



December 14, 2010

Honorable Mary Nichols, Chair
California Air Resources Board
1001 I Street
Sacramento, CA 95812

RE: CA Air Resources Board Proposed Regulation Order for a CA Cap-and-Trade Program on Greenhouse Gas Emissions & Market-Based Compliance Mechanisms

Dear Ms. Nichols,

Agricultural Council of California (Ag Council) represents agricultural cooperatives and farmer-owned businesses. Collectively, we represent over 10,000 farmer-owners and over \$8 billion in sales. Ag Council members participate in domestic and international markets, sending products throughout the United States and to over 100 countries.

Environmental sustainability is not new to our membership. Many agricultural and food processors respond to market forces that require them to achieve certain environmental thresholds and as such, they routinely set internal standards for environmental improvements. Many of our members have the most efficient boilers and equipment available to meet these thresholds.

However, it should be noted that many of the requirements in the implementation of AB 32 are problematic and many of the assumptions made do not apply to our industry. Food processing is mostly a seasonal industry, with operations lasting less than four months out of the year, with the exception of dairy. Furthermore, our industry is sensitive to import pressures from domestic competitors in other states as well as foreign competitors such as China, Greece, Italy, South America and Mexico. Crop characteristics such as the amount of solids or sugars also play a role in the efficiency and operation of our boilers and equipment, often creating variable fruit and vegetable quality that may require more or less time cooking, depending on solids, size and other variables.

Throughout our meetings with staff and elected officials regarding AB 32 implementation, several questions have been raised as to the ability of food processors to move into another market. It should be noted that facilities used to produce food are dedicated to the specific commodity. Movement from food production to another type of market, or even another type of

commodity is highly unlikely due to the dedicated nature of the facilities. Equipment, facilities lay-out and labor are highly-specialized and cannot easily be transformed to other types of production. Should the cost of producing food become too high, a processor cannot enter another type of manufacturing without millions in costs to overhaul the entire plant. Additionally, a food processor cannot interchange between types of food produced because the equipment is so specialized. For example, a tomato processor cannot go into almond processing in the near future, without major investments.

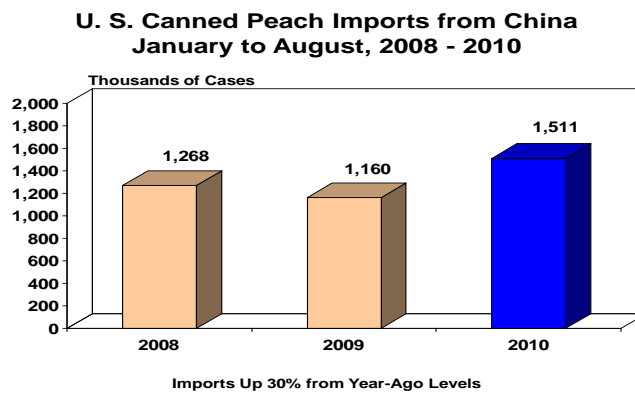
ISSUES OF CONCERN WITH CURRENT DRAFT OF REGULATIONS:

Emissions leakage for the food processing industry is our central concern in this regulation. Agricultural products are very sensitive to low-cost competitors in domestic and international markets. Many of these markets can flood segments of our industry in a matter of months, such as the current situation in the canned peach industry.

The November 12, 2010 edition of “Peach Fuzz,” a newsletter by the CA Canning Peach Association, demonstrates the problems associated with low-cost competitors such as China:

“CANNED PEACH IMPORTS UP 45%, EXPORTS DOWN 2%”

Canned peach imports for June-August totaled 887,886 cases, up 45% from the 614,329 cases imported for the first three months of the 2009-10 marketing year. China continues to be the leading importer with 589,760 cases shipped. In fact, Chinese imports for the calendar year (thru August) have reached 1,510,768 cases which represents a 30% increase over last year’s volume. Canned peach exports for June-August totaled 175,138 cases, down 2% from the 179,059 cases exported during this period last year. Mexico is the leading export destination with 70,606 cases shipped.”



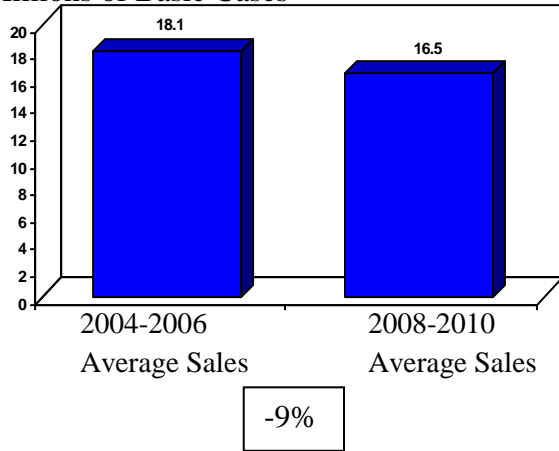
Courtesy of CA Canning Peach Association

The California Canning Peach Association further demonstrates the U.S.'s loss of market share in the following graphs.

Canned Peach Sales Trends

3 Year Average Volume: 2004-2006 vs. 2008-2010

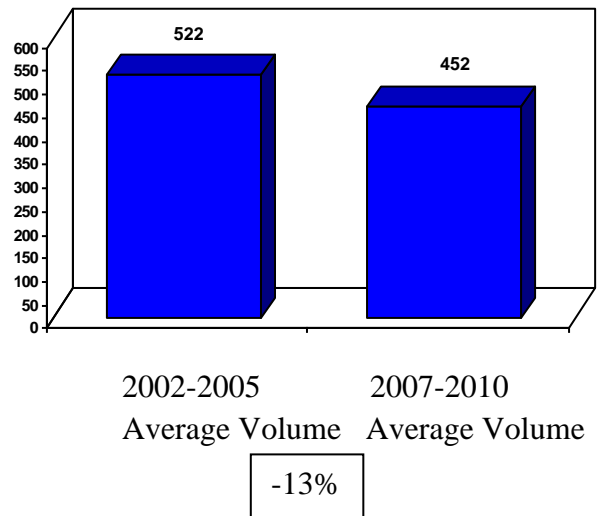
Millions of Basic Cases



Comparison of Peach Delivery Volumes

4 Year Average Volume: 2002-2005 vs. 2007-2010

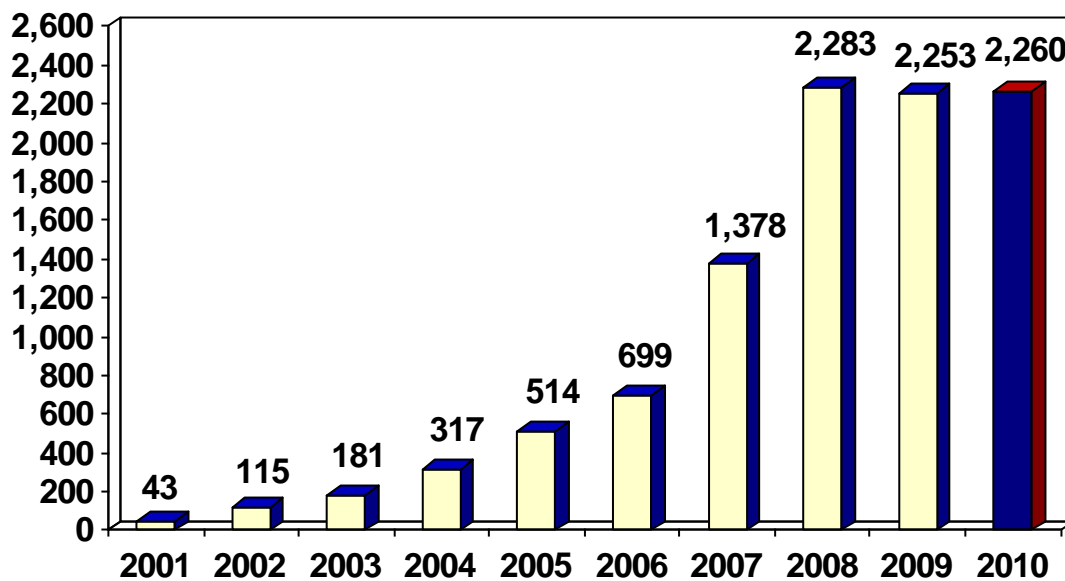
Thousands of Tons



U. S. Canned Peach Imports from China

2001 – 2010

Thousands of Cases



Imports from China have tripled since 2006.

China and Mexico are gaining significant market share in the processing tomato industry as well. According to the USDA's Foreign Ag Service, *World Horticultural Trade & U.S. Export Opportunities*, August 2005 report:

“China is the world’s largest tomato paste and puree exporter, with 2004 exports of 438,192 tons... In the last few years, China has bought major tomato processors in the EU. As a result, European exports of tomato paste and puree have declined. From 2002-2004, EU25 exports of paste and puree have decreased 23 percent, while China’s rose 34 percent...”

According to the USDA's Foreign Ag Service, *World Markets & Trade: Fresh & Processing Tomato*, July 2008 report:

“Mexico is the leading tomato exporter, accounting for almost half of world exports. Exports for marketing year (MY) 2007/08 (October-September), are forecast to increase slightly to 1.1 million tons due to higher production and favorable prices... China continues to expand tomato production, processing capacity, and exports... Processing tomato production is expected to reach a record 5.2 million tons and is anticipated to continue rising over the next few years due to expanding acreage in Inner Mongolia. Over 80 percent of China’s processing tomato production is expected to be used for paste.

Due mainly to higher production forecasts, exports are projected to reach another record. From July 2007 through May 2008 (latest data available), exports reached 103,000 tons, up 35 percent from the previous year.”

In both cases, the U.S. is the leading market of imports, with foreign competition gaining significant ground in the latter report. Both reports can be found at:

USDA; Foreign Ag Service; *World Horticultural Trade & U.S. Export Opportunities*. August 2005. http://www.fas.usda.gov/http/Hort_Circular/2005/08-05/08-01-05%20Tomato%20article.pdf

USDA; Foreign Ag Service; *World Markets & Trade: Fresh & Processing Tomatoes*. July 2008. <http://www.fas.usda.gov/http/2009%20Tomato%20Article.pdf>

Alternatively, the dairy sector is highly dependent on an export market that could fluctuate as a function of production costs. According to the U.S. Dairy Export Council's "September Export Data – top line analysis," dated November 10, 2010:

“ 2010 U.S. dairy exports continued at a record pace through September. Aggregate volume of dry ingredients (milk powders, whey proteins and lactose), cheese and butterfat was 131,395 tons in September, up 57 percent from a year ago, according to trade data released November 10 by USDA's Foreign Agricultural Service. Total export value in September was \$345.5 million, up 87 percent. The increase pushed year-to-date export value to \$2.718 billion, a rise of 69 percent over the first nine months of 2009.

September gains capped an active third quarter for U.S. suppliers.”

Leakage Risk:

According to CA Department of Food & Agriculture, of the top ten commodities, over half are exposed to international trade issues. Many export to international markets, while others face pressures from importing markets.

Industry Assistance Factor:

In Appendix J, the regulation states that the Industry Assistance Factor is essentially the ability an industry has to pass-on carbon costs. With low-cost competitors throughout the world, even a minimal increase in cost could displace certain market segments as demonstrated in the previously listed reports.

Recommendations:

- The formula for trade exposure and emissions leakage should be reevaluated to give special consideration to agricultural import and export markets. Food processing should be moved to the “high” leakage risk category, due to increasing international and domestic markets as stated in the previous data points.
- Food manufacturing is located in the second Industry Assistance Factor tier (Industry Assistance Factor of 100%; 75%; 50%), and should be moved to the top industry assistance factor tier due to price pressures from international markets. Even a minimal increase in costs could displace U.S. markets, giving more ground to domestic and international competitors.

Emissions Intensity:

Within the regulation, staff realizes the importance of domestic competition and the ability of emissions leakage to other states, granting easier access to California markets. Staff also observed that emissions intensity may not play a direct role in emissions leakage.

However, the report also states that emissions intensity is to serve as a “proxy” for compliance costs. This assessment is not accurate for the food industry. The California Air Resources Board (CARB) staff assumes a “low” emissions intensity for the food industry, while compliance costs are quite higher for food processing when domestic and international markets are lost to lower-priced competition and food processors are left competing with companies in an auction market that has no price caps for allowances. This is coupled with the fact that the vast majority of food processing is a seasonal industry in which emissions are generated.

Recommendations:

- Ag Council agrees with staff assessments regarding domestic competition as being problematic as it relates to the food and agricultural industry. A different approach should be taken for food processing in determining compliance costs and/or emissions intensity. The emissions intensity variable in the product-based allocation calculation should be replaced with another variable that truly represents the cost of compliance for the food industry. Staff should take more time to work with the food processing industry to determine an appropriate factor for this variable.

Product-Based Benchmarking:

With approximately 400 agricultural commodities and even more byproducts on store shelves, it will be quite problematic for CARB staff to attempt to create product-based benchmarks for food processing. Management of a product-based system is beyond the scope of CARB’s expertise.

Recommendation:

- Energy-based benchmarks are more acceptable to the food processing industry and would create a more streamlined system for CARB regulators. However, some flexibility should be allowed within the system to achieve collective goals of CARB and food producers who wish to grow the industry.
- A well known industry set of standards and efficiency promulgated by a respected group, the American Society of Mechanical Engineers, should be used in place of CARB’s proposed efficiency rule. These standards are familiar to processors, and were created over many years of study by a third party trade association.

Free Allowances & Public Utilities:

Ag Council appreciates CARB's first three years of free allowances to avoid extreme market fluctuations. CARB also plans to provide free allowances to the utilities so that they can offset costs that are likely going to be experienced by rate payers. Should these allowances be auctioned, Ag Council requests that some of that relief be provided to food and agriculture. These funds could help offset costs incurred by rate increases and investments at the plant, but potentially be invested in research and development in existing and future technologies.

Recommendation:

- CARB should include report language specifying that agricultural and food processing sectors should be considered as rate-payers and some of those funds should be directed back toward the industry accordingly.

Other miscellaneous issues:

- Inclusion of a robust offsets program is essential to cost-containment of AB 32. The 8 percent limitation is too restrictive and will prevent interest and investment in innovative emissions reductions projects in uncapped sectors. Agricultural cooperatives, in particular, have a unique opportunity to participate in carbon sequestration activities of their grower-owners and utilizing those offsets as part of the compliance rules in cap & trade. Limiting the total allowance market to only 8 percent for offset projects discourages potential participation in the program from production agriculture and could prevent this unique opportunity for agricultural cooperatives. Ag Council urges the Board to review this cap in the future as potential new offset protocols come on line. Without a promise to review the 8 percent cap, this may provide a strong disincentive for capital to be invested by state or private organizations to development of new offsets.
- Mandatory reporting at 10,000 MTCO₂E should be delayed until additional workshops can be conducted and staff has time to work with the affected stakeholders. There has been very little outreach from CARB to the agricultural community to help us determine who may be affected by this rule. Ag Council believes this substantial change is premature and unnecessary at this time.
- Once this rule is adopted, California will be serving as a case study in climate change for the rest of the country. As experienced in many sectors of the food and agriculture industry, certain market segments could be flooded with imports in a matter of months such as the previously-stated case in the processed peach industry. CARB staff should be required to report to the Board on the findings of impacts on food processing as the regulation is underway so as to avoid these types of situations.

SPECIAL CONSIDERATIONS:

Many of the assumptions made throughout the document do not apply to agriculture or food processing. Therefore an industry-wide study should be conducted to fully understand the

impacts to the food processing sector. We are hopeful that our analysis of the following assumptions will assist CARB staff when trying to determine appropriate participation for the agriculture and food processing sectors. While there are several assumptions that are problematic for our industry, two highlights include:

Economic & Allocation Advisory Committee (EAAC) Recommendations:

- In Appendix L, the EAAC assumes companies will fluctuate to variable power sources, depending on the price available for those sources. The opportunity for fuel substitution is minimal in the short and long term because many of our food processors are already utilizing the cleanest forms of fuel and technology. Absent this transition, the analysis goes on to state that reducing output due to price increases is the second option to reduce greenhouse gas emissions. On page L-27, the report states “higher prices will elicit a reduction in the quantity demanded for these products, leading to a reduction in greenhouse gas emissions.” When applying this theory to the food industry, it underscores our concerns about emissions leakage and the need to protect our local food industry.

Pay-back Periods:

- Assumptions on pay-back periods are faulty because CARB assumes pay-back periods on an annual basis. On page F-7, the regulation states that pay-back periods on capital costs are under three years. Many food processors operate only a few months out of the year, so this pay-back period on technology adaptation would have to be tripled or quadrupled to create a more accurate projection for our industry.

Ag Council appreciates the opportunity to work with CARB on this regulation. We look forward to continuing our working relationship regarding climate change and are hopeful for a workable outcome for our industry. Should you have any questions or concerns, please do not hesitate to contact me at (916) 443-4887.

Sincerely,



Emily Rooney
President

Citations:

USDA; Foreign Ag Service; *World Horticultural Trade & U.S. Export Opportunities*. August 2005. http://www.fas.usda.gov/http/Hort_Circular/2005/08-05/08-01-05%20Tomato%20article.pdf

USDA; Foreign Ag Service; *World Markets & Trade: Fresh & Processing Tomatoes*. July 2008. <http://www.fas.usda.gov/http/2009%20Tomato%20Article.pdf>

U.S. Dairy Export Council's "September Export Data – top line analysis." November 10, 2010. <http://usdec.files.cms-plus.com/TradeData/PDFs/Summary%20of%20U.S.%20Exports%20Year-To-Date%20.pdf>

Other Examples of International Pressures on Agricultural Commodities:

LA Times; *Market watch: Hard Times for CA Asparagus*. March 2010. <http://articles.latimes.com/2010/mar/12/food/la-fo-marketwatch-20100312>

NY Times; *U.S. Apple Growers Feel Heat from China*. June 2007. <http://www.nytimes.com/2007/06/25/business/worldbusiness/25iht-apples.1.6312540.html>

LA Times; *Influx of Chinese Garlic Wrinkles Noses in U.S.* February 2005. http://www.wright.edu/~tdung/Chinese_garlic.pdf