State of Utah
Department of Commerce
Division of Public Utilities

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MEMORANDUM

To: Public Service Commission

From: Chris Parker, Director
Artie Powell, Energy Section Manager
Carolyn Roll, Utility Analyst
Joni Zenger, Technical Consultant
Thomas Brill, Technical Consultant

Date: March 31, 2011

Re: Docket No. 09-035-23, Division's Audit of PacifiCorp's 2010 Fuel Inventory Policies and Practices

RECOMMENDATION

The Division has reviewed PacifiCorp's (the Company) fuel inventory policies and procedures and finds that the Company has adhered to the Commission's directive in this docket. No further action is required.

ISSUE

In the course of the general rate case proceedings in Docket No. 09-035-23, and as a result of the Electric Lake Settlement in February of 2008, the Division raised the issue of the appropriate coal inventory levels that the Company should maintain at its Utah plants.[1] The Division noted that a review of the Company's coal procurement policies and practices had not been conducted

[1] Docket No. 09-035-23, Direct Testimony of Michael J. McGarry, Sr., DPU Exhibit 3, October 8, 2009.

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for more than fifteen years.[2] As a result, the Commission determined that the Company should have a regularly reviewed and updated Company Coal Policy in place. In its Report and Order the Commission stated the following:[3]

> We direct the Division, beginning in 2011, to conduct an annual audit of the Company's fuel inventory management policies, procedures, and actual practices and provide a summary of its audit and associated findings to the Commission by no later than March 31 of each year for the previous year's activity.

This memorandum is in response to the Commission's directive. The Division has reviewed the Company's 2010 fuel management policies, procedures, and actual practices and provides this report to the Commission. This report does not preclude the Division's analysis of coal inventory levels or any associated net power costs issues and making further recommendations in the current general rate case, Docket No. 10-035-124.

DISCUSSION

In conducting its audit, the Division met with the Company's Fuel Resources Department on February 16, 2011 and again on February 22, 2011. At the meetings, the Division discussed in detail the assumptions and inventories at each of the Company's owned and affiliate plants The Division reviewed confidential documents at both meetings, including PacifiCorp's Coal Inventory Policies and Procedures (the Manual) dated September 30, 2010, signed by Ms. Cindy A. Crane, Vice President of Interwest Mining & Fuels (the Company's Fuels Department).

The Division notes that the Company retained Pincock, Allen & Holt (PAH) to analyze the coal inventory policies associated with its plants in Utah and Wyoming. The PAH assignment resulted in two separate reports. The first report (Phase I of the assignment) dated August 13, 2009, addressed the Carbon, Huntington, and Hunter plants in Utah.[4] The second report (Phase

[2] Confidential Response to DPU # 26.4, September 18, 2009. (In 1991 and in 1995 Energy Ventures Analysis, Inc. was retained by an inter-jurisdictional task force to review PacifiCorp's coal procurement policies and management practices.)
[3] Docket No. 09-035-23, Report and Order on Revenue Requirement, Cost of Service and Spread of Rates, February 18, 2010, p. 106.
[4] Coal Inventory Policies for Coal-Fired Power Plants in Utah, PAH, dated August 13, 2009.

II) dated January 28, 2010, covered the Wyodak, Dave Johnston, Jim Bridger, and Naughton plants in Wyoming.[5] The Division reviewed both confidential consultant reports. Although the Company has interests in the Cholla plant in Arizona and the Craig and Hayden plants in Colorado, these reports were targeted to be Phase III and Phase IV of the PAH assignment. For the jointly owned plants, PacifiCorp is a minority owner. The inventory levels for these plants are determined collectively by the plant owners. At this time the Company has not completed Phases III and IV of the assignment.

Lastly, the Division reviewed spreadsheets containing inventory data for each plant. We looked at both historic and average stockpile levels, compared these to the Company's targeted inventory levels, and determined if the Company met its targeted levels. The Division also ensured that the Company has in place tracking and monitoring requirements associated with its policy.

FINDINGS

First, the Division determined that the Company's goal and commitment to provide low-cost power to its customers drives its fuel procurement practices. The Company's Manual states that the Company's strives to optimize delivered fuel costs and ensure supply reliability, while providing appropriate fuel supplies and qualities based on the particular needs at each generating plant. The objectives the Company's fuel management activities as presented in the Manual are to provide the lowest cost of fuels over the long run, maintain adequate inventory levels at each thermal generation station, and build a portfolio of fuels. Consideration is given to the delivered cost of fuel, reliability of supply, fuel quality, environmental impact, financial or risk exposure, operational cost, transportation, and flexibility.[6]

[5] Coal Inventory Policies for Coal-Fired Power Plants in Wyoming, PAH, dated January 28, 2010.
[6] PacifiCorp's Confidential Coal Inventory Policies and Procedures, September 30, 2010, p. 4. (Here and elsewhere in the Division's Audit report, the Division paraphrases the Company's Manual to protect confidential information.)

Second, the Division identified many issues that affect the Company's inventory and procurement policies. These include: coal quality degradation, geologically complex mines, the dynamics of the coal industry, and changes in mining regulations due to increased safety concerns. Each of the coal basins is managed as a system, although each coal basin is unique. Therefore, the Company employs a diversified coal supply strategy, particularly for its short-term strategy. This is due to a decrease in coal suppliers, the need to blend lower-quality coal with higher-quality coal in order to get optimized fuel burn, plant outages, higher rail rates, higher spot coal prices, and third-party coal contract revisions, re-openers, or escalation clauses.

In 2010 the Company dealt with problems such as derailment of planned coal deliveries, extreme temperatures making it difficult if not impossible to unload frozen trains, mine closures, difficult access to the nearest alternative coal supply, and a geological slide at one of the Company's mines. In addition, the Company had to back down coal-fired generation due to the increase in wind resources. This equates to reduced levels of coal. At times actual generation fell below budget levels at the non-Company owned plants, which resulted in inventory levels being over target. The Company is tracking and monitoring all of these issues in its policies for procurement and for establishing stockpile target levels at each plant.

In the longer term the Company is factoring, in its analyses and planning, upcoming labor negotiations, long-term basin depletion, coal quality, the financial stability of coal companies in Utah, and the fact that the market is not liquid.

With respect to the previously mentioned PacifiCorp consultant reports, the consultant reports recommended maintaining coal inventory levels of two to three months at its three Utah plants and a somewhat lower range at its four Wyoming plants. The Utah consultant report also considered potential coal supply disruption scenarios, such as a mine disaster resulting from natural causes such as earthquakes or landslides or due to labor disputes. The consultant reports identified high operating levels, matched with highly variable coal supply, given an admittedly rare mine disaster leads to relatively high recommended inventory levels.

PacifiCorp's consultant used an inventory simulation model that covers each day of a one-year period. An analysis of coal inventory policy involves five steps: 1) developing a quantitatively accurate inventory model; 2) quantifying typical fluctuations in coal delivery and consumption and how they affect prudent inventory levels; 3) assessing relatively unlikely events that affect inventory levels; 4) determine prudent coal inventory ranges; and 5) recommend appropriate plant-specific inventory policies.

During the course of the year 2010, there were a couple of plants where at times inventory levels exceeded or were below targeted inventory levels, but the Division believes that these deviations were fully explained as part of the Company's fuel management strategy and fell within the Company's policies and procedures that we reviewed.

In the past rate cases the Division has reviewed the aerial surveys and plant coal pile survey reports. The 2010 quarterly reports will be reviewed in the current rate case.

CONCLUSION

The Division finds that the Company is in compliance with the Commission's directives in its 2009 Report and Order with respect to fuel inventory policies. The Division has reviewed the Company's Manual, the third-party reports, and has conducted our own analysis of target levels versus actual inventory of coal at the Company's generation plants. The Company has adopted and implemented PAH's findings for Phase I and Phase II of its assignment into its own Manual. The Division finds that (1) the Company has formal policies and procedures in place for its fuel procurement and coal inventory levels; (2) the Company has adhered to its policies and procedures in 2010, as formally stated in its Manual; (3) the Company is in compliance with its target inventory ranges for the year 2010; and (4) the Company's policies provide the flexibility its needs to react to favorable market conditions.

The Company's Fuel Resources Department has adopted guidelines that state that the Company plans to review and revise its coal inventory Policies and Procedures when necessary and applicable or to otherwise meet its commitment to provide low-cost power to its customers through its fuel procurement practices. The Division recommends that when changes are made to the Company's Manual, the Company should forward a copy of the revised or updated Manual to the Division.

The Division also recommends that the Commission determine that the Company is in compliance with its 2009 directive. Inasmuch as the Division will perform the same or similar audit each year, the Division recommends the Commission clarify the proper docket numbering for its future annual reports to the Commission.

CC Dave Taylor, Rocky Mountain Power
Michele Beck, Office of Consumer Services