November 4, 2016

Clerk of the Board
California Air Resources Board
1001 I Street
Sacramento CA 95812

Submitted Electronically:
https://www.arb.ca.gov/lispub/comm2/bccommlog.php?listname=ct-amendments-ws

RE: October 21, 2016 Workshop and the Informal Staff Proposal for the Industry Assistance Factor Calculation

Dear Chairwoman Nichols and Members of the Board:

Agricultural Council of California (Ag Council) and Dairy Institute of California appreciate the opportunity to submit comments in response to the October 21, 2016 workshop and the Informal Staff Proposal for the Industry Assistance Factor Calculation (Staff Proposal).

Ag Council is a member-supported organization advocating for more than 15,000 farmers across California, ranging from small, farmer-owned businesses to some of the world's best-known brands. Ag Council works tirelessly to keep its members productive and competitive, so that agriculture can continue to produce the highest quality food for the entire world.

The Dairy Institute is a California dairy processor trade association founded in 1939. Dairy Institute represents milk and dairy processor on legislative, regulatory and economic policy.

A number of our member companies participate in the cap-and-trade program, and as a result, we wanted to take the opportunity to comment on two key points:

- First, we strongly oppose the Air Resources Board's (ARB) proposed post-2020 approach to allowance allocation that uses the non-peer reviewed results of two academic studies and continues to categorize food processing in the medium leakage category.
- Second, we understand that ARB is considering adopting measures in response to Assembly Bill (AB) 197 and environmental justice (EJ) concerns. We would like to express our opposition to these new approaches because they are ill suited for the cap-and-trade program and will not advance the goals that we all share, including cleaner air, lower global greenhouse gas (GHG) emissions, and a growing economy.

CARB'S PROPOSED POST-2020 FRAMEWORK

At the onset of the cap-and-trade program, ARB devised an allowance allocation method that included emissions intensity and trade exposure metrics, which resulted in the food processing sector being designated as "medium" leakage risk. However, the original data collected by ARB failed to recognize that most of California's food processing industry is highly seasonal and does not take into account the international competitive pressures of the world markets.

In 2011, Board Resolutions 11-32[1] directed staff to investigate potential improvements to the industrial allowance allocation to better meet the AB 32 objective to minimize emissions leakage to the extent feasible. In response, ARB commissioned three emissions leakage studies to inform the development of assistance factors (AFs) for allowance allocation. Two of these were broad-sector studies, which analyzed both international emissions leakage[2] and domestic leakage.[3] The third study specifically focused on production and emission leakage from California's food processing industry.[4] The purpose of the third study, approved in Resolution 11-32, was to acquire the data necessary to determine an accurate AF for food processors, as the current leakage risk factors were not scientifically supported.

The results of all three studies were released in May 2016 and in August 2016, staff released Appendix E, Staff Report: Initial Statement of Reasons (August 2, 2016). In the opening second paragraph, staff states:

> *"In commissioning the three studies, staff had intended to develop a revised methodology by which revised AFs, not including transition assistance, could be calculated and applied in the third compliance period (2018-2020). These revised AFs would be at sector-specific levels necessary to minimize potential emissions leakage. After additional thought and discussion with stakeholders, staff decided to extend transition assistance through the third compliance period, at levels set in the 2013 regulatory amendments. Any revised AFs that may be proposed as part of 15-day comment period would be implemented starting in the fourth compliance period (post-2020)."*[5]

In this statement, staff is giving new direction for the application of the leakage studies and on October 21, 2016 staff put out a proposal that outlines ARB's revised methodology for calculating AFs. The new methodology is informed by the international and domestic leakage studies. Staff is not proposing to use the data from the food processing leakage study. When asked why, staff stated that the Hamilton et. al. study was too conservative and looked at data from research reports, not real world data. It is our understanding that data was collected from existing food processing facilities however, some of the assumptions were outdated. For example, in Ag Council's September 19, 2016 comments, they pointed out that the authors cite milk utilization data from 2001, when there is more recent data available from CDFA.[6] Substantial public sector funds were spent to support this study and after many years of research, we urge ARB to revisit and review its findings. If the study was updated, it will likely demonstrate the inability to pass on the cost of this program in the food processing industry.

[1] https://www.arb.ca.gov/regact/2010/capandtrade10/res11-32.pdf
[2] Fowlie, M.L., Reguant, M., Ryan, S.P. (2016). Measuring Leakage Risk. University of California Berkeley.
[3] Gray, W., Linn, J., Morgenstern, R. (2016) Employment and Output Leakage under California's Cap-and-Trade Program: Final Report to the California Air Resources Board. Resources for the Future.
[4] Hamilton, S. F., Ligon, E., Shafran, A., Villas-Boas, S. (2016). Production and Emissions Leakage from California's Cap- and-Trade Program in Food Processing Industries: Case Study of Tomato, Sugar, Wet Corn and Cheese Markets. Orfalea College of Business, Cal Poly San Luis Obispo.
[5] https://www.arb.ca.gov/regact/2016/capandtrade16/appe.pdf
[6] https://www.arb.ca.gov/lists/com-attach/73-capandtrade16-UTIGYVEgVSsKbQNt.pdf (page 4)

We have additional concerns that neither the international nor the domestic leakage studies look at market demand when estimating leakage and they do not take into account the uniqueness of producing food. The leakage studies should include an analysis on upstream and downstream cost impacts if ARB is to use the results of the leakage studies to calculate specific AFs for specific industries.

For example, California dairy processing plants currently participating in ARB's cap-and-trade program are continually competing against both domestic and international competitors for those markets. Space in both markets is neither stable nor reliable, and is readily filled by the most price attractive competitor. The only factor reliably determining the successful competitor in either domestic or international markets is price. The costs imposed by regulatory compliance have been challenging for dairy processors and the proposed dramatic increase in those costs would be highly problematic. This is because such costs cannot be absorbed without making California dairy product processors much less competitive against their domestic and international counterparts, who do not carry such costs. The rationale that increased costs can be passed along or offset in domestic and international markets is disproven by the current situation, where California milk powder exports have dropped precipitously as California prices have remained higher than prices in competing Oceana and other powder supplying regions. As in the international space, domestic market sales are determined by competitive pricing. There is no offset or placeholder in either market when the cost of operation rises markedly above competitors.

We hope that ARB will reevaluate its AF methodology and implement the cap-and-trade regulation in a way that more accurately portrays the international and domestic pressures on the California agricultural sector. Failure to minimize leakage will not just have direct consequences for California food processing, its employees, and the communities that it supports; it will have a negative impact on global GHG emissions. As locally produced food declines in state and production increases out of state or abroad, it is likely that a more GHG intensive process will be used and emissions associated with shipping will increase overall GHG emissions. This outcome directly conflicts with ARB's original purpose of analyzing and minimizing leakage risk at all.

ARB's RESPONSE TO EJ CONCERNS

Due to a recently released research brief, *A Preliminary Environmental Equity Assessment of California's Cap-and-Trade Program*[7] and the passage of AB 197, staff has been asked by Board Members at ARB to review program effectiveness for direct emission reductions. Therefore, staff is considering several potential program design changes.

Offsets Usage Limit

Staff is considering lowering the offset usage limit for post-2020. Offsets are a proven and cost-effective means of meeting AB 32 compliance obligations. They are also an effective means of achieving significant GHG emissions reductions here in California and globally, since carbon dioxide pollution knows no boundaries. ARB's original parameters that GHG reductions due to offsets meet the criteria of being real, additional, quantifiable, permanent, verifiable, and enforceable, have slowed growth of the program. California is paving the way on climate change programs and as a result, is a global leader. It is important that California maintain and build a

[7] http://dornsife.usc.edu/assets/sites/242/docs/Climate_Equity_Brief_CA_Cap_and_Trade_Sept2016_FINAL2.pdf

strong offset program to demonstrate to the world that offset programs can be successful. We should not continue to restrain the ability of offsets to reduce emissions. ARB should expand and expedite the use of offsets, which is consistent with ARB's statutory obligation to achieve the maximum technologically feasible and cost-effective GHG emissions reductions.

Treatment of Unsold Allowances
Staff is considering changes to the treatment of unsold allowances by retiring some or all unsold allowances with vintage year 2020 or earlier. The cap-and-trade program was designed to address periods when allowance demand is low through an auction price stabilizing mechanism. It is very important that this change be subject to a cost-containment evaluation so that we continue to meet AB 32's statutory objective, to develop market mechanisms as cost-effectively as possible.

Cost-Burden Approach
Staff is considering shifting to a cost-burden approach for the industrial allowance allocation methodology. We have questions with this new potential approach:

- How would this approach take into account the current goal under AB 32 to minimize leakage?
- How does this approach account for the ability of the agricultural industry, including food processors, to pass on regulatory costs to consumers, given domestic and international competition and continually fluctuating global markets?

Prior to shifting approaches, we urge ARB to study the impacts of these potential changes in an effort to minimize leakage.

In closing, we recommend that ARB hold off on implementing a decrease in assistance factors for post-2020. Our members haven't even experienced the result of a decrease to 75 percent in the assistance factor that will occur in the third compliance period (2018-2020). It is not possible to predict the extent that the increase in carbon prices will affect food processing and more importantly emissions leakage. Before considering refining the assistance factor, ARB should at least keep the same assistance factor as the third compliance period for 2021-2023 and review actual emissions leakage data. Food processing plants carry with them billions of dollars in facility investment and thousands of employees. Regulatory uncertainty and change in direction that make producing food less viable are highly damaging and can prove irreversible.

We appreciate your consideration and the opportunity to comment. Our intention in these comments is to avoid simply shifting emissions to other locations outside of California. Should you have any questions or need anything further from us, please feel contact Rachael O'Brien at (916) 443-4887 or via email at Rachael@agcouncil.org.

Respectfully,

Emily Rooney
President
Agricultural Council of California

Rachel Kaldor
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