Office Of The City Auditor
Colorado Springs, Colorado

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15-29 Colorado Springs Utilities 2016 Rate Case Audit

November 2015

Purpose

The review focused on the accuracy and consistency of the methodology used to develop the proposed rate changes. We also reviewed for compliance with rate development guidance approved by the Utilities Board.

Highlights

Colorado Springs Utilities rate filing included changes to the Water Service Rates, Electric Service Rates, Electric Cost Adjustment (ECA), and Gas Cost Adjustment (GCA) effective January 1, 2016. Overall, depending on rate class, the total bill for water rates will increase 4.5 - 7%, electric rates will increase 1.4 - 2.3%, and gas rates will decline 7.5 - 14.2%. Additionally, the rate filing included ECA and GCA realignment to combine the supply charge with the fuel adjustment. Rate design changes such as fixed charge increases were made to promote revenue stabilization.

We provide our conclusions on each of the rate filings as follows:

- Water Service Rate change: We conclude that the cost of service study and proposed rates were prepared accurately using consistent methodology.
- Electric Rate change: We conclude that the cost of service study was prepared using consistent methodology. The cost of service study was prepared accurately, except that the forecast for commercial rate ETL had not been adjusted to reflect historical trends. Actual revenues were expected to be significantly less than forecast for this rate class. As a result, revenues will not support the full recovery of the cost of service.
- ECA and GCA realignments and adjustments: We conclude that the rate adjustments changes and realignments were prepared accurately. The gas fuel realignment was revenue neutral to Utilities. However, when the GCA and Gas Capacity Charge (GCC) are combined, residential customer classes charges increased, while commercial and industrial gas customer classes decreased.
- The proposed ECA and GCA collected balances were not consistent with current Enterprise Scorecard guidance. Utilities' forecast of GCA and ECA over-collected balances never goes below \$5 million and are shown between \$8-\$10 million for GCA and \$6 to \$8 million for ECA most of the year. Colorado Springs Utilities has proposed an increase in target collected balances to promote revenue stability, which will decrease customer refunds. At the time of our review, updated formal guidance had not been adopted.

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Management Response

Utilities believes it has filed a 2016 Rate Case that demonstrates generally accepted ratemaking practices grounded in the rate design guidelines and sound professional judgment that results in just and reasonable rates that are not unduly discriminatory. See detailed responses presented with each observation.

Observations

1. City Council should decide whether ECA and GCA will be a pass through or a rate stabilization tool. Utilities Board should provide formal guidance and enterprise scorecard measures for ECA and GCA collected balances based on Council's decision.

2. Colorado Springs Utilities should continue to research the root cause of the significant revenue shortfall in the ETL rate class. By March 31, 2016, Utilities management should report research results to the Utilities Board and propose appropriate forecast and rate changes if needed.

City Council should determine whether:

A. The rate case should be approved as submitted,

B. Change the ETL rate increase to 12% to start addressing past under collections, or

C. Defer rate changes for the ETL rate class until after root cause analysis is complete.

3. City Council should provide direction on how the funds associated with the \$1 million water surplus should be used.

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Fuel Cost Adjustments (ECA and GCA)

Colorado Springs Utilities proposed a reduction to $.3034 for residential customers and $.2855 for commercial customers for the combined GCA and GCC with the rate filing. This includes the supplemental filing of November 10, 2015 to the GCA effective January 1, 2016. An ECA reduction to $.0249 was proposed with the rate filing to be effective January 1, 2016.

Realignment - We reviewed the supporting calculations for combining supply charges with ECA and GCA. In addition to this realignment, Colorado Springs Utilities' filing included moving some costs to a separate Gas Capacity Charge (GCC). While this change was revenue neutral to Colorado Springs Utilities, the GCC is based on forecasted demand, which varied by rate class, resulting in increases for residential customer classes, and decreases for other classes. The realignment increased residential gas rates by .9%. It decreased commercial gas rates by 2.2% and industrial gas rates by 2.3%. The realignment effects were fully disclosed in Colorado Springs Utilities electric and gas service reports.

Collected Balance Guidance - Utilities website states, "Changes to the costs adjustments, which can be made monthly, directly reflect costs that we are paying – we do not profit from increases to the adjustments." The website indicates the ECA and GCA were a mechanism to pass through costs of purchased fuel or energy. Targeted over-collected balances were not in alignment with a pass through of actual costs. The definitions from Utilities website were as follows:

- ***Electric Cost Adjustment (ECA)*** *– The mechanism that tracks and passes through to customers the actual cost of purchased fuel or purchased electricity. Springs Utilities can increase or decrease the ECA on a quarterly basis if actual costs vary from forecasted prices.*
- ***Gas Cost Adjustment (GCA)*** *– The mechanism that tracks and passes through to customers the actual cost of the purchased natural gas. Springs Utilities can increase or decrease the GCA on a quarterly basis.*

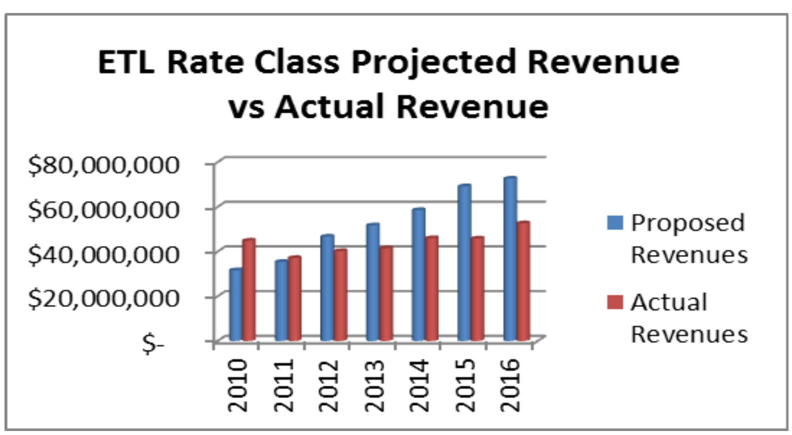
For 2015, a Colorado Springs Utilities enterprise scorecard measure was in place for ECA and GCA collected balances. Under the scorecard measure, the 'meets expectations' result for year to date average collected balance was no more than $4 million over-collected or under-collected for the ECA and $7 million over or under collected for the GCA. The year to date average collected balance at September 30, 2015 was $5.1 million for the ECA and $7.4 million for the GCA, which was in the 'needs improvement' category in the scorecard. Based on the proposed forecast, Utilities forecasts indicate collected balances between $8-$10 million for GCA and $6 to $8 million for ECA until late 2016.

We understand that Colorado Springs Utilities has proposed to the Utilities Board Finance and Strategic Planning Committees a change to increase target collected balances for the ECA and GCA. Utilities has proposed targets of a $0-$6 million over collected balance for the ECA and a $0-$10 million over collected balance for GCA. At the time of our review, updated formal guidance and related scorecard measures had not been adopted by Colorado Springs Utilities. We note that monthly reports of the ECA and GCA actual and forecast collected balances were distributed to the Utilities Board for review.

Electric Service Cost of Service and Rate Filing

The Electric Cost of Service Study and Rate Filing was prepared on a consistent basis with prior cost studies. We noted that in the rate filing, electric residential fixed charges component of the overall bill was increased 21.75%. Commercial and industrial fixed charges were increased by 5.6 - 6% percent, approximately equal to the overall electric service increase. The objective of the residential fixed charge increase was to promote revenue stabilization, as stated in the Electric Service Rate Case Filing Report.

As reported in Report 15-24 Comparison of Projected to Actual Revenue, actual revenues were significantly less than forecast for large commercial customer classes, particularly the ETL customer class, for the past several years. Revenues for this rate class were $6.4 million, $10 million, and $12.5 million less than projected for 2012 through 2014, and were expected to be in the range of $19 million less than forecast in 2015. As 2016 volumes are comparable to 2015 forecast volumes with a 6% rate increase for the class, significant under-recovery in 2016 is expected.



Colorado Springs Utilities was in the process of researching the root cause for under recovery in this rate class. This research was expected to be completed by March 31, 2016. The 2016 forecast supporting the Electric Service Filing was not adjusted to reflect the historical trends referenced on the prior page. As a result, revenues will not support the full recovery of the cost of service. This potential under recovery was not reported in the rate case as filed. The rate case shows the ETL proposed revenue being 104% of the adjusted cost of service. Colorado Springs Utilities management will report the results of their analysis of this shortfall to the Utilities Board and propose any necessary changes to the forecast and rates after the end of first quarter 2016.

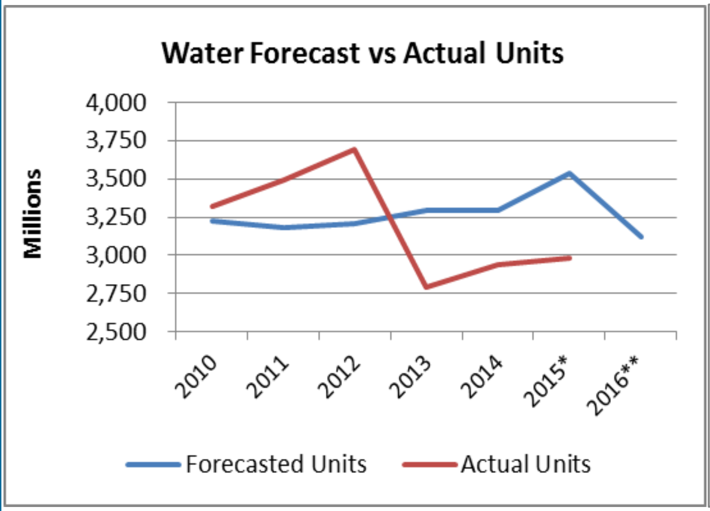
Water Cost of Service and Rate Filing

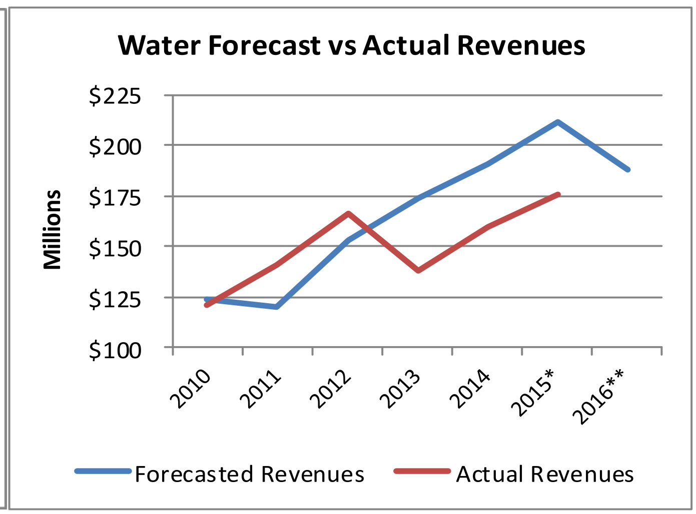
Water Service rates were last increased on average 10% effective for 2013 and 10% for 2014, with no rate increases filed for 2015. A methodology change was implemented in the 2016 Water Cost of Service Study to allocate treatment, distribution mains, and reservoir costs based on forecasted demand for each class. This is similar to the methodology change implemented for the 2015 Electric Service Rate Filing.

We noted that in the 2016 Water Service Rate Filing, fixed charges for residential, commercial and industrial rate classes were increased by 16.3 percent for residential and 16.4 percent for non-residential. The objective of the fixed charge increase was to promote revenue stabilization through fixed cost recovery. Additionally, the commodity increase for non-residential customers was primarily applied to winter rates to promote fixed cost recovery.

The 2016 Water Service Cost of Study included $1,000,000 identified as a Surplus Fund Transfer to the City in the Water Service Report. At the time of our review, a resolution regarding the remittance or use of these funds were not in place.

The 2016 water revenue forecast has been adjusted downward from 2015 to better align with historical trends.





* Amounts are 8 months worth of actuals and 4 months of forecasted. Amounts are taken from Monthly Financial Reporting Package provided by CSU.

** Amounts are from the 2016 WCOSS.

Colorado Springs Utilities Management General Response

As the regulator of Utilities, City Council has a duty to determine fair, just and equitable rates for all utility services based on the evidence presented to support the proposed rates. The City Council, through its role as the Utilities Board governs the management and operations of the Utilities through established written policies. Utilities believes it has filed a 2016 Rate Case that demonstrates generally accepted ratemaking practices grounded in the rate design guidelines and sound professional judgment that results in just and reasonable rates that are not unduly discriminatory. For additional clarification, Utilities has submitted detailed responses shown with each observation that follows.

Observation 1

Current ECA and GCA collected balances were not in compliance with existing guidance. Colorado Springs Utilities management has proposed an increase in the targeted collected balances for the Electric Cost Adjustment (ECA) and Gas Cost Adjustment (GCA). However, formalized updated guidance instructing the Utilities to improve rate stabilization through over collection and providing tolerances for over and under collection had not been approved.

Year to date average collected balances for the ECA and GCA were in the 'needs improvement' category of the enterprise scorecard as of September 30, 2015. The forecast submitted with these filings indicated a collected balance of $8-10 million for both the ECA and the GCA until late 2016.

The ECA and GCA were defined as a pass through of actual fuel costs. Over-collection of balances did not align with the cost pass through objective. Recognizing seasonality, targeting a $0 balance on a monthly basis would not be prudent. However, the forecasted collection balance should approach $0 at least once a year to reflect a pass through of costs to current customers.

Recommendation

City Council should decide whether ECA and GCA will be a pass through or a rate stabilization tool. If it is not to be used as a rate stabilization tool, the rates should be adjusted down so the projected balance approaches $0 at some point in 2016.

Council could instruct Utilities to comply with current guidance, in which case, refunds to customers should be increased to reduce collected balances.

Based on Council's decision, Utilities Board should provide formal guidance and enterprise scorecard measures for ECA and GCA collected balances.

Management Response

The Electric and Gas Cost Adjustment is a direct pass-through rate structure regardless of the amount of over or under collection balance. EL-8 monthly monitoring provides Utilities Board current and projected over/under collection balances. Through monthly monitoring, Utilities Board directs Utilities to file rate adjustments based upon striking a balance between the following criteria; the magnitude of rate adjustments in consideration of impact to customer's bills, minimization of the number of ECA and GCA rate adjustment proceedings and maintaining financial stability associated with fuel cost recovery.

Observation 2

Actual revenues for the large commercial customer ETL rate were significantly less than forecast for 2012-2014. Revenues for 2015 were expected to be $19 million less than forecast.

The volumes in the 2016 forecast were comparable to 2015 with a proposed rate increase of 6%. As a result, a significant revenue shortfall for this rate was expected to continue in 2016. Rates for this class would have to be increased approximately 59% to recover the cost of service using historical demand.

Colorado Springs Utilities was in the process of researching the root cause of the revenue shortfall, which was expected to be completed March 31, 2016.

City Council could elect to approve the electric rate case as presented, or could elect to increase the proposed rates for this customer class to address the expected revenue shortfall. Alternatively, rate changes could be considered after the root cause analysis is complete.

Recommendation

Utilities should continue to research the root cause of the significant shortfall between forecast and actual revenues in the ETL rate class.

Utilities management should report results to the Utilities Board and propose appropriate forecast and rate changes, if needed.

City Council should determine if the rate case should be approved as submitted, or if additional rate increases are warranted for this class. Alternatively, City Council could consider rate changes after March 31, 2016 when root cause analysis is scheduled to be complete.

Management Response

Utilities has previously committed to identify root cause of ETL rate class revenue trends by March 31, 2016 in management responses to both the 2015 Electric Rate Case audit and the 2015 Comparison of Projected to Actual Revenue audit. Any additional action, based on the root cause analysis will be proposed at that time.

Observation 3

The 2016 Water Service Cost of Study included $1,000,000 identified as a Surplus Fund Transfer to the City in the Water Service Report. This amount was included as a cost in the 2016 Annual Operating Plan. At the time of our review, a resolution regarding remittance to the City or any other use of the funds was not in place.

Recommendation

Management should work with City Council to ensure Utilities 2016 appropriation includes a resolution related to the Surplus fund transfer.

Management Response

Surplus Payments to the City must be appropriated in the budget and included in rate filings prior to the authorization of the surplus through resolution and ultimate transfer. Utilities is appropriately positioned to either 1) respond to a request from City Council to submit a resolution for surplus payment or 2) take no action to authorize surplus. If the latter applies, the budgeted amount identified in the rate filing will either support financial stability by increasing cash on hand or be utilized for other business needs recommended by Utilities and approved by Utilities Board.