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Department of Commerce Division of Public Utilities

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Memorandum

To: Public Service Commission of Utah

From: Utah Division of Public Utilities

Chris Parker, Director

Artie Powell, Manager

Doug Wheelwright, Utility Technical Consultant Supervisor

Joni S. Zenger, Utility Technical Consultant

David Williams, Utility Analyst

Date: March 31, 2020

Re: **Docket No. 20-035-12**, Division's Audit of PacifiCorp's 2019 Fuel Inventory Policies and Practices.

Recommendation (No Action)

The Utah Division of Public Utilities (Division) has reviewed the 2019 coal fuel inventory policies and procedures of PacifiCorp (the Company) and finds that the Company is generally 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.¹ This memorandum represents the Division's tenth 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 cost issues in future Energy Balancing Account filings, or in upcoming general rate case proceedings, including the currently noticed general rate case proceeding.²

Discussion

In conducting its review, the Division met with the Company's Fuel Resources Department on March 13, 2020 via conference call. At the meeting the Company and the Division discussed the assumptions and inventories at each of the Company's owned and affiliated coal plants. The Division also looked at plant deliveries, coal supply, and coal consumption at the Company's operating plants. The Division reviewed confidential documents, including the December 2019 coal inventory levels and PacifiCorp's Coal Inventory Policies and Procedures, dated March 13, 2020 (the 2020 Policies and Procedures Manual).

The Company regularly contracts with a third-party consultant to review the Company's coal inventories and determine if the target ranges for each plant are adequate to ensure an economic and reliable supply of fuel to the generating stations. An update to the third-party review is particularly important when there are changes to coal market conditions, such as bankruptcies, changes in coal quality, transportation disruptions, labor disputes, changing generation requirements, and early plant retirements. The most recent third-party review was performed by the consulting firm RPMGlobal (RPM). RPM published its updated review on March 19, 2018. The Division reviewed the 2018 RPM Report in its 2019 audit of PacifiCorp's 2018 fuel inventory policies and practices, as well as its review in this 2020 audit.

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

² Docket No. 20-035-04, Rocky Mountain Power's Notice of Intent to File a General Rate Case on or about May 5, 2020, and Request for Approval of Test Period, January 17, 2020.

For the review of 2019 inventories, the Company provided the end-of-year inventories at each plant, as well as both the previous year's targets and any new adjusted targets. The Division looked at both historical and average stockpile levels, compared to the Company's targeted inventory levels and determined whether the Company met its targeted tonnage levels and days' worth of inventory (days' burn) at each respective coal generating plant. The targeted fuel inventory levels and days burn are based on recommended target levels that were determined in the analysis contained in the RPM Report. The Division verified that the Company has tracking and monitoring requirements in place that correspond with its policies and procedures. The Fuel Resources Department monitors inventory levels, and aerial surveys are performed quarterly for the Company's operated coal plants to determine the stockpile amounts.

The Commission's Report and Order in Docket No. 09-035-23 states the following goals of the Company's coal inventory policy:

The policy should provide an overall management strategy, flexibility to react to favorable market conditions, documentation requirements for deviations from the policy with an assessment of the costs and benefits associated with deviations, and tracking and monitoring requirements. In response to this policy, the Division should, during the course of its annual auditing, review inventory levels and compliance with inventory policies.³

The Division has reviewed the following documents:

- The 2020 Policies and Procedures Manual (confidential)
- The PacifiCorp Coal Inventory Confidential Review of 2019 Inventory Levels with the Division of Public Utilities, March 13, 2020 (the Review of 2019 Inventory Levels) (confidential)
- The Coal Inventory Study for Coal-Fired Power Plants in Wyoming and Utah, March 19, 2018 (the 2018 RPM Report) (confidential)
- Other materials provided by the Company (confidential)

³ Docket No. 09-035-23, Report and Order on Revenue Requirement, Cost of Service and Spread of Rates, February 18, 2010, p. 105.

Findings

The Company's Coal Inventory Policies and Procedures manual (Policies and Procedures Manual) is updated each year. This year's manual, the 2020 Policy and Procedures Manual, is dated March 13, 2020. The 2020 Policy and Procedures Manual states that a guiding strategy of coal inventory management is "to provide low cost power to its customers." More specifically, the objectives include providing the lowest cost fuels over the long run, maintaining adequate inventory levels at each plant, and managing a complex portfolio of fuels at each plant.⁴

In its review, the Division considered issues that currently affect the Company's fuel inventory levels and its procurement practices. These issues include the following:

- A decline in coal-fired generation and correspondingly lower average capacity factors;
- The risk profile of geologically complex mines and mine sources;
- The dynamics of the coal industry, including transportation issues, bankruptcies, and future plant closures;
- Contract specifics (such as take-or-pay contracts, contracts which allow purchasing flexibility, etc.); and
- Environmental laws and regulations, including the uncertainty of current environmental policies and regulations.

The Company employs a diversified coal supply strategy, planning for and managing a multitude of factors, including a decrease in coal production, the shrinking number of coal suppliers, the need to blend lower-quality coal with higher-quality coal in order to get optimized fuel burn, temporary planned and unplanned plant outages, the possibility of permanent plant outages or closures, fluctuating rail rates, and complex third-party coal contracts.

The Division determined that the Company is managing inventories by considering appropriate factors in the near-term and in its longer-term analyses and planning. The Company's fuel

⁴ 2020 Policy and Procedures Manual, p. 4. Here and elsewhere in the Division's report, the Division paraphrases the Company's Policies and Procedures Manual and other documents to protect confidential information.

procurement policies and practices provide some flexibility in order for the Company to react to changing market conditions and to take advantage of contract advantages when present.

Recent plant closures, as well as upcoming coal plant retirements announced in the Company's 2019 Integrated Resource Plan (IRP),⁵ make it even more difficult to optimize delivered fuel supplies and costs while ensuring an adequate and reliable supply at the lowest cost practicable. In 2019 the Company's Fuel Resources Department did a commendable balancing act accomplishing these objectives.

This changing dynamics in the industry indicate that a third-party study update is appropriate to determine whether the Company's Policies and Procedures and/or target levels at each plant need to be updated. This will help the Company continue to manage fuel supply risk at least cost. The Division recommends the Company contract with a consultant to complete this study by the end of 2020 or by the first quarter of 2021.

Overall Coal Inventory

Taking all plants as a whole, and accounting for the Company's share of inventory at each plant, the Company's coal inventory was at the end of 2019 within the target range recommended in the RPM report. If inventories for each month are averaged for the whole year, the Company was well within range of its target for the year.

Inventory at Specific Plants

With respect to individual plants, most plants were within their target ranges at the end of year 2019. Overall, the fuel inventory of all plants combined decreased during the year leading up to December 2019. In general, the Division agrees that the decrease in overall inventory was prudent, due to business and operational projections. For example, temporary planned and unplanned outages can affect coal inventories, causing inventories to rise in certain months while repairs are performed. At other plants, lower inventories may be appropriate to provide the

⁵ Docket No. 19-035-02, PacifiCorp's 2019 IRP, Volume I, October 18, 2019, p. 13.

flexibility leading up to plant closures or divestitures of PacifiCorp's contractual interests.

At the Company's Jim Bridger plant, the Company has a sharing arrangement with Idaho Power that provides flexibility for each company to use the other company's coal supply. This allows the Company to control costs by maintaining flexibility of monthly and year-end supply. This is particularly useful in mitigating the increased supply risk associated with underground mining, as is the case at Bridger. The Company finds itself managing demand in a trend that has continued since 2017, where Idaho Power's generation at the plant has declined substantially. In this case, the total plant inventory is a better measure of the plant's inventory status than PacifiCorp's share. On a total plant basis, inventory was slightly below target at the end of 2019, but is expected to remain very close to total plant inventory target levels for the foreseeable future.

One of the Company's owned and operated plants had inventory above the upper end of the target range at the end of 2019. The Company has determined that it can provide lower cost fuel at this plant to its customers by taking advantage of current contract prices that will not be available indefinitely.

With respect to the plants that the Company owns jointly, as a minority owner the Company has somewhat limited influence over the inventory levels at those plants, because inventory levels are determined collectively by the plant owners. The inventory levels at most joint-owned plants are within or near the target ranges at the end of 2019. However, at one joint-owned plant, the Company is keeping inventory near the lower end of the range to take operational projections into account.

The Company updated its 2020 Policies and Procedures based on the analysis in the March 19, 2018 RPM report and based on operational and contract expectations at the various plants. The Division has reviewed the Policies and Procedures, dated March 13, 2020. The Division finds that the Company is in compliance with the Commission's directive in its 2009 Report and Order with respect to the Company's fuel inventory policies and procurement practices. The Company provided the end-of-year inventories at each plant, as well as both the previous year's targets and

the new adjusted targets. Where overall end-of-2018 levels were outside of the targeted levels, the Company's inventory stock is well within range in 2019.

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 2019, and as amended with an effective date of March 13, 2020; and (3) the Company's policies provide flexibility for the Company to react to the changes in the market that the industry faced this past year.

The Division has reviewed the 2020 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 and has prudent business reasons for plants that are outside the fuel inventory target ranges. Where inventories are outside of the targeted levels, the Company has plans in place to bring the inventory stock into targeted levels as appropriate.

The Division determined that the Company is managing inventories by considering appropriate factors in its longer-term analyses and planning. The Company's fuel procurement policies and practices provide some flexibility in order for the Company to react to changing market conditions and to take advantage of contract advantages when present. However, due to recent plant closures and announced coal plant retirements, the Division recommends the Company hire a third-party consultant to update or revise the 2018 RPM Report to ensure policies, practices, and target inventory levels are optimized. No action is required by the Commission.\

Cc: Jana Saba, Rocky Mountain Power
Michelle Beck, Offices of Consumer Service