Agricultural Council of California

Agricultural Energy Consumers Association

September 19, 2016

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

Submitted Electronically:
https://www.arb.ca.gov/lispub/comm/bccommlog.php?listname=ghg2016

RE: Proposed Amendments to the Regulation for the Mandatory Reporting of Greenhouse Gas Emissions

Dear Chairwoman Nichols and Members of the Board:

Agricultural Council of California (Ag Council) and Agricultural Energy Consumers Association (AECA) appreciate the opportunity to submit comments based on the August 2, 2016, Proposed Amendments to the Regulation for the Mandatory Reporting of Greenhouse Gas Emissions (Regulation).

Ag Council is a member-supported organization advocating for more than 15,000 farmers across California, ranging from small, farmer-owned businesses to the 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. A number of our member companies participate in the cap-and-trade program, and as a result, we appreciate the opportunity to comment on the Regulation.

AECA is a nonprofit organization representing the energy interests of California agriculture. AECA was founded in 1991 by growers and other members of the agricultural community concerned primarily about electricity costs, but also about gas costs. AECA represents the collective interests of the state's leading agricultural associations, including California Citrus Mutual, Western Growers Association, California Fresh Fruit Association, Milk Producers Council, California Dairies, Inc., California Poultry Federation, Almond Alliance, California Grain and Feed Association, Western Agricultural Processors Association, and California Cotton Ginners and Growers Association. AECA also works on behalf of the combined interests of several county farm bureaus and more than two dozen agricultural water districts. AECA's membership is broad based, reflecting family farmers from Redding in the north to San Diego in the south, who grow crops ranging from alfalfa to walnuts. Through its members and membership associations, AECA represents in excess of 40,000 California agricultural producers. Many of our members are vertically integrated and, as a result, AECA also represents the interests of numerous food and fiber processing operations located throughout California.

Food producers, including cooperatives and farmer-owned businesses, can easily exceed the 25,000 metric tons on CO2 emissions threshold when cooking, cleaning or processing food. Our intention in these comments is to help inform the Air Resources Board (ARB) policy regarding the future of the cap-and-trade program, minimize the potential harm to the agricultural sector and avoid simply shifting emission to other locations outside of California.

Agricultural Economy

California's agricultural industry produces more than 400 commodities. In 2015, California's farms and ranches received approximately $47 billion for their output. This represents a decrease of nearly 17 percent compared to 2014.[1] Dairy production value fell by more than $3 billion in 2015 and the value for nut production declined considerably across the board. Early 2016 numbers for tomato processing show the current forecasted production is 11 percent below the 2015 crop.[2]

These numbers certainly demonstrate the impacts of the recent drought, but the data also reflect changes in international markets. Farmers and food processors are subject to global commodity markets and cannot simply raise prices to cover costs. Many buyers of our products – big box, traditional grocery chains and restaurant chains – set the price they will pay our farmers. If California farmers cannot meet the price, the buyers can and do purchase agricultural products from other states and countries. These facts, along with increasing regulatory costs, are driving family farmers out of business or out of the state and fueling a trend toward consolidation.

Furthermore, agricultural counties in California have been hit hard by unemployment. The largest agricultural producing counties in the United States (U.S.) are Tulare and Fresno. In July 2016, the unemployment rate in the Tulare County was 11.3 percent and the unemployment rate in Fresno County was 9.4 percent. This compares with an unadjusted unemployment rate of 5.9 percent for California and 5.1 percent for the nation during the same period.[3]

<u>Concerns with the Proposed Regulation</u>

Emissions leakage for food and agriculture is Ag Council and AECA's central concern in this Regulation. Many food products do not go to market without further processing. Producing and processing food is mostly a seasonal activity, with operations lasting less than four months out of the year, with the exception of the dairy industry, where products are produced and processed throughout the year. Our industry is sensitive to import pressures from domestic competitors in other states as well as foreign competitors from countries such as China, Greece, Italy, South America and Mexico.

---

[1] https://www.cdfa.ca.gov/statistics/PDFs/2015Report.pdf

[2] https://www.nass.usda.gov/Statistics_by_State/California/Publications/Vegetables/2016/201608ptom.pdf

[3] http://www.labormarketinfo.edd.ca.gov/data/unemployment-and-labor-force.html

Many agricultural products are subject to trade exposure from low-cost competitors. Some of these markets can flood segments of our industry, such as the current situation in the canned peach industry. For example, the July 21, 2016 edition of "Peach Fuzz," a newsletter by the CA Canning Peach Association, demonstrates the problems associated with low-cost competitors.

> *California's canned peach imports for the 2015/16 marketing year reached a third consecutive all-time record high with 5,683,772 cases, up 9 percent from the previous record of 5,229,457 cases imported. China continues to be the leading importer with 3,046,046 cases shipped (54 percent of total volume). Unfortunately, the impact of this increased import volume is being felt in both the foodservice and retail market channels as this volume displaces domestic canned fruit sales. As an indication of the magnitude of canned peach imports in relation to domestic production, the 2015/16 canned peach imports amount to the equivalent of nearly 114,000 tons, which is 35 percent of California's peach crop this year.*

This is just one example of a California food product being displaced by out-of-state suppliers. Another example of domestic pressure and competition is found in the dairy industry. California has experienced 20 consecutive months of milk production declines due in large part to higher production costs. Meanwhile, Wisconsin broke state milk production records in 2015 and has experienced 27 consecutive months of milk production increases. With this, it is becoming increasingly evident that the ongoing cost structure in California will adversely impact milk production. Processors could ultimately be unable to meet contractual commitments for both domestic and export opportunities and this has us very concerned.

The dairy sector has also been experiencing a decline in the number of dairy farms for several years. According to the California Department of Food and Agriculture (CDFA), 290 dairies have closed or left California since 2011, and 53 dairies have gone out of business in the first five months of 2016 alone.[4]

Medium Leakage Risk Designation

Section 95870 – Disposition of Vintage 2013-2020 Allowances

- *Table 8-1: Assistance Factors by Industrial Activity for 2013-2020* (Page 153)
  This table shows that ARB staff is proposing NO CHANGES in industry assistance for food processing industry (NAICS code 311). Food Processing will remain a medium leakage risk for the third compliance period.

Under the existing allowance allocation methodology for the cap-and-trade program, ARB devised an emission intensity and trade exposure metric that resulted in the sector producing food being designated as "medium" leakage risk. For the first two compliance periods, companies producing food were granted a 100 percent Industry Assistance Factor. However, in the third compliance period (2018-2020) the allocated assistance will drop to 75 percent. To cover their compliance obligations, our member companies will have to purchase additional allowances. With low-cost competitors throughout the world, even a minimal increase in cost could displace certain market segments.

---

[4] https://www.cdfa.ca.gov/dairy/pdf/Annual/2011/2012_Annual_2011_Data.pdf (page 7) & https://www.cdfa.ca.gov/dairy/pdf/Annual/2016/MidYear2016.pdf (page 2)

This classification was based on a 2016 leakage analysis[5] of the food industry that was outdated, incomplete and incorrect on a number of issues. The leakage analysis only looked at four commodities produced in California, which is a fraction of the 400 commodities that are produced in the state. Additionally, the cheese portion of the analysis assumes federal programs are in place to support the industry.[6] These programs no longer exist. The Dairy Product Prices Support Program (DPPSP) ended on December 31, 2013. The Dairy Export Incentive Program ended on September 30, 2013 and was not used for approximately ten years prior.

The author also cites milk utilization data from 2001[7], when there is more recent data available from CDFA. Furthermore, the author states that imports are limited to 2-3 percent,[8] when in fact in times where there are disparities in international and U.S. prices, imports actually increase. The author also states that U.S. dairy is insulated from world market prices and foreign import trade,[9] however 15 percent of milk produced in the U.S. goes to export markets.

CDFA could provide additional information clarifying pressures from international markets. The study suggests that environmental costs could be mitigated through California's pricing system or "independent marketing system,"[10] but the program is not that simplified to easily offset all immediate costs bourn by the industry. The study also states, "The total cost to firms producing cheese ranges from $50 - $70 million a year, or 10-13 cents per pound of production."[11] These numbers are inaccurate. CDFA publishes actual cheese manufacturing costs every year that would be helpful in this piece of the study. Due to the major flaws in this report, it would be beneficial to have the author work more closely with CDFA to build a more accurate study of California dairy.

ARB has the authority to provide relief for industries like ours that are sensitive to trade exposure. However, we have not been granted 100 percent free allowances at this time. We hope that ARB will reevaluate its study on the industry and implement the Regulation in a way that more accurately portrays the international and domestic pressures on the California agricultural sector.

Recommendation: The food product sector should be moved to the top Industry Assistance Factor tier of "high" and receive 100 percent free allowances due to price pressures from domestic and international markets. Given the previous examples of the peach industry import pressures, coupled with the already existing problems of California dairies leaving the state, leakage has already been demonstrated within California agriculture due to the competitive disadvantages we are experiencing in our current regulatory environment. This

---

[5] 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.
[6] Hamilton et. al. (2016). Leakage, Page 13.
[7] Hamilton et. al. (2016). Leakage, Page 12.
[8] Hamilton et. al. (2016). Leakage, Page 13.
[9] Hamilton et. al. (2016). Leakage, Page 13.
[10] Hamilton et. al. (2016). Leakage, Page 13.
[11] Hamilton et. al. (2016). Leakage, Page 13.

impending Regulation is bound to exacerbate this issue, as we are the only state in the nation with this law.

"Expanded" Definition of Leakage
According to the Initial Statement of Reason (ISOR), emissions leakage occurs when a program-caused decrease in emissions in California results in a corresponding program-caused increase in out-of-state emissions. The program-caused increase in out-of-state emissions is a necessary condition for emissions leakage. A drop in California emissions and/or economic activity alone is not a sufficient condition for, nor sufficient evidence of, emission leakage.

California agriculture is already experiencing leakage in many of its commodities. We agree with ARB when it admits that the climate change regulation is likely to cause additional leakage and are pleased that it is attempting to mitigate the issue. We wish other state agencies would employ the same practice. However, it is admittedly difficult to determine exactly which regulation is causing leakage and it is likely that the entire complex regulatory environment in California is causing leakage. However, ARB needs to continue to recognize its role in leakage. This is underscored by the fact that ARB has invested so much in various leakage analyses.

Recommendation: One size does not fit all. We urge ARB to create a flexible enough definition (or understanding) of leakage so that it can be responsive to the various types of pressures that industries can experience as being the only state in the nation to embark upon an economy-wide cap-and-trade program.

Transition Assistance and APCR
Staff proposes to eliminate transition assistance and allowances allotted for the Allowance Price Containment Reserve (APCR) beginning in 2021 and proposes complete elimination by 2030. ARB will freely allocate allowances to industrial sectors based on leakage risk.

Recommendation: Transition assistance and APCR should continue to be provided beyond 2021 and 2030. This would provide staff flexibility that would allow the cap-and-trade program to respond to market issues. As the cap declines, the cost of allowances will increase. While the APCR has not been utilized at this time, it is highly likely the price will escalate as the overall cap declines. By keeping APCR, ARB would have the option to provide relief in tighter markets. ARB could exercise this option as it sees fit and it would not be a mandatory program.

The state's policy focus should be to reduce emissions while keeping businesses competitive in a global market. Currently, less than one percent of global emissions come from California. California should remember its goal is not ultimately just to reduce emissions but also to create a model for others, and these changes could assist in this effort by minimizing the cost of the program.

- *Table 8-2: Number of California GHG Allowances Allocated to the APCR for Budget Years 2021-2031* (page 162)

In this table the annual number of allowances allocated to the APCR are shown to decrease each year from 2021 to 2030, with no allowances allocated to the APCR from the 2031 budget year and beyond. We disagree with the proposal to discontinue the price containment allowances post-2030 because that is when we anticipate the cost of allowances will likely skyrocket and covered facilities will need the additional protection.

Recommendation: ARB should propose additional mechanisms, including a hard-price cap, to minimize costs in the event that the prices of allowances drastically increase. This is prudent in case ARB has incorrectly assumed that the allowances in the APCR are sufficient to meet the cost containment needs of the program through 2031 and beyond.

Section 95973 Requirements for Offset Projects Using ARB Compliance Offset Protocols (Starts Page 271 & Page 56 of ISOR)

- The Regulation requires that offset projects may not receive ARB offset credits for the entire Reporting Period when they are out of regulatory compliance with any local, regional, and national laws. For agricultural projects such as digesters, that potentially could mean a minor notice of violation could cause the entire offset project to be disqualified.

  Recommendation:
  - ARB should create a right-to-cure provision allowing for the operator of an offset project to fix minor violations prior to disqualifying the project. It is important that offset projects are not eliminated due to a minor violation and that the violations only impact credits until the situation is corrected.
  - Separating the digester project, from the dairy it is located at, will be key so that violations confined to the dairy do not have an effect on the digester project.

- The amendments would also limit the period of time methane capture offset projects are ineligible to receive ARB offsets for not being in regulatory compliance. This is an interesting concept. Limiting ineligibility would be helpful, but we are unsure at this time how it would work and would like the opportunity to discuss this further.

- The purchase of existing offset projects has not taken-off as originally anticipated by ARB or the offset community. There are a number of issues discouraging the purchase of offsets. Among them are concerns about buyers' liability over the life of an offset project. Liability of the quality and duration of an offset project is left with the buyer unless the risk is addressed contractually. Only a small number of sellers provide assurances and contractual contingencies. The majority of offset projects require the buyer to take on the liability indefinitely.

  Recommendation: Staff should delete the terms related to buyer liability and let the market dictate those terms. As ARB moves toward attempting to approve new protocols on offset projects, this issue will continue to stymie the offset market. This must be addressed going forward.

Section 95802 – Definitions
We appreciate staff working with covered entities in the Fruit and Vegetable Canning benchmark to amend definitions relating to tomato processing. These amendments help clarify covered activities that are performed under food manufacturing NAICS code 311421.

Staff has also proposed several changes to definitions for Dairy Product Manufacturing activities. Staff states there were issues with the original benchmark but no explanation regarding the problem is provided. Staff should provide an understanding on their thinking for NAICS code 31151, to help inform the dairy industry and this regulatory process.

We oppose the deletion of the definition for "dairy product solids for animal feed processing." Staff states that they are eliminating this definition, as well as the benchmark, because the level of allowance allocation under the benchmark is negligible. Dairy product solids for animal feed processing are a byproduct from normal manufacturing. Because it is a byproduct it is difficult to predict when the benchmark may be utilized, but it is needed. We urge ARB to keep this benchmark.

Section 95852.2 – Emissions without a Compliance Obligation
Ag Council and AECA support the addition of #13, "Carbon dioxide from fermentation that occurs during the production of food and beverages." This language reflects the variable nature of the fermenting process, and we support providing this flexibility.

Section 95891 – Allocation for Industry Assistance
Table 9-1: Product-Based Emissions Efficiency Benchmarks (page 174)
This table proposes changes to benchmarks for covered facilities.

- Staff is proposing to eliminate the benchmark for tree nut manufacturing because emissions per unit of product are highly variable. In absence of a benchmark, staff is proposing that covered entities conducting this activity will receive allowance allocations under the energy-based methodology.

  We oppose the deletion of this benchmark. All agricultural production is subject to weather changes, which will alter the emissions of processing plants. Additionally, many crops have alternating crop years, which means some harvest years are lighter than others. This will also impact the amount of processing and emissions that occur during the processing cycle. These events do not mean that the product-based benchmark is not needed. In fact, the benchmark is needed even more so that the potential variability in crop years is reflected in the regulation. Otherwise, it will further disadvantage the processor by moving it into a generic energy-based system. This change creates additional issues for covered entities performing this activity, as noted in our comments below under (c)(3) Energy-Based Allocation Calculation Methodology.

  <u>Recommendation:</u> Reinstate the benchmark for tree nut manufacturing and refine the product-based benchmark to reflect updated data and efficiency trends.

- Staff proposes to delete the "dairy product solids for animal feed processing" benchmark. We oppose the deletion of this benchmark. As stated before, dairy product solids for animal feed processing are a byproduct from normal manufacturing. Therefore, this benchmark needs to remain in the Regulation.

  Recommendation: We urge ARB staff to work with the dairy industry to find a solution to maintain this benchmark. Simply deleting the benchmark is not the proper course of action.

- There are a number of food processing industries that staff has yet to propose a new benchmark for, such as dairy manufacturing.

  Recommendation: If ARB is going to change the dairy benchmarks, the industry needs advanced, and deeply involved, stakeholder input. In the ISOR, staff asserts that they have worked with the industry on changes that may be made to the dairy product manufacturing benchmark. We hope this is the case and would like to be informed of the entities staff is working with on a go-forward basis.

(c)(3) Energy-Based Allocation Calculation Methodology (page 195)
Staff proposes to modify provisions related to when an entity receiving energy-based allocation does not perform a covered activity for part of a year because it has shut down or exited the program. When this occurs, the covered entity must return freely allocated allowances for that year to ARB in proportion to the fraction of time during the year that it was shut down.

Ag Council and AECA are concerned for any of our member companies that may receive an allowance allocation under the energy-based methodology in the future. In our analysis, our members could be subject to this "return of allowances" provision. Some of our members only operate part of the year or could easily drop below the program threshold in the off-season (and periodically for an entire year due to small crop size, or other issues), causing them to return a proportion of the allocations they receive. The process for returning allocations is unclear and increases uncertainty in this program.

Recommendation: ARB needs to make some accommodation for the seasonal nature of agriculture and the volatility our sector experiences from extreme weather and changes in water availability. These influences are out of our control and affect the volume of processed food in California.

If ARB is concerned with businesses that are no longer in the program selling free allowances, it could prohibit those types of sales without the requirement of the "return back" provision it currently proposes.

Miscellaneous
Allowance Allocation for Purchased Electricity
On page 42 of the ISOR, staff discusses allocations for industrial covered entities that purchase electricity. Starting with vintage 2021 allowance allocation, staff proposes to modify the product and energy-based emissions efficiency benchmarks to include emissions associated

with purchased electricity. This means that industrial covered entities will receive allowance allocation directly from ARB to help offset increased electricity costs from the Program.

Recommendation: In our analysis, this is a helpful proposal. ARB says this will have an effect on benchmarks, but there is a lack of specificity on how the impacts will play-out. We look forward to working with staff on this provision.

Reducing Emissions Throughout California's State Agencies
California's other regulations and purchasing programs should reflect the state's priority in reducing emissions. This commitment to addressing climate change is not occurring across all state agencies and local public entities as it should.

For example, just last year, a local school district chose to buy tens of thousands of dollars of cheaper food imports sourced from over 6,000 miles away. Meanwhile, several food processing facilities within a two-hour drive of the school district process the very same product. While the financial cost of the product may have been slightly less expensive, the environmental cost was not.

California farmers and the food processing industry are subject to numerous directives to purchase lower-emission tractors, forklifts and more fuel-efficient trucks, all of which come at a financial cost. All of these environmental benefits – as a result of investments by farmers and food producers – are more than negated when public agencies import products with a large GHG footprint. The state must not undermine its significant efforts to reduce GHGs by spending taxpayer dollars to import products from nations not complying with equivalent emissions standards, not to mention food safety and other environmental standards. We urge ARB to engage with other state agencies to ensure that their practices are also reducing emissions, similar to private industry.

Ag Council and AECA appreciate the opportunity to work with ARB on this regulation. We look forward to continuing our working relationship regarding climate change and are hopeful for a workable outcome for our industry.

Thank you for your time and consideration of our concerns. Should you have any questions or concerns, please do not hesitate to contact Rachael O'Brien with Ag Council at (916) 443-4887 or Michael Boccadoro with AECA at (916) 441-4383.

Sincerely,

Emily Rooney

Emily Rooney
President
Agricultural Council of California

Michael Boccadoro

Michael Boccadoro
Executive Director
Agricultural Energy Consumers Association