
To: CARB Cap and Trade Program Development Team
*Submitted Electronically*

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**CLFP Comments on Proposed Cap-and-Trade Regulation**

The California League of Food Processors (CLFP) recognizes the significant amount of effort that Air Resources Board (CARB) staff has devoted to developing the proposed cap-and-trade regulation and appreciates the opportunity to comment on the proposal. CLFP believes that the implementation of this regulation will have a significant economic impact on the food processing sector.

Simply put, the economic stakes are high, and the cap-and-trade program must function properly from the first day of trading or risk a loss of confidence by participants and other stakeholders as well as substantial economic harm to the industries required to participate.

Having reviewed the proposed regulation posted October 29, 2010, it is our position that the regulation is incomplete and relies too heavily on assumptions regarding the market factors attributed to the industries proposed to be subject to the cap and trade regulation - this is especially true regarding the food processing industry.

It is CLFP's opinion that the Board should reconsider the adoption of the proposed regulation at this time in light of its incomplete nature and the obvious need for additional economic analysis. CLFP has found 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 and may severely hamper the ability of California's food processors to remain competitive.

Food processing, especially fruit and vegetable canning, is a seasonal industry, with operations lasting less than four months out of the year. Seasonality also plays a role in raw product characteristics which directly affect the efficiency and operation of our boilers and equipment, often creating variable fruit and vegetable quality that may require more or less time cooking, and constant boiler adjustments to maintain operational safety and product consistency. This native California industry is highly sensitive to import pressures from domestic competitors in other states and especially to foreign competitors such as China, Greece, Italy, South America and Mexico, some of which have made significant gains in market share in recent years.

To that end, CLFP makes the following recommendations:

**Leakage**

Emissions leakage for the food processing industry is our central concern in this regulation. CLFP notes that the emissions intensity matrix discussed in Appendix K is based on a "one-size fits all" approach. This is unworkable for the food processing industry.

*Trade Sensitivity*

Most California industrial sectors are global players; this is particularly true of the California food processing industry. Food processing is a highly competitive business that tends to be characterized by small financial margins making our products sensitive to low-cost competitors in domestic and international markets. CLFP believes that if the compliance costs become too high a number of food processors will become uncompetitive, losing customers and business to competitors not burdened with added compliance costs.

*NAICS Designation*

In Appendix J, the regulation states that the Industry Assistance Factor is essentially the ability an industry has to pass-on carbon costs. Staff utilizes the NAICS classification standards to determine the leakage risk that will be assigned to each industry. In utilizing only a three-figure NAICS designation, the leakage risk for fruit and vegetable food processors is seriously diluted. As such, food processors will face serious difficulties in adapting to the low-carbon business landscape envisioned in the proposed regulation given both the current economic downturn, the unique nature of the food processing industry in California and the intense competition for national and international market share.

*CLFP Recommends:*

1. Direct staff to develop techniques to evaluate the trade exposures of the fruit and vegetable food processing industry and that staff include affected industry stakeholders in developing these alternative techniques.
2. Direct staff to compile an industry study in concert with the CLFP and report to board on progress.
3. Delineate the NAICS classification to a finer detail (four or six digits) for fruit and vegetable food processors.
4. Develop new matrix for determination of leakage risk for fruit and vegetable food processors.

**Benchmarking**

In establishing a emissions benchmark, it is vital that the CARB recognize that food processing is an energy intensive and trade sensitive sector that has a vital role in maintaining the California economy and will be the key factor in any Central California economic recovery.

*Energy-based benchmark*

Given the number and variability of the products produced by California's food processors, it is not feasible for CARB staff to attempt to create product-based benchmarks for the food

processing industry. CLFP believes that management of such a system, if attempted, is beyond the scope of CARB's expertise.

In Appendix J, CARB staff proposes to use a "fallback approach" for benchmarking of industries facing leakage or competitive risk but for which a product-based benchmark has not yet been developed. Energy-based benchmarks are more acceptable to the food processing industry and would create a more streamlined system for CARB regulators. However, careful consideration should be given to potential industry expansion that will provide flexibility within the system to accommodate both the goals of CARB and of the food processors.

*Boiler Efficiency*

Many of the assumptions made throughout the document do not apply to agriculture or food processing. For example, staff assumptions regarding boiler size do not reflect the industry standard or practice. Boilers currently used by most CA food processors are larger than the averages that staff cites in support of its regulation. Boilers sizes range from 93 MMBtu to 183 MMBtu per hour natural gas input, significantly larger than the published estimates. Additionally, staff fails to take into account that all of the large processors return the boiler condensate to a deserter tank for reuse in the boilers at rates that are as high as possible and that the boilers utilized by food processors have blow down heat recovery units on all boiler systems and maintain steam traps in proper function.

Staff has set boiler efficiency benchmark at 85%. This standard is set based on staff's own set of equations. Staff's need to employ a simple method for establishing CO2e for individual industrial sites is understandable. However, our opinion is that staff's equations do not take into account the actual efficiency of steam production or end use in the food processing industry. This means facilities with very inefficient systems but low use won't be taxed at the same rate as a highly efficient facility with higher use. This is why CLFP is requesting to use the ASME standard for assessment of steam production and use efficiency. The ASME standard takes into account the steam "system" efficiency and establishes accepted, industry standards for their calculations.

*Three-year average insufficient*

In addition, we are concerned that a three year average will produce a more punitive benchmark that does not reflect accurate energy needs. Because of the unique factors identified in the food processing industry, it would be more accurate for the industry benchmark to be set at the highest emissions level encountered in any one year operating period. Special consideration should be made for new facilities that do not have the operating history. For instance, new facilities with shorter baseline periods, in cases less than three seasonal years, should use the maximum full season operating emission rate.

*CLFP Recommends:*

1. CARB adopt the energy-based benchmark ("fallback") for food processors permanently.
2. Order staff to utilize accepted ASME standards in calculating boiler efficiencies for food processors.

**Facilitate Industry Growth and Expansion**

*Transferable Credits*

In order to incentivize innovation, CLFP urges CARB to ensure that credits be transferrable between facilities owned by the same entity. Transferable credits will succeed in giving producers the incentive to increase innovation across facility portfolios, especially where such upgrades make the most sense for the business. For instance, it may fit into a company's overall procurement strategy to upgrade a system at a plant that emits less than 25,000 tons CO2e/year rather than at one which must buy allocations. The reward for those reductions should be reflected in the company's overall participation in the cap and trade program.

*Efficiency Upgrade Credits*

Food processors have implemented energy efficiency measures for many years. These projects include flue gas recirculation and economizers for boilers as well as energy efficiency audits by third parties and utilities to optimize energy use. While more can be done, implementing the next generation of efficiency upgrades can be cost prohibitive for some facilities. CLFP recommends that CARB broaden the scope of qualified opportunities to receive credit for these investments in addition to clean burning fuels, such as Combined Heat and Power (CHP).

*Pay-back Periods:*

Assumptions on pay-back periods are faulty because CARB assumes pay-back periods on an annual basis. In Appendix F, staff proposes Emissions Reduction Strategies asserting in the regulation that pay-back periods on capital costs are under three years. As food processors only operate a few months out of the year, this pay-back period on technology adaptation is unworkable for the food processing industry. Any pay-back for capital investments would be significantly lengthened due to seasonal operation norms.

*CLFP Recommends:*

1. Allow for the transfer of compliance instruments/credits between facilities owned by the same entity thereby providing incentives to food processors to increase innovation across facility portfolios.
2. Broaden the scope of qualified opportunities to receive credit for efficiency investments.
3. Recalculate pay-back periods to reflect actual industry practices.

**Accounting For New Entrants and Facility Expansions**

The proposed regulation is silent for the most part regarding the treatment of plant expansions. Therefore, in order to accommodate expansion and industry growth, food processors adding a new process or expanding existing facilities should expect to be provided with the full complement of free allocations as if it were a new entrant into the program.

*CLFP Recommends:*

1. For new processes and/or plant expansions added to existing facilities, the new additions should be regarded as new entrants into the program and provided free allocations.

The above issues and recommendations are necessary in order for both staff and the industry to begin to address the many remaining issues in the proposed regulation.

**Special Considerations**

Many of the assumptions made throughout the proposed regulation are not applicable to either agriculture or food processing. Therefore CLFP believes an industry-wide study should be conducted to fully understand the impacts to the food processing sector.

In addition, CLFP presents comments on these additional issues of importance concerning the proposed cap and trade regulation:

**California-only Market**

Despite assurances to the contrary, we believe that California's Cap and Trade will be unique in the U.S for some time, as evidenced by continued shrinking of the Western Climate Initiative's member states. California, by going it alone, risks grave economic harm and risks recovery from the recession if there are no other strong market partners. California jeopardizes the progress it has made as a leader in air quality and as a supporter of green business should its rush to implement an incomplete regulation.

In addition, November's federal elections have all but guaranteed that there will be no effort to establish a federal cap and trade market nationally. Given this development, California's efforts to implement a cap and trade will only add to the burden of California businesses and families struggling under a continuing recession.

**Auction and Allocations**

CARB staff proposes a few price containment mechanisms to moderate allowance prices, including a $10 price floor for the auction of allowances, and fixed-price sales from an allowance containment reserve account starting as low as $40 in 2012 and rising thereafter to $70 in 2020 (check). The level of pricing in the allowance containment reserve is not well justified – more data is needed. The floor at $10 is unrelated to any finding that it is necessary to spur market activity that would not also occur at $5, for example. Also, the CARB staff report finds that $30 is the estimated cost for abatement, yet the $40 level is the starting point for the high prices.

CLFP recommends that CARB postpone determination of these thresholds until the regulation is more complete -- all the allocation benchmarks determined and all the monitoring tools established the ability to accurately measure leakage and anticipate other potential market failures. This will dictate the appropriate levels for the reserve pricing necessary to ensure market stability.

**Auction Revenues**

CLFP also opposes using auction revenue to fund any of programs that do not directly relate to reducing long-term greenhouse gas emissions. Auction revenue should be dedicated first to transition assistance to reduce or prevent losses due to leakage related to higher prices and lower profits or to offset costs resulting from modification or retrofit of existing operations or the purchase of new equipment to reduce onsite GHG emissions necessary in meeting compliance goals.

**Offsets**

Offsets represent an important cost containment tool for many food processors and producers. CLFP continues to strongly advocate 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. CARB should 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 supports the notion that the 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.

**Linkage with Future Cap-and-Trade Programs**

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. Although California has been a leader with respect to climate change, California businesses will suffer and environmental goals will not be met if regulators do not closely coordinate and link market programs. CLFP believes that a "go-it-alone" approach is not a viable option.

CLFP looks forward to continuing the dialogue with ARB regarding the structure of the cap-and-trade program and how it can be best shaped to minimize compliance costs and preserve the viability of the food processing industry in California.

CLFP appreciates the opportunity to work with CARB on this regulation. We look forward to continuing our working relationship regarding climate change and remain hopeful for a workable outcome for our industry. Should you have any questions or concerns, please do not hesitate to contact me at (916) 640-8150.