State of California

Memorandum

Date: November 9, 2016

To: Edward Randolph
Director of Energy Division

From: **Public Utilities Commission— San Francisco** Kayode Kajopaiye, Branch Chief
Utility Audit, Finance and Compliance Branch

Subject: Pacific Gas and Electric Company Advice Letter 4834-E
Quarterly Procurement Plan Compliance Report for the First Quarter of 2016
Summary of Negative Findings

Based on the results of its performed procedures to assess compliance, the Utility Audit, Finance and Compliance Branch (UAFCB) is issuing its negative findings on Pacific Gas and Electric Company's (PG&E) Quarterly Procurement Plan Compliance Report (QCR) filed by Advice Letter (AL) 4834-E. UAFCB assesses compliance in accordance with agreed-upon procedures with Energy Division (ED) and does not assess compliance with all aspects of the procurement-related state law or those directives. In addition, PG&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. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants (AICPA).

A. Summary of Negative Findings:

1. **PG&E failed to demonstrate its compliance with Decision (D.) 04-12-048, Ordering Paragraph (OP) 15.** In Q1, PG&E executed a two-year gas transportation bilateral contract. PG&E failed to timely and properly consult with its Procurement Review Group (PRG) regarding this contract prior to the contract execution.

2. **PG&E failed to demonstrate compliance with OP 3.d and page 20 of D.03-06-067, pages 39 and 40 of D.03-12-062 and page 41 of D.14-02-040.** PG&E failed to provide its strong showing justification for the aforementioned gas transportation bilateral contract.

B. Recommendations:

1. **PG&E should implement and enforce its internal control that would ensure timely and proper consultation with the PRG for bilateral contracts with terms longer than three calendar months in duration.**

2. **PG&E needs to provide its strong showing justification for any bilaterally-negotiated contracts that are longer than one calendar month.**

C. Background:

As required by D.02-10-062, OP 8 and clarified in D.03-12-062, PG&E, San Diego Gas and Electric

(SDG&E), and Southern California Edison (SCE) must each submit a Quarterly Procurement Plan Compliance Report (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, 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. **PG&E failed to demonstrate its compliance with D.04-12-048, OP 15.** In Q1, PG&E executed a two-year bilateral gas transportation contract. PG&E did not timely and properly consult with its PRG regarding the contract prior to the contract execution.

In its e-mail dated January 28, 2016 addressed to its PRG, PG&E asserted the following:

> Although PG&E included this transaction in its December 15, 2015 PRG presentation, it did not take the additional step of providing the PRG with notice just prior to transaction execution, which was not in accordance with the requirements of its 2014 Bundled Procurement Plan for a bilateral transaction. PG&E staff mistakenly believed that the December 15, 2015 notification was sufficient for this type of transaction. Going forward, PG&E will install the appropriate safeguards to prevent this from re-occurring.

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

PG&E's response:

In its response dated October 5, 2016 to the above-mentioned finding, PG&E asserts the following:

> PG&E would like to correct the statement in the finding: "PG&E presented its gas transportation position in its December 15, 2015 PRG meeting but did not specifically mention about the contract". This transaction was included on Slide 7 of the physical gas presentation at the December 15, 2015 PRG meeting. This was the root cause of the error. It should not have been mentioned in that PRG presentation because it used the bilateral execution method rather than electronic solicitation. PG&E did consult the PRG in advance of executing the transaction but used the wrong consultation method.
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> To prevent this error from re-occurring PG&E will take the following actions: (1) PG&E will exclude these type of transactions from the quarterly PRG updates; (2)

PG&E developed a table to guide the gas traders on procurement processes, PRG consultation, and IE requirements (this will ensure that traders use the correct PRG consultation method for all transaction types); and (3) PG&E added this table to its Physical Gas Trader Desk Procedures.

UAFCB's Rebuttal: UAFCB agrees with the above-mentioned actions that PG&E will take to improve its PRG consultation in a timely manner. UAFCB will do a follow-up review on the same issue in future engagements.

2. **PG&E failed to demonstrate compliance with D.03-06-067, OP 3.d., page 20 of D.03-06-067, pages 39 and 40 of D.03-12-062 and page 41 of D.14-02-040.** In Attachment M, PG&E failed to provide its strong showing justification for the aforementioned bilateral gas transportation contract. The contract has a term of more than one calendar month and is subject to the strong showing justification requirement per the aforementioned Commission's directives.

Criteria:

D.03-06-067, OP 3.d requires utilities to provide strong showing justification for bilateral transactions with terms longer than one calendar month as stated below:

> We waive the strong showing standard for negotiated bilateral contracts for non-standard products procured 31 days or less in advance of need with terms of one calendar month or less. Although we waive the strong showing standard for negotiated bilateral contracts for non-standard products procured 31 days or less in advance of need with terms of one calendar month or less transactions, the utilities should demonstrate that such transactions are reasonable based on available and relevant market data supporting the transaction. This may include showing competing price offers, results of market surveys, broker and online quotes, and/or other sources of price information such as published indices, historical price information for similar time blocks, and comparison to RFOs completed within one month of the transaction. **We retain the strong showing standard for all other bilateral transactions. [Emphasis added]**

Page 20 of D.03-06-067 states:

> We maintain the strong showing standard for negotiated bilaterals for transactions of products executed more than 31 days in advance of need and longer than one-calendar month in duration.

D.03-12-062, pages 39 and 40 and D.14-02-040, page 41 indicate:

> Second, utilities may use negotiated bilateral contracts to purchase longer term non-standard products provided they include a statement in quarterly compliance filings to justify the need for a non-standard product in each case. The justification must state why a standard product that could have been purchased through a more open and transparent process was not in the best interest of ratepayers.

PG&E's response:

In its response dated October 7, 2016 to Finding 2, PG&E asserts:

> PG&E believes that the PG&E California Gas Transmission contract that was transacted bilaterally on 01/26/16 is not subject to a strong showing and that Attachment M correctly states no gas transactions were subject to a strong showing during the quarter.
>
> The purpose of the strong showing is for the utilities to "make a showing that such transactions represent a reasonable approximation of what a transparent competitive market would produce." (D.02-10-062, p. 34) Since the two-year gas transportation contract is a CPUC-tariff service offered only at full tariff (no negotiation) it is not procured from a competitive market and thus the strong showing requirement is not applicable. The price for the service was set by the CPUC and is therefore just and reasonable.

UAFCB's Rebuttal: OP 3.d and page 20 of D.03-06-067, pages 39 and 40 of D.03-12-062 and page 41 of D.14-02-040 explicitly require that utilities provide strong showing justification for bilaterally-negotiated transactions with terms longer than one-calendar month in duration. Since the gas transportation contract is a non-standard product and only offered at the full CPUC-tariff, PG&E simply needed to indicate in Attachment M that the contract is a CPUC-tariff service offered only at full tariff (no negotiation) and is not procured from a competitive market as its strong showing justification.

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 PG&E's QCR filed in AL 4834-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 other purpose.

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