



Portland General Electric Company
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March 19, 2012

Via Electronic Filing and U.S. Mail

Oregon Public Utility Commission
Attention: Filing Center
550 Capitol Street NE, #215
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Re: UM 1182

Attention Filing Center:

Enclosed for filing in the captioned docket are an original and five copies of:

▪ **COMMENTS OF INVESTOR-OWNED UTILITIES**

This is being filed by electronic mail with the Filing Center. An extra copy of the cover letter is enclosed. Please date stamp the extra copy and return to me in the envelope provided.

Thank you in advance for your assistance.

Sincerely,

A handwritten signature in black ink, appearing to read "V. Denise Saunders", written in a cursive style.

V. DENISE SAUNDERS
Associate General Counsel

VDS:cbm
Enclosures
cc: UM 1182 Service List

**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON**

UM 1182(2)

In the Matter of)	
PUBLIC UTILITY COMMISSION OF)	COMMENTS OF INVESTOR- OWNED UTILITIES
OREGON,)	
Investigation Regarding Competitive Bidding)	

In accordance with the February 22, 2012, Status Report submitted by the Staff of the Oregon Public Utility Commission (OPUC or Commission), Portland General Electric Company (PGE), PacifiCorp and Idaho Power Company (collectively the Investor-Owned Utilities or IOUs) submit these recommendations on how to proceed in this docket.

I. Background

In its Order No. 11-001, the Commission reopened Docket UM 1182 to further examine issues related to the Competitive Bidding Guidelines adopted by the Commission in Order No. 06-446.¹ The Commission identified three specific issues to be addressed. This phase of the docket addresses the third issue: a “determination of the appropriate analytic framework and methodologies to use to evaluate and compare resource ownership to purchasing power from an independent power producer (Guideline 10(d)).”² Specifically, the Commission stated that it wants a “more comprehensive accounting and comparison of all of the relevant risks, including consideration of construction risks, operation and performance risks, and environmental

¹ *In the Matter of the Public Utility Commission of Oregon Investigation Regarding Performance-Based Ratemaking Mechanisms to Address Potential Build v. Buy Bias*, Docket No. UM 1276, Order No. 11-001 at 6 (Jan 3, 2011).

² ALJ Prehearing Conference Memorandum at 1 (Jan 26, 2011).

regulatory risks.”³ The Commission stated that it wants “more in-depth analysis of all of these risks and invited comment on the analytic framework and methodologies that should be used to evaluate and compare resource ownership to purchasing power from an independent power producer.”⁴

At a workshop on November 18, 2011, the parties agreed on a list of twelve factors that might be appropriate for consideration in evaluating the risks and advantages of utility-owned resources compared to those offered by other bidders, such as independent power producers (IPPs) in a competitive bid evaluation process. The parties then participated in a workshop on February 9, 2012, at which they unsuccessfully tried to reach agreement on identifying three factors, from the original twelve, for in-depth consideration. As indicated in the February 22, 2012, Staff Status Report, the parties agreed to submit comments with their respective recommendations on how the Commission should proceed in this docket.

As discussed more fully below, the IOUs believe that the parties should initially focus on analyzing no more than three key factors. We believe a limited focus on these key factors will allow the parties to work more efficiently and expeditiously, and the outcome of this initial effort will help the Commission evaluate whether or not analysis of the remaining issues is warranted. We also believe that the initial list of factors must include a broad assessment of counterparty risk because this risk affects virtually all of the other factors on the list and can have a significant impact on customers. The initial list should also include an examination of asset residual or “terminal value,” which can also have significant customer effects and can be quantitatively determined using established financial valuation methods. We also take the opportunity to identify some fundamental issues that should be considered in an analysis of any of the factors.

³ Order No. 11-001 at 6.

⁴ *Id.*

Finally, we reiterate our concerns that contested case procedures will be necessary if there are any disagreements as to fact or expert opinion related to any analytic framework. We therefore encourage the Commission to consider directing the parties to initially attempt to develop a conceptual framework or set of policy recommendations, in lieu of a specific analytic framework, to assess the relative risks and benefits to customers of utility-owned resources and contracts in the competitive bidding process. We have included as Attachment A, a chart assessing the potential for formulaic examination for each of the factors identified by the parties.

II. The Commission Should Direct the Parties to Start with No More than Three Issues

Developing an analytic framework for evaluating any of the factors identified by the parties will not be easy or quick. For many issues, the process will be complicated by an inability to find and/or process relevant data, achieve consensus regarding key assumptions and methodologies, and to agree on outside expert opinion and analysis. We believe that there may be other ways of comparing IPP and utility-owned generation that do not require analyzing irrelevant data or expert opinion and we discuss these in Part IV of these comments. However, if the Commission determines that the parties should continue to pursue an analytic approach, then we believe the process is likely to be more efficient and expedient if the parties initially focus on no more than three factors.

In an attempt to identify which factors may be good candidates for initial consideration, Attachment A indicates for each factor whether there is customer exposure under utility-owned generation and a purchased power agreement (PPA),⁵ whether the economic significance of the factor is high, medium or low, whether there is relevant data available to support a quantitative assessment, and whether a viable analytical approach exists. As discussed below, we believe

⁵ The term "PPA" is intended to include any contract for the purchase of capacity, energy or the lease of a generation facility or equipment owned by an IPP.

that counterparty risk and residual / terminal value should be on the initial list of factors to consider. Counterparty risk should be considered initially because it impacts virtually all other factors on the list and because it can have significant economic consequences for customers. We also believe that terminal value should be included in the initial list of issues. Like counterparty risk, it can have significant economic impacts on customers. Residual / terminal value associated with generation sites can also impact the long-term (inter-generational) value and stability of the utilities resource portfolio. In addition, because it is a widely recognized and applied financial concept, the parties will have established quantification methods that can be used to determine the economic impact associated with terminal value.

A. Counterparty Risk Should be on the Initial List of Factors

The IOUs believe that counterparty risk should be included on the initial list of factors to be considered in this phase of the docket. There are two primary aspects of counterparty risk, both of which can have significant impacts on the utility and its customers. The first is the risk that a counterparty will become unwilling or unable to perform some or all of the provisions of a specific contract due to a change in circumstance that adversely impacts the economics of the transaction. This risk is referred to as transaction-specific risk. This could happen, for example, when a counterparty encounters a problem with the development or construction of a new generation project (e.g., inability to obtain all necessary permits or acquire acceptable financing), but is able to void contract effectiveness, or avoid performance requirements and/or damages through a condition precedent clause (these are common provisions in contracts associated with generation projects that are not yet built). Similar contractual claims that excuse performance exist for significant and unforeseen problems that could be encountered for a contract with an existing generator (e.g., force majeure). Another example is a no damages provision that excuses

performance, provides for a change in pricing and/or allows for a no damages termination if a significant, unforeseen event such as a change in environmental law or regulation is encountered. This type of provision is becoming more common in long-term wholesale energy contracts to address the potential for significant changes in future environmental regulations (e.g., regulations pertaining to CO₂ and greenhouse gas emissions).

The second primary area of counterparty exposure is financial risk – the risk that a counterparty will no longer be able to fulfill many or all of its contract obligations due to insolvency or a material deterioration of the organization’s financial condition.⁶ This type of counterparty risk is commonly referred to as “Credit Risk.”

Counterparty risk underlies virtually all of the other factors identified by the parties. For example, in the case of unexpected capital additions, there may be a risk that an IPP has the contractual ability to terminate, renegotiate, or pass the cost through to the buyer under a PPA if a major non-elective capital addition is required on the generation resource underlying the PPA.⁷ Even in the absence of such contractual rights, it would be important to evaluate the risk that, if the cost of a capital addition is large enough, the counterparty could elect to breach the agreement, initiate a legal dispute or be forced to file for bankruptcy. In other words, because IPPs are typically not regulated by the Commission, an IPP’s guarantee to keep the utility and its customers insulated from any unexpected cost or supply deviations is only as good as the level of collateral offered by the counterparty or its parent company and the ability of the utility to perfect its security rights in a legal proceeding. Even if a selling counterparty was large enough and exhibited the financial wherewithal to insulate a purchasing utility from all of the risks

⁶ It is common that an IPP will form a limited liability corporation (LLC) and place the assets underlying a PPA in the LLC. By doing so, the IPP / parent company is protected should the LLC fail.

⁷ Costs determined as prudent that are passed through to the utility, as buyer, would subsequently be passed through to customers.

associated with the generation and delivery of electricity, no prudent organization would do so. If adverse circumstances encountered by the seller / generation owner resulted in significant financial losses due to continued contract performance, elective or forced default would likely occur.

We must also keep in mind that wholesale energy contracts provide for a monetary remedy (financial damages); therefore the equitable remedy of specific performance generally will not be available for the purchaser to compel the seller to continue to deliver electricity or capacity in accordance with the terms of the agreement. Since typical PPA credit and collateral provisions only account for a portion of the full financial risk of replacing a long-term, significant contract, utility customers would ultimately bear both the supply and financial risk of counterparty performance failure and default.

The same types of risks apply to contractual provisions related to cost overruns, operation and maintenance (O&M) increases, changes in outage rates, production forecasts, heat rate changes, and changes in laws or regulations. These risks last throughout the term of the contract and can be substantial. If a utility has relied upon a PPA to supply its customers, and that supply source is disrupted or terminated, then the utility's customers are exposed to potentially large additional costs for acquiring replacement power, and in extreme cases may even be subject to loss of power.⁸

We believe this factor is one that could possibly be resolved without a strict analytic framework. However, if necessary, relevant data for evaluating counterparty risk exists. For example, it may be possible to estimate the frequency with which contracts fail or are renegotiated due to changes in seller circumstances. It is also possible to find data on

⁸ While a utility may have financial performance assurance provisions in a PPA, the performance assurance is never a perfect hedge and typically does not provide the utility adequate rights to prevent loss of power.

bankruptcies for organizations in the wholesale energy markets. Some data sources include regulatory files (lists of advice letters related to procurement including contract cancellations and renegotiation) or bankruptcy case histories.⁹

Given the potential impacts on customers and the relative significance of the risk as compared to all other factors identified by the parties, we believe that counterparty risk should be included on the initial list of factors to be examined.

B. Terminal Value Should Also be on the List of Initial Factors

Another important factor that should be initially evaluated relates to the residual or “terminal” value of a generation resource. Terminal value measures the remaining economic value of a long-term asset such as a generation project. This residual value includes the project assets / attributes that exhibit useful lives and economic benefits beyond the estimated life of the generator, including site characteristics and long-lived supporting infrastructure associated with the plant (i.e., natural resources / land, leases, permits, buildings, pipelines, transmission and inter-connection facilities). In particular, the underlying site control / access via leases and / or owned land rights can extend well beyond the initial estimate for the expected life of the generator(s). Terminal value can also include the value of continuing to operate the generator beyond the originally projected useful life of the asset. It is not un-common for utility generation assets to continue beneficial operations long after their initial “book life.” In the case of generation tied to natural resources such as hydro, wind and other renewable resources, there is inherent value in the site itself (windy location, water flows suitable for hydro generation, high solar insolation, etc.). These “high value” renewable resource locations are often scarce or unique in their suitability for generation permitting, construction and proximity to transmission

⁹ Copies of actual PPAs would also be helpful to document the risks that IPPs demonstrably absorb or whether IPPs typically reserve rights to renegotiate or terminate PPAs. However, in light of NIPPC’s refusal to provide its members’ PPAs, we believe the issue can be analyzed with the sources we have identified.

facilities. For a renewable resource, residual value would also include the associated future renewable energy credits and any other environmental attributes. Given the increasing Renewable Portfolio Standards (RPS) in Oregon and around the region, the residual value of renewable resources could be increasingly valuable to customers in the future.

As it relates to this docket, terminal value represents the benefit to customers when the utility holds the rights to the future value associated with the generation project and site. In other words, when comparing a long-term PPA to a utility-owned resource, any analysis must consider whether the customers will retain something of value at the end of the PPA term or estimated useful life for the utility-owned generation.¹⁰ These benefits can be significant. The IOUs' expiring Mid-Columbia (Mid-C) hydro generation agreements are a good example of the difference in residual value between a contract resource and a utility-owned resource. The IOUs do not retain the "terminal value" of these long-lasting, highly valuable hydro resources on behalf of its customers once the contracts end. Instead, this value will accrue to the project owners. The useful life and economic benefit of the generation projects will extend well beyond the term of the IOU contracts, despite the fact that the Mid-C agreements were very long in duration.

The issue of who holds the future / residual value (terminal value) associated with electric generation, the utility for its customers or the IPP for their shareholders, impacts future generations. Understandably, an IPP does not want to relinquish terminal value in a PPA because it represents future shareholder value. Just as understandably, a utility (the buyer) wants to hold the terminal value because it represents future value (benefit) for customers.

¹⁰ The terminal value of utility-owned assets is inherently held by the utility, for the benefit of customers. If desired by the Commission, each utility can provide examples of hydro or thermal assets or PPAs where customers have benefited by the utility holding the terminal value.

The remaining worth of assets and their associated attributes is a concept widely used in the financial industry. Parties can provide evidence of established quantification methods that can be used and considered by the Commission during this docket. In addition to more traditional discounted cash-flow (DCF) and real-option methodologies, market indications of generation terminal value may also be obtained through future request for proposal processes where sellers provide bids for both a PPA and asset sale for the same project.

The core issue of terminal value as it relates to generation resource evaluation and selection is what party receives the benefit of the asset's residual value. Customers inherently receive the benefit of terminal value when the cost of utility-owned generation is included in rates. Therefore, in order to fairly compare the benefits and risks of the utility-owned resource vs. a PPA, residual value (or absence of residual value) must be considered. In the case of a typical long-term PPA, the utility and its customers provide the revenue stream that enables the underlying generation assets to be financed; however, at the end of the PPA term, they receive no further benefit. In short, because terminal value can have significant customer effects and can be quantitatively determined using recognized financial valuation methods, it should be included on the initial list of factors to be considered in this docket.

III. Elements Necessary for a Fair and Accurate Comparison

Regardless of which issues the Commission chooses to address, there are certain elements that are essential to conducting an in-depth analysis of the risks associated with PPAs and utility benchmark resources. These elements are:

- The analysis must examine data for executed PPAs as well as contemporary examples of benchmark resources

- The data analyzed must be relevant (e.g., in terms of timeframe, markets, regulatory environment) for the purpose of a Commission decision impacting future processes
- Benefits to customers as well as downside risks must be considered

A. Data Pertaining to PPAs as well as Benchmark Resources Must be Considered

An analytic framework for comparing utility resource ownership to various forms of PPAs with an IPP will necessarily need to use data pertaining to executed IPP contracts, as well as relevant examples of utility-owned resources. It is impossible to compare two resource procurement alternatives when you have data for only one of the alternatives. This means the parties will need to examine actual IPP data for any factors analyzed in order to draw well-reasoned conclusions. For example, a comparison of the relative risks associated with increases in O&M costs will have to consider any provisions in IPP contracts that identify how such risks are allocated, such as change in law provisions under which the utility-buyer bears the risk of cost increases associated with environmental regulations or provisions that transfer the risk of additional wear and tear costs associated with dispatch to the utility-buyer. Similar types of contractual provisions should be considered for issues related to changes in outage rates, terminal value, other end-effects, cost over- and under-runs, capital additions, heat rate degradation, or other performance factors (e.g., capacity factors for variable energy resources).

Unfortunately, while the IOUs, in response to requests from NIPPC, have provided utility plant data dating back to 1990, NIPPC has stated that it cannot reciprocate and provide the IOUs with any of the PPAs that its members have executed.

NIPPC seems to believe that we can obtain sufficient contractual data from the standard templates used in RFP filings or in IPP contracts that the three utilities in this docket have

executed. The contract templates included in RFP filings are not the final agreements executed by the parties and are expressly subject to change during the RFP process.¹¹ Therefore contract templates do not provide an accurate source of information with respect to actual PPA terms and risk / cost allocation. Their terms, particularly many of the terms relating to the issues identified in this docket, are often heavily negotiated. NIPPC has advocated utilizing historic data to determine the amount of bias, if any, for the issues identified. Unless a PPA utilizing the standard template is actually executed, without change, no such historic data would exist.

We believe that the Commission desires a better understanding of *actual* risks and benefits associated with IPP contracts and cost-based benchmark resources. To that end, actual contracts must be used to identify and analyze the risks and mitigations connected with PPAs.

NIPPC has made some bold assertions about the risks that IPPs will absorb, but has thus far refused to make the actual content of contracts available so the IOUs can validate NIPPC's verbal claims. The IOUs believe that analyzing the risks associated with actual executed contracts is the best way for the Commission to obtain the answers and evidence it seeks. A subset of such contracts will only provide a partial picture. Absent demonstrable contractual evidence, the only way to assure that customers receive the risk mitigation benefits that NIPPC claims the IPP market will provide in a PPA is to incorporate such provisions as non-negotiable terms and conditions in standard contract templates for use during future procurement processes.

¹¹ PGE's draft RFP for Power Supply Resources filed in Docket No. UM 1535 states "[f]or purchase agreement proposals, Bidders must use one or more of the purchase agreement templates included in this RFP, and must include any proposed revisions to the contract (shown in red-line) as part of their response package to this RFP. PGE will evaluate all proposed revisions, but is under no obligation to accept any revisions or adopt any changes. Changes, if any, to terms and conditions or revisions to the templates will be discussed with Bidders selected for post-bid negotiations." *PGE's Draft 2011 RFP for Capacity Power Supply Resources*, OPUC Docket No. UM 1535 at 18 (January 25, 2012).

B. The Data Used Must be Relevant

When analyzing risks associated with PPAs and benchmark resources, it is important that the data used be relevant. For example, NIPPC has provided the other parties with a paper, prepared by an outside consultant, which purports to analyze cost overruns based on nine plants built in California – a different regulatory jurisdiction with different rules governing resource development. We believe that any data used in developing an analytical framework needs to be relevant to resource development in Oregon (i.e., resource development included in rates in Oregon). Similarly, the data must be historically relevant. We note that NIPPC requested plant data from the IOUs as far back as 1990. We question whether data originating as far back as 1990, before the competitive bidding requirements existed and in a non-contemporary commercial environment, will be relevant enough to allow the Commission to render a decision that impacts future competitive bidding processes. It is also important to consider that the operational environment in the region is evolving to meet the system needs and challenges of increasing levels of variable energy resources. As a result, Balancing Authority requirements and market design changes are forcing wholesale energy buyers and sellers to incorporate new standards, terms and conditions that address increasing flexibility needs (e.g. dynamic transfer capability). The evolving regional operating and market environment makes it more challenging to rely too heavily on historical contracts as a basis for accounting for the risks associated with future PPAs or utility-owned resources.

We note that an analysis of wind capacity factor projections presents a particularly challenging issue with regard to obtaining relevant data. Because wind energy is still a developing industry in this region with a relatively short operational history, all developers of wind-powered generation resources have experienced continuously evolving wind assessment

methodologies.¹² Due to several wind industry trends, wind assessment methodologies have evolved over time to keep pace. These trends include, among others, larger wind turbines, an accelerated development pace, and growth in the size of a typical wind project. The wind assessment methodologies utilized for previously developed utility-owned and PPA wind resources currently in the utilities' portfolios is less evolved than the methodologies that will be applicable for future competitive procurement processes. We have included as Attachment B a presentation to the American Wind Energy Association that describes the industry-wide issue related to wind project capacity factor estimates in detail. We note that because this is an industry-wide issue, it affects both utility-owned generation, as well as IPP-owned generation. In addition, it is not unusual, during a competitive procurement process, for the buyer to retain a consultant to independently evaluate the long-term normalized annual production estimate¹³ for each alternative so that each normalized estimate is evaluated on a like basis using consistent methodologies. This gives further reason that issues related to wind capacity factors need not be addressed at this time and, indeed, are best addressed as a procedural practice during each procurement process.

In short, because any data analysis of this issue would require use of past data that is not applicable going forward, we do not think issues related to wind capacity factor lend themselves to analysis at this time.

C. Where it Exists, Customer Benefits as well as Risks Should be Analyzed

Many of the issues identified by the parties offer the potential for both customer benefit and risk. For example, while there is the risk that the initial construction cost of a power plant may be greater than the cost estimate of a utility benchmark bid or the cost estimate that

¹² How variance in normalized forecast versus actual wind generation is incorporated into rates is a function of utility specific rate making proceedings and not the competitive bidding process.

¹³ The normalized production estimate for wind projects is often referred to as the probability fifty (P50) estimate.

underlies a PPA proposal, there is also the potential benefit that the actual construction cost will be lower than the initial cost estimate. In particular, market advancements with respect to engineering, procurement, and construction (EPC) contracts have substantially reduced the risk of construction cost delays and over-runs for new generation projects – both for IPPs and utilities. Today’s large and financially strong EPC firms and turbine manufacturers provide “full-wrap,” fixed price bids for power plant construction that contain robust performance guarantees and damages provisions. These contracts largely insulate the utility and its customers from delays in plant completion construction cost over-runs. On the other hand, if the actual construction costs are less than the original estimate, customers receive the full benefit in the case of a cost-based utility-owned resource. However, the same benefits would not be passed on to utility customers under a PPA. A similar dichotomy exists with regard to changes in online dates, forced outage rates, expected O&M costs, production estimates, end-effects, heat rate degradation and changes in ROE. Another category from which customers can benefit is unexpected beneficial changes in tax laws or accounting treatments. Examples include tax credits and/or beneficial depreciation schedules. For all of these issues, the possibility that costs, benefits and performance will be underestimated (reducing costs to customers) as well as overestimated (increasing costs to customers) would need to be considered.

IV. Contested Case Procedures May Be Necessary to Fully Consider Disagreements About Facts or Expert Opinions. Alternatively, it May be Possible to Develop Conceptual Framework or Policy Recommendations without Using Contested Case Procedures.

In their comments filed as an attachment to Staff’s Report on the Status of the Docket on January 3, 2012, the IOUs indicated that if the issues raised in this docket require a determination of fact or will rely on expert opinion, then the Commission should provide the highest level of

scrutiny to any contested facts or expert opinions before issuing a decision.¹⁴ The IOUs suggested that, in such case, the Commission should employ the procedures used in contested case proceedings, including reasonable discovery, testimony and cross-examination, to resolve any issues upon which the parties cannot agree. Given the issues that exist with regard to data collection, data usage and the inability of the parties to reach consensus on a process for moving forward in the docket, we increasingly believe that contested case procedures will ultimately be needed if the Commission desires to adopt a fair and adequate analytic framework for use in future competitive procurements.

On the other hand, as suggested in our filing, we believe that it may be possible to develop a conceptual framework for analyzing PPA and utility resources or, alternatively, to develop a set of policy recommendations to address any perceived bias without using contested case procedures. The development of conceptual or policy approaches would avoid the issues the parties have already encountered with developing an adequate and relevant data set and, because such conceptual approaches are not likely to depend on factual assumptions or expert testimony, could avoid the necessity to employ contested case procedures. We encourage the Commission to allow the parties to submit proposals for a conceptual framework or policy recommendations on any of the issues, prior to attempting to develop an analytic framework.

V. Conclusion

In conclusion, the IOUs encourage the Commission to direct the parties to focus on initially no more than three factors and to include counterparty risk and terminal value on the initial list. We also believe it may be more effective and efficient to develop a conceptual framework or policy recommendations, instead of a strict analytic framework, for most of the factors. We encourage the Commission to ask the parties to determine whether such conceptual

¹⁴ Staff's Status Report at 20 (January 3, 2012).

or policy approaches are possible, prior to attempting to develop an analytic framework for each of the factors.

DATED this 19th day of March, 2012.

Respectfully submitted,



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CERTIFICATE OF SERVICE

I hereby certify that I have this day caused **COMMENTS OF INVESTOR-OWNED UTILITIES** be served by electronic mail to those parties whose email addresses appear on the attached service list for OPUC Docket No. UM 1182.

Dated at Portland, Oregon, this 19th day of March, 2012.



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