September 27, 2011

TO: The Honorable Mary Nichols, Chair
California Air Resources Board

FR: John Larrea, Governmental Affairs
California League of Food Processors (CLFP)

RE: Comments per 2nd 15-day Rulemaking on Cap-and-Trade Regulation

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The California League of Food Processors is pleased that the California Air Resources Board staff has seen fit to make some recommended changes based on our previous comments to the 15-day rulemaking package. However, though current comments will not change the current regulation, nonetheless CLFP believes it is necessary to submit these comments to reaffirm the need for further changes

CLFP still has significant concerns regarding the cap-and-trade proposal, both specific and in general. Many of the food processors' recommendations would aid in either clarifying or alleviating the more arbitrary items that increase compliances cost and leakage and have little or no environmental benefit, especially for food processors and other valley industries. In light of California's worsening economy it becomes even more imperative that the cap-and-trade regulations not hamper or delay industry's effort to jumpstart the state's economic engine.

Recent studies suggest that the Inland California, including the Central and San Joaquin Valleys, will lag behind any recovery by three years or more (UCLA Anderson Forecast released Sept. 2011) through 2017. The inland counties represent the heart of where food processors operate. The specter of long-term economic stagnation in Inland California is already evident. AB 32 in general and a cap-and-trade specifically, offers nothing to help alleviate these dire economics except to increase energy and fuel costs and to force decreases in production.

Food processing emissions represent less than .05 percent of the total industrial emissions in the state. It is vital that CARB look at other factors beyond the sterile methodologies embodied in the rulemaking effort. Valley communities, the very essence of "low-income" and which depend upon the Ag and food processing industries for their livelihoods, will be adversely impacted – communities with populations ranging from 1500 to 15,000 that already suffer unemployment rates of 16% to 24% or more.

Regarding the CARB process, as the deadline for submitting the rule to the Office of Administrative Law approaches, CLFP believes it is necessary to express our dismay regarding the 15 day update process and the prospect for further rule changes and updates next year. This rule is extremely complex and it will have a large impact on the California economy. It should be incumbent upon CARB to conduct additional workshops and provide more time for the public to provide feedback, as well as for the staff to hear and incorporate reasonable changes to the rule – 15 days for written comment is insufficient for a rule of this magnitude. CLFP urges CARB to adopt a more robust public process going forward. Getting it right is more important than meeting a deadline dreamed up by a dysfunctional political process.

It is with these goals in mind, CLFP recommends that Board members adopt the following provisions for inclusion in the regulation at the earliest possible time:

Extend NAICS Code Designations for Food Processing Sector

Food manufacturing is the only industry for which the CARB has aggregated up to the 3-digit level per the North American Industry Classification System (NAICS). Every other industry is disaggregated at least to the 4-digit level. Using 3-digit level data obscures important differences among industry segments. For example, sector 3114 food processors are grouped with poultry processors in sector 3116, which have a very different energy use pattern. Food processors appear to be more energy intensive than the rest of the food manufacturing sector. Thus, the energy intensity measure for sector 3114 is diluted unless the NAICS code designations are expanded.

CLFP recommends that the NAICS Code designation covering food processors be expanded.

Designate Food Processing as Uncapped Sector (NAICS 3114)

Uncapped establishments will not be subject to any form of direct GHG regulation and thus will not incur any costs, either in implementing reductions or buying and selling allowances, or in regulatory compliance, associated with AB 32. This situation is identical to what was foreseen for implementing an EITE adjustment—regulated facilities are likely to face a competitive cost disadvantage to firms that provide a close

substitute. The uncapped facilities, smaller emitters in this case, can increase their output and attendant GHG emissions, thus defeating the intent of AB 32 to reduce overall GHG emissions.

Providing free allowances to large food processing emitters only partially mitigates this situation however. In an industry where so much of the competitive in-state production will fall below the regulatory threshold, and so few of the capped facilities have large emissions (only a half dozen of the sector 3114 plants emit more than 50,000 tons), better public policy is to uncap the entire food processing sector and leave the emission reduction strategies to other means.

For food processors, almost all emissions come through either natural gas or electricity use. The load serving entities for both natural gas and electricity will be under the cap and trade program by 2015. The energy utilities will have strong incentives to encourage their customers, including food processors, to reduce their emissions through utility-based programs and measures. Thus, the food processing sectors will be regulated through an alternative means, but in a less costly manner.

CARB should designate food processors (NAICS 3114) as an uncapped sector.

<u>Benchmarks</u>

The purpose of distribution benchmarks is to establish equitable bases for distribution of free allowances within industries, taking into account the higher complexity and existing energy efficiency of California industrial facilities. CARB should continue to work with trade exposed and energy intensive industries to develop benchmarking methods that are supported by the impacted sectors.

CARB should not be using benchmarking and other distribution methods to undercut the free allocation of allowances to energy intensive and trade exposed industries. CARB should not, for secondary reasons, adopt benchmarking methods which penalize the superior energy efficiency of California industries relative to competitors in other states, or methods which distort the distribution of allowances among industry members without regard to energy efficiency.

To be fair to California industries, energy benchmarks should be set based upon a national standard. Setting industry-wide benchmarks, using only California facilities after nearly 30 plus years of energy efficiency efforts and expenditures by California industries, will only further exacerbate the trade exposure of California industrial facilities. Industry in California will be even more susceptible to competitors or startups in states choosing not to enact climate change regulations on their industrial base.

Unfortunately, CARB's most recent proposals on benchmarking create increasing concern on the part of industry, that the basic principle of free allowance allocation is being subordinated to secondary concerns. This will likely result in large allowance shortages for many facilities and significant adverse impacts for California businesses and their workers.

Provide for Emissions Allowance Borrowing

CLFP supports emissions borrowing. The current regulation only allows emissions banking in the cap-and-trade. CARB should allow borrowing allowances with some limits and standards. The ability to borrow will aid in reducing costs and allow companies to meet obligations without penalty for short periods of time.

Multi-Year Allocations

Without the benefit of multi-year allowance allocations, regulated entities will not be able to properly determine their growth potential and plan accordingly to select new sites or expand current facilities. A multi-year allocation approach allows regulated entities the time necessary for capital planning purposes. It is not very feasible for a facility to responsibly plan an expansion or retrofit that will take multiple years, if it must start the project without knowing how it will obtain allowances to cover facility emissions in future years of the project. Multi-year allocations will allow businesses to plan ahead.

Offsets

Offsets represent an important cost containment tool for many food processors and producers and should the economy ever rebound, offsets will be vital to keeping the cost of allowances from skyrocketing as industries begin to ramp up production to meet demand. CLFP has recommended that CARB not take a restrictive approach to the use of emission offsets by cap-and-trade program participants such as limiting the number or percentage of offsets that can be used; the geographic location of offsets; or the types of offsets that would be eligible.

Allowing the use and availability of a large quantity of offsets from the very beginning of the program will be crucial to the program's success. Policies that increase the likelihood of an inadequate supply of offsets and the inability to link to other cap and trade program will greatly decrease the potential for a cost effective California program.

CLFP recommends that CARB instead focus on the quality of offsets; that they meet the requirements of being real, additional, quantifiable, verifiable, and permanent. As long as offsets meet that rigorous standard then their use by regulated entities should not be limited for compliance purposes. CLFP also recommends that the proposed

8% level be established as a floor, and that additional offsets be allowed as necessary to maintain costs of the program within acceptable limits. For the same reason, we also recommend that the regulation not impose geographic limitations at this time.

Forward Carry Of Unused Offset Capacity:

In an effort to provide flexibility and reduce compliance costs to regulated entities, companies should be allowed the flexibility of banking unused offsets on a year-to-year basis. Another mechanism that should be available to regulated entities is the ability to trade the balance of their remaining offsets to another company.

Dispute Resolution Program

Currently the cap-and-trade and mandatory reporting regulations give CARB's Executive Officer sole authority on program implementation, including determining whether regulated parties have complied with regulations and to determine penalties. Absent costly and time consuming litigation, there is currently no independent administrative option for stationary source facilities to challenge the Executive Officer's decisions that could not be resolved.

The CLFP believes the Executive Officer should not have the final decision on such a comprehensive program as AB 32, and instead it would be in both CARB's and the regulated industry's best interest that a formal, autonomous dispute resolution process should be established in order to provide independent decision making with equity for all parties involved in any dispute.

This program should use an unbiased mechanism to resolve disputes, variances and penalty disagreements with the Executive Officer. Without such a program issues that could be resolved relatively quickly could become time-consuming litigation which could hinder the goals of AB 32.

Industry Stakeholder Advisory

The AB 32 Implementation Group supports and encourages a stakeholder advisory committee to provide continual and thoughtful feedback to CARB as the program rolls out during the next few years.

Changes Specific to Food Processing Industry

Based upon past meetings with CARB staff, our understanding is that the following are approved interpretations:

1. Anomaly years (short season start-ups, etc.) will be excluded in setting the benchmarks for the compliance period in which they occur.

2. The years prior to a facility expansion would also be excluded (i.e. new boiler additions to existing facilities).

3. That a company would be allowed to carry over excess or unused reductions into the next compliance period.

4. That new boilers would be treated as a new process and eligible for separate benchmarking and allowance allocations.

5. That a company would be able to aggregate its compliance instruments among facilities, as opposed to meeting its compliance obligation on a facility by facility basis

Thank you for considering our comments. Should you have any questions or need anything further, please feel free to contact John Larrea at (916) 640-8150.

cc:
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