



## **Energy Risk Management Policy**

### **Version 2.0**

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## **1. Philosophy, Objectives and Scope**

This Energy Risk Management Policy (ERMP) outlines the philosophies and objectives of Ava Community Energy (Ava) Board of Directors (Board). The Energy Risk Management Regulations (ERMR) also adopted by Ava expand on the roles, strategies, controls and authorities authorized in this policy to form a comprehensive energy risk management program. The ERMR shall be read in conjunction with this ERMP.

### **1.1. Risk Philosophy**

The overall goal of this ERMP is to:

- Serve the participating jurisdictions' needs subject to Board approved risk tolerance limits;
- Provide as much energy supply (generation and capacity) cost certainty for Ava's customers as possible while maintaining a least cost supply portfolio; and
- Enhance the value of Ava's assets to meet the financial goals and requirements of the participating jurisdictions.

As a joint powers authority, Ava is in the business of generation, transmission and procurement of energy for the benefit of its participating jurisdictions. Ava's objective is to develop the least cost supply portfolio to meet load requirements of its customers, while maximizing revenues from sales of surplus energy, capacity and other wholesale energy and transmission services (e.g. resource optimization). However, unlike a private-sector entity, Ava's primary purpose in the power supply business is to serve its customers. Ava's goal is to be a cost hedger for its participating jurisdictions' load and, therefore, is precluded by this policy from engaging in speculative activities typical to many organizations orientated toward profit maximization.

Ava management recognizes that certain risks are incidental to normal power supply operations and hedging activities. Ava's goal is to avoid unnecessary risk and to limit, to the extent practicable, any risks associated with normal cost-hedging activities. This document serves as a vehicle to describe and define the limits for activities considered as appropriate for Ava in a normal course of business.

### **1.2. Business Activities**

A primary part of Ava's main business is to procure or produce power supplies, capacity, and reserves to meet its customer load requirements. The resource (capacity/energy) supply portfolio may consist of physical assets, such as power plants and distributed energy resources, fixed and variable priced supply contracts of varying lengths, and agreements for other related supplies and services needed to ensure reliable delivery of electricity to Ava's customers.

### **1.3. Transacting Objectives**

Ava's overall transacting objective is to meet the load requirements of its customers with an optimized resource supply portfolio. Ava's objectives when transacting on behalf of its

customers for the procurement of energy and energy related supplies and services are as follows:

- Meet customer load requirements including energy, capacity and reserves;
- Provide stable rates for the participating jurisdictions;
- Obtain the best available price for power supply while complying with the requirements of this policy and other objectives established by the Board (e.g. renewable energy policy goals);
- Manage Ava's assets to optimize value;
- Act to limit exposure to extreme market system changes;
- Follow effective wholesale counterparty credit management procedures; and
- Develop and maintain Ava's investment grade credit rating.

#### **1.4. Scope of Policy**

This ERMP addresses risks arising from Ava's participation in the wholesale energy markets and applies to all energy and energy related transactions made by Ava. This ERMP does not address the following types of general property and casualty business risk: fire, accident and casualty; health, safety, and workers' compensation; general liability; and other such typically insurable perils. The term "risk management," as used herein, is therefore understood to refer solely to risks related to participation in wholesale energy markets as herein defined.

Ava is exposed to three quantifiable risks: load and resource variability (volumetric), cost variability (price), and counterparty credit risk. From the perspective of risk mitigation, Ava's primary objective is to cover load and optimize the value of assets. Taking risks in order to arbitrage market opportunities, or risks unrelated to Ava's normal power supply business activities, is not permitted.

Ava is also exposed to regulatory and operational risks. However, these exposures are not quantifiable as they affect structural change. As a result, these risk categories are managed as separate enterprise risk exposures and are not directly governed by this ERMP.

This ERMP prescribes the management organization, authority and processes to monitor, measure and control the risks to which Ava is exposed in the normal course of business. Specific methodologies used to measure, monitor and control these risks shall be established by the Chief Executive Officer's Risk Oversight Committee (ROC), in accordance with sound utility practices and included in the ERMR.

#### **1.5. Applicability**

This ERMP is effective immediately upon its adoption by the Board. It applies to Ava's wholesale supply operations, long-term contracting for energy/capacity and services, acquisition of generation resources, credit risk management and other related ancillary activities undertaken by Ava.

#### **1.6. Policy Review and Amendments**

Prudence is required in implementing any and all policies and procedures. Market and industry norms, technology and risk tolerances tend to change over time. Therefore, this policy should be reviewed as needed, in order to make adjustments in response to changes in business objectives and/or industry norms. Amendments to this ERMP shall be done only by approved Resolution of the Board.

## **2. Risk Strategy & Parameters**

An important aspect of implementing an overall energy risk management policy is the development of related strategies to mitigate all of the related risks associated with energy transacting activities. The key strategies of Ava are outlined below.

### **2.1. Counterparty Risk Management**

Counterparty risk is defined as the exposure to economic loss resulting from default by a party to a contract (e.g., a *counterparty*). Counterparty risk affects both contracts requiring physical settlement and those specifying monetary settlement. For all fixed price energy transactions, the counterparty must possess at least a BBB- (or equivalent investment grade rating) by a nationally recognized statistical rating organization (NRSRO). Ava staff may consider counterparties with a rating below investment grade, or a counterparty without a NRSRO rating on a case-by-case basis, with the approval of the ROC.

Effective wholesale counterparty management and credit analysis is essential to mitigate the counterparty risks associated with commodity transactions in the energy markets. The objective is to preserve Ava's capital, liquidity, and supply reliability by limiting counterparty credit risk and supplier concentration to acceptable levels. Methodologies to achieve this objective are set forth in the ERMR.

### **2.2. Balanced Load**

Ava shall maintain an integrated and balanced portfolio of resources to cover its customer load within a dual volume and cost-at-risk framework.

### **2.3. Minimum Coverage Requirements**

Ava shall establish minimum coverage requirements, combined with defined cost-at-risk metrics, for capacity and energy as determined by the ROC and outlined in the ERMR.

### **2.4. Diversification of Portfolio**

Ava shall strive to develop a resource portfolio that includes diversification in fuel type, contract duration, geographic location, counterparty, pricing terms, cash reserves and types of products.

### **2.5. Purchase to Cover Load Serving Obligations - No Speculation**

As discussed in Section 1.3, Ava's overall objective for energy procurement activities is to cover

the load serving obligations of its customers. In the course of performing these activities, Ava shall not engage in activities that expose its participating jurisdictions to speculative transactional risks and shall only utilize approved transaction parameters as determined by the ROC and outlined in the ERMR.

## **2.6. Use of Derivatives and Financial Transactions**

Use of financial derivatives or transactions (as opposed to physical or “embedded” options) is allowed in limited circumstances by Ava. These include transactions used to set price caps and floors, or hedge against load/price volatility. Examples include:

- Exchange traded Puts and Calls;
- Electric Futures;
- Electric Options; and
- Weather Derivatives.

Use of certain types of financial derivatives is necessary in order to mitigate various risks outlined in this policy while optimizing the resource portfolio. Such types of allowable financial derivatives or transactions (but not individual transactions) must be approved by the ROC as outlined in the ERMR as developed by the ROC in accordance with this policy.

## **3. Risk Controls**

### **3.1. Control Principles**

Ava will strive to conduct its energy risk management activities in accordance with best practices of the energy industry, but implementing such practices must be cost justified and balanced between costs and benefits. Processes and control systems must be in place that allow Ava to identify, measure, monitor, control and track its risk exposures. These processes and control systems shall include the following risk management control principles:

- Appropriate segregation of duties and internal controls will be used;
- Appropriate systems to ensure accurate and effective management reporting;
- Necessary resources in place to achieve management objectives;
- Attract and retain skilled and trained personnel;
- Cross-train and provide cross coverage;
- Employees conducting energy transactions are free of conflicts of interest;
- Authority and approval delegation is commensurate with accountability and capability;
- Performance measurement and reporting incorporate risk and return measures; and
- Ongoing monitoring of control effectiveness.

### **3.2. Internal Controls**

Internal controls shall be based on proven principles that meet the stringent requirements of generally accepted auditing standards (GAAS), financial institutions and credit rating agencies. The required controls shall include all customary and usual business practices designed to 1) prevent errors and improprieties, 2) ensure accurate and timely reporting of results of operations and other information pertinent to management, and 3) facilitate attainment of business objectives.

### **3.3. Segregation of Duties**

Responsibilities related to energy transacting shall be segregated in a manner consistent with the control principles listed above by means of clearly defined roles and responsibilities for the Front Office, Middle Office and Back Office operations. Such roles and responsibilities can also be provided by a qualified third-party services provider. Specific roles, responsibilities and organizational structure of these functions are outlined in Section 4 of the ERMP.

These controls shall be fully integrated into all business activities of Ava, and there shall be active participation by senior management in risk management processes.

### **3.4. Conflicts of Interest**

All Ava employees who are engaged in energy supply resource transactions, counterparty credit evaluation, or oversight of the foregoing and are employed in any job classification listed in the Ava Conflict of Interest Code are required to complete annual conflict of interest filings on FPPC Form 700 and disclose investments as required by that code.

In addition to the foregoing disclosure requirement, Ava employees engaged in energy supply resource transactions, counterparty credit evaluation or oversight of the foregoing, are barred from investing in any company with whom Ava has consummated energy or related purchases or sales within the last two years.

Such employees must divest existing direct holdings in energy counterparties prior to engaging in any negotiating, evaluating, transacting or oversight functions. The ban on investment and requirement for divestment applies regardless of whether or not the investment would be of sufficient size (\$2,000) to require disclosure on FPPC Form 700.

Ava employees supervising staff who are subject to this policy are responsible for routinely reviewing Form 700 of each such staff member for the purpose of identifying potential financial conflicts of interest. General Counsel will assist in reviewing these forms and providing legal advice in connection with such reviews upon request.

## **4. Roles, Responsibilities, & Organization**

This section of the ERMP defines the overall roles and responsibilities for implementation of this ERMP. The coordinated efforts of personnel across several divisions are required to successfully

implement Ava's risk management program. Section 4 of the ERMP outlines the basic roles and responsibilities of each organizational function. Specific details and the specific roles and responsibilities of the oversight and operational divisions within the energy risk management program structure at Ava are outlined in the ERMR, as developed by the ROC and revised from time to time.

#### **4.1. Ava Board of Directors**

The Board has the ultimate oversight over Ava operations and is responsible for establishing an organizational-wide framework for risk management and ensuring that risk management results are achieved as planned. The Board shall approve and establish organizational policies for risk management and delegate to the Chief Executive Officer the responsibility for implementing the ERMP. With responsibility for the ultimate oversight over Ava operations, the Board shall be responsible to ensure the risk management results are achieved in accordance with the ERMP.

#### **4.2. Chief Executive Officer**

The Chief Executive Officer has overall responsibility for implementing the ERMP and for communicating risk management issues to the Board. The Chief Executive Officer shall be responsible for delegating specific duties for carrying out the policy and insuring compliance with it by all affected Ava employees or contractors. The Board acknowledges that the Chief Executive Officer shall establish the ROC as a member/staff function and may delegate certain functions to the ROC, which delegation is ratified by this ERMP.

#### **4.3. Risk Oversight Committee**

The Risk Oversight Committee (ROC) is responsible for overseeing compliance with risk management policies within Ava. The ROC serves as the highest level of organizational risk management reporting to the Chief Executive Officer. The ROC shall consist of at least five (5) members including Ava Management, participating jurisdictional representatives and Ava's legal counsel, as designated by the Chief Executive Officer from time to time. A quorum for the ROC to do business shall be a simple majority of Committee members or their designees.

The participating jurisdictions may nominate potential ROC members. The Chief Executive Officer shall select ROC representatives in his or her sole discretion. Each ROC member shall have one vote, and may appoint a voting alternate with the approval of the Chief Executive Officer. The ROC will meet at least quarterly, to act on the responsibilities mentioned above. The ROC shall have the responsibility for monitoring that business is conducted in accordance with the ERMP and advising the CEO. The ROC shall adopt and keep current "Energy Risk Management Regulations," which shall define in detail the internal controls, strategies and processes for managing risks covered under the ERMP. Specific ROC responsibilities are outlined in detail in the ERMR.

#### **4.4. Front Office (Planning and Procurement)**

The Front Office is responsible for resource planning and procuring resources to meet the

physical, financial and contractual requirements of Ava, with load/resource balancing provisions and such other arrangements as may be approved by the Board in the future. The function includes contract administration, managing the risk assumptions for electricity transactions, including physical and financial needs analyses, energy purchases and sales, procurements of capacity, ancillary services and coordinating energy delivery scheduling. The Front Office is responsible to ensure that the procedures and processes needed to transact business within the ERMP are in place and they perform all duties related to actual transacting in the wholesale energy markets. The Front Office is the primary interface with potential wholesale transacting counterparties. The Chief Executive Officer and Head of Power Resources are responsible for managing the Front Office and can be supported by qualified third party suppliers. Front Office activities and detailed responsibilities are outlined in the ERMR.

#### **4.5. Middle Office Controls and Reporting**

The duties of the Middle Office will be conducted by the Finance Department, and/or are supported by a qualified third-party supplier. Its primary purpose is to manage risk oversight and controls. The Middle Office provides independent oversight of the risks assumed by the Front Office in the course of transacting energy products and services. The Middle Office must be independent from the Front Office functions. The Head of Finance is responsible for managing the Middle Office. Detailed responsibilities of the Middle Office are described in the ERMR.

#### **4.6. Back Office (Settlements and Recording)**

The Back Office is primarily responsible for settlement of bills, recording transactions, bookkeeping and accounting, and contract compliance. It is responsible for providing assurance of accurate transaction records and settlements. Back Office functions are conducted by personnel in the Finance Department, and/or are supported by a qualified third-party supplier. Detailed responsibilities of the Back Office are described in the ERMR.

#### **4.7. Auxiliary Functions**

Additional issues impacting the overall power supply and risk management program include establishment of financial reserve requirements, which are generated by auxiliary support functions in the Finance Department.

The Finance Department is responsible for preparation of the budget and the calculation of rates used to bill customers for their related power supply usage. In addition, the Finance Department is responsible for establishment of necessary reserve levels for the various projects owned by Ava, if any, and for the Ava in general. The Finance Department is also responsible for establishment of reserves necessary for credit risks related to counterparty credit as mentioned in the ERMP, but as more clearly defined in the ERMR.

#### **4.8. Authorities, Delegations, Limits and Prohibitions**

All executed transactions shall conform to the policies set forth herein. It shall be the responsibility of the ROC, with approval of the Chief Executive Officer, to establish appropriate

individual transacting authority limits for the various personnel involved in the Front Office function. All staff with designated responsibility for Middle Office or Back Office functions are strictly prohibited from executing any wholesale transactions. The Middle Office shall be responsible for informing counterparties of such approved authorizations, including transacting authority and restrictions, along with product types and/or term and dollar limits.

## **5. Policy Compliance**

### **5.1. Compliance Exceptions**

Compliance exceptions are actions which violate the authority limits or directives set forth herein or in the ERMR as developed and adopted pursuant hereto by the ROC.

### **5.2. Reporting of Exceptions**

The Chief Executive Officer shall notify the ROC of exceptions to mandated policies, procedures and regulations within 48 hours after they are identified, and ensure Front Office prepare a full report for review and discussion at the next ROC meeting.

### **5.3. Audit**

Compliance with this ERMP and with the specific ERMR requirements instituted pursuant to this ERMP, shall be subject to examination by Ava's independent auditors or by such other reviewers that Ava or ROC may appoint to evaluate the effectiveness of mandated controls.

### **5.4. Reserves**

The ROC and the Chief Executive Officer, or his/her designee, are responsible for ensuring adequate reserves for energy price exposure and credit losses are maintained by Ava. The reserve estimate methodology, as established by the Finance Department, shall be reviewed and approved as needed to ensure appropriate reserve levels are maintained and funded.

### **5.5. Systems, Tools and Training**

Ava employees who are authorized to perform energy risk management functions on behalf of Ava shall be provided with the necessary systems and tools to support all risk management processes.

Provision shall be made in the budgets submitted for each division which performs market risk management functions on behalf of Ava for the acquisition and maintenance of computer systems, software, communications equipment, data services and other analytical, measurement and reporting tools.

Provision shall also be made in the budgets submitted for each Ava division/department which performs market risk management functions on behalf of Ava for managers and staff to attend seminars and courses in risk management on a regular basis.