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Via Federal Express and Registered Mail
Dawn G. Abrahamson
City Clerk, City of Vallejo
555 Santa Clara Street
Vallejo, CA 94590

Re: Vallejo's Lakes Water System Service Area Class Action Lawsuit

Dear Ms. Abrahamson:

I. Introduction

This firm represents the Green Valley Landowners' Association, a California mutual benefit corporation (the "GVLA"). The GVLA sends this letter on behalf of its members and as the representative of and for the class of persons and entities who paid for, are paying for, or will pay for water service from the City within the City's Lakes Water System (the "LWS") between 1992 and June 30, 2014 (the "LWS Customers").

Simultaneously with this letter, this firm, on behalf of the GVLA, has served the City of Vallejo (the "City") with a claim under the Government Claims Act (Cal. Gov. Code §§900, *et seq.*). Also accompanying this letter is a response to the appraisal of the LWS commissioned by the City. If the present dispute cannot be resolved within 45 days, the GVLA is prepared to file a class action lawsuit on behalf of all the LWS Customers.

The class action lawsuit would challenge the past, present and future rates levied upon the LWS Customers for water service from the City. The lawsuit will seek monetary damages in the amount of $11,996,971 and an order prohibiting the City from charging the LWS Customers more than 2% of the cost of operating, maintaining and providing water service within the LWS. The lawsuit will also seek an injunction prohibiting the City from selling or further obligating the LWS.

The purpose of this letter is twofold: (i) to set forth the factual and legal basis for these claims, and (ii) to invite the City to mediate this dispute in the hopes of resolving the claims of the LWS Customers without the necessity of a protracted class action lawsuit.

II. Executive Summary

The LWS Customers' legal claims can be summarized as follows:

1. The relationship between Vallejo and the LWS Customers is contractual. (*Hobby v. Sonora* (1956) 142 Cal. App. 2d 457, 459; *Tronslin v. City of Sonora* (1956) 144 Cal. App. 2d 735, 738; *Elliot v. City of Pacific Grove* (1975) 54 Cal. App. 3d 53, 56.)

2. Vallejo promised to provide water to the existing LWS Customers and their predecessors-in-interest. Having agreed to provide water to the LWS Customers, Vallejo is bound to continue to provide such water indefinitely. (*Fellows v. City of Los Angeles* (1907) 151 Cal. 53; *City of South Pasadena v. Pasadena Land and Water Company* (1908) 152 Cal. 379; *B.H. Leavitt v. Lassen Irrigation Co.* (1909) 157 Cal. 82, 93.)

3. In exchange, the LWS Customers promised to pay for such water. These mutual promises create a contract between Vallejo and the LWS Customers.

4. In addition, the parties made an <u>additional</u> set of implied promises which form an important part of the contracts with Vallejo.

5. A promise may be stated in words, either oral or written, or may be inferred wholly or partly from conduct. (Restatement (2d) Contracts §4.) In other words, a promise may either be express or implied. (Civ. Code §1619.)

6. An implied promise is one, the existence and terms of which are manifested by the acts and conduct of the parties, interpreted in the light of the subject-matter and of the surrounding circumstances. (Civ. Code §1621; *Marvin v. Marvin* (1976) 18 C3d 660, 678, fn. 16.) In determining whether an implied agreement exists, reference is made to whether, under the circumstances, a reasonable person would conclude, from the surrounding circumstances and the words and conduct of each party, that there was an agreement. (CACI 302.)

7. There is no legal difference between an express promise and an implied promise. (*Division of Labor Law Enforcement v. Transpacific Transportation Co.* (1977) 69 CA3d 268, 275.) Implied promises are just as valid as express contracts. (CACI 305.)

8. Here, as demonstrated below, the LWS Customers and Vallejo impliedly agreed that Vallejo would share in the costs of the LWS. Based on historic cost-sharing ratios,

Vallejo impliedly agreed to pay at least 98% of the cost of operating, maintaining and improving the LWS.

9. Vallejo first breached its implied contracts with the LWS Customers in 1992 when it passed an ordinance shifting 100% of the costs to the LWS Customers. Vallejo cannot, by ordinance or otherwise, change, modify or alter its agreements with the LWS Customers without their consent. (*Tronslin v. City of Sonora* (1956) 144 Cal. App. 2d 735; *Stanislaus Water Co. v. Bachman* (1908) 152 Cal. 716; *Louisiana-Pacific v. Humboldt Bay Municipal Water Dist.* (1982) 137 Cal. App. 3d 152.)

10. Vallejo breached the implied contracts in 2009 when it, again, significantly raised rates, on the LWS Customers and required the LWS Consumers to pay 100% of the cost of the LWS. The breach arising from the 2009 rate increase is continuing in nature and is the subject of a Tolling Agreement between the GVLA (as the representative of the LWS Customers) and Vallejo.

11. The remedies for this breach and the others described below are three-fold.

    a. First, the LWS Customers are entitled to damages equal to the difference between what they paid or will pay between July 1, 2009 and July 1, 2014 multiplied by the share of the LWS costs Vallejo is contractually obligated to (but did not) pay. This amount is $11,996,971, as detailed below.

    b. Second, the LWS Customers will be entitled to an injunction and/or an order of specific performance requiring Vallejo to continue to share in the future costs of operating, maintaining and improving the LWS. Annual operational costs are over $3 million per year. In addition, over $24 million of assets are more than 30 years beyond their useful life. Within 10 years, an additional $6 million of assets will be beyond their useful life and will be in need of replacement. Vallejo is contractually obligated to pay at least 98% of these capital and operational costs indefinitely.

    c. Third, the LWS Customers will be entitled to an injunction prohibiting the City from selling and further obligating or encumbering the LWS in order to prevent a breach of the City's contractual and fiduciary obligations to the LWS Customers.

12. In addition, the City's actions, including, without limitation, passing 100% of the cost of the LWS onto just 809 customers, amount to a breach of its fiduciary duties of care and loyalty to the LWS Customers. (*City of South Pasadena v. Pasadena Land and Water Company* (1908) 152 Cal. 379, 394; *Durant v. City of Beverly Hills* (1940) 39 Cal. App. 2d 133, 137; *B.H. Leavitt v. Lassen Irrigation Co.* (1909) 157 Cal. 82, 87.)

13. Finally, any rate structure which excludes *any* contribution by Vallejo to the LWS is, as a matter of law, unreasonable, discriminatory and unlawful. (*Durant v. City of Beverly Hills* (1940) 39 Cal. App. 2d 133, 139; *Hansen v. City of San Buena Ventura* (1986) 42 Cal. 3d 1172; *Elliot v. City of Pacific Grove* (1975) 54 Cal. App. 3d 53.)

III. Factual History

The LWS was created in 1893 when Vallejo constructed a diversion dam on Green Valley Creek in Solano County. The diversion dam was coupled with a 14-inch transmission pipeline which brought water from the Green Valley Creek to Vallejo via Jameson Canyon Road (the "Green Line"). Shortly after completing the diversion dam, Vallejo created Lake Frey in 1894 and Lake Madigan in 1908, both located upstream from the diversion dam.

Within a short time, Lakes Frey and Madigan were insufficient to meet the demands of Vallejo's growing population, which in 1920 was 21,107. The City estimated that its population would double between 1925 and 1935 (Amended Permit Application No. 1908). The increasing demand prompted Vallejo to apply for a permit to store 37,000 acre feet of water in the Gordon Valley area of Napa County. The proposed waterworks would supply water "for municipal purposes in the city of Vallejo" (Application No. 1907-1908.)[1] The City was issued a license (No. 5828) in 1959 for storing and using water in Lake Curry for municipal purposes.

In pursuance of its permit, Vallejo constructed a dam and reservoir known as Lake Curry. The Lake Curry dam was completed in December 1925. Vallejo constructed a 24-inch gravity-fed transmission line from Lake Curry to Vallejo (the "Gordon Line"). Because of Vallejo's immediate need for additional water, the construction of the dam and Gordon Line was done hastily and in a substandard fashion, even by the standards of the time.

In order to transport water from the LWS to Vallejo, the City needed easements from the non-resident owners along the Green and Gordon Lines. In some instances, the City acquired the needed easements by condemnation, a power available to the City because the water was being put to beneficial public use within Vallejo. In the majority of cases, the City entered into agreements with the non-resident owners to acquire the needed easements (and in some cases, to obtain riparian water rights). While the terms of the easement agreements vary slightly, in general, the non-resident owners granted the easements for no or nominal monetary consideration ($1 to $10) and in exchange were allowed to connect to the Green or Gordon Lines and to receive free water. It is believed that approximately 60 LWS Customers – almost 10% of all LWS Customers – receive free water pursuant to these easements. The easement agreements expressly state that the easements are needed to provide water to the residents of Vallejo.

[1] The permit application was subsequently amended to limit storage to 10,000 acre feet and would allow Vallejo to divert no more than 5,058.9 acre feet of water annually (Amended Application No. 1908; Application No. 1907-1908).

After obtaining the easements, the City continued to agree to provide water service to additional customers within the LWS. These service extensions were done without the benefit of a master plan for the LWS. The service extensions were granted as a means for the City to raise additional revenue to cover the cost of operating the LWS and to expand the City's sphere of influence. Beginning in 1958, for example, all new service connections stipulated that they would be annexed to the City upon the City's demand.

The LWS Customers who did not receive free water paid the same water rates as Vallejo residents from 1893 through 1951. After 1951, the LWS Customers who did not receive free water paid rates which were the same as or slightly more than Vallejo residents. Until recently, LWS was funded overwhelmingly by customers within the City of Vallejo. **Exhibit A** is a table summarizing the historic rates paid by Vallejo customers and LWS Customers.

From 1893 through 1959 – for more than half a century – the City's water needs were met exclusively by the LWS. Indeed, without the LWS, it is safe to assume that Vallejo as we know it would not exist. However, in the 1950's Vallejo obtained generous water rights from the Sacramento River Delta (Cache Slough) and contracted for water from the Solano Project (Lake Berryessa). Vallejo never applied these water rights for the benefit of the LWS Customers. Having secured these water rights for its own residents, the relative importance of the LWS, once vital to the City's water needs, gradually diminished.

Despite its diminished importance, the City continued to use water from the LWS (specifically, Lake Curry) until 1992. According to the City, "Lake Curry was an active and important part of the City's water supply system between 1926 and 1992" (Fed. Regis., Vol. 68, No. 157, Aug. 14, 2003). Even in 2003, over a decade after it stopped using Lake Curry, the City represented to the Bureau of Reclamation that Lake Curry water was "critical to the City in meeting its existing and future [water] demands" (*id.*).

New drinking water treatment regulations were adopted by the California Department of Health Services (DHS) in 1991. In 1992, the water quality from Lake Curry had deteriorated to a point where the Lake Curry treatment plant could no longer provide water which met the DHS requirements (Licensee Report 1992-1994). Instead of fixing the water quality problem, or improving the water treatment facilities, the City voluntarily elected to shut down the Lake Curry water treatment plant and to discontinue all municipal use of Lake Curry water (Licensee Report 1992-1994).

The City's election to abandon Lake Curry as an active domestic water source meant that for the first time in over 100 years, the City was no longer receiving water from the LWS. Accordingly, in 1992 the City broke with more than 100 years of history and unilaterally decided to divest itself of the LWS by passing the full cost of the LWS to the LWS Customers. To put this in perspective, in 1991, the cost of the LWS was shared by 30,000 or more metered customers in Vallejo and several hundred metered customers within the LWS (Licensee Report

1986-1988). In 1992, the cost of operating the LWS – a large-scale municipal water project – was borne entirely by just several hundred metered customers within the LWS (Licensee Report 1992-1994).

Not surprisingly, the City's decision to stop contributing to the LWS resulted in significant rate increases for the LWS Customers. As shown in **Exhibit B**, the average rates for the LWS Customers increased by over 230% in 1992. At the very same time, having unilaterally decided to stop contributing to the LWS, the City was able to dramatically reduce the rates it was charging its own residents.

In 2009, the City enacted Ordinance No. 1619 N.C. (2d) which further raised rates on the LWS Customers (the "2009 Rate Increase"). As a result of the 2009 Rate Increase, LWS Customers pay consumption charges which are 3.5 times the amount paid by Vallejo residents and fixed service charges (including the "upgrade surcharge") which are 4.5 times the amount paid by Vallejo residents. Based on the City's projected revenue requirements, between July 1, 2009 and June 30, 2014, just 809 LWS Customers will pay $12,241,807 to operate the LWS. Vallejo's 38,000 metered customers pay nothing. Water rates for the LWS Customers are some of the highest in the State.

On June 9, 2009, the GVLA entered into a tolling agreement with Vallejo (the "Tolling Agreement") which, on behalf of the LWS Customers, tolls "any applicable statutes of limitations regarding a potential challenge to the rate increase [which occurred in 2009]." The Tolling Agreement was extended for a tenth time on June 13, 2013 and expires on December 31, 2013.[2]

The City is in the process preparing a new 5-year rate study for the LWS. Like the 2009 study which formed the basis for the 2009 Rate Increase, the City intends on passing the full cost of the LWS to 809 LWS Customers. The new rates will take place on July 1, 2014.

In March 2013, the City received an appraisal of the pipe, pump and treatment plant assets within the LWS. The appraisal was performed by FCS Group. Based on this appraisal, we are informed that the City is issuing a request for offers to sell the LWS to a privately owned utility. Notably, the proposed sale would not include any of the watershed and non-watershed land which is a part of the LWS. There are 1,171 acres of watershed land and approximately 13,000 acres of non-watershed (excess) land. Vallejo apparently intends to keep the non-watershed land for its own benefit in violation of State policy which *encourages* the sale of non-essential land and *requires* that land sale proceeds be reinvested in water infrastructure, plant and facilities (Cal. Pub. Util. Code §789.1). Based on a $2,000 per-acre appraisal the City received

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[2] We observe that at the same time it was executing the 9th and 10th versions of the Tolling Agreement, Vallejo represented to the bondholders of its Water Revenue Refunding Bonds, Series 2013, that there were no pending or threatened actions which would have an adverse effect on the water system or the ability of the City to raise water system rates (including the LWS).

on December 31, 2010, the estimated value of this land, the vast majority of which is no longer necessary for the system, is over $29 million.

III. Legal Analysis

The City is obligated contractually and as a fiduciary to contribute 98% of the cost of the LWS. The City breached these obligations when it enacted the 2009 Rate Increase which passed 100% of the cost of the LWS to the LWS Customers. The City also has a legal obligation not to discriminate against the LWS Customers and to charge them a reasonable rate. Any rate structure which excludes Vallejo is, as a matter of law, unreasonable. Unless enjoined, the City will continue to breach these obligations when it puts the new 5-year plan into effect in 2014.

A. The City's Contractual and Fiduciary Relationship with the LWS Customers

The relationship between a municipal supplier of water and its non-resident customers is contractual (*Hobby v. Sonora* (1956) 142 Cal. App. 2d 457, 459; *Tronslin v. City of Sonora* (1956) 144 Cal. App. 2d 735, 738; *Elliot v. City of Pacific Grove* (1975) 54 Cal. App. 3d 53, 56). In the instant case, some LWS Customers are successors in interest to the original easements granted when the Green and Gordon Lines were constructed. For the remaining LWS Customers, the contractual relationship stems from the City's agreement to allow them to connect to the LWS and to receive water.

In addition, the contractual relationship described above gives rise to a trust relationship between the City and the LWS Customers. In *City of South Pasadena v. Pasadena Land and Water Company* (1908) 152 Cal. 379, 394, the Supreme Court said that the municipality supplying water to non-resident customers holds "title as a mere trustee, bound to apply it to the use of those beneficially interested" (*see also, Durant v. City of Beverly Hills* (1940) 39 Cal. App. 2d 133, 137; *B.H. Leavitt v. Lassen Irrigation Co.* (1909) 157 Cal. 82, 87). As a matter of law, this trust relationship makes Vallejo a fiduciary of the LWS Customers and imposes upon Vallejo fiduciary duties of care and loyalty (*Lix v. Edwards* (1978) 82 Cal. App. 3d 573, 581).

B. The Parties Impliedly Agreed that Vallejo Would Share in of the Cost of the LWS

As discussed above, the relationship between Vallejo and the LWS Customers is contractual. A contract may be express, implied, or both (Civ. Code §1619, Restatement (2d) Contracts §4). An implied agreement is manifested by the acts and conduct of the parties as interpreted in light of the subject matter and the surrounding circumstances (*Marvin v. Marvin* (1976) 18 Cal. 3d 660, 678, fn. 16; Civ. Code §1621). In determining whether an implied agreement exists, reference is made to the circumstances which existed at the time of contract formation and whether a reasonable person would conclude from those surrounding circumstances and the words and conduct of each party, that there was an agreement (CACI 302). There is no legal difference between an express agreement and an implied agreement

(*Division of Labor Law Enforcement v. Transpacific Transportation Co.* (1977) 69 Cal. App. 3d 268, 275; CACI 305).

Here, the parties impliedly agreed that Vallejo would pay the vast majority (at least 98%) of the cost of the LWS. The implied agreement is supported by the following facts:

First, the LWS system was built to provide water "for municipal purposes in the city of Vallejo" (Application No. 1907-1908). Vallejo constructed a large–scale municipal waterworks project for the benefit of its' own residents, and not for the benefit of the present or future non-residents within the LWS. The decision to provide water to the LWS Customers was incidental and auxiliary to the main purpose of providing water to Vallejo's growing resident population.

Second, the LWS system was designed and constructed solely as a means of transmitting water from Lakes Frey, Madigan and Curry to Vallejo. For almost 100 years, the LWS consisted of two separate transmission systems (the Green and Gordon Lines) which brought water to Vallejo from two separate sources (Lakes Frey/Madigan and Lake Curry). The LWS Customers in Green and Gordon Valleys were "connected" only insofar as they both received water from Vallejo. Practically, however, they received water from separate sources through separate treatment facilities and from separate transmission systems. It was not until 1992 that Vallejo unilaterally and radically altered the system to perform as an *ad hoc distribution* system for purposes of providing water to the LWS Customers. The resulting inefficiencies in the system today are directly attributable to the fact the system was transformed in such a radical and unforeseeable manner.

Third, the waterworks infrastructure constructed by Vallejo to serve its own needs greatly exceeds the needs of the handful of LWS Customers it serves. Even in 2013, LWS Customers use just 500 acre feet of water per year. Vallejo, in contrast, uses over 20,000 acre feet per year. A waterworks project exclusively for the LWS, would not require reservoirs with storage of almost 13,000 acre feet (an amount *26 times* the LWS' needed water requirements), nor would it require oversized 14-inch and 24-inch transmission pipes. Indeed, a small waterworks project for several hundred rural property owners would usually rely on ground water, and would most likely not include a water treatment facility. Rather, this large scale infrastructure was needed to supply significant quantities of water to Vallejo's rapidly growing population. Since Vallejo discontinued using LWS water, LWS is one of the most asset intensive water system in California. According to the appraisal of the LWS, the LWS is *five* times more asset intensive than the second most asset intensive system considered by the appraiser (LWS Appraisal, March 2013).

Fourth, we are unaware of a *single* instance in California or elsewhere in which a municipality constructed a large scale water infrastructure project for its own benefit, allowed non-residents to connect to that system, and then unilaterally decided to divest itself from the system indefinitely, leaving the non-residents to pay 100% of the cost. The absence of such

situations leads to the conclusion that the parties never contemplated or intended that Vallejo would embark on such a path.

Fifth, Vallejo contractually agreed to provide free water in perpetuity to approximately 60 customers within the LWS. We have reason to believe that all of the first LWS Customers in Green Valley, Gordon Valley, and Cordelia received free water pursuant to these agreements. The provision of free water to almost 10% of the LWS Customers is evidence that the parties never intended or expected that the remaining LWS Customers would fund the entire cost of the LWS. Certainly the 61st customer – the first paying customer – never anticipated that he or she would be 100% responsible for the cost of the LWS. In addition, Vallejo contractually obligated *itself* to provide the free water. The parties could never have intended that Vallejo would breach this obligation and shift its own responsibility to provide free water to the remaining paying LWS Customers.

Sixth, beginning in 1958 (Ord. No. 324 N.C.) every single LWS Customer was required, as a condition of obtaining a water service connection, to execute and deliver "a recordable agreement running with the land, whereby as a condition of water service, the premises will be annexed to the City upon demand of the City." Given Vallejo's development in and ties with the LWS service area (especially in Green Valley), it was Vallejo's stated intention to annex the LWS Customers who first obtained service after 1958 (which constitutes the vast majority of the LWS Customers). It is impossible to believe that the parties ever could have contemplated or intended that the same City which wanted to annex the LWS Customers "upon demand" would later disown them entirely by unilaterally divesting itself of any continuing obligation to the very same customers. This is further supported by the fact Vallejo and its residents had a significant presence in Green Valley since the early 1950's.

Seventh, of significant importance is the conduct of the parties for decades after the creation of the LWS. The court in *Riverside Heights Water Co. v. Riverside Trust Co.* (1906) 148 Cal. 457, 467 recognized that "In the case of an ambiguous contract, the conduct of the parties may be proved to aid in its interpretation . . . ." It was not until 1992 that Vallejo unilaterally decided that its residents would no longer pay for the LWS. However, between 1880 and 1992, the costs of operating the LWS were shared by LWS Customers and Vallejo's residents. From the creation of the LWS until 1951, LWS Customers paid for the system pro rata based on their water usage. This practice is the best evidence of the parties' intent. After 1951, LWS residents were charged rates which were usually, but not always, slightly more than those being charged Vallejo residents. This long standing course of performance sheds light on the initial understanding and intent of the contracting parties – namely, that Vallejo would always share in the vast majority of the cost of the LWS. The parties' course of performance and dealing has long been held to be admissible to explain, *supplement* or *qualify* a written agreement (CCP §1856(c); Restatement (2d) Contracts §§202, 220, 223). As explained by one commentator, "The parties to an agreement know best what they meant, and their action under it is often the strongest evidence of their meaning" (Restatement (2d) Contracts §202, cm. g).

Eighth, Vallejo acquired the easements and riparian water rights for relatively nominal cash consideration. The real consideration was the promise of a reliable water supply at reasonable rates. If the parties knew that Vallejo would seek to charge unreasonable rates (or to dramatically alter the rate paying base by excluding its own residents), the non-monetary consideration would have disappeared and the owners would have demanded higher upfront cash compensation. Indeed, the deals entered into between 1893 and the 1920's were *only* attractive because it was understood that the cost would be shared among a large consumer base. The easements would not have been granted voluntarily if Vallejo had the right to unilaterally shift the full cost of the LWS to the handful of non-resident Customers within the LWS. This is especially true given the extent and size of the LWS infrastructure, as discussed above.

Ninth, the LWS Customers relied upon the understanding that the costs would be shared with Vallejo residents when they began to subdivide and develop their properties. This reliance forms a separate basis for the enforcement of the parties' agreement (Restatement (2d) Contracts §90) and resulted in an implicit, but binding, understanding – you may develop your properties with the agreement that you will have a continual source of reliable, reasonably priced water which will be paid for by you and the residents of Vallejo. For example, the original LWS Customers would not have developed their properties if they expected that in 1930, Vallejo would decide it no longer wanted Lake Curry water and would instead pass on the initial $1 million cost to a handful of LWS Customers who existed at that time. The Supreme Court in *Stanislaus Water Co. v. Bachman* (1908) 152 Cal. 716, 729-30 emphasized the importance of the permanence of water rights stemming from the initial contract, and Vallejo's decision to shift the cost of the LWS to the LWS Customers dramatically altered these rights.

Tenth, even after Vallejo unilaterally stopped contributing to the LWS, the City could not bring itself to entirely divest itself from the LWS. For example, the City represented to the federal government as recently as 2003 that Lake Curry water was "*critical* to the City in meeting its *existing and future [water] demands*" (Fed. Regis., Vol. 68, No. 157, Aug. 14, 2003, italics added). Vallejo likewise represented to the State Water Resource Control Board that as of *2008*, it "continues to attempt to be able to use Lake Curry water for municipal use" within Vallejo (Licensee Report for 2005-2007). How could the parties have ever contemplated that Vallejo would not continue to share in the cost of the LWS when Vallejo – *almost 20 years* after it did just that – continued to assert that the LWS was "critical" to the City's own municipal water supply?

Finally, Vallejo never could have condemned property for the Green and Gordon Line easements unless it intended on putting the water to use within the City. It is axiomatic that the power to condemn presupposes a "public use" – here, use within Vallejo (Cal. Water Code §§71693-71694). Vallejo had no power to condemn property to provide water exclusively to non-residents. Again, the water provided to the LWS's Customers was incidental to the main purpose of serving Vallejo residents. Further, the leverage Vallejo was able to extract in

obtaining the voluntary easements stemmed from the threat of condemnation if an agreement was not reached.

The court in *Riverside Heights*, *supra*, enforced a similar implied contractual understanding. In that case, Matthew Gage owned a water supply 15 miles north of the lands he wanted to irrigate (in what would later be known as the City of Riverside). In order to get the water from the supply source to Riverside, Gage entered into a "considerable number" of agreements with various owners between 1884 and 1886. As with the case of the LWS, the agreements were not uniform, but generally, in exchange for the needed easements, Gage agreed to provide the owners with a specified quantity of water for irrigation. In exchange, the owners agreed to "pay the expense of maintaining and repairing the canal in the same proportion as the amount of water to which [they were] entitled under the contract would bear to the whole amount of water flowing in the canal" (*id.* at 460).

Two years after completing the canal, Gage made an addition to the canal in order to bring the same water further south from Riverside. Gage's successor, Riverside Trust, sought to recoup the cost of the addition to the canal from Riverside Water Company (the mutual water company formed by the owners). The issue before the Supreme Court was whether the Riverside Water Company was obligated under the original contracts to pay for the cost of the canal extension.

Riverside Trust argued that the owners were bound by the original contracts which expressly obligated them to pay the cost of the canal in proportion to their interests in the water delivered. The Riverside Water Company argued that when the contracts were entered into, they only contemplated building the canal to Riverside, but did not contemplate a further extension of the canal.

The Supreme Court began by recognizing that the contracts were "more or less indefinite in the description of the canal" making it impossible from the terms of the contracts themselves to determine whether the owners were obligated to pay for the canal extension. Given this, the Court approved the admission of extrinsic evidence of the parties' intent, reasoning that "The language of the contracts being uncertain in respect to the identity of the canal to be constructed by Gage, it was proper to admit evidence of the circumstances surrounding the parties at the time . . ." (*id.* at 465).

At the trial court, the owners offered extrinsic evidence that "at the time these several contracts were made" the canal "was proposed to be constructed only from the source of supply" to Riverside, but that "at that time no further extension had been made, nor was it then generally known or understood that any extension was to be made, or was in contemplation" (*id.* at 464). The owners also offered extrinsic evidence that Gage's purpose in building the canal was to irrigate his land in Riverside "and that there was no intimation by him that he expected, intended, or desired to extent the canal" (*id.* at 465).

In light of this evidence, the Supreme Court affirmed the ruling of the trial court that the Riverside Water Company (and its owners) were not contractually obligated to contribute to any of the expenses of extending the canal south from Riverside. The Court reasoned that "The rights of the parties being fixed by the contracts at the time they were made, Gage could not add to the burdens of the other parties by extending the canal further south so as to irrigate other lands and charging the other parties with the expenses of operating such extension" (*id.* at 466).[3]

As in *Riverside Heights*, it is not necessary for the parties' contracts to expressly stipulate that the costs of the LWS would be shared by the LWS Customers and Vallejo. Rather, the court will enforce the implied understanding of the parties at the time of contracting just as if such a stipulation existed.

In addition to the facts above and the *Riverside Heights* case, the implied understanding between the LWS Customers and Vallejo is further supported by the implied covenant of good faith and fair dealing which has been described as "a kind of 'safety valve' to which judges may turn to fill gaps and qualify or limit rights and duties otherwise arising under rules of law and specific contract language" (*Foley v. Interactive Data Corp.* (1988) 47 Cal. 3d 654, 683-84). As explained by one commentator, "Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party . . . ." (Restatement 2d Contracts §205, com. a.) Although the contracting parties did not expressly provide that Vallejo would pay the vast majority of the cost of the LWS, this was certainly a part of the agreed common purpose of the LWS and was consistent with the expectations of the parties as evidenced by decades of sharing in the costs.

C. Vallejo's Share of the Costs of Operating the LWS is 98%

As demonstrated above, the parties implied agreed to share in the cost of the LWS. Until it unilaterally breached its agreements with the LWS Customers, for nearly 100 years, Vallejo and the LWS Customers paid for the cost of the LWS pro rata. Historically, the ratio of Vallejo residents to LWS Customers (all of whom used and relied upon LWS water) has been approximately 98:2, or more. The water consumption between Vallejo's residents and the LWS Customers is likewise approximately 98:2. Given development trends within the LWS and Vallejo, the evidence is expected to show that at the time the majority of LWS connections were made, the ratio was even higher than 98:2.

Based on historical figures, it is evident that not only did the parties agree that Vallejo would share in the cost of the LWS, but that Vallejo's share of the cost was significant – 98% or more.

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[3] The Supreme Court also rejected the argument that the Riverside Water Company was estopped to argue that it did not agree to pay for the canal extension by virtue of the fact they initially paid for the additional costs.

D. Vallejo Breached the Agreements with the LWS Customers when it Unilaterally Decided to Pass 100% of the Cost of the LWS onto the LWS Customers

Vallejo first breached its contractual agreements with the LWS Customers in 1992, the same year it chose to abandon Lake Curry instead of making the required improvements to comply with the federal and state safe drinking water requirements.

To put this in perspective, prior to 1992, the cost of the LWS was shared by several hundred connections within the LWS, plus *over 30,000* connections (*100,000* residents) in Vallejo (Licensee Report 1986-1988). After 1992, the cost of the LWS was born *entirely* by the same several hundred customers – a drop in the number of rate payers of more than 98% (Licensee Report 1992-1994). In addition, the several hundred customers within the LWS were not only forced to pay 100% of the cost, but to add insult to injury, they also had to support Vallejo's own obligation to provide free water to the original easement holders.[4]

Vallejo breached its contractual agreements again in 2009 with the 2009 Rate Increase. It is this breach for which the LWS Customers seek monetary damages. In essence, after the parties performed consistently with the implied agreement described above for over 100 years, Vallejo breached and by ordinance passed the cost of the LWS system – formerly shared by more than 30,000 metered customers – to just several hundred Customers within the LWS.

Further, although a breach of contract does not require bad faith, at the same time it was telling the LWS Customers they were on their own, Vallejo was representing to the federal government as recently as 2003 that Lake Curry water was "*critical* to the City in meeting its *existing and future [water] demands*" (Fed. Regis., Vol. 68, No. 157, Aug. 14, 2003, italics added). Vallejo likewise represented to the State Water Resource Control Board that as of *2008*, it "continues to attempt to be able to use Lake Curry water for municipal use" within Vallejo (Licensee Report for 2005-2007).

E. Vallejo Cannot, By Ordinance or Otherwise, Breach its Agreements with the LWS Customers

It is no defense that the breach at issue involved a series of ordnances enacted by the Vallejo City Council. Courts have long held that a municipal water supplier cannot by ordinance breach its agreements with non-resident Customers.

In *Tronslin v. City of Sonora* (1956) 144 Cal. App. 2d 735, the plaintiff granted the defendant city an easement for purposes of constructing a sewer pipe. As consideration for the

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[4] Between 2009 and 2014, the paying LWS Customers will incur almost $900,000 in additional expense to honor *Vallejo's* contractual obligation to provide free water to approximately 60 consumers within the LWS. Vallejo's breach of this obligation gives rise not only to $900,000 in damages, but will also entitle the LWS Customers to "tort of another" attorney's fees as damages in enforcing their rights (*Prentice v. North American Title Guaranty Corp.* (1963) 59 C2d 618, 620; *De la Hoya v. Slim's Gun Shop* (1978) 80 CA3d Supp., 6, 9 [extending tort-of-another doctrine to breaches of contract]).

easement, the city agreed to allow the plaintiff to install connections to and use the sewer pipe. Thereafter, the city passed an ordinance imposing an annual $24 charge against each non-resident using the city's sewer. The court held that the ordinance was invalid because it violated the original contract the plaintiff had with the city. The court reasoned as follows:

> The right-of-way across plaintiff's land could only have been acquired in one of two ways-either by condemnation or by contract. In the present case it may have been that the city, in lieu of condemnation of the property of plaintiff and payment to him of the damages which necessarily would have flowed therefrom, or for one of many other reasons, decided in its discretion to escape what might have been a long and costly proceeding and to accomplish the same purpose by an agreement, i.e., that for the right to possess and use a way across plaintiff's land for the construction and maintenance of its sewer, it would give to plaintiff the right to connect with and to use the sewer. Its act in so doing could in no sense be said to have been an invalid exercise of its power to contract. **And having entered into a valid contract, it could not, by ordinance, impair the same.** (*Id.* at 738, emphasis added.)

Also in accord is *Stanislaus Water Co. v. Bachman* (1908) 152 Cal. 716. In that case, a utility contracted to provide water to the defendant's predecessor in interest for no more than $1.50 per acre per year. The utility subsequently raised the price to $2.30 per acre and sued the defendant to collect the increased rate. The court agreed that $2.30 was a fair price, but held that the utility was bound by the original contract rate. Language in *Bachman* even goes so far as to suggest that the increase in the contract rate was akin to actually cutting off the supply of water altogether. Specifically, the court reasoned that "If the right to the use of water for that purpose cannot be made permanent, but is subject to change or termination at the hands of the public authorities under the guise of regulation and control, then such use would be of little value" (*id.* at 729-30).

The more recent case of *Louisiana-Pacific v. Humboldt Bay Municipal Water Dist.* (1982) 137 Cal. App. 3d 152, is also on point. There, the defendant water district entered into a long-term contract with the plaintiffs with respect to the rates it would be charged. The contract was entered into in order to induce the plaintiff to locate its mill within the water district's boundaries.

After performing under the contract for 18 years, the defendant passed a resolution which set new rates for all Customers (including the plaintiff). The defendants justified this on the grounds the contract with the plaintiff was an "invalid limitation" of its power to set rates. The defendant relied on Water Code §71616 which empowers water districts to set rates which will "pay the operating expenses of the district." The defendant claimed this statute allowed it to set rates notwithstanding any existing contracts, arguing that §71616 trumped §71592 which allows a water district to enter into contracts.

The trial court sided with the defendant holding that §71616 allowed the district to override its contract with the plaintiff. The trial court reasoned that "[n]o where in the law is a section which empowers the Board to enter into a long term contract for the sale of water by which the rates for water sold are not only frozen but are fixed without regard to the legal criteria set forth in Water Code Section 71616."

The judgment was reversed on appeal. The court of appeal ruled that §71614 and §71616 of the Water Code were discretionary and did not conflict with or supersede §71592. The court, quoting from and relying on *Public Service Co. v. St. Cloud* (1924) 265 U.S. 352, reasoned that:

> "where a public service corporation and the municipality have power to contract as to rates, and exert that power by fixing the rates to govern during a particular time, the enforcement of such rates is controlled by the obligation resulting from the con-tract." The Court concluded that the subject statutes conferred upon the city the power to set rates by either contract or regulation: "[W]e think that the City might either contract as to the rates, as an incident to its power of granting the right to construct and operate the public utility, or, if it did not exercise this power to contract, might thereafter 'regulate and prescribe' the rates in the exercise of the governmental authority conferred by the proviso. One power, however, is not destructive of the other. *And where a municipality has both the power to contract as to rates and also the power to prescribe rates from time to time, if it exercises the power to contract, its power to regulate the rates during the period of the contract is thereby suspended, and the contract is binding.* (Italics in original; citations omitted.)

Based on this, the court held that "a district's power to contract may not be superseded by regulation." The court further justified its decision on the grounds the defendant entered into a long term contract with the plaintiff in order to induce the plaintiff to move its mill to within the district and to supply a guaranteed source of revenue.

F. Proposition 218 Does Not Justify the LWS Rate Structure

Although Vallejo first decided to pass the full cost of the LWS onto the LWS Customers in 1992, Vallejo cannot rely on Proposition 218 (Cal. Const. Art. 13D), passed in 1996, to retroactively justify its breach. Vallejo seems to be under the false impression that Proposition 218 bars it from sharing in the cost of water service within the LWS. This argument is without merit.

Nothing in Proposition 218 prohibits the City from levying property related fees on its own residents to pay for the LWS. Article 13D, §6(b)(4) provides that "no fee or charge may be imposed for a **service** unless that service is actually used by, or immediately available to, the owner of the property in question." The "service" in question is water service. Since Vallejo residents receive water "service", §6(b)(4) simply does not apply. This is not the case of the City

providing water service to LWS Customers, but not affording similar water service to its own residents. Everyone receives water service, only from difference sources. Vallejo's reading of §6(b)(4) would improperly prohibit a municipality from charging everyone for the same "service" depending on where the *source* of the service came from. This is no authority in Proposition 218 or its case law which supports, let alone compels, such a conclusion.

Even if Proposition 218 precludes Vallejo from levying property related fees on its own residents for the cost of the LWS (it does not), Proposition 218 does not prohibit Vallejo from funding "its share" of the LWS by *other means*, such as through general taxes or from its own general fund.

In addition, the City is estopped, based on its own actions, from claiming the LWS is a separate "service" distinct from the water service it provides to its own residents. First, to the extent the LWS is a separate service, it is only separate because Vallejo unilaterally made it so in 1992 when it breached its contracts with the LWS Customers and voluntarily discontinued water transmission from the Gordon and Green Lines to Vallejo. No court will allow Vallejo to rely on Proposition 218 when the separate nature of the services was caused by Vallejo's own breach. Nor will a court allow the City to claim that the LWS is truly separate when it represented by the federal and state governments in 2003 and 2008, respectively, that Lake Curry and the LWS were "critical" to Vallejo's own municipal water supply.

Second, under Article 13D, §4(e), the City may not impose an assessment if there is a majority protest. If the LWS were truly a separate "service" this would mean the 2009 Rate Increase could not take effect if 51% of the *809* LWS Customers protested the assessment. However, in order to pass the 2009 Rate Increase over the objections of a majority of the LWS Customers, the City chose to lump the LWS Customers with its own residents for purposes of §4(e), meaning that it would take 51% of approximately *39,000* Customers to block the rate increases on the LWS. Vallejo cannot have it both ways. Either the LWS is separate, in which case the 2009 Rate Increase was invalid under §4(e), or the LWS is not separate, in which case Prop. 218 is no defense. No court will allow Vallejo to simultaneously claim the LWS Customers are a part of Vallejo's water service (in order to allow it to increase rates over the objection of the LWS Customers), but are a separate service (in order to justify the astronomical rates is passed).

G. Vallejo Breached Its Fiduciary Duty to the LWS Customers

In addition to breaching its contractual agreements with the LWS Customers, Vallejo breached its fiduciary duties to the LWS Customers. Vallejo's fiduciary duties include duties of loyalty and care and arise from the City's trust and agency relationship with the LWS Customers. These fiduciary duties arise from the trustee-beneficiary relationship which exists between the City and the LWS Customers as recognized by the Supreme Court in *City of South Pasadena v. Pasadena Land and Water Company* (1908) 152 Cal. 379, 394 (*see also*, *Durant v. City of*

Beverly Hills (1940) 39 Cal. App. 2d 133, 137; *B.H. Leavitt v. Lassen Irrigation Co.* (1909) 157 Cal. 82, 87).

Vallejo's fiduciary duty of loyalty "disallows the pursuit of self-interest" (Restatement (3d) Agency, §8.01, cm. b). As a fiduciary, the City is precluded from acquiring "material benefits in connection with transactions or other actions undertaken on the principal's behalf or through the agent's use of position" (*Id.*, §8.02, cm. a). Where there are more than two beneficiaries of a trust (here, Vallejo residents and the LWS Customers), the "trustee has a duty to deal impartially with them" (Prob. Code §16003; Restatement (2d) Trusts §183).

Vallejo's fiduciary duty of care requires it to act "with care, competence and diligence" (Restatement (3d) Agency, §8.08). In *Lukrawka v. Spring Valley Water Company* (1915) 169 Cal. 318, the Supreme Court held that a public utility has an implied obligation to provide "reasonably adequate" facilities to serve the present and future needs of the consumer public. Under *Lukrawka* and subsequent Supreme Court decisions in *City of South Pasadena*, 152 Cal. at 594 and *Durant v. City of Beverly Hills* (1940) 39 Cal. App. 2d 133, 137, this means that Vallejo has a fiduciary duty to maintain, repair and replace existing infrastructure so that it may continue to meet the needs of the LWS Customers.

Vallejo breached its fiduciary duties to the LWS Customers by:

- Unilaterally deciding it would no longer share in the cost of the LWS. Vallejo, in effect, put the interests of its own residents ahead of the interests of the LWS Customers.

- Failing to replace aging infrastructure. For example, 74% of the pipeline assets are more than *30 years* beyond their useful life. The cost of replacing these decrepit assets is more than *$24 million.*

- Passing the full cost of the LWS onto the LWS Customers after failing to replace the aging infrastructure. In essence, during the nearly 100 years when Vallejo did share in the cost of the LWS, it failed to make virtually any improvements to the system. In 1992, the City divested itself from the LWS and then dumped the dilapidated system on the LWS Customers with the expectation that 809 connections would fund deferred capital improvements which will cost over *$30 million* over the next ten years.

- Misrepresenting the condition of the LWS to the LWS Customers in 1992 by telling the LWS Customers in a public meeting that the system was in good working order and free from defects. In addition, in 1992, the City failed to disclose that 74% of the pipeline assets were *then* beyond their useful lives and in

need of immediate replacement. It was not until the GVLA obtained a copy of the appraisal in 2013 that the true age and condition of the LWS was discovered.

- Causing a threat to health and safety by failing to maintain and test the fire hydrants within the LWS. Due to the age of the pipes within the LWS (which Vallejo failed to replace and adequately maintain), the hydrants cannot be tested due to concerns that the water pressure would cause a catastrophic failure of the pipe system.

- Producing an objectively false and misleading appraisal designed to conceal millions of dollars of customer contributed capital in an attempt to drive up the "rate base" and hence purchase price for the LWS (as demonstrated in the accompanying appraisal letter). In essence, Vallejo is asking the LWS Customers to pay for the same system twice (plus a markup for profits recoverable by an investor owned utility).

- Not selling or attempting to sell "unneeded" watershed and non-watershed real property associated with the LWS in order to fund deferred and necessary capital improvements to the LWS system in violation of State policy (Cal. Pub. Util. Code §§789-790.1).

- Attempting to sell the LWS pipes, pumps and water treatment assets while simultaneously keeping for its own profit and benefit the unneeded watershed and non-watershed real property associated with the LWS in violation of State policy (Cal. Pub. Util. Code §§789-790.1). The value of this land is approximately $29 million.

- Claiming that the real property surrounding Lake Curry is not a part of the LWS (and hence, Vallejo's to dispose of for its own benefit). The land surrounding Lake Curry is and has been a part of the LWS, a fact Vallejo recently recognized when it represented to the bondholders of its Series 2013 Bonds that Lake Curry was a part of the LWS and when it represented to the state and federal governments that Lake Curry was "critical" to the City's own municipal water supply.

- Attempting to sell the LWS without any water rights (which was achieved by removing the watershed property surrounding Lakes Frey and Madigan from the scope of the appraisal). Vallejo compounded this breach by then seeking to profit from the sale of the very same water rights to an investor owned utility (who would then recoup the price, plus a profit) from the LWS Customers.

- Breaching its contractual obligations to the LWS Customers (by burdening them with 100% of the cost of the LWS), and then seeking to benefit from such a breach by collecting on a $3.2 million "loan" from the City to the LWS Customers. This "loan" purportedly arises from a pre-2009 "subsidy" Vallejo allegedly provided to the LWS. The appraisal commissioned by the City seeks to recover this "loan" from the LWS Customers should they decide to purchase the system.

- Treating the LWS Customers as a part of Vallejo's water service (in order to allow it to increase rates over the objection of the LWS Customers), while simultaneously claiming the LWS is a separate service (in order to justify the 2009 Rate Increase).

- Forcing the LWS Customers to pay 100% of the cost of the LWS on the grounds Vallejo no longer used the LWS, while simultaneously represented to the Federal and State Governments that the LWS (specifically, Lake Curry) was a "critical" part of the *City's* existing and future water needs.

H. The 2009 Rate Increase is Per Se Unreasonable and therefore Unlawful

In addition to breaching its contractual and fiduciary duties to the LWS Customers, the City's decision to unilaterally stop sharing in the cost of the LWS and to pass the full cost of operating the system onto the LWS Customers is *per se* unreasonable, discriminatory and therefore unlawful.

It has long been held that a municipality which supplies water to non-residents has a duty to provide such water at a reasonable rate. This duty was first recognized in *Durant*, *supra*, where the Court held that a municipal water supplier "assumed a trust to perform the contract" and this obligation includes the duty "to continue to serve [non-residents] at a reasonable rate" (39 Cal. App. 2d. at 138, italics in original). A rate which is "unreasonable, unfair or fraudulently or arbitrarily established" is discriminatory and therefore unlawful (*id.* at 139; *see also*, *Hansen v. City of San Buena Ventura* (1986) 42 Cal. 3d 1172; *Elliot v. City of Pacific Grove* (1975) 54 Cal. App. 3d 53 ["There exists in plaintiff, as a user of a public utility's sewer service, a primary right that he cannot be charged an unreasonable rate for such service and there rests on the city, as a public utility, the corresponding duty not to charge plaintiff an unreasonable rate for such service."]).

While the GVLA does not dispute that a municipality can charge non-residents more than its charges its own residents (*see, e.g.*, *Hansen*, 42 Cal. 3d at 1181), it was always implicitly understood that the costs of the LWS would be shared and spread among a large rate paying base

which *included* Vallejo's residents. This was the pattern and practice of the parties for almost 100 years before Vallejo decided to discontinue using LWS water in 1992.

Any rate which excludes Vallejo residents from the rate paying base is *per se* unreasonable given the dramatic departure from the intent of the parties and 100 years of performance. This is consistent with the case law addressing the reasonableness of water rates charged to non-residents. In every decision of which we are aware, the issue was whether the rate charged to the non-residents was reasonable in comparison to the rates charged the residents. We are unaware of a *single* case in California or elsewhere in which a court held or even suggested that it would be reasonable for the municipality to pay *nothing* for a water system it constructed and used and to burden the non-residents with *100%* of the cost.

I. Remedies for Vallejo's Breach

At the very least, the LWS Customers' damages date to the 2009 Rate Increase which is the subject of the Tolling Agreement.[5] (*See also, Howard Jarvis Taxpayers Ass'n v. City of La Habra* (2001) 25 Cal. 4th 809, 812 [a municipalities "continued imposition and collection [of a fee or tax] is an ongoing violation, upon which the limitations period begins anew with each collection"].)

Damages in this case would include, at a minimum, the difference between what LWS Customers paid, and what LWS Customers *should have paid* had Vallejo residents paid their fair share of the LWS costs (Cal. Civ. Code §3300). According to Vallejo's own calculations, the revenue requirement for the LWS between 2009 and 2014 is $12,241,807, all of which has been paid or will be paid by just 809 LWS Customers (Vallejo, 2009 Rate Study). As discussed above, as a matter of contract, Vallejo was obligated to pay at least 98% of these costs. Based on the historic cost sharing which forms the basis for the agreements, this means that between 2009 and 2014, LWS Customers will have overpaid by approximately $11,996,971. If this action cannot be resolved short of litigation, the LWS Customers seek to recover these damages at trial (plus any other damages accruing prior to 2009 which were only recently discovered).

In addition, the LWS Customers are entitled to an injunction prohibiting Vallejo from charging the LWS Customers more than 2% of the cost of the LWS, or, alternatively, an order requiring Vallejo to specifically perform its contractual obligations in the future. This means that the costs of operating the LWS beginning July 1, 2014 must be borne 98% by Vallejo (or its assignee, assuming a third party would agree to purchase a system subject to such conditions). These costs of operation include deferred and necessary capital improvements. As discussed above, the replacement cost of those assets already thirty years or more beyond their useful life is over $24 million. Within ten years, the replacement cost of assets beyond their useful life will add an additional $6 million for a total of approximately $30 million. Vallejo will be responsible

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[5] Due to the recent discovery of the condition of the LWS as disclosed in the FCS appraisal, some damages may be back well before the date of the 2009 Tolling Agreement.

for 98% of these costs. Vallejo will also be responsible for the normal operational and maintenance costs of the system which could exceed $3 million per year and will increase in the future.

Finally, the LWS Customers will also seek a preliminary and permanent injunction preventing Vallejo from selling and further obligating or encumbering the LWS (in whole or in part, including facilities, watershed land, non-watershed land and water rights) to any third party. This injunction is needed to enjoin a further breach of contract and breach of fiduciary duty as discussed above.

J. The LWS Customers Are Entitled to their Attorney's Fees

In any legal action with Vallejo, the LWS Customers would be entitled to attorney's fees under CCP §1021.5, the private attorney general statute. Fees are recoverable under §1021.5 if the action results in the enforcement of an "important right affecting the public interest" and the action confers a "significant benefit on the general public or a large class of persons." The LWS Customers will seek not only their reasonable fees (which could be significant), but also a multiplier on top of those fees.

Here, the importance of the right at issue – the right to affordable water – cannot be denied. The Human Right to Water Bill, codified in Water Code §106.3 provides that, "It is hereby declared to be the established policy of the state that every human being has the right to safe, clean, *affordable*, and accessible water adequate for human consumption, cooking, and sanitary purposes." The legislative history to §106.3 indicates that the bill emphasizes "that access to safe and *affordable* water is a fundamental human right essential to our health, the environment and the economy." (Assembly Floor Analysis of AB 685, May 31, 2011.) It is also the established policy of the State that water for domestic purposes is the "highest use of water" (*id.*, §106).

As it currently stands, just 809 connections pay for the astronomical costs of the LWS, which are *already* some of the highest in the State. The LWS Consumer's current bills are minor, however, when one considers the additional cost to fund the $24 million in capital improvements which are immediately needed, or the $30 million in capital improvements which will be needed over the next ten years. Further, if the LWS is sold to a private utility, our best-case calculation show that the average bi-monthly water bill for each LWS Consumer would be at least ***$1,150***. A water bill of almost $7,000 per year is by definition, not affordable. Further, such a catastrophic escalation of water rates would result in the loss of at least $70 million in property values to the LWS Customers.

Nor can it be doubted that any change to the status quo will create a significant benefit on a large class of persons. In *Monterey/Santa Cruz County Bldg. and Const. Trades Council v. Cypress Marina Heights, LP* (2011) 191 CA4th 1500, 1523, the court held that the lawsuit benefitting 900 construction workers met a "large class of persons" requirement. In *Robinson v.*

City of Chowchilla (2011) 202 CA4th 382, 396, an action benefitting the state's 1400 police chiefs was found to be a "large class of persons." Within the LWS there are 809 *connections*, but these connections serve over 2,000 individuals, well in excess of the large class of persons in *Monterey/Santa Cruz* and *Robinson*.

In addition to §1021.5, the LWS Customers will be entitled to their attorney's fees *as damages* under the tort-of-another doctrine (*Prentice v. North American Title Guaranty Corp.* (1963) 59 Cal. 2d 618, 620; *De la Hoya v. Slim's Gun Shop* (1978) 80 Cal. App. 3d Supp., 6, 9 [extending tort-of-another doctrine to breaches of contract]). As discussed above (*see*, fn. 4), Vallejo breached *its* contractual obligation to provide free water to approximately 60 customers, and instead passed that obligation onto the LWS Customers. This breach has forced the paying LWS Customers to bring this action against the City to protect their rights, and the legal fees incurred in the action will be recoverable as an element of damages (*Prentice*, 59 Cal. 2d at 620 [tort-of-another doctrine applies when the defendant's tort or breach of contract requires the plaintiff to defend *or bring* an action against a third party to protect its interests]).

IV. Conclusion

Vallejo's liability is substantial. The LWS Customers' damages arising from the 2009 Rate Increase are at least $11,996,971. Vallejo is also required to contribute 98% of the costs of the LWS going forward. The current cost of operating the LWS is almost $3 million per year *in addition to* the $30 million in deferred capital improvements which will be needed over the next ten years. Vallejo will be responsible for 98% of these costs and expenses. Vallejo will also be responsible for the LWS Customers' attorney fees and costs, plus a multiplier. Vallejo's total exposure is more than $40 million (without including Vallejo's share of contributing to the ordinary operating costs of the LWS and without including the LWS Customers' attorney fees).

We strongly believe that a jury will agree that Vallejo and the LWS Customers impliedly agreed that Vallejo would pay 98% of the cost of the LWS. We also believe that a jury will agree that Vallejo's decision to unilaterally divest itself from its obligation to pay for the LWS is a breach of Vallejo's fiduciary duty. We further believe that a judge will find that the LWS Customer's rates are per se unreasonable because Vallejo pays nothing for the system it created and used for almost a century.

Nevertheless, we recognize that litigation can be time consuming and protracted. Given the poor condition of the LWS system and the need for immediate capital improvements, time is of the essence. Accordingly, the LWS Customers would prefer to resolve the problem now through a negotiated settlement with Vallejo than through a lengthy litigation. To that end, we propose to mediate this dispute within the next thirty days. For the mediator, we suggest Randy Wulff of Wulff, Quinby, Sochynsky. Mr. Wulff specializes in complex litigation and is perhaps the most respected and effective mediator in the Bay Area. We are open to other mediators Vallejo might suggest.

I look forward to your response. As you know, if this dispute cannot be resolved within 45 days, we will be required to file the civil class action complaint.

Very truly yours,

Stephen M. Flynn

cc. Osby Davis, Mayor (via U.S. Mail)
Claudia Quintana, City Attorney (via U.S. Mail)
Daniel E. Keen, City Manager (via U.S. Mail)
David Kleinschmidt, Public Works Director (via U.S. Mail)
Franz Nestlerode, Water Superintendent (via U.S. Mail)

Exhibit A
Historical Vallejo Resident and LWS Water Rates

Year	Ordinance Number	Vallejo Residents	LWS Customers
1925	437 N.S.	$1.25/mo minimum $0.25/100 cf	N/A
1951	121 N.C.	$1.50/mo minimum $0.30/100 cf	N/A
1958	324 N.C.	$1.50/mo minimum $0.30/100 cf	N/A
1971	26 N.C. (2d)	$1.75/mo minimum $0.35/100 cf	$2.65/mo minimum $0.48/100 cf
1977	386 N.C. (2d)	$1.75/mo minimum $0.35/100 cf	$2.65/mo minimum $0.50/100 cf
1980	537 N.C. (2d)	$1.50/mo minimum $0.94/100 cf	$2.40/mo minimum $0.94/100 cf
1984	748 N.C. (2d)	$1.62/mo minimum $1.02/100 cf	$2.59/mo minimum $1.02/100 cf
1985	805 N.C. (2d)	$1.75/mo minimum $1.10/100 cf	$2.80/mo minimum $1.22/100 cf
1986	875 N.C. (2d)	$2.15/mo minimum $1.35/100 cf	$3.44/mo minimum $1.50/100 cf
1992	1211 N.C. (2d)	$4.00/mo service charge $0.90/100 cf	$8.00/mo service charge $3.50/100 cf
1995	1334 N.C. (2d)	$4.00/mo service charge $0.90/100 cf	$20.00/mo service charge $4.46/100 cf $30.00 upgrade surcharge
1996	1334 N.C. (2d)	$4.00/mo service charge $0.90/100 cf	$20.00/mo service charge $4.46/100 cf $40.00 upgrade surcharge
2009	1619 N.C. (2d)	$13.40/mo service charge $2.25/100 cf	$22.45/mo service charge $6.07/100 cf $40.00 upgrade surcharge
2013	1619 N.C. (2d)	$16.45/mo service charge $2.88/100 cf	$34.75/mo service charge $10.02/100 cf $40.00 upgrade surcharge

Exhibit B

Historical Vallejo Water Rates