



GARY HERBERT.  
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State of Utah  
Department of Commerce  
Division of Public Utilities

FRANCINE GIANI  
*Executive Director*

CHRIS PARKER  
*Director, Division of Public Utilities*

## MEMORANDUM

**To:** Public Service Commission

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

**Date:** March 31, 2014

**Re:** Docket No. 14-035-35, Division's Audit of PacifiCorp's 2013 Fuel Inventory Policies and Practices.

### RECOMMENDATION

The Division of Public Utilities (Division) has reviewed PacifiCorp's (Company) fuel inventory policies and procedures and finds that the Company has adhered to the Commission's directive in this matter. The Division recommends that the Commission find that the Company is in compliance with the directive in its 2009 Report and Order with respect to its fuel inventory policies. However, the Division notes that the Company's fuel inventory policies have not been formally reviewed by a third-party consultant since the 2009-2010 timeframe. The Division finds that the downsizing in the number of coal operations, emerging environmental regulations, and other changing conditions suggest a need for an updated review of the coal inventory policies for PacifiCorp's coal-fired power plants in Utah and Wyoming. Therefore, the Division recommends that the Commission order the Company to obtain a third-party review of the Company's current coal inventory policies and update the stockpile target levels at its Utah and

Wyoming coal operating plants. The Division recommends that the update be conducted before the Division's 2015 audit of fuel inventory policies and practices.

## **ISSUE**

In the course of the general rate case proceedings in Docket No. 09-035-23, the Commission determined that the Company should have a regularly reviewed and updated Company Coal Policy in place. As a result, the Commission directed 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> This memorandum is in response to the Commission's directive and reports on the Division's fourth annual audit and associated findings of the Company's 2013 fuel management policies, procedures, and actual practices.

The Division has reviewed the Company's 2013 fuel management policies, procedures, and updates to its policies 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 in the current Energy Balancing Account filing (Docket No. 14-035-31) or in the current general rate case filing (Docket No. 13-035-184).

## **DISCUSSION**

In conducting its review, the Division met with the Company's Fuel Resources Department on March 18, 2014, including Ms. Cindy A. Crane, Vice President of Interwest Mining & Fuels (the Company's Fuels Department). At the meeting the Division discussed in detail the assumptions and inventories at each of the Company's owned and affiliate plants. The Division reviewed confidential documents, including Company coal and transportation contracts and PacifiCorp's Coal Inventory Policies and Procedures (Manual) dated January 2, 2014. The Division also reviewed spreadsheets containing inventory data for each plant. The Division looked at both

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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.

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 policies and procedures. The Fuel Resources Department monitors inventory levels, and aerial surveys are performed quarterly for PacifiCorp operated coal plants.

A third-party review of the Company's coal procurement policies and management practices was performed in 1991 and again in 1995 by Energy Ventures Analysis, Inc. (EVA), who were retained by an Inter-Jurisdictional Task Force to review PacifiCorp's fuel management and coal supply practices.<sup>2</sup> As part of the EVA recommendations, PacifiCorp established stockpile targets for each of its coal generating plants.

A subsequent overall review took place when 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.<sup>3</sup> The second report (Phase II) dated January 28, 2010, covered the Wyodak, Dave Johnston, Jim Bridger, and Naughton plants in Wyoming.<sup>4</sup> 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. However, since the inventory levels for these plants are determined collectively by the plant owners and PacifiCorp is a minority owner in these plants, Phases II and IV of the PAH assignment were canceled. The Division points out that the Company's 2014 Coal Inventory Policies and Procedures are based on the PAH reports from 2009 and 2010.

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<sup>2</sup> Confidential Evaluation of the Coal Procurement Policies and Coal Management Practices of PacifiCorp, prepared by Energy Ventures Analysis, Inc., January 1991; Confidential Update to Evaluation of the Coal Procurement Policies and Coal Management Practices of PacifiCorp, prepared by Energy Ventures Analysis, Inc., July 1995.

<sup>3</sup> Coal Inventory Policies for Coal-Fired Power Plants in Utah, PAH, dated August 13, 2009.

<sup>4</sup> Coal Inventory Policies for Coal-Fired Power Plants in Wyoming, PAH, dated January 28, 2010.

## **FINDINGS**

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 of the Company's fuel management activities as presented in the Manual are to provide the lowest cost 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.<sup>5</sup>

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, and third-party coal contract revisions, re-openers, or escalation clauses.

Third, the Division identified that the Company is factoring in its longer-term analyses and planning for emerging environmental regulations, continuing 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.

The Division's audit identified the following key findings:

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<sup>5</sup> PacifiCorp's Confidential Coal Inventory Policies and Procedures, January 2, 2014 (Here and elsewhere in the Division's Audit report, the Division paraphrases the Company's Manual to protect confidential information.)

1. The Company has formal Coal Inventory Policies and Procedures in place that it adheres to. The Company's goal and commitment to provide low-cost power to its customers drives its fuel procurement practices.
2. Factors contributing to the 2013 fuel inventory levels include: lower natural gas prices, decreased burn requirements, coal quality degradation, transportation issues, geologically complex mines, and the changing dynamics of the coal industry.
3. Overall the 2013 inventory levels of PacifiCorp's Utah fleet are slightly below short-term targeted levels due to ongoing labor negotiations and production slowdowns. The Company anticipates a conclusion to the labor negotiations in 2014. Stockpile levels at the Utah plants decreased in 2013 and are expected to continue to decline during 2014. The Company's goal is to be within targeted long-term levels by the end of 2014.
4. With regards to the Company's Southwest Wyoming plants, PacifiCorp announced in 2012 that its Naughton Unit #3 will be repowered to natural gas on or before December 31, 2017. The Company is currently slightly below its short/intermediate term inventory target levels, but plans to put in place a long-term inventory target once Naughton Unit #3 is repowered to natural gas. The flexibility of this target will be beneficial as the Company converts Unit #3 to natural gas use.
5. Power River Basin plants were also below targeted levels due to coal consumption exceeding budget and service interruptions associated with rail transportation out of the Powder River Basin.
6. Inventory levels at the Company's joint-owned plants were above target levels due to an unexpected outage and due to a slight decrease in coal consumption. However, as a minority owner PacifiCorp has limited influence over the inventory levels at those plants. Inventory levels for these plants are determined collectively by the plant owners. The

plant owners realize the importance of reducing inventory levels and are collectively working on an inventory reduction plan.

With respect to the Division's overall audit, the Division recognizes that dynamic conditions require some of the Company's coal plants to be within or slightly above targeted inventory levels. Therefore, the Company made several updates to its 2012 Coal Inventory Policies and Procedures. At some plants the Company implemented both short and long-term inventory policies. In the 2013 Manual the Company expects the Utah plants will be within the range of long-term inventory target levels by the end of 2014. The Division has reviewed the updated Policies and Procedures, dated January 2, 2014.

As previously mentioned, it has been approximately five years since the coal inventory policies for PacifiCorp's Utah and Wyoming coal-fired power plants have been formally reviewed and updated by a third-party. At the time of the 1991 EVA report, there were 11 mining companies operating 16 mines in Utah and eight mines in operating in Wyoming. Since that time the number of mining companies, the number of operating coal mines, and annual coal production have all decreased in both states. The supply and demand for coal has changed significantly since both the EVA and the PAH reports were issued. Factors such as supply or transportation disruptions, coal quality, coal market conditions, new environmental laws and regulation, plant closures, and the general downsizing in the number of coal operations drive the need for a new look at the Company's target inventory levels at its Utah and Wyoming fleets. The Division does not see a need to perform a formal update of its joint-owned plants, inasmuch as PacifiCorp, a minority owner, has limited influence over the inventory levels at those plants. The Division recommends that the Commission order the Company to prepare an update of its coal inventory policies prepared by a third-party consultant and file the update prior to the Division's March 2015 audit.

In the Commission's August 10, 2012 letter confirming to the Company that it had complied with its Fuel Inventory Policies and Practices, the Commission determined that the Company

should forward a copy of the revised or updated Manual to the Division within 60 days of any updates or revisions to the Manual. The Division requests that all future updates to the Manual be provided with a redline copy, in addition to the revised or updated Manual, in order to readily identify the changes that were made.

## **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 adhered to its policies and procedures in 2013, and as amended on January 2, 2014; and (3) the Company's policies provide some flexibility to react to changing market conditions. 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. 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.

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 recommends that the Commission acknowledge the Company's compliance. The Company's formal policies and procedures are in place for its fuel procurement and coal inventory levels. 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 in compliance with its policies and procedures or has plans to do so in the near future.

The Division recommends that the Commission order the Company to conduct a third-party review of the Company's Coal Inventory Policies for its Utah and Wyoming coal-fired generating plants. The consultant's review and the Company's updated policies should be filed

with the Division before March 1, 2015. Finally, when changes are made to the Company's Manual, the Company should forward a copy of the revised or updated Manual to the Division within 60 days, as directed by the Commission. However, the Division requests that the Commission require a red-lined version of the update to also be filed.

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