

Section 9(c) of the Reclamation Project Act of 1939 refers to furnishing water for "municipal water supply or miscellaneous purposes." In view of this language and the history of our program, we believe that "M&I" water service is everything but service of water to farms requiring irrigation water. ^{1/} On-farm domestic and related livestock use of water will continue as a legitimate agricultural water use. It may not be administratively practicable to differentiate between agricultural and M&I water service using the definition of a "farm" found in WPI 198.2.6.A. Therefore, identification of an M&I function should be done in concert with the parameters established under WPI 192.1.4.

B. Establishment of Water Charges or Periodic Payments

(1) The following parameters define the boundaries for establishment of rates or periodic payments:

(a) Minimum cost of service - The minimum cost of service to a contractor will be that water rate or periodic payment necessary to recover all allocable annual operation, maintenance, and replacement (OM&R) costs and allocable capital costs, plus interest, over the maximum authorized repayment period. In other words, if the maximum authorized repayment period is 50 years, then capital and interest costs would be amortized over that period and OM&R costs would be paid annually.

(b) Least-cost alternative - The least-cost alternative to the Federal water supply goes beyond just identifying the dollar cost of constructing a non-Federal project. It means identifying a valid and comparable alternative amount of water over a comparable period of time using non-Federal financing. From this information, it should be possible to project what the annual payment or water rate would be to amortize the costs of the non-Federal project.

(2) For most existing projects and projects authorized but not yet built or which are under construction, the minimum cost of service will be the basis for establishing M&I water rates or levels of repayment. This basic policy may be modified in consideration of the following factors:

1/ The following definition of a "farm" is taken from WPI 198.2.6.A. "A farm is any place from which \$1,000 or more of agricultural products, including livestock, were sold or normally would have been sold, during the census year. Farms are to be reported as operatorships, i.e., it is all the land on which some agricultural operations are performed by one person, either by his own labor alone or with the assistance of members of his household. The land operated by a partnership or corporation is likewise considered a farm. A 'farm' may consist of a single tract of land, or a number of separate tracts, and the several tracts may be held under different tenures, as when one tract is owned by the farmer and another is rented by him. This includes all of the land without respect to the size of the operation."

(a) When M&I water service is intended for an industrial or commercial contractor, consideration should be given to negotiating a water rate that approaches the per acre-foot charge for the least-cost alternative. Depending on the financial and legal parameters of the project, revenues may be used to accelerate repayment of the M&I function, assist repayment of the irrigation function, or assist in the repayment of other projects.

(b) Unless prohibited by legislation, water rates for M&I service should consider the opportunity costs associated with foregone hydropower production or other quantifiable factors. Consideration of such costs are particularly important if the provision of M&I water supply will lower the present net worth of expected revenues to the United States and/or there is no practical opportunity to reallocate costs among project functions.

(c) For projects where water service contracts are periodically renewed, consideration should be given to assigning part of the irrigation costs to M&I water users for repayment. Such a policy also could be introduced gradually into other existing projects where water service contracts are used, or could be used, and when there exists a significant potential for M&I contractors to help repay a project's irrigation function.

In future planning documents and when we have the opportunity to comment on proposed authorizing legislation, the possibility of a shorter repayment period for a project's M&I function and/or repayment assistance to the project's irrigation function should not be precluded but should be specifically recognized in the same manner as the role of the power function. Within the parameters of cost of service and the least-cost alternative, project authorizations should allow the M&I function to assist in the repayment of the irrigation function. Depending on these parameters, irrigation costs can be assigned for repayment by M&I water users as well as power users, perhaps on a proportionate basis.

C. Adjustment of Water Rates

Repayment contracts will not contain provisions for periodic adjustment of a contractor's obligation unless the adjustment mechanism is associated with account charge provisions in combination irrigation/M&I contracts. Water service contracts will always contain provisions for periodic review and adjustment of water rates at least every 5 years.

Adjustment of rates under minimum-cost-of-service contracts shall reflect the changes in OM&R and power costs, and variances in expected amortization of the repayment obligation due to historical or projected changes in water deliveries and cost allocations. However, if historical water deliveries have accelerated the repayment of capital costs, then the water rate should not be lowered.

Adjustment of water rates in contracts based on criteria other than minimum cost of service should ensure that the expected repayment period and/or assistance to irrigation are maintained. For example, if the original water rate was negotiated to return 150 percent of the minimum cost of service, this percentage should be maintained. Again, a downward adjustment of water rates would be precluded.

In the event that a project's M&I function is repaid, or that the entire project is repaid, then the M&I pricing policy will be established in light of legal and financial parameters, e.g., authorizing legislation, assistance required by companion projects, etc.

D. Quantity and Buildup Requirements

Within this determination is the requirement that water conservation be made a condition of Federal water service. There is some justifiable concern that buildup schedules for water use which require increasing use and payment for water will conflict with water conservation goals which encourage less use of water. It is possible that if water conservation is encouraged and followed, then we may be in a position of charging higher rates for less water. This, of course, serves to discourage water conservation.

Mitigating against this potential scenario are several factors. First, in many situations, the demand for water is relatively inelastic with respect to price, i.e., a change in price will involve a relatively small change in the quantity of water demanded. Also, the price of raw water may be of relatively little importance to an industrial or commercial contractor in relation to its other factor inputs to its production process. (It should also be noted that water pricing as a conservation tool would be ineffective under the above assumptions.)

Second, careful evaluation of present and future efficient uses and demand for water will automatically take into account water conservation. Therefore, there may not be much of a need to adjust water rates if slower-than-expected buildup in the use of water is not experienced and the repayment of costs allocated to the M&I water service function does not suffer.

Third, a decreased demand for M&I water could be recognized in a reallocation of costs to another project function and/or marketing of water to another water user.

Overall, the exact terms regarding the quantity of water the United States will be obligated to make available to a particular contractor should be influenced primarily by the supply and demand for water. If the supply of water is expected to be rather tight in the future, then the contractual provisions regarding interim buildup and ultimate use should be fairly exact and stringent. This would help to ensure that the contractor's needs are met to the greatest extent practicable and, perhaps, reserving water for future customers.

Alternatively, a situation where much water is available but little demand is evidenced could allow more flexible terms to be placed in the contract. For example, instead of targeted minimum quantities of water which a contractor must pay for, a minimum and maximum quantity of water could be specified within which the contractor could vary its annual use and payment. However, it may be prudent to limit the term of the water service contract (e.g., 20 years) in case significant demands are placed on the water supply in the future. This could ensure that unused water supplies can be beneficially reallocated. Also, recognition should be given to the needs of the contractor in setting the term of the contract. A municipality may have a bond issue tied to the securing of an adequate water supply for a certain number of years. An industrial concern may only need a water supply for the useful life of its facilities.

Basically, each contract will need to be tailored to fit the specific water supply situation. The limiting factors will be that (1) permanent water deliveries will not be authorized beyond those specified by the Congress or those identified in the applicable planning documents, and (2) except where otherwise provided by law, the requirement in subsection 9(c) of the Reclamation Project Act of 1939 that, "no contract relating to municipal water supply for miscellaneous purposes . . . shall be made unless, in the judgment of the Secretary, it will not impair the efficiency of the project for irrigation purposes. . ." shall be observed.

E. Short-Term Water Service Contracts

There is a continuing need to make available water supplies on a short-term basis. Usually, these water supplies are necessary (1) to accommodate potential long-term contractors during the negotiation and approval of such long-term contracts; (2) to supply long-term contractors with water in excess of the maximum contractual entitlements; or (3) to accommodate contractors, such as road construction companies, who have short-term water needs. The following principles shall be observed in negotiating such short-term contracts.

At a minimum, short-term M&I water service rates will be set to recover the minimum cost of service. Depending on the contracting policy for the project, the following factors also should be considered in establishing short-term water rates:

- (1) The short-term water rate should be set as close as possible to the long-term water rate;
- (2) For those entities, such as construction companies, which only require a small amount of water for a short time, a minimum charge should be imposed plus a fair rate for water service in excess of a quantity which equates to the minimum charge (this assures that administrative costs are covered);
- (3) Recovery of any deficit under a long-term contract.

Short-term water service contracts with entities having existing long-term water service or repayment contracts shall not substitute for those contracts in authorizing delivery of water. Necessary changes in long-term contracts shall be in the form of amendments to the long-term contracts.

In accordance with current Water and Power Instructions, short-term M&I water service contracts in excess of 500 acre-feet annually, and/or for more than 1 year's duration, shall be submitted to this office and the Solicitor's Office for review, and approval by the Assistant Secretary - Land and Water Resources, or the Secretary.

In conjunction with short-term irrigation water marketing programs, each region will prepare an annual report which identifies all short-term M&I water service contracts executed during the calendar year and which summarizes the terms of each contract, e.g., water rate, water quantity, length of contract, and purpose of contract. A consolidated report will be submitted to the Secretary on, or before, December 31 of each year.

F. Option Contracts

Potential industrial or commercial contractors are often faced with the necessity of securing adequate water supplies for their proposed projects as a prerequisite to approval or construction of a project. As energy projects are proposed in the future, it would seem reasonable to expect that option contracts will become more prevalent. (Note that option contracts also require appropriate environmental documentation under NEPA.)

The period of time a contractor may keep an option open may extend for the maximum contract period authorized by law as long as the option contract provides for marketing of the reserved water to an entity which is willing to put such water to immediate use and pay full price. The option contractor should be provided the opportunity to initiate full payment for the reserved water in the event another entity requests immediate water service.

Regarding the option charge, the minimum charge should be that necessary to return interest, at the authorized project rate, associated with the reserved water supply. The project water marketing policy may be designed to establish an appropriate option charge in excess of this criterion. For example, the option charge may be based on a percentage of the long-term water rate, or may be set to recover interest and allocated operation, maintenance and replacement costs.

No credit will be afforded a contractor for past payments of the option charge except that the option charge paid in the year that initial water use occurs may be credited to the full water rate on a per acre-foot basis.

G. Contracting Alternatives

The two types of contracts that are used in marketing M&I water are usually referred to as "repayment" and "water service" contracts. A repayment contract requires fixed annual installments over a given number of years. A water service contract requires payments based on a charge for each acre-foot of water used during a period. Authorization for the repayment-type contract is provided in subsection 9(c)(1) of the Reclamation Project Act of 1939. Subsection 9(c)(2) of the act provides authorization for the water service-type contract. The Water Supply Act of 1958 allows the Secretary to negotiate repayment or water service contracts to achieve the return of costs associated with the provision of M&I storage in reservoirs constructed by the Corps of Engineers or us.

The following guidelines should be observed in selecting the type of contract to be used:

(1) When a project has a substantial M&I function but little or no irrigation function, there is no opportunity to assist in the repayment of other project costs, and there is only one contracting entity, then repayment contracts will be used (e.g., the McGee Creek Project).

(2) Where the normal practice is to use water service contracts to achieve repayment objectives due to practicable limitations on the use of repayment contracts (e.g., Central Valley Project), then water service contracts should continue to be utilized.

(3) Where a project has both a significant M&I and irrigation function, then the contracting approach should be tailored to repayment needs of the project. For example, an optimal contracting approach may dictate that the main storage and conveyance facilities be covered by a water service contract while the local distribution systems be covered by a repayment contract. Water rates and periodic repayment installments would be established accordingly for the M&I and irrigation functions.

H. Operation, Maintenance, and Replacement of Project Facilities by Contractors

Whenever possible, the contractor(s) should assume the physical OM&R of the project facilities instead of paying Water and Power to OM&R the facilities. Where there are multiple contractors for a project, then this can be handled by (a) designating one contractor to OM&R the facilities; (b) specifying, where possible, that each contractor OM&R facilities which only serve it; (c) arrange for a consortium or association of contractors to OM&R facilities which serve them in common.

I. Use of Other Contracting Authorities

The authorities under the Act of April 16, 1906 (34 Stat. 116), or the Act of February 25, 1920, may be used when the specific situation warrants such use. Recommendations for utilization of these authorities will be carefully reviewed by this office and the Solicitor's Office.

J. General Contracting Principles

The following principles shall be adhered to in the M&I contracting process:

(1) Executed and validated repayment or water service contracts are required with appropriate organizations prior to the commencement of the construction of facilities to serve those organizations. Operating agreements, letters of intent to repay, or other pledges shall not substitute for firm repayment contracts. Consideration will be given to postponing a firm repayment contract on that portion of projects costs deferred pursuant to the Water Supply Act of 1958 if such action is viewed as being a reasonable risk.

(2) Unless otherwise specified by law, M&I repayment contracts must expressly recover all Federal costs with interest that are allocated to the construction and/or assigned to annual OM&R of facilities to serve the contractor.

(3) Repayment or water service contracts shall not obligate the United States to construct facilities that are not specified in the authorizing statute, that are not referenced by the authorizing act in relation to a specific feasibility report, or are not otherwise clearly authorized by Congress. Repayment or water service contracts shall not obligate the Federal Government to make expenditures beyond that specified by Congress in the authorizing statute. Where the estimate of total Federal obligations exceeds the authorized cost ceiling (as indexed, if permitted), contracts will not be approved until adequate authority has been provided by Congress.

(4) Repayment contracts shall contain maps (attached to and expressly made part of the contract by the text) defining and designating facilities to be constructed to the extent possible. The contract will only provide for the construction of those facilities identified in the appropriate planning report or specifically authorized by the Congress. The contract map(s) should not preclude design changes which will not have a significant negative effect on the contractor's repayment ability or will result in violation of the contractual cost or repayment ceiling. The contract also shall state the estimated cost of the facilities beyond which no Federal expenditures obligation will exist unless the authorizing legislation permits indexing.

(5) Once executed, the terms in the repayment or water service contract must be adhered to. Following contract execution, any significant changes or proposed changes in costs or system design will be immediately reported to the Commissioner who, in turn, will bring such changes to the attention of the Assistant Secretary - Land and Water Resources. "Significant changes" in this context means:

(a) Any change which results in a projected overrun of the cost expenditure ceiling or maximum repayment ceiling for those contracts which do not contain expenditure indexing provisions.

(b) Any change which results in a projected overrun of the cost expenditure ceiling or maximum repayment ceiling for those contracts which contain expenditure indexing procedures and such change is not attributable to indexible factors.

(c) Any change or cumulative change in system design which will result in modification, deletion, or addition to the system by changing the projected system cost by 10 percent or more; by changing the annual projected operation, maintenance and replacement costs by 10 percent or more; or by changing the projected annual commitment of project-use power to the contractor by 10 percent or more.

This policy is effective immediately for all new, amendatory, and supplemental M&I water service and repayment contracts except for those proposed contract negotiations where specific deviations from the above principles have been approved. Any proposed departure from the policy expressed above should be explicitly set forth in a proposed basis to negotiate a particular contract and the proposed Secretarial approval memorandum for a proposed form of contract.

The above principles will be set forth and elaborated upon in Part 193 of the Water and Power Instructions.

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