



Memorandum

Date: April 6, 2018

To: Edward Randolph
Director, Energy Division

From: **Public Utilities Commission—** Tracy Fok, Program and Project Supervisor
San Francisco Utility Audit, Finance and Compliance Branch

Subject: San Diego Gas and Electric Company Advice Letter 3138-E
Quarterly Procurement Plan Compliance Report for the Third Quarter of 2017
Summary of Negative Findings

The Utility Audit, Finance and Compliance Branch (UAFCB) issues this memorandum containing its negative findings on San Diego Gas and Electric Company's (SDG&E) Quarterly Procurement Plan Compliance Report (QCR) filed by Advice Letter No.(AL) 3138-E. The negative findings are based on the results of UAFCB's performed procedures to assess SDG&E's compliance. UAFCB assesses SDG&E's compliance in accordance with agreed-upon procedures (AUP) with Energy Division (ED) and does not assess the compliance with all aspects of procurement-related state law and procurement-related directives mandated by the California Public Utilities Commission (CPUC or Commission). In addition, SDG&E's transactions conducted in the Integrated Forward Market (IFM) and the Residual Unit Commitment Market (RUC) are outside the scope of the agreed-upon procedures engagement.

A. Summary of Negative Findings:

SDG&E failed to demonstrate that it was in compliance with Decision (D.)02-10-062, Appendix B, and Public Utilities Code (PUC) §581. SDG&E incorrectly reported a bilateral contract executed in the third quarter of 2017 (Q3) as a Request for Offer (RFO) contract on its Q3 QCR and Attachment H. On February 23, 2018, SDG&E submitted amended QCR and Attachment H to correct its reporting errors in response to UAFCB's findings.

B. Recommendations:

SDG&E needs to correctly classify its contracts based on contract selection methodologies and nature of contracts. Moreover, before submitting its QCR filings, SDG&E should thoroughly review its QCR and related attachments to ensure that all documents are correct and accurate. SDG&E needs to increase its internal controls and implement and enforce the new controls to ensure the accuracy of its QCR filings before submitting such filings to the Commission.

C. Background:

As required by D.02-10-062, Ordering Paragraph (OP) 8 and clarified in D.03-12-062, SDG&E, Pacific Gas & Electric Company (PG&E), and Southern California Edison (SCE) must each submit a QCR for all transactions of less than five years duration executed in the quarter. UAFCB conducts the quarterly procurement engagements based on the scope specified by ED, using procedures agreed upon between ED and UAFCB. ED specified which aspects of the utilities' Commission-approved procurement plans, Assembly Bill (AB) 57 procurement rules and several procurement-related rulings and decisions to test for compliance. The decisions and rulings that ED chose directives from to test for compliance include, but are not limited to, D.02-10-062, D.03-06-076, D.03-12-062, D.04-12-048, D.07-12-052, D.08-11-008, D.12-01-033, D.15-10-031 and D.16-01-015. Based on our understanding

with ED, UAFCB does not test all of the transactions that the utilities include in their QCR.

D. Negative Findings:

SDG&E failed to demonstrate that it was in compliance with D.02-10-062, Appendix B, and PUC §581. SDG&E incorrectly classified a bilateral contract as a RFO contract. As a result, SDG&E incorrectly reported this contract on its Q3 QCR and Attachment H (New contracts Executed and Amended).

Criteria:

1. In Appendix B of D.02-10-062, the Commission requires that each utility file each quarter's energy procurement transactions of less than five years duration with a QCR and related attachments by an advice letter. The QCR and related attachments must contain, among other things, information that is complete and accurate and include, but not limited to, the number and volume of transactions.
2. PUC §581 requires that every public utility receiving from the commission any blanks with directions to fill them shall answer fully and correctly each question propounded therein, and if it is unable to answer any question, it shall give a good and sufficient reason for such failure.

SDG&E's response:

On March 7, 2018, SDG&E explained why it classified the contract as a RFO contract instead of a bilateral contract as follows:

- a. SDG&E stated that the contract in question was the result of negotiations regarding an offer from SDG&E's RFO. The offers to sell and purchase were dependent on each other, and would not have been able to be executed individually. SDG&E further stated that during the negotiations the counterparty was unwilling to sell its Resource Adequacy (RA) capacity without having replacement capacity available, and that the absence of replacement capacity would trigger a price increase. In order to secure the Local RA capacity from the counterparty at the original bid price, SDG&E negotiated to provide replacement capacity for its planned outages in October and November of 2018. Because the sale was an integral component of the transaction that resulted from RFO offer, SDG&E believed that it was proper to classify the RA sale agreement as a Competitive Solicitation (or RFO) contract. SDG&E questioned the finding of an error in this regard given (a) the inter-dependent nature of the components of the transaction; and (b) the lack of definitive guidelines for classification of transactions, but agreed to submit a supplemental advice letter to amend QCR and Attachment H – New Contracts Executed / Contracts Amended in accordance with UAFCB's direction provided.
- b. SDG&E understood the finding signified that where a transaction involved multiple components (e.g., a sale and a purchase), each component of the transaction had to be broken out separately and classified individually in the QCR. SDG&E will apply this principle going forward. SDG&E stated that it would be helpful that ED and UAFCB establish clear, upfront standards for classification of transactions to ensure that transactions are not inadvertently misclassified, thereby reducing the number of "errors" found in the audit process.

UAFCB's Rebuttal:

SDG&E needs to correctly classify its contracts based on contract selection methodologies and nature of contracts. Moreover, before submitting its QCR filings, SDG&E should thoroughly review its QCR and related attachments to ensure that all documents are correct and accurate. SDG&E needs to vigorously implement and enforce new internal controls to ensure the accuracy of its QCR and related attachments before submitting them to the Commission.

E. Conclusion:

UAFCB was not engaged to and did not conduct an examination, the objective of which would be the expression of an opinion on SDG&E's QCR filed in AL 3138-E. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to ED.

This memo is intended solely for the information and use of ED and should not be used by anyone other than ED or for any purpose.

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