1. Does accepting the Offer of Compromise preclude the SDCWA from litigating against the MWD on future rate cases or other matters? Please clarify the limitations that occur from accepting this Offer of Compromise?

No, accepting the offer does not mean that SDCWA cannot sue Metropolitan in the future. It does resolve all of the pending litigation and all other existing issues through the date of acceptance of the Offer. Accepting the Offer to Compromise does not prevent SDCWA from suing Metropolitan in the future regarding a new future act, omission, or practice of Metropolitan, whether in connection with rate-setting or otherwise.

The limitation on future lawsuits is based on the following contained in the Offer to Compromise:

   (1) a general release of claims, known and unknown, that exist through the date of acceptance;

   (2) waivers of any claims regarding

   a. the legality of the price term in the Exchange Agreement
   b. specified demand management funding, and
   c. provision of the financial planning model

   (3) an agreement that, as of the date of signing, SDCWA is not aware of any unlawful conduct by Metropolitan which SDCWA has not asserted in a lawsuit; and

   (4) the preclusive effect of the entry of judgements in the cases.

Meghan’s Thoughts: MWD is downplaying the strength and breadth of the waiver language in the settlement offer. MWD seeks to have the CWA agree to a sweeping waiver of rights to sue in the future. MWD is correct that CWA would be able to sue in the future, however, the scope of any claim would be severely limited by the provisions of the proposed settlement agreement.

(a) At paragraph 2 - The waiver covers any future claim regarding any provision of the Exchange Agreement. This would include a waiver of CWA’s right to sue MWD for any rate that is governed by the Exchange Agreement. I am not familiar with the Exchange Agreement, this would certainly include not only the transportation rate but also any rate add-on for future costs of the Delta conveyance project. At present, the cost of the Delta conveyance project purely speculative and could be much higher than current estimates. Based on a basic internet search, I found press statements by MWD indicating that it plans to contribute as much as $10.8 billion to the cost of the Delta conveyance project. Based on my reading of the documents, MWD has not yet decided how it will allocate the Delta conveyance project costs within its current rate structure, i.e., what portion to designate as supply and what portion to designate as transportation costs. The revised pricing provision allows MWD to add a portion of the costs of the Delta conveyance project to the transportation rate after completing a cost of service study. The waiver would prohibit CWA from challenging the allocation that results from that cost of service study as violating Proposition 26. If CWA believes that the rate add-on unlawfully allocates costs of the Delta conveyance project to CWA, CWA will be forced to pay the rate add-on for years without the ability to challenge the rate.

(b) At paragraph 5 - The waiver covers any and all claims, known and unknown, that CWA could have asserted against CWA for any time period prior to the date of the settlement. This goes beyond any dispute that may relate to the Exchange Agreement. This waiver covers any claims relating to any dispute arising from the CWA/MWD relationship. Therefore, any future claim CWA claim against MWD in any future date could not seek damages or refund for overpayment for any rates paid prior to the date of the settlement agreement.
(c) At paragraph 5 (first sentence) and paragraph 6 – This combination of provisions can be interpreted in a number of ways. If the provisions are interpreted in a manner that gives the most restrictive reading, the provisions could mean that CWA is agreeing and consenting to the lawfulness of all current MWD acts, omissions and practices. If interpreted in such a manner, the provision could limit any future CWA claim against MWD for a practice beyond the 2020 settlement agreement if that practice was in place prior to the execution of the settlement agreement. For example, consider a hypothetical situation where CWA wants to challenge the lawfulness of charge X in 2025, and charge X was in place at the time of the settlement agreement in 2020. MWD will be able to rely on the language in paragraphs 5 and 6 of the settlement agreement to argue that CWA contractually agreed to the lawfulness of charge X. MWD makes clear that it interprets these provisions in a restrictive manner when it states above: "Accepting the Offer to Compromise does not prevent SDCWA from suing Metropolitan in the future regarding a new future act, omission, or practice of Metropolitan, whether in connection with rate-setting or otherwise."

(d) At paragraph 8 – CWA indefinitely waives the right to seek and obtain any MWD rate model. In my opinion, it would be a bad idea for CWA to indefinitely waive the right obtain the rate model. Without access to the rate model used to allocate costs and set rates, CWA would find it almost impossible in the future to challenge any component of the rate governed by the Exchange Agreement or any other rate or fee charged by MWD. Importantly, as the CWA talking points explain, MWD is moving away from volumetric charges toward the use of more fixed charges and fees. Fixed charges must comply with the cost of service requirements of Proposition 26. For a variety of reasons, fixed charges more frequently fail to comply with the law. However, without access to the MWD rate model explaining the allocation of costs to the fixed charge, it will be particularly difficult to assess whether a fixed charge is in compliance with the law.

2. What is the ENR rate? Why was this rate selected?

The Offer to Compromise includes an annual escalation in the exchange price by an amount equal to the Construction Cost Index (20 Cities) as published in the Engineering News Record (ENR). It is a widely-used index for construction costs and was chosen as the escalator to address increases in future construction-related expenditures to the conveyance/distribution system. It is an index that is determined by a nationally respected trade organization, not Metropolitan.

A large portion of the costs that go into the System Access Rate and are allocated to conveyance/distribution are Metropolitan's construction related expenditures to repair and replace and add to the conveyance/distribution system. Using this index is a better fit than something like CPI which includes items like food and housing that have no relationship to the items that Metropolitan allocates to conveyance/distribution.

(a) Meghan's Thoughts: At paragraph 2 – The settlement agreement seeks to couple the rate to the Construction Cost Index (CCI) which would theoretically allow the rate to adjust each year with the rate of inflation. As the CWA talking points make clear, this provision seeks to exempt MWD from the requirement that the rate be tied to the actual cost of service as required by Proposition 26. There can be benefits to coupling the rate to an inflation index in the short term, including price certainty and protection from large increases. However, for the long-term arrangement (up to 100 years) between CWA and MWD, the coupling proposed by MWD will likely result in a rate sharply diverges from - and is higher than - the cost of the service MWD provides to CWA. First, the country may go through a major inflation event such as what occurred in the 1970’s. In the 1970’s, there were significant increases in the price of goods and services which caused significant increases in the indices. Such an inflation event in the future may result in a significant increase in the rate. However, due to MWD’s ability to postpone projects until after inflation subsides, the increased rate will not reflect the costs of the service provided to CWA by MWD. Second, although more unlikely, the nation may go through a major deflation event such as occurred in 1930-33. During that time, the price indices registered negative values. Under the terms of paragraph 2, the rate paid by CWA would not decrease in response to a deflation event.
3. Can Metropolitan change a variable or add a cost component to the exchange price term after SDCWA has signed the agreement?

Metropolitan has proposed a fixed price (starting at $450 per acre-foot) with the annual escalator described above for the Exchange Agreement going forward. The only additional cost that Metropolitan may add to the exchange price is the portion of Metropolitan’s cost of a Delta conveyance project on the State Water Project determined to be attributable to transportation, following a cost of service study.

Meghan’s Thoughts: See comment (a) to point 1. MWD argues that the rate provision provide certainty as to future pricing. However, the ability to add on to the rate for the Delta conveyance project creates great uncertainty as to the amount of the rate in the future. The Delta conveyance project cost add-on to the rate could be significant. The fact that the amount of this add-on and the methodology that MWD will use to allocate the costs of the project to CWA is unknown substantially reduces the certainty that the pricing provision provides. Further, if CWA is not permitted to analyze the MWD rate model for the allocation of the costs for the Delta conveyance project, CWA will be unable to determine whether the rate add-on exceeds the cost of service properly allocable to CWA and therefore violates Proposition 26.

4. What happens if SDCWA has an alternative conveyance system before 2047?

The Exchange Agreement provides (at Section 3.7 – Alternative Facilities) that SDCWA may determine, in its sole discretion, to permanently reduce the water it makes available to Metropolitan for exchange in order to transport it through alternative facilities, with five years’ notice to Metropolitan.

Meghan’s Thoughts: I do not have access to the MWD/CWA Exchange Agreement. Therefore, I cannot offer any thoughts on this topic.

5. Does this agreement shield the SDCWA from unforeseen maintenance costs to the SWP being passed on to the SDCWA in some form?

Yes, and this is a significant benefit of the Offer to Compromise to SDCWA because, pursuant to the appellate court decision (which the California Supreme Court declined to review), Metropolitan can legally include SDCWA’s share of all State Water Project transportation costs in the exchange price.

Instead, the offered price term protects SDCWA from future State Water Project maintenance and repair costs. As one example, there are likely to be substantial costs to deal with and repair subsidence to the California Aqueduct and other parts of the State Water Project. The Offer to Compromise would tie the price term only to the ENR Construction Cost Index, instead of Metropolitan’s System Access Rate through which these costs are recovered from all member agencies.

The only exception is the transportation cost of a Delta conveyance project, as stated in the offer and above.
Meghan's Thoughts: See comment (a) to point 1 and comment to point 3. By setting the rate and tying increases to the CCI, MWD is waiving the ability to directly allocate the specific maintenance costs of the SWP to CWA through the rate set in the Exchange Agreement. MWD could not subsequently seek to increase the exchange rate to cover the costs of unexpected or increased maintenance and repair costs for the SWP. However, it should be presumed that the $450 rate includes some allocation of SWP cost to CWA. Further, MWD is permitted use any portion of the rate revenue generated from CWA to cover maintenance costs for SWP at its discretion.

Importantly, according to the CWA talking points, CWA representatives strongly believe that MWD will seek to recover the costs of the maintenance and repair of the SWP from CWA by increasing rates, fees and charges that CWA pays to MWD other than the rate fixed in the Exchange Agreement. While MWD cannot increase the exchange rate under the terms of the Exchange Agreement to recover future maintenance and repair costs of the SWP, the settlement agreement does not prevent MWD from increasing other rates, fees and charges or adopting new charges to recover from CWA costs associated with the maintenance and repair of the SWP.