California League of Food Processors

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Subject: California League of Food Processors Comments on June 22, 2010 workshop
Submitted Electronically

Date: July 13, 2010

The California League of Food Processors (CLFP) recognizes the significant amount of effort that Air Resources Board (ARB) staff has devoted to developing the proposed cap-and-trade regulation and appreciates the opportunity to comment on the proposals for cost containment and offset policy laid out during the June 22 workshop. Most CLFP members will be impacted by costs passed along by upstream fuel and energy providers. Food processors are already experiencing the effects of high energy costs therefore; we support policies that will minimize cost increases in the process of achieving AB 32 reduction goals.

Cost Containment

The ability of the market mechanisms to contain costs will be vital to ensuring that the cap and trade market functions properly with the least amount of damage to an already reeling state economy. This means that the industrial sector participants must have certainty that allowance prices will remain within reasonable bounds. GHG targets are important, and a transition to a low carbon energy base is desirable, however, reduction targets cannot ignore the economic health of the state nor the viable industries that support the economy, and produce food and goods for California's citizens

Additionally, CLFP assumes that the ARB will fully address the economic and emissions leakage risks that are manifest in the various strategies on allowance allocation. Cost containment will be a key factor in preventing many food processors from becoming leakage prone. Food processors are price-takers, it will be difficult for most firms to absorb these costs or pass them on to buyers in the highly competitive food processing industry. As such, increased operating costs will affect the ability of California food processors to compete with rivals in other states or nations. Food processing is a highly competitive business that tends to be characterized by relatively low financial margins.

Market Design: Avoiding high prices through a well-designed market is the best cost-containment approach. However, in determining the various aspects of the market such as caps, banking and borrowing rules, use of offsets, approval of offsets and other "structural" decisions

ARB should embrace solutions suggested by both cost and reasonable and achievable technology designs. Market intervention via cost containment mechanisms, such as presented in the workshop, should be a last resort or rarely used safety mechanisms to correct minor discrepancies in the functioning of the market.

Cost Containment Mechanisms: From the workshop it seems that ARB understands the need for market mechanisms that will operate when necessary in order to assure that a supply of affordable allowances will be always be available. An ample supply likely tends to support market participants' current operations and encourages business expansions in California. Such mechanisms will work to provide assurances for participants as well as encourage investors in making long term commitments to the state. However, CLFP believes that the addition of a "hard cap" (in order to set an acceptable price) should be seriously considered. Unless the underlying market structure is workable, CLFP is not sure that a soft cap will provide the necessary assurance to the market.

In addition, CLFP believes the addition of a reserve function will also add to participants' confidence that prices will remain both reasonable and stable. It is our understanding that a reserve function could attempt to keep prices under a soft price cap, while a higher hard price cap would come into play if prices are not successfully mitigated by the reserve operation.

Offsets

Offsets: It is undeniable that offsets will be a crucial factor to the success of the Cap and Trade Market and represent an important cost containment tool for many food processors. CLFP believes that more, rather than fewer, offsets will greatly enhance the chances for market participants to meet their compliance goals without suffering devastating economic hardship and increase the potential for a cost effective California-***only*** program. CLFP urges the ARB to take to heart Governor Schwarzenegger's admonition in his March 24 letter to ensure an "ample supply of high quality offsets" should be available in the program. By this, we believe the Governor was directing ARB to forego the unnecessarily restrictive 4% quantitative limit on the use of offsets.

The EU ETS recognizes the importance of the food processing industry having identified food processors as one of the businesses exposed to "significant risk of carbon leakage" by the cost of compliance with the EU ETS. The same issues exist here.

That said, along with free allocation of credits, CLFP supports the unlimited use of offsets for meeting emission reduction requirements under the cap. This offset availability is necessary as most food processing facilities, even with substantial investment, would be unable to further reduce onsite GHG emissions. Emissions generated at food processing plants are due to the large boilers necessary to cook products and sterilize equipment. In order to further reduce emissions most food processors would have to curtail processing and reduce product output. Food processors are unable to reduce energy consumption in the processing cycle without compromising food safety and quality.

Additionally, it is important to note that most food processors have purchased, or will soon be purchasing equipment to comply with ongoing amendments to air quality regulations. The cumulative costs of environmental regulation is high for most California food processors because profits are low and capital is scarce due to the ongoing credit crisis and will likely remain so for the foreseeable future.

Therefore, food processors should either be exempted from the GHG targets altogether or be given wide latitude in utilizing free allocations and offsets in whatever percentage and combination necessary to meet compliance goals.

Geographic Limitations: ARB states that there will be no geographic limits on offsets, but elsewhere in the presentation states that "offset projects must be located in the United States, Canada or Mexico in order for ARB to issue credits". ARB's insistence on approving all offset credits results in a very restrictive, de-facto geographic limit on offsets. ARB should abandon any requirement to approve any and all offset credits and instead agree to accept credits (that can be periodically audited) from existing programs that are widely accepted elsewhere in the world. ARB's approval of offset projects should be limited to projects in California and elsewhere in North America where these projects have not been developed under any other accepted protocol.

Linkage: Given that climate change is a global challenge requiring a global solution, it is critical that a global, fungible market for high-quality offsets emerges. ARB should avoid setting up a bifurcated system wherein California has its own overly restrictive requirements for offsets. During the 6/22 workshop, staff discussed a number of requirements for offset project approval. These include requiring "regulatory additionality" and "substantial co-benefits" in order for certain offset credits to be accepted. Not only would these requirement result in fewer offsets available for use in California, but they would make it even less likely that California to be able to link with other programs who would be unlikely to accept these restrictive offset requirements.

Buyer Liability: The concept of buyer liability is also troubling, especially since it is likely that the ARB will be providing some type of approval or qualification methodology for offsets beforehand. Of course, the environmentalists are all for buyer liability despite having not an ounce of skin in the game given that they produce nothing, manufacture nothing, or risk anything if the market design proves unworkable. If the ARB is seriously considering buyer liability under these circumstances that the CLFP recommends there should be no limits on offsets in meeting reduction goals.

Permanence: The ARB position thinking on what constitutes “permanent” for purposes of carbon reductions from qualified offsets must be reasonable and based on sound and proven business practices. The idea that a business would be responsible for carrying on its books liability costs for a carbon reduction or removal for 100 years or more is absurd. Such costs will make businesses, especially food processors more susceptible to leakage. Additionally, these costs add nothing to the business’ bottom line, production, or plans for expansion. An analogous situation might be wherein someone was to build a home and live in that home for ten years. Then, upon selling the home, was required to obtain and maintain insurance to cover the house against damage or loss indefinitely despite no longer owning or living in the house.

Rather CLFP suggests that the ARB explore a protocol for the gradual reduction of risk exposure; something akin to “risk amortization” wherein a business will have the ability to reasonably identify both time and cost factors associated with the offset and is able to identify the end to liability exposure for unforeseen carbon releases.

Finally, any definition of permanence must be subject to the concept of force majeure or "Acts of God" otherwise the costs of ensuring against such catastrophic losses associated with accidental or unforeseen carbon releases will be immense.

Thank you for the opportunity to comment. Please call if you have any questions.

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