VALLEY CLEAN ENERGY ALLIANCE

Staff Report – Item 22

TO: Valley Clean Energy Alliance Board of Directors

FROM: Mitch Sears, Interim General Manager
Gary Lawson, Sacramento Municipal Utility District (SMUD)

SUBJECT: Amendment #1 to the VCE Wholesale Energy risk Management Policy

DATE: June 17, 2019

RECOMMENDATION

Recommend that the VCE Board of Directors adopt the resolution approving Amendment #1 to the VCE Wholesale Energy risk Management Policy which Amendment is shown in Attachment 1.

BACKGROUND

On December 14, 2017, the Board adopted the current VCE Wholesale Energy Risk Management Policy ("Policy"). Up to this point, the guidelines and limits in this Policy have served VCE well. This includes the credit limit for any power supplier of $1.5 million as detailed in Section 6.1 of the Policy. The purpose of this provision is to limit the exposure of VCE to a concentration of power procurements with any one supplier. The way the exposure is determined is to calculate Counter Party Credit Exposure. Should Credit Exposure to any counter party increase to a level greater than the $1.5 million limit, no more power transactions would be entered into with that counter party.

COUNTER PARTY CREDIT EXPOSURE

The way that the counterparty credit exposure is calculated, is to ask and answer the question, "What would VCE have to pay for a replacement power contract, should a counter party fail to deliver under a contract?" The basic formula for counter party credit exposure is:

Counter Party Credit Exposure = Cost of Possible Replacement Power Contract
- Total Existing Contract Value

This can be calculated simply by taking the contract volume and multiplying that by the difference between the current market price, and the contract price, as shown in the following formula:

Counter Party Credit Exposure = Contract Volume x (Current Market Price – Contract Price)

To explain, we provide an example energy transaction with Counter Party "A" the details of which are shown below in Table 1.

Table 1. Counter Party "A" Transaction Details

Contract Volume, MWhs	200,000
Delivery Term	2020
Contract Price, $/MWh	$22.50
Contract Execution Date	6/1/19
Total Contract Value, $	$4,500,000
Market Price at time of Contract, $/MWh	$22.50
Market Price on 12/1/2019, $/MWh	$31.60

Table 2 below shows the credit exposure calculation made at the time the contract was signed (6/1/2019), and then 6 months later, on 12/1/2019, after the market price had increased.

Table 2. Counter Party "A" Credit Exposure Calculations

Time of Calculation	*Volume*	*Market Price*	*Contract Price*	*Exposure*
At Time of Contract	200,000	$22.50	$22.50	$0
12/1/2019	200,000	$31.60	$22.50	$1,820,000

In this example, under the Credit Policy SMUD would not enter into any new contracts with Counter Party "A" because credit exposure has risen to levels greater than the $1.5 Million limit. In general, this is a good thing, to spread credit risk over many counter parties.

DISCUSSION

The problem created by the current credit exposure limit of $1.5 million relates to purchases of Resource Adequacy ("RA") capacity. The supply of RA capacity itself is tight, there are a limited number of counter parties in the RA market, and the single largest RA supplier to the power market in northern California is Pacific Gas & Electric.

The existing credit exposure limit could hinder VCE's ability to procure the required Resource Adequacy.

The proposed Amendment #1 targets only VCE purchases of RA by eliminating the credit exposure limit of $1.5 million just for RA. No other power product is impacted by the change.

ENTERPRISE RISK OVERSIGHT COMMITTEE REVIEW

Staff reviewed the recommendation with VCE's Enterprise Risk Oversight Committee on May 24, 2019 which approved sending staff's recommendation to the Board for approval.

CONCLUSION

Staff makes the proposed specific recommendations in the aforementioned resolution.

Attachment

1. Proposed Edits for Amendment #1 of the VCE Wholesale Energy Risk Management Policy

Attachment 1

Proposed Edits for Amendment #1 of the VCE Wholesale Energy Risk Management Policy

6 Credit Policy

During startup of VCEA's Program, most transactions will be executed by the WESP utilizing WESP's enabling agreements, and with this activity VCEA is exposed to pass-through credit risk. As VCEA builds its own counterparty master trading agreements, transactions executed directly by VCEA agreements will carry direct credit risk. For activity on the WESP and/or VCEA agreements, VCEA will scale its credit limits to WESP's credit limits based on VCEA's risk tolerance. For VCEA counterparties, where an agreement exists between VCEA and a VCEA counterparty, the WESP will recommend limits within VCEA's risk tolerances, subject to EROC approval.

All procurement activities executed by the WESP on behalf of VCEA, using WESP's counterparty agreements, will be subject to the credit policies and procedures outlined in the WESP's Energy Risk Management Policy. The WESP's credit policy requires the WESP's Credit Manager, on an ongoing basis, to monitor all counterparties for creditworthiness. Additionally, counterparties shall be reviewed if a change has occurred in credit ratings, market conditions, or financial condition.

This evaluation, including any recommended increase or decrease to a credit limit, shall be documented in writing and include all information supporting such evaluation in a credit file for the counterparty. A credit limit for a counterparty will based on 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. Third party credit analysis, trade, 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 the WESP's Energy Risk Management Policy.

6.1 Credit Limit and Monitoring

In executing transactions on VCEA's behalf, the WESP will observe a pass-through counterparty credit maximum limit equal to $1.5 million, with an exception for Resource Adequacy capacity purchase/buy transactions, which will not be included in this credit limit.

The WESP Credit Manager will continuously monitor the current credit exposure for each counterparty with whom the WESP transacts on behalf of VCEA and include such exposure in the current counterparty Credit Exposure Report. This report will be made available, reviewed and communicated to the EROC pursuant to the reporting requirements outlined in Section 7.

VALLEY CLEAN ENERGY ALLIANCE

RESOLUTION NO. 2019- _______

A RESOLUTION OF THE VALLEY CLEAN ENERGY ALLIANCE APPROVING AMENDMENT #1 TO THE VALLEY CLEAN ENERGY WHOLESALE ENERGY RISK MANGEMENT POLICY

WHEREAS, the Valley Clean Energy Alliance ("VCEA") is a joint powers agency established under the Joint Exercise of Powers Act of the State of California (Government Code Section 6500 et seq.) ("Act"), and pursuant to a Joint Exercise of Powers Agreement Relating to and Creating the Valley Clean Energy Alliance between the County of Yolo ("County"), the City of Davis ("Davis"), and the City of Woodland ("City") (the "JPA Agreement"), to collectively study, promote, develop, conduct, operate, and manage energy programs; and

WHEREAS, managing energy commodity risks is a critical function that will allow VCEA to carry out its Mission;

WHEREAS, VCEA will benefit from a Wholesale Energy Risk Management Policy that establishes a risk management program, identifies specific risk management functions and procedures to manage energy commodity risks, and establishes clear risk management standards to guide Energy procurement decisions; and,

WHEREAS, on December 14, 2017, the Board of Directors adopted a Wholesale Energy Risk Management Policy.

NOW, THEREFORE, the Board of Directors of the Valley Clean Energy Alliance hereby adopts

1. Amendment #1 to the VCE Wholesale Energy Risk Management Policy (Attachment 1), said Amendment in Section 6.1 Credit Limit and Monitoring, page 15, targets only VCE purchases of Resource Adequacy by eliminating the credit exposure limit for Resource Adequacy only.

ADOPTED, this ____________ day of ______________, 2019, by the following vote:

AYES:
NOES:
ABSENT:
ABSTAIN:

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Tom Stallard, VCEA Chair

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Alisa M. Lembke, VCEA Secretary

Exhibit A: Amendment #1 of the VCE Wholesale Energy Risk Management Policy, Section 6.1 Credit Limit and Monitoring, page 15 only

EXHIBIT A

Amendment #1 of the VCE Wholesale Energy Risk Management Policy