

April 29, 2014

Brownstein Hyatt Farber Schreck Opens Door to the California Water Market

Californians have long recognized the need for water markets in solving the state's frequent imbalances in supply and demand. Brownstein Hyatt Farber Schreck has consistently endeavored to knock down these barriers on behalf of our clients and water users throughout California.

On April 24, San Francisco Superior Court Judge Curtis E.A. Karnow entered a Statement of Decision on Rate Setting Challenges by the San Diego County Water Authority (SDCWA) against the Metropolitan Water District of Southern California (MWD). In the 66-page ruling, Judge Karnow addressed SDCWA's challenges to the legality of four rates set by MWD including its "System Access Rate," "System Power Rate," "Water Stewardship Rate" and "Wheeling Rate" (collectively, "Rates"). He found that these Rates—charged to transport or "wheel" non-MWD water through MWD's pipelines and facilities—are not reasonable, and violate California's Wheeling Statute, Government Code §549997(a) and the common law.



Chris Frahm

The trial court decision could provide the last piece of the puzzle necessary to make the conveyance of water cost-effective across California, including water transfers to the more than 19 million people who live and work in Southern California. The court also found that MWD's current Rates violate Proposition 26 (Prop 26), a voter-approved measure passed in November 2010. Prop 26 is intended to prevent public agencies from passing hidden taxes by requiring rates to be tied to the actual cost of service. SDCWA argued that MWD was misallocating its State Water Project supply costs and the costs MWD incurs for conservation and local water supply subsidies to its transportation rates, thus artificially driving up the cost of conveyance and subsidizing MWD's water supply rates. Various described as "cost shifting," "hold harmless" and "rate stability," Judge Karnow rejected MWD's contention that this can be a proper basis for MWD's Rates, finding instead that rates must be established based on "cost causation" principles. The court's opinion should help willing buyers and sellers secure conveyance of transfer water based on the actual costs attributable to conveyance rather than other considerations, as intended by California's wheeling law and Prop 26.

Chris Frahm, a shareholder at Brownstein, played a key role in the case as special counsel to SDCWA on the MWD Program and Rates litigation, working with trial lawyers based in San Francisco where the case was tried. MWD's overcharges this year alone are estimated at \$54 million and were expected to grow to more than \$217 million annually by 2021. Over the life of the contract, the disputed charges were projected to exceed more than \$2 billion, thereby frustrating voluntary water transfers. The precedent established by the decision should serve to limit the charges collected by public conveyance owners to the true costs of transporting water and have no negative impact on their ability to recover the true costs they incur to provide conveyance service.

Phase Two of the bifurcated trial will now examine whether MWD has also breached one of the Colorado River agreements by setting illegal conveyance rates. Judge Karnow bifurcated the breach of contract causes of action and they will be set for trial in Phase Two of the case later this year.

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Brownstein's representation in this case is consistent with the long history of legal and policy assistance it has provided to willing buyers and sellers across the West. For the last 15 years, Brownstein's Natural Resources Department has played an integral role in helping the SDCWA secure highly reliable water supplies from the Colorado River and other venues. [Scott Slater](#) of Brownstein previously led the negotiations on behalf of SDCWA of a 2003 Quantification Settlement Agreement (QSA) and related agreements settling longstanding disputes among California water agencies that obtain water from the Colorado River. One of those agreements is the Exchange Agreement between SDCWA and MWD, which governs MWD's transportation of SDCWA's Colorado River water supplies that gave rise to the suit.

In June of last year, Brownstein attorneys [Liz Rothman](#) and [Amy Steinfeld](#) led litigation efforts finally securing validation of the 2003 QSA after two trials and three trips to the Court of Appeal. The QSA provides for the conservation, exchange and transfer of Colorado River water within California and provides the legal certainty necessary for other supply programs designed to bring California within its 4.4 million acre-feet annual apportionment. [Brad Herrema](#) is also a member of Brownstein's SDCWA team, representing the client before the State Water Resources Control Board.

The firm remains committed to assisting our clients to pursue consensual transfers among willing sellers and willing buyers as a key component of solving California's worsening short- and long-term water supply shortages.

This document is intended to provide you with general information regarding challenges to the legality of four rates set by MWD. The contents of this document are not intended to provide specific legal advice. If you have any questions about the contents of this document or if you need legal advice as to an issue, please contact the attorneys listed or your regular Brownstein Hyatt Farber Schreck, LLP attorney. This communication may be considered advertising in some jurisdictions.

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