 2005. (Exh. 207, p. 341.) Metropolitan's voluntary commitment to water management promotes the state's policy in favor of water management. (See Stats. 1993, ch. 313, § 1.)

In addition, Metropolitan is the single largest contractor on the State Water Project. (Littleworth & Garner, *supra,* at p. 25; see *ante*, fn. 3.) It is obligated to pay more than 60 percent of the project's overall costs. (CT

p. 1117.) Metropolitan's total annual obligation to the project exceeds $200 million. (CT p. 2688.) Metropolitan must meet this obligation whether or not water is available or needed.[4] (See CT p. 1117.)

About 75 percent of Metropolitan's revenues are derived from the sale of water. (Exh. 3, Exh. B, Att. 1, p. 6.) Metropolitan is required by law to set rates for the sale of water at a level that enables it to maintain and operate the system, pay its contract for the State Water Project, and repay its debts. (Stats. 1972, ch. 169, § 1, p. 389, West's Wat. Code – App. (1995 ed.) § 109-238.) The balance of revenues comes from property taxes and miscellaneous service charges. (Exh. 3, Exh. B, Att. 1, pp. 6, 8.) Metropolitan's revenues must be sufficient to repay its revenue bonds, general obligation bonds, and commercial paper short-term debts. (CT p. 2688.) These bonds fund projects to improve Metropolitan's ability to distribute and store imported water, such as the ongoing Eastside Reservoir project (estimated to cost $2 billion to complete) and the Inland Feeder project (estimated to cost $1.03 billion to complete). (Exh. 207, pp. 343-344.)

Eighty-five percent of Metropolitan's annual expenses are fixed, but its annual revenues are not. Metropolitan's revenues from water sales vary from year to year. (Exh. 3, Exh. B, Att. 1, p. 6.) When member agencies reduce their purchases, Metropolitan must compensate for the lost revenues either by raising its water rates, increasing property taxes[5] and service charges, or drawing down its financial reserves. (See CT pp. 2709-2721 [discussing Metropolitan's financial sensitivity to water sales].)

4/ Metropolitan's annual entitlement from the State Water Project is 2,011,500 acre-feet (Littleworth & Garner, *supra,* at p. 25), though the most it has ever taken in a single year was 1,400,000 acre-feet in 1990 (Exh. 207, p. 310).

5/ Metropolitan's ability to increase property taxes, however, is limited by article XIIIA of the California Constitution.

The law requires Metropolitan's water rates to be "uniform for like classes of service throughout the district." (Stats. 1969, ch. 209, § 134, p. 506, as amended by Stats. 1984, ch. 271, § 4, West's Wat. Code – App. (1995 ed.) § 109-134.) Following this law and the custom and practice of the water industry, Metropolitan sets its water rates on a "postage-stamp" basis, which means the price for an acre-foot of water is set in advance and does not vary with the distance the water must travel or the portions of the system actually used to reach the purchaser.[6] (Exh. 3, Exh. B, Att. 1, p. 3.)

D. Wheeling Transactions.

Metropolitan owns most of the water that flows through its system. On occasion, Metropolitan conveys water owned and sold by others. (Exh. 1, p. 2.) This sort of transaction – in which Metropolitan makes its system available for others to use in transporting non-Metropolitan water – is commonly referred to as a "wheeling" transaction.

Metropolitan has provided wheeling services primarily on an emergency basis or to assist agencies during droughts. (Exh. 1, Att. A, p. 4.) From 1972 to 1983, and again in 1990 and 1992, Metropolitan wheeled water to Tijuana, Mexico on an intermittent, emergency basis. (Exh. 1, Att. A, pp. 13-15.) In 1977, during a severe drought, Metropolitan provided emergency service to deliver Castaic Lake Water Agency's State Water Project entitlement. (Exh. 1, Att. A, p. 14.) Metropolitan has wheeled water from the Colorado River to the Coachella Valley Water District and from Castaic Lake

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6/ An acre-foot of water is the amount of water needed to cover one acre of land with water one foot deep. (Merriam-Webster's Collegiate Dictionary (10th ed. 1993) p. 11.) An acre-foot contains roughly 325,000 gallons. (See The World Almanac (1999) Weights and Measures, Tables of Equivalents, pp. 609-610 [acre equals 43,650 square feet; cubic foot equals 7.481 gallons].)

for the Santa Barbara County Flood Control and Water Conservation District. (Exh. 1, Att. A, pp. 13-14.) In each of these instances, the amount of water wheeled was small and the transaction was of limited duration. (Exh. 1, Att. A, p. 4.) Thus, the rate Metropolitan charged for the use of its facilities depended on the circumstances of the particular transaction. (Exh. 1, Att. A, pp. 13-15.) In one other instance, Metropolitan entered into a long-term agreement to provide wheeling service for substantial amounts of water for the Castaic Lake Water Agency. (Exh. 1, Att. A, p. 4.) In none of these wheeling transactions was the water wheeled to a current member agency.

E. The Wheeling Statutes.

In 1986, the Legislature enacted Water Code sections 1810-1814, commonly known as the "wheeling statutes." The wheeling statutes prohibit Metropolitan and other agencies from denying access to their water conveyance systems to bona fide transferors for wheeling transactions whenever "unused capacity" exists. (Wat. Code, § 1810.)[7]

> "'Unused capacity' means space that is available within the operational limits of the conveyance system and that the owner is not using during the period for which the transfer is proposed and which space is sufficient to convey the quantity of water proposed to be transferred." (§ 1811, subd. (e).)

A transferor's right to wheel water is subject to several conditions and restrictions. (See, e.g., § 1810, subds. (b), (d); § 1814.) The most significant statutory restriction – and the one at the heart of this case – is the requirement that the transferor pay the owner "fair compensation" for use of the conveyance system. (§ 1810, 1st par.) "Fair compensation" is defined to mean

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7/ Unless otherwise indicated, all further statutory references are to the Water Code.

> "the reasonable charges incurred by the owner of the conveyance system, including capital, operation, maintenance, and replacement costs, increased costs from any necessitated purchase of supplemental power, and including reasonable credit for any offsetting benefits for the use of the conveyance system." (§ 1811, subd. (c).)

The wheeling statutes leave it to the agency owning the facility to determine "in a timely manner" the amount and availability of capacity, and the "terms and conditions, including operation and maintenance requirements and scheduling, quality requirements, term or use, priorities, *and fair compensation*." (§ 1812, emphasis added.) In making these determinations, the agency must act reasonably and "consistent with the requirements of law to facilitate the voluntary sale, lease, or exchange of water," and it must "support its determinations by written findings." (§ 1813.) Should any determination be challenged in a judicial action, the court "shall consider all relevant evidence, and . . . give due consideration to the purposes and policies of this article" and "shall sustain the determination of the public agency if it finds that the determination is supported by substantial evidence." (*Ibid.*)

PROCEDURAL HISTORY

A. The Administrative Proceedings.

1. Metropolitan's development of a uniform wheeling rate.

The methodology Metropolitan used to set its wheeling rates – and the rates themselves – evolved from a long and thorough administrative process.

In the 1990s, Metropolitan, in conjunction with its member agencies, groundwater basin management agencies, and other water providers in southern California, developed an Integrated Resources Plan. (Exh. 207, p. 260.) The Integrated Resources Plan is a "comprehensive long-term water resources strategy to meet the needs of southern California." (Exh. 207, p. 271; see generally Exhs. 206 & 207.) At one of the assemblies to develop the Integrated Resources Plan, assembly members called on Metropolitan to develop an explicit policy on wheeling. (Exh. 3, p. 2.) Such a policy became advisable for several reasons, including "the trend toward market mechanisms . . . more efficient than regulation for pricing and allocating resources and services"; the success of the California Emergency Water Bank in moving water from agricultural sellers to urban buyers during the 1987-1992 drought; and the requirements of the recently enacted wheeling statutes. (Exh. 3, p. 3.)

In September 1995, Metropolitan's General Manager presented the Board with an information letter on wheeling, which the Board approved. (Exh. 1.) The letter described four proposed conditions for wheeling: (1) the system's capacity and facilities must be sufficient to accommodate the wheeled water; (2) existing water quality must be maintained; (3) written agreements must be executed to document the terms of the wheeling transaction; and (4) compensation must be based on the amount of water wheeled. (Exh. 1, pp. 3-4.) The letter included an issue paper with a detailed discussion of the compensation Metropolitan would receive for wheeling. (Exh. 1, Att. A, pp. 7-11.) It explained that equivalent margin pricing, which the electric and gas industries had used, would insure that Metropolitan's financial needs were met and that nonwheeling member agencies would not be burdened with costs that a wheeling member agency would have paid had it instead bought water from Metropolitan.[8] (Exh. 1, Att. A, pp. 9-11.) The letter set forth several scenarios showing the operation of wheeling rates in practice. (Exh. 1, Att. A, pp. 10-11.) It also noted that the equivalent margin pricing method assumed that the wheeling member agency would otherwise have bought water from Metropolitan. (Exh. 1, Att. A, p. 9.) Because this assumption would not be valid in years when Metropolitan experienced supply shortages, the letter noted that a wheeling policy might provide for member agencies to pay less than a full wheeling rate in those years. (Exh. 1, Att. A, p. 11.)

In an October 1995 letter, Metropolitan's General Manager and Chief of Planning and Resources offered a proposed wheeling policy for the Board's consideration. (Exh. 2.) Besides explaining the use of equivalent margin pricing similar to that in the September 1995 letter, the October 1995 letter explained that equivalent margin pricing would not be in effect when Metropolitan declared a shortage, because Metropolitan's regular water sales rates would be set to recover fixed costs based on expected deliveries. (Exh. 2, p. 6.) During shortages, member agencies' wheeling of water would be presumed to cover water supply needs that Metropolitan could not meet. (*Ibid.*)

2. Adoption of the wheeling principles.

In January 1996, Metropolitan initiated a Rate Refinement Process to address some immediate concerns of member agencies and Metropolitan's management about Metropolitan's rate structure. (Exh. 3, p. 3.) Among the member agencies participating directly in the Rate Refinement Process was

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8/ By "equivalent margin pricing," Metropolitan meant a pricing method for wheeling rates that would provide the same level of revenues to Metropolitan that water rates provided, less the costs avoided by not providing an increment of water. (Exh. 1, Att. A, p. 9.)

defendant San Diego. (Exh. 3, p. 3.) Out of the Rate Refinement Process came certain wheeling principles and Resolution No. 8515, in which the Board proposed to adopt specific wheeling rates after a public hearing. (Exh. 6, p. 13; Exh. 3, Exh. A-1; Exh. 7.) The Board adopted both the wheeling principles and the resolution on November 19, 1996.

The wheeling principles and Resolution No. 8515 were based on a Technical Report prepared by Metropolitan staff and presented to the Board. The Technical Report explained that fairness and equity supported adoption of a uniform wheeling rate that would require wheeling parties to pay their fair share of Metropolitan's fixed costs:

> "The board, in its role of overseeing regional water management, has made long-term programmatic and financial commitments on behalf of the region, in the belief that these commitments are in the best interests of the region. These financial commitments must be repaid. As member agencies using water from Metropolitan must pay for these fixed commitments, primarily through water rates, members using the system to wheel non-Metropolitan water through the system must pay an equivalent amount to recover their share of these fixed commitments through charges for wheeling. The pricing structure of the wheeling charges must be consistent with the pricing structure for water to ensure fairness and equity in how users pay for the regional system." (Exh. 3, Exh. B, Att. 1, p. 1.)

The Technical Report also explained that, because the Metropolitan water conveyance system was integrated, member agencies benefitted from the entire system regardless of which facilities in the system they actually used. (Exh. 3, Exh. B, Att. 1, p. 4.) For this reason, the cost of Metropolitan's *water service* was uniform and reflected the cost of the entire system. (*Ibid.*) Likewise, the report explained, the cost of Metropolitan's *wheeling service* to member agencies should be uniform and reflect the cost of the entire system. (*Ibid.*)

The Technical Report identified the revenues Metropolitan must recover from water service and wheeling service. (Exh. 3, Exh. B, Att. 1, pp. 7-8.) It then disaggregated costs into five categories: transmission, storage, supply, power, and treatment. (Exh. 3, Exh. B, Att. 1, pp. 9-10.) Transmission costs are "debt service, operations and maintenance expenses, and take-or-pay contract costs associated with aqueducts and pipelines," including State Water Project costs "identified as transportation (both capital and operations and maintenance)." (Exh. 3, Exh. B, Att. 1, p. 9.) Storage costs are "the costs of operating and maintaining facilities that provide storage for emergency, seasonal, and carryover needs." (*Ibid.*) Supply costs are "the costs of operating and maintaining water source facilities," such as dams, wells, and the like. (*Ibid.*)

The Technical Report then set forth a method for calculating two different rates for wheeling service – a "firm" and a "nonfirm" rate – based on the unavoidable costs associated with transmission, storage, and supply.[9] (Exh. 3, Exh. B, Att.1, pp. 17-18.) The firm wheeling rate covered more than the as-available service required by the wheeling statutes. Member agencies paying the firm wheeling rate could *reserve* unused capacity in both pipelines and reservoirs; once reserved, firm wheeling service would be accorded the same priority as existing water service. (Exh. 3, Exh. B, Att. 1, p. 17.) In calculating this rate, Metropolitan used the unavoidable costs of transmission, storage, and supply. (*Ibid.*) Based on these costs, Metropolitan calculated a firm wheeling rate of $262 per acre-foot. (*Ibid.*)

9/ Power costs (the costs of power contracts and generating facilities) were excluded from the wheeling rate calculation because the wheeling statutes specifically provide that the wheeler shall pay the transfer's incremental power costs only. (Exh. 3, Exh. B, Att. 1, p. 19; see § 1811, subd. (c).) Treatment costs were excluded because the statutes require the wheeler to pay necessary costs of treatment so that water quality is not adversely affected. (Exh. 3, Exh. B, Att. 1, p. 19; see § 1810, subd. (b).)

The nonfirm wheeling rate would be charged for the as-available service required by the wheeling statutes. (Exh. 3, Exh. B, Att. 1, p. 18.) Metropolitan considered only transmission costs in calculating this rate. (*Ibid.*) Moreover, it discounted the transmission costs to take into account the fact that the rate would cover service only when capacity was available. (*Ibid.*) Based on these costs, Metropolitan calculated a nonfirm wheeling rate of $141 per acre-foot. (Exh. 3, Exh. B, Att. 1, p. 19.)

In Resolution No. 8515, the Board gave notice to the public (including the member agencies) of the Board's intent to consider the recommendation of Metropolitan's General Manager to adopt the wheeling rates described in the Technical Report. (Exh. 7.) The resolution stated that the rates would apply only to wheeling transactions to be completed within one year. (Exh. 7, p. 2.) Wheeling rates for shortage periods and for entities other than member agencies would be negotiated on a case-by-case basis. (Exh. 7, p. 4.)

3. Adoption of the wheeling rates.

On December 9, 1996, the Board held a public hearing on the proposed wheeling rates. (Exh. 17.) Vincent F. Biondo, Jr., general counsel of San Diego, spoke at the hearing. (Exh. 17, pp. 10-15.) He asked the Board to approve a tolling agreement between Metropolitan and San Diego for filing a validation action if the Board approved the proposed wheeling rates. (Exh. 17, p. 13.) He did not address the reasons for San Diego's opposition to the wheeling rates.

On December 27, 1996, at Biondo's request, the Board's Executive Secretary sent each director a copy of Biondo's statement at the public hearing and a December 6, 1996 letter he had sent to the Chairman of Metropolitan's Board. (Exh. 5.) In the letter, Biondo argued that Metropolitan had not computed the proposed wheeling rates in accordance with the wheeling statutes. (Exh. 5, letter, pp. 5-7.)

At the Board's regular meeting on January 14, 1997, the Board adopted the wheeling rates with the approval of the directors representing all member agencies except San Diego. (Exh. 8; CT p. 646.) In addition, the Board pledged revenues from wheeling transactions as security for Metropolitan's commercial paper obligations. (CT pp. 128-132.)

B. The Validation Action.

1. Nature and purpose; venue.

The day after the Board adopted the wheeling rates, Metropolitan filed the present action to validate its pledge of the wheeling rate revenues. A validation action is an in rem proceeding filed by a public agency to obtain court approval of its financing commitments where statutorily permitted. (Code Civ. Proc., § 860; *Friedland v. City of Long Beach* (1998) 62 Cal.App 4th 835, 838.) The superior court approved notice by publication under Code of Civil Procedure section 861. (CT p. 164.)

Pursuant to Code of Civil Procedure section 394, subdivision (a), defendants Imperial Irrigation District (Imperial), San Diego, and CPIL moved to transfer the case to a neutral county or judge. (CT pp. 202-203.) Metropolitan did not oppose the motion. (CT p. 451.) The Judicial Council specially assigned Judge Laurence D. Kay of the San Francisco Superior Court to sit on the Los Angeles Superior Court for purposes of deciding this matter. (CT p. 557.)

2. Defendants' demurrers.

Defendants Imperial (joined by CPIL) and San Diego filed demurrers advancing three arguments: (1) a validation action was not the appropriate procedure; (2) even if it was, Metropolitan had not given proper notice; and (3) as a matter of law, the wheeling rates did not comply with the wheeling statutes. (CT pp. 369, 562.) In opposing the demurrers, Metropolitan requested judicial notice of documents relating to the legislative history of the wheeling statutes. (CT p. 583.)

The trial court overruled the demurrers. (CT p. 1893; see generally RT 7/28/97.) It held validation was an appropriate procedure and Metropolitan's summons substantially complied with the Code of Civil Procedure. (CT p. 1893.)

As for defendants' third argument, that the wheeling rates did not comply with the statutes, the superior court explained: "The Court cannot determine from the face of the complaint and from matters judicially noticeable that Metropolitan's method of calculating its wheeling rates is unreasonable or otherwise illegal as a matter of law." (CT p. 1893.)

3. Bifurcation of issues; trial procedures.

After overruling the demurrers, the court ruled that the issues would be bifurcated for trial. Phase I of the trial would involve two issues:

> "1. May [Metropolitan] set 'postage stamp' wheeling rates, and set such rates in advance without regard to any particular proposed wheeling transaction, in light of Water Code §§ 1810-1814, and the legislative history, intent, and purpose of those statutes?

> "2. May [Metropolitan] include all of its systemwide costs in calculating its wheeling rates, or may it only include costs relating to particular facilities?
>
> "The question of the reasonableness of the dollar amount of [Metropolitan's] wheeling rates, and any other remaining issues, will be tried at a later date if necessary." (CT p. 1893.)

The court and the parties agreed that in Phase I of the trial, the court would receive limited testimony in writing only. (CT p. 1894.) Metropolitan would submit two expert declarations. (*Ibid.*) Defendants, collectively, would also submit two expert declarations. (*Ibid.*) The court allowed limited deposition discovery of the experts. (*Ibid.*) The parties would submit exhibits after meeting and conferring on their admissibility. (*Ibid.*) The court allowed the parties to file briefs supplemental to the memoranda that had been filed in support of and in opposition to the demurrers. (CT p. 1895.)

After the hearing on the demurrers and before the trial, several additional parties – Chemehuevi Indian Tribe, Quechan Indian Tribe, Inyo-Mono County Farm Bureau, and Cadiz Land Company, Inc. (now Cadiz, Inc.) – joined the case as defendants. (CT pp. 2052-2053.) Another entity, Environmental Defense Fund, sought leave to join as a defendant but the court denied it leave. (CT pp. 2052-2053.) The court did allow Environmental Defense Fund and Western Water Company to file briefs as amici curiae. (CT p. 3718.)

4. The evidence and trial.

Before the trial, the parties met and conferred concerning the exhibits. Metropolitan offered to designate an administrative record of the evidence that had been before the Board when it adopted the wheeling rates, but the other parties refused to agree to an administrative record designation. (CT p. 2155, fn 2.)[10] Metropolitan therefore submitted both evidence that was part of the Board's record and additional expert testimony. (CT pp. 2165; 3149-3153.)

For its expert testimony, Metropolitan submitted the Declaration of Brian G. Thomas, an economist employed by Metropolitan who had been actively involved in calculating the wheeling rates.[11] (CT pp. 1111, 1112.) Thomas's declaration described Metropolitan's structure, explained the principles behind Metropolitan's wheeling rates, described the integration of Metropolitan's system and how its components and facilities worked together, and explained the economic rationale behind including systemwide, capital costs in a uniform, "postage-stamp" wheeling rate, i.e., a rate per acre-foot of water wheeled regardless of the distance the water traveled. (CT pp. 1112-1129.) Thomas also explained that if one member agency avoids paying an appropriate share of system costs by paying only the costs associated with the facility used for the wheeling transaction, then other member agencies would have to pay a higher water rate. (CT p. 1126.)

Defendants offered the declarations of Richard Howitt, an expert in water resources, and David Kennedy, the head of the California State Department of Water Resources. (CT pp. 1554-1562; 2529-2561.) Howitt's declaration expressed his opinion that the rates set by Metropolitan for

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10/ Inyo-Mono County Farm Bureau filed a statement denying that Metropolitan had offered to designate an administrative record. (CT p. 3551.) Imperial and San Diego filed legal briefs arguing that the substantial evidence standard of Water Code section 1813 did not apply. (CT pp. 3203, 3314.)

11/ Metropolitan also submitted the Declaration of Steven P. Erie, Ph.D. (CT pp. 1143-1172.) Dr. Erie offered expert testimony concerning a long-term wheeling transaction that was being negotiated between San Diego and Imperial. After Imperial refused to provide discovery on this transaction, the parties ultimately agreed that Imperial would not offer any evidence concerning the transaction. (CT pp. 2529 & 3534, fn. 1.) Therefore, Imperial withdrew portions of the declaration of its expert, Richard Howitt. (CT p. 2529.)

wheeling would not promote voluntary transfers because the transfers would not be economically viable. (CT pp. 2529-2561.) Howitt also argued that one member agency's avoidance of its share of system costs would not necessarily result in higher water rates for other member agencies. (CT pp. 2554-2557.) Kennedy's declaration described the method used by the Department of Water Resources for processing water transfer requests. (CT pp. 1559-1562.)[12]

Imperial and San Diego each offered numerous exhibits; the other defendants offered a few more. (CT pp. 2176, 2521, 2910, 2918, 2920, 3037.) Metropolitan objected to many of the exhibits (CT p. 3125), noting that they were outside the administrative record (CT p. 3126).

The trial itself consisted solely of oral argument and was completed in one day. (RT 11/7/97.)

5. The tentative decision and judgment; Metropolitan's first appeal.

On January 12, 1998, the superior court issued its tentative decision refusing to validate Metropolitan's wheeling rates. (CT p. 3714.) Without considering whether Metropolitan's Board had sufficient evidence before it to support a postage-stamp wheeling rate based on systemwide costs, the court held the rates did not comply with the requirements of the wheeling statutes. (CT pp. 3718-3719.) This, the court held, was a legal question for the court to determine de novo. (*Ibid*.)

Referring only to the language of the statute and not to the legislative history or any evidence offered by the parties, the court concluded:

> "[T]he Legislature intended section 1811(c) to refer to any *additional* capital, operation, or maintenance costs brought

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12/ Two other declarations submitted by defendants, those of Richard Katz and Robert Campbell, were withdrawn at trial. (RT 11/7/97, p. 5.)

> about by a specific water transfer. The Wheeling Statutes exist in the first place to facilitate individual water transfer transactions and to provide that the owner of the system be made whole for the incremental cost of the transfer." (CT p. 3719.)

The court also concluded that the wheeling statutes did not protect Metropolitan's member agencies in the event they suffered financial injury in the form of increased water rates as a result of Metropolitan's inability to collect more than the "incremental cost of the transfer" from parties to a wheeling transaction. (CT p. 3719.) The court further held that reasonable compensation was limited to "facilities actually used in a given transfer." (CT p. 3720.) Despite its stated view that only the legal interpretation of the wheeling statutes was at issue, the court also questioned whether wheeling transactions would in fact cause financial injury to Metropolitan's member agencies (CT p. 3723), though the record before the Board showed that the agencies would suffer such injury (see *ante*, at p. 17).

The court also held that the firm wheeling rate, which included charges for guaranteed capacity and reservation of storage space, could not be validated because "Rates set under the Wheeling Statutes are for the cost of using unused capacity, not reserving or creating unused capacity." (CT p. 3725.)[13] The nonfirm wheeling rate, by contrast, did not provide enough service, the court said, because while section 1810, subdivision (c), provides that use of unused capacity can be interrupted only in case of an emergency,

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13/ Metropolitan accepts the court's ruling that sections 1810-1814 do not require Metropolitan to guarantee capacity or reserve storage spaces and thus do not authorize a firm wheeling rate. Metropolitan's appeal involves only the nonfirm wheeling rate. Throughout this brief, references to Metropolitan's wheeling rates are to its nonfirm wheeling rate, unless the firm wheeling rate is specifically mentioned.

the nonfirm wheeling rate allowed Metropolitan to interrupt use for any reason.[14] (CT p. 3725.)

Finally, the court ruled that the postage-stamp rate was not permitted under the statute. "The Legislature must have intended that the owner make its determination of capacity *after* receiving a proposal for a particular transaction." (CT p. 3726.)

In an "addendum," the court ruled on the parties' evidentiary objections and requests for judicial notice. (CT pp. 3727-3732.) Over Metropolitan's objections, the court admitted evidence that was not before Metropolitan's Board when it adopted the wheeling rates. (CT pp. 3728-3729.) It granted in part and denied in part the request for judicial notice of legislative history materials. (CT pp. 3727-3732.) The court took judicial notice of the amendments to the wheeling bill as it passed through the Legislature and of some analyses of the bill. It did not take judicial notice of letters or enrolled bill reports. (*Ibid*.)

Metropolitan filed Proposals and Specification of Controverted Issues Pursuant to Rule of Court 232(a). (CT p. 3733.) The court nonetheless entered judgment against Metropolitan on January 30, 1998. (CT p. 3800.) In its concurrently filed Statement of Decision, the court adopted its Tentative Decision in whole with only minor corrections. (CT pp. 3802-3803.)

On February 13, 1998, Metropolitan filed a timely notice of appeal from the judgment. (CT pp. 3839-3844; see Code Civ. Proc., § 870, subd. (b).) The judgment is appealable under Code of Civil Procedure section 904.1, subdivision (a)(1).

14/ Because the court concluded Metropolitan's rate-setting methodology was legally flawed, the court did not reach the question whether substantial evidence supported the Board's findings or the specific wheeling rates the Board adopted.

6. The order on attorney's fees and costs; Metropolitan's second appeal.

On April 15, 1998, the superior court awarded defendant CPIL its attorney's fees and the other defendants their costs. (CT2 pp. 601-610.) The court denied the motions of Imperial, San Diego, Chemehuevi Indian Tribe, and Quechan Indian Tribe for attorney's fees. (CT2 pp. 601-610.)

On May 5, 1998, Metropolitan filed a timely notice of appeal from the post-judgment order on fees and costs. (CT2 pp. 629-634.) The order is appealable under Code of Civil Procedure section 904.1, subdivision (a)(2).

LEGAL DISCUSSION

II.

THE TRIAL COURT ERRED BY RULING METROPOLITAN COULD NOT RECOVER CAPITAL OR SYSTEMWIDE COSTS THROUGH ITS WHEELING RATE.

A. The Wheeling Statutes Guarantee Metropolitan "Fair Compensation" For Granting Access To Its System. What Constitutes "Fair Compensation" Is Left For Metropolitan To Determine, In Conformity With Law.

Under section 1810, a party proposing to wheel water must pay "fair compensation" to the agency that owns the water conveyance system. "Fair compensation" is defined as "the reasonable charges incurred by the owner of the conveyance system, including capital, operation, maintenance, and replacement costs, increased costs from any necessitated purchase of supplemental power, and including reasonable credit for any offsetting benefits for the use of the conveyance system." (§ 1811, subd. (c).)

The *agency* is charged with responsibility for determining "fair compensation." (§ 1812, subd. (b) [the "agency owning the water conveyance facility shall . . . determine . . . fair compensation"].) In other words, the agency is responsible for determining the "reasonable charges" it incurs to provide the wheeling service. In making its determination, the agency "shall act in a reasonable manner consistent with the requirements of law to facilitate the voluntary sale, lease, or exchange of water and shall support its determinations by written findings." (§ 1813.)

In a judicial action concerning the agency's determination of fair compensation, "the court shall sustain the determination of the public agency if it finds that the determination is supported by substantial evidence." (§ 1813.)

As directed by the statutes, Metropolitan's Board determined fair compensation by identifying the reasonable charges Metropolitan incurs to provide wheeling service, and the Board made appropriate written findings to support its determination. (Exh. 8.) The dispute is whether Metropolitan acted consistently with the requirements of law in setting a uniform wheeling rate that (a) allowed Metropolitan to recover a pro rata portion of its capital and systemwide costs, and (b) applied on a "postage-stamp" basis, i.e., regardless of the distance the water traveled or the particular facilities used. As we discuss below, Metropolitan complied with the law in all respects.

B. Metropolitan Acted In Conformity With Law By Setting Wheeling Rates To Recover Capital Costs, Not Just Marginal Costs.

1. The wheeling statutes specifically allow recovery of capital costs.

The fundamental goal of statutory interpretation is to ascertain the intent of the Legislature. (*Central Pathology Service Medical Clinic, Inc. v. Superior Court* (1992) 3 Cal.4th 181, 186 (hereafter *Central Pathology*).) The court's first step is to examine the language of the statute, giving the language its usual, ordinary import. (*Id.* at pp. 186-187.) The words of the statute must be construed in context, and statutes relating to the same subject must be harmonized. (*Ibid.*)

If the language of the statute is clear and unambiguous, construction is not necessary, nor is it necessary to resort to indicia of the intent of the Legislature. (*Delaney v. Superior Court* (1990) 50 Cal.3d 785, 798.) But if uncertainty exists, consideration should be given to the consequences that will flow from a particular interpretation. (*Central Pathology, supra,* 3 Cal.4th at p. 187.)

Both the legislative history of the statute and the wider historical circumstances of its enactment may be considered to ascertain the legislative intent. (*Central Pathology, supra,* 3 Cal.4th at p. 187.)

If neither the language of the statute nor its legislative history reveals the Legislature's intent, the court must apply reason, practicality, and common sense. (*Halbert's Lumber, Inc. v. Lucky Stores, Inc.* (1992) 6 Cal.App.4th 1233, 1239.) The words of the statute should be interpreted to make them workable and reasonable, in accord with common sense and justice, and to avoid an absurd result. (*Ibid.*; *see Central Pathology, supra,* 3 Cal.4th at

p. 191.) If the statute is amenable to two alternative interpretations, the one that leads to the more reasonable result (*Lungren v. Deukmejian* (1988) 45 Cal.3d 727, 735) or the constitutional result (*Summit Care-California, Inc. v. Department of Health Services* (1986) 186 Cal.App.3d 1584, 1588) will be followed.

The text of the wheeling statutes themselves shows that "fair compensation" may include recovery of not just marginal or incremental costs but capital costs as well.[15]

First, the wheeling statutes specifically define "fair compensation" to include capital costs:

> "'Fair compensation' means the reasonable charges incurred by the owner of the conveyance system, including *capital*, operation, maintenance, and replacement costs, increased costs from any necessitated purchase of supplemental power, and including reasonable credit for any offsetting benefits for the use of the conveyance system." (§ 1811, subd. (c), emphasis added.)

Second, the Legislature knew how to limit recovery to marginal costs when it wanted to do so. Thus, in defining the "reasonable charges" that make up fair compensation, the Legislature carefully limited the recovery of power costs to "increased costs from any necessitated purchase of supplemental

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15/ "Marginal cost" and "incremental cost," when used by economists, have technically different meanings. "Marginal cost" "refers to the increase in the firm's total outlays resulting from a small rise in the output of [the product]." (Baumol & Sidak, *The Pricing of Inputs Sold to Competitors* (1994) 11 Yale J. on Reg. 171, 176.) "Incremental cost is a generic concept referring to the addition, per unit of the additional output in question, to the firm's total cost when the output of [the product] expands by some preselected increment." (*Ibid.*) The two can result in a different calculation under some circumstances. (*Ibid.*) Because the Legislature and the trial court used both terms interchangeably, we also use the terms interchangeably here to mean the cost Metropolitan incurs by reason of transporting an acre-foot of water that it would not otherwise incur.

power." (§ 1811, subd. (c).) Similarly, the statute specifically limits replacement costs to those attributable to the proposed use:

> "'Replacement costs' mean the reasonable portion of costs associated with material acquisition for the correction of unrepairable wear or other deterioration of conveyance facility parts which have an anticipated life which is less than the conveyance facility repayment period and *which costs are attributable to the proposed use*." (§ 1811, subd. (d), emphasis added, added by Stats. 1986, ch. 918, § 2 and amended by Stats. 1998, ch. 485, § 161, eff. Jan. 1, 1999.)[16]

The Legislature imposed *no* such limitations on the "capital, operation, [and] maintenance . . . costs" (§ 1811, subd. (c)) recoverable by the owner of the conveyance system. The Legislature did *not* limit the owner to recovering only those capital, operation, and maintenance costs attributable to the proposed use. The only statutory limitation on recovery of those costs is that they must be reasonable costs "incurred by the owner of the conveyance system" (§ 1811, subd. (c)), i.e., they must be actual costs, and the compensation must be "for that use [of the conveyance facilities]" (§ 1810, 1st par.).

> "'It is a well recognized principle of statutory construction that when the Legislature has carefully employed a term in one place and has excluded it in another, it should not be implied where excluded.' (*Ford Motor Co. v. County of Tulare* (1983) 145 Cal.App.3d 688, 691 . . . .)" (*Brown v. Kelly Broadcasting Co.* (1989) 48 Cal.3d 711, 725.)

The Legislature's conspicuous failure to limit recovery of the capital, maintenance, and operation costs to incremental costs – as it did for power and replacement costs – is telling. The principle of not implying a term where the

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<u>16</u>/ The 1998 amendment made only nonsubstantive, grammatical changes to the subdivision. Further references to section 1811, subdivision (d) are to the subdivision as it existed before January 1, 1999, i.e., as it existed when the Board adopted the wheeling rates and when judgment was entered in the trial court.

Legislature has excluded it bars an interpretation of the wheeling statutes that would limit system owners to recovering only the *incremental* cost of capital, operation, and maintenance attributable to a wheeling transaction.

The statute is so clear on this point that neither of the water entities appearing as defendants (San Diego and Imperial) contended that marginal cost recovery was appropriate in a system like Metropolitan's where member agencies do not pay for capital costs on a contract basis. (See, e.g., CT p. 709 [Imperial states it does not contend marginal cost recovery is appropriate]; CT p. 2418 [San Diego embraces Department of Water Resources' method of calculating wheeling rates, which includes capital costs (see CT p. 1560)].)

Nonetheless, in its tentative decision (subsequently adopted as its statement of decision), the trial court ruled that the Legislature's use of the term "incurred" compelled the conclusion that "the Legislature intended section 1811(c) to refer to any *additional* capital . . . costs brought about by a specific water transfer." (CT p. 3719, original emphasis.) Aside from the fact the court disregarded the principles of statutory interpretation discussed above, its holding is logically flawed. Wheeling transactions, by definition, occur only when the system has *existing* unused capacity. The wheeling statutes do not require or contemplate expansion of existing facilities to accommodate a wheeling transaction. Thus, a wheeling transaction does not require a system owner to incur "additional" or incremental *capital* costs. The wheeling statutes necessarily contemplate that the owner will recover an appropriate share of the capital costs for existing facilities. The capital costs are "incurred" just as the incremental costs are "incurred." Nothing in the verb "incur" precludes recovery of capital costs.

In short, because the statute on its face permits recovery of "capital," it cannot be fairly interpreted to limit the owner's recovery to incremental costs – and neither San Diego nor Imperial argued otherwise.

2. The Legislature specifically declined to limit "fair compensation" to marginal cost recovery.

The Legislature's rejection of a specific provision contained in an act as originally introduced strongly supports the conclusion that the act should not be construed to include the omitted provision. (*Ford Motor Co. v. County of Tulare* (1983) 145 Cal.App.3d 688, 692.) The legislative history of the wheeling statutes demonstrates that the Legislature specifically rejected a marginal cost limitation.

As introduced by Assemblyman Katz, Assembly Bill 2746 required wheeling parties to pay for the "fair market value" of the use. The bill provided:

> "For purposes of this article, 'fair market value' includes, but is not limited to, the reasonable operation and maintenance costs and depreciation costs associated with the conveyance facility use, offset by enhanced revenues, if any, realized by the public agency." (CT p. 594.)

On April 2, 1986, the Assembly amended the bill to provide:

> *"'Fair market value' means the marginal cost to the owner of a conveyance facility operator to provide the service and a markup of 6 percent to compensate the owner for the cost of doing business."* (CT pp. 596-597.)

When the Assembly amended the bill on April 22, 1986, it once again changed the definition of "fair market value," this time to *delete* the concept of marginal cost and to provide explicitly for recovery of capital, operation and maintenance costs:

> "'Fair market value means ~~the marginal cost to~~ *not more than the pro rata capital and operation and maintence* [sic] *cost plus the incremental operation and maintenance cost to* the owner of a conveyance facility operator to provide the service and a markup of 6 percent to compensate the owner for the cost of doing business." (CT pp. 599-600.)

The Senate made more radical changes. Rather than "fair market value," the owner would receive "fair compensation," and the Senate scrubbed the reference to "incremental" costs:

> *"'Fair compensation' means the reasonable charges incurred by the owner of the conveyance system, including capital, operation, maintenance, and replacement costs, and including reasonable credit for any offsetting benefits for the use of the conveyance system."* (CT p. 603.)

The Senate preserved the "incremental" cost idea of the bill passed by the Assembly only in the definition of the new term "replacement costs":

> *"'Replacement costs' mean the reasonable portion of costs associated with pumping or power recovery plants which have an anticipated life which is less than the conveyance facility repayment period and which costs are attributable to the proposed use."* (CT p. 603.)

In one further amendment to the definition of "fair compensation," the Senate reintroduced the marginal cost idea for *power* costs:

> "'Fair compensation' means the reasonable charges incurred by the owner of the conveyance system, including capital, operation, maintenance, and replacement costs, *increased costs from any necessitated purchase of supplemental power,* and including reasonable credit for any offsetting benefits for the use of the conveyance system." (CT p. 606.)

With these provisions, the governor signed the bill into law. (Stats. 1986, ch. 918.)

The foregoing review of the legislative history reveals that, in one of the statutes' earliest versions, "fair market value" (not "fair compensation") was defined as "*the* ***marginal*** *cost to the owner of a conveyance facility operator to provide the service*." (CT pp. 596-597, bold emphasis added.) A subsequent version moved from a "marginal" cost theory of compensation to a "pro rata" theory of compensation. (CT pp. 599-600 ["*the* ***pro rata*** *capital and operation and maintence* [sic] *cost plus the incremental operation and maintenance*" (bold emphasis added)].) Later versions of the bill and the statutes as finally enacted did not apply the concepts of "incremental" and "marginal" costs to capital, operation, and maintenance costs. The Legislature's specific rejection of a marginal cost limitation comports with the language of the statutes as codified. In the end, the Legislature dropped all language defining the capital, operation, and maintenance costs which the agency could recover as "fair compensation," presumably so as not to unduly limit the agency's reasonable discretion to make the determinations delegated to it in section 1812, subdivision (b), and section 1813.

C. Metropolitan Acted In Conformity With Law By Setting Wheeling Rates To Recover Systemwide Costs, Not Just Facility-Specific Costs.

1. The wheeling statutes distinguish between a "system" and a "facility."

The wheeling statutes also allow the agency to set its wheeling rate based on its systemwide costs, not just the costs of a particular facility. The Legislature's repeated use of the term "conveyance system" rather than "facility" in the definition of "fair compensation" (see *ante*, at p. 30) must be respected.[17] The Legislature knows the difference between a "facility" and a

17/ A "facility" is "something (as a hospital) that is built, installed, or established to serve a particular purpose." (Merriam-Webster's Collegiate Dictionary, *supra,* at p. 416.) A "system" is a group of "facilities." (See *id.* at p. 1197 [defining "system" as "a group of devices or artificial objects or an organization forming a network"].)

"system," and it uses those terms advisedly both in the wheeling statutes and throughout the Water Code.[18]

The Legislature authorized recovery of the "reasonable charges incurred by the owner of the conveyance *system*" and required the owner to give reasonable credit for "any offsetting benefits for the use of the conveyance *system*." (§ 1811, subd. (c), emphasis added.)

Elsewhere, in contrast, the wheeling statutes allow the transferor to use a "water conveyance *facility*" (§ 1810, 1st par., emphasis added); protect the rights of others to receive water from the owner of the "conveyance *facility*" (§ 1810, subd. (a), emphasis added); address the effect of the transfer on the water quality in the "*facility*" (§ 1810, subd. (b), emphasis added); and allow replacement costs for deterioration of "conveyance *facility* parts" (§ 1811, subd. (d), emphasis added).

Settled rules of statutory construction preclude any reading of the wheeling statutes that treats "facility" and "system" as synonymous. (See *Mercer v. Perez* (1968) 68 Cal.2d 104, 112 [declining to interpret "ground" and "reason" to have same meaning because Legislature chose to use two different words rather than same word; to interpret the words as having the same meaning would violate basic principle that significance should be given to every word of an act, if possible, and construction that renders word surplusage should be avoided]; *Delaney v. Superior Court*, *supra*, 50 Cal.3d

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18/ Thus, the Legislature has defined "public water system" to mean "a system for the provision of piped water to the public." (§ 10912.) A "public water system" includes "Any collection, treatment, storage, and distribution facility . . . used primarily in connection with the system." (§ 10912, subd. (a); see also, e.g., § 161.5 ["The California Water Commission shall have the power to name all facilities of the State Water Resources Development System owned by the state"]; § 11901 [purpose of chapter to provide for "a system of public recreation facilities at state water projects"]; § 13452 [groundwater recharge project "facilities" "may consist of the separable features, or an appropriate share of multipurpose features, of a larger system"].)

at pp. 798-799.) Rather, in accord with ordinary usage, a "facility" is a part of an entire "system."

The statutory definition of "unused capacity" further illuminates the distinct meanings of "facility" and "system" and thus sheds light on the meaning of "fair compensation."

> "'Unused capacity' means space that is available within the operational limits of the conveyance system and that the owner is not using during the period for which the transfer is proposed and which space is sufficient to convey the quantity of water proposed to be transferred." (§ 1811, subd. (e).)

In other words, capacity is assessed by reference to "the operational limits of the conveyance *system*," not by reference to any particular conveyance *facility* within the system.

The logical interpretation of the reference to the "conveyance system" in the definition of "fair compensation" is that the owner of a system is entitled to compensation from the wheeling parties for all costs incurred in building, operating, and maintaining the entire system.

2. The Legislature decided not to limit compensation to facility-specific costs.

Just as it specifically rejected marginal cost recovery (see *ante*, at pp. 33-35), the Legislature also specifically rejected language that would have limited recovery of capital, operation, and maintenance costs to those associated with the particular facilities through which the water flows in a wheeling transaction.

The bill as originally introduced allowed compensation for operation and maintenance costs "associated with the conveyance *facility* use." (CT p. 594, emphasis added.) Subsequent versions in the Assembly contained less direct references to the facility until the Senate rewrote the bill essentially as the Legislature and the Governor ultimately enacted it – without any limiting language and instead providing for recovery of "reasonable charges incurred by the owner of the conveyance *system*." (Compare CT pp. 596-597, 599-600, with CT p. 603, emphasis added.)

The Legislature's intent, evidenced by the plain language of the statute and its history, was to allow the owner of a water conveyance system to recover all reasonable capital, maintenance, and operation costs having some relation to the use of the system for wheeling, thereby making the owner whole for the use of the system. Beyond that, the Legislature did not precisely describe which particular capital, operation, and maintenance costs it had in mind. Instead, it left the determination of which particular costs could be recovered to the agency owning the system. (§ 1812, subd. (b).)

D. Metropolitan's Rate-Setting Methodology Comports With The Legislature's Intent And The Policy Behind The Wheeling Statutes. Moreover, It Avoids Serious Constitutional Questions About The Wheeling Statutes.

1. Metropolitan's methodology ensures its viability by forestalling "free rider" problems and the resulting "death spiral."

As explained above, Metropolitan recovers the vast majority of its costs through a water rate charged for each acre-foot of water sold. (See *ante,* at pp. 10-12.) If Metropolitan does not sell the amount of water anticipated, it cannot recover all its costs. If a member agency that has been buying its water from Metropolitan chooses instead to buy water elsewhere and wheel it through Metropolitan's system, Metropolitan loses a sale. The wheeling member will be using the system built, in part, for its benefit, but not paying for it. Unless that member agency pays for its share of Metropolitan's unavoidable costs through a wheeling charge, those costs must be shifted to Metropolitan's remaining customers.

Metropolitan calculated its wheeling rates to include the same transmission-related costs that it includes in the rates it charges for the water it sells. In other words, whether a member agency purchases water from Metropolitan or from a third party, the member pays a transmission charge that compensates Metropolitan for its capital investments and systemwide costs.

Under this rate structure, Metropolitan and its member agencies are protected when wheeling transactions displace water sales (which happens whenever a member wheels water in lieu of purchasing water available from Metropolitan) because Metropolitan still recovers its costs. If Metropolitan were required to charge a wheeling rate below the transportation charge its own members pay when they purchase water from Metropolitan, Metropolitan would be compelled to cut important programs and raise its water rates or increase the taxes it assesses (to the extent it can, see *ante*, fn. 5) to make up for the costs it could not recoup in its wheeling rate.

For example, "Estimates of the impact to non-participants of wheeling rates that do not recover all appropriate capital and operating costs range from $2 million to over $35 million annually." (CT pp. 1126-1127.) If Metropolitan were limited to recovering only the marginal costs of facilities used in a particular wheeling transaction, "For every 200,000 acre feet of water that a member agency wheels instead of purchasing full service delivered water from Metropolitan, approximately $52 million in costs will be shifted to those member agencies that pay for full service water." (CT2 p. 339.) Some, but not all, of those costs could be reduced by scaling back or dropping Metropolitan's important voluntary programs like water management. Metropolitan budgets millions of dollars every year (as of 1996, about $29 million) to support water management programs (e.g., conservation and recycling). (Exh. 207, pp. 341-343.) Metropolitan thus supports the state policy favoring water conservation (see Stats. 1993, ch. 313, § 1), but no law requires it to do so. Metropolitan would have no choice but to reduce or eliminate its participation in these programs to mitigate the cost shift resulting from marginal cost wheeling rates.

But even if the entire water management program were cut, Metropolitan probably would not save enough to compensate for its inability to recover full costs through its wheeling rates. Consequently, Metropolitan would have to raise the rates it charges for the water it sells. Metropolitan's member agencies that do not wheel water – and ultimately their customers – would bear the consequences.

As discussed above, the Legislature's intent was to allow the owner of a water conveyance system to recover the reasonable charges incurred in making facilities within the system available for wheeling and thus to be made whole. If Metropolitan has to raise water rates to its member agencies who are not wheeling water as a result of a wheeling transaction by another member agency, then Metropolitan has not received fair compensation making it whole.

Where uncertainty exists in construction of a statute, "consideration should be given to the consequences that will flow from a particular interpretation." (*Central Pathology, supra,* 3 Cal.4th at p. 187.) Here, one can foresee a "death spiral" if Metropolitan cannot recover sufficient revenues to make it whole. While the remaining member agencies purchasing water from Metropolitan pay steadily increasing water rates to make up for the inadequate revenues from wheeling transactions, the member agencies using wheeled water pay a wheeling rate subsidized by the increasing water rates. Seeing that water purchases are subsidizing wheeling transactions, ever more member agencies will choose to purchase wheeled water rather than purchase water from Metropolitan at a price that reflects the unavoidable costs of transmission. The member agencies who do continue to purchase Metropolitan water will be paying ever higher water rates, to the extent that Metropolitan's financial integrity may be impaired. Further investment in the system will be perceived as further subsidization for the agencies wheeling at subsidized prices, jeopardizing Metropolitan's ability to maintain its system and to provide a reliable water supply for 16 million southern Californians.

The Legislature certainly did not intend to subject water agencies to this sort of "death spiral" when it mandated that agencies make unused capacity in water conveyance systems available for wheeling transactions in exchange for "fair compensation." Efficient use of water would hardly be promoted by a rate system that results in the slow demise of public water agencies.

Indeed, the Legislature specifically provided that other users of the water conveyance system are *not* to be harmed by the wheeling transaction:

> "This use of a water conveyance facility is to be made *without injuring any legal user of water* and without unreasonably affecting fish, wildlife, or other instream beneficial uses and without unreasonably affecting the overall economy or the environment of the county from which the water is transferred." (§ 1810, subd. (d), emphasis added.)

The plain meaning of this subdivision is that no one who uses water in a lawful manner should be harmed when a transfer is accomplished under the wheeling statutes.

The trial court, however, read the subdivision to refer only to legal users of water in the county of the water's origin. The court relied on other sections of the Water Code (CT pp. 3722-3723), but none of those other sections (i.e., sections 386, 1020-1030, 1702, 1725, and 1736) defines "legal user of water" to refer *only* to users of the water at its point of origin. Instead, each of those sections authorizes and governs the terms of a transfer or lease of water. Each is thus concerned with how the authorized transfer or lease will affect those already using the water. In *that* context, "legal user of water" refers to those at the point of the water's origin.

But it does not follow that in any statute, whatever the context, "legal user of water" always refers to users of the water at the point of origin. The wheeling statutes are not concerned with *authorizing* transfers or leases of water. Rather, they are concerned with the conditions under which a bona fide transferor may have access to a publicly funded water conveyance system and the protections that must be afforded other users of the system. Thus, subdivision (a) of section 1810 protects the right of long-term water service contractors to use unused capacity. Subdivision (b) addresses water quality concerns of those already using the system to transport water. Subdivision (c) protects existing users' rights to use excess capacity in an emergency. Thus, in the context of these subdivisions, the phrase "legal user of water" in subdivision (d) must refer to an existing user of the system.

In sum, the Legislature intended to make water conveyance systems available for wheeling transactions *without harming the owners of those systems*. By setting a wheeling rate that in fact makes it whole and thereby ensures the continued viability of its system, Metropolitan acted consistently with the intent of the wheeling statutes.[19]

19/ Metropolitan is not alone among agencies in setting rates that recover systemwide costs relating to use of a conveyance system. Other rate-setting agencies, including the California Public Utilities Commission, have adopted rates that allow suppliers of conveyance to recover their systemwide costs. (Baumol & Sidak, *supra,* at p. 180 (citing, *inter alia*, Alternative Regulatory Framework for Local Exchange Carriers (1989) 33 Cal.P.U.C.2d 43).)

2. It is *fair* for Metropolitan to include in its wheeling rates the same transmission costs it charges its member agencies when it sells water to them.

To calculate the rates it would charge its member agencies to wheel water, Metropolitan disaggregated the three component costs that comprise the rate at which it sells water to member agencies: supply, transmission, and storage costs. (See *ante*, at p. 18.) Metropolitan then adjusted downward the transmission component its member agencies pay for purchased water to account for system peaking capacity and system utilization (because if the system is at capacity, then wheeling is not available). That adjusted transmission component became the "nonfirm" wheeling rate. (CT p. 47; see *ante*, at pp. 18-19.) Thus, under Metropolitan's methodology, member agencies who wheel water purchased from third parties would pay *less* for transmission of the water than member agencies who purchase water from Metropolitan.

The wheeling statutes guarantee Metropolitan "fair compensation." The wheeling rate is fair because it equals the rate Metropolitan charges its own members to transport water it sells them, less the system-peaking-capacity and system-utilization components which are by definition not applicable to an excess capacity transaction.

It would be *unfair* if Metropolitan could *not* charge a transmission rate equivalent to the transmission rate it charges to transport water it sells. (See Baumol & Sidak, *supra,* at p. 173 [regulation that forces supplier of input to charge a rival less for the input than it charges itself will severely handicap the supplier].) Because Metropolitan's Board has set its regular water rates at a level necessary to cover its costs, by definition a wheeled-water transmission rate lower than that set for regular purchased-water transmission (adjusted for system peaking costs) is insufficient to cover Metropolitan's costs incurred in the transaction.

By setting wheeled-water transmission rates on a par with purchased-water transmission rates, Metropolitan is necessarily recovering the reasonable charges incurred in the transmission of wheeled water, as permitted by the wheeling statutes.

3. Metropolitan's wheeling rate avoids subsidization of wheeling transactions, thus promoting competition and efficient use of water.

A stated goal of the wheeling statutes is to promote efficient use of water. (See Stats. 1986, ch. 918, § 1.) The trial court's construction of the statutes, however, will not promote efficient use of water; it will promote *inefficient* use.

With respect to water sales, part of the service (transportation) is controlled by the water conveyance system owner but another part of the service (the water itself) is competitive. "Economic efficiency requires that the competitive segment of the service be performed only by efficient suppliers – that is, by those suppliers whose incremental costs incurred to supply the service are the lowest available." (Baumol & Sidak, *supra*, at p. 184.) Forcing the entity that owns the conveyance system to sell the use of the system to a *less* efficient supplier of water at a rate that allows that supplier to be rewarded for its inefficiency simply effects a subsidy for the less efficient supplier. (Baumol & Sidak, *supra*, at p. 186.) A less efficient supplier of water is one whose water cost is greater than Metropolitan's. (Exh. 268, p. 1607.) For example, if Metropolitan has water supplies at $100 per acre-foot and wheeled water is available at $200 per acre-foot, the more efficient supplier is

Metropolitan. (*Ibid.*) If Metropolitan's transportation rate for wheeled water were lower than its transportation rate for its own water, the less efficient supplier could nonetheless provide water at an overall cheaper rate, but at Metropolitan's expense. Such a system would be inefficient because it would create a market for more costly water – which would merely replace available, cheaper water – through artificially low transportation costs.

Moreover, in this situation, a third-party seller could simply raise the price of the water itself to just under the point where the water price plus the wheeling rate equals Metropolitan's bundled rate for water and delivery. As Metropolitan loses sales, it would be forced to raise the water rates it charges its member agencies to recoup the costs it would not be recouping in the wheeling rate. In effect, Metropolitan's member agencies would be subsidizing wheeling transactions. The agency that purchases water from the third-party seller may pay slightly less than it would pay to Metropolitan for water and delivery, but the portion of the price representing the cost of water would be higher. Thus, the seller, not the purchasing agency, would reap most of the benefit of Metropolitan's subsidized wheeling rate. To the extent the purchasing agency pays a slightly lower total price than what Metropolitan would charge, the purchaser benefits at the expense of all the other agencies, who must shoulder higher water rates. The region as a whole is worse off by reason of wheeling transactions at subsidized rates.

Indeed, a significant reason for defendants' objection to Metropolitan's wheeling rate was that it would make the price they hoped to charge (or pay) for water noncompetitive when combined with the cost to wheel the water. (CT p. 1708 [Metropolitan's wheeling rate would prevent Chemehuevi Indian Tribe from receiving "fair rental value" for use of its water]; CT p. 2416 ["it becomes clear that it is not possible to compete with [Metropolitan's] rate for untreated water"].) Metropolitan's rate for delivery of untreated water (as of

August 1997) was $349 per acre-foot. (CT p. 1128.) Water sellers like Imperial and the Chemehuevi Tribe hope to sell their water at rates ranging from $200 to more than $300 per acre-foot.[20] (CT p. 1126 [Imperial proposing to sell water to San Diego for $200 to $306 per acre-foot]; CT p. 1708 [Chemehuevi Tribe has entered into letters of intent for leasing water at minimum price of $200 per acre-foot].) A seller asking $300 per acre-foot can compete with Metropolitan only if it pays a wheeling rate of less than $49 per acre-foot.

If sellers are required to pay the true cost of transmission, as reflected in Metropolitan's wheeling rates, rather than having the unfair advantage of a below-cost wheeling rate, price comparisons between the water offered by Metropolitan and that offered by other water sellers will be meaningful. Other water sellers will be able to compete only if they can supply water as efficiently as Metropolitan, so efficient water use will be promoted. If a seller is able to offer water at a price below what Metropolitan charges, then the transaction makes economic sense and everyone involved benefits. The seller recoups its expenses and earns its profit, the buyer pays less for delivered water, and Metropolitan, through its wheeling charge, recoups the costs it incurs to provide the transportation service, thereby sparing its member agencies a price hike and avoiding the "free rider" problems that would jeopardize Metropolitan's viability (see *ante*, at pp. 38-42).

In contrast, if Metropolitan were obliged to offer below-cost wheeling rates, the subsidized wheeled water would be used in place of water already purchased and reserved for the benefit of southern California. For example, Metropolitan's contract with the State Water Project requires it to pay for its

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20/ Under the Boulder Canyon Project Act, Imperial pays nothing "for water or for the use, storage, or delivery of water for irrigation or water for potable purposes." (43 U.S.C.A. § 617.)

two million acre-foot annual entitlement *regardless* whether it actually takes the water. (CT p. 1117.) A major part of the rate Metropolitan charges for the sale and delivery of water is designed to pay for this entitlement. Thus, southern Californians purchasing water from Metropolitan are paying to ensure that State Water Project water is available for all residents of Metropolitan's service area. If wheeling is allowed at subsidized rates, Metropolitan will have to increase its water rates to recoup costs not covered by the wheeling rates. This rate increase would reflect the cost of delivering water to some southern Californians in place of State Water Project water. Other southern Californians who purchase water from Metropolitan would, in effect, be paying twice – once to pay for State Water Project water (which benefits all of Metropolitan's member agencies) and again to pay for delivering wheeled water (which benefits only the purchasing agency). Paying twice for water is inefficient, but the trial court's interpretation of the wheeling statutes will produce exactly that result.

4. The trial court's construction of the wheeling statutes should be rejected because it raises serious questions whether the statutes unconstitutionally impair bonds secured by Metropolitan's water revenues.

Even if the text of the wheeling statutes, the legislative intent, and the policy underlying the statutes left any doubt that the statutes permit Metropolitan to recoup its capital and systemwide costs through its wheeling rates, the court would be obliged to so construe the statutes under "the principle that a statute which is reasonably susceptible of two constructions should be interpreted so as to render it constitutional." (*San Francisco Unified School Dist. v. Johnson* (1971) 3 Cal.3d 937, 942; see *Estate of Skinker* (1956) 47 Cal.2d 290, 297.)

The trial court's reading of the wheeling statutes – which denies Metropolitan the ability to recover the full costs that the Board determined Metropolitan incurs to render wheeling service – should be rejected because it raises grave constitutional problems under the impairment-of-contract clauses in both the United States Constitution and the California Constitution. (See *Morro Hills Community Services Dist. v. Board of Supervisors* (1978) 78 Cal.App.3d 765, 773-774 [preferring statutory interpretation that "avoids conflict with the constitutional proscription against impairing contracts"].)

Article I, section 10 of the United States Constitution and article I, section 9 of the California Constitution prohibit "law[s] impairing the obligation of contracts." To determine whether a legislative act has violated these state and federal constitutional provisions, courts first look to whether the impairment is "substantial." (See *Board of Administration v. Wilson* (1997) 52 Cal.App.4th 1109, 1154 [interpreting state clause].) If a substantial impairment is found, the law is unconstitutional unless the State had a "significant and legitimate public purpose" and sought to effectuate that purpose by reasonable means. (*Id.* at p. 1156.)

Courts have found a "substantial impairment" of public bonds where the legislation in question substantially affected the "financial framework" originally relied upon by bondholders in purchasing the securities. For example, in *Islais Co., Ltd. v. Matheson* (1935) 3 Cal.2d 657, bonds were issued by a group of property holders to cover an assessment by a local reclamation district. The bonds were issued pursuant to a California code section that specified the interest rate and penalties for delinquencies. After issuance, the Legislature amended the code section to reduce the interest rates and penalties. The Supreme Court held that, because the interest rates and penalties were "an integral part of the fund specifically constituted by law as security for the payment of outstanding bonds," amendment of the code section violated the federal and state contract clauses. (*Id*. at p. 666; see *United States Trust Company v. New Jersey* (1977) 431 U.S. 1, 19 [52 L.Ed.2d 92, 97 S.Ct. 1505, 1516] [legislation repealing statutory covenant between port authorities and bondholders limiting port authorities' ability to purchase commuter railroads was an unconstitutional impairment of contract because the covenant was an "important security provision"].)

Metropolitan issues bonds that are secured by its water sales revenues. (Exh. 207, p. 346; see Stats. 1972, ch. 169, § 1, p. 389, West's Wat. Code – App. (1995 ed.) § 109-237 [Board may provide for issuance and sale of revenue bonds].) In addition, Metropolitan's take-or-pay contract with the State Water Project (see *ante,* fn. 3) provides essential security for the holders of bonds issued by the State Water Project (§ 12937, subd. (b)).

Metropolitan's ability to repay its own revenue bonds and to fulfill its financial commitment to the State Water Project depends on its water revenues. Metropolitan's ability to generate water revenues is therefore a crucial component in the financial structure of both its own revenue bonds and the State Water Project's bonds.

If the wheeling statutes are interpreted to allow Metropolitan to recover only the marginal costs of providing wheeling service and thus to subsidize the transportation costs of competing water sellers, Metropolitan's ability to compete will be hobbled. For all the reasons discussed above, Metropolitan's water sales will decline, and its ability to raise water rates to compensate for the decline in sales will be hampered by the need to compete with sellers enjoying the unfair advantage of below-cost transportation charges. The entire financial framework of the bonds will be disrupted. The bondholders could, with justification, challenge the wheeling statutes as unconstitutionally impairing their security.[21]

On the other hand, if the wheeling statutes are interpreted to allow recovery of capital and systemwide costs – i.e., the costs the Board found Metropolitan incurs to provide wheeling service – the financial framework of the bonds would not be substantially affected, and no constitutional problems would arise. To avoid the constitutional problems, the wheeling statutes should be so interpreted.

III.

THE TRIAL COURT ERRED BY RULING METROPOLITAN COULD NOT SET A UNIFORM POSTAGE-STAMP WHEELING RATE FOR ITS MEMBER AGENCIES.

The Legislature requires that Metropolitan's water rates be "uniform for like classes of service throughout the district." (Stats. 1969, ch. 209, § 134, p. 506, as amended by Stats. 1984, ch. 271, § 4, West's Wat. Code – App. (1995 ed.) § 109-134.) In compliance with this legal requirement, and following the custom and practice of the water service industry, Metropolitan sets uniform postage-stamp rates for the water it sells to its member agencies without reference to the source of the water, the facilities used, or the distance traveled. As a result, each member agency pays the same average rate per acre-foot for its water. Otherwise, members would pay perhaps dozens of

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21/ The bondholders could also challenge the wheeling statutes under section 12937, subdivision (b), which provides that the State Water Project contracts "shall not be impaired by subsequent acts of the Legislature during the time when any of the bonds authorized herein are outstanding . . . ."

dramatically different rates for essentially the same service from a shared water supply system.

Statutes relating to the same subject must be harmonized. (*Central Pathology, supra,* 3 Cal.4th at p. 187.)

Since Metropolitan charges, and receives its revenues through, a postage-stamp rate for the water it *sells*, it is fair, appropriate and consistent with the legislative rate-setting scheme for Metropolitan to charge a postage-stamp rate for wheeling service. Were Metropolitan to charge a wheeling rate on a point-to-point, i.e., a per-mile, basis rather than on a uniform, postage-stamp basis, the wheeling rate would not be comparable to the water rate. It would be difficult for Metropolitan to assure its member agencies that they were paying a fair rate for wheeling compared to the rate for water.

Nothing in the wheeling statutes suggests that Metropolitan is prohibited from setting postage-stamp rates for wheeling water for its member agencies. The statutory language simply requires Metropolitan to set fair compensation that recovers the charges Metropolitan incurs in wheeling water. That Metropolitan's Board – composed of representatives of its member agencies – would choose to recover reasonable charges incurred in wheeling by setting uniform wheeling rates that are easily comparable to water sales rates is consistent with the wheeling statutes.

Metropolitan could, theoretically, recalculate its systemwide costs every time it receives a wheeling request. It makes more sense, however, simply to calculate those systemwide costs in advance of a request. More importantly, repeated recalculation of systemwide costs could expose Metropolitan to charges that different member agencies are being charged different wheeling rates – and that Metropolitan's compensation was not "fair" – because of some minor adjustment or change in the figures used. Member agencies could perceive Metropolitan's wheeling rates as not uniform.

By instead starting on a level playing field with a single, uniform rate to wheel water, then calculating power costs and offsetting benefits in connection with each transaction, as required by section 1811, subdivision (c), Metropolitan both satisfies the statute and recovers fair compensation. Nothing in the statute requires that Metropolitan recalculate fair compensation anew for each transaction. It only requires that Metropolitan calculate fair compensation in a timely manner. (§ 1812.) The apparent purpose of such a requirement is to facilitate water transfers by avoiding unnecessary delays in their administration. Setting a uniform rate prospectively itself facilitates water transfers, not just by preventing delays but by enabling parties to enter contracts for water transfers with an accurate idea of the costs involved.

The trial court construed the statutory requirement that the owner determine the system's unused capacity "in a timely manner" to mean that the owner cannot set a wheeling rate in advance of any wheeling request. (CT p. 3726.) The court's reasoning was unsound. Setting a wheeling rate and determining unused capacity are two different tasks, and they need not occur simultaneously. There is no reason why the owner cannot set a wheeling rate in advance, on a per acre-foot basis, then await a specific wheeling request before determining whether the system has sufficient unused capacity to accommodate the proposed wheeling transaction.

IV.

THE ATTORNEY'S FEES AWARD TO CPIL SHOULD BE REVERSED BECAUSE CPIL DID NOT ESTABLISH THAT IT CONFERRED A SIGNIFICANT BENEFIT ON THE PUBLIC OR THAT IT VINDICATED AN IMPORTANT RIGHT.

A. The Court May Not Award Private Attorney General Fees Unless All The Statutory Criteria Are Met.

The trial court awarded $70,600 in attorney's fees to CPIL under Code of Civil Procedure section 1021.5 (hereafter section 1021.5) (CT2 p. 608), which authorizes an award of attorney's fees to a "private attorney general." A fee award under section 1021.5 is reviewed for abuse of discretion. (*City of Sacramento v. Drew* (1989) 207 Cal.App.3d 1287, 1297.) The trial court's discretion is confined by the substantive law of section 1021.5. (*Id.* at p. 1298.)

In a case such as this, which produced no monetary recovery, the party seeking attorney's fees must show three elements: (1) that the action "'has resulted in the enforcement of an important right affecting the public interest,'" (2) that "'a significant benefit, whether pecuniary or nonpecuniary has been conferred on the general public or a large class of persons,'" and (3) that "'the necessity and financial burden of private enforcement are such as to make the award appropriate.'" (*Woodland Hills Residents Assn., Inc. v. City Council* (1979) 23 Cal.3d 917, 935 (hereafter *Woodland Hills*), quoting § 1021.5.) Each element must be satisfied. (*Satrap v. Pacific Gas & Electric Co.* (1996) 42 Cal.App.4th 72, 81 ["where the court finds that one of the statutory criteria is *not* met, it is unnecessary to make findings concerning the remaining criteria"].)

As Metropolitan shows below, CPIL did not establish either that it conferred a significant benefit on the public or that it enforced an important right. Accordingly, this court should reverse the order awarding attorney's fees to CPIL.

B. CPIL Did Not Meet Two Of The Statutory Criteria.

1. No significant benefit was conferred.

No fees can be awarded under section 1021.5 absent a *significant* benefit to the public. (*Woodland Hills, supra,* 23 Cal.3d at p. 939.) The trial court abuses its discretion if it awards fees where the action confers only a minimal benefit on the public. (*Mandicino v. Maggard* (1989) 210 Cal.App.3d 1413, 1416.) The significance of the benefit and the size of the benefitted class must be determined from a realistic assessment, in light of all the pertinent circumstances, of the gains that have resulted. (*Woodland Hills, supra,* 23 Cal.3d at pp. 939-940.)

The present case is fundamentally a dispute over how to allocate the costs of Metropolitan's water conveyance system. The effect of the trial court's judgment is to shift the costs of building and maintaining that system among members of the general public. Some members of the public may realize minimal economic benefits from the judgment, but others may be harmed.

For example, assume a hypothetical transaction in which Imperial wheels water to San Diego through Metropolitan's conveyance system. If Metropolitan's nonfirm wheeling rate applies, San Diego's customers will pay the true cost of transporting the water. In contrast, if the marginal cost rate contemplated by the trial court's judgment applies, Metropolitan will not be able to include the true cost of wheeling the water in the wheeling rate. (See CT p. 1126; CT2 p. 339.) San Diego's customers would avoid paying their appropriate share of the system costs. (See *ibid.*) Other residents of Metropolitan's service area who continue to obtain water from Metropolitan would have to pay higher water rates to make up for the costs Metropolitan was unable to recoup in its wheeling rates. (See *ante*, at p. 40; CT pp. 1126-1127; CT2 p. 339.) But, even while San Diego's customers are paying less to Metropolitan for the use of the system, they may well be paying more to Imperial for the water itself than Imperial could otherwise charge to remain competitive with Metropolitan. As explained in detail above (see *ante*, at pp. 38-42), what San Diego saves in wheeling charges, it will likely pay in the form of a higher water price.

A judgment deciding who must pay the true cost of water service can hardly be characterized as a significant benefit justifying an award of attorney's fees when the practical effect of the judgment is to confer a windfall on sellers of water at significant expense to many state residents.

CPIL postulated that the judgment will benefit the environment and the state's water resources. (CT2 pp. 64, 66-67.) It argued that if Metropolitan were forced to subsidize the cost of wheeling, then wheeled water would be much cheaper, leading to increased use of wheeled water and increased benefits to the environment. (*Ibid.*)

The trial court correctly rejected CPIL's argument. (CT2 p. 605.) CPIL's theory of significant benefit to the environment is speculation. CPIL offered no evidence to support the theory. Moreover, the public hardly benefits when less efficient suppliers of water are able to compete only because their costs are subsidized by that very public. Any claim that consumers will see any "significant benefit" from cheaper wheeled water is pure speculation. How legislatively mandated subsidization for wheeling water will affect the general public has yet to be seen. It cannot be used here to support a claimed "significant benefit."

The trial court nonetheless found a significant benefit to the public, not because of any benefit to the environment or any impact on consumer prices but because

> "it is sufficient public benefit that the Wheeling Statutes have been interpreted in accordance with legislative intent.
>
> ". . . Securing compliance with a statute consistent with legislative intent is a common justification for fees without further benefit. *Woodland Hills, supra,* at 936-939." (CT2 pp. 605-606.)

In fact, *Woodland Hills, supra,* 23 Cal.3d at page 939, says just the opposite. Simply vindicating legislative intent does *not* confer a "significant benefit":

> "Of course, the public always has a significant interest in seeing that legal strictures are properly enforced and thus, in a real sense, the public always derives a benefit when illegal private or public conduct is rectified. Both the statutory language ('*significant* benefit') and prior case law, however, indicate that the Legislature did not intend to authorize an award of attorney fees in every case involving a statutory violation." (*Ibid.*)

Instead, the trial court must make a realistic assessment of the gains that have resulted, and then determine the significance of the benefit, if any, and the size of the benefitted class. (*Id.* at pp. 939-940.) *Folsom v. Butte County Assn. of Governments* (1982) 32 Cal.3d 668, cited by the trial court here in support of its assertion that fulfilling legislative intent is sufficient significant benefit, does not relieve the trial court of the obligation of making this assessment. In that case, the question before the Supreme Court was whether the plaintiffs were "successful." (*Id.* at p. 686.) As the Supreme Court noted, appellants did not challenge the trial court's other findings, including the finding of a significant benefit. (*Id.* at p. 687 & fn. 35.)

Because the trial court did not apply the *Woodland Hills* standard, the order was inconsistent with the substantive law of section 1021.5 and thus outside the court's discretion. (See *City of Sacramento v. Drew, supra,* 207 Cal.App.3d at p. 1298.) The order awarding attorney's fees must be reversed.

2. The trial court's order does not identify any important public right.

Woodland Hills, supra, and section 1021.5 require a finding by the trial court that the litigation vindicated an important right. (*Woodland Hills, supra,* 23 Cal.3d at p. 935.) While the right need not be constitutional,

> "the Legislature obviously intended that there be some selectivity, on a qualitative basis, in the award of attorney fees under the statute, for section 1021.5 specifically alludes to litigation which vindicates 'important' rights and does not encompass the enforcement of 'any' or 'all' statutory rights." (*Ibid.*)

Even litigation broadly vindicating constitutional rights does not necessarily reach the level of importance required by *Woodland Hills*. (*Marini v. Municipal Court* (1979) 99 Cal.App.3d 829, 837 [where defendant sought to construe and apply constitutional principles but did not challenge them, no vindication of important right].)

In its motion for attorney's fees, CPIL never explained what "important right" the litigation had vindicated, and the trial court did not find that CPIL had vindicated an important right.[22] The trial court's failure to make any finding in its order granting the award requires reversal.

22/ Metropolitan noted in its opposition to the motion for attorney's fees that vindication of an important right was a necessary prerequisite to an award of attorney's fees. (CT2 p. 314.)

C. Reversal Of The Court's Judgment In Any Respect Requires Reversal Of The Attorney's Fees Award.

"Where there is no causal connection between the plaintiff's action and the relief obtained, an attorney fee award is not proper." (*Westside Community for Independent Living, Inc. v. Obledo* (1983) 33 Cal.3d 348, 353; see *Ciani v. San Diego Trust & Savings Bank* (1994) 25 Cal.App.4th 563, 572 [where private party participates in litigation with public party, private party must have advanced significant factual or legal theories adopted by the court or produced substantial evidence significantly contributing to the judgment].) In the trial court, CPIL rode the coattails of Imperial and San Diego. Despite the considerably more active participation of Imperial and San Diego, the trial court nonetheless awarded attorney's fees to CPIL based on its finding that CPIL advanced statutory construction arguments that the court accepted. (CT2 p. 608.) Therefore, the court held, CPIL had rendered "necessary significant services of value and benefit to the public." (CT2 p. 608.)

Of course, if this court reverses the judgment, CPIL will no longer be a "successful" party. The order awarding attorney's fees would have to be reversed.[23] (See § 1021.5 ["a court may award attorneys' fees to a successful party"]; *Simpson v. Unemployment Ins. Comp. Appeals Bd.* (1986) 187

23/ Likewise, in the event of reversal, the order awarding costs to the other defendants would have to be reversed. Defendants were awarded costs because the court found they were "prevailing parties" entitled to costs as a matter of right under Code of Civil Procedure section 1032, subdivision (a)(4). (CT2 p. 602.) That subdivision contains several alternative definitions for "prevailing party." While not specified by the court, defendants were apparently prevailing parties because they were "defendant[s] where neither plaintiff nor defendant obtains any relief." (See Code Civ. Proc., § 1032, subd. (a)(4).) If the judgment is reversed, it could no longer be said that Metropolitan did not obtain any relief. Thus defendants would no longer be prevailing parties entitled to costs.

Cal.App.3d 342, 354 [where judgment for plaintiff reversed, award of attorney's fees to plaintiff reversed as well because plaintiff no longer a "successful party"].)

But even if this court does not reverse the judgment in full, so long as the court disagrees in any respect with the trial court's construction of the wheeling statutes, the order awarding attorney's fees to CPIL should be reversed. The trial court will need to review this court's decision to determine whether it enforces an important right or confers a significant benefit on the public. If so, the trial court will then need to reevaluate CPIL's contribution to that result.

CONCLUSION

For the reasons discussed above, this court should reverse the judgment denying validation of Metropolitan's wheeling rates and should hold that the methodology by which Metropolitan set its wheeling rates comports with the requirements of the wheeling statutes. The court should also reverse the post-judgment order awarding attorney's fees to CPIL and costs to the other defendants.

Dated: August 24, 1999

Respectfully submitted,

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THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA
N. GREGORY TAYLOR

By:______________________________
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