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CENTRAL DIVISION

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HUNBERG
SUPERIOR COURT
SAN DIEGO COUNTY, CA

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CALIFORNIA DEPARTMENT OF WATER RESOURCES

13
14 SUPERIOR COURT OF CALIFORNIA
15 COUNTY OF SAN DIEGO

Case No. GIC 789291

16 SEMPRA ENERGY RESOURCES,
17 a California Corporation;

18 Plaintiff,

19 vs.

20 CALIFORNIA DEPARTMENT OF WATER
21 RESOURCES, an agency of the State of California; and
DOES 1 through 10,

22 Defendants,

ANSWER TO COMPLAINT
FOR DECLARATORY RELIEF

23 AND CROSS-RELATED ACTIONS.
24

25 Defendant and Cross-Complainant CALIFORNIA DEPARTMENT OF WATER
26 RESOURCES, an agency of the State of California (the "Department") answers the Complaint
27 for Declaratory Relief of Plaintiff and Cross-Defendant SEMPRA ENERGY RESOURCES, a
28 California corporation ("SER"), as follows:

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DEPARTMENT OF WATER RESOURCES' ANSWER TO COMPLAINT FOR DECLARATORY RELIEF

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ANSWER TO ALLEGATIONS OF COMPLAINT

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2 1. In answering Paragraph 1 of the Complaint on information and belief, the
3 Department admits the allegations set forth therein.

4 2. In answering Paragraph 2 of the Complaint, the Department admits that it is an
5 agency of the State of California.

6 3. In answering Paragraph 3 of the Complaint, the Department lacks sufficient
7 information or belief on the basis of which to admit or deny the allegations made therein, and on
8 that basis denies those allegations.

9 4. In answering Paragraph 4 of the Complaint, the Department denies that SER and
10 Department entered into an Energy Purchase Agreement on May 4, 2001. The Department
11 admits that it executed an Energy Purchase Agreement in the form attached as Exhibit A to the
12 Complaint on or about May 4, 2001 (the "Agreement"). The Department alleges that SER
13 induced the Department's execution of the Agreement by fraud. In particular, and without
14 limitation, the Department alleges that SER induced it to execute the Agreement by falsely
15 representing to the Department that: (a) SER actually anticipated that its Elk Hills project would
16 achieve commercial operation as a simple cycle generating facility ("Elk Hills (SC)") in
17 April 2002; (b) SER had the requisite corporate authority to perform the Agreement, including
18 but not limited to the duty to making commercially reasonable efforts to cause Elk Hills (SC) to
19 achieve commercial operation as a simple cycle generating facility on or about April 1, 2002; and
20 (c) SER's performance of the Agreement, including, but not limited to, its commitments with
21 respect to Elk Hills (SC), would not violate or conflict with any agreement to which SER was a
22 party or by which it or any of its property was bound. Because of that fraud in the inducement,
23 the Department did not consent to the Agreement, and the Agreement therefore does not
24 constitute a valid or binding agreement between SER and the Department.

25 5. In answering Paragraph 5 of the Complaint, the Department denies the allegations
26 contained therein to the extent that they purport to reflect the terms of an existing contract
27 between SER and the Department. The Department alleges that if the Agreement represented a
28 valid, binding contract between SER and the Department, it contemplated a transaction for the

1 purchase and sale of electric capacity and energy from SER's generation resources, and that
2 SER's construction of new generating facilities was an integral part of the bargained-for
3 exchange.

4 6. In answering Paragraph 6 of the Complaint, the Department denies the allegations
5 contained therein to the extent that they purport to reflect the terms of an existing contract
6 between SER and the Department. If the Agreement did represent a valid, binding contract
7 between SER and the Department, the Department denies that SER has fully complied with the
8 terms thereof, in that SER was required to, but failed to, make commercially reasonable efforts to
9 achieve Commercial Operation of the Elk Hills (SC) project, in violation of section 2.10(a) of the
10 Agreement. The Department lacks sufficient information or belief on the basis of which to admit
11 or deny the remaining allegations, and, on that basis, denies those allegations.

12 7. In answering Paragraph 7 of the Complaint, the Department denies the allegations
13 contained therein to the extent that they purport to reflect the terms of an existing contract
14 between SER and the Department.

15 8. The Department denies SER's allegation in Paragraph 7 of the Complaint that
16 "The Agreement describes, in Appendix B, certain projects ('Projects') that SER has or will own,
17 lease or operate," in that the Agreement does not provide that SER will itself own, lease or
18 operate all of the Projects listed on Appendix B. The Agreement in fact states that "Certain
19 affiliates of SER (the 'Project Companies') own and operate, or will own, lease and/or operate,
20 the generating facilities described in Appendix B (the 'Projects')," and further alleges that the
21 Agreement defines "Affiliate" as follows:

22 "Affiliate" means, with respect to any person, any other person (other than an
23 individual) that, directly or indirectly, through one or more intermediaries,
24 controls, or is controlled by, or is under common control with, such person. For
25 this purpose, "control" means the direct or indirect ownership of fifty percent
(50%) or more of the outstanding capital stock or other equity interests having
ordinary voting power.

26 9. The Department denies that the Agreement defines "Market Sources" as alleged in
27 Paragraph 7 of the Complaint. The pertinent language actually reads as follows: "'Market
28 Source' means any marketer, trader, seller or generator other than the Project (including Seller's

1 Affiliates) from which Seller could obtain power supplies.”

2 10. The Department admits that, as alleged in Paragraph 7 of the Complaint, the
3 Agreement states that “Seller may provide the Energy from any Project, Market Source or
4 combination of Projects and/or Market Sources,” but denies that the quoted language fully
5 describes the Agreement’s provisions concerning SER’s rights or obligations in relation to
6 sources of energy to be sold under the Agreement. If there were a valid and existing agreement
7 between SER and the Department, Appendix B of the Agreement would limit the language on
8 which SER relies by stating the maximum amount of energy to be provided from any such source
9 generally, and in particular, would permit SER to sell no more than 300 megawatts of energy
10 from any market source. In addition, in bidding for the Agreement, SER represented that it only
11 intended to rely on Market Sources as a source of energy to be sold to Department (a) during the
12 period from June 1, 2001 to September 30, 2001, during which period SER stated that it planned
13 to supply 300 megawatts of power from Market Sources, and (b) again from October 1, 2002 to
14 May 31, 2003, after Elk Hills (SC) had ceased operation to permit completion of Elk Hills (SC)
15 during which period SER stated that it planned to supply 280 megawatts of energy from Market
16 Sources. In contract negotiations, SER abandoned plans to provide energy from Market Sources
17 during the period from October 1, 2002 to May 31, 2003 after SER and the Department agreed to
18 a reduction in the contract quantity for that period to permit SER to meet its delivery obligations
19 from the capacity of the El Dorado Project.

20 11. In answering Paragraph 8 of the Complaint, the Department denies the allegations
21 contained therein to the extent that they purport to reflect the terms of an existing contract
22 between SER and the Department.

23 12. The Department denies SER’s allegation in Paragraph 8 of the Complaint that, “In
24 executing the Agreement, SER made a forward commitment to supply Department with energy
25 requiring at least 1900 megawatts of capacity.” In bidding for the Agreement (to which bid the
26 Agreement expressly refers in its Recitals), SER proposed a transaction under which SER would
27 provide “[l]ong-term base load capacity . . . from clean, natural gas fired combined-cycle plants,”
28 “[l]ong-term peaking capacity . . .,” and “[a] 10-year term which provides a stable, low priced

1 platform of base load reserves.” SER also stated that: “Purchaser would receive and purchase,
2 and Seller would deliver and sell, electric capacity and energy from SER’s generation resources
3” Consistent with SER’s stated intention and the language of the Agreement itself, the
4 Agreement does not limit SER’s obligation to provide new generating capacity from the Projects
5 by the amount of the Department’s energy purchases, in that:

6 (a) Section 2.10(a) of the Agreement provides that SER *must* make
7 commercially reasonable efforts to cause each of the Projects listed on Appendix B that
8 were not operational as of May 4, 2001 to achieve commercial operation;

9 (b) The parties contemplated that, given the expenditure of commercially
10 reasonable efforts by SER, those new Projects would achieve commercial operation and
11 would provide up to 3,750 megawatts of generating capacity;

12 (c) Recital C of the Agreement states that the Project Companies “will . . .
13 operate” the Projects;

14 (d) Section 2.10(d) of the Agreement states, *inter alia*, that “Seller will
15 operate . . . each Project;”

16 (e) Although Appendix C of the Agreement sets for varying amounts of
17 energy to be delivered from time to time and reflects the parties’ intent that SER would
18 provide up to 1,900 megawatts of electricity, sections 2.10(b) and 2.11 of the Agreement
19 contain a mechanism for SER to unilaterally reduce the contract quantity if, despite its
20 commercially reasonable efforts, a Project fails to achieve commercial operation.

21 13. The Department lacks sufficient information and belief on the basis of which to
22 admit or deny SER’s allegation in Paragraph 8 of the Complaint that, “[a]t the time the
23 Agreement was executed, SER was in the process of developing the Projects, but did not have
24 sufficient generation facilities to supply energy under the Agreement,” and on that basis denies
25 that allegation.

26 14. The Department lacks sufficient information and belief concerning SER’s
27 purposes on the basis of which to admit or deny SER’s allegation in Paragraph 8 of the
28 Complaint that, “[i]n order to mitigate its risk that it would have a substantial forward

1 commitment to supply energy without its own generation facilities (and thereby be required to
2 use Market Sources to fulfill its contractual obligations to Department), SER negotiated a right
3 (section 2.10 of the Agreement) to reduce its energy delivery commitments under the Agreement
4 if it did not achieve commercial operation of the Projects,” and on that basis denies that
5 allegation.

6 15. The Department admits that as alleged in Paragraph 8 of the Complaint, section
7 2.10 of the Agreement requires SER to make commercially reasonable efforts to achieve
8 commercial operation of each Project. The Department denies that the purpose of that provision
9 was “[s]o as not to give SER an unfettered right to reduce its energy delivery commitments,” and
10 alleges that the purpose of that provision was to require SER to honor its commitment to
11 California electricity consumers to create the new generating capacity set forth in Appendix B of
12 the Agreement.

13 16. The Department admits that the following quote from the Agreement set forth in
14 Paragraph 8 of the Complaint accurately repeats a part of a sentence in section 2.10(a) of the
15 Agreement, but denies that the underlining and capitalization in the phrase as quoted are correct,
16 and further denies that the quoted language recites the entire Agreement provision:

17 “[N]othing in this section 2.10 or any other provision of this Agreement shall be
18 construed as obligating [SER] to commence or continue efforts to achieve
Commercial Operation of any Project.”

19 The quoted language is part of a longer sentence that reads in full as follows and must be read as
20 a whole:

21 Seller will make commercially reasonable efforts to achieve Commercial
22 Operation of each Project on or before the Commercial Operation Target Date for
such Project in Appendix B, but nothing in this Section 2.10 or any other
23 provision of this Agreement shall be construed as obligating Seller to commence
or to continue efforts to achieve Commercial Operation of any Project.

24 In that connection, the Department alleges that if the Agreement is a valid, binding contract
25 between SER and the Department, then:

26 (a) Section 2.10 of the Agreement imposes on SER an absolute duty to make
27 commercially reasonable efforts to achieve commercial operation of each and every
28 Project listed on Appendix B of the Agreement; and

1 (b) In negotiating the Agreement, both SER and the Department contemplated
2 the language SER quotes from second half of the above-cited sentence would serve *only*
3 to insulate SER from claims of breach arising from the failure of any Project, despite
4 SER's commercially reasonable efforts, to achieve commercial operation, but would not
5 excuse SER from making those efforts in the first instance.

6 17. The Department denies SER's allegation in Paragraph 8 of the Complaint that,
7 "[t]he sole consequence of a commercially unreasonable failure by SER to timely commence
8 operation of any Project is, pursuant to section 2.10 of the Agreement, to limit SER's otherwise
9 unilateral right to reduce its energy delivery commitments under the Agreement" and alleges that:

10 (a) Nothing in the Agreement would give SER the right to unilaterally reduce
11 the contract quantity absent its failure, *despite commercially reasonable efforts*, to
12 achieve commercial operation of any Project;

13 (b) Sections 2.10(b) and 2.10(d) of the Agreement, which describe and limit
14 SER's alternatives when despite its commercially reasonable efforts a Project fails to
15 achieve commercial operation, include no sanction for a failure to make those efforts;

16 (c) The duty to make commercially reasonable efforts is a material term of the
17 Agreement; and

18 (d) If SER's fraudulent misrepresentations to the Department had not vitiated
19 the Department's consent to the Agreement and the Agreement did constitute a binding
20 contract between SER and the Department, any failure on SER's part to make
21 commercially reasonable efforts to achieve commercial operation of any Project would be
22 a material default which, if left uncured following notice of the same pursuant to section
23 6.01(b) of the Agreement, would constitute a breach of contract.

24 18. The Department lacks sufficient information and belief on the basis of which to
25 admit or deny SER's allegation in Paragraph 8 of the Complaint that, "SER has not chosen to
26 reduce its energy commitments, but has plans to continue to fulfill its obligations to deliver
27 power from any combination of Projects and/or Market Sources' as specifically contemplated by
28 section 2.01," and in particular has no independent knowledge concerning any forward looking

1 choices SER has made or its current intentions concerning deliveries of power from new
2 generating facilities to the Department, and on that basis denies that allegation. To the extent
3 that the phrase “as specifically contemplated by section 2.01” alleges the parties’ intent with
4 respect to the Agreement, the Department incorporates herein each and every admission or denial
5 made, and every objection asserted, with respect to section 2.01 of the Agreement in its answer to
6 paragraphs 4 and 7 of the Complaint herein.

7 19. In answering Paragraph 9 of the Complaint, the Department denies the allegations
8 contained therein to the extent that they purport to reflect the terms of an existing contract
9 between SER and the Department.

10 20. The Department admits SER’s allegation in Paragraph 9 of the Complaint that the
11 Elk Hills Project is one of the generating facilities listed in Appendix B of the Agreement.

12 21. The Department denies on information and belief SER’s allegation in Paragraph 9
13 of the Complaint that the Elk Hills Project is a joint venture between SER and Occidental
14 Petroleum and alleges that:

15 (a) Occidental Energy Venture Corp. (“OEVC”) and SER are parties to a
16 January 1999 joint development agreement relating to Elk Hills, pursuant to which they
17 agreed to jointly develop Elk Hills to jointly share the costs and benefits associated with
18 that Project; and

19 (b) Elk Hills is currently owned and/or being developed by Elk Hills Power,
20 LLC, a California limited liability whose members are Sempra Energy Elk Hills Power
21 Corp , a wholly-owned subsidiary of SER, and EHPP Holdings, Inc., a wholly-owned
22 subsidiary of OEVC.

23 22. The Department admits that, as alleged in Paragraph 9 of the Complaint,
24 Appendix B of the Agreement lists Elk Hills as both a simple cycle facility (Elk Hills (SC)) and
25 as a combined cycle facility (Elk Hills (CC)).

26 23. The Department admits that, as alleged in Paragraph 9 of the Complaint, the
27 Department contemplated that Elk Hills (SC) would be built and operated “to meet peak power
28 demands during the summer of 2002.” The Department lacks sufficient information or belief on

1 the basis of which to admit or that allegation as it relates to SER's contemplation, and on that
2 basis denies that allegation.

3 24. The Department lacks sufficient information and belief on the basis of which to
4 admit or deny SER's allegation in Paragraph 9 of the Complaint that "'Simple cycle' plants are
5 more expensive to operate, less efficient and create more pollution than do combined cycle
6 plants," on that basis denies that allegation.

7 25. The Department lacks sufficient information and belief on the basis of which to
8 admit or deny SER's allegation in Paragraph 9 of the Complaint that after Elk Hills (SC) ceased
9 commercial operation, it would have to be partially dismantled to permit the construction of Elk
10 Hills (CC), on that basis denies that allegation.

11 26. In answering Paragraph 10 of the Complaint, the Department denies the
12 allegations contained therein to the extent that they purport to reflect the terms of an existing
13 contract between SER and the Department.

14 27. The Department denies on information and belief SER's allegation in Paragraph
15 10 of the Complaint that "construction of simple cycle operations was commenced at the Elk
16 Hills Project," and alleges on information and belief that (a) construction of the Elk Hills Project
17 as a combined cycle generating facility commenced in or about May 2001; (b) neither SER nor
18 Elk Hills Power, LLC ever obtained regulatory approval to build Elk Hills (SC); (c) neither SER
19 nor Elk Hills Power, LLC sought regulatory approval to do so until August 2001; and (d) neither
20 SER nor Elk Hills Power, LLC legally could have commenced "construction of simple cycle
21 operations . . . at the Elk Hills Project."

22 28. The Department denies on information and belief SER's allegation in Paragraph
23 10 of the Complaint that "construction of simple cycle operations . . . at Elk Hills Project . . .
24 ceased in October 2001," in that: (a) there was never any construction at Elk Hills specific to a
25 simple cycle project, and (b) on or about October 9, 2001, the Elk Hills Power, LLC management
26 committee voted to completely bypass construction of Elk Hills (SC) and proceed directly with
27 Elk Hills (CC).

28 29. The Department further denies on information and belief SER's allegation in

1 Paragraph 10 of the Complaint that, "Simple cycle operations at Elk Hills were planned by the
2 project owners at a time when there appeared to be a shortage of power for the summer of 2002."

3 30. The Department lacks sufficient information or belief on the basis of which to
4 admit or deny the remaining allegations of Paragraph 10 of the Complaint, and, on that basis,
5 denies those allegations.

6 31. In answering Paragraph 11 of the Complaint, the Department incorporates herein
7 by this reference and reasserts every admission, denial and objection it has stated in answering
8 Paragraphs 1 through 11, inclusive, of the Complaint.

9 32. In answering Paragraph 12 of the Complaint, the Department denies the
10 allegations contained therein to the extent that they purport to describe an actual controversy
11 concerning the terms of an existing contract between SER and the Department.

12 33. The Department denies SER's allegation in Paragraph 12 of the Complaint that
13 "[b]y letter dated March 29, 2002, Department has taken the position that SER is obligated to
14 proceed with the development of simple cycle operations at Elk Hills, despite the fact that such
15 operations and efforts are not and would not be commercially reasonable," and specifically
16 denies that in the March 29, 2002 letter the Department acknowledged that "such operations and
17 efforts are not and would not be commercially reasonable." If there is a contract, the Department
18 is entitled to suspend performance under the Agreement's express terms, in that:

19 (a) SER failed to make commercially reasonable efforts to achieve
20 Commercial Operation of Elk Hills (SC) on or before the Commercial Operation Target
21 Date set forth in Appendix B of the Agreement;

22 (b) That failure being a material failure in performance that was not cured
23 within 60 days after the Department gave SER a notice of default, under sections 6.01(b)
24 the Agreement an Event of Default would exist;

25 (c) Under section 6.06, the Department is entitled to suspend performance by
26 reason of the Event of Default.

27 34. The Department denies SER's allegation in Paragraph 12 of the Complaint that in
28 a letter dated May 6, 2002, it took the position that "SER is obligated to achieve commercial

1 operation of *all* Projects described in the Agreement regardless of whether it would be
2 commercially reasonable to do so.” In its letter of May 6, 2002, the Department took the position
3 that, consistent with section 2.10(a) of the Agreement , SER is required to make commercially
4 reasonable efforts to achieve commercial operation of all of the Projects listed on Appendix B of
5 the Agreement that had not already achieved commercial operation as of May 4, 2001. In
6 addition, the Agreement is properly interpreted as contemplating that SER will be obliged to
7 complete each of the Projects to the extent that its commercially reasonable efforts should or do
8 result in that completion.

9 35. In answering SER’s allegation in Paragraph 12(b) of the Complaint that “SER
10 disagrees with the Department’s position,” the Department admits that SER disagrees with the
11 position described in Paragraph 12(a) of the Complaint, but denies that Paragraph 12(a)
12 accurately describes the Department’s position. The Department admits that SER takes the
13 positions alleged in Paragraph 12(b).

14 36. In answering Paragraph 13 of the Complaint, the Department admits that “SER
15 desires a declaration of its rights and obligations under the Agreement,” but denies that SER is
16 entitled to the declaratory relief sought.

17 37. In answering Paragraph 14 of the Complaint, the Department denies the
18 allegations stated therein.

19 38. Except as otherwise admitted or denied herein above, the Department denies on
20 information and belief each and every allegation of Paragraphs 1 through 14, inclusive, of the
21 Complaint.

22 **AFFIRMATIVE DEFENSES**

23 **First Affirmative Defense**

24 39. As a first and separate affirmative defense, the Department asserts that SER is
25 barred by the doctrine of laches from obtaining the judicial declaration sought by its Complaint

26 **Second Affirmative Defense**

27 40. As a second, separate and further affirmative defense, the Department asserts that
28 SER’s action is barred by the doctrine of unclean hands.

1 **Third Affirmative Defense**

2 41. As a third, separate and further affirmative defense, the Department asserts that if,
3 as SER contends, it has no obligation to complete any specific Project, then its promise to make
4 commercially reasonable efforts to achieve commercial operation of those Projects and its several
5 other promises relating to the Projects in the Agreement were all illusory. Because SER's
6 promises relating to the Projects were consideration for the Department's promise to purchase
7 energy from SER's generation portfolio, SER's own Complaint reveals that even if it were not
8 void for lack of consent, the Agreement would be void for lack of consideration.

9 **Fourth Affirmative Defense**

10 42. As a fourth, separate and further affirmative defense, the Department asserts that
11 even if the Agreement were not void for lack of consent, SER's promise to make commercially
12 reasonable efforts to cause Elk Hills (SC) to achieve Commercial Operation on or before the
13 Commercial Operation Target Date stated in the Agreement was consideration for the
14 Department's promise to buy energy from SER, and SER's complete failure to perform that
15 obligation has resulted in a failure of consideration that defeats the Agreement's effectiveness
16 and excuses any further performance by the Department with respect to purchases from SER for
17 the period beginning April 1, 2002 and ending September 30, 2002.

18 **Fifth Affirmative Defense**

19 43. As a fifth, separate and further affirmative defense, the Department asserts that
20 SER is barred by the doctrine of estoppel from obtaining the declaratory relief sought.

21 **Sixth Affirmative Defense**

22 44. As a sixth, separate and further affirmative defense, the Department asserts that
23 SER has failed to do equity in the matters alleged in the Complaint herein, and is therefore barred
24 from obtaining the relief sought by its Complaint.

25 **PRAYER FOR RELIEF**

26 WHEREFORE, the Department prays judgment as follows:

- 27 1. That the Court deny SER the declaratory relief requested;
28 2. For its reasonable attorneys' fees and costs of suit herein; and

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3. For such other and further relief as the Court may deem just and proper.

Dated: July 1, 2002

Respectfully submitted,

BILL LOCKYER
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BY: 
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