



Memorandum

Date: December 27, 2018

To: Edward Randolph
Director of Energy Division

From: **Public Utilities Commission—
San Francisco** Tracy Fok, Program & Project Supervisor
Utility Audit, Finance and Compliance Branch

Subject: San Diego Gas and Electric Company Advice Letter 3254-E
Quarterly Procurement Plan Compliance Report for the Second Quarter of 2018
Summary of Negative Findings

The Utility Audit, Finance and Compliance Branch (UAFCB) issues this memorandum containing its negative findings on San Diego Gas and Electric Company (SDG&E) Quarterly Procurement Plan Compliance Report (QCR) filed by Advice Letter No. (AL) 3254-E. The negative findings are based on the results of UAFCB's performed procedures to assess SDG&E's compliance. UAFCB assesses SDG&E's compliance in accordance with agreed-upon procedures (AUP) with Energy Division (ED) and does not assess the compliance with all aspects of the procurement-related state law and procurement-related directives mandated by the California Public Utilities Commission (CPUC or 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.

A. Summary of Negative Findings:

1. **SDG&E failed to demonstrate compliance with Decision (D).03-06-067, Ordering Paragraph (OP) 3 (d).** In the second quarter of 2018 (Q2) QCR, SDG&E failed to provide sufficient strong showing justification on Attachment M for two bilateral contracts executed during Q2 with terms longer than one calendar month. On October 17, 2018, SDG&E amended Attachment M to include sufficient strong showing justification for these two contracts in response to UAFCB's finding.
2. **SDG&E failed to demonstrate compliance with D.07-12-052, OP 27 and Public Utilities Code (PUC) §581.** SDG&E failed to include four non-investment grade counterparties with which it transacted during Q2. On November 5, 2018, SDG&E amended Attachment B to include these counterparties in response to UAFCB's finding.

B. Recommendations:

1. SDG&E should implement an effective review process to ensure that sufficient strong showing justification is included for all transactions subject to the strong showing requirement indicated in D.03-06-067.

2. SDG&E needs to be familiar with the QCR reporting requirement and implement and enforce an effective review process to ensure the reporting accuracy of its QCR and related attachments before submitting them to the Commission.

C. Background:

As required by D.02-10-062, OP 8 and clarified in D.03-12-062, SDG&E, Pacific Gas & Electric Company (PG&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 between ED and UAFCB. ED specified which aspects of the utilities' Commission-approved procurement plans, Assembly Bill (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 D.03-06-067, OP 3 (d).** In Q2, SDG&E executed two (2) sales bilateral contracts that require strong showing justification. SDG&E reported these contracts on attachment M but failed to demonstrate that such contracts are reasonable based on available and relevant market data supporting the contracts.

Criteria:

- a. 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 these 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]

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

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

SDG&E's response: On August 30, 2018, SDG&E asserted the following:

- a. SDG&E is submitting an amended Attachment M - Q2 2018 Transactions Subject to Strong Showing to provide additional justification. Within the amended Attachment M, SDG&E has included an attachment from the CAISO website which posted the 2018 Transfer of Import Capability which shows all market transactions for 2018 to date. The attachment demonstrates that SDG&E transacted at reasonable prices based on CAISO market information for import points that are not located at major trading hubs.
- b. SDG&E believed that the first submission of Attachment M was sufficient justification for an illiquid non-standard transaction not sold through brokers or exchanges. However, SDG&E agrees to provide additional information to justify the Strong Showing of the bilateral Import Capability Transfers in Q2 2018. SDG&E endeavors to provide adequate and accurate information in all quarterly filings and shall diligently scrutinize and provide adequate justifications for all transactions subject to strong showings going forward.
- c. On October 17, 2018, SDG&E amended Attachment M to include proper justification in response to UAFCB's finding.

UAFCB's Rebuttal:

The strong showing justification from the first submission of Attachment M did not demonstrate that the bilateral transactions are reasonable based on available and relevant market data supporting the transaction. However, SDG&E's endeavor to provide adequate justifications for all future transactions subject to strong showing is greatly appreciated.

2. **SDG&E failed to demonstrate compliance with D.07-12-052, OP 27 and PUC §581.** On Attachment B of its Q2 QCR, SDG&E failed to include four (4) non-investment grade counterparties with which it transacted bilaterally. The transactions executed with these non-investment grade counterparties were included in Attachments A and H of SDG&E's Q2 QCR.

Criteria:

- a. D.07-12-052, OP 27 indicates that the Commission directs the ED, in conjunction with the external auditors and the IOUs (Investor Owned Utilities) to continue the collaborative effort formed earlier this year and develop a reformatted QCR. The Commission delegates authority to ED to authorize the implementation of the reformatted and streamlined QCRs and to make ministerial changes to the content and format of the report as needs arise. The reformatted QCR requires all the IOUs to report any non-investment grade counterparties that the IOUs transact with on Attachment B.
- b. 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: On November 5, 2018, SDG&E responded that:

- a. SDG&E historically only included physical gas & power transaction counterparties in Attachment B for non-investment grade reporting. SDG&E has not seen any decisions to indicate that this was incorrect.
- b. Nonetheless, at the auditor's request, SDG&E will include all non-investment grade counterparties that it transacts with, including pertinent counterparties reported on Attachments A, H, and Q.
- c. SDG&E amended Attachment B to include all non-investment grade counterparties in response to UAFCB's finding.

UAFCB's Rebuttal:

Per D.07-12-052, IOUs shall follow the current QCR reporting template developed collaboratively with ED. As required on the template, all non-investment grade counterparties with whom the utility transacted during the quarter should be reported on Attachment B.

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 AL 3254-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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