



**RCA
CITY OF AUSTIN
RECOMMENDATION FOR COUNCIL ACTION**

**AGENDA ITEM NO.: 3
AGENDA DATE: Thu 06/10/2004
PAGE: 1 of 2**

SUBJECT: Authorize negotiation and execution of (1) brokerage agreements for Austin Energy's purchase or sale, for hedging purposes, of financial contracts traded on regulated commodity exchanges; and (2) ISDA (International Swaps and Derivatives Association, Inc.) master agreements for over-the-counter hedging transactions, along with related credit, security and insurance agreements with qualified brokerage firms, financial institutions, investment banks, and other appropriate counter-parties in the financial, energy and natural gas industries in an aggregate amount of expenditures not to exceed \$300,000,000, to implement a hedging program as authorized by the related Resolution and Policy for Energy Risk Management previously adopted by the City Council.

AMOUNT & SOURCE OF FUNDING: Funding for related expenses associated with the purchase and sale of financial hedging instruments for fuel and power under the Risk Management Program will be provided through the Electric Fuel Charge revenue.

FISCAL NOTE: There is no unanticipated fiscal impact. A fiscal note is not required.

REQUESTING Austin Energy
DEPARTMENT:

**DIRECTOR'S
AUTHORIZATION:** Juan Garza

FOR MORE INFORMATION CONTACT: Michael McCluskey, Sr. VP, Wholesale & Retail Markets/
322-6295

PRIOR COUNCIL ACTION: 5/22/03 - Resolution approving pilot hedging program and execution of hedging agreements, and Policy for Energy Risk Management.

BOARD AND COMMISSION ACTION: Recommended by the Electric Utility Commission.

PURCHASING: N/A

MBE / WBE: N/A

AE has conducted a pilot energy risk hedging program under the authorization provided by the Resolution and Policy for Energy Risk Management adopted by the City Council on May 22, 2003. AE recommends expansion and continuation of the program in order to fully implement Austin Energy's Policy for Energy Risk Management approved by Council on May 22, 2003. The expenditure authority sought under this request reflects a full-scale risk management program consistent with the Policy for Energy Risk Management. The costs of hedging transactions, including associated fees, gains and losses are applied to AE's recoverable fuel expense.

The pilot program utilized exchange-traded and over-the-counter financial instruments to hedge the risks of fluctuating prices for fuel and power. The pilot commenced in August 2003 and was limited to commitments up to \$25 million (approximately 15% of AE's fuel and purchase power requirements) for transactions up to 36 months into the future. The pilot program successfully demonstrated AE's ability to control the volatility of its energy costs using financial hedging instruments. During the pilot AE established and tested new processes and procedures as well as new brokerage and trading agreements. Over 500 financial contracts were successfully traded, settled and accounted for, reducing by 32% the



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volatility on almost a quarter of AE's natural gas requirements over the pilot period. An external review of the program conducted by Risk Management Incorporated (RMI), a nationally recognized energy risk management consulting firm, found AE's energy risk program to be in line with industry best practices. The review noted AE's solid system of checks and balances, sound segregation of duties and strict compliance monitoring; and good initial objectives for the purposes of a pilot program. RMI's recommendations centered on enhancements to support and operate an expanded risk program.

This resolution increases the expenditure authority for hedging transaction to \$300 million allowing AE to protect a larger portion of its portfolio over a rolling 60-month time horizon. The resolution authorizes AE to execute brokerage agreements with qualified energy commodity brokerage firms that are members of the New York Mercantile Exchange.

AE will execute brokerage agreements with such qualified firms as may be reasonable and necessary to conduct the exchange-traded instrument portion of the energy risk management program. The brokerage agreements enable AE to place orders with any of the brokerage firms in the pool to purchase or sell futures contracts, options and similar financial contracts used for hedging as described in the Resolution and Policy for Energy Risk Management.

In addition, the resolution authorizes AE to execute the International Swaps and Derivatives Association Master Agreement (ISDA Agreement) and such other industry standard contract forms as may be reasonable and necessary with qualified counter-parties. The ISDA Agreement is the standard contract used to implement over-the-counter (i.e., privately negotiated, not implemented through a public exchange) energy risk management transactions between two parties.

The brokerage agreements and ISDA Agreement or similar agreements described above provide a framework for the hedging program and do not obligate Austin Energy to enter into any specific risk management transactions. All hedging transactions will be conducted in accordance with to the Policy for Energy Risk Management.

AE may enter into brokerage agreements and ISDA Agreements or similar industry standard agreements with brokerage firms, financial institutions, investment banks and other appropriate counter-parties in the financial, energy and natural gas industries that meet AE's criteria for reliability of execution, customer services, creditworthiness, and financial stability. As companies meeting these criteria are identified now and in the future, they will be added to the pool of service providers by execution of an approved brokerage or master agreement with AE. When AE desires to enter into a hedging transaction, it will consider or solicit offers from the parties in the pool. The specific terms and conditions of an individual energy risk management transaction, such as the quantity and type of hedging contracts purchased or sold, the price, or the duration, will be memorialized at the time of the transaction in a separate transaction confirmation.



Electric Utility Commission

April 19, 2004

Meeting

Authorize negotiation and execution of (1) brokerage agreements for Austin Energy's purchase or sale, for hedging purposes, of financial contracts traded on regulated commodity exchanges; and (2) ISDA (International Swaps and Derivatives Association, Inc.) master agreements for over-the-counter hedging transactions, along with related credit, security and insurance agreements with qualified brokerage firms, financial institutions, investment banks, and other appropriate counter-parties in the financial, energy and natural gas industries in an aggregate amount of expenditures not to exceed \$300,000,000, to implement a hedging program as authorized by the related Resolution and Policy for Energy Risk Management previously adopted by the City Council.

Motion by: Fath

Seconded by: Owens

Ayes: Carr, Fath, LeGette, Owens, Sarma, Shaw, and Skeith

Nays: NONE

Abstaining: NONE

Off the dais: NONE

Absent: Fernandez

The motion passed on a 7 – 0 vote.