



Memorandum

Date: August 31, 2011

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 3836-E
Quarterly Procurement Plan Compliance Report for the First Quarter 2011

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 Pacific Gas and Electric Company's (PG&E) Advice Letter No. (AL) 3836-E. PG&E's audited procurement transactions during the first quarter of 2011 (Q1) were, in all material respects, in compliance with PG&E's procurement plan, as approved in Decision (D.) 07-12-052, Assembly Bill (AB) 57 procurement rules, and several procurement-related Commission directives.

A. Summary of Audit Findings:

1. **PG&E failed to demonstrate that it was in compliance with D. 02-10-062, Appendix B.** PG&E failed to correctly report Attachments A, B, C, D, H and M of its Q1 Quarterly Compliance Report (QCR) filing.

In response to UAFCB's finding, PG&E filed its corrected Attachments A, B, C, D, H, and M on June 17, 2011.

2. PG&E did not appropriately address the concerns of its independent evaluator (IE) regarding its bilateral contract negotiations with Shell Energy North America (SENA) to its Procurement Review Group (PRG) and ED.

B. Recommendations:

1. **Before submitting its QCR filing, PG&E should thoroughly review its QCR and related attachments to ensure accuracy.**
2. **PG&E must properly address the concerns of its IE regarding its bilateral contract negotiations to its PRG and ED to ensure transparency of the contract negotiations.**

C. Background:

As required by D.02-10-062, Ordering Paragraph (OP) 8. and clarified in D.03-12-062, Pacific Gas & Electric, San Diego Gas and Electric (SDG&E), and Southern California Edison (SCE) must each submit 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 all AB 57 procurement rules and several procurement-related 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, and D.08-11-008.

D. Findings

1. Errors in the QCR

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

Finding: PG&E did not correctly report the following attachments of its Q1 QCR filing:

- a. In Attachment C, PG&E incorrectly categorized 19,200 MWh off-peak volumes as peak volumes for its balance of month transactions.
- b. In Attachment H, PG&E inadvertently excluded an auction contract executed during Q1.
- c. In Attachments A and D, PG&E understated 30,367,200 MMBtu for its gas physical volume.
- d. PG&E did not correctly report its Attachments B and M because of the aforementioned understatement in its gas physical volume.

PG&E's Response: PG&E filed its corrected Attachments A, B, C, D, H, and M on June 17, 2011.

UAFCB's Rebuttal: None.

2. IE's Concern Regarding the Bilateral Contract Executed with SENA

Finding: The PRG indicated that SENA, instead of entering into a bilateral contract with PG&E, should go through a request for offers (RFO) process for the purpose of negotiation transparency. To address the PRG's concern, PG&E engaged Arroyo Seco Consulting (Arroyo) as an IE to oversee PG&E's negotiation process of this bilateral contract and avoided a lengthy RFO process.

Arroyo, however, issued a qualified opinion in its IE report and reported the following concerns with respect to PG&E's negotiation with SENA:

- a. Arroyo did not directly observe any of the bilateral negotiations between PG&E and SENA. Arroyo was not engaged to serve as IE for the bilateral contract until after the basic terms of the agreement had been agreed.
- b. Arroyo is concerned that PG&E only requested SENA to lower its price but did not request other participants to do the same.

PG&E's Response:

1. PG&E indicates that its bilateral contract is compliant with PG&E's 2006 Conformed Long-Term Procurement Plan Authority.
2. PG&E consulted with its PRG and properly addressed the PRG's concerns.
3. Arroyo's qualified opinion is that the negotiations between PG&E and SENA were handled in a manner fair to other competing gas suppliers.
4. Arroyo's opinion is that PG&E's bilateral contract with SENA merits CPUC approval.

UAFCB's Rebuttal:

UAFCB does not object PG&E's response. However, PG&E needs to address the above-mentioned Arroyo's concerns to its PRG and ED to ensure transparency of the bilateral contract negotiations and to improve PG&E's process of future bilateral contract negotiations and IE involvement.

E. Conclusion

Except for the items noted in Section D above, PG&E's AL 3836-E and its Q1 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 Q1 transactions, in material respects, appear to be complete, accurate and properly authorized by its management.

This audit is limited in scope and does not provide full assurance to the reasonableness of PG&E's Q1 QCR filing or its Q1 transactions.

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

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