

Board Meeting  
September 23, 2010

APPROVE POLICY FOR USE OF FINANCIAL TRANSACTIONS  
TO SUPPORT ENERGY COMMODITY PROCUREMENT

**Action:** Approve Policy for Use of Financial Transactions for Energy Commodities

**Funding:** No New Funding Required

The Vice President/Chief Financial Officer and Comptroller, after internal review and in consultation with external experts, recommends approval of a policy allowing the use of certain financial transactions to support the University's overall energy procurement program. This policy will define the specific types of financial transactions that may be utilized and provide a framework for their use in a manner consistent with the University's Enterprise Risk Management requirements and the University's overall policy regarding the use of derivative financial products to hedge certain financial risks.

The University currently procures energy commodities (primarily natural gas, electricity, and coal) consistent with a policy that has been previously approved by the Board. This policy provides for the procurement of energy commodities using a 36-month rolling forward horizon and a dollar-cost averaging approach. The objectives of the current procurement policy are:

1. Provide a high degree of budget certainty (financial risk management) for the current fiscal budget period and provide budget guidance for the upcoming fiscal budget period;
2. Insure that actual procured energy costs are reasonably consistent with longer-term average market prices;
3. Achieve improved effectiveness in the integration of market resources as part of the overall energy supply mix utilized to meet the University's energy needs;
4. Define underlying processes to insure a rational, objective procurement program consistent with established risk management policies; and
5. Provide a reporting process to measure the effectiveness of the policy implementation.

Actual procurement activities are performed by Prairieland Energy, Inc., consistent with a formally defined procurement process that includes input from outside market experts. Specific actions as defined in this process are reviewed and approved by an Energy Management Committee that includes representatives from each campus and University administration.

As a further enhancement of this overall procurement policy, it is proposed that the University authorize the use of defined financial transactions to make commitments for future energy commodity needs in a manner consistent with the Energy Procurement Plan and Policy and to provide measures that limit the economic exposure of the University to changing energy market prices. The expected benefits from the use of these financial transactions include:

1. Greater overall flexibility.
2. Improved liquidity.
3. Better ability to match commitments to specific needs of the University.
4. Improved market access and market efficiency.
5. Improved ability to further mitigate market risk exposure.

The following specific types of financial transactions are recommended for approval:

1. Options for purchases (or sales) for future periods (within the 36-month rolling horizon).
2. The use of caps/collars as a mechanism to limit financial exposure to changes in market prices.
3. Activate transactions extended over time that effectively “lock-in” desired economics of relative cost difference between natural gas and market electricity.

The policy also delegates to the Vice President/Chief Financial Officer and Comptroller the responsibilities of:

1. Approving the internal process and oversight requirements for the implementation of use of approved financial transactions for energy commodities;
2. Making regular reports to the Board on the status of the use of financial transactions being used as part of the overall energy procurement program; and
3. Ensuring that all affected units of the University follow the requirements and intent of the policy.

Therefore, the following recommendations are submitted for Board approval:

1. Approve Policy for Use of Financial Transactions to Support Energy Commodity Procurement.
2. Delegate to the Vice President/Chief Financial Officer and Comptroller the responsibility for:
  - a. approving the specific implementation of the policy, including oversight responsibilities;
  - b. making regular reports to the Board on the status of the use of financial transactions being employed; and
  - c. ensuring that all affected units of the University follow the requirements and intent of the policy.

The Board actions recommended in this item complies in all material respects with applicable State and Federal laws, University of Illinois *Statutes, The General Rules Concerning University Organization and Procedure*, and Board of Trustees policies and directives.

Accordingly, the Vice President/Chief Financial Officer and Comptroller recommends adoption of the proposed policy modification.

The President of the University concurs.