California Food Producers

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

Date: July 5, 2018

RE: Comments on the June 21st Workshop to Continue Informal Discussion on Potential Amendments to the Cap-and-Trade Regulation and PRELIMINARY DISCUSSION DRAFT of Potential Changes to the Regulation for the California Cap on Greenhouse Gas Emissions and Market Based Compliance Mechanisms

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The California League of Food Producers (CLFP) appreciates the opportunity to provide comments on the June 21st Workshop to Continue Informal Discussion on Potential Amendments to the Cap-and-Trade Regulation (Cap-and-Trade) as well as comments on the recently released preliminary discussion draft on such potential changes.

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.

INDUSTRY ASSISTANCE

100% Industry Assistance in Third Compliance Period

CARB chose a market designed to minimize leakage utilizing a system of allowance allocation that includes industry assistance. CLFP supports CARB's recognition of the critical need to ensure program consistency as evinced in Board Resolution 17-21 which directed 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."

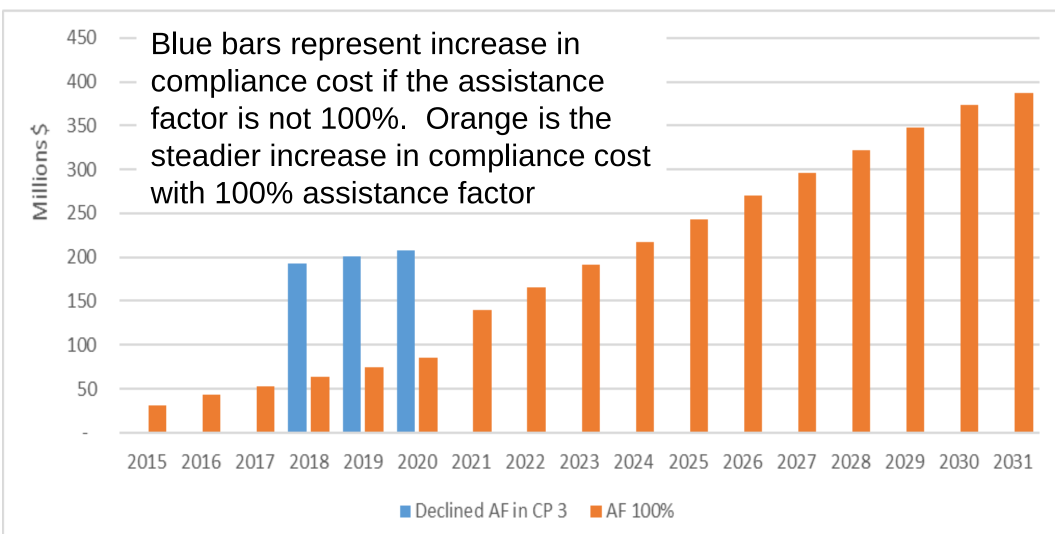
Each one of the twenty-one CLFP members subject to the cap-and-trade regulation are subject to competitive markets, both domestically and internationally. Ever increasing costs of production from the state's carbon reduction policies, combined with cost increases in other area such as fuels, raw product, transportation, insurance, workers compensation, wages, and local permitting, must be taken into account when considering amendments on cost containment and impacts on compliance costs for entities subject to cap-and-trade regulation.

The passage of SB 32 significantly changed the dynamic of the cap-and-trade for many companies. In AB 398, the Legislature recognized leakage risk threatens job growth, the competitiveness of California industries, the state's economy, and undermines continued GHG emissions reductions. Lawmakers responded by ensuring companies would receive 100% assistance factors beyond 2020.

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. CLFP supports CARB's effort to guard against economic and environmental leakage risk by providing **<u>100% industry assistance factor for all leakage classifications in the 3rd compliance period of 2018-2020</u>**.

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

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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The chart illustrates the need to maintain consistency in the cap-and-trade program. 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.

COST CONTAINMENT

Price Ceiling

CLFP continues to support its previous position that the focus should be on program stability and impacts on obligated entities should the price ceiling be breached. Minimizing uncertainty and leakage should be the highest priority when determining the appropriate ceiling value. AB 398 requirements for a price ceiling must be commensurate with minimizing the potential adverse impacts on the California economy and jobs should the price rise above the price ceiling.

A ceiling price greater than $32-35/t does not take into account the risk that many companies must consider when budgeting and forecasting operational costs, whether for the year or multiple years. Attempting to incorporate the need to budget hundreds of thousands, if not millions, of dollars should the allowance market spike is not a reasonable budgeting expectation. It seems just as likely that a company will measure any potential price spike in compliance costs or allowance prices against the cost of a production stoppage. Either scenario will likely result in job losses, market losses, and a measurable loss in competitiveness.

CLFP still believes that any continued reliance on the Carbon Disclosure Project (CDP) for determining a range for setting the price ceiling is misguided and is at odds with the establishment of a price ceiling that will protect the cap-and-trade program and acknowledge the risk to obligated facilities.

Speed Bumps (Price Containment Points)

It is important that the price containment points be positioned so as to provide appropriate market signals early enough to act as a warning of oncoming market volatility. The goal is cost containment and protection of the program. Speed bumps must meet the dual requirements of strategic placement and be funded with sufficient allowances to ensure effectiveness.

Cap Adjustment Factors (CAF)

Cost containment need not only focus on identifying a workable price ceiling. Other factors should be included in the analysis. It is important that CARB reconsider the Cap Adjustment Factor (CAF) and the stringency factors and their impacts on leakage risk and program stability.

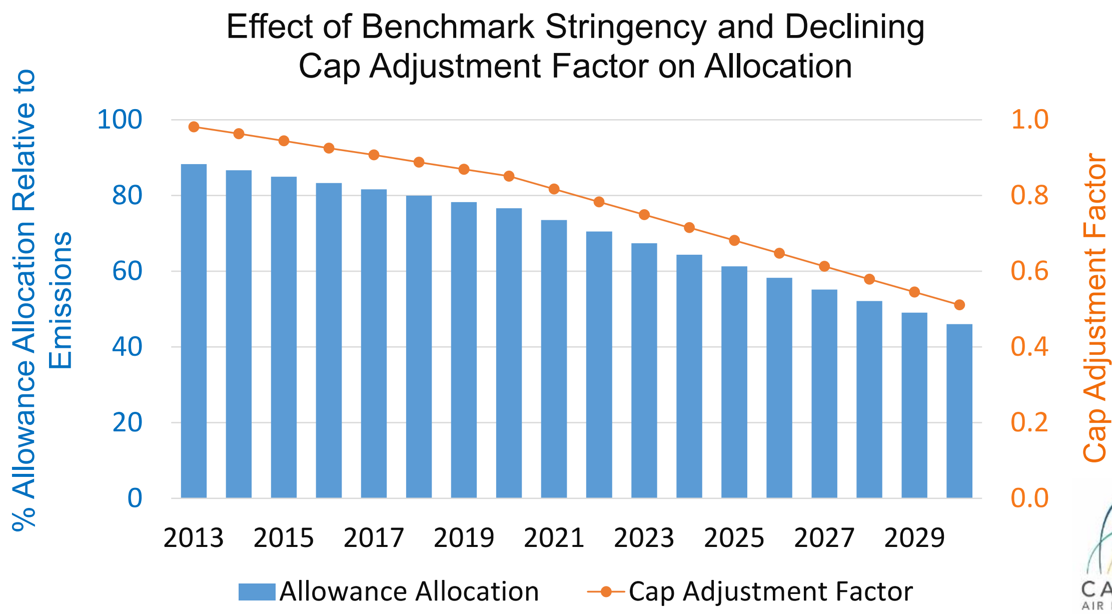
It is CLFP's position that the cap decline, beginning in 2021, is severe enough in and of itself to justify eliminating the both the CAF and the 10% stringency factor. CARB projections (Chart 2) clearly show that by 2030 most covered entities will see their allowance allocations significantly reduced 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, and it becomes clear that the 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.

CARB has previously indicated an intention to provide an opportunity for covered facilities to address their current CAF. When considering the food processing sector in California, it is important that CARB recognize and acknowledge that the greenhouse gas emissions from this sector represent less than 1% of the total state-wide greenhouse gas emissions. As such, imposition of the current CAF will impose an unnecessary economic burden on this sector without having any impact on whether or not the State will attain the 2030 goal.

In order to address this issue, CLFP recommends that CARB provide a CAF of 1.0 for the food processing sector for the fourth compliance period, 2021-2023. In addition, CLFP recommends that CARB provide for a detailed economic assessment of the impact on the food processing sector using the most current available data and information. This economic assessment should be undertaken and completed prior to the end of the fourth compliance period. On-going, periodic economic assessments, to be conducted prior to the end of each compliance period, are recommended with the results used to determine the appropriate CAF for the food processing sector for the subsequent compliance period.

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.



Direct Environmental Benefits (DEBS)

CLFP supports California's use of a market-based program, including the use of high-quality carbon offsets in the cap-and-trade program. CLFP views offsets as critical component in achieving the statutory GHG emission reductions at the lowest cost possible – as mandated under California's climate legislation. And, while disappointed that available percentages were reduced for post-2020, nevertheless CLFP urges CARB staff to continue to work to maximize the benefits of offsets' ability to contain costs and support the development of new innovative projects and technologies.

However, CLFP cautions CARB not to lose sight of the cost-containment aspects of offsets when addressing DEBS. A direct environmental benefit in the State should be viewed broadly in order to maximize the benefits to the program while recognizing the science behind the fundamental nature of GHGs and global climate change.

CLFP believes maximizing offsets will have a direct positive benefit within California, including within designated disadvantaged communities, by promoting economic development associated with new and expanding offset projects within the state, and mitigating the cost impacts of the program.

<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.