

Hunch becomes a hunt

BACKSTORY: Suspicious, city hires big gun to pry into PGE

By NICK BUDNICK Issue date: Tue, Jan 31, 2006

The Tribune



TRIBUNE PHOTO: L.E. BASKIN

New City Hall consultant — and former PGE executive — Robert McCullough (left) meets with (from second from left) Commissioner Randy Leonard, chief of staff Ty Kovatch and lawyer Ann Fisher. On orders to look into PGE's role in the Enron Corp. scandal, the utility's nonpayment of county taxes and subsequent rate hikes for local consumers, McCullough has collected about 12 million documents for review.

Before white-haired Portland consultant Robert McCullough showed up at City Hall for his job interview in January, he'd envisioned potential pitfalls, but not this one — the self-described "6-3 rotund Irishman" wiped out on the lobby's wet marble floor.

Called to the scene, city Commissioner Randy Leonard says his first thought was: "Oh my God,

we killed our consultant."

"I had a bleeding skull, and my knee was the size of a basketball," McCullough says. "I had a choice to work for the city — or sue it."

It was an inauspicious beginning for the man whom the City Council is counting on to support a politically risky, never-before-tried gamble — to find enough evidence to single-handedly reduce the electricity rates charged Portlanders by Portland General Electric, the utility that provides power to 1.5 million Oregonians.

Tapping a stash of \$700,000 that was left over from the city's failed effort to buy PGE, the city has hired McCullough, a \$350-an-hour former PGE executive, to sift through mounds of data. The goal: to see if the company's involvement with improper Enron Corp. energy shenanigans has fueled a lasting power-rate hangover for Portlanders. If they find the evidence, Leonard has vowed to bring PGE rates down, using a long-forgotten city ordinance that surfaced only recently.

As for compromising with PGE, Leonard says if there's proof of fraud or deceit, forget it: "There will be no settlement."

PGE Associate General Counsel Jay Dudley thinks Portland is wasting its time with McCullough, citing an internal 2002 investigation into the questionable transactions that were followed up on by the Federal Energy Regulatory Commission. "At the end of the day we found no evidence that our traders engaged in activities that hurt the power markets," he says. "We had no knowledge of what was going on."

The area McCullough is tackling is one where certainty is hard to find. In a dozen cases of alleged market manipulation that McCullough's worked on, he says his side won about half the time. Most of the outcomes he considers victories were settlements that he says he cannot discuss because of confidentiality agreements. So whether McCullough can deliver for Portland is an open question — despite an intellect that even his critics agree is formidable.

"Many consider him godlike," says Jerry Leone, the former manager of the Public Power Council. "There are others, I believe, who consider Robert the devil incarnate."

Millions of documents filed

McCullough's lair is a white one-story house on Southeast Woodstock Boulevard near Reed College, filled with polished wood, warmly colored rugs, stacks of federal energy reports and such utility industry esoterica as a statue of Reddy Kilowatt, the utilities' perky 1920s-era answer to Mickey Mouse.

But what gets your attention are the computer screens. There are flat-screen Samsung monitors everywhere. Most desks have three, allowing McCullough's crew of brainy Reed undergraduates and recent graduates to compare multiple sets of data at once. In the basement sit rows of dark minimonoliths, computer servers packed with evidence. "We have 12 million Enron documents stored on these computers," McCullough says. "We often get calls from prosecutors, the FBI and the press saying, 'Can you find us something?' ... Literally we can search the whole thing in 17 seconds."

Among the documents are references to McCullough, such as an Enron e-mail sarcastically referring to him as "the Robin Hood of the Pacific Northwest."

Indeed, the Enron scandal seems to have given McCullough his true calling — as well as a financial windfall thanks to the subsequent litigation it spawned.



McCullough was a PGE executive until 1991, then co-founded an energy-marketing business, which failed. He became a consultant, working for Indian tribes, aluminum companies and steel mills, as well as underdog local utilities fighting voracious larger counterparts. He even worked for PGE, which by then had become an Enron subsidiary, as recently as 1998.

Then, on May 22, 2000, wholesale energy prices across the West shot up by a factor of 10 or more, sparking what became known as the California energy crisis. According to the Enron book, "Conspiracy of Fools" by Kurt Eichenwald, McCullough was among the first to suspect what was going on. Sitting in the lobby of the Ritz-Carlton Montreal Hotel, chatting on his cell phone with Seattle public utility officials, he challenged their complacency, saying, "Why are prices so high if there's not a lot of demand?"

Industry officials blamed it on a variety of factors, including the weather — you name it. Portland energy attorney Dan Meek speaks with awe of the trade-press article in which he says McCullough was the first to "systematically destroy" the denials that someone had been gaming the system to drive up rates and pocket massive profits. Meek says, "He is, I think, the outstanding expert on Western energy market manipulation."

PGE was a way in

The California energy crisis had its roots in Portland. Enron's 1997 purchase of PGE gave Enron "entree to California's power grid and a copy of the utility industry's secret playbook," wrote Fortune magazine reporters Bethany McLean and Peter Elkind in their book, "The Smartest Guys in the Room."

McCullough, for his part, likens the Enron-PGE relationship to Dr. Evil and his "Mini-me" in the movie "Austin Powers." Enron, he says, took advantage of the dark corners of utility deregulation: "They were mugging people where there were no streetlights."

And one of the biggest victims was the Northwest — in fact, Enron drew the bulk of its profits here, says Eric Christensen, associate general counsel for Snohomish Public Utility District in Washington, which has been the leader in suing Enron for reimbursement of its escalated rates.

Christensen says that when his utility obtained Enron's company data and e-mails from the federal government, McCullough was "instrumental" in finding scams federal regulators had missed. "He uncovered the fact that they were using five different sets of accounting books. ... He uncovered shocking evidence about the amount of profits that Enron was taking out of the Northwest."

"We consider him a hero," says Will Patton, a Seattle assistant city attorney who's been working with McCullough on that city's effort to secure refunds for customers. "Enron probably has a dartboard with his profile on it."

McCullough's critics accuse him of arrogance and overconfidence, according to his friend and former partner, Marty Howard.

"It has been said of Robert that he is often wrong, but never in doubt," Howard says. "The truth of the matter is he is not wrong that often, but he has a lot of confidence."

Indeed, McCullough shuns the usual dry econo-speak. In a memo characterizing PGE's response to the 2002 FERC investigation, McCullough wrote that "the documents describe a utility operating at the bare edge of everyday competence."

His bold statements have made him a media darling, quoted in newspapers coast to coast. But they also chafe his more staid peers.

"I think sometimes he might be a little bit hyperbolic in his opinions, stronger maybe than they should be," says retired energy consultant Merrill Schultz, who worked with McCullough in the Northwest utilities' power pool for more than a decade.

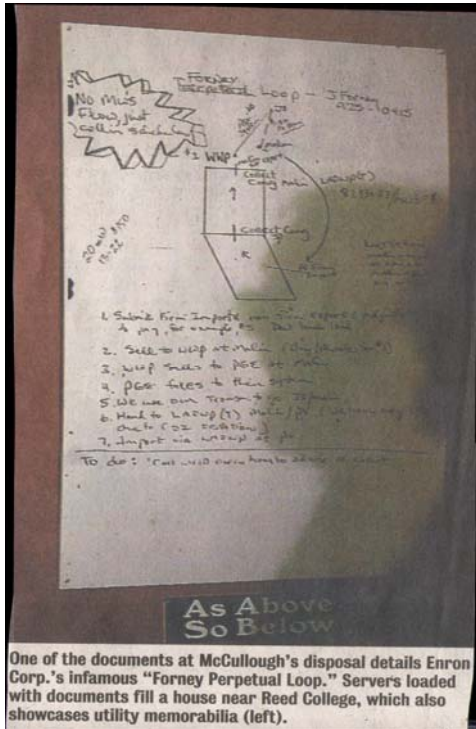
"I think Robert is supremely confident of his ability," says Ken Cannon, former head of Industrial Consumers of Northwest Utilities. "Sometimes that's not always borne out in a court of law."

In 2002, a federal administrative law judge ripped McCullough's testimony, siding with Enron's Harvard experts and accusing the Portland consultant of shoddy research in support of Snohomish's case, calling his testimony "flawed" and "discredited."

McCullough acknowledges, "We got our asses kicked . . . we were totally outgunned." But years later, he notes, an exhaustive FERC review found that, in fact, his hypothesis was correct and the Harvard professors were wrong.

It takes lots of cash to win

Cannon suggests the city should watch over its contract with McCullough, which grants him a maximum of \$95,000, to keep him on task. "If you look at some of the other investigations that he helped in the past, you can run up some mighty large bills, because it's very, very data intensive," he said. "Robert's not cheap, I think *that's* for sure."



One of the documents at McCullough's disposal details Enron Corp.'s infamous "Forney Perpetual Loop." Servers loaded with documents fill a house near Reed College, which also showcases utility memorabilia (left).

Christensen says that Snohomish has paid McCullough \$2 million to \$3 million in the last four years, in a case that is pending at the 9th U.S. Circuit Court of Appeals. Thanks to McCullough's Reed-spawned employees' willingness to work for low pay, Christensen says, "he runs a very low-overhead operation. So I think we've gotten a better bang for the buck than the bad guys have."

In the industry, McCullough is known for his luxurious tastes. At the large annual Christmas party he and his wife host, he answers the door in a top hat and tuxedo tails; guests are feted with fine champagne and gourmet catering from Caprial's Bistro. A buy-American kind of guy, he drives a black, new Cadillac; in winter he can be seen wearing a large fur coat made from Hudson Bay beavers that his Canadian clients, the Cree Indians, killed and ate.

All of which is why the Cree tribe's French-Canadian attorney, Robert Mainville, can't help but start laughing when asked to describe McCullough. "In Canada, we're left-wing, eh? I think of him as a conservative Republican."

McCullough says he is a "Teddy Roosevelt Republican," referring to the president who first became alarmed at the illegal and monopolistic dealings of Sam Insull. That's the Western energy magnate who founded PGE's predecessor, Portland Electric, seven decades ago — only to have his business empire crumble amid scandals and criminal charges, leading to utility reforms that lasted until the '90s and deregulation. Then, with Enron, history repeated itself.

Leaked papers set off search

Now it's PGE's dealings that are at issue.

Last year, a lawsuit filed by energy attorney Meek against PGE uncovered documents that some interpreted as showing that the utility, while an Enron subsidiary, had boosted profits while failing to pay Multnomah County taxes. Though sealed, they found their way to Willamette Week and subsequently The Oregonian.

PGE has denied the allegations, saying the e-mails have been misinterpreted. But Portland was still smarting from Enron's rejection of its bid to buy PGE in bankruptcy court in an attempt to bring down rates. So, following years of negative headlines about PGE, including that the utility had failed to pay state and federal taxes, the latest allegations struck a nerve.

Commissioners Erik Sten and Leonard set off to probe the tax issue, and also to see if PGE's dealings with Enron — schemes with names like "Death Star" and "Ricochet" — had led to higher, unjustified rates charged to Portlanders. Maury Galbraith, an Oregon Public Utility Commission economist, echoed other economists who told the Tribune that PGE's denials notwithstanding, it's plausible, even probable, that the deals PGE engaged in did, in fact, help inflate the market. The question that's more difficult to show is by how much — let alone whether McCullough and his colleagues can prove it. Galbraith thinks the deals probably had a small impact on rates.

McCullough, however, says that while comparing PGE's records to Enron in a preliminary scan, he and his team have found "anomalies" that suggest the questionable deals may be more extensive than anyone has yet realized.

Determining the truth, he says, will depend on whether PGE supplies more information — and even then it won't be easy.

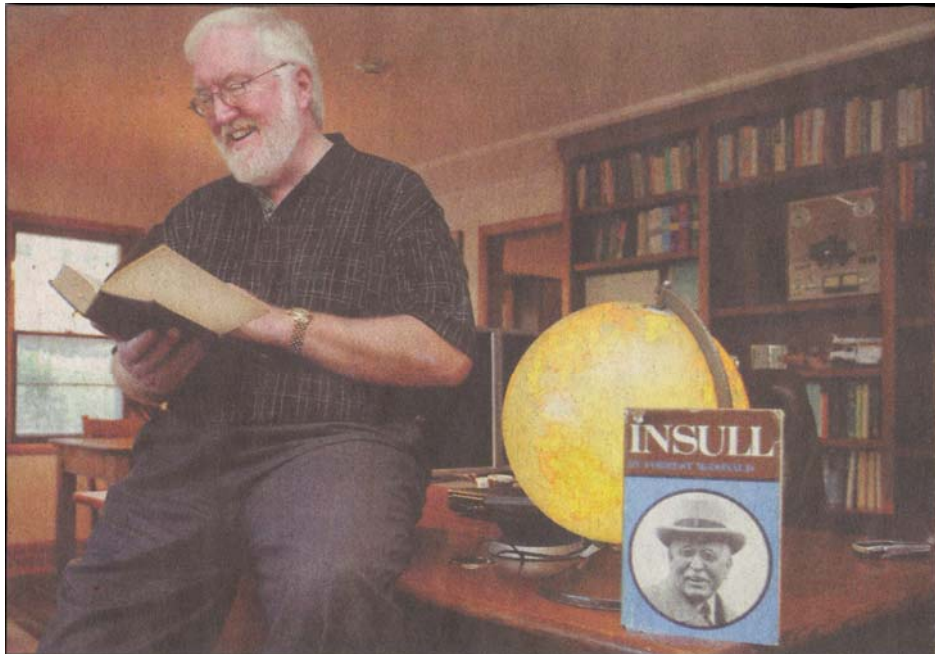
"The fact of the matter is, proving white-collar crime is astonishingly difficult," McCullough says.

Critics, such as Melinda Davison, an attorney who represents PGE's industrial customers, says she thinks the city should instead be putting McCullough to work helping her at the state Public Utility Commission in an upcoming rate hearing, thus helping all PGE customers see their rates reduced, not just Portland's. "We would welcome their assistance in looking at all aspects of PGE's rates to make sure that they are fair, just and reasonable."

Leonard says appealing to the PUC is pointless because state regulators have left PGE off the hook in the past. "If I was PGE, I would say the same thing, because they've been able to get away with some of these issues ... without the PUC catching them."

Citing PGE's 2001 rate hike of 51 percent for businesses, Leonard says the city has a duty to figure out if it's being ripped off. And, he says, the guy he met under such unusual circumstances three weeks ago is just the guy to do it.

"He's brilliant," Leonard says. "More than once I've thought, 'How did we not know about this guy before we hired him?' It's amazing."



TRIBUNE PHOTO: L.E. BASKOW

Robert McCullough knows the utility industry in and out, collecting books and lore about its players. A favorite tome in his library profiles Sam Insull, president of Chicago Edison Co. in the early 1900s and a brazen businessman.