



MEMORANDUM

EUGENE WATER & ELECTRIC BOARD

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TO: Commissioners Brown, Mital, Helgeson, Manning and Simpson
FROM: Cathy Bloom, Finance Manager; Sue Fahey, Fiscal Services Supervisor;
Anna Wade, Senior Financial Analyst
DATE: March 25, 2014
SUBJECT: Annual Report on Power Trading Compliance and Financial Results
OBJECTIVE: Information Only

Issue

The October 2012 revision to Board Policy SD8, Power Risk Management Policies, requires the Finance Manager to present a report to the Board at least annually that covers the policy's trading and contracting compliance and the financial results of power trading. This backgrounder provides that information for calendar year 2013.

Background

Oregon statutes stipulate the appropriate scope for a governmental agency's investment of "surplus funds." Accordingly, EWEB's activities in the power markets must be associated with the provision of electricity to meet anticipated sales and generation forecasts. In 2006, Board Policy SD8 was developed to provide oversight control and guidance to the power trading operations. SD8 is included as an attachment for your reference.

Discussion

SD8.2 - Anti-speculation Statutes: In Compliance

To comply with anti-speculation statutes, SD8 requires managing its average megawatt market positions so that exposure to prices is limited. Occasionally changes to forecasts, load and/or generation result in SD8 position limits being exceeded. In those events, risk management control procedures developed under SD8.4 require positions to be brought back into compliance no later than the next trading day unless preapproved by the Financial Manager and Power Operations Manager. EWEB was in compliance with this procedure in 2013.

SD8 requires the mid-term position to be managed for a minimum of three years; however the Risk Management Committee (RMC) has adopted a more prudent practice of analyzing market position over a 5 year period.

SD8.3 - Financial Exposure Limitation: In Compliance

In addition to megawatt position limits, SD8 requires that controls be implemented to reduce the financial risk associated with market positions and ensure that results of trading activity combined with reserves provide adequate funding to cover other Electric Utility expenditures. EWEB was in compliance with this policy in 2013. The RMC evaluates financial risk beyond the SD8 three year minimum to encompass a five year time horizon.

Risk management control procedures also require that the following year's market position be hedged to the level included in the long-term financial plan by July. Given the Electric Utility's recent financial challenges, the RMC approved completing that activity by January in 2013 and 2014.

2013 RMC Actions

In addition to reviewing compliance on a monthly basis, the following actions were taken by the RMC in 2013:

- Risk management procedures were updated to:
 - Provide more specificity on Renewable Energy Certificate transactions to ensure that they meet mandated renewable portfolio requirements
 - Provide for authorization and additional review when trades are executed by staff acting in a back up capacity.
- Flakeboard America, LTD contract changes were approved which were ratified by the Board at the September 17, 2013 meeting.
- Direction was provided to staff on various projects relating to power supply assets.
- The termination of the Metro Wastewater power purchase agreement.
- The period for mid-term to cure the 2018 position limit compliance was extended by one month to improve counterparty liquidity.

Recommendation and Requested Board Action

This item is information only and no Board action is being requested at this time.

Attachments: Board Policy SD8

Policy Number: SD8
Policy Type: Strategic Direction
Policy Title: Power Risk Management Policies
Effective Date: October 2, 2012

1. Formation of Risk Management Committee

A Risk Management Committee (RMC) will be established to provide oversight control and guidance to the power trading and contracting operation.

The RMC will be comprised of the General Manager, Assistant General Manager, Finance Manager, Power Resources & Strategic Planning Manager, Trading/Power Operations Manager, Fiscal Services Supervisor, and the Generation & Fleet Services Manager. As a practical matter, minor title and/or work scope changes affecting RMC members shall not require formal amendment to this policy.

This committee, which will meet as necessary, will be responsible to the Board of Commissioners for prudent implementation of these policies and oversight of the trading operation to ensure compliance with this policy and overall good industry practices. On at least an annual basis or as necessary, the Finance Manager will present a report to the Board covering the trading and contracting compliance with this policy and the financial results obtained. Detailed responsibilities of the RMC include:

- Oversee the approval of all wholesale power trading accounts and counterparties to insure creditworthiness.
- Establish and periodically review the exposure and trading limits for trading operations, which shall not exceed the overall trading limits established by this Policy Statement.
- Authorize physical and financial wholesale power trading representatives to conduct trades and contracts pursuant to this policy.
- Review and approve retail contracts that are not subject to traditional retail tariffs.

2. Compliance with Anti-Speculation Statutes

EWEB must comply with ORS statutes stipulating the appropriate scope of investments for "surplus funds." Accordingly, EWEB's activities in the power markets must be associated with the provision of electricity to meet anticipated sales and generation forecasts. These criteria will be applied:

Real Time (a 24 hour day)

EWEB will manage its Real Time position so that its exposure to market prices for the balance of the day is no greater than 50 average megawatts surplus or deficit.

Short Term (balance of month and following month)

EWEB will manage its Short Term position so that its exposure to market prices for the balance of the month and the following month is no greater than 75 average megawatts surplus or deficit.

Mid Term (period beyond short term)

EWEB will manage its Mid Term position so that firm power supplies are within 25 average megawatts of expected firm sales.

This criteria will be applied to Mid Term time periods beyond the short term:

- For each month within the current and next prompt quarter
- For each of the next three quarters
- For each year within the next three years

The Board may grant exception to this policy to deal with specific circumstances, such as long-term resource acquisitions.

3. Financial Exposure Limitation

In addition to the megawatt position limits set forth in the Compliance with Anti-Speculation Statutes policy above, EWEB will implement additional controls to further limit financial risk associated with its market positions. The function of these additional controls would be to ensure that EWEB's projected contribution margin, when combined with available reserves and borrowing authority, will provide funding capabilities to cover other budgeted/projected expenditures at the Electric Utility.

Real Time (a 24 hour day)

Because total volumes and resulting exposure is small, no financial exposure limits are required.

Short Term (balance of month and following month)

EWEB will manage its Short-Term position such that there is a 95% probability an adverse market price movement will result in no more than a \$2 million risk exposure. The Board delegates the setting of methodologies for determining financial risk to be used to the Risk Management Committee.

All Traded Periods

At least on a monthly basis, Fiscal Services with the assistance of Power Operations and General Accounting, will monitor the contribution margin and resulting impact on reserves and available borrowing authority for each month over the succeeding 18 to 36 months. In addition, a probability analysis will be conducted. The target is to have a contribution margin which when combined with available Power Reserve/Unallocated Power Fund and borrowing authority will meet or exceed the funding needs of the Electric Utility in each month with at least 90 percent probability and leave an appropriate safety margin. Currently, that safety margin is determined to be at least \$20 million. Subject to annual review, the contribution margin is calculated by summing wholesale, retail and service revenue from the trading floor and subtracting purchased power, transmission and generation costs, as well as CILT expense. The RMC may establish tighter exposure limits to effectively manage the overall position.

4. Development of Detailed Control Procedures

Consistent with Committee of Chief Risk Officers Risk Policies, detailed control procedures will be developed by EWEB and approved by the RMC. These procedures will incorporate strong dual controls between those groups initiating trades and the risk management/accounting functions.

The Policy and Procedures Guide will further establish the roles and responsibilities of the Power trading, accounting, and Fiscal Services staff. The detailed policies and procedures will incorporate a credit approval and monitoring process to manage and measure credit exposure. The Policy and Procedures Guide, and its inherent controls will be approved by the RMC and reviewed on an ongoing basis.

5. Authorized Activities

The following types of price risk management instruments/transactions are authorized for trading activities:

- Physical delivery contracts with a term up to and including one year.
- Financial agreements with approved counterparties with a term up to and including one year.

The Policy and Procedures Guide as approved by the RMC will specify a process for determining the appropriate use of physical and financial hedge instruments. The Guide will also stipulate the types of swaps and options approved for use by the trading operation. The list of approved products and appropriate uses will likely change as the market changes and EWEB's trading operation gains experience with their use.

Source: Power Risk Management Policies and Procedures, Adopted 08/17/1999, Revised 03/05/2002, 9/19/2006, 10/2/12