

# L.A. Firm's Entry in Diablo Suit Was Key to Settlement

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Pacific Gas & Electric had spent more than \$70 million and the Diablo Canyon case was going nowhere until about a year ago, when the giant utility transferred control of the case from in-house counsel to consolidate it in the hands of Los Angeles-based O'Melveny & Myers.

The decision to move the case by PG&E's new management is widely credited with moving the difficult case — brought by the government agencies to reduce the amount ratepayers would contribute toward enormous cost overruns at the nuclear plant — toward resolution. The case was settled Monday in a landmark agreement praised by all sides.

Under the settlement, agreed to by PG&E, Public Utilities Commission staff and Attorney General John Van de Kamp — who intervened in the case on behalf of consumers in 1984 — PG&E must absorb \$2 billion in Diablo cost overruns and can charge customers for Diablo only if the plant performs efficiently and safely.

"O'Melveny & Myers did for this litigation what Bechtel [Corp.] did for the power plant," said Special Assistant Attorney General Michael Strumwasser, Van de Kamp's principal representative in the Diablo case. Bechtel was called in to correct significant design and construction problems.

Strumwasser said new PG&E management, including Chief Executive Officer Richard A. Clarke and President George Manneatis, vastly improved the company's managerial decisions, both at the plant and in resolving the tangled litigation surrounding its construction. "Manneatis brought Diablo back from disaster," Strumwasser said.

PUC attorney Edward W. O'Neill said that pursuing the case might have meant disaster for the utility in the courtroom. "To tell the truth," he said, "I was dis-



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**DIABLO SETTLEMENT:** Edward W. O'Neill, left, and Ira R. Alderson Jr. of the PUC's legal division spent four years developing the case against PG&E.

appointed that they chose to settle. We had a very strong case, and I was looking forward to litigating it."

The Diablo project began more than two decades ago. For the last four years, O'Neill, as lead litigation attorney for the PUC's Division of Ratepayer Advocates, and teams of government attorneys painstakingly developed the case against making ratepayers foot the bill for cost overruns at the plant.

Taxpayers have already invested at least \$10 million in pursuing the case,

which at times involved at least 30 private and public lawyers, and which has cost PG&E \$100 million in legal costs to date.

The case was settled on the eve of hearings before the PUC, which were expected to take a year — and perhaps double the litigation costs for all sides.

"A good deal of [the fees and costs accumulated] before we came on the scene," said Joseph Malkin, an O'Melveny partner who estimated that his firm's expenses and billing were less than

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# Diablo Settlement Hinged on L.A. Firm

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\$15 million.

The settlement revolved around a unique arrangement called "performance-based pricing," which places responsibility for the plant's operation on the utility and not on its customers. The agreement must be approved by the PUC, although experts in the case say approval is likely.

Heading the settlement negotiations for O'Melveny was the firm's highly respected chairman, Warren Christopher, with Malkin leading a parallel litigation team. Christopher said the number of O'Melveny lawyers involved in the case "varied from time to time — as many as 20 at some times. Ten-plus is certainly conservative."

Working with Christopher on the PG&E settlement team were O'Melveny lawyers Donn Miller and John Stamper and PG&E attorney Peter Hanschen. The PUC's settlement team consisted of William Ahern, director of the ratepayers' advocacy division, and assistant general counsel Ira Alderson.

In the attorney general's office, the case was handled by Deputy Attorneys General Mark Urban in Sacramento, Peter Kauffman in San Diego and Peter Van der Naillen in San Francisco, with Strumwasser and Chief Assistant Attorney General Andrea Ordin, both based in Los Angeles, assisting in strategy and settlement negotiations.

To prepare the ratepayers' case for hearing, O'Neill worked virtually full-time [plus overtime] for four years. Since 1986, the team was comprised of four lawyers — O'Neill and staff attorneys Arocles Aguilar, Steven Weissman and Kathleen Maloney.

"I put in lots of overtime," said O'Neill, "several thousand hours in the last couple of years, six days a week. But then everyone on the case did that."

O'Neill said the PUC hired about 30 firms as outside consultants with expertise in specialized fields. Although he finds incredible the \$100 million in legal costs

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— Edward O'Neill, Public Utilities Commission attorney

[which includes costs of discovery, expert consultants and other related costs] spent by PG&E on the case, O'Neill said he was not overwhelmed by the superior resources of his opponents.

"We felt more overwhelmed by the magnitude of the case itself," he said. "There is just an enormous amount of information, something like seven million pages of documentation. We felt overwhelmed by the volume of material rather than the resources of PG&E. The case has required enormous resources."

DAG Urban said O'Neill's collection of information in the case was "incredibly impressive."

"We [the attorney general's office] weren't the major litigating party, the [PUC] staff was, so there was a comfort zone for us," added Urban, who estimates he spent half of all his work time in the past four years on Diablo Canyon. "It would have been an overwhelming case to try, with the number of exhibits, the daily hearing schedule, no preparation time."

The PUC's cost estimates for legal expenses in the case does not include attorney salaries and support/office staff, nor does it include the resources of the attorney general's office which were added to the case.

"In terms of resources, there was never time or resources enough to do everything we wanted to do, and we had to pick our targets," said Strumwasser. "Ed O'Neill worked hours that are as tough as any I know of. He would have put on a very professional, very credible case."

"In terms of cost effectiveness, taxpayers have probably never gotten more for their dollars than in this case," Strumwasser added. Under terms of the settlement, rates can only be raised by 1.6 percent July 1, followed by 1.3 percent increases each Jan. 1 from 1989 through 1991 and "moderate increases" thereafter. And, rates will be based strictly on plant performance — if the plant doesn't perform, PG&E doesn't get paid.

PG&E's Clarke said in a prepared statement that PG&E agreed to the settlement — which also means a reduced dividend to shareholders — because "it significantly reduces the uncertainties about when the case will be completed and how the complex issues will be resolved." The financial cost to the company and its shareholders, he added, represents a "painful" downside.

Certainly a major factor in the utility's decision to settle was a scathing PUC staff report that \$4.4 billion of the plant's

\$5.5 billion cost should be "disallowed" [the settlement calls for \$2 billion to be absorbed by the utility and not passed on to ratepayers].

"I'm sure PG&E saw that [the PUC staff report] as staggering," said Alderson. "Another key thing is that some of the investment houses said in January that the company could make a disallowance of \$1.5 to \$2 billion. When the financial community says that — and they tend to be more conservative — that was like a third-party validation of the staff report."

"Everyone would have liked to settle before [the hearings became imminent]," he added. "The rhetoric starts getting intense as the hearing approaches. People get locked into position and can't move to a mutually gratifying settlement."

"The key that led to the settlement was a real solid case."

O'Melveny's Christopher, lead negotiator for PG&E in the settlement talks, said the firm has been "working steadily toward settlement" since its lawyers took over the case for PG&E about 13 months ago. He said the negotiations "have been particularly intense since the first of the year."

"Like all settlements, it involves compromises on all sides," he added. "There is no question that it is a precedent-setting, innovative approach to this matter, both in terms of the willingness of the company to accept responsibility for producing the energy and being paid for it on a basis fixed in advance, [as well as] a willingness to agree to [an independent] safety committee."

Although declining to specify how much the firm was paid for its work in behalf of PG&E, Christopher said the \$100 million expended by PG&E in legal expenses represents a broad range of litigation costs.

"Somebody was joshing me about those being the lawyers' fees or O'Melveny & Myers' fees," he added, "and that could not be more inaccurate."