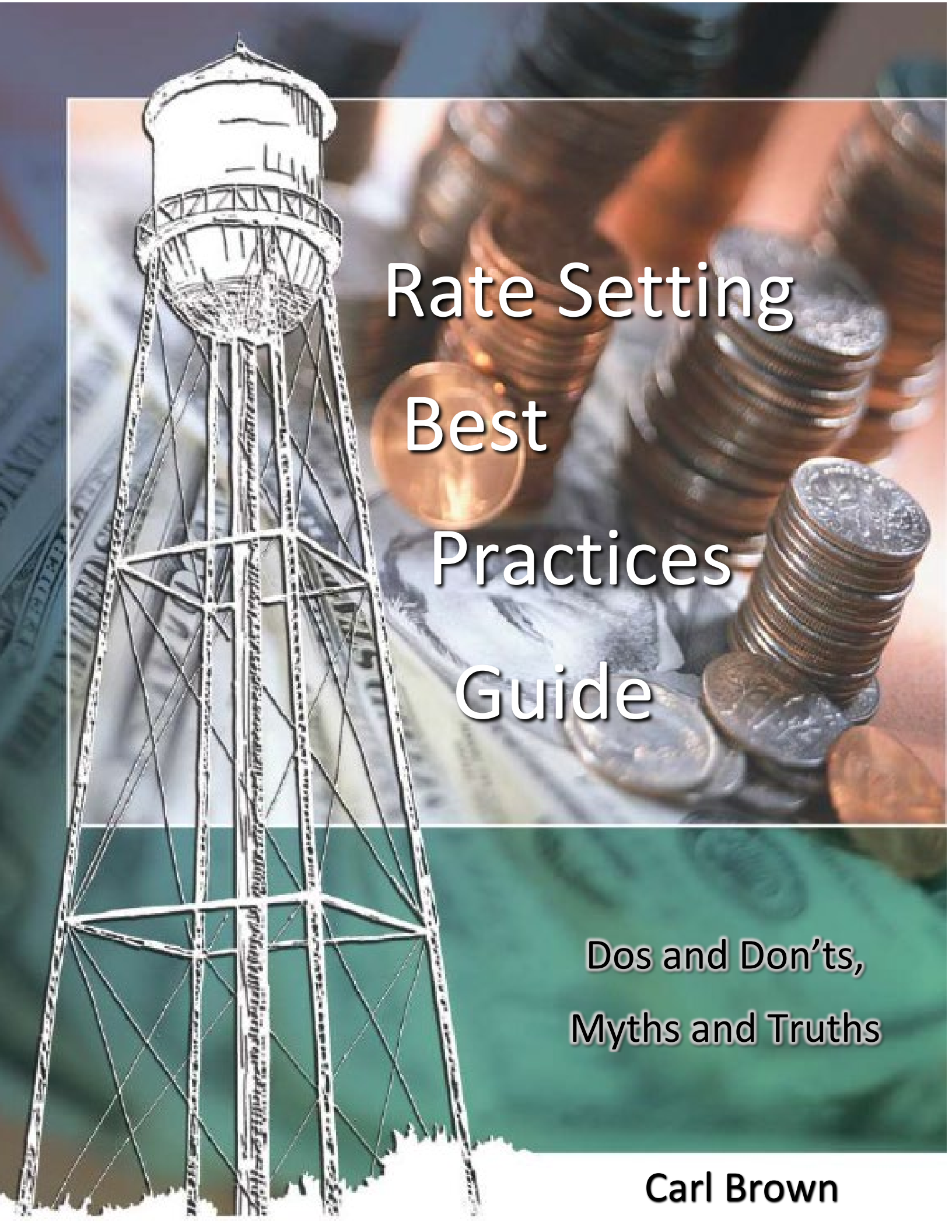

Rate Setting Best Practices Guide

Dos and Don’ts,
Myths and Truths

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Contents

Chapter 1: Introduction

The mission of a public utility is to:

1. Provide a valuable service to the public,
2. Do it effectively, and as much as possible,
3. Do it fairly.

Water and sewer services are especially valuable because they strongly promote public health along with commerce. But all utilities are important to the well-being of people and our economy and most serve the environment, as well. Missions 1 and 2 are givens.

As to Mission 3, all utilities should provide service fairly. Fairness has to do with how the service itself is provided. But it also has to do with pricing of the service. As a utility rate analyst, my forte' is not utility service provision. I leave that to others. My focus is pricing of that service.

The following pages contain a listing of rate setting (and related) best practices, dos and don'ts, myths, and truths. This list is long, but still not all-inclusive. There are many issues to consider, at least in certain situations. I cannot cover them all here.

Legal disclaimer:

The author is not an attorney and offers no legal opinions in this guide.

Target Audience:

This guide targets those who calculate or adopt utility rates – boards, councils, clerks, finance directors, city and district administrators and similar folks.

If you are in this group, please read and pass this around to your colleagues. If you are not in this group, please pass this along to those who are.

Language in this guide:

Whenever possible, I use the first person "I," rather than the third person "the author." I also say "you" referring to you personally, but often the "city," "district" or other entity you represent. I am sure you can tell "who" I am referring to in each context.

Self-promotion:

Whenever a rate analyst writes a guide about their field of expertise, it will include elements that are self-promoting. In this guide I say, "You should only hire a rate analyst to do rate analysis." I am a rate analyst, so that is self-promoting. But it is also good advice.

My advice to you helps me. It also helps any good analyst. But my focus is helping you set utility rates that are adequate and fairly structured and do it with little hassle at reasonable expense.

Should you do all these best practices? Most of them? Some of them? Would you like the rule-of-thumb about which best practices you should do? Sorry, there is no such rule, but start here.

When setting utility rates, and doing related things, size (complexity) of the utility matters.

Large utilities should do all, or nearly all the best practices in this guide as completely as possible. Large utilities have a high capacity, or economy of scale, to do work and reap rewards for doing that work. They can do even marginal best practices and still reap a reward.

Tiny utilities, on the other hand, need to pick and choose. Tiny utilities have poor economy of scale. Their reward to investment ratio is not good for some of these best practices.

In-between utilities can do many best practices, but they still need to pick and choose a bit.

Economy of Scale

If you set out to provide water service, the first gallon you produce and deliver will be the most expensive gallon. The one-billionth gallon will be quite cheap.

All water utilities produce the first, really expensive gallon. Small utilities don't graduate much past that, so they have poor economy of scale. Large utilities produce most of their flow in the cheap water range. They have a high economy of scale.

What does that mean for your utility?

- If you have fewer than 50 to 100 connections or customers, you are tiny. The next time you hire out a rate analysis, for example, may be 30 years from now when you build a brand-new treatment plant, or other expensive capital improvement.
- If you are approaching 1,000 connections, small, you can productively use a rate analysis every 10 years or so, or whenever you build that new plant, big upgrade, or expansion. And you can productively do more of the other best practices, too.
- If you have 1,000 to 5,000 connections, medium sized, you should get that analysis about every 5 years. Or you should get it whenever you build that new plant if that is coming sooner. Plus, you can productively do most other best practices, too.
- If you have 50,000 connections, large, you can productively do it all. On the rate analysis front, you might (but I do not recommend it) want to have one of your staff accountants and an engineer (you have several of each) get rate analysis training and have them do in-house analyses more often than every 5 years. It would also be nice to have those trained analysts do financial projections of the usefulness of various asset management initiatives and other high-level best practices.

I focus on the rate analysis best practices partly because that is what I do and what I know best. But the practice with the highest reward to investment ratio for nearly every utility is rate analysis, at least occasionally. So, it makes "investment sense" to get your rates set right, even if you fall short on other kinds of best practices.

Said another way, rates need to be high enough to fund the best run utility, and the worst. And in either case, if your rates are unfair, you are courting danger of ratepayer revolt.

Rate analysis and retirement investing are cousins. They each, hopefully, produce a payback of the fee paid or the principal invested, respectively. On the investing side, a good mutual fund will return the principal invested plus that much again in about five to eight years. In other words, it takes five to eight years to double your retirement money.

A much-needed rate analysis, done by most any experienced rate analyst will, if called for, do the same in a week or maybe two. For many of the analyses I do, the payback period is three days or less. And that is done working for client utilities that average about 3,000 connections.

For a moment now, I will slip into almost pure "selling" mode to say this. A good and much needed rate analysis for a small utility provides such a large return on investment that it is hard to believe. (For big utilities, it can get really unbelievable.) Most people reject things that are hard to believe. That is understandable and usually reasonable, but unfortunate in this case. You could resist spending say $9,000 for a rate analysis, because you want to "hold the line" on expenses, but that would likely cost the utility on the order of $500,000 in extra user charges not assessed and collected over the next five years. Don't you wish you could put $9,000 into your retirement portfolio and have it turn into $500,000 in five years?

From this discussion you may have figured out your utility needs more revenue and fairer rates right now. Most do. And there are other best practices that will gain your utility strong rewards, too. That means the following best practices are not just interesting to read about. Or that they are something you should consider doing "someday" when the workload slacks off. Most are things you should start doing now.

Some of the following best practices go against what you have been taught, so they may offend you. For that, I apologize now. I mean no offense to anyone. I mean only to help utilities, and their customers, get better rate setting results. I have learned from others who have been around the block before me. At this stage in my career, I have been around the block myself. Now I am trying to pass knowledge along to you.

***

Chapter 2: Rate Setting Best Practices for Utilities

Rate setters, you need to perform these tasks.

Truths to Keep in Mind

Utilities live or die on their rates. All ratepayers want excellent service for which they pay little. Some want all the service and none of the bill. Most ratepayers know almost nothing about what it takes to provide service. Few even know where their water comes from and where their sewer goes to, or what happens to them in either place.

1. Abide by all state laws, bond agreements, agency regulations and anything else that relates to how you set rates.

   This is kind of the "other duties as assigned" clause for utilities. Many things, regulatory in nature, affect rate setting. Or they affect things and actions that affect how rates need to be set. Abide by "the law."

   I place this best practice up front because it covers a host of things that you just need to do and have little alternative but to do. Now, we can get on with rate setting issues in which you have some options about what and how you do them.

2. Be open and honest with ratepayers, when necessary, painfully so.

   Do this all the time. It will keep you on the straight and narrow. Your ratepayers will grow to appreciate it and trust you for it. Their trust and support are critical to the success of the utility.

   This behavior is not complicated. It is the Boy Scout way, the Girl Scout way, the smart and easy way to make sure you consistently tell people the same "story" every time. To be blunt; do not create the story on the fly. When the story is the truth – facts, not spin – it is a lot easier to remember the story you are telling. The story does not change until the facts change. And then you tell folks the facts have changed.

   Extend the painfully honest treatment to your rate analyst or prospective rate analysts, too. If you already have one on board, openness helps them to get the utility and your ratepayers the rates they need and do it quicker. Volunteer information even if you think it might not be relevant. Sometimes it is.

   If an analyst is only a prospect so far, your openness puts them on notice that you are looking for, and you insist they be open and honest with you, too. Honesty and openness are not always comfortable, but they are a great foundation for a good working relationship.

3. Strongly related to Best Practice Number 2, always keep the difficult-to-pay customers in mind when setting rates.

   I always consider the bill effect on the "little old lady, widowed, retired, living alone on Social Security." I advise client utilities to try to keep her bill from becoming unaffordable, turning her into a bad customer. Yes, that goes against the "everyone should pay their own way" notion. But that notion is sometimes trumped by another important notion – that you should operate a good

business. You do not have to care about the general welfare to do that. You should, however, avoid being written up by the local paper for hurting the "little old lady…" That is bad business.

Even if you care nothing for the "little old lady…," the health of everyone demands that you not subject too many people to sickness. We want people to be healthy, if not for their benefit, then at least for our own benefit and the benefit of all the other ratepayers.

Granted, the utility service you provide is almost certainly healthful for those who use it. That is just how we do utility service in this Country. But if the cost is too high for the "little old lady…" to use all the water she should to maintain adequate sanitation, she will conserve. If she conserves too much and gets sick, she may infect others. The monetary worst-case scenario is, she will go to the hospital and run up some unpaid medical costs for all of us to pay. Public health costs money and some customers simply will not be able to pay their full bill. The rest of us must take up the slack.

This is my advice to the utility manager or board that subscribes to the "everybody should pay their own way" notion. Take a breath. Lean heavily on the notion that a utility is first, and always, a business. Businesses cannot sustain themselves if they create too many bad customers. Pure and simple, you do not want to turn the "little old lady…" into a bad customer.

Generally, **"bad customer"** means a non-paying customer. You will have some of those. It is just human nature. But do not unnecessarily create more bad customers.

4. Stop comparing your utility's rates to the rates of other utilities.

Such a comparison can only be useful if you have done a "comparables study," in which case, you only compare your rates to those utilities that are comparable to yours. Comparables studies are difficult and expensive to do. That money would be better spent on a good rate analysis to arrive at rates that <u>your</u> utility and ratepayers need.

A **"comparables study"** is a comparison of your utility with others that are <u>like</u> yours: same type, age, size, materials, same kind of location (soils, terrain, development, etc.), similar water source and quality of water, similar effluent characteristics and receiving body of water for sewer, similar jobs market (competition for labor), similar degree of sustainability and more.

You might do a comparables study to figure out how to perform better. And it is good practice to compare your connection (system development) fees to your "competitors" to avoid pricing yourself out of future development. (See Best Practice Number 13.) But do not set user charge rates based on what the rates are in neighboring utilities.

It is misleading at best to compare your rates with those of other utilities. Such comparisons give ratepayers unrealistic expectations – everyone wants to pay the lowest rates. Thus, rate comparisons can only help one utility – the one with the lowest rates. And often that backfires because those ratepayers want to <u>continue</u> paying the lowest rates, even though they are unsustainable. Rates should be calculated to properly serve the utility in question and its ratepayers, not some other utility and its ratepayers.

5. "Right-size" your rates.

   Right-sized rates are not too complex, not too simple, as close to a cost-to-serve structure as is practical and set up to serve the situations of the utility and its ratepayers. Rate setting is a "Goldilocks" balancing act. I call these "great rates," hence, the name of my company.

6. When it is time to get right-sized rates, get a good rate analysis done.

   A good rate analysis is useful for many things. Many, many things.

7. When your analyst says, "Adopt these rates," do it.

   First, I grant that the board or council and many staff members know local conditions and needs better than any outside rate analyst. Your analyst should take those things into account. But few people know the math, methods, and strategies of rate analysis like a good rate analyst does. That specialist has analyzed rates in many different situations. Because of that prior experience, which local folks do not have, the analyst may know that a certain rate structure or strategy would work better for you than the one you think is best.

   The analyst will not arrive at "correct" rates, because there is no such thing. But they will probably be closer to "right" than anyone else. If they are wrong, you can blame them and make them do it over.

   If you adopt the rates the analyst recommends, you can tell your ratepayers the facts – you are following the expert's advice. Remember Best Practice Number 2 above? It is hard to fault following the expert's advice. And very importantly, doing that insulates you from conflicts of interest in the rate structures you adopt because you did not structure rates to benefit yourself or your friends. The analyst, an outsider, calculated that structure.

   To be a bit contradictory, I also must say that it is never wrong to question your analyst, their math, or their theory of rate setting. A couple of opposing examples illustrate this.

   Your analyst may know the math of rate analysis thoroughly. But they may have little experience in how rates affect ratepayers, real people. The math should be done correctly, but it should be guided by practicality. A good rate analyst also knows ratepayers, and their leaders, need to be "brought along" to grow to accept fact-based rates. But the analyst should not dictate that process to you. If your analyst seems to gloss over the people side of new rates, give them some guidance. You will both be better off for it.

"Rate analysis" considers all key rates-related issues over a five to ten-year projection period to arrive at a set of rates and fees that fully fund the utility and do it fairly.

The American Water Works Association describes a **"rate study"** as doing nearly as much as rate analysis. However, in practice, what passes as a "rate study" often considers only one year and far fewer rates-related issues. Most rate studies do not classify costs to the customer level, which must be done if rates are to be fair at the customer level.

On the flipside, if your analyst does not do cost classification and use the result as the basis for at least one rate structure scenario they develop for you – cost-to-serve rates – they are sliding away from analysis and going straight to politics. But you, the local folks should be doing the politics part, not the analyst. An analyst with a strong personality and presentation style can "sell" a structure that is far from cost-to-serve or is otherwise unfair. You should guard against that and correct them, if needed.

"Cost classification" is the process of divvying all costs into categories: peak flow capacity costs, equally sharable fixed costs, costs related to service volume or other criteria.

Once costs have been divvied into the various categories, the analyst can calculate system development fees, the basic minimum charge, and the average unit charge, all in a cost-to-serve structure that will fully fund the utility.

Analysts should develop the facts and provide guidance, while leaving the politics up to the elected officials who must adopt the new rates. This does not mean analysis is good and politics is bad. It means there are two separate functions going on. One is factual and advisory. The other is getting rates adopted in a political arena. The latter must happen, even if no analysis is done. But rate setting works better if it is based on good information and data. After all, you cannot judge when you have reached the "Goldilocks" balancing point if you do not first figure out how the costs really are incurred.

I adhere to the following approach. I think you should require it of your rate analyst, whoever they are.

> *Your analyst should do the full suite of math calculations to determine cost-to-serve rates that will sustain the utility for a long time. On the short side, five years are adequate. I go ten years. If you want to stick with cost-to-serve rates, no more analysis is needed, and you are ready to move on to adopt those rates.*
>
> *But you may think the rate structure that will best serve your community's situation should be different than cost-to-serve in some way. Tell your analyst what you think. In that case, the analyst should still present to the decision-makers and ratepayers the cost-to-serve rates and the analysis behind them. That scenario becomes the factual base line for comparisons.*
>
> *The analyst should also present the rate structure you prefer and describe the ways they differ from cost-to-serve rates. Importantly, they should present the **reasoning** for those variances – why they are better or preferred by your leadership, how they will reduce rate "shock" or whatever the reasoning may be for choosing those rates.*
>
> *In this way, everyone will know the "math facts." And they will know how and why the preferred rates differ from the "math facts" rates. Then they can make informed judgements and decisions about what rates to adopt. Quite importantly, this process keeps the analyst from playing in local politics. They are serving as the "fact checker" for you and the ratepayers, but you get to decide your own fate.*

This strategy harkens back to Best Practice Number 2, be open and honest. I will cap this esoteric discussion with an easy-to-understand and common example.

The math says the "little old lady…" should pay $50 per month for 2,000 gallons of water. Analysis – the math – also shows that bill would be completely unaffordable for her. So, decision-makers, with agreement from most of the public then decide to set rates that will only charge her $25 per month, with other ratepayers paying a bit more to make up the revenue shortfall. The job of the analyst then, is to calculate how much higher all the other rates would need to be to cover the revenue shortfall. If the board or council and most ratepayers are fine with that structure, they have determined what "fair" is to them and the analyst produced the math to make sure those rates will work.

8. If you are a rates adopter and you do your own "rate studies," stop that!

As you saw in Best Practice Number 7 just above, rate analysis is technical. The analyst should serve in an advisory role. Because of conflicts, the rates calculator should not be a rates adopter, too. It is even tricky if the rates calculator is on the staff of the rates adopters, such as the finance director or clerk of the town or district.

I tell clients this fact. I do their rates, present at their council or board meeting, some ratepayers hate on me for what I recommend, but then I go home in another town or even another state. If the clerk or finance director is also the analyst, they go home in the same neighborhood as all those mad people. They shop in the same stores. They go to church with them. Some of them are relatives. It can get uncomfortable for the local "analyst." For me? No.

Unless you are an experienced rate analyst, when you calculate rates, you are probably making errors. Do not feel bad about that. I see some analysts and especially other service providers do that, too. If you calculate the rates, YOU will get blamed by customers who do not like or trust those rates.

Do-it-yourself rate studies? Don't do it!

The best-case scenario for do-it-yourself rates is, you calculate rates that truly are appropriate, but ratepayers perceive that you have conflicts of interest because you are a customer, and you have friends, family and others close to you who are customers. Ratepayers readily perceive conflicts of interest when it comes to rates. Sometimes their perception is, in fact, correct. Sometimes they will claim there is a conflict just to throw up a smoke screen to stop the new rates, because they simply do not want to pay them.

Hire a rate analyst when you need rate analysis, avoid conflicts of interest, avoid errors, and get the full rate revenue increase the utility needs.

Finally, you probably do your own rate studies because you think it will be too expensive to hire a rate analyst. If you can afford to hire an accountant to "do your books," you can well afford to hire a rate analyst to make sure there is enough money in the "books" to pay for everything, including that accountant. As a bonus, the analyst can make sure you get revenue from customers fairly and do it for several years, maybe even many years into the future.

9. While you should not do your own rate studies, you should do your own annual incremental across-the-board increases during the years between rate analyses.

   Raise rates every year, at least a little bit. Inflation happens. Keep up with it.

   This is how you should proceed with initial rate adjustments and incremental increases.

   Step 1: Get a rate analysis done by a good rate analyst, so you will know how high and how to structure rates and fees initially. That is the first set of rate adjustments. The analyst should also tell you how much you likely should increase rates across-the-board in future years, usually to keep up with inflation. (If the analyst projected that in future years you should exceed or lag inflation by a certain percentage, do future increases to achieve that.)

   Raise rates every year, at least a little bit.

   Step 2: The next year at budget preparation time, you should calculate how much higher the budget needs to be compared to the current year's expenditures. When you adopt the new budget, adopt across-the-board rate increases that will fund that budget properly. Do both in tandem and ratepayers will understand. (By the way, to do this right follow the directions in the book, "How to Get Great Rates," Chapter 9. The book is a free download at https://gettinggreatrates.com/Freebies.)

   Repeat Step 2 each year until the rate structure becomes unfair enough to make a new rate analysis worthwhile, usually in about five years.

   Think of the two steps like this:

   Step 1: A professional mechanic replaces the engine in your car because the engine leaked out the oil and seized up.

   Step 2: You make sure you check and change the oil regularly, from now on.

   Going about rate calculations and rate adjustments in this way, the restructuring adjustments are calculated by the analyst, infrequently. That keeps your rate analysis costs down. The across-the-board increases are done by you each year as you prepare each budget.

10. You try to run a zero balance in the utility because it is a "non-profit." Stop that.

    Non-profit does not mean have no reserves. That is a sure way to go broke. Big things unexpectedly break or happen. You should have strong reserves to be ready for them.

    Ratepayers like the idea of no reserves in the utility fund. They would rather have that money in their own hands. But ratepayers really do not like the reality of their water or sewer service being cut off because something in the utility broke and the utility had no reserves to fix it.

A final word on letting ratepayers hold the reserves – they just will not do it. Some cannot. They are poor, have a low-paying job and live paycheck-to-paycheck. Some make much more, but they still spend it all and do not hang onto personal reserves. For many reasons, most households in the U.S. have essentially no savings or reserves. We could moralize about that, but the fact is the fact. If the utility is to serve its customers well, which includes getting through some difficult times without interrupting service, the utility must hold substantial reserves on behalf of their ratepayers. Ratepayers may not be responsible about maintaining reserves, but you must be.

11. On a related note, stop subsidizing the water utility with sewer revenues, or the sewer utility with general funds or any service with funds from any other service.

    Generally, every revenue generating service should pay its own way. Sure, it may be impossible for the city's soccer league, that assesses a fee to participants, to be self-supporting. But every water, sewer, trash, electric and similar utility should be self-supporting. When you start down the slippery slope of one utility funding another, you are setting yourself up for mismanagement and maybe termination. At the least, by definition and fact, the rates will be unfairly structured because they will not be structured on a cost-to-serve basis for that utility.

    That does not mean the town or city should not get a "cut" of the utility's revenues. In a town or a city that provides utility services, the town or city administration and staff provide services to the utilities – billing, general administration, purchasing, personnel management and more. The town or city should be paid for the services it provides to the utilities. Thus, one of the line-item costs in each utilities' budget should be payment to the town or city for such services. This situation is not a utility subsidizing the city. It is a utility paying for services it receives.

12. Stop including a usage allowance, "free water," in your rates.

    Water is not free, and it is not fair to "give" 2,000 gallons per month to all if not all use 2,000 gallons every month. Any usage allowance skews rate structure fairness. Almost always, that goes against the "little old lady…" kinds of customers. See Best Practice Number 3 above.

    There is the common notion that the allowance is a way of providing a "life-line" volume, enabling the "little old lady…" to only pay her minimum charge and nothing extra for that 2,000 gallons. That is only the case if you analyze costs and apply the cost of providing the first 2,000 gallons to unit charges, not the minimum charge. But such analysis is almost never done and there is no way to arrive at the true cost of providing the first 2,000 gallons anyway. (For sure, the first 2,000 gallons costs more to produce and deliver than the last 2,000 gallons.) That means, you cannot factually defend the amount of cost applied to unit charges. And that will get you crosswise with Best Practice Number 3.

    Finally, there are better, more defensible ways of reducing the burden on the minimum charge, which is the lion's share of the "little old lady's…" bill. That comes in the next two best practices.

You can give water away, but that does not make it free.

13. Stop allowing new connections at low connection fee rates.

    Reality check: Almost all utilities under-charge for new connections, and that is understandable. The true cost of new connections is high and nearly every utility is competing with every other utility to entice growth, meaning, new customers. Thus, the one fee you need to be at least somewhat competitive on is new connection fees. Otherwise, developers go down the road to another town or area if they can build cheaper there and increase their profit.

    Still, building and maintaining capacity to serve costs a lot of money. You should recover more of that cost up-front, preferably with meter size-based system development fees that are keyed to the capacity of different meter sizes to sustainably pass and accurately meter flow.

    In other words, growth should pay for growth, as much as is practical. Otherwise, existing customers must subsidize growth through their regular user charge rates. By default, that cost usually gets added to the minimum charge which most hurts, you guessed it, the "little old lady…"

    At a minimum, new connection fees should be set high enough to pay the out-of-pocket cost of allowing and enabling new connections. That includes permitting connections; providing meters, pipes, and other equipment to new customers; making inspections of new connections before they are covered; etc. If fees are set higher than that, and they should be, they will recover some capacity costs. Very few water and sewer utilities set their connection fees high enough to recover all capacity costs. But you should recover all you reasonably can in system development fees, then get the rest from minimum charge surcharges.

14. Start assessing minimum charge surcharges that recover capacity costs proportionate to meter size.

    Not all water and sewer utilities need or should have meter size-based minimum charges. Small systems with only two or maybe three of the smaller meter sizes and none that are large, usually do not warrant the added rate structure complexity of meter size-based rates. The added complexity is not worth the marginal increase in structure fairness.

    But usually at around 1,000 connections, meter size-based rates make sense. The extra fairness is worth the added structure complexity. That is especially true in a small town where a cannery, a manufacturing plant or a greenhouse operation uses ten percent of the town's water volume and has a six-inch meter.

    Meter size-based minimum charges should recover two kinds of costs. One is the basic cost of providing service to any customer – billing, general administration, the capital cost of providing a base volume of service, and similar costs.

Peak flow capacity costs, however, should not be shared by all customers equally. They should be assessed to each customer based on their ability to demand flow, whether they ever use it or not. Meter size relates well to capacity cost. While the math gets complicated, it is a part of the calculations a rate analysis should include anyway. Therefore, if your situation warrants it, be sure to have the analyst include these calculations when you next have your rates analyzed.

15. Start raising rates every year, at least a little bit.

    This point was covered above and is amplified here for good reason. Unless your utility is and will be sustainably cheaper to own and operate in the future than it is now, you should not hold rates steady or even think about lowering them. (There are a few exceptions, mainly having to do with qualifying for grants, but this is otherwise a good rule of thumb.)

Raise rates every year, at least a little bit.

Sure, you may have a year where costs go down. You may have two. But you should be wary about lowering rates. It is almost always a better strategy to hold rates steady or only raise them slightly during such a year. Inflation will come back. You can count on that.

If, after several years, you find your reserves growing egregiously too high, maybe you can slow down the annual increases and let costs catch up to revenues, which will lower your reserves slowly. More likely than doing that, you will realize you have capital improvement needs that you now, finally, can address. Build more infrastructure sooner. That will improve service more rapidly, which ratepayers like.

16. Start planning for and costing out capital improvement program (CIP) expenses.

    Analysis is responsible only if it fully considers CIP needs. In fact, current or approaching CIP needs are usually the prime reason utilities request rate analysis.

17. Start scheduling and costing out equipment repair and replacement (R&R) needs, for the same reason as CIP.

    Excel spreadsheets to help you do CIP and R&R planning, scheduling, and costing are available for free download at https://gettinggreatrates.com/freebies. These spreadsheets can help any utility regardless of size, age, and complexity do a better job of CIP and R&R. They get at the heart of asset management, enabling smaller systems bootstrap their way up to asset management. These spreadsheets, used by a long-term, seasoned operator may be all a small utility needs to do reasonable asset management.

    The more thorough and effective approach for slightly larger or complex systems is to do full-blown asset management. Asset management covers all aspects of the life and function of systems. In fact, rate analysis and rate setting are subsets of asset management. Rate analysis and asset management are simple in concept but complex to pull off. To do asset management well, it helps to have a software program keep track of everything, schedule maintenance and replacement tasks, track costs, and comprehensively plan.

There is software out there that does this. Most is quite complex and expensive, not practical for small or even medium size systems. I recently found one program that is flexible, comprehensive, easy to use and economical for smaller systems, written by an engineer/planner/programmer who has deep experience in asset management. That is Aktivov Asset Management https://www.aktivov.com/ (Other than rural water associations as a group, this is the only endorsement in this guide). You should visit their website and feel free to contact me about it, too.

18. Start recording balances, incomes, and expenses in standard format financial statements.

    Export those statements to Excel or another spreadsheet format for analysis. Owning and operating a utility sustainably means you need to do some analysis.

19. Start reviewing data from your billing program to better manage the utility's finances, water loss, frequent flyers that do not pay their bills and more.

    Just like financial statements, you should export this data to Excel or another spreadsheet format for your analysis, and eventually, that of a rate analyst.

    To give you an idea of what kinds of data this analyst, and just about any analyst will need, visit the "Freebies" page above and review the "Data Needs Sheet."

20. If your billing program cannot produce useful management data in a spreadsheet format so you can examine whatever you want, ask the software producer for that capability. If they cannot provide it, ditch that program and get one that can.

    Billing programs are databases – a matrix into which you enter data. They include an interface for data entry. They also include an interface for getting things out of the database – bills, reports, and the like.

    Billing programs are remarkable tools, but they are only completely useful if you can use them in ways besides simply calculating bills. For rate analysis, I almost always must get individual customer usage data from the billing program. It is very difficult, sometimes impossible to get that data out of some billing programs in a format that is usable for analysis.

    A robust billing program should make data export into several formats easy, not difficult, or impossible. If your billing program does not support such use, I recommend you research billing programs and acquire one that not only calculates bills, but fully supports export of that data for other purposes. If you decide to research other billing programs, I have a few suggestions.

        Contact your state rural water association and municipal league, tell them what you are trying to do and ask for their recommendations and guidance.

Specify to prospective program suppliers that the acquired billing program must include options to export data at any time to Microsoft Excel and Word formats, Portable Document Format (PDF) and Delimited Text Format. In addition, when specifying Delimited Text Format, be sure the program includes the option of exporting in "Tab Delimited" format. That format enables conversion to spreadsheet formats without data being merged and made unusable.

Finally, if you do not acquire a more user-friendly billing program, I recommend staff consistently export data into Excel and Delimited Text formats from the current billing program, if possible, on the cycle required by the program. That may be monthly. (Quite literally, that task needs to be listed on a calendar as a standing task for staff to perform. Miss one download and you have a big hole in your data set.) Save those data files permanently for use outside of the program, so you and others can gain full benefit from the data included in the program.

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Chapter 3: "Personal Services" Background Information

Rate analysis is a "personal service." Many other services are, as well. This chapter gives background information for getting such services. Much of this has to do with restrictions that law and policy place on how you can get personal services. Longstanding practice comes into play, too. If you do not care about background and you just want to know how to do this, skip to Chapter 4, 5, and 6. Otherwise, read on.

A reminder: The author is not an attorney and offers no legal opinions in this guide.

U.S. cities, towns, utility districts and authorities and other such entities provide utility services. You might think that solicitation of personal services is tightly regulated by federal and state law and doing the solicitation effectively is just a matter of abiding by the law. That is not the case.

Based on my years of experience and much research, I have found there is not one law or even a set of laws that govern solicitation of all kinds or dollar amounts of personal services. That makes sense. Personal services range widely by nature, from manual labor to the highly technical; and by dollar amount, from a few hundred dollars to millions. It would be difficult to mandate in one law exactly how personal services must be acquired in all cases. If the law did attempt to do that, many services would be lumped in with others that were not compatible, so service acquisition would be cumbersome and expensive for some services and utilities. That most affects smaller towns and utilities.

Definitions

Personal Services are NOT products or "things." Rather, they are forms of work done by people. Examples: engineering, accounting, software programming, and utility rate analysis.

A Request for Qualifications (RFQ) is a solicitation of an individual's or firm's capability to perform certain work. It is probably most often used for hiring a consulting engineer to design something.

A Request for Proposals (RFP) includes coverage of qualifications, but it asks the proposer to also tell you what they plan to do, how they will do it and what it will cost you, plus other things.

RFQs and RFPs both get at the notion of qualifications-based selection (QBS).

QBS is the best way to get highly technical and expensive services. Rate analysis is highly technical. But the fees paid for that service should be tiny compared to the fees paid for designing a treatment plant, for example. That means, if you want to keep analysis fees low and still get a great rate analysis, you need to simplify the service acquisition process.

Federal law governing solicitation and contracting requirements seems to be aimed primarily at federal procurement. You likely benefit from such laws and programs, like being able to purchase certain equipment or even some services from a blanket contract held by the federal government. States offer similar blanket procurement opportunities for local governments, too. A big value of such programs is that local governments can gain the benefit of highly contested solicitations, some of which can be quite technical and complex, but not have to do all the due diligence work themselves. They just purchase under the blanket contract.

Some states are very active and prescriptive in laws about how local governments must acquire personal services. Most are not.

My research indicates that most state procurement laws are aimed at relatively "big ticket" items, usually those costing more than $100,000, but occasionally ranging as low as $10,000. Only in rare situations should rate analysis be a big-ticket item. Rate analysis for Denver is just going to be big-ticket. Denver utilities are big, complicated things. Rate analysis for a population 5,000 town is not big-ticket, so you should not make it big-ticket by complicating the acquisition process.

What does this mean for you? First, you, or your attorney should research your state's laws concerning personal services solicitation. Do what you are required by law to do. But likely, you can do it simply, as described earlier. Strive to serve your citizens and customers as well as you can when soliciting personal services. Simpler and cheaper serves them better than complicated and more expensive.

A bit more information will help you better understand the general process of acquiring personal services. After that, the last two chapters of this guide will go into more detail with the rest of the numbered best practices.

Discussion items:

- As a local government official, or an official of a utility owned by a local government, in all things that you do you should strive to serve your customers and citizens well and do it as transparently as is practical.
    - First, do that because it is the right thing to do.
    - Second, being trustworthy and transparent engenders trust in you by ratepayers. You need that.
    - Third, states have open meetings, open records laws. Break those laws and, sure, you are in some legal trouble. But mainly, you upend the first and second points just mentioned. You lose citizen and ratepayer support.
- Your job is to serve people well. The people need to be aware you are doing so. Often, your actions are not visible for all to see – you are busy getting the work done and they are busy with their lives. Sometimes you need to explicitly tell them what you are doing. Part of serving folks well involves why and how you solicit personal services, occasionally including rate analysis. Tell folks about it. They simply do not want to pay more, but you need to show them you are trying to charge them fairly. A good rate analysis will deliver that.

- Personal services like engineering are quite technical and critical to public safety, public health, and environmental protection. Consequently, such services are expensive. Criticality and high expense call for a solicitation method that is of the highest order. That is usually called, "qualifications-based selection," or QBS. You can Google "qualifications-based selection" to learn about this process. If you use QBS well, you probably will NOT get the cheapest engineer. You may even get the most expensive. But you should get the best engineer, or among the best, to satisfy your mix of needs. Some engineered things can "collapse and kill people," so you must get the engineering right.
- While rate analysis requires special expertise, too, and the resulting rates are critical to the financial health of the utility, a rate analysis cannot collapse and kill people. QBS principles are imbedded in the simple solicitation process described earlier for getting a rate analysts. Rate analysis results in rates that will serve well for five years to perhaps ten years. Rate analysis will be relatively cheap, if solicited appropriately. And if rates do not perform as expected, they can be reanalyzed and adjusted. (It is hard to "adjust" a bridge you just finished building.) If you get the right kind of guarantee, a rate analysis do-over will be free. To generalize, engineering is a "once and done," rather extraordinary event. Rate analysis and rate resetting is more of a workmanlike, ongoing process.
- Finally, consider these things concerning rate analysis solicitation. As you specify more "deliverables" and "how the work must be done" sorts of requirements, you move from paying a low fee for analysis that does what you need, to paying a high fee for something that may or may not do what you need. (If you specify what you want, but you do not know what you truly need, you may get what you asked for, but it may not satisfy you real needs.) Thus, to get what you need but not pay too much for it, you must specify less:
    - Tell the prospect your goal, like, "We want rates that are adequate to pay all system costs and be fairly structured."
    - Tell them when the proposal is due, how to submit, who to submit it to, and just a few other need-to-know details.
    - Beyond that, just answer their scoping questions.

  This chapter introduced the solicitation process I recommend. Related issues will be fleshed out in the remaining two chapters.

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Chapter 4: Soliciting "Personal Services"

Think of the solicitation approach described in this chapter as the "minimalist" approach. Actually, there is a minimalist approach, and then there is an even easier (for you) minimalist approach – the RATES Program. To use either, you need to NOT do things that do not help your cause and instead, do certain things that do help your cause. The next chapter covers solicitation using RFPs and RFQs. Whether you use the minimalist approach or the RFP/RFQ approach in Chapter 5, there are best practices that apply to either. As you read Chapters 5 and 6, you can figure out which ones those are.

In this chapter, I start with an outline of the approach to solicit a wide range of personal services. This approach works well for most kinds of services. I follow that with an example of how to apply this to rate analysis services. This simple, quick process works for most utilities. The rest of this chapter then fleshes out the process with details and background information.

Appropriate solicitation will get the kind and quality of service you need, set you up to pay a reasonable fee for that service, and prove to ratepayers, taxpayers, and citizens that what you have done will serve them well.

First, the outline of how you should go about this, generally.

***

Getting a Personal Services Provider's Help: <u>Your Part of the Process</u>

1. *You (city administrator, district manager, other official) should get approval from your governing body to solicit and hire a personal services provider (PSP)*
2. *You should carry out due diligence:*
    a. *Call the association(s) you belong to, and other referrers,*
    b. *Check out the potential PSP(s),*
    c. *Check references of PSP(s),*
    d. *Check reports PSP(s) produced, asset management program of PSP(s), whatever the case may be,*
    e. *Check fees, guarantee, etc. of PSP(s). Once satisfied that a PSP is a good candidate to help you…*
3. *You call the PSP(s) who are expert in the service you need*

4. *It's OK, even useful, to call a potential PSP candidate several times:*
    a. *Once to assess them a bit – Are they really a rate analyst? Do they provide a great asset management program? This call will help you determine what you need and can expect from this PSP. Perhaps you should require the same from other PSPs. These calls will help you learn how to get served properly by the PSP you eventually choose.*
    b. *Call again to let the PSP scope the project.*
    c. *Call again after you get their proposal to make sure you understand what they offer, fees, etc., and perhaps to accept their proposal.*
5. *When you receive the preferred PSP's proposal, accept or reject it*
6. *Use the same process for any other PSPs*

Getting a PSP's Help: <u>The PSP's Part of the Process</u>

1. *PSP scopes your situation and needs (work needed to do the project, "red tape" you require, etc.)*
2. *PSP calculates fees for services*
3. *PSP sends proposal and you accept or reject*
4. *The chosen PSP analyzes, sets you up with an asset management program, or does the work of whatever the "project" is*
    a. *In the case of rate analysis, the PSP gives you a report and guides you in rate setting and related issues*

***

Now that you have seen the outline of a solid but easy solicitation process, you are probably thinking, "This is going to be a lot of work." First, it is less work and more productive work than the RFP/RFQ approach. And second, you may be able to avoid most of this work because someone else has already done it for you. Several state rural water associations have done much of the due diligence work their members would otherwise need to do themselves. That effort is called the "RATES Program."

The RATES Program

My firm serves as the rate analyst for the "RATES Programs" of the rural water associations in Colorado, Kansas, Nevada, New Mexico, North Dakota, Virginia, and Wyoming. Visit https://gettinggreatrates.com/-RATES-Programs to learn how the program works.

Most prospective clients that come to me through the RATES Programs do not prepare RFPs. Most just call their Association and ask for rate setting help. When the Association can help, it does. When the member system needs more complex help, the Association refers them to me. They call me. I scope their needs and situation (using the same scoping process and math every time) and then I propose. Almost all accept my proposal. I analyze and, using that information and guidance, they adjust rates.

The RATES Programs are how I market in these states. As described earlier, that saves me hours acquiring projects, so I give member systems a 25 percent discount on my fees. That usually places my fees at the top of the bottom third of my comparable competition. I like this trade-off because I do not like to market. I like to spend my time analyzing rates and getting them set right. Of course, the associations like giving their member systems a nice perk of membership: little work on their part, dependable analysis, and dependable and low cost. Member systems save enough through the discount to pay their annual dues for several years.

You might ask, "How do I know I am getting a good deal and good service if I get rate analysis through the RATES Program?" This is how.

What I do and what I charge is supervised by the Associations. They have vetted me, my pricing, and my services and they know how other service providers perform, too. They chose me for this service because my firm provides their member systems a balance of deep expertise, effectiveness, and economical fees. Most of these Associations have known and worked with me for many years, some for more than two decades. I copy them on all important correspondence I have with their members, things like proposals, rate analysis reports and invoices, so the Associations always know what I am up to and what I am charging.

This is the big protection feature for you. These Associations laid their reputations on the line when they partnered with me. Their number one priority is protecting their members. If they even get a hint that I am not taking good care of their members, I am gone. I am comfortable with that. My number one priority is protecting and serving my clients well, whether they come to me through a RATES Program or not.

If your Association has the RATES program, if you trust that the Association performed and will continue to perform its due diligence work to protect you, and if your purchasing policies allow it, you can call the Association, ask for rate analysis help and the Association and/or I will take it from there.

If you can use the RATES Program, just call your rural water association to start that. Otherwise, read on.

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How to Solicit Rate Analysis

A. *Your board or council should direct the city administrator, district manager or whoever the prime executive is to seek out and perhaps hire a rate analyst. That might be done with a resolution statement to this effect:*

> ***The Council intends to set fair rates and fees that will fully fund the City's water utility, such fees will begin as soon as is reasonably possible and with periodic adjustments, they will progress into the future. To that end, the Council hereby authorizes the City Administrator to promptly solicit the services of utility rate analysts. The selected analyst will be tasked with determining the structure and level of such rates and fees on a cost-to-serve basis, or other basis desired by the Council, and advise the Council of the same. If the fees for such services provided by the most appropriate rate analyst, as determined by the City Administrator, are not expected to exceed $_____, the City Administrator is hereby authorized to hire that analyst, notify the Council of their choice, and proceed with the analysis project. If, however, those fees are expected to exceed the limit, or if it later appears they will exceed the limit, the City Administrator shall present the results of their analyst investigations and make a hiring recommendation to the Council. The Council shall then make the hiring decision.***

B. *The executive should start by calling the state's rural water association, municipal league, or other appropriate "referrers" to find rate analysts, then talk to those prospects on the phone. The executive should solicit each service provider they identify as a rate analyst, but not solicit those who are not a rate analyst.*

C. *Promptly solicit and receive proposals from rate analysts by e-mail.*

You should only hire people to do a specialized thing who specialize in <u>that</u> thing.

D. *Consider the contents of the rate analysts' proposals – what they say the utility needs, what they will do, what their rate analysis methodology is, what they will give you, what they will charge, what their guarantee is, etc. Importantly, learn about each analyst from calls to them and to their references and others. Read several reports that each analyst provided to prior clients to learn what the utility might expect to receive in its situation. Finally, consider the fees each analyst proposed.*

E. *The executive should hire the analyst who will give the utility the mix of expertise, services and fees that will best serve the needs of the utility and ratepayers if the analyst's fees are not expected to exceed the limit set by the council.*

F. *If the fees of the executive's choice of analyst may exceed the spending limit, the executive should present to the board or council the results of their investigations and provide a detailed justification for hiring the preferred analyst at those fees. Taking those recommendations into account, the board or council should then select an analyst. The board or council may direct the executive to hire a certain analyst. And it may choose to finalize that selection by a resolution statement to this effect:*

> ***At the direction of the Council, the City Administrator conducted a search, solicitation, and evaluation of water rate analyst candidates for the City's water system and recommended the City hire the rate analysis firm called, "ABC, LLC" (the Analyst) of Cedar Grove, Kansas. The Council subsequently reviewed the City Administrator's evaluations and hiring recommendation and concurs with hiring the Analyst because the firm is judged to have the most appropriate mix of experience, capability, availability, and reasonable fees to satisfy the City's rate analysis needs. As proposed by the Analyst, those fees will be $_____ for the rate analysis and $_____ for one on-site visit to present findings and results to the Council, the total of which will be $_____, assuming one on-site visit will be sufficient.***
>
> ***The Council hereby accepts the "ABC, LLC" proposal and hereby authorizes the City Administrator to promptly notify the Analyst they have been selected and request they initiate the project as soon as possible.***

G. *Once a selection has been made, the executive should notify the selected analyst they were chosen, tell them what services are desired and proceed with the project.*

Notes:

Keep things in perspective. This point cannot be over-stressed. Rate analysis is not $500,000 worth of engineering for a $5,000,000 water plant that will bind the utility to debt payments for 20 or 40 years and could fail and kill someone or have flaws that could maim an operator. Rate analysis should cost $9,000, give or take maybe three thousand. It would not make sense to invest excessive staff time or have the board or council invest hours of their time trying to make the solicitation and selection process perfect. In addition, most rate analyses lead to overall rate increases, meaning, revenue increases. That means, the more time you spend soliciting and selecting, the less time is available to collect the extra revenue. Time is money. At some point, you must stop fiddling and get the rate analyst calculating new rates.

If your city, district, or other entity has a spending limit for a broad range of personal services of say, $20,000, that should easily cover a good rate analyst with reasonable fees. If not, the council or board should set the limit in the statement in Bullet Point A above significantly higher, to enable rate analyst selection by the executive.

Wildcard – A complicating factor, like a wholesale supply agreement, litigation, or a big system improvement on the horizon.

As a reference point, my comprehensive analyses usually come in between $6,000 for a small system with few "wildcards," and $12,000 for utilities with more than 10,000 connections and a fair number of "wildcards." That covers a water, sewer, stormwater, or trash collection utility. Electric runs about 50 percent higher. I list all clients for the last four-plus years in my references document available at https://gettinggreatrates.com/Freebies. Fees paid for projects are included, so you can get a clear idea about fees to expect from me and other appropriately priced analysts.

How High Should You Set the Limit?

The spending limit should be set rather high, perhaps double what you think it will need to be. That is not to enable the chosen analyst to creep their fees upward. If you require lump-sum fees, as you should, you can prevent that. Rather, a high limit will enable the executive to be the one to make the rate analyst selection, even if you guessed wrong about what the service would cost.

Why should the executive choose the analyst?

Through research, the executive will gain first-hand knowledge of each candidate. Some of that knowledge will be impressions that go to the ability of an analyst to do an excellent rate analysis and successfully lead the board or council to adopt appropriate rates. Remember: the goal is adopting appropriate rates. Rate analysis is just a step down that path.

Some information the executive gathers about candidates, and especially the impressions they get cannot be transmitted easily to the board or council to enable it to make a fully informed choice of rate analysts.

The spending limit should not be a "red light," stopping you from purchasing services that are more expensive than that. They are a "flashing red light" that require you to stop, then proceed appropriately. In other words, to exceed the limit, you should have just cause. All utilities should be fully funded and do it with fair rates. If an analyst can get you to such rates and that analyst offers the best mix of expertise, services, and fees in your situation, but their fees will exceed the limit, you simply set the limit too low.

Or, if the project reasonably should cost $6,000, and a competent and well-regarded analyst is available for $6,000, but for some reason the executive prefers an analyst that will charge $60,000 (and that does happen), the governing body should question why that analyst is the preferred choice. That is why we have layers of government – to make sure somebody is not making a big mistake with taxpayer or ratepayer money.

***Sole source it**: If you did your due diligence, you found an analyst who can serve you well, you have justifiable reasons to hire them, but you did not find other rate analysts who possess the attributes you desire (and that is common), you should justify your selection and hire that analyst. You should not solicit proposals from other service providers whom you are not willing to select, just so you can say you hit the magic number of proposals or turndowns (usually three). Responding to a solicitation takes time. Do not waste service providers' time. That is their most valuable resource. In the resolution stating the board or council's sole source hiring decision, simply state the reasons for considering only that provider.*

Sole sourcing gets a bad rap. But sometimes, as in rate analysis, there really is only one service provider who can best satisfy your mix of needs with their mix of attributes. You can often determine the best choice of analyst by carrying out the contact work in Bullet Points B and D above. If you find that rate analyst first, or you only find that rate analyst, hire them.

The gist of this discussion is this. There is no silver bullet for finding, soliciting, and selecting a great rate analyst for your project. It takes work to do proper due diligence, and that does not guarantee the outcome. More on the guarantee soon.

I offer one last tip about getting to the magic three proposals or turndowns if you are determined to do that. There are many service providers from other fields who do rate "studies," they would like to do rate studies, or they do something they call a rate "study," but it really is not up to the level of analysis you need. If you get such a proposal and reject it, it counts toward the magic three. If you determine a service provider does a level of calculations that is below the standard you need, and you decline to let them propose at all, that counts, too. Document these toward getting the magic three. But really, respect these service providers and try not to use up too much of their time in a lost cause.

***

Chapter 5: Soliciting Using RFPs and RFQs

Note: This is not the solicitation methodology I recommend for rate analysis services, but if you choose this method, you can make it work better using some of these best practices. Many of these best practices also serve well if you use the method described in Chapter 4, as well.

Hiring a rate analyst is rife with opportunities to make errors. This chapter covers the solicitation tool commonly called the RFQ or RFP. Here, both are collectively called, "RFPs." If you want to read in depth about this process, visit https://gettinggreatrates.com/Freebies and download the "Rate Setting Issues Guide."

Some firms that do rate studies are geared toward responding to long, detailed RFPs. They accept that the costs of responding to them is an unavoidable cost of doing business, so they incur the cost and pass it on to clients. I, and I suspect other analysts, do not like spending about 20 percent of our time responding to RFPs and otherwise "marketing." Time is my most valuable resource and I would rather spend it analyzing than selling. If you will simplify your solicitation and selection process, you can markedly lower the fees you pay for rate analysis, end up getting the best rate analysis possible, and save yourself time, too. In other words, if you must use an RFP, streamline it so it will work better.

A fair way to summarize the following practices is, "less is more." There are a few things that you should do and that you certainly should require of rate analysis RFP responders. But generally, you should write out and specify little and let responders "fill in the blanks" as they see fit.

21. Stop sending out 20-page rate study RFPs.

    For most medium sized utilities, the full fee for rate analysis should be less than $12,000. For a small utility with a simple situation, it should cost $9,000 or less. If you send out a 20-page RFP, the resulting analysis will cost more, probably on the order of double or triple what it should. Oh, do I know some rate analysis fee horror stories!

    It takes you, and probably a selection committee, hours to write up a 20-page RFP. What is the value of your time? The time it takes for me to respond to a 20-page RFP amounts to about one-quarter of the time it takes to do a rate analysis. I know it takes other responders many hours, as well. The value of our time to satisfy your RFP runs up your costs and it does not improve the results you would get.

    It is not the RFP that gets you good results. It is the analyst you find and choose. A solid solicitation process and a bit of work you do before you even solicit will get you there.

If you send out an RFP at all, keep it short and simple, something like the two-page "RFPQ Template" in Microsoft Word format, available on the "Freebies" page. You can download that document, fill in the details for your solicitation probably in an hour or two, and your RFPQ is done. But do not mail it out. Just use it as a cheat-sheet of information to tell each prospect on the phone.

22. You require lots of deliverables in your RFPs, like a copy of the model so you can do do-it-yourself rate updates later, a detailed timetable for completion of milestones, progress reporting, meetings, etc. Stop that.

    Let the prospective analyst, in their proposal, tell you what they will do, when, what they will give to you, and so on. There are things you should expect, and some you should not:

    - *Expect all to give you a narrative report of their findings and recommendations; guidance on how to execute the new rate and policy changes you need. Also expect printouts of the models that show how they arrived at those findings and recommendations. But let the prospect state what they will give you.*
    - *Expect all analysts to say they can attend a meeting or meetings of the board or council to go over the analysis and recommendations and answer questions. Everybody needs good information. In addition, having the analyst explain things takes some of the heat off the board or council. That is both proper and good for the council or board. The council or board is just trying to serve people well. It is difficult to do that when they are dodging arrows and spears from ratepayers about how, and who developed those rates.*
        - *COVID-19 wreaked havoc with in-person meetings. Even small towns and districts learned that meeting by Zoom, or other remote application can be very productive, and cheap. It costs a lot to pay an analysts to travel to you. Oftentimes, a two-hour meeting on-line will work just fine, and save some dollars, too. Keep open the option of meeting remotely.*
    - *Do not bank on the analyst completing milestones on a set schedule. "Slippage" may be their fault, or it may be yours. Utility staff must provide data to work with and it is my experience that staff promptness, or lack thereof, in getting that data to me determines how quickly I can complete a project. Some clients are quite slow at sending data. That is not a complaint, just a fact. They had full-time jobs before the analysis came along. Thus, the analysis will be a team effort, and the whole team must move fast for the analysis to be done fast.*
    - *This is a big one. Do not expect to be able to use the spreadsheet model the analyst created to analyze your rates and fees. If that spreadsheet does all that it should, it will be very complicated. And it probably is not a single spreadsheet, either. Instead, it is a set of spreadsheets all linked together. (In my case, I run a spreadsheet for the volumes used and billed to every rate class. If you have five rate classes, I have five of those sheets. Plus, I*

link to your spreadsheets for incomes and expenses, balances, capital improvement needs/plans, and whatever else you have in spreadsheet format.) The analyst knows how to use their spreadsheets, but few others could safely pick up and use them. Wading around in a specialist's rate modeling sheets is probably too ambitious for you to try. Additional model considerations:

- *If the model used to analyze your rates truly is simple and transparent enough for you to safely use, you probably did not need that person's services in the first place. Your rate structure needs, and other parts of your situation were simple enough that a free service provider could have given you all the help you needed. Or you could have had your clerk or finance director do that level of calculations and forgo hiring a rate analyst entirely.*
- *The analyst should have built into their modeling how to adjust rates in the future. For example, their modeling should show you how to adjust rates initially. And it should show you how much to raise rates over the next five to ten years, too, if a certain set of assumptions comes true.*
- *Occasionally, model updates really are needed. Perhaps your original assumptions about future capital improvement costs were too low, so three years on you must figure out if the rates the analyst calculated back then will still work now. The analyst should talk you through that on the phone if that is possible. If not, the analyst, for a small fee, should update their models of your rates for you. In my case, updates are usually quick and cheap to do. It is cheaper and safer to just ask for a model update, than to get the model and try to use it yourself.*
- *The model take-home message is, do not ask for a copy of the actual model. Just get PDFs of the printout portion of models as documentation of the analysis. Even though the PDF does not show the math that happens in the cells of the spreadsheet, it documents most of the data that went into the models, some calculations and certainly the rates that came out. Thus, you can verify that those rates are what the analyst included in their written report.*

23. Stop requiring RFP responders to send you five <u>printed</u> copies of their proposal package.

We all operate in an electronic world now. There simply is no need for five physical copies of an RFP response. None. Zero. In fact, your RFP and prospects' responses should not be reduced to paper. All should be created, stored, and transmitted electronically.

Stop killing trees unnecessarily.

Five packages of each prospect's response add up to a box or two of expensive-to-store public records for you, for what is probably a six to ten-thousand-dollar project. Being physical copies stored away in a basement or warehouse, they will probably never be seen again until years from now when it is time to rogue

the files and dispose of those that have fulfilled their records retention requirement. That is a waste in so many ways.

This is the better alternative. Send RFPs and receive responses by e-mail. We analysts still must dream up what to say in our response, but at least we will not kill a tree or pay staff to create a literal "paper trail." And on your side, records storage and eventually records deletion will be easy and cheap since it is all electronic.

As to the five committee members who were going to review those printed sets of each proposal, you have those folks on e-mail. Forward proposals to them. They can review just as well on a computer screen, or in a pinch, on their cell phones. It is a lot easier for them to review proposals during their day by opening their laptop or phone, than by carrying around a folder full of paper.

24. Excessive RFP response requirements inflate your cost. Stop doing that.

You state in the RFP, "The (City/District) will not be responsible for costs incurred to respond to this RFP." As they say, "there is no free lunch." We responders will not send you an invoice for responding to your RFP. We just build the cost of RFP responses into the fees of those RFPed projects we do get.

Responders must recover all costs of responding to RFPs, whether they win or lose your project. The winner must also cover the cost of doing the work of that analysis. And they must make a profit if they want to be an on-going concern.

There is no free lunch.

Consider this example. You get five responders to your RFP. Each one spends $5,000 (mostly in staff time and overhead) to prepare responses. Each one wins one out of five projects on which they propose. Thus, the "marketing" cost of the responder who wins your project is $25,000 – Five tries at $5,000 each with a win rate of one out of five. Said more starkly, $25,000 only acquires the winner. Then, you still must pay them for the actual rate analysis work they do for you. Cut the response cost down to $1,000 for each responder (that is still optimistic if you issue a written RFP) and you save yourself $20,000. By doing that, you probably will save yourself more than what you will pay for the actual analysis work.

You might think I am exaggerating. I am not. On the rare occasion I respond to a typical on-paper RFP, I spend about 20 hours – $2,500 – writing it up and making five paper copies of everything. (For comparison, I do most analysis projects in about 60 hours.) When a utility allows me to propose in my typical template-based way, it takes about three hours to scope the project, prepare the proposal and e-mail it. Time is money. Let all your prospects propose by e-mail and you should cut the total marketing costs you pay down to a couple thousand dollars or so. Or send the solicitation just to me and "marketing" will cost you about $400.

The bottom line is, if you increase the cost of acquiring your project, you will increase the fees you pay for the project. And most if not all that increased cost goes to pay for marketing, not analysis.

25. Accept this. You might know how to specify steps, processes, timetables, milestones, models, etc. for some kinds of personal services. But you do not know how to do that for rate analysis, and that is OK. That is exactly why you need a rate analyst.

    You do not need deep knowledge of rate analysis to get a great rate analysis done. You do not need to be prescriptive when soliciting a rate analyst. In fact, being prescriptive is counterproductive. You just need to be a clear thinking, observant person willing to do a little investigating.

    Don't be prescriptive. Just state your goal.

    Instead of being prescriptive in the RFP, do this:

    - *Tell prospects, "We want rates that will adequately fund the utility and do it with fairly structured rates at the ratepayer level."*
    - *Also give prospective analysts details about how and when to respond, and things of that nature. Then stop.*

    The previous statements should seem familiar. Most of the solicitation should involve the prospect asking questions to scope your needs and situation, so they can determine what services you need and what fees to charge for those services. That is the analyst's area of expertise. Let them do that. And let them respond as it seems appropriate to them. How they respond will tell you a lot about each prospect. And you will learn even more when you get referrals, check references, and read some of their reports.

26. Stop sending rate analysis RFPs out to the world.

    This one takes a book to explain. The shorter version is this.

    You should not solicit someone for rate analysis whom you have not actually talked to, read some of their analysis reports and talked to others whom they have served, so you can verify they are a rate analyst. Since rate analysis is what you need, only solicit rate analysts. Do not solicit non-rate analysts for rate analysis. If you are going to hire a rate analyst, you will only waste your time and the time of any non-rate analyst you solicit. Someday when you need engineering, loan structuring, bond brokerage, financial advisement, legal or accounting services, you can contact and investigate those specialists. But this is not that day.

    > *I just offended engineers and many others. Some of you experts from other fields occasionally do rate studies or maybe you would like to. I am sorry I offended you. I mean you no slight. I will grant that most of you are smarter than me. You may be skilled in many fields. You may be a quick study in others. You may be able to do math better than me and spreadsheets better than me. But unless you are an experienced rate analyst, I am a better rate analyst than you, at least, right now. (And other rate analysts are better at this than you, too.) Maybe you will catch up to me someday, but you will probably need to put another 100 analyses under your belt before you do. That is not me bragging. That*

is me being real. Expertise comes from experience, study, and application. But keep at it because we need more rate analysts than we have right now.

Now back to you, rate analysis solicitor, if a service provider does not hang out a "shingle" that says, "I am a utility rate analyst," they are not one, so you should not send them a rate analysis RFP. Doing so only complicates your solicitation and selection work. Would you send a solicitation for a new roof for your house to your dentist or accountant? Sending that RFP only to roofers is not disrespectful of your dentist and accountant. It is acknowledgment that roofers do roofs better than dentists and accountants do roofs, even if the roofer is not as smart or as educated.

The "world" does not do rate analysis. Rate analysts do.

You should only hire people to do a specialized thing who specialize in <u>that</u> thing. In the case of rate analysis, doing so will make your project more effective and cost less, too.

Back to the "sending it to the world" issue, RFPs can foster competition among providers of the service being solicited. But the world does not do rate analysis, rate analysts do.

Acquiring rate analysis cannot be done better by writing an ever more detailed RFP and sending it to ever more possible, but unlikely, service providers. Doing solicitation well requires a more targeted approach with a far less prescriptive RFP. In fact, you should…

Only hire people to do a specialized thing who specialize in <u>that</u> thing.

Corollary: If you would not hire them to do the work, do not solicit a proposal from them.

27. Stop sending out rate study RFPs <u>altogether</u>.

    RFP blasphemy!

    Here is the truth. The RFP does not get you great rates. To get great rates, you must find and hire a great rate analyst. Whether you issue a request for proposals or not, you must make some calls to succeed at this. You should call your rural water association and ask them if they know rate analysts they would recommend. Then, call those analysts. Call references those analysts give you. Some references may tell you about other analysts they know, so call those, too. Note that the common denominator here is, <u>call</u> people. We analysts do not need an RFP as guidance for how to analyze your rates. We just need a call from you. We can do the rest.

    Even when you have a more ridged solicitation process, it still should be permissible for your executive to make the actual contacts by phone and receive responses by e-mail. If so, do it that way. If not, change it so you can do it that way. The personal contact the executive makes enables the executive to take the measure of prospective analysts. Some prospects can hide behind a well-written RFP response. But they cannot hide on the phone call and the follow-up reference checking your executive can do for you.

If your acquisition policy prohibits phone call solicitation for personal services like rate analysis, rewrite the policy. Going the phone call route, you can avoid writing up detailed RFPs, receiving boxes of responses, reviewing those responses by committee, and carrying out other processes that run up the costs of acquiring service and delay getting to the end goal, getting appropriate rates enacted.

One final comment: Written solicitations are often used to keep prospects at arm's length. You want to avoid us. You might say it is to prevent bias or the appearance of bias. Or that it is meant to create and maintain a level playing field for all prospects. But in rate analysis, someone on "your side" needs to get to know the prospects a bit. Phone and video calls are great for that, so do not push us away. Talk to us.

I hope I have made the case that maintaining separation from prospects will not protect and serve you well. But talking to prospects, and getting to know them and their work, will.

***

Chapter 6: Keys and Pitfalls to Effective Solicitation

In this, the last chapter, I cover issues which can be applied to the RFP process. But if you send out an RFP or an RFQ, you simply will not be able to include all these practices. Thus, this chapter is most in play when soliciting rate analysts as outlined in Chapter 4. That is, call or contact those who you know to be rate analysts. Call others who may know a rate analyst. Then contact the analyst(s). Also contact other utilities that have used those rate analysts to get their feedback. Reference checking is a good place to restart the list. Now, the best practices.

28. Stop asking analyst prospects for two or three references. Require a long list.

I do about twenty rate analyses per year for about a dozen clients. I suspect other analysts do volume like that, too. Some do many more. We can all find two or three clients to serve as glowing references, so a couple of references hand-picked by the analyst will not help you. Instead of asking for two or three references, require prospects to give you a list of all their rate analysis clients for at least the last two years – no cherry picking. Other analysts could have very good and useful lists that are different from mine. But I will describe my list to give you an idea of what you may want to see in such a list.

> *I maintain a rolling list of clients. (visit https://gettinggreatrates.com/References to see them.) I add new clients to the list until it covers the last five calendar years. When the calendar rolls over January 1, I drop off the oldest year's references, retain the most recent four years' references and start adding new clients acquired in the current year. In that list I include each client's basic project information, contact information, fees they paid and a note if they were a repeat client. This makes it easier for prospective clients to find past clients that would be good for them to call.*
>
> *This list is a data set of my last four to five-years of clients. Prospective clients can easily figure out the sizes and types of utilities I commonly serve and what my fees run like. Prospects can look over a dozen example rate analysis reports on my Web site on the "Freebies" page, and they will get an accurate picture of what to expect from me.*
>
> *I believe repeat clients tell a lot about a rate analyst, so I note those. Repeat clients make up one-third to one-half of my clients. It varies over the years.*

If one of your prospective analysts does not maintain a client list of their last four years, that is fine. But you should get the last year or two, with all clients during that period included on the list. Do not settle for two hand-picked references.

A final note: It is not practical to ask for more than five years of client contacts. Administration staff in many small towns and utilities turn over fast. Of my five-years-ago clients, about one-third of those contacts have since moved on, so the prime person who knew me is not there anymore. Reference checking does not work well if the contact person is no longer there.

Even when the contact is still there, after three or four years they have absorbed the new rates and recommendations. The initial rates have faded from memory. How rates get adjusted in future years has become second nature to the contact. Lots of work-life has happen since I was around. Many of my contacts have forgotten about me. And I only e-mail past clients if I come across something that should be quite useful to them, so I do not keep my name in front of them as a marketing ploy. (If I want help, I ask for it. I treat others that way, so I do not pester past clients.) When it comes time for the next analysis, many of my past clients look me up. Otherwise, I have slipped their minds. And that is as it should be.

That is a lot of information about references. But I think contacting a prospect's past clients is a major key to making sure you get served well. Check their references!

29. Is a prospective rate analyst really a rate analyst? How do you know? Do this. Ask them how they make their living.

    How can you easily tell who is a rate analyst? Income source is probably the easiest metric you can use. It will tell you who is or is not a rate analyst:

    - *If rate analysis fees are well below 50 percent of a service provider's income, I, for one, question their claim of being a rate analyst. For sure, they do something else to make most of their living and rate analysis is a sideline. If a prospect falls into this category, you need to check further to make sure their sideline experience is strong enough to satisfy your rate analysis needs. Maybe it is. Or maybe it is not.*
    - *At greater than 50 percent, they are a rate analyst, though they cannot, or they choose not to make all their living from that line of work.*
    - *For example: My revenue is 100 percent rate analysis related. I derive no earned income from anything else. Oh, I know a lot about many related fields, which sure does help me do what I do, but I am a rate analyst, pure and simple.*

    You do not necessarily need a rate analyst who gets 100 percent of their income from rate analysis. But income source will tell you if rate analysis is, or is not, the prospect's primary line of work. Ask each prospect how they make their living.

    That said, make sure you ask the income percentage question of prospects fairly. This should be the percentage of income earned by the person or "department" that will be doing your rate analysis.

    My firm is basically me. Analysis is all I do. However, there are large engineering and other firms that have an entire department that does financial advisement and "rate studies" or even rate analysis. If the firm does not have a whole department of rate analysts, they may have one person on staff who specializes in rate analysis who would do your analysis. It is that person for which you want to know the income percentage that is from rate analysis. If that person, or department

does nothing but rate analysis, sure enough, you have a rate analyst or a whole department full of them.

30. Insist on a guarantee to this effect: "If you are not satisfied with our work, don't pay us." (That is our guarantee.)

    A guarantee to that effect is much better assurance you will be satisfied than would be a solicitation that details timetables, deliverables, a ten-page contract, and other requirements. With a no-recourse guarantee, you are the one who decides if the service provider will get paid. Not a court. Not an arbitration board. No red tape to deal with. Such a guarantee is good assurance the prospect knows how to figure out what you need and will dependably deliver it. If a prospect is not willing to offer such a guarantee, I recommend you not accept their proposal. By not offering such a guarantee, they are saying they are just not sure they can satisfy you. You should trust the assessment they made.

    The core of rate analysis is the same from one utility to the next. However, some things are only discovered as the project unfolds. A good analyst knows that going in. We know how to deal with things that are revealed by analysis. In fact, revealing things through analysis is what we do. You should not pay a service provider to successfully complete a prescribed set of steps, milestones, or deliverables spelled out in an RFP, only to have them fail to get you to the finish line – appropriate rates.

31. You must trust that an analyst you solicit, and certainly the analyst you hire, can deliver the results you desire.

    Related to the previous point, this best practice harkens back to Best Practice Number 2 and others. You can only develop trust if you get a sense of the capability and trustworthiness of the analyst. You cannot do that if you hold analysts at arm's length by placing RFP paperwork and other measures between you and them. Remove the roadblocks to interaction so we analysts can make good scoping decisions and so you can make an informed hiring decision about us. Talk to us. Talk to references. Talk to referrers. Talk to your rural water association and others. Talking to people is the best way to find out who to trust to serve you well.

32. Stop requiring long, legalese contracts for rate analysis.

    Attorneys: I got your attention with this one. Hear me out.

    A long contract that covers all the bases will enable you to legally bind me to all the RFP requirements and successfully win your client's case in court if I do not complete a milestone or deliver a deliverable. But milestones and deliverables do not assure rate setting success. And utilities do not want to go to court, even if they are nearly certain to win. Just going there will cost them dearly in several ways. I think the no-recourse guarantee is the more succinct solution to most issues that may arise regarding rate analysis. It will enable your client to cut me loose quickly and cleanly, so they can quickly hire another rate analyst who can satisfy them.

If you absolutely insist on your client utility having a contract, I suggest you do it with a letter of engagement to which you will append the analyst's proposal. That way, you can use the analyst's promises, in their own words, against them, if needed. If you include a letter of engagement, it should be simple: state that the proposal contains the details of the agreement and include places for the utility's representative plus a witness, and the analyst's representatives to sign. Most such letters I have seen also restate the fees for the various service packages, but anytime something gets restated, there is the opportunity for misstatement.

I have a one-page template for a letter of engagement and other analysts probably do, too. You can download my letter of engagement template, in Microsoft Word format, from my "Freebies" page at https://gettinggreatrates.com/Freebies.

There is also the lag time it takes you, the attorney, to write up a contract, get it approved by the board or council, send it back and forth between the parties for signatures and finally have the client utility issue a notice to proceed. That slows down getting to the goal, new rates. That lag time will probably cost the utility many times more in uncollected extra revenues than what the utility will end up paying you and me both. That is a costly way for them to do business.

Now, back to the rate analysis solicitors. A long contract is not a good substitute for trust, backed up by a no-recourse guarantee. Get to know, and know about, the chosen analyst. Require the winning proposal to state the analyst's commitments, the support they will need from you, the fees they will charge for "service packages" and of course, their no-recourse guarantee. If you accept what the analyst is offering, tell them you accept or reject proposed service packages laid out in the proposal. In my case, your verbal or e-mailed acceptance and selection of service packages is all the "contract" I need. I suspect many other analysts operate that way, too.

33. You give proposers 30 to 45 days to respond to your solicitation. No, no, no!

If you solicit me by phone, and allow me to propose in my standard format, I can usually turn the proposal around in a day. I am sure other analysts can respond quickly, too, if you allow them to propose in their normal template-based (quick) way.

Long response deadlines waste time. That will likely cut into the revenues you otherwise could collect. Time is money. Of my 350 analyses as of this writing, I only recall a small handful of projects where I found they should reduce rate revenues. And as I recall, in all those situations it was a city where one utility's rates were too high, another utility's rates were too low, but the overall revenues between the two needed to go up. It is almost a rule: rate analysis leads to increased revenue. And an increase postponed is revenue lost.

With that in mind, a long response time begs for voluminous, expensive submittals, running up your costs and delaying adoption of new rates. If you solicit correctly, and receive responses by e-mail, one week is plenty of time for rate analysts to propose to you. If it takes longer than that for a rate analyst to respond, you should question how quickly they will complete the actual analysis project.

34. Also related to solicitation timing: Give analysts and yourselves enough time to work before you need new rates in place. Allow a good six months.

    I advise hustling the solicitation and then tell you the project is going to take six months. Sounds odd, doesn't it?

    I will not spend six months working on your analysis. Most analyses take me one to two weeks. You will take up most of the elapsed time. As an example, this is how it usually goes on my analyses.

    > *I have eight to ten rate analyses in the works during normal times. So, as soon as you give me the go-ahead on my proposal, I would take a couple hours to get you started on data gathering. I would also get you set up, internally, as a new client – create the invoices I will end up sending you, create rate analysis project folders for you on my hard drive, an e-mail folder, a paper folder (which I try very hard not to use very much), and a few other tasks. Then, I would go back to other project work while you gathered data.*
    >
    > *You would probably take a month or two mainly to get around to gathering and sending data. You, or the clerk or finance director you assigned the data gathering task to, had a full-time job before the rate analysis project came along, so I am not faulting you. You must spend some time gathering data, and eventually, you do.*
    >
    > *As soon as you sent in some basic data – like income and expense statements, balance sheet, listing of current rates or copies of the rate ordinances, usage data from your billing program – I would take a few hours out of other project work to input that data into a model template, the starting place for your model. Soon, I would send you draft data sheets for review. Then, I would go back to other client project work, invoicing, article writing and other things. At this stage, my work for you is still not "analysis." It is just data organization, model building and data entry.*
    >
    > *After a little more lag time, you would call or e-mail me to let me know I had all data correct in the draft sheets. Or if I did not, you would send to me or call in to me data corrections, comments, guidance, and such to help me perfect the data.*
    >
    > *Once the data is in pretty good shape, I would begin the actual analysis part of your project. That includes calculating how high your reserves should be; calculating how your new connection fees should be structured and the revenues they would produce; doing "what-ifs" on various rate structures, capital improvements timing and funding options; and more. The "what-if" work would seek the optimum mix and structure of rates, fees, improvements, and everything else that may be important to enable you to arrive at fairly structured and adequate rates and fees.*

When the analysis is well along, I would prepare a draft final report and send it to you. You would review it, make corrections if needed, give me comments and we would go back and forth until the report, and the resulting rates and fees, satisfy you. I would then issue the report in its, hopefully, final form. But "final" is a slippery slope. Things are always subject to change at any stage of the process.

I would attend a board or council meeting to describe the analysis, results, rate recommendations and answer questions. After that, the rate setting ball is mainly in your court, though I sometimes get asked for another scenario or two as clients work through the rate adjustment process. Or they may send me a draft rate ordinance to review.

Eventually, you adopt new rates.

This sounds like a "big deal," and it is, but I am the one doing most of the work. There is not a great deal of work for you to do. However, there are many opportunities for progress to get stalled. Though I try to work projects in the order received, in practice, I do most of my work on a first complete data-in, first analysis-out basis. Some clients are slow. If they are not ready to proceed, I move on to other projects. Thus, if you move quickly on your side, I will try to match you.

A solicitation with a completion deadline of two months? Get real.

I occasionally get a rate analysis solicitation with a completion deadline of two months. Do not do that to any analyst. Analysts have many other projects lined up right now and it just takes some time to work them. And it is going to take you some time to gather and send data and provide good feedback, so the analysis can do for you what you need it to do. Forget the analyst. <u>You</u> probably cannot meet a two-month deadline.

35. Again, related to solicitation timing: You think you should wait until the next fiscal year, when rate analysis costs can be put into that year's budget for payment, before you solicit a rate analyst.

    Almost never should you postpone starting rate analysis because it is not yet in a budget.

It is almost a rule: rate analysis leads to increased revenue.

Waiting to solicit is one of the costliest (in dollars) mistakes I see utilities make. Waiting to solicit delays getting rates adjusted. If you need more revenue, which is almost always the case, and you let one month go by before soliciting, you will lose more revenue in that month due to rates being too low, than what the analysis would cost. In some cases, my clients need to raise their revenues so much that my fees only consume three days' worth of those extra revenues.

Getting rate analysis done a few days, or perhaps one month sooner is a net revenue booster. Thus, it does not take a "rate analysis" line item in a budget to pay us. We pay for ourselves out of the extra revenue we enable you to collect almost as soon as you adjust rates. That statement even applies to those analysts that charge three times what we charge. It will take longer to regain what you pay them, but you will cover their fees quickly, too.

To say it clearly, if I completed the analysis and you raised your rates a month before the new budget year started, the extra revenues the new rates would generate during that month would pay my fee and still net some extra revenue for the fiscal year not yet completed. Thus, you would end that year more strongly in the "black," or less in the "red" than you had budgeted.

Waiting to start a rate analysis until the expected rate analysis fees can be placed into a budget is almost always a costly mistake.

Local governments are mandated to build and adopt budgets and amendments. But for all practical purposes, having rate analysis fees in a budget is almost never an issue in net dollars. The result of what we do almost always boosts the income side of your budget far more than whatever you put in the budget to pay for our service.

36. Stop getting analysis that calculates cost-to-serve rates only to the rate class level, even though that is common practice.

There are only a few things that you, a non-rate analyst, need to know about rate analysis. This is one of them.

It is a common misconception that cost-to-serve rates at the rate class level are fair rates. They are, but only to the rate class level. However, rate classes do not pay utility bills. Ratepayers pay utility bills, so cost-to-serve calculations must be done to the ratepayer level to be completely fair.

> *Rate study folks, I made many of you mad. Sorry about that. Stick with me.*
>
> *It is common and accepted practice to design rates so that the right amount of revenue comes from each rate class, to pay the costs of each rate class. That is fair on a rate class basis. But not on a ratepayer basis. In fact, of the rate studies by others that I have reviewed, their rate class fairness calculations were done well. But structuring should go deeper.*
>
> *Think of it this way. Your client utility has a group of 100 customers. You separate out ten customers that are like each other and call that a "class." You identify costs to serve that class. But that class will not pay "its" bill. Within that class are a few service hogs and many others who require less. Rate structuring should take that into account. Thus, you need to classify costs all the way to the ratepayer level to arrive at fair rates at the level where those fees are collected.*
>
> *Rate study folks, I hope you can agree with that.*

Rate classes do not pay utility bills. Ratepayers do.

Utility representatives, back to you, rate structure fairness at the rate class level is a good thing, but not enough. I want you to achieve fairness all the way to the ratepayer level. Make sure your rate analysis goes all the way.

37. Stop paying for rate analysis by the hour.

> *Dang, I lost the rate study folks again!*

Rate study folks, I know being paid hourly smooths the way to just getting the job done, regardless of whatever curves each situation might throw at you. (Later you will see situations where even I request hourly pay – lump-sum fees do have their limits.) You may not have a clear idea in the beginning of what a client might require from you. Your safety valve is hourly pay. But that creates a problem on the buyer's side of the equation. More on that in a moment.

At the outset, you should scope the situation thoroughly and build a proposal with lump-sum fees based on that knowledge. Of course, my telling you that you should scope thoroughly assumes the project will be solicited in a way that allows you to do that. If the utility issues an RFP that funnels analysts toward hourly pay without scoping, and they will not allow a variance, you are stuck. We all see that done a lot. However, whenever possible I recommend you switch to lump-sum fee proposals for rate analysis for the following reason. (And utility folks, this reasoning is all about serving you better.)

We all know that all utilities need rate analysis at least occasionally, some regularly, but few have gotten even their first rate analysis. Many of those that do get analysis, do not get it often enough to keep their rates in great shape. Bottom line: utilities would get better rate setting results if they hired a specialist when needed and did that as frequently as they need it. The common alternative, which is a do-it-yourself rate study, has led many utilities to become financially unsustainable and with unfairly structured rates, to-boot. We analysts need to encourage more analyses, not fewer. And those analyses need to be done by specialists. We can be change agents to make that happen if we price our service right. Lump-sum fees can help us do that. How?

You and I know that many utility managers and decision-makers avoid hiring out rate analysis because they fear the unknown, which is completely reasonable. They do not know what rate analysis is, where it will lead, or what a paid-by-the-hour rate analysis will end up costing.

Utility management and decision-makers are concerned that analysis will cost double or triple what the analyst estimated in the beginning when they are paying by the hour. Solution: remove the unknown by proposing lump-sum fees. Known fees will eliminate a big impediment to getting rate analysis. That will give rate analysts more analyses to do. That will result in more utilities having better rate setting information and data with which to make good decisions. Utilities will become better funded, so they will perform better. Ratepayers will pay fair rates. Rate analysts will analyze more rates.

That, rate analysts and rate study folks, is most of my take on hourly versus lump-sum fees for rate analysis. Utilities should buy results, not hours. They should pay lump-sums for analyses: $XX for water rate analysis, $YY for sewer rate analysis and $ZZ for an on-site visit to address the board or council.

Back to the utility folks, even if you entertain a proposal from a firm that, in its normal practice gets paid by the hour (commonly engineering, and for good reason in that case), you should require firms to propose rate analysis on a lump-sum basis.

To be clear, do not have the analyst throw all the possible services your utility might need into one basket and charge you one fee for the whole basket. You might not need the whole basket.

In a lump-sum fee proposal, there should be several lump-sums: one for each clearly identifiable service. In that way, if you choose to hire the analyst for a water rate analysis but not for a sewer rate analysis, which the analyst also proposed, you will owe them the water rate analysis lump-sum fee but not the fee for sewer. If you accepted their proposal for one on-site visit but it turns out, you did not need a visit, you do not owe them an on-site visit fee. But if you ended up having them do two visits, you owe them for two visits. Thus, fees you are obligated to pay are on a lump-sum basis but within that structure, you have options to take or decline services, too. You are still in control of cost.

Soliciting rate analysis by the hour is like soliciting purchase of a utility service truck by the hour to purchase, set up, service, prepare, install toolboxes, deliver, and do whatever else needs to be done to get you the truck. Maybe the Chevy dealer offers an hourly rate half that of Ford, but it will take Chevy three-times the hours to get you the truck. Thus, the Chevy rate would be cheaper, but the final cost would be higher.

Utility people, you don't compare hourly rates to purchase trucks. You compare total cost – a lump sum. Do the same with rate analysis.

Here is the crux of this pricing structure. Going in, with lump-sum fees, you know what the project will cost you, unless you change your selection of services. In that case, a change in the cost is all up to you. Whereas, in a paid by the hour arrangement, the service provider estimates hours at the beginning. But until they finish, you do not really know what the project will cost. And how much it will end up costing is in the service provider's hands, not yours.

Clearly identifiable services:

- Water rate analysis
- Sewer rate analysis
- Trash collection rate analysis
- On-site visit to present results of any or all analyses

YOU, the utility, should always be in control of the final cost. That is why you should insist on lump-sum fees. And YOU, the utility, should always be satisfied. That is why you require the no-recourse guarantee.

As wonderful as lump-sum fees are, there are reasonable exceptions.

One exception is this. Even I will not work in support of a lawsuit prosecution or defense unless I do it on an hourly basis. I did two of those for lump-sums early in my career. Lawyers can work you to death for a lump-sum fee. Lesson learned.

A partial exception is when a utility has an unknown but potentially large number of scenarios that may need to be modeled. A prime example is modeling of capital improvement needs, timing, and funding options, and how they will affect rates. Neither I, nor the utility know for sure how many scenarios may be needed until the capital improvements planning and funding plays out.

In multiple scenario situations, I make my best estimate of the number of scenarios the utility is likely to need, and I include that work in my lump-sum price for rate analysis. Then, if the utility wants to go over the scenario limit, they pay for additional scenarios on an hourly basis. That way they get a reasonable number of scenarios modeled for a known fee. That usually covers all they end up requiring. And if they want more than that, they pay additional. The basic service is covered in the lump-sum fee, so that part is known at the beginning. And even though some work might end up being done on an hourly basis, the client still must request that work be done.

I started the second paragraph above with "A partial exception…" While a few utilities have requested more scenarios than I had included in the lump-sum rate analysis fee, I have gotten good at estimating what will be needed. Thus, if you go over the included number of scenarios, you will pay extra for those. But that is not likely to happen.

A final note about scenarios: In my experience, I almost always discover and report the set of rates a utility will end up adopting in my first set of recommendations. But sometimes management of a utility does not want to adopt those rates, initially. Most often, those rates are a big bill increase for most ratepayers and management does not want to do that to them. So, they ask for other ways of structuring rates or another "silver bullet" solution to reduce the rate shock. I model additional scenarios, or funding options, to reduce the increases or to place more of the burden on different types of ratepayers or funding sources.

In the end, most utilities figure out that I found the optimum option in the first go-round, so they go back to the earlier recommended set of rates. That is OK. There is value in exhausting all the possibilities. There is value when the board or council can be brutally honest and tell ratepayers they looked at every option and this one is the best.

I model numerous "scenarios" in every rate analysis I do, and I do not charge separately for them. Most scenarios are just part of my due diligence to arrive at rates that are fair and adequate according to cost-of-service principles. Some are done to make sure I have considered everything that may be important. Most only take minutes to investigate. That is the beauty of a dynamic model. Everything I discover in this process that is worth reporting gets incorporated into the final models and report I issue to the client for the basic lump-sum fees I proposed.

Separate identifiable "scenarios" then, are those that are identified separately. If a client asks for something different enough that I need to model it, it results in a different set of rates, and I report it as a "scenario." If the client paid for up to three scenarios in the lump-sum fee for an analysis, they already got all those scenarios and they request a fourth, they would pay separately for the fourth.

Winston Churchill once said, "You can always count on the Americans to do the right thing after they have tried everything else."

38. In your solicitation, you require periodic reporting on milestone completion. Unnecessary.

Rate analysis is quick. The analyst gathers data, analyzes rate needs and other things, writes a narrative report to go along with the model(s) and presents results and recommendations to the governing body. Throughout the process the analyst is going to keep the utility's contact apprised of their progress. The contact can forward messages to others if they need to know what is happening. So, to drag the process out with milestone completion reporting and assessment primarily forces fees higher.

39. In your solicitation, you should require insurance – general liability, auto liability, and errors and omissions insurance – but do not get carried away.

    Do not require the "if the thing collapses, the service provider's insurance must pay us" kind of insurance. This requirement is a carryover from engineering RFQ templates that so many utilities use to also get rate analysis services. Rate analysis is not engineering. Engineered things can fail. On rare occasions, that failure can kill someone. You need to be insured against that.

    Rate analysis deals with finance, math, policy, and education; not concrete, steel, electricity, and such. If the designed rates do not satisfy you, they can be redone. And the no-recourse guarantee empowers you to direct the analyst to redo the rates or get fired without pay.

40. You say in the solicitation or RFP, "The recommended rates must not reduce the stability or dependability of rate revenues." Do not say that ever again!

    It seems all RFPs include this stipulation. I do not know where this stipulation came from, but it is usually mathematically unachievable. Before I respond to such a solicitation, I must explain to the solicitor, if I am allowed to explain, that I will not commit to that stipulation. Why?

    That stipulation prevents restructuring rates to improve rate structure fairness. For example, the minimum charge produces revenue that is almost guaranteed – it is the most stable and dependable revenue generator of almost any rate structure. If the minimum charge is disproportionately high, and that is quite common, this stipulation will prevent lowering the minimum charge. But a too-high minimum charge disproportionately hits "the little old lady…" Remember her? Usage allowances and declining unit charges have similar effects.

    If you have very many unfair structures built into your current rates, and you are adamant about adhering to the "don't reduce revenue stability" clause, rate restructuring to improve fairness might be impossible. You prevent analysis from doing what it does best – help you arrive at fairly structured and adequate rates. Thus, it would be quicker, easier, and certainly cheaper for you to just raise all current rates and major fees by whatever percent of additional revenue you need and forget about making the rates fairer.

    If you want fair rates that will be sustainable, you need a rate analyst with all the structuring tools available to them. Do not hamstring your analyst.

    Sorry that I got all strident on you, but you need to trust your analyst to get you to both adequate and fairly structured rates.

Stop requiring an in-person interview of analyst candidates.

Analysis should be a relatively cheap service, and it is almost entirely done remotely. If you, with the help of references and referrers, cannot figure out who would serve you well, an in-person "dog and pony show" probably will not make your choice better. It might even lead you astray.

In-person interviews add to the fees you will pay. If you really must see the person, do a meeting by way of Teams, Zoom, or another on-line meeting application.

41. Stop paying $25,000+ for a rate study.

    Most issues already brought up center on the cost issue. It is either, you do not want to pay anything for something that will help you immensely. Or you pay a fortune for something that should have been cheap. And being expensive does not guarantee it will serve you well.

    For my firm, the fee range of $6,000 to $12,000 covers analysis for most systems from 500 to 10,000 connections (fees are a little lower for smaller systems, higher for bigger, more complicated ones). Most of my multi-utility analysis projects (water, sewer, and trash collection, for example) come in well under $10,000 for each utility, almost regardless of utility size.

    Why do I warn against paying extreme fees for rate analysis? Because it happens a lot, but I will not bore you with the horror stories. The bottom line is, I do not like to see towns and utilities get gouged on fees.

    This is not a "rule of thumb," but it is close: If your city or district serves fewer than 5,000 connections and it is looking at a $25,000 price tag for a rate analysis or "rate study," something is wrong!

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To conclude, I hope I helped you see that many common practices are not useful when it comes to rate setting, rate analysis, and getting and paying for rate analysis. Some practices are downright counterproductive. The same techniques and practices work for acquiring an asset management program and many other personal services you need to acquire, so apply what you have learned in this guide to other services you need with tweaks to match the service.

I hope I have encouraged you to try setting utility rates in a new and better way.

Now, get the rate setting help you need, right-size those rates as soon as you can, and keep up with it. The utility will be better off for it. Your ratepayers will be, too.

Best regards,

GettingGreatRates.com

Carl E. Brown

President