



Memorandum

Date: February 16, 2010

To: Julie Fitch
Director of Energy Division

From: **Public Utilities Commission—** Kayode Kajopaiye, Branch Chief
San Francisco Division of Water and Audits

Subject: Pacific Gas and Electric Company Advice Letter 3550-E
Quarterly Procurement Plan Compliance Report for the Third Quarter of 2009

A. Summary of Audit Findings:

1. **Appendix B, PG&E's Quarterly Compliance Report (QCR) filing contains data errors associated with holiday transactions.** These errors ultimately had no impact on ratemaking because the final settlement amounts of the transactions were accurately reported in PG&E's Energy Resource Recovery Account (ERRA). These errors exist in all PG&E's QCR filings since the first quarter of 2008, and possibly even earlier.

B. Recommendations:

1. **PG&E should review the NERC holiday transactions incurred in each quarter and correct any errors associated with these transactions before it submits its QCR filing to the Commission.**
2.).

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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 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 Utility Commission's (Commission) approved procurement plans, while complying with all AB 57 procurement rules and numerous procurement-related regulatory rulings and decisions, including, but not limited to, D.02-10-062, D.03-06-076, D.03-12-062, D.07-12-052, and D.08-11-008.

On October 30, 2009, PG&E filed AL 3550-E, which summarized its electric and natural gas procurement activities for the period July 1 through September 30, 2009 or Q3. During Q3, PG&E executed a total of 3,753[redact] transactions consisting of, but not limited to, physical power and financial hedging transactions, as compared to 12,383[redact] in the third quarter of 2008. This represents a decrease of 70% [redact] in its transactions over the same quarter in 2008 and a 58% decrease[redact] over the average number of transactions for 2008 of 8,845 [redact]. In response to a UAFCB data request, PG&E indicated that the primary reason for the decrease is PG&E's mandatory participation in the California Independent System Operator's (CAISO) new day ahead Integrated Forward Market (IFM), as part of the Market Redesign and Technology Upgrade (MRTU), starting in the second quarter of 2009 (Q2) [redact].

Prior to the launch of MRTU, load serving entities (LSE), including PG&E, had to maintain enough energy to satisfy their load and sales obligations by generating electricity or acquiring it through contracts and/or purchases in the bilateral energy market[redact]. PG&E is required to report physical power purchases and sales in the bilateral energy market in its QCR. The majority of energy procurement transactions PG&E reported in its third quarter of 2008 QCR mostly consist of physical energy deals transacted in the bilateral energy market[redact].

With the advent of the IFM at the beginning of Q2, physical power purchases by LSE in the bilateral energy market have decreased significantly and have almost been eliminated. LSE can now purchase physical energy in CAISO's centralized day-ahead energy market or IFM, based on price curves that potential buyers submit to the CAISO. The CAISO in turn, buys electricity from suppliers based on price curves submitted by those suppliers[redact]. PG&E is not required to report physical power purchases in CAISO's centralized market in its QCR. Hence, the number of physical transactions is greatly reduced in the post-MRTU Q3 as compared to the pre-MRTU third quarter of 2008[redact].

¹ UAFCB first discussed this issue in its audit report memorandum on the fourth quarter of 2008, dated July 15, 2009, and in each memorandum since then.

² UAFCB first discussed this issue in its audit report memorandum on the first quarter of 2009, dated September 30, 2009, and in each memorandum since then.

Details regarding this audit's scope, sampling methodology, and procedures are included in this memorandum in Appendix A.

D. Audit Findings:

1. NERC Holiday Transaction Errors

Criteria: Appendix B of D.02-10-062 requires that utilities file each quarter's procurement transactions by advice letter. The advice letter must contain, among other things, information that is complete and materially accurate, including, but not limited to, the number and volume of transactions.

Findings: PG&E has reported erroneous volumes and notional amounts for some of the NERC holiday transactions in all of its QCR filings submitted to the Commission.³ PG&E has inadvertently assigned 8, instead of 24, off-peak hours to NERC holidays during its preparation of its QCR filings. PG&E should assign 24 off-peak hours to each of these days when it prepares its QCR filing. The transaction errors reported in the QCR have no impact on ratemaking.

Although the final settlement amounts recorded in ERRRA were correct, ED urges PG&E to correct this error pattern. ED requested PG&E to quantify the percentages of volume and value that have been misstated from 2004 through 2008, in order to determine the materiality of this issue. PG&E provided that analysis on April 22, 2010, and supplemented its response May 14, 2010.

PG&E's Response: In its e-mail dated January 29, 2010, PG&E indicated that it is the utility's goal to identify reasonable and rational solutions to the aforementioned identified error pattern and that it will look for ways to improve the accuracy of its QCR reporting. The solutions that PG&E is evaluating include, but are not limited to, the following:

1. Prepare a look-up table to assess if a transaction date falls on any NERC holidays. If it does, PG&E will calculate 24 off-peak hours for that date.
2. Prepare a look-up table to assess if a transaction flows from Sunday through Monday with Monday as a NERC holiday. If it does, then the total off-peak hours for this transaction will be 48 as both Sunday and Monday would be off-peak time.
3. An individual who is knowledgeable regarding trading and flowing dates will perform a quality assurance check.
4. Perform transactional checks and reviews on a daily trading basis. If errors of any sort are found, resolutions of these errors will be handled on a daily basis, rather than on a monthly or quarterly basis.

³ NERC is an organization comprised of electric utilities and energy supplies. NERC's purpose is to ensure the reliability of the electric supply for North America. NERC is self-regulated but is overseen by Federal Energy Regulatory Commission (FERC) and other government agencies of both the United States and Canada. NERC establishes certain standards and has determined that New Year's Day, Memorial Day, Labor Day, Thanksgiving and Christmas are holidays and that each of these five days are to be considered off-peak.

E. Conclusion

Except for the items noted in Sections E above, PG&E's AL 3550-E and its Q3 procurement transactions for electricity and natural gas were, in material respects, in compliance with PG&E's Commission-approved procurement plan and all relevant Commission decisions. PG&E's Q3 transactions, in material respects, appear to be complete, accurate and properly authorized.

If you have any questions on UAFCB's audit, please contact Tracy Fok at (415) 703-3122.

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