



To: Mary Nichols, Chair

California Air Resources Board

Fr: California League of Food Processors

Date: November 4, 2016

Re: California Air Resources Board's Consideration of the Proposed Amendments to the Cap-and-Trade Regulation

The California League of Food Processors (CLFP) appreciates the opportunity to provide comments on items discussed during the October 21, 2016 workshop on AB 197 & Post-2020 Cap-and-Trade Program Design and the proposed Post-2020 Allowance Allocation.

CLFP hopes these comments will aid the CARB Board and staff in forming fair, policy-oriented, and data-supported regulations regarding future GHG allowance allocations, recognizing that avoiding the potential harm to the California economy beginning in 2021 will require straight-forward analysis and a thorough vetting of studies sans political expectations. Consequently, the decisions that CARB makes regarding post-2020 implementation of the state's goals embodied in Senate Bill 32 (Pavley), requiring CARB to ensure that the statewide GHG emissions are reduced to at least 40 percent below 1990 levels by 2030, are guaranteed to have a significant impact on the ability of firms in this state to remain competitive in the future.

It is important to note, that while the California Legislature has chosen to pursue this questionable increase in the state's goal regarding the reduction of GHG emissions, having proceeded without the benefit of investigation or study as to the impacts on the state's economy, facilities and companies subject to the Cap-and-Trade must hope that CARB staff are up to the task of defending the program against non-scientific, politically-expedient claims and "findings."

With that, CLFP submits the following comments:

AB 197 and Post-2020 Cap-and-Trade Design

In general, CLFP supports the current program and methodology for allocating allowances to the industrial sectors.

Over the past two compliance periods food processors, as well as other industrials, have gained a measure of confidence in the operations of the cap-and-trade market in its current form. However, in attempting to meet the dictates of AB 197, CARB staff's initial recommendations as to potential design changes have reintroduced the uncertainty that has plagued business and industry since the beginning of this program.

Offset Credits

CLFP vigorously opposes the reduction of offset credit percentage post-2020. In fact, CLFP supports raising the percentage thereby providing obligated facilities with more choices on how best to meet the significant compliance cost increases should the current recommendations be adopted.

In its October 21st presentation, staff mentions that any changes in offset usage limits would be subject to a cost-containment/economic analysis. Yet staff's initial proposal is to further reduce offset usage post-2020, presumably as a first response to the requirements of AB 197, prior to any analysis.

What then is the purpose of such speculative recommendations? Especially recommendations that are unsupported by any prior analysis? If it is unknown what the economic impacts of reducing or eliminating offsets will be, why even make the statement?

CLFP urges staff to be more circumspect before advancing recommendations unsupported by data or rigorous analysis. Such actions by staff undermines the confidence of obligated entities in the entire process.

Industrial Allowance Allocation

Current allowance allocation and transition assistance to covered entities subject to the cap-and-trade is aimed at leakage prevention.

Now CARB staff proposes shifting to a cost-burden approach. Per staff, this would allow for the reduction of allowances that, in theory, would reflect a reduced compliance obligation owing to expected onsite emissions reductions. Staff justifies the proposed allocation reductions based on the 2009 recommendation of the Economic and Allocation Advisory Committee (EAAC).

Staff makes no comment on the nature of the "expected onsite emissions reductions" that will result in the allocation reductions. For the industrial sector, the most likely source of

reductions will be either through production curtailments or trade exposure due to increased costs of compliance. And such reductions will be accompanied by job and market losses.

The most *unlikely* scenario is emissions reductions resulting from new technology as the the Governor and the Legislature continue to divert auction funds, without objection from CARB, instead of directing funds back to the obligated entities for investment in and installation of new technologies that would provide direct emissions reductions from the source and aid facilities in meeting their ever-increasing compliance obligations. In other words, actually fulfilling the purpose of the state's cap-and-trade.

CARB staff's reliance on the 2009 EAAC report is questionable at best. That report is nearly eight years old. It was drafted during a severe recession and based on data and market assumptions that no longer have any real, identifiable, relevance to California's present economy, much less post-2020.

Treatment of Unsold Allowances

CARB staff is proposing to retire some or all the unsold State-owned allowances with vintage year 2020 or earlier. The proposal is based in part on such an adjustment being in recognition that current emissions are declining faster than anticipated.

Addressing the two components of staff's recommendations: first, CARB staff is proposing to revise the auction rules to effectively remove allowances from the market if they remain unsold at auction after two years. The proposed changes come on the heels of the massively undersubscribed May 2016 allowance auction in which market participants only purchased about 11% of current vintage allowances offered for sale. The current rule allows unsold allowances to be reintroduced to the market at auction in limited quantities after two consecutive auctions clear above the Auction Reserve Price.

While CARB's proposed rules would keep this structure in place, it would move allowances remaining unsold into the Allowance Price Containment Reserve (the APCR) after two years. APCR allowances are available for purchase at auction at fixed prices as a cost containment measure but those numbers are likely to go up under the proposed rule; CARB is proposing to consolidate the APCR into a single price tier of \$60 plus the Auction Reserve Price. (taken from Lathrop and Watkins comments)

As for Post 2020 Treatment of compliance instruments, retiring the unsold allowances on top to the earlier proposal may significantly affect cost. Combine that with fewer overall

free allocations and retiring unsold allowances suggests there may be an increased potential for a price spike.

CARB staff should bear in mind that this cap-and-trade market is still quite young, just short of two compliance periods (four years). While some tweaking of the program is to be expected, the magnitude of change represented by these recommendations has only increased anxiety and reintroduced uncertainty into a fairly smooth-functioning market. That the Legislature is dismayed at the dwindling auction fund amounts is understandable. What is not, are CARB's recommendations that seemingly are more in line with meeting the Legislature budget expectations than in strengthening this vital cost containment tool.

Cost-Containment Evaluation

CLFP notes that staff has indicated that this proposed change, and others, would be subject to a cost-containment evaluation. What does staff mean by a cost-containment evaluation? What is the nature of this evaluation? Will it be a study by an acceptable independent source or will it be similar to the staff evaluation of the Fowle/international and RFF/domestic leakage studies that resulted in the current post-2020 AF recommendations?

Elimination of Transition Assistance

Staff recommends the elimination of transition assistance, offering no other justification for this change than they always intended to eliminate it. Staff then determines that three compliance periods are sufficient for obligated facilities to have adjusted to their compliance obligations and transition assistance can be ended.

If cap-and-trade were to remain unchanged going into 2021 and beyond, that argument might have been sufficient. But the changes proposed by staff for the fourth compliance period, if adopted, will drastically alter several aspects of the current cap-and-trade which will increase the burden imposed upon industrial facilities.

Relying on an intention devised at the start of this program, especially in light of SB 32 and AB 197, would be unconscionable. Transition assistance, like every other aspect of the cap-and-trade in the development of new regulations, should be examined and given due consideration as to its role in contributing to the success of this program.

CLFP believes that Transition Assistance will continue to play an important role in maximizing emissions reductions under the cap-and-trade regulation in the fourth compliance period.

CLFP recommends tying Transition Assistance reductions to verifiable new technology development on a sector by sector basis. It is without question that new emissions reductions technology is necessary to ensure California will be able to meet this new 2030 goal. The alternative is production reductions or industrial flight (leakage) resulting in previously mentioned job losses.

Given that the Legislature has not seen fit to return any auction funds to the obligated entities nor to authorize investment in R&D to develop the needed technologies, it is left to CARB to find ways to support the development of new technology. Tying Transition Assistance to new technology development is one suggestion.

Post-2020 Allowance Allocation

In the workshop, staff proposed to utilize the recently released leakage studies (domestic and international) to calculate assistance factors (AF) for the post-2020 period. Despite three CARB-funded studies having been released, only two, the Berkeley study (Fowlie/international) and the Resources for the Future (RFF/domestic) are being used in determining the new assistance factors. The Food Processing Industry study (Hamilton et.al.) is not being used in determining the new post-2020 AFs.

It has been CLFP's position from the date of release of both the RFF/domestic and Fowlie/international studies in May 2016 that CARB should vet these studies thoroughly and provide opportunity for actual peer review before relying on the studies in the development of a new AF methodology. CARB staff is relying on study results using confidential data from the U.S. Census Bureau – data that cannot be accessed, inspected, or verified by anyone other than the authors.

Additionally, the authors of the Fowlie/international study make overt mention of the limitations of the findings:

The natural next step, from the perspective of a policy maker looking to assess leakage risk and target leakage mitigation measures, is to translate these responsiveness measures to corresponding measures of market transfer and associated emissions leakage. However, pushing on to this next step amounts to pushing up against the limits of available data. One complication is that calibrating the measures of leakage risk implied by

the theory requires dividing one noisy estimate by another. Other caveats include the fact that we cannot directly observe foreign production and instead employ an imperfect proxy. In what follows, we describe a conceptually consistent, albeit noisy and caveated, derivation of leakage risk measures. (Measuring Leakage Risk, Fowlie et. al. May 2016, page 38)

Given the noisiness of these estimates, we cannot estimate the transfer rate for any given industry with any degree of confidence. (Ibid, page 39)

This calls into question the robustness of the studies for the purpose of developing a new Allocation methodology post-2020.

Measure Twice, Cut Once

Perhaps CARB staff can benefit from an axiom employed by construction trades worldwide:

Measure twice, cut once. Make a wrong cut and the piece is unusable thereby ruining valuable and costly material. Carpenters and builders have learned to avoid making this mistake the hard way. This saying is a constant reminder that one has one shot at getting it right, or it will cost time, money, and even reputation.

To CLFP's knowledge, every single company with facilities subject to the cap-and-trade regulation has made a request to CARB to peer review these studies, to take a second measurement, in other words. In this spirit, it is hard to understand how CARB staff can suggest a 77% reduction in overall food processor AF post-2020 without additional economic analysis. This proposal comes despite the Hamilton et. al. study's conclusion that food processing warrants a high leakage risk.

For in-state cheese processors, the proposed AFs are even grimmer. Staff proposes to reduce dairy/cheese industry AFs by 81% to 95% beginning 2021. And this despite the Hamilton et.al. study estimated market transfer effects (i.e., the share of the decrease in in-state production transferred to out-of-state producers) for processed cheese manufacturing could be as high as 57 percent.

The current leakage studies are only the first measurement. Another is clearly needed. Yet, CARB simply ignores industry stakeholder requests for peer review of the Fowlie/international and RFF/domestic leakage studies before proceeding to develop and release recommendations for post-2020 assistance factors. Such drastic and questionable

reductions demand a thorough peer review of the underlying studies, possibly additional studies as well.

Short of this, it is questionable whether CARB is holding to the actual requirements under AB 32 in considering the cost-effectiveness of the regulations.

As a reminder, AB 32 states:

The regulations adopted by the state board pursuant to this section shall achieve the maximum technologically feasible and cost-effective reductions in greenhouse gas emissions from those sources....
(Assembly Bill 32, Chapter 488, Statutes of 2006) *emphasis added*.

The operative words are “shall achieve.”

One of the most disturbing aspects of the proposed AFs is that they imply that GHG intensity of imported products are on par with California products. This is not the case with food production internationally. While some European processors may employ newer technologies, other regions are far less advanced. For example, in tomato processing, given China’s overwhelming use of coal in heat and power generation, CLFP believes it can safely be assumed that GHG intensities, if compared, are not equal on a product-to-product basis and could range anywhere from 2:1 or greater.

Furthermore, the current staff recommendation calling for a 77% reduction in industry assistance will continue to burden an industry already struggling to maintain market competitiveness against international state-supported production. If it is CARB’s intention to shift market power to more GHG intensive market participants, approval of these AFs will meet that goal.

The emissions of the food processing industry represent only -0.4 percent of the total emissions in California. California’s food processors operate in the most economically challenged areas in this state. Many facilities represent the largest, and sometimes, the sole major employer in the area. Yet, based upon a single study, CARB can recommend additional economic burdens and confidently expect no impacts on jobs, local economies, or market competitiveness for the affected industry.

Food Processor Leakage Study (Hamilton et.al.)

The question remains on how CARB intends to use the agency-funded Cal Poly study (Hamilton et.al.) for determining allowance allocations to the food processing industry. During the workshop, CLFP asked why the Hamilton et.al. study was not used, nor mentioned, in staff's development of the proposed post-2020 AF, and CLFP was told the study was "too conservative." CLFP asked for clarification and staff did agree to provide such.

However, CLFP believes CARB would be prudent to use the findings in the Hamilton et.al. study in the development of the AFs for the food processing industry. The study uses detailed facility-level cost and sales data and met its stated goal of measuring production leakage in four of the largest food processing industries in California.

For the food processing industry, the Hamilton study provides clear direction for CARB. Given the uniqueness of the industry, special emphasis must be employed to account for the variables in our markets that exist in no other industries, as well as the potential major impacts on disadvantaged communities should food processing jobs disappear. The Hamilton et. al. study makes a strong and unrefuted argument for continuing 100% transition assistance for food processors beginning 2018. As for post-2020 metrics, both the Fowlie Study and the RFF Study need to be augmented to accurately reflect the market demands present in the food processing industry.

CARB must take seriously industry's request for a review and possibly an additional study to augment the Fowlie/international and RFF/domestic leakage studies. Further AF development will require accurate and recent market data specific to industrial markets in general, and the food processing industry in particular, for use in establishing the new metrics for determining AFs in the 4th compliance period.

CLFP looks forward to continued engagement on these vital topics.

cc: California Air Resources Board Members
Dr. Steve Cliff, Senior Advisor to the Chair
Richard Corey, Executive Officer
Edie Chang, Deputy Executive Officer