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EUGENE WATER & ELECTRIC BOARD

Rely on us.

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

FROM: Sue Fahey, Finance Manager; Anna Wade, Senior Financial Analyst

DATE: April 13, 2016

SUBJECT: Clearing Update

OBJECTIVE: Information Only

During a recent one on one discussion between Commissioner Mital and Interim General Manager Dave Churchman, a question arose around EWEB's efforts related to financial trading and clearing. Mr. Churchman was not sure of the specific details so he asked Ms. Fahey if she could provide an update, which was subsequently forwarded to Commissioner Mital. Commissioner Mital requested that Management share this update with all Commissioners as well in the event that you were also curious and to promote transparency. The following summary of actions to date and expectation for future potential are offered in response.

Management has long held an interest in clearing activities for both the operational liquidity and risk mitigation that could be achieved by executing transactions through a Forward Contract Merchant (FCM). Interest in this service intensified during the 2008 financial crisis as bilateral trade parties exited the market or came under financial distress and failed to meet EWEB's credit standards.

Based upon ongoing dialogue with industry partners, few entities of EWEB's size and charter have experience with clearing. At the potential for a market shift by the significant federal encouragement (and potential mandate) introduced in Dodd-Frank legislation and further evidenced by successful contract negotiation between BPA and an FCM service provider, EWEB staff issued a Request for Proposals (RFP) for clearing services on March 9, 2012. Three responses were received, with Jefferies Bache unanimously selected as the most responsive proposer. In fact, Jefferies was perceived by several selection committee members as the only qualified submission. Unfortunately, the negotiation process that followed was an extremely protracted process. Both EWEB and Jefferies were unaccustomed to the legal requirements and limitations of one another.

To further complicate matters, Jefferies experienced a series of corporate mergers and asset sales throughout the process. Not long before the RFP posted, Prudential Bache had been acquired by Jefferies Group. As the parties continued forward, Jefferies Group announced an all stock merger between Leucadia National Corporation, with Jefferies continuing to operate as a wholly-owned holding company of Leucadia. Contract standards, corporate flexibility and staffing were all in flux as the parties navigated the myriad contracts required to establish EWEB's account.

The parties successfully executed a Futures Account Agreement in August of 2014. In the months that followed, staff turned to the development of internal processes and controls, establishment of

accounts, as well as Board allocation of reserves.
Meanwhile, in early 2015, Societe Generale SA, France's second largest bank, agreed to take over most of Jefferies Bache clients. Jefferies was closing down the rest of the business that would not be taken over by Societe Generale. EWEB was notified that it was unlikely the bank would have interest in an account of EWEB's size.

Staff continue to monitor the potential for clearing or any other opportunities that would enhance the products and strategies currently employed in the prudent management of EWEB's portfolio. At this time, cost effective access to clearing services appear limited. Recently, in an "*Update and Overview of U.S. and Canadian Derivatives Reform*", Alexander Holtan of Sutherland Asbill & Brennan opined that central clearing has not proved to be a regulatory panacea for energy derivatives as intended. In fact, the number of FCMs has declined dramatically. The prolonged down turn in commodity prices has thinned margins, while regulatory oversight by the Commodity Futures Trading Commission has increased costs. For the remaining FCM providers, customer selectivity has increased and anecdotal evidence suggests that longer term liquidity is reduced even in clearing house trading.

Power risk staff continues to work diligently to develop and maintain a strong counterparty approval list for forward trading. Recent hedging activity has benefited from improved counterparty liquidity and greatly reduced the urgency for alternative trade execution venues at this time. That said, the market access EWEB currently enjoys could change under a variety of circumstances. The experience and knowledge gained throughout the contracting process with Jefferies, will better position management to react and respond more quickly to market illiquidity in the future.