CITY OF CAÑON CITY

City Council

City Council Chambers
128 Main St., Cañon City, CO 81212
(719) 269-9011 • www.canoncity.org

VISION COMMITTEE MEETING
March 22, 2023
5:00 p.m.

AGENDA

1. **CALL TO ORDER: City Council Chambers, City Hall**

2. **ROLL CALL: COUNCIL MEMBERS DENNEHY, SCHMISSEUR, B. SMITH, STEIN, TRACY, WORTHINGTON, MAYOR PRO TEM HAMRICK, MAYOR SMITH.**

3. **DISCUSSION:**

   A. Cañon City Energy Committee Update

4. **ADJOURN The next scheduled meeting is April 19, 2023.**

Posted pursuant to code on Thursday, March 16, 2023.
Cindy Foster Owens, City Clerk

CITY OF CAÑON CITY

City Administrator

P.O. Box 1460 • 128 Main Street
Cañon City, CO 81215-1460
(719) 269-9011 • www.canoncity.org

TO: Mayor and City Council

FROM: Ryan Stevens, City Administrator

PREPARED BY: Cindy L. Foster Owens

DATE: 03/22/2023

RE: Canon City Energy Committee Update

SUMMARY: * The Energy Committee has been working on various paths forward. The attached report is their next interim report that they would like to present to City Council and receive feedback on how to proceed.

REVIEWED BY LEGAL? **Yes** • **No**

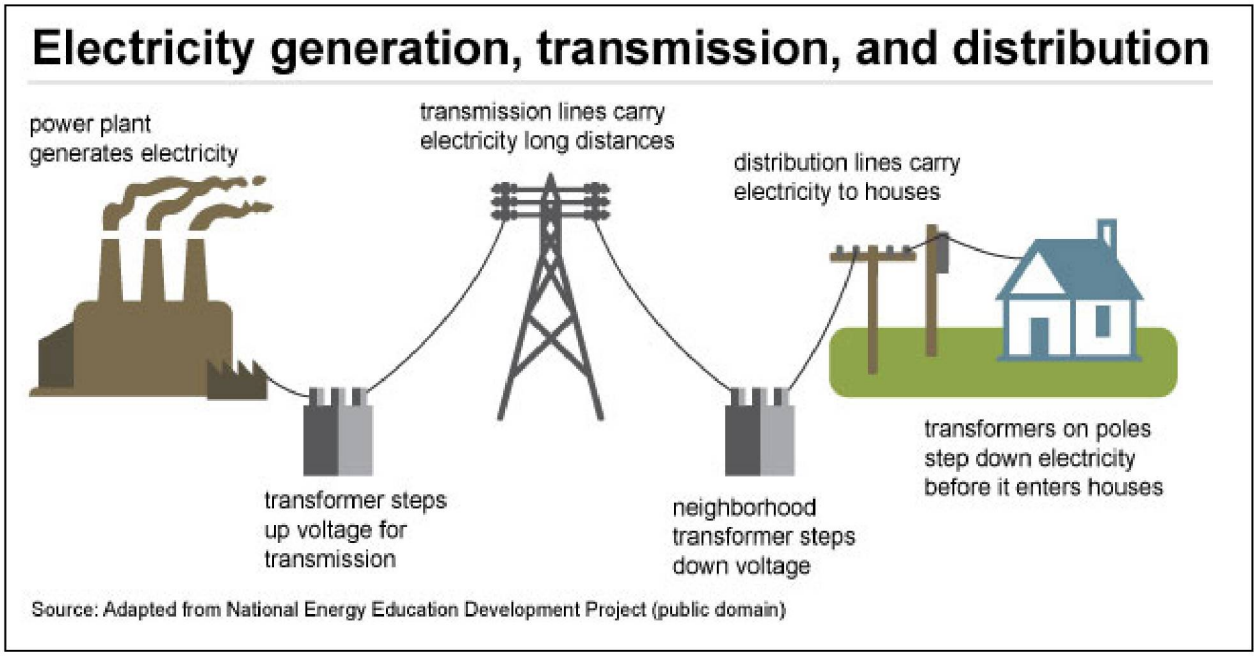
RECOMMENDED ACTION: Discussion

# of attachments 1

Cañon City Energy Franchise Committee Report

Electric Service Options

March 22, 2023



Investor-Owned Utility

Rural Cooperative Utility

Municipal Utility

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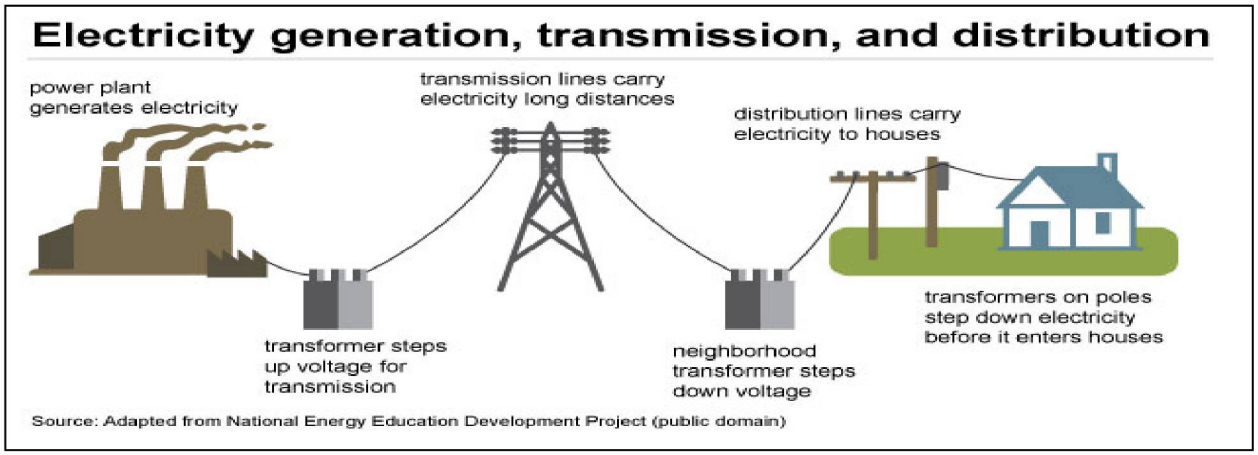
I. Cañon City's Options for Electrical Service

Colorado options for electrical service are (1) retail customers can be served by an investor-owned utility (IOUs), (2) a cooperative utility, or (3) a municipal utility. The two IOUs, Black Hills Energy (BHE) and Public Service Company of Colorado, d/b/a Xcel Energy Corp. (hereafter referred to as Xcel), are regulated by the Colorado Public Utilities Commission (PUC). Coloradans are also served by 29 municipal and 22 rural electric cooperatives. Since municipal and rural electric cooperatives are not operated as for-profit corporations, they are not regulated by the Colorado Public Utilities Commission.



Characteristics	Investor-Owned Utility	Rural Cooperative Utility	Municipal Utility
Ownership	Public Stockholders	Customers/Members	Municipality
Board of Directors	Elected by Stockholders	Elected by Customers/Members	Elected by Residents
Operation of Utility	For-Profit	Not-For-Profit	Enterprise Fund
Co. Public Utility Comm. Oversight/Regulated	Oversight & Regulated	Not Regulated	Not Regulated
Rate Determination Made	Interaction with State PUC/BHE/Stakeholders	Board of Directors	Board of Directors
Profits Included in Rates	Yes	No	Possible
Profits to Owners	Yes	No	Possible
Pays Fed. & State Taxes	Yes	No	No
Fees to Colorado PUC	Yes	No	No

II. Cañon City's Current Electrical Provider: *Black Hills Energy*

A. Overview

Cañon City currently receives electrical service from Black Hills Energy, an investor-owned utility. The franchise agreement with BHE and Cañon City expired in 2017. As per Cañon City's Charter, a special election was held on November 3, 2020 in which 65% voted against renewing a new franchise agreement with BHE. The major issue is assumed to be the high cost of retail service for Cañon City.

The Colorado Public Utilities Commission provides oversight and regulation of Black Hills Energy. The PUC reviews and decides on requests from BHE to construct certain facilities, approve franchise agreements, mergers or acquisitions, service territories, rates, billing, metering, disconnections, reconnections, customer deposits, and other terms and services.

An investor-owned utility is a for-profit, shareholder-owned utility. They are privately owned, governed by well compensated private boards, return profits to shareholders, pay taxes to federal, state, and local governments, and any rate changes must be approved by the Colorado Public Utilities Commission.

Investor-owned utility board members are accountable to shareholders; they are judged not on their ability to provide low-cost, reliable power or excellent service, but on their ability to maximize profits for the investor-owned utility or its holding company and to pay a quarterly dividend to shareholders.

According to a 2021 rate study conducted by the Colorado Public Utilities Commission they found that Black Hills' retail electric rate for residential customers averaged 16.38 cents per kWh compared to the statewide average of 12.18 cents. This residential rate was 4.2 cents more per kWh or 34% higher than the state average. (See Index 2: CAMU Residential Electric Cost Survey July 2022)

Rate Class	Average Rate	Black Hills	Xcel
Residential	12.18	16.38	11.13
Commercial	9.79	11.12	9.37
Industrial	7.39	8.50	7.66
Overall Average	9.95	12.24	9.31

B. BHE Rate Determination

The Colorado Public Utilities Commission in Appendix A of their rate study reported, "The amount of generation built by Black Hills and its IPP affiliate is quite substantial and is a major driver of rates."

The PUC uses a revenue formula which allows BHE to include all operating expenses as well as a rate of return on their rate base. BHE's rate base includes such things as generation fleet, transmission assets, distribution network and at times other assets such as pension plans. The larger the amount of assets in the rate base increases the rates paid by customers.

The regulated monopoly of investor-owned-utilities such as BHE creates a tension between the profit maximizing motive of utility companies and its shareholders on the one hand and price fairness to customers on the other hand. The PUC is the state agency that makes the final decision on what price they consider to be fair for Cañon City customers.

C. BHE Structure

Investor-owned utilities use a unique business model. The controlling business entity is a Corporate Parent Holding Company. The Corporate Parent Holding Company in turn owns numerous Utility Operating Companies. Black Hills Corporation has eight Operating Companies of which Black Hills Energy is one of them.

BHE is a vertically integrated utility which means they provide generation, transmission, distribution, and have Purchase Power Agreements with Black Hills Corporation and others.

As an investor-owned utility, BHE has been granted a Certificate of Public Convenience and Necessity by the Colorado Public Utility Commission to service a specific geographical area. The following communities have franchise agreements with BHE: Pueblo, Brookside, Cheraw, Coal Creek, Crowley, Cripple Creek, Florence, Fowler, Manzanola, Olney Springs, Ordway, Rockvale, Rocky Ford, Silver Cliff, Sugar City, Swink, Victor, Westcliffe, and Williamsburg. Cañon City and Pueblo West, a metro district, do not have existing franchise agreements.

Operational costs include power generation/supply expenses; transmission expenses; distribution operation and maintenance expenses; administrative and general expenses; customer service and billing expenses; capital improvement expenses; and debt repayment expenses.

Generation comes from both company owned units as well as purchasing electricity at wholesale through Purchase Power Agreements. In 2019 Black Hills power generation mix consisted of 73.37% from natural gas sources and 26.63% from renewable sources. Updates from Black Hills staff indicate that the 2020 power mix increased to 30% renewable sources, which reaches Colorado's mandates for renewables for 2020. Colorado's mandate for carbon emission reductions will currently go up to 80% in 2030 using a 2005 base.

A single transmission line that runs south of Cañon City and parallel to the Arkansas River currently brings powers to the city. The transmission line connects to transmission substations in Fremont County. Backup power, if the existing transmission line is lost, is provided by the Western Area Power Administration power line. In addition, Black Hills Energy is building a second 39-mile single circuit 115-kilovolt transmission line which should be operational in 2023.

The distribution network is a system of wires that picks up where transmission lines leave off. Transmission substations connect with distribution substations that use step down transformers. There are six distribution substations that service all of Fremont County. Older substations include North Cañon, East Cañon, South Cañon, and the Cañon Plant. Two new substations, Hogback and Penrose, will be operational in 2023. In turn, electricity is distributed to both Cañon City and Fremont County customers from these distribution substations. The distribution grid connects substations to customers ranging from industries, to businesses, to residential homes. In neighborhoods, another small transformer mounted on pole or in a utility box converts the power to even lower levels to be used in homes.

Operational expenses for distribution networks include distribution expenses, customer service expenses, administrative and general expenses and customer program expenses. Distribution network expenses includes all costs to operate and maintain the distribution system including substations. Customer service expenses include labor and expenses incurred to provide customer service such as billing, meter reading, customer information and advertising, records and collection. Administrative and general expenses include all other labor and expenses necessary to run the electric utility. Labor includes personnel in

billing/customer service, accounting, information systems, and management. Customer program expenses include special customer programs such as energy efficiency and electric vehicle programs.

D. BHE Long-Term Debt

The utility industry requires large investment in long-term assets. Investor-owned utilities such as BHE can use bonds, preferred stock, common stock, as well as loans with affiliated companies to raise funds for capital improvements. The PUC approves all capital improvements such as generation, transmission, and distribution assets of BHE. In determining rates for customers the PUC allows BHE to repay their long-term debt as well as allowing BHE to make a profit on their investment in their long-term assets or their rate base.

Assets in the rate base or long-term assets depreciate each year and decline in value. BHE's investment in long-term assets is around $600 million. If no new capital improvements are approved by the PUC, rates could potentially go down; but it is in the profit motive of BHE to continually invest in long-term assets in order to maximize revenue. Once again the PUC has the final say in what types of investments are prudent, necessary and best for Cañon City customers.

The increase in rate base by Operating Companies such as Black Hills Energy, represents a lucrative opportunity for more profits for the Parent Holding Company, Black Hills Corporation. Parent Holding Companies such as Black Hills Corporation many times use what is called double leveraging to finance the assets of their Operating Companies, instead of issuing stock to raise capital. An example of this is that Black Hills Corporation or one of its Operating Companies borrows money to finance large investments. In turn one of their Operating Companies such as Black Hills Energy pays back the loan at a higher rate of interest. In the 2020 FERC Form 1 Statement of Income, it reports that Black Hills Energy paid interest on debt to Associated Companies totaling $18,502,221.00 for 2020.

Examples of how the Parent Holding Company, Black Hills Corporation, uses this double leveraging with its Operating Companies is further illustrated in the 2020 FERC Form 1 Comparative Balance Sheet of Black Hills Energy. On page 112 of the report it lists long-term debt from advances from associated companies at $150,000,000. In addition, under current & accrued liabilities it lists notes payable to associated companies of $267,355,725 and accounts payable to associated companies of $32,328,663. Adding all three of these liabilities totals $449,684,388 to associated companies.

E. BHE Agreements

Cañon City currently does not have a franchise agreement with Black Hills Energy as it expired in 2017 and in November 2020 citizens voted down a new franchise agreement.

Franchise agreements are a negotiated contract between a municipality and an electric service provider that governs the utility right of way. These agreements commonly include stipulations regarding the city's right of way that utilities use to install and maintain electrical infrastructure.

Cities in Colorado may assess franchise fees on electric utility bills within their boundaries. Typically, the franchise fee recoups the cost of the utility company's use of public space, also called public "right of way", for energy infrastructure such as power lines.

Since a new franchise agreement was voted down in 2020, Cañon City's Council decided to stop collecting the 3% franchise fee in 2021 which reduced city revenue by about $500,000 a year. However, the City does collect a 3% sales tax on customer bills.

If other electrical options are not pursued, Cañon City needs to determine with Black Hills Energy if a new franchise agreement needs to be developed and taken to a vote or if a different type of an agreement needs to be made.

F. BHE Cost Relief Options

Black Hills Energy rates are approved by the Colorado Public Utilities Commission with limited Cañon City input. It appears as if BHE is not offering any rate relief for its customers. The City will need to discuss with BHE about any possible rate reduction efforts.

The suggestions for rate relief options from the Colorado Public Utilities Commission's recent rate study should be examined further.

In December 2022, the Public Utilities Commission released a report of its study about Community Choice Energy. Community Choice Energy has the potential to enable communities to meet their renewable energy goals and to reduce their electricity rates by allowing wholesale competition and local control over the energy supplier and energy mix without changing the local utility, Black Hills Energy's status as sole supplier of electric transmission, distribution, billing, and customer service functions.

The City should be involved with all BHE proceedings with the PUC which can impact electrical rates. Cañon City should also work with other communities who are serviced by BHE at PUC proceedings.

The City should make sure that its residents know and take advantage of all potential BHE programs as well as any State and/or Federal energy programs.

III. Rural Electric Cooperative Utility Option

An alternative to BHE is that a rural electric cooperative utility could (a) buy the BHE Colorado electric system or (b) be involved as an integral partner with a municipal utility. BHE has made it known that their business is currently not for sale. This backs up its March 2018 decision when BHE turned down an unsolicited $1.1 billion purchase offer from the San Isabel Electric Association in Colorado.

Cooperatives are member driven, not profit-driven like investor-owned utilities. Operating much like a grocery cooperative or a credit union, each electric cooperative is an independent utility owned by its customers. Unlike investor-owned utilities, cooperatives set their rates strictly to cover the cost of doing business including current costs as well as future investments in their system. If annual revenues exceed costs, co-op members get a credit. Decisions are made by a local board of directors elected by coop members.

Cooperatives finance long-term assets internally through patronage capital and through loans. Today, electric cooperatives are the only U.S. utilities that rely on government and other loans to finance capital construction using sources such as CoBank and the Cooperative Finance Corporation.

CoBank, which is part of the US Farm Credit System, provides loans and financial services to cooperatives, agribusiness, rural public utilities and other farm credit associations, who collectively own CoBank. CoBank offers a broad range of competitively priced, flexible loan programs, leasing services and other financial services that enable electric cooperatives to fulfill their mission of providing reliable power to rural communities. Today, over 75% of electric distribution, transmission and generation cooperatives work with CoBank for their banking and financial needs.

Many cooperatives also borrow money for infrastructure projects from the government through the Rural Utilities Service (RUS), an arm of the U.S. Department of Agriculture. However, access to federal funding can require additional time and requirements, which may be difficult to meet. Cooperative Finance Corporation, CFC, was formed to supplement the loan programs of RUS. The National Rural Utilities Cooperative Finance Corporation (CFC) is a member-owned cooperative association incorporated by and for rural electric cooperatives. CFC provides credit and industry-leading financial products to America's 900-plus local, not-for-profit, consumer-owned electric cooperatives and rural utility systems. CFC provides a range of services including financing for infrastructure such as distribution lines and power plants, emergency lines of credit so power can be restored quickly after a disaster, loan syndications and loan resale, strategic planning and financial analysis, financial education and training, and much more.

Since Black Hills Energy is not willing to sell their business, utilizing a rural electric cooperative could possibly be a hybrid with a municipal utility. A third party partner such as a rural electric cooperative could develop power generation/supply agreements; develop transmission contracts; and take over operation of distribution and maintenance; administrative and general; customer service and billing responsibilities.

IV. Municipal Utility Option

Home | American Public Power Association

EES Consulting: 2019 Pueblo's Phase 1 &2 Studies

A. Cañon City's Current Electric Service

Cañon City currently has electrical service provided by Black Hills Energy, an investor-owned utility. Investor-owned utilities are private, for-profit enterprises. They are owned by investors or shareholders, who generally are not customers of the utility or members of the community, and their primary motivation is to increase the value to shareholders. As private businesses, investor-owned utilities do pay taxes to local governments, but customers have no voice in the operation of the utility.

According to a 2021 rate study conducted by the Colorado Public Utilities Commission they found that Black Hills' retail electric rate for residential customers averaged 16.38 cents per kWh compared to the statewide average of 12.18 cents per kWh. This residential rate was 4.2 cents more per kWh or 34% higher than the state average. (See Index 2: CAMU Residential Electric Cost Survey July 2022)

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The Cañon City Energy Franchise Committee was formed by the City Council after voters turned down a renewal of the franchise agreement with Black Hills Energy in November 2020. The committee's focus has been to examine different business models that could possibly save customers money on their electric bills. The formation of a municipal electrical utility is one possible business model.

B. Municipal Overview

In most states, citizens have the right to determine whether to own and operate their own public utility. Forming a new public power utility isn't a quick or easy process. It takes time and money and requires the commitment of the community and its elected officials. It requires a long-term view of solving problems and a commitment to see it through.

Public power utilities are entities of local or state government. The public power business model is based on public ownership and local control, a not-for-profit motive, and focus on its customers. Because they are public entities, public power utilities do not pay federal income taxes or most state taxes, but they support the local government through payments in lieu of taxes, transfers to the general fund, and free or reduced-cost electric services to the municipal government.

The governance structure for each utility varies. Some are governed by the city council; others are controlled by an independent utility board whose members may be elected or appointed by the mayor and city council. Public power utilities are owned and accountable to the people they serve. Citizens have a direct and powerful voice in utility decisions and policies, both at the ballot box and in open meetings where business is conducted.

Public power's rates, on average are lower. Year after year, for more than 50 years, data from the U.S. Department of Energy show that investor-owned utilities and rural electric cooperatives charge more on average for electricity than public power utilities. In 2014, residential customers of investor-owned utilities paid average rates that were 14 percent higher than those paid by customers of public power utilities.

There are 28 community owned electrical utilities in Colorado and more than 2,000 cities and towns in the United States that light up their homes, businesses and streets with public power electricity that comes from a community owned and operated utility.

C. Authority to Municipalize

A community is within its rights to determine which public services it will provide to its citizens, whether those services include electric, water, wastewater, gas, sewer, cable or internet services. Locally, Cañon City provides water and stormwater services while the Fremont Sanitation District provides sewer and wastewater services.

In 1902, by a vote of the people, Colorado adopted the concept of home rule for municipalities. The home rule provisions were included within the Colorado Constitution as Article XX. The home rule amendment contains an explicit authorization allowing home rule municipalities to offer electric utility service both within and outside municipal limits. Cañon City is a home rule municipality.

Under the Colorado Constitution, the City, as a home rule city, is empowered to purchase or condemn utility facilities wherever located in furtherance of a public purpose. The City may condemn BHE facilities that are located both inside and outside the City or just those facilities located inside the City boundaries; however, the process becomes more complicated if the City were to condemn outside of the City boundaries as the Colorado Public Utilities Commission (CPUC) may exercise jurisdiction over facilities that serve ratepayers outside the City limits.

Cañon City's BHE franchise agreement expired in 2017 and was not renewed by voters in a 2020 election. Not having a current franchise agreement with BHE is the first step for Cañon City to municipalize an electric utility. This is in contrast with Pueblo which still had years left on their franchise agreement with BHE remaining when they were trying to municipalize.

Even though BHE is not a willing seller, the City does have the option of Colorado's Condemnation Law through the eminent domain process to create a new municipal electric utility for Cañon City.

D. Feasibility Studies

The Black Hills Energy electric system has been studied several times in the past few years for the economic feasibility of a potential purchase.

First, in March 2018 BHE received and turned down an unsolicited $1.1 billion purchase offer from the San Isabel Electric Association in Colorado. San Isabel determined through their feasibility studies that the BHE system was a viable system for them to buy and operate. San Isabel's studies are not available to review.

Next, in 2018-2019 the City of Pueblo conducted phase 1 and phase 2 feasibility studies through EES Consulting. The study evaluated the financial, engineering, operational and legal feasibility of forming a

municipal utility to serve electric customers under three scenarios: the City of Pueblo, Pueblo County and the entire BHE Colorado system.

According to the study, operationally, the most appropriate BHE facilities to acquire were distribution equipment and substations in all of BHE's Colorado service territory. The BHE distribution system was in adequate condition. Based on their field investigation work, the facilities appeared to be in good condition and subject only to routine maintenance.

The study did not recommend the purchase of BHE generation sources and recommended that all wholesale power needs should be provided via contractual agreements with BHE and/or other qualified third-party power suppliers and vendors.

The study also recommended that the City should not purchase BHE transmission level voltage facilities. It recommend that the City purchase transmission service from BHE (or other providers) under standard open access tariffs.

The conclusion of EES Consulting was that municipalization could provide current BHE electric customers with significant retail rate savings in the range of 10-14%. In contrast, BHE hired a consulting firm, Concentric Energy Advisors, Inc., who concluded municipalization would not work.

In the May 2020 ballot initiative, Pueblo voters rejected an effort to end the existing Black Hills Energy franchise and form a municipal utility. By voting against municipalization, Pueblo voters chose to continue receiving electric service from Black Hills Energy while maintaining the existing franchise agreement with the City of Pueblo which continues through 2030. As stated by the website of the American Public Power Association, BHE opposition to this initiative outspent the municipal supporters 50 to 1. Ending the franchise agreement with BHE would have been a step needed in order to form a municipal electric utility in Pueblo.

V. Potential Cañon City Municipal Electric Utility

A. Experienced Third-Party Partner: An experienced third-party electric utility partner is recommended to assist with all aspects of the municipalization process.

B. Feasibility Studies on BHE: Both San Isabel Electric Association and the City of Pueblo conducted feasibility studies and determined that it was economically feasible to purchase the BHE system.

The conclusion of EES Consulting was that a Pueblo Municipalization could provide current BHE electric customers with significant retail rate savings in the range of 10-14%. Further they reported that forming a municipal utility would have other benefits such as local control over power supply, resource type, rates, local programs, and key decision-making.

BHE turned down the San Isabel offer. The citizens of Pueblo voted no to ending their franchise agreement early with BHE which would have opened the opportunity to municipalize.

Although the two studies referred to concluded that it would be economically feasible, it is beyond the scope of this report to determine the economic feasibility. This report assumes that the City determines that it is economically feasible to proceed with condemnation. Pueblo's Feasibility Studies and the American Public Power Association website were used to develop a pathway for municipalization.

C. Condemn BHE Distribution Assets: Purchase only targeted BHE distribution assets. This is the same as the recommendation of Pueblo's consultant.

D. Do Not Condemn BHE Generation: The City should follow the Pueblo Study's recommendation and not purchase BHE generation facilities. All wholesale power needs should be provided via contractual agreements with BHE and/or other qualified third-party power suppliers and vendors. Colorado's Renewable Energy Standard can be met which is currently set to be 80% by 2030.

Hundreds of public power utilities also participate in joint-action power supply agencies to gain economies of scale in wholesale supply that small municipal utilities might otherwise find unattainable. Some new public power utilities may also be eligible to receive hydro power allocations.

E. Do Not Condemn BHE Transmission: Given that open access to BHE transmission is already available through Federal requirements, acquisition of the BHE electric transmission seems unnecessary. The City should purchase transmission service from BHE (or other providers) under standard open access tariffs.

F. Determine Service Area: The City will need to determine if it will service areas outside of the city limits. If so, those specific areas need to be identified. If the service area includes locations outside of Cañon City, the Colorado Public Utilities Commission will be involved.

G. Colorado Public Utilities Commission Jurisdiction: The CPUC does not have jurisdiction over a municipal utility operating solely within its boundaries. Therefore, if the City were to create a municipal utility to only serve residents within its municipal boundaries, the CPUC would not have any jurisdiction over the City's facilities, rates, and service. The CPUC does have jurisdiction in the following:

1. Certificate of Public Convenience and Necessity (CPCN): One form of CPUC regulation is the requirement of a certificate of public convenience and necessity (CPCN). CPCNs are required by the CPUC prior to a public utility entering into a franchise agreement, operating within a particular service territory or constructing or extending facilities. The CPUC would likely monitor the changeover process until it is proven to be viable.

2. Transfer of Assets: The CPUC does have jurisdiction over the transfer of a certificate of public convenience and necessity (CPCN) when a city has condemned public utility facilities outside its municipal boundary or when facilities serve ratepayers outside city limits. In the recent City of Boulder proceedings the CPUC determined that it has jurisdiction over the transfer of assets, wherever located, that serve ratepayers outside the city's jurisdiction prior to the implementation of condemnation proceedings. The CPUC's determination has been affirmed by a state trial court; however, neither the Colorado Supreme Court nor an appellate court have decided the issue.

3. Facility Separation: Boulder's municipalization was further complicated by a decision of the CPUC and a state trial court. In Decision No. C13-1350, the CPUC determined that: If Boulder seeks to condemn facilities, wherever located, that [the Company] currently uses, at least in part, to serve customers located outside of Boulder's city limits, this Commission must have the ability to investigate and determine how the facilities should be assigned, divided, or jointly used. Boulder filed an application with the CPUC to determine how facilities that serve customers outside city limits should be

assigned, divided, or jointly used to protect the system's effectiveness, reliability, and safety. Thus, a Commission proceeding addressing these facilities should precede a condemnation action to allow the district court to rule on the public need and value of facilities that the Commission determines may be the subject of transfer to Boulder.

4. Rates: A municipal utility operating outside its boundaries can be subject to CPUC rate regulation. State law does appear to limit the CPUC's jurisdiction over a municipal utility operating outside its municipal boundary, though, by only allowing approval of "rates, charges, tariffs, or voluntary plans" when those rates and charges vary from those set within the municipal boundary.

H. Appraisal of Distribution Assets to be Condemned: Assuming that the City has determined that forming a new public power utility is economically feasible, the next phase identifies distribution facilities to be acquired, estimates the property value, determines the general condition of the facilities to be acquired, and estimates the costs of separating the new system's facilities from the remaining parts of the incumbent's system.

A qualified consulting firm needs to be hired to conduct an appraisal to help identify the most economical option for creating a new public power utility of whether to buy or build. The study should provide a range of values for the system to be acquired.

The incumbent utility will argue for the appraisal method that results in the highest possible estimate, which may include not only the value of the system, but also going concern, goodwill and lost future profits (including a share of its most expensive generating plant). This cost may be higher than the cost of building a new electric system, which is why building duplicate facilities is sometimes considered.

As with any type of appraisal, several methodologies may be used to determine the value of the electric distribution system facilities and property that would be acquired. The main approaches to appraising a system are system facilities and property that would be acquired are:

- *Original cost less depreciation (OCLD) or "Book value"*: Value of the system is equal to the original cost of building the current system, less the accumulated depreciation of those assets. This is the valuation method used in utility ratemaking.

- *Reproduction cost less depreciation (RCLD):* Value of the system if it were built today, using the same specifications as when it was originally constructed. Uses the original cost of the system as a base, adjusted up based on increases in the cost of utility facilities, less the accumulated depreciation of those assets. Reproduction costs include both the actual costs of building the infrastructure, as well as related essential costs including legal and engineering fees, executive and management costs and overhead.

- *Replacement cost new less depreciation (RCNLD):* Similar to RCLD, but this approach assumes that the system were built today, it may be a better, or more efficient, system.

- *Going concern*: This income-based approach attempts to value the electric system based on estimated future earnings that would be lost if the utility were sold. "Going concern" may also be used to refer to assets of a business, such as property records, customer information records, operating records, etc. This approach may be used instead of or in addition to the other valuation

methods. *("Legal Issues in Forming a Municipal System: Condemnation, Valuation, and Ouster of Existing System," Clint Vince, Esq., and Cathy Fogel, Esq., Sullivan & Worcester, LLP, 1993.)*

In some cases, courts have allowed additional costs in recognition that the city is acquiring a going concern. This generally depends on the incumbent utility's right to serve, with little or no "going concern" value awarded in cases where the utility's franchise is nonexclusive, revocable at will, or expired. (Vince and Fogel 1995.)

While private utilities may assert that a community must pay "market prices" for electric facilities, *the most common valuation methods are original cost less depreciation and replacement cost less depreciation.*

A qualified consulting firm performing the appraisal will include a legal assessment to evaluate the suitability of each method and determine which is most appropriate. The appraisal of the distribution assets to be condemned is part of Colorado's statutory prerequisites which must be satisfied before filing an eminent domain action in district court. In addition, the City would also be responsible to pay the reasonable fee for BHE to obtain their own appraisal of the distribution assets to be condemned as part of the statutory prerequisites to be satisfied prior to filing a district court case.

I. Long-Term Debt Components for Purchase of BHE Distribution Assets

1. Distribution Asset Valuation. A consultant's appraisal will provide estimated costs but ultimately the distribution asset's value will be determined in court through the eminent domain process. In Pueblo's feasibility study the BHE system value or "fair market value" assumed in the Study was set at Replacement Cost New Less Depreciation (RCNLD). This RCNLD valuation method is likely higher than the actual fair market value of the BHE assets at issue if adjudicated.

2. Generation Stranded Costs. Stranded costs for generation assets will be determined by the Federal Energy Regulatory Commission. FERC defines wholesale stranded costs as "any legitimate, prudent and verifiable cost incurred by a public utility or transmitting utility to provide service to a retail customer that subsequently becomes, either directly or through another wholesale transmission services purchaser, an unbundled wholesale transmission services customer of such public utility or transmitting utility." 18 C. F. R § 35.26(b)(1)(ii). In Pueblo's feasibility study it stated that the City can expect to pay for cost stranding (stranded costs) due to the agreement between BHE and Black Hills Corporation Independent power producer (BHCI) for capacity and output from the Pueblo Airport Generating Station. In Pueblo's Feasibility Study cost stranding payments were included in the initial financing structure for the municipal utility.

3. Distribution Facility Separation Costs. Determining separation Costs for the distribution facility will involve the Colorado Public Utilities Commission. In Pueblo's feasibility study it stated that the city may have to pay costs associated with severing the distribution system in the city from the incumbent's remaining system (reintegration costs, for example). In Pueblo's Feasibility Study these separation costs were included in the initial financing structure for the municipal utility.

4. Stranded Costs for Transmission: The Federal Energy Regulatory Commission (FERC) does not automatically review the sale of a private utility's assets to a municipality. A 1996

FERC order on wholesale transmission access does allow for stranded cost recovery from new municipal utilities (called "retail-turned-wholesale" customers in the order), but only under specific circumstances. The order provides for stranded cost recovery if the new municipal utility uses FERC-mandated transmission service to reach a new power supplier.

In some cases, a new municipal utility chooses to sign a power supply contract with the utility that formerly served the city. FERC's stranded cost provisions do not apply in these cases because the private utility is not providing transmission access to another supplier; rather it is still supplying power to the new municipal utility.

5. Legal Fees. Fees include those for condemnation proceedings as well as for Colorado Public Utilities Commission and Federal Energy Regulatory Commission involvement.

6. Start-up Costs. Start-up costs include cash for working capital, start-up expenditures such as staffing and equipment, and facilities and inventory costs.

J. Long-Term Financing: The value of BHE distribution assets determined in district court as well as stranded costs, separation costs, start-up costs, and legal fees will be included in long-term financing.

All utilities regularly issue debt to undertake capital projects, and the funds for repayment of the debt are collected from utility customers via utility bills over many years. There are major differences though: public power customers are assured that the projects are for the benefit of their own community, while investor-owned utility or cooperative customers may be paying for projects that primarily benefit customers in another part of the state or region. In addition, public power customers own these assets instead of leasing the assets of an investor-owned utility.

Taxpayer money is not at risk. In almost all cases, public power utilities issue revenue bonds to purchase the electric distribution system, and these bonds are repaid from electric utility revenues. Revenue bonds, unlike general obligation bonds, are not backed by the city or by the city's ability to impose taxes; rather they are backed by the revenues of the utility. The new electric revenue bonds would have no impact on other city projects and borrowings.

Municipalities are prohibited by federal tax law from using tax-exempt financing to purchase the output facilities of investor-owned utilities, unless they obtain a portion of their state's volume cap for such financing. However, there is no such limitation on the use of tax-exempt financing for the building of a new system or for improvements to the distribution facilities once they are purchased from the private utility. The public power utility is likely to have a strong credit rating, and new capital expenditures may be funded at a much lower cost of capital than if the system were privately owned.

The three largest credit rating companies acknowledge the advantages of public power's business model and assign much higher ratings on average to public power than to investor-owned utilities.

The debt required for the acquisition of utility assets can be substantial, but that does not mean it is not a good investment, especially if the assets will provide net and possibly increasing benefits for many decades.

K. Expect Opposition to Municipalization: A for-profit electric utility will take extreme measures to stop the formation of a new public power utility even in very small communities. The incumbent utility

fears a domino effect in that if one community establishes a public power utility, others may follow. This means a loss of electric load and revenue for the incumbent utility.

One should expect the incumbent utility to take the city to court. There will be a cost in time, money and perhaps political will. When a private utility talks about a costly legal challenge to forming a public power utility, it is really part of a public relations battle to stop the initiative. The incumbent's goal is not necessarily to win, but to exhaust city funds or influence city officials and civic leaders into abandoning the idea of municipalization.

Once a community begins to evaluate the public power option, politics almost certainly will play a role. The pros and cons of municipalization may become the focus of political campaigns. The incumbent utility may thrust the issue into elections by putting up candidates to run against local policymakers who support evaluating or pursuing the public power option.

The incumbent utility will wage a major public relations battle to stop the community from forming a public power utility. The utility will use its considerable economic and political clout to sway public opinion against the formation of the new public power utility. The incumbent may use mailers, bill stuffers, newspaper editorials, television, radio, internet ads and videos, and presentations by company officials filled with messages aimed at confusing the issues, creating fear, and spreading misinformation. They may hire a professional PR firm and give it a large budget. Incumbent utilities will strive to create doubt about the formation of a public power utility, whether it can be done and how successful it will be.

L. Develop Community Education: The American Public Power Association, APPA, has stressed the importance of community education throughout the municipalization process. "Local officials should involve citizens, businesses, and local media in the process. The public should be informed about a proposed new utility and information should include the benefits of public power to the community and education should continually evolve. Any misinformation spread by the incumbent utility should not be allowed to go unchallenged." An educational community plan needs to be developed prior to a city election.

M. Hold a City Election: According to Pueblo's consultant EES Consulting they reported that "There are several steps the City would have to take to create a municipal utility. First, a majority of City voters would have to vote to approve creating a municipal utility at either a regular or special election. (C.R.S. §§ 31-15-707(1)(a)(II) and), 31-15-302(1)(d)(II)) If the City desires to issue debt or obtain a loan to provide for acquisition costs, Colorado law requires certain prerequisites, such as the passage of an ordinance and/or a vote of the electorate. (C.R.S. § 31-15-302)

In looking at recent Colorado municipalization efforts, EES Consulting report gave a summary of the ballot issues presented to the city of Boulder's voters: "Boulder initially sought to form a municipal utility that would serve customers within its municipal boundary as well as extra-territorial customers. (In a recent CPUC decision, Boulder states that it is only seeking to serve customers within city limits. Decision No. C17-0750 (Aug. 30, 2017)."

"Boulder's attempt at Municipalization were complicated by the language of the charter amendment approved by voters in 2011, which requires that in order to proceed with the creation of a municipal electric utility, the City Council would first have to determine "that it can acquire the electrical distribution system in Boulder and charge rates that do not exceed those rates charged by Xcel Energy at the time of acquisition and that such rates will produce revenues sufficient to pay for operating expenses and debt payments, plus an amount equal to twenty-five percent (25%) of the debt payments; and with the

reliability comparable to Xcel Energy and a plan for reduced greenhouse gas emissions and other pollutants and increased renewable energy."

"Additionally, in 2013, Boulder voters approved an ordinance permitting the acquisition if the bonds to purchase the existing assets and pay for stranded costs did not exceed $214 million." Boulder has since abandoned their efforts to municipalize.

Holding a Cañon City election to decide on municipalization would give local elected officials the public's opinion on what direction Cañon City residents want the City to pursue for electric services. Decisions on what to have on the ballet need to be made such as authorization to create a municipal utility and to identify if the city council or an elected board will make policy decisions. Like Boulder, an additional vote would need to be held to authorize the City to issue bonds. Lessons about complicating the requirements to municipalize can be learned from the Boulder example, merely make it a simple vote to municipalize.

N. Decision on Who Will Be Local Policy Makers: The governance structure for each utility varies. Some are governed by the city council; others are controlled by an independent utility board whose members may be elected or appointed by the mayor and city council. This decision could be decided by Cañon City residents at a city election on the same ballot as a vote to authorize municipalization.

When the community owns the utility, the community controls the utility's priorities. Decisions about pricing electricity, building power plants, purchasing wholesale power and service policies are made locally and reflect the values and choices of the community.

Public power utilities are under more intense scrutiny than private utilities because they are governed and regulated by local officials directly accountable to the utility's customer-owners. Governance takes place at the ballot box and in public forums. Investor-owned utility customers have no direct relationship to utility management and cannot participate in board meetings, and cooperative utilities may not be subject to the same sunshine laws that govern public power utilities. Public power governing boards' local accountability gives their customers more protection than other utility models.

O. Third-Party Partner for Distribution Operations: Many cities already have experience owning and maintaining a water, sewer or natural gas utility. A new municipal electric utility can combine billing, meter reading, call centers, and other functions with those already offered by the city for other services.

A municipal electric utility would be operated as a Colorado enterprise fund. An enterprise fund pays for its costs of operations, predominantly from user fees, and does not receive revenue from taxes. Cañon City currently has both a water enterprise and a stormwater enterprise.

Most public power utilities are distribution only, meaning they do not own and operate their own power plants and bulk transmission. For the operation of a Cañon City electrical utility, the City could select to form their own department or could contract with a third-party partner to handle distribution and most day to day operations of the utility. A third-party partner is recommended.

As an example, in 2001 the City of Hermiston Oregon formed a third-party hybrid. Under a contract with a local rural electric cooperative, the cooperative provided all operations, maintenance, billing, service calls, etc. The City's one employee, a general manager, handled Purchase Power Agreements with the Western Area Power Administration which supplied all the power for the city utility. The general manager also handled transmission issues, energy efficiency programs and other matters. Their general manager previously worked with other investor-owned utilities.

A third-party partner selected by the City would handle all operations. They would operate and maintain the distribution system including substations; customer service tasks such as billing, meter reading, customer information, advertising, records and collection; administrative and general work necessary to run the electric utility such as billing/customer service, accounting, information systems, and management; and any customer service programs such as energy efficiency and electric vehicle programs.

P. Components of Annual Budget: In order to determine projected rates to be charged, an annual operating budget as well as a capital budget need to be estimated. The annual budget calculated for the Pueblo study showed the following expenses:

- Power Supply and Transmission
- Distribution Operation and Maintenance
- Customer Service
- Administrative & General
- Payments in Lieu of Taxes (to Cañon City)
- Customer Programs
- Capital Improvement Projects
- Debt Repayment (Capital Budget)

A third-party partner for the operation of the distribution operations should be able to assist with putting together estimates for the annual operating budget. The capital budget will include the long-term debt and debt repayment required for the purchase of the distribution assets, stranded costs, separation costs, start-up costs, and legal fees and can also be estimated by a third-party partner after an appraisal of assets.

Once the annual operating budget and capital budget have been estimated, the total represents the revenue requirement for the municipal utility to determine what the rate will be.

Public power utilities' rates are generally regulated through oversight of the local governing board. Their rates are designed to cover the cost of service. Public power utilities are also not in business to make a profit, they provide an essential service on a not-for-profit basis, which eventually means lower rates. In contrast, investor-owned utilities charge rates that include a profit factor, that is, the cost to provide their shareholders with a return on equity.

The biggest determinant in public power's lower rates is its not-for-profit status. Public power works for Main Street, not Wall Street.

Q. Eminent Domain Steps Prior to Filing a Petition in Condemnation: Since BHE is not a willing seller, Cañon City does have the option of Colorado's Condemnation Law through the eminent domain process. The approval of a Cañon City vote to municipalize electric operations needs to be done prior to the eminent domain process starting. The appraisal of the distribution system to be condemned needs to be completed by the City as part of Colorado's statutory prerequisites which must be satisfied before filing an eminent domain action in district court. Steps include:

Step #1: Notice of Intent. This includes a description of property to be acquired and the condemning authority shall pay the reasonable costs of the owner's appraisal if the appraisal is submitted to the condemning authority within 90 days of the date of their notice of intent.

Step #2: Good Faith Negotiations. The two appraisals may be used by each party to negotiate in good faith for the acquisition of the property, but neither party is bound by such appraisals. The prerequisite

generally requires only a condemning authority to make a reasonable good faith offer to reach a purchase agreement with the owner. Lengthy or face-to-face negotiations are not required. Making a reasonable offer to purchase in good faith by letter and allowing the property owner time to respond, is sufficient to show a "failure to agree".

Step #3: Final Written Offer. If the parties fail to reach agreement on the fair market value of the property being acquired, the municipality, prior to proceeding to trial on the issue of valuation, shall furnish the utility with a final offer.

R. Eminent Domain District Court Process:

Step #1. File Petition in Condemnation: Condemnation actions are commenced with the filing and service of a pleading referred to as a petition in condemnation. Personal service on all respondents named in the condemnation action pursuant to C.R.C.P. 4 is required of the summons, the petition in condemnation, and any other documents that are filed to commence the condemnation case. Once the condemnation action has been filed and served, the utility will file an answer, which may challenge the right to condemn the property.

Step #2. Pretrial Process & Trial: Condemnation actions are viewed as special statutory proceedings that must be conducted in strict accordance with the condemnation statutes. The sole purpose of the statutory framework governing condemnation proceedings is to determine if the right to condemn properly lies, and, if it does, the amount of just compensation that must be paid for the taking of the property at issue. Pursuant to C.R.S. § 38-1-119, condemnation actions are often characterized as expedited proceedings because they are to be given "preference over other civil actions . . . in the manner of setting the same for trial." This statutory description of an eminent domain proceeding is important because C.R.C.P. 16(a) exempts "expedited" proceedings from the case and trial management provisions of the Rules of Civil Procedure "unless otherwise ordered by the court or stipulated by the parties.

Step #3. Jury Trial or Board of Commissioners: Pursuant to C.R.S. § 38-1-106, if a respondent has not elected to have the issue of value determined by a jury "before the expiration of the time for the defendant to appear and answer," the value will be determined by a "board of commissioners" appointed by the court. The appointment of the commissioners is then controlled by C.R.S. § 38-1¬105(1), which provides that the commission shall be constituted of "not less than three disinterested and impartial freeholders." Unlike a jury that must consist of "freeholders residing in the county in which the petition is filed," C.R.S. § 38-1-105(1) does not require the commissioners to be freeholders in any particular county.

Step #4. Discovery: Although condemnation proceedings are akin to "expedited" proceedings and thus are arguably exempt from some of the disclosure and discovery rules found in C.R.C.P. 26, most litigants voluntarily agree to comply with these rules to avoid surprise at trial and to allow for adequate preparation of the case. Thus, in nearly all condemnation actions, written discovery is regularly conducted by interrogatories, requests for admissions, and requests for document production and oral discovery by depositions are routinely taken of all expert witnesses who may testify in the case, as well as all key lay witnesses.

Step #5. Law & Motion: As long as the requested relief is not inconsistent with the condemnation statutes, litigants in a condemnation action are free to file many of the same motions that are normally filed in other civil proceedings.

Step #6. Motions In Limine. All legal issues dealing with the right to condemn property must be resolved by the trial judge either at the immediate possession hearing or at an in limine hearing specifically scheduled for this purpose. Separate and apart from this duty, it is also the responsibility of the judge to resolve issues of law that concern the manner by which the just compensation for the taking of the property will be determined.

Step #7. Trial. What to expect during a valuation trial will largely depend upon whether the case is being tried to a jury or a commission. In cases where the trial judge presides over a jury, the proceedings will likely be conducted in a more formal manner, with a greater emphasis being placed on the Rules of Evidence and Rules of Civil Procedure. Although adherence to the standard civil litigation rules is also necessary in valuation trials before a commission, such trials tend to be less formal. Because a commission acts in the capacity of a "judicial body," greater latitude may be given in the presentation of the case, in the argument of counsel, and in the admission of the evidence.

Index 1: Black Hills Energy Option: On-Going Actions

1. Select methods to communicate with Cañon City residents.
   a. City website, City Social Media, Emails
   b. Energy Committee's page on City's webpage
   c. Water Billing and Water confidence report
   d. Stormwater Quarterly Newsletter
   e. Local media: Papers, Radio Station, TV
   f. Speakers Bureau
   g. Black Hills Energy website and emails to residents.
   h. Community/Civic/Business Organizations

2. Communicate to residents' with on-going information about BHE's electrical service topics.
   a. All potential BHE programs that are available to customers.
   b. All potential State and Federal programs from the Colorado Energy Department available
   c. Potential programming to assist low-income customers.

3. Discussions with BHE for any potential bill relief options.
   a. Discussions and information sharing with BHE.

4. Cañon City local government involvement with the PUC with issues that impact electrical rates.
   a. Set up an on-line account with the PUC to obtain notice of future rate hearings with BHE.
   b. If appropriate, make a public comment about BHE's hearing at the PUC.

5. Cañon City work with other communities who are serviced by BHE at PUC proceedings.
   a. Develop a listing of cities that could be contacted.
   b. Contact area's city clerks to obtain contact person in the city for electrical service and any non-political groups interested in electrical service topics.
   c. Approval of City Council to create a network with local communities.

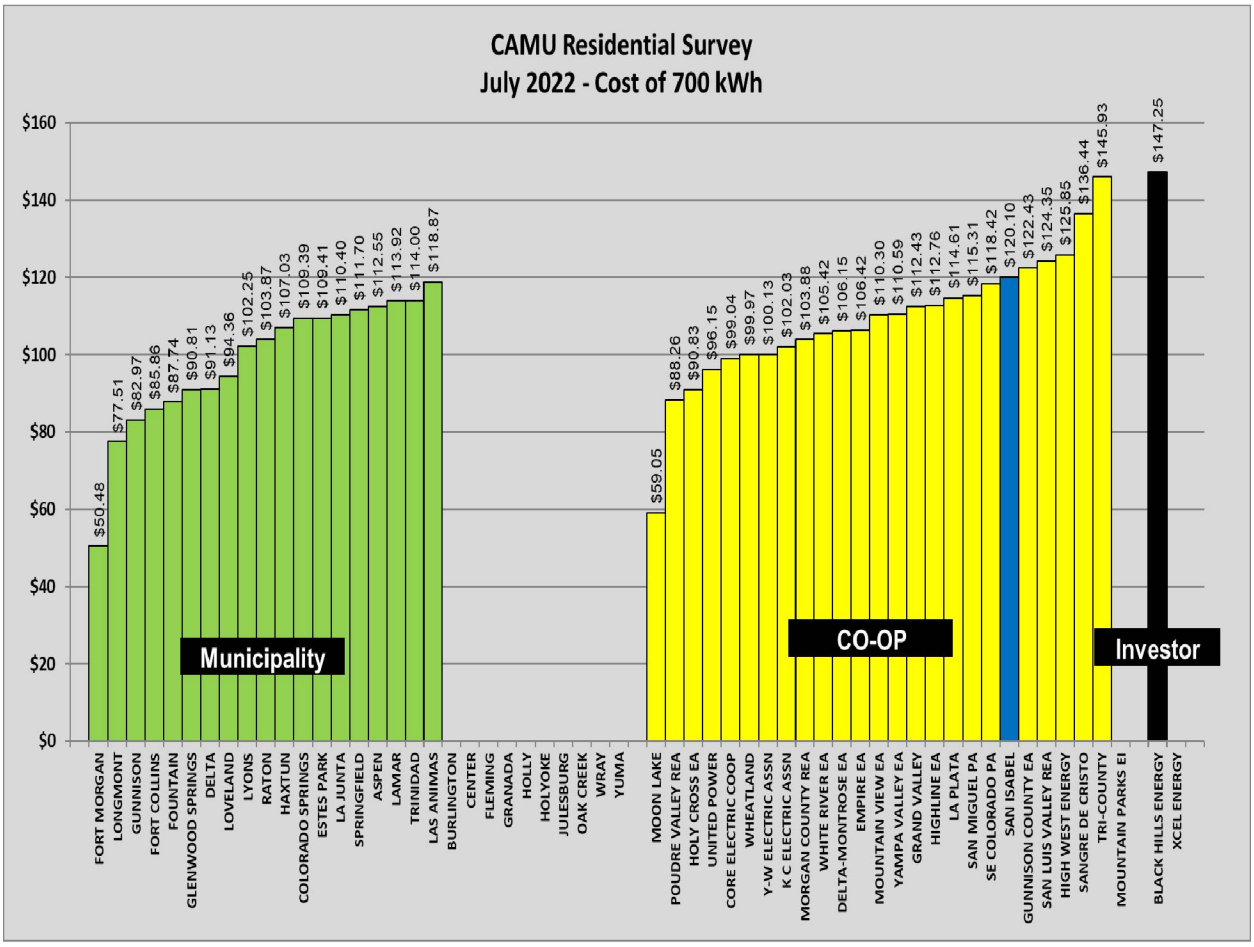
6. Cañon City work with other communities to develop state legislation to assist with electric issues.
   a. Lobbying efforts for the City need to have approval by the City Council.
   b. Contact the Chamber of Commerce about hosting a legislative hour and ask if the City or Energy Committee could present about electrical issues.

7. Investigate potential of community solar.
   a. Identify and evaluate BHE requests for proposals for community solar projects from private businesses to see if the City can benefit from these projects.
   b. Identify pros and cons for community scale, rooftop, and subscription solar projects.

8. Evaluate rate relief options from PUC rate study to see if options could help with rate relief.
   a. Reduced Cost of Debt. At the next rate case for BHE, advocate and intervene at PUC hearing for a reduced cost of debt. In Commission Decision No. C-16-1140 for BHE cost of debt staff recommended 4.88%, BHE recommended 5.2% while the Commission awarded 5.29%.
   b. Follow legislation efforts for Community Choice Energy to see if it offers any potential for future electric cost relief.

9. City discussion with BHE to determine if a new franchise agreement will be presented for a vote or if a different type of agreement needs to be developed.

Index 2: CAMU Residential Electric Cost Survey July 2022
Colorado Association of Municipal Utilities



Black Hills Energy	$147.25	Investor-Owned Utility
Colorado Springs	$109.39	Municipal Utility
Fountain	$87.74	Municipal Utility
CORE	$99.04	Rural Electric Cooperative Utility
San Isabel	$120.10	Rural Electric Cooperative Utility
Sangre De Cristo	$136.44	Rural Electric Cooperative Utility