United States Department of the Interior

NATIONAL PARK SERVICE
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IN REPLY REFER TO:

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(2410)

To: Regional Concession Chiefs

From: Acting Chief, Commercial Services Program

Subject: Commercial Services Impacts and Changes in Utility Charging Policies and Procedures Related to Director's Order 35B

Director's Order 35B, *Sale of NPS-Produced Utilities* (DO 35B), dated December 31, 2011, and the associated Reference Manual 35B, released in February 2012, updated NPS policies for recovering costs associated with providing utility services to non-NPS users, including concessioners, CUA holders, and lessees. These policies replaced those in Special Directive 82-3, *Rates for NPS-Produced Utilities.*

This memorandum provides background, policy, and guidance on the management of utility charges to NPS concessioners based on DO 35B. In particular, the memorandum outlines changes in procedures for setting and managing concessioner utility rates and the process for handling franchise fee adjustments and utility pass-throughs (hereinafter referred to as add-ons).

The concession management policies and procedures herein supersede the following: NPS 48 Chapter 18, Section F.2, Utility Charge Exception; NPS 48 Chapter 24, Section G, Utilities; the November 2, 2010, memoradum Recovery of NPS Utility Charges from Non-NPS Commercial Services Users; and Special Directive 82-3, *Rates for NPS-Produced Utilities.*

**Changes to Utility Rates for Commercial Services as a Result of DO 35B**
DO 35B will affect utility charges to concessioners and other non-NPS users as follows:

1. **Capitalization/Recapitalization Costs**. In accordance with DO 35B, the NPS must recover allocated costs for all capital and recapitalization projects. Cost recovery will begin for utility projects completed during and after 2012. Historically, the NPS has charged non-NPS users for operating and maintenance (O&M) costs as well as component renewal/repair and rehabilitation costs but has not charged for capital costs. O&M includes system operation, servicing, inspections, testing, and minor parts repairs or replacements that occur annually. Component renewal/repair and rehabilitation includes work, inspection, and replacement of parts or components, or similar activities that occur less than once a year (e.g., replacement of pumps and generators). Capital actions are the replacement or major upgrade of the infrastructure of a utility (e.g., replacing or adding a plant, large sections of pipe, or major pieces of equipment). This change in policy may increase the cost of concessioners' utilities in parks where capital projects occur.

2. **Actual Costs.** In lieu of comparability, DO 35B requires that parks set NPS utility rates using actual costs calculated according to systematic, Servicewide methods. A concessioner's utility rate could increase or decrease if the new, more accurate actual cost calculation methods reveal inaccuracies in prior calculations.

3. **Rate Cap**. Recognizing the potential for significant utility rate increases as a result of this new procedure, DO 35B caps any annual rate increase at 10 percent for existing contracts. This cap can be applied to utility rate increases resulting from DO 35B beginning in 2012 and covers any rate increases whether from capitalization/recapitalization or operating costs. The 10 percent cap does not apply to new contracts that have been fully burdened with the actual cost of the utilities, including recapitalization as part of the new contract financial analysis. Per DO 35B, the 10 percent cap does, however, apply if costs incurred during the term of a new contract were not accounted for during prospectus development.

4. **Waivers.** In extreme circumstances, DO 35B allows for a waiver of some or all utility charges for existing or new contracts upon completion of a feasibility analysis and approval by the WASO Associate Director, Park Planning Facilities & Lands, in consultation with the Associate Director, Business Services, and the Associate Director, Interpretation & Education.

**Setting NPS Utility Rates**
A park's facility management division is responsible for setting utility rates. Rates include operating and maintenance costs, component renewal/repair and rehabilitation, and capital/recapitalization costs. Rates related to operating and maintenance costs are determined by calculating these costs for the park system and distributing those costs across all users. Rates related to component renewal/repair and rehabilitation and capital costs are determined by prorating the cost of an improvement over its life and user base. These costs cannot be applied until a project is operational.

DO 35B contains detailed instructions on this process. The WASO Park Facility Management Division (PFMD) is providing park-level facilities personnel with implementation assistance in the form of cost recovery models, orientation, and training focused on the new procedures for calculating and setting rates. PFMD is developing a standardized report to document the cost basis for rates charged to non-NPS users. Concessions specialists with questions regarding the potential for rate increases as a result of DO 35B should contact their park's facilities division.

**Evaluating and Charging Utility Costs in Concession Contracts**
Commercial Services is responsible for evaluating the utility costs of concessioners and determining how these costs are to be managed. Key changes to these procedures from those prior to DO 35B and this memorandum are:

1. Completion of an analysis of utility cost impacts to new contracts without initial consideration of add-ons;
2. The use of industry norms (rather than rate comparables) and the consideration of all utilities (park-provided or otherwise) in this analysis;

3. Analysis and approval for add-ons at the WASO level; and,
4. Add-on allowance only when rates exceed the industry norm and cannot be absorbed in the contract.

**New Contracts**

For new contracts (i.e., contracts issued after the date of this memorandum), the full cost of utilities to the concessioner will be calculated into the *pro forma* financial statement completed during prospectus development. This full cost must include projected operating costs and allocated capital improvement costs for all utilities. This analysis will not consider current or future add-ons. The minimum franchise fee will be adjusted as necessary to account for the magnitude and impact of utility costs over the life of a contract.

In the event that a contract is determined to be infeasible, or when a franchise fee reduction to account for utility costs is such that it would severely limit a park's ability to manage its concession operation safely and effectively, the concessioner's total utility expenses and other line-item expenses will be compared to industry norms to determine if such costs are abnormal. If concessioner utility expenses are projected to exceed the industry norm, an add-on of this variance may be considered.

Because of the complexity of assessing utility costs and impacts to the contract, and in order to remain consistent in approach, the WASO Commercial Services Program will conduct this additional analysis and potential add-on determination. A request for this analysis must be made by the park, through their regional Commercial Services Program. The WASO Commercial Services Program will work with the park and region to obtain all necessary information and complete the analysis. If the WASO analysis supports a utility add-on, annual add-on schedules will be determined for the period of the contract.

If analysis supports an add-on, the Regional Director must request an approval for the add-on from the Associate Director, Business Services. This request must include a justification that explains the need for the add-on and document the park's intended uses of any franchise fees preserved by the add-on. The Associate Director, Business Services, may approve or deny the request or may approve an add-on amount other than the amount requested.

**Changes during the Term of a Concession Contract Issued After DO 35B**

There is the potential for increases in utility costs during the term of a new contract that were not anticipated or accounted for during prospectus development. Per DO 35B, the 10 percent cap for increases in the concessioner annual utility rates applies in these cases.

In addition to this rate cap, a cost increase occurring during the term of the contract may also be evaluated to determine if it exceeds industry norms and justifies contractual adjustment and/or add-on. The WASO Commercial Services Program will conduct an analysis upon request to determine if such measures are appropriate. Contractual adjustments and/or add-ons will be considered only in the event that the unanticipated cost increases place the concessioner utility costs outside industry norms. Typical cost escalations (e.g., inflation) will not be considered adequate justification for a contractual adjustment or add-on. As with new contracts, add-ons to visitor rates are not the preferred alternative and require clear justification and approval of the Associate Director, Business Services.

Planned capital projects might not materialize, or might cost less than anticipated, or rates may otherwise be reduced. Although contractual adjustments in such circumstances are rare, they can be pursued with adequate justification. A request for such analysis may be initiated at the park, region, or WASO level and will be completed by the WASO Commercial Services Program. Any such adjustments are also subject to the approval of the Associate Director, Business Services.

**Existing Contracts**
If an add-on has already been authorized for an existing contract (i.e. a contract issued before release of this memorandum), a park may continue to approve such an add-on, if justified. A park's concession program is responsible for determining if an add-on is justified by comparing the utility rates of the park-provided utilities against the utility rates of rate comparables. If this analysis demonstrates that the NPS-provided utility rates are higher, an add-on may be continued to account for the rate difference. This process is consistent with procedures established in the Commercial Services Rate Administration Guide and historical NPS-provided utility management policy. Note that the applicability of an add-on should be considered only after the 10 percent cap allowed under DO 35B is applied, if applicable. The superintendent must review and approve the add-on annually.

**Distributing Add-On Costs to Visitor Services**
A concessioner is responsible for proposing a distribution scheme for the approved add-on. Add-on surcharges should be distributed across those services that are the predominant users of the utility, which are often lodging and food and beverage operations. It is unnecessary to distribute charges across all services if some of those services are inconsequential. When making this calculation, a concessioner should employ a reasonable method such as using a ratio of utility costs as a percentage of gross revenue. A concessioner must submit its utility add-on distribution request to the Superintendent, who must review the request and approve it in writing.

**Franchise Fee Payments on Pass-Through Revenues**
Utility add-on revenues should not be included in gross receipts for the purpose of calculating franchise fees. The application of such fees increases the cost to visitors in a manner contrary to the mission of the NPS. WASO has issued separate guidance for reporting add-on charges on the Concessioner Annual Financial Report. This guidance is available in the Commercial Services SharePoint Policy Library under the Financial Management topic.

**Distribution and Comments**
Please distribute this memorandum immediately to all parks in your region with concession operations. For more information on this issue, please contact Lora Farabaugh, Concession Management Specialist, at 303/978.6903 or Lora_Farabaugh@nps.gov.