5. Revisions to the Governing Policy for <u>Energy Risk Management</u>

The President and Chief Executive Officer submitted the following report:

<u>SUMMARY</u>

"The Trustees are requested to reaffirm the Governing Policy for Energy Risk Management (the 'Policy'), which is attached hereto as Exhibit '5-A,' with two clarifying modifications. The Policy supersedes the version of the Policy approved by the Trustees at their meeting of September 28, 2010.

"In accordance with leading industry practice, the Trustees' approval of the revised Policy is intended as a reaffirmation of the philosophy, framework and delegation of authority for the Authority's Energy Risk Management Program (the 'Program'). In addition, the revised Policy incorporates two modifications that improve the specificity of the authorizations under the Policy. First, the revised Policy clarifies that the authority for transactions relating to environmental attributes is included in the transaction authority delegated by the Policy to the Executive Risk Management Committee (the 'ERMC'). Second, the revised Policy explicitly incorporates the requirement for Trustee approval of transactions for energy and energy-related products, including environmental attributes, for terms exceeding four years.

"The members of the ERMC have reviewed the revised Policy and recommend its approval.

<u>DISCUSSION</u>

1. Reaffirmation Of Policy

"The electric energy, generation-fuel and related products required (or produced) by the Authority and its customers are subject to the forces of unregulated, wholesale commodity markets. As such, the prices of these products are volatile and uncertain, in turn, exposing the Authority's bottom line and its customers' rates to significant uncertainty (i.e., price risk). To enable staff to manage these market risks in a structured and well-controlled manner, the Trustees have, since 1988, taken several actions to provide the guidance and authority to enter into forward transactions for energy and energy-related products to mitigate the potential for undesirable cost outcomes.

"At their meeting of September 28, 2010, the Trustees approved the current version of the Policy. The Policy outlines the philosophy, framework and delegation of authority for the Program and provides the necessary authority to an appointed ERMC to oversee implementation of the Program, including the authority to enter into forward hedging transactions. The core philosophy and framework of the Program in the revised Policy is wholly consistent with the Policy approved at the September 28, 2010 meeting, and, in keeping with leading practices, the Trustees are to periodically review and reaffirm the Policy.

2. Transaction Authority for Environmental Attributes

"The September 28, 2010 Trustee action superseded a February 26, 2008 Trustee item, which authorized specific transaction limits by products, with the following exception:

> The limits for short-term procurement of physical natural gas, gas transportation, fuel oil and emissions allowances, as required for operation of the Authority's fossil-fueled generation plants, remains as authorized under the Trustee-approved action of February 26, 2008.

The Policy approved by the September 28, 2010 Trustee action delineates the scope of authorized transactions as follows:

> …all forward transactions for electrical energy, capacity, ancillary services, transmission rights, natural gas, fuel oil, traded emissions, and other energy-market products used for generation or the fulfillment of customer load obligations.

"The language of the September 28, 2010 Trustee item did not specifically address transaction limits for the procurement of environmental attributes which had been previously authorized by the Trustees within the action of February 26, 2008. Environmental attribute transactions are principally entered into by the Authority on behalf of customers to meet requirements such as Executive Order 111, or in response to a customer's decision to increase the renewable energy component of its operations. The Authority also procures environmental attributes as required to meet Executive Order 111 and other requirements for its own facilities, including the corporate headquarters in White Plains.

"Environmental attributes represent all environmental characteristics, however defined, attributable to generation from renewable sources of energy. These attributes transact in a manner similar to other energy and energy-related products already under the purview of the Policy. Accordingly, the Trustees are requested to add the authority for transactions relating to environmental attributes to the current transaction authority consolidated under the ERMC.

3. *Transactions of Greater than Four Years*

"At the July 26, 2010 meeting, the Trustees authorized adoption of a new Power Resource Departmental Procedure entitled 'Competitive Solicitations for Power Supply Products' which served to embody the requirement to obtain Trustee authorization prior to the issuance of competitive solicitations for purchases of energy, capacity, ancillary services and environmental attributes. Consistent with the authority to enter into energy-related forward transactions, the level of transaction authority delegated to the ERMC for environmental attributes in the revised Policy is non-speculative, limited to the volumes associated with anticipated customer and Authority requirements and for a term not to exceed four years. In order to codify this across all products, the revised Policy explicitly states that Trustee authorization is required prior to entering into transactions for energy and energy-related products (including environmental attributes) of greater than a four-year term, or the issuance of competitive solicitations for the same.

"Upon the adoption of the revised Policy, the Power Resource Departmental Procedure entitled 'Competitive Solicitations for Power Supply Products' will no longer be required as the controlling document of the authority for environmental attribute transactions or the requirement to obtain Trustee approval prior to any competitive solicitations for transactions greater than a four-year term.

"A redlined version of the proposed amended Policy is attached as Exhibit '5-B.' Deletions are shown by strikethroughs in brackets; additions are shown by bolded and underscored text. The final version of the proposed amended Policy is attached as Exhibit '5-A.'

FISCAL INFORMATION

"There is no direct fiscal impact associated with implementing the revisions to the Policy, or otherwise, by this Trustee action.

RECOMMENDATION

"The Vice President – Chief Risk Officer recommends that the Trustees approve the Policy for Energy Risk Management as reflected in Exhibit '5-A' and discussed above.

"For the reasons stated, I recommend the approval of the above-requested action by adoption of a resolution in the form of the resolution below."

Mr. Scott Scholten presented highlights of staff's recommendation to the Trustees. Responding to a question from Trustee Nicandri, Mr. Scholten said the Trustees are being requested to approve the Policy; it does not require approval by the Governance Committee. He added that the Policy delegates authority to the Energy

Risk Management Committee ("ERMC") and outlines its limitations. Also, the Authority's risk management program is implemented under the governance of the ERMC and the Policy sets forth the guidelines for that task.

In response to a question from Trustee O'Luck, Mr. Scholten said even if there are no changes to the Policy, as a rule, the Trustees are asked to reaffirm the Policy on a yearly basis.

The following resolution, as submitted by the President and Chief Executive Officer, was unanimously adopted.

> **RESOLVED, That the revised Governing Policy for Energy Risk Management (the "Policy") establishing the philosophy, framework and delegation of authority necessary to govern the activities of the Authority related to its Energy Risk Management program is hereby adopted in the form attached as Exhibit "5-A"; and be it further**
>
> **RESOLVED, That the Executive Risk Management Committee consisting of four members as appointed by the President and Chief Executive Officer and chaired by the Acting Chief Financial Officer is hereby granted the authority, within the requirements established by the Policy, to enter into transactions for environmental attributes to meet the requirements of Authority customers or facilities for a transaction term not to exceed four years beyond the last day of the month the transaction is entered, with specific Trustee approval required prior to entering transactions, for energy and energy-related products of greater than a four-year term, or the issuance of competitive solicitations for same; and be it further**
>
> **RESOLVED, That the Chairman, the Vice Chairman, the President and Chief Executive Officer, the Acting Chief Operating Officer, the Acting Chief Financial Officer, the Vice President – Chief Risk Officer and any other necessary Authority officers are, and each of them hereby is, authorized on behalf of the Authority to do any and all things, take any and all actions and execute and deliver any and all agreements, certificates and other documents necessary to effectuate the foregoing resolution, subject to the approval of the form thereof by the Executive Vice President and General Counsel.**

January 31, 2012
Exhibit "5-A"

New York Power Authority

Governing Policy for Energy Risk Management

Revision Date:	January 31, 2012
Superseding:	Trustee Resolution & Policy of September 28, 2010

ARTICLE I. PURPOSE OF THE ENERGY RISK MANAGEMENT PROGRAM

Section 1.01 Introduction

The New York Power Authority ("NYPA"or "the Authority") and its customers are routinely exposed to energy commodity price risk in the conduct of operations. In most cases price and volume variability impose a substantial and direct risk (or opportunity) to the goals of NYPA's business units as well as to their competitive posture. Management of these risks is important to our success and our customers' wellbeing. This Governing Policy for Energy Risk Management ("Policy") sets forth the philosophy, framework, and delegation of authority necessary to govern NYPA's activities related to its energy risk management program ("Program").

NYPA will conduct risk management activities in a manner that supports NYPA's mission, mitigates energy-market exposure related to price and volume variability, and prevents unauthorized financial risk, including counterparty risk. Subordinate to those goals, the objective of cost reduction and the achievement of financial goals will be pursued within the constraints stated herein and as further delineated by management. All Program objectives and activities will be conducted in accordance with this Policy. Controls and procedures to be further delineated by management shall be in conformance with this Policy.

Section 1.02 Scope and Objectives

The objectives of the program are: to identify exposures to energy price volatility as well as volumetric risk; to quantify the potential impact on the Authority's customers and its own financial condition, including the attendant credit risks; and to monitor and mitigate those exposures where they might exceed management-determined risk tolerances while maintaining adequate flexibility to improve financial performance. The successful management of NYPA's resources as outlined in its mission statement requires predictability in financial performance related to its core business dealings. Hedging activities will be conducted to secure more certainty in this regard. The diligent measurement and awareness of risk factors will enable both enhancement of operating decisions and improved extraction of value from physical assets, thereby enhancing financial performance.

This Policy applies to all forward[1] transactions for electrical energy, capacity, ancillary services, transmission rights, natural gas, fuel oil, traded emissions, environmental attributes and other energy-market products used for generation, the fulfillment of customer load obligations or related requirements. The Policy governs forward physical supplies, sales and financial derivatives that impact NYPA's risk exposures in the energy market. ERMC delegation of transaction authority for forward transactions shall be for no more than four (4) years beyond the last day of the month in which the transaction is entered. Transactions of more than four (4) years term, as well as competitive solicitations relating to such transactions require the prior approval of the Trustees.

This Policy does not govern: spot[2] transactions for the purchase or sale of natural gas, natural gas transportation, fuel oil and emissions allowances, including CO_2, NOx and SO_2, transactions with the New York Independent System Operator ("NYISO"), including the bidding of generator energy and capacity, and the scheduling of load; nor transactions related to strategic procurement.

NYPA will operate under a "non-speculative" philosophy. Hedging will be conducted with a

[1] "Forward" refers to all periods beyond the current month.

[2] "Spot" refers to transactions for physical commodities, with delivery typically during the same month in which they are transacted. In certain cases, where transactions occur later in the month, commodity delivery may occur in the following month.

clear recognition of the hierarchy of the following risk management objectives:

1. **Match Core Business Objectives:** Secure fixed or floating price structures or related options on energy-market commodities associated with generation or load-serving requirements.

   Fixed-price commitments shall not be executed for volumes in excess of high-confidence volume forecasts, including customer requirements and estimates of generating assets' supply and sales. The nature of derivative obligations shall be no more firm than the certainty of volumetric expectations, using options to secure financial rights without obligation where volumes are substantially uncertain.

2. **Mitigate Risk:** Given volatile energy markets, manage energy and energy-related product costs and revenues toward the mitigation of unfavorable results and the promotion of results within acceptable boundaries.
3. **Improve Financial Performance:** Where practical and in deference to objectives #1 and #2, reduce costs or increase revenues relative to defined targets and/or budgets by securing market positions or realigning existing hedge positions as deemed favorable.

ARTICLE II. ENERGY RISK MANAGEMENT POLICY

Section 2.01 Delegation of Authorities

a) Board of Trustees

This Policy has been established by the Board of Trustees ("Trustees") and the Trustees must approve any amendments to this Policy.

b) Executive Risk Management Committee

Subject to Paragraph (c) below, an Executive Risk Management Committee ("ERMC") is established by this Policy as management's controlling authority with respect to energy market risk and hedging activities; the ERMC shall be governed by the provisions herein.

- The ERMC shall consist of five (5) members, including four (4) members appointed from NYPA's executive corps by the CEO;

- It shall be chaired by the Chief Financial Officer ("CFO"); or, in the absence of the "CFO", another member delegated this responsibility by the "CFO";
- A quorum shall consist of any three (3) members including the chair;
- Actions of the ERMC shall be authorized by an affirmative vote of a simple majority of appointed members.

The "ERMC" is hereby charged with the following responsibilities, and necessary authorities are conveyed accordingly:

1. To ensure that all energy market hedging activities are conducted in accordance with this Policy;
2. To establish management procedures ("Procedures") for the administration of the Program, including:
   - Hedge strategy formulation and execution protocols
   - Permissible risk-mitigation products and instruments
   - Transaction limits
   - Organizational roles and separations
   - Approval hierarchies
   - Contract procedures
   - Credit and collateral management procedures
   - Risk quantification and monitoring procedures
   - Other controls and procedures as deemed necessary for the orderly conduct of the Program;
3. To establish risk tolerances related to price and volume variability and their potential impact on financial results for NYPA and its customers; and
4. To provide directives and guidance to NYPA management regarding all aspects of the Program.

c) Chief Financial Officer

The Chief Financial Officer ("CFO") is ultimately responsible for the financial integrity of NYPA and, accordingly, no delegation of authority to the ERMC is intended to impair the CFO's ability to protect such financial integrity. Under normal circumstances it is expected that tolerances and other Program issues will be determined by the ERMC, but in the event of unusual circumstances the CFO may act, as deemed necessary in his or her discretion, to preserve financial viability. In the event of such circumstances the Trustees shall be notified expeditiously of the conditions and resolution associated with such action.

Section 2.02: Separation of Duties

The ERMC, in formulating Procedures, shall provide for separation of duties in a manner that assures checks and balances among three distinct organizational functions delineated below:

1. Front Office – responsible for the execution of hedge strategy and transactions,
2. Middle Office – responsible for risk and compliance monitoring
3. Back Office – responsible for deal confirmations, cash management and accounting.

In fulfilling its role, the Back Office shall independently obtain primary documentation from counterparties with respect to deal confirmations and shall not depend solely on information provided by internal sources.

Also, in accordance with its independent role, the Office of Internal Audit shall conduct periodic reviews of the Program of a scope and on a schedule of its choosing.

Section 2.03 Activities

Permissible transactions for purposes of risk management shall be restricted to products and instruments specified by the ERMC and deployed for the following applications:

i. Mitigating risk related to the cost of energy or related products to be procured for normal business purposes.
ii. Mitigating risk related to the price of energy and related products sold by NYPA.
iii. Mitigating risk related to margins where NYPA owns generation or other capacity.
iv. Mitigating risk related to the locational cost differentials of energy and fuel procured or sold for transmission or transportation to an ultimate location.
v. Mitigating risk related to customer contract obligations related to energy markets.
vi. Mitigating risk of excessive out-of-the-money settlements associated with hedge transactions.

Section 2.04 Reporting

Maintenance of timely reports is critical to an orderly Program. At a minimum, the Program shall maintain a record of transactions; volumes and values of hedged and floating positions, both physical and financial; the linking of financial hedges with physical volumes; and quantification of the company's exposure to market volatility. These and other records shall be maintained in accordance with directives of the ERMC.

Quarterly, the CFO shall provide to the Trustees a report regarding Procedures established under the Program, as well as Program results and a summary of compliance status for the period.