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July 29, 2008

VIA U.S. MAIL

Hon. Patrick Power
Administrative Law Judge
Oregon Public Utility Commission
PO Box 2148
Salem, OR 97308-2148

Re: Wah Chang v. PacifiCorp, UM 1002

Dear Judge Power:

I write on behalf of PacifiCorp to advise you of new case authority that is relevant to the above-referenced proceeding. On June 26, 2008, the Supreme Court of the United States issued its decision in *Morgan Stanley Capital Group Inc. v. Public Utility District No. 1 of Snohomish County et al.*, 128 S. Ct. 2733, 2008 WL 2520522 ("*Snohomish*"). A copy of the Court's opinion is enclosed.

Background

Snohomish involved a challenge to long-term wholesale electricity contracts entered into during the 2000-2001 California energy crisis. Faced with extraordinary prices in the spot market, utilities entered into long-term fixed-rate contracts that became unprofitable when the crisis subsided. The buyers then challenged the contract rates as unjust and unreasonable. The Federal Energy Regulatory Commission upheld the contracts under the well-known *Mobile-Sierra* doctrine, which holds that rates set by private contracts are presumed to be "just and reasonable" and may be avoided only if the complainant shows that they are contrary to the public interest.

In 2006, the U.S. Court of Appeals for the Ninth Circuit reversed FERC, ruling that the agency had misconstrued *Mobile-Sierra* and purporting to circumscribe the types of cases

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to which the *Mobile-Sierra* doctrine may be applied. In its decision last month, the Supreme Court sharply disagreed with the Ninth Circuit's reasoning and discussion of *Mobile-Sierra*. (The Court nevertheless affirmed the judgment and remanded the matter to FERC because of other errors.)

Relevance to this Docket

Although *Snohomish* is not controlling in this state proceeding, we bring it to your attention because the parties discussed *Snohomish* and *Mobile-Sierra* at length in their briefing.

PacifiCorp has consistently argued that *Mobile-Sierra*-type principles govern Wah Chang's petition, as evidenced by the Commission's own 2001 order denying the petition. Wah Chang, on the other hand, argues that *Mobile-Sierra* principles have no applicability in Oregon and that the Commission erred in 2001 when it applied the "public interest" standard to Wah Chang's request to avoid the MESA. *See* Post-Hearing Opening Brief of PacifiCorp at 17-20; Wah Chang's Post-Hearing Opening Brief at 5-7.

Wah Chang also contends that even if Oregon does follow *Mobile-Sierra* principles, that doctrine still does not affect Wah Chang's petition. Specifically, Wah Chang relies on the *Ninth Circuit's* decision in *Snohomish* for the notion that *Mobile-Sierra* applies only where a contract rate is challenged as being too low, not too high. Wah Chang Post-Hearing Reply Brief at 4 ("[W]here, as here, the contention is that a contract rate is too *high* rather than too low, 'stability of contract' concerns must give way to an agency's 'statutory responsibility' to protect the public from unreasonable rates.").

Wah Chang also argues that the reasonableness of a contract rate depends on its proximity to the "marginal cost" of producing electricity—a concept for which Wah Chang finds support in the Ninth Circuit's *Snohomish* decision. *Id.* at 15.

Last month's decision by the Supreme Court is therefore noteworthy for its disagreement with the Ninth Circuit's reasoning on which Wah Chang depends, and for its robust reaffirmation of fundamental *Mobile-Sierra* principles that this Commission should continue to apply, and which call for the rejection—again—of Wah Chang's attempt to get out of its contract.

The Supreme Court's Decision

1. The Court reaffirmed that under *Mobile-Sierra*, a party can avoid a contract rate only by showing "serious harm" to the public interest:

> [T]he party charging the rate and the party charged [are] often sophisticated businesses enjoying presumptively equal bargaining power, who could be expected to negotiate a "just and reasonable" rate as between the two of them. Therefore, only when the mutually agreed-upon contract rate seriously harms the consuming public may the Commission declare it not to be just and reasonable.
>
> *Snohomish*, 128 S.Ct. at 2746 (internal citation omitted).

2. The Court rejected the idea that *Mobile-Sierra* has any less force in a dysfunctional market. If anything, stability of contracts takes on *heightened* importance:

> Nor do we agree with the Ninth Circuit that FERC must inquire into whether a contract was formed in an environment of market "dysfunction" before applying the *Mobile-Sierra* presumption. Markets are not perfect, and one of the reasons that parties enter into wholesale-power contracts is precisely to hedge against the volatility that market imperfections produce.... It would be a perverse rule that rendered contracts less likely to be enforced when there is volatility in the market....
>
> To be sure, FERC has ample authority to set aside a contract where there is unfair dealing at the contract formation stage.... But the mere fact that the market is imperfect, or even chaotic, is no reason to undermine the stabilizing force of contracts that the FPA embraced as an alternative to "purely tariff-based regulation." We may add that evaluating market "dysfunction" is a very difficult and highly speculative task—not one that the FPA would likely require the agency to engage in before holding sophisticated parties to their bargains.
>
> *Id.* at 2746-2747 (internal citations omitted).

3. The Court rejected the Ninth Circuit's different standard for "high rate" challenges that bases the reasonableness of a rate on its relationship to "marginal cost" (just as Wah Chang would have the Commission do in this proceeding):

> A presumption of validity that disappears when the rate is above marginal cost is no presumption of validity at all, but a reinstitution of cost-based rather than contract-based regulation. We have said that, under the *Mobile-Sierra* presumption, setting aside a contract rate requires a finding of "unequivocal public necessity," or "extraordinary circumstances." In no way can these descriptions be thought to refer to the mere exceeding of marginal cost.
>
> The Ninth Circuit's standard would give short shrift to the important role of contracts in the FPA, as reflected in our decision in *Sierra*, and would threaten to inject more volatility into the electricity market by undermining a key source of stability. The FPA recognizes that contract stability ultimately benefits consumers, *even if short-term rates for a subset of the public might be high by historical standards*—which is why it permits rates to be set by contract and not just by tariff....
>
> Besides being wrong in principle, in its practical effect the Ninth Circuit's rule would impose an onerous new burden on the Commission, requiring it to calculate the marginal cost of the power sold under a market-based contract. Assuming that FERC even ventured to undertake such an analysis, rather than reverting to the *ancien règime* of cost-of-service ratesetting, the regulatory costs would be enormous. We think that the FPA intended to reserve the Commission's contract-abrogation power for those extraordinary circumstances where the public will be severely harmed.
>
> *Id.* at 2748-2749 (emphasis added, internal citations omitted).

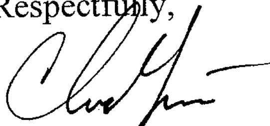
4. The Court held that the *Mobile-Sierra* presumption may be voided by unlawful market activity *only* where direct causation is established:

> We emphasize that the mere fact of a party's engaging in unlawful activity in the spot market does not deprive its forward contracts of the benefit of the *Mobile-Sierra* presumption. There is no reason why FERC should be able to abrogate a contract on these grounds without finding a causal connection between unlawful activity and the contract rate.

Id. at 2751.

For the foregoing reasons, PacifiCorp respectfully submits that the Supreme Court's *Snohomish* decision provides further support for PacifiCorp's position that the MESA should be upheld and Wah Chang's petition should be denied.

Respectfully,



Christopher L. Garrett

CLG:jg
Enclosure

c: Milo Petranovich
Natalie Hocken

BEFORE THE PUBLIC UTILITY COMMISSION OF OREGON

UM 1002

WAH CHANG, Petitioner, v. PACIFICORP, Respondent.	CERTIFICATE OF SERVICE

I certify that I have served a letter dated July 29, 2008, to Administrative Law Judge Patrick Power upon all parties of record in this proceeding by mailing a copy properly addressed as shown below and by electronic mail pursuant to OAR 860-013-0070, to the following parties or attorneys of parties:

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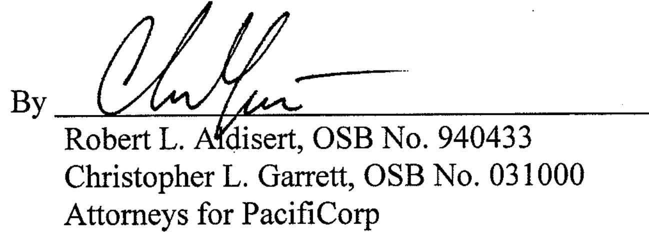
DATED: July 31, 2008

PERKINS COIE LLP



By ______________________

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