ORAL ARGUMENT – 11/20/02
01-0785
SOUTHERN UNION V. PG&E

LAWYER: The liability issues in this case are really addressed by two over-arching legal issues. The first is whether or not a single business enterprise is a viable theory in the State of Texas for any purpose either for a cause of action or a remedy. It has not been expressly recognized by this court, although it's being used somewhat in the CAs. The second, and I think the more focal issue in this court is whether or not that sort of a theory, that theory can be used to collapse a regulatory segmentation of a regulated industry where components of that industry have been discretely defined by state policy, both by the legislature and the RR commission.

This case demonstrates what can happen when such a regulatory system is judicially collapsed in an ad hoc court proceeding between parties to a particular case. In this case the very unbundling that the legislature and the RRC did of the gas industry in order to meet intrastate competition would be critical to the state. Unbundling of transportation and the merchant's side of the gas business was rebundled by the TC. And in so doing the sale of a noncontracting party, a party to the case that was not even a party to ordinance 11.29, the contract, only that party's sales became the basis for the breach of contract of the contracting party. It allowed the TC, or the TC and the CA by unbundling those segments labeled Transportation as a sham. It empowered the CA it thought to ignore the _____ doctrine as inapplicable because transportation was in this case found to be a sham.

It made the segmented entities that were authorized to function as they did in the gas business joint obligors of the contractual responsibilities of the local distribution company. It extended the local distribution company's tariff rates on gas to an unregulated SMP, to the sale of an unregulated SMP. It defeated as a matter of law or defeated in any respect the affirmative defenses of waiver, estoppel and ratification by simply saying that the city didn't know that the entities were not being operated as separate entities. Well they were being operated as separate entities and were authorized to do so by the regulators. They swept all of the PG&E entities into a single entity for purposes of this case, and even caused the courts to disregard contractual points of delivery outside of the city that were points of delivery agreed to by the customers who bought SMP gas.

All of those things happened as a result of the collapse of the regulatory scheme that was set in place. There are two sets of undisputed facts. One, the local distribution company, Rio Grande Valley Gas Co. (RGVG) paid 4% franchise fees on all of its receipts from all of its sales.

OWEN: Could you impose a franchise tax under a transportation tariff or not?

LAWYER: Yes.

OWEN: And did they?

LAWYER: That issue could have been tried, and we thought it might have been tried, but it wasn't tried.

OWEN: Factually what happened? When the city filed or allowed transportation tariffs to be filed did it have some agreement that transporters or suppliers would pay a franchise tax of some sort in conjunction with transportation tariffs?

LAWYER: It may have. If ordinance 1129, the franchise fee contract is read broadly enough, there could have been an obligation on Rio Grande Valley Gas co. to pay 4% on the transportation fees that it got for transporting the customer's gas that was purchased from the SMP's. Because the phrase is that the local distribution company will pay a franchise fee on all of its receipts from the sales of all gas within the city.

OWEN: You take the position the franchise agreement does not cover transportation?

LAWYER: It may cover 4% of the fees received for transportation. That issue was not tried in this case.

OWEN: I thought your briefs took the position that transportation is not a sale and they don't owe anything for transportation?

LAWYER: That is our position. The issue was never tried in this case. If it ever gets tried that will be our position. But I'm saying that is still an open issue because it's never been resolved in litigation here or as far as I know elsewhere.

OWEN: In PG&E's reply on page 13, you try to address some of the evidence that they talk about, some of the corporate formalities that were ignored on page 4 of their brief on the merits. And they talk about that Reata declared dividends to a company that wasn't a parent or a shareholder and they go through some factual list of things that they did that ignored corporate formalities. What's your position about those? Are those accurate facts or they just don't matter?

LAWYER: The record about those facts is very lengthy. The fact that that dividend was declared, that is an accurate statement of the way the dividend was declared. It is not an accurate statement to describe how the papers that actually papered the transfer were laid out entity to entity all the way to an entity that's not even a party here where these dividend _____. Our position is of course that really is immaterial that corporate formalities or observation corporate formalities is not a basis to collapse even a nonregulated entity under 2.21.

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TIMMS: I'm here on behalf of the Souther Union petitioners, and I would like to

address the attorney's fees issues. I have three topics I would like to cover under the attorney's fees issues. The first is the need for substantive evidence of the work that's actually done. Second is the ramifications of the city's post-filing appellate losses. And third, the standards for determining if attorney time is inextricably intertwined.

The first issue is frankly that there's no substantive evidence concerning what the attorneys did in this case. The very first factor listed in the disciplinary code, the very first factor discussed by their expert was, the time and labor required. In this case we have no substantive evidence of the time and labor required. Their expert was ___ Smizer. Miser. He took the stand and he testified as to reasonableness. In essence what he testified was that if the attorneys had spent $3.9 million prosecuting this case, that sum would be reasonable. But he admitted that he did not know what attorneys had done what on the case. He admitted that he had seen no time sheets. He admitted he had seen no backup data. He admitted that he had no idea what the attorneys had done as a factual matter.

PHILLIPS: Were any of these attorneys in-house or city, or were they all outside attorneys?

TIMMS: There were all outside attorneys. So our position is that they needed to put on substantive evidence of the work that was done. What they did was they put in documents through Smizer that we learned with their briefing and whatnot were merely put in to reflect what he relied upon in reaching his conclusions concerning reasonableness. Which means that they are not in there to prove the substance of what was done. And so we have a case where it's almost like a hanging hypothetical. He said that if they did these things it would have been reasonable, but there's no underlying evidence of what was done. And we say that somebody with knowledge of the work that was done needed to put in some evidence of the work that was done, and we simply do not have that here.

HECHT: Why doesn't the record itself provide some evidence, that just the pleadings and the motions and the orders...

TIMMS: That is true under 38.004 of the Texas Civil Pract and Rem Code. And that clearly applies only if it's a trial to the bench. Otherwise, it's not evidence to a jury. The code does not provide for that.

I'd also like to talk about the problem with the results obtained in this case. Over time the attorneys' fees have become completely divorced from the results that were obtained. The liability and damages awards have decreased through post-trial and on appeal. Many entire causes of action have gone away.

OWEN: How do you put in front of the jury, how does the jury consider the results obtained when they don't really know what the results are when they are answering the questions?

TIMMS: I think that that becomes an inquiry that needs to continue with the case. The jury can only assess what it can assess at that time. But this case has changed dramatically on appeal. And they have lost - well we're down right now to a judgment that's only 6% of what the jury originally awarded. So I think that it becomes the obligation of the TC and the CA to keep assessing whether there is a rational relationship between the attorney's fees and the results obtained.

WAINWRIGHT: Will that go both ways? What if post-trial because of disagreements with the JNOV for example the judgment increases, and then would there have to be a determination, not in this case, but in another case that the fees ought to go up?

TIMMS: I'm not sure that that example works because if it was a JNOV then you would have a finding of liability. Probably a finding of damages and attorneys' fees that were JNOV. The reversible of the JNOV would simply give rise to all of that again. But if we came up with an example it might work in reverse and need to keep assessing that.

OWEN: But what does a TC do - the TC takes the jury's answer to lots of liability and damages issues. And the jury doesn't really know what the final judgment is going to add up to be. It's job is just to fill in blanks. What does the TC do or an appellate court do when the jury puts in a number in a blank, and the jury may have thought that the recovery was going to be $13 when it's really $1. From the perspective of both the TC and the CA what do you do with that jury finding of total fees?

TIMMS: I think that the CA and the TC both have approximately the same options before them. They can remit down to a sum that they think is reasonable given what's happened post-trial, or they can grant a motion for new trial just on the attorney's fees, to have a new trial on that issue in light of what the actual judgment is. And in this case they lost $4 million post-trial. And when you look at their contract they had two breaches of contract coming out of the jury verdict. They added up to $4.8 million. They lost $4 million of that. And that is a huge change on their only reason for getting attorneys' fees, which is the breach of contract. So I think that it becomes a judicial function after awhile to look at excessiveness, reasonableness, and whether it needs to remit or remand for a new trial.

Another issue that we would like to discuss is the failure to segregate time in this case. We have really no evidence of what time was spent, but we can look at the record that they put in as supposedly supporting what they had done, or Smizer's testimony. And what we can see just by looking at those records is that they worked on other matters. They worked for other clients. They worked on other cases. They have time written down for responding to motions for summary judgment like tort claims. So obviously that time should be subrogated.

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RESPONDENT

HOGAN: I represent The City of Edinburg, which is both a petitioner and a respondent

in this court. We are a petitioner asking that those portions of the jury verdict which have been taken away from us at the TC level and at the appellate court level be reinstated. We are a respondent on the issues that have been addressed this morning by the defendants in the case.

I know this case involves a lot of individualized issues, but the over-arching factual theory of the case is actually fairly straightforward and I think it disposes of the number. Certainly of the liability and damages arguments that have been touched upon today. All of the city's claims arise out of the franchise fee agreement that was signed between the city and Rio Grande Valley Gas Company (RGVG) in 1985.

The city has alleged and proved that RGVG and then its successor, Southern Union, breached that franchise fee agreement in two different ways. One, by not paying all of the franchise fees that were due on gas sales, the revenues that RGVG and later Southern Union obtained from gas sales. That encompasses the idea of the sham transportation arrangements. And then the second breach of contract theory is for RGVG's and Southern Union's transfers of ownership and operational control of various pipes in the city and allowing other people to utilize pipes in the city, to make sales within the city, to transport and distribute gas both in the city and through the city's pipes, all of which are on city property. So that's sort of the two separate breach of contract theories that exist and both of which were found by the jury on a liability basis.

RGVG also sued various other PG&E entities for tortuous interference. That was for wilfully and intentionally inducing these two breaches of contracts. So they are very parallel. They are exactly the same factual scenario. There is also a ____ finding, which is simply a finding that certain people who own now have ownership of pipes that are on city property are not allowed to do so. They don't have the permission of the city to be there. That's exactly these same transfers. It arises out of the same nucleus of fact. These transfers of pipes without the city's permission by RGVG initially and continued by Southern Union. And then obviously the attorneys' fees follow from the breach of contract theories and our claims for single business enterprise are a way to get to the other Valero defendants other than the ones who were specifically named on the contract.

OWEN: In connection with your sham transaction claims, do you at any point contend that any of these companies violated RR Commission rules or regulations governing special marketing programs?

HOGAN: In a sense yes. I think if you read this record, you will see - I mean if we want to accept that what the defendant has argued, the contracts that were set up, the actual written documents, if that's real transportation, and that's what our expert who was an acknowledged expert, John Brick_____, no challenge to his testimony, to his qualifications, to his expertise, to his methodology, nothing, he came in and he testified that what happened here is not real transportation.

OWEN: If you contend that any of these entities violated the RR commissions scheme for special marketing programs can you tell me what specific regulations were violated?

HOGAN: No. I can't tell you that standing here today. It may be in the record. It may not be. In large part this is not developed. I think even if you look at the briefing of where we are today - I mean the idea that the single business enterprise finding itself somehow implicated RR commission regulations, or that they couldn't be sued or held liable as a single business enterprise because that violated RR commission regulations, that is not a point that is briefed or before this court. The only complaint that are made, it wasn't made the TC level, it wasn't made at the CA, the only time that any sort of a question about what this single business enterprise theory had done and that it violates or implicates RR commission regulation is only as to the CA's opinion. Not the underlying finding. Not the underlying judgment.

OWEN: I'm just asking what you contend. You say that the way these were structured violates the S&P program?

HOGAN: No. For me right now it's just a complete non-issue. What we say is that what they did was a breach of the contract that they signed with us.

OWEN: What about article 2.21?

HOGAN: I think there are a couple of responses. First, what we submitted we say tracks art. 2.21. It includes the language that there must be an actual fraud with the intent to commit an actual fraud. I can read you that jury question. It's also true that this jury question was not objected to. There was nothing more that was asked in terms of any instruction that was omitted or that the instruction that was given was incorrect and didn't comply with art. 2.21. So I would say that to the extent that we believe that the court would have reason to disagree with the actual jury instruction that was given on single business enterprise, that likewise is not before the court.

OWEN: Are you saying that the single business enterprise theory is totally contained in art. 2.21, or is it something separate?

HOGAN: I don't think it's totally contained. The way art. 2.21 reads it basically says that in order to hold affiliates or parents or shareholders liable on an alter ego or a similar theory, and then it drops down and includes single business enterprise within those types of theories, you must show certain things, which includes an actual fraud.

So what I'm saying is is that it doesn't attempt to list out as this court did in George Grubbs all of the element that might exist for a single business enterprise theory. It doesn't do that for alter ego either. But it does say that you can't prevail without proof of actual fraud. We submitted a jury charge that we think tracks that language correctly, and evidently so did the defendants because there was no objection to that language in the jury charge.

HECHT: But you agree with the defendant's complaint at least to some extent that the CA makes it sound like you can use the theory to make Reata a signatory to the contract?

HOGAN: I don't know if I would go quite that far. All we say that this is is it was submitted correctly and it was used correctly in the judgment. It was made to make joint and several liability. It imposed joint and several liability on a group of defendants who operated as a single business enterprise when one of those entities was found liable on a contract claim.

HECHT: And so then your liability theory on the first of your two claims that you mentioned earlier comes down to whether the transportation charges were in reality sales of gas?

HOGAN: That is a major portion of what we claim. Now I disagree that the issue of whether RGVG and Southern Union were required to pay on even their transportation revenues was not tried in this lawsuit. It most certainly was tried in this lawsuit. We've cited the evidence in our brief. We did try that issue. It is within what was submitted to the jury. And it supports a number, an award of damages in this case for even just on that very narrow little portion.

But there is no doubt that the big bulk of what we are saying is sort of twofold. One that this transportation was actually a sale. There can be no transportation. These defendants did not do what the contract says. When they say that these contracts specified points of delivery outside the city that's absolutely correct. And those contracts say that at those points of delivery the gas is going to be measured and that quantity of gas which is measured at this point of delivery outside the city is what the entity ultimate purchaser is going to be billed for. And that quantity of gas that is delivered outside the city is going to be billed. And then the transporter is going to come in and it's going to be responsible for delivering that quantity of gas that's metered out here less a shortage under a very complicated scheme to a meter that is down here at the ultimate customer's plant. That's what those contracts say. That is not what happened. That is what our expert said should happen. He said, that's absolutely transportation. That's what happens in the industry every single day in terms of transportation. It just didn't happen here.

HECHT: You do make the same argument regarding the transportation of gas that was furnished by unrelated entities, the people that have nothing to do with Valero?

HOGAN: Yes. There are very few of them. They aren't involved in the damages in this case. And many of them the transportation was done correctly. And ultimately some of them - even one of the customers in particular built its own pipeline, and it doesn't even cross city property. There are ways in which transportation is done correctly and which the city is not claiming that its franchise fee agreement was breached. It's just that these particular labels that were put on are completely after the fact. They are nothing but a sale at the customer's plant. And those sales no matter who they were made by franchise fees were owed. And the franchise fees were owed by the party that signed the contract.

We explain how in certain circumstances you might consider that this was an assignment to Reata or Mercado.

HECHT: But you don't claim that would be owed if the gas supplier was unrelated or

you do?

HOGAN: No. I think we do. I think that the CA's opinion perhaps is a little sloppy, but I think that the fact that these companies are related is evidentiary to support the breach finding. What it shows is frankly that it's a part of why they did what they did, how they benefitted from what they did. But it's not necessary to establish the breach. We don't care who it was. If you don't actually measure the gas and have a point of delivery outside the city where the ultimate customer takes title and actually obtains something at that point in time, then it's not transportation anymore. It's simply a sale. The gas flowed from the field to the customer. It was measured only after the customer had used it. It was measured only by RGVG and Southern Union. The customer got a bill only from RGVG and Southern Union. It was a distinction that was made only at the accounting level to split apart these payments. And to backtrack and say, well since they used this much here we must have imported this much down here. As the expert explained there is no logic to being able to make that sort of a statement at all. Gas is completely fungible.

OWEN: Let's suppose a large industrial customer bought both from a third party unrelated, like 50% of its gas supply was spot market, and 50% of it was gas from one of the Reata entities. And all the gas goes through the same pipeline. There's got to be an allocation at some point as between the two suppliers. How's that different?

HOGAN: Well it matters where that allocation occurs. It's how that allocation occurs.

OWEN: The spot market gas came from the same well. One well is producing a whole bunch of gas. Reata is buying half of it and the spot marketing broker is buying the other half. It's unrelated to Reata. It comes out of the same well, goes into the same pipeline, at some point it's measured, shrinkage deducted. An accounting has to occur as between the two sellers. How is that different?

HOGAN: It simply matters where it occurs. If it's all coming out of the same well and two different purchasers are purchasing it, well then frankly those purchasers are going to have to have some measurement. They are going to know which amount they are buying.

OWEN: It's measured at the wellhead and it's measured at the delivery point.

HOGAN: There are meters for these delivery points all up and down the pipeline. Not as if there's only a meter at the wellhead and meter at the customers...

OWEN: What is the difference in your view when the third party is involved as opposed to Reata?

HOGAN: Nothing.

OWEN: Why is one legitimate transportation and the other is not?

HOGAN: What distinguishes legitimate transportation from - and by legitimate frankly we don't - none of this matters except in terms of the city's franchise agreement. And that means that if you don't have the transportation, if it's not measured at a meter outside the city, then that means it's delivered only inside the city. And if it's delivered inside the city then franchise fees are owed on it.

OWEN: On the entire sale, not the transportation?

HOGAN: On the entire sale.

OWEN: So anytime the local distribution company transports a third party's gas it owes 4% on what the third party charges the customer. Is that your position?

HOGAN: No. My position is is that if this had worked exactly as the contract said it should work and exactly as our expert testified that it should have worked, which is that the gas be transported, which is the way it's set up. It's purchased at the well by company X, and it brings gas to a delivery point, and that delivery point is specified as a metering facility at a particular point outside the city limit. And the contract said that at that point the customer takes title to a set amount of gas that it wishes to purchase through that meter, and that they are going to be billed for the gas that they purchased at that meter for the amount that comes through.

And then there's another contract that says, okay, and we now, RGVG it becomes, we're going to pick your gas up that you're purchasing out here at this meter, and we're going to transport it for you for a fee to your point inside the city. And all we're saying is is that this point that everyone agrees upon where we are going to deliver and measure and bill you for got completely left out of the mix. It didn't happen.

OWEN: Let's suppose that RGVG decides to go out of the gas business entirely. Doesn't want to sell gas anymore at all and it's just going to be a transportation entity. And third parties using RGVG's facilities buy gas at the wellhead as a broker and pays RGVG to transport from the wellhead to the industrial customer inside the city limits. How much does RGVG have to pay the city under those circumstances?

HOGAN: If they do it correctly, they owe the city 4% of what they earn in transportation fees.

OWEN: And the only thing you say has to be correct about it is there has to be physical metering outside the city limits?

HOGAN: That's right, because that's what transportation requires. That's what the contract said. That's what the expert said. That's the evidence of breach in this case. That is a factual breach matter. And there is expert testimony, and there is documentary testimony. There is loads of testimony that that is not what happened in this case.

OWEN: So in my example, if the delivery point is at the wellhead and then it's remeasured at the customer's intake point, does RGVG owe 4% of the total sales price of the gas or 4% of the transportation fee it received?

HOGAN: If it's sold only at the wellhead - franchise agreements are very complicated. RGVG's franchise is for the city of Edinburg. It may own pipes outside the city. It may not own pipe outside the city. And different people can own segments of these pipes at various places along the way. So it does matter who is the transporter and where is it measured and where does it come in to the city, and where does the actual sale take place. If it's purchased and metered out of the wellhead and the consumer down here goes out there and says I'm buying this amount of gas at the wellhead and I'm now going to pay somebody to transport it for me, then it's done absolutely properly. And again the only thing that RGVG would owe is 4% of its transportation but only even there it's going to be the transportation costs that it would have paid inside the...

OWEN: The customer says, I want gas delivered to my doorstep. And again a nonaffiliated, third party buys the gas at the wellhead and pays RGVG to transport it from the wellhead to the customer. It pays them a transportation fee. What does RGVG owe the city under those circumstances.

HOGAN: Again, if the customer actually purchases it out there at the wellhead...

OWEN: No. I'm saying the customer takes title to it at its inlet facility.

HOGAN: If that's true, then that's a sale inside the city. That's exactly what we said...

OWEN: Even though RGVG didn't make the sale. It's doing pure transportation.

HOGAN: That's right. That goes back to even what Mr. Soules was suggesting here.

OWEN: What is his gross revenue from that transaction?

HOGAN: The way it reads is it's 4% of its gross income derived from all gas sales in the city.

OWEN: What is RGVG's gross income derived on that particular transaction?

HOGAN: It may be only 4% of the transportation.

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REBUTTAL

LAWYER: I want to address the questions about the 4% on the transportation, what I call the $89,000 question. What they are having to rely upon is the original franchise agreement, and

they are having to rely upon that to say that we owed on transportation even though it refers explicitly only to gas sales.

That's our position. It might be that when the city three times passed transportation ordinances, that they could have required us to pay a franchise tax on our transportation but they did not. And it is not a part of those ordinances. And that's why they have to go back to the original franchise agreement.

OWEN: What does the record say about your ability to transport gas under their existing tariffs? I guess what I'm getting at, can you transport gas under your gas sales 4% franchise tariffs or not?

LAWYER: We felt that we had to go to the city to get another ordinance to allow us to do that. And those are the three ordinances that we got from the city. We felt that we could not just transport under our previous franchise agreement and that's why we have those other three ordinances that the city mandated that we provide transportation.

Let me talk about the case that they presented to the jury because it has nothing to do with the $89,000 question. What they presented to the jury was a theory that all gas sales within the Edinburg vicinity was our gas sales. All of them. For instance, when she was talking right now about the plant that went off line completely, Aztec(?) decided to purchase completely from third parties and to transport it to their plant themselves through their own pipeline that they built. That is $2.5 million worth of the damages that they presented to the jury. Supposedly that is our gas sales even though we did not see one bit of that gas.

Another portion of their gas sales is gas that we purchased. We have to buy gas to resale it in the city. Those gas purchasers are someone else's gas sales and so they also counted that as a portion of their damages. To the tune of like $750,000. And then the other $1.5 million is the gas sales that occurred both from Reata, Mercado and all these other entities including the State of Texas to take all their gas sales and multiply it by - and this is important. They don't take the gas sales prices that existed plus the transportation that we were charging to say what it was, how they would assess their damages. Instead they used an artificial gas price. What we would have charged under our tariffs if we had actually sold all that gas ourselves. So the $89,000 issue, 4% of the transportation is nowhere in their case that they presented to the jury or their damages that they presented to the jury because they chose instead to go with these artificially inflated sales numbers, artificially inflated prices and that's what they presented to the jury.

So that brings us back to attorney's fees. If the court says look we think you owe the $89,000, there is no time that went into that case, because that case is not what they presented. I looked at their first pleading this morning. It always was this large grossly inflated breach of contract and so they have no timing on that issue.

HECHT: How is this case related if it is to the class action case?

LAWYER: They started out together. This case was the class action case. The city of Edinburg originally brought this case as a class action. And then just about 4 days or a week or so before the class certification hearing, the city of Phar(?) intervened and asked to be a class rep, and then there was a motion to sever Edinburg. So all of the class claims, some of which they are claiming as attorney's fees here, went with the city of Phar(?) action which became the San Benito action, which then presented many of these same claims in the class action setting.

HECHT: And where is it?

LAWYER: You granted petition for review.

HECHT: But that's San Benito not...

LAWYER: Well city of Phar didn't like being a class rep anymore so we have Mercedes and Weslaco took over as class reps. San Benito didn't like the settlement and so it leads a group of people who are protesting that.