

Memorandum



Date: December 30, 2016

To: Edward Randolph
Director, Energy Division

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

Subject: San Diego Gas and Electric Company Advice Letter 2935-E
Quarterly Procurement Plan Compliance Report for the Second 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 San Diego Gas and Electric Company's (SDG&E) Quarterly Procurement Plan Compliance Report (QCR) filed by Advice Letter No. (AL) 2935-E. UAFCB assesses compliance in accordance with agreed-upon procedures with Energy Division (ED) and does not assess compliance with all aspects of procurement-related state law and procurement-related directives mandated by the California Public Utilities Commission (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. 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. SDG&E failed to demonstrate compliance with pages 8 and 9 of Decision (D.) 06-12-009, Appendix B of D.02-10-062, and Ordering Paragraph (OP) 27 of D.07-12-052.** In the second quarter of 2016 (Q2), SDG&E executed three contract amendments that 1) made changes to a tolling purchase agreement, 2) reflected a settlement to resolve disputes regarding economic curtailment and payment and 3) clarified delivery of energy. SDG&E filed these executed amendments for approval through its Q2 QCR. Pursuant to D.06-12-009, pages 8 and 9, SDG&E should not have filed the contract amendments for approval in its QCR.
- 2. SDG&E failed to demonstrate compliance with Ordering Paragraph (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.** In Q2, SDG&E executed gas physical and financial transactions bilaterally with terms longer than one calendar month in duration. In its original QCR, SDG&E failed to provide a strong showing justification for these bilateral transactions in Attachment M of its Q2 QCR. On October 4, 2016, SDG&E submitted amended Attachment M to supplement its Q2 QCR by including its strong showing justification for the aforementioned bilateral transactions.
- 3. SDG&E failed to demonstrate that it was in compliance with D.02-10-062, Appendix B and Public Utilities Code (PUC) §581.** In Q2, SDG&E made reporting errors in Attachments A and H of its Q2 QCR. In Attachment A, SDG&E incorrectly reported the "power flow start hour" for its electric physical transactions. In Attachment H, SDG&E incorrectly included a Combined Heat and Power (CHP) purchase contract for the Commission's approval. The CHP contract should not be reported as a contract for the Commission's approval via the QCR. Instead, it should be reported as a contract reported for information purposes only in Attachment H. On August 16, 2016 and September

6, 2016, SDG&E submitted an amended Attachment H and A, to correct the aforementioned reporting errors.

B. Recommendations:

1. **SDG&E should not file any contract amendments as part of its QCR for the Commission's approval. Pursuant to the QCR template issued by ED in 2008 in response to OP 27 of D.07-12-052, SDG&E must report contract amendments in the Information Purposes Only section of its QCR Attachment H.**
2. **SDG&E must provide a strong showing justification for any bilateral transactions that are longer than one calendar month.**
3. **SDG&E should strengthen its review of the information included in QCR to ensure the accuracy and completeness of such information before submitting QCR to the Commission.**

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), SDG&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 by 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. **SDG&E failed to demonstrate compliance with pages 8 and 9 of D.06-12-009, Appendix B of D.02-10-062, and the QCR template issued by ED in 2008 in response to OP 27 of D.07-12-052.** In Q2, SDG&E executed three amendments that 1) made changes to a tolling purchase agreement, 2) reflected a settlement to resolve disputes regarding economic curtailment and payment and 3) clarified delivery of energy. SDG&E filed the executed amendments as contract amendments for the Commission's approval through its Q2 QCR. Pursuant to D.06-12-009, pages 8 and 9, SDG&E should not have submitted the contract amendments for the Commission's approval in its QCR. SDG&E must report contract amendments in the Information Purposes Only section of its QCR Attachment H.

Criteria:

1. Pages 8 and 9 of D.06-12-009 state:

However, the PTQCR (Procurement Transaction Quarterly Compliance Reports) is not the appropriate vehicle for requesting approval of contract amendments and modifications. The PTQCR is a compliance filing that explains a why and how a utility enters into a contract. As such, the PTQCR is not an appropriate vehicle for an approval request. The PTQCR serves a specific

purpose as defined in D.04-10-062, Conclusion of Law 7. That purpose is not compatible with a request for contract modifications. PG&E should file a separate advice letter when seeking Commission approval for contract amendments and modifications. The requirement that PG&E not use the PTQCR for contract approval request is not intended to limit or hinder PG&E's management from exercising their discretion in managing the procurement contracts on a day-to-day basis. Nor is PG&E prevented from filing pre-approval requests via an application or a separate advice letter as deemed appropriate by PG&E management.

Previously, the annual ERRA reasonableness application process was used to seek approval of contract amendments and modifications, and we do not object to its continued use for such purpose.

2. In Appendix B of D.02-10-062, the Commission requires that each utility report on each quarter's energy procurement transactions of less than five years duration in a QCR submitted by an advice letter. The QCR must contain, among other things, information that is complete and accurate, including but not limited to, the number and volume of transactions.
3. In D.07-12-052, OP 27, the Commission delegated authority to ED to authorize the implementation of a reformatted and streamlined QCR and to make ministerial changes to the content and format of the report as needs arise. Subsequently in 2008, ED issued a reformatted standardized QCR template for utilities to comply with when compiling their QCR to submit with their quarterly advice letters. In the standardized template, Attachment H, in a section labeled Information Purposes Only, is to include a summary of contracts/amendments executed during the quarter filed via separate applications or advice letters.

SDG&E's response:

In its response dated October 4, 2016 to the above-mentioned finding, SDG&E asserts:

SDG&E respectfully disagrees with DWA's assertion that Amendment 3 with [REDACTED] should have been reported in the "Information Purposes Only" category. While the amendment was related to a tolling purchase agreement filed under a separate advice letter, this amendment was not reviewed as a part of that advice letter, or through any other process outside of the QCR process. Therefore, SDG&E believes it is appropriate to report the amendment to [REDACTED] for the Commission's approval via the Q2 2016 QCR Filing.

SDG&E respectfully disagrees with DWA's assertion that the clarifying agreement with [REDACTED] should have been reported in the "Information Purposes Only" category. While the clarifying agreement was related to a tolling purchase agreement filed under a separate advice letter, this agreement was not reviewed as a part of that advice letter, or through any other process outside of the QCR process. Therefore, SDG&E believes it is appropriate to report the clarifying agreement to [REDACTED] for the Commission's approval via the Q2 2016 QCR Filing.

SDG&E respectfully disagrees with DWA's assertion that the settlement resolution with [REDACTED] should have been reported in the "Information Purposes Only"

category. While the settlement resolution was related to a tolling purchase agreement filed under a separate advice letter, this resolution was not reviewed as a part of that advice letter, or through any other process outside of the QCR process. Therefore, SDG&E believes it is appropriate to report the settlement resolution to [REDACTED] for the Commission's approval via the Q2 2016 QCR Filing.

SDG&E believes that it correctly classified the contract amendment, clarifying agreement and settlement resolution and does not consider this to be an error requiring corrective action. SDG&E has requested a meeting with relevant DWA and Energy Division staff to discuss this categorization of amendment and contracts in order to have greater clarity for this and future QCR filings.

Since SDG&E believes that it correctly reported this contract amendment, SDG&E does not perceive a need to file an amendment.

In its supplemental response dated October 12, 2016, SDG&E asserts:

The QCR process was established in D.02-10-062 and requires, inter alia, that the utilities include in the QCR a "[c]opy of each contract" entered into during the relevant reporting period. The purpose of the QCR is to ensure transparency of utility transactions to enable a finding that such transactions "are in compliance with the upfront standards identified by the Commission."

In D.04-12-048, the Commission ordered the IOUs to file a joint proposal to reformat the QCR in order to provide the Commission concise and coherent information. The current QCR template was adopted by the Commission in D.07-12-052. The decision outlines the collaborative process between the Energy Division and the IOUs that resulted in the proposed template document. The adopted template established the format of the report and specified the content to be provided in each attachment. The Commission delegated to Energy Division authority to continue refining the QCR template, as well as the authority "to make ministerial changes to the content and format of the report as needs arise." The current QCR template includes Attachment H, which calls for "New Contracts Executed / Contracts Amended."

It is important to note that while the Commission has directed Energy Division to "create guidelines that enable consistency across the utility QCR submissions," no such guidelines exist. Rather, direction regarding the contents of the QCR report is provided in piecemeal fashion through various Commission decisions, some of which relate to a single utility. On occasion, direction is provided verbally by Commission staff.

SDG&E's approach to preparation of its QCR is to favor transparency and to present a reasonably full accounting of its contracting activities for the quarter, in keeping with the direction in D.02-10-062 to provide contract information. Given the lack of a formal, comprehensive QCR guidelines document, SDG&E relies on the minimal direction provided in statewide proceedings, past precedent, common sense and, where it is offered, guidance provided by Commission staff in determining what information to include in its QCR.

In D.14-11-042, the Commission made clear that minor/non-material contract amendments do not necessitate a separate advice letter approval process. In order to ensure Commission awareness of such amendments (to RPS and other contracts), SDG&E's practice has been to include such amendments in Attachment H to its QCR, which, as noted above, calls for information related to contract amendments. Through discussion with Utility Audit, Finance, and Compliance staff, however, SDG&E has recently become aware that PG&E and SCE include contract amendments such as those at issue here in their respective ERRA filings rather than in their QCR. SDG&E has no objection to this approach and confirms that it will include the Q1 and Q2 contract amendments identified in the audit in its 2016 ERRA Compliance filing. SDG&E does, however, object to the characterization of its decision to originally include the amendments in its QCR as an error.

The direction to provide minor/non-material contract amendments in the ERRA filing rather than in the QCR was apparently provided by the Commission in the context of PG&E's 2005 ERRA proceeding, which produced D.06-12-009. SDG&E was not aware until now of the direction provided in this PG&E-specific decision and the Commission did not, so far as SDG&E is aware, repeat the direction in any decision issued in the LTPP proceeding or any other statewide proceeding to which SDG&E was party. In the nearly ten years since issuance of the PG&E ERRA decision, no concern has been expressed that SDG&E's practice of including contract amendments in the QCR deviated from that of PG&E and SCE; indeed, in D.14-12-048, the Commission declared "[w]e find that the QCR submissions are sufficiently standardized as ordered by Commission decision." Moreover, to the extent QCR Attachment H calls for information concerning "Contracts Amended," it was reasonable for SDG&E to conclude that contract amendments should be included in that QCR Attachment. SDG&E submits that rigid adherence to an unspoken or obscure rule that has never been presented to it is unreasonable. Given the absence of a comprehensive rules document and the lack of clarity regarding the applicable rules, some flexibility in enforcement of "rules" is warranted.

As noted above, SDG&E will change its procedure for reporting contract amendments to align it with that of the other IOUs. SDG&E strongly recommends that this requirement related to reporting contract amendments – as well as any other QCR requirements adopted informally or in IOU-specific proceedings – be included in a comprehensive guidelines document or at the very least, formally adopted in the relevant statewide proceeding.

UAFCB's Rebuttal: None.

- 2. SDG&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.** In Q2, SDG&E executed gas physical and financial transactions bilaterally with terms longer than one calendar month in duration. SDG&E failed to provide a strong showing justification for these bilateral transactions in Attachment M. On October 4, 2016, SDG&E submitted amended Attachment M to supplement its Q2 QCR by including its strong showing justification for the aforementioned bilateral transactions.

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.

SDG&E's response:

In its response dated September 6, 2016 to the finding, SDG&E asserts:

The transactions in question are index priced transactions. SDG&E has not provided strong showing justification(s) on Attachment M for index priced transactions in the past, because the nature of these transactions implies they are at market prices. SDG&E agrees to amend Attachment M and will provide strong showing justification for such transactions in the future for bilateral index priced transactions.

The transaction in question is a financial transaction. SDG&E has not provided strong showing justification(s) on Attachment M for financial transactions in the past, because SDG&E does not consider these transactions to be procurement but rather to provide protection against price volatility for procurement activity that will take place in the future. SDG&E agrees to amend Attachment M and will provide

strong showing justification for such transactions in the future for financial transactions.

SDG&E amended Attachment M to include its strong showing justification for the aforementioned bilateral transactions on October 4, 2016.

UAFCB's Rebuttal: None.

3. **SDG&E failed to demonstrate that it was in compliance with D.02-10-062, Appendix B and PUC §581.** In its Q2 QCR, SDG&E made reporting errors in Attachments A and H. In Attachment A, SDG&E incorrectly reported the “power flow start hour” for its electric physical transactions. In Attachment H, SDG&E incorrectly included a CHP purchase contract for the Commission’s approval. The CHP contract should not have been reported as a contract for the Commission’s approval via the QCR. It should have been reported as a contract filed for information purposes only.

On August 16, 2016 and September 6, 2016, SDG&E submitted an amended Attachment H and A, to correct the aforementioned reporting errors. SDG&E’s failure to correctly report QCR attachments has been a UAFCB finding 13 times from 2009 through 2015.

Criteria:

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 in a QCR by an advice letter. The QCR filing must contain, among other things, information that is complete and accurate, including but not limited to, the number and volume of transactions.

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:

In its responses dated August 16, 2016 and September 6, 2016 to the finding, SDG&E asserts:

SDG&E’s agreement with [REDACTED] was reported in the incorrect section of Attachment H. The [REDACTED] contract is a tariffed AB 1613 Combined Heat and Power agreement. Attachment H will be revised with the [REDACTED] agreement reported in the information purposes only section. While the contract cover sheet is on a page that was added to the tariff in 2011, the agreement itself was effective May, 1 2016, which the agreement states in the first paragraph.

The original Attachment A – Electric Physical Transactions didn’t format “Power Flow Start Hour” data correctly.

UAFCB's Rebuttal: Incorrect and inaccurate QCR reporting has been a UAFCB finding numerous times in 2014 and 2015. UAFCB continues to find errors and mistakes in SDG&E’s filings. SDG&E needs to vigorously implement and enforce new internal controls to ensure the accuracy of its QCR and related attachments before submitting any QCR to the Commission. In the future, UAFCB will

recommend ED reject any SDG&E QCR that contains significant reporting errors for correction and resubmittal.

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 Advice Letter (AL) 2935-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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