M E M O R A N D U M

EUGENE WATER & ELECTRIC BOARD

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TO: Commissioners Simpson, Brown, Helgeson, Manning and Mital

FROM: Cathy Bloom, Finance Manager

DATE: May 24, 2013

SUBJECT: Financial Policies Update

OBJECTIVE: Approval of Financial Policies

Issue

The Board provided direction on March 19, 2013 to change the financial target for the Electric Utility. The direction was to move the targeted financial rating from AA to A. Attached are updated Board financial policies reflecting the changes based on the Board's direction.

Background

In 1990, following a period of financial uncertainty and public concern, the Board adopted a set of financial policies that provide high level guidance for EWEB's financial health and well being. Since that time, the policies have been reviewed by management annually and updated, as necessary, every three to five years. The last review took place June 2011. Based on the direction to change the targeted financial rating, and therefore, the associated financial targets and metrics, it is appropriate that the Board approve the attached updated policies document at this time.

Discussion

The changes below to the financial targets and metrics are reflected within the attached Financial Policies. The policies have been updated based on 1) the change in the financial rating target from AA to A for the Electric Utility from the March 19th Board meeting, 2) Power Reserve Target approved at the May 7th Board meeting, 3) Capital Improvement Reserve increase based on the increase in depreciation expense, and 4) Working Cash Target increase to better achieve days cash targeted range.

The increase in the working cash targets below contribute to an overall total reserve target increase to $58 million and $13 million for the Electric and Water Utilities, respectively, as reflected on page 21 of the Financial Policies. The previous targets were $53 million and $10 million for the Electric and Water Utilities, respectively. The result is a "days cash" target of 100 days for the Electric Utility and 90 days for the Water Utility. As defined on pages 3 and 4 of the attached policies, the days cash target reflects the average daily cash requirements for operations and falls within the performance standard of 90 to 150 days.

Recommended changes to targets are as follows:

Electric Utility

	From	To
Debt Service Coverage Target	2.0 to 2.50	1.75 to 2.0
Power Reserve Target	$19.8 million	$13.2 million
Working Cash Target	$15 million	$24 million
Capital Improvement Reserve Target	$15 million	$18 million

Water Utility

	From	To
Working Cash Target	$2.0 million	$3.4 million

Recommendation

Management recommends approval of the attached financial policies that support the Board's targeted level of financial performance. If you have any questions please contact Cathy Bloom.

Requested Board Action

Approval of the attached Financial Policies.

Eugene Water & Electric Board

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Financial Policies

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1.0 RESERVE POLICIES

1.1 Rate Sufficiency Policy

Rates and charges will be adequate to provide revenues sufficient to maintain a degree of financial soundness over and above requirements for compliance with existing bond covenants.

Discussion:

EWEB bond resolutions contain a rate sufficiency covenant that is a standard provision in municipal utility bond contracts. The covenant requires that rates and charges be set at a level that is high enough to pay the costs of operating and maintaining the utilities. This rate sufficiency policy is a higher standard than that required by the standard rate covenant contained in the bond resolutions. The policy is intended to supplement the weaker financial performance standards set out as minimum requirements in the bond resolutions. The financial standard implied by this policy is that rates and charges will be maintained at a level consistent with an average credit rating of A for the Electric Utility and AA rating for the Water Utility.

Credit rating agencies evaluate creditworthiness by assessing an organization's ability to adequately address issues of strategic importance. Credit analysis includes the track record of performance as reflected in widely used ratios and statistics. These measurements are compared with other similarly situated utilities to determine relative financial strength within the industry. An example of such a statistic is "debt service coverage ratio" which shows how many times debt service can be paid from net operating revenues. Minimum legal debt service coverage requirements are 1.35 times debt service for issuing new debt. EWEB's long term target for debt service coverage ratio for the Electric Utility is 1.75 to 2.0 and the Water Utility is 2.00 to 2.50 times debt service.

Performance standards and actual 2012 results are as follows. Performance standards, where established, are based on review with our Financial Advisor and what they are observing in the financial markets and rating agency reviews of public utilities that own generating facilities.

	Actual 2012	Performance Standard
Electric Utility		
Working Capital Days Cash	105 days	90 to 149 days
Current Ratio	4.636x	3.250x
Debt Service Coverage	1.93x	1.75 to 2.0x
Water Utility		
Working Capital Days Cash	34 days	90 to 120 days
Current Ratio	1.65x	3.250x
Debt Service Coverage	2.78x	2.0 to 2.50

Working cash balances are based on the amount of cash needed to pay for ongoing operational expenditures during the year and maintain an amount of working capital to support the day's cash ratio sufficient to maintain higher than average credit rating. The target for working cash is $24 million and $3.4 million for the Electric and Water Utility, respectively.

The performance standards were obtained by Moody's scorecard information from "Rating Methodologies; US Public Power Electric Utilities with Generation Ownership Exposure" November 9, 2011 for the Electric Utility and HDR consultants review in 2012 for the Water Utility.

1.2 Rate Stability Policy

Certain funds will be held in reserve for the purpose of mitigating the customer rate impact of unanticipated events.

Discussion:

It is the nature of budgets, financial projections, and other statements about the future to contain uncertainty. The intent of this policy is to set aside funds or other financial instruments to smooth out the financial impact on customers when assumptions about the future do not comport with actual events as they transpire.

The "Slice of System" Bonneville contract has effectively passed the risk of hydro-conditions onto Slice customers such as EWEB. However, the amount of actual power received under the Slice product will vary with the performance of the federal based system. In years of heavy water flow, EWEB may have rights to power that may be in excess of their needs, and in poor water years EWEB would need to augment its share of Slice output with their own generation or market purchases.

Because this contract provides volatility in the amount of power received compared to what is needed to serve retail loads, the principal determinants of financial performance are the amount of power that is available for purchase or sale and the price of power in the market. This gives rise to large variation in the available funding for utility programs and operations from one year to the next.

To carry out this policy, a Power Reserve account has been established to smooth the effects of power availability, prices, and load variations. The desired balance corresponds to the hydro-generation availability assumption used in the budget. If "normal" or "average" generation is assumed, then a larger reserve account is needed than if a lower percentage of average generation is assumed. The target is reviewed and calculated annually as part of the annual budget process. Deposits and withdrawals from the reserve account are made on a monthly basis to reflect the extent to which actual power budget performance is deviating from budgeted performance expectations.

A Water Operating Reserve account is used in similar fashion to smooth out the revenue effects of wet/cool or dry/hot summers at the close of the year. In addition, Operating Reserve accounts and Self-Insurance Reserve accounts have been established to provide funding of unforeseen cost contingencies, and to fund the out-of pocket liability costs of third party claims. These accounts are adjusted annually to reflect the operating budget performance of the most recent full fiscal year. The target for the Self-Insurance Reserve for Electric and Water totals $2,000,000 which is based on the amount EWEB is self-insured. Excess liability insurance protects EWEB after the self-insurance limit is exhausted.

Performance standards and actual 2012 results are as follows. 2012 actual balances are after board authorized transfers in May, 2013.

	Actual 2012	**Performance Standard**
Electric Utility		
Power Reserve	$13,200,000	$13,200,000
@ 90% of normal hydro generation		
Operating Reserve	$ 1,000,000	$ 1,000,000
Self-Insurance Reserve	$ 1,748,000	$ 1,720,000

Water Utility

Operating Reserve	$ -0-	$1,000,000
Self-Insurance Reserve	$ 285,000	$ 280,000

1.3 Capital Reserve Policy

Net investment in utility plant assets will be maintained, including such capital additions and reserves as may be necessary to support growth in loads and customer base.

Discussion:

EWEB's approach to financing capital assets uses a combination of current rates, capital improvement reserves, accumulated systems development charge receipts, and debt financing. Capital projects are classified as Type 1, Type 2, or Type 3. Each year, an amount is budgeted from rate revenues to provide ongoing funding for a base level of capital additions and replacements. The base level amount is determined through an evaluation of the age and condition of basic capital infrastructure of the Electric and the Water Utilities. This amount represents what is needed annually to maintain the desired level of service reliability on a long-term basis. These are considered Type 1 capital projects; projects that are ongoing capital infrastructure replacements.

Type 2 capital projects include capital improvement projects which are large rebuilding or expansion projects that occur periodically and are typically funded through bonds. Type 3 capital projects are major strategic projects and are funded with bonds and/or reserves or some combination thereof.

Capital funding requirements are determined by a Capital Improvement Plan (CIP). The CIP is a ten-year projection of capital needs that is updated annually and approved by the Board. The CIP sets out, for each utility, the anticipated need for utility and support infrastructure to meet customer demands and system reliability standards. Identified in the CIP is an indication of the proportion of funding from 1) rates, 2) accumulated reserves, 3) interest and other earnings on accumulated reserves, and 4) debt proceeds.

Each month, one twelfth of the base level amount is deposited into the Capital Improvement Reserve account. Withdrawals are made monthly from the account to reimburse the Working Capital Account as capital projects are completed.

The target amount for the Electric and Water Utility Capital Improvement Reserve is based on one year's depreciation expense adjusted for service reliability needs.

The Targets are:

Electric Utility: $7.5 million to $18 million (2013 Depreciation Budget - $17.9 million)

Water Utility: $3.5 million to $7 million (2013 Depreciation Budget - $4.7 million)

1.4 Retirement Benefits Funding Policy

All long-term liabilities that must be either disclosed and/or accounted for in the financial statements will be funded according to a rational and consistent plan that targets full funding of the liabilities over a specified period of time.

Discussion:

Financial reporting requirements for governmental and private sector concerns continue to converge regarding the consistency and transparency of unfunded retirement liabilities. For EWEB, unfunded retirement liabilities result from pension and other postemployment benefit programs. The primary financial strategy with these plans is to pay the actuarially determined annual required contribution, which pays for the current costs and unfunded liabilities over a designated period of years. However, if the funded status of the plans reach 70% funded status or less, an assessment of accelerated funding should be performed. When the funding status of the plan is at or below 70% of funded status, the plan is financially unstable as the plan is no longer self funding based on actuarially determined contribution rates. Below is a summary of the three plans.

1) **Pension Plan** - The Oregon PERS (OPERS) continues to experience volatility in regard to the rates employers pay to the state pension plan for benefits. EWEB pays the actuarial determined rate. In years where there is a difference between the PERS ordered contribution rate and the amount provided for in the financial pro-forma, the excess amounts will be set aside in a Board reserve for reduction of the unfunded liability in the future.

2) **Other Post-employment Benefits** – EWEB created a trust in November 2007 as a fund through which assets are accumulated and benefits are paid for other postemployment benefits (OPEB), other than pension benefits. Eligible retirees and beneficiaries of EWEB receive health care and life insurance benefits.

3) **Supplemental Retirement Plan** – EWEB created a pension plan in 1968 to provide supplemental retirement benefits to employees. The objective of the plan was to provide a benefit on retirement, which together with benefit from the OPERS, will

provide 1.67% of the highest 36-month average salary for each year of service. The plan was closed in 1988. EWEB has a designated pension fund that funds the annual cost of paying for this closed plan. The unfunded actuarial liability as of January 1, 2012 was $1.7 million and due to the nature of the closed plan, it is more cost effective to pay-as-you go, than set up a trust.

2.0 FINANCIAL MANAGEMENT POLICIES

2.1 Cost Management Policy

EWEB will take cost management actions that provide for authorized budgets and include actions to maintain expenditures within authorized budget levels.

Discussion:

The annual budget is the primary tool for setting rates and controlling costs within a given year. For accounting and budgetary purposes, the budgets are broken into operating and capital components. The operating budget of the electric utility further separates power and related costs as distinct from non-power operating costs. The reason for this is that the cost of power and related items generally varies with changes in sales volume. Non-power items are composed of mostly labor, services and materials that are less susceptible to variations in sales volumes.

The annual budget is the maximum level of expenditure authorized by the Board. Conditions may arise during any given budget year that cause projected expenditures for either utility as a whole to be higher than those approved by the Board in the annual budget. If any of the specific conditions occur as defined in Board Policy EL1 - Financial Controls, Executive Management is required to propose a budget amendment. (Board Policy EL1 is attached as Appendix C.)

The budget amendment proposal must state the causes of the projected non-budgeted expenditures, the offsetting actions taken to mitigate the increase, and the source of any additional funding requested. The Board will consider each proposed budget amendment and either approve or disapprove. In the event of disapproval, the General Manager will exercise established authorities in taking actions necessary to curtail spending within authorized levels.

To monitor the budget, cost management procedures involve the monthly review of variances from the authorized budget by the Leadership Team. The review of power-related items is performed by the Power Risk Management Committee and is separate from non-power items. Actual and projected capital and other non-power expenditures are monitored by the Leadership Team which includes the General Manager. With the assistance of financial staff, the Leadership Team determines what degree unfavorable variances in one department can be offset by favorable variances in another. In the event of a shortfall, the Leadership Team will determine whether to bring a budget amendment forward or curtail other activities to remain within authorized spending levels.

2.2 Budget Policy

The authorized annual spending plan will be balanced such that resources meet or exceed requirements in each fiscal year.

Discussion:

Long-term financial stability can be assured only if, in each year, the annual spending plan is fully funded and results in a balanced budget. The budget is considered balanced when the following four conditions are met:

1) Expected annual operating revenues exceed anticipated operation and maintenance expenses.

2) Budgeted capital outlays are funded in full from a combination of net operating revenues, capital improvement reserves, accumulated system development charges, and debt proceeds.

3) Pro forma presentation of annual operating results shows positive net income.

4) Pro forma presentation of debt service coverage shows a ratio at or above the Board established performance standard (Rate Sufficiency Policy 1.1).

2.3 Debt Policy

Funds to acquire major capital improvements will be provided in accordance with the estimated useful lives of such assets.

Discussion:

Prudent financial practice dictates the use of debt financing only in those cases where public policy, equity, and economic efficiency favor the use of debt over current financing. In EWEB's case, debt is considered an appropriate funding option for Type 2 and Type 3 capital projects. (See the discussion under Capital Reserve Policy 1.3.) Debt service payments should coincide with the useful life of the asset and should be structured to mirror the stream of benefits from the facility or project being funded.

Long-term debt financing will be considered for those major system improvements that meet two general criteria:

- The asset has a relatively long useful economic life (at least 10 years);
- The asset is a significant item included within the capital budget portion of the electric and water project plans.

However, if debt levels are too high the utility could become over-leveraged relative to its asset base and revenue producing capability. In all cases, management will balance the benefit of long term financing with the overall health of the organization as determined by appropriate measures of financial leverage.

Performance standards and actual 2012 results are as follows. Performance standards, where established, are based on review with our Financial Advisor and what they are observing in the financial markets and rating agency reviews of public utilities that own generating facilities.

	Actual 2012	**Performance Standard**
Electric Utility		
Debt/Asset Ratio	50%	60% or less *
Debt/Equity Ratio	92%	91%
Water Utility		
Debt/Asset Ratio	47%	60% or less
Debt/Equity Ratio	81%	89%

2.4 Billing and Collection Policy

Services will be billed in an accurate and timely manner and collected with fair and equitable consideration for all customers.

Discussion:

Sound business and collection practices will be applied uniformly to all customers. EWEB maintains a customer credit rating system to provide fair and equitable consideration in deposit and collection practices for all customers. Decisions to extend payment terms for anyone are based on the customer's good faith, ability to pay, and payment history.

EWEB provides cost-effective customer assistance programs (*e.g.,* Average Payment Plan, Customer Care, payment extension options, dispute/appeals recourse, *etc*.). EWEB will also cooperate with customers participating in social service programs such as the Limited Income Home Energy Assistance Program (LIHEAP) and other resources available to customers.

EWEB makes every reasonable and cost-effective attempt to secure payment of all accounts receivable. In accordance with bond covenants, products and services are not provided free of charge. Bills are issued based upon actual use of products and services, except that billings are estimated when EWEB service meters are inaccessible, or other considerations necessitate issuing estimated billings.

EWEB employees make a concerted effort to inform customers about the options available to them regarding payment for and controlled use of EWEB products and services as situations may deem advisable. In addition, we have built strong partnerships with community social service organizations that create preventive strategies for avoiding disconnection of services.

Performance standards and actual 2012 results are as follows:

	Actual 2012	**Performance Standard**
Write-offs as a % of Rate Revenue	.21%	.5% or less

3.0 RISK MANAGEMENT POLICIES

3.1 Enterprise Risk Management Policy

Risks associated with EWEB operations will be proactively managed in a cost-effective and efficient manner consistent with prudent utility practice.

Discussion:

Risk is an inherent attribute of all utility activities. Risk is operationally defined as the probability that actions taken or not taken by utility employees will result in financial gain or loss. Within an organizational context, the broadest operational meaning of risk is that changes in utility activity intended to achieve a programmatic result, such as a particular product reliability standard or a financial goal, could have an unintended result. The practical application of this policy dictates that utility employees consciously consider the potential consequences of their actions and act affirmatively to decrease the probability of financial loss accruing to EWEB.

The objective of risk management involves the continual identification of EWEB's exposure to accidental, contractual, legal or regulatory losses. Affirmative control and immunization of risk to the greatest extent possible is accomplished by transferring risk through managed contract administration, retaining risk within established guidelines, and protecting against unpredictable loss through reasonable use of commercial insurance. EWEB will transfer much of its liability contractually, and retain those risks that can be self-assumed without seriously affecting the financial condition of the organization when this is the most economical and practical means of meeting such obligations. EWEB will purchase sufficient insurance coverage when the risk is of a catastrophic nature or beyond the capacity of the organization to absorb, or when it is required by law or contract. However, insurance shall, of necessity, be limited to availability of coverage at reasonable cost, consistent with the probable frequency, severity and impact of losses on the financial stability of the organization.

Due to the nature and extent of commodity risks, power supply related risk management policies are separately addressed in the Power Risk Management Policy.

3.2 Power Risk Management Policy

Purchases and sales of electric power and related financial instruments will be managed to maximize the benefits to customers from wholesale transactions while minimizing the risk that wholesale activities will adversely affect retail prices.

Discussion:

For many years the staff at EWEB has worked to reduce power purchase costs while managing or avoiding risks that might result in price shocks or supply interruptions. Rapid changes in the electric power industry since 2000 have challenged traditional methods and prompted EWEB to migrate with power management systems and controls similar to those used in commodity trading organizations.

The Board has established power risk management policy statements to provide direction and oversight as referenced in Board Policy SD8 - Power Risk Management Policies, attached as Appendix B to this document.

3.3 Investment Policy

EWEB's investment portfolio will be managed to achieve safety of capital, achieve market rates of return, and provide sufficient liquidity to meet disbursement schedules.

Discussion:

EWEB's investment policy calls for the investment of excess funds in a manner which will preserve capital and provide sufficient liquidity to meet cash flow demands while conforming with all State statutes governing investment of public funds and bond covenants. The policy includes provisions with respect to diversification and the credit quality of securities purchased. EWEB's primary objectives are, in order of priority: safety of principal, liquidity and achieving a rate of return at least equal to the return on a comparably maturing U.S. Treasury bill. EWEB attempts to match its investments to anticipated cash flow requirements. Securities are intended to be held to maturity, unless the quality, yield or maturity characteristics of the portfolio can be improved by replacing one security with another.

4.0 ACCOUNTING POLICIES

4.1 Financial Entity Policy

EWEB will account for separate financial entities and will clearly define relationships among those entities to facilitate management decision-making.

Discussion:

1) Financial Reporting and Budget

Financial Reporting and Bond covenants require that EWEB maintain separate financial records for the Electric System and the Water System. Each entity has separate legal standing and revenues backing their respective bond issues and separate budgets. Often, the systems share personnel or other resources. The shared resources are allocated between the systems for accounting and ratemaking purposes.

2) Reporting Entity

For external reporting purposes, EWEB is required to follow Governmental Accounting Standards Board (GASB) definition of a reporting entity as EWEB is considered a primary government.

For internal reporting purposes, the results and financial position of the Electric System and the Water System will be reported separately. In addition, any component of either System, which can be separately reported, and for which separate reporting would be useful, such as a major line of business, separate class of customer, or new operation will be separately reported as required by EWEB management from time to time.

EWEB also has various relationships with other parties, such as 1) Western Generation Agency, an Intergovernmental Agency cogeneration project, 2) Trojan Nuclear Project, a jointly owned decommissioned nuclear plant and 3) Harvest Wind, a joint ownership with an equity investment in a wind generating facility and 4) OPEB Trust, post employment health care and life insurance benefits trust. These projects or investments are separate legal entities that are properly recorded within the Electric System and are fully disclosed in the footnotes of the financial statements.

4.2 Capitalization Policy

Major utility expenditures for labor, materials and/or services that result in revenue or benefits in future reporting periods will be capitalized and allocated to match such future revenue or benefits through periodic amortization or depreciation.

Discussion:

1) Utility Plant in Service

The physical assets that make up the electric and water production, transmission and distribution systems, including the acquisition of land or construction of a building are capitalized and included in plant in service.

2) Preliminary Investigations and Regulatory Deferrals

It is common utility practice to defer costs of investigations of projects the utility believes will be viable in the future. An example of this for EWEB is the preconstruction relicensing costs for the Carmen-Smith Project. EWEB also defers revenues and costs to be charged to future periods to match the time periods when the revenue and expenses are included in the rates (regulatory deferrals). Examples of this are the deferral of electric derivatives, sick leave at retirement, and net pension obligation of the supplemental retirement plan.

5.0 REFERENCE DOCUMENTS

5.1 Appendix A: Board Policy SD6 Financial Policies

Policy Number: **SD6**
Policy Type: **Strategic Direction**
Policy Title: **Financial Policies**
Date Approved: **July 19, 2005**

The following financial policies shall govern staff's operation of the utilities:

1. Rate Sufficiency Policy - Rates and charges will be adequate to provide revenues sufficient to maintain a high degree of financial soundness over and above requirements for compliance with existing bond covenants. (FP 1.1)

2. Rate Stability Policy - Certain funds will be held in reserve for the purpose of mitigating the customer rate impact of unanticipated events. (FP 1.2)

3. Capital Reserve Policy - Net investment in utility plant assets will be maintained, including such capital additions and reserves as may be necessary to support growth in loads and customer base. (FP 1.3)

4. Retirement Benefits Funding Policy - All long-term liabilities that must be either disclosed or accounted for in the financial statements will be funded according to a rational and consistent plan that targets full funding of the liabilities over a specified period of time. (FP 1.4)

5. Cost Management Policy - EWEB will take cost management actions that provide for authorized budgets and include actions to maintain expenditures within authorized budget levels. (FP 2.1)

6. Budget Policy - The authorized annual spending plan will be balanced such that resources meet or exceed requirements in each fiscal year. (FP 2.2)

7. Debt Policy - Funds to acquire major capital improvements will be provided in accordance with the estimated useful lives of such assets. (FP 2.3)

8. Billing and Collection Policy - Services will be billed in an accurate and timely manner and collected with fair and equitable consideration for all customers. (FP 2.4)

9. Enterprise Risk Management Policy - Risks associated with EWEB's operations will be proactively managed in a cost-effective and efficient manner consistent with prudent utility practice. (FP 3.1)

10. Power Risk Management Policy – Purchases and sales of electric power and related financial instruments will be managed to maximize the benefits to customers from wholesale transactions while minimizing the risk that wholesale activities will adversely affect retail prices. (FP 3.2)

11. Investment Policy - EWEB's investment portfolio will be managed to achieve safety of capital, achieve market rates of return, and provide sufficient liquidity to meet disbursement schedules. (FP 3.3)

12. Financial Entity Policy - EWEB will account for separate financial entities and will clearly define relationships among those entities to facilitate management decision-making. (FP 4.1)

13. Capitalization Policy - Major utility expenditures for labor, materials and/or services that result in revenue or benefit in future reporting periods will be capitalized and allocated to match such future revenue or benefits through periodic amortization or depreciation. (FP 4.2)

Source: Board Approved 01/18/2000, Ratified 04/19/2005, Amended 07/19/2005

5.2 Appendix B: Board Policy SD8 Power Risk Management Policies

Policy Number: **SD8**
Policy Type: **Strategic Direction**
Policy Title: **Power Risk Management Policies**
Date Approved: **September 19, 2006**
Date Revised: **October 2, 2012**

1. Formation of Risk Management Committee

A Risk Management Committee (RMC) will be established to provide oversight control and guidance to the power trading and contracting operation.

The RMC will be comprised of the General Manager, Assistant General Manager, Finance Manager, Power Resources & Strategic Planning Manager, Trading/Power Operations Manager, Fiscal Services Supervisor, and the Generation & Fleet Services Manager. As a practical matter, minor title and/or work scope changes affecting RMC members shall not require formal amendment to this policy.

This committee, which will meet as necessary, will be responsible to the Board of Commissioners for prudent implementation of these policies and oversight of the trading operation to ensure compliance with this policy and overall good industry practices. On at least an annual basis or as necessary, the Finance Manager will present a report to the Board covering the trading and contracting compliance with this policy and the financial results obtained. Detailed responsibilities of the RMC include:

- Oversee the approval of all wholesale power trading accounts and counterparties to insure creditworthiness.
- Establish and periodically review the exposure and trading limits for trading operations, which shall not exceed the overall trading limits established by this Policy Statement.
- Authorize physical and financial wholesale power trading representatives to conduct trades and contracts pursuant to this policy.
- Review and approve retail contracts that are not subject to traditional retail tariffs.

2. Compliance with Anti-Speculation Statutes

EWEB must comply with ORS statutes stipulating the appropriate scope of investments for “surplus funds.” Accordingly, EWEB’s activities in the power markets must be associated with the provision of electricity to meet anticipated sales and generation forecasts. These criteria will be applied:

Real Time (a 24 hour day)

EWEB will manage its Real Time position so that its exposure to market prices for the balance of the day is no greater than 50 average megawatts surplus or deficit.

Short Term (balance of month and following month)

EWEB will manage its Short Term position so that its exposure to market prices for the balance of the month and the following month is no greater than 75 average megawatts surplus or deficit.

Mid Term (period beyond short term)

EWEB will manage its Mid-Term position so that firm power supplies are within 25 average megawatts of expected firm sales.

This criteria will be applied to Mid Term time periods beyond the short term:

- For each month within the current and next prompt quarter
- For each of the next three quarters
- For each year within the next three years

The Board may grant exception to this policy to deal with specific circumstances, such as long-term resource acquisitions.

3. Financial Exposure Limitation

In addition to the megawatt position limits set forth in the Compliance with Anti-Speculation Statutes policy above, EWEB will implement additional controls to further limit financial risk associated with its market positions. The function of these additional controls would be to ensure that EWEB's projected contribution margin, when combined with available reserves and borrowing authority, will provide funding capabilities to cover other budgeted/projected expenditures at the Electric Utility.

Real Time (a 24 hour day)

Because total volumes and resulting exposure is small, no financial exposure limits are required.

Short Term (balance of month and following month)

EWEB will manage its Short-Term position such that there is a 95% probability an adverse market price movement will result in no more than a $2 million risk exposure. The Board delegates the setting of methodologies for determining financial risk to be used to the Risk Management Committee.

All Traded Periods

At least on a monthly basis, Fiscal Services with the assistance of Power Operations and General Accounting, will monitor the contribution margin and resulting impact on reserves and available borrowing authority for each month over the succeeding 18 to 36 months. In addition, a probability analysis will be conducted. The target is to have a contribution margin which when combined with available Power Reserve/Unallocated Power Fund and borrowing authority will meet or exceed the funding needs of the Electric Utility in each month with at least 90 percent probability and leave an appropriate safety margin. Currently, that safety margin is determined to be at least $20 million. Subject to annual review, the contribution margin is calculated by summing wholesale, retail and service revenue from the trading floor and subtracting purchased power, transmission and generation costs, as well as CILT expense. The RMC may establish tighter exposure limits to effectively manage the overall position.

4. Development of Detailed Control Procedures

Consistent with Committee of Chief Risk Officers Risk Policies, detailed control procedures will be developed by EWEB and approved by the RMC. These procedures will incorporate strong dual controls between those groups initiating trades and the risk management/accounting functions.

The Policy and Procedures Guide will further establish the roles and responsibilities of the Power trading, accounting, and Fiscal Services staff. The detailed policies and procedures will incorporate a credit approval and monitoring process to manage and measure credit exposure. The Policy and Procedures Guide, and its inherent controls will be approved by the RMC and reviewed on an ongoing basis.

5. Authorized Activities

The following types of price risk management instruments/transactions are authorized for trading activities:

- Physical delivery contracts with a term up to and including one year.
- Financial agreements with approved counterparties with a term up to and including one year.

The Policy and Procedures Guide as approved by the RMC will specify a process for determining the appropriate use of physical and financial hedge instruments. The Guide will also stipulate the types of swaps and options approved for use by the trading operation. The list of approved products and appropriate uses will likely change as the market changes and EWEB's trading operation gains experience with their use.

Source: Power Risk Management Policies and Procedures, Adopted 08/17/1999, Revised 03/05/2002, 9/19/2006, 10/2/12

5.3 Appendix C: Board Policy EL1 Financial Controls

Policy Number: **EL1**
Policy Type: **Executive Limitations**
Policy Title: **Financial Controls**
Date Approved **May 16, 2006**

Consistent with the Financial Policy on Budget (SD4), staff will bring a balanced budget to the Board for approval on an annual basis. In its totality, the annual budget is the absolute maximum level of expenditure authorized by the Board. In addition to the annual budget, staff will bring a Five-Year Capital Improvement Plan for each utility to the board for approval on an annual basis. Conditions may arise during any given budget year that cause projected expenditures for either utility as a whole to be higher than those approved by the Board in the annual budget. In the following circumstances executive management is required to propose a budget amendment:

1. The operating budget of either the Water or the Electric utility is projected to exceed the authorized budget amount.

2. The total EWEB labor and benefit expenditures are expected to be more than the budgeted labor and benefit costs.

3. The capital budget of either the Water or the Electric utility is projected to exceed the authorized budget amount; or

    a. Expenditures for a major capital project are projected to exceed or are actually expended in excess of the budgeted amount for that project by the lesser of 25%, or $250,000 for Electric or $125,000 for Water; or

    b. A project that is not in the approved Five-Year Capital Improvement Plan that is projected to cost in excess of $500,000 for Electric or $250,000 for Water in the current year.

    c. Budget amendments required under either “a” or “b” above will be accompanied by an updated view of the Five-Year Capital Improvement Plan, with the impact of the proposed amendment reflected in the plan. The update is for review purposes only; the Five-Year Capital Improvement Plan will only be approved once per year.

The Board will consider each proposed budget amendment and either approve or disapprove. In the event of disapproval, the General Manager will exercise established authorities in taking actions necessary to curtail spending within authorized levels.

All other budget variances will be managed at the discretion of the General Manager.

Note: Major Capital Budget Projects are defined as those projects in excess of $500,000 for the Electric Utility or $250,000 for the Water Utility. Lists of projects that meet these criteria are included in the budget document approved by the Board for both the Electric and Water Utilities.

Source: Jim Origliosso, Board Approved 2000, Ratified 04/19/2005, Amended 07/19/2005, Amended 01/17/2006, Amended 05/16/2006

5.4 Appendix D: Cash and Reserve Targets

5/22/2013

	Cash and Reserve Accounts	Electric Utility Target	Water Utility Target
1)	Working Cash	$24,000,000	$3,400,000
2)	Power Reserve	13,200,000	
3)	Operating Reserve	1,000,000	1,000,000
4)	Self-Insurance Reserve	1,720,000	280,000
5)	Capital Improvement Reserve	18,000,000	7,000,000
	Total	$57,920,000	$13,080,000

1) Working Cash – amount of cash needed to pay for ongoing operational costs during the year.

2) Power Reserve – amount of reserves to offset fluctuations in hydroelectric generation, market prices, load and budgeted draw on reserves.

3) Operating Reserve – reserve for emergency operating costs.

4) Self-Insurance Reserve – reserve to pay for claims incurred during the year and target is based on the $2 million self-insurance coverage limit.

5) Capital Improvement Reserve – reserve for capital improvements and target is based on one year's depreciation.