


RESOLUTION No. 30975

A RESOLUTION adopting a Risk Management Policy for the City Light Department.

Introduced:	4.9.07	By:	
Referred:	4.9.07	To:	Emergency + Technical
Referred:		To:	
Reported:			
Passed:		Signed:	
Filed:	3.30.09	Published:	

3/30/09 Retired

US5171

LAW DEPARTMENT



City of Seattle

Gregory J. Nickels, Mayor

Office of the Mayor

March 27, 2007

Honorable Nick Licata
President
Seattle City Council
City Hall, 2nd Floor

Dear Council President Licata:

I am pleased to transmit the attached proposed Council Resolution that adopts a new commodity trading risk management policy for the City Light Department.

The nature of City Light's core business requires it to engage in transactions in wholesale energy markets, especially the market for power. That engagement carries with it risks that the Utility is charged with managing on behalf of its customers, which was one of the lessons learned from the California Energy Crisis of 2000/2001. Industry Best Practice and prudent oversight require that the City establish a risk management philosophy and policy to govern City Light's management of the risks it faces. The accompanying document "Seattle City Light Risk Management Policy" establishes such policies.

Thank you for your consideration of this legislation. Should you have questions, please contact Herb Hogue, Chief Financial Officer, at 684-4649.

Sincerely,

A handwritten signature in black ink, appearing to read 'Greg Nickels', written over a circular stamp that is partially obscured.

GREG NICKELS
Mayor of Seattle

cc: Honorable Members of the Seattle City Council



RESOLUTION 30975

A RESOLUTION adopting a Risk Management Policy for the City Light Department.

WHEREAS, in order to provide electricity to its customers economically, the City Light Department routinely buys and sells wholesale energy products; and

WHEREAS, that engagement in wholesale energy markets necessarily exposes the City Light Department to risk, including market and credit risk; and

WHEREAS, Industry Best Practice requires that the City Light Department have a clear and binding statement of policy to govern the management of those risks; and

WHEREAS, Industry Best Practice further requires that such policies be endorsed by the City Light Department's governing body; NOW, THEREFORE,

**BE IT RESOLVED BY THE CITY COUNCIL OF THE CITY OF SEATTLE, THE
MAYOR CONCURRING, THAT:**

Section 1. The risk management philosophy and policy attached hereto as Exhibit A fairly and reasonably represents the intent of the City of Seattle in the matter of the City Light Department's management of the commodity trading risks it is charged to manage and has the full endorsement of the City of Seattle, and is hereby adopted.



Adopted by the City Council the ____ day of _____, 2007, and signed by me in open
session in authentication of its adoption this ____ day of _____, 2007.

President _____ of the City Council

THE MAYOR CONCURRING:

Gregory J. Nickels, Mayor

Filed by me this ____ day of _____, 2007.

City Clerk

(Seal)

Exhibit A: Seattle City Light Risk Management Policy



EFFECTIVE DATE: TBD

SEATTLE CITY LIGHT

Risk Management Policy

Date Effective: TBD

© Seattle City Light
700 Fifth Avenue, Suite 3300
PO Box 34023
Seattle, WA 98124-4023
Phone (206) 684-3200 • Fax (206) 684-3158

Exhibit A to Resolution



Table of Contents

AUTHORITY, PURPOSE & SCOPE	1
AUTHORITY.....	1
PURPOSE & SCOPE	1
RISK POLICY APPROVALS AND AMENDMENTS.....	1
COMPLIANCE WITH LAWS AND REGULATIONS	2
MISREPRESENTATION & CONFLICT OF INTEREST	2
POLICY VIOLATIONS.....	2
ORGANIZATION & GOVERNANCE	3
INDEPENDENCE AND SEGREGATION OF DUTIES.....	3
ROLE OF THE CITY & THE SUPERINTENDENT	3
ROLE OF THE CHIEF FINANCIAL OFFICER	3
ROLE OF THE RISK OVERSIGHT COUNCIL (ROC)	4
ROC STRUCTURE	4
ROC RESPONSIBILITIES	5
ROC REPORTING RELATIONSHIP.....	5
ROLE OF THE POWER MANAGEMENT GROUP (PMG).....	5
PMG RESPONSIBILITIES	5
PMG ORGANIZATION.....	6
PMG REPORTING RELATIONSHIP.....	6
ROLE OF THE RISK OVERSIGHT GROUP (ROG).....	6
ROG RESPONSIBILITIES	6
ROG REPORTING RELATIONSHIP	7
RISK MANAGEMENT APPROACH	8
RISK MANAGEMENT PHILOSOPHY.....	8
MARKET RISK POLICIES.....	8
FORWARD HEDGING STRATEGIES.....	9
RISK LIMITS	10
CREDIT RISK MANAGEMENT PHILOSOPHY	10
CREDIT RISK POLICIES	11
PROCEDURES MANUAL	12
RISK REPORTING	12
APPENDIX I CITY RESOLUTION.....	1
APPENDIX II ORGANIZATION CHART	1
APPENDIX III COMPLIANCE STATEMENT	1

AUTHORITY, PURPOSE & SCOPE

AUTHORITY

The City Light Department of the City of Seattle ("City Light") operates under the authority of the Mayor and City Council of the City of Seattle ("City"). City Light is charged by the City with operating its power supply resources, transmission agreements and electric system to meet the power needs of its customers. The City recognizes that because of the nature of its customer demand and power supply portfolio, City Light will experience imbalances between the two and must therefore transact in the physical and financial wholesale energy markets for energy services and products to achieve balance.

Meeting the electricity needs of its customers, managing the risks inherent in the portfolio, and optimizing the value of surplus power and transmission assets are the primary reasons for City Light to transact in wholesale energy markets.

PURPOSE & SCOPE

The purpose of this document ("Risk Policy") is to lay out the general principles, functional organization, roles and responsibilities, and delegations of authority that will govern how City Light conducts business in the wholesale energy markets.

The specific operating procedures and parameters for implementing this Risk Policy will be detailed in the Risk Management Procedures Manual ("Procedures Manual") to be reviewed and approved by the Risk Oversight Council ("ROC"), a body within City Light established by this Risk Policy and reporting to the Superintendent.

All City Light employees in relevant functional areas are expected to comply with, and acknowledge their understanding of both this Risk Policy document and the associated Procedures Manual. The Risk Policy and associated Procedures Manual constitute the sole governing statements for City Light's wholesale energy activities.

RISK POLICY APPROVALS AND AMENDMENTS

This Risk Policy will become effective upon the expressed approval of the City.

In adopting this Risk Policy document by City Resolution (attached as Appendix I), the City approves these risk management policies and delegates the authority and responsibility for their implementation to the Superintendent of City Light and his or her designees.

Each year prior to July 1, the ROC will review the elements of this policy and bring forth to the City any recommended changes. In reviewing the policy and recommending modifications, the ROC will consider any material changes in City Light's business activities and financial health. Recommendations shall include a complete description of the reason for such changes and their anticipated impact.

COMPLIANCE WITH LAWS AND REGULATIONS

Employees shall comply with all applicable laws and regulations including, but not limited to, Anti-Market Manipulation rules established by Congress and the Federal Energy Regulatory Commission. Employees should be familiar with the relevant laws and regulations and seek clarification from the Risk Oversight Manager as required. The Risk Oversight Manager shall seek the advice of the City Law Department as required. The Law Department shall advise City Light on the legal and regulatory guidelines that govern the purchase and sale of all authorized products, and shall support City Light's training of employees.

MISREPRESENTATION & CONFLICT OF INTEREST

City Light personnel shall not withhold or conceal information regarding transactions or risk management activities from any person responsible for the accurate recording and reporting of such activities, nor shall they misrepresent any such information.

Employees shall always put the interests of City Light ahead of any interest they may have in entities with which they transact. Further, employees authorized to place or execute wholesale energy transactions on behalf of City Light may not engage in such activities for their personal accounts. Employees will disclose to their supervisor any conflict of interest that could reasonably be construed as preventing them from acting solely in the interests of City Light. Failure to do so is a violation of this Risk Policy.

POLICY VIOLATIONS

All persons engaged in the implementation, management, or administration of these policies and associated procedures, as detailed in the Procedures Manual, will sign the Statement of Compliance (see Appendix III), stating that they have read, understood and agree to comply with them.

Any person found in direct violation of these policies and associated procedures may be subject to disciplinary action, including possible termination.

ORGANIZATION & GOVERNANCE

INDEPENDENCE AND SEGREGATION OF DUTIES

An effective risk management and compliance program requires clear segregation of duties, reporting lines, and incentives between functions and personnel who originate and manage risk, and those who analyze, monitor and report risk.

City Light has developed a risk management and risk oversight organizational structure to support this requirement (see Appendix II). The core elements of the structure are:

- Superintendent;
- Chief Financial Officer ("CFO");
- The Risk Oversight Council ("ROC");
- The Power Management Group ("PMG"); and
- The Risk Oversight Group ("ROG").

The following sections define the risk management roles and responsibilities of the City and the individuals and groups within the above defined structure.

ROLE OF THE CITY & THE SUPERINTENDENT

The City has ultimate oversight responsibility for City Light's risk management program and is responsible for approving this Risk Policy. In approving this document, the City delegates the authority for implementing a risk management program consistent with this Risk Policy to the Superintendent of City Light through the ROC.

ROLE OF THE CHIEF FINANCIAL OFFICER

The CFO is the chair of the Risk Oversight Council and is responsible for establishing and managing City Light's credit risk management program.

The CFO recommends the methodology used to compute the credit that will be extended to any counterparty to the ROC, and is responsible for oversight of ongoing credit evaluation, monitoring of credit exposure, and the management and administration of the credit function. Prior to July 1 of each year, the CFO will submit these methods to the ROC for review and approval.

The CFO may suspend transactions with a counterparty at any time due to concerns about the counterparty's credit-worthiness or ability to fulfill the terms of a transaction. The CFO will notify the ROC and the Power Management Executive in writing of such decision and the reasons for it at the first available opportunity. Once such notice is

received, no additional transactions will be completed with the counterparty until further notice.

ROLE OF THE RISK OVERSIGHT COUNCIL (ROC)

The ROC has the authority and responsibility for approving and implementing the procedures and parameters contained in the Procedures Manual consistent with this Risk Policy. It is also responsible for setting City Light's risk profile and exposure in compliance with this Risk Policy and directing the development of City Light's risk management strategy.

ROC STRUCTURE

The ROC shall be comprised of the following City Light employees:

- Chief Financial Officer (Chair)
- Risk Oversight Manager
- Power Supply and Environmental Affairs Officer
- Power Management Executive (Non-voting)

(Note: The Power Management Executive will be required to attend ROC meetings and be an active participant, but will not have a vote.)

Any three of the four members of the ROC will constitute a quorum. The ROC will make decisions and take actions by a simple majority vote. If the ROC reaches an impasse that cannot be addressed through a vote, the issue will be referred to the Superintendent for resolution.

The ROC shall meet no less than twice per calendar month. Attendance of ROC meetings shall be mandatory for appointed members. Member attendance shall be recorded in the ROC meeting minutes. Any member of the ROC can request an emergency meeting of the ROC to address circumstances or issues that may require immediate attention.

Alternates are not allowed on the ROC unless special circumstances limit a member's participation. Under those circumstances, the member may designate a temporary alternate provided, however, that the ROC must approve the alternate and the term for which the alternate will replace the sitting member.

The Risk Oversight Manager will act as Secretary to the ROC and will document all meetings and actions taken by the ROC in meeting notes distributed to ROC members for their review and acceptance. Such meeting notes shall be distributed to the ROC members within two business days of the meeting. Approved minutes will be sent by the chair to the Superintendent within one business day of approval by the ROC.

ROC RESPONSIBILITIES

The activities and responsibilities of the ROC include the following:

- Review and approve the Procedures Manual;
- Review and approve risk management strategies to be implemented by the Power Management Group;
- Review and approve the methodologies used to limit credit to counterparties;
- Continuously monitor and assess compliance with these policies;
- When necessary discuss and approve limit exceptions and direct remedial action where appropriate;
- Perform an annual review of policies and recommend changes to the Superintendent;
- Discuss topics of interest concerning industry best practices; and,
- Other activities relevant to the implementation and oversight of these policies including monitoring modeling, business process, and physical asset risk.

ROC REPORTING RELATIONSHIP

The ROC reports directly to the Superintendent. The CFO, as chair, will brief the Superintendent on City Light's exposure and the ROC actions on a regular basis.

The Risk Oversight Manager has a direct line of communication with the Superintendent on matters pertaining to risks.

Prior to the start of the fiscal year, the ROC will issue a report of its attainment of goals for the year and its assessment of the status of the system for the coming fiscal year.

ROLE OF THE POWER MANAGEMENT GROUP (PMG)

The PMG manages the generation portfolio on behalf of City Light. It transacts in the wholesale energy market as needed to balance the supply of electricity to demand and to mitigate the risks inherent in managing the system, subject to the limitations set forth by this Risk Policy and the ROC.

PMG RESPONSIBILITIES

The activities and responsibilities of the PMG include:

- Meeting City Light's customer load obligation;

- Managing City Light's generating resources, contracts and transmission agreements to meet its hourly, daily, balance of month and forward month obligations;
- Extracting value from City Light's power supply portfolio and transmission contracts with due consideration of risk;
- Formulating and recommending risk mitigation strategies to the ROC that are consistent with City Light's objectives and this Risk Policy;
- Implementing strategies approved by the ROC; and,
- Other activities relevant to the daily management of a power system.

PMG ORGANIZATION

The PMG is functionally organized along wholesale market segments for Real-time, Daily/Balance of the Month, and Forward transactions.

The primary focus of the Real-time and Daily/Balance of Month functions is balancing the supply of power to meet City Light's customer demand in the near term. Forward marketing is primarily responsible for hedging City Light's portfolio exposure resulting from hydro generation uncertainty and market price volatility. Forward marketing is responsible for managing City Light's power supply portfolio from one to eighteen months into the future.

Consistent with Risk Limits defined in this Policy and direction established by the ROC, the head of the PMG, the Power Management Executive, is responsible for overseeing all power market activities conducted by City Light including monitoring of short term market activities and implementation of longer term hedging strategies. As needed, the Power Management Executive will discuss and review City Light's power marketing activities with the ROC.

PMG REPORTING RELATIONSHIP

The Power Management Executive, reports directly to the Power Supply and Environmental Affairs Officer of City Light.

ROLE OF THE RISK OVERSIGHT GROUP (ROG)

The ROG provides staffing to support the ROC, producing reports, analysis, and recommendations for the ROC. While oversight staff may provide input to the PMG, they will maintain a strict separation of duties and under no circumstances will ROG staff direct, engage in, or be involved with wholesale energy transaction on behalf of the utility.

ROG RESPONSIBILITIES

The activities and responsibilities of the ROG include the following:

- Measuring and reporting on the utility's risk profile daily;
- Recommending specific risk limits consistent with the utility's risk management objectives and risk tolerance;
- Recommending credit limits for new and active counterparties to the CFO;
- Reporting credit exposure and maintaining credit control;
- Monitoring compliance with policy and established procedures;
- Reporting violations of limits or policy and recommending remediation when necessary;
- Engaging the ROC in discussions regarding events or developments that could expose the utility to potential losses;
- Evaluating the effectiveness of the risk metrics employed;
- Validating and testing models used in risk management to ensure that market and credit risks are accurately quantified;
- Researching, developing, testing, and implementing risk measurement methodologies and models;
- Developing, maintaining, and proposing changes to the Procedures Manual; and,
- Other activities relevant to the oversight of these policies.

ROG REPORTING RELATIONSHIP

The head of the ROG, the Risk Oversight Manager, reports directly to the Chief Financial Officer.

Risk Management Approach

RISK MANAGEMENT PHILOSOPHY

City Light's current power supply portfolio consists primarily of hydro-based generation (approximately 90%). Historically, City Light's combined generation output has exceeded its retail customer demand by approximately 40% on an expected annual basis. Depending on hydro conditions, however, its surplus generation can easily vary from 10% to 70% of its retail customer demand in a given year. This hydro uncertainty, coupled with wholesale energy market price volatility, leads to significant variability in City Light's net wholesale sales revenue from the sale of that surplus.

City Light manages this revenue risk in order to protect the interests of the utility and its ratepayers. City Light hedges its exposure by buying and/or selling physical energy and associated products in the wholesale energy market prior to, and all the way up to, the hour of delivery. While City Light's principal objective is to ensure that it meets its retail customer demand obligation, it tries to do so in a way that generates additional value from its generation portfolio, with due consideration of risk.

By participating in the wholesale energy market, City Light is exposed to and needs to manage, a variety of risks including:

- Market price risk – the risk of loss due to price changes;
- Credit/performance risk – the risk of loss due to default or failure to perform on contracts;
- Volumetric risk – the risk of loss due to unpredictable variations in the output of the generation fleet or demand;.
- Modeling/valuation risk – the risk of loss due to inaccurate valuation of exposure;
- Operations risk- the risk of loss due to physical assets failing to perform; and,
- Operational risk – the risk of loss due to flawed or inadequate business processes.

While all of these are under the purview of the ROC, only the approach to market and credit risk are discussed here.

MARKET RISK POLICIES

The following market risk policies shall govern City Light's participation in wholesale energy markets. Specific limits, methodologies, reports, operational procedures, and approval processes will be detailed in the Procedures Manual.

- City Light will keep the fundamental interests of its ratepayers in mind as it manages its risk.
- City Light will ensure that it meets its native retail customer demand obligation with a high level of certainty.
- City Light shall not engage in any transactions that are purely speculative in nature or that cannot be tied directly to managing its underlying power supply position.
- City Light will ensure that it has full knowledge of its position in all transacted products and the resulting exposure, and understands the implications of its hedging activities.
- Only personnel authorized by the ROC can transact on behalf of City Light.
- City Light may only transact in wholesale energy products approved by the ROC.
- City Light may only transact within limits approved by the ROC. The limit structure shall be based on parameters such as volume, tenor, and/or at-risk measures, as deemed appropriate by the ROC.
- Metrics for assessing City Light's market risk exposure will be specified, measured, monitored and reported on a regular basis.
- All wholesale energy transactions will be carried out on recorded phone lines.
- On a daily basis, all wholesale transactions will be captured in the official system of record, and all price curves will be independently validated by the ROG.
- For the purpose of managing the portfolio, net forward market positions will be marked to market each business day.
- Models and inputs for valuation and risk measurement shall be subjected to a validation and change control process. The models employed and associated processes shall be described in detail in the Procedures Manual.
- Market and credit risk reports will be submitted to the members of the ROC and the Superintendent on a weekly basis at a minimum.

FORWARD HEDGING STRATEGIES

Consistent with market risk policies defined herein and the Risk Limit defined below, the PMG, in concert with the ROC, will develop forward month hedging strategies as a means to help reduce the variability of City Light's net wholesale revenues and increase the overall level of expected revenues.

Prior to October 1, of each year, the PME shall submit all hedging strategies for the upcoming calendar year to the ROC in writing for review and approval. All such hedging strategies will be fully developed and reviewed in detail with the ROC, including a detailed examination of the net benefits and reduction in risk associated with each strategy.

Once approved and adopted by the ROC, the hedging strategy will be fully documented in the ROC meeting notes. The PME shall carry out such approved hedging strategies consistent with the Risk Limits (specified below), conditions and direction imposed by the ROC, the principles contained in this document and industry procedures and practices. At each ROC meeting the PME shall provide a report that summarizes the status and results of each hedging strategy.

RISK LIMITS

Each business day, the PMG will manage City Light's exposure consistent with the Risk Limits as defined below. These limits override any current hedging strategy that may be in place at the time such limit is reached or exceeded. Once such limit is exceeded, the PMG will take immediate corrective action. Corrective action may include purchasing power to eliminate forecasted deficits in any month or calendar quarter or re-balancing City Light's forward portfolio position through a combination of purchases, exchanges or other products available from the market. The PMG shall promptly report, in writing, to the ROC any limits that are exceeded, the reasons and conditions that caused such exceedance and the actions being undertaken by the PMG to return within such limits.

Limits

Prompt Month: At no time will the PMG enter a month carrying a net combined energy deficit of more than 50 average megawatts under expected conditions.

Forward Months: The PMG will take corrective action if at any time there is a forecasted net combined system energy deficit at a 75% confidence level for any future calendar quarter over the following 12 month period. The corrective action shall reduce said deficit to zero.

CREDIT RISK MANAGEMENT PHILOSOPHY

Because it has surplus power even under drought conditions, City Light must sell significant quantities of power on the wholesale market. Industry practice dictates settlement no sooner than twenty days after the end of the delivery month, requiring that City Light extend credit to its counterparties. Further, as noted earlier, City Light seeks to manage its price risk by selling some portion of that surplus in the forward market, resulting in its extending credit for longer periods, sometimes up to a year.

City Light manages this risk by:

- Subjecting potential counterparties to a rigorous credit worthiness assessment process;
- Establishing strict credit limits for counterparties based on that assessment; and,
- Continuously monitoring the financial health of active counterparties and adjusting credit limits as appropriate.

To protect its financial integrity, City Light will generally deal only with investment grade counterparties in good financial health. However, on occasion – for example during the runoff period (April–June) – City Light may be obliged to sell to less creditworthy counterparties to avoid spilling water and thereby wasting the power.

CREDIT RISK POLICIES

The following credit risk policies shall govern the management of City Light's credit exposure. Specific limits, methodologies, reports, operational procedures, and approval processes will be detailed in the Procedures Manual.

City Light may only transact within credit limits approved by City Light's CFO using methodologies approved by the ROC. The maximum credit to be extended to a counterparty will be based on a number of factors which may include the counterparty's credit score, net worth, cash flow, profitability, and Paydex score or payment history with City Light. At any given time for any given counterparty, the CFO will set the limit up to, but not exceeding, this maximum limit.

Except under 'must sell' circumstances, City Light will only consider extending credit to counterparties that have two full years of audited financial statements (with an unqualified opinion) and a minimum net worth of \$2.5 million.

City Light may consider credit enhancements that meet the following criteria:

- Prepayment for the product or service;
- An acceptable irrevocable standby letter of credit from a creditworthy provider for the benefit of City Light;
- An acceptable parent guarantee from a parent with ratings of at least 'BBB' and/or 'Baa2' from S&P and Moody's, respectively, and no ratings below investment grade; or,
- Other credit enhancement deemed acceptable by the CFO.

An acceptable standby letter of credit shall be from a bank with at least an "A" credit rating from two or more major credit rating agencies. If a parent guarantee is issued, the Guarantor must meet City Light credit qualification requirements and qualify for the amount of the credit guaranteed.

Metrics for measuring City Light's credit risk exposure will be specified, measured, monitored and reported by the Risk Oversight Group on a regular basis.

PROCEDURES MANUAL

The specific operating procedures and parameters for implementing the policies in this document will be detailed in the Procedures Manual. Changes to the Procedures Manual will be reviewed and approved by the ROC for consistency with the Risk Policy.

RISK REPORTING

City Light will ensure that its system of record and its infrastructure for identifying, monitoring, measuring and reporting risks are adequate.

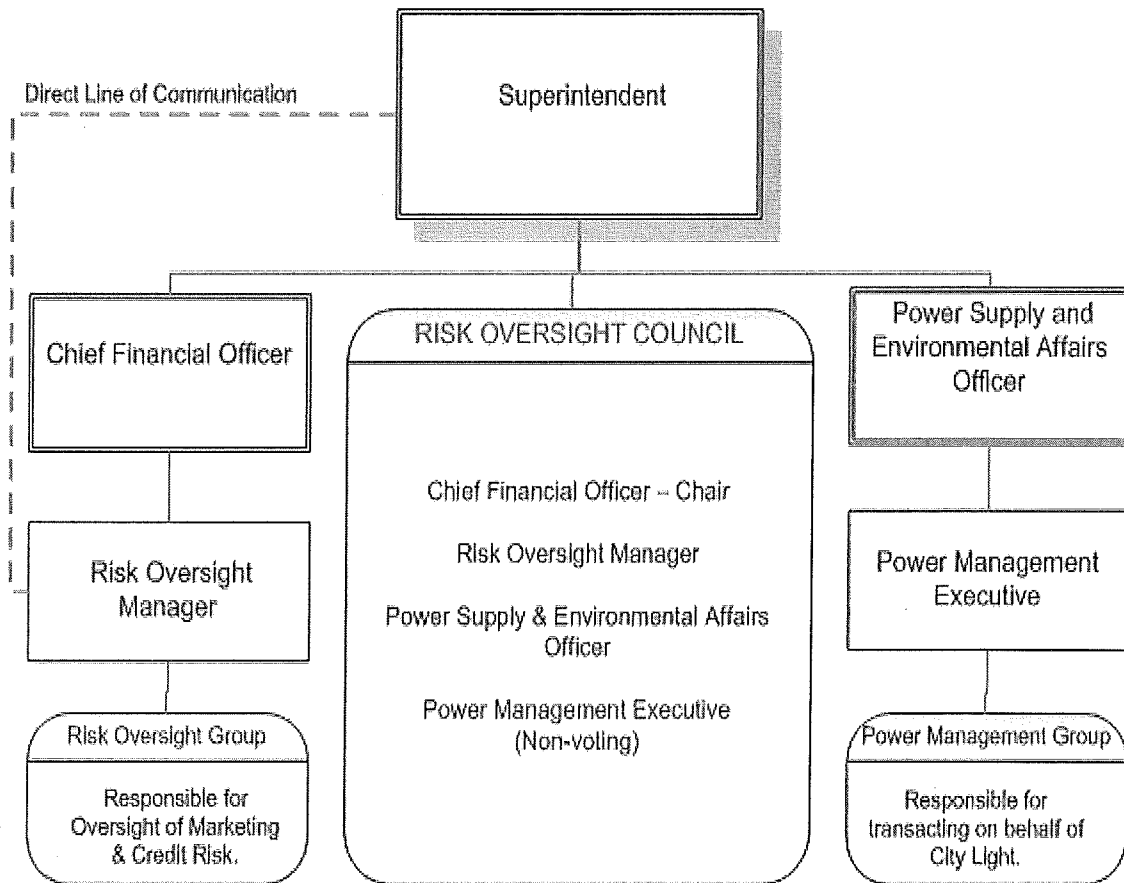
EFFECTIVE DATE: TBD

Appendix I City Resolution

<< To be added when passed by Council & Mayor >>



Appendix II Organization Chart



EFFECTIVE DATE: TBD

Appendix III Compliance Statement

The undersigned employee hereby acknowledges receipt and review of the City Light's Risk Management Policy dated

_____.

The undersigned further acknowledges that this Risk Policy defines the policy of City Light that the employee is expected to comply with, and that failure to comply with this Risk Policy may result in, among other things, disciplinary action up to and including termination.

Acknowledged by:

Employee Name (Print)

Employee Signature

Employee Function

Date

Persons required to sign this compliance statement

Function
Chief Financial Officer
Power Supply Officer & Environmental Affairs Officer



Risk Oversight Manager
Power Supply Executive
Director, Power Supply
Director, Resource Planning & Portfolio Management
Marketer
After-the-Fact Accountant
Senior Credit Analyst
Senior Risk Analyst
Risk Analyst
Credit Analyst

FISCAL NOTE FOR NON-CAPITAL PROJECTS

Department:	Contact Person/Phone:	DOF Analyst/Phone:
City Light	Tony Kilduff/4-3659	Karl Stickel/4-8085

Legislation Title:

A RESOLUTION adopting a Risk Management Policy for the City Light Department.

• **Summary of the Legislation:**

The legislation adopts a risk management policy document.

- **Background:** *(Include brief description of the purpose and context of legislation and include record of previous legislation and funding history, if applicable):*

A risk management policy document is indicated by Industry Best Practice and was requested by Council in Resolution 30632.

- *Please check one of the following:*

 X **This legislation does not have any financial implications.** *(Stop here and delete the remainder of this document prior to saving and printing.)*