Policy No. 18-09

Energy Risk Management Policy

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Section 1: POLICY OVERVIEW

1.1 Background and Purpose

Desert Community Energy (“DCE”) is a public joint powers agency located within the Coachella Valley. DCE desires to implement and administer a community choice aggregation (“CCA”) program for cities in the Coachella Valley that elect to become participants. The CCA program will give its members an opportunity to join together to procure electricity supplies and implement local programs that meet the goals of the local communities. Electricity procured to serve customers will continue to be delivered over SCE’s transmission and distribution system.

Presently, DCE’s Members include the following:

- City of Cathedral City
- City of Palm Desert
- City of Palm Springs

Providing retail electric generation service to customers enrolled in the CCA program exposes DCE to risks such as retail load uncertainty (due to weather, customer opt-out, and other factors), energy market price, counterparty credit, SCE generation and PCIA rate competitiveness and other regulatory risks.

This Energy Risk Management Policy (“Policy”) establishes DCE’s Energy Risk Management Program (“Program”) including risk management functions and procedures to manage the risks associated with power procurement activities.

The ultimate purpose of this Policy is to help DCE increase the likelihood of achieving its goals by specifying management responsibilities, organizational structures, risk management standards, and operating controls and limits necessary to properly identify and manage DCE’s exposure to risk.

1.2 Scope

Unless otherwise explicitly stated in this Policy, or other policies approved by the Board, this Policy applies to all power procurement and related business activities that may impact the risk profile of DCE. This Policy documents the framework by which management, staff, consultants and The Energy Authority (TEA) will:

- Identify and quantify risk
- Develop and execute procurement strategies
- Create a framework of controls and oversight
- Monitor, measure and report on the effectiveness of the Program

To ensure successful operation of the CCA program, DCE has partnered with experienced consultants to provide energy-related services. Specific to power procurement, DCE has partnered with TEA. At the outset of the CCA program, TEA will be executing the preponderance of front- (transacting), middle- (monitoring) and back-office (settlement) related activities on DCE’s behalf as discussed at Section 4.4. In providing these services for DCE, TEA will adhere to and be governed by this Policy. TEA maintains its own
risk management policies and procedures, following industry practices of segregation of duties, which also govern activities executed on DCE’s behalf.

1.3 Energy Risk Management Objective
The objective of the Energy Risk Management Policy is to provide a framework for conducting procurement activities that maximizes the probability of DCE meetings the goals listed in Section 2.1.

Pursuant to this Policy, DCE will identify and measure the magnitude of the risks to which it is exposed and that contribute to the potential for not meeting identified goals.

1.4 Policy Administration
This Policy document has been reviewed and approved by the DCE Board of Directors (“Board”). The Risk Management Team (“RMT”) and Board must approve amendments to this Policy, except for the appendices, which may be amended with approval of only the RMT. The RMT must give notice to the Board of any amendment it makes to an appendix or a reference policy or procedure document.
Section 2: GOALS AND RISK EXPOSURES

2.1 Policy Goals

To help ensure long term viability for the CCA, DCE has outlined the following Policy goals. These goals establish metrics used for modeling and measuring risk exposures of the CCA.

- DCE will target to maintain competitive retail rates with SCE after adjusting for the PCIA and Franchise Fee.
- DCE will target, during the initial years of operation, to fund financial reserves with the following objectives:
  - Establish long-term business sustainability
  - Build collateral for power procurement activities
  - Establish an investment grade credit rating
  - Develop a source of funds for investment in generation and other local programs
  - Stabilize rates and dampen year-to-year variability in procurement costs

The goals outlined above are incorporated into the financial models that are used in modeling and measuring risk exposures. It is important to note that the goals listed above are not intended to be a comprehensive list of goals for DCE. Rather, the above reflect a subset of goals critical to long-term business viability of DCE.

2.2 Risk Exposures

DCE’s CCA program faces a range of risks during launch and ongoing operation including:

- Customer Opt-Out risk
- Market risk
- Regulatory risk
- Volumetric risk
- Model risk
- Operational risk
- Counterparty credit risk
- Reputation risk

Customer Opt-Out Risk

Customer opt-out risk is the primary risk DCE faces. Customer opt-out risk includes any condition or event that creates uncertainty within, or a diminution, of DCE’s customer base, thereby increasing the potential for DCE to not meet its Policy goals. DCE faces other risks, but the ultimate concern is often how these other risks may affect customer opt-outs. This Policy addresses this paramount risk, as well as the secondary risk types listed below. These risks are not all inclusive but are identified as the risk factors driving DCE’s success.

The most relevant measures of the success of this Policy include:
• Retail rate competitiveness with SCE
• Financial reserve level

For the purpose of this Policy, risk exposure is assessed on all transactions (energy, environmental attributes, capacity, etc.) executed by TEA on behalf of DCE, or by DCE unilaterally, as well as the risk exposure of open positions and the impacts of these uncertainties on the CCA’s load obligations. The following are components of DCE’s energy risk that will be assessed, monitored and managed.

2.3.1 Market Risk
Market risk is the uncertainty of DCE’s financial performance due to variable commodity market prices (market price risk) and uncertain price relationships (basis risk). Variability in market prices creates uncertainty in DCE’s procurement costs and can materially impact DCE’s financial position. Market risk is managed by regular measurement, execution of approved procurement and Congestion Revenue Right strategies and the limit structure set forth in this Policy.

2.3.2 Regulatory Risk
CCAs remain comparatively new legal entities in the State of California and are subject to an evolving legal and regulatory landscape. Additionally, CCAs are in direct competition with California’s Investor Owned Utilities (“IOUs”) in retail electricity, which face the risk of stranded investments in generating assets and power purchase agreements procured in the past to serve now departing CCA loads. The manner in which the stranded costs of these legacy power supplies are allocated to departing CCA loads is the subject of regulatory proceedings at the CPUC. New and evolving regulations result in retail rate competitiveness risks that are unique to CCAs. DCE will manage regulatory risk by:

• Regular monitoring and analysis of legislative and regulatory proceedings impacting CCAs;
• Actively participating in and representing DCE customer interests during regulatory and legislative proceedings;
• Regular monitoring and reporting of actual and projected financial results including probability-based and stressed financial results assuming a range of market and retail rate scenarios (both DCE and SCE);
• Structuring procurement strategies with the objective function of maintaining a favorable retail rate savings relative to SCE;

2.3.3 Volumetric Risk
Volumetric risk is the uncertainty of DCE’s financial performance due to variability in the quantity of retail load served by DCE. Retail load uncertainty results from customer opt-outs, temperature deviation from normal, unforeseen adoption of behind the meter generation by DCE customers, as well as local, state and national economic conditions. Volume risk is managed by taking steps to:

• Quantify anticipated SCE generation and PCIA rates, and variability therein;
• Quantify variability in procurement costs;
• Monitor and adjust for non-regulatory factors driving volumetric uncertainty (e.g., weather);
• Adopt a formal procurement strategy;
• Implement a key accounts program and maintain strong relationships with the local community;
• Monitor trends in customer onsite generation, economic shifts, and other factors that affect electricity customer consumption and composition;
• Expand DCE’s customer base by incorporating other eligible cities within the Coachella Valley into the CCA program.

2.3.4 Model Risk

Model risk is the uncertainty of DCE’s financial performance due to potentially inaccurate or incomplete characterization of a transaction or power supply portfolio elements due to fundamental deficiencies in models and/or information systems. Model risk is managed by:

• TEA and Risk Management Team approval and ratification of financial and risk models;
• Ongoing review of model outputs as part of controls framework;
• Ongoing DCE and TEA staff education and participation in CCA industry forums;
• Ongoing update and improvement of models as additional information and expertise is acquired

2.3.5 Operational Risk

Operational risk is the uncertainty of DCE’s financial performance due to weaknesses in the quality, scope, content, or execution of human resources, technical resources, and/or operating procedures within DCE. Operational risk can also be exacerbated by fraudulent actions by employees or third parties or inadequate or ineffective controls. Operational risk is managed through:

• The controls set forth in this Policy
• RMT oversight of procurement activity
• Timely and effective management reporting
• Staff resources, expertise and/or training reinforcing a culture of compliance
• Ongoing and timely internal and external audits

2.3.6 Counterparty Credit Risk

Counterparty credit risk is the potential that a counterparty will fail to perform or meet its obligations in accordance with terms agreed to under contract. DCE’s exposure to counterparty credit risk is controlled by the limit controls set forth in the Credit Policy described in Section 6.

2.3.7 Reputation Risk

Reputation risk is the potential that DCE’s reputation is harmed, causing customers to opt-out of DCE’s service and migrate back to SCE. Reputational risk is managed through:

• Implementation and adherence to this Energy Risk Management Policy
• Establishment and adherence to industry best practices including both those adopted by other CCAs, as well as those adopted by traditional municipal electric utilities.
2.4 Risk Measurement Methodology

A vital element in DCE’s Energy Risk Management Policy is the regular identification, measurement and communication of risk. To effectively communicate risk, all risk management activities must be monitored on a frequent basis using risk measurement methodologies that quantify the risks associated with DCE’s procurement-related business activities and performance relative to identified goals.

Risk measurement of DCE’s position will be performed using a method that calculates projected procurement costs on an annual basis at various probabilities and that further provides a comparison of projected DCE retail rates to those of SCE. The rate comparison will be adjusted for actual and projected PCIA and Franchise Fee charges. Risk measurement methodologies shall be re-evaluated on a periodic basis to ensure DCE and TEA adjust their methods to reflect the evolving regulatory and competitive landscape. The implementation of these methods shall be overseen and validated by TEA and ratified by the RMT.
Section 3: BUSINESS PRACTICES

3.1 General Conduct

It is the policy of DCE that all personnel, including the Board, management, and agents, adhere to standards of integrity, ethics, conflicts of interest, compliance with statutory law and regulations and other applicable DCE standards of personal conduct while employed by or affiliated with DCE.

3.2 Trading for Personal Accounts

All DCE Directors, management, employees, consultants, and agents participating in any transaction or activity within the coverage of this Policy are obligated to give notice in writing to DCE of any interest such person has in any counterparty that seeks to do business with DCE, and to identify any real or potential conflict of interest such person has or may have with regard to any existing or potential contract or transaction with DCE. Further all persons are prohibited from personally participating in any transaction or similar activity that is within the coverage of this Policy, or prohibited by California Government Code § 1090, and that is directly or indirectly related to the trading of electricity and/or environmental attributes as a commodity.

If there is any doubt as to whether a prohibited condition exists, then it is the employee’s responsibility to discuss the possible prohibited condition with her/his manager or supervisor.

3.3 Adherence to Statutory Requirements

Compliance is required with rules promulgated by the state of California, California Public Utilities Commission, California Energy Commission, Federal Energy Regulatory Commission (FERC), Commodity Futures Trading Commission (CFTC), and other regulatory agencies.

Congress, FERC and CFTC have enacted laws, regulations, and rules that prohibit, among other things, any action or course of conduct that actually or potentially operates as a fraud or deceit upon any person in connection with the purchase or sale of electric energy or transmission services. These laws also prohibit any person or entity from making any untrue statement of fact or omitting to state a material fact where the omission would make a statement misleading. Violation of these laws can lead to both civil and criminal actions against the individual involved, as well as DCE. This Policy is intended to comply with these laws, regulations and rules and to avoid improper conduct on the part of anyone employed by DCE. These procedures may be modified from time to time by legal requirements, auditor recommendations, RMT requests, and other considerations.

In the event of an investigation or inquiry by a regulatory agency, DCE will provide legal counsel to employees. However, DCE will not appoint legal counsel to an employee if DCE’s General Counsel and Executive Director determine that the employee was not acting in good faith within the scope of employment.

DCE employees are prohibited from working for another power supplier, CCA or utility in a related position while they are simultaneously employed by DCE unless an exception is authorized by the Board. For clarity, this prohibition is not intended to prevent DCE staff from performing non-CCA activities on behalf of DCE (or the Coachella Valley Association of Governments) in the normal course of its business.
3.4 Transaction Type, Regions and Markets

Authorized transaction types, regions and markets are listed in Appendix B to this Policy. These transaction types, regions and markets are and shall continue to be focused on supporting DCE’s financial policies, including approved procurement strategies. New or non-standard transaction types may provide DCE with additional flexibility and opportunity but may also introduce new risks. Therefore, transaction types, regions and markets not included in Appendix B, or transactions within already approved transaction types that are substantially different from any prior transaction executed by DCE, must be approved by the RMT prior to execution using the process defined below.

When seeking approval for a new or non-standard transaction type, region, and/or market, a New Transaction Approval Form, as shown in Appendix C, is to be drafted describing all significant elements of the proposed transaction. The proposal write-up will be prepared by TEA and will, at a minimum, include:

- A description of the benefit to DCE, including the purpose, function and expected impact on costs (i.e.; decrease costs, manage volatility, control variances, etc.)
- Identification of the in-house and/or external expertise that will manage and support the new or non-standard transaction type
- Assessment of the transaction’s risks, including any material legal, tax or regulatory issues
- How the exposures to the risks above will be managed by the limit structure
- Proposed valuation methodology (including pricing model, where appropriate)
- Proposed reporting requirements, including any changes to existing procedures and system requirements necessary to support the new transaction type
- Proposed accounting methodology
- Proposed work flows/methodology (including systems)

It is the responsibility of TEA’s Middle Office to ensure that relevant departments have reviewed the proposed transaction and that material issues are resolved prior to submittal to the RMT for approval. If approved, Appendix B to the Policy will be updated to reflect the new transaction type.

3.5 Counterparty Suitability

TEA’s counterparty credit limits and approval processes will govern counterparty suitability for all transactions executed by TEA on behalf of DCE. TEA will provide a credit review and recommendation, consistent with the credit policies described in Section 6, for any counterparty with whom DCE contracts directly.

3.6 System of Record

TEA’s Middle Office will maintain a set of records for all transactions executed in association with DCE procurement activities. The records will be maintained in US dollars and transactions will be separately recorded and categorized by type of transaction. This system of record shall be auditable.

3.7 Transaction Valuation

Transaction valuation and reporting of positions shall be based on objective, market-observed prices. Open positions will be valued (marked-to-market) daily, based on consistent valuation methods and data.
sources. Whenever possible, mark-to-market valuations should be based on independent, publicly available market information and data sources.

3.8 Stress Testing

In addition to limiting and measuring risk using the methods described herein, stress testing shall also be used to examine performance of the DCE portfolio under potential adverse conditions. Stress testing is used to understand the potential variability in DCE’s projected procurement costs, and resulting retail rate impacts and competitive positioning, associated with low probability events. The TEA Middle Office will perform stress-testing of the portfolio on a monthly basis and distribute results to the RMT.

3.9 Trading Practices

It is the expressed intent of this Policy to prohibit the acquisition of risk beyond that encountered in the efficient optimization of DCE’s generation portfolio and execution of procurement strategies. As such, speculative transactions are prohibited. In the course of developing operating plans and conducting procurement activities, DCE recognizes that expertise must be employed by TEA staff, and it is not the intent of this Policy to restrain the legitimate application of analysis and market expertise in executing procurement strategies intended to minimize costs within the constraints of this Policy. If any questions arise as to whether a proposed transaction(s) constitutes speculation, TEA shall conduct an analysis of the transaction and the RMT shall review the transaction(s) to determine whether the transaction(s) would constitute speculation and document its finding in the meeting minutes.
Section 4: ORGANIZATIONAL STRUCTURE AND RESPONSIBILITIES

4.1 Risk Management Organizational Structure

Below is a high-level organization chart describing DCE’s risk management governance.

![Organizational Chart]

4.2 Board of Directors

The DCE Board of Directors has the responsibility to review and approve this Policy. With this approval, the Board assumes responsibility for understanding the risks DCE is exposed to due to CCA Program activity and how the policies outlined in this document help DCE manage the associated risks. The Board of Directors is also responsible to:

- Determine DCE strategic direction
- Understand the procurement strategy employed
- Approve risk exposures beyond the RMT’s authority
- Approve voting members of the RMT

4.3 Risk Management Team (RMT)

The RMT is responsible for implementing, maintaining and overseeing compliance of this Policy. The voting members of the RMT shall be Board-approved DCE staff members and an independent outside third-party representative (if such representative is deemed necessary and approved by the Board). A representative from TEA will serve as a non-voting member. Each voting member will be assigned one vote. The current voting members of the RMT are:

- Executive Director
- CCA Program Director
- Director, Environmental Resources
- Deputy Executive Director, Administrative Services
- Independent outside third-party

The primary goal of the RMT is to ensure that the procurement activities of DCE are executed within the guidelines of this Policy and are consistent with Board directives. The RMT is also responsible to consider and propose recommendations to this Policy when conditions dictate.
Pursuant to direction from the Board of Directors and the limitations specified by this Policy, the RMT and the Executive Director maintain full authority over all procurement activities for DCE. This authority includes, but is not limited to, taking any or all actions necessary to ensure compliance with this Policy.

The RMT is responsible for overseeing implementation of this Policy, procurement strategies, and the adoption of new product types. The RMT is also responsible for ensuring procurement strategies are consistent with DCE’s strategic objectives and for reviewing financial results. The RMT shall meet at least quarterly and record business in meeting minutes that will be approved by the RMT. No decision of the RMT is valid unless a majority of voting members has stated approval with a quorum of voting members participating in the vote, including the Executive Director. All decisions by the RMT, other than those made by common consent, shall be made by simple majority vote of the RMT members.

The RMT maintains the authority and responsibility to:

- Approve and ensure that all procurement strategies are consistent with this Policy;
- Determine if changes in procurement strategies are warranted;
- Approve new transaction types, regions, markets and delivery points;
- Understand financial and risk models used by TEA;
- Understand counterparty credit review models and methods for setting and monitoring credit limits;
- Receive and review reports as described in this Policy;
- Meet to review actual and projected financial results and potential risks;
- Escalate to the Board of Directors with any risks beyond the RMT’s authority;
- Review summaries of limit violations and recommend corrective actions, if necessary;
- Review the effectiveness of DCE's energy risk measurement methods;
- Maintain this Policy;
- Monitor regulatory and legislative activities

4.4 Power Manager

DCE has partnered with TEA as its Power Manager. TEA, as outlined in its Risk Policy, maintains a strong segregation of duties, also referred to as "separation of function" that is fundamental to manage and control the risks outlined in this Policy. The Power Manager will provide education to the RMT on the risk and credit models, methods and processes that it uses to fulfill its obligations under this Policy. Individuals responsible for legally binding DCE to a transaction will not also perform confirmation, or settlement functions. With this in mind, TEA’s responsibilities are divided into front-middle-back office activities, as described below.

4.4.1 Power Manager - Front Office

The Power Manager’s Front Office has overall responsibility for (1) managing all commodity and transmission activities related to procuring and delivering resources needed to serve DCE's load, (2) analyzing fundamentals affecting load and supply factors that determine CCA's net position, and (3) transacting within the limits of this Policy, and associated policies, to balance loads and resources, and
maximize the value of DCE’s assets through the exercise of approved optimization strategies. Other duties associated with these responsibilities include:

a. Assist in the development and analysis of risk management hedging products and strategies, and bring recommendations to the RMT
b. Prepare a monthly operating plan for the prompt months that gives direction to the day-ahead and real-time trading and scheduling staff regarding the bidding and scheduling of CCA’s resource portfolio in the CAISO market
c. Develop, price and negotiate hedging products
d. Forecast day-ahead and monitor/forecast same-day loads
e. Keep accurate records of all applicable transactions they enter

4.4.2 Power Manager – Middle/Back Office

The Power Manager Middle Office provides independent market and credit risk oversight. The Power Manager Middle Office is functionally and organizationally separate from the Front Office. The Power Manager Back Office provides support with a wide range of administrative activities necessary to execute and settle transactions and to support the risk control efforts (e.g. transaction entry and/or checking, data collection, billing, etc.) consistent with this Policy. The Power Manager Back Office is functionally and organizationally separate from the Front Office.

The Power Manager’s Middle and Back Offices have primary responsibility for trading controls and for ensuring agreement with counterparties regarding the terms of all trades, including forward trading. The Power Manager has the primary responsibility for:

a. Estimating and publishing daily forward monthly power and natural gas price curves for a minimum of the balance of the current year through the next calendar year
b. Calculating and maintaining the net forward power positions of CCA
c. Ensuring that CCA adheres to all risk policies and procedures of both CCA and the Power Manager in letter and in intent
d. Maintaining the overall financial security of transactions undertaken by the Power Manager on behalf of CCA
e. Implementing and enforcing credit policies and limits
f. Handling confirmation of all transactions and reconciling differences with the trading counterparties
g. Reviewing trade tickets for adherence to approved limits
h. Ensuring all trades have been entered into the appropriate system of record
i. Ensuring that both pre-schedule and actual delivery volumes and prices are entered into the physical database
j. Carrying out month-end checkout of all transactions each month
k. Reviewing models and methodologies and recommending RMT approval
Section 5: DELEGATION OF AUTHORITY

With the approval of the Policy, the DCE Board is explicitly delegating operational control and oversight to the RMT and Power Manager, as outlined through this Policy. Specifically, to facilitate daily operations of the CCA, the Board is delegating transaction execution authorities shown in the table below.

<table>
<thead>
<tr>
<th>Position</th>
<th>Maturity Limit</th>
<th>Term Limit</th>
<th>Volume Limit (MWh)(^1)</th>
<th>Value Limit(^2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk Management Team</td>
<td>30 Months</td>
<td>24 Months</td>
<td>1,000,000</td>
<td>$4,000,000</td>
</tr>
<tr>
<td>Executive Director</td>
<td>24 Months</td>
<td>18 Months</td>
<td>750,000</td>
<td>$2,000,000</td>
</tr>
<tr>
<td>TEA</td>
<td>18 months</td>
<td>12 Months</td>
<td>500,000</td>
<td>$1,000,000</td>
</tr>
</tbody>
</table>

\(^1\)Volume limit applies only to energy purchases, including index-based renewable and carbon-free energy purchases.

\(^2\)Value limit apply to non-energy product transactions (e.g., Resource Adequacy).

These authorities will be applied to wholesale power procurement executed outside of the California Independent System Operator (“CAISO”) markets. These limits provide both DCE and TEA needed authorities to manage risks as they arise. Transactions falling outside the delegations above require Board approval prior to execution. Activity with CAISO is excluded from this table due to the nature of the CAISO market, where prices for activity may not be known until after transactions are committed.

All procurement executed under the delegation above, must align with the DCE’s underlying risk exposure (load requirements, locational and temporal) that is being hedged consistent with the approved Procurement Strategy.

5.2 Monitoring, Reporting and Instances of Exceeding Risk Limits

The TEA Middle Office is responsible for monitoring and reporting compliance with all limits within this Policy. If a limit or control is violated, the TEA Middle Office will send notification to the TEA trader responsible for the violation and the RMT. The RMT will discuss the cause and potential remediation of the exceedance to determine next steps for curing the exceedance.
Section 6: CREDIT POLICY

During startup of DCE, it is expected that transactions will be executed by TEA on TEA agreements, and thus DCE is exposed to pass-through credit risk. As the CCA builds its own counterparty master trading agreements, transactions executed utilizing DCE’s agreements will carry direct credit risk. For activity on TEA and/or CCA agreements, DCE will adopt a scaling methodology to adjust TEA’s credit limits to DCE’s risk tolerance. For scaling with DCE counterparties, where an agreement exists between DCE and an entity, the RMT will approve changes to credit limits, otherwise TEA will automatically scale the TEA limit to the DCE risk tolerance.

All procurement activities executed by TEA on behalf of DCE, using TEA’s counterparty agreements, will be subject to the credit policies and procedures outlined in TEA’s Energy Risk Management Policy. TEA’s credit policy requires that all counterparties be evaluated for creditworthiness by the TEA Middle Office prior to execution of any transaction and no less than annually thereafter. Additionally, counterparties shall be reviewed if a change has occurred, or perceived to have occurred, in market conditions or in a company’s management or financial condition. This evaluation, including any recommended increase or decrease to a credit limit, shall be documented in writing and includes all information supporting such evaluation in a credit file for the counterparty. A credit limit for a counterparty will not be recommended or approved without first confirming the counterparty’s senior unsecured or corporate credit rating from one of the nationally recognized rating agencies and/or performing a credit review or analysis of the counterparty’s or guarantor’s financial statements. The TEA credit analysis shall include, at a minimum, current audited financial statements or other supplementary data that indicates financial strength commensurate with an investment grade rating. Trade and banking references, and any other pertinent information, may also be used in the review process.

Counterparties that do not qualify for a credit limit must post an acceptable form of credit support or prepayment prior to the execution of any transaction. A counterparty may choose to provide a guarantee from a third party, provided the third party satisfies the criteria for a credit limit as outlined in TEA’s Energy Risk Management Policy.

6.1 Credit Limit and Monitoring

In executing transactions on DCE’s behalf, TEA will observe a pass-through counterparty credit maximum limit equal to $2.0 million.

The TEA Middle Office will establish continuous monitoring of the current credit exposure for each counterparty with whom TEA transacts on behalf of DCE and include such information in the current Counterparty Credit Risk Report. This report will be made available, reviewed and communicated to the RMT pursuant to the reporting requirements outlined in Section 7.
Section 7: POSITION TRACKING AND MANAGEMENT REPORTING

Minimum reporting requirements are shown below. The reports outlined below will be made available to RMT members and TEA staff:

- **Daily Financial Model Forecast**
  Latest projected financial performance, marked to current market prices, and shown relative to financial goals.

- **Monthly Net Position Report**
  Prepare a forward net position report, not less frequently than monthly, and report the results to the RMT.

- **Monthly Pass-through Counterparty Credit Exposure**
  This report will show how the credit exposures for transactions that TEA executes on behalf of DCE will pass-through TEA to DCE.

- **Monthly Risk Analysis**
  This will include a Cash Flow at Risk and stress test of financial forecast relative to financial goals.

- **Quarterly Board Report**
  Update on activities and projected financial performance to be presented quarterly at DCE Board meetings.
Section 8: POLICY REVISION PROCESS

DCE’s Energy Risk Management Policy will evolve over time as market and business factors change. At least on an annual basis, the RMT will review this Policy and associated procedures to determine if they should be amended, supplemented, or updated to account for changing business conditions and/or regulatory requirements. If an amendment is warranted, the Policy amendment will be submitted to the DCE Board for approval. Changes to appendices to this Policy may be approved and implemented by the RMT.

8.1 Acknowledgement of Policy

Any DCE employee participating in any activity or transaction within the scope of this Policy shall sign, on an annual basis or upon any revision, a statement approved by the RMT that such employee has:

- Read DCE’s Energy Risk Management Policy
- Understands the terms and agreements of said Policy
- Will comply with said Policy
- Understands that any violation of said Policy shall be subject to employee discipline up to and including termination of employment.

8.2 Policy Interpretations

Questions about the interpretation of any matters of this Policy should be referred to the RMT.

All legal matters stemming from this Policy will be referred to General Counsel.
Appendix A: AUTHORIZED TRANSACTION TYPES, REGIONS AND MARKETS

All transaction types listed below must be executed within the limits set forth in this Policy. *(The following transaction types can be ‘nonstandard’ at DCE subject to RMT approval)*

**Over the Counter Products**

- CAISO Market Products
  - Day-ahead and Real-time Energy
  - Congestion Revenue Rights
  - Convergence
  - Inter Scheduling Coordinator Transactions
  - Tagging into and out of CAISO
- Physical Power Products
  - Short and Long-Term Power
  - Physical OTC Options
- Physical Resource Adequacy Capacity
- Physical Environmental Products
  - Renewable Energy Credits
  - Specified Source Power
  - Carbon Allowances and Obligations

The point of delivery for all products must be at a location on the CAISO transmission grid.
Appendix B: NEW TRANSACTION APPROVAL FORM

New or Non-Standard Transaction Approval Form

Prepared By:

Date:

New or Non-Standard Transaction Name:

Business Rationale and Risk Assessment:

- Product description – including the purpose, function, expected impact on net revenues (i.e., increase, manage volatility, control variances, etc.) and/or benefit to DCE
- Identification of the in-house or external expertise that will be relied upon to manage and support the new or non-standard transaction
- Assessment of the transaction’s risks, including any material legal, tax or regulatory issues
- How the exposures to the risks above will be managed by the limit structure
- Proposed valuation methodology (including pricing model, where appropriate)
- Proposed reporting requirements, including any changes to existing procedures and system requirements necessary to support the new product
- Proposed accounting methodology
- Proposed Middle Office work flows/methodology, including systems
- Brief description of the responsibilities of various departments within DCE who will have any manner of contact with the new or non-standard transaction

Reviewed by:

__________________________________________________________________________  ____________________________________________________________________________ Date
CCA Program Director

__________________________________________________________________________  ____________________________________________________________________________ Date
TEA Representative

__________________________________________________________________________  ____________________________________________________________________________ Date
Executive Director
Appendix C: DEFINITIONS

**Back Office**: That part of a trading organization which handles transaction accounting, confirmations, management reporting, and working capital management.

**Bilateral Transaction**: Any physical or financial transaction between two counterparties, neither of which is an exchange or market entity (e.g., MISO).

**Cash Flow at Risk (CFaR)**: A measure of the potential shortfall in cash flow from a specified level during a specified period of time at a specified confidence level. The CFaR of any Portfolio is equal to the Portfolio’s current Mark-to-Market value less its Terminal Value.

**CAISO**: California Independent System Operator. CAISO operates a California bulk power transmission grid, administers the State’s wholesale electricity markets, and provides reliability planning and generation dispatch.

**CCA**: Community Choice Aggregator. CCAs allow local government agencies such as cities and/or counties to purchase and/or develop generation supplies on behalf of their residents, businesses and municipal accounts.

**CFTC**: Commodity Futures Trading Commission. The CFTC is a U.S. federal agency that is responsible for regulating commodity futures and swap markets. Its goals include the promotion of competitive and efficient futures markets and the protection of investors against manipulation, abusive trade practices and fraud.

**Commodity**: A basic good used in commerce that is interchangeable with other commodities of the same type. Commodities are most often used as inputs in the production of other goods or services. The quality of a given commodity may differ slightly, but it is essentially uniform across producers. When they are traded on an exchange, commodities must also meet specified minimum standards, also known as a basis grade.

**Confirmation Letter**: A letter agreement between two counterparties that details the specific commercial terms (e.g., price, quantity and point of delivery) of a transaction.

**Congestion Revenue Right**: A point-to-point financial instrument in the Day-Ahead Energy Market that entitles the holder to receive compensation for or requires the holder to pay certain congestion related transmission charges that arise when the transmission system is congested.

**Counterparty Credit Risk**: The risk of financial loss resulting from a counterparty to a transaction failing to fulfill its obligations.

**CPUC**: California Public Utilities Commission

**Day-ahead Market**: The short term forward market for efficiently allocating transmission capacity and facilitating purchases and sales of energy and scheduled Bilateral Transactions conducted by an Organized Market prior to the operating day.

**Delivery point**: The point at which a commodity will be delivered and received.

**Energy Risk Management Policy**: Energy Risk Management Policy is defined on page 3 of this document.

**FERC**: Federal Energy Regulatory Commission. FERC is a federal agency that regulates the interstate transmission of electricity, natural gas and oil. FERC also reviews proposals to build liquefied natural gas terminals, interstate natural gas pipelines, as well as licenses hydroelectric generation projects.
Front Office: That part of a trading organization which solicits customer business, services existing customers, executes trades and ensures the physical delivery of commodities.

Franchise Fee: A franchise fee is a percentage of gross receipts that an IOU pays cities and counties for the right to use public streets to provide gas and electric service. The franchise fee surcharge is a percentage of the transmission (transportation) and generation costs to customers choosing to buy their energy from third parties. IOUs collect the surcharges and pass them through to cities and counties.

Hedging products: Hedging products means capacity, energy, renewable energy credits or other products related to a specific transaction.

IOU: An Investor Owned Utility (IOU) is a business organization providing electrical and/or natural gas services to both retail and wholesale consumers and is managed as a private enterprise.

Limit structure: A set of constraints that are intended to limit procurement activities.

Limit violation: Any time a defined limit is violated.

Mark to Market Value: the value of an asset based on its current market price.

Middle Office: That part of a trading organization that measures and reports on market risks, develops risk management policies and monitors compliance with those policies, manages contract administration and credit, and keeps management and the Board informed on risk management issues.

Net Forward Position: A forecast of the anticipated electric demands of a load serving entity compared to existing resource (generation and/or power purchase agreements) commitments.

Nonstandard: Nonstandard refers to any product that is not commonly transacted among market participants in forward markets. The nonstandard attribute of the product could be a function of a number of factors such as volume, delivery period and/or term.

Opt-out Rate: Typically expressed as a percentage, the Opt-out Rate measures the ratio of eligible customers of a CCA that have elected to remain a bundled service customer of the IOU rather than take generation services from the CCA.

PCIA: Power Cost Indifference Adjustment. The PCIA is intended to compensate IOUs for their stranded costs when a bundled customer departs and begins taking generation services from a CCA.

Schedule: Schedule or Scheduling means the actions of the counterparts to a transaction, and/or their designated representatives, of notifying, requesting and confirming to each other the quantity and type of product to be delivered on a given day.

Separation of function: Separation of function, also referred to as “segregation of duties,” is part of a complete risk control framework. Individuals responsible for legally binding the organization to a transaction should not also perform confirmation, clearance or accounting functions. DCE will maintain appropriate segregation of duties in its organization and activities.

Settlement: Settlement is the process by which counterparties agree on the dollar value and quantity of a commodity exchanged between them during a particular time interval.

Speculation: Speculation is the act of trading an asset with the expectation of realizing financial gain resulting from a change in price in the asset being transacted.
**Stranded cost:** Stranded costs commonly refer to generation costs that an IOU (although could be any load serving entity) is allowed to collect from customers through retail rates but that will not be recovered if the generation is sold in wholesale electricity markets.

**Stress testing:** Stress testing is the process of simulating different financial outcomes to assess potential impacts on projected financial results. Stress testing typically evaluates the effect of negative events to help inform what actions may be taken to lessen the negative consequences should such an event occur.

**Terminal Value:** The Terminal Value is the present value of all future cash flows.