



Finance Committee Supplemental Report

CITY OF
**PALO
ALTO**

From: Kiely Nose, Interim Director of Utilities

Meeting Date: May 7, 2025

Item Number: 2.a, 3.b

Report #:2504-4606

TITLE

Recommendation to the City Council to Adopt a Resolution Approving the FY 2026 Gas Utility Financial Forecast and Reserve Transfers, the Natural Gas Cost of Service and Rate Study, and General Fund Transfer; and Amending Rate Schedules G-1 (Residential Gas Service), G-2 (Residential Master-Metered and Commercial Gas Service), G-3 (Large Commercial Gas Service), and G-10 (Compressed Natural Gas Service) and Implement a Climate Credit in FY 2026

RECOMMENDATION

This item is a continuation of the item discussed with the Finance Committee on April 15, 2025. Staff originally recommended the City Council to Adopt a Resolution Approving the FY 2026 Gas Utility Financial Forecast and Reserve Transfers, the Natural Gas Cost of Service and Rate Study, and General Fund Transfer; and Amending Rate Schedules G-1 (Residential Gas Service), G-2 (Residential Master-Metered and Commercial Gas Service), G-3 (Large Commercial Gas Service), and G-10 (Compressed Natural Gas Service) and Implement a Climate Credit in FY 2026.

Alternatively, staff have identified options for the Committee to consider ultimately with an alternative recommendation for consideration:

Committee provide feedback to staff to revise the proposed FY 2026 rates to retain the current FY 2025 rate structure, with rate increases to meet the revenue requirements for FY 2026, and provide a one-time climate credit to some of the G2 small commercial customers (small and medium meter capacities), approximately \$1.1 million.

BACKGROUND / ANALYSIS

On April 15, 2025, the Finance Committee discussed a Recommendation to the City Council to Adopt a Resolution Approving the FY 26 Gas Utility Financial Forecast and Reserve Transfers, the Natural Gas Cost of Service and Rate Study, and General Fund Transfer. The Finance Committee did not take any action on that date and continued the meeting to May 7, 2025. The Finance Committee directed staff to return on May 7, 2025 with answers to a series of questions on climate credit options for residential gas customers as well as provide information

on the Natural Gas Cost of Service and Rate Study. Staff will share this information via a presentation on May 7, 2025 and continue the discussion with the Finance Committee members

Overall, staff recognize a key step in the COSA process was not completed, which was typically a public discussion to kick off the study with the appropriate body to discuss guiding principles and legal requirements. Cost of Service Analyses are intended to provide an objective and accurate study of the aggregate cost to provide a service, and how to allocate that cost across customer base, which then informs rate-setting decisions. However, staff recognizes that stakeholder engagement and feedback is a critical step in the rate-setting process. The 2025 COSA proposes to re-allocate costs between the G1 and G2 customer classes. In light of the feedback from the Finance Committee and residents on this revised cost allocation, staff recommends that the 2025 COSA continue to be reviewed with the UAC for further refinement in advance of and in preparation for implementation as part of the FY 2027 rate setting process.

In the interim, staff recommend the committee adopt the current FY 2025 rate structure, with rate increases to meet the revenue requirements for FY 2026, and provide a one-time climate credit to some of the G2 small commercial customers (small and medium meter capacities), using approximately \$1.1 million in funding from the City's Cap and Trade program revenue.

The City's gas utility sells freely allocated allowances which generates revenue. The City receives allowances as part of its State-mandated participation in the Western Climate Initiative Cap and Trade Program (Cap and Trade). Council has adopted a policy for the use of Cap and Trade revenues identifying a preference for emissions reductions, though it does not preclude use of funds for climate credits. Climate credits are a legally permissible and commonly used by electric and gas utilities. For example, PG&E has issued climate credits to its residential and commercial customers for several years. There are approximately \$13.6 million in available funds as a result of spending delays through the pandemic. These funds must be spent within 10 years of collection and a credit demonstrates a continued necessity and use of these funds.

Allocating climate credits to the G2 (small and medium meter capacities) customers would advance the relief to the applicable customers anticipated by Council's election to continue to base rates on the 2020 COSA .

ATTACHMENTS

Attachment A: Presentation

APPROVED BY:

Kiely Nose, Interim Director of Utilities