Kings County Farm Bureau

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January 11, 2010

Ms. Lucille Van Ommering
Climate Change Cap-and-Trade Section
California Air Resources Board
PO Box 2815
Sacramento, CA 95812

RE: Kings County Farm Bureau Comments Regarding ARB's Preliminary Draft Regulation for a California Greenhouse Gas Emission Cap-and-Trade Program

Dear Ms. Van Ommering:

The Kings County Farm Bureau recognizes the significant amount of effort that Air Resources Board (ARB) staff has devoted to developing the Preliminary Draft Regulation (PDR) and appreciates the opportunity to comment on the proposal. The PDR provides a starting point for discussing a wide range of specific market structure, operations, and oversight issues. However, it is clear that there are many issues that require further clarification, discussion, and refinement. As you are aware, the business community is very concerned about the costs, regulations, and risks inherent in implementing an emissions trading program that will ultimately affect virtually every sector of California economy. Contrary to the stated purposes of the regulation, the current Cap & Trade program, as proposed, does not solve the greenhouse gas (GHG) problem. The problem will be exacerbated by industries outsourcing to offshore operations, as California businesses operate in a global economy. Only by creating incentives and policies that will encourage the free market to look at solving the problem, will the economy of California improve and the overall risk from climate change be altered.

The Need for Creative Policy Initiatives:

An excellent precedent exists for a creative public policy approach to incentivize the private industry to significantly reduce its GHG contribution on a voluntary basis, as recently summarized in an article entitled "Testing, Testing" by Atul Gawande in the December 14, 2009 issue of "The New Yorker" .[1]

Prior to World War I, our country was still a relatively poor nation, in large part because of the low productivity of U.S. agriculture characterized by fragmentation, disorganization and an

[1] http://www.newyorker.com/reporting/2009/12/14/091214fa_fact_gawande?currentPage=all#ixzz0c98mz0Vc

inborn reluctance to adopt improved practices. The result was low crop yields, unreliable quality, limited consumer choices and high market costs. Agriculture was, as it had been for centuries, inordinately labor intensive with close to half of the country's workforce dedicated to the sector. Farmers relied on human resources because labor was relatively inexpensive, just as the structure of agriculture today is based on cheap land, abundant water, inexpensive energy and less-than-full accounting for its environmental impacts.

As a consequence, food costs consumed more than 40% of an average family's income. Given these conditions, it was not possible for the nation to raise its standard of living and emerge as an industrial power. A reduction in food costs was required to allow discretionary income to be spent on goods and services in other economic sectors. Additionally, a reduction in labor requirements allowed human resources to be redeployed into emerging industrial sectors. What was needed then was nothing short of a fundamental restructuring of agricultural operations, just as today. **It will not be possible to cost-effectively solve the GHG problem without a modern transformation of the combustion processes utilized in industries.**

At that time, the federal government instituted a series of initiatives, programs and policies that helped millions of farmers change the way they worked while honoring individual land ownership and the value of private sector initiative. State programs at land grant institutions followed the creation of federal programs that were based on the understanding that farmers were not going to change their methods without seeing for themselves the benefits of adopting new techniques and practices. The federal government initiated the Extension Service, conducted a series of demonstration farms and pilot programs across the country and created what has become a network of agricultural experiment stations in every state of the country to develop and teach the most productive methods for growing livestock and producing crops. The government invested in providing timely and accurate data to farmers, initiated a statistics service, began to provide more accurate forecasts to the marketplace, produced new genetic varieties of crops and livestock and developed and taught improved approaches to productivity. There were compromises and concessions and wrong turns. But the strategy worked, because United States agencies were allowed to proceed by trial and error, continually adjusting their policies over time in response **NOT TO IDEOLOGY,** but to hard measurement of the results against societal goals. In short, the PDR does not honor private business nor recognize the value of private sector initiative.

Food processors and other manufacturers, dehydrators, dairy operations, cotton ginning and processing facilities, and farm operations will have to adapt quickly to the low-carbon business landscape, and many will need substantial financial resources to develop and implement new technologies and practices. Under the PDR, and without incentives, many firms will fail during this transition and the California experience may well collapse. The Economic and Allocation Advisory Committee (EAAC) proposes full auctioning of allowances. This cost burden coupled with the expected 60% increase in energy costs, increased transportation costs due to low carbon fuel, and increased materials costs, only exacerbates the problem. Add to these, the recommendation for 100% auctioning of emissions allowances, and then re-distributing the billions of dollars in revenue that will be generated by the cap-and-trade auctions away from incentives to assist those businesses. In short, the PDR does not honor private business nor recognize the value of private sector initiative.

The Economic Impact of the Cap-And-Trade Program

The Kings County Farm Bureau believes that the market design is critical because the potential economic impact of the GHG cap-and-trade program on the business sectors, particular those sectors affiliated with agricultural production, will likely be quite significant. The following points are derived in part from the comments prepared by the California League of Food Processors (CLFP):

- For the firms captured in the GHG cap-and-trade program, the cost of purchasing emissions allocations and offsets to meet compliance obligations will be substantial, likely several hundred thousand dollars per year or more, and millions of dollars over the ten-year period. It will be difficult for most firms to absorb these costs or pass them on to buyers in the highly competitive food processing industry.
- All facilities will incur major costs when they modify their operations or purchase new equipment to reduce onsite GHG emissions. Technology to reduce and or capture CO2 is only in the beginning development stages. Most of the emissions generated at food processing plants are due to the large boilers necessary to cook products and sterilize equipment. With current available technology, many facilities will not be able to greatly reduce their combustion emissions without compromising food safety or quality, or curtailing production. It also is important to note that most food processors have purchased, or will soon be purchasing, equipment (e.g. SCR units to reduce boiler NOx emissions, forklifts, and off-road equipment) to comply with other air quality regulations. The cumulative cost of regulation is problematic for most California businesses because profits are low and capital is scarce and this situation may not change significantly for some time. The GHG fee combined with the proposed full auction of allowances will drain available capital from these institutions, prohibiting the needed capital improvements and/or research and development.
- As noted by the CLFP, food processing tends to be very energy intensive, therefore, significant increases in energy costs due to the California climate change program will affect the ability of firms to compete. It is important to note that most large food processors have made major investments in energy efficiency and conservation in recent years, so further reductions may require using technologies or practices that do not meet cost-effectiveness thresholds. Quite simply, major reductions in fossil fuel combustion may not be feasible at many facilities. The technology is not available and, as mentioned previously, the GHG fee structure and auctioning of allowances will drain available capital from these institutions
- The production inputs used by agricultural operations, food processors (packaging, raw farm products, trucking), and other industries are relatively energy intensive. Higher energy prices and other embedded cap-and-trade costs will likely increase the cost of production for most food processors and agricultural operators. If transportation fuels are included in the cap-and-trade program in 2012, it will likely have an immediate and substantial impact on fuel price thereby affecting farm production costs, trucking rates, and costs throughout the transportation sector. In the absence of a worldwide GHG program or, at a minimum, a national program with similar program requirements, California businesses will be at a competitive disadvantage since the costs will not be able to be passed on. Imports of food products and offshore processing and

manufacturing will usurp California businesses, further deteriorating the California economy.

- The Kings County Farm Bureau agrees that food processors and other affected industries will incur substantial administrative costs to comply with GHG emissions monitoring, reporting, registration, verification, planning, and trading requirements. Many firms have indicated that they do not have this type of expertise available and will have to hire staff to devote to these tasks and/or hire consultants. A recent study commissioned by the Office of Planning and Research[2] documented that California businesses incur very high regulatory compliance costs and taxes. The cap-and-trade program and AB 32 regulations will add to that burden. At this point in time, with the absence of GHG banking protocols, the timeline required to develop protocols, and the monitoring and enforceability requirements (which has not been developed by CARB) the Kings County Farm Bureau sees little benefit that agriculture can provide in the way of offset generation. The continuing regulatory development process will render many, if not most, farm practice innovations moot and ineligible for offset generation.
- Cap-and-trade market and regulatory uncertainty have already complicated business planning efforts, increased risk, and may increase capital borrowing costs. Most businesses do not have experience in trading GHG emissions instruments. Many firms will face a steep learning curve, and this uncertainty will likely be reflected in the financial returns expected by lenders or investors to compensate for the higher level of risk. The timeline for compliance, and the auction practically being implemented with this rule development process, does not allow for a learning curve or financial planning.
- Increased operating costs will affect the ability of California farms and businesses to compete with rivals in other states and nations. Farm production and food processing is a highly competitive business characterized by relatively low financial margins. Hundreds of farmers, thousands of production workers, numerous suppliers, and a number of rural communities located across the state depend on the transportation, fuel, energy, and processing industries. As the compliance costs mount, and California producers and processors become noncompetitive in the world market, these industries will become another casualty of the high cost of doing business in California and will cease to exist.

At this point, the cumulative long-term costs that will be borne by businesses due to implementation of AB 32 have not been fully quantified. The Kings County Farm Bureau agrees with the CLFP and requests that ARB develop company-specific case studies to better understand and quantify the potential regulatory financial burden and how it will affect the ability of the enterprises to continue and compete. This type of study could be a very useful complement to the macroeconomic analysis conducted by ARB.

Specific Comments Regarding ARB's November 24, 2009 PDR

The Kings County Farm Bureau has reviewed the PDR and has several comments for consideration by ARB (many of these points are in agreement with the CLFP):

[2] Cost of Regulations on California Small Business, Varshney and Associates, September, 2009.

- Offsets have proven to be a very important cost containment option for many firms. The Kings County Farm Bureau agrees that ARB not take a restrictive approach to the use of emission offsets by cap-and-trade program participants. ARB should not impose any arbitrary restrictions on the cap-and-trade program participants regarding the number/percentage of offsets that can be used, the geographic location of offsets, or the types of offsets that would be eligible. ARB should instead focus on the *quality* of the offset: that it meets 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. GHG is a worldwide pollutant, not limited to, or controlled solely by California.
- Emissions borrowing and banking should be allowed to provide more compliance flexibility. As long as firms have to meet the mandated long-term emissions reduction targets, then ARB should provide them with the tools to best manage their own internal planning and investment paths to satisfy those requirements.
- A key cap-and-trade cost containment and risk management provision will be to institute a carbon price safety valve. This can be accomplished by either releasing allowances when market prices approach an established maximum level, or to set a price ceiling. A safety valve is necessary to help market participants to plan their financial outlays and to minimize the potential for short-term market manipulation by non-regulated entities that may be purchasing allowances.
- The Kings County Farm Bureau also supports having three-year compliance periods to provide firms with a sufficient planning horizon and to cope with annual fluctuations in production and sales. However, we also oppose ARB's proposal to have an annual compliance true-up. The annual true-up will negate much of the advantages of having a three-year compliance period, as firms will be forced to make investments on an arbitrary annual basis rather than based on the most cost-effective option.
- The Kings County Farm Bureau agrees with the CLFP and recommends the formation of a permanent advisory committee for the cap-and-trade program. The purpose of the advisory committee would be to review how the cap-and-trade program is functioning in terms of market efficiency and fairness. The advisory committee would include economists with specific expertise in emissions markets and representatives from the regulated sectors. We also agree with CLFP that an independent dispute resolution process be developed to address some of the issues that may arise from the cap-and-trade market.
- Both ARB and the program participants will be on a steep learning curve during the initial years of emissions trading. ARB should avoid imposing automatic penalties for non-compliance, especially for clerical or administrative errors.
- On page 27 of the PDR, ARB suggests that firms with emissions that drop below 25,000 metric tons will continue to have surrender obligations for six consecutive years. This provision should be modified to reflect that once a firm drops below the threshold, they should not have to surrender emissions allowances unless their emissions again exceed the minimum threshold. This provision negates the incentive to reduce GHG emissions to below the threshold, and provides further incentive for firms to close or relocate to other regions.
- ARB should ensure that its cap-and-trade program will link directly to a U.S. federal program and to regional programs such as the Western Climate Initiative. With respect

to climate change, California has been a leader, yet California businesses will suffer and environmental goals will not be met if regulators do not closely coordinate and link market programs.

- The Kings County Farm Bureau requests that opt-in participation not be allowed. ARB's regulation proposes to allow entities that are not required to surrender emission allowances to "opt-in" to participation in the allowance auctions. This would increase the risk of market manipulation by speculators, increase costs to participants, and should not be allowed.

Conclusions and Recommendations:

The PDR appears more to reflect an ideology of suppression of business enterprise, as opposed to support. The PDR does not appear to support private business, nor recognize the value of private sector initiative. If that had been the case, then recognition of the difficulty that this regulation will place on California farms and business would be more apparent. More research and incentives, as opposed to fee and enforcement penalties, that provide solutions and maintain California's business competitiveness in a global market should be developed as part of this cap-and- trade rule and the overall AB 32 process.

The Kings County Farm Bureau shares the concern that the direct compliance costs and cumulative secondary economic costs generated by the cap-and-trade program will be excessive and have a very detrimental impact on the ability of many California farms and supporting businesses and processors to remain financially solvent and compete effectively. Our understanding is that regulators in the European Union (EU) faced a similar issue and concluded that food processing is a vital sector to Europe's economy and is subject to strong international competition. The Kings County Farm Bureau supports providing food processors and other agricultural based operations with additional free GHG emissions allowances during the 2013-2020 time period.

Thank you for the opportunity to provide comments on the proposed draft rule.

Sincerely,

Kings County Farm Bureau