



City Council Staff Report

From: City Manager
Report Type: **CONSENT CALENDAR**
Lead Department: **Utilities**

Meeting Date: **September 9, 2024**
Staff Report: 2405-3038

TITLE

Adoption of a Resolution Amending Resolution 9486 to Increase the Purchase Amount of Greenhouse Gas Allowances in the California Cap-and-Trade Auction to Satisfy the City's Gas Utility Compliance Obligations to an Amount Not-to-Exceed of \$6,000,000 per Year; CEQA Status: Not a Project

RECOMMENDATION

Staff recommends that the City Council adopt a resolution (Attachment A) amending Resolution 9486, approved in 2015, to increase the purchase amount of greenhouse gas (GHG) allowances in the California Cap-and-Trade auction from the current cap of \$4,000,000 per year to an amount not-to-exceed of \$6,000,000 per year to satisfy the City's actual and/or forecast compliance obligations for the gas utility.

EXECUTIVE SUMMARY

The City must purchase GHG allowances for the gas utility and may need to purchase allowances for the electric utility to comply with California's Cap-and-Trade Program. An "allowance" is the limited tradable authorization to emit up to one metric ton of CO₂e. These allowances may be purchased through the Cap-and-Trade auction run by the California Air Resources Board (CARB). Pursuant to Palo Alto Municipal Code section 2.30.340(b) and consistent with the City's Energy Risk Management Policy's Section G listing of authorized products, [Resolution 9486](#)¹ gave the City Manager, or their designee, the authority to purchase GHG allowances in auctions ran by CARB (or any successor state agency) in the amount not to exceed \$4,000,000 per year for the purpose of satisfying the City's actual and/or forecast compliance obligation for the gas utility, and in the amount not-to-exceed of \$250,000 per year for the electric utility. However, the projected GHG allowance purchases for the gas utility in calendar year 2024 is expected to be more than \$4,000,000 with costs projected to increase every year in the future. Therefore, staff recommends increasing the allowance purchasing authority related to the gas utility to the amount not-to-exceed of \$6,000,000 per year.

BACKGROUND

The Global Warming Solutions Act of 2006, also known as Assembly Bill (AB) 32, requires that California's GHG emissions in 2020 be the same as in 1990, an estimated 15% reduction. CARB

¹ Resolution 9486: <https://portal.laserfiche.com/Portal/DocView.aspx?id=10157&repo=r-704298fc>

was authorized to develop regulations to reach this goal, and the Cap-and-Trade Program is one of several tools designed by CARB to achieve the desired GHG reduction goal. Under the terms of CARB's Cap-and-Trade Program, an overall limit on GHG emissions from capped sectors of the state's economy was set. In short, covered facilities subject to the cap must procure sufficient "allowances," like permits, to cover their GHG obligations, and those facilities also are able to trade allowances to emit GHGs up to the capped amount. Burning one therm of natural gas produces approximately 0.0053 metric tons of CO₂e. A more detailed discussion of the Cap-and-Trade Program is available in [Staff Report 5174](#)².

CARB's implementation of its Cap-and-Trade Program started November 2012 and included electric distribution companies. Starting in 2015, the scope of the Cap-and-Trade Program expanded and natural gas suppliers became covered entities with a compliance obligation based on their retail gas sales.

With the passage of AB 398 in 2017, the Cap-and-Trade Program was extended to 2030. The program was adjusted to double in stringency beginning in 2021 to help the State achieve the 2030 GHG Reduction Target of at least 40% below 1990 levels. In 2022, AB 1279 further required the State to reduce GHG emissions by 85% below 1990 levels and achieve carbon neutrality by 2045.

ANALYSIS

Since 2015, both the City's gas and electric utilities have been covered by CARB's Cap-and-Trade Program. Under the terms of the program, the City's gas utility is allocated some free allowances, but will also need to purchase additional allowances to cover all GHG emissions caused by the City's gas utility customers' natural gas usage.

As noted above, [Resolution 9486](#)³ authorized the City Manager (or their designee) to procure GHG allowances from CARB-run auctions in the amount not to exceed \$4,000,000 per year for the gas utility, and in the amount not to exceed \$250,000 per year for the electric utility. These limits on the City Manager's purchase authority were developed based on the assumptions concerning the price of GHG allowances and projections for the City's gas and electric utilities at the time.

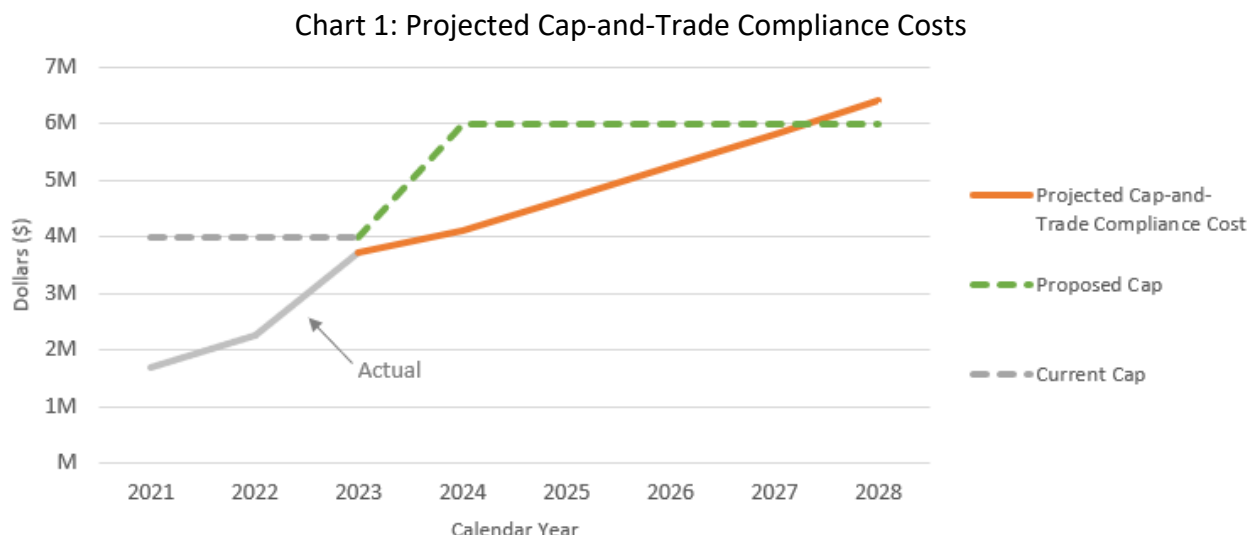
The City's cost of complying with the Cap-and-Trade regulation is increasing. First, the number of free allowances allocated to the City's gas utility decreases annually, resulting in an increasing allowance purchase obligation, and CARB is considering accelerating that decrease. Second, the number of allowances in the market decreases over time, which is designed to increase allowance prices.

As a result, Staff is projecting that the purchases of allowance in calendar year 2024 may exceed the current authority of \$4,000,000 per year, and compliance costs are forecast to increase in future years. Staff is proposing to increase the current purchase authority from

² Staff Report 5174: https://www.cityofpaloalto.org/files/assets/public/v/1/agendas-minutes-reports/reports/city-manager-reports-cmrs/year-archive/2014/final-staff-report-id-5174_use-of-cap-and-trade-compliance-revenues.pdf

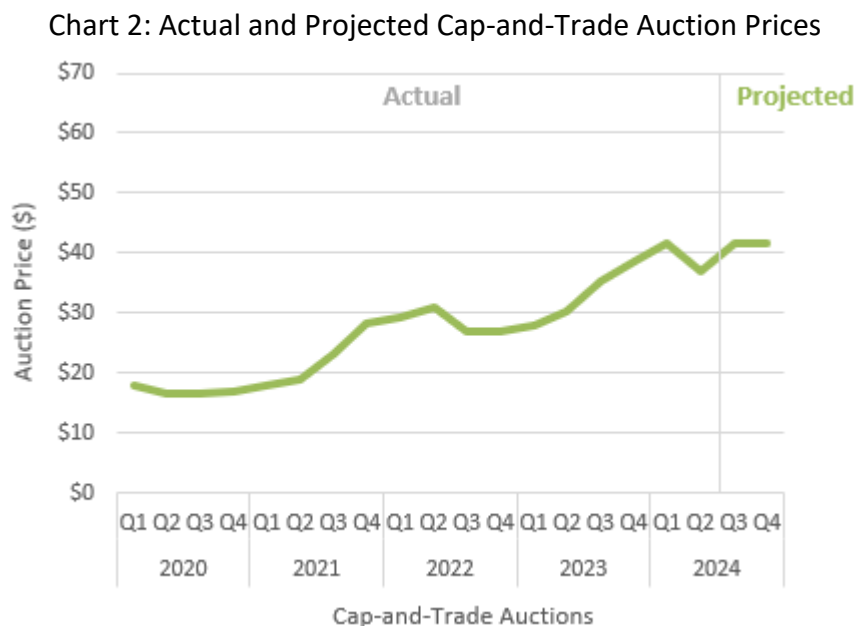
³ Resolution 9486: <https://portal.laserfiche.com/Portal/DocView.aspx?id=10157&repo=r-704298fc>

\$4,000,000 per year to \$6,000,000 per year, which will allow the City to continue to meet its compliance obligation by purchasing allowances for the next 3 years.



FISCAL/RESOURCE IMPACT

The gas utility is required to purchase an increasing number of allowances each year. By 2030, 100% of the emissions generated by the combustion of natural gas within the City will need to be covered with purchased allowances. The cost of those allowances depends upon the City's gas use, the number of free allowances granted to the City by CARB, and the price of the allowances in the auction.



Staff recommends the City Council authorize the City Manager or their designee to purchase GHG allowances in CARB auctions to increase from \$4,000,000 per year to the amount not-to-exceed of \$6,000,000 per year for the gas utility. Staff recommends this limit based on the

calendar year 2027 projected gas allowance purchases (129,831 metric tons CO₂e /year) and an allowance price of \$44.80/metric tons CO₂e:

$$129,831 \text{ metric tons CO}_2\text{e} * \$44.80/\text{metric tons CO}_2\text{e} = \$5,816,000$$

The City is not currently required to purchase allowances for the electric utility because it does not own any facilities that emit 25,000 metric tons of CO₂e or more, which is the threshold for compliance. Therefore, the original authorization to purchase GHG allowances in the amount not-to-exceed of \$250,000 for the electric utility remains unchanged.

The Fiscal Year 2025 Budget for purchase of GHG allowances reflects current GHG allowance price projections. The Fiscal Year 2026 Proposed Budget will be updated to include anticipated allowance purchases. The cost allowance purchases are funded via the Gas Cap-and-Trade Compliance Charge paid by Palo Alto gas utility customers. The Cap-and-Trade Compliance Charge is adjusted quarterly to ensure enough revenue is collected to cover the cost of compliance. The maximum Cap-and-Trade Charge is \$0.25 per therm in the Council-approved rate schedules. If, in the future, Staff anticipates compliance costs increasing beyond the Council approved maximum charge, Council approval of a higher maximum charge will be recommended.

ENVIRONMENTAL REVIEW

Adoption of this resolution is not subject to California Environmental Quality Act review because it does not meet the definition of a “project” under California Public Resource Code section 21065.

ATTACHMENTS

Attachment A: Resolution Amending Reso 9486 Greenhouse Gas Allowance Purchases

APPROVED BY:

Dean Batchelor, Director of Utilities

Staff: Eric Wong, Resource Planner