California Food Producers

We Help Bring California's Goodness to the World

TO: Rajinder Sahota, Assistant Chief Industrial Strategies Division
Jason Gray, Branch Chief – Cap-and-Trade Program
California Air Resources Board
1001 I Street
Sacramento, CA 95814

FR: John Larrea, Director Government Affairs
California League of Food Producers

Date: May 10, 2018

RE: Comments on the April 26th Workshop to Continue Informal Discussion on Potential Amendments to the Cap-and-Trade Regulation

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The California League of Food Producers (CLFP) appreciates the opportunity to provide comments on response to the April 26th Workshop to Continue Informal Discussion on Potential Amendments to the Cap-and-Trade Regulation (Cap-and-Trade).

CLFP represents 47 industrial food processors in California. Food and beverage processing in California accounts directly for $25.2 billion in value added and 198,000 direct full- and part-time jobs. Food processing reverberates through local and regional economies throughout California. On average for every $1 of value added in food and beverage generated results in $3.25 dollars in additional economic activity. Each job in food and beverage processing generates 3.84 jobs in total.

CLFP adopts by reference the comments submitted by the stakeholder group led by the California Manufacturers' & Technology Association (CMTA).

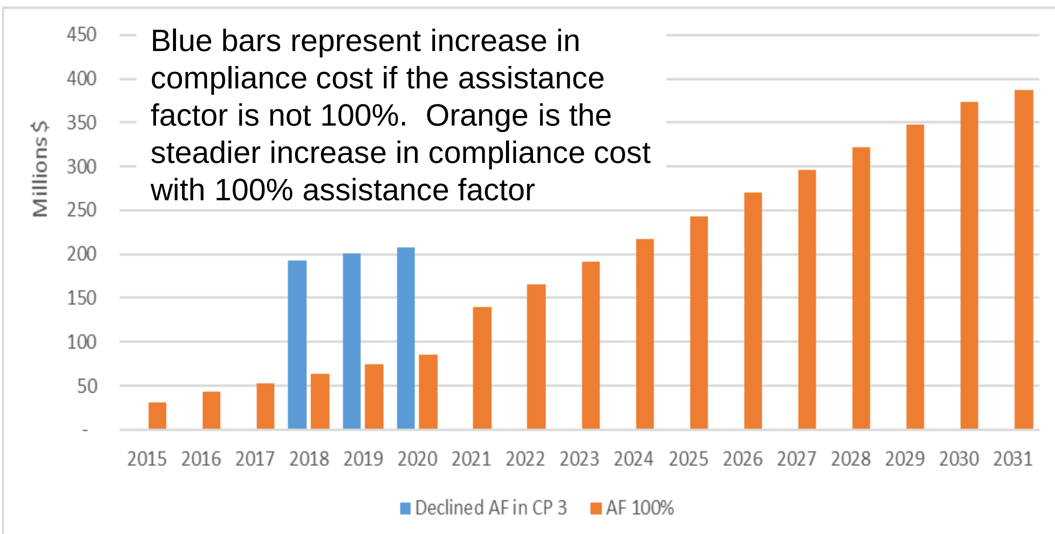
INDUSTRY ASSISTANCE FACTORS – THIRD COMPLIANCE PERIOD (CP3)

CARB chose a market designed to minimize leakage utilizing a system of allowance allocation that includes industry assistance. CLFP supports CARB's recognition of this critical component of the state's cap-and-trade program expressed in Board Resolution 17-21 wherein the Board directed ARB staff to "propose subsequent regulatory amendments to provide a quantity of allocation, for the purposes of minimizing emissions leakage, to industrial entities for 2018 through 2020 by using the same assistance factors in place for 2013 through 2017."

Each one of the twenty-one CLFP members subject to the cap-and-trade regulation are threatened by competition, both domestically and internationally, due to increased costs of production from the state's carbon reduction policies. CLFP is relieved that CARB recognizes the importance of guarding against economic and environmental leakage and continues to support CARB's efforts to reduce leakage risk. The best way to ensure California maintains job growth and production increases, which leakage risk threatens, and continuing to reduce GHGs, is through the **extension of the 100% industry assistance factor for all leakage classifications in the 3rd compliance period of 2018-2020.**

As CARB's own diagram shows, industries face significant cost increases between now and 2020 should CARB fail to make the necessary changes. These changes are necessary for a number

Estimated Compliance Cost for Sectors in Medium and Low Leakage Risk Categories



- Assumes $15 allowance value for 2015 – 2020 and $20 for 2021 – 2023
- Uses 2016 emissions as a proxy for emissions in 2017 and beyond

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of reasons.

First and foremost, it was not contemplated at the time the program was implemented that it would be extended beyond 2020. The passage of SB 32 significantly changed the dynamic of the cap-and-trade for many companies. The Legislature recognized the impact that this change would have on the economy, and on the competiveness of California industry, and sought to mitigate it by providing for 100% assistance factors beyond 2020 for all industries. CARB staff's recommendation to level up the assistance factors in the third compliance period acknowledges both the seriousness of the post-2020 leakage threat under SB 32, and the Legislative objective in looking to minimize that leakage by addressing the growing, disparity in production costs between California cap-and-trade industries and entities in other jurisdictions as early as possible.

Second, program consistency must be maintained. The failure to align CP3 assistance factors with the rest of the program going forward threatens program stability and is likely to have unforeseen consequences that may not manifest until late in the compliance period, especially for food processors.

The immediate effect, as well as the cumulative effect, of the loss of allowance allocations, especially when coupled with increasing costs of energy, water, labor, and other requirements of business operations in California, threaten a company's ability to remain profitable and competitive. Now, faced with growing economies, both nationally and around the world, increased competition is particularly worrisome for food processors as many of their finished products are, in many instances, priced out to four decimal places. In other words, profit margins on products grow thinner every day.

Price Ceiling

AB 398 requires that CARB establish a price ceiling and that certain prescribed considerations be used in establishing the price ceiling. As the cap-and-trade program continues to into post-2020, food processors believe a reasonable price ceiling should be designed to minimize adverse impacts on the California economy and jobs as well as act as a bulwark against economic and environmental leakage and avoid threats to the long-term viability of the cap-and-trade program.

However, CLFP is concerned over CARB staff's interpretation of a report from the Carbon Disclosure Project (CDP), as it findings seem at odds toward the establishment of a reasonable price ceiling. CLFP believes that a price ceiling set at $150 will only contribute to uncertainty and increase the risk for leakage. Such pricing is more likely to lead to the suspension of the program well before the price ceiling or price containment points are reached. Additionally, how is such pricing expected to entice other states to join the state's cap-and-trade market?

A price ceiling is, by definition, supposed to ensure cost containment by providing pressure relief against rising allowance costs. CLFP urges CARB to reexamine its interpretation of the CDP report, especially in light of previous comments, brought to CLFP's attention, by other qualified stakeholders, indicating that the proposed ceiling prices are statistically invalid. Protection of our members is paramount for CLFP, and based on what we understand, it seems more in line with available data that a ceiling price of $32-35/t would be more appropriate and adequately protect our food processor members.

SPEED BUMPS (Price Containment Points)

It is important that the price containment points be positioned so as to provide appropriate market signals, aid in mitigating extreme price volatility, and act as a warning flag for the legislature and stakeholders that the market needs attention. Practically speaking, the price containment points should function as market speed bumps, slowing upward price movements for a period of time so that stakeholders, CARB, and the legislature can evaluate abatement opportunities without risking substantial damage to the state's economy or to the industries subject to the state's compliance obligation under the cap-and-trade program.

Cap Adjustment Factors (CAF)

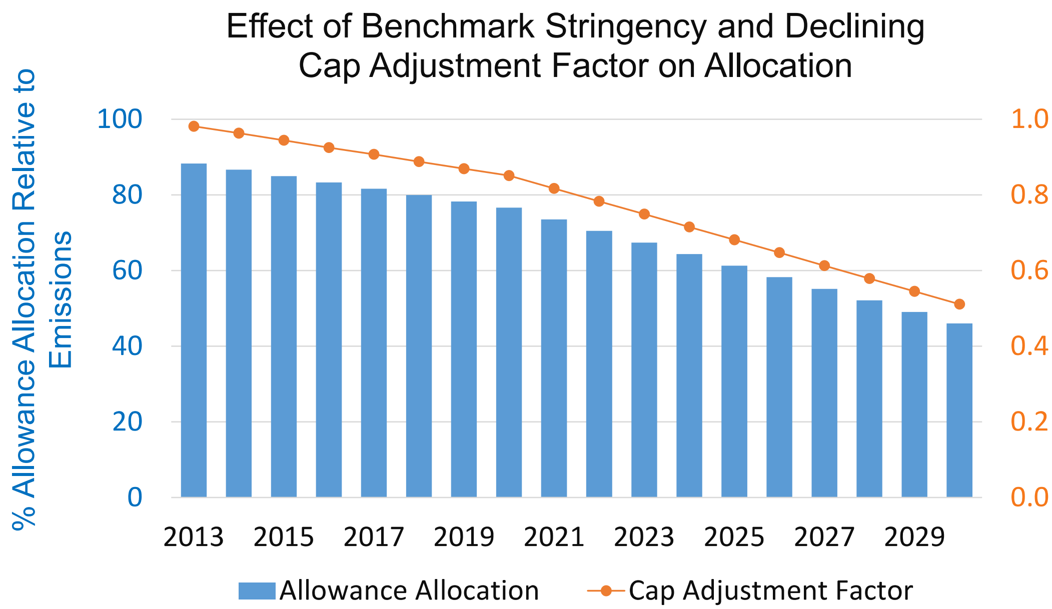
Now that AB 398 has extended the cap-and-trade beyond 2020, it is important that CARB reconsider the Cap Adjustment Factor (CAF) and the stringency factors and their impacts on leakage risk. It is CLFP's position that the cap decline, beginning in 2021, is severe enough in and of itself, to justify eliminating the both the CAF and the 10% stringency factor. CARB projections (Chart 2) clearly show that by 2030 most covered entities will see their allowance allocations significantly reduced over time. The loss of allowances to this degree may contribute to the leakage risk that the cap-and-trade is designed to mitigate. Factor in the CAF and some food processors project their allowance allocations will drop to well below 50% of their compliance obligation requirement.

Couple these increasing compliance costs with other market and supply factors such as energy price increases, the current CAF has an enormous impact on a facility's ability to meet its compliance obligation, both now and in the future. The resulting increase in compliance costs (Chart 1) will continue to threaten California's food processing industry well beyond 2020, right through the end of the decade.

While CLFP supports CARB's intention to provide an opportunity for covered facilities to address their current CAF (slides 6-8), it must be noted that the suggested path for development of the criteria for evaluating eligibility for an alternate CAF relies upon industrial sector data collected prior to 2012. Much has changed, both economically, in the food processing sector, and in the markets in which food processors compete.

CLFP believes a clear understanding of the economic effects of the CAF needs to be determined in order to inform the development of the evaluation criteria that will determine eligibility for an alternate CAF. CLFP supports an economic analysis aimed at determining the impacts of the CAF on specific sectors, by 6-digit NAICS designation.

CLFP is currently studying the evaluation criteria on slides 6-8 and looks forward to working with CARB on the development of the eligibility criteria for an alternate CAF.



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<u>CONCLUSION</u>

CLFP appreciates this informal process whereby issues and ideas can be discussed and shared prior to engagement in the formal rulemaking process. The decisions made by CARB on these future regulatory amendments will directly affect the CLFP members who have invested substantial amounts of capital in compliance costs and new technologies in an effort to comply with the state's ambitious environmental goals.

CLFP looks forward to continuing its involvement and working together with CARB throughout the stakeholder process.