

Memorandum



Date: August 7, 2014
To: Edward Randolph
Director of Energy Division
From: **Public Utilities Commission—** Kayode Kajopaiye, Branch Chief
San Francisco Division of Water and Audits
Subject: Southern California Edison Advice Letter 2996-E
Quarterly Procurement Plan Compliance Report for the Fourth Quarter of 2013

Based on the results of its audit, the Utility Audit, Finance and Compliance Branch (UAFCB) of the Division of Water and Audits did not find any material reasons for Energy Division (ED) to deny the approval of Southern California Edison's (SCE) Advice Letter No. (AL) 2996-E. The procurement transactions that SCE executed during the fourth quarter of 2013 (Q4) and that the UAFCB examined demonstrated, in all material respects, compliance with certain aspects of procurement-related state law and Commission 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, SCE'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. **SCE failed to demonstrate that it was in compliance with Decision (D.) 02-12-074, Ordering Paragraph (OP) 24(b).** SCE did not ensure that one of its employees that it transferred to its Trading and Energy Operations (TEO) Department in Q4 signed and acknowledged SCE's Code of Conduct (COC) agreement within an appropriate timeframe. SCE's failure to ensure its new and transferred TEO employees signed and acknowledged its COC agreement with an appropriate timeframe has been a UAFCB audit finding multiple times in the past.
2. **SCE failed to demonstrate that it was in compliance with D.04-12-048, OP 15.** SCE failed to consult with its Procurement Review Group (PRG) before it executed two transmission loss power purchase contracts with Avista Corporation and Idaho Power Company. These two contracts each have terms greater than 90 days or three calendar months.

B. Recommendations:

1. **SCE should require all of its new and transferred TEO employees to sign and acknowledge the COC in a timely manner.**
2. **SCE needs to consult with its PRG before it executes any contracts with terms greater than 90 days or three calendar months.**

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), San Diego Gas & Electric Company (SDG&E), and SCE must each submit a Quarterly Compliance Report (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' 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' California Public Utilities Commission's (Commission) approved procurement plans, AB 57 procurement rules and several procurement-related rulings and decisions to test for compliance. The directives of the decisions and rulings ED chose 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, and D.12-01-033. UAFCB, however, does not test all of the transactions that the utilities include in their QCR.

D. Findings:

1. **Finding:** During Q4, one of SCE's existing employees who transferred to its TEO department did not sign and acknowledge SCE's COC agreement in a timely manner.

Criteria: In D. 02-12-074, OP 24(b), the Commission requires that each utility must adopt, actively monitor, and enforce compliance with a comprehensive code of conduct for all employees engaged in the utility's energy procurement process. It is a good management practice for an employee to sign COC agreement within two weeks of starting employment in SCE's TEO department. If any TEO employees sign the COC agreement outside of this two-week timeframe, SCE's internal control risk in its TEO department can increase significantly because the TEO employees may violate SCE's COC rules without reviewing and understanding these rules.

SCE's Response: SCE implemented new internal controls starting on April 1, 2014 to address this finding. These controls include semi-weekly monitoring of internal human resources reports and a more stringent internal requirement that both new and transferred employees sign the code of conduct acknowledgement form within two weeks of their hire date. SCE will continue to monitor and improve its compliance with its COC policy and procedures and ensure that all affected employees sign the code of conduct agreement in accordance with SCE's internal policies.

UAFCB Rebuttal: SCE's failure to ensure its new or transferred TEO employees signed and acknowledged its COC agreement within an appropriate timeframe has been a UAFCB audit finding multiple times in the past. UAFCB will continue to review SCE's compliance with the Commission's COC requirements and ensure that SCE's internal controls regarding COC compliance work effectively.

2. **Finding:** **SCE failed to demonstrate that it was in compliance with D.04-12-048, OP 15.** In Q4, SCE executed two transmission loss power purchase contracts with Avista Corp. and Idaho Power Company. The term for each of these two contracts is 12 months. SCE, however, did not specifically consult with its PRG regarding the counterparties, prices, and terms of the aforementioned contracts.

Criteria: In D.04-12-048, OP 15, the Commission requires that utilities consult with the PRG for transactions with delivery periods greater than three calendar months, or one quarter.

SCE's Response: The two contracts in question are transmission power loss provider agreements. They are used to financially settle the physical power losses that occur when moving power across the Avista Corp. or Idaho Power Company transmission lines. These agreements are similar to master agreements as they establish the settlement provisions for losses if SCE procures Electricity Transmission Products from Avista Corp. or Idaho Power Company. SCE asserts that the loss provider agreements are not transactions and do not create any physical or financial obligation. As such, SCE believes that these two contracts do not fall under the purview of D.04-12-048, OP 15.

As with master agreements, SCE alleges that it was not obligated to consult with its PRG for the contracts in question.

UAFCB's Rebuttal: Master agreements are general in nature without any specification of prices, terms, and delivery locations. However, the nature of the two contracts in question is not similar to that of master agreements as the contracts actually specified the prices, delivery locations, and terms. In addition, the contracts can create physical obligation to the suppliers and financial obligation to SCE because power losses can occur as results of transmitting power through the suppliers' grid. The contracts do fall under the purview of D.04-12-048, OP 15.

E. Conclusion:

Except for the items noted in Section D above, SCE's Q4 procurement transactions for electricity and natural gas that the UAFCB examined were, in material respects, in compliance with the aspects of SCE's Commission-approved procurement plan and relevant Commission decisions that the UAFCB tested compliance with. SCE's Q4 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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