

CITY OF ROCHELLE
ADMINISTRATIVE POLICY FOR
MITIGATING ENERGY TRANSACTION RISKS

Version 1.0 Approved by City of Rochelle City Council _____, 2017

OVERVIEW

City of Rochelle, through Rochelle Municipal Utilities, owns and operates an electric distribution system in accordance with Illinois law for the purpose of providing and delivering low cost, reliable power to its residents. The City is dedicated to keep the cost of electricity stable and competitive through a variety of means, including ownership of generation, participation in power projects through its membership in the Northern Illinois Municipal Power Agency and entry into power and energy purchase transactions with wholesale providers.

This administrative policy for mitigating energy transaction risks (Policy) details the essential components of a prudent risk management process for its energy procurement activities. The Policy is intended to provide an overarching framework and control structure specifically for the City's participation in deregulated wholesale energy markets. The Policy recognizes that there are certain risks inherent in such transactions. The City is responsible for minimizing those risks in order to meet its mandate of maintaining low and stable electric rates for its retail customers, as well as to maintain its strong financial standing more generally.

OBJECTIVE

The primary objective of the City's risk management activities is to balance the goals of maintaining long term, low cost and environmentally responsible power supply while stabilizing rates and maintaining the City's strong financial health. The City plans to continue developing a long term power supply portfolio based on ownership of physical assets and entry into both long term and short term purchased power contracts. The goal of this balanced approach is to maintain long term rate stability.

RISK EXPOSURES

The City of Rochelle is exposed to many forms of risk that can have a detrimental impact on rates and financial conditions. The following list highlights a few of these risks:

- Commodity Prices (including fuel, congestion and losses)
- Volumetric (load forecast)
- Unit outages
- Operations
- Credit
- Contract Prices
- Regulatory/Environmental
- Market Liquidity
- Financial Liquidity

By formulating and implementing general policies and guidelines in the areas of hedging, trading authority, credit support and contracting, the City can mitigate these risks to tolerable levels.

RISK MANAGEMENT POLICIES

A. Scope

The following Risk Management structures and policies apply to all aspects of the City of Rochelle's power supply planning, procurement, market activities, rates/billing and finance/accounting.

- These policies prescribe the management, organization, authority, processes, tools and systems to monitor, measure and mitigate the energy market risks to which the City of Rochelle is exposed.
- These policies do not address general business risks such as fire, accidents, casualty, worker health and safety or general liability; such risks are addressed through the City's insurance policies.
- These policies are intended to supplement, not to replace or modify, the City's purchasing procedures and with a view toward developing policies specific to the City's energy purchasing activities.

B. Risk Management Structure

City of Rochelle personnel perform many different tasks in the areas of planning, engineering, forecasting, rates, finance, accounting and customer service. The City of Rochelle also works with outside consultants to assist in its power supply management activities. The following guidelines are intended for use with this Policy.

1. Designated Risk Officer

The Superintendent of Electric Operations shall function as the "Designated Risk Officer," with responsibility for overseeing compliance with this Policy.

2. Training

The Superintendent of Electric Operations shall ensure that all outside consultants with whom the City of Rochelle works shall have the necessary training and qualifications to perform applicable energy market functions on behalf of the City of Rochelle.

3. Trade Capture, Confirmation and Settlement

The Superintendent of Electric Operations shall (i) make sure that all energy trades are approved and/or executed by authorized City of Rochelle officials and such trades are within purchase guidelines established by the City Council for specific power purchase transactions; (ii) review and verify, or cause to be reviewed and verified by qualified outside consultants, all entered trade confirmations prior to signing; (iii) cause appropriate City of Rochelle accounting personnel to

receive invoices and process for appropriate approvals and payments, as well as to check monthly totals and verify invoices with counterparties.

4. FTR Auction Transactions

Financial Trading Rights (FTRs) will generally be procured and sold via the PJM auctions. The Superintendent of Electric Operations shall ensure that the City of Rochelle utilizes qualified outside consultants to procure and sell FTRs in monthly FTR auctions in accordance with a recommended FTR plan for the applicable time period.

C. Commodity Hedging

The City of Rochelle is exposed to many financial risks in its operations, including those due to fluctuations in the cost of market power and natural gas. The risks can manifest themselves as cost fluctuations due to both the actual price of market commodities and cost fluctuations due to the volumetric risks of the quantities exposed to those prices. The most effective way to stabilize such fluctuations is through a defined and practiced commodity hedging program. The hedging program will limit exposure to these price fluctuations by fixing the prices at fixed and known amounts. The purpose of this policy is to define general purchasing guidelines and processes for determining purchase quantities.

1. Speculation

Speculative buying and selling of any commodity is strictly prohibited. Speculation is defined as the forward buying of power or gas not required to serve electric load, or the forward selling of energy not covered by a City of Rochelle owned or contracted resource, or the taking of an FTR position not associated, or correlated with actual congestion exposure. In no event shall transactions be entered into in order to speculate on future market conditions or should individual market views on the part of City of Rochelle personnel be used to circumvent these guidelines. Instructions from PJM or other applicable regional transmission organization to run City of Rochelle owned generation for economic or reliability reasons does not constitute speculation.

2. Hedge Activities

The City of Rochelle's hedging activities will be based on limiting the effects of market price movements on the City's market exposure. This will be accomplished by the forward purchasing or selling of commodity products.

The following transactions are permitted under this hedging policy:

- Physical or Financial Forwards
- Fixed Price Physical or Financial Call/Put Options (Power or Gas)
- Heat Rate Based Physical or Financial Call/Put Options
- Fixed Price Unit Power Agreements
- Long Term Purchase/Sale Agreements
- Financial Transmission Rights (FTRs)

- Bilateral Capacity Transactions
- Other hedge transactions recommended by outside consultants and approved by the Electric Superintendent

Nothing in this policy affects or limits the City of Rochelle's ability to continue procuring physical assets or long term purchased power agreements.

The City will hedge a portion of its forecasted requirements not covered by fixed sources or sales quantities over customer load requirements. This portion may include, but is not limited to:

- Market purchases above resources
- Market sales above member load requirements
- Market energy required during planned or forced outages of non firm resources
- Contract energy that is priced on a market index
- Contract energy subject to unknown annual adjustments
- Natural gas used to serve native load
- Marginal congestion and losses incurred via the prevailing Locational Marginal Price (LMP)

In order to determine the hedge quantities, models will be developed to produce simulations of City of Rochelle operations, taking into account market price, volatility, commodity correlation, unit maintenance outages, unit forced outages, PJM LMPs, including congestion and losses, and load forecast error and variability. Hedge quantities will be calculated based on expected model results utilizing qualified staff or qualified outside consultants. Scenarios will be run with the hedges in place to quantify risk reduction and reported to the Superintendent of Electric Operations.

When procuring hedges, the amounts required may be rounded to levels normally traded and available from the City's counterparties.

In addition, calculated expected native load natural gas usage will be reported to the Superintendent of Electric Operations for natural gas hedging consideration.

FTRs will be procured as needed in the available RTO auctions. FTR positions taken should correspond to an actual path on which the City has congestion exposure. Positions may be taken on paths in which the City does not have a corresponding exposure only if the historic correlation between the selected path and the actual path it is intended to hedge exceeds .90.

The Superintendent of Electric Operations, in discussion with qualified outside consultants, will evaluate and determine procedures for the procurement of hedges for power and natural gas. FTRs will be procured per the auction schedules published by the applicable RTOs.

The most recent City of Rochelle load forecast shall be used as a basis for each run of the risk assessment model. On a regular basis, a historic analysis of the current load forecast shall be prepared for review by the Superintendent of Electric Operations. Should unexplained

deviations occur, the Superintendent of Electric Operations shall ensure that proper adjustments to the forecast are made.

D. Transaction Authority

The City Council shall establish contract volumes and dollar amounts for bilateral contracts at the request of the Superintendent of Electric Operations, who will then work with qualified outside consultants to procure appropriate energy transactions for ultimate approval by the City Council. Bilateral power, natural gas and FTR transactions may only be entered into with counterparties in compliance with the City of Rochelle credit review policy (see below, section D) and in accordance with applicable RTO rules. All approvals from the City Council in connection with transaction limits for bilateral transactions must be provided or confirmed in written format. FTRs will generally be procured and sold via the PJM auctions. The Superintendent of Electric Operations will work with qualified outside consultants to procure and sell FTRs in monthly, quarterly or annual FTR auctions in accordance with plans approved by the Superintendent of Electric Operations.

E. Counterparty Credit Review and Assessment

The City of Rochelle considers the credit-worthiness of all parties with which it does business. This policy has been specifically developed to document the credit policies and procedures under which the City of Rochelle undertakes power purchase and sales transactions.

If Rochelle Municipal Utilities would like to do business with a counterparty, it will cause to be developed and executed an EEI, ISDA or other credit agreement ("Credit Agreement") with that counterparty prior to any transaction taking place. The Credit Agreement will address the credit parameters under which the counterparties will conduct business. A counterparty's credit is reviewed during the negotiation of the Credit Agreement. Once these EEI or ISDA agreements are in place, Rochelle Municipal Utilities will initiate individual transactions using a confirmation, which contains the details of the individual transaction, the date, the amount, the price, etc.

Rochelle Municipal Utilities monitors current industry events for any information about companies that would influence their financial stability. Rochelle Municipal Utilities from time to time may utilize credit reporting services to assist in monitoring the creditworthiness of counterparties. The Superintendent of Electric Operations will notify the accounting department of any known change in the financial status of an existing supplier.

The City will seek to avoid entering into forward transactions that create excessive exposure to any single counterparty. City Council approval is required prior to entering into any transaction that would result in an aggregate forward transaction value in excess of \$1,000,000 with any single counterparty.

The Superintendent of Electric Operations is authorized to negotiate ISDA's, EEIs and purchased power agreements with a counterparty.

F. Reporting

The Superintendent of Electric Operations will provide reporting on risk policy compliance and general market information at the request of the City Council.