

CITY OF LODI  
INFORMAL INFORMATIONAL MEETING  
"SHIRTSLEEVE" SESSION  
CARNEGIE FORUM  
305 WEST PINE STREET  
TUESDAY, DECEMBER 14, 1999

An Informal Informational Meeting ("Shirtsleeve" Session) of the Lodi City Council was held Tuesday, December 14, 1999 commencing at 7:00 a.m.

ROLL CALL

Present: Council Members – Hitchcock, Land, Nakanishi, Pennino and Mann (Mayor)

Absent: Council Members – None

Also Present: City Manager Flynn, Deputy City Manager Keeter, Finance Director McAthie, Electric Utility Director Vallow, City Attorney Hays and City Clerk Reimche

Also in attendance was a representative from the Lodi News Sentinel and The Record.

TOPIC(S)

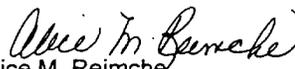
1. Electric Utility Risk Management and Open Access

(Due to a conflict of interest, Council Member Pennino abstained from discussion of this matter and vacated his Council seat.)

ADJOURNMENT

No action was taken by the City Council. The meeting was adjourned at approximately 8:30 a.m.

ATTEST:

  
Alice M. Reimche  
City Clerk

Northern California Power Agency

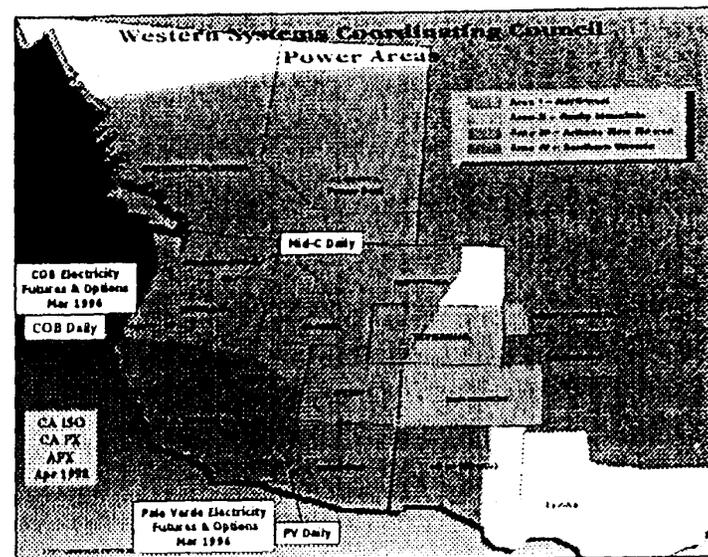
# Risk Management Workshop

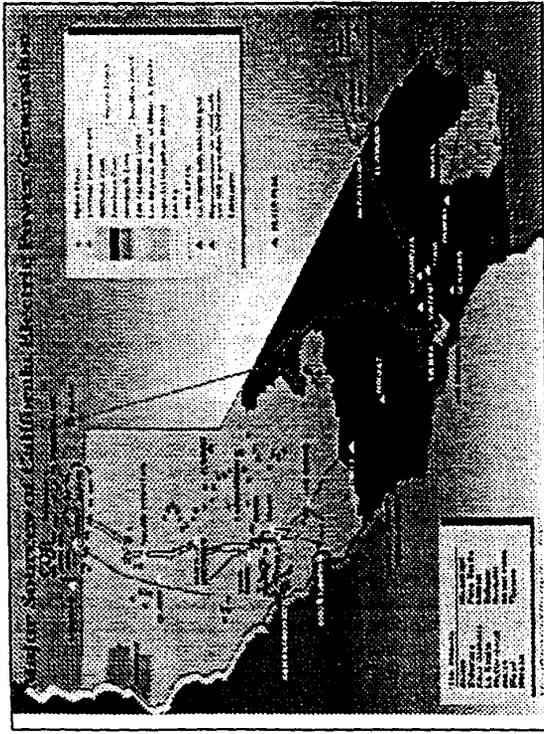
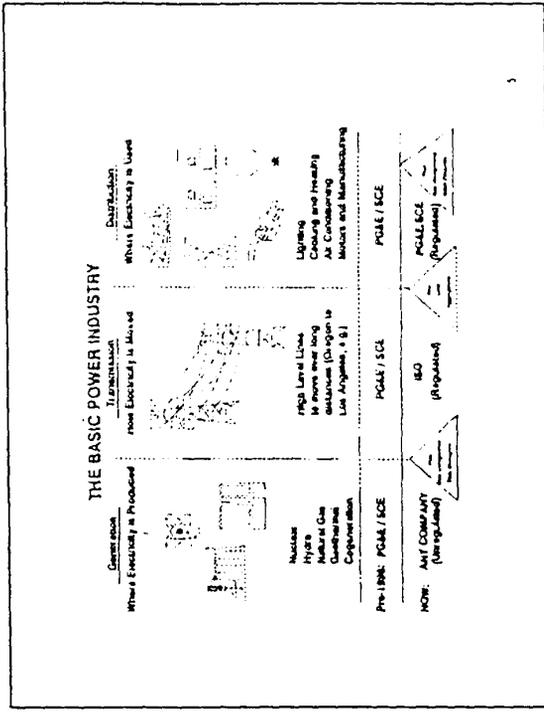
Lodi

December 1999

## Risk Management Workshop

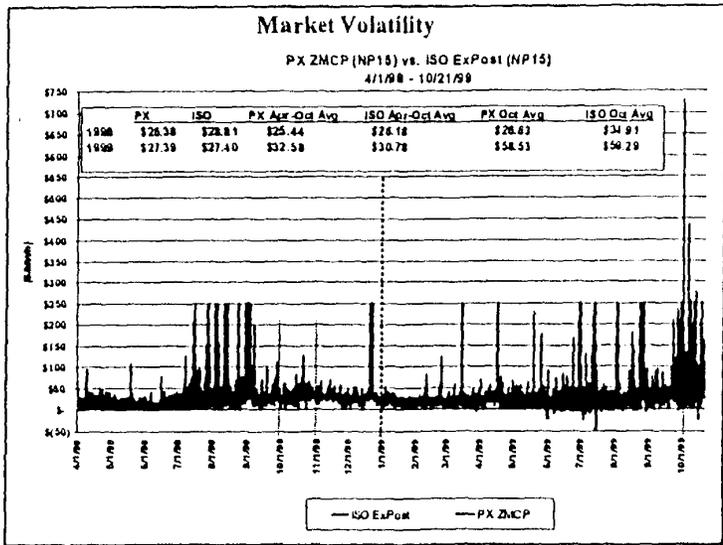
- Introduction
  - Market Evolution & Risk
  - Need for Risk Management
  - History & Changes at NCPA
- NCPA Commission Policy & Gen Mgr Guidelines
- NCPA Interim Policy, Processes & Procedures
  - Trade & Procurement Process (Pooling Agreement)
  - Functional Responsibilities
  - Transaction Authorizations, Limits & Controls
  - Credit Risk
- Summary & Current Activities





### Market Volatility

PX ZMCP (NP15) vs. ISO ExPost (NP15)  
4/1/98 - 10/21/98



### Market Evolution

- What's New?
- What's the Same?

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### What's New?

- Market Complexity
- Price Volatility and Discovery
- New Participants
- Counter-Party Risks
- New Opportunities

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### What's the Same?

- Member Utility's Obligation to Serve
- Maximize Value of Resources/Assets
- Serve Load at Lowest Cost
- Minimize Risk

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### Types of Risk

- Market
  - price, liquidity, basis, customer, weather
- System
  - physical delivery, equipment failures
- Credit
  - Counter-Party & Member to Member
- Administrative
  - internal business processes
- Other
  - legal, regulatory, & political

### Need for Risk Management

- Physical & Financial Requirements
    - Member
    - NCPA Pool (merged)
  - *Example: to provide reliable customer service and secure an operating margin to meet financial obligations (e.g. General & Rate Stabilization Funds)*
- Does price volatility & physical uncertainties exist?
  - Are the physical & financial requirements exposed?
  - Does the exposure exceed the risk tolerance?

### Example: Objective of Risk Management

- To management risks to ensure that the activities of the Member Utility and the activities of NCPA performed on behalf of the Member, do not expose the Member Utility
  - to losses that reduce operating margin to unacceptable levels
  - compromise any other of its physical and financial objectives and commitments

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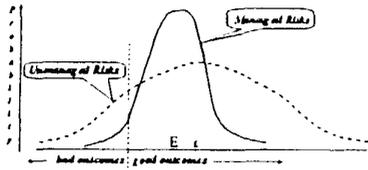
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### Managing Risk

- To increase the probability of good outcomes and reduce the probability of bad outcomes
- Must identify, understand & manage risks.



### NCPA Commission Risk Management Policy - 1/99 General Manager and ROC Responsibilities

- Developing energy trading processes, procedures & limits
- Assuring that individual Members may not specific risk management instructions to be followed by NCPA
- Creating & administering a credit rating policy for business counter-parties
- Approving the use and limits of specific financial risk management instruments
- Assuring that appropriate authority delegations are in place and followed
- Setting qualifying parameters and financial limits for business relationships with counter-parties
- Instituting appropriate and timely risk monitoring and regular reporting for use by Commission and NCPA management

### NCPA Risk Management History

- 1998 Consultant Review & Operational Audit
- General Manager Guidelines - Sep 98
- 1999 Strategic Planning Session
- Commission Policy Guideline - Jan 99
- Establish ROC - Feb 99
- 1999 Interim IPIs - Jul 99
- Current Focus
  - Authorities and Delegations
  - Credit Policies
  - Transactions Tracking and Reporting
  - Develop Trade & Risk Strategy, Performance Targets and Risk Measures

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### NCPA Changes

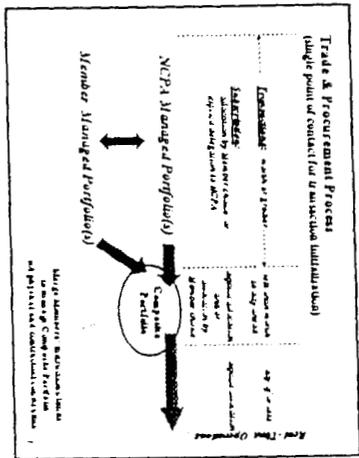
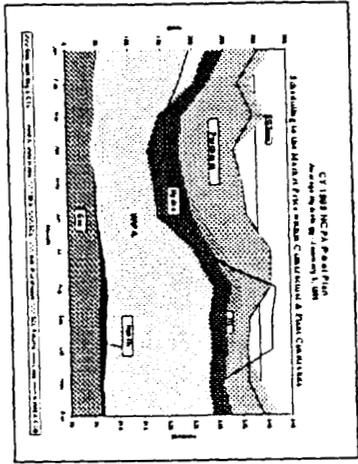
- General Manager Guidelines to limit risk
- Creation of Risk Oversight Committee
- 1999 Interim 3Ps
  - Policies, Processes, and Procedures
- Reorganization of NCPA Trade and Procurement Process

### General Manager Guidelines - Sep 98

- Resources 1st to load then market (w/ provisions of Pooling Agreement)
- Trading used to balance Loads/Resources
- Low risk positive margin deals okay
- No long-term deals at unknown prices
- Counter-parties must meet interim credit requirements
- Full internal communications

### NCPA Trade and Risk Management 1999 Interim Policy, Processes & Procedures

- Policy Guideline
- Trade and Procurement
- Trade Authorization, Limits & Controls
- Credit Risk
- Appendices
  - Member Suspension Process
  - Internal Authorization Levels
  - NCPA Approved Trading Counterparties List



- Authorized/Routine Transactions**
- Firm and purchases & sales:
    - capacity energy; fuel to maintain standby energy; biomass
    - capacity energy; fuel and related resources (transmission, hydro, etc.)
    - power (etc.) but on behalf of other market participants and buy/sell transactions for short-term power
  - Transmission and transmission rights
  - Purchases and sales to substitute the use of Member-owned; higher cost resources with lower cost market alternatives if the transaction producer provides margin without increasing risk.
  - Spot purchases & sales of capacity/energy/fuel.

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NCPA Authorities - Pooling

- Article 8.1
- Article 8.7
- Article 8.11

- Schedule 2.02  
- Schedule 3.01

Pooling Agreement  
Article 8.1

• The objectives of the Pool central dispatch shall be as follows:

- (a) to **supply the capacity and energy requirements** of the combined Parties at the lowest practicable cost;
- (b) to accomplish the requirements of (a), above, in a **reliable and safe manner**.

Pooling Agreement  
Article 8.7

- **Resource Substitution**: NCPA may schedule or dispatch any resource to meet a Party's load as long as such load is met with no decrease in quality and quantity of service and no increase in cost, including opportunity cost. **Resource substitution shall be permitted** to provide the most efficient and cost effective use of each Party's and the Pool's generation and transmission resources.

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Pooling Agreement  
Article 8.11

- Energy Transactions with Non-Parties. **The Pool is authorized to enter into contracts for energy and/or operating reserves with Non-Parties** in accordance with applicable Pooling Schedule(s). Energy transactions with Non-Parties, which do not otherwise have associated ownership rights, will be allocated to the Parties in accordance with the applicable Pooling Schedule.

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Pooling Schedule 2.02

- NCPA should attempt to **sell excess energy** to the market at the highest possible price above true variable cost consistent with Pooling Schedule 8.01. At a minimum, NCPA should sell the excess at a price that will recover true variable costs.

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Pooling Schedule 3.01

- Transactions with Non-Parties. **NCPA may purchase energy from Non-Parties** when it is economical... or necessary to do so.
- Short Term Contracts. **NCPA may enter into short term contracts and agreements for up to one year with Non-Parties**, provided that such contracts and/or agreements are entered into to reflect unforeseen factors, such as weather variations, forecast errors and outages, and/or to reduce overall Pool costs whenever possible.

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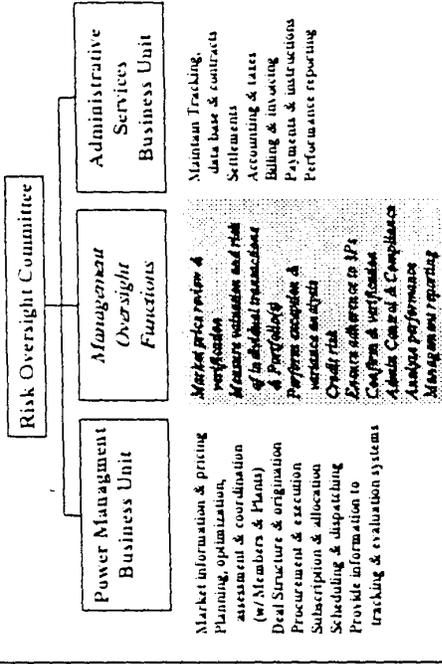
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**Member's Decision & Subscription Procedure**

- Member-owner Subscription to Facility Sale
  - \* not participate
  - \* subscribe to pro-rata share or less
  - \* exercise first right of refusal
- Insufficient Subscription level
  - \* reduce sale
  - \* subscribing Members may step up
  - \* re-subscribe if price/terms/conditions are changed
- Pool Member Subscription + Long-term or Term Transactions
  - \* Member decision (by affirmative indication)
  - \* NCPA decision (by Member delegation - in writing)
- + All other transactions
  - \* Default Subscription allocators
  - \* Except - Transactions requiring SOT/COTP - hourly allocation based on SOT/COTP surplus capability

*Non-Subscribing Member has no responsibility for the transaction*

**Risk Management Functional Responsibilities**



## Trade Authorization, Limits and Controls




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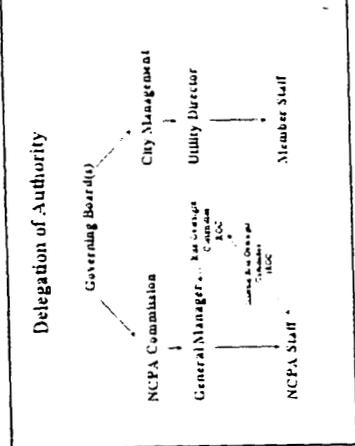
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## Controls and Procedures

- Record Keeping
- Transaction Tracking
  - Member Transactions
  - NCPA Transactions on behalf of Members
  - Allowable Trade
  - Approved Trader
  - Trade & Credit Limits
  - Approved Counter Parties
  - Creditworthiness
  - Completeness

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### Controls and Procedures

- Transaction Verification
- Failed Transaction
  - Disputes
  - Did not meet terms of contract
- Billing & Payment
  - Invoice Within 2 days
  - Pay Within Terms of Contract
- Reporting
- Record Keeping

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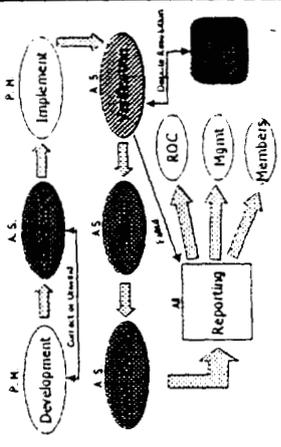
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### Controls and Procedures




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### Credit Risk

- Credit Policy
- What is Credit Risk?
- Qualifying Trading Partners
- Implementation Guidelines
- Credit Watch List
- Credit Risk and Members
- NCPA External Credit Rating
- Conflicts of Interest

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### Credit Policy

- Recognition that NCPA is a public entity
- Diversify Portfolio
- Not Knowingly participate in "Sleeve Transactions"
- Avoid counter-parties with bad press or on any credit watch list
- Contracts to have pre-payment or termination for credit changes

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### What is Credit Risk?

- Risk of financial loss from counter-party failure to perform
- Credit Default - Potential loss from credit risk exposure which is closely linked to Market risk
- Credit risk can arise from
  - Counter-parties
  - Members

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### Interim Guidelines for Qualifying Trading Partners

- Must Meet Minimum Credit Rating, or
- Supply credit enhancements (LOC, Escrow deposit, pre-payment, corp. guarantee)
- Staff recommendation to ROC based on past history and financial position
- Limit term and amounts with new counter-parties

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**Implementation Guidelines**

- Qualifications based on data from other rating agencies
- Ratings are dynamic and require periodic review
- NCPA to act prudently
- Events of non-compliance to be reported

**NCPA Credit Watch List**

- Placed on list for Non-compliance
- Minimum of 3 months
- Currently One Entity on NCPA List

**Credit Risk and Members**

- Member contracts assigned to NCPA must be with NCPA Approved Counterparties
- Member transactions will be included in total exposure limit
- Members must consult with NCPA prior to committing to ensure minimum credit requirements

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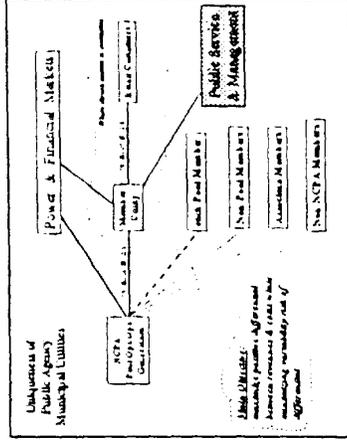
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### Summary of Member Obligations

- Participate in Subscription Process or delegate trading to NCPA; section 2.2.4
- Provide Authorizations to NCPA; section 3.1
- Complete required transaction tracking forms; section 3.5.3
- Trade only with NCPA Approved Counterparties; section 4.7
- Consult with NCPA prior to committing NCPA with a counter-party; section 4.7

### Current Activities

- Coordinate 3Ps development w/ Member efforts
  - Member Authorizations & Issues
- Develop:
  - Value of Services
  - Trade & Risk Strategy
  - Performance Targets
  - Risk Measures
- Transaction data base & tracking software
- Review Credit Policy & Procedures
- Staff Assignments and Training



# City of Lodi Electric Utility Department Open Access Milestones

	January	February	March	April	May	June
Adopt Open Access (OA) Policies						
Initiate Customer Surveys and Meetings						
Initiate Marketing Program Development and Implementation						
Adopt Open Access Rules and Regulations	→			<div style="display: flex; flex-direction: column; align-items: center;"> <div style="display: flex; align-items: center; margin-bottom: 5px;"> <span style="margin-right: 10px;">Open Access</span>  </div> <div style="display: flex; align-items: center; margin-bottom: 5px;"> <span style="margin-right: 10px;">Rates and Pricing</span>  </div> <div style="display: flex; align-items: center; margin-bottom: 5px;"> <span style="margin-right: 10px;">Marketing and Customer Service</span>  </div> <div style="display: flex; align-items: center;"> <span style="margin-right: 10px;">Contract Management</span>  </div> </div>		
Adopt Metering and Billing Procedures	→					
Initiate Unbundled Rate Study and Pricing	→					
Approve New Products and Services	→					
Adopt Consumer Protection Services and Procedures	→					
Adopt CTC Charges	→					
Adopt Energy Service Provider Agreement	→					
Negotiate Agreements, as needed, with PG&E, Western, ISO, and others for Direct Access		→				

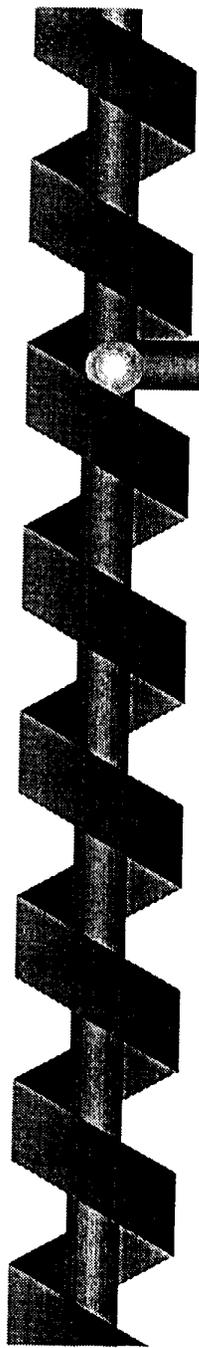
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# **Lodi Electric Utility Department**



## **Open Access**

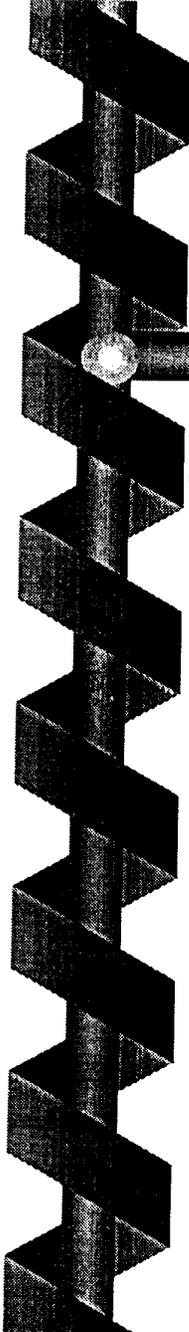


# Lodi Electric Utility Department Open Access

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## ⊗ Electric Industry Restructuring

- AB 1890
  - Independent System Operator (ISO)
  - Power Exchange (PX)
  - Divestiture of Generation Plants
  - Rate Freeze/CTC

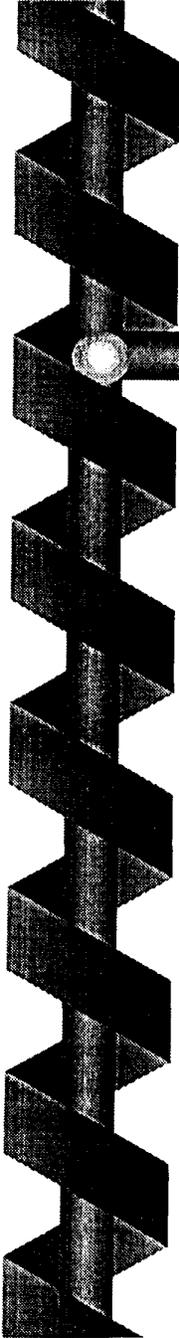


# Lodi Electric Utility Department Open Access

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## ⊗ Electric Industry Restructuring (cont.)

- Municipal Utilities
  - CTC Recovery
  - ISO
  - Open Access
  - Generation Competition Only
  - Public Benefit Programs
  - Other

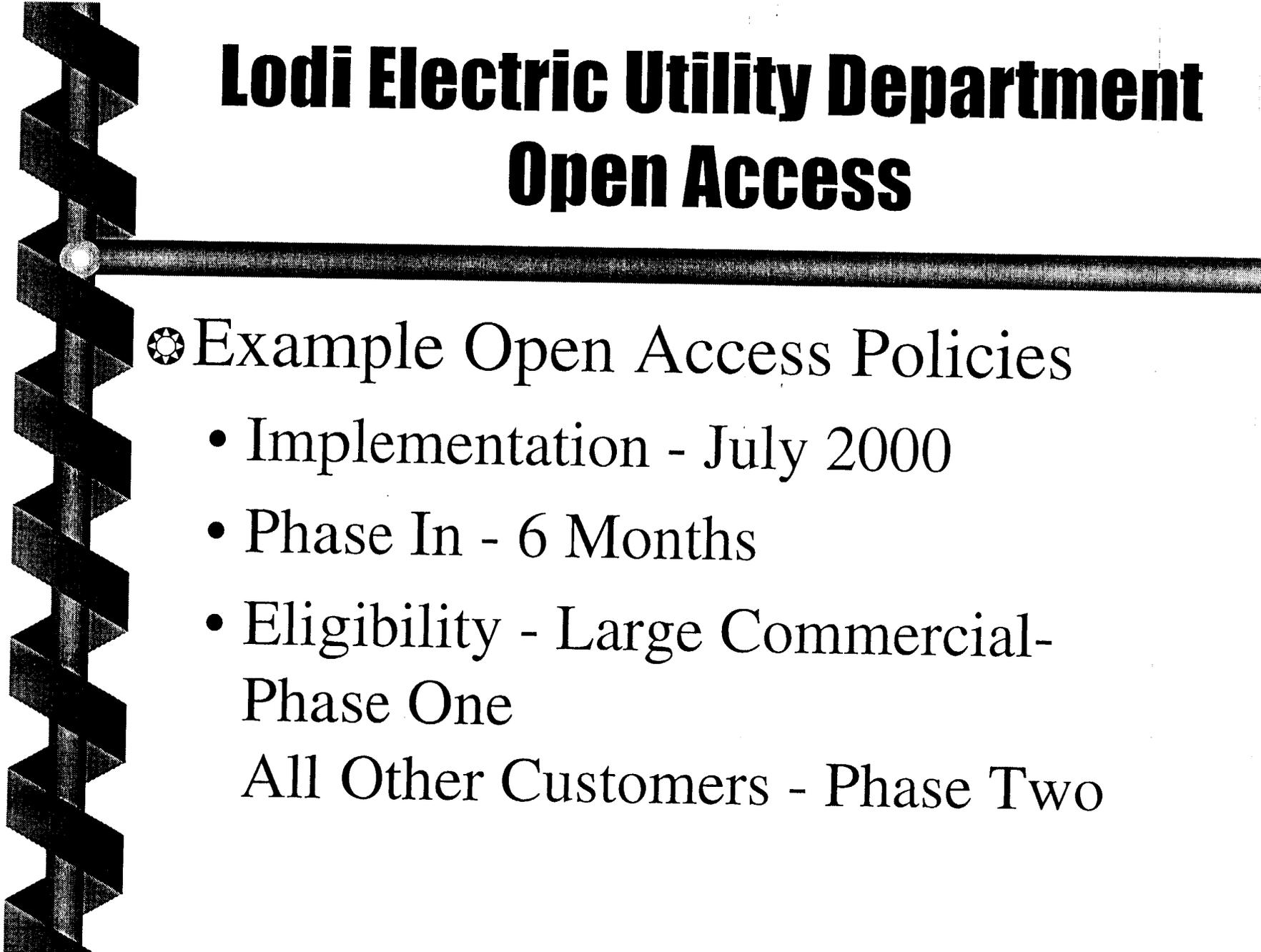


# Lodi Electric Utility Department Open Access

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## ⊗ Open Access Policies

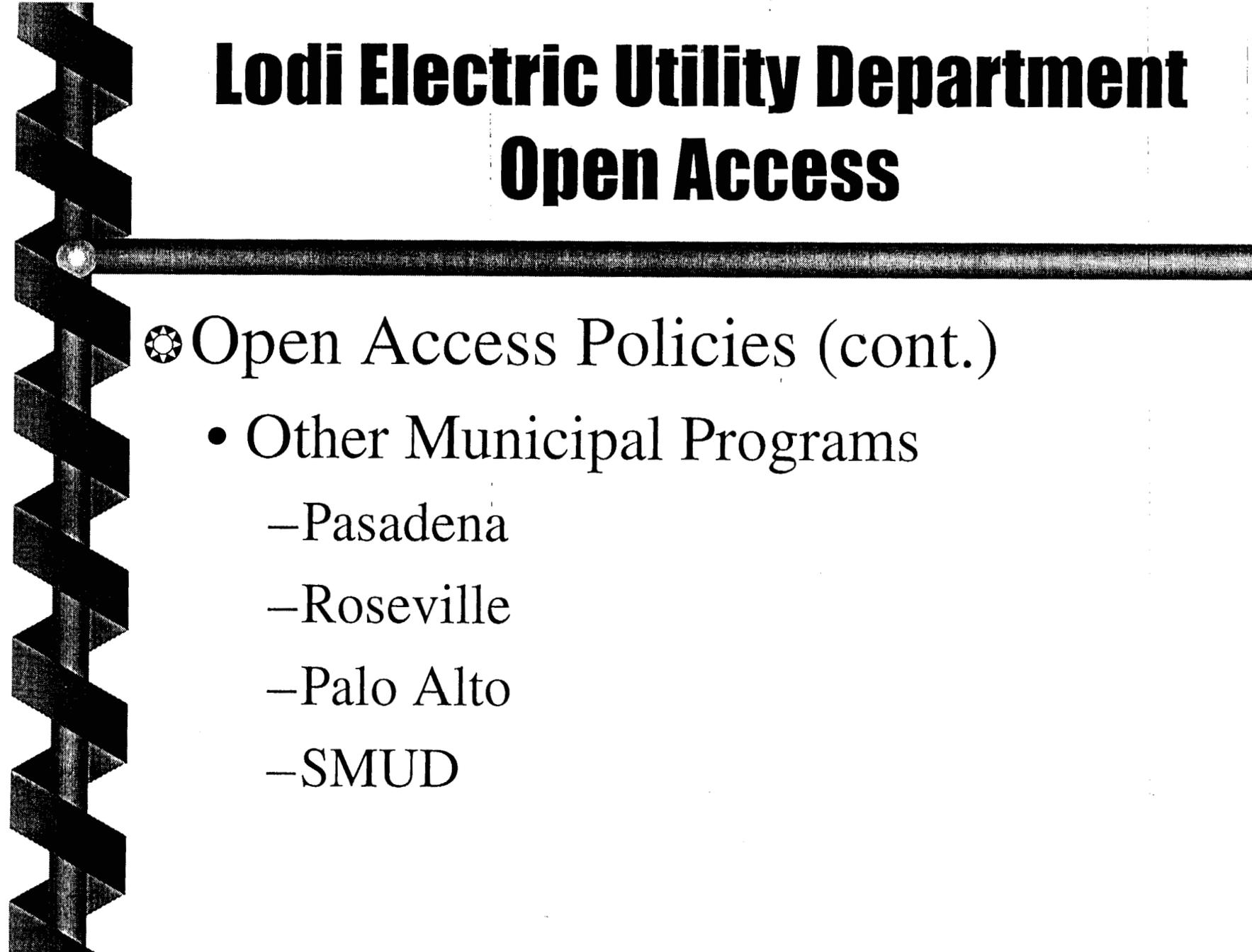
- Implementation Date
- Phase-In Period
- Eligibility
- Program Type



# Lodi Electric Utility Department Open Access

## ☉ Example Open Access Policies

- Implementation - July 2000
- Phase In - 6 Months
- Eligibility - Large Commercial-  
Phase One  
All Other Customers - Phase Two



# Lodi Electric Utility Department Open Access

## ◉ Open Access Policies (cont.)

- Other Municipal Programs
  - Pasadena
  - Roseville
  - Palo Alto
  - SMUD