LANE POWELL
ATTORNEYS & COUNSELORS

RICHARD H. WILLIAMS
503.778.2160
williamsr@lanepowell.com

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VIA ELECTRONIC FILING <*puc.filingcenter@state.or.us*>
AND REGULAR MAIL

The Honorable Patrick J. Power
Public Utility Commission of Oregon
550 Capitol Street NE, Suite 215
PO Box 2148
Salem, OR 97308-2148

Re: Wah Chang v. PacifiCorp
Docket UM 1002

Dear Judge Power:

This letter responds to PacifiCorp's letter dated July 29, 2008, concerning *Morgan Stanley Capital Group Inc. v Public Utility District No. 1 of Snohomish County et al.*, __ U.S. ___, 128 S. Ct. 2733, 2008 WL 2520522 (2008) ("*Snohomish*").

1. *Snohomish* does not support PacifiCorp's argument that "*Mobile-Sierra*-type principles govern Wah Chang's petition." (Letter at 2)

Snohomish applied the Federal Power Act to questions concerning FERC's regulation of wholesale power purchase contracts. In contrast, the Commission will apply Oregon public utility law to questions concerning a retail power purchase contract. Unlike federal law, Oregon law does not include principles analogous to the *Mobile-Sierra* doctrine. In its 2001 order in our case denying relief, the Commission gave reasons similar to *Mobile-Sierra*, but that is the only instance cited by PacifiCorp,[1] and the Commission later abandoned its emphasis on sanctity of contract when it amended the Klamath Basin irrigators' contracts without referring at all to *Mobile-Sierra* principles. Wah Chang's Post-Hearing Opening Brief at 7-8.[2]

Snohomish is not cause for the Commission to reinstate sanctity of contract as paramount. It is not binding on the Commission, and differences in law and fact make it

[1] The 2001 order cited a 1995 order declining to modify a settlement agreement.

[2] The Klamath water users argued that the 2001 order in our case required the Commission to reaffirm their contracts, *see* Klamath Off-Project Water Users' Response to PacifiCorp's Motion for Summary Judgment at 43-45, filed April 28, 2005 in Docket UE 171, but the Commission did not address the argument.

unpersuasive as a guide in our case. *First*, the opinion emphasized that the Federal Power Act assigns an "important role" to negotiated rate contracts in the regulation of wholesale markets and thus that contract stability is an important goal of the Act. *Snohomish* at 2749. "[T]he regulatory system created by the [FPA] is premised on contractual agreements voluntarily devised by the regulated companies; it contemplates abrogation of these agreements only in circumstances of unequivocal public necessity." *Id.* at 2739 (internal quotation marks and citation omitted). In contrast, Oregon rate regulation is not premised on contractual agreements between public utilities and their customers, and such contracts are few in number.[3]

Second, the *Snohomish* contracts had fixed rates, and they were made during the 2000-2001 crisis. *Id.* at 2743. The buyers thus knew the market conditions and agreed to pay the "very high" prices specified in their contracts. *Id.* In contrast, Wah Chang's rate became variable in September 2000, three years after it entered into the MESA and shortly after the crisis began. Unlike the *Snohomish* buyers, Wah Chang did not enter into the MESA during a period of market dysfunction and did not agree to pay the specific rates it was compelled to pay. For that reason, The Supreme Court's concern—that avoiding contracts made to stabilize ultimate consumers' rates during market chaos could contribute to future instability[4]—is not present in our case.

Third, the *Snohomish* contracts did not have a "Memphis" or other clause providing that one party unilaterally or FERC may amend the rate without a showing of injury to the public interest. *See id.* at 2739, 2745 n. 2. In contrast, the MESA included a provision, captioned "Jurisdiction of Regulatory Authorities," contemplating that the Commission may issue "orders which require PacifiCorp to alter or amend any of the provisions of this Agreement." WC Exhibit 101 at 6 (admitted in 2001). Given that PacifiCorp expressly acknowledged that the Commission may order an amendment, doing so is not inconsistent with its contractual expectations.

2. The Ninth Circuit's "zone of reasonableness" analysis is consistent with Oregon law.

The Ninth Circuit opinion reviewed by the Supreme Court distinguished between buyers' challenges to high rate contracts and sellers' challenges to low rate contracts. The Ninth Circuit concluded that low rate contracts were governed by the *Mobile-Sierra* public

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[3] PacifiCorp's Schedule 400, Special Contracts, lists two contracts. Portland General Electric's Schedule 99, Special Contracts, lists one. The schedules can be read on the utilities' websites.

[4] *See id.* at 2747 ("[b]y enabling sophisticated parties who weathered market turmoil by entering long-term contracts to renounce those contracts once the storm has passed, the Ninth Circuit's holding would reduce the incentive to conclude such contracts in the future").

interest standard and that high rate contracts were unjust and unreasonable if rates exceeded a "zone of reasonableness" roughly defined by marginal cost or by supply and demand in a normally functioning market. *See Snohomish* at 2747-48.

The Supreme Court disagreed, but the Commission is of course free to agree with the Ninth Circuit and ought to. The Supreme Court rejected the Ninth Circuit's standard because it "would give short shrift to the important role of contracts in the [Federal Power Act]***and would threaten to inject more volatility into the electricity market by undermining a key source of stability." *Id.* at 2749. As discussed, contracts do not play the "important role" in Oregon public utility regulation that they do in wholesale market regulation, and they are not a "key source of stability" of Oregon retail rates. The Supreme Court's reasons for rejecting the Ninth Circuit's standard have no force in our case.

Wah Chang's market-indexed rates plainly exceeded the zone of reasonableness. They were not the product of normal market forces, and they far exceeded marginal cost. PacifiCorp served Wah Chang from its general system resources,[5] and its marginal cost of serving Wah Chang was not different from its cost of serving other customers. If PacifiCorp's avoided cost is used to calculate its marginal cost of serving Wah Chang, MESA revenues also far exceeded marginal cost as so determined.

The conclusion to be drawn is that PacifiCorp hugely profited from unjust rates paid by Wah Chang. During the period of indexed rates, September 2000 to September 2002, Wah Chang paid PacifiCorp $37,240,000.[6] Using standard cost-of-service industrial rates as the cost of serving Wah Chang, PacifiCorp's profits from the MESA for the period totaled about $27,000,000.[7] Using marginal cost based on avoided cost, PacifiCorp's profits totaled about $26,000,000.[8]

The Commission is charged by statute to protect Oregon consumers, while allowing public utilities a fair rate of return. ORS 756.010(1). The Ninth Circuit's zone of

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[5] PacifiCorp's Response to ALJ Data Request 2, filed July 30, 2008; WC Exhibit 713 at 5, line 14, through 6, line 2 (admitted in 2001).

[6] PacifiCorp's Response to ALJ Data Request 1, filed March 31, 2008 (showing MESA revenues).

[7] Calculated by subtracting hypothetical cost of service revenues from $37,240,000. *See* Wah Chang's Response to Ruling Dated June 26, 2008, filed July 31, 2008, at 3-4 and Attachment 1 (showing Schedule 48T revenues and marginal cost as calculated using avoided cost).

[8] Calculated by subtracting energy marginal cost calculated using avoided cost from $37,240,00. *See* Wah Chang's Response to Ruling Dated June 26, 2008, filed July 31, 2008, at 3-4 and Attachment 1 (showing Schedule 48T revenues and marginal cost as calculated using avoided cost).

reasonableness standard, as applied to Wah Chang's petition, comports with the Commission's charge. The Supreme Court's *Mobile-Sierra* standard as applied in *Snohomish* does not.

3. Even if the Commission mistakenly applies *Mobile-Sierra* principles as the Supreme Court applied them, *Snohomish* and the record support the grant of Wah Chang's petition.

Wah Chang contends that it is entitled to relief because market dysfunction, including market manipulation, caused its market-indexed rate to be unjust and unreasonable. PacifiCorp, relying on *Mobile-Sierra* principles, contends that Wah Chang's showing of market dysfunction and resulting exorbitant rates does not suffice. PacifiCorp's July 29 letter and this letter's foregoing discussion address those contentions.

However, Wah Chang also contends that it is entitled to relief because PacifiCorp engaged in "unjust and unreasonable exactions and practices," ORS 756.040(1), by participating in manipulative trading schemes that caused higher prices in the California spot markets and at COB.

Snohomish supports Wah Chang's position. The buyers contended that their sellers had engaged in short term market manipulation that increased forward market prices and thus the prices they agreed to pay. The Supreme Court remanded the case to FERC to clarify its findings on this issue. In so doing, the Supreme Court acknowledged that "[w]here, however, causality [between unlawful activity and the contract rate] has been established, the *Mobile-Sierra* presumption should not apply." *Snohomish* at 2751.

The record in our case amply demonstrates the causal connection between manipulative trading schemes and higher prices at the California PX and the California ISO and between higher prices in those markets and the market at COB measured by the Dow COB index. The record also amply demonstrates that PacifiCorp's traders facilitated those schemes by engaging in nontransmission buy-resells. Wah Chang thus has shown a "causal connection between unlawful activity and the contract rate," and the Commission "should be able to abrogate [the MESA] on these grounds." *Id.*

Very truly yours,

Richard H. Williams

Richard H. Williams

Attachment: Certificate of Service
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CERTIFICATE OF SERVICE

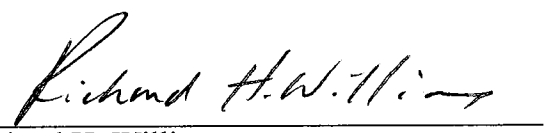
I certify that on August 7, 2008 served the foregoing LETTER TO HONORABLE PATRICK J. POWER, DATED AUGUST 7, 2008, upon all parties of record in this proceeding, by delivering a copy in person or by mailing a copy properly addressed with first class postage prepaid, or by electronic mail pursuant to OAR 860-013-0070, to the following parties or attorneys of parties:

Paul Graham
Assistant Attorney General
Department of Justice
Regulated Utility & Business Section
1162 Court Street NE
Salem, OR 97301-4096
paul.graham@state.or.us

Natalie Hocken
Vice President & General Counsel
PacifiCorp
825 NE Multnomah, Suite 2000
Portland, OR 97232
natalie.hocken@pacificorp.com

James M. Van Nostrand
Perkins Coie LLP
1120 NW Couch Street, Tenth Floor
Portland, OR 97209-4128
jvannostrand@perkinscoie.com

Christopher Garrett
Perkins Coie LLP
1120 NW Couch Street, Tenth Floor
Portland, OR 97209-4128
cgarrett@perkinscoie.com



Richard H. Williams
Of Attorneys for Petitioner Wah Chang