

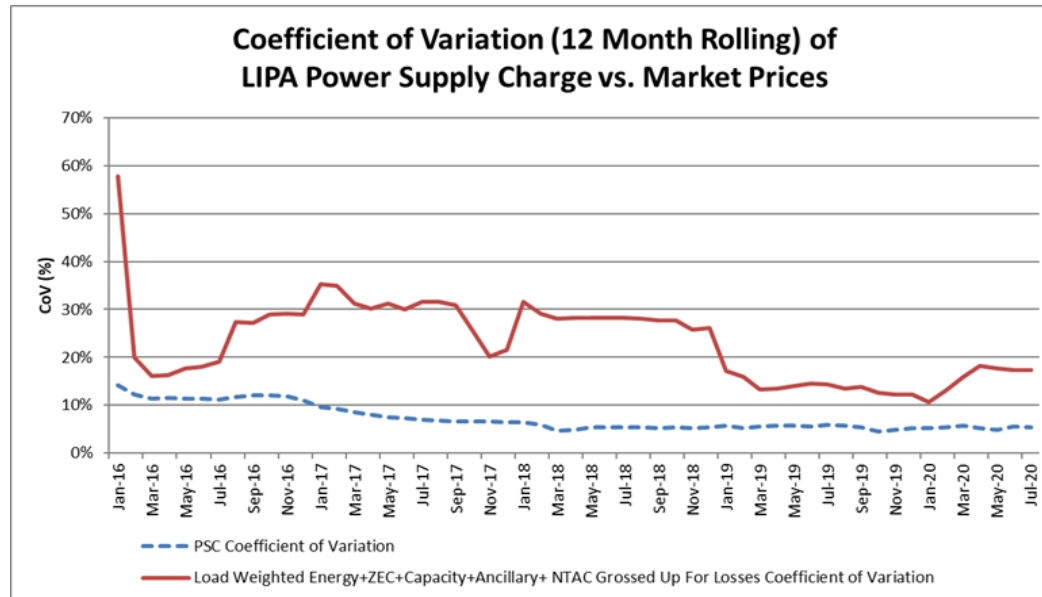


# POWER SUPPLY HEDGING PROGRAM POLICY ANNUAL COMPLIANCE REPORT

September 23, 2020

# MEETING THE BOARD POLICY OBJECTIVE

**Objective:** Mitigate a portion of Power Supply Charge (PSC) volatility



✓ Hedging activity has resulted in PSC volatility through July 2020 at 5.32%, while wholesale spot market is more than 3x that at 17.28%

## Governance of the Power Supply Hedging Program

### *Power Supply Risk Management Committee (PRMC)*

#### *Must have at least 3 members, 2 from Senior Staff*

- ✓ 9 LIPA Staff sit on the PRMC, chaired by CFO and is comprised of 5 Senior Staff
- ✓ PRMC meets monthly with PSEG ER&T to discuss:
  - Hedge position; market changes; counter party credit health, compliance to LIPA Hedge Plan, and quarterly benchmarking
  - Maintain Procedures Manual and LIPA Hedge Plan

## Transparency of the Power Supply Hedging Program

- ✓ PSEG ER&T provides PRMC daily, weekly and monthly hedging activity reports

# KEY PROVISIONS OF THE POLICY

## Maximum net hedge level 90% of projected fuel and power needs

- ✓ Current yearly and individual monthly hedge levels are below 90%

	Bal. Cal '20	Cal '21	Cal '22	Cal '23
Hedge Level	77%	73%	61%	49%

## Maximum hedge term 72 months

- ✓ PRMC approved hedge term horizon in LIPA Hedge Plan currently extends out 40 months to December 2023; in January 2021 hedges will extend out 47 months

## All hedges are for the purpose of appropriate risk mitigation

- ✓ Transactions are based on time or value triggers not market speculation

## Counterparty Credit Review

- ✓ PSEG Credit Management reports credit exposure weekly and monthly and performs a LIPA counterparty credit health review

# Questions?

**BOARD AGENDA SUMMARY SHEET**

<b>Committee or Board:</b> Board	<b>Date:</b> September 11, 2020	<b>Board Meeting Date:</b> September 23, 2020
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**For All Board Voting Items:**

**Title of Agenda Item:** Approval of the Annual Report on the Board Policy on the Power Supply Hedging Program

**Consent Agenda:**  Yes  No

**Accompanying Presentation:**  Yes  No

**Recommendation from Committee:**  N/A  F&A;  GP&P;  Oversight & Clean Energy

**LIPA Presenter:** Corey Horowitz

**PSEG Long Island Presenter:** N/A

**Enterprise Risk Management Discussion:**  Yes  No

**For Policy Reports Only:**

**Type of Policy / Report:**  Operating;  Governance;  Compliance;  Mission

**Date of Last Report:** September 25, 2019

**Compliance Since Last Report:**  Yes  No

**Proposed Changes to Policy:**  Yes  No

<b>Requested Action:</b>	The Board is requested to adopt a resolution: (i) approving the annual report on the Policy; and (ii) finding that LIPA has complied with the Policy.
<b>Summary: (include proposed amendments to Board Policies, if applicable)</b>	<p>By Resolution No.1352, dated March 29, 2017, the Board adopted the Policy to maintain an effective commodity hedging program (“Program”), focused on meeting the expectations of LIPA’s customers for reasonable stability and predictability in power supply costs. The Policy was last reviewed and amended by Resolution No. 1493, dated September 25, 2019.</p> <p>The F&amp;A Committee, in its Charter, was delegated the responsibility of reviewing LIPA’s practices relating to commodity risk management. The F&amp;A Committee considers as part of its review whether LIPA and its Service Provider PSEG ER&amp;T has remained in compliance with the Policy. Certain responsibilities, as set forth in the Policy, were delegated by the Board to the Chief Executive Officer including maintaining a Power Supply Risk Management Committee to oversee the activities of PSEG ER&amp;T.</p> <p>Staff recommends that, for the reasons set for in the accompanying memorandum, the Board find that LIPA has complied with the objectives of the Policy for the period since the last annual review.</p>

**FOR CONSIDERATION**

September 23, 2020

**TO:** The Board of Trustees

**FROM:** Thomas Falcone

**SUBJECT:** Approval of the Annual Report on the Board’s Policy on the Power Supply Hedging Program

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**Requested Action**

The Board of Trustees (the “Board”) of the Long Island Power Authority (“LIPA”) is requested to adopt a resolution: (i) approving the annual report on the Board Policy on the Power Supply Hedging Program (the “Policy”) for the period since the last annual review; and (ii) finding that LIPA has complied with the Policy, which resolution is attached hereto as **Exhibit “A”**.

**Background**

By Resolution No.1352, dated March 29, 2017, the Board adopted the Policy to maintain an effective commodity hedging program (“Program”), focused on meeting the expectations of LIPA’s customers for reasonable stability and predictability in power supply costs. The Policy was last reviewed and amended by Resolution No. 1493, dated September 25, 2019.

The Finance & Audit Committee (“F&A Committee”) of LIPA’s Board, in its Charter, was delegated the responsibility of reviewing LIPA’s practices relating to commodity risk management. The F&A Committee considers as part of its review whether LIPA and its Service Provider PSEG Energy Resources and Trade (“PSEG ER&T”) has remained in compliance with the Policy. Certain responsibilities, as set forth in the Policy, were delegated by the Board to the Chief Executive Officer including maintaining a Power Supply Risk Management Committee (“PRMC”) to oversee the activities of PSEG ER&T.

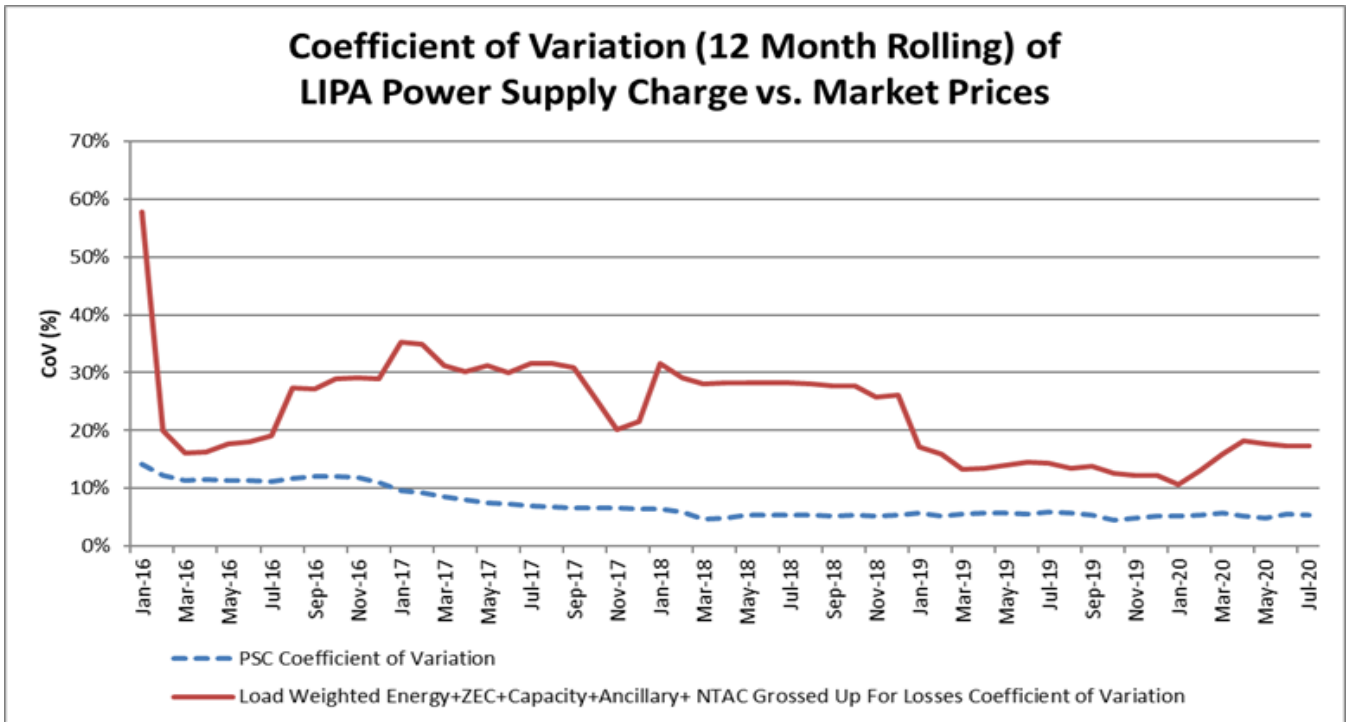
Specifically, the Policy provides that “the Chief Executive Officer, or his or her designee, will provide an annual compliance report on the Power Supply Hedging Program to the Finance and Audit Committee.”

**Compliance with the Policy**

Staff recommends that, for the reasons set for below, the Board find that LIPA has complied with the objectives of the Policy for the period since the last annual review.

The Policy is intended to “Mitigate a portion of the volatility of power supply costs in a programmatic and reasonable way on behalf of the LIPA’s customer-owners.”

- The PRMC approves the Program which identifies certain power supply cost components that can be fixed to create reasonable and stable rates. In general, hedging these cost components has proven to reduce the volatility of LIPA’s Power Supply Charge (“PSC”) for customers. As part of its biannual Program update, on June 24, 2020 PSEG ER&T presented to the F&A Committee a graph indicating the actual PSC volatility as compared to the volatility customers would be exposed to based upon unhedged market prices. The following graph reflects current data indicating the PSC volatility through July 2020 is 5.32% while market is more than three times that amount at 17.28%.



The Policy shall be “executed using financial derivative and physical supply and delivery contracts for a portion of LIPA’s projected fuel and purchased power purchases, provided, however that: the net hedge position does not exceed 90% of projected fuel and purchased power needs; and the term of any such hedge does not exceed ten years without the prior approval of the Board or a term in excess of seventy-two (72) months without the prior approval of the Finance and Audit Committee of the Board.”

- PSEG ER&T executes both financial and physical hedge transactions on LIPA’s behalf for defined volumes that as of January 1, 2021 would be within a 59-month hedge horizon. All transactions are monitored by PSEG Enterprise Risk Management Back-Office operations (“PSEG Back-Office”) for compliance; PSEG Back-Office generates and distributes hedge ratio position reports daily, weekly, and monthly to LIPA’s PRMC staff.
- Hedge transactions are triggered based on a time or value trigger protocol that has been established with an independent third-party hedge advisor. Time-trigger transactions allow for the accumulation of minimum required volume hedge levels over time. Value-triggered transactions allow for the accumulation of additional hedge levels based on lower decile



pricing levels versus four-year historical pricing. In addition, volumes associated with Purchase Power Agreements (“PPAs”) having fixed prices and LIPA’s 18% ownership of Nine Mile Point 2 are included as part of the hedged volume. Currently, the PRMC has set a maximum hedge level limit of 85%.

- No hedges exceed a term of seventy-two months and the net hedge position does not exceed 90% of projected fuel and purchased power needs, meeting the requirements of the Policy.

The Policy states that the Program shall “Achieve appropriate risk mitigation and is not for purposes of financial speculation.”

- All transactions are based on PRMC approved projected fuel and power requirements associated with LIPA’s annual sales forecast. Specific power supply component volumes are also validated against historical consumption data. Each hedge transaction is reviewed by PSEG Enterprise Risk Management’s Middle-Office group (“PSEG Middle-Office”) for compliance to PRMC approved Program and procedures.

The Policy states that the Program shall “Provide transparency regarding LIPA’s commodity risk management activities and the results of such activities.”

- PSEG ER&T, PSEG Back-Office and PSEG Middle-Office provide to the PRMC staff on a daily, weekly, and monthly basis a hedge transaction report, hedge position report, and position valuation report. In addition, the following table identifies several other required reports to the PRMC and to LIPA’s F&A Committee, their distribution and reporting frequency, and the originator of the reports.

<b>Report</b>	<b>Distribution</b>	<b>Normal Frequency</b>	<b>Originator</b>
Trading Activity Summary	PRMC Traders	Daily Weekly	Front Office Middle Office
Position Report	PRMC Traders	Weekly	Middle Office
Credit Risk Exposure Reports	PRMC Traders	Weekly	Middle Office
PRMC Meeting Minutes	PRMC	As Meetings are Held	PRMC Designated Secretary
Benchmarking	PRMC	Quarterly	Independent third-party hedge advisor
Power Supply Hedging Program	Board Finance & Audit Committee	Bi-annually	PSEG ER&T
Annual Compliance Report	Board Finance & Audit Committee	Annually	CEO or Designee

The Policy requires that “LIPA’s Chief Executive Officer shall appoint a [PRMC] consisting of at least three LIPA staff, two of which must be drawn from LIPA senior management. The PRMC will establish, maintain, and monitor processes and controls, the conduct of LIPA’s Power Supply Hedging Program, and the activities of its Service Provider, PSEG ER&T. The key provisions of the PRMC’s activities shall include”:

“Oversight and ensuring that all Program activities conducted by LIPA and PSEG ER&T are in accordance with the Board Policy”.

- All active participants of the Program are required to read and comply with the PRMC Approved Policies, Controls and Procedures Manual for Power Supply Hedging Program (“Manual”), which incorporates the Board Policy. All active participants are required to certify compliance with the Manual and Policy by executing the Yearly Certification of Compliance with Risk Management Policy and Procedures Form.

“Determining LIPA’s tolerance for exposure to fuel and purchased power price movements and power supply cost volatility considering the costs of limiting such exposure.”

- The PRMC has approved the Manual for the hedging Program that establishes LIPA’s tolerance for exposure to fuel and purchased power price movements. The PRMC has established minimum and maximum hedging limits by time-period as well as collateral posting limits.
- The cost of the Program is evaluated each day in the form of mark-to-market value of the positions and stress testing collateral exposure potential of all positions executed to limit PSC volatility.

“Addressing all risk factors that are demonstrably quantifiable, actionable and material to the Program.”

- The Manual specifically identifies authorized markets and delivery points, permissible hedge instruments and the terms and volumes available for hedging to reduce PSC volatility. It also addresses the PSC hedge components that are quantifiable, actionable, where sufficient market liquidity is available to hedge the required products and delivery points (i.e. natural gas, gas basis, power, power basis).

“Establishing risk boundaries consistent with such tolerances and evaluating allowable financial and physical instruments in executing the Program.”

- The Manual specifically identifies authorized markets, delivery points, permissible hedge instruments, terms and volumes associated with hedging to reduce PSC volatility. The Manual also addresses minimum and maximum hedge levels by time-period consistent with utility peers.

“Establishing appropriate processes and protocols to review and monitor counterparty credit worthiness on a regular basis.”

- The Manual identifies specific procedures carried out by PSEG Credit Risk Management on behalf of LIPA for managing and monitoring counterparty credit risk on an on-going basis. PSEG Credit Risk Management provides the PRMC with a credit report each week, as noted above.

“Monitoring Commodity Futures Trading Commission rule making and all other regulatory and legal requirements to ensure that LIPA is taking all actions required to maintain compliance with respect to any transactions under the Power Supply Hedging Program.”

- PSEG ER&T, PSEG Corporate Legal department and LIPA’s internal and outside counsel monitor Commodity Futures Trading Commission regulatory rulemaking to determine what actions, if any, LIPA is required to undertake to assure continued compliance.

### **Annual Review of the Policy**

The Policy was last amended by the Board pursuant to Resolution No. 1493, dated September 25, 2019, at which time the Policy was significantly updated. Staff has completed its annual review of the Policy and has no suggested amendments at this time.

### **Recommendation**

Based upon the foregoing, I recommend approval of the above requested action by adoption of a resolution in the form attached hereto.

### **Attachments**

**Exhibit “A”** Resolution

**RESOLUTION APPROVING THE ANNUAL REPORT ON THE BOARD POLICY ON  
THE POWER SUPPLY HEDGING PROGRAM**

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**WHEREAS**, the Board Policy on the Power Supply Hedging Program (the "Policy") was originally approved by the Board of Trustees by Resolution No.1352, dated March 29, 2017; and

**WHEREAS**, the Policy was last reviewed and amended by Resolution No. 1493, dated September 25, 2019; and

**WHEREAS**, the Finance and Audit Committee of the Board of Trustees has conducted an annual review of the Policy and has recommended that the Policy has been complied with.

**NOW, THEREFORE, BE IT RESOLVED**, that consistent with the accompanying memorandum, the Board hereby finds that LIPA has complied with the Policy for the period since the last annual review and approves the annual report to the Board.

Dated: September 23, 2020