A Tale (Or Two) Of Two (Or More) Forums

"It was the best of times; it was the worst of times."

By Robert E. Maloney, Jr. and Milo Petranovich of Lane Powell PC

The chance to prove the client's case in two courts; the chance to lose in each. The opportunity to employ the rules in one court to the client's advantage in another; the risk that a loss in the first is preclusive in the second. The prospect of a quick decision in one court; the purgatory of endless litigation in another.

A. Two Cases, Many Forums

The Electricity Cases.

Our client, Wah Chang, is in the service territory of PacifiCorp, an electric utility. Wah Chang uses a tremendous amount of electricity in its manufacturing processes, all of which it must buy from PacifiCorp at the standard industrial rate, or tariff. Seeking to lower costs, Wah Chang entered into a five year contract with PacifiCorp to purchase its power at wholesale market rates, rather than the standard industrial tariff. Such wholesale market rates had been consistently below the standard industrial tariff, and Wah Chang and PacifiCorp chose a market price index—the Dow Jones California Oregon Border Index (Dow COB)—that would establish the monthly price Wah Chang would pay for the electricity it would buy from PacifiCorp. But just as the price indexed contract went into effect, the California energy crisis erupted. Prices in Western wholesale energy markets skyrocketed—and so did market price indexes like the Dow COB. Wah Chang's monthly power bill skyrocketed too—from about $300,000 a month to as much as $6 million a month.

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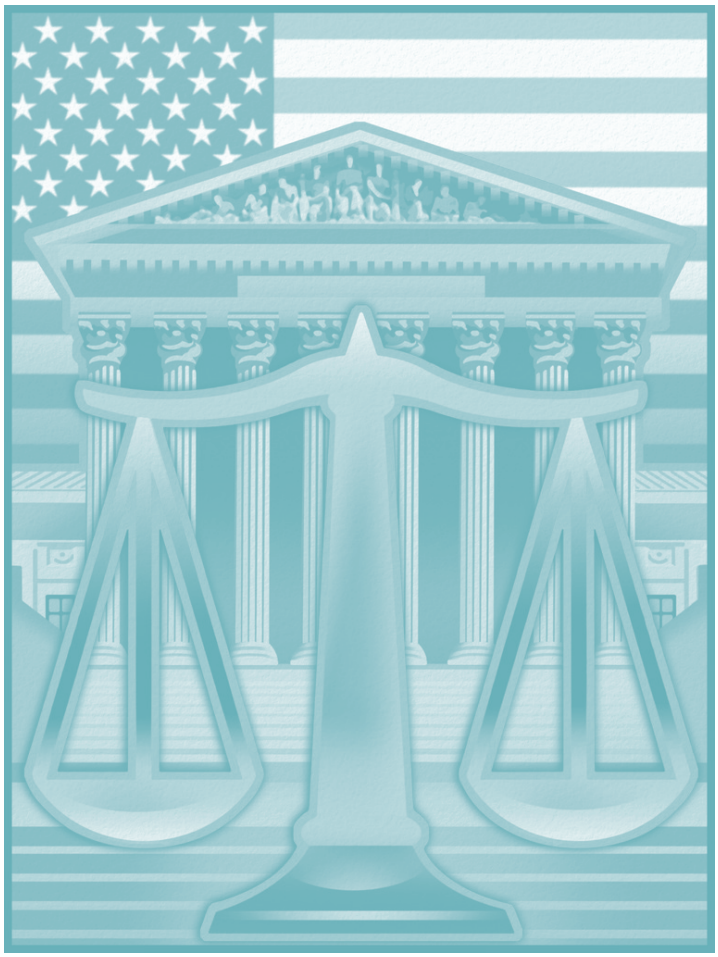

Wah Chang sought relief from its contract in two forums: it petitioned the Oregon Public Utility Commission ("PUC") for an order that the indexed rate it must pay under the contract was "unjust and unreasonable," a concept unique to regulated utility practice. Wah Chang also filed a civil lawsuit in state court, asserting the contract should be declared void, by virtue of the doctrine of frustration of purpose.

PacifiCorp moved to dismiss the state court case, arguing first that the PUC had exclusive jurisdiction over the matter, because it involved issues of rate regulation. Alternatively, PacifiCorp argued that there was concurrent jurisdiction at the PUC and in state court, but the doctrine of primary jurisdiction demanded the case be heard by the PUC, which has expertise in such matters. The state court ruled there was

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concurrent jurisdiction, and that it was fully capable of handling matters of contract—"qua contract." The dispute proceeded in two forums.

Thereafter, the PUC ruled the rate was not unjust or unreasonable, that Wah Chang had "assumed the risk" of market price increases. And the state court granted PacifiCorp's motion for summary judgment, ruling in essence that Wah Chang could expect some degree of market speculation to affect market prices, and that was the most that the evidence suggested.

Then, the previously hidden evidence of Enron's manipulation of the energy markets became public. The state court vacated its judgment on the basis of newly discovered evidence—the new evidence suggested active and illegal market manipulation, not mere market speculation—and the PUC was ordered by the Marion County Circuit Court to reopen its case and take new evidence.

Armed with the evidence of Enron's perfidy, Wah Chang filed civil lawsuits against Enron and others, alleging violation of the antitrust laws and the federal racketeering statute. Now, there were proceedings in three forums: Oregon state court, Oregon's PUC, and federal court.

2. The Securities Fraud Cases.

At about the same time Enron was unraveling, Electro Scientific Industries, Inc. ("ESI"), an Oregon publicly traded company, had its own problems. Our client, Jim Dooley, was ESI's CFO, and then its CEO. When he was named CEO, a newly appointed CFO discovered what he believed to be anomalies in ESI's financial statements. At the suggestion of the new CFO, ESI began an independent internal investigation of its accounting, and discovered what it believed to be errors in its filed financial statements. It self-reported to the Securities and Exchange Commission and began the process of restating its previously filed financial statements. A civil class action securities fraud claim followed, naming ESI, Dooley, and others as defendants. ESI terminated Dooley "for cause" under its employment contract with him. The SEC filed a civil action against Dooley. The U.S. Attorney for the District of Oregon filed criminal securities fraud claims against Dooley. Dooley was now a defendant in three lawsuits, one of them criminal.

B. Different Forums, Different Discovery

The good news is that one can leverage the different discovery rules in the different forums to the client's advantage.

In the electricity pricing cases, Wah Chang used the PUC discovery procedures to obtain documents and interrogatory answers (the PUC procedure is called "data request"), and to obtain expert discovery. Wah Chang conducted depositions under the procedures available in state court. Using the PUC procedures, Wah Chang obtained the tape recordings made of the conversations of PacifiCorp electricity traders during a two-year period—it is industry practice that all conversations of traders be recorded. There were more than half a million recorded conversations that had to be reviewed.

Similar advantages were eventually available in the Dooley securities fraud cases. Discovery was stayed in the securities fraud class action, and it soon settled. Depositions and sworn statements of numerous witnesses were taken by the SEC in the SEC proceeding, but they were not immediately available to Dooley, and then the SEC action was stayed pending completion of the criminal matter, as is often the case. Then, unexpectedly for a civil lawyer, the criminal case proved a treasure trove of discovery. The government is required to turn over evidence in its possession, including possible exculpatory evidence, to the defendant. The SEC had shared much of its information with the prosecutor—not uncommon in such parallel proceedings. And ESI had turned over to the prosecutors both the written result of its internal investigation and much of the backup documents, interviews, and other evidence from the investigation. Almost all of that was produced by the prosecutor to Dooley—the good news is that Dooley now had about one million documents related to the cases against him. The bad news was that the documents came in bulk, largely unclassified and undifferentiated.

There were other challenges. First, the electricity pricing cases. The PUC's administrative law judges are knowledgeable and experienced in the complicated world of utility rate setting. But compared to civil judges, they are relatively inexperienced in handling discovery disputes. And the state court was not inclined to get involved in enforcing the PUC's unique written discovery procedures, even though the parties agreed that discovery in one case could be used in the other.

Back to the securities fraud cases.

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The rules governing the prosecutor's obligations to produce exculpatory evidence are broad, and the court supervises the discovery process. But the considerations are different than in civil cases, and the dynamics of defending a criminal prosecution, while at the same time exploring with the prosecutor the possible reality of a guilty plea, require careful weighing of the considerations.

C. *Preclusion—What Is the Effect in One Forum of a Ruling in Another*

Once you move to the merits, things get really complicated. First, the electricity pricing case.

A doctrine related to the PUC's sole jurisdiction to set utility rates complicated Wah Chang's ability to pursue its case in state court. To the extent Wah Chang's case in the state court would set or affect the rate it would pay to its utility, the PUC arguably had exclusive jurisdiction over the dispute. On the other hand, the state court had jurisdiction to determine the equitable contract issues: was there a frustration of a primary purpose of the contract? To avoid implicating "rate" issues in state court, Wah Chang simply asked the state court to declare the contract void, and that Wah Chang would then ask the PUC to determine what rate would have been charged in the absence of the special contract—in Wah Chang's view, the standard industrial tariff rate. The difference between that standard rate and what it paid under the inflated market indexed rate, together with interest, was about $50 million. Wah Chang also had legal claims: breach of the contractual covenant of good faith and fair dealing, tortious breach of that covenant, and money had and received. But seeking monetary damages for those claims again risked invading the rate setting province of the PUC, so Wah Chang instead sought a restitutionary measure of damages that would require the jury only to determine whether there was a material breach, but not to calculate and award damages.

The state court agreed with Wah Chang's positions. But then the PUC issued its ruling as to whether the indexed rate was unjust and unreasonable—it held that the rate was not, and in doing so, made many factual findings. And it did more; it ruled that it had exclusive jurisdiction over the dispute. PacifiCorp immediately moved for summary judgment in the state court, arguing that the facts found by the PUC were entitled to preclusive effect; not claim preclusion, but issue preclusion. And one of the issues determined was that the PUC had exclusive jurisdiction. Wah Chang countered that the issues in the PUC were not the same as the issues in the state court proceeding so there could be no issue preclusion, and that the state court had already decided the exclusive jurisdiction issue. The state trial court agreed with Wah Chang's positions.

Back to Dooley. He pleaded guilty to one count of criminal securities fraud—an omission in an oral statement to the company's outside auditor during a quarterly review of the company's financial statements. Dooley had obtained an opinion that severance benefits offered by ESI to employees in Japan were not legally required and, on that basis and under the rules for accounting for contingent liabilities, Dooley reversed an existing accrual for such benefits on the company's books, generating income for the company in that fiscal quarter. Dooley had obtained the opinion that there was no legal requirement for severance packages in Japan from the company's international controller. He advised the company's outside auditor of the opinion that the benefits were not legally required, but did not disclose that the advice was from the company's controller—not from legal counsel. One count of the indictment against Dooley alleged that such an omission in the oral statement to the outside auditor constituted securities fraud. Dooley pleaded guilty to that count, and the government dismissed all the other counts. Dooley was sentenced to six months' home confinement. Dooley then settled the SEC claim, agreeing not to serve as an

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officer or director of a publicly traded company, but neither admitting nor denying the SEC allegations.

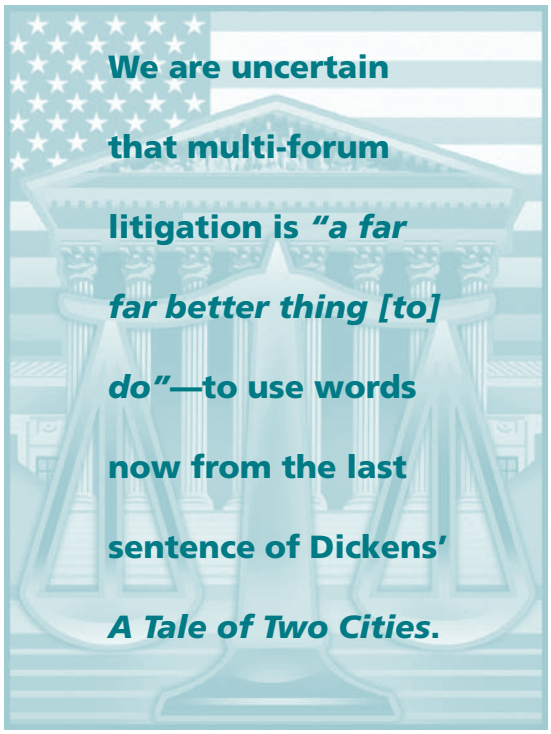
Dooley had a breach of contract claim against ESI. His employment agreement provided for severance benefits worth approximately $1 million if he was terminated. However, if he was terminated "for cause," he was entitled to no severance benefits. Dooley filed a breach of contract claim before the American Arbitration Association—the contract provided for such arbitration—asserting that ESI improperly terminated him under the "for cause" provision, when his actions did not meet the "for cause" standards.

ESI promptly moved for summary adjudication in the arbitration, arguing that Dooley's guilty plea conclusively precluded him from asserting that his termination was not "for cause." Dooley countered that the contract's "for cause" provision required, by its own terms, that Dooley knowingly and intentionally engage in criminal conduct, but Dooley's guilty plea was only to a reckless state of mind—consequently, the issues in the two forums were different, so the guilty plea was not preclusive. The arbitrator denied ESI's motion for summary adjudication.

D. Multi-Forum Issues at Trial

The Wah Chang case was tried—several counts to the jury, several to the judge. The Dooley case was arbitrated before a single arbitrator.

Several stubborn multi-forum problems arose in the Wah Chang trial. Remember the antitrust and racketeering case Wah Chang had filed against Enron and others? It had been dismissed under the federal filed rate doctrine, which gives exclusive jurisdiction over issues related to wholesale energy sales to the Federal Energy Regulatory Commission ("FERC"). PacifiCorp sought to introduce the complaint as an admission by Wah Chang that its damages were caused by Enron and its co-conspirators, not by PacifiCorp's actions. The trial court ruled the complaint inadmissible—its probative value greatly outweighed by its potential prejudice, both to Wah Chang and to PacifiCorp. Wah Chang sought to introduce various FERC rulings and determinations that the Western energy markets had been the subject of massive manipulation. The trial court ruled that the FERC rulings would not be admitted—the jury might defer to the FERC rulings, and that would invade the province of the jury. However, the trial court did allow Wah Chang to place in evidence PacifiCorp's briefs in the FERC proceedings, as an admission by PacifiCorp that the wholesale markets were manipulated.



E. Trial Results, and Lessons

After 3 1/2 weeks of trial, the jury returned a verdict for PacifiCorp. The judge ruled in favor of PacifiCorp several days later. An appeal is being considered. The PUC ruling that the contract rate was just and reasonable is on appeal. From the filing of the first actions, it is now 10 years, and counting.

In the Dooley arbitration, which spread over four weeks, the arbitrator ruled in favor of Dooley. He interpreted the "for cause" clause in the employment contract to require Dooley to intentionally engage in criminal activity, and he ruled the evidence was that Dooley had no such state of mind. He awarded Dooley about $1.2 million, which included pre-award interest. ESI has challenged the award in federal court, raising again the alleged preclusive effect of Dooley's guilty plea. From the filing of the first securities fraud suit, it is now only eight years, and counting.

We are uncertain that multi-forum litigation is *"a far far better thing [to] do"*—to use words now from the last sentence of Dickens' ***A Tale of Two Cities***. But, we are certain that sometimes it is necessary, and we must carefully navigate its opportunities and risks. ❐