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State of Utah
Department of Commerce
Division of Public Utilities

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MEMORANDUM

To: Utah Public Service Commission

From: Division of Public Utilities
Chris Parker, Director
Artie Powell, Manager, Energy Section
Carolyn Roll, Utility Analyst
Joni Zenger, Technical Consultant

Subject: Docket No. 15-035-39, Division's Audit of PacifiCorp's 2014 Fuel Inventory Policies and Practices.

Date: March 26, 2015

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 Docket No. 09-035-23. No further action is required at this time.

ISSUE

This memorandum is in response to the Commission's directive in the 2009 general rate case (Docket No. 09-035-23) 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 activity¹ This memorandum is in response to the Commission's directive and reports on the Division's fifth annual audit and associated findings of the Company's 2014 fuel management policies, procedures, and actual practices.

The Division has reviewed the Company's 2014 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. 15-035-03) or in future rate case proceedings.

DISCUSSION

In conducting its review, the Division met with the Company's Fuel Resources Department on March 9, 2015. At the meeting the Division discussed the assumptions and inventories at each of the Company's owned and affiliate plants. The Division reviewed confidential documents, including the December 2014 coal inventory levels and PacifiCorp's Coal Inventory Policies and Procedures (Manual) dated January 2, 2014. 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 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.

In its 2013 report to the Commission, the Division noted several changing conditions suggesting that the need for an updated audit and third-party review of the coal inventory policies for PacifiCorp's coal-fired power plants in Utah and Wyoming.² These conditions include the downsizing in the number of coal operations and emerging environmental regulations. Therefore, the Division recommended that the Commission order the Company to obtain a third-

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 DPU 2013 Fuel Inventory Report, Docket No. 14-035-35, March 31, 2014.

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 made the recommendation that this work be performed before the Division's 2015 audit report that is due to the Commission on March 31, 2015. The Commission did not adopt this recommendation. The most recent third-party review of the Company's coal procurement policies and management practices was performed by Pincock Allen and Holt (PAH) in the 2009 to 2010 timeframe. The Division points out that the Company's current coal inventory policies and procedures are based on the PAH reports from 2009 and 2010.

However, at the March 9, 2015 meeting with the Company, the Division was informed by the Company that it has contracted with PAH to perform an audit and update of its fuel inventory levels at the Company's Utah and Wyoming coal plants. The PAH audit is in progress and is expected to be completed by this summer. The Company will re-assess its position with respect to target inventory levels, procurement, and other actions impacted as a result of the Deer Creek transaction and with the findings from the PAH review. The Division requests that the Company provide a copy of the PAH report to the Division as soon as it becomes available and before March 1, 2016 for inclusion in next year's audit.

During this past year the Company experienced personnel changes to its Fuel Resources Department. Also, the Company filed a request with the Commission to close the Deer Creek mine and sell the associated mining assets. This transaction includes new long-term coal supply agreements and several other factors that will affect the current and future year coal procurement practices and inventory levels.

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 Manual states that its goal is 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 Division has determined that the Company's fuel procurement practices are based on its goal and commitment to provide low cost power to its customers. Consideration is given to coal quality degradation, the delivered cost of fuel, reliability of supply, financial or risk exposure, operational cost, transportation, and flexibility.³

In the long-term, the Division identified other factors that affect the Company's inventory and procurement policies, including the complexity and geological nature of mines, the dynamics of the coal industry, changes in mining regulations due to increased safety concerns, and evolving environmental regulations. 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.

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:

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 2014 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 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.)

3. Overall the 2014 inventory levels of PacifiCorp's Utah fleet are slightly below short-term targeted levels as both labor negotiations and production slowdowns continued. The Company concluded the labor negotiations in October 2014. Stockpile levels at the Utah plants decreased in 2014 and are expected to continue to decline during 2015 as a result of the closure of the Deer Creek mine. New inventory target levels will be implemented in 2015.
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. Problems with mining equipment contributed to the lower inventory levels in 2014.
5. Powder River Basin plants continue to be below targeted levels due to coal consumption exceeding budget and ongoing 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 unexpected outages and decreased 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. Inventory levels are trending downward in the right direction.

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. As noted above, the Company's third-party review of its Utah and Wyoming coal inventory levels is in progress and is expected to be completed by summer of 2015. The Company did not make changes to its 2014 Coal Inventory Policies and Procedures.

During the year 2014, there were many extenuating circumstances that will likely result in changes to the Company's coal inventory policies and procedures going forward, including: closing the Deer Creek mine; settling the labor agreement; and entering into new long-term coal supply agreements. With the findings from the PAH review and internal changes at the Company, the Division expects the Company to update its Manual in 2015.

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 in 2014.

CONCLUSION

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.

1. The Division also 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.
2. After the Division's 2013 Fuel Inventory Report to the Commission, the Commission confirmed in its May 15, 2014 letter to the Company that it had met its compliance obligations for the year and determined the following conditions:
3. When changes are made to the Manual, the Company should forward a copy of the revised or updated Manual to the Division within 60 days of any updates or revisions.

All future updates to the Manual should be provided with a redline copy, in addition to the revised or updated Manual, in order to readily identify the changes that were made. Any updated third-party reviews should be provided to the Division. Issues related to prudent coal inventory policies will be address in general rate cases. With respect to this year's report, the 2014 Fuel

Inventory Report, the Division requests the Commission order the same three conditions noted above and find the Company is in compliance for the year 2014.

cc:

Bob Lively, Rocky Mountain Power

Michele Beck, Office of Consumer Services