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SUPERIOR COURT OF THE STATE OF CALIFORNIA

COUNTY OF SAN FRANCISCO

SAN DIEGO COUNTY WATER AUTHORITY, Petitioner and Plaintiff, v. METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA; ALL PERSONS INTERESTED IN THE VALIDITY OF THE RATES ADOPTED BY THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA ON APRIL 10, 2012 TO BE EFFECTIVE JANUARY 1, 2013 AND JANUARY 1, 2014; and DOES 1-10;, Respondents and Defendants.	Case No. CPF-10-510830 Case No. CPF-12-512466 **MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF RESPONDENT AND DEFENDANT METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA'S MOTION FOR A NEW TRIAL** Hon. Curtis E.A. Karnow Dept.: 304 Actions Filed: June 11, 2010; June 8, 2012 Trial Date: Completed Date: December 17, 2015 Time: 2:00 pm

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I. INTRODUCTION

The Court should correct prejudicial errors and address significant omissions that have resulted in an excessive judgment of over $232 million against Metropolitan Water District of Southern California ("MWD").[1] After a bench trial, the Court has broad powers to change its Statements of Decision or modify the judgment based on the existing record, as well as to order a new trial on some or all of the issues in the case. This is particularly appropriate when the judgment (or decision) is so ambiguous and uncertain that it is impossible to tell how a material constitutional issue – Proposition 26 in this case – is determined, when the conclusion on that constitutional issue is "against the law," and when the damages award overcompensates the plaintiff. Code Civ. Proc. §§ 662, 657.[2]

Here, the Phase I decision is "against the law," because (1) it does not apply *Goodman v. County of Riverside,* a binding appellate decision relating specifically to the State Water Project ("SWP") costs of State Water Contractors including MWD,[3] and (2) it fails to apply the exceptions to Proposition 26 intended by the voters for payor-specific charges. Cal. Const., art.[4] XIII C, § 1(e)(1) and (2); *see also* Code Civ. Proc. § 657(6) (motion for new trial proper when decision is "against the law"). The decision lacks analysis regarding the applicability of these exceptions to MWD's water rates. *See Schmeltzer v. Gregory*, 266 Cal. App. 2d 420, 422 (1968) (motion for new trial proper when decision is ambiguous or uncertain). However, its analysis on other issues demonstrates the Court subjected the MWD rates to a much stricter cost standard than

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[1] On August 28, 2015, the Court awarded San Diego County Water Authority $188,295,602, plus interest on its breach of contract claim. On October 9 and 30, 2015, the Court ruled that the statutory 10% prejudgment interest – not Section 12.4(c) of the Exchange Agreement – applies to interest on the damages award, resulting in an additional $44,139,469 in damages, with statutory prejudgment interest continuing to accrue until the entry of judgment, which has not yet occurred as of the date of this Motion's filing.

[2] While MWD objects to the Court's Statements of Decision on many legal and factual grounds, it raises only certain major errors herein.

[3] *Goodman v. Cnty. of Riverside*, 140 Cal. App. 3d 900, 910 (1983).

[4] All references to articles are to the articles of the California Constitution, unless otherwise noted.

is required by Proposition 26 and other rate setting principles.[5]

In addition, the Court denied MWD a fair trial by denying limited supplemental expert discovery to address the effect, if any, of the Phase I decision on damages under the Exchange Agreement, and in precluding expert and fact testimony on contract damages at trial. Code Civ. Proc. § 657(1) and (7). Expert discovery closed before the Phase I trial and clearly the experts could not have opined on the application of the Phase I decision to contract damages before the Phase I decision was issued. Expert and factual evidence in light of the Phase I decision was required not only for San Diego County Water Authority ("SDCWA") to prove breach and damages, but for MWD to defend itself.

Further, the Court committed prejudicial errors to which MWD objected, leading to an excessive damages award. Code Civ. Proc. § 657(7). The Phase I decision improperly served as the sole basis for the finding of breach, which lead to the excessive contract damages award, but that decision was not applicable outside the wheeling context. The Court also erred in awarding SDCWA 100% of the disputed costs, which the Phase I decision did not support. Additionally, the over $232 million award is excessive and overcompensates SDCWA, because the parties' lawful first year contract price must be the baseline; MWD established that 40% of SDCWA's 2011-2014 exchange water deliveries were SWP water, so 40% of the deliveries should be excluded from the damages calculation; and SDCWA failed to apply the proper unit rate for the exchange water SDCWA received. Finally, in awarding statutory prejudgment interest, the Court disregarded the Exchange Agreement's interest provision. The judgment fits squarely within the grounds for new trial as it contains excessive or inadequate damages, based on erroneous applications of the law. Code Civ. Proc. § 657(5), (6) and (7).

II. THE COURT HAS BROAD DISCRETION TO CHANGE ITS STATEMENTS OF DECISION, MODIFY ITS JUDGMENT OR GRANT A NEW TRIAL

A "decision may be modified or vacated, in whole or in part, and a new or further trial

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[5] *See California Farm Bureau Fed'n v. State Water Res. Control Bd.*, 51 Cal. 4th 421, 438-439 (2011); *see also Capistrano Taxpayers Ass'n v. City of San Juan Capistrano*, 235 Cal. App. 4th 1493 (2015); *Moore v. City of Lemon Grove*, 237 Cal. App. 4th 363 (2015).

granted on all or part of the issues…," even after entry of judgment. Code Civ. Proc. § 657. The court's power to grant a new trial is extremely broad, and extends to the following grounds: (1) irregularity in the proceedings; (2) misconduct of the jury; (3) accident or surprise; (4) newly discovered evidence; (5) excessive damages; (6) insufficiency of the evidence; and (7) error in law. *Id.*; *see also Jiminez v. Sears, Roebuck & Co.*, 4 Cal. 3d 379, 387 (1971); *Lane v. Hughes Aircraft Co.*, 22 Cal. 4th 405, 411 (2000) (new trial orders are reviewed under a highly deferential standard); *Diel v. Sec. Title Ins. Co.*, 142 Cal. App. 2d 808, 811 (1956) (motion for new trial properly granted after bench trial).

On a motion for new trial in a matter tried without a jury, the court may change or add to the statement of decision, modify the judgment, vacate the judgment, grant a new trial on part of the issues, or vacate and set aside the statement of decision and judgment and reopen the case for further proceedings. Code Civ. Proc. § 662; *Lala v. Maiorana*, 166 Cal. App. 2d 724, 734 (1959) (affirming trial court's ruling that set aside previous findings of law and the judgment predicated thereon). Courts may even consider new legal theories under undisputed facts to rule on a motion for new trial when the judgment is challenged on grounds that it is "against the law." Code Civ. Proc. § 657(6). *Hoffman-Haag v. Transamerica Ins. Co.*,, 1 Cal. App. 4th 10, 15-16 (1991) (motion for new trial properly granted on basis of Insurance Code statute not raised or considered at trial).

III. THE PHASE I RATE RULING IS AGAINST THE LAW AS IT IS INCONSISTENT WITH BINDING APPELLATE HOLDINGS AND LEGAL STANDARDS

A judgment is against the law and properly the basis for a new trial when "the findings are so inconsistent, ambiguous, and uncertain that they are incapable of being reconciled and it is impossible to tell how a material issue is determined … ." *Schmeltzer,* 266 Cal. App. 2d at 423; Code Civ. Proc. § 657 (6). Here, the Court's Phase I ruling ignores binding appellate law relating to treatment of MWD's costs. Moreover, the Phase I ruling ignores binding and critical legal standards for constitutional rate challenges established by the California Supreme Court. Indeed, it is impossible to reconcile the Phase I conclusions with the published decisions and, at a minimum, detailed analysis is required to explain the Court's departure from existing binding law

and principles.

A. The Phase I Decision Is Against The Law On The Material Issue Of Recovery of MWD's SWP Transportation Costs Through Its Transportation Rates And Rate For Wheeling Service

SDCWA made two arguments why SWP transportation costs should not be recovered through MWD's transportation rates and rate for wheeling service: (1) SWP costs are not MWD's costs because MWD does not own the SWP distribution system; and (2) wheelers do not use the SWP system. SDCWA Phase I Closing Br., 24-25. Both arguments are wrong. Nevertheless, the Court invalidated the 2011-2014 System Access Rate ("SAR") and System Power Rate ("SPR") as overcollecting from wheelers, because those rates include SWP transportation costs. The Court ruled that MWD could not include 100% of the SWP transportation costs in these rates, and that SWP costs are "supply costs" because the State (not MWD) owns and operates the SWP. Phase I Statement of Decision On Rate-Setting Principles ("Phase I SOD"), 53, 65.

The Court's ruling that there is "no reasonable basis" to conclude that SWP costs are MWD's costs is inconsistent not only with the State Water Contract between MWD and the State Department of Water Resources ("DWR"), but also with an appellate decision that is directly on point. In *Goodman v. Cnty. of Riverside,* 140 Cal. App. 3d 900 (1983), the Court of Appeal analyzed whether taxes assessed by a retail water agency, which is a State Water Contractor, complied with Proposition 13. That issue turned in part on whether the costs of SWP construction, operation, maintenance and replacement, for which the property taxes were assessed, were the State's costs or the agency's costs. *Id*. at 903, 910-11. The Court of Appeal explained that, although the SWP was funded by state bonds, the funding was pursuant to legislation that directed DWR to enter into contracts with local governmental entities requiring each to pay according to their entitlement, even though an agency may not "actually receive water." *Id.* at 904-05 (a typical contract between the State and a DWR contractor agency was entered into for the direct benefit of the SWP bond holders).

The plaintiffs argued that "the state is the debtor" and that the local water agency "never assumed any part of the debt." *Id.* at 907, 909. The Court of Appeal disagreed:

> The entire cost of the [SWP] was to be met by the proceeds of these

> contracts. *The state's General Fund was clearly nothing more than a conduit for the contract payments,* with the state, practically speaking, serving as a guarantor . . . .

Id. at 909 (concluding that the local agency had the debt obligation) (emphasis added). The costs of "building, operating, maintaining, and replacing the [SWP]" were – by voter approval – to be "met by payments from local agencies." *Id.* at 910. It is the SWP contracting agencies that have "ultimate responsibility for the indebtedness" and therefore own the cost obligations. The voters' approval for the *State* to build the SWP, issue debt to do so, and enter into the State Water Contracts, the Court of Appeal reasoned, was approval also of the Contractors' obligations *and right to exercise its taxing authority to pay for the SWP*. *Id.* at 909.

Here, the Court's conclusion that MWD may not recover its SWP costs through its transportation rates because it does not "own" the SWP is contrary to the *Goodman* decision. Under its contract with DWR, MWD and not the State owns the costs, which is the relevant fact. It is obligated to pay all costs necessary to transport SWP water to MWD's service area, including capital costs for facilities to deliver water, maintenance and repair costs, and the power costs to pump water to MWD. DTX-006 at 26, 64, 67, 72, 80-81, 84, 88, 101. Because MWD is billed separately by DWR for these "transportation charges," MWD is able to specifically identify the portion of its SWP costs that relate to transportation and then reasonably and accurately allocates those transportation costs to the SAR and SPR components of its rates. DTX-137[6]

MWD's allocation of costs in determining its transportation rates and rate for wheeling service is consistent with *Goodman*. As the Court explained there, the voters understood and approved that State Water Contractors may meet their debt obligations pursuant to their *own* revenue raising mechanisms. As the *Goodman* decision makes clear, the SWP costs *are* MWD's costs, and the SWP is *an integral part* of MWD's transportation system used to convey water and provide wheeling services. Under *Goodman*, MWD's Board could reasonably allocate SWP transportation costs to transportation, and its decision was entitled to this Court's deference.

[6] The SAR and SPR also recover costs associated with MWD's transportation facilities, its distribution system, and the Colorado River Aqueduct (CRA). DTX-039 at 3; DTX-45 at 6-7.

In Phase I, the Court agreed that wheelers can be lawfully charged for the system-wide costs attributable to the conveyance system. Phase I, SOD, 57. Clearly member agencies purchasing full service water also can be lawfully charged for these system-wide costs. Here, the evidence shows that the SWP portion of MWD's transportation system costs is essential to providing conveyance services, including to SDCWA. SDCWA's person most knowledgeable on damages, Assistant General Manager Dennis Cushman, admitted that MWD is required by law to provide a blend of SWP water, to the extent determined by MWD to be reasonable and practical, and that MWD has to pay SWP transportation costs to provide SWP water to SDCWA. Trial Transcript ("Trial Tr.") at 238:12-239:1 (Cushman); MWD Act § 136. Further, SDCWA's December 2008 letter requesting wheeling service for the year 2009 referenced MWD's right to use the SWP facilities, evidencing SDCWA's understanding that MWD's wheeling services necessarily include the right to use the SWP facilities. Trial Tr. at 1507:2-16 (Stapleton); DTX-75. Moreover, MWD's deliveries to SDCWA under the Exchange Agreement during the years at issue (2011-2014) were 40% SWP water and 60% Colorado River water. Trial Tr. at 1684:2-8 (Yamasaki); DTX-1156.

This Court's error in finding that SWP costs are not part of MWD's system-wide conveyance costs had a far-reaching domino effect in Phase I. It improperly skewed the Court's reasonableness analysis under the Government Code, Proposition 26, the Wheeling Statute and the common law. And if the Court properly recognized the SWP transportation costs as MWD's costs, then it would follow that MWD's rates which include these costs are charges for the purchase or use of local governmental property, which fits Proposition 26's (e)(4) exception (which does not contain a reasonableness requirement). In addition, the Court could not properly conclude that the SAR and SPR are invalid under the Wheeling Statute solely because those rates include SWP costs.[7] Thus, given the absence of findings on these material issues, including the

[7] The Exchange Agreement is not a wheeling agreement and SDCWA *did not* wheel water during the operative time period. Trial Tr. at 1087:2-5 (Cushman); Trial Tr. at 1574:9-1583:8 (Stapleton); DTX-44A at 438:14-20; DTX-78 at 20-22; DTX-1143 at 153-157. Moreover, agencies that *do* wheel water do not pay the SPR—instead, wheelers pay the SAR, the WSR and actual power costs

applicability of *Goodman*, the Court should revisit its findings and conclusions and follow *Goodman*.

SDCWA was required to prove that MWD's decision to allocate its SWP transportation costs to the transportation components of its full service water rate (the SAR and SPR) and its rate for wheeling service (the SAR) was arbitrary and capricious or unreasonable for purposes of the non-Proposition 26 claims.[8] That is a showing SDCWA did not and cannot make. This failure affected the Phase I facial challenge to these rates, as well as the Phase II breach of contract claim as the parties agree the price term is based on the transportation components of the full service rate. On the Proposition 26 claim on which MWD had the burden of proof, MWD through the State Water Contract and the *Goodman* decision amply satisfied it.

The Court's conclusion that SWP costs are not MWD's costs is inconsistent with the evidence and contrary to binding law; it requires a new ruling. Civ. Proc. Code §§ 657(6), 662.

B. The Phase I Decision Is Against The Law On The Material Issue Of The Applicability Of The Exceptions To Proposition 26 For A Payor-Specific Benefit And Service

Throughout this case, MWD has asserted that Proposition 26 does not apply to its rates (for full service water or wheeled water services).[9] MWD will not rehash those arguments. Instead, MWD asks the Court to analyze the reasonableness of MWD's costs pursuant to specific

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of moving wheeled water through MWD's distribution system. Trial Tr. at 1081:1-6 (Cushman); DTX-1149A. As a matter of law, the Wheeling Statute cannot invalidate the SPR.

[8] Judicial review of an administrative agency's quasi-legislative action is confined to the question of whether such action is arbitrary, capricious, or without reasonable or rational basis. *Great Oaks Water Co. v. Santa Clara Valley Water Dist.*, No. 239 Cal. App. 4th 456, 507 (2015). A court violates the separation of powers when it substitutes its own judgment for the judgment of the governing body of the agency. *Id.* at 507.

[9] As MWD has explained, its rates are not "imposed" on MWD's member agencies, nor are they compulsory. Therefore the rates are not "taxes" under section 1(e) of Article XIII C of the California Constitution. Moreover, multiple Proposition 26 exceptions to the definition of taxes apply. Specifically, MWD's rates fit Proposition 26's first and second exceptions for a payor-specific government benefit/privilege and service/product, as discussed herein, as well as Proposition 26's fourth exception for the purchase or use of local government property. Further, even if Proposition 26 applies, the rates were approved by a two-thirds vote of MWD's Board of Directors, which is the relevant electorate given MWD's role as a wholesale water agency and the State law requirement that the representatives on MWD's Board set MWD's rates (MWD Act § 133).

exceptions to the definition of "taxes" added by Proposition 26: the exception at article XIII C, § 1, subd. (e)(1) for the reasonable costs incurred by MWD to provide the payor-specific benefits of conveyance, and the exception at article XIII C, § 1, subd. (e)(2) for the reasonable costs incurred by MWD to provide the payor-specific services of conveyance. Art. XIII C, § 1, subd. (e)(1) and (2). The Court's conclusion that Proposition 26 applies to MWD's payor-specific charges is incorrect and no analysis in the Phase I decision explains how, or whether, the Court applied the correct reasonableness standard, established by the California Supreme Court, applicable to payor-specific exceptions. *See* Phase I SOD, p. 48 (lacking any reference to specific exceptions analyzed under Article XIII C, § 1, subd. (e)); *Cal. Farm Bureau*, 51 Cal. 4th at 438-439 (explaining reasonable cost standard).

Whether a charge is exempt from Proposition 26 pursuant to the payor-specific charges exception depends on the reasonableness of the collective costs to an agency. Art. XIII C, § 1(e)(1) and (2) (exempting charges to the extent they do not exceed the agency's reasonable costs); *Cal. Farm Bureau*, 51 Cal. 4th at 438-439. Yet the Supreme Court decision explaining that standard is not analyzed or applied in the Phase I decision. Notably, the development of recent appellate cases relating to constitutional rate setting since the Phase I decision was issued highlights the significance of the missing analysis. *See Capistrano Taxpayers Ass'n v. City of San Juan Capistrano* ("*Capistrano*") 235 Cal. App. 4th 1493 (2015); *Moore v. City of Lemon Grove* ("*Lemon Grove*") 237 Cal. App. 4th 363 (2015).

In the Phase I decision, the Court references a "cost causation principle" and its analysis indicates it applied a specific cost *proportionality* analysis, which *may* arguably be appropriate for a Proposition 218 case – but it is not correct for the Proposition 26 exceptions that expressly call for a "reasonable" cost standard. Phase I SOD, pp. 27-30 (addressing Proposition 218 and 26 cases interchangeably) and 47-48 (applying "cost causation principle"); *see also* Article XIII D, §§ 4, 6 (proportionality required for special assessments and property-related fees). The Court's use of a stricter cost allocation standard than is required, *even in Proposition 218 cases*, departs from well-established principles existing prior to the Phase I decision and further applied since that decision.

Notably, the standard the Court applied in the Phase I decision is diametrically different than the standard this same Court recently applied in another rate challenge. This Court presided over a rate challenge to the validity of a fee. RJN, Ex. 2, *BIA* Trial Court Statement of Decision, p. 4; *see also BIA*, 352 P.3d 418 (Cal. 2015), California Supreme Court's grant of review; RJN, Ex. 3, Case Summary re Issues on Review. In *BIA*, this Court explained that the "critical touchstone of 'reasonableness' is not measured by the impact on individual payors; it is 'measured collectively'." In other words, individual cost proportionality or cost causation, as this Court has applied in the present case, is *not* the constitutional test for the validity of fees that are subject to a reasonableness standard. *See id.* Indeed, in *BIA*, this Court upheld as reasonable a fee charged to one group of waste dischargers (stormwater dischargers) that collected more from that group than the costs the Board incurred to run the program for that group of users. *See* RJN, Exs. 2-3. The California Supreme Court has granted review of *BIA* to address specifically whether the charge at issue there is subject to Proposition 26. RJN, Ex. 3.

Moreover, as recent Proposition 218 cases demonstrate, even the stricter cost proportionality required by Proposition 218, compared to Proposition 26, does not limit rates to the costs of providing a specific service or benefit to a specific user. *See Capistrano,* 235 Cal. App. 4th at 1502; *Lemon Grove,* 237 Cal. App. 4th at 373-374. Thus, the Court's conclusion that MWD's generally applicable transportation rates and rate for wheeling service for 2013-2014 violate Proposition 26, based on proportional "cost causation principles," is "against the law." This is particularly true if, as it appears, the Court based its decision on a single payor: SDCWA.

C. MWD's Payor-Specific Charges for Conveyance Are Exempt From the Proposition 26 Definition of Taxes Under the Correct Reasonable Cost Standard

The language of the Proposition 26 exceptions reflects the intent of the voters: to leave unaffected "legitimate [government] fees" charged for governmental activity directly related to a group of payors and measured pursuant to a collective reasonableness standard. *See* RJN, Ex. 1, Ballot Pamp., Gen. Elec., Nov. 2, 2010, argument in favor, at 60, and Legislative Analysis at 58 ("Some Fes and Charges Are Not Affected. The change in the definition of taxes would not affect most user fees …"); *see also* art. XIII C, § 1, subd. (e)(1) – (7). Although the voters sought to

redefine local "taxes" to add the constitutional voting requirement to charges imposed by local agencies for services or government activity unrelated to the payor, the voters approved exceptions for payor-specific charges they believed would "Not [be] affected" by Proposition 26. *Id.*[10] The exceptions at section 1(e) reflect the manner in which each of the types of charges, including user fees, were treated prior to Proposition 26 and mandates how they should be treated after Proposition 26.[11] Relevant here are the two specific exceptions that exclude from Proposition 26 charges to the extent they collectively constitute all of the reasonable costs of the agency to provide the benefit or service to the group of payors. Art. XIII C, § 1, subd. (e)(1) and (2). These exceptions are subject to a collective reasonableness standard, consistent with the reasonableness standard consistently applied by the California Supreme Court before Proposition 26. *See Cal. Farm Bureau*, 51 Cal. 4th at 438-439.

Section 1(e)(1) of article XIII C of the California Constitution excludes from the definition of "tax":

> A charge imposed for a *specific benefit conferred or privilege* granted directly to the payor that is not provided to those not charged, and which does not exceed *the reasonable costs* to the local government of conferring the benefit or granting the privilege.

Art. XIII C, § 1(e)(1) (emphasis added). The language in Proposition 26's (e)(1) and (e)(2) is very similar. The (e)(2) exception excludes from the definition of "tax":

> A charge imposed for a *specific government service or product*

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[10] Thus, the MWD Board's allocation of SWP transportation costs to transportation in accordance with *Goodman* should "not be affected" by Proposition 26.

[11] Although courts have held that fees and charges for retail water service and other *property-related* retail water service are subject to Proposition 218; wholesale water and user fees, for example, unrelated to real property were not previously subject to Proposition 218 or considered a tax. *See Arcade County Water Dist. v. Arcade Fire Dist.*, 6 Cal. App. 3d 232, 240 (1970) ("characterization of [water] charges as a 'tax' is unfounded. A charge for services rendered is in no sense a tax"), citing *City of Oakland v. E.K. Wood Lumber Co.*, 211 Cal. 16, 25 (1930) (charge for service provided by government agency is not a tax imposed pursuant to police or other government power), superseded by statute at Gov. Code on other ground, § 53069.9*; Bighorn-Desert View Water Agency v. Verjil*, 39 Cal. 4th 205. 216 (2006) (retail water service to real property is subject to Art. XIII D, § 6 (added by Proposition 218), because the charges are imposed as an incident of property ownership); *Griffith v. Pajaro Valley Water Mgmt Agency*, 220 Cal. App. 4th 586, 594 (2013) (groundwater pumping charge subject to Art. XIII D, § 6).

> provided directly to the payor that is not provided to those not charged, and which does not exceed *the reasonable costs* to the local government of providing the service or product.

Art. XIII C, § 1(e)(2) (emphasis added). Both call for a review of the reasonableness of all of the agency's costs, which remains the constitutional test for the reasonableness of these payor-specific charges. *See Cal. Farm. Bureau*, 51 Cal. 4th at 438-439. Based on the Supreme Court's broad reasonableness standard of *Cal. Farm Bureau*, it is "against the law" to apply the reasonable cost standard interchangeably with the stricter cost proportionality standard." *See* Phase I SOD, pp. 26-30 (applying Proposition 218 decisions).

Here, the application of the same reasonableness standard to MWD's rates under Article XIII C, section (1)(e)(1) and (2) should yield the same result as in *Cal. Farm Bureau*. It is well established that MWD can develop rate structures based on the holistic costs of providing a service and is not required to develop user-specific rates. *Metro. Water Dist. of S. Cal. v. Imperial Irrigation Dist.*, 80 Cal. App. 4th 1403, 1426-27 (2000) (MWD can recover its costs through its wheeling rate "for the use of the (entire) conveyance system," not solely costs associated with the particular facilities used in a specific wheeling transaction); *Cal. Farm Bureau*, 51 Cal. 4th at 438 (in analyzing regulatory fees imposed pursuant to the Water Code, explaining that the reasonable cost of providing services is not measured on an individual basis, but instead collectively considering all rate payors). Proposition 26 does not alter this standard.

In fact, even recent decisions in the Proposition 218 context – which requires a stricter and more precise cost allocation than that of Proposition 26 – confirm that a public agency's holistic costs should be considered in making a cost of service determination. For example, in *Capistrano*, the Court of Appeal explained that, under Proposition 218, a public agency could properly pass on to its customers the capital costs of improvements to provide additional increments of water. 235 Cal. App. 4th at 1502. There, the city properly imposed a fee for recycled water services and delivery of recycled water services, despite the fact that not all ratepayers used recycled water. *Id.*; *see also Morgan v. Imperial Irrigation District*, 223 Cal. App. 4th 892, 918 (2014) (proportional cost of service review does not require precise calculations or information); *Lemon Grove*, 237 Cal. App. 4th at 370, 373-374 (apportionment of costs based on "best estimate" or

informal methods meets agency's burden under Proposition 218 as it was "reasonable under the circumstances"); *Griffith*, 220 Cal. App. 4th at 601 (an agency's rate methodology should be upheld if it is a reasonable way to apportion the agency's cost of service).

Thus, when applying the Proposition 26 (e)(1) and (e)(2) exceptions – which require a less strict reasonableness standard than a "cost causation" proportionality standard – to MWD's generally applicable transportation rates and rate for wheeling service, the Court should look at the *entire cost* to MWD to transport or to wheel all water for all of its member agencies. Art. XIII C, § 1, subd. (e)(1) and (2); *see also Cal. Farm Bureau*, 51 Cal. 4th at 438. Agencies that pay MWD's transportation rates or its rate for wheeling service receive the benefit of MWD's entire distribution and conveyance pipes and other transportation facilities, may use these pipes and facilities, and may also take advantage of MWD's contractual right to use the SWP pipes and other SWP transportation facilities. Trial Tr. at 1432:25-1433:5 (Upadhyay). Under Proposition 26, in assessing a facial challenge to MWD's generally applicable rates, it is "against the law" for the Court to limit its inquiry to the specific costs for a particular kind of conveyance, wheeling or exchange transaction.

Similarly, the demand management programs funded by the Water Stewardship Rate ("WSR") are part of MWD's collective costs for purposes of Proposition 26's (e)(1) and (e)(2) reasonableness analysis. In Phase I, the Court concluded that the WSR could benefit conveyance, lessen the need to spend on infrastructure, and free up capacity (which, for example, benefits those who wish to wheel water if there is available capacity). Phase I SOD, 60-61. The WSR pays for programs relevant to maintenance of MWD's system at large and that ease the overall burden on the distribution system. Trial Tr. at 1402:19-1404:1 (Upadhyay). Those costs must be considered by the Court when evaluating whether MWD's transportation rates or rate for wheeling service exceed its overall cost of service and whether its cost apportionment is reasonable. *See Griffith*, 220 Cal. App. 4th at 601 (costs of pipeline to deliver water to one set of groundwater pumpers subject to a groundwater pumping fee was properly charged to *all* groundwater pumpers and meets the substantive proportional limitations of Proposition 218); *see also Morgan*, 223 Cal. App. 4th at 918 (Proposition 218's reasonableness standard requires the agency to use reliable cost of service

information, not exact precision in apportioning costs).

The Court should vacate its Phase I Statement of Decision to consider, under the correct applicable law and standard, whether MWD's 2013-2014 transportation rates and rate for wheeling service fit Proposition 26's (e)(1) and (e)(2) exceptions.

IV. THE COURT'S DECISION NOT TO REOPEN EXPERT DISCOVERY FOR PHASE II AND TO PRECLUDE EVIDENCE DURING THE PHASE II TRIAL DENIED MWD A FAIR TRIAL

An erroneous ruling that precludes a party from introducing evidence is prejudicial and warrants a new trial. *Ballard v. Pac. Greyhound Lines*, 28 Cal. 2d 357, 362 (1946); *Chanda v. Fed. Home Loans Corp.*, 215 Cal. App. 4th 746, 751-52 (2013); *Bice v. Stevens*, 129 Cal. App. 2d 342, 356 (1954)*; see also Gonzales v. Pac. Greyhound Lines*, 34 Cal. 2d 749, 754 (1950); *In re Marriage of Carlsson*, 163 Cal. App. 4th 281, 294 (2008); *People ex rel. Dep't of Transp. v. Clauser/Wells P'ship*, 95 Cal. App. 4th 1066, 1086 (2002); *Jones v. Johnston Testers*, 132 Cal. App. 2d 162, 171 (1955). Code of Civil Procedure Section 657(1) authorizes a new trial based on "any order of the court or abuse of discretion by which either party was prevented from having a fair trial." Moreover, Section 657(7) also authorizes a new trial based on an error in law at trial to which the moving party objected.

In Phase I, the Court found that MWD could not include *all* SWP transportation costs and demand management costs in its transportation rates and rate for wheeling service, but it did not find what percentage *could* be allocated to these rates. Phase I SOD, 60. Neither party's expert had rendered, nor could have rendered, an opinion that applied the Court's Phase I analysis to the facts of the case, as expert discovery ended before the Phase I trial began.[12] Indeed, the Phase I trial was a facial challenge to rates that were already set and was limited primarily to the

[12] MWD's designated expert, Christopher Woodcock, explained that "until the Court rules [on the legality of MWD's rates], it is impossible to determine what the damages are, if any," from any alleged breach of the Exchange Agreement. DTX-123. Woodcock Expert Report at p. 25. SDCWA's person most knowledgeable on damages agreed that calculating damages prior to the Court's Phase I determination would not be possible. *See* Cushman Deposition at 422:7-10, 14-19, 44:3:20-444:2, designated for trial Dec. 16, 2013.

administrative record.[13] This limitation was proper in evaluating the rates as set by MWD's Board in Phase I, but not in determining alternative lawful rates that *could be* set in Phase II, where the scope of evidence on the breach of contract claim was relevance.

After the Court issued its Phase I decision, MWD moved to reopen expert discovery for a limited purpose. The Phase II trial required a determination of what rates *could have been set* by MWD's Board consistent with the Court's Phase I ruling regarding MWD's transportation rates and rate for wheeling service. This analysis is necessary because SDCWA is only entitled to the difference, if any, between the highest lawful rate it could have been charged under the Court's Phase I decision and what it actually paid. Any other standard would give SDCWA an unlawful windfall on its contract damages claim.

Despite MWD's showing of good cause, the Court refused to reopen expert discovery. It held that because MWD asserted the Court lacked jurisdiction to determine contract damages until the rate challenge was litigated through appeal and MWD's Board adopted replacement rates if applicable, MWD could not alternatively pursue the proposed expert discovery to rebut SDCWA's claimed damages. Dec. 4, 2014 Order at 2:6-12. This ruling was inconsistent with well-recognized principles that a party can argue in the alternative, which SDCWA was permitted to do. *Lynch & Freytag v. Copper,* 218 Cal. App. 3d 603, 613 (1990) (inconsistent contract defenses have long been recognized and permitted). The ruling unfairly limited MWD's ability to advance a damages case at trial.

The Court compounded the error during the Phase II trial. It improperly ruled that MWD's expert could not testify on: (1) "The fair and reasonable alternatives available to MWD to recover proper costs for exchange water, including fixed infrastructure costs, power costs and costs associated with conservation"; (2) "Reasonable and fair rates MWD could have charged SDCWA under the 2003 amended and restated exchange agreement"; and (3) "what MWD could properly have charged SDCWA in light of the rulings in Phase I." Trial Tr. at 1548:1-1549:4. Further, the

[13] In Phase I, the Court permitted evidence outside the administrative record only with respect to the "wheeling statute" at Water Code § 1810. Nov. 5, 2013 Order re: Pretrial Rulings, pp. 17-18.

Court erroneously sustained objections to a substantial portion of June Skillman's fact testimony, on the ground it was undisclosed expert testimony. *Id.* at 1805:24-1806:8; 1817:17-22; 1818:24-1819:12; 1825:10-1826:5; 1829:18-1830:14; 1831:5-18; 1832:12-17; 1833:14-1834:1 (Skillman).

By severely limiting MWD's expert and fact presentation during Phase II, the Court unfairly precluded MWD from offering multiple alternative measures of contract damages, and from presenting the fact evidence of the calculation of the alternative measure it did present concerning the delivery of 40% SWP water and 60% Colorado River water. That rendered the measure of damages all-or-nothing – and only SDCWA stood to benefit from the Court's rulings. The Court should vacate the judgment and its Phase II Statement of Decision and order a new trial on all issues in Phase II after the parties have conducted appropriate expert discovery.

V. THE DAMAGES AWARD IS EXCESSIVE AND OVERCOMPENSATES SDCWA

When damages are excessive, the judgment must be vacated and a modified judgment entered or a new trial granted. Code Civ. Proc. §§ 657(5), 662, 662.5. Damages are excessive where the evidence does not justify the amount of the award. *Stevens v. Parke, Davis & Co.*, 9 Cal. 3d 51, 61-62 (1973); *Mokler v. Cnty. of Orange*, 157 Cal. App. 4th 121, 147 (2007) (new trial was proper where damages were excessive); *McCoy v. Pac. Mar. Ass'n*, 216 Cal. App. 4th 283, 306 (2013) (damages are excessive if plaintiff receives more than is recoverable by law).

"Except as expressly provided by statute, no person can recover a greater amount in damages for the breach of an obligation, than he could have gained by the full performance thereof on both sides." Civ. Code § 3358; *see Brandon & Tibbs v. George Kevorkian Accountancy Corp.*, 226 Cal. App. 3d 442, 468 (1990); *Glendale Fed. Sav. & Loan Ass'n v. Marina View Heights Dev. Co.*, 66 Cal. App. 3d 101, 123 (1977). Here, the damages award exceeds the detriment caused by the alleged breach and gives SDCWA more compensation than it would have received by full performance of the Exchange Agreement.[14]

[14] MWD maintains that SDCWA has not borne its burden of proving (1) a breach, because MWD performed as agreed and the Phase I decision only invalidated rates in the non-applicable wheeling context, and (2) due to a breach it paid more than MWD could legally charge, because it did not present any evidence as to what MWD's rates could have lawfully been. MWD Closing Br., 3:4-

A. The Phase I Decision Did Not Support Breach Or Damages

The Phase I decision improperly served as the sole basis for the finding of breach that led to the excessive contract damages award in Phase II of the case. The Court erred by applying its Phase I decision, which concerned a facial challenge to MWD's transportation rates and rate for wheeling service, to satisfy the necessary element of breach of the parties' contract in an exchange transaction. In Phase I, the Court ruled only that MWD's 2011-2014 generally applicable transportation rates, and hence its wheeling rate, over collected from wheelers. Phase I SOD, 65. This ruling cannot apply outside the wheeling context, and the Exchange Agreement does not involve wheeling.

The ruling is also not applicable to the parties' agreed consideration in the Exchange Agreement transaction, which is unique to these two parties. The damages award ignores the $235 million in State funding and over $1 billion in water rights that MWD provided to SDCWA, along with other contractual benefits SDCWA received which are *not* received by wheelers who pay MWD's rate for wheeling service, as consideration for SDCWA's payment of the contract price based on the SAR, SPR and WSR. MWD Phase II Closing Br., 38:15-39:9; *see also* Trial Tr. at 1475 (Stapleton) (value of canal lining water). The damages award is excessive because it is predicated on an unsupported finding of breach and disregards relevant consideration.

B. The Phase I Decision Did Not Award SDCWA 100% Of Challenged Costs

In Phase I, the Court ruled that the administrative records did not support allocating 100% of the challenged costs to conveyance. Phase I SOD, 60. The ruling allowed for the possibility that a lesser percentage of the challenged costs were properly allocable to conveyance. Yet the Court's Phase II decision simply awarded SDCWA all of its payments on 100% of the challenged costs. The Phase II decision assumes, contrary to the Phase I decision, that *none* of the SWP costs or the WSR costs can be allocated to conveyance or lawfully charged to SDCWA under the Exchange Agreement. Even SDCWA's expert conceded that SDCWA would have paid some portion of these disputed costs. Trial Tr. at 1137:6-14 (Denham).

6:6; *see* Trial Tr. at 1128:8-11 (Denham) ("[I'm] not a water rate-making expert.").

The Court acknowledged the rule that "damages may not exceed the benefit which (the injured party) would have received had the promisor performed." Phase II SOD, 12:13-16 (quoting *Brandon & Tibbs*, 226 Cal. App. 3d at 468). And the Court recognized that SDCWA's theory of damages during the Phase II trial violated this core legal principle:

> San Diego's approach may overcompensate San Diego, because San Diego (1) removed all State Water Project costs from Met's conveyance rates although I have only ruled that Met could not include 100% of those costs through its conveyance rates; and (2) removed the entire Water Stewardship Rate from Met's conveyance rates although I only ruled that Met could not recover 100% of those costs through its conveyance rates.

Id. at 16:21-23 (footnote omitted). Yet, the Court awarded 100% of the challenged costs, resulting in an excessive damages award that is contrary to law, to the evidence, and the Phase I decision.

C. Alternative Damages Calculations Based On SDCWA's Theory Of The Case Demonstrate The Excessiveness Of The $188 Million Principal Award

1. Since The First Year Price Of $253 Was Legal, It Should Be The Basis For The Damage Calculation

The Exchange Agreement provides a price of $253 per acre-foot for the first year of the contract. PTX-65, § 5.2. This contract price was the sum of the transportation rates set by MWD's Board and in effect when the contract was signed – the SAR, the SPR and the WSR. *Id.*

The Court held that MWD's 2011-2014 transportation rates unlawfully over collected from wheelers and were charged to SDCWA in breach of the Exchange Agreement's price term. Phase II SOD, 10:14-16, 20:9-10. SDCWA "agreed to pay only (1) a fixed initial rate" and then any subsequent lawful rate set by MWD. *Id.* at 19:19-20:1. The Court held that "fixing a $253 price is not illegal." *Id.* at 23:6.[15]

SDCWA's damages evidence ignored the initial, lawful price provision in the contract ($253) and, instead, calculated damages based on an even lower price created by Dan Denham. The resulting damages award violates California law because it exceeds the difference between the

[15] MWD disputes these findings. MWD believes its rates were lawful, and therefore $253 and every annual price thereafter under the Exchange Agreement was lawful. MWD also asserts that if, as the Court has found, its rates were unlawful, then the price for *every* year was unlawful and the contract would be void as illegal. However, given the Court's rulings, MWD believes the Court was required to use the $253 price as the baseline for SDCWA's claimed contract damages.

amount SDCWA paid and the amount it would have paid if MWD had continued to charge the lawful initial price.

The proper damages calculation is given here:

Year	Actual Price ($/AF	Lawful Contract Price ($/AF)	Corrected Overcharge ($/AF)	Exchange Water (AF)	Corrected Damages
2011	$372 -	$253 =	$119 x	143,243 =	$17,045,917
2012	$396 -	$253 =	$143 x	186,861 =	$26,721,123
2013	$453 -	$253 =	$200 x	180,256 =	$36,051,200
2014	$445 -	$253 =	$192 x	179,993 =	$34,558,656
Total					$114,376,896

Compare PTX-0508, -0509, -0510, and -0511.

The Court awarded damages of $188,295,602, which exceeds the amount of damages SDCWA could lawfully recover by $73,918,706. The Court should revise its Phase II Statement of Decision and reduce its damages award to $114,376,896.

2. The Damages Are Excessive Because The Court Excluded SWP Costs For The SWP Water SDCWA Received Under The Contract

In Phase I, the Court concluded that MWD's 2011-2014 transportation rates (the SAR, SPR and WSR) and the rate for wheeling service are illegal because they over collect from wheelers. Phase II SOD, 13:4-8. However, the Court did not find that it is illegal for member agencies that receive SWP water to pay SWP transportation costs. Here, it is undisputed that over the relevant four-year period, 40% of the exchange water delivered to SDCWA was from MWD's SWP supplies.[16] Under the terms of the contract, MWD was entitled to deliver SWP water and SDCWA agreed to those terms. PTX-65, §§ 1.1(m), 3.3; Trial Tr. at 1568:5-14 (Stapleton). Having agreed to the potential sources of the exchange water, SDCWA also agreed to pay the charges MWD collected from its member agencies for transporting that water. PTX-65, § 5.2. Thus, there could be no breach of the price provision for the rates charged for SWP water.

Moreover, SDCWA could not have suffered damages by paying the lawful rate for the

[16] Exhibit DTX-1156 shows the total volume of exchange water by year and by source. 282,942 acre-feet of the total 690,353 acre-feet were SWP water supplies – that equates to 40.9%.

SWP water it received from MWD under the Exchange Agreement. Yet, Denham's damages calculation removes *all* the SWP costs from the price paid for *all* exchange water – even though those costs were properly collected for the SWP portion of exchange water (40%).

To properly calculate the damages, Denham's "overcharge" for the SAR and SPR should not be recovered for the SWP water delivered. That excess damages calculation is given here:

Year	Denham "Overcharge" for Access/Power for SWP Water ($/AF)	SWP Volume in Exchange Water (AF)	Excess Damages
2011	$195	76,581	$14,933,295
2012	$189	118,532	$22,402,548
2013	$274	56,284	$15,421,816
2014	$261	31,545	$8,233,245
Total			$60,990,904

See PTX-0508 through 0511 (Denham "overcharges" for access and power rates) and DTX-1156 (for SWP volumes of water delivered in connection with the Exchange Agreement).

The Court awarded damages of $188,295,602, which should be reduced by $60,990,904 to account for the SWP components of the SAR and SPR for 40% of the exchange water SDCWA received from MWD. The Court should reduce its damages award to $127,304,698.

3. Denham's Erroneous Unit Rate Inflated SDCWA's Claimed Damages

MWD charges rates on a volumetric basis – dollars per acre-foot. The unit rate is determined by the fraction, $/acre-foot, and is calculated by dividing the total costs to be collected through the rate by the volume of water to be sold at that rate. The unit rate is then multiplied by the volume of water sold to determine the amount due. To obtain an accurate result, all aspects of the equation must be correct, starting with the unit rate.

SDCWA relied on its expert Dan Denham's analysis to prove damages. First, Denham took the SWP costs in the SAR, and divided only those costs by the entire volume of MWD's water supply (SWP water and Colorado River Aqueduct ("CRA") water), which creates a new volumetric rate (Denham's "Difference/Credit"). Trial Tr. at 1143:4-25; 1144:1-9 (Denham). Second, Denham subtracted the Difference/Credit from MWD's system-wide SAR rate, which

resulted in what Denham labeled the "Corrected Rate." *Id.* at 1140:12-25. Third, Denham multiplied the Difference/Credit by the exchange water acre feet, to get what he called the "SAR Overcharge." *Id.* Denham repeated the same three-step process for the SPR rate to get what he called the "SPR Overcharge." Denham added the SAR Overcharge, the SPR Overcharge and the WSR[17] for 2011-2014 and concluded that SDCWA was overcharged $188,340,476.

Denham's conclusion regarding damages is only as sound as each step in his methodology.[18] Here, Denham fails on the first step. To create his Difference/Credit, Denham took only SWP costs and divided those costs by the entire volume of MWD water (SWP water and CRA water). This violates the fundamental rule governing the formulation of water rates – a unit rate is calculated by dividing the total costs to be collected through the rate by the volume of water *to be sold at that rate*. *See* Trial Tr. at 1899:8-24 (Woodcock) (MWD's rate expert described this rule as "a matching principle in rate setting.") Denham admits that he is "not a water rate-making expert." *Id.* at 1128:8-11 (Denham). Denham's opinion is not based on a methodology accepted by water rate-making experts. His conclusion regarding damages lacks foundation and is flawed.

Denham purported to extract SWP costs from MWD's system-wide unit rate structure. But Denham failed to tie the specific category of costs that MWD could lawfully recover from SDCWA (non-SWP costs) to the volume of water to be sold at that rate (non-SWP water) as required in setting unit rates. To determine SDCWA's damages, Denham should have developed a volumetric rate that captures non-SWP costs in connection with the delivery of CRA water.

Denham's report includes the breakdown between SWP and "Other District" costs for the SAR and SPR. Expert Witness Decl., filed Oct. 28, 2013, Exh. B, Tables 1 & 2. The volume of water from each source (SWP versus CRA) that was used for setting MWD's rates each year was

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[17] Denham excluded the entire WSR from his calculation of what SDCWA should have paid under the Exchange Agreement; he did not create a new unit rate to capture demand management costs.

[18] Like a house built on sand, an expert's opinion is no better than the facts on which it is based. *People v. Gardeley*, 14 Cal. 4th 605, 618 (1996). Where an expert's opinion is based on assumptions not supported by the record, or upon matters not reasonably relied upon by other experts, the expert's opinion cannot constitute substantial evidence to support an award of damages. *Pacific Gas & Electric Co. v. Zuckerman*, 189 Cal. App. 3d 1113, 1135-36 (1987); Evid. Code § 801(b).

available to Denham to use in calculating an appropriate unit rate. *See* AR-600, MWD2012_011551 (2011 costs reflect deliveries of 1,180,000 acre-feet of CRA water), AR-722, MWD2012-_012815 (2012 costs reflect deliveries of 1,160,000 acre-feet of CRA water), AR-896, MWD2012_014921 (2013 and 2014 costs reflect deliveries of 727,000 acre-feet and 890,000 acre-feet of CRA water, respectively).

The proper calculation of damages under Denham's method would create a unit rate for access and power based on Denham's "Other District" costs divided by the volume of CRA water. Below is a chart that reflects Denham's erroneous methodology, corrects the unit rate based on the proper $/AF equation, and shows the excessive damages calculation:

Year	Denham's Unit Rate for Access/Power[19] $ (excluding SWP costs)/AF (including SWP water volume)	Corrected Unit Rate for Access/Power[20] $ (excluding SWP costs)/AF (excluding SWP water volume)	Difference Between Denham and Correct Rates for Access/Power	Excess Damages Difference x Exchange Water
2011	$136	$215	$79	$11,316,197
2012	$164	$219	$55	$10,277,355
2013	$138	$305	$167	$30,102,752
2014	$143	$266	$123	$22,139,139
Total				$73,835,443

See Denham's Report, Expert Witness Decl. filed Oct. 28, 2013, Exh. B, Table 2 (for Denham's "Corrected Rate" for access and power) and Table 1 (for Denham's measure of non-SWP (i.e., "Other District") access and power costs).

The Court awarded damages of $188,295,602, which should be reduced by $73,835,443 based on application of the proper unit rate for the exchange water SDCWA received from MWD. As such, the Court should reduce its damages award to $114,460,159.

D. The Court's Over $44 Million Prejudgment Interest Award Is Excessive

The Court should also grant a new trial on the ground that its damages award is made even

[19] This column reflects Denham's combined "Corrected Rate" for access and power.

[20] This column reflects "Other District" costs divided by CRA water volume.

more excessive by its October 9 and 30, 2015 rulings awarding SDCWA over $44 million in prejudgment interest as part of damages, which is continuing to accrue. Code Civ. Proc. § 657(5) and (6). This award is excessive as it is based on statutory 10% interest rate that applies *only* when the parties have not agreed to a legal rate of interest, which is not the case here. Interest SOD, 1. The award is predicated on an invalidation of the parties' agreement on interest and is therefore against the law. *Resolution Trust Corp. v. First Am. Bank*, 155 F. 3d 1123, 1128-1129 (1998) (error to substitute statutory 10% interest rate when the parties stipulated to interest).

California Civil Code Section 3289(a) is clear that when a contract provides a "legal rate of interest" that rate applies for the purposes of prejudgment interest as damages. Civ. Code § 3289. In its October 9, 2015 Order, the Court found Section 12.4(c) of the Exchange Agreement did not set the amount of prejudgment interest that is due if SDCWA prevails in the dispute. But in Section 12.4(c), the parties agreed that MWD is to maintain in a separate interest bearing account SDCWA's exchange water payments that are in dispute, and at the conclusion of the dispute, MWD is to pay the disputed amount "plus all interest earned thereon." PTX-065. The plain meaning is that MWD is to pay the interest that was earned in the interest bearing account.

The Court bases its ruling in part on the fact that SDCWA requested that MWD set aside a certain amount as the disputed payments, and then at trial recalculated and claimed a higher amount as the disputed payments. The Court awarded that higher amount and MWD adjusted its set aside to match the disputed payments that SDCWA now claimed. Interest SOD at 2-3. There is nothing inconsistent with these facts concerning the disputed payments, and the parties' agreement that the interest due would be the interest earned on the disputed payments. Even if there were, the result should be that SDCWA is contractually precluded from recalculating what it asked MWD to set aside as disputed, rather than negating the parties' agreement as to the interest to be paid.

The Court also based its ruling in part on fact that it had already ruled that Section 12.4(c) was a security provision, not a "damages provision." Interest SOD, 3. There is nothing inconsistent with the fact that Section 12.4(c)'s purpose was to ensure the disputed payments were maintained during the pendency of the dispute, and the parties' agreement that the interest due

would be the interest earned on the disputed payments.[21]

The Court further indicated that an agreement that allows interest to be earned based on MWD's investment portfolio is problematic. Interest SOD, p. 3. But the parties' agreement provided only for the disputed payments to be placed in an interest bearing account and for "all interest earned thereon" to be paid at the conclusion of the dispute. *See Resolution Trust Corp.*, 155 F. 3d at 1128-1129 (the parties may agree to any manner of calculating the interest rate). Interest earned on MWD's investment portfolio (which is the interest other MWD accounts earn) satisfies the contract. It is also a legally appropriate provision. In *Lilli Ann Corp. v. City and County of San Francisco*, which the Court did not address, the Court of Appeal rejected an argument that the interest language in Revenue and Tax Code, Section 5141 is unclear as to its designation of prejudgment interest. 70 Cal. App. 3d 162, 198 (1977). That Section provides interest "at a rate per centum per annum equal to the rate per centum per annum that the defendant *has received, through investment or by bank deposit, on the amount allowed and recovered as taxes*." *Id.* (emph. added). The Court ruled the defendant taxing agency's investment or bank deposit rate applies as simple interest on the award. *Id.* As in *Lilli Ann*, here the legal rate of interest is set by the defendant agency's investment portfolio.

The Court also concluded that the legal rate of interest must be part of a "damages provision" in the contract. *Id.* at 3. However, Section 3289 merely provides that the interest rate used for prejudgment interest in a contract shall be the interest rate agreed to by the parties under the contract; it does not require that the interest rate be part of a "damages provision." Civ. Code § 3289(a). None of the cases interpreting contractual interest rates involve a "damages provision." Courts apply any legal rate in the contract that was intended to apply when one party delayed or deprived the other party of money under the contract. *See Resolution Trust Corp.*, 155 F. 3d at

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[21] Indeed, it is only when an interest rate provision has been invalidated as illegal, such as one containing a usurious rate, that it cannot serve as the legal interest rate for purposes of prejudgment interest. *See Mark McDowell Corp. v. LSM 128*, 214 Cal. App. 3d 1427, 1432 (1989), overruled on other grounds by *Southwest Concrete Products v. Gosh Construction Corp.*, 51 Cal. 3d 701, 708 (contractual interest rate found to be usurious does not govern prejudgment interest under Civil Code Section 3289).

1128-1129 (provision setting interest on late payments); *Granite Const. Co. v. American Motorists Ins. Co*, 29 Cal. App. 4th 658, 670-671 (1994) (same). Section 12.4(c) is no different.

Additionally, it is unreasonable for the Court to interpret Section 12.4(c) as providing benefits *only* to SDCWA. *See* Civ. Code § 3542 (contract "interpretation must be reasonable"). The Court's ruling assumes MWD would agree to a "security" provision without obtaining any benefit in return. MWD is a public agency, thereby making its liabilities more secure than those of other parties. Indeed, the security to judgment creditors against public agencies is already provided by statute. *See* Gov. Code § 970, *et seq.* (governing payment of judgments against public agencies). It is unreasonable to conclude MWD provided *additional* security to SDCWA for nothing in return. Instead, the reasonable interpretation is that MWD obtained a lower stipulated legal rate of interest than it would be required to pay under the statutory 10% interest rate of Section 3289(b).

Lastly, the Court's conclusion that statutory interest was mandatory because the damages award was certain contradicts the Court's Phase II decision. Civ. Code § 3289(a); Phase II SOD at 16-17 ("San Diego's approach may overcompensate San Diego"), 18 ("It asks too much of San Diego to require it to recalculate Met's rates with any useful degree of precision").

The Court awarded statutory prejudgment interest of $44,139,469, with 10% statutory prejudgment interest continuing to accrue until the entry of judgment. The Court should reduce its prejudgment interest award to contractual prejudgment interest in the amount of $4,145,412.45 through September 2015 (Supplemental Declaration of Hal Soper III, filed Sept. 30, 2015, ¶ 13, Ex. G), with contractual prejudgment interest continuing to accrue until the entry of judgment.

VI. CONCLUSION

For the foregoing reasons, MWD respectfully requests that the Court vacate the judgment and issue a new Phase I Statement of Decision correcting the treatment of SWP transportation costs in connection with MWD's transportation rates and rate for wheeling service, and the Court's analysis and conclusion concerning Proposition 26's exceptions.. The Court should allow limited supplemental expert discovery and thereafter, issue a new Phase II Statement of Decision (1) reevaluating the Court's Phase II rulings in light of its corrected Phase I findings and

additional expert evidence; and (2) if the Court's Phase II liability finding remains, reducing the damages award to an amount that is not excessive under California law. Alternatively, the Court should issue an order conditionally granting a new trial on damages with a remittitur reducing the damages award on SDCWA's contract claim to one of the alternative damages calculations set forth herein, as well as reducing prejudgment interest to the interest earned on the contractual interest bearing account through the date of entry of judgment.

DATED: November 16, 2015

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