



# Memorandum

**Date:** December 31, 2015

**To:** Edward Randolph  
Director of Energy Division

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

**Subject:** San Diego Gas and Electric Company Advice Letter 2770-E  
Quarterly Procurement Plan Compliance Report for the First Quarter of 2015

*DKW,  
for*

**Based on the results of its audit, the Utility Audit, Finance and Compliance Branch (UAFCB), of the Division of Water and Audits, recommends that unless San Diego Gas and Electric Company (SDG&E) amends its Advice Letter (AL) 2270-E to remove the transaction mentioned in Sections A and D below, Energy Division (ED) should not approve AL 2770-E. Otherwise, UAFCB did not find any material reasons for ED to deny the approval of SDG&E's AL 2770-E.** Except for the findings mentioned below, the procurement transactions that SDG&E executed during the second quarter of 2015 (Q2) and UAFCB examined demonstrated compliance, in all material respects, with certain aspects of procurement-related state law and California Public Utilities Commission (Commission or CPUC) directives. The UAFCB assesses compliance in accordance with agreed-upon procedures with ED and does not assess compliance with all aspects of the procurement-related state law or those directives. 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 UAFCB's audits.

## A. Summary of Negative Audit Findings:

- 1. SDG&E failed to demonstrate that it was in compliance with Resolution E-4642 and Decision (D.) 02-10-062.** SDG&E reported an agreement that it executed with CP Kelco, U.S., Inc. (Kelco) as part of compliant transactions included in its Q2 Quarterly Compliance Report (QCR) filing. SDG&E should not have included the transaction as a separate agreement because it is an amendment to the Transition Power Purchase and Sale agreement (PPSA) executed between the two parties on December 20, 2012. Per ED's instruction, SDG&E should not include this transaction along with the compliant transactions in the Q2 QCR filing. ED indicated that SDG&E should file this transaction as a contract amendment to the Transition PPSA through a separate advice letter or through SDG&E's Energy Resource Recovery Account (ERRA) proceedings for the Commission's approval.
- 2. SDG&E failed to demonstrate that it was in compliance with Public Utilities Code (PUC) §581.** SDG&E made an error in its response to UAFCB's document request related to gas physical transactions reported in SDG&E's ERRA.
- 3. SDG&E failed to demonstrate that it was in compliance with PUC §454.5, D.02-10-062 and D.03-12-062.** SDG&E does not have a list of authorized brokerages, exchanges and futures commission merchants in its current Bundled Procurement Plan (BPP) approved by the Commission.

## B. Recommendations:

- 1. SDG&E must amend AL 2770-E and its Q2 QCR filing to remove the contract executed with Kelco and file a contract amendment to the Transition PPSA through the ERRA proceeding as the deadline for filing a separate advice letter for the contract amendment has passed.**

- 2. SDG&E must develop, implement and enforce internal controls over its ERRA reporting to ensure that such reporting is accurate.**
- 3. SDG&E must include a list of brokerages, exchanges and futures commission merchants in its next BPP proceeding for the Commission's authorization. In the interim, SDG&E should immediately file a Tier 3 advice letter with a list of its brokerages, exchanges, and futures commission merchants for the Commission's approval.**

#### **C. Background:**

As required by D.02-10-062, Ordering Paragraph (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 filing for all transactions of less than five years duration executed in the quarter. ED requested that the UAFCB conduct compliance audits of these utilities' QCR filings.

UAFCB conducts the quarterly procurement audits based on procedures specified by ED, and as such these examinations are by design agreed-upon procedures. 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 directives ED chose to test for compliance include, but are not limited to: some of the ordering paragraphs included in 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. UAFCB, however, does not test all of the transactions that the utilities include in their QCR.

#### **D. Findings:**

- 1. SDG&E failed to demonstrate that it was in compliance with Resolution E-4642, Findings and Conclusions (F&C) # 5 and the first paragraph of Appendix B in D.02-10-062.** SDG&E incorrectly reported an amendment that it executed with Kelco as a bilateral contract in Attachment H of its Q2 QCR filing. The nature of this transaction is actually an amendment to the Transition PPSA executed between the two parties on December 20, 2012 because it merely extends the agreement term for an additional six months, from July 1, 2015 to December 31, 2015.

The Transition PPSA was originally filed in a separate Tier 3 advice letter (AL 2517-E) and approved in Resolution E-4642. The review and approval criteria for that advice letter were significantly different from those for the QCR filing. Thus, any change to the Transition PPSA that is inconsistent with Resolution E-4642 should be thoroughly reviewed for determining whether the Commission's approval should be granted.

According to F&C # 5 of Resolution E-4642, the Transition PPSA should terminate no later than July 1, 2015. The extension to December 31, 2015 associated with the Transition PPSA would be inconsistent with this resolution. Instead of being included in the QCR, the extension should be filed as an amendment to the Transition PPSA through a separate advice letter or, if appropriate, an ERRA proceeding.

**Criteria:** F&C # 5 of Resolution E-4642 indicates:

The Transition Agreement will terminate upon election of the seller, buyer or no later than July 1, 2015. The transition PPA will commence thirty days after the Commission approval.

The first paragraph in Appendix B of D.02-10-062 requires the utilities to file each month's transactions that conform to the approved procurement plan by advice letter.

**SDG&E's Response:**

SDG&E indicated:

Rather than amend the Agreement itself, which would have required a filing with the Commission, SDG&E and Kelco agreed to treat the extension as a new short-term agreement, rather than a PPSA amendment.

The CP Kelco US letter agreement dated June 23, 2015 did not require any pre-approval from the Commission (through an advice letter or application) as set forth in the Commission's policy for bilateral agreements. Beginning with D.04-12-048 the Commission has allowed SDG&E to enter into contracts of less than five years duration (including all extensions) without pre-approval from the Commission. This allowance was further clarified in D.07-12-052, at pages 171-72:

- IOU may execute a contract of under five years without pre-approval for which deliveries end at any point within the 10-year LTTP procurement cycle, provided the procurement complies with a procurement limit methodology (which various parties refer to as a ratable rate, laddering, or layering methodology) developed by the IOU and approved by a Commission resolution or decision.
- Absent a Commission-approved procurement limit methodology, an IOU may execute a contract of under five years without pre-approval provided, per existing ED guidance, that the five-year duration clock begins:
  - At the time the contracted resources begin delivery if delivery begins within one year of contract execution; or
  - At the time of contract execution if delivery does not begin within one year of contract execution.
- In calculating contract duration, calendar days are used, not days of obligation, days of service under the contract, or days of need for the resource.

There is no "procurement limit methodology" applicable to the procurement of CHP, and so the Kelco letter agreement falls under the second bullet above. Deliveries under the contract began nine (9) days after contract execution, and so the contract is exempt from Commission pre-approval due to the five year clock beginning "within one year of execution."

**UAFCB's Rebuttal:** ED agrees with UAFCB confirmation that the contract executed between SDG&E and Kelco should not be a new contract and is actually an amendment to the Transition PPSA between the two parties because the nature of the transaction is merely to extend the original agreement term for an additional six months. The language SDG&E quoted from D.07-12-052 does not apply in this case because the extension of the Transition PPSA is inconsistent with Resolution E-4642. ED also agrees with UAFCB that SDG&E should not report the extension of the contract as a new bilateral contract along with other compliant transactions included in the Q2 QCR filing. Instead, SDG&E should file the contract extension as an amendment through either a separate advice letter or an ERRR proceeding.

**2. SDG&E failed to demonstrate that it was in compliance with PUC §581.** SDG&E made an error in its response to UAFCB's document request related to gas physical transactions reported in the ERRAs. Although SDG&E correctly reported its gas physical transactions in the ERRAs, it made an error in its calculation of generation costs. The error resulted in approximately \$400,000 understatement of the ERRAs.

**Criteria:** 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:** After UAFCB notified SDG&E about the aforementioned error, the utility immediately corrected its generation cost calculation and revised its ERRAs balance accordingly.

**UAFCB's Rebuttal:** SDG&E must develop, implement and enforce internal controls over its ERRAs reporting to ensure that such reporting is accurate. The internal controls shall include thorough reviews of every aspect of the ERRAs reporting.

**3. SDG&E failed to demonstrate that it was in compliance with PUC §454.5, D.02-10-062 and D.03-12-062.** SDG&E does not have a list of authorized brokerages, exchanges and futures commission merchants in its current Bundled Procurement Plan (BPP) approved by the Commission. As a result, SDG&E has been executing some of its trades through various brokerages, exchanges and futures commission merchants that the Commission were not made aware of and did not pre-approve in SDG&E's BPP.

**Criteria:** PUC §454.5 requires the IOU to file proposed procurement plan for the Commission's approval. The procurement plan should include, but not be limited to, the IOU's competitive procurement process under which the IOU may request bids for procurement-related services, including the format and criteria of that procurement process.

Page 32 of D.02-10-062 indicates:

- Approved utility plans will identify and describe the various electronic energy trading exchanges that each utility proposes the use (e.g., Bloomberg, Trade Spark, Intercontinental Exchange).
- The procurement plan shall demonstrate that the identified electronic trading exchanges the utility intends to use provide transparent prices.

Page 38 of D.03-12-062 indicates:

Whereas SCE and SDG&E identified in their proposed short-term plans the brokerages and exchanges those firms propose to rely on, PG&E did not. PG&E should provide such a list in compliance advice letter filing updating its short-term plan.<sup>1</sup>

**SDG&E's Response:** SDG&E is not aware of the Commission's explicit requirements that the IOU must include their brokerages, exchanges and futures commission merchants in their BPP for the Commission's approval.

**UAFCB's Rebuttal:** SDG&E must include a list of brokerages, exchanges and futures commission merchants in the next BPP proceeding for the Commission's authorization. In the interim, SDG&E

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<sup>1</sup> This statement implies that the IOU are required to include a list of brokerages and exchanges that they use in their procurement plans for the Commission's approval.

should immediately file a Tier 3 advice letter with a list of its brokerages, exchanges, and futures commission merchants for the Commission's approval.

**E. Conclusion:**

Except for the items noted in Section D above, SDG&E's AL 2770-E and its Q2 procurement transactions for electricity and natural gas that UAFCB examined were, in material respects, in compliance with the aspects of SDG&E's Commission-approved procurement plan and certain ordering paragraphs from relevant Commission decisions that the UAFCB tested compliance with. SDG&E's Q2 transactions that the UAFCB examined, in material respects, appear to be complete, accurate and properly authorized by its management.

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

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