RECOMMENDATION

Staff and the Utilities Advisory Commission (UAC) recommend that the City Council adopt the attached resolution approving a 20 percent gas supply rate increase to be effective January 1, 2005, representing a 14 to 19 percent average retail rate increase on customer bills, and a projected $2 million increase in revenues.

UTILITIES ADVISORY COMMISSION REVIEW AND RECOMMENDATIONS

On November 3, 2004, the UAC considered the proposal from staff to increase gas supply rates by 30% effective January 1, 2005. The presentation included rate alternatives, each of which had different future effects on the Gas Utility’s revenue streams and Supply Rate Stabilization Reserve balances.

The UAC unanimously (with Commissioner Rosenbaum absent) recommended Council adoption of an alternative to staff’s proposal: a 20% gas supply increase (rather than 30%), to be effective January 1, 2005. The UAC-recommended rate increase will recoup the FY 2004-05 increased cost of natural gas, but will not add revenues to the Supply Rate Stabilization Reserve sufficient to achieve the target guideline without another supply rate increase in the future.

The UAC felt that this rate increase allowed a reasonable reserve level (although close to the guideline minimum), and decreased the possibility of “rate shock” when combined with the 8.5 percent Electric Rate increase already scheduled for January 1, 2005.
**ALTERNATIVES**

Staff evaluated several rate increase options and discussed the impacts with the UAC.

A rate increase lower than the recommendation will not leave the Gas Supply Rate Stabilization Reserve with adequate financial resources to shield the gas utility from further market volatility. Without a rate increase, the Gas SRIR balance is projected to be $1.1 million below the FY 2004-05 minimum guideline of $6.3 million by June 30, 2005, and $4.2 million below the FY2004-05 target guideline by June 30, 2005.

To increase rates to cover the cost of gas and to bring the Gas SRSR balance to the target guideline during FY 2006-07 would require an increase in the gas supply rate of 30 percent. This rate increase would increase the average residential bill by approximately $10.40 rather than the proposed $9.29 (a 21% increase in the average residential gas bill).

To increase rates to cover the cost of gas and to bring the Gas SRSR balance to the target guideline during FY 2004-05 would require an increase in the gas supply rate of 42 percent. This rate increase would increase the average residential bill by approximately $14.95 or 30 percent rather than the proposed $9.29 (a 30% increase in the average residential gas bill). Such an increase would still maintain Palo Alto rate levels below those of the surrounding PG&E communities. It would also position the Palo Alto to be able to reduce rates to match projected future reductions in PG&E rates as gas prices reduce in future years. However, such a large rate increase in mid-winter may result in an economic shock to customers, especially when combined with the Council-approved 8.5 percent Electric rate increase also scheduled for January 1, 2005.

**RESOURCE IMPACT**

Approval of this natural gas rate adjustment will result in an increase of 18.6 percent (depending upon customer usage) for the average residential gas bill (Rate Schedule G-1) effective January 1, 2005. It would also increase Rate Schedule G-6 (Municipal Gas Service) by 44.8 percent to recover the cost of gas (currently below cost of acquisition).

The rate increase requires amending the 2004-05 adjusted budget to reflect a rise in Gas Fund revenues of $3.7 million ($2 million from residential and commercial “pool” customers and $1.7 million from “market-based” revenue “pass-through”) and an additional appropriation of $3.4 million for gas commodity purchases beyond the amount appropriated in the 2004-05 adopted budget.

Moreover, the rate increase is expected to add to the Gas Supply Rate Stabilization Reserve by $0.3 million, resulting in a reserve balance of $7.2 million as shown in Attachment C. This is above the $6.3 million Minimum Guideline for the Gas Supply Rate Stabilization Reserve approved by Council. However, it will be $1.8 million below the Target balance of $9.4 million.

**POLICY IMPLICATIONS**

These recommendations do not represent a change in current City policies. The proposed rate increase is consistent with the Utilities Strategic Plan approved by the Council “to provide superior financial performance to the City and competitive rates to customers”.

CMR:478:04
**TIMELINE**

The effective date of the proposed rates is effective January 1, 2005.

**ENVIRONMENTAL REVIEW**

The adoption of the resolution does not constitute a project under the California Environmental Quality Act, therefore, no environmental assessment is required.

**ATTACHMENTS**

A. Resolution  
B. Budget Amendment Ordinance  
C. BAO Impact Spreadsheet  
D. Gas Rate Schedules G-1, G-2, and G-6  
E. November 3, 2004 Report to the UAC Proposed Gas Rate Increase  
F. Draft excerpt of Minutes from November 5, 2004 UAC meeting

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