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

Date: October 22, 2018

RE: Comments on the Proposed Amendments to the Cap-and-Trade Regulation and MRR

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).

CLFP represents 47 industrial food processors in California. CLFP and its members have worked with CARB staff since the adoption of AB32 and the inception of the climate change program. CLFP members include twenty-one members who have facilities covered by the cap-and-trade program and who have been participating in the CARB rule development process for years. Overall, 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 is pleased that the primary focus of many of the proposed amendments is cost containment as instructed by AB 398. This issue is paramount for food processors both in the third compliance period as well as post-2020 where compliance costs will effectively double for cap-and-trade entities. Coupled with the enormous cost increases expected due to such events as wildfire recovery, new groundwater regulations, federal clean air act requirements, and energy rate increases, leakage risk should remain the major concern for CARB going forward and the watchword for post-2020 implementation of the cap-and-trade over the remainder of the third compliance period.

INDUSTRY ASSISTANCE

100% Industry Assistance in Third Compliance Period

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 under California's program. However, lawmakers also noted that industry not only met the reduction goals prescribed by AB 32 but will exceed the total emissions reductions required under the current program. In acknowledgment of this achievement, and in noting the increased leakage risks posed by SB 32, the Governor Brown and the Legislature responded by ensuring companies would receive 100% assistance factors beyond 2020.

The CARB Board'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" highlights the need for a consistent transition between 2018 and 2020.

CLFP fully supports the proposed adjustment to the assistance factors for the third compliance period. CARB staff's recommendation in the proposed regulation package 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. Given CARB's acknowledgment that other jurisdictions are failing to adopt carbon pricing policies, CLFP supports CARB's effort to guard against the continuing economic and environmental leakage risk by setting assistance factors for all sectors at 100 percent for the **3rd compliance period of 2018-2020**.

As noted by CARB staff:

AB 32 [and] AB 398 both speak to the need to minimize leakage. Free allocation of allowances is the primary mechanism in the Cap-and-Trade Program to respond to this mandate. AB 398 sets the post-2020 assistance factors to 100 percent. It is reasonable to set the post-2020 assistance factors for the baseline scenario to at least those in the third compliance period as CARB would continue to be required to minimize leakage under AB 32. The existing 50%, 75%, and 100% baseline further reflects that in the previous regulatory revisions approved by the Board in 2017, staff was continuing to consider whether to maintain these three assistance factor levels based on leakage studies and Board direction in the 2018-2030 timeframe, or to modify them based on additional leakage assessments.

Overall, CLFP believes that this change is necessary as a failure to align CP3 assistance factors with the rest of the program going forward frustrates the need for certainty necessary for business planning, threatens program stability, and is likely to have unforeseen consequences that may not manifest until late in the compliance period, especially for food processors.

Because the impacts associated with the third compliance period are ongoing, (the loss of industry assistance is affecting companies now) CLFP respectfully recommends that the Board consider the issue of industry assistance in the third compliance period be taken up separately from the regulatory package, possibly returned to the October 25 agenda.

COST CONTAINMENT

Price Ceiling

Assembly Bill 398 (Garcia, 2017) directs the California Air Resources Board (CARB) to include a price ceiling in the proposed regulation to control the prices of allowances. When setting the price ceiling, the legislation specifically directs CARB to “avoid adverse impacts on resident households, businesses, and the state’s economy.” This important and straightforward direction reflects a widespread and bipartisan recognition that the costs of climate regulations must be managed in order for the regulations to be successful and avoid damaging the market competitiveness of the state’s industrial sectors or driving California consumers, workers, and businesses into insolvency.

In establishing the price ceiling, AB 398 requires CARB to consider all of the following: CARB must avoid adverse impacts on California’s economy at all levels; the 2020 tier prices in the current Allowance Price Containment Reserve (pre-2020 Reserve); the social cost of carbon; the Auction Reserve Price; the potential for environmental and economic leakage; and the cost per metric ton of GHG emissions to achieve the statewide GHG emission reduction targets.

Simply put, CLFP supports CARB’s approach in the development of the price ceiling. And while not perfect, the current proposal strikes a balance between the very real need for program cost containment and economic protection against maintaining the environmental integrity of the program given the increased costs of compliance presented by the post-2020 regulation. The price ceiling numbers are clearly not aimed at simply trying to maximize costs.

Some stakeholders are arguing that CARB’s proposal will set a price ceiling that is nearly twice as high as experts recommend. Environmental groups, renewable tech industry, and environmental justice advocates, as well as other non-obligated industries, heartily argue for a higher price ceiling, essentially advocating for a much costlier program post-2020. Some stakeholders may even hold hope that the market will immediately jump to the ceiling price after 2021. However, these premises can only employ speculation regarding future market activity that may or may not come to pass.

CLFP believes that proposed price ceiling meets the requirements mandated under AB 398; and that, if voted out by the Board, will provide effective cost containment protections without maximizing compliance costs or undermining the environmental integrity of the cap-and-trade program overall.

Moreover, given the ongoing monitoring and annual reporting required under AB 398 should provide sufficient advanced notice of any imminent market meltdown long before the price ceiling would be breached. As an industry subject to a compliance obligation, CLFP is very concerned about be able to catch and fix any market dysfunctions in a timely manner which the current regulatory package seems to provide.

Delay Increasing Uncertainty for Obligated Entities in Third Compliance Period

What is frustrating for CLFP is that continued argument over this single issue, which may or may not occur, has jeopardized the efforts of the rest of the stakeholders and CARB to amend the regulation in a timely matter. Much needed amendments, such as leveling the third compliance period, are held hostage as well.

The increased costs of the third compliance period are affecting companies now; the loss of twenty-five percent of industrial assistance is happening now; the uncertainty that exists now continues to plague companies with compliance obligations from any reasonable future fiscal planning.

Overall, CLFP continues to advocate its previous position that the focus should be on program stability and addressing impacts on obligated entities in determining the post-2020 price ceiling and speed bump placement. CLFP believes 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. CLFP shares CARB's confidence that the built-in monitoring of the allowance markets and annual reporting requirements should the price ceiling be breached is sufficient to provide market participants and the state early warning as to any market dysfunctions. CARB staff has already acknowledged that a ceiling price set too high will undermine the directives of AB 398 cost containment requirements

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)

CLFP continues to urge CARB to ensure that flexibility is a prominent part in the application of the cap adjustment factor analysis. 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. Many food processors will see their actual allowance allocations drop below 50% by 2030 despite an assistance factor of 100%. The loss of allowances to this degree will likely increase the risk of leakage, the very harm that the cap-and-trade is designed to mitigate.

Coupled with increasing compliance and operational costs attributable to other market and supply factors, the CAF will nullify the effectiveness of cost containment goals and continue to threaten California's food processing industry well into the next decade.

In the proposed amendments CARB has provided some covered facilities the opportunity to address their current CAF. However, CARB continues to limit the CAF adjustment consideration to only process emissions. While that may have been acceptable under the current cap-and-trade regulation, the doubling of the cap decline factor after 2020 demands a reassessment of the impact of SB 32 on existing industries, possibly on a subsector basis, in order to get a better understanding of the impact on industries such as food processors.

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 one-half of one percent of the total state-wide greenhouse gas emissions. Left as is, the imposition of the current CAF will impose an unnecessary economic burden on the food processing sector and, through them, the communities in which they operate. Communities, that for the most part, have been identified as disadvantaged under the CalEnviro Screen.

Clearly, legitimate cost containment efforts will require some form of detailed economic assessment of the impact of the CAF on the food processing sector that will occur as the result of the loss of allowances engendered through the application of the CAF. This impact needs to be determined in order to inform the development of the evaluation criteria that will determine eligibility for an alternate CAF. CLFP continues to support the development of a CAF 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.

CONCLUSION

CLFP urges CARB to move the regulatory package as proposed as expeditiously as possible. The amendments contained in the proposed regulatory package are needed in order to provide the certainty that obligated entities require in order to plan for operations. CLFP members have invested substantial amounts of capital in compliance costs and new technologies in an effort to comply with the state's ambitious environmental goals. This regulatory package will provide the necessary certainty and balance going forward.

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