

# Memorandum



**Date:** July 31, 2013  
**To:** Edward Randolph  
Director of Energy Division  
**From:** **Public Utilities Commission—** Kayode Kajopaiye, Branch Chief  
**San Francisco** Division of Water and Audits  
**Subject:** Southern California Edison Advice Letter 2844-E  
Quarterly Procurement Plan Compliance Report for the Fourth Quarter of 2012

**Based on the results of its audit, the Division of Water and Audits' Utility Audit, Finance and Compliance Branch (UAFCB) did not find any material reasons for Energy Division (ED) to deny the approval of Southern California Edison's (SCE) Advice Letter No. (AL) 2844-E.** The SCE procurement transactions during the Fourth quarter of 2012 (Q4) that UAFCB examined were, in all material respects, in compliance with SCE's Procurement Plan, as approved in Decision (D.) 12-01-033, Assembly Bill (AB) 57 procurement rules, and several procurement-related Commission directives. SCE's transactions conducted in the Integrated Forward Market (IFM) and the Residual Unit Commitment Market (RUC) are outside the scope of UAFCB's audits. This audit is limited in scope and does not provide full assurance to the reasonableness of SCE's Q4 Quarterly Compliance Report (QCR) filing or its Q4 transactions.

## A. Negative Audit Finding:

**SCE failed to demonstrate that it was in compliance with D.04-12-048, Ordering Paragraph (OP) 15.** SCE failed to consult with its Procurement Review Group (PRG) before it executed seven resource adequacy (RA) sales contracts with various counterparties, which have contract terms greater than 90 days or three calendar months.

## B. Recommendations

**SCE should consult with its PRG before it executed any contracts with terms greater than 90 days or three calendar months.**

## C. Background:

As required by D.02-10-062, OP 8, and clarified in D.03-12-062, Pacific Gas and Electric Company (PG&E), San Diego Gas and Electric Company (SDG&E) and SCE must each submit a quarterly compliance report (QCR) for all transactions of less than five-years duration executed in the quarter. ED requested that the UAFCB conduct compliance audits of these utilities' quarterly procurement compliance filings.

The objective of these quarterly audits is to determine if the utilities were in compliance with their California Public Utilities Commission's (Commission) approved procurement plans, while complying with AB 57 procurement rules and several procurement-related regulatory rulings and decisions, including, but 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, and D.12-01-033.

## D. Negative Findings

**Finding 1: SCE failed to demonstrate that it was in compliance with D.04-12-048, OP 15.** In Q4, SCE executed seven RA sales contracts with the following four counterparties:

1. Calpine Energy Services LP,
2. Constellation Energy Commodities Group Inc.,
3. EDF Trading North America, LLC, and
4. Shell Energy North America (US) LP.

The contract terms of these RA sales contracts ranged from five months to 12 months. In the PRG meeting dated September 26, 2012, SCE notified its PRG that it proposed to sell its excess local RA. SCE further noted in the meeting that it negotiated potential bilateral transactions for selling the excess local RA with counterparties and would execute bilateral contracts if acceptable pricing and contract terms could be reached. SCE, however, did not specifically present the counterparties, prices, and terms of the aforementioned seven RA sales contracts to its PRG and also did not consult with its PRG specifically on the aforementioned contracts.

**Criteria:** In D.04-12-048, OP 15, the Commission requires that utilities consult with the PRG for transactions with delivery periods greater than three calendar months, or one quarter.

**SCE's Response:** SCE asserts the following:

1. Page 37 of D.03-12-062 indicated that the Commission requires the utilities consult with their PRG for transactions greater than 90 days, but leaves to the utilities' discretion the exact process for approaching such procurement.
2. SCE's notification to the PRG during the September 26, 2012 PRG meeting regarding selling its excess RA capacity and negotiating potential bilateral transactions should suffice the Commission's requirements indicated in D.03-12-062, Page 37 and D.04-12-048, OP 15.
3. In the past, the UAFCB has never provided an audit finding that SCE did not meet the requirement to consult with its PRG for bilateral transactions greater than 90 days or three calendar months.
4. Consultation with the PRG on a transaction-specific basis is often not feasible due to the time constraints of accepting a proposed deal. At times, such acceptance must occur immediately upon the offer being made to SCE or SCE will lose out on the deal. SCE alleges that this is exactly the flexibility that the Commission intended to leave to the discretion of the utilities when it instituted the requirement indicated in D.03-12-062, page 37.

**UAFCB's Rebuttal:** D.03-12-062 indicated that Office of Ratepayer Advocates (ORA) requested that the Commission approve an eleven-step procurement process for use by PG&E, SCE and SDG&E. The process included three steps for the utilities to consult with their PRG specifically on transactions as shown below:

1. Share bids with PRG;
2. Evaluate candidate hedges and rank according to cost-benefit analysis; and
3. Meet with the PRG and solicit comments from PRG members and attempt to reach a consensus.

The Commission agreed with ORA that ORA's recommended eleven-step procurement process represented a prudent and common sense approach. The Commission does not explicitly require the utilities to follow the process for short-term transactions less than 90 days because the process is

clearly too burdensome for these short-term transactions. For longer-term transactions beyond 90 days, however, the Commission indicated that it prefers that the utilities follow the ordered process. The Commission further indicated that it requires that the utilities consult with their PRG for transactions greater than 90 days, but leaves to the utilities' discretion the exact process for approaching such procurement.

SCE's notification to the PRG during the September 26, 2012 PRG meeting regarding selling its excess RA capacity and negotiating potential bilateral transactions does not follow the Commission's requirements indicated in D.03-12-062, page 37 and D.04-12-048, OP 15. SCE's notification was not transaction-specific and did not rank candidate hedges according to a cost-benefit analysis for the PRG to evaluate. D.04-12-048, OP 15 specifically indicated that the Commission requires that utilities consult with the PRG for transactions with delivery periods greater than three calendar months, or one quarter. SCE's notification that took place during the September 26, 2012 PRG meeting did not mention any of the RA sales transactions that it planned to execute in Q4.

UAFCB did not detect SCE's non-compliance with the requirement previously and thus did not provide a similar audit finding in the past, including the first quarter of 2010 and the second and fourth quarters of 2011. Because of resource constraints, UAFCB will not issue amended memos for the previous quarters.

Per Energy Division, if SCE had time constraints and could not timely conduct a PRG meeting to specifically discuss the aforementioned RA sales contracts, SCE could e-mail its PRG members regarding these contracts and solicit the PRG members' feedback prior to its contract execution. SCE should have communicated its negotiation status of the RA sales contracts with its PRG members by e-mailing during its negotiation process if conducting a PRG meeting is not feasible.

**E. Conclusion:**

SCE's AL 2844-E and its Q4 procurement transactions for electricity and natural gas that UAFCB reviewed were, in material respects, in compliance with SCE's Commission-approved procurement plan and all relevant Commission decisions. SCE's Q4 transactions that UAFCB reviewed, in material respects, appear to be complete, accurate and properly authorized by management.

If you have any questions, please contact Tracy Fok at (415) 703-3122.

cc: Rami Kahlon, Director, Division of Water and Audits  
Judith Ikle, Energy Division  
Ed Charkowicz, Energy Division  
Lily Chow, Energy Division  
Donna Wagoner, Division of Water and Audits  
Tracy Fok, Division of Water and Audits