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16
17 SUPERIOR COURT OF THE STATE OF CALIFORNIA
18 COUNTY OF SAN DIEGO
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20 Coordination Proceeding Special Title
21 (Rule 1550(b))
22 NATURAL GAS ANTI-TRUST CASES
I, II, III & IV
23

J.C.C.P. Nos. 4221, 4224, 4226 and 4228
CALIFORNIA STATE AGENCIES'
JOINT OPPOSITION TO PROPOSED
PUBLICATION NOTICE

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25 [This Document Relates to the Southern
California Cases Only]
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Date: January 13, 2006
Time: 2:30 p.m.
Place: Dept. 71
Judge: Coordination Trial Judge:
Hon. Ronald S. Prager

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I. **INTRODUCTION**

On January 11, 2006, at approximately 2:00 pm, the California Department of Water Resources and California Electricity Oversight Board (collectively, “the State Agencies”) learned of plaintiffs’ Motion On Shortened Time And Motion In Support Of Preliminary Approval Of Class Action Settlement, then scheduled for hearing less than two hours later. The State Agencies immediately contacted the Court and requested an opportunity to be heard. The Court permitted representatives of the State Agencies to attend the hearing telephonically, during which time the State Agencies expressed their serious concerns about statements contained in the proposed Notice of Settlement and Fairness Hearing (“Notice”). The Court ordered the State Agencies to submit any papers on this subject by no later than 4:00 pm, January 12, 2006. The State Agencies submit this paper and supporting declarations pursuant to the Court’s order.

The State Agencies file this paper for a specific limited purpose: to bring to the Court’s attention materially misleading and incorrect statements in Plaintiffs proposed Notice. As detailed below, the Notice on which Class Counsel seek the Court’s approval -- even as subsequently revised by Plaintiffs following yesterday’s hearing -- does not accurately state the value of the consideration in the Settlement or the rights Plaintiffs are potentially trading away. In fact, the total consideration that can credibly be claimed is only a small percentage of the \$1.7 billion asserted by Class Counsel -- perhaps as little as \$181 million. As detailed below, given the disparity in valuations, this Court should not approve any notice until it satisfies itself that the values set forth in the Notice are realistic and terms of the Settlement accurately stated.¹

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II. **DISCUSSION**

A. **The Proposed Settlement Provides Nothing Approaching \$1.7 Billion in Value to Ratepayers**

Plaintiffs state in their Notice that in “exchange for the release of pending claims,

¹ Because of the limited time available to file these comments, the State Agencies focus entirely on the Notice. The State Agencies, however, do not waive any arguments and objections to the issues posed by Plaintiffs’ Motion for Preliminary Approval of Class Action Settlement.

1 Sempra will provide total consideration to the class of approximately \$1.7 billion . . .” This
2 overstates the value significantly for the reasons we discuss below. Plaintiffs have since revised
3 their proposed Notice to say “The Plaintiffs and the Sempra Defendants have entered into a
4 settlement *that the Plaintiffs valued* at approximately 1.7 billion as follows: . . .” Revised
5 Notice at 2 (emphasis added).² Presumably, Plaintiffs believe expressing their belief as to the
6 valuation of the proposed settlement -- as opposed to stating an objective value as was done in
7 the first Notice -- will lessen its misleading nature. It does not. While reasonable minds may
8 differ on valuing certain aspects of the proposed settlement, Plaintiffs’ valuation is sufficiently
9 off the mark as to be misleading. We examine below each of the elements of the asserted \$1.7
10 billion Class Counsel identifies in their Notice.

11 1. **The proposed settlement does not provide \$325 million**
12 **in cash payments to be paid in eight annual**
13 **installments.**

14 The first item Plaintiffs identify in their \$1.7 billion valuation is “\$325 million in
15 cash payments to be paid in eight annual installments.” While the Notice implies these payments
16 are to be made to the class members, only \$181 million of the \$325 million identified by Class
17 Counsel have any reasonable likelihood of getting to class members.

18 Paragraph 4.1(a) of the proposed Settlement Agreement identifies a series of
19 payments totaling \$325 million to be paid out over time. (\$166 million is to be paid over two
20 years; \$159.4 million is to be paid over eight years.) In addition, the Agreement provides for an
21 additional \$22 million dollars paid to specific parties. The Agreement provides further that any
22 attorneys fees and costs will be subtracted from the cash payments. *Id.* ¶4.1(f) (“Any attorneys
23 fees and costs . . . shall be deducted from the cash payments set forth in Paragraph 4.1(a) as
24 determined by the Class Action Court.”) Class Counsel do not disclose this in the Notice.
25 Instead, they only note that they will make an application at the final fairness hearing for an

26 ² The State Agencies received this revised Notice after the close of business yesterday and
27 assume Plaintiffs will lodge it with the Court before the hearing on Friday, January 13, 2006.
28 Accordingly, we will focus our attention on this document.

1 award of fees and costs not to exceed \$170 million. Notice at 3. The way the Settlement is
2 drafted, the Agreement appears to presume an award of \$166 million to Class Counsel.³ See
3 Declaration of Gary Taylor In Support Of California State Opposition To Proposed Publication
4 Notice ¶5 (“Taylor Decl.”).

5 For the Notice to be accurate, it should state the cash payments class members can
6 actually expect to receive. That figure should be \$157 million (\$325 million less \$166 million).
7 The \$325 million figure in Class Counsel’s Notice is misleading. Taylor Decl. ¶5.

8 **2. The supposed \$300 million price reductions under the**
9 **Sempra CDWR contract are largely illusory.**

10 The Notice asserts ratepayers will receive “\$300 million in savings associated
11 with price reductions on power contracts with the CDWR through 2011.” Given the structure of
12 the settlement, this assertion is inaccurate. In the midst of the energy crisis, CDWR entered into
13 a long term power purchase agreement with Sempra. That contract is the subject of extensive
14 ongoing litigation between the parties in a number of different forums. One such case -- referred
15 to as the Elk Hills litigation -- arises out of CDWR’s complaint that Sempra breached the
16 contract by failing to construct the Elk Hills power plant near Bakersfield on the schedule and in
17 the manner Sempra promised. See Cross Complaint, *Sempra Energy Resources v. California*
18 *Department of Water Resources*, No. GIC789291 (San Diego Sup. Ct.); see also *Sempra Energy*
19 *Resources v. California Department of Water Resources*, D043397 (4th App. Dist. 2005)
20 (reversing Superior Court grant of summary judgment in favor of Sempra).

21 Another pending matter is an arbitration currently being handled by the American
22 Arbitration Association and based on CDWR’s allegation of Sempra’s multiple contract
23 breaches. *CDWR v. Sempra Energy Resources*, No. 74 Y 198 00193 04 VSS (AAA). The

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25 ³ Class Counsel have not made this obvious in the Agreement. It can, however, be pieced
26 together by the schedule on which payments are to be distributed. The proposed Agreement
27 provides that one slug of cash -- \$166 million -- will be paid in two equal annual payments
28 unlike all the other payments in the Agreement, which are to be paid over eight years. This
payment schedule coincides exactly with the payment schedule for fees and costs set forth in the
Attorneys Fees provision in (Section 8.3) of the Agreement. Taylor Decl. ¶ 5 .

1 parties will shortly be submitting closing briefs after having recently completed a two week
2 hearing; a decision is expected in April. As in the Elk Hills litigation, CDWR seeks termination
3 of the agreement as well as damages. Additional litigation in the future between the parties is
4 likely.⁴

5 The Agreement references the pending arbitration and provides that to the extent
6 this proceeding -- or any of the other proceeding -- reduces the value of the contract *to Sempra*,
7 every dollar beyond an initial \$150 million threshold is subtracted from the \$300 million energy
8 price, right up to the entire \$300 million. Agreement ¶ 4.1(b). The Agreement refers to such
9 offsets as “CDWR Arbitration Offsets.” *Id.*

10 It is quite likely these offsets will wipe out the entire price reduction intended to
11 benefit the class members. If, for example, the contract were terminated, that would amount to
12 more than \$1.5 billion in lost value to Sempra, and cause the \$300 million in benefit to the class
13 associated with the settlement to disappear. Declaration Of Philip Hanser In Support Of
14 California State Agencies’ Opposition To Proposed Publication Notice (“Hanser Decl.”) ¶8.
15 Even without termination, if CDWR is successful in reducing the contract value to Sempra by
16 \$450 million or more, the \$300 million price reduction goes away. *Id.* ¶9. That is entirely
17 plausible given the pending and future claims against Sempra. Hauser Decl. ¶10.

18 Plaintiffs’ suit arises out of allegations of Sempra’s improper exercise of market
19 power in the gas markets. CDWR’s arbitration claim arises out of allegations of Sempra’s
20 multiple breaches of a power purchase agreement. In their supporting memorandum of points
21 and authorities, Class Counsel says “Sempra insisted on not paying the same amount of
22 reduction twice -- one pursuant to the Settlement Agreement and a second time pursuant to a
23 potential arbitration award.” Plaintiffs’ Memorandum of Points and Authorities at 18-19. That
24 explanation simply makes no sense. The claims plaintiffs are settling are unrelated to CDWR’s
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26 ⁴ CDWR has already put Sempra on notice that it intends to initiate another arbitration arising
27 out of Sempra’s improper use of the California Independent System Operator energy markets to,
28 in effect bill CDWR for energy it never produced.

1 claims.

2 In any event, nothing in the Notice discloses that the \$300 million price
3 reductions are entirely contingent on such wholly unrelated events. Given the strength of
4 CDWR's claims against Sempra, in both the pending arbitration and other proceedings that have
5 been or will be filed in the near future, it is quite likely that Class members will never receive
6 *any* of this consideration. Class Counsel have no reasonable basis, therefore, for counting this
7 value in their aggregate settlement figure.

8 **3. Plaintiffs have grossly overvalued the change in energy**
9 **delivery locations; it is not worth \$270 million.**

10 Class Counsel's Notice next suggests that the proposed settlement includes "\$270
11 million in savings caused by a change in energy delivery locations." Notice at 2. Like the
12 previous figures, this figure is also wildly out of line with reality.

13 The Agreement provides for a "Unilateral Limitation on the Exercise of Sempra
14 Generation's Delivery Flexibility under [the] CDWR Contract," whereby Sempra will limit its
15 deliveries to the southern California zone ("SP15"), the Palo Verde scheduling point in Arizona,
16 and the interconnection points of its own generating facilities. It would discontinue delivering
17 energy to other points outside California, such as the scheduling points at the California-Oregon
18 Border ("COB"), North of Oregon Border ("NOB"), and Four Corners, and to the northern
19 California zone ("NP15"). Hanser Decl. ¶5.

20 As an initial matter, Sempra's offer is worth far less than \$270 million. CDWR
21 estimates this figure is closer to \$80 million, given Sempra's continued flexibility to deliver to
22 Palo Verde, which is itself a highly problematic delivery point given the transmission congestion
23 between there and California. Hanser Decl. ¶7.

24 Moreover, whether this concession has any value to ratepayers assumes Sempra
25 has the right to make such energy deliveries in the first place. This is one of CDWR's major
26 claims in the pending arbitration, namely that points such as COB, NOB, and Four Corners are
27 not permissible delivery points. Hanser Decl. ¶6. Assuming an arbitral outcome in DWR's
28 favor, Sempra would be barred from delivering to those points. Therefore the value of that part

1 of Sempra's offer would be zero. *Id.* Plaintiffs' Notice says nothing of this fact.

2 In sum, this settlement term, if it has any value (which turns on the outcome of the
3 pending arbitration), is worth at most \$80 million to ratepayers, not \$270 million.

4 **4. Plaintiffs have no basis for placing a value of \$745**
5 **million on structural changes to utility operations.**

6 The biggest component of Class Counsel's \$1.7 billion settlement value claim has
7 to do with structural changes Sempra has agreed to make to its gas utility operations. Class
8 Counsel values these changes in their Notice at \$745 million. Notice at 3.

9 This figure is highly speculative, however, given the fact that the Settlement
10 merely requires Sempra to propose changes to the CPUC for approval. It is not contingent on the
11 adoption of *any* structural reforms and, given the manner in which CPUC proceedings proceed,
12 one can expect a lengthy proceeding that may in the end yield *little or no results*. Thus, there is
13 no certainty what reforms, *if any*, will be made. Taylor Decl. ¶7. There is nothing in the Notice
14 that reflects the fact that there may not be, at the end of the day, any changes to warrant the
15 significant amount of consideration Class Counsel ascribe this part of the Settlement.

16 The \$745 million figure is speculative for a number of additional reasons. The
17 Agreement does not provide the necessary level of detail to understand the intent of Sempra's
18 agreement with respect to market structure reform; it is difficult to know whether the changes
19 Sempra will propose will have any meaningful impact. Taylor Decl. ¶7. Second, it falls short of
20 taking the necessary measures to mitigate Sempra's market power. *Id.* Indeed, it may be that the
21 proposed consolidation of SoCal Gas' and SDG&E's operations will actually worsen, rather than
22 lessen, Sempra's market power. *Id.* Finally, many of the actions Sempra proposes to take as part
23 of this settlement are steps it had previously proposed to the California Public Utilities
24 Commission (CPUC), and therefore, are not the result of Plaintiffs' settlement efforts. *Id.*
25 Against that backdrop, it is hard to justify the \$745 million figure Class Counsel assigns to this
26 element of the settlement. *Id.*

1 5. **The \$74 Million in Discounts for Natural Gas From**
2 **Sempra's Mexico-Based LNG Facility is Entirely**
3 **Speculative.**

4 The last item in Class Counsel's Notice is \$74 million in discounts for natural gas
5 from the LNG facility Sempra is constructing in Mexico. As mentioned above, it is unclear
6 whether the structural measures proposed by Sempra are sufficient and, if they are, whether they
7 will ever actually be implemented. The relevant provision in the Agreement provides Sempra
8 will sell certain quantities of natural gas at a discount off of the California Border Index price.
9 Whether this results in any value to ratepayers, however, will depend on whether the structural
10 changes contemplated by the Settlement in fact mitigate Sempra's market power and,
11 importantly, prevent it from being able to influence the border index price. If the appropriate
12 measures are not put in place, the risk remains that even with a discount off the index price,
13 ratepayers would realize no savings. *See* Taylor Decl. ¶6. Consequently, the savings associated
14 here are speculative.

15 6. **Plaintiffs can only legitimately assert the proposed**
16 **Settlement is worth \$1181 million to ratepayers.**

17 For the reasons discussed above, the Notice is misleading and inaccurate in
18 suggesting the Settlement is worth \$1.7 billion. The only consideration from Sempra that is
19 certain are the cash payments to the Class (\$159.4 million) plus the additional \$22 million to
20 various individual parties. Every other element of the \$1.7 billion are contingent on the outcome
21 of CDWR's pending litigation (energy contract price reductions, change in energy delivery
22 locations), yet to be filed CPUC proceedings (discounted natural gas and structural changes) or
23 are exaggerated (energy delivery point). The Notice ignores all of these elements and for these
24 reasons is inadequate.

25 B. **The Proposed Notice is Inadequate by Failing to Explain What**
26 **Claims are Being Released as Part of the Settlement**

27 Given time constraints, the Attorney General and the State Agencies have filed
28 separate briefs. However, the State Agencies join in the Attorney General's paper in which he
expresses concern over the scope of the releases contained in the Agreement and the lack of

1 information contained in the Notice. The revised Notice provides only that “class members will
2 broadly release the Sempra defendants and certain additional subsidiaries and affiliates from
3 certain claims relating to natural gas and electricity between September 1996 and January 4,
4 2006.” Unfortunately, neither the notice, the Settlement Agreement nor the Motion in Support of
5 Preliminary Approval make clear what the intended scope is meant to be. For the reasons stated
6 by the Attorney General, the State Agencies believe the Notice is inadequate in this regard as
7 well.

8 **III. CONCLUSION**

9 This Court should not approve Class Counsel’s Proposed Publication Notice until
10 it satisfies itself that the statements contained in the Notice are accurate and fairly characterize
11 both what the classes are receiving and giving up as part of the Settlement.

12 DATED: January 12, 2006

Respectfully submitted,

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15 By: 

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