



MWD

METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

Date: May 31, 2000
To: Board of Directors
From: General Counsel
Subject: Decision on Metropolitan's Wheeling Appeal

On May 30, 2000, the Second District Court of Appeal issued its opinion reversing the trial court's decision against Metropolitan in its wheeling case, Metropolitan Water District v. All Persons Interested. In a unanimous opinion signed by Justice Paul Turner, presiding justice of Division Five of the Second Appellate District, the Court held that Metropolitan had properly followed the law in establishing its wheeling rate. In particular, the court held that neither Metropolitan nor any other conveyance system owner is prohibited by the Wheeling Statutes from setting a fixed wheeling rate which includes recovery of a proportionate share of system-wide costs. The Appellate Court ordered its opinion published; as a published opinion it will be binding on all trial courts in California. The case will now be sent back to the trial court for a determination whether the specific costs included in Metropolitan's rate calculation were proper.

Metropolitan's Board adopted Metropolitan's current wheeling rate methodology on January 14, 1997. Since Metropolitan was the first public agency to have established a methodology to determine "fair compensation" for wheeling in its system under the Wheeling Statutes, it filed an action to determine the validity of its methodology. The case was assigned to Judge Laurence Kay of the San Francisco Superior Court, who issued a decision on January 30, 1998, determining that Metropolitan's wheeling rate violated the Wheeling Statutes. Prior to reviewing the specific facts underlying Metropolitan's wheeling rate, Judge Kay interpreted the statutes to prohibit, as a matter of law, conveyance system owners such as Metropolitan from setting a fixed wheeling rate in advance of a particular transaction; from recovering system-wide costs; and from recovering anything more than the incremental costs of the wheeling transaction. Because he determined that Metropolitan's methodology was prohibited by statute, the trial judge did not review whether the specific system costs actually included were proper.

On Metropolitan's appeal from the trial court's decision, the Court of Appeal completely overruled Judge Kay's interpretation of the Wheeling Statutes. In so doing, the Court made several important legal determinations, including:

- Nothing in the Wheeling Statutes nor its legislative history supports the trial court's conclusion that system-wide costs may not be included in a wheeling rate calculation.
- The language of the statute does not support defendants' (San Diego County Water Authority, Imperial Irrigation District and others) contention that only point-to-point costs may be recovered, but "rather the Legislature has chosen words which convey a materially

broader right of compensation on the part of the water system operator, in this case, the Metropolitan Water District.”

- The Wheeling Statutes do not limit “fair compensation” to “actual, increased, or marginal expenditures in terms of ‘capital, operation, and maintenance costs,’” and “had the Legislature intended to limit recoverable capital, operation, and maintenance costs to actual cost, it would have used specific language to that effect.”
- A wheeling rate need not be established on a case-by-case basis, but may be a fixed rate established in advance of particular transactions.
- The construction of the Wheeling Statutes by conveyance system owners such as Metropolitan must be accorded great weight.

The opinion also disagreed with a number of assertions made by defendants regarding the Legislature’s intent with respect to the recovery of “fair compensation.” First, the Court found no evidence supporting defendants’ assertion that “the Legislature acted out of a concern that water conveyance facility owners in general, or the Metropolitan Water District in particular, were blocking wheeling transactions by ‘demanding unreasonable prices for access.’” It then went on to explain that “contrary to the assertions of the San Diego County Water Authority and CPIL, the Legislature did not enact any language requiring that wheeling transfers be accomplished ‘at the lowest possible charge.’” Instead, the language used by the Legislature was intended to allow the owner of a conveyance system to recover fair compensation for, and avoid financial impact from, the requirement that it allow third parties to use its system:

“The Legislature recognized that in return for making facilities available, a water conveyance system owner should be reasonably compensated for the use of the system. There is no indication the Legislature ever intended that the water conveyance system owner should suffer potential or actual financial loss as a result. Rather, the Legislature took repeated steps to enact compensatory language that would enable water conveyance system owners to provide the desired wheeling services while recovering their costs. In short, the Legislature did not intend that the impact of the Wheeling Statutes should be to cause a water conveyance system owner to lose money or to subsidize wheeling transfers.”

The opinion also responded to the San Diego County Water Agency’s assertion that it was unreasonable to require member agencies to pay for past system costs in a wheeling transaction. The Court held that it was reasonable to recover those costs because the member agencies caused Metropolitan, “through its board of directors, to incur the cost of developing the infrastructure that serves the member agencies; an infrastructure that is utilized in wheeling water.”

Thus, the Appellate Court determined that a conveyance system owner may establish a methodology for calculating a fixed wheeling rate that includes system-wide costs and is not limited to incremental costs. Since the trial court incorrectly determined that Metropolitan could not set such a rate, it did not review the specific cost items that Metropolitan included in its wheeling rate. Consequently, the Appellate Court returned the case to the trial court to determine, consistent with the appeals court’s legal determinations, whether Metropolitan properly include specific costs in its wheeling rate calculation.

Board of Directors

Page 3

May 31, 2000

In addition to further trial court proceedings, defendants may petition the Appellate Court to reconsider its decision by June 14, 2000, and ultimately may petition the California Supreme Court to review the appeals court's decision.

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