



## Office of the City Auditor

Date: December 4, 2009

To: Honorable Mayor and Members of City Council  
Kathy Young, City Clerk

From: Denny Nester, Assistant City Auditor  
09-20

Re: 2010 PILT Projections

At the Rate Hearing on November 24, 2009, I made a brief presentation quantifying the amount of PILT, which should be included in the 2010 Electric Rate Case based on my interpretation of Resolution 205-00. In some instances, the Resolution does not offer clear guidance and my office had requested that CSU and the City provide clarification. In 2007, an Executive Agreement was developed by CSU and the City in an attempt to address some of these issues. However, that agreement did not provide the clarification requested by the City Auditor. Therefore, I have prepared the following calculations presuming Resolution 205-00 and the associated cover letter provide the guidance for the calculations. I have attached a copy of the Resolution and cover letter as Appendix A for your review.

### Executive Summary

This analysis of PILT Rate Adjustment calculations is based on the assertion that Resolution 205-00 and the cover letter from Phil Tollefson in 2000 present the authoritative guidance related to PILT Rate Adjustments. Since all rate cases since 2007 presented in this report were Non-ECA and Non-GCA Rate Cases, no clarification was needed concerning how the overall revenue increase should be calculated. We have assumed that non-fuel costs moved from the base rate should result in an increase in the PILT similar to increases in the overall revenues for the service being reviewed.

Based on our review, the Non-ECA Electric Rate Filing for 2010 appears to be understated by \$5,591,549. The budget for CSU is consequently understated by \$6,409,184. The City's Budget for PILT in 2010 is understated by \$4,423,064.

This PILT Review did not address any impact related to Ballot Issue 300.

### Resolution 205-00 Background

Resolution 205-00 was adopted in December 2000 with an effective date of November 1, 2000. The Resolution was adopted in response to anticipated regulatory changes and market conditions. It changed the basis for calculating PILT payments from a percentage of gross

sales in electric and gas services from 8% and 6.5% of sales, respectively, to a fixed rate per Mcf of natural gas and per kWh of electricity applied to all inside City sales volumes.

The preamble of the Resolution notes the many reasons for which the Resolution was enacted. The preamble includes recognizing that per the City Charter, any remaining surplus of net earnings of CSU after necessary requirements may be appropriated to the general revenues of the City. The preamble also sets forth the *rationale* for PILT, which is to compensate the General Fund for the loss of revenues for sales and use taxes, ad valorem property taxes and franchise fees or taxes that the General Fund would receive if privately owned electric and natural gas utilities operated and provided services within the City limits. It also states that significant increases in both purchased gas and purchased power costs should not be permitted to cause a similarly significant increase in PILT transfers.

The primary direction received from the Resolution can be found in Section 2. Section 2 begins, "In lieu of franchise taxes or fees, and sales and use taxes, and ad valorem property taxes that would otherwise accrue to the City if electric and gas services were provided by privately owned utilities, there shall be appropriated annually from the net earnings of CSU to the General Fund of the City an equivalent amount." I view this sentence as the *rationale* for PILT. I do not view it as a formula for recalculating the PILT amount. The City has not adopted a percentage to be applied to sales as a franchise tax or fee. The preamble for 205-00 clearly states, "WHEREAS, the Council most recently set forth the *rationale* for payment in lieu of taxes transfers to the City's General Fund in resolution No. 187-92, whereby it was determined that the purpose of transferring revenue from CSU to the General Fund is to compensate the General Fund for the loss of revenues from sales and use taxes, ad valorem property taxes and franchises fees or taxes that the General Fund would receive if privately owned electric and natural gas utilities operated and provided service within the City limits; and WHEREAS, the Council reaffirms its determination that the purpose of transferring revenues from CSU to the General Fund is to compensate the General Fund for loss of revenue....." It appears that when the first sentence of Section 2 ends in the words "an equivalent amount", this phrase may be a carryover from the prior PILT Resolution 187-92, which starts with the same verbiage, but continues, "there shall be to the General Fund of the City an amount equivalent to 8% and 6.5% respectively of the gross-revenues of the Electric and Gas Department..." Without a franchise fee rate set by City Council for electric and gas services, it would be impossible to calculate "an equivalent amount" as a dollar value. I do not interpret this first sentence to be a formula for calculating the PILT as seems to be implied by the Executive Agreement.

The second sentence of Section 2 sets forth the method of calculation for PILT. The sentence reads, "The calculation of PILT will be based on a fixed rate per Mcf of natural gas and per kWh of electricity applied to all inside City sales volumes." You may note that the actual rates are not included in the resolution, but were established by an accompanying letter from Phil Tollefson. For purposes of illustration, I have created a table below recalculating the amount of electric PILT paid in June 2009.

Total kWh of electricity delivered within the City	298,083,946
Multiplied by the Electric PILT Rate used in June 2009	X \$0.004710
Electric PILT amount paid to the City	<u>\$1,591,702</u>

The third sentence then states that the fixed rates were determined based on the current (2000) levels of PILT and that those rates "will be increased automatically to reflect subsequent

changes in the base rates for natural gas and electric service as approved by Council from time to time,....” Again, the method of automatic adjustment was not specified in the Resolution. However, in the accompanying letter, Phil Tollefson states, “The initial assessment rates will be subject to periodic adjustment for approved base rate increases, based on the percentage increase in overall service revenues resulting from the approved base rate changes.” The calculations below illustrate how this adjustment mechanism was applied to the Electric Rate Case, which became effective on June 1, 2004.

Initial Electric PILT Rate	\$ 0.004355
Increased by the percentage increase in overall service revenues resulting from the approved base rate changes of 8.05% as shown on Schedule 10 of the rate case	X <u>.0805</u>
Amount of increase to be added to the Initial Rate	\$ 0.000351
Plus the initial Electric PILT Rate	+ <u>\$ 0.004355</u>
New Electric PILT Rate Effective 6/1/04	<u>\$ 0.004706</u>

(Note that this process can also be stated as  $\$0.004355 \times 1.0805 = \$ 0.004706$ .)

#### The Concern related to the 2010 Electric Rate Case and Budget

As stated in the City Auditor's letter related to the Rate Cases currently before City Council, CSU has not adjusted the PILT rates for the 11.28% increase for the Gas Non-GCA (base) Rate case implemented in January 2008, the 13.71% increase for the Electric Non-ECA (base) Rate case implemented in February 2009, and is not proposing an increase in PILT for the 2010 Electric Non-ECA (base) Rate case. To complicate matters, the 9.38% increase indicated in the proposed case for 2010 does not factor in costs that have been moved into the ECA. Per the 2010 Annual Operating Plan for CSU, “The ‘Non-Fuel’ costs moved in 2010 are approximately \$15.6 million for electric and \$1.1 million for gas, for a total of \$16.7 million.”—see Footnote 3 on CSU Annual Operating Plan page attached as Appendix B. Working with CSU staff, we determined that the \$15.6 million stated above is overstated based on offsetting revenues. We have calculated the net amount of transfers to ECA as \$11,027,676, which is equivalent to a 5.98% in the 2010 base rates (See Appendix C). While Resolution 205-00 is not clear that this adjustment should be made, it appears reasonable.

#### Electric PILT Rate Adjustments

The PILT Rate for electric service has only been adjusted once since it was adopted in 2000. Per Mr. Tollefson's cover letter, “the initial PILT Rate for electric and natural gas will be 0.4355 cents per kilowatt hour delivered and 31.687 cents per thousand cubic feet of gas delivered.” The PILT Rate for electricity remained at 0.4355 center per kWh until June 2004. At that time, City Council approved an 8.05% increase in electric rates, which necessitated an automatic adjustment in the PILT rate for electricity. As directed in Mr. Tollefson's cover letter, the initial assessment rate of 0.4355 was adjusted by the approved increase in the overall service revenue of 8.05%, going from 0.4355 to 0.4706.

Effective February 1, 2009, City Council approved a 13.71% increase in electric service rates. At that time, the PILT Rate should have been automatically increased by 13.71%. The PILT Rate, which should currently be in effect would be 0.5351, which can be recalculated as 0.4706 x 1.1371 (the rate in effect prior to the increase multiplied by 1 plus the percentage of the increase). However, this automatic adjustment was not implemented.

Following this same logic, the PILT rate should be automatically adjusted by the approved increase in the overall service revenues that are proposed by the current 2010 Electric Rate Case. Per Schedule 10 of this case, electric rates will be increasing by 9.38%. As previously discussed, CSU has moved costs to the ECA, which are equivalent to an additional 5.98% increase to base rates. Therefore, the rate which should be in effect (.5351 cents per kWh) should be increased by 15.36%, (i.e., 9.38% + 5.98% = 15.36%). The PILT Rate for 2010 should be .6173 cents per kWh. The table below summarizes the changes to both Electric and Gas PILT Rates if we assume Resolution 205-00 is the authoritative guidance for PILT adjustments.

**Payment-in-Lieu-of-Taxes (PILT)  
Rate History Pursuant to Resolution 205-00  
2007 – 2010**

Description	2007	2008	2009	2010
<u>Electric City Sales</u>				
Assessment Rate Kwh Delivered	0.004706	0.004706	0.004706	0.005351
% Rate Increase	-	-	13.71% (1)	9.38%
ECA 2010 Composite vs Previous Base rates	-	-	-	5.98% (2)
Adjusted Assessment Rate Kwh Delivered	<u>0.004706</u>	<u>0.004706</u>	<u>0.005351</u>	<u>0.006173</u> (3)
<u>Gas City Sales</u>				
Assessment Rate @ 14.65 Mcf Delivered	0.351850	0.351850	0.391539	0.391539
% Rate Increase	-	11.28% (4)	-	-
Adjusted Assessment Rate @ 14.65 Mcf Delivered	<u>0.351850</u>	<u>0.391539</u>	<u>0.391539</u>	<u>0.391539</u>

Notes:

- (1) No electric base rate increases in 2007 or 2008. Electric base rate increase effective February 2009.
- (2) Electric base rate increase effective January 2010.
- (3) Percentage of Adjusted Total Revenue for amounts previously included in base rate to be included in 2010 ECA rate filing.
- (4) No gas base rate increases in 2007. Gas base rate increase effective January 2008.

## **Gas PILT Rate Adjustments**

The PILT Rate for gas service has only been adjusted once since it was implemented in 2000. In January 2005, CSU increased gas rates. At that time, the City Auditor questioned the percentage increase in PILT which was presented with the gas rate case. CSU had proposed a 3.5% increase to the PILT Rate, while the overall increase in revenues as presented on Schedule 10 indicated that rates were increasing by approximately 22%. After meeting with CSU on the issue and recognizing that the preamble of Resolution 205-00 indicated that significant increases in purchased gas should not be permitted to cause a similarly significant increase in the payment of PILT transfers, the City Auditor recommended that an 11% increase in the PILT Rate be implemented. This percentage was calculated based on a definition of base rates as being total gas revenues less Supply Charges and GCA Charges. At that time, the City Auditor also informally recommended that the City and CSU define base rates and the methodology to address the movement of costs from the fuel rate (GCA) to the base rate calculations. The City Auditor asked that a Memorandum of Understanding be developed between the City and CSU to ensure that changes in the Base Rates that are the result of incorporating costs that were previously being recovered via an ECA or GCA be excluded from the PILT calculation, if that was agreed to by both parties.

The initial PILT Rate for gas service was 31.687 cents per Mcf as stated in Mr. Tollefson's cover letter in 2000. In January 2005, that rate was increased by 11%. The new rate was 35.185 cents per Mcf.

Effective January 1, 2008, City Council approved a Non-GCA Base Rate Case, which called for an 11.28% increase in base rates. As shown in the previous table, this 11.28% increase in base rates should have resulted in an 11.28% increase to the PILT Rate. Multiplying the then current rate of 35.185 cents per Mcf by 1 plus 11.28% results in a rate of 39.1539 cents per Mcf, which should have been in effect since January 2008.

## **Projected Underpayment of PILT through 2009**

Based on the PILT rates described on the preceding pages, I have calculated the amount of PILT, which was underpaid in 2008 for the gas PILT as \$795,043. This amount can be recalculated using the quantity of gas sold in 2008 of 20,031,835 Mcf multiplied by rate of 39.1539 cents per Mcf less the same quantity of gas times the rate of 35.185, which was actually used to calculate and pay PILT to the General Fund in 2008.

The same calculation can be performed for 2009 using the actual amount of gas sold through October 2009 of 13,857,514 Mcf plus an estimate for the remaining months of November and December 2009 of 4,713,133 Mcf. Based on this quantity of gas being sold, we estimate gas PILT will be underpaid by \$737,050 in 2009.

Applying this calculation method to electric PILT since the implementation of the increased electric rates in February, we can calculate an estimated electric PILT underpayment for 2009. Between February 1 and October 31, 2009, CSU sold 2,778,968,179 kWh of electricity within the City of Colorado Springs, which was subject to PILT. CSU estimates that an additional 631,453,230 kWh of electricity will be sold by the end of December 2009. Based on these actual and estimated sales, we can estimate the amount of electric PILT underpayment that will

occur through 2009 as being \$2,186,080. These calculations can be seen in detail at Appendix D.

### PILT Estimates for 2010

Using the same method described above, we have calculated the impact on the CSU 2010 Budget and the associated Non-ECA Electric Rate Case. The impact is summarized in the table below.

**Payment-in-Lieu-of-Taxes (PILT)**  
**Total Summary Pursuant to Resolution 205-00**  
 (Utilizing Proposed 2010 Budget - Delivered Volume)

Description	2010 Pursuant to Resolution 205-00	2010 Pursuant to Executive Agreement	Difference
<u>Electric City Sales</u>			
KWH Delivered	3,821,974,880	3,821,974,880	
Assessment Rate	0.006173	0.00471	
Delivered Assessment	<u>\$ 23,593,051</u>	<u>\$ 18,001,502</u>	<u>\$ 5,591,549</u>
<u>Gas City Sales</u>			
@ 14.65 Mcf Delivered	20,601,046	20,601,046	
Assessment Rate	0.391539	0.35185	
Delivered Assessment	<u>\$ 8,066,113</u>	<u>\$ 7,248,478</u>	<u>\$ 817,635</u>
 Total PILT	 <u>\$ 31,659,164</u>	 <u>\$ 25,249,980</u>	 <u>\$ 6,409,184</u>

### Explaining Other PILT Estimates

City Council was presented with three different estimates of PILT at their meeting of November 24, 2009. CSU presented the 2010 Proposed Budget amount of \$25,249,980 as shown in the table above. They calculated this amount based on the PILT rates which were in effect in 2007 when an Executive Agreement was signed by the City Manager and Chief Executive Officer of CSU. That agreement indicated that "the fixed volumetric rates utilized to establish the annual PILT payment to the City will remain effective until superseded pursuant to..." other sections of the agreement. However, the City and CSU did not agree upon elements of the calculations, which would have been needed to implement the methodology for calculating PILT specified in the Executive Agreement.

The City presented an amount of \$27,236,100. The City calculated this amount in 2008 based on their 2008 estimate for PILT with an escalation factor for anticipated population growth. The same amount was presented in both the 2009 and 2010 Budgets for the City.

## OVERALL OPINION

Overall, the preceding analysis of PILT Rate Adjustment calculations are all based on my assertion that Resolution 205-00 and the cover letter from Phil Tollefson in 2000 are the authoritative guidance related to PILT Rate Adjustments. Since all rate cases since 2007 presented in this report were Non-ECA and Non-GCA Rate Cases, no clarification was needed concerning how the overall revenue increase should be calculated.

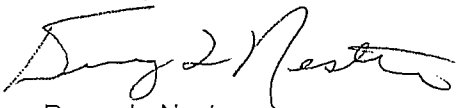
Based on our review, the Non-ECA Electric Rate Filing for 2010 appears to be understated by \$5,591,549. The budget for CSU is understated by \$6,409,184. The City's Budget for PILT in 2010 is understated by \$4,423,064.

This PILT Review did not address any impact related to Ballot Issue 300.

We thank Colorado Springs Utilities and especially the General Manager of Financial Services along with the Pricing and Forecasting Department for their cooperation during this review. We also want to thank the Financial Services section of the City.

Please contact me if you have any questions regarding this report.

Sincerely,



Denny L. Nester  
Assistant City Auditor

cc: Jerry Forte, CSU Chief Executive Officer  
Bill Cherrier, CSU Chief Financial and Planning Officer  
Stella Chan, CSU Manager, Pricing and Forecasting  
Dave Maier, CSU Manager, Enterprise Risk Manager  
Sonya Thieme, CSU Interim General Manager, Financial Services  
Henry Henderson, CSU Principal Pricing Analyst  
Penny Culbreth-Graft, DPA, City Manager  
Terri Velasquez, City Chief Financial Officer  
Kara Skinner, City Financial Services Manager  
Pat Kelly, City Attorney

RESOLUTION NO. 205-00

## A RESOLUTION RELATING TO THE APPROPRIATION AND PAYMENT OF REVENUES TO THE GENERAL FUND OF THE CITY IN LIEU OF FRANCHISE TAXES OR FEES, SALES AND USE TAXES, AND AD VALOREM PROPERTY TAXES FOR THE PROVISION OF ELECTRIC AND GAS DELIVERY SERVICE

WHEREAS, the City of Colorado Springs is a home rule city and municipal corporation formed in 1909 under the authority of the Colorado Constitution, Art. XX, §6 and the City Charter; and

WHEREAS, the City of Colorado Springs is the only legal structure for all the functions rendered on behalf of the citizens of Colorado Springs, including the provision for municipal, utility and other services; and

WHEREAS, the City Charter Art X, §20 provides for general powers of the City regarding franchises granted by vote of the electorate to any person, firm or corporation which, by definition, precludes the grant of a franchise to operations of the City; and

WHEREAS, one of the purposes of granting such franchises is to define the franchisee's right to occupy the public rights of way, which by definition is not necessary for Colorado Springs Utilities because it is a municipal utility, an integral part of the City of Colorado Springs and an enterprise by definition under TABOR; and

WHEREAS, the electorate of the City adopted a Charter provision which established a Public Utilities Department consisting of the Division of Water and Water Works, the Division of Electric Light and Power, and the Division of Gas and any other utility acquired by the City as Charter §79(a) which was later amended to constitute part of Article VI of the City Charter (Utilities); and

WHEREAS, pursuant to Article VI, §6-40(a) of the Charter, the funds of Colorado Springs Utilities (CSU) shall be kept separate from the funds of all other departments of the City, except that, pursuant to Article VI, §6-40(b) of the Charter, any remaining surplus of net earnings of CSU after necessary requirements may be appropriated to the general revenues of the City of Colorado Springs (City) by the City Council in its Annual Budget and Appropriation Ordinance; and

WHEREAS, the Council most recently set forth the rationale for payment in lieu of taxes transfers to the City's General Fund in Resolution No. 187-92, whereby it was determined that the purpose of transferring revenues from CSU to the General Fund is to compensate the General Fund for the loss of revenues from sales and use taxes, ad valorem property taxes and franchise fees or taxes that the General Fund would receive if privately owned electric and natural gas utilities operated and provided service within the City limits; and

WHEREAS, the Council reaffirms its determination that the purpose of transferring revenues from CSU to the General Fund is to compensate the General Fund for the loss of revenues it would otherwise receive from sales and use taxes, ad valorem property taxes and franchise fees or taxes that the General Fund would receive if privately owned electric and natural gas utilities operated and provided service within the City limits; and

WHEREAS, changing regulatory and market conditions can erode the amounts of payments in lieu of taxes transferred from CSU to the City's General Fund with the potential for such revenue erosion to increase over time with regard to electric and gas service revenues; and

WHEREAS, given the potential for such revenue erosion, the Council in its Decision & Order 99-1(G) directed the CSU to revise the methodology used to calculate payment in lieu of taxes; and

WHEREAS, CSU has considered the causes for the potential adverse impact on payment in lieu of taxes transfers to the City's General Fund due to current and anticipated regulatory changes and market conditions; and

WHEREAS, CSU has determined an efficient calculation methodology whereby CSU will apply a per unit charge to quantities of gas and electricity delivered, thereby insuring the City of a more secure revenue stream of payments in lieu of taxes; and

WHEREAS, the recent significant increases in both purchased gas and purchased power costs should not be permitted to cause a similarly significant increase in the payment in lieu of taxes transfers; and

WHEREAS, the Council finds that the methodology suggested by CSU regarding the calculation of payments in lieu of taxes should apply to the CSU provision of electric and gas delivery service and that implementation of the methodology will provide a transfer to the City's General Fund of sufficient amounts to compensate the General Fund for revenues from sales and use taxes, ad valorem property taxes and franchise fees or taxes that the General Fund would receive if privately owned electric and gas utilities operated and provided service within City limits; and

WHEREAS, City Council now desires to repeal previously adopted Resolution No. 187-92 concerning payments in lieu of taxes and franchise fees.

NOW, THEREFORE, BE IT RESOLVED BY THE CITY COUNCIL OF THE CITY OF COLORADO SPRINGS:

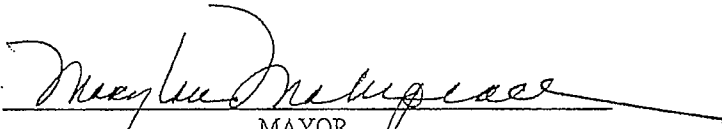
Section 1: That Resolution No. 187-92 dated November 24, 1992, is hereby repealed and superseded by the provisions of this Resolution in its entirety retroactively effective to November 1, 2000.

Section 2: In lieu of franchise taxes or fees, and sales and use taxes, and ad valorem property taxes that would otherwise accrue to the City if electric and gas services were provided by privately owned utilities, there shall be appropriated annually from the net earnings of the CSU to the General Fund of the City an equivalent amount. The calculation of PILT will be based on a fixed rate per Mcf of natural gas and per kWh of electricity applied to all inside City sales volumes. The initial fixed rates have been determined based on current levels of PILT and will be increased automatically to reflect subsequent changes in the base rates for natural gas and electric service as approved by Council from time to time; subject to the limitation that any such annual appropriation shall only be made from surplus earnings of CSU after the necessary requirements CSU as a whole have been satisfied as provided by the Charter.

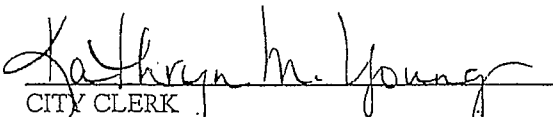
Section 3: The amounts appropriated for each fiscal year as provided in Section 2 above shall be transferred by monthly payments from CSU to the General Fund of the City.

Section 4: This Resolution shall become retroactively effective and shall apply to CSU payments in lieu of franchise taxes or fees and sales, use, and ad valorem property taxes to the General Fund of the City beginning November 1, 2000.

Dated at Colorado Springs, Colorado, this December 12, 2000.

  
MAYOR

ATTEST:

  
CITY CLERK

## Interoffice Memorandum

Date: November 29, 2000

To: City Council Members

From: Phillip H. Tollefson, P. E., Executive Director, Utilities *PHT*

Subject: **A RESOLUTION RELATING TO THE APPROPRIATION AND PAYMENT OF REVENUES TO THE GENERAL FUND OF THE CITY IN LIEU OF FRANCHISE TAXES OR FEES, SALES AND USE TAXES, AND AD VALOREM PROPERTY TAXES FOR THE PROVISION OF ELECTRIC AND GAS DELIVERY SERVICES**

**SUMMARY**

To ensure a continuing just and reasonable level of Payment in Lieu of Taxes (PILT) transfer to the City of Colorado Springs' (City) General Fund, Colorado Springs Utilities (CSU) is recommending a revision of the PILT assessment methodology to account for regulatory changes and related changes in market conditions. CSU's proposal is in accordance with Council's directive in Decision & Order 99-1(G), wherein Council ordered that "the methodology used to calculate the payment in lieu of tax should be changed before the end of the year so that no negative impact by nontariff gas sales will be felt by the general fund". In addition, since CSU recognizes that the conditions which warrant the need for PILT revision in connection with transporting third-party gas are quite similar to those under which CSU wheels third-party electric energy, CSU is proposing to address both issues contemporaneously.

The proposal is straightforward: the current mechanism whereby CSU computes the monthly PILT based on a percentage of inside City limits revenues will be replaced by a calculation based on a fixed rate per Mcf, or kWh, on the commodity volumes delivered within the City limits, regardless of the entity supplying the commodities. In this manner, the City's General Fund will not be adversely impacted by customer decisions to purchase energy commodities from third party sources. The per-unit delivery assessment was designed to replicate the prior PILT calculation methodology in terms of providing payments to the General Fund which are equivalent to applicable franchise fees, sales and use taxes and ad valorem property taxes. The per-unit delivery assessment also provides an efficient mechanism for preventing the PILT transfers from escalating significantly as a result of the very large pass through increases in purchased gas and purchased power costs evident in CSU's recent GCA and ECA filings. The PILT revision must be adopted by City Council in order to become effective.

Adoption can be by resolution. The resolution is not subject to the notice and hearing provisions set forth in C.R.S. § 40-3.5-101 et seq. and, as explained more fully below, the resolution may be adopted without the notice and hearing usually associated with ratemaking matters.

### **BACKGROUND**

City Council directed CSU to come back with a proposal to change the method used to calculate PILT to address concerns about the negative impacts of nontariff gas sales on the General Fund in DECISION & ORDER 99-1(G) adopted May 25, 1999. As a result, CSU has reviewed this issue and recognized that the same issue will arise for electricity sales at some future date.

PILT payments based upon a percentage of total revenues could lead to the erosion of PILT collections if open-access and customer choice options reduce the commodity portion of revenues in the PILT equation. CSU's proposal addresses this concern via a PILT assessment mechanism that applies a fixed rate to the quantities of electricity and natural gas delivered through CSU electric and natural gas distribution systems to customers within the City. The principal advantage of the proposed change in methodology is that it maintains a stable revenue stream for the General Fund regardless of which companies actually supply the commodities within the City. In addition, PILT transfers to the City's General Fund will continue to grow as the City grows and more customers inside the City purchase electricity and natural gas. Finally, assessing PILT on a per-unit basis will allow for fair competition between commodity suppliers should retail wheeling eventually prevail as a matter of policy in Colorado.

The recent, very substantial increases in the ECA and GCA rate components and the likelihood that such escalations will continue have the potential to very materially increase the level of PILT transfers to the General Fund. Such material increases are not consistent with PILT transfers predicated on the benefit received by CSU ratepayers as a result of CSU's "franchise" rights to occupy the public rights of way. Our historic approach to such circumstances has been to remove the energy pass through increases from the PILT calculations. A PILT calculation based on the proposed per-unit basis is an efficient mechanism for preserving an appropriate rationale for the resulting transfers.

### **PROCESS FOR ADOPTION OF THE REVISED PILT ASSESSMENT MECHANISM**

The previously determined methodology for determining the level of PILT transfers to the General Fund is set forth in Council Resolution No. 187-92. As such, the proposed revision is in resolution form, superseding and replacing the prior resolution in its entirety.

The proposed PILT revision is designed to replicate the transfer philosophy adopted by City Council in 1992. No change in the allocation of PILT to CSU's customer classes is intended, or would result from this proposal. The potential for changes in cost allocation and class rates will be studied in conjunction with filing of the next gas and electric rate cases, however no current changes will occur. The PILT rate will not change based upon ECA or GCA changes that reflect changes in the cost of natural gas or in the cost of fuel and purchased power; however, at the time of any future base rate increases, the PILT rate will be appropriately increased to reflect the approved rate increase.

### CONCLUSION

Regulatory changes and their resultant impacts on energy commodity markets have the potential to adversely impact PILT transfers from CSU to the City's General Fund. Rapid increases in energy costs and the consequent increases in the ECA and GCA rate components have the potential to materially disrupt the rational basis for the level of PILT transfers. As directed by Council, CSU has identified a revision in the PILT assessment methodology, which safeguards the previously established just and reasonable level of PILT transfers while protecting CSU's ability to compete. The revised PILT calculation methodology will also preserve a rationale basis for the level of PILT transfers by removing the potential impact of the recent ECA and GCA increases. Calculating the level of PILT payments by applying a per-unit charge to the quantity of energy commodities delivered by CSU accomplishes both of these objectives efficiently.

The initial per unit PILT assessments for electric and natural gas will be 0.4355 cents per kilowatt hour delivered and 31.687 cents per thousand cubic feet of gas delivered. These initial assessment rates will be subject to periodic adjustment for approved base rate increases, based on the percentage increase in overall service revenues resulting from the approved base rate changes.

Attached is a Resolution, which will revise the payment in lieu of taxes methodology. After your approval, the Resolution should be placed on the December 12 City Council Agenda so that it can become retroactively effective to November 1, 2000.

Attachment

## COLORADO SPRINGS UTILITIES

2010 Annual Operating Plan

In Thousands of Dollars

### Budget Summary

The 2010 Proposed Budget is developed with direction from the CEO that Colorado Springs Utilities must:

- Maintain financial stability of Colorado Springs Utilities
- Maximize service productivity
- Appropriate only what is required to operate the business
- Ensure the best use of customer dollars
- Prepare for economic recovery

2010 Budget compared to 2009 (in thousands of dollars)

	2010 Proposed Budget	2009 Approved Budget	Increase / (Decrease)	% Change
Fuel Costs <sup>1,3</sup>	\$391,991	\$445,046	(\$53,055)	-11.9%
Non-fuel Operations & Maintenance <sup>3</sup>	252,633	248,971	3,662	1.5%
Debt Service	91,229	80,424	10,805	13.4%
Additions to Restricted Funds <sup>4</sup>	99,148	9,224	89,924	974.9%
Other <sup>2</sup>	4,056	2,689	1,367	50.8%
Payments in Lieu of Taxes (PILT)	25,250	25,999	(749)	-2.9%
Capitalized Interest	4,675	3,936	739	18.8%
Capital Projects	241,474	306,854	(65,380)	-21.3%
<b>TOTAL</b>	<b>\$1,110,456</b>	<b>\$1,123,143</b>	<b>(\$12,687)</b>	<b>-1.1%</b>

<sup>1</sup> Includes Front Range Power purchases for wholesale sales and gas purchases for wholesale sales.

<sup>2</sup> Includes Customer Rebates and Franchise Fees

<sup>3</sup> 2010 Budget amounts for "Fuel" include commodity costs and other fuel-related variable costs previously included as "Non-Fuel". 2009 "Fuel" amounts include commodity costs only. The "Non-Fuel" costs moved in 2010 are approximately \$15.6 million for electric and \$1.1 million for gas, for a total of \$16.7 million.

<sup>4</sup> Additions to Restricted Funds is for additional borrowing for SDS and environmental controls for the electric service. In previous years this category has been included in "Other". However, for purposes of clarity and transparency this year it is being shown as a separate line item.

The resulting Budget of \$1,110.5 million is necessary to:

- Meet environmental and regulatory requirements
- Maintain critical existing infrastructure
- Provide investment for future demand

## Amounts Transferred from Base Rates to ECA in 2010

New Accounts included in ECA per the Annual Operating Plan			
Account Description	Amount		
Steam Power Generation Non-Fuel Expense	\$ 6,117,757		
Steam Ex	714,911		
Steam Expense - Chemistry	533,701		
Electric Expense - Water Purchase	3,273,231		
Electric Expense - Chemistry	1,136,647		
Hydraulic Power Generation - Water for Power	944,135	Note A	#4
Other Power Supply Expenses - Other Expenses	<u>2,839,042</u>		
Amount moved to ECA per Annual Operating Plan	<u>\$ 15,559,424</u>		#1

Asset Optimization Revenues moved from Base Rates to ECA in 2010			
Account Description	Amount		
Coal Sales	\$ (2,072,000)		
Front Range Merchant Agreement	(9,089,000)		
Front Range O&M Agreement	<u>(2,520,000)</u>		
Total Revenues transferred to ECA	<u>\$ (13,681,000)</u>		#2

Expenses related to Revenues moved from Base Rates to ECA in 2010			
Account Description	Amount		
Off-system Coal Sales Expense	\$ 1,900,000		
Front Range Merchant Agreement Expense	<u>8,193,252</u>		
Total Expenses related to Revenues transferred to ECA	<u>\$ 10,093,252</u>		#3

Summary of Amounts Transferred from Base Rates to ECA in 2010			
Amount moved to ECA per Annual Operating Plan	\$ 15,559,424		#1
Less total Revenues transferred to ECA	(13,681,000)		#2
Plus total Expenses related to Revenues transferred to ECA	10,093,252		#3
Less new account related to Hydro-electric generation	<u>(944,135)</u>		#4
<b>Net Amount Transferred from Base Rates to ECA</b>	<b><u>\$ 11,027,541</u></b>		

Note A: Per Financial Planning and Pricing, this account is an interservice cost that was never charged before 2010. The account relates to the purchase of raw water, which flows through the Ruxton Hydro-Electric Facility. It is a new revenue stream for Water and a new cost for Electric.

Note B: In 2009, the ECA calculation included sales margin for Off-System Sales, but not margin for other asset optimization categories.

Appendix D

PILT Analysis prepared by the Office of the City Auditor

Period	Quantity Sold	Rate Used	Rate Proposed	Historical PILT Payments	Proposed PILT Amount	Amount Underpaid
Gas	20,031,834.59	0.351850	0.391539	7,048,201	7,843,244	795,043
Gas	13,857,514.00	0.351850	0.391539	4,875,766	5,425,757	549,991
Gas	4,713,133.00	0.351850	0.391539	1,658,316	1,845,375	187,060
Total for 2009	18,570,647.00			6,534,082	7,271,133	737,050
Electric	2,778,968,179.00	0.004710	0.005351	13,088,940	14,870,259	1,781,319
Electric	631,453,230.00	0.004710	0.005351	2,974,145	3,378,906	404,762
Total for 2009	3,410,421,409.00			16,063,085	18,249,165	2,186,080
Estimated Total Gas & Elec for 2009				22,597,167	25,520,298	2,923,131

**Total Estimated Underpayment at the end of 2009**

**\$ 3,718,174**

2010 Calculations Based on Volumes in Budget -- CSU Calculation compared to Auditor's Calculation

Period	Quantity Projected	Rate Used	Rate Proposed	CSU Projected PILT Payments	Auditor Proposed PILT Amount	Amount Underestimated
Electric	3,821,974,880	0.004710	0.006173	18,001,502	23,593,051	5,591,549
Gas	20,601,045.50	0.351850	0.391539	7,248,478	8,066,113	817,635
Total Estimated Underpayment Budgeted for 2010				25,249,980	31,659,164	<b>\$ 6,409,184</b>