

# **SAN DIEGO GAS AND ELECTRIC COMPANY**

Audit Report

## **AFFILIATE TRANSACTION RULES**

*For Calendar Years 2012 and 2013*



**BETTY T. YEE**  
California State Controller

April 2018



**BETTY T. YEE**  
California State Controller

April 26, 2018

Alice Stebbins, Executive Director  
California Public Utilities Commission  
505 Van Ness Avenue  
San Francisco, CA 94102

Dear Ms. Stebbins:

The State Controller's Office, pursuant to an Interagency Agreement 14IA5019 with the California Public Utilities Commission (CPUC), conducted an audit of San Diego Gas and Electric (SDG&E)—an Investor Owned Utility (IOU)—for calendar year (CY) 2012 and CY 2013. The purpose of the audit was to determine whether SDG&E's interactions and business activities with its related entities (affiliates) are in accordance with the Affiliate Transaction Rules (ATRs) established by the five-member Commission, the members of which sit on the CPUC.

The ATRs define standards of conduct governing relationships between IOUs and their affiliated, unregulated entities. These rules are established to ensure that IOUs avoid cross-subsidization of activities and foster market competition. These standards of conduct ensure that utilities:

- Meet their obligation to provide energy at the lowest reasonable cost; and
- Do not favor or otherwise engage in preferential treatment of their affiliates.

Our audit determined that SDG&E substantially complied with the ATRs; however, we noted several instances of non-compliance that did not significantly impact SDG&E's ability to conform to the ATRs. Regardless, SDG&E is required to report all instances of non-compliance, with remedies, to the CPUC for approval.

If you have any questions, please contact Andrew Finlayson, Chief, State Agency Audit Bureau, at (916) 324-6310.

Sincerely,

*Original signed by*

JEFFREY V. BROWNFIELD, CPA  
Chief, Division of Audits

JVB/as

cc: Michael Picker, President

California Public Utilities Commission

Carla J. Peterman, Commissioner

California Public Utilities Commission

Martha Guzman Aceves, Commissioner

California Public Utilities Commission

Liane M. Randolph, Commissioner

California Public Utilities Commission

Clifford Rechtschaffen, Commissioner

California Public Utilities Commission

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# Audit Report

## Summary

The State Controller's Office (SCO), pursuant to Interagency Agreement 14IA5019 with the California Public Utilities Commission (CPUC), conducted an audit of San Diego Gas and Electric Company (SDG&E)—an Investor Owned Utility (IOU)—for calendar year (CY) 2012 and CY 2013. The purpose of the audit was to determine whether SDG&E's interactions and business activities with its related entities (affiliates) are in accordance with the Affiliate Transaction Rules (ATRs) established by the five-member Commission (Commission), the members of which sit on the CPUC.

The ATRs define standards of conduct governing relationships between IOUs and their affiliated, unregulated entities. These rules are established to ensure that IOUs avoid cross-subsidization of activities and foster market competition. These standards of conduct ensure that utilities:

- Meet their obligation to provide energy at the lowest reasonable cost; and
- Do not favor or otherwise engage in preferential treatment of their affiliates.

Our audit determined that SDG&E substantially complied with the ATRs; however, we noted several instances of non-compliance that did not significantly impact SDG&E's ability to conform to the ATRs. Regardless, SDG&E is required to report all non-compliance instances, with remedies, to the CPUC for approval.

## Background

As a result of the deregulation of utility service providers in the late 1980s and early 1990s, the Commission gave IOUs the authority to reorganize under a holding company structure (parent company and subsidiaries) rather than remain an integrated series of producers and suppliers of energy-related products and services.

The IOUs argued that deregulation would allow them the flexibility to invest their profits more efficiently; however, the Commission expressed concerns about the potential for the preferential treatment and cross-subsidization of nonregulated affiliates. To mitigate these concerns, the Commission imposed the ATRs. Since inception of the ATRs in 1993, the Commission has periodically revised the ATRs in response to new or revised legislation.

For example, in 2005, the Commission issued Decision (D.) 06-12-029 in Rulemaking (R.) 05-10-030, in response to the Energy Policy Act of 2005, which repealed the Public Utility Holding Company Act of 1935. This decision reviewed existing regulations to determine whether changes or additions to the ATRs were required. Revisions were made to improve internal consistency or to delete outdated provisions concerning initial compliance with the original ATRs.

The ATRs, as most recently set forth in D.06-12-029, Attachment 1, Appendix A-3, are applicable for the audit period (CY 2012 and CY 2013). Each IOU must annually submit a compliance plan that describes the mechanisms and procedures in place enabling the IOU to comply with the ATRs. Also, each IOU is required to designate an Affiliate Compliance Manager to ensure that the mechanisms and procedures conform to the ATRs. In addition, as required, the IOU submits an annual affiliate transaction report to disclose affiliate activities.

### **San Diego Gas and Electric Company**

SDG&E is a CPUC-regulated public utility, providing electric and gas services to a service area that spans approximately 4,100 square miles. SDG&E services approximately 3.6 million people through 1.4 million electric meters and 900,000 natural gas meters in San Diego and Southern Orange counties.

Sempra Energy is the parent company of SDG&E and the Southern California Gas Company (SoCalGas). Sempra Energy was created in 1998 by a merger of Los Angeles-based Pacific Enterprises, the parent company of SoCalGas, and Enova Corporation, the parent company of SDG&E. In 2013, Sempra Energy had over 230 subsidiaries—SDG&E's affiliates—with various business activities. Approximately 80 of SDG&E's affiliates were designated as covered affiliates, meaning the affiliates and transactions are subject to the ATRs.

Except for Sempra Energy's corporate (headquarters) office, none of SDG&E affiliates are located or conduct business in SDG&E's 4,100 square-mile service area. Except for SoCalGas, none of the covered affiliates conduct any business with SDG&E. SDG&E, however, provides and receives accounting and administrative support (shared) services to and from Sempra Energy; this arrangement benefits all of the affiliates.

SDG&E and SoCalGas are Sempra Energy's CPUC-regulated utilities. SoCalGas provides gas services in Los Angeles County and its vicinity. The two utilities do not share service territories. However, through a long-term CPU-approved agreements, SoCalGas provides gas and gas storage services for SDG&E's gas (core) customers. These transactions are governed by the CPUC Merger Agreement and not the ATRs.

SDG&E employs approximately 5,000 individuals in several professions with the business objective of delivering energy to its customers. SDG&E has established policies, procedures, and processes for its business functions to ensure that related-entity business is conducted in accordance with the ATRs.

### **Prior Review**

Pursuant to ATR VI.C, the Commission requires affiliate transaction audits to be performed biennially by independent auditors. NorthStar Consulting Group conducted an audit of SDG&E's CY 2010 and CY 2011 affiliate activities. The report, issued in August 2014, documented 13 instances of non-compliance.

**Objective, Scope,  
and Methodology**

The objective of our audit was to determine whether SDG&E complied with ATRs I through IX for CY 2012 and CY 2013. Specifically, the audit determined whether:

- SDG&E's Annual Affiliate Transaction Compliance Plans (Compliance Plans) were in accordance with the ATRs;
- SDG&E has adequate systems in place to enforce the ATRs;
- SDG&E applied the ATR I.A definition of the term "affiliate" correctly (5% or more of outstanding securities owned by the IOU or by any of its subsidiaries);
- SDG&E properly classified "affiliates" as "covered" or "non-covered" according to ATR II.B; and
- SDG&E complied with ATR VII regarding utility products and services—Non-tariffed products and services (NTP&S).

To achieve our audit objectives, we:

- Reviewed the prior ATR report for CY 2010 and CY 2011, issued by NorthStar Consulting Group, to gain an understanding of prior audit issues, corrective action plans and the mechanisms and procedures to address those prior audit issues and corrective actions;
- Reviewed Compliance Plans and related policies and procedures;
- Reviewed annual reports on affiliate transactions to identify the extent of affiliate activities;
- Interviewed key SDG&E staff to gain an understanding of the organization, affiliates, and functional areas subject to the ATRs;
- Conducted walk-throughs with employees responsible for affiliate-related functional areas in order to gain an understanding of the internal controls, policies, procedures, processes, and administrative and accounting functions in place; and
- Based on our walk-throughs, conducted tests of relevant internal controls and tests of transactions for each applicable (see Attachment for procedures performed).

For each affiliate transaction activity examined, the total population—such as shared corporate support service with affiliates—was not defined. For this reason, instances of non-compliance could not be projected to the population.

Public Utilities Code section 583 requires each IOU to ensure the confidentiality of non-public information, such as a ratepayers' protected personal information, and that such information is available and disseminated only through an IOU's Affiliate Compliance Manager. All information requested by the SCO was approved by SDG&E's Affiliate Compliance Manager in its Regulatory Department.

We conducted this performance audit in accordance with *Generally Accepted Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

We did not audit SDG&E's financial statements. We limited our scope to planning and performing audit procedures necessary to gain an understanding of the policies, procedures, processes, and administrative and accounting functions in effect for the audit period to ensure that transactions between the utility and its affiliates conformed to the ATRs.

## **Conclusion**

Except for the instances of non-compliance noted in the Findings and Recommendations section of this report, SDG&E complied with ATRs I through IX for CY 2012 and CY 2013. The instances of non-compliance noted in the accompanying findings did not significantly impact SDG&E's ability to substantially comply with the ATRs.

As requested by the Commission, a description of the test procedures performed by the SCO, and the results, accompany this report (Attachment 1—SCO's Analysis of SDG&E's Compliance with the Affiliate Transaction Rules).

## **Follow-up on Prior Audit Findings**

The prior audit report for CY 2010 and CY 2011 by NorthStar Consulting Group was issued in August 2014, which was subsequent to our audit period. Therefore, we neither evaluated nor reported on the status of prior audit findings.

## **Views of Responsible Officials**

We issued a draft audit report on March 15, 2018. Martine Blair, Federal Regulatory Business Manager responded by letter dated April 6, 2018. SDG&E agreed with Finding 1, disagreed with Finding 3, and neither agreed nor disagreed with Findings 2, 4, 5, and the Observations.

## **Restricted Use**

This report is solely for the information and use of SDG&E, the CPUC, and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this report, which is a matter of public record.

*Original signed by*

JEFFREY V. BROWNFIELD, CPA  
Chief, Division of Audits

April 26, 2018



## Summary of Audit Results

Affiliate Transaction Rule	Section	Rule Description	Compliance (Yes / No / No Activity)	Observation	Reference
<b>I</b>		<b>Definitions</b>			
	A	"Affiliate"	Yes		
	B-H	Various Definitions	No Activity <sup>1</sup>		
<b>II</b>		<b>Applicability</b>			
	A	Applicability	No Activity <sup>1</sup>		
	B	Transactions/Coverage	No	Incorrectly classified affiliate	Finding 1
	C	Violate/Circumvent Rules	Yes		
	D-H	Applicability Coverage	No Activity <sup>1</sup>		
<b>III</b>		<b>Nondiscrimination</b>			
	A	Preferential Treatment	No	Inability to maintain required records	Finding 2
	B	Affiliate Transactions	Yes		
	B.1	Resource Procurement	Yes		
	B.2	Provision of Supply, Capacity, Services or Info	Yes		
	B.3	Offering Discounts	Yes		
	B.4	Tariff Discretion	Yes		
	B.5	No Tariff Discretion	Yes		
	B.6	Processing Requests for Services Provided by the Utility	No Activity <sup>2</sup>		
	C	No Tying of Services	Yes		
	D	No Assignment of Customers	Yes		
	E	No Business Development	Yes		
F	Affiliate Discount Reports	No Activity <sup>2</sup>			
<b>IV</b>		<b>Disclosure and Information</b>			
	A	Customer Information	No	Improper release of customer information	Finding 3
	B	Non-Customer Specific Non-Public Information	Yes		
	C	Service Provider Information	No Activity <sup>2</sup>		
	D	Supplier Information	Yes		
	E	Affiliate Advice/Assistance	Yes		
	F	Record-Keeping	No	Inability to maintain required records	Finding 2
	G	Maintenance of Affiliate Contracts and Related Bids	Yes		
H	FERC Reporting Requirements	No Activity <sup>1</sup>			

## Summary of Audit Results (continued)

Affiliate Transaction Rule	Section	Rule Description	Compliance (Yes / No / No Activity)	Observation	Reference
<b>V</b>		<b>Separation</b>			
	A	Corporate Entities	Yes		
	B	Separate Books and Records	Yes		
	C	Shared Plant and Facilities	Yes		
	D	Joint Purchases	Yes		
	E	Corporate Support	Yes	Undefined shared services – parent company continues to assist in long-term financial hedging, derivatives, and arbitrage services	Observation 1
	F.1	Corporate ID and Advertising	Yes		
	F.2	Different Treatment	Yes		
	F.3	No Utility Billing Envelope Advertising Space to Affiliates	Yes		
	F.4	No Joint Advertising or Marketing	Yes		
	F.5	No Research and Development Subsidization	Yes		
	G.1	No Joint Employees	Yes		
	G.2.a	Tracking Employee Movement	Yes		
	G.2.b	Transfer Residency Requirements	Yes		
	G.2.c	Transfer Payments	Yes		
G.2.d	No Transfer Release of Information	Yes			
G.2.e	Loaned Labor Guidelines	No Activity <sup>2</sup>			
H	Transfer of Goods and Services	Yes			
<b>VI</b>		<b>Regulatory Oversight</b>			
	A	Compliance Plans	Yes		
	B	New Affiliate Notifications	No	Untimely new affiliate notifications	Finding 4
	C	Affiliate Audit	Yes		
	D	Witness Availability	No Activity <sup>1</sup>		
	E	Officer Certifications	Yes	Annual Officer Certification inconsistent with the required language	Observation 2
<b>VII</b>		<b>Utility Products and Services (NTP&amp;S)</b>			
	A	General Rule	No Activity <sup>1</sup>		
	B	NTP&S Definitions	No Activity <sup>1</sup>		
	C	Utility Products and Services	Yes		
	D.1	Precedent Conditions	No Activity <sup>2</sup>		
	D.2	Precedent Conditions	No Activity <sup>2</sup>		
	D.3	Precedent Conditions	No Activity <sup>2</sup>		
	D.4	Precedent Conditions	No Activity <sup>2</sup>		
	E	Advice Letter Requirements	No Activity <sup>2</sup>		
	F	Existing Offerings	Yes		
	G	Section 851 Application	No Activity <sup>2</sup>		
H	Periodic Reporting NTP&S	Yes			
I	NTP&S to Affiliates	No Activity <sup>2</sup>			

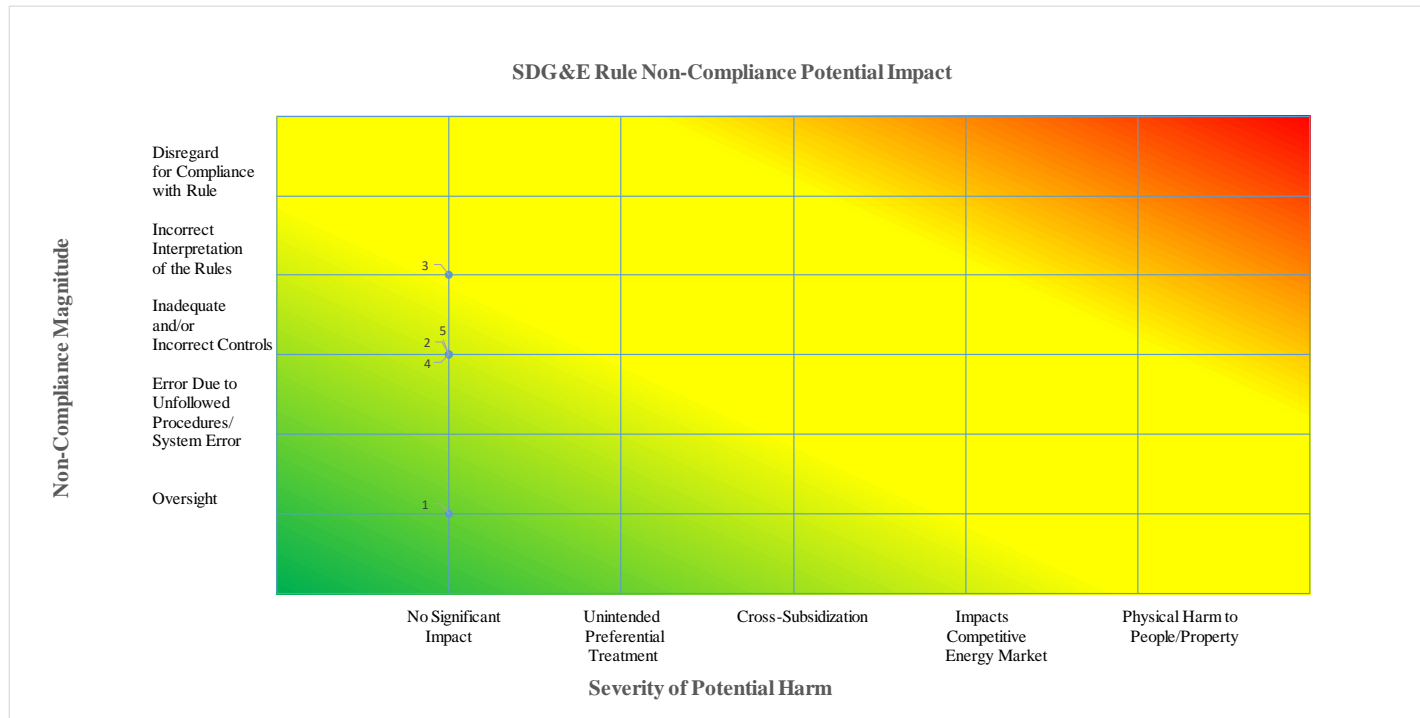
## Summary of Audit Results (continued)

Affiliate Transaction Rule	Section	Rule Description	Compliance (Yes / No / No Activity)	Observation	Reference
<b>VIII</b>		<b>Complaint Procedures and Remedies</b>			
	A	CPUC Strictly Enforces ATRs	No Activity <sup>1</sup>		
	B	Standing	No Activity <sup>1</sup>		
	C.1	Complaint Filing Procedure	No Activity <sup>1</sup>		
	C.2	Affiliate Compliance Manager Responsibilities	Yes		
	C.3	Inform Results of Dispute Resolution Process	No Activity <sup>2</sup>		
	C.4	Complaint Resolve Procedures	No Activity <sup>2</sup>		
	C.5	Complaint Report/Resolve	No Activity <sup>1</sup>		
	C.6	Preliminary Discussions: Complaint Contact/Meeting	No Activity <sup>2</sup>		
	D.1	Remedies: Commission Enforcement	No Activity <sup>1</sup>		
	D.2	Utility Violations and Fines, Reparations	No Activity <sup>1</sup>		
	D.2.a	Reparations	No Activity <sup>1</sup>		
	D.2.b	Fines	No Activity <sup>1</sup>		
	D.2.i	Severity of Offense	No Activity <sup>1</sup>		
	D.2.b.ii	Conduct of Utility	No	Non-conformance and remedies	Finding 5
	D.2.b.iii	Financial Resources of Utility	No Activity <sup>1</sup>		
	D.2.b.iv	Fine Level, Evaluation	No Activity <sup>1</sup>		
	D.2.b.v	Role of Precedent	No Activity <sup>1</sup>		
<b>IX</b>		<b>Protecting the Utility's Financial Health</b>			
	A	Utility Capital Information	Yes		
	B	Capital Deviations/Reporting	Yes		
	C	Ring-fencing	Yes		
	D	Changes to Ring-fencing	Yes		

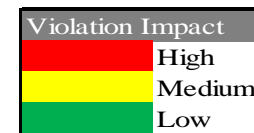
<sup>1</sup>Rule is definitional in nature; no specific action was required of SDG&E.

<sup>2</sup>Based on the information SDG&E made available, there was no affiliate activity.

## Heat Map— Graphical Representation of Instances of Non-Compliance



Finding Reference	Severity of Potential Harm	Non-Compliance Magnitude	Affiliate Transaction Rule	Finding Description
1	1	1	II.B	Incorrectly classified affiliate
2	1	3	III.A/IV.F	Inability to maintain required records
3	1	4	IV.A	Improper release of customer information
4	1	3	VI.B	Untimely New Affiliate Notifications
5	1	3	VIII.D.2.b.ii	Non-conformance and remedies



Prepared by the State Controller's Office

# Findings and Recommendations

## **FINDING 1— Incorrectly classified affiliate**

SDG&E incorrectly classified one of its affiliates that is subject to the ATRs in its 2012 Annual Compliance Plan. SDG&E reported 222 and 225 affiliates in its CY 2012 and CY 2013 Compliance Plans. The affiliate, TecnoRed S.A., was incorrectly classified as a non-covered affiliate during CY 2012. TecnoRed S.A. should have been classified as a covered affiliate for CY 2012 because, in addition to being a construction services company, the entity was also engaged in using natural gas to generate electricity.

Section II.B of SDG&E's CY 2012 Compliance Plan states, in part:

SDG&E classifies "covered" affiliates as those affiliates that engage in the marketing or provision of natural gas and/or electricity as follows: trading natural gas and/or electricity; offering products that use natural gas or electricity; or offering a service that relates to the use of natural gas and/or electricity.

Section II.B of SDG&E's CY 2013 Compliance Plan states, in part:

SDG&E classifies "covered" affiliates as those affiliates that engage in the marketing or provision of natural gas and/or electricity as follows: trading natural gas and/or electricity; offering products that use natural gas and/or electricity; or offering a service that relates to the use of natural gas and/or electricity.

ATR II.B states:

For purposes of a combined gas and electric utility, these Rules apply to all utility transactions with affiliates engaging in the provision of a product that uses gas or electricity or the provision of services that relate to the use of gas or electricity, unless specifically exempted below. For purposes of an electric utility, these Rules apply to all utility transactions with affiliates engaging in the provision of a product that uses electricity or the provision of services that relate to the use of electricity. For purposes of a gas utility, these Rules apply to all utility transactions with affiliates engaging in the provision of a product that uses gas or the provision of services that relate to the use of gas. However, regardless of the foregoing, where explicitly provided, these Rules also apply to a utility's parent holding company and to all of its affiliates, whether or not they engage in the provision of a product that uses gas or electricity or the provision of services that relate to the use of gas or electricity.

Section VI.B of SDG&E's CY 2012 and CY 2013 Compliance Plans states, in part:

The ACD will conduct an annual review of all affiliate business descriptions to assess each affiliate's designation as "non-covered," "covered," and/or "energy marketing." Under this process, the ACD will provide each affiliate's business description to designated affiliate contact personnel to confirm whether the business description remains applicable or whether it has changed. Based upon these responses, the ACD will evaluate whether an affiliate should be reclassified, and then notify the CPUC in accordance with this Rule.

ATR VI.A states, in part:

No later than June 30, 2007, each utility shall file a compliance plan by advice letter with the Energy Division of the Commission. The compliance plan shall include:

1. A list of all affiliates of the utility, as defined in Rule I A of these Rules, and for each affiliate, its purpose or activities, and whether the utility claims that Rule II.B makes these Rules applicable to the affiliate...

### Recommendation

We recommend that SDG&E comply with ATR II.B by implementing mechanisms and procedures to properly classify and report covered and non-covered affiliates.

### SDG&E Response

SDG&E agrees that it incorrectly classified Techno Red S.A. in 2012. TechnoRed S.A. has since been correctly listed as “covered” in SDG&E’s master list of affiliates.

As stated in Finding #5 below, SDG&E has recognized a need to improve its processes around new affiliate notifications. Accordingly, enhancements were made to the new affiliate notification and reporting process. Thus, while SDG&E understands that, for the audit period 2012/2013, delays continued to occur, SDG&E undertook to enhance its processes after the 2010/2011 audit, and now has a more robust process in place. It is important to recognize that SDG&E did not conduct any business transactions with TecnoRed S.A. and was operationally and physically separate from TechnoRed S.A. during the audit period (and remains so today).

### SCO Comment

Our finding and recommendation remain unchanged.

## **FINDING 2— Inability to maintain required records**

SDG&E maintains recorded telephone messages and conversations for only the most recent 36 months. Consequently, the recorded audio data for CY 2012 and January through August of CY 2013 were unavailable. We were limited to selecting and listening to recorded messages and telephone calls from September through December 2013. The 420 calls we listened to were related to accounts receivable. None of the calls discussed affiliate businesses.

Although we noted no instances of improper affiliate transactions, SDG&E did not maintain the necessary records for the entire audit period.

ATR IV.F states:

A utility shall maintain contemporaneous records documenting all tariffed and nontariffed transactions with its affiliates, including but not limited to, all waivers of tariff or contract provisions, all discounts, and all negotiations of any sort between the utility and its affiliate whether or not they are consummated. A utility shall maintain such records for a

minimum of three years and longer if this Commission or another government agency so requires. For consummated transactions, the utility shall make final transaction documents available for third party review upon 72 hours' notice, or at a time mutually agreeable to the utility and third party.

If D.97-06-110 is applicable to the information the utility seeks to protect, the utility should follow the procedure set forth in D.97-06-110, except that the utility should serve the third party making the request in a manner that the third party receives the utility's D.97-06-110 request for confidentiality within 24 hours of service.

### Recommendation

We recommend that SDG&E comply with ATR IV.F by establishing mechanisms and procedures to ensure that records are maintained for sufficient time to verify compliance with the ATRs.

### SDG&E Response

The Customer Contact Center fields over 8 million calls per year that involve all types of customer calls. SDG&E retains these calls for three years. The calls that were reviewed raised no affiliate issues. That is no surprise because calls to the Customer Contact Center should not raise Affiliate Transaction Rules related issues. No affiliate of SDG&E is engaged in a retail energy business in California. Accordingly, there would be no reason for affiliate issues to be discussed on calls with the Customer Contact Center.

SDG&E has looked into preserving the calls for five years. This longer retention period is expected to cost SDG&E and SoCalGas ratepayers approximately \$1.4 million per year. This is a large expense for an action that has no reasonable audit or compliance purpose.

### SCO Comment

Our finding and recommendation remain unchanged.

## **FINDING 3— Improper release of customer information**

SDG&E's Compliance Plans and Customer Call Center Policies and Procedures allow verbal authorization for the release of customer information to third parties as an alternative to written customer consent. SDG&E requires written customer authorization to release customer documentation to third parties.

Although we do not question SDG&E's authentication process to confirm customer identify, the release of customer information without written consent to third parties is explicitly prohibited by ATR IV.A.

Section IV.A of SDG&E's CY 2012 and CY 2013 Compliance Plans states, in part:

SDG&E requires authorization by written paper or electronic customer consent for the release of any customer specific information unless allowed by an order of the Commission or other regulatory agency or allowed by a legal process.

ATR IV.A states:

A utility shall provide customer information to its affiliates and unaffiliated entities on a strictly non-discriminatory basis, and only with prior affirmative customer written consent.

#### Recommendation

We recommend that SDG&E comply with ATR IV.A by establishing mechanisms and procedures for proper release of customer information only after receiving written customer consent.

#### SDG&E Response

SDG&E does not require written customer authorization. The issue of whether SDG&E should allow customers to authorize the release of their data through electronic means was addressed in the prior audit for CY 2010 and 2011. SDG&E continues to disagree with this finding. There is no evidence to suggest that SDG&E releases customer documentation to third parties without the customer's consent. The only issue here is whether that consent must be in writing.

Under California Civil Code Section 1633.7, "If a law requires a signature, an electronic signature satisfies the law." Therefore, as a matter of California law, SDG&E is allowed to accept electronic authorization from its customers in lieu of written authorization. The statutory law makes the retention process more effective and efficient and customer-friendly, all while preserving documentation showing customers' consent. Nonetheless, SDG&E is willing to change its practices -- to the detriment of its customers -- if that is what the Commission ultimately decides.

#### SCO Comment

Our finding and recommendation remain unchanged.

As stated in the finding, our review of the processes determined that SDG&E allows verbal authorization, which is not a form of electronic authorization, to release customer information. While electronic authorization could be a form of written consent, such mechanisms were not presented or considered during the audit. SDG&E should discuss this issue with the CPUC and obtain approval for such mechanisms.

#### **FINDING 4— Untimely new affiliate notifications**

SDG&E did not immediately notify the CPUC and post notice on its electronic bulletin board after creating several new affiliates. Sempra Energy, the parent holding company for SDG&E, created a total of 39 new affiliates during CY 2012 and CY 2013. Of the 39 new affiliates created during the audit period, we found the following instances of untimely notifications:

- Fifteen of the 39 affiliates had instances (six in CY 2012 and nine in CY 2013) of untimely notification to the CPUC;
- Fourteen of the 39 affiliates had instances (six in CY 2012 and eight in CY 2013) of untimely notification on its electronic bulletin board; and



- Four of the 39 affiliates had instances (CY 2013) of untimely new affiliate notification advice letters to CPUC within the required 60 days.

The untimely notifications were for the following new affiliates:

<b>Affiliate</b>	<b>CPUC Notification (Days)</b>	<b>Website Posting (Days)</b>	<b>Advice Letter Filing (Days)</b>
<b>2012 New Affiliates</b>			
Gasoductos de El Encino, S. de R.L. de C.V.	11	11	24
Transportadora El Encino, S. de R.L. de C.V.	11	11	24
Controladora Sierra Juarez, S. de R.L. de C.V.	29	7	57
Semco Holdco, S. de R.L. de C.V.	29	7	57
ELETRANS S.A.	7	7	27
Mesquite Power Operations, LLC	14	14	55
<b>2013 New Affiliates</b>			
Gasoducto del Sur S.A.	69	69	88
Sempra LNG Holdings I, LLC	7	3	56
ELETRANS II S.A.	14	14	922
Broken Bow II Wind Holdings	174	174	183
Broken Bow(Wind) II, LLC	174	174	183
Inversiones Sempra Latin America Limitada	13	13	57
Gasoductos Ingeniería, S. de R.L. de C.V.	15	15	58
Gasoductos Servicios Subholding, S. de R.L. de C.V.	15	15	58
Flat Ridge 3 Wind Energy LLC	14	14	40

Section VI.B of SDG&E's CY 2012 Compliance Plan states, in part:

SDG&E will comply with this Rule as new covered and non-covered affiliates are created. Within two calendar days of notification to SDG&E, SDG&E will also notify the CPUC of: (1) any newly formed U.S. domestic covered or non-covered affiliate; or (2) the confirmation of registration with foreign governmental authorities for covered or non-covered affiliates located outside the U.S.; and then post this information on its internet web site.

SDG&E will file an advice letter with the Energy Division within 60 calendar days of the creation of: (1) any new U.S. domestic covered or non-covered affiliate; or (2) the confirmation of registration with foreign governmental authorities for covered or non-covered affiliates located outside the U.S. The advice letter will provide the information required by this Rule for the new covered or non-covered affiliate.

Section VI.B of SDG&E's CY 2013 Compliance Plan, states, in part:

SDG&E will comply with this Rule as new covered and non-covered affiliates are created. Within two business days of notification to SDG&E, SDG&E will notify the CPUC of the confirmation of: (1) the formation of any new U.S. domestic covered or non-covered affiliate; or (2) the confirmation of registration with foreign governmental authorities for covered or non-covered affiliates located outside the U.S.; and then post this information on its internet web site.

SDG&E will file an advice letter with the Energy Division within 60 calendar days of the confirmation of: (1) the formation of any new U.S. domestic covered or non-covered affiliate; or (2) the registration with foreign governmental authorities for covered or non-covered affiliates located outside the U.S. The advice letter will provide the information required by this Rule for the new covered or non-covered affiliate.

ATR VI.B states:

Upon the creation of a new affiliate, the utility shall immediately notify the Commission of the creation of the new affiliate, as well as posting notice on its electronic bulletin board. No later than 60 days after the creation of this affiliate, the utility shall file an advice letter with the Energy Division of the Commission. The advice letter shall state the affiliate's purpose or activities, whether the utility claims that Rule II B makes these 52 Rules applicable to the affiliate, and shall include a demonstration to the Commission that there are adequate procedures in place that will ensure compliance with these Rules.

Commission Resolution E-3539 states, in part:

[T]he utility shall immediately notify the Commission of the creation of the new affiliate, as well as posting notice on its electronic bulletin board.... To be clear, the utility will notify the Energy Division in writing, within three business days of its creation, of the new affiliate's name, headquarters, primary officers, contract person for the Commission, and its intended function.

#### Recommendation

We recommend that SDG&E comply with ATR VI.B by implementing mechanisms and procedures to ensure that the CPUC is immediately notified when a new entity is created or acquired, information about the new entity is immediately posted on its electronic bulletin board, and an advice letter for the newly created affiliate is filed with the CPUC within the required 60 calendar days.

#### SDG&E Response

SDG&E has recognized a need to improve its processes around new affiliate notifications. Accordingly, enhancements were made to the new affiliate notification and reporting process. SDG&E understands that, for the audit period 2012/2013, delays continued to occur. SDG&E began to implement enhancements to its processes after the 2010/2011 audit, and now has a more robust process in place.

#### SCO Comment

Our finding and recommendation remain unchanged.

SDG&E's assertion that it has made enhancements to its notification process was made subsequent to the audit period. We have not reviewed, and cannot comment on, the validity of this assertion, as these processes were developed subsequent to the audit period. We will follow up during the next audit to ensure that such corrective actions have occurred.

**FINDING 5—  
Non-conformance  
and remedies**

SDG&E did not effectively implement mechanisms and procedures to prevent, detect, disclose, and rectify affiliate rule violations during the audit period, as required by ATR VIII.D.2.b.ii. SDG&E did not prevent, detect, disclose, and rectify the rule violations identified in Findings 1 through 4.

Section VIII of SDG&E's CY 2013 Compliance Plan states, in part:

SDG&E utilizes web-based training, the Affiliate Compliance Guidelines (ACG), SDG&E's Compliance Plan, and Sempra Energy's Code of Business Conduct, which are all available to employees on SDG&E's intranet, to ensure that employees are knowledgeable of the Rules.

Training directs employees to contact ACD, the Affiliate Compliance Helpline or the Ethics Helpline, or their Affiliate Compliance Coordinator to report any potential violation of the Rules. They also allow the employee to report potential weaknesses in internal controls. The Ethics Helpline allows for the reporting of an issue with or without identifying the source. Affiliate transactions issues reported to the Ethics Helpline are forwarded to the manager of Affiliate Compliance. It is the Company's obligation to ensure that any such concerns, raised in good faith, can be done so without retaliation and are appropriately investigated and resolved.

Upon notification of an alleged violation, the manager of Affiliate Compliance, or any employee designated by the manager of Affiliate Compliance, will immediately begin an investigation into the alleged violation and notify the Affiliate Compliance Officer and the Law Department of the investigation. The Affiliate Compliance Officer will be kept apprised of the investigation until a resolution is reached. The investigation shall consist of gathering all relevant facts and data concerning the event(s) in question and reviewing those facts and data to determine whether, and to what extent, a violation has occurred. Corrective action will be taken and steps to prevent further violations will be implemented.

ACD will maintain records of facts gathered in conjunction with the investigation. SDG&E will evaluate the nature of the violation and will notify the CPUC either through written communication or by notifying the external auditors during the course of the audit, depending on the timing and severity of the offense as outlined in the Rules.

ATR VIII.D.2.b.ii states:

This factor recognizes the important role of the public utility's conduct in (1) preventing the violation, (2) detecting the violation, and (3) disclosing and rectifying the violation.

The public utility is responsible for the acts of all its officers, agents, and employees:

"In construing and enforcing the provisions of this part relating to penalties, the act, omission, or failure of any officer, agent or employee of any public utility, acting within the scope of his [or her] official duties or employment, shall in every case be the act, omission, or failure of such public utility." Public Utilities Code §2109.

- (1) Prior to a violation occurring, prudent practice requires that all public utilities take reasonable steps to ensure compliance with Commission directives. This includes becoming familiar with applicable laws and regulations, and most critically, the utility regularly reviewing its own operations to ensure full compliance. In evaluating the utility's advance efforts to ensure compliance, the Commission will consider the utility's past record of compliance with Commission directives.
- (2) The Commission expects public utilities to monitor diligently their activities. Where utilities have for whatever reason failed to meet this standard, the Commission will continue to hold the utility responsible for its actions. Deliberate as opposed to inadvertent wrong-doing will be considered an aggravating factor. The Commission will also look at the management's conduct during the period in which the violation occurred to ascertain particularly the level and extent of involvement in or tolerance of the offense by management personnel. The Commission will closely scrutinize any attempts by management to attribute wrong-doing to rogue employees. Managers will be considered, absent clear evidence to the contrary, to have condoned day-to-day actions by employees and agents under their supervision.
- (3) When a public utility is aware that a violation has occurred, the Commission expects the public utility to promptly bring it to the attention of the Commission. The precise timetable that constitutes "prompt" will vary based on the nature of the violation. Violations which physically endanger the public must be immediately corrected and thereafter reported to the Commission staff. Reporting violations should be remedied at the earliest administratively feasible time. Prompt reporting of violations furthers the public interest by allowing for expeditious correction. For this reason, steps taken by a public utility to promptly and cooperatively report and correct violations may be considered in assessing any penalty.

#### Recommendation

We recommend that SDG&E report instances of non-compliance to the CPUC in accordance with ATR VIII.D.2.b.ii. We also recommend that SDG&E establish mechanisms and procedures to prevent and detect ATR violations.

#### SDG&E Response

SDG&E treats self-reporting as a path when issues are discovered internally. Potential issues raised in this audit will be shared with Commission Staff in the normal course of the audit process.

#### SCO Comment

Our finding and recommendation remain unchanged.

# Observations and Recommendations

**OBSERVATION 1—  
Undefined shared  
services – parent  
Company continues to  
assist in long-term  
financial hedging,  
derivatives, and  
arbitrage services**

As also observed during the previous audit, SDG&E's Compliance Plans permit its parent company function, Sempra Energy Treasury, to assist in the planning and arranging of hedging and financial derivative use for long-term financing of activities other than resource procurement. Though not specifically stated, SDG&E interprets the ATRs have determined that hedging and financial derivatives in support of its long-term financing are permissible shared activities. As the ATR is not specific, we could not determine whether such shared hedging and financial activities are permissible pursuant to the ATRs. Our audit did not determine the extent of such activities for the audit period.

Hedging for resource procurement is a means of price protection. Essentially, it allows an IOU to secure commodity acquisition prices using a financial instrument such as a commodity futures contract. An energy derivative is an exchange transaction derived from an underlying energy asset, such as natural gas, crude oil, or electricity.

SDG&E does not engage in these types of affiliate transactions, as they are unallowable. As reported in Sempra Energy's 2012 and 2013 Annual Reports, SDG&E uses hedging and derivative instruments to manage risks related to commodity prices, interest rates, credit, and other market risks.

Note 10 of the Consolidated Financial Statements from Sempra Energy's 2012-2013 Annual Report states:

Interest rate derivatives are utilized by the California Utilities as well as by other Sempra Energy subsidiaries. Although the California Utilities generally recover borrowing costs in rates over time, the use of interest rate derivatives is subject to certain regulatory constraints, and the impact of interest rate derivatives may not be recovered from customers as timely as described above with regard to natural gas derivatives...

The prior audit determined that the use of an affiliate, Sempra Energy Treasury, to assist in the planning and arrangement of financial derivatives for long-term financing was an unallowable function. In response, SDG&E argued:

As explained in SDG&E's Compliance Plans, the restriction against shared hedging and financial derivative services does not encompass non-energy hedging and financial derivatives. The plans further specify that the Sempra Energy Treasury and Finance shared service departments ("Treasury Department") could assist SDG&E with planning and arranging hedging and financial derivative use in support of SDG&E's long-term financings. NorthStar objects to hedging and financial derivative services on a shared basis even when those services bear no relationship to energy markets and pose no possibility of affiliate abuse. NorthStar's reading of this rule is unduly restrictive non-energy related hedging and financial derivative work presents no opportunity for preferential treatment in favor of energy affiliates or harm to utility customers or the California market.

The CPUC did not conclude whether financial derivatives in support of long-term financing were permissible affiliate activities.

Section V.E of SDG&E's CY 2012 and CY 2013 Compliance Plans states, in part:

SDG&E understands Rule V.E's prohibition on shared "hedging and financial derivatives and arbitrage services," to apply to employees engaged in hedging electric and natural gas commodities, and not to the use of hedging and financial derivatives in support of SDG&E's long term financings. The Sempra Energy Treasury and Finance shared service departments may assist SDG&E with planning and arranging hedging and financial derivative used in support of SDG&E' long-term financings. They also engage in corporate oversight of SDG&E' risk management function and set corporate risk-management policies.

ATR V.E states, in part:

Examples of services that may not be shared include: employee recruiting, engineering, hedging and financial derivatives and arbitrage services, gas and electric purchasing for resale, purchasing of gas transportation and storage capacity, purchasing of electric transmission, system operations, and marketing.

We agree that SDG&E does not share hedging or derivative work involving energy products or services with its energy affiliates and has complied with ATR V.E in this regard. The issue is the contradiction in ATR V.E; the rule prohibits hedging, financial derivatives, and arbitrage services while allowing the sharing of "financial planning and analysis."

#### Recommendation

We recommend that the CPUC evaluate whether hedging, financial derivatives, and arbitrage services for long-term financing activities should be an allowed shared service under ATR V.E.

#### SDG&E Response

SDG&E's Compliance Plan states the following regarding these activities:

"SDG&E understands Rule V.E's prohibition on shared "hedging and financial derivatives and arbitrage services," to apply to employees engaged in hedging electric and natural gas commodities, and not to the use of hedging and financial derivatives in support of SDG&E's long term financings. The Sempra Energy Treasury and Finance shared service departments may assist SDG&E with planning and arranging hedging and financial derivative used in support of SDG&E's long-term financings. They also engage in corporate oversight of SDG&E's risk management function and set corporate risk-management policies."

This shows that certain Sempra Employees assist SDG&E. Nowhere does it say that any affiliate is involved in these activities.

In response to the 2010/2011 audit, , and after consultation with CPUC Staff, SDG&E added the following language in its Compliance Plan beginning with the 2015 Compliance Plan:

*“No SDG&E employees would be involved in hedging for covered affiliates. Similarly, no employees of a covered affiliate would be in hedging for SDG&E.”*

#### SCO Comment

Our observation and recommendation remain unchanged.

SDG&E’s assertion that it enhanced its notification process was made subsequent to the audit period. We have not reviewed, and cannot comment on, the validity of this assertion, as these processes were developed subsequent to the audit period. We will follow up during the next audit to ensure that such corrective actions have occurred.

#### **OBSERVATION 2— Annual Officer Certification inconsistent with the required language**

SDG&E submitted the required Annual Officer Certifications for CY 2012 and CY 2013 in a timely manner. Consistent with previous Annual Officer Certifications, SDG&E included disclosures on the certifications in addition to the standard and required language specified in ATR V.I.E. The additional disclosure in the Annual Compliance Plan states:

This certificate does not include violations, if any, already reported to the Commission during the reporting period. This certificate also excludes audits or investigations, if any, still in progress at the end of the reporting period. If violations are ultimately found, they will be reported consistent with SDG&E’ affiliate compliance plans.

SDG&E’s CY 2012 and CY 2013 Compliance Plans state:

SDG&E’s Affiliate Compliance Office is responsible for coordinating and obtaining the Officer Certifications from the “key officers.” ATR V.E lists the key officers as “the Chair of the entire corporate enterprise, the President at the utility and its holding company parent, the chief executive officer at each, the chief financial officer at each, and the chief regulatory officer at each, or in any case, any and all officers whose responsibilities are the functional equivalent of the foregoing.” Officer Certifications are obtained for those key officers where those positions exist.

ATR V.I.E states:

No later than March 31 of each year, the key officers of a utility and its parent holding company, as defined in Rule V E (corporate support), shall certify to the Energy Division of the Commission in writing under penalty of perjury that each has personally complied with these Rules during the prior calendar year. The certification shall state:

I, [name], hold the office of [title] at [name of utility or holding company], and occupied this position from January 1, [year] to December 31[year],

I hereby certify that I have reviewed the Affiliate Transaction Rules Applicable to Large California Energy Utilities of the California Public Utilities Commission and I am familiar with the provisions therein. I further certify that for the above period, I followed these Rules and am not aware of any violations of them, other than the following: [list or state "none"].

I swear/affirm these representations under penalty of perjury of the laws of the State of California.

\_\_\_\_\_[Signature]  
Executed at \_\_\_\_\_ [City], County of \_\_\_\_\_, on  
\_\_\_\_\_ [Date]

ATR V.E states, in part:

For purposes of this Rule, key officers are the Chair of the entire corporate enterprise, the President at the utility and at its holding company parent, the chief executive officer at each, the chief financial officer at each, and the chief regulatory officer at each, or in each case, any and all officers whose responsibilities are the functional equivalent of the foregoing.

Although the officer certifications have been submitted to the CPUC in a timely manner and consistent with the Annual Affiliate Compliance Plan, it is unclear whether the added disclosure meets the requirements of ATR VI.E.

#### Recommendation

We recommend that CPUC evaluate the Annual Officer Certifications submitted by SDG&E to determine whether the added disclosure meets the requirements of ATR VI.E.

#### SDG&E Response

On this issue, SDG&E engaged in meaningful discussions with CPUC Staff after the 2010/2011 audit concluded. There were discussions regarding the possibility of modifying the current footnote language. SDG&E made clear at the time that the footnote is intended to clarify the meaning of the attestation and not to change the substance of it. SDG&E is willing to continue working with CPUC Staff on the footnote, to the extent Staff remains interested in doing so.

#### SCO Comment

Our observation and recommendation remain unchanged.

SDG&E's assertion that it enhanced its notification process was made subsequent to the audit period. We have not reviewed, and cannot comment on, the validity of this assertion, as these processes were developed subsequent to the audit period. We will follow up during the next audit to ensure that such corrective actions have occurred.



**Attachment 1—  
SCO's Analysis of SDG&E's Compliance with the  
Affiliate Transaction Rules**

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## General

We designed, developed, and performed the following procedures to determine whether SDG&E complied with each of the subsections of ATRs I through IX. We performed test procedures on selected accounting records, administrative documents<sup>1</sup>, and internal control standards for the audit period.

For ATRs I through IX, we:

- Interviewed SDG&E personnel regarding its training programs, processes, and procedures for ensuring compliance with the ATRs;
- Identified all prior ATR-related audit findings and recommendations, as well as the SDG&E's, for consideration in planning the audit;
- Reviewed SDG&E's Compliance Plans and Annual Reports to ensure that proper policies and procedures were in place to comply with the ATRs;
- Reviewed Annual Reports to gain an understanding of affiliate activities;
- Identified utility non-compliance postings and self-reporting to the CPUC for any ATR violations;
- Analyzed discrepancies between Compliance Plans and any audit/review findings regarding actual behavior and actions of the utility in preventing, detecting, and reporting instances of non-compliance; and
- Assessed whether instances of non-compliance or violations of ATRs caused actual or potential harm to ratepayers.

### Conclusion

SDG&E provided Compliance Plans, Annual Reports, and existing policies and procedures to ensure that affiliate activities were conducted in accordance with the ATRs. Sempra Energy is the parent company of SDG&E, its affiliate companies, and SoCalGas, another CPUC-regulated utility.

Except for SoCalGas, none of the covered affiliates conduct business with SDG&E. SoCalGas provides gas and gas storage services for SDG&E's gas (core) customers. This arrangement was approved by the CPUC as part of the merger agreement between the parent companies of SoCalGas and SDG&E. These transactions between SDG&E and SoCalGas are subject to the CPUC's Merger Rules and not the ATRs.

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<sup>1</sup>Administrative documents include advice letters, which are filed for authorization by and are the required communication between the utility and the CPUC. These documents are filed for various purposes including submission of required Compliance Plans, Annual Reports, and changes and additions to tariffed and other utility products and services.

SDG&E's training strategy guides the training activities of the Affiliate Compliance Department, and establishes customized affiliate compliance curricula and training frequencies for targeted SDG&E, Sempra Energy, and affiliate employee audiences. All training curricula address fundamental topics of affiliate compliance, including core principles of the ATRs, the prohibition against preferential treatment of affiliates, the proper pricing and reporting of all utility-affiliate transactions, and the protection of nonpublic utility information.

## **Affiliate Transaction Rule I**

### **Definitions**

ATR I provides key terms that a utility must use to define its business and activities. To determine whether SDG&E complied with ATR I in its interpretation and application of the definitions to its affiliate transactions, we:

- Reviewed the Compliance Plans, Affiliate Compliance Guidelines, and Annual Reports to ensure consistency of definitions with the ATRs. Reviewed and compared the above-mentioned documents and SDG&E's administrative and accounting records to determine consistency of definitions pursuant to this ATR I;
- Reviewed training materials provided to SDG&E employees and affiliates to ensure that the definition of affiliate was properly conveyed; and
- Assessed the degree to which SDG&E's interpretation and application of the term "affiliate" complied with the letter and spirit of the definitions prescribed in ATR I.

### Conclusion

Based on the information provided and the procedures performed, we determined that SDG&E complied with ATR I.

## **Affiliate Transaction Rule II**

### **Applicability**

ATR II provides criteria that describes which affiliates are covered by the ATRs. These rules apply to affiliates that engage in the provision of products that use gas, or services that relate to the use of gas, unless specifically exempt. To determine whether SDG&E appropriately classified affiliates based on their business activities, we:

- Reviewed SDG&E's Corporate Governance affiliate database to identify SDG&E's affiliate population, and ensured that all active affiliates were properly included in its Compliance Plans;
- Reviewed training materials provided to the responsible SDG&E employees to ensure that SDG&E is providing guidance on affiliates subject to ATRs;
- Identified all 39 new affiliates and examined source documents including, but not limited to, advice letters, business descriptions, and ownership/title records to verify SDG&E's assessment of the affiliates as "covered" or "non-covered"; and

- Examined 20 instances in which affiliates were reclassified during the audit period to ensure that SDG&E properly reassessed the affiliates' business activities based on SDG&E reassessment files, advice letters, business descriptions, and other research.

#### Conclusion

Based on the information provided and procedures performed, we determined that SDG&E did not comply with ATR II (see Finding 1).

## **Affiliate Transaction Rule III**

### **Non-discrimination**

#### **Affiliate Transaction Rule III.A – Non-preferential treatment regarding services provided by the utility**

ATR III.A requires affiliates to be treated on a nondiscriminatory basis, just as non-affiliated companies would be treated. To determine whether any affiliates received preferential treatment regarding services provided by SDG&E:

- Ensured that SDG&E did not provide or represent to its affiliates or customers of its affiliates any preferential treatment over non-affiliated suppliers or their customers in the provision of services;
- Inspected letters, memos, brochures, pamphlets, advertising, and supporting materials for trade shows, conventions, and community fairs;
- Reviewed 420 recorded Customer Contact Center (CCC) telephone conversations with utility customers;
- Reviewed the processes and procedures contained in SDG&E's Core Aggregation Transportation program website;
- Reviewed the customer service voice-activated telephone system;
- Inquired about policies, procedures, and processes for third-party customer information requests to ensure that SDG&E has a non-discriminatory process for processing such requests;
- Obtained third-party customer information request forms and summary reports. Analyzed a sample of forms to determine whether forms were processed in a non-discriminatory, non-preferential manner;
- Reviewed customer information service requests to ensure that no unauthorized information was given to affiliates during CY 2012 and CY 2013;
- Reviewed the list of service providers to identify affiliates and determined affiliate activities to ensure that no preferential treatment is given to affiliates; and
- Identified SDG&E's affiliate customers and determined whether services and charges were consistent with non-affiliate residential and commercial customers. Reviewed accounting records to ensure that there were not any discount adjustments.

## Conclusion

Based on the information provided and the procedures performed, we determined that SDG&E did not comply with ATR III.A (see Finding 2).

### **Affiliate Transaction Rule III.B – Affiliate Transactions**

ATR III.B identifies transactions permitted by the ATRs between the utility and its affiliates, including tariffed products and services; the sale of goods, property, products or services made generally available by the utility or affiliate to all market participants through an open, competitive bidding process; the provision of information made generally available by the utility to all market participants; and Commission-approved resource procurement by the utility, or as provided for in ATRs V.D (joint purchases), V.E (corporate support), and VII (new products and services). To identify affiliate transactions determine whether they were limited to allowable products and services, we:

- Reviewed SDG&E's policies, procedures, training materials, and the CY 2012 and CY 2013 Compliance Plans for ATR III.B;
- Obtained a summary transaction list of all resource procurement transactions between SDG&E and its affiliates that were conducted through the Intercontinental Exchange, brokers, open auctions, and all other transactions, such as those from the operational hub. Tested a sample of resource procurement transactions and verified that the transactions either were approved by the CPUC or were blind transactions;
- Inquired whether SDG&E provided utility information, services, or unused capacity or supply information to any entity;
- Inquired whether SDG&E offered to sell surplus natural gas and capacity through venues other than blind transactions. Reviewed accounting records and source documents to determine whether these transactions were indeed blind in nature, meaning transactions were at an independent exchange in which buyer and seller became aware of the identity of the other party only after the transaction was executed;
- Inquired whether SDG&E maintains surplus storage contracts;
- Reviewed the gas supply capacity system, Allegro System, and identified supply and excess capacity transactions;
- Inquired whether any of the excess capacity was sold back to the supplier via bilateral or tolling agreements with affiliates;
- Reviewed Schedule C of the Annual Report to determine whether SDG&E received services from affiliates;
- Reviewed accounting records and expenditure reports to identify charges, receivables, and payables due from and to affiliates;
- Identified any related entities for whom SDG&E provides utility services (as previously determined, the holding company, Sempra Energy, is the only related entity that receives these utility services);

- Reviewed 10 invoices for the holding company and an unrelated business located next door to the holding company. Determined whether the utility rates were consistent with the tariff rates;
- Reviewed provisions contained in SDG&E's tariff sheets in effect during the CY 2012 and CY 2013 audit period to determine whether tariff discretions were allowed;
- Reviewed accounting records to identify discount or subsequent reduction of invoiced amount to the holding company;
- Identified all requests for services processed by SDG&E for affiliates and its respective customers. Ensured that any requests processed for affiliates were processed in the same manner and within the same time as other market participants;
- Reviewed 420 recorded CCC telephone conversations to determine whether there were any differences in processing requests between affiliate and non-affiliate customers; and
- Requested customer service request records to identify affiliate activities.

#### Conclusion

Based on the information provided and procedures performed, we determined that SDG&E complied with ATR III.B.

#### **Affiliate Transaction Rule III.C – Tying of services provided by a utility prohibited**

ATR III.C prohibits a utility from tying the provision of services it provides to the taking of any goods or services from its affiliates. To determine whether SDG&E tied customers to its affiliates, we:

- Reviewed Schedule C and D from the CY 2012 and CY 2013 Annual Reports to determine whether SDG&E received and provided services to affiliates;
- Reviewed accounting records and expenditure reports to determine charges, receivables, and payables due from and to affiliates; and
- Inspected advertising and other marketing materials; bill inserts; the SDG&E website; and supporting material for trade shows, conventions, and community fairs, and reviewed 420 recorded CCC telephone conversations with utility customers to determine whether the utility tied a service to the taking of any good or service from an affiliate.

#### Conclusion

Based on the information provided and the procedures performed, we determined that SDG&E complied with ATR III.C.

**Affiliate Transaction Rule III.D – No assignment of customers**

ATR III.D prohibits the utility from assigning its current customers to its affiliates, unless the same opportunity is also available to all competitors. To determine whether SDG&E improperly assigned customers to its affiliates, we:

- Reviewed the Employee Affiliate Compliance Training Course, CCC employee training, and Sempra Energy Code of Business Conduct employee training for specific references to ATR III.D prohibiting the assigning of customers to affiliates;
- Verified whether any SDG&E core or non-core customers were assigned to an affiliate; and
- Reviewed SDG&E's list of non-core energy suppliers and participating core transportation agents for core customers and verified whether any affiliates were gas suppliers to SDG&E's core or non-core customers.

Conclusion

Based on the information provided and the procedures performed, we determined that SDG&E complied with ATR III.D.

**Affiliate Transaction Rule III.E – Business development and customer relations**

ATR III.E states that the utility must not provide information to or promote affiliate businesses. To determine whether SDG&E provided information to or promoted affiliate businesses, we:

- Identified types of business development and customer programs during the audit period; inquired whether any of these services were provided by affiliates;
- Requested copies of Advice Letters, if any, for new products and services;
- Identified whether any business programs were developed for affiliates or in partnership with affiliates;
- Evaluated advertising materials, bill inserts, press releases, and other sales and marketing materials to ensure that SDG&E did not provide information to or promote affiliate businesses; and
- Reviewed 420 recorded CCC telephone conversations to ensure that SDG&E did not discuss or promote affiliate businesses.

Conclusion

Based on the information provided and the procedures performed, we determined that SDG&E complied with ATR III.E.

**Affiliate Transaction Rule III.F – Affiliate discount report**

ATR III.F states that, if the utility provides an affiliate a discount, rebate, or other waiver of any charge or fee for products and services, the utility shall post a notice on its electronic bulletin board within 24 hours identifying the affiliate; the volume, value, and rate charged; the maximum rate; and the means by which non-affiliates may obtain a similar offer. To determine whether SDG&E posted Affiliate Discount Reports in a timely manner, we:

- Requested from SDG&E records of all discounts provided to affiliates;
- Reviewed postings and other available evidence to determine whether notice of the discount, rebate, or other waiver of any charge or fee for products and services was posted within 24 hours from the time of the transaction; and
- Verified whether the posted notice contained all information required by ATR III.F.

Conclusion

Based on the information provided and the procedures performed, we determined that SDG&E complied with ATR III.F.

**Affiliate  
Transaction  
Rule IV**

ATR IV provides the requirements that the utility must follow in disclosing information, including customer, non-customer-specific non-public, service provider, and supplier information. ATR IV also provides guidelines for affiliate-related advice or assistance, record-keeping, maintenance of affiliates' contracts and related bids, and Federal Energy Regulatory Commission (FERC) reporting requirements.

To determine whether SDG&E (1) provided customer information to its affiliates exclusively, or without consent, (2) made non-customer-specific non-public information available to its affiliates contemporaneously with all other service providers, (3) included an affiliate on any service provider list made available by SDG&E to its customers, (4) provided its customers advice or assistance with regard to its affiliates or other service providers, and (5) maintained appropriate affiliate transaction records, we:

- Reviewed summary logs of requests for customer information made by third parties to verify whether any customer information was released to an affiliate. If so, confirmed that the customer gave written consent and the utility posted the release of information to an affiliate;
- Reviewed CCC training programs, policies and procedures, and scripts to verify whether they included instructions not to release customer information without written consent;
- Reviewed SDG&E's training programs to verify whether they included compliance requirements for any release of non-customer-specific non-public information;



- Verified whether SDG&E provided non-customer-specific, non-public information to any affiliates and, if so, whether the information was posted to the SDG&E's electronic bulletin board;
- Reviewed the service provider list for core and non-core customers to determine whether any affiliates were included;
- Verified whether SDG&E first obtained written affirmative authorization from suppliers before providing non-public information to its affiliates or non-affiliated entities;
- Reviewed 420 recorded CCC telephone conversations to ensure that SDG&E did not offer or provide its customers with advice or assistance regarding to its affiliates;
- Reviewed advertising, marketing, and other promotional materials to verify whether SDG&E offered or provided its customers with advice or assistance regarding its affiliates;
- Reviewed meeting minutes for the governing boards of (1) Sempra Energy, (2) SoCalGas, (3) SDG&E, and (4) Sempra U.S. Gas and Power to identify discussions of non-customer-specific information;
- Verified whether SDG&E maintained all records documenting all tariffed and non-tariffed transactions with its affiliates for at least three years; and
- Verified whether SDG&E maintained the records of all contracts and related bids for at least three years.

#### Conclusion

Based on the information provided and the procedures performed, we determined that SDG&E did not comply with ATR IV (see Finding 3).

## **Affiliate Transaction Rule V**

### **Separation**

#### **Affiliate Transaction Rule V.A – Corporate entities**

ATR V.A requires the utility, its parent holding company, and its affiliates to be separate corporate entities. To verify separation between SDG&E, its parent company, and its affiliates, we reviewed SDG&E's CY 2012 and CY 2013 Annual Reports, 10-K Reports, organization charts, chart of accounts, company literatures, employee manuals, Commission Advice Letters, and documents issued to create each new affiliate to determine whether the utility and its affiliates are separate corporate entities in accordance with ATR V.A.

#### Conclusion

Based on the information provided and the procedures performed, we determined that SDG&E complied with ATR V.A.

**Affiliate Transaction Rule V.B – Books and records**

ATR V.B requires the utility, its parent holding company, and its affiliates to maintain separate books and records in accordance with the FERC-established Uniform System of Accounts and Generally Accepted Accounting Principles. To determine whether SDG&E maintained separate books and records, we reviewed SDG&E's chart of accounts, Annual Reports, and annual audited financial statements to determine whether SDG&E maintained separate books and records in accordance with ATR V.B.

**Conclusion**

Based on the information provided and the procedures performed, we determined that SDG&E complied with ATR V.B.

**Affiliate Transaction Rule V.C – Sharing of plant, facilities, equipment, or cost**

ATR V.C requires the utility and its affiliates to maintain physical separation. This ATR prohibits the utility from sharing office space, office equipment, services, and systems such as computers or information systems with its affiliates. To determine whether SDG&E maintained distinct and unshared space and resources, we:

- Reviewed SDG&E's office locations and facility access security measures to identify whether the utility and its affiliates maintain physical separation in accordance with ATR V.C; and
- Obtained a list of employees who transferred from SDG&E to an affiliate during the audit period and ensured that system access was terminated concurrent to the date of transfer.

**Conclusion**

Based on the information provided and procedures performed, we determined that SDG&E complied with ATR V.C.

**Affiliate Transaction Rule V.D – Joint purchases**

ATR V.D prohibits joint purchases of traditional utility merchant products and services between the utility and its affiliates. To determine whether SDG&E engaged in joint purchases for these products and services with its affiliates, we:

- Gained an understanding of the types of joint purchases SDG&E engages in with its affiliates;
- Reviewed SDG&E's joint purchase agreements to verify whether joint purchases are allowable and in accordance with ATR V.D; and
- Reviewed a list of all joint purchases between SDG&E and its affiliates to verify whether it included products or services related to the traditional utility merchant function.

### Conclusion

Based on the information provided and procedures performed, we determined that SDG&E complied with ATR V.D.

### **Affiliate Transaction Rule V.E – Corporate support**

Rule V.E prohibits certain types of corporate support between the utility and its affiliates. To determine whether shared corporate support between SDG&E and its affiliates excluded employee recruiting, engineering, hedging, financial derivatives, arbitrage services, gas and electric purchasing for resale, purchasing of gas transportation and storage capacity, purchasing of electric transmission, system operations, or marketing, we:

- Reviewed SDG&E's list of corporate support costs, corporate officers, and the allocation methodology used to determine whether corporate support shared between SDG&E and its affiliates is allowable and in accordance with ATR V.E;
- Examined the CY 2012 and CY 2013 Compliance Plans for evidence of corporate officer verifications, and identified shared officers to verify that no key officers were shared;
- Reviewed SDG&E's written policies and procedures for shared services and labor;
- Examined SDG&E's processes and procedures for intercompany billing and cost allocation; and
- Reviewed and selected inter-affiliate bills and supporting cost detail to verify that only services allowed under ATR V.E were being shared with affiliates.

### Conclusion

Based on the information provided and the procedures performed, we determined that SDG&E complied with ATR V.E.

### **Affiliate Transaction Rule V.F – Corporate identification and advertising**

ATR V.F. prohibits shared advertising and corporate identification between the utility and its affiliates. To verify whether SDG&E and its affiliates shared advertising and corporate identification activities, we:

- Reviewed SDG&E's bill inserts (33 and 20 for CY 2012 and CY 2013, respectively) and advertising materials to determine whether corporate identification and advertising for SDG&E were allowable and in accordance with ATR V.F.;
- Reviewed SDG&E's marketing documents to verify that SDG&E did not promote or advertise affiliate association with SDG&E, represent preferential treatment of affiliates, provide advertising space to its affiliates, and/or participate in joint advertising with affiliates; and

- Confirmed that SDG&E's research and development activities or investments in advanced research technology were not shared with or subsidized by its affiliates.

#### Conclusion

Based on the information provided and procedures performed, we determined that SDG&E complied with ATR V.F.

#### **Affiliate Transaction Rule V.G – Employees**

ATR V.G prohibits joint employment between the utility and its affiliates. To determine whether SDG&E and its affiliates shared employees, we:

- Reviewed SDG&E's list of employee transfers and loaned labor transactions to determine whether employee movements and transactions for SDG&E were in compliance with ATR V.G;
- Verified whether any board member or corporate officer served with the holding company, SDG&E, and an affiliate simultaneously;
- Confirmed that corporate officers from SDG&E and the holding company are appropriately described in the CY 2012 and CY 2013 Compliance Plans, and ensured that SDG&E is not sharing officers and directors to circumvent any of the ATRs;
- Ensured that SDG&E reported employee movements to the Commission in Schedule H of the Annual Report;
- Verified whether SDG&E employed any individuals jointly with an affiliate to perform other than allowed shared services;
- Reviewed lists of employee transfers to ensure that employees who transferred to an affiliate did not return to SDG&E within one year, and if an employee did return to SDG&E, the employee was not retransferred, reassigned, or otherwise employed by an affiliate within two years;
- Reviewed signed transfer documents and forms and the affiliate transfer process flows to ensure that transferring employees acknowledged the restrictions imposed by the ATRs; and
- Determined whether SDG&E made temporary or intermittent assignments or rotations to its energy marketing affiliates.

#### Conclusion

Based on the information provided and the procedures performed, we determined that SDG&E complied with ATR V.G.

**Affiliate Transaction Rule V.H – Transfer of goods and services**

ATR V.H identifies types and values of transferred goods and services between the utility and its affiliates. To determine whether the transfers of goods and services between SDG&E and its affiliates were allowable and in accordance with CPUC-directed fully-loaded costs concepts, we:

- Reviewed SDG&E's list of all property transfers between it and its affiliates to determine whether the transfers were allowable and in accordance with ATR V.H; and
- Examined transfer costs and methods used to verify whether transfer costs were priced in accordance with CPUC-directed fully-loaded cost concepts.

**Conclusion**

Based on the information provided and the procedures performed, we determined that SDG&E complied with ATR V.H.

**Affiliate  
Transaction  
Rule VI****Regulatory oversight**

ATR VI provides the requirements for utility compliance with regulatory oversight. To determine whether SDG&E complied with the regularly oversight requirements, we:

- Verified whether SDG&E filed its yearly Compliance Plan with the CPUC by June 30 as required;
- Verified whether SDG&E's yearly Compliance Plans contained a complete listing of all of SDG&E's affiliates, their purposes or activities, and whether SDG&E claims that ATR II.B makes these ATRs applicable to each affiliate;
- Examined the CY 2012 and CY 2013 Compliance Plans' mechanisms and procedures to verify that SDG&E had adequate procedures in place to ensure compliance with the ATRs;
- Identified 39 new affiliates created during 2012 and 2013 and for all 39 new affiliates:
  - Identified the creation or acquisition date of the affiliate
  - Verified whether SDG&E notified the Commission and posted on its website within three business days of the creation of the new affiliate;
  - Verified whether SDG&E filed an advice letter with the Commission within 60 days of the parent company's creation or acquisition of the affiliate; and
  - Verified whether the advice letters stated the affiliates' purposes or activities, whether SDG&E claimed that ATR II.B makes these ATRs applicable to the affiliate, and included a demonstration of the procedures in place to ensure compliance with these ATRs;

- Verified whether officers and employees were made available to testify before the Commission as necessary or required;
- Confirmed that the CY 2010 and CY 2011 ATR audit was paid for by SDG&E's shareholders and was not included in its General Rate Case calculations;
- Confirmed that all key officers submitted certifications to the Commission and verified that certifications were signed after the period of compliance;
- Verified that the Annual Officer Certifications were filed by March 31 of the following year; and
- Verified whether the Annual Officer Certifications is consistent with the content required.

#### Conclusion

Based on the information provided and procedures performed, we determined that SDG&E did not comply with ATR VI (see Finding 4).

## **Affiliate Transaction Rule VII**

### **Utilities products and services**

ATR VII provides the accounting and reporting requirements for additional approved products and services – NTP&S that the utility may offer. To determine whether SDG&E complied with the accounting and reporting requirements for these products and services:

- Requested that SDG&E identify any new NTP&S categories for the audit period;
- Reviewed Commission-approved advice letters to ensure that the NTP&S meet the criteria of ATR VII.C;
- Reviewed correspondence and data provided to the Commission in applicable advice letters to gain an understanding of SDG&E's evaluation of how the existing NTP&S categories impact the marketplace;
- Examined the types of NPT&S contracts SDG&E entered into to ensure that the services provided meet the criteria of ATR VII.C;
- For each NTP&S, examined the actual costs and revenues and verified whether SDG&E properly complied with the sharing mechanisms authorized in the relevant resolution/decision issued by the Commission;
- Reviewed marketing materials related to NTP&S to ensure that ratepayers are not charged for advertising costs;
- Confirmed that SDG&E did not have NTP&S property transfers with any affiliates; and
- Verified whether SDG&E has established periodic reporting and auditing requirements for NPT&S, and has met these requirements.

## **Affiliate Transaction Rule VIII**

### Conclusion

Based on the information provided and procedures performed, we determined that SDG&E complied with ATR VII.

### **Compliant procedures and remedies**

ATR VIII provides requirements for resolving complaints regarding ATR violations and requires specific compliance actions by the utility to prevent, detect, and disclose violations. To determine whether SDG&E complied with requirements for resolving and reporting instances of ATR violations, we:

- Examined SDG&E's Compliance Plans to verify that proper procedures were in place to comply with ATR VIII;
- Verified whether SDG&E had assigned, as required, an Affiliate Compliance Manager, and examined their responsibilities; and
- Examined actions regarding all ATR non-compliance complaints, and verified whether SDG&E properly notified the Commission's Energy Division regarding these complaints.

### Conclusion

Based on the information provided and procedures performed, we determined that SDG&E did not comply with ATR VIII (see Finding 5).

## **Affiliate Transaction Rule IX**

### **Protecting the utility's financial health**

ATR IX requires the utility to submit an annual report with financial data and projections of necessary capital by November 30. ATR IX also requires the utility to obtain a non-consolidation opinion demonstrating that the utility has appropriate provisions in place to protect its assets should its parent company enter into Chapter 11 bankruptcy. To determine whether SDG&E is in compliance with ATR IX, we:

- Examined CPUC-required capital reports presenting SDG&E's shareholder's equity and debt. Verified whether these reports included the requirements listed in ATR IX.A and were filed annually by November 30;
- Reviewed D.12-12-634 noting authorization of SDG&E's capital structure; and
- Verified that SDG&E obtained a non-consolidation opinion demonstrating that SDG&E has appropriate provisions in place to protect its assets should its parent company enter into Chapter 11 bankruptcy.

### Conclusion

Based on the information provided and the procedures performed, we determined that SDG&E complied with ATR IX.

**Attachment 2—  
SDG&E Response to Draft Audit Report**

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**Martine Blair**  
Federal Regulatory Business  
- Manager  
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[MBlair@semprautilities.com](mailto:MBlair@semprautilities.com)

April 6, 2018

Andy Finlayson, Chief State Agency Audits Bureau –  
State Controllers' Office  
P O Box 942850  
Sacramento, CA 94250-5874

**Re: Authority for Findings & Recommendations in 2012/2013 CPUC Affiliate  
Transaction Rules Compliance Audit**

Dear Mr. Finlayson,

I, Martine Blair, Federal Regulatory Business Manager at SDG&E/SoCalGas hereby accepts authority for the responses shown in the Findings and Recommendations sections of the attached document.

All further questions or comments regarding its content should be referred to me at: (619) 696-2343.

Sincerely,

SAN DIEGO GAS & ELECTRIC

By: 

Martine Blair

Federal Regulatory Business Manager

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**Affiliate Compliance Transaction Rules Audit for  
Years 2012 and 2013**

**Findings & Observations**

**AUDIT FINDING #1 – Incorrectly Assigned Affiliates:**

*“SDG&E incorrectly classified an affiliate that is subject to Affiliate Transaction Rules (ATRs) in its 2012 Annual Compliance Plan. The affiliate, Techno Red S.A. was incorrectly classified as a non-covered affiliate during CY 2012. TecnoRed S.A., should have been classified as a covered for CY 2012 because in addition to being a construction services company, the entity was also engaged in the activity of using natural gas to generate electricity.”*

**SDG&E’s RESPONSE:**

SDG&E agrees that it incorrectly classified Techno Red S.A. in 2012. TechnoRed S.A. has since been correctly listed as “covered” in SDG&E’s master list of affiliates.

As stated in Finding #5 below, SDG&E has recognized a need to improve its processes around new affiliate notifications. Accordingly, enhancements were made to the new affiliate notification and reporting process. Thus, while SDG&E understands that, for the audit period 2012/2013, delays continued to occur, SDG&E undertook to enhance its processes after the 2010/2011 audit, and now has a more robust process in place. It is important to recognize that SDG&E did not conduct any business transactions with TecnoRed S.A. and was operationally and physically separate from TechnoRed S.A. during the audit period (and remains so today).

**AUDIT FINDING #2: Inability to Maintain Required Records:**

*“SDG&E maintains voice recorded messages for only the most recent 36 months. Consequently, the recorded audio data for CY 2012 and January through August CY2013 were unavailable. We were limited to selecting and listening to recorded messages and telephone calls from September through December 2013. The 420 calls we listened to were related to accounts receivable. und. None of the calls discussed affiliate businesses.*

*Though no instance of affiliate transactions were noted, SDG&E has not maintained the necessary records for the entire audit period.”*

**SDG&E’s RESPONSE:**

The Customer Contact Center fields over 8 million calls per year that involve all types of customer calls. SDG&E retains these calls for three years. The calls that were reviewed raised no affiliate issues. That is no surprise because calls to the Customer Contact Center should not

raise Affiliate Transaction Rules related issues. No affiliate of SDG&E is engaged in a retail energy business in California. Accordingly, there would be no reason for affiliate issues to be discussed on calls with the Customer Contact Center.

SDG&E has looked into preserving the calls for five years. This longer retention period is expected to cost SDG&E and SoCalGas ratepayers approximately \$1.4 million per year. This is a large expense for an action that has no reasonable audit or compliance purpose.

**AUDIT FINDING #3: Improper Release of Customer Information:**

*“SDG&E’s Compliance Plans and Customer Contact Centers Policies and Procedures allow verbal authorization for the release of customer information to third parties as an alternative to written customer consent. SDG&E requires written customer authorization to release customer documentation to third parties.”*

**SDG&E’s RESPONSE:**

SDG&E does not require written customer authorization. The issue of whether SDG&E should allow customers to authorize the release of their data through electronic means was addressed in the prior audit for CY 2010 and 2011. SDG&E continues to disagree with this finding. There is no evidence to suggest that SDG&E releases customer documentation to third parties without the customer’s consent. The only issue here is whether that consent must be in writing.

Under California Civil Code Section 1633.7, “If a law requires a signature, an electronic signature satisfies the law.” Therefore, as a matter of California law, SDG&E is allowed to accept electronic authorization from its customers in lieu of written authorization. The statutory law makes the retention process more effective and efficient and customer-friendly, all while preserving documentation showing customers’ consent. Nonetheless, SDG&E is willing to change its practices -- to the detriment of its customers -- if that is what the Commission ultimately decides.

**AUDIT FINDING #4: Untimely New Affiliate Notifications:**

*“SDG&E did not immediately notify the CPUC as well as posted notice on its electronic bulletin board for creating of several new affiliates. Furthermore, for several affiliates, SDG&E did not timely file new affiliate notification advice letters to CPUC within required 60 calendar days. Semptra Energy, the parent holding company for SDF&E, created a total of 39 new affiliates during CY 2012 and CY 2013. Of the 39 new affiliates created during the audit period, we found following instances of untimely notifications:*

- 16 instances (7 – CY 2012 and 9 – CY 2013) of untimely immediate notification to the CPUC
- 14 instances (6 - CY 2012 and 8 – CY 2013) of untimely notification on its electronic bulletin board

- 4 instances (CY 2013) of untimely new affiliate notification advise letters to CPUC within the required 60

The prior audit had also identified that SDG&E had not timely informed CPUC of the new affiliates. We found that though SDG&E has adequate new affiliate notification procedures in place to ensure compliance with the requirements of ATR Rule VI.B, it appears that that these procedures were not continually conformed to. The utility stated that when a new affiliate is created, it would notify the Commission and post a notice on its website within two calendar days as well as file a new affiliate advice letter with the CPUC within 60 days.

The untimely notifications were for the following new affiliates:

<i>Affiliate</i>	<i>CPUC Notification in Days</i>	<i>Website Posting in Days</i>	<i>Advice Letter Filing in Days</i>
<b>2012 New Affiliates</b>			
<i>Gasoductos de El Encino, S. de R.L. de C.V.</i>	11	11	24
<i>Transportadora El Encino, S. de R.L. de C.V.</i>	11	11	24
<i>Controladora Sierra Juarez, S. de R.L. de C.V.</i>	7	7	60
<i>Semco Holdco, S. de R.L. de C.V.</i>	7	7	60
<i>ELETRANS S.A.</i>	7	7	30
<i>Mesquite Power Operations, LLC</i>	14	14	55
<i>Mesquite Solar Development, LLC</i>	7	1	51
<b>2013 New Affiliates</b>			
<i>Gasoducto del Sur S.A.</i>	73	69	88
<i>Sempra LNG Holdings I, LLC</i>	7	3	56
<i>ELETRANS II S.A.</i>	14	14	922
<i>Broken Bow II Wind Holdings</i>	174	174	183
<i>Broken Bow(Wind) II, LLC</i>	174	174	183
<i>Inversiones Sempra Latin America Limitada</i>	13	13	57
<i>Gasoductos Ingeniería, S. de R.L. de C.V.</i>	15	15	58
<i>Gasoductos Servicios Subholding, S. de R.L. de C.V.</i>	15	15	58
<i>Flat Ridge 3 Wind Energy LLC</i>	14	14	40

### **SDG&E's RESPONSE**

SDG&E has recognized a need to improve its processes around new affiliate notifications. Accordingly, enhancements were made to the new affiliate notification and reporting process. SDG&E understands that, for the audit period 2012/2013, delays continued to occur. SDG&E

began to implement enhancements to its processes after the 2010/2011 audit, and now has a more robust process in place.

**AUDIT FINDING #5: Non-Conformance and Remedies:**

*“SDG&E did not effectively implement mechanisms and procedures to prevent, detect, disclose, and rectify affiliate rule violations during the audit period, as required by ATR VIII.D.2.b.iii. SDG&E did not prevent, detect, disclose, and rectify the rule violations identified in Findings 1 through 4.*

**SDG&E’s RESPONSE:**

SDG&E treats self-reporting as a path when issues are discovered internally. Potential issues raised in this audit will be shared with Commission Staff in the normal course of the audit process.

**OBSERVATION #1: Undefined Shared Services:**

*“As also observed during the previous audit, SDG&E’s Compliance Plans permits its parent company function, Sempra Energy Treasury, to assist in the planning and arranging of hedging and financial derivative use for long-term financing for activities other than resource procurement. Though not specifically stated, SDG&E interprets the ATRs to deem hedging and financial derivatives in support of its long-term financing as permissible activities. As the ATR rule is not specific, we could not determine if such hedging and financial activities are permissible pursuant to the affiliate rules. Our audit did not determine the extent of such activities for the audit period.*

*Hedging, for resource procurement, is a means of price protection. It allows an IOU to essentially secure, with its suppliers, commodity acquisition prices using a financial instrument such as a commodity futures contract. An energy derivative is an exchange transaction derived from an underlying energy asset, such as natural gas, crude oil, or electricity.*

*SDG&E does not engage in these types of affiliate transactions as these are unallowable. As reported in Sempra Energy’s 2012 and 2013 Annual Reports, SDG&E uses hedging and derivative instruments to manage risks including commodity price risks, interest rate risks, credit risks and other market risks.”*

**SDG&E's RESPONSE:**

SDG&E's Compliance Plan states the following regarding these activities:

"SDG&E understands Rule V.E's prohibition on shared "hedging and financial derivatives and arbitrage services," to apply to employees engaged in hedging electric and natural gas commodities, and not to the use of hedging and financial derivatives in support of SDG&E's long term financings. The Sempra Energy Treasury and Finance shared service departments may assist SDG&E with planning and arranging hedging and financial derivative used in support of SDG&E's long-term financings. They also engage in corporate oversight of SDG&E's risk management function and set corporate risk-management policies."

This shows that certain Sempra Employees assist SDG&E. Nowhere does it say that any affiliate is involved in these activities.

In response to the 2010/2011 audit, , and after consultation with CPUC Staff, SDG&E added the following language in its Compliance Plan beginning with the 2015 Compliance Plan:

*"No SDG&E employees would be involved in hedging for covered affiliates. Similarly, no employees of a covered affiliate would be in hedging for SDG&E."*

**OBSERVATION #2: Annual Officer Certification Inconsistent with the Required Language:**

SDG&E submitted the required Officer Certifications for CY 2012 and 2013 in a timely manner. Consistent with previous Annual Officer Certifications, SDG&E included an added disclosure on the certification in addition to the standard and required language specified in the ATR, VLE. The additional disclosure as specified in the Annual Compliance Plan states:

*"This certificate does not include violations, if any, already reported to the Commission during the reporting period. This certificate also excludes audits or investigations, if any, still in progress at the end of the reporting period. If violations are ultimately found, they will be reported consistent with SDG&E's affiliate compliance plans."*

**SDG&E's RESPONSE:**

On this issue, SDG&E engaged in meaningful discussions with CPUC Staff after the 2010/2011 audit concluded. There were discussions regarding the possibility of modifying the current footnote language. SDG&E made clear at the time that the footnote is intended to clarify the meaning of the attestation and not to change the substance of it. SDG&E is willing to continue working with CPUC Staff on the footnote, to the extent Staff remains interested in doing so.

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