

**DISTRICT OF COLUMBIA**

**WATER AND SEWER AUTHORITY**

# Board of Directors

DC Retail Water and Sewer Rates Committee

## Tuesday, September 27, 2016

9:00 a.m.

 MEETING MINUTES

**Committee Members in Attendance**

Rachna Butani, Acting Chairperson

Matthew Brown, Board Chairman

Ellen Boardman

Howard Gibbs

Reverend Kenrick Curry

Ana Harvey

**DC Water Staff**

 Mark Kim, Chief Financial Officer

Henderson Brown, General Counsel

Syed Khalil, Director Rates and Revenue

Linda Manley, Board Secretary

**Consultant**

John Mastracchio, Arcadis

**Call to Order**

Acting Chairperson Ms. Butani called the DC Retail Water and Sewer Rates Committee meeting to order at 9:00 a.m.

**Review 2016 Potomac Interceptor Cost of Service Study (Attachment A)**

Mr. Kim began the meeting with a review of the 2016 Potomac Interceptor Cost of Service Study. He introduced Mr. John Mastracchio from Arcadis, who served as DC Water’s consultant on this project. Mr. Kim went on to explain that the 86th U.S. Congress authorized the design and construction of the Potomac Interceptor (PI) on June 12, 1960. PI is a large sewer that emanates from Virginia and connects into DC Water’s system. DC Water has four “PI customers” (Dulles Airport, National Park Service, Department of the Navy and the Town of Vienna). DC Water charges them for wholesale wastewater treatment services pursuant to agreements signed in 1960.

Mr. Kim explained that there are four separate agreements signed with each of these customers. These PI Customer agreements are separate from the Intermunicipal Agreement (IMA) agreement and the Loudoun County Sanitation Authority Agreement and there is no duplication of cost recovery. Under the Agreement, the PI customers’ rates are adjusted periodically (three years or greater intervals). Charges are based on a proportionate allocation of capital and operating costs and are to be recovered through a rate per million gallons of wastewater flow. PI customers are billed quarterly based on measured flow.

Included in this study is a True-Up process, whereby DC Water looks at the actual costs, makes sure that our former rate accurately reflected what the cost of service was, and, if necessary, makes an adjustment. Historically that adjustment is included in the new rate. For example, if the previous rate was set too high, then there would be a downward adjustment in the forward rate; and if the previous rate had been set too low, then there would be an additional charge on top of the projected rate.

Charges are based on the proportional allocation of each of the PI customer’s share and are billed quarterly in arrears at a rate established by the Cost of Service study.

Mr. Mastracchio stated that the objective of the study was to determine costs of providing services to the PI customers, which include: 1) true-up for FY 2014 through FY 2016; 2) estimate costs of services and PI customer flows for FY 2017 through FY 2019; and 3) establish a rate for cost recovery for FY 2017 through FY 2019.

Mr. Mastracchio gave a brief overview of the methodology used. There are two components of the rate calculation: 1) capital cost recovery component; and 2) operations and maintenance cost component. Each of these components were evaluated specifically as they relate to the 1960 agreements. The capital costs of PIs are allocated based on their reserve capacity and the operating costs are allocated based on annual wastewater flows. The capital and operating costs are added to get the total cost share, which is then divided by wastewater flows to determine the rate per million gallons.

Board Chairman Mr. Brown inquired if overhead was included in the cost. Mr. Mastracchio replied that there was some overhead and some conveyance but mostly the plant cost.

Mr. Mastracchio explained the operating expenses that were eligible for inclusion in the PI Cost of Service. These eligible operating costs are related to: 1) wastewater treatment operations and maintenance; 2) maintenance services; 3) sewer services; 4) distribution & conveyance systems; and 5) administration.

Mrs. Boardman asked a question regarding how the eligible cost percentages are derived for each of these categories. Mr. Mastracchio responded that DC Water tracks all of these costs associated with each of these categories and these are coded as to whether they are applicable to PI users or not.

Mr. Mastracchio then discussed the capital expenses eligible for inclusion in the PI Cost of Service calculation. Beginning in 2012 and 2013, there was a significant rise in eligible capital costs due to: 1) nitrogen & biosolids projects at the plant; and 2) tunnel / dewatering pump station projects. This rise in costs will be amortized over the next (30) thirty years but will impact the rates.

Mr. Mastracchio explained the cost share basis both for capital and operating costs. He pointed out that these four PI users are small users and account for a very small fraction of the capital cost allocation; less than 1%. Similarly, these four PI customers account for a very small fraction of the operating costs; again, less than 1%.

Next Mr. Mastracchio showed slide with FY 2014 – FY 2016 True-Up Evaluation Results. The chart reflected the recoverable costs for each of the 4 PI customers, the amount paid and the difference showing over / underpayment. This true-up amount was rolled up into the next 3 year cycle of rates.

Acting Chairperson Ms. Butani noted that the under/over-payment would be allocated over the course of the next 3 years and she wanted to know the rationale for that. Mr. Kim responded that this has been the past practice. This was to ensure that there wouldn’t be large true-up amounts due every 3 years and smooth it out and roll it into the rate. However, due to the large spike in plant-related capital expenditures the projections of future expenditures have not been as accurate as used to be historically, which has resulted in larger true-up amounts.

Mrs. Boardman asked why we don’t just charge each customer based upon their actual use. Mr. Kim replied that this whole process is governed by the original 1960 agreement and it lays out the process by which the rates shall be set as well as the true-up.

Mrs. Boardman wanted to know why in 50 years this agreement hasn’t been re-visited and modified.

Mr. Kim stated that in his tenure at DC Water there have been some requests from the PI customers to renegotiate the terms of this agreement, including whether they ought to pay for the service at all as well as requests for increases in capacity. Unfortunately, DC Water does not currently have the capacity to increase their allocated shares. There are a number of issues such as these that have kept DC Water from reviewing or modifying the existing agreement.

Acting Chairperson Ms. Butani asked how many times the rates had to be decreased. Mr. Kim replied that it depends upon each customer. Every time DC Water does the tri-annual Cost of Service study, there are some customers whose rates on a percentage basis go up and for others the rates may be flat or go down.

Mr. Mastracchio pointed out that the size of the true-up depends on the difference between projected and actual costs and flows.

Acting Chairperson Ms. Butani asked if DC Water is taking into account growth of communities. She noted that Dulles and Vienna are growing considerably and wants to know if our models take into account what the expected growth is for those areas.

Mr. Kim noted that this is one of the issues that would come up if DC Water were to re-negotiate the 1960 agreement. He added that the size of the PI is not changing.

Board Chairman Mr. Brown noted that there are two components of the rate, the operating and the capital, and wanted to know whether DC Water segregates these dollars when they receive them. Mr. Kim replied that DC Water pays these costs up front for the customers and then reimburse itself. However, these costs are applied to operating and capital when collected.

Mr. Mastracchio showed the slide on FY 2017 – 2019 Projected Rates. He explained that: 1) inclusion of prior period true-up adjustments in the projected rates contributes to significant rate variability; and 2) excluding them will stabilize the rate adjustments.

Mr. Kim stated that it’s important to point out the cost of service is going up at that annualized 2-3% per year. However, it is the true-up piece that gets added to the rate and that makes the rate seem to vary more significantly from period to period.

Mrs. Boardman noted that in this particular period we have under-billed and that we are essentially floating a loan to our customers and inquired if any consideration was given to that loss and if there was any penalty in the agreement.

Mr. Kim responded that this is the case for this period but in the past we have seen both under and over billing of customers. He stated that we must get our projections tighter and more in line. He added that we have also tried to address the notion of distorting the base rate by offering customers this year for the first time an option as to whether or not they wanted the true-up to be incorporated into their next rate or whether they wanted to settle one time right now. Interestingly, two of the customers chose to settle now in order to reset their rate back to a more true cost of service; the other two customers chose to add the true-up on top of their projected rate. This is interesting and likely speaks to their budgeting process. Having the rate provided over a three-year period gives them the opportunity to do financial planning around it. Giving them a real-time actual bill may hamper their budgeting process. Also, from DC Water’s perspective administrative burden to track and to generate a quarterly bill might be disproportionate to the amount of revenues received.

Mrs. Boardman asked if the option of paying the true-up up front or adding it to the current rate was part of the original agreement or was it at our discretion.

Mr. Kim responded that the agreement was silent on this point, and so it was an option DC Water came up with this year to try and address the true-up. He pointed out which of the 4 companies opted to pay the true-up now and which chose to have it added to their rate. He felt that this is an incrementally better process.

Mr. Gibbs inquired about option number 2 on slide 15 specifically where the PI Customer owed DC Water money.

Mr. Kim responded by saying that we reached out to the PI customers during the course of the Cost of Service provided them with preliminary projections and rates and whether there was an over / under payment. DC Water asked PI customers to provide their preferred payment option: 1) prior period true-up adjustments; and 2) without applying prior period true-up adjustments. Each PI customer responded: 1) Dulles had underpaid and they chose to pay up front; 2) Navy overpaid but chose to include the true-up; 3) NPS overpaid and chose not to include the true-up adjustment in the rates; and 4) Vienna underpaid but chose the option to include the true-up adjustment. Our conclusion is that by offering the PI customers these options to address the true-up either upfront or over time provided them the flexibility to better handle their finances.

Mr. Mastracchio summed up his presentation with three recommendations: 1) consider excluding prior year true-up amounts from the rate projections and handle them separately; 2) adopt proposed rates; and 3) monitor billed vs. actual cost annually and track differences and where substantial, inform the affected PI customers.

Mr. Kim noted that there was no committee action needed on any of the issues discussed today. The presentation was merely a briefing to the committee.

**DC Retail Water and Sewer Rates Committee Workplan**

FY 2016 Completed DC Retail Rates Committee Workplan (Attachment B)

Mr. Kim reviewed the FY 2016 completed workplan with the Committee. He said that he was happy to report that all tasks had been completed.

FY 2017 Proposed DC Retail Rates Committee Workplan (Attachment C)

Mr. Kim updated the Committee on the FY 2017 proposed workplan.

**Other Business**

No other business

**Executive Session**

No executive session

**Agenda for October 25, 2016 Committee Meeting (Attachment D)**

Mr. Kim indicated that the DCGIS Flyover presentation scheduled for the October Committee meeting would be moved in conjunction with the CRIAC review planned for the December Committee meeting. There being no other scheduled business, the Committee agreed to cancel the October 25, 2016 meeting.

**Adjournment**

The meeting was adjourned at 9:52 a.m.

**FOLLOW-UP ITEMS – DC Retail Water and Sewer Rates Committee Meeting (September 27, 2016)**

There were no follow-up items