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BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON

UM 1002

WAH CHANG,)	
)	
)	Petitioner,
)	
)	vs.
)	
PACIFICORP,)	
)	
)	Respondent.

ORDER

DISPOSITION: CONTRACT TERMS AFFIRMED

Introduction and Background

On December 1, 2000, Wah Chang filed a petition for relief from a special contract with PacifiCorp for electric service. Wah Chang asked for immediate relief from the rates specified in the special contract, and for permanent relief from those rates. The Commission denied Wah Chang's request for interim relief in Order No. 01-185 on February 21, 2001. This order addresses Wah Chang's request for permanent relief from the rates specified in its special contract with PacifiCorp, called the Master Electric Service Agreement (MESA).

Pursuant to notice, Administrative Law Judge Lowell Bergen presided over a hearing on June 22, 2001. Attorney Richard Williams represented Wah Chang and Attorney Jay Zollinger represented PacifiCorp. Post-hearing briefs were filed until August 17, 2001. The Commission listened to oral argument from the parties on September 24, 2001. This order is based on the preponderance of the evidence received at the hearing.

Petitioner Wah Chang is a division of a California corporation that is part of the Allegheny Technologies family of companies. Wah Chang manufactures specialty metals and chemicals, such as zirconium and titanium, at its plant in Millersburg, Oregon. Wah Chang uses electricity to power a variety of furnaces, motors, and fans. Wah

Chang's electricity load averages approximately 17.4 megawatts, or 13,600 average megawatt hours, per month.

Prior to 1997 PacifiCorp provided electricity to Wah Chang under PacifiCorp's standard industrial Schedule 48T. Starting in 1995 Wah Chang considered ways to reduce its electricity costs. It discussed the matter with PacifiCorp and in August 1996 the two parties signed a special contract for electric service. The contract was submitted to the Commission's Staff, which recommended that the Commission suspend the contract. Staff believed that the proposed contract did not meet the criteria the Commission uses when it approves or rejects proposed special contracts.

Those criteria stem from ORS Chapter 757 provisions prohibiting unfair discrimination among customers and authorizing the Commission to classify customer groups based on their different service characteristics. The Commission specifically addressed special contract principles in Order No. 87-402. Special contracts can be used to offer a discount to a large customer that has energy alternatives and might reduce or discontinue service from the utility company if it must continue to pay rates established in the applicable tariff schedule. Before the Commission will approve a contract that specifies rates that are different from the rates established in the standard published tariff, the proponent must demonstrate to the Commission's satisfaction that several conditions exist. The conditions include: other ratepayers will benefit from the special contract; any discount is not larger than necessary; and that the special contract is not unduly discriminatory.

In regulating public utility companies, one goal is to set rates so that each utility customer pays rates that cover incremental costs and make a contribution toward the utility company's fixed costs. If a large customer ceases to receive service from a utility company, or significantly reduces service, that customer's contribution toward fixed costs is lost. Other customers could be called on to increase their contribution to fixed costs. Special contracts frequently are used to provide discounts to customers so they will remain on the system and continue to contribute to fixed costs. Special contracts are particularly useful for establishing discount rates to customers who have viable alternatives to the utility's service and the utility has more capacity than it needs to serve its other customers. Discount rates should be no greater than necessary and must at least cover variable costs and make a contribution to fixed costs.

As mentioned above, when the 1996 special contract between PacifiCorp and Wah Chang was filed with the Commission, the Commission's Staff concluded that the criteria for approval had not been met and recommended that the Commission suspend the proposed special contract. Staff believed that any showing of a need for a price discount was insufficient and that PacifiCorp had not shown that Wah Chang had viable alternatives that might cause it to discontinue service from PacifiCorp. PacifiCorp then withdrew its request for Commission approval of the special contract.

Wah Chang's Actions and Contentions

Wah Chang looked at alternative sources of electricity and considered an arrangement whereby the City of Millersburg would establish a municipally owned electric system that would provide electricity to Wah Chang. A feasibility study concluded that the project was feasible.

Wah Chang and PacifiCorp continued to negotiate about a special contract to substitute for the standard industrial rates established in PacifiCorp's Schedule 48T. They agreed on the terms of the MESA, and signed it in September 1997. The MESA establishes prices for the ensuing five-year period. At our Public Meeting on September 9, 1997, we approved the MESA on the condition that a paragraph that dealt with revision of the contract for possible future stranded costs or other costs be removed from the MESA. The offending paragraph was removed and the MESA became effective for the five-year period starting on September 12, 1997. The MESA provides that rates during the first three years of the contract are fixed. During the final two years of the contract, the rates are based on market factors, including the daily average California-Oregon border prices as published in *The Wall Street Journal* (referred to as the Dow Cob index). The market-based rates became effective on September 12, 2000.

Wah Chang saved money during the first three years of the MESA. The rates during that time were fixed under a formula that changed rates as consumption changed. The rates were less than the average rate of approximately \$40 per megawatt hour specified in PacifiCorp's Schedule 48T. However, since the change to wholesale market prices in September 2000 until the hearing in June 2001, Wah Chang states that it had paid PacifiCorp an average rate of \$267 per megawatt hour.

In its original petition for relief, Wah Chang asked us to order PacifiCorp to serve Wah Chang at PacifiCorp's Schedule 48T rates. At the hearing, Wah Chang changed its request for relief and now asks us to revise the MESA rate to a flat amount of \$49.55 per megawatt hour. The rate is derived from PacifiCorp's estimate in Docket No. UE 116 that it will receive that rate from Wah Chang during the test year used in the UE 116 docket. Wah Chang also asks us to make Wah Chang whole by requiring PacifiCorp to refund the difference between its market based receipts from Wah Chang and what PacifiCorp would have received if the rates had been just and reasonable. In addition, Wah Chang asks us to order PacifiCorp to share with Wah Chang any refunds PacifiCorp receives from actions ordered by the Federal Energy Regulatory Commission (FERC). Wah Chang suggests that a second phase of this proceeding could address issues related to the amount of retroactive relief Wah Chang should receive.

Wah Chang argues that the "outrageously high" rates recorded in the Dow Cob index were not foreseeable when the MESA was signed in 1997. It states that electricity is a significant component of its cost of doing business, and it notes that the volatility of the Dow Cob index makes planning decisions more difficult. Wah Chang

asks us to determine that the Dow Cob index pricing under the MESA results in unjust and unreasonable rates.

Wah Chang contends that contracts for price indexing, like the MESA, make sense as long as traditional market forces continue as expected. But price indexing is not appropriate in a market in which market power is used to create a dysfunctional market. Wah Chang contends that since May 2000 the California electric wholesale market has not functioned as economic theory suggests it should. Wah Chang suggests that collusion or profiteering caused the California electric wholesale market to become dysfunctional.

Wah Chang contends that the loss of revenues to PacifiCorp that would result from revising MESA rates downward would not harm PacifiCorp's other customers. The argument stems from the willingness of Wah Chang to pay PacifiCorp what PacifiCorp projected it would receive from Wah Chang in its recent rate proceeding. The projection is for the calendar year 2001 test year adopted in that proceeding. Wah Chang contends that any possible future harm to other PacifiCorp customers as a result of rate changes is speculative and hypothetical.

Wah Chang has been exploring ways to mitigate its high electricity bills. One of its successes has been the construction of natural gas-burning generators located at its manufacturing plant. The generators began producing electricity in June 2001 and produce approximately 14 megawatts of electricity for Wah Chang's use. The generators supply a large portion of Wah Chang's average 17.4 megawatt load.

Another successful mitigation effort involved the resale of electricity by a sister corporation. Oregon Metallurgical Corporation (Oremet) is owned by the same company that owns Wah Chang. Oremet manufactures specialty metals at a plant in Albany and has a contract with the Bonneville Power Administration (BPA) to purchase electricity at the BPA firm priority rate. Oremet does not plan to use that power and is free to remarket it. For the months of January and May through September 2001, Oremet sold to BPA for resale by BPA to another energy company substantial blocks of electricity. Oremet made substantial net revenue gains on those sales of surplus energy to BPA (the amount is confidential).

Wah Chang also considered financial hedges as a way to mitigate its electricity bills. In general terms, a financial hedge can be described as a promise on the part of one party to pay a fixed amount to a second party in exchange for the second party's promise to pay for the consequences of an uncertain event if that event actually occurs. It is a transfer of money in exchange for the assumption of risk. The fixed price is generally higher than the average expected market price at the time of delivery, but the first party gets price certainty. When the Dow Cob prices increased and became very volatile, PacifiCorp suggested that Wah Chang obtain a financial hedge to mitigate its exposure to price increases. Wah Chang investigated financial hedges and decided against obtaining any at that time, believing prices would come down. Finally, in May

2001 Wah Chang's parent company executed on behalf of Wah Chang a financial hedge that fixed the price for most of Wah Chang's purchased power for the period June through September 2001. The contract rate is confidential, but is higher than Dow Cob prices prevailing just prior to the hearing. Wah Chang is now unwilling to assume the risk and complexity of financial hedges for the time remaining under the MESA.

FERC recently took action to stabilize the California wholesale energy market. Among its actions was the imposition of "soft price caps" on wholesale prices. Fortunately, the Dow Cob prices have eased substantially in recent weeks. Wah Chang points out that the FERC action does not solve the wholesale energy market problem even though wholesale prices have recently trended downward.

PacifiCorp's Actions and Contentions

PacifiCorp states that at the time the terms of the MESA were being negotiated, PacifiCorp was unwilling to contract with Wah Chang for a five-year fixed-price rate. PacifiCorp was concerned that prices that far in the future were too speculative to form the basis for a reasonable fixed-price contract. Both parties knew that electricity prices in the future could go up or down significantly. PacifiCorp simply did not want to accept the risk that its future electricity costs could increase significantly while it was obligated to provide the electricity at a fixed price. It would agree to a five-year contract only if Wah Chang would accept the risk of price changes during the last two years of the contract. Wah Chang accepted that condition, and the parties agreed to sign the MESA. The MESA provides for three years of fixed rates and two years of market-based rates. Wah Chang thereby knowingly assumed the risk of market-based rates during the last two years of the contract.

During negotiations preceding the execution of the MESA, PacifiCorp discussed with Wah Chang mechanisms that could be employed to reduce Wah Chang's risks of future price increases. Price caps and costless collars (which establish a floor price and a ceiling price) were discussed but not chosen by Wah Chang. PacifiCorp contends that Wah Chang knowingly decided to assume the impacts of all market price changes during the final two years of the MESA. In June 2000 Wah Chang and PacifiCorp again discussed rates for the final two years of the MESA. The discussion included the possibility that if Wah Chang fixed its load characteristics (made a commitment to use set amounts of electricity on an hourly basis) a fixed price might be possible. The parties were not able to reach agreement on the terms of such an arrangement. The parties also discussed then, and at other times, the possibility of Wah Chang obtaining financial hedges to mitigate its exposure to future price hikes. At the hearing PacifiCorp stated that Wah Chang could now purchase electricity for future delivery at a price approximately the same as the fixed rate it is requesting in this proceeding.

PacifiCorp points out that its cost of serving its customers will not change whether Wah Chang pays the prices established in the MESA or some other price.

Therefore, if Wah Chang is allowed to pay rates less than those established in the MESA, PacifiCorp would need to recover the lost revenue from its other customers as long as market rates are higher than any new rates established in this proceeding.

To gain Commission approval for the MESA, Wah Chang demonstrated that it had a viable alternative to PacifiCorp's service and would leave PacifiCorp's system except for the MESA. If Wah Chang had discontinued service from PacifiCorp, PacifiCorp would either have sold a comparable amount of electricity on the market or would have avoided purchasing on the market that amount of electricity for resale. PacifiCorp contends that this reality further supports the use of the market rates established in the MESA.

PacifiCorp contends that Wah Chang has not demonstrated a viable legal reason for allowing it to change the MESA rates or terminate the contract signed by both parties and approved by the Commission.

Commission Analysis and Decision

The Commission's policy has been to uphold agreements negotiated by parties at arm's length. In Order No. 95-857 the Commission stated that when

“ . . . the Commission adopts a Memorandum of Understanding or other settlement agreement, it does so because it finds the agreement to be reasonable and consistent with Commission policy and law....[I]t is our general policy that only the most compelling circumstances justify retroactive modification of a Commission order adopting a fully negotiated settlement agreement. Such circumstances might include facts constituting mistake, fraud, impossibility, or some other extraordinary basis for modifying an executed agreement. We do not agree that new information alone is a sufficiently compelling circumstance to retroactively modify the terms of a fully negotiated agreement.”

The Commission was addressing a memorandum of understanding in that order, but the language states the Commission's serious reluctance to modify agreements executed between parties and approved by the Commission.

Wah Chang could have reduced its risk for future price changes by agreeing to a price cap or collar when the MESA was negotiated. Wah Chang declined, apparently because to do so would limit its gain if prices decreased in the future. A natural consequence of that decision is the assumption of potential price changes, up or down. Wah Chang knowingly assumed the full impact of future price changes in the belief that prices would decline. It must also accept the risk of future price increases.

Wah Chang contends that granting it relief from the MESA rates would not harm other PacifiCorp customers. It cites a revenue estimate PacifiCorp made in its recent rate case. PacifiCorp contends that it would need to obtain additional revenue from other customers if rates to Wah Chang were reduced. Whether granting Wah Chang relief from the MESA rates would harm other PacifiCorp customers is uncertain. Under rate regulation, reductions in revenue from a large customer or a class of customers can and frequently do require other customers to pay higher rates. The potential for harm to other customers, while not dispositive, suggests that we should be cautious in considering a request to revise an executed contract we previously found to be fair and reasonable.

It may be possible that Wah Chang could now obtain its future electricity needs for the time period covered by the MESA for approximately the same rate it requests in this proceeding. It declines, citing risk and complexity factors. It is, however, a potential alternative available to Wah Chang.

Wah Chang has theories about the California electricity market and prices. FERC and others also have theories. We will not try in this proceeding to determine the causes for the price increases in the California wholesale market. We simply note that prices in that market since the summer of 2000 have been volatile and at times very high.

Dow Cob prices have decreased substantially the past few months. During the weeks just prior to the hearing in this docket, the weighted average of Firm Flat Dow Cob prices varied from a high of \$127.23 per megawatt hour to a low of \$34.94.¹ At the oral argument before the Commission on September 24, the record was updated to show that those prices ranged from a high of \$27.36 per megawatt hour to a low of \$22.10 per megawatt hour between September 1 and September 19, 2001. The lower rates were less than PacifiCorp's Schedule 48T rate of approximately \$40 per megawatt hour. It is possible that the worst of the crisis is over, at least for the time period covered by the MESA.

In addition, the generating facilities Wah Chang installed at its plant will substantially reduce the impacts of MESA rates on its operations.

Wholesale electricity prices could go up or down during the remaining months of the MESA. Recent trends in the regional wholesale electricity market are encouraging for those buying into that market or whose prices are tied to it. Recent price trends bolster the Commission's belief that continuation of the MESA under the terms negotiated by the parties and approved by the Commission would not be contrary to the public interest. The rates specified in the MESA are not unjust or unreasonable.

¹ Wah Chang's rates under the MESA would not be exactly the same as these figures, but they are a reasonable approximation of the COB price component of the rates established in the MESA.

This is not a case in which the parties failed to understand the meaning of the contract. Wah Chang, PacifiCorp, and the Commission clearly understood that the MESA provided for market-based rates for the last two years of the contract's term. Wah Chang and PacifiCorp knew that the risk for price changes during the final two years of the contract was Wah Chang's. MESA rates favored Wah Chang during the first three years of the contract term. Since September 2000 the MESA rates have generally favored PacifiCorp. We do not know which party will be favored during the remainder of the contract term. Business decisions made about the future are inherently risky. We are not persuaded to now impose our will on the parties and revise the rates they negotiated.

Having decided that Wah Chang is not entitled to relief from the rates it agreed to in the MESA, there is no reason to discuss Wah Chang's request for retroactive relief or a possible second phase of this proceeding.

ORDER

IT IS ORDERED that the petition for relief filed by Wah Chang against PacifiCorp is denied.

Made, entered, and effective _____.

Roy Hemmingway
Chairman

Lee Beyer
Commissioner

Joan H. Smith
Commissioner

A party may request rehearing or reconsideration of this order pursuant to ORS 756.561. A request for rehearing or reconsideration must be filed with the Commission within 60 days of the date of service of this order. The request must comply with the requirements in OAR 860-014-0095. A copy of any such request must also be served on each party to the proceeding as provided by OAR 860-013-0070(2). A party may appeal this order to a court pursuant to applicable law.