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Division of Public Utilities

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## MEMORANDUM

**To:** Public Service Commission

**From:** Chris Parker, Director  
Artie Powell, Energy Section Manager  
Carolyn Roll, Technical Consultant  
Joni Zenger, Technical Consultant  
Lane Mecham, Utility Analyst

**Date:** June 6, 2018

**Re:** Docket No. 18-035-07, Division's Audit of PacifiCorp's 2017 Fuel Inventory Policies and Practices.

### RECOMMENDATION (NO ACTION)

The Division has reviewed PacifiCorp's (the Company) 2017 fuel inventory policies and procedures and finds that the Company is in compliance with the Public Service Commission's (Commission) directive in Docket No. 09-035-23. No further action is required.

### ISSUE

This memorandum is in response to the Commission's Report and Order in Docket No. 09-035-23 that directs the Division 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.<sup>1</sup> On March 20, 2018, the Division requested an extension of time to complete this year's audit. The Commission granted the Division an extension until June 30, 2018, to complete its findings.

This memorandum represents the Division's eighth annual audit and report to the Commission. This report does not preclude the Division's analysis of coal inventory levels or any associated net power costs issues in the current Energy Balancing Account filing (Docket No. 18-035-01) or in upcoming general rate case proceedings.

## **DISCUSSION**

In conducting its review, the Division met with the Company's Fuel Resources Department on March 20, 2018. At the meeting, the Division discussed the assumptions and inventories at each of the Company's owned and affiliated plants. The Division also looked at plant deliveries, coal supply, and coal consumption at PacifiCorp's operating plants. The Division reviewed confidential documents, including the December 2017 coal inventory levels and PacifiCorp's Coal Inventory Policies and Procedures (Manual) dated March 20, 2018. The Division 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 verified that the Company has in place tracking and monitoring requirements associated with its policies and procedures. The Fuel Resources Department monitors inventory levels, and aerial surveys are performed quarterly for PacifiCorp operated coal plants.

Per the Division's recommendation in its March 31, 2014 audit report,<sup>2</sup> the Company performed an updated analysis of its current coal inventory policies and updated the stockpile target levels at its Utah and Wyoming coal operating plants. The Company retained the consulting firm Runge, Pincock, Minarco (RPM), to update the coal inventory review in 2018. RPM performed

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<sup>1</sup> Docket No. 09-035-23, Report and Order on Revenue Requirement, Cost of Service and Spread of Rates, February 18, 2010, p. 106.

<sup>2</sup> Docket No. 14-035-35, Division's Audit of PacifiCorp's 2013 Fuel Inventory Policies and Practices, March 31, 2014.

the analysis and completed its report on March 19, 2018. The Division has reviewed the report and confirmed that target inventory levels have been updated using the recommendations from that report.

## **FINDINGS**

The Division has reviewed the Company's Coal Inventory Policies and Procedures and has conducted its own analysis of target levels versus actual inventory of coal at the Company's generation plants. The Company's commitment to the goal of providing low-cost power to its customers drives its fuel procurement practices. The Company's Manual states that the Company 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.

Consideration is given to the delivered cost of fuel, reliability of supply, fuel quality, environmental impacts, financial or risk exposure, impact on operations and/or operational costs, transportation, and flexibility.<sup>3</sup>

In its review, the Division identified issues that currently affect the Company's inventory and procurement practices. These include, a decline in coal-fired generation, geologically complex mines, the dynamics of the coal industry, and environmental laws and regulations. The Company employs a diversified coal supply strategy 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, and third-party coal contract revisions, re-openers, or escalation clauses.

The Division determined that the Company is factoring in its longer-term analyses and planning for emerging environmental regulations, long-term basin depletion, coal quality, the financial stability of coal companies in Utah, and the fact that the market is not liquid. The Division notes

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<sup>3</sup> PacifiCorp's Confidential Coal Inventory Policies and Procedures, January 1, 2016 (Here and elsewhere in the Division's Audit report, the Division paraphrases the Company's Manual to protect confidential information.)

that the Company's fuel procurement policies and practices provide some flexibility in order for the Company to react to these types of changing market conditions.

The Division's audit identified the following key findings:

1. The Company has formal Coal Inventory Policies and Procedures in place that it adheres to. According to the Company's policies, the Company's goal and commitment to provide low-cost power to its customers drives its fuel procurement practices.
2. Inventory levels at most of PacifiCorp's Utah plants are at or above target levels at year end. The Division inquired with the Fuel Resources department about one plant that was slightly under the target level and was satisfied that the difference is short-term and the Company is managing it appropriately. The Division also discussed plants with above-target inventory levels and determined that, given the economic risk and tradeoffs at Utah plants, the short-term high level is justified. This is an example where the flexibility of the Company's fuel management practices proves beneficial. Other factors that continue to affect inventories at Utah plants are difficult mining conditions and steady reserve depletion. The Company expects that it will take a few years to get back to its longer-term target levels as it manages its take-or-pay contract commitments. The Company's procurement strategy protects the Company's shareholders and ratepayers from the risk of paying liquidated damages that might have otherwise been incurred.
3. With regard to the Company's southwest Wyoming plants, mine production issues were a key factor affecting the Wyoming plants in 2017. The Company established new inventory targets in 2018 and is continuing the process of gradually building inventory to meet newly established levels. The Company expects its Naughton generating Unit #3 to be closing in the near term and, as a result, is transitioning to its long-term inventory target. The Company plans to maintain its inventory levels at its transitional targets until the unit closure. In Wyoming, the Jim Bridger inventory levels were below targeted levels at year end 2017, however, the Company has a sharing agreement with the state of

Idaho on a large stockpile of coal. The Company appears to be appropriately managing the Jim Bridger inventory.

4. Powder River Basin plants continue to experience service interruptions associated with rail transportation out of the Powder River Basin. Inventory levels stayed relatively constant throughout the year despite these interruptions. Inventory levels were slightly below the target levels, and the Company will continue to increase inventory to reach its targeted levels by the end of 2018, in compliance with its Coal Inventory Policies and Procedures.
5. Inventory levels at the Company's joint-owned plants were well above target levels.<sup>4</sup> As a minority owner PacifiCorp has limited influence over the inventory levels at those plants because inventory levels are determined collectively by the plant owners. The plant owners expect the inventory levels will be within targeted levels by the end of 2018.

With respect to the Division's overall audit, the Division recognizes that the coal industry is facing unprecedented challenges that require some of the Company's coal plants to be either above or below targeted inventory levels in the short term. Where target levels are outside of the targeted levels, the Company has plans in place to bring the inventory stock into targeted levels as soon as practicable.

The Company updated its Coal Inventory Policies and Procedures in 2018 based on the analysis in the March 19, 2018 RPM report. The Division has reviewed the Policies and Procedures, dated March 20, 2018, which is the most current Manual. The Division finds that the Company is in compliance with the Commission's directive in its 2009 Report and Order with respect to its fuel inventory policies and procurement practices.

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<sup>4</sup> The Company has interests in the Cholla plant in Arizona and the Craig and Hayden plants in Colorado.

The Division re-iterates that in the Commission's August 10, 2012 letter<sup>5</sup> confirming to the Company that it had complied with its Fuel Inventory Policies and Practices, the Commission determined that the Company should provide to the Division a copy of any revisions or updates to the Manual within 60 days after the revisions. Again, the Division requests that all future updates to the Manual be provided to the Division along with a redline copy of the updates to the Manual within the 60 days, as stated in the Commission's letter.

## **CONCLUSION**

The Division concludes that: (1) the Company has formal policies and procedures in place for its fuel procurement and coal inventory levels; (2) the Company has generally adhered to its policies and procedures in 2017, and as amended with an effective date of March 20, 2018; and (3) the Company's policies provide flexibility for the Company to react to the unprecedented changes in the market that the industry faced this past year. The objectives of the Company's fuel management practices 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. The Division requests that the Company provide to the Division all future updates to the Manual, along with a redline copy of the changes that were made to the Manual within 60 days.

The Division has reviewed the Company's Coal Inventory Policies and Procedures and has conducted its own analysis of target levels versus actual inventory of coal at the Company's generation plants. The Division notes that the Company is generally in compliance with its policies and procedures or has plans to do so in the near future.

CC    Jana Saba, Rocky Mountain Power  
      Yvonne Hogle, Rocky Mountain Power  
      Michele Beck, Office of Consumer Services

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<sup>5</sup> Docket No. 09-035-23, Correspondence from Gary L. Widerburg, August 10, 2012.