DISTRICT OF COLUMBIA
WATER AND SEWER AUTHORITY

BOARD OF DIRECTORS

Joint Meeting of the
Finance and Budget and Audit Committees

Thursday, May 26, 2005
8:00 a.m.

MEETING MINUTES

BOARD MEMBERS	WASA STAFF
Glenn S. Gerstell	Jerry Johnson, General Manager
David J. Bardin	Paul Bender, Chief Financial Officer
Paul Folkers	Avis M. Russell, General Counsel
Anthony Griffin	Linda Manley, Secretary to the Board
Bruce Romer	Michelle Cowan, Director of Finance & Budget

Chairman Gerstell called the meeting to order at 8:10 a.m.

Financial Report

Michelle Cowan, Director of Finance & Budget, presented the April 2005 financial report. Ms. Cowan noted that at last month's meeting, staff provided an extensive mid-year financial review and that this month there are no significant changes to report. Ms. Cowan reported that WASA is on track to meet or exceed most financial benchmarks. Operating receipts are two percent ahead of budget and operating expenditures total approximately 50 percent of budget with 58 percent of the fiscal year complete. Capital disbursements are substantially below original projections; as part of last month's mid-year review, management presented a revised year-end capital spending projection which reduced the original projection from $297 million to $241 million. Detailed analysis of capital spending was presented to the Environmental Quality & Operations Committee in May. Finally, Ms. Cowan noted that WASA's cash reserves remain above Board policy levels, averaging $117 million year-to-date vs. the policy requirement of $97.7 million.

Electricity Update

Paul Bender, Chief Financial Officer, discussed the status of current prices and WASA's next procurement for electricity services. When WASA executed its current contract with Amerada Hess in January, we paid an average of $47/MWH for approximately 23 percent of our supply, which is the same as the contract-to-date market price of $47/MWH paid for the remaining 77 percent of our power needs. Mr. Bender explained that electricity prices tend to track the price of oil and prices have continued to decline over the last 1-2 months, vs. earlier in the year when prices were increasing.

WASA could lock in for the remaining 77 percent of power needs for all months except July and August at approximately $46 to $47/MWH. Mr. Bender noted that historically, futures prices include a 10 to 20 percent premium (vs. the actual market price experienced). Because of this, the current plan is to continue to buy at market unless prices decline considerably.

Power Procurement

Mr. Bender reported that WASA advertised an RFP on May 18 with proposals due in 30 days. The scope of services in the RFP is similar to WASA's existing contract with Hess – WASA will have the ability to lock in blocks of power at a fixed price when futures pricing meets budget targets. To the degree that WASA does not lock in blocks, pricing will be established each day with direct pass-through of all costs. We have asked potential suppliers to provide us with a block bidding process that ensures access to the wholesale market and more transparency in bidding. The RFP and proposed contract provide for a term of five years, with automatic one-year rolling extensions, allowing us to always have the ability to lock in blocks of power for the subsequent four years. Mr. Bender noted that the RFP is more streamlined than last year's RFP because we not asking for fixed price proposals.

Mr. Bender explained that the schedule calls for management to present a recommended firm to the Committee next month, with Board action anticipated in July.

Extension of Letter of Credit on Commercial Paper Program

Ms. Cowan presented an overview of the actions required by the Board to extend the letter of credit on WASA's commercial paper program through December 2015. The extension allows for optional termination by both parties – WestLB can terminate in 2010 with 180 days notice, and WASA can terminate or substitute an alternate letter of credit at any time. WASA also negotiated reduced pricing on the letter of credit – pricing on the utilized portion was reduced from 28 basis points to 24 basis points; pricing on the unutilized portion was reduced from 15 basis points to 12.5 basis points resulting in savings of $30,000 to $65,000 annually, depending on how much commercial paper is outstanding. (The annual cost of the letter of credit is approximately $180,000, assuming $50 million in commercial paper outstanding on average.) The extended letter of credit would be grandfathered into WestLB's sovereign-backed ratings.

Ms Cowan provided an overview of the draft documents needed to execute the extension. The resolution authorizes the Board to enter into the amendments to the reimbursement agreement and extend the letter of credit. It also delegates to the Chairman, Vice Chairman, General Manager and Chief Financial Officer the ability to execute the documents. Mr. Johnson noted an additional change to paragraph 3 of the resolution that would allow other WASA employees to execute ancillary certificates only with the approval of the General Manager or Chief Financial Officer. Ms. Cowan also briefly discussed the draft amendments to the reimbursement agreement and letters of credit.

Mr. Gerstell asked whether the rating agencies would receive notice of this extension. Ms. Cowan responded that staff will notify the rating agencies, although it would likely go to the rating agencies' structured products group. Chairman Gerstell also asked whether West LB is executing similar extensions with other customers and if WASA's deal compares favorably to others. Based on discussions with West LB, Ms. Cowan responded that she understood the majority of existing WestLB clients have extended, including the Metropolitan Washington Airports Authority with a three-year extension.

Bond Counsel Contract Extension

Mr. Bender reported that WASA has a one-year contract with three annual renewal options for bond counsel services. WASA is in the second option year of the contract, which expires in June. If the third option year is exercised, the contract value will exceed $1 million, and thus requires Board approval.

Chairman Gerstell asked whether WASA is billed on an hourly basis for bond counsel services. Ms. Cowan replied that services are provided on an hourly rate basis, but WASA negotiated a “not to exceed” cap for bond transactions.

Chairman Gerstell asked Ms. Russell whether she had any concerns regarding the proposed extension. Ms. Russell responded that she participated at the end of the bond deal, but that she has no reason not to extend the contract.

Insurance Renewals & Flood Coverage

Mr. Bender reported that WASA changed the expiration dates of all its insurance policies to June 15. This will streamline the administrative process and have our property insurance expire before, rather than immediately after, the hurricane season. Mr. Bender noted that at last month’s meeting, staff provided an overview of the extension or rewrite of the majority of our policies, including general liability, public officials’ liability, and the third party administrator for workers’ compensation claims. We are now ready to cancel and rewrite the three remaining policies – property, crime and fidelity – so they also expire on June 15, 2006. Mr. Bender reported that after discussion with our advisors and insurance brokers, management believes that WASA’s current insurance carriers offer the most competitive options for these renewals.

The largest policy, property insurance, can be renewed with FM Global with the same coverage terms for an annual premium of $805,000, a $132,000 reduction from the old policy cost. Mr. Bender noted that WASA will also receive a credit for the remaining June 15 to October 1 period of the existing policy, for a net cost of approximately $570,000 to renew this policy through June 15, 2006. Because this modification is over $500,000, Board approval is required.

On flood coverage, Mr. Bender reported that WASA continues to maintain $10 million of flood insurance coverage under its property insurance policy, the same as prior years. In 2004, FM Global completed an extensive on site review of the potential for flood losses and is concerned about our flood exposures. WASA’s internal engineering reviews have determined that the cost of a floodwall to address the insurance company’s concerns would not be cost effective. Additional flood insurance coverage through FM Global, without building a floodwall, will be very expensive – current quotes are approximately $125,000 for an additional $5 million of coverage. Staff recommends that WASA maintain its current level of coverage.

Chairman Gerstell asked whether there is any industry standard as to when renewal dates should occur and if WASA is properly timing its entry into the insurance market. Mr. Bender responded that, in general, the timing is good because market rates are flat or declining compared to the last 2-3 years, and the change from October 1 to June 15 will also be beneficial.

The Committee recommended approval of the insurance extensions.

Internal Audit Report

Jerry Johnson referred to the second quarter internal audit activity report and proposed that the Committee deal with that item by exception. No issues were raised by Committee members.

Rates Calendar

Jerry Johnson reviewed the rate increase schedule. WASA representatives have met with nine ANC and other community groups to date, with several more meetings scheduled. Unlike prior years, WASA has attended community group-sponsored meetings as opposed to holding standalone meetings on the rate increase. This has been very successful, with WASA reaching out to many more people than in the past.

Mr. Johnson reported that the upcoming public hearing, scheduled for June 2 at the Metropolitan Washington Council of Governments, will not include a lengthy staff presentation at the beginning of the meeting. WASA's agenda now allows more time for customer questions and comments. In July, the Board and staff will consider WASA's financial position as well as all customer comments received, with scheduled action in September by the Board.

A.S. McGaughan Settlement Issue with WSSC

Mr. Johnson reported on the status of the A.S. McGaughan settlement issue. As background, Mr. Johnson explained that this issue relates to the settlement of a longstanding construction claim. In 1989, WASA's predecessor agency contracted with A.S. McGaughan to construct eight sedimentation basins at Blue Plains. Due to differing site conditions than originally designed, construction was substantially delayed. A.S. McGaughan filed a claim with the D.C. Contract Appeals Board for compensation of these delays. In September 1998, WASA and McGaughan reached agreement on a settlement of $31 million, which was approved by the Board of Directors as a joint use item and paid from bond proceeds.

At the time of the settlement, the Board directed the General Manager to pursue claims against the two design engineers, Metcalf & Eddy and Delon, Hampton and Associates, for their role in this project. In May, the General Manager reached agreement with both firms for cash payments of $750,000 and credits for services to be supplied in the future of $750,000. $500,000 has been received to date in accordance with these settlements, and will be credit to each user jurisdiction.

Mr. Johnson reported that in 2002, WASA billed the user jurisdictions for their share of the settlement. In October 2002, WASA received payment from Fairfax County and the Loudoun County Sanitation Authority for their share, including interest from 1998 to 2002. WSSC has not yet paid its share.

Mr. Johnson stated that he has been meeting on a regular basis with WSSC's new General Manager, and that he understood that WSSC management has obtained approval from its Commission to pay the principal amount only ($14.2 million), but no interest. This authorization expires at the end of June 2005. Mr. Johnson stated that under the IMA, he understands that all payments should include interest and he would not advise the Board to waive interest in this case. Mr. Johnson also noted that interest could be calculated in three different ways, resulting in a range of interest costs from $2.8 million to $4.6 million. WSSC's Internal Auditor's interpretation of the interest methodology would result in total interest costs of $4.1 million.

A discussion ensued among Committee members of the issue and various interest calculation methodologies. Mr. Johnson and Mr. Bender referred the Committee to excerpts of the IMA which were distributed to the Committee.

Chairman Gerstell stated that he did not support waiving interest and suggested that the General Manager continue his discussions with WSSC. Mr. Griffin noted that the interest calculation methodology should be the same for all three user jurisdictions.

Mr. Johnson agreed to meet again with WSSC's General Manager and report to the Committee at its June meeting.

Hearing no further business from the joint Committee members, Mr. Gerstell adjourned the meeting at 8:55 a.m.