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METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

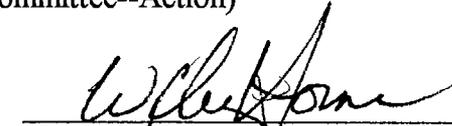
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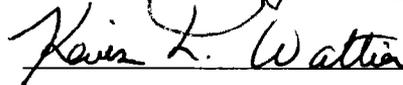
January 28, 1997

To: Board of Directors (Executive Committee--Action)

From: General Manager

Submitted by: F. Wiley Horne
Deputy General Manager





Subject: Guiding Principles on Business Initiatives

RECOMMENDATION(S)

That the Board approve modified Guiding Principles as described in this letter to guide the oversight and administration of the District's business initiatives.

EXECUTIVE SUMMARY

For some time, staff, Board, and member agencies have been working to develop new approaches to service and competitiveness. In May 1996, your Board set policy principles and guidelines for providing more extensive services to the member agencies (see Attachment C). In August 1996, staff and the members produced a Directory of Metropolitan to Member Agency Services, an "in-the-family" yellow pages providing equal access to all member agencies.

In October and November 1996, oral discussions were begun on how Metropolitan can improve its competitiveness through rigorous asset management and business practices. This led to a working set of Guiding Principles which were presented to the Executive Committee in November and December (see Attachment B). This second round of input from directors and agency managers is reflected in a set of modified Guiding Principles, which are proposed for approval by your Board in February (Attachment A). Response to Directors' questions asked at the January Executive Committee is included in a section at the end of this letter.

As modified, the Guiding Principles provide a policy for business practice which is compatible with the Mission, the needs of the member agencies, the District's cost containment program, and the interests of the region including the private sector. They emphasize joint action with the members. They emphasize joint action with the private sector to expand private sector business opportunities. They emphasize ploughing new revenue sources back into the core business to assist rate management. They emphasize Board approval of new practices. They set the stage for Metropolitan to implement business initiatives in desalination, real property, and water quality. The goal is to increase the enterprise value of Metropolitan for both the members and the region as a whole.

DETAILED REPORT

Background

For some time, staff, directors, and member agencies have been working together to strengthen the District's service and competitiveness. During 1996, the calendar of events has been:

January, February	Oral reports on expanded service to member agencies.
March, April	Members provide input on Directory of Services.
May	Board approves policy principles and guidelines for expanded service to members (Attachment C).
July	Adopted budget trims \$50 million per year from O&M and \$300 million from CIP.
June	Board approves funding and marketing agreements with Joint Venture partners Parsons and IDE to develop and market desalination technology.
August	Staff and members publish Directory of Services.
September	Staff retreat on competitiveness identifies initiatives in desalination, real property, machine shop, and water quality.
October, November	Oral report to Executive Committee on asset management and business practices.
November	Preliminary Guiding Principles to Executive Committee for discussion (Attachment B).
December, January	Proposed modifications to Guiding Principles (body of letter and Attachment A).

The preliminary November Guiding Principles have been modified as described below in accord with directors' and agency managers' thoughts.

Proposed Guiding Principles, as Modified

This section explains how director and agency responses were used to modify the November Principles:

First, the members wanted more emphasis on the primacy of the Mission. Typical comments were "...management must stay focused on core issues..." and "...don't get diverted" and "...remember, business has a cost, too." Recently, a member emphasized that cost containment, asset management and business must reinforce each other: "...asset management and business must be joined at the hip with cost containment." These related thoughts are now made clear in modified Principle 1. The earlier November Principle 2 which called for active management of assets as part of the Mission, was folded into modified Principle 1:

Modified Principle 1. The Mission is Paramount. Quoting from the Administrative Code, Section 4201:

“The mission of the Metropolitan Water District of Southern California is to provide its service area with adequate and reliable supplies of high quality water to meet present and future needs in an environmentally and economically responsible way.”

“Economically responsible” calls for active management and productive use of assets as part of the Mission. But management must remain focused on the core mission, and costs must be accurately accounted as between core mission and business initiatives. Assets will be acquired only for the mission. Asset management, business initiatives, and cost containment must work together toward the common goals of rate management and competitiveness.

Second, some directors and members were concerned that staff might be tempted to propose risky courses of action to achieve a target return. They wanted a plainly stated emphasis on “...solid, conservative practices.” One director wanted it clearly understood that asset management should be undertaken where practicable, but should not be relied on to meet essential revenue requirements. Modified Guiding Principle 2 now has a heading which emphasizes these conservative values.

Modified Principle 2. Solid, Conservative Asset Management. Management and business practices used to acquire, safeguard, maintain, use, control, and dispose of assets will be prudent and not subject the District to significant risk.

Third, some members reminded staff that developing programs are more efficient and effective when there is early and continuing member agency input. In a similar vein, a director cited an example--telecommunications site leasing--where members and Metropolitan should be partners in marketing. These thoughts are captured in modified Principle 3 which strengthens the November version of this principle:

Modified Principle 3. Partnership with Member Agencies. The District shall manage its assets to create the best value and utility for the member agencies. To this end, the members will be active partners in evaluating business initiatives, and will be offered participation where practicable.

Fourth, one director felt that staff presentations had placed too much emphasis on the benefits of business opportunities to Metropolitan alone, or to Metropolitan and the members. He felt the real story was in public/private partnerships--Metropolitan, its members, and the private sector joining forces to create new sources of economic opportunity for the region as a whole. For example, the desalination partnership with R. M. Parsons, Inc., creates a new basic

industry benefiting the entire region. The concept of building the regional economy was added as a new guiding principle in November:

Modified Principle 4. Create Economic Opportunities. Metropolitan's assets and capabilities should be combined with those of the member agencies and private sector to create new economic opportunities. Metropolitan, working with the member agencies, shall create regional economic opportunities for California businesses and foster public/private partnerships to implement these opportunities. In other words, our management practices should enhance Metropolitan's, the members', and the region's competitiveness, all together.

Fifth, the member agency managers at their December meeting at Las Virgenes thought that competition with the private sector should be addressed directly. Accordingly, the November version of the "competitiveness" principle was amended to emphasize partnership with the private sector. Another member, however, thought it important to preserve the unique supporting relationship between Metropolitan and its members, where professional and technical services are frequently shared to achieve the most efficient use of assets "within the family." Both ideas are now reflected in Principle 5:

Modified Principle 5. Cooperation with Private Sector. Metropolitan and its member agencies will create private sector business opportunities through cooperative business arrangements. The historic supportive relationship between Metropolitan and its members shall continue.

Sixth, a member agency stated that it wanted explicit Board approval of new initiatives:

Modified Principle 6. Board Approval. The Board of Directors shall discuss, consider, and as appropriate, approve each new business initiative, other than those entered into with member agencies under established Board policy.

Relationship to Previously Adopted Principles

These modified Guiding Principles on asset management and business development are **additive** to the Board's May 1996 Guidelines for service to member agencies shown in Attachment C. Both govern together, and there is no conflict. In this connection, it is specifically noted that net revenue from asset management and business initiatives is required under the May Guidelines to be applied to rate management.

Status Report on Initiatives

Three initiatives, in real property, water quality, and desalination, are under development pending the Board's deliberations on the Guiding Principles. Acting project managers have been identified for each initiative, and preliminary business plans and scopes of work have been prepared. These will be presented throughout 1997 to the Board, starting in January with an introduction by the three project managers.

Figure 1 illustrates the relative advancement of each initiative. Desalination has been the lead initiative, based on the Board's actions since 1990 and its June 1996 authorization of the design and marketing agreement.

Water quality has been developing a niche in research-grade analytic work for other utilities in Southern California, as well as undertaking successful efforts to attract grant funds. Longer-term water quality initiatives involve (1) gene probe licensing or laboratory services in connection with Cryptosporidium assay, and (2) conversion of a newly patented synthetic substance into an engineered solution to salinity problems on the Colorado River and other regions of the world.

Real property through the asset management initiative is implementing telecommunications site licensing, movie-shoot opportunities, and, as a longer-term consideration, joint development or entitlement of District lands surrounding District facilities. The goal is to realize greater return from District lands, and to more closely control land uses surrounding District facilities for compatibility with the core Mission.

The machine shop initiative is more conceptual than the others at this point, though it should be noted that two activities have been carried out for some years at the LaVerne shop: (1) high-quality contract machining of large turbines and pump impellers for State Water Project facilities owned by the California Department of Water Resources, and (2) fabrication of steel pipeline (replacement sections) for member agencies and subagencies, on both an emergency and planned basis. The strategic value of the machine shop was most evident following the Northridge earthquake in January 1994, when District forces designed, fabricated, excavated, welded in place, backfilled, tested, and recommissioned a 84-inch inlet pipeline at the Jensen water treatment plant--all within 70 hours after the earth shaking stopped.

Additional details will be provided to the Board by the individual project managers themselves, starting with the January Board meeting.

Response to Director's Question at January 1997 Executive Committee Meeting

A question was raised about the potential impact of income generated through business initiatives on Metropolitan's federal and state income tax status. Generally, the Internal Revenue Service regards all income of states and political subdivisions of states as exempt from federal income tax, regardless of its source. This means that for federal income tax purposes, any net income received by Metropolitan through its business development activities would be no different from other revenues. The California Franchise Tax Board follows the same approach as

the Internal Revenue Service in this area, so that the income of political subdivisions within California is exempt from California franchise and income taxes.

Arrangements with private sector entities involving the use of Metropolitan assets may impact the tax status of tax-exempt bonds used to finance those assets. Therefore, the specifics of all such proposals must be reviewed by Metropolitan's General Counsel and bond counsel before they are pursued. This review is required by your Board's previously adopted May 1996 Guidelines (contained in Attachment C). The General Counsel's review will be reported to your Board as part of each Board letter requesting approval to proceed with a business initiative.

FWH:ng

Attachments (4)

FIGURE 1

PROGRESS OF THE FOUR LEAD BUSINESS INITIATIVES

JANUARY 1997

Status of Four Initiatives

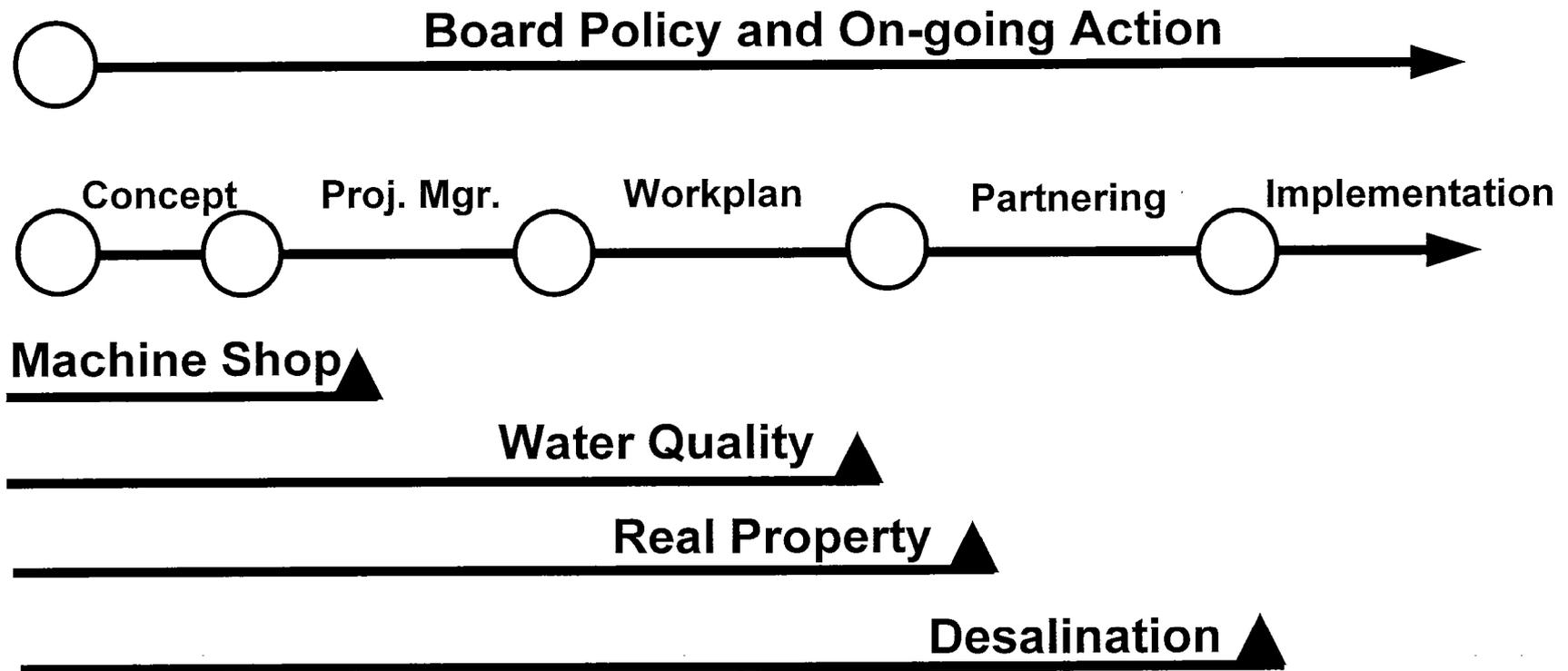


Figure 1

ATTACHMENT A

**PROPOSED GUIDING PRINCIPLES
FOR BUSINESS DEVELOPMENT, AS MODIFIED TO REFLECT
DIRECTOR AND AGENCY COMMENTS**

JANUARY 1997

**PROPOSED GUIDING PRINCIPLES
FOR BUSINESS DEVELOPMENT, AS MODIFIED TO RELECT
DIRECTOR AND AGENCY COMMENTS**

JANUARY 1997

Modified Principle 1. The Mission is Paramount. Quoting from the Administrative Code, Section 4201:

“The mission of the Metropolitan Water District of Southern California is to provide its service area with adequate and reliable supplies of high quality water to meet present and future needs in an environmentally and economically responsible way.”

“Economically responsible” calls for active management and productive use of assets as part of the Mission. But management must remain focused on the core mission, and costs must be accurately accounted as between core mission and business initiatives. Assets will be acquired only for the mission. Asset management, business initiatives, and cost containment must work together toward the common goals of rate management and competitiveness.

Modified Principle 2. Solid, Conservative Asset Management. Management and business practices used to acquire, safeguard, maintain, use, control, and dispose of assets will be prudent and not subject the District to significant risk.

Modified Principle 3. Partnership with Member Agencies. The District shall manage its assets to create the best value and utility for the member agencies. To this end, the members will be active partners in evaluating business initiatives, and will be offered participation where practicable.

Modified Principle 4. Create Economic Opportunities. Metropolitan’s assets and capabilities should be combined with those of the member agencies and private sector to create new economic opportunities. Metropolitan, working with the member agencies, shall create regional economic opportunities for California businesses and foster public/private partnerships to implement these opportunities. In other words, our management practices should enhance Metropolitan’s, the members’, and the region’s competitiveness, all together.

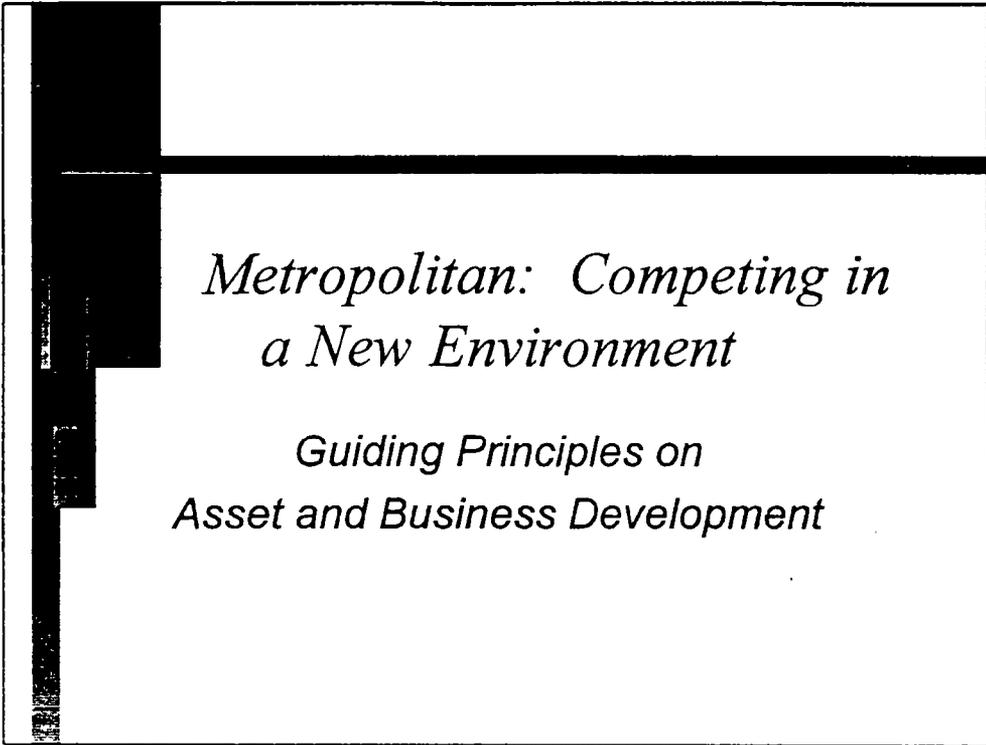
Modified Principle 5. Cooperation with Private Sector. Metropolitan and its member agencies will create private sector business opportunities through cooperative business arrangements. The historic supportive relationship between Metropolitan and its members shall continue.

Modified Principle 6. Board Approval. The Board of Directors shall discuss, consider, and as appropriate, approve each new business initiative, other than those entered into with member agencies under established Board policy.

ATTACHMENT B

**PRELIMINARY GUIDING PRINCIPLES PRESENTED TO
EXECUTIVE COMMITTEE**

NOVEMBER, DECEMBER, 1996



*Metropolitan: Competing in
a New Environment*

*Guiding Principles on
Asset and Business Development*

Notes:

Background

May 1996

■ *General Manager's Workplan 1996-97
identified as district initiatives:*

Development of Business Opportunities

Development of Financial Plans

■ *Board adopted initial principles and
guidelines for Business Development*

Notes:

First Step

Receive input from the Board regarding:

*Guiding Principles and guidelines on
Asset and Business Development*

Key projects

Guidelines for organization

Notes:

Guiding Principle on Asset and Business Development

Purpose

*Metropolitan shall carry out the Board's mission statement in a manner which will **optimize the value and use of all its assets** including: real property, equipment, expertise, financial capabilities, intellectual property and contractual rights.*

Note: Make our assets work harder

Notes:

Guiding Principles

1. The mission comes first.

The mission of the Metropolitan Water District of Southern California is to provide its service area with adequate and reliable supplies of high quality water to meet present and future needs in an environmentally and economically responsible way.

Note:

“Economically responsible” calls for active management and productive use of assets.

Notes:

Guiding Principle

2. The District is required to acquire and maintain assets to perform its mission. The use of these assets shall be optimized.

Note:

"Optimized" refers to highest lifetime value for the mission, balancing current uses versus future needs. It does not imply bias toward short-term or commercial uses.

Notes:

Guiding Principles

3. The District shall apply the *solid, conservative, standards* in acquiring, safeguarding, maintaining, using and disposing of its assets.

**Note:
No speculation**

Notes:

Guiding Principles

*4. The District shall manage its assets to create the **greatest value and utility** for the member agencies.*

Note:

Member Agency advise on asset management and business opportunities will be continually sought and presented to the Board at each quarterly report.

Notes:

Guiding Principles

*5. The District shall endeavor to structure its water service and rates, its business practices, and its internal operations to **compete successfully in a competitive world.***

Note:

Metropolitan's competitive program combines three factors: affordable rate, downward pressure on costs, and asset management to augment revenue.

Notes:

Guiding Principles

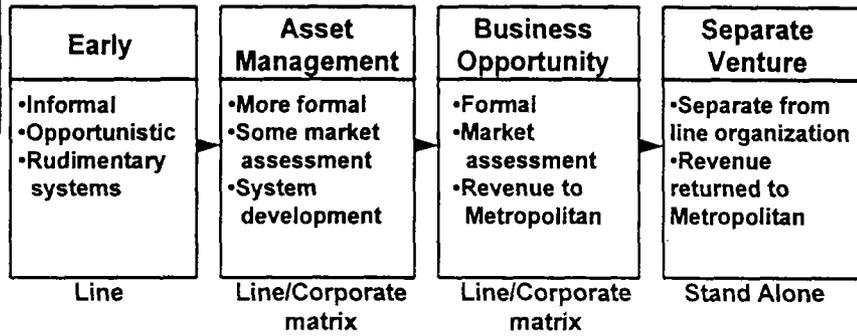
6. Metropolitan, working with its member agencies, shall create regional economic opportunities for California businesses and foster public/private partnerships to implement these new opportunities.

Note:

Metropolitan's assets should create benefits for the entire region, including the private sector. In other words, we want to enhance Metropolitan's competitiveness, and our region's competitiveness as well.

Notes:

Stages of Business Development



Notes:

ATTACHMENT C

**PRINCIPLES APPROVED BY THE BOARD OF DIRECTORS
IN MAY 1996 TO GOVERN THE PROVISION OF
EXPANDED SERVICES TO MEMBER AGENCIES**

(These Principles remain in place and are additive to the Business Initiative Guiding Principles proposed herein.)



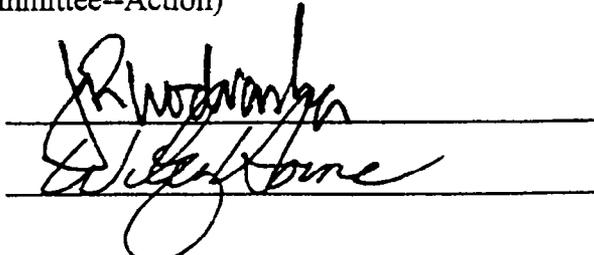
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METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

Revised 8-6

May 13, 1996

To: Board of Directors (Executive Committee--Action)

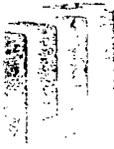
From: General Manager 

Submitted by: F. Wiley Horne
Deputy General Manager

Subject: Approval of Initial Policy Principles for Resource (Business) Development Programs

At the Engineering and Operations Committee meeting of May 13, 1996, the Committee voted to approve and revised the Initial Policy Principles for Resource (Business) Development Programs and its attachment underscored as follows:

- **Mission.** Services must advance Metropolitan's mission.
- **Uniqueness.** To avoid competition issues, services should utilize unique capabilities or fill a need that Metropolitan is uniquely positioned to meet.
- **Business Case.** Services must provide net financial benefit, approved by the Chief Financial Officer, taking advantage of existing resources and assets.
- **Rate Reduction.** Revenue will be utilized to maintain or reduce water rates and charges.
- **Risk.** Services must not expose Metropolitan and member agencies to significant fiscal risk.
- **Authority.** Services within Metropolitan's authority as determined by the General Counsel.
- **Board of Directors Approval.** Required of each nonmember request recommended by staff.



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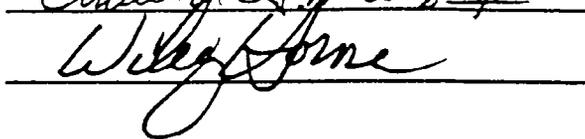
METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

8-6

April 23, 1996

To: Board of Directors (Executive Committee--Action)
 (Engineering and Operations Committee--Action)

From: General Manager 

Submitted by: F. Wiley Horne
 Deputy General Manager 

Subject: Approval of Initial Policy Principles for Resource (Business) Development Programs

RECOMMENDATION

It is recommended that the Board of Directors approve a starting set of policy principles to guide the staged development of Resource (Business) Development Programs.

EXECUTIVE SUMMARY

For over 60 years Metropolitan has provided various services to member agencies and other organizations. Recently, member agency managers have expressed a desire for improved access to Metropolitan's services as well as an interest in additional services. Metropolitan has also experienced an increase of requests from nonmember agencies. To this end, staff has received comments over the past three months from your Executive Committee, the Engineering and Operations Committee, and from a Member Agency Work Group, formed in February to work with staff.

Based on these comments, a starting set of policy principles (Attachment 1) was crafted to: (a) provide for the equitable and efficient provision of services to member agencies, (b) provide for the collaborative development of service programs jointly between Metropolitan and the member agencies, and (c) provide services to nonmember entities under the following guidelines:

- **Mission.** Services must advance Metropolitan's mission.
- **Uniqueness.** To avoid competition issues, services should utilize unique capabilities or fill a need that Metropolitan is uniquely positioned to meet.
- **Business Case.** Services must provide net financial benefit, approved by the Chief Financial Officer, taking advantage of existing resources and assets.
- **Risk.** Services must not expose Metropolitan and member agencies to significant fiscal risk.
- **Authority.** Services within Metropolitan's authority as determined by the General Counsel.
- **Board of Directors Approval.** Required of each nonmember request recommended by staff.

The program development work will be staged and undertaken jointly with the Member Agency Work Group. As the service program is developed, additional or revised policy principles will be brought to your Board for discussion and approval. Reports on progress will be made at least quarterly.

In response to your Directors' additional comments made in April 1996, clarifications were made to this document as indicated by the underlined text.

DETAILED REPORT:

Background

Since its inception, Metropolitan has provided various services at cost or for free to member agencies. It is proposed that this policy be maintained as fundamental. Pipeline inspections, refurbishment of valves, and emergency repairs have long been part of Metropolitan's unwritten service menu. In the past ten years, Metropolitan has also been called upon to provide services such as water quality monitoring and testing and health and safety training.

Historically, Metropolitan has also provided various services to nonmember agencies including the State of California Department of Water Resources, the Central Arizona Project, and the State of Baja, Mexico. This work has involved problem-solving services such as on-site inspection and lab testing or shop services, such as pipe fabrication and valve rehabilitation.

Recent Events

In August 1995, member agency managers asked Metropolitan to provide a directory of services to facilitate access to the proper staff and resources. This publication is scheduled for distribution in May 1996 and this will facilitate equitable and efficient access, as well as measurement of demand, for individual services.

Metropolitan continues to receive requests for various services from nonmember agencies, including local governments and other public and private organizations outside of Metropolitan's service area. Opportunities to participate in grants for cryptosporidium and seawater desalination research, and to partner with Daniel, Mann, Johnson, & Mendenhall to provide pipeline inspection for the Korean Government are recent examples. Because of the potential costs as well as benefits to Metropolitan, guidelines are needed to adequately evaluate the requests prior to recommending Board approval.

In January, February, and March, staff approached Board committees and member agency managers to discuss the issues in establishing procedures for evaluating these requests and making recommendations for policy.

Policy Development

A number of issues pertaining to member agency services, as well as the provision of services to nonmember agencies, have emerged through many discussions with managers and your Board. The following points were made by Board members at the Executive Committee meeting in February and at the Engineering and Operations Committee meeting in March:

1. Developing resources, providing services to others--how does it relate to our mission?
2. We should capitalize on competencies to conduct our core business.
3. Protect our intellectual property rights; patent our inventions and sell them.
4. Find opportunities for grants.
5. Use our economy of scale opportunities.
6. We have acknowledged expertise. We have a big investment here, lets use it.
7. Work must be done for true business reasons, not for image.
8. We have several revenue opportunities.
9. We have few true revenue opportunities.
10. What are our opportunities? We need to examine every option.
11. We are in a world economy; we must look at the broad picture.

12. We should not offer services in competition with the private sector.
13. Support our local economy.
14. We should be competitive.
15. Be mindful of our true costs of providing services.
16. Do we have an excess of staff? Are we trying to find work for staff?
17. Our machine shop services are unique and valuable to member agencies.
18. Water quality lab services are needed by member agencies.
19. Fees for services to nonmember agencies should be higher than those for members.
20. We need a structure to analyze opportunities; a sound business framework.
21. Don't launch a big program; be careful.
22. What does our legal authority allow us to do?

Based on these comments, staff has developed guidelines which allow for the provision of services: (a) where Metropolitan must maintain unique capabilities to carry out its own mission; (b) where competition with the private sector is not an issue; (c) where the Chief Financial Officer finds that there is a well-documented fiscal benefit to Metropolitan; (d) where the General Counsel finds that the service is within Metropolitan's existing authority; (e) where Metropolitan and member agencies are not exposed to significant financial risk; and (f) where there may be partnering opportunities with member agencies.

In order to adequately address all issues, either through policy or procedures, we are recommending a staged program development with a starting set of policy and guidelines (Attachment 1).

Staged Approach

Our general approach is to develop the program in tiers. This approach provides structure and flexibility in developing opportunities and coordination with current cost-containment initiatives.

The first tier will focus on Member Agency Services and ensuring direct, efficient access to these services. This will be done in conjunction with the Member Agency Work Group formed in February.

The second tier will focus on responding to requests for service from nonmember agencies from the government or nonprofit sector. The approach will develop a business case framework for analyzing each request (which will address risk, competition, available resources, scheduling, costs, benefits, etc.); identifying legal authority; and submitting the recommended request packages to the Board of Directors for approval.

The third tier pertains to requests for services from the private sector. The request from Daniel, Mann, Johnson & Mendenhall to partner for providing services to the Korean government is an example of Tier III. This is separated from the nonprofit sector because of the complexity of the legal issues. Additional work will be required to fully scope this tier and the issues involved. This approach permits coordination with cost-containment measures and provides structure and flexibility in developing opportunities and guidance to staff to further develop individual program features and processes.

Initial Program Policy and Principles

As a foundation for going forward, it is recommended that the attached Policy and Guidelines be approved. Quarterly progress reports will be made to your Board. It is anticipated that recommendations will be made in the future to modify or enhance this policy as the developmental work progresses.

Response to Director's Comments from April 1996

In response to comments received at the April Engineering and Operations Committee meeting, clarifications were made to this policy. New text is underlined and includes:

1. Classification of partnering to provide services to Korea as Tier III, not Tier II.
2. Ensuring member agencies equal access to services.
3. Using existing resources.
4. Clarification pertaining to the process for evaluating and recommending Board approval of nonmember agency (Tier II) service requests.

SW/aj:rev5
(10feb96)

PROPOSED POLICY AND GUIDELINES

GENERAL POLICY

- Metropolitan will use its unique expertise, assets, and capabilities for the benefit of member agencies in a manner which addresses its stated mission.
- Metropolitan will focus on member agency services and provide for the equitable and efficient provision of services to members. Program procedures will be implemented to ensure that each member agency has equal access to all services.
- Metropolitan will provide for the collaborative development of service programs with member agencies using existing resources.
- Metropolitan will consider providing services to nonmember governmental entities on a case-by-case basis using the guidelines listed below.

GUIDELINES

- **Mission.** Services must advance Metropolitan's mission.
- **Uniqueness.** To avoid competition issues, services should utilize unique capabilities or fill a need that Metropolitan is uniquely positioned to meet.
- **Business Case.** Services must provide net financial benefit, approved by the Chief Financial Officer, based on costs, taking advantage of existing resources and assets.
- **Rate Reduction.** Revenue will be utilized to maintain or reduce water rates and charges.
- **Risk.** Services must not expose Metropolitan and member agencies to significant fiscal risk.
- **Authority.** Services must be within Metropolitan's authority as determined by the General Counsel.

Board of Directors Approval. Required of each nonmember request recommended by staff.