



United States Department of the Interior

BUREAU OF RECLAMATION
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Memorandum

To: Regional Director PN, MP, UC, LC, SW, UM, LM

From: Commissioner (Sgd) R. N. Broadbent

Subject: Bureauwide Municipal and Industrial Water Marketing Policy

Attached is a copy of the subject policy statement for your use and implementation as of the date of this memorandum. The only exceptions to this policy are those bases of negotiations which have been previously approved in this office.

The policy statement represents regional input from the task force which met in Salt Lake City, Utah, on June 30 and July 1, 1983. A draft policy statement was circulated for further regional comment and input on July 29, 1983. We believe the attached policy statement accommodates the concerns expressed by those who reviewed and commented on the July 29 draft.

The section entitled Repayment Interest Rates was added to accommodate the August 24, 1983, memorandum from the Deputy Assistant Secretary - Policy, Budget and Administration on the subject "FY 1985 Budget Passback" (copy attached). See particularly, the paragraph identified as Operation and Maintenance Facilities. Also, attached is a copy of the June 30, 1983, letter from Joseph J. Tribble, Assistant Secretary for Conservation and Renewable Energy of the Department of Energy. That letter establishes repayment policy for power features of Federal multiple-purpose projects. The attached water marketing policy is intended to conform with items 1 and 5 of that policy for interest computations and interest rate determinations for new projects.

Please include this memorandum in section IV of your looseleaf policy instructions sent to you on February 26, 1980. That manual remains in effect until Series 190 of the Reclamation Instructions has been released.

Attachments

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Bureauwide

Municipal and Industrial Water Marketing Policy

Objective

The objectives of this water marketing policy are fourfold. The first is to assure that costs of developing and supplying municipal and industrial water are fully recovered with appropriate interest costs. The second is to accelerate repayment of the Federal investment. The third is to identify some specific ratesetting methods and policies which achieve the first two objectives. The fourth is to encourage innovation and excellence in M&I ratesetting to meet the first two objectives.

Background

Municipal and industrial water service ratesetting has historically been based strictly on allocated costs plus interest at the authorized project interest rate. The resultant municipal and industrial water service rates have been as varied as the projects which deliver the water and the users who receive the service. While it is recognized that many of the rate variations result from peculiarities specific to project authorizations, there is room within those variations where general policy guidance is appropriate in moving toward the stated objectives and toward consistent contracting practices for preparing municipal and industrial (M&I) water service contracts.

Policy

Each new contract should be approached within the following policy framework:

1. Every attempt should be made to evaluate and use one of the preferred ratesetting methods identified in this policy memorandum, or an alternative to accomplish these objectives should be developed and presented in the basis of negotiations for a proposed contract.
2. Irrespective of the ratesetting method used, a regular rate review, no less often than 5 years, is required. Operation, maintenance and replacement (OM&R) charges should be billed and adjusted annually or provided for in internal accounting procedures based on actual expenses.
3. Each contract should provide for both a standby and a delivery charge when appropriate. Standby charges are appropriate when a water use build up period or development period is involved. At a minimum, the standby charge must be sufficient to recover the interest at the project interest rate and OM&R for the amount of water under contract. The only year the standby charge should be credited towards delivery charges is in the year in which delivery is first made and only to that year's payment.
4. A reasonable period of time, depending on the proposed use of the water, should be identified in the contract for commencing beneficial use of the water. After that time, a mandatory take-and-pay, or termination schedule, shall apply to water under contract. This precludes speculation and indefinite holding of water for a minimal charge. Should a bona-fide second offer for the water

appear, and other water is not available for contracting, the contract should provide for right of first refusal by the contractor who would be required to immediately pay the delivery charge for water remaining on standby or relinquish the water covered by the contract.

5. A specific use for the water service should be clearly stated in the contract. Any deviation from such use or any assignment to another entity must have the approval of the United States subject to the security of financial obligations, compliance with appropriate related laws such as NEPA, and the concurrence of the State involved.

6. Each region should consider establishing a fee for both short and long-term water service contracts. The fee should be adequate to recover the costs of preparing, (including the costs of complying with the National Environmental Policy Act, etc.) negotiating and administering the contract. Alternatively, contracting costs should be placed in an O&M rate base for recovery directly through billing procedures or water charges.

Repayment Interest Rates

Project authorizations often contain specific rates of interest or interest rate formulas which determine the interest costs associated with project repayment. In addition, section 9(c)(1) of the Reclamation Project Act of 1939, section 301(b) of the Water Supply Act of 1958, and various other general repayment authorities contain specific and general interest rate criteria. The following policies shall be applicable to establishing interest rates for repayment purposes.

1. The contracting authority under section 9(c)(1) should be avoided if its use precludes the use of an interest rate in excess of 3.5 percent.

2. Interest rates or formulas in project authorizing acts shall determine the interest rate to be used for project repayment purposes when initially constructing a project and contracting for repayment.

3. Unless clearly and expressly prohibited by general or specific Reclamation law applicable to the project, all project costs for additions, replacements, renovations, and rehabilitation, including capitalization of O&M costs (when unavoidable), associated with interest-bearing project purposes, shall be accumulated at a current interest rate. The interest rate shall be that calculated pursuant to the formula contained in the project authorizing act for the current year. Absent such a formula, the interest rate shall be that calculated pursuant to section 202(3)(c)(ii) of the Reclamation Reform Act of 1982.

4. Unless clearly and expressly prohibited by general or specific Reclamation law applicable to a project, current interest rates should be used to accumulate interest charges against those project facilities which were intentionally deferred for construction by project sponsors until significantly after the completion of other project features.

Preferred Ratesetting Methods for Industrial Water Users

There are five ratesetting methods that have been used for establishing rates for industrial users. A very brief description of each follows. Contact points for more detailed information on each are also noted.

1. Debt Service. Using 10-year Treasury interest rates, which are representative of the actual financing costs to the Treasury, this method computes the present worth of an investment. At the beginning of each year, the total unpaid investment for consumptive uses is indexed to account for the interest on unpaid investment and amortized at an appropriate interest rate to derive a rate for each use. Recognizing interest charges for a year vary with the date of execution, two rates for each use, one for the first half and one for the second half of the year are set to reflect interest costs. Special applications to contracts with large volumes of water and the entity's inability to accept shortages in dry years are appropriate. Contact Position - Chief, Repayment Staff: Location: Upper Colorado Region, Salt Lake City, Utah, Telephone FTS 588-5435, Commercial (801) 524-5435.

2. Value of Federal Power Foregone - Opportunity Cost

When water service is provided by Federal contract to an industrial user, the water depleted from the system is typically no longer available for Federal hydropower generation. Generation losses may have to be replaced by purchasing energy from other available sources at market rates to meet Federal power customer commitment. The UM Region has used this procedure to establish a postage stamp or utility type rate by pricing the value of Federal power foregone at the highest point in the Pick-Sloan Missouri Basin Program power system. This established a minimum or base price for the entire UM Region. Contact Position - Chief, Repayment Branch: Location: Upper Missouri Region, Billings, Montana, Telephone FTS 585-6413, Commercial (406) 657-6413.

3. Cost of Alternative Facilities

The parameters for the Ruedi Reservoir (Fryingpan-Arkansas Project) industrial water marketing program were established through the use of the alternative cost of facilities and the cost of service approach. It was assumed the maximum rate that an entity would be willing to pay would be their viable alternative cost of facilities. Also, it was established that the minimum acceptable payment to the United States would be the return of its investment plus a prorata share of the operation and maintenance costs. These assumptions provided the negotiation parameters. Contact Position - Chief, Repayment Branch: Location: Lower Missouri Region, Denver, Colorado, Telephone FTS 234-3327, Commercial (303) 234-3327.

4. Willingness to Pay

Where there is competitive industrial demand for a limited water supply, negotiation of rates by using a bidding method may be appropriate. Contact Position - Chief, Repayment Branch: Location: Lower Missouri Region, Denver, Colorado, Telephone: FTS 234-3327, Commercial (303) 234-3327.

5. Market Value

Where already clearly established values for water exist in a geographical location, those values should be used as a guideline to negotiate water service rates. A certain amount of discretion should be used in this case. Contact Position - Chief, Repayment Staff: Location: Upper Colorado Region, Salt Lake City, Utah, Telephone FTS 588-5435, Commercial (801) 524-5435.

Ratesetting for Municipal and Domestic Uses

It is understood that customers for municipal and domestic water may not be able to compete in the immediate market area with the industrial entity for water. Such customers in general have no profit motive. While the general policy applies, specific ratesetting methods for such water service contracts will be considered on a case-by-case basis, and are not covered under this policy directive.