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July 26, 2011

REPORT TO THE HONORABLE MAYOR AND CITY COUNCIL

LEGAL UPDATE REGARDING WATER RATES FIXED BY METROPOLITAN WATER DISTRICT AND COUNTY WATER AUTHORITY

BACKGROUND

On January 24, 2011, the City Council held a noticed public hearing pursuant to Proposition 218 regarding a pass-thru increase in the City's water rates. At the time of the hearing, Council discussion involved the reason for the rate increase, specifically, why the County Water Authority (CWA) was required to raise its rates, thus leading to the instant pass-thru hearing. One of the reasons brought up during the discussion was the pending lawsuit between the Metropolitan Water District (MWD) of Southern California and the CWA, wherein CWA alleges that MWD is illegally charging its member agencies rates that they should otherwise be entitled to pay.

ANALYSIS AND CONCLUSION

The City Council requested this Office to conduct legal research into action the City might take against CWA or MWD rate increases. This Office has located the attached Report to the Honorable Mayor and City Council dated October 4, 1991, which concludes that the City has no legal or regulatory recourse with regard to the recent MWD or CWA rate increases (see page 7).

We have conducted additional legal research to determine if the conclusions in the 1991 Report should be changed due to changes in legislation or case law. We have determined that the conclusions in the 1991 Report remain valid.

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By _____
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RCP:cfq
Attachment
RC-2011-29

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October 4, 1991

REPORT TO THE HONORABLE
MAYOR AND CITY COUNCIL

WATER RATES FIXED BY THE COUNTY WATER AUTHORITY AND METROPOLITAN WATER DISTRICT

At its meeting of July 30, 1991, the San Diego City Council directed this office to examine and report on actions the Council could take with regard to rate increases imposed by the City's major water suppliers, the San Diego County Water Authority ("CWA") and the Southern California Metropolitan Water District ("MWD"). Specifically, we were asked to explain the City's legal relationship with these two public agencies where their setting of water rates is at issue. Some factors prompting the inquiry included recent rate increases by both the CWA and the MWD, and the fact that the MWD is perceived to have cash reserves which might well exceed its operative needs. We have given consideration to the question as it pertains to both agencies, and as explained more fully below, it appears to us that on available evidence there is no legal action the City could reasonably take to control proposed rate increases by the CWA and the MWD. The following explanations give the bases of our conclusions, first with respect to the CWA and then as to the MWD.

County Water Authority

The question as to what the City can do about the rates set by the CWA is not a new one. In a memorandum to the City Manager dated May 7, 1947, a copy of which is attached as Enclosure (1), (then) City Attorney J.F. DuPaul analyzed the statutes which give the CWA its rate setting authority and determined that, absent some compelling cause in equity, the rate problem presented to him likely could not be remedied in the courts. Although Mr. DuPaul's memorandum is somewhat dated and the facts before him were to some extent different from those now at issue, the basic concern for the authority and limitations of the CWA in setting water rates remains the same. Since there have been no material changes in the law, we commend his advice to you as being as valid today as it was in 1947. However, we will repeat and expand upon that advice in the context of current circumstances.

The CWA derives its authority to set rates from the very legislation which permitted its formation - the County Water Authority Act. Statutes of 1943, chapter 545, as amended, (Cal. Uncodified Water Acts, Act 9100 (Deering 1970)). Section 5 of the CWA Act is entitled "Powers of incorporated authority," and subdivision (13) expressly provides for the power:

> To fix, revise, and collect rates or other charges for the delivery of water, use of any facilities or property, or provision of services. In fixing rates the board may establish reasonable classifications among different classes and conditions of service, but rates shall be the same for similar classes and conditions of service.

Section 7 of the CWA Act, subdivision (j), provides that:

> The board of directors, so far as practicable, shall fix such rate or rates for water as will result in revenue which will pay the operating expenses of the authority, provide for repairs and maintenance, and provide for the payment of the interest and principal of the bonded debt . . . .

If the revenues from rate payments prove to be inadequate to pay the interest or principal of bonded indebtedness, subdivision (j) of section 7 further empowers the board of directors to levy a tax on the real and personal property within CWA boundaries to make up the difference needed to meet bond obligations. While the issue presently under consideration involves rates rather than taxes, we mention this provision because it might be argued that if rates are high enough to produce revenues which will cover all CWA operating and debt expenses, then no taxes ought to be levied. However, we are not aware of any facts which suggest that revenues from the newly imposed rates will indeed be adequate to cover all operations and bond expenses coming due, and thus a tax could conceivably still be levied.[1]

The CWA legislation envisions a self-sustaining Water Authority where revenues from rate payments ideally will support

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[1]In a telephone conversation on September 24, 1991, CWA Finance Manager Jim Munson represented to this office that the CWA presently levies a tax in the amount of .0032 cents on each $100.00 of assessed valuation in order to pay debt service on general obligation bonds issued in 1957 and 1966. This tax, he says, generates an annual revenue of roughly $4.5 million, a comparatively small amount of the CWA's annual revenue.

its operations, including the financing of debt. But where rate revenues may fall short of its fiscal needs, the legislature has endowed the CWA with taxing authority to ensure its ability to operate and to discharge debt. Thus, it is clear that subdivision (j) of section 7 authorizing the board of directors to set rates implies that the board is to consider existing circumstances and use its sound discretion in fixing the rates. Mr. DuPaul's memorandum makes express reference of the words "so far as practicable" which precede the words "shall fix such rate or rates" in subdivision (j) of section 7. We agree that the purport of these words is the investment of discretionary powers in the board of directors of the CWA to fix rates as it deems reasonably appropriate.

Section 3 of the CWA Act provides:

> County water authorities may be organized and incorporated hereunder by two or more public agencies in any county, which public agencies need not be contiguous, and when so incorporated, such authorities shall exercise the powers herein expressly granted, together with such implied powers as are necessary to carry out the objects and purposes of such authorities. Each such authority when so organized, shall be a separate and independent political corporate entity.

The CWA is thus a distinct governmental entity and the fixing of rates by its board is a legislative function which is accorded great deference by the courts. Rates set by a public corporation ordinarily will not be judicially questioned or countermanded. Marin Water and Power Co. v. Town of Sausalito, 168 Cal. 587, 594 (1914). When a municipal or otherwise public corporation such as the CWA possesses the express authority to buy and sell water by contract and to fix rates under those contracts, the terms of the agreements rest within the discretion of the authorities of that public corporation and may only be countermanded by the courts in cases of fraud, abuse, or excess of authority, or inequity in the terms of the agreements. Id. at 598. It is therefore clear that a court will not set aside rates fixed by the CWA board of directors absent proof of one of the foregoing factors.

OK

It is also plain that the Public Utilities Commission, which has authority to regulate the rates of public utility corporations, does not have jurisdiction to regulate the rates set by public corporations like the CWA. This is because public political corporations like the CWA have a structure and purpose very similar to mutual water companies which are exempt from commission regulation. Public Utilities Code section 2705 contains the following pertinent language:

> Any corporation or association which is organized for the purposes of delivering water to its stockholders or members at cost, . . . and which delivers water to no one except its stockholders and members, or to the state or any agency or department thereof, to any city, county, school district, or other public district, or to any other mutual water company, at cost, is not a public utility, and is not subject to the jurisdiction, control or regulation of the commission . . . .

This section concludes with a statement that the term "cost" means "without profit." Since the legislation creating the CWA authorizes it to fix rates and levy taxes to maintain its operations, develop its systems, and pay bond debt, but does not provide for the making of profit, and because the CWA board of directors is composed of members representing its component parts, a strong analogy exists to the exemption of mutual companies contained in Public Utilities Code section 2705. The reasons underlying the exemption created by that statute are present when major customers have a voice in the management of the utility and are in a position to effectively enforce their proportionate rights as stockholders; the opposite is true when major customers do not have such rights. Corona City Water Co. v. Public Utilities Commission, 54 Cal. 2d 834 838, 839 (1960). The legislative purpose behind the exemption from commission regulation provides that when a mutual water corporation is substantially customer-controlled and delivers water at cost, the usual judicial contract remedies available to those who deal with it are an adequate substitute for public utility regulation. Id. The CWA, of course, is not expressly a mutual company and its members do not own stock in the sense of private ownership. Rather than being elected by stockholders, the CWA directors are appointed by each member agency. Hence, ratepayers have indirect representation through their member agencies and their agency appointees. The CWA therefore cannot set rates without due regard to the ratepayers, for the ratepayers control the composition of the CWA board. The City of San Diego, as a component member of the CWA, has a proportionate voice in its management by virtue of its right to appoint representatives to the board of directors. For these reasons we are certain that the CWA is not subject to regulation by the Public Utilities Commission.

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Since the Public Utilities Commission lacks jurisdiction to regulate the CWA, we next consider whether, under present circumstances, a court might find a compelling equitable reason to vacate rates presently set by the CWA board. Even if there were such reason, a court would only have authority to set aside

unreasonable rates but could not itself fix rates. Durant v. City of Beverly Hills, 39 Cal. App. 2d 133 (1940). We recall Mr. DuPaul's discussion of equitable bases for relief set forth in pages seven through nine of his memorandum, but the facts of the situation then confronting him were much different than those which now exist.

The situation in 1947 was such that the City of San Diego was the only component member of the CWA which had contracted to buy any water from it. Thus it was believed that the CWA, in order to make financial ends meet, had shifted a disproportionate burden onto the City by including a heavy surcharge on the price of water (it was said that CWA bought the water for $8.00 per acre-foot from MWD and in turn set rates to the City at $12.00 per acre-foot). Under those facts we believe Mr. DuPaul was quite right to at least suggest the possibility of making an equitable claim that the rate was disproportionate to benefits received by the City, and that the rate was therefore unreasonable or discriminatory or confiscatory.

In contrast to those facts are present circumstances. The City of San Diego is no longer the only member of the CWA paying rates to it under contract for water supply. Most, if not all, CWA members are now to some extent supplied by it. The rates as presently set apply to all members alike and there is no evidence that imposition of these rates upon all buyers results in a disproportionate burden on the City of San Diego. The City thus would not appear to have a claim that it has been unfairly singled out.

CWA board member Mike Madigan explains in a letter to the City Manager, dated June 19, 1991 (attached), that the recent $15.00 per acre-foot rate increase, as well as those which may be planned in the near future, are entirely for the purpose of funding its planned capital improvement projects. The CWA has asserted a rational basis for making the decision to raise rates, and it is most likely that a court would decline to question these grounds. Courts will not hear complaints about the setting of rates unless there is some proof of fraud or proof that the legislative discretion of the board was patently abused. Absent such factual support, judicial relief would not be available.

Metropolitan Water District

The foregoing discussion relating to the rate setting authority of the CWA is largely transferable to the MWD. The MWD was formed in 1928 pursuant to the Metropolitan Water District Act, Statutes of 1927, chapter 429 (Cal. Uncodified Water Acts, Act 9129 (Deering 1970)). The Act was repealed and reenacted by the Metropolitan Water District Act of 1969. Statutes of 1969, chapter 209, as amended (Cal. Uncodified Water Acts, Act 9129b

(Deering 1970))[2]. This legislation now defines the structure, rights, and duties of the MWD.

The MWD is a quasi-municipal corporation which (like the CWA) is an independent political corporate entity. Section 26; City of Pasadena v. Chamberlain, 204 Cal. 653 (1928). It is managed by a board of directors which has been given the authority to set rates for the water it sells. Sections 50 et seq.; section 131. The MWD possesses all powers expressly set forth in the legislation authorizing its formation as well as such powers as may reasonably be implied from the Act. Section 120. When the MWD board sets rates, it performs a legislative function expressly within its authority.

We refer to the discussion of the CWA above for the authorities which hold that this legislative function cannot be controlled by the courts, absent compelling facts that will support equitable claims. As a public non-profit corporation established primarily to supply water to its component members, the MWD likewise would not be subject to regulation by the Public Utilities Commission. Its major buyers, one of which is the CWA, have a voice in the setting of rates because those buyers have representatives on the MWD board (sections 51 and 52).

One important distinction between the City's relation to the CWA and its relation to the MWD is the fact that the City is not a component member of the MWD and therefore makes no appointments to its board. This is because the City does not buy water directly from the MWD. The City therefore has no appointed voice on the MWD board, but does have somewhat of an indirect voice insofar as the CWA is represented on that board. The City's lack of direct privity with the MWD would seem to make contentions about unreasonable rates more difficult to pursue because the City is not even a direct buyer of MWD water. Granted, the City ultimately does buy MWD water, but this is through the CWA and hence, is derivative and not direct. It appears then that as a matter of standing to complain about rate setting abuses or inequities imposed by the MWD board, the CWA would be a necessary party.

There again, on the basis of present facts, we are aware of no evidence that would support a claim for equitable relief from the present rates, be the complaint made by the CWA or the City. True, one important factor in assessing the equities of the recent rate increase is the extent of MWD reserves. But the MWD maintains that the reserves, however extensive they may be, are vital to its capital improvement program. Mr. Madigan, who is also a MWD board member, explains that the recent $25 per acre-foot rate increase is adequate to keep the MWD capital program on

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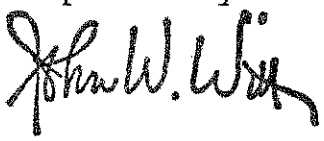
[2]All further statutory references are to the MWD Act of 1969.

track only through drawdown of the MWD rate stabilization fund, and that if the reserve funds were not built to the point where they are today, rates would be much higher in succeeding years. Unless contrary evidence exists, no valid objection to the rates will be found by the courts. Again, only if it can be shown that the MWD board perpetrated a fraud or clearly abused its discretion will courts intervene.

Conclusion

In consideration of all the present facts, the City of San Diego has no legal or regulatory recourse with regard to the recent CWA and MWD rate increases. Therefore, we respectfully recommend, as Mr. DuPaul did in 1947, that the Honorable Mayor and City Council "instruct the representatives of the City of San Diego on the board of directors of the San Diego County Water Authority of their policy in this matter." In turn, the CWA might be urged to inquire of its representative on the MWD board of directors exactly what facts support the rate increase. Although we believe that both boards have already explained their positions, more detailed factual information might be revealed regarding the revenues, reserves, expenses, and planned capital improvements of the CWA and the MWD.

Respectfully submitted,



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