American Forest & Paper Association

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Comments on Preliminary Draft Regulation for a California Cap-and-Trade Program January 11, 2010

The American Forest & Paper Association (AF&PA) appreciates the opportunity to submit comments on the Preliminary Draft Regulation (PDR) for a California Cap-and-Trade Program the published November 24, 2009.

The American Forest & Paper Association is the national trade association of the forest products industry, representing pulp, paper, packaging and wood products manufacturers, and forest landowners. Our companies make products essential for everyday life from renewable and recyclable resources that sustain the environment. The forest products industry accounts for approximately 6 percent of the total U.S. manufacturing GDP, putting it on par with the automotive and plastics industries. Industry companies produce $200 billion in products annually and employ approximately 1 million people earning $54 billion in annual payroll. The industry is among the top 10 manufacturing sector employers in 48 states.

AF&PA would like to highlight several design elements that are of critical importance to the forest products industry: definition of eligible biomass; the formula for allocating allowances to manufacturing facilities; the availability of and eligibility for offset credits; and desire for a single national program.

Definition of Eligible Biomass

On page 7, the PDR requests feedback on two proposed definitions of biomass. AF&PA recommends the use of the definition included in the PDR rather than the definition contained in the California Energy Commission's Renewable Energy Program Guidebook. The forest products industry meets over 65 percent of its energy needs through the use of renewable biomass, much of which is in the form of byproducts. The PDR definition explicitly includes such byproducts.

AF&PA recommends that either the definition of biomass or Section 95950 "Emission Categories to Calculate Surrender Obligations" (currently a placeholder) exclude "paper which is commonly recycled" from eligible biomass to help prevent the burning of recyclable paper for energy.

In addition, as California considers the definition of eligible biomass or the categories of biomass combustion that must remit allowances, we think it is important to incorporate viable provisions to promote sustainable forest management.

Allowance Allocations

Allowances should be granted to the manufacturing sector -- especially those segments with limited ability to pass increased costs through to their customers -- versus having to purchase them at auction. Allowances should be distributed in proportion to actual absolute emissions.

Allocating allowances is essential for maintaining a viable forest products industry in the U.S. The forest products industry has limited ability to pass along increased costs to its customers due to foreign competition. Therefore, the industry will have to absorb the cost of reductions, as well as increased electricity and fuel prices passed on by the electric power and petroleum distribution sectors. Without an adequate allocation of long-term allowances, the U.S. forest products industry would see its slim profit margins significantly reduced or eliminated.

In addition to direct emissions, indirect costs imposed on industry sectors should be taken into account when determining the apportionment of allocations. Any charge for carbon emissions will foster responses beyond just the emitting entities paying more for those emissions. For example, a price on carbon will increase the demand (and price) for natural gas, particularly by the power generation sector. We will also encounter supply chain, purchased electricity, and product distribution costs related to climate policies. These developments would increase the cost structure in our industry and put us at an even greater competitive disadvantage. Allowances should be allocated to help cover these costs until new technologies are available and competitiveness and leakage concerns are mitigated

AF&PA strongly supports the use of actual emissions as the basis for allowance allocations. The use of sector averages as the basis for allocation is unworkable for several manufacturing sectors, and unfairly creates winners and losers. AF&PA recommends that federal and state programs not adopt this approach for the following reasons:

Creation of winners and losers

Most manufacturers, including the forest products industry, have large variation in products and processes. Due to this large variation, dissimilar products and processes would be placed in the same sector category, resulting in a completely unrepresentative sector average which will, in turn, over-allocate allowances to some facilities and under allocate allowances to others in a manner that is not based on their comparable efficiencies. Attempts to refine these categories often results in data availability problems as energy data is typically collected at a facility level rather than by product or process.

In addition, a sector average approach penalizes smaller, older facilities, and those with regional access to particular fuels. Industry internal analysis shows that fuel type rather than process efficiency is the overriding factor that determines the number of allowances a facility would receive. Facilities using coal, regardless of their efficiency, would receive only a fraction of the allowances needed to ensure competitiveness. It is important to note that the forest products industry is extremely capital-intensive; its return on assets does not exceed its cost of capital. Without an adequate supply of allowances, less efficient facilities or those using coal will close rather than make the capital investments that policy makers expect to result from the use of a sector averaging provision. Adequate allowances will enable those facilities to make the appropriate capital investments in a manner that will keep them in business for the long term. Otherwise, production will move to unregulated regions.

Uncertainty

The use of sector averages creates significant uncertainty for facilities as they plan capital investments in GHG efficiency. Periodic updating of the sector average is unpredictable, and therefore a facility does not know the expected level of allowances beyond a short window of time. Calculating return on investment in efficiency improvements is impossible when the improvement may or may not result in an increased allocation. If a facility is benchmarked against its own emissions rather than undeterminable sector average, it will provide the certainty needed to make informed capital planning decisions.

International Benchmarks

There is widespread misconception that U.S. manufacturing is the most energy efficient in the world. As policymakers move toward an international climate agreement, a global carbon market, and examine comparable actions by trading partners, the relative inefficiency of many U.S. manufacturing sectors will become evident. Due to the poor economic health and high capital costs required to make investments in efficiency, U.S. Forest Products industry efficiency does not compare favorably against some of its international competitors, both in developed countries and in emerging economies where state of the art facilities are being built, sometimes with government subsidies. Similarly, international benchmarks used as the basis for sector crediting in developing countries or border adjustments will only serve to put many U.S. manufacturers at a competitive disadvantage.

Unnecessary Complexity

An overly complex allocation method is unnecessary particularly when resulting environmental impacts are determined by the cap and not the allocation. The development of appropriate comparisons among facilities will be extremely resource intensive for regulatory agencies and in some cases will not be possible given the complexity and variability of production processes.

Allowance allocation is the best tool for addressing competitiveness issues for energy intensive, trade exposed industries. A border tax or other border

measures are highly imperfect and will have their own negative repercussions. If a border tax is levied on imports, it is likely that developing countries will find a way to protect their industries. Experience teaches us that even if we secured a favorable WTO ruling on a border tax, there are many ways for governments and companies to work around it to protect their jobs and maintain their export industries. Governments with large publicly-owned forest estates can reduce the price of wood fiber concessions to their forest products companies. Other WTO-legal subsidies exist that countries could use to offset the cost of a U.S. border tax. Moreover, a tax at the U.S. border will not affect competition in third country markets unless the added cost of meeting a U.S. climate change regime is rebated to U.S. exporters at the border. The forest products industry is routinely a target for retaliation when the U.S. does implement border measures.

Offsets

Allowing use of offsets to mitigate emissions regulated by a cap and trade program is an important component for limiting costs of the program. Increasing the availability of credits in the market through offsets will help keep compliance costs lower than they would otherwise be. There should be broad flexibility in allowing real, verifiable offset credits that a company can generate or utilize to mitigate its GHG emissions. There should be minimal limits on the number or location of offsets allowed by the policy.

AF&PA has commented extensively on the Climate Action Registry Forest Offset Protocols and against their adoption by the California Air Resources Board. The latest revisions of the California Forest Protocol have not achieved the stated objectives to reduce transaction costs, increase potential benefits to landowners and provide fewer restraints on land management options so the program is attractive to a broader spectrum of landowners. It remains a high cost, high restriction, long-term, conservation easement focused on wildlife habitat values.

This program will continue to be avoided by most private landowners who value the choice to manage their forestland for their independent objectives. It also deliberately limits the participation of the tens of thousands of landowners who manage their forests intensively for wood products and economic returns. Most importantly, it severely limits recognition of the carbon benefits that these intensively managed forests could provide to help reduce atmospheric carbon dioxide.

AF&PA is currently participating in a broad stakeholder effort with U.S. and Canadian forestry and environmental groups to develop a North American consensus forest carbon measurement standard. The goal of this new consensus standard, developed under a process accredited by the American National Standards Institute (ANSI) and the Standards Council of Canada, is to harmonize existing and emerging forest carbon measurement protocols from state, provincial, regional, and national climate policies and programs. The resulting bi-national consensus standard will establish uniform policies across North America to provide a broadly-supported basis for forest carbon protocols in both countries.

Unintended Consequences of Taking "Business as Usual" for Granted

In 2006, AF&PA member pulp and paper mills generated 64 percent of the energy they used from biomass; members' wood products facilities generated 74 percent of their energy from biomass. Currently, our industry is a leader in the use of energy efficient combined heat and power (CHP) systems (29 percent of all U.S. co-generated electricity is produced by pulp and paper mills). The carbon that U.S. forests and forest products currently store each year is enough to offset approximately 10 percent of all U.S. CO_2 emissions. More than half the forestland in the U.S. is privately owned--roughly 424 million acres. Of that, 354 million acres are actively managed for timber. Private landowners in the U.S. plant about 4 million trees each day.[1] EPA estimates that the amount of carbon stored annually in forest products in the U.S. is equivalent to removing more than 100 million tons of CO_2 from the atmosphere every year. In 2006, AF&PA member companies avoided 21.1 million metric tons CO_2e of methane through their use of recovered fiber that would have otherwise decayed in a landfill.

Since many forest products industry practices reduce greenhouse gases, it is important that policymakers create incentives for maintaining existing climate friendly practices. As climate policies often focus on incentivizing additional energy efficiency improvements, use of renewable fuels, or carbon sequestration in forests, they often fail to recognize the benefits of existing business practices that avoid GHG emissions and sequester and store carbon. In effect, this creates disincentives for existing users of renewable energy and owners of forests, distorts markets, and disadvantages those landowners and forest products manufacturers who are leaders now in the use of energy efficient combined heat and power, carbon neutral biomass, and forest and product sequestration. Unintended consequences occur when policies reward new entrants and disadvantage those that are currently engaged in the desired activity. For example, a conservation organization that typically purchases and places a conservation easement on forestland may not be eligible for offset credits for forest carbon sequestration because this project would be considered "business as usual." Protocol developers are beginning to understand the drawbacks of the "business as usual" concept and alternative baseline scenarios are emerging to accommodate this imperfection. The definition of "additional" in the PDR includes the flawed concept of "business as usual." Because of all of these potential unintended consequences, the rule must be flexible to continue to encourage sequestration in all forests – regardless of their historical use.

Single National Program

AF&PA supports a single national emissions reduction program that establishes uniform national standards and mechanisms and requirements that are consistent and efficient. The program should also recognize the ability of states to carry out the program where

[1] [1] Forest Resources of the United States, 2007; Draft RPA Review Tables: U.S. Dept. of Agriculture, http://www.fia.fs.fed.us/documents/pdfs/2007_RPA_REVIEW_TABLESv2c.pdf; Tree planting in the United States - 1999; U.S. Dept. of Agriculture

requirements have been established that are consistent with the federal program. We do not support the implementation of multiple-state, regional, or statutory programs that impose varying compliance and reporting obligations. We support the harmonization of any existing state and regional programs with a federal program. A single national program would provide businesses with a level of certainty that is critical for business planning purposes, particularly for our industry where companies typically have facilities in several States. It would also allow for the fungibility of allowances and offset credits and eliminate the potential for leakage or competitive disadvantage across jurisdictions.

In Closing

Thank you for the opportunity to comment on the design of the Preliminary Draft Regulation for a California Cap-and-Trade Program. Please do not hesitate to contact us if you have any questions or if we can be of assistance in any way.

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