



# Memorandum

**Date:** April 26, 2018

**To:** Edward Randolph  
Director of Energy Division

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

**Subject:** Southern California Edison Company Advice Letter 3683-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 Southern California Edison Company's (SCE) Quarterly Procurement Plan Compliance Report (QCR) filed by Advice Letter No.(AL) 3683-E. The negative findings are based on the results of UAFCB's performed procedures to assess SCE's compliance. UAFCB assesses SCE's compliance in accordance with agreed-upon procedures (AUP) with Energy Division (ED) and does not assess the compliance with all aspects of the procurement-related state law and procurement-related directives mandated by the California Public Utilities Commission (CPUC or Commission). In addition, SCE'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:

1. **SCE failed to demonstrate that it was in compliance with Decision (D.) 02-10-062, Appendix B, and Public Utilities Code (PUC) §581.** In its third quarter of 2017 (Q3) QCR, SCE made reporting errors in Attachment H. On January 12, 2018, SCE submitted an amended Attachment H to correct its reporting errors in response to UAFCB's findings.
2. **SCE failed to demonstrate compliance with D.12-04-046, (OP) 14.** SCE neither distributed its August 2017 Procurement Review Group (PRG) meeting summary to its PRG members nor made it publicly available in a timely manner.
3. **UAFCB is unaware of any specific requirements established by the Commission regarding how investor-owned-utilities (IOU) should transact or contract with risky counterparties that file bankruptcy.** In Q3, SCE executed two purchase contracts, knowingly with a counterparty that had filed bankruptcy. SCE presented the contracts to its PRG after the contract execution. Also, SCE did not indicate in its presentation to the PRG regarding the counterparty's bankruptcy and the impact of the bankruptcy on the counterparty's performance ability and financial obligations in the contracts.

## **B. Recommendations:**

- 1. SCE should thoroughly review its QCR and related attachments and ensure that all documents are correct and accurate. SCE needs to implement an effective review process to ensure reporting accuracy of its QCR and related attachments before submitting them to the Commission.**
- 2. SCE should implement internal controls to ensure that its PRG meeting summaries are distributed to its PRG members or made publicly available in a timely manner.**
- 3. The Commission needs to provide specific guidance regarding how the IOU should transact or contract with risky counterparties that file bankruptcy. The guidance may include, but is not limited to, the following:**
  - a. Prior to transacting or contracting with bankrupt counterparties, the IOU need to inform and discuss with PRG regarding the financial status of the bankrupt counterparties and their ability to fulfill contract requirements.**
  - b. The IOU need to include robust safeguarding provisions in contracts, which provide strong protection for the IOU as well as ratepayers when bankrupt counterparties fail to deliver or perform in accordance with their contracts.**

## **C. Background:**

As required by D.02-10-062, Ordering Paragraph (OP) 8 and clarified in D.03-12-062, SCE, Pacific Gas & Electric Company (PG&E), San Diego Gas and Electric (SDG&E) 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:**

- 1. SCE failed to demonstrate that it was in compliance with D.02-10-062, Appendix B, and PUC §581. In its Q3 QCR, SCE made reporting errors in Attachment H. The reporting errors are described in detail below:**
  - a. SCE reported incorrect delivery terms, volume (MW), and price/nominal cost (per kw-mo) for four (4) Resource Adequacy (RA) contracts.**



- b. SCE reported incorrect price/nominal cost (per kw-mo) for one (1) Greenhouse Gas Emission Request for Offer (GHG RFO) contract.

On January 12, 2018, SCE submitted an amended Attachment H to correct the aforementioned reporting errors.

**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 by an advice letter. The QCR and related attachments must contain, among other things, information that is complete and accurate including, but not limited to, the number and volume of transactions.
2. PUC §581 states:

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.

**SCE's response:**

On January 3, 2018, SCE stated that the incorrect data points were due to data entry errors made by its staff. The corrective action that SCE will take for future QCR and related attachments is implementing new internal controls that include a quality control check of data entries.

On January 12, 2018, SCE filed a revised Attachment H to correct the reporting errors via a supplemental advice letter.

**UAFCB's Rebuttal:**

Before submitting its QCR and related attachments, SCE should thoroughly review them to ensure that all documents are correct and accurate. SCE needs to vigorously implement an effective and thorough review process to ensure the accuracy of its QCR and related attachments before submitting them to the Commission.

2. **SCE failed to demonstrate compliance with D.12-04-046, OP 14. SCE did not distribute its August 2017 PRG meeting summary in a timely manner.** SCE distributed its August 9, 2017 PRG meeting summary on September 18, 2017. According to D.12-04-046, OP 14, SCE is required to distribute its PRG meeting summary the earlier of a) 14 days after the PRG meeting, or b) 48 hours before the next regularly scheduled procurement review group meeting. The earlier of these two dates for the August 9, 2017 meeting was August 21, 2017.

**Criteria:**

In D.12-04-046, OP14, the Commission adopted the proposal that meeting summaries be distributed on the earlier of 1) 14 days after the PRG meeting, or 2) 48 hours before the next regularly scheduled PRG meeting.

**SCE's Response:**

On January 23, 2018, SCE indicated that the aforementioned non-compliance was a result of temporary work transfer internally at the utility. In this particular instance, the responsibility of facilitating the August 9, 2017 conference call was transferred to accommodate schedules, but follow up items, such as distributing the summary, remained the responsibility of SCE's regular chair person. The disconnect in the transfer of work resulted in the delayed posting.

SCE will continue to monitor the summaries closely and will distribute the summary the earlier of a) 14 days after the PRG meeting, or the b) 48 hours before the next regularly scheduled PRG meeting. Also, in the event of temporary work transfers, SCE will use calendar reminders to aid in the proper and timely distribution of PRG Summary.

**UAFCB's Rebuttal:**

SCE should strictly implement and enforce internal controls to ensure that its PRG meeting summaries is distributed timely.

- 3. UAFCB is unaware of any specific requirements established by the Commission regarding how the IOU should transact or contract with risky counterparties that file bankruptcy.** Filing bankruptcy by counterparties with ongoing contract performance and/or financial obligations significantly increases non-performance and credit risk of such counterparties. Also, cash collateral posted by bankrupt counterparties and received by the IOU within a 90-day period prior to bankruptcy filing could be subject to recapture by the bankruptcy court if deemed a preferential transfer. As such, additional precautions and safeguards should be in place when the IOU transact or contract with bankrupt counterparties.

In Q3, SCE executed two purchase contracts, knowingly with a counterparty that had filed bankruptcy. SCE had cash collateral from the bankrupt counterparty to mitigate the financial risk that SCE was exposed to if the counterparty failed to deliver or perform in accordance with the contracts.

Eventually SCE presented the two contracts to its PRG after its contract execution. When presenting the contracts to its PRG, the utility omitted the counterparty's bankruptcy and the impact of the bankruptcy on the counterparty's performance ability and financial obligations in the contracts. Moreover, the utility did not include additional safeguarding provisions in the contracts, which may provide robust protection for itself as well as ratepayers if the bankrupt counterparty failed to deliver or perform in accordance with the contracts.



Although the bankrupt counterparty ultimately delivered and performed in accordance with the contracts, UAFCB determines that the loopholes of transacting or contracting with bankrupt counterparties by all the IOU should be evaluated and addressed by the Commission.

UAFCB recommends the Commission provide specific guidance regarding how the IOU should transact or contract with risky counterparties that file bankruptcy. The guidance may include, but is not limited to, the following:

- a. Prior to executing any transactions or contracts with bankrupt counterparties, the IOU need to inform and discuss with PRG regarding the financial status of the bankrupt counterparties and their ability to fulfill contract obligations.
- b. The IOU need to include robust safeguarding provisions in contracts, which provide strong protection for the IOU as well as ratepayers when bankrupt counterparties fail to deliver or perform in accordance with their contracts.

**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 SCE's QCR filed in AL 3683-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.

cc: Barbara Owens, Risk and Compliance Officer  
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