

Reclamation Manual

Directives and Standards

Subject:	Water Rates and Pricing
Purpose:	To set forth general requirements and options for establishing contract rates for irrigation, municipal, industrial, and miscellaneous uses of project water under Reclamation law. The benefit of this Directive and Standard (D&S) is that it promotes consistency in the application of generally applicable rate setting requirements for water-related contracts.
Authority:	The Reclamation Act of 1902 (ch.1093, 32 Stat. 388); the Sale of Water for Miscellaneous Purposes Act of 1920 (1920 Act) (41 Stat. 451; 43 USC 521); the Reclamation Project Act of 1939 (1939 Act) (53 Stat. 1187; 43 USC 485, <i>et seq.</i>); the Water Conservation and Utilization Act of 1939 (WCUA) (53 Stat. 1418; 16 USC 590y, <i>et seq.</i>); the Act of July 2, 1956 (70 Stat. 483; 43 USC 485h-1 – 485h-5); the Water Supply Act of 1958 (WSA) (72 Stat. 320; 43 USC 390b); the Act of June 21, 1963 (77 Stat. 68; 43 USC 485(h)); and acts amending and supplementing these laws
Approving Official:	Director, Policy and Administration (Director)
Contact:	Water and Environmental Resources Division, 84-55000

- 1. Introduction.** This D&S sets forth generally applicable requirements and processes for pricing contract water provided pursuant to the 1939 Act, the 1920 Act, and the WCUA for irrigation use or municipal and industrial (M&I) use, as those terms are defined at Paragraphs 3.G. and 3.I. of Reclamation Manual (RM) Policy, *Water-Related Contracts—General Principles and Requirements* (PEC P05). It also identifies both required and discretionary components of contract prices.
- 2. Applicability.**¹ This D&S applies to all Bureau of Reclamation personnel involved in water-related contracting activities, within the following parameters:
 - A. Higher-Level Authorities.** This D&S does not override requirements imposed by project-specific legislation,² treaties, judicial directives, or other applicable higher-level authorities, such as Federal regulations and Executive Orders.

¹The requirements in this D&S apply generally to water-related contracting activities. Given the variability of circumstances affecting these activities, it is appropriate to note that requests can be made to the Commissioner for waivers from RM Policy requirements in accordance with Paragraph 4.A. of RM Policy, *Bureau of Reclamation's Directives System (the Reclamation Manual (RM))* (RCD P03) and D&S, *Request for Waiver from a Reclamation Manual (RM) Requirement and Approval or Disapproval of the Request* (RCD 03-03). The Commissioner cannot waive requirements fixed by higher-level authorities.

²Including statutes and documents incorporated by reference into statutes, as well as compacts, settlements, and other agreements directed or ratified by Congress.

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- B. **Prospective Application to Contracts.** To the extent that this D&S establishes new requirements for water-related contracts, it will be applied prospectively to contracts executed, renewed, amended, or supplemented on or after its issuing date through the formal contracting process between the contractor and Reclamation.³ Contract amendments and supplements executed solely to conform a contract to the discretionary provisions of the Reclamation Reform Act of 1982 (Pub.L. 97-293, Title II, § 201; 43 U.S.C. 390aa, *et seq.*) or that do not provide any additional or supplemental benefit do not initiate the application of new requirements established by this Policy.
3. **Definitions.** The definitions provided in Paragraph 3 of PEC P05 and the following definitions apply to this D&S wherever the defined terms are used herein.
- A. **Appropriate Share.** In reference to project construction and operation, maintenance, and replacement (OM&R) costs, a share that fairly reflects the project benefits accruing to the contractor through the contract.
- B. **Construction Costs.** The costs of labor, land, materials, and financing to plan, design, and construct a project facility or feature of a project facility (e.g., a dam, pipeline, canal, etc.) for the purpose of providing new or additional benefits (e.g., irrigation, M&I, etc.). See RM D&S, *Plant Accounting - General Property, Plant, and Equipment (PP&E)* (FIN 07-20) for a more detailed list of items that are considered construction costs.
- C. **OM&R Costs.**⁴ The annual costs of ongoing, regular, or routine operation, maintenance, repairs, replacements, and other activities and actions necessary for continued structural integrity and operational reliability of project facilities required for the delivery of project water. See Paragraph 5 below for associated requirements. See RM Policy, *Allocation of Operation, Maintenance, and Replacement Costs* (PEC P07) for definitions relating to types of OM&R costs and treatment of the various types of costs in the cost allocation process.
- D. **Replacement Fund.** An optional fund that is additional to the contractor's required emergency reserve fund, addressed below under paragraph 5.B., and is funded, maintained, and used by the contractor to defray extraordinary OM&R (XOM) costs according to contractually established terms and conditions. See also Paragraph 3 of Temporary RM D&S, *Extended Repayment of Extraordinary Operation and Maintenance Costs* (PEC TRMR-49) defining the term "XOM."

³These contracting actions are normally requested by the contractor, rather than being sought by the United States.

⁴Note that the term "OM&R" is often used interchangeably with the term "O&M" (operation and maintenance). This Policy uses the term "OM&R," but either term may appear in contracts and other documents. Unless a different intention is apparent, "O&M costs" and "OM&R costs" should be understood to refer to the same costs.

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- E. **Replacement Fund Charges.** Charges made by the contractor in accordance with the relevant provisions of its contract with Reclamation and deposited into a Replacement Fund, as defined above. These charges are beyond the contractor's emergency reserve fund and Reclamation's charges to cover annual OM&R costs. See Paragraph 5 below for associated requirements.
4. **Responsibilities.**
- A. **Director.** The Director is responsible for providing guidance as needed, and for otherwise working with the regions to ensure the proper implementation of this D&S. The Director is also responsible for working with the regions to ensure that bases of negotiation (BONs) submitted for the Commissioner's approval include appropriate rate provisions based on the requirements of this D&S and any other relevant requirements. For requirements regarding the BON process, see RM Policy, *Bases of Negotiation for New and Amendatory Water Service, Repayment, and Related Contracts* (PEC P06) and RM D&S, *Preparing Bases of Negotiation for New and Amendatory Water Service, Repayment, and Related Contracts* (PEC 06-01).
- B. **Regional Directors.** Regional directors are responsible for ensuring the implementation of this D&S in their regions, which includes proposing appropriate rates in BONs, where required; negotiating within approved parameters; and administering the relevant contractual provisions. Where contract approval authority has been delegated to the regional directors, they are responsible for ensuring that the contracting actions they approve include appropriate rate provisions.
5. **General Charges.**
- A. **Annual OM&R Costs.** Contracts subject to this D&S will cover an appropriate share of annual OM&R costs. The rate components addressed in Paragraphs 6 and 7 below are additional to any OM&R costs owed to the United States or the project operating entity. Full payment of OM&R costs is required in advance of water delivery. Advance payment of OM&R costs to the United States will be adjusted to actual costs either during the year or at the year's end.
- B. **Emergency Reserve Fund.** Where applicable, appropriate charges will be assessed for emergency reserve funds, in accordance with RM Policy, *Reclamation Standard Water-Related Contract Articles* (PEC P10) and either RM D&S, *Reclamation Standard Water-Related Contract Articles, Standard Article 8: Emergency Reserve Fund (Annual Deposit)* (PEC 10-08) or RM D&S, *Reclamation Standard Water-Related Contract Articles, Standard Article 9: Emergency Reserve Fund (One-Time Deposit)* (PEC 10-09).
- C. **Replacement Fund.** If a contract establishes a replacement fund, the replacement fund charges will be additional to the minimum requirements established by contract for the

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emergency reserve fund and will be separately accounted for. The contract will limit the allowable uses of funds accumulated from replacement charges in accordance with the definition at Paragraph 3.D., above.

6. Irrigation Rates.

- A. **Irrigation Repayment Contracts Under Subsection 9(d) of the 1939 Act (9(d) Contracts).** Pricing for irrigation water made available under 9(d) Contracts will include an appropriate share of the reimbursable construction costs allocated to irrigation, without interest. Construction costs charged to irrigators will be adjusted according to the ability of the irrigators to pay where irrigation assistance is available and appropriate. Annual payments will be established to ensure recovery of the repayment obligation within the contractual repayment period.⁵
- B. **Irrigation Water Service Contracts Under Subsection 9(e) of the 1939 Act (9(e) Contracts).** Water service rates for 9(e) Contracts will reflect an appropriate share of reimbursable costs⁶ of constructing water supply facilities⁷ that are allocated to irrigation, without interest. When the contractor has paid an amount equal to the construction cost reflected in the water rate, this component will cease to be charged.
- (1) **Ability to Pay.** Rate adjustments based on the ability of the irrigators to pay will reduce the construction component charge without affecting the overall share of construction costs attributed to the contractor.⁸
 - (2) **Rate Reviews.** Each contract will include a provision for rate adjustments based on periodic rate reviews or other criteria. The intervals between rate reviews will not exceed 5 years. Rate reviews are not required for contracts of less than 5 years or when a contract's remaining term is less than 5 years.

⁵Subsection 9(d) limits the contractual repayment period to a maximum of 40 years. Project-specific authorities may authorize a different maximum repayment period for contracts otherwise executed pursuant to subsection 9(d).

⁶These rates do not constitute repayment obligations that would bind the contractor to a specific sum, but they are calculated to recover outstanding project costs, and so are characterized as *reflecting*, rather than *including*, an appropriate share of those costs.

⁷Subsection 9(e) Contracts cannot be used to recover reimbursable costs associated with water distribution works, which must instead be recovered through repayment contracts under subsection 9(d). Water supply facilities are facilities or features of a unit or project that make the project water supply available through storage and/or transportation. Water distribution works are those works needed to transport the water from the supply facilities to the end users. A basic distinction between supply works and distribution works is that supply works are of general use to the project and can reasonably be expected to continue to serve their purposes if the specific locations of water use change, whereas distribution works are tied to specific locations of use. Most water contracts define these features.

⁸This is because, whereas repayment contracts fix repayment obligations to be completed within a given number of years, water service contracts can normally be renewed or converted to repayment contracts, so that lower periodic payments need not affect the amount of the overall agreed payment.

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- C. **Warren Act Contracts.**⁹ For requirements concerning Warren Act contracts, including requirements for pricing and the disposition of revenues, see RM Policy, *Use of Excess Capacity in Reclamation Projects for the Impoundment, Storage, and Carriage of Non-Project Water* (WTR P04) and RM D&S, *Use of Excess Capacity in Reclamation Projects for the Impoundment, Storage, and Carriage of Non-Project Water* (WTR 04-01), and see RM D&S, *Charges for Use of Federal Assets* (PEC 01-01).

7. M&I Rates.

- A. **M&I Repayment Contracts under Subsection 9(c)(1) of the 1939 Act (9(c)(1) Contracts).** Pricing for M&I water made available under 9(c)(1) Contracts will include an appropriate share of the reimbursable project construction costs allocated to M&I, to be repaid over a period of not more than 40 years, with interest¹⁰ at a rate not exceeding 3.5 percent.
- B. **M&I Water Service Contracts under Subsection 9(c)(2) of the 1939 Act (9(c)(2) Contracts).**¹¹ Water service rates for 9(c)(2) Contracts will reflect an appropriate share of outstanding reimbursable costs¹² that are allocated to M&I, with interest at a rate established in accordance with subsection 301(b) of the WSA,¹³ unless applicable project-specific legislation specifies a different interest rate.

(1) Paid-Out Projects and Contractors.

- (a) **Construction Component Charge.** M&I rates under 9(c)(2) Contracts in paid-out projects or with paid-out contractors are no longer required to include a construction component charge.

⁹The Warren Act of 1911 (Pub. L. 61-406; 43 USC 523 – 525) authorizes contracts under which water users may carry non-project water through Reclamation project facilities for irrigation purposes.

¹⁰Required interest charges include interest during construction and interest on investment, as applicable according to the terms of RM D&S, *Interest During Construction* (FIN 07-20-10) and RM D&S, *Interest on Investment* (FIN 06-30C). The terms “interest during construction” and “interest on investment” are used herein as defined at Paragraphs 3.A. and 3.B. of PEC 05-05.

¹¹The purpose of Paragraph 7.B. is to define and implement the Secretary’s broad authority under subsection 9(c)(2) of the 1939 Act and under the 1920 Act for establishing water rates. The statute provides the discretion to set rates in a manner that balances the needs of water users and the interests of the United States. In the case of 1920 Act contract rates, there is the additional option, at the contractor’s election, to include rate components after the reimbursable project costs have been paid for accumulating funding for certain future costs associated with maintaining and rehabilitating the relevant facilities (see Paragraph 7.C., below).

¹²These rates do not constitute repayment obligations that would bind the contractor to a specific sum, but they are calculated to recover outstanding project costs, and so are characterized as reflecting, rather than including, an appropriate share of outstanding costs.

¹³This interest rate is updated annually and distributed by Policy and Administration to other Reclamation offices. It is available on the U.S. Department of the Treasury’s website at http://www.treasurydirect.gov/govt/rates/tcir/tcir_fy2011_opdirannual.htm.

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- (b) **Replacement Fund Charge.** At the contractor's option, the contract will establish a replacement fund and replacement fund charge to be assessed after payout of project construction costs, in accordance with Paragraphs 3.D. and E. and 5.C. above.¹⁴
- (2) **Developing Negotiating Parameters.**¹⁵ To the extent available, and where different rates or rate-setting methods are not specified by applicable law, the following data or methods will be used in determining a range of rates for negotiating purposes. See Appendix A to this D&S, *Application of M&I Rate Requirements in PEC 05-01 as Issued on July 24, 2013.*
- (a) **Determining an Appropriate Baseline (Floor).** A current cost method will be used to establish a presumptive baseline or floor M&I rate for contract negotiation purposes,¹⁶ subject to determinations made in accordance with Paragraph 7.B.(2)(d), below.
- (b) **Determining an Appropriate Ceiling.** Where available, market data will be used to determine prevailing water service prices in the local market,¹⁷ and the upper end of the local market rates will serve as the absolute ceiling¹⁸ for the negotiating range. For each proposed rate, Reclamation will, at a minimum, examine the water market in the area and document and analyze the extent to which market transactions provide appropriate guidance for pricing M&I water. See Paragraph 2.B. of PEC 01-01 regarding the meaning of "market value" or "market price."
- (c) **Additional or Alternative Factors.** The following information will be used as available, and as needed or otherwise deemed appropriate, to develop and justify negotiating parameters.
- (i) **Existing Contract Rates.** Where available, M&I rates under existing Reclamation water service contracts within the relevant area will be considered in determining an appropriate rate, to the extent that those rates reasonably represent the local market rate, or in place of the market rate, if those data are unavailable.

¹⁴This provision sets forth options for rate components that contractors may utilize after payout of reimbursable project construction costs for accumulating funds for certain future costs associated with the relevant Federal facilities. This paragraph is not intended to limit other options that may be available to contractors for accomplishing the same objectives or to disturb existing arrangements that contractors may already have instituted with their water users.

¹⁵The purpose of these determinations is to assist in calculating an appropriate price range prior to negotiations.

¹⁶This can be accomplished by indexing original project construction costs to current dollars, or estimating the costs of constructing new facilities capable of developing and delivering comparable water supplies.

¹⁷This data may be requested from the Water and Environmental Resources Division of Policy and Administration (84-55000).

¹⁸If the presumptive floor rate under Paragraph 7.B.(2)(a) is higher than the absolute ceiling rate under Paragraph 7.B.(2)(b), the ceiling rate will serve as the contract rate.

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- (ii) **Opportunity Costs of Foregone Hydropower Production.** Where applicable, and unless prohibited by legislation, opportunity costs associated with foregone hydropower production resulting from the M&I water use established under the contract will be considered in developing the negotiating parameters for water rates.
 - (d) **Payment Capability.** At the request of the contractor, Reclamation will conduct a study to determine the water users' payment capability. The study's conclusions will be used in determining an appropriate rate. The contractor requesting the study will be responsible for costs associated with performing the study. Existing payment capability studies that are relevant to the contracting entity, comply with applicable Reclamation policy, and were completed within the prior 5 years will be used to the extent deemed adequate by both parties.
 - (3) **Use of Revenues.** Revenues exceeding the minimum requirements of Paragraphs 5.A. and 7.B., above, will be used for the following purposes and/or other purposes authorized by applicable Federal law and agreed by the parties:
 - (a) **Accelerated Repayment of M&I Costs.** Where there are outstanding project construction costs allocated to M&I, amounts collected through the negotiated subsection 9(c)(2) rates that are above the amounts needed to meet the minimum requirements under Paragraph 7.B. above will be used to accelerate repayment of those costs.
 - (b) **Irrigation Assistance.** Where reimbursable project construction costs allocated to M&I have been repaid, the construction component of the subsection 9(c)(2) rates will be used to assist in the repayment of any outstanding reimbursable project construction costs allocated to irrigation that have been determined to be beyond the ability of the project irrigation water users to pay.
 - (4) **Rate Reviews.** Each contract will include a provision for rate adjustments based on periodic rate reviews or other criteria. The intervals between rate reviews, where applicable, will not exceed 5 years.
- C. **1920 Act Contracts.** Rates for 1920 Act contracts will reflect an appropriate share of outstanding reimbursable project construction costs with interest at a rate established in accordance with subsection 301(b) of the WSA. Rate determinations will be made otherwise in accordance with Paragraph 7.B.(2), above. See Paragraph 5.F.(2) of RM D&S, *Crediting Requirements for Incidental Revenues* (PEC 03-01) for disposition of revenues collected as the construction cost component. When all reimbursable project construction costs have been repaid, M&I rates under 1920 Act contracts are no longer

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required to include a construction cost component. At the contractor's option, the contract will establish charges to be assessed after payout of project construction costs, to be used as specified below.

- (1) **Construction Component Charge: Statutory Credits to the Project (Statutory Credits).**¹⁹ Any revenues collected as construction cost components after payout will be deposited in the Reclamation fund as statutory credits,²⁰ in accordance with PEC 03-01, to be applied against future obligations for repayment of project construction costs, including Safety of Dams costs (see RM D&S, *Safety of Dams Repayment* (PEC 05-05)).
- (2) **Replacement Fund Charge.** At the contractor's option, the contract will establish a replacement fund and replacement fund charge to be assessed after payout of project construction costs, in accordance with Paragraphs 3.D. and E. and 5.C. above.

D. M&I Contracts Pursuant to Section 9 of the WCUA. In addition to general charges required under Paragraph 5, above, rates for water made available under contracts executed pursuant to section 9 of the WCUA will be calculated to produce revenues at least sufficient to cover an appropriate share of outstanding reimbursable project construction costs allocated to M&I, with interest at a rate established in accordance with subsection 301(b) of the WSA, unless applicable project-specific authority requires a different rate. Revenues derived from WCUA M&I contracts will be deposited in the General Treasury as miscellaneous receipts.

- (1) **Construction Component Charge.** When all reimbursable project construction costs have been repaid, M&I rates under section 9 Contracts are no longer required to include a construction component charge.
- (2) **Replacement Fund Charge.** At the contractor's option, the contract will establish a replacement fund and replacement fund charge to be assessed after payout of project construction costs, in accordance with Paragraphs 3.D. and E. and 5.C. above.

8. Documentation. All pricing decisions require a documentary record describing how the relevant rates were developed and providing information to show rates that would have

¹⁹The term "statutory credits to the project" is defined in Paragraph 3.K. of RM Policy *Incidental Revenues* (PEC P03).

²⁰The 1920 Act requires these revenues to be credited to the project providing the contract water, and the revenues are statutorily barred from being otherwise credited. Statutory credits are construction charge revenues accumulated in the Reclamation fund and credited to a particular project after the project's reimbursable construction costs have been repaid. Statutory credits are, in effect, advance payments *to* the Reclamation fund rather than funds requested *from* the Reclamation fund, and are therefore applied without the need for an appropriation. They are available only to defray future reimbursable construction repayment obligations (normally associated with dam safety) incurred for the project that generated them.

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resulted if alternative methods had been used (e.g., market data, existing contracts, current cost calculations, etc.). A discussion concerning the rationale for selecting a particular rate will become part of Reclamation's official records concerning the transaction, including a justification for why market rates were not used in setting contract rates, if applicable.

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