

The Source

UTILITY ENTERPRISE MANAGEMENT

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Are Your Utility Rates Fairly Allocated to Your Customers?

If you are like most utilities, your rate structure has been in place for many years, and its origin may be unknown. You may have concerns about the fairness of your rates, and it may be a challenge to annually generate enough revenue to cover all operation costs, including adequate reserves. While many utilities have adopted annual planning practices that enable them to prepare for future improvements, many others are caught off-guard when capital improvement needs occur. An effective strategy designed to take the guesswork out of utility rate planning is the utilization of a cost of service study in conjunction with a capital improvement plan.

Understanding your utility's costs of service by user class is particularly important in instances where the utility has distinctively different types of users. That is, if all user classes use water or generate wastewater in a similar fashion, there is likely little difference in the cost to serve a residential user and the cost to serve a commercial user. However, if your user base includes large industrial customers that consistently use large volumes of water, or discharge high volume or high strength wastewater, the cost associated with serving that type of customer will be different than the cost to serve the average residential household. In this case, all users will benefit from determining the appropriate cost to serve each user type.

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Note: This article is the second in a series regarding the issues associated with lease/leaseback of utility assets in the North Central Region.

Is Time Running Out for Lease/Leaseback?

On October 21, 2003, the United States Senate Committee on Finance held a hearing to examine the current situation regarding tax shelters - both corporate and individual - and the government's response. Republican Senator Chuck Grassley from Iowa, chairman of the Committee, contends that these tax

shelters cost taxpayers billions of dollars a year in lost revenue. Of particular interest to Utility and City Managers is the response to testimony by a former leasing industry executive who explained how tax shelter architects use the leasing of subway systems, bridges, and other public infrastructure in the United States and Europe to shelter billions of dollars from taxes. This is the underlying concept for the lease/leaseback transactions currently under consideration by many political subdivisions in the North Central Region.

Senator Grassley commented, "It's hard to believe that city assets are helping tax shelter promoters. Roads and bridges built with tax dollars are leased out to shelter promoters so major corporations can get a phony tax deduction. Even the subway system of Washington, D. C., our nation's capital, has been leased as part of a shelter scheme. We need to shut down this type of tax shelter and all others in the process." Grassley is promoting bipartisan legislation that would ensure that the Internal Revenue Service has more information about questionable transactions so it can distinguish between legal tax transactions and illicit tax shelters. His international tax reform and manufacturing tax relief legislation, overwhelmingly passed by the Finance Committee on October 1, could close the loophole allowing the use of city assets for tax shelters.

So far, lease/leaseback is still an available option. The Senate has twice followed the Finance Committee's leadership in approving tax shelter reforms; however, the House has not yet adopted this Senate legislation. Grassley said he hopes the government agencies that need legislation for increased enforcement will help push Congress to give the bill final passage.

On November 18th, Grassley expanded his pursuit of abusive tax shelters by asking the Transportation Department for copies of documents regarding the process that allows major corporations to claim tax breaks from using the nation's highways, subways, airports, and water lines. Grassley said he also plans to make the effective date of his legislation to shut down these tax shelters immediate instead of the date of enactment.

For those entities that are comfortable with the process and pursuing lease/leaseback arrangements, this may create a sense of urgency. For those questioning the process, Grassley's bill may put an end to their soul-searching. For complete narratives of the hearings, visit <http://finance.senate.gov/> and click on the "hearings" icon. ■

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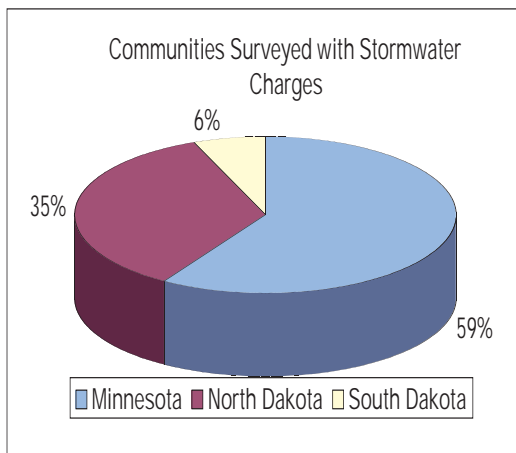
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Regional Rate Survey: Stormwater Utility Rates

In the 2003 Utility Rate survey conducted by AE2S, 29 percent of the communities surveyed reported stormwater charges. Of those charging for stormwater, the monthly fee ranged from \$1.25 to \$5.00. The majority of the communities having a stormwater charge were located in Minnesota. ■



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A cost of service evaluation involves the categorization of all utility costs into fixed and variable components. The costs are then distributed to the various user classes - such as residential, commercial, and industrial users. This process incorporates all relevant costs, including administrative costs, utilities, supplies, maintenance, transfers, equipment, operational expenses, capital outlay, and debt service. These costs are then allocated to each user class based on the service level the utility provides.

Once the cost of service by user type is determined, utilities have a basis upon which to set fair and equitable rates for each user class. It should be noted that the cost of service can vary from year to year as use patterns amongst users change. As a result, utilities are cautioned to ease into major changes to the utility rates, to avoid overcorrecting for any existing inadequacies. A review of the appropriateness of utility rate structures is recommended as an annual activity to be conducted in conjunction with annual capital improvement and budget planning. ■

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