

RESOLUTION NO. _____

A RESOLUTION OF THE COUNCIL OF THE CITY OF SAN JOSE APPROVING A NEW COUNCIL POLICY NO. 1-23 ENTITLED “ENERGY RISK MANAGEMENT POLICY”

WHEREAS, on November 7, 2017, the City Council approved Ordinance No. 30028 to add Title 26 to the San José Municipal Code, establishing operational parameters for San José Clean Energy (“SJCE”) including an obligation to prepare a Risk Management Policy (“Policy”); and

WHEREAS, the goals of the Policy are to: 1) serve SJCE’s customers’ needs, subject to Council-approved risk tolerance limits; 2) provide as much energy supply cost certainty as possible for SJCE’s customers while maintaining a least-cost supply portfolio; and 3) meet all portfolio objectives such as renewable energy content and greenhouse gas-free supplies; and

WHEREAS, the Policy establishes a front, middle, and back office in compliance with Federal Energy Regulatory Commission requirements, and provides that the City Manager will establish a Risk Oversight Committee that will meet at least quarterly and is responsible for monitoring and controlling risks; and

WHEREAS, the Energy Risk Management Regulations (“ERMR”) sets approved products and transaction limits, requiring that all contracts over \$1 million and longer than six months obtain Council approval when possible; and

WHEREAS, the ERMR document provides more details on the roles, strategies, controls, and authorities described in the Policy, and in conjunction with the Policy provides a comprehensive energy risk management program; and

WHEREAS, approval of the Policy will allow SJCE to proceed with procurement of energy supplies to meet the Phase I load which is scheduled to launch on September 1, 2018; and

WHEREAS, the City Council desires to establish a new City Council Policy No. 1-23 entitled "Energy Risk Management Policy" and the City Manager will propose Energy Risk Management Regulations for the Risk Oversight Committee to adopt;

NOW, THEREFORE, BE IT RESOLVED BY THE COUNCIL OF THE CITY OF SAN JOSE THAT:

A new City Council Policy No. 1-23 entitled "Energy Risk Management Policy," which policy is attached hereto as Exhibit "A" and incorporated herein by this reference as though fully set forth herein, is hereby approved.

ADOPTED this _____ day of _____, 2018, by the following vote:

AYES:

NOES:

ABSENT:

DISQUALIFIED:

SAM LICCARDO
Mayor

ATTEST:

TONI J. TABER, CMC
City Clerk

EXHIBIT A

City of San José, California

COUNCIL POLICY

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| EFFECTIVE DATE | REVISED DATE | |
| APPROVED BY COUNCIL ACTION | | |

1.0 PHILOSOPHY, OBJECTIVES AND SCOPE

This Energy Risk Management Policy (ERMP) outlines the philosophies and objectives of San José Community Energy (SJCE) as set by the San José City Council (“Council”). The Energy Risk Management Regulations (ERMR) also adopted by SJCE expands on the roles, strategies, controls, and authorities authorized in this policy to form a comprehensive energy risk management program. The ERMR shall be read in conjunction with this ERMP.

1.1 Risk Philosophy

The overall goal of this ERMP is to:

- a. Serve SJCE’s customers’ needs subject to Council approved risk tolerance limits.
- b. Provide as much energy supply cost certainty for SJCE’s customers as possible while maintaining a least cost supply portfolio.
- c. Meet all the portfolio objectives such as renewable energy content and greenhouse gas-free supplies.

As a city, SJCE is in the business of generation, transmission, and procurement of energy for the benefit of its customers. SJCE’s objective is to develop the least cost supply portfolio to meet load requirements of its customers, while maximizing revenues from sales of surplus energy, capacity, and other wholesale energy and transmission services (e.g. resource optimization). However, unlike a private-sector entity, SJCE’s primary purpose in the power supply business is to serve its customers. SJCE’s goal is to be a cost hedger for its customers’ load and, is therefore, precluded by this policy from engaging in speculative activities typical to many organizations orientated toward profit maximization.

SJCE management recognizes that certain risks are incidental to normal power supply operations and hedging activities. SJCE’s goal is to avoid unnecessary risk and to limit, to the extent practicable, any risks associated with normal cost-hedging activities. This

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document serves as a vehicle to describe and define the limits for activities considered appropriate for SJCE in a normal course of business.

1.2 Business Activities

A primary part of SJCE’s main business is to procure power supplies, capacity, and reserves to meet its customer load requirements. The resource (capacity/energy) supply portfolio may consist of fixed and variable priced supply contracts of varying lengths and agreements for other related supplies and services needed to ensure reliable delivery of electricity to SJCE’s customers.

1.3 Transacting Objectives

SJCE’s overall transacting objective is to meet the load requirements of its customers with an optimized resource supply portfolio. SJCE’s objectives when transacting on behalf of its customers for the procurement of energy and energy related supplies and services are as follows:

- a. Meet customer load requirements including energy, capacity, and reserves;
- b. Provide stable rates for SJCE’s customers;
- c. Obtain the best available price for power supply while complying with the requirements of this policy and other objectives established by the Council (e.g. renewable energy and GHG-free policy goals);
- d. Act to limit exposure to extreme market system changes;
- e. Follow effective wholesale counterparty credit management procedures; and
- f. Develop and maintain SJCE’s investment grade credit rating.

1.4 Scope of Policy

This ERMP addresses risks arising from SJCE’s participation in the wholesale energy markets, and applies to all energy and energy related transactions made by SJCE. This ERMP does not address the following types of general property and casualty business risk: fire, accident, and casualty; health, safety, and workers’ compensation; general liability; and other such typically insurable perils. The term “risk management,” as used herein, is therefore understood to refer solely to risks related to participation in wholesale energy markets as herein defined.

SJCE is exposed to three quantifiable risks: load and resource variability (volumetric), cost variability (price), and counterparty credit risk. From the perspective of risk mitigation, SJCE’s primary objective is to cover load and optimize the value of assets. Taking risks to arbitrage market opportunities, or risks unrelated to SJCE’s normal power supply business activities, is not permitted.

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SJCE is also exposed to regulatory and operational risks. However, these exposures are not quantifiable as they affect structural change. As a result, these risk categories are managed as separate enterprise risk exposures and are not directly governed by this ERMP.

This ERMP prescribes the management organization, authority and processes to monitor, measure, and control the risks to which SJCE is exposed in the normal course of business. Methodologies used to measure, monitor, and control these risks shall be established by the City Manager’s Risk Oversight Committee (ROC), in accordance with sound utility practices as included in the ERMR.

1.5 Applicability

This ERMP is effective immediately upon its adoption by the Council. It applies to SJCE’s wholesale supply operations, short and long-term contracting for energy, capacity, credit risk management, and other related ancillary activities undertaken by SJCE.

1.6 Policy Review and Amendments

Prudence is required in implementing all policies and procedures. Market and industry norms, technology and risk tolerances tend to change over time. Therefore, this policy should be reviewed as needed, to make adjustments in response to changes in business objectives and/or industry norms. At a minimum this policy should be reviewed annually. Amendments to this ERMP shall be done only by approved Resolution of the Council.

2.0 RISK STRATEGY & PARAMETERS

An important aspect of implementing an overall energy risk management policy is the development of related strategies to mitigate all related risks associated with energy transacting activities. The key strategies of SJCE are outlined below.

2.1 Counterparty Risk Management

Counterparty risk is defined as the exposure to economic loss resulting from default by a party to a contract (e.g., a counterparty). Counterparty risk affects both contracts requiring physical settlement and those specifying monetary settlement. For all fixed price energy transactions, the counterparty must possess at least a BBB+ (or equivalent investment grade rating) by a nationally recognized statistical rating organization (NRSRO). SJCE staff may consider counterparties with a rating below investment grade, or a counterparty without a NRSRO rating on a case-by-case basis, with the approval of the ROC.

Effective wholesale counterparty management and credit analysis is essential to mitigate the counterparty risks associated with commodity transactions in the energy

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markets. The objective is to preserve SJCE’s capital, liquidity, and supply reliability by limiting counterparty credit risk and supplier concentration to acceptable levels. Methodologies to achieve this objective are set forth in the ERMR.

2.2 Balanced Load

SJCE shall maintain an integrated and balanced portfolio of resources to cover its customer load with a risk framework that includes both volume and cost of the portfolio.

2.3 Minimum Coverage Requirements

SJCE shall establish minimum coverage requirements for capacity and energy as determined by the ROC and outlined in the ERMR.

2.4 Diversification of Portfolio

SJCE shall strive to develop a resource portfolio that includes diversification in the type of resources, contract duration, geographic location, counterparty, pricing terms, cash reserves and types of products.

2.5 Purchase to Cover Load Serving Obligations – No Speculation

As discussed in Section 1.3, SJCE’s overall objective for energy procurement activities is to cover the load serving obligations of its customers. In the course of performing these activities, SJCE shall not engage in activities that expose its customers to speculative transactional risks, and shall only utilize approved transaction parameters as determined by the ROC and outlined in the ERMR.

2.6 Use of Derivatives and Financial Transactions

Use of financial derivatives or transactions (as opposed to physical or “embedded” options) is *not* allowed by SJCE. These include transactions used to set price caps and floors, or hedge against load/price volatility. Examples include:

- Exchange traded Puts and Calls;
- Electric Futures;
- Electric Options; and
- Weather Derivatives.

The use of Congestion Revenue Rights (CRR’s) *is* permitted by SJCE and is not considered use of derivatives or financial transactions. CRR’s are financial instruments made available through the CAISO’s CRR Allocations and Auctions. CRRs are acquired primarily to offset transmission congestion costs.

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3.0 RISK CONTROLS

3.1 Control Principles

SJCE will strive to conduct its energy risk management activities in accordance with best practices of the energy industry, but implementing such practices must be cost justified and balanced between costs and benefits. Processes and control systems must be in place that allow SJCE to identify, measure, monitor, control, and track its risk exposures. These processes and control systems shall include the following risk management control principles:

- Appropriate segregation of duties and internal controls will be used;
- Appropriate systems to ensure accurate and effective management reporting;
- Necessary resources in place to achieve management objectives;
- Attract and retain skilled and trained personnel;
- Cross-train and provide cross coverage;
- Employees conducting energy transactions are free of conflicts of interest;
- Authority and approval delegation is commensurate with accountability and capability;
- Performance measurement and reporting incorporate risk and return measures; and
- Ongoing monitoring of control effectiveness.

3.2 Internal Controls

Internal controls shall be based on proven principles that meet the stringent requirements of generally accepted auditing standards (GAAS), financial institutions and credit rating agencies. The required controls shall include all customary and usual business practices designed to 1) prevent errors and improprieties, 2) ensure accurate and timely reporting of results of operations and other information pertinent to management, and 3) facilitate attainment of business objectives.

3.3 Segregation of Duties

Responsibilities related to energy transacting shall be segregated in a manner consistent with the control principles listed above by means of clearly defined roles and responsibilities for the Front Office, Middle Office, and Back Office operations. Such roles and responsibilities can also be provided by a qualified third party services provider. Specific roles, responsibilities, and organizational structure of these functions are outlined in Section 4 of the ERMP.

These controls shall be fully integrated into all business activities of SJCE, and there shall be active participation by senior management in risk management processes.

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3.4 Conflicts of Interest

In accordance with the California Political Reform Act, consultants shall cause each person performing services for the SJCE to complete annual conflict of interest filings and disclose investments as required by the FPPC and this Section.

All SJCE employees who are engaged in energy supply resource transactions, counterparty credit evaluation, or oversight of the foregoing and are employed in any job classification listed in the SJCE Conflict of Interest Code are required to complete annual conflict of interest filings on FPPC Form 700 and disclose investments as required by that code.

In addition to the foregoing disclosure requirement, SJCE employees engaged in energy supply resource transactions, counterparty credit evaluation or oversight of the foregoing, are barred from investing in any company with whom SJCE has consummated energy or related purchases or sales within the last two years.

Such employees must divest existing direct holdings in energy counterparties prior to engaging in any negotiating, evaluating, transacting or oversight functions. The ban on investment and requirement for divestment applies regardless of whether or not the investment would be of sufficient size (\$2,000) to require disclosure on FPPC Form 700.

SJCE employees supervising staff who are subject to this policy are responsible for routinely reviewing Form 700 of each such staff member for the purpose of identifying potential financial conflicts of interest. City Attorney will assist in reviewing these forms and providing legal advice in connection with such reviews upon request.

4.0 ROLES, RESPONSIBILITIES, & ORGANIZATION

This section of the ERMP defines the overall roles and responsibilities for implementation of this ERMP. The coordinated efforts of personnel across several Departments are required to successfully implement SJCE’s risk management program. Section 4 of the ERMP outlines the basic roles and responsibilities of each organizational function. Specific details and the specific roles and responsibilities of the oversight and operational divisions within the energy risk management program structure at SJCE are outlined in the ERMR, as developed by the City Manager’s ROC and revised from time to time.

4.1 City Council

The Council has the ultimate oversight over SJCE operations and is responsible for establishing an organizational-wide framework for risk management and ensuring that risk management results are achieved as planned. The Council shall approve and establish organizational policies for risk management and delegate to the City Manager the responsibility for implementing the ERMP. With responsibility for the ultimate

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oversight over SJCE operations, the Council shall be responsible to ensure the risk management results are achieved in accordance with the ERMP.

4.2 City Manager

The City Manager serves as the chief administrative officer of the City. The City Manager is responsible for administering City operations and staff, advising the City Council, managing the day-to-day delivery of public services, and implementing Council policies. The Council acknowledges that the City Manager shall establish the ROC and may delegate certain functions to the ROC, which delegation is ratified by this ERMP.

4.3 Director of Community Energy

The Director of Community Energy (“Director”) has overall responsibility for implementing the ERMP and for communicating risk management issues to the City Manager and Council. The Director shall be responsible for delegating specific duties for carrying out the policy and ensuring compliance with it by all affected SJCE employees or contractors.

4.4 Risk Oversight Committee

The Risk Oversight Committee (ROC) is responsible for overseeing compliance with risk management policies within SJCE. The ROC serves as the highest level of organizational risk management. The ROC shall consist of seven voting members: the City Manager, the Director of Community Energy, the Director of Finance, the City’s Risk Manager, the Budget Director, the Community Energy Department’s Deputy Director of Power Resources, and the Community Energy Department’s Division Manager for Administration and Finance. The City Attorney will provide legal advice to the ROC. A quorum for the ROC to do business shall be no less than five ROC Committee members, or their designees.

Each ROC member shall have one vote, and shall appoint a voting alternate. The ROC will meet at least quarterly, to act on the responsibilities mentioned above. Minutes to each meeting will be maintained per the City’s record retention policy. The Director of Community Energy shall make annual reports to the appropriate Committee and Council regarding business transacted by the ROC.

The ROC shall have the responsibility for ensuring that business is conducted in accordance with the ERMP. The City Manager’s ROC shall adopt and keep current “Energy Risk Management Regulations,” which shall define in detail the internal controls, strategies, and processes for managing risks covered under the ERMP. Specific ROC responsibilities are outlined in detail in the ERMR.

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4.5 Front Office (Planning and Procurement)

The Deputy Director of Power Resources is responsible for managing the Front Office, and can be supported by qualified third party suppliers. The Front Office is responsible for resource planning and procuring resources to meet the physical, financial, and contractual requirements of SJCE, with load/resource balancing provisions and such other arrangements as may be approved by the Council in the future. The function includes contract administration, managing the risk assumptions for electricity transactions, including physical and financial needs analyses, energy purchases and sales, procurements of capacity, ancillary services and coordinating energy delivery scheduling. The Front Office is responsible to ensure that the procedures and processes needed to transact business within the ERMP are in place and they perform all duties related to actual transacting in the wholesale energy markets. The Front Office is the primary interface with potential wholesale transacting counterparties. Front Office activities and detailed responsibilities are outlined in the ERMR.

4.6 Middle Office (Controls and Reporting)

The Community Energy Department’s Division Manager of Administration and Finance is responsible for managing the Middle Office in collaboration with the Finance Department. The Community Energy Department’s Administration and Finance Division will conduct the duties of the Middle Office, and/or are supported by a qualified consultants and service providers. Its primary purpose is to manage risk oversight and controls. The Middle Office provides independent oversight of the risks assumed by the Front Office in the course of transacting energy products and services. The Middle Office must be independent from the Front Office functions. Detailed responsibilities of the Middle Office are described in the ERMR.

4.7 Back Office (Settlements and Recording)

The Community Energy Department’s Division Manager of Administration and Finance is responsible for managing the Back Office in collaboration with the Finance Department. The Back Office is primarily responsible for settlement of bills, recording transactions, bookkeeping and accounting, and contract compliance. It is responsible for providing assurance of accurate transaction records and settlements. Back Office functions are conducted by personnel in the Community Energy Department’s Administration and Finance Division and are supported by staff in the Finance Department and qualified consultants and service providers. Detailed responsibilities of the Back Office are described in the ERMR.

4.8 Auxiliary Functions

Additional issues impacting the overall power supply and risk management program include establishment of financial reserve requirements, which are generated by auxiliary support functions in the Community Energy Department’s Administration and Finance Division and the City Manager’s Budget Office.

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The Community Energy Department's Administration and Finance Division in collaboration with the City Manager's Budget Office is responsible for preparation of the budget and the calculation of rates used to bill customers for their related power supply usage. They are also responsible for the establishment of reserves necessary for credit risks related to counterparty credit as mentioned in the ERMP, but as more clearly defined in the ERMR.

4.9 Authorities, Delegations, Limits, and Prohibitions

All executed transactions shall conform to the policies set forth herein. It shall be the responsibility of the ROC, to establish appropriate individual transacting authority limits for the various personnel involved in the Front Office function. All staff with designated responsibility for Middle Office or Back Office functions are strictly prohibited from executing any wholesale transactions. The Middle Office shall be responsible for informing counterparties of such approved authorizations, including transacting authority and restrictions, along with product types and/or term and dollar limits.

5.0 POLICY COMPLIANCE

5.1 Compliance Exceptions

Compliance exceptions are actions which violate the authority limits or directives set forth herein or in the ERMR as developed and adopted pursuant hereto by the ROC.

5.2 Reporting of Exceptions

The Director of Community Energy shall notify the ROC of exceptions to mandated policies, procedures, and regulations within 48 hours after they are identified, and ensure Front Office prepare a full report for review and discussion at the next ROC meeting.

5.3 Audit

Compliance with this ERMP and with the specific ERMR requirements instituted pursuant to this ERMP, shall be subject to examination by the City Auditor and SJCE's independent auditors or by such other reviewers that SJCE or ROC may appoint to evaluate the effectiveness of mandated controls.

5.4 Reserves

The ROC is responsible for ensuring adequate reserves for energy price exposure and credit losses are maintained by SJCE. The reserve estimate methodology, should be established in collaboration with the City Manager's Budget Office and it shall be

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reviewed and approved as needed to ensure appropriate reserve levels are maintained and funded. It should be set and reviewed annually as part of the Budget process.

5.5 Systems, Tools, and Training

SJCE employees who are authorized to perform energy risk management functions on behalf of SJCE shall be provided with the necessary systems and tools to support all risk management processes.

Provision shall be made in the budgets submitted for each group which performs market risk management functions on behalf of SJCE for the acquisition and maintenance of computer systems, software, communications equipment, data services and other analytical, measurement and reporting tools.

Provision shall also be made in the budgets submitted for each group which performs market risk management functions on behalf of SJCE for managers and staff to attend seminars and courses in risk management on a regular basis.