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SUPERIOR COURT OF THE STATE OF CALIFORNIA

COUNTY OF SACRAMENTO

CALIFORNIA CHAMBER OF COMMERCE, a nonprofit business association, and LARRY DICKE, a State of California Taxpayer,

Petitioners/Plaintiffs,

vs.

CALIFORNIA AIR RESOURCES BOARD, MARCY NICHOLS, in her official capacity as Chair of the Air Resources Board, JOHN BALMES, M.D., SANDRA BERG, DORENE D'ADAMO, HECTOR DE LA TORRE, RONALD O. LOVERIDGE, BARBARA RIORDAN, RON ROBERTS, ALEXANDER SHERIFFS, M.D., DANIEL SPERLING, AND KEN YEAGER, members of the Air Resources Board, and DOES 1 THROUGH 10, inclusive

Respondents/Defendants.

Case No.: 34-2012-80001313

MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF VERIFIED COMPLAINT IN INTERVENTION OF THE NATIONAL ASSOCIATION OF MANUFACTURERS

Department: 29
Judge: Hon. Timothy M. Frawley
Hearing Date: May 31, 2013
Date Action Filed: Nov. 13, 2012

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INTRODUCTION

The National Association of Manufacturers ("the NAM") submits this memorandum of points and authorities in support of its Verified Complaint in Intervention to enjoin, and declare invalid, regulations adopted by the California Air Resources Board ("ARB" or "Board"), pursuant to Assembly Bill 32, Statutes 2006, chapter 488 ("AB 32"), that permit the Board to conduct auctions and reserve sales for greenhouse gas ("GHG") emission allowances under California's Cap-and-Trade Regulation, 17 CCR § 95801 *et seq*. The sale of allowances at auctions and reserve sales by ARB is unlawful because (1) it is unauthorized by AB 32, and, in the alternative, (2) it violates the California Constitution because the sale of allowances to generate revenue constitutes an impermissible tax adopted pursuant to a statute that did not garner the necessary two-thirds majority in the California Legislature.

First, the allowance auction and reserve sale provisions of the Cap-and-Trade Regulation are unlawful because the Legislature did not authorize the Board to sell allowances to regulated parties to generate billions of dollars under AB 32. The language, structure, purpose, and legislative history of AB 32 all confirm that ARB is not authorized to generate such extraordinary revenues—perhaps the largest of any purported environmental regulation in the United States—through the auction or sale of emission allowances. AB 32 was designed to reduce GHG emissions, not to generate revenues for a wide variety of State programs. The allowance auction and reserve sale provisions adopted by the Board impose unnecessary costs on the NAM's members and are not required to serve the goal of reducing the level of GHG emissions from the industries subject to the Cap-and-Trade Regulation. The Legislature did not grant, *sub silentio*, ARB authority to transform a program designed to reduce the aggregate level of GHG emissions for specified industries into a revenue-generating program that would impose unprecedented financial burdens on numerous sectors of California industry. As the Supreme Court has explained, "'the drafters of legislation do not ... hide elephants in mouseholes.'" *Cal. Redevelopment Ass'n v. Matosantos*, 53 Cal. 4th 231, 260–61 (2011). Indeed, ARB's position is unsupported by the language of AB 32, subverts AB 32's fundamental structure, and would call into doubt the constitutionality of AB 32.

Second, in the alternative, if AB 32 were construed to allow allowance auction and reserve sales, then the Cap-and-Trade Program is unlawful because AB 32 would constitute a revenue-generating tax that was not adopted by a two-thirds majority of the members of the Legislature as required by the California Constitution. AB 32 does not require that the massive revenues generated from the Cap-and-Trade auctions and reserve sales be used for purposes related to the Cap-and-Trade Program. And the revenues far dwarf the cost of carrying out that program or programs implemented by ARB and other agencies under AB 32.

For these reasons, the NAM seeks (1) a writ of mandate to prevent the Board from conducting unauthorized and illegal auctions and reserve sales; (2) a declaration that the auction and reserve sale provisions of the Cap-and-Trade Regulation are invalid and unenforceable and violate the California Constitution; and (3) an injunction preventing the implementation of the allowance auction and reserve sale provisions of the Cap-and-Trade Regulation.

BACKGROUND

A. The California Constitution

In 1978, California voters adopted Proposition 13, which added Article XIIIA to the California Constitution. At the time of its adoption, Proposition 13 provided that "any changes in state taxes enacted for the purpose of increasing revenues collected pursuant thereto ... must be imposed by an Act passed by not less than two-thirds of all members elected to each of the two houses of the Legislature." Proposition 13 was designed, among other things, to make it more difficult for State and local governments to impose new State and local taxes. Thus, the California Constitution requires a supermajority vote of each house of the Legislature before a new tax can take effect. This provision of the California Constitution was in effect at the time the California Legislature adopted AB 32.[1]

[1] In 2010, California voters amended Article XIIIA of the California Constitution by approving Proposition 26. Proposition 26 provided that, after January 1, 2010, subject to certain exceptions, "[a]ny change in state statute which results in any taxpayer paying a higher tax must be imposed by an act passed by not less than two-thirds of all members elected to each of the two houses of the Legislature," and expanded the definition of "tax" to include "any levy, charge, or exaction of any kind imposed by the State," with specified exceptions. Cal. Const., art. XIIIA, § 3(a)–(b).

B. The Global Warming Solutions Act of 2006 ("AB 32")

In 2006, the Legislature enacted Assembly Bill 32, Stats. 2006, ch. 488, which added Division 25.5 to the Health and Safety Code, §§ 38500 *et seq.* AB 32 was passed by 59% of the Assembly and 58% of the Senate. AB 32 was not adopted by two-thirds of all the members of each house of the Legislature.

The stated purpose of AB 32 is to reduce GHG emissions in California. Health & Safety Code § 38501. To this end, AB 32 delegates to ARB the authority to adopt regulations applicable to GHG emission sources limiting the amount of GHG emissions by certain entities so that, by 2020, statewide GHG emissions will be reduced to 1990 levels. *Id.* § 38550.

AB 32 is divided into 7 parts. Part 1 designates ARB as the "state agency charged with monitoring and regulating sources of emissions of greenhouse gases that cause global warming in order to reduce emissions of greenhouse gases." *Id.* § 38510. Part 2 directs ARB to "adopt regulations to require the reporting and verification of statewide greenhouse gas emissions and to monitor and enforce compliance with this program." *Id.* § 38530(a). Part 3 requires ARB to "determine what the statewide greenhouse gas emissions level was in 1990, and approve ... a statewide greenhouse gas emissions limit that is equivalent to that level, to be achieved by 2020." *Id.* § 38550.

Part 4 provides for ARB to "adopt rules and regulations ... to achieve the maximum technologically feasible and cost-effective greenhouse gas emission reductions from sources or categories of sources, subject to the criteria and schedules set forth in this part." *Id.* § 38560. ARB must "[d]esign the regulations, including distribution of emissions allowances where appropriate, in a manner that is equitable, seeks to minimize costs and maximize the total benefits to California, and encourages early action to reduce greenhouse gas emissions." *Id.* § 38562(b)(1). Part 5 authorizes ARB to include "market-based compliance mechanisms to comply with the regulations." *Id.* § 38570. Part 6 governs enforcement of AB 32 and authorizes ARB to monitor compliance and enforce any rule or regulation under AB 32. *Id.* § 38580(a).

Finally, Part 7, entitled "Miscellaneous Provisions," authorizes ARB to "adopt by regulation, after a public workshop, a schedule of fees to be paid by the sources of greenhouse gas emissions

regulated pursuant to [AB 32], consistent with Section 57001." *Id.* § 38597. The "revenues collected pursuant to this section" must be "deposited into the Air Pollution Control Fund and are available upon appropriation, by the Legislature, for purposes of carrying out [AB 32]." *Id.* Section 57001, in turn, is designed "to encourage more efficient and cost-effective operation of the programs for which the fees are assessed, and ... to ensure that the amount of each fee is not more than is reasonably necessary to fund the efficient operation of the activities or programs for which the fee is assessed." *Id.* § 57001(a).

C. ARB's Cap-and-Trade Regulation Proposal

Pursuant to Part 5 of AB 32, on October 28, 2010, ARB issued a proposed regulation to establish a market-based Cap-and-Trade Program. The proposed Cap-and-Trade Program would require certain industrial and utility sources of GHGs to acquire, and later surrender to ARB, an "allowance" for every metric ton of CO_2e they emitted during multi-year compliance periods. *See* ARB, Staff Report: Initial Statement of Reasons, Proposed Regulation to Implement the California Cap-and-Trade Program ("ISOR") at ES-2 (Request for Judicial Notice ("RJN") Ex. 3). These allowances would be tradable in the marketplace among private parties. *Id.* ARB proposed to reduce, over time, the total number of allowances available for each compliance period, thereby reducing the total level of GHGs that could be lawfully emitted in California by these regulated industries. *Id.* at ES-3.

Under its proposal, ARB would, in part, freely grant allowances to entities regulated by Cap-and-Trade, and, in part, sell allowances at public auctions and set-price reserve sales payable to the State of California. *Id.* ARB proposed that, over time, it would shift to greater and greater reliance on auctions and reserve sales. *Id.* at ES-4. ARB further proposed that auction revenues be appropriated by the Legislature to "use the revenue for public benefit," for example, (1) by redistributing allowance proceeds from fuel suppliers directly to consumers to help offset the higher fuel costs that would be passed along to consumers, (2) by funding a "Community Benefit Fund," and (3) by establishing a competitive grant program to invest in projects like research into low-GHG technologies or workforce training. *Id.* at II-29–II-30.

ARB included similar recommendations in Board Resolution 10-42, adopted on December 16, 2010. RJN Ex. 4. It embraced the use of "allowance value," *i.e.*, revenue generated from the sale of allowances, to finance public and private investments oriented toward (1) "green job training," (2) "economic opportunities and environmental improvements in disadvantaged communities," (3) "adaptation to climate change," and (4) "low-cost GHG emissions reductions, including investments in energy efficiency, public transit, transportation and land-use planning, and research, development, and deployment." *Id.* at 11–12. In addition, ARB recommended that allowance revenues be "[r]eturn[ed] ... to households either through lump-sum rebates ... or through cuts or avoided increases in the State's individual income or sales tax rates." *Id.* at 12.

ARB recognized that the method of allocating GHG allowances would not affect the amount of GHG reductions the Cap-and-Trade Program achieved because "[t]he limit on GHG emissions—the program 'cap'—determines the environmental effectiveness of the cap-and-trade program." ISOR at ES-3.[2]

D. Cap-and-Trade Final Statement of Reasons

Following publication of the proposed Cap-and-Trade Regulation, ARB considered and responded to comments outlining objections to Cap-and-Trade. ARB was told that its "proposal to raise funds via an auction for reasons outside of administrative fee purposes is beyond [ARB]'s regulatory authority." ARB, Final Statement of Reasons for Rulemaking, California's Cap-and-Trade Program ("FSOR") at 731 (RJN Ex. 5). Commenters explained that the auction revenue proposals were "contrary to the legislative intent of AB 32," *id.*, and that "an auction and its proceeds are not only unauthorized by AB 32, but equate to a tax that will require 2/3 vote of the legislature," *id.* at 723.

ARB rejected these objections. *See id.* at 732. *First*, with regard to the issue of statutory authority, ARB acknowledged that AB 32 "does not direct ARB to use any particular method to

[2] ARB's analysis was confirmed by the Legislative Analyst's Office ("LAO") in an August 17, 2012 letter to Assembly Member Henry T. Perea. "[A]n allowance auction is not necessary to meet the AB 32 goal of reducing GHG emissions statewide to 1990 levels by 2020," the LAO concluded, "because it is the declining cap on emissions that will reduce the state's overall level of GHGs—not the manner in which allowances are introduced into the market." RJN Ex. 8.

distribute allowances, and does not specify that some methods are allowed and others are not." *Id.* ARB asserted that "in authorizing ARB to distribute allowances, and requiring that market-based compliance mechanisms must meet certain criteria, the Legislature did not intend to forbid ARB from choosing this widely recognized distribution method." *Id.* ARB stated that while "[t]here are a variety of ways to allocate allowances," auctioning of allowances is "the method that has been recommended by the Market Advisory Committee and many other economists." *Id.*

The Market Advisory Committee was created by the Secretary of Environmental Protection to advise ARB "regarding the development of a greenhouse gas-reduction plan for California." ISOR, App. H at H-8. Importantly, the Market Advisory Committee concluded that "the method of initial allowance distribution has no effect on the environmental outcome, that is, the achievement of the emissions cap," *id.* at H-66, and explained that "[t]he method by which emission allowances are distributed under a cap-and-trade program does not affect the total greenhouse gas emissions under the program, but will affect the distribution of economic costs associated with meeting California's greenhouse gas emission targets," *id.* at H-9.

The Committee recommended that revenues from auctions, *i.e.*, "allowance value," be "utilized to provide transition assistance for workers and industries subject to strong market pressures from competitors operating in jurisdictions that lack similar caps on greenhouse gas emissions." *Id.* at H-9–H-10. The Committee further recommended that the "state could also offset the economic impact of the program by using auction revenues to finance reductions in income taxes or other taxes that distort economic decisions." *Id.* at H-68. The Committee elaborated that "[i]f allowances are auctioned, some of the revenue from the auction can be used to finance reductions in State tax rates, or can be returned to taxpayers directly through rebate checks, perhaps on a per-capita basis." *Id.* The Committee acknowledged, however, that "[s]ome observers have suggested that [ARB] may not have the authority to auction and that auctioning might require further legislative action." *Id.* at H-70.

Second, ARB did not directly address the argument that the sale of allowances constituted a tax that required a two-thirds majority vote of the California Legislature. Instead, ARB responded that it believes "that in authorizing ARB to distribute allowances, and requiring that market-based

compliance mechanisms must meet certain criteria, the Legislature did not intend to forbid ARB from choosing this widely recognized distribution method. In other words, as the administrating agency charged with interpreting AB 32, ARB believes that AB 32 provides ARB with the authority to include auctions as a feature of a cap-and-trade program." FSOR at 732, 2190.

E. The Final Cap-and-Trade Regulation

On October 20, 2011, ARB adopted the final Cap-and-Trade Regulation, which went into effect on December 22, 2011. The final regulation retained the proposed regulation's plan to grant allowances freely, in part, and to sell allowances, in part, through auctions and reserve sales, with increasing reliance upon auctions and reserve sales in successive compliance periods. 17 CCR §§ 95870, 95910–95914. The only parts of the regulation at issue in this proceeding are the provisions through which ARB allocates to itself an increasing percentage of each year's authorized emission allowances and sells them at auctions or at fixed-price reserve sales.

On June 28, 2012, ARB approved amendments to the Cap-and-Trade Regulation, which went into effect on September 1, 2012. The Cap-and-Trade Regulation, as amended, requires certain "covered entities" responsible for annual GHG emissions greater than or equal to 25,000 metric tons CO_2e to acquire a "compliance instrument" for every metric ton of CO_2e they emit, and then surrender these compliance instruments to ARB annually. *Id.* §§ 95811, 95812, 95850, 95855, 95856. This requirement is known as a covered entity's "compliance obligation." *Id.* § 95802(54).

Failure to meet a compliance obligation, or other violations under the Cap-and-Trade Regulation, subjects regulated entities to potential penalties, including civil fines and criminal penalties up to and including incarceration. Each 45-day period after failing to meet a compliance obligation constitutes a separate violation. *Id.* §§ 96013, 96014; Health & Safety Code § 38580. "Compliance instruments" that can satisfy an entity's compliance obligation are principally GHG "allowances" created by ARB. 17 CCR § 95820(a). Once acquired by regulated entities, GHG allowances may be traded among entities subject to ARB's oversight. *Id.* §§ 95920–95922. Under the Cap-and-Trade Regulation, ARB will decrease the number of GHG emission allowances annually. *Id.* § 95841. This declining "cap" on total permissible emissions is the mechanism by which the Cap-and-Trade Program aims to reduce GHG emissions.

The Cap-and-Trade Regulation phases in participation in the Cap-and-Trade Program over three successive "compliance periods." *Id.* §§ 95840, 95851. The first compliance period, from January 1, 2013, to December 31, 2014, requires participation from specified utility and heavy industry sectors. *Id.* The second and third compliance periods, from January 1, 2015, to December 31, 2017, and from January 1, 2018, to December 31, 2020, respectively, expand participation to other industries that account for mobile GHG emissions. *Id.*

The Cap-and-Trade Regulation provides that a portion of the GHG allowances ARB creates each year will be allocated directly to certain utilities and other industrial covered entities. *Id.* §§ 95890–95892. These "direct allocations" are apportioned according to the industry's vulnerability to "leakage."[3] *See id.* § 95870(d)–(e) & tbl. 8-1. Within the utility and industrial sectors eligible for direct allocation of allowances, ARB will distribute GHG allowances to individual entities based upon industrial output. *Id.* §§ 95891, 95892 & tbls. 9-1 & 9-3.

The proportion of allowances designated for free direct allocation diminishes each year under the Cap-and-Trade Program. *See, e.g., id.* §§ 95870, 95891 & tbl. 9-2. In total, by 2020, ARB currently plans to directly allocate approximately 50% of GHG allowances. Legislative Analyst's Office, "Evaluating Policy Trade-Offs in ARB's Cap-and-Trade Program," at 10 (Feb. 9, 2012) ("LAO Policy Report") (RJN Ex. 6). Under the Cap-and-Trade Regulation, allowances that are not directly allocated by ARB will be initially sold in 1,000-allowance bundles through public auctions and reserve sales. 17 CCR §§ 95910–95914.

The Cap-and-Trade Regulation sets an initial GHG allowance auction date for November 14, 2012. *Id.* § 95910(a)(1). The regulations schedule future auctions on a quarterly basis. *Id.* § 95910(a)(2). The first reserve sale is scheduled for March 8, 2013. Future reserve sales will be scheduled six weeks after each quarterly auction. *Id.* § 95913(d).

The Cap-and-Trade Regulation provides that "auction[s] will consist of a single round of bidding," during which "[b]ids will be sealed." *Id.* § 95911. "No allowances will be sold at bids lower than" a minimum "auction reserve price." *Id.* "The Auction Reserve Price for ... allowances

[3] Leakage occurs when GHG-generating activity (and its accompanying economic activity) shifts outside of a cap-and-trade jurisdiction, resulting in no net decline in global GHG emissions.

auctioned in 2012 will be $10 per allowance." *Id.* For future auctions, "the Auction Administrator will announce the Auction Reserve Price," which will be "increased annually by 5 percent plus the rate of inflation." *Id.* "Allowances ... which remain unsold shall be kept ... for later auction." *Id.*

At the November 14, 2012 quarterly auction, ARB offered 23,126,110 allowances for the 2013 compliance period. RJN Ex. 9. Bids for allowances ranged from a high of $91.13 to a low of $10.00 per allowance. *Id.* ARB sold all the allowances offered at auction at a settlement price of $10.09 per allowance, for a total of over $233 million dollars in revenue generated. *Id.* ARB also sold 5,576,000 allowances for the 2015 compliance period at a cost of $10.00 per allowance. *Id.* Altogether, at the November 14, 2012 auction, ARB raised nearly $289 million dollars. *Id.* The Legislative Analyst's Office ("LAO") estimates that in fiscal year 2012–13, ARB's auctions will "generate roughly $660 million to upwards of $3 billion." Legislative Analyst's Office, "The 2012–13 Budget: Cap-and-Trade Auction Revenues," at 1 (Feb. 16, 2012) ("LAO Budget Report") (RJN Ex. 7). Over the life of the program, the LAO estimates that ARB will raise as much as $12 billion to $70 billion in additional revenue for the State. *Id.* at 13.

For each compliance period, ARB will withhold a percentage of the GHG allowances it creates for "reserve sales." 17 CCR § 95870(a). At reserve sales, ARB will sell GHG allowances at specific tiers of escalating prices. The reserve sale prices for the initial March 8, 2013 reserve sale range from $40 to $50 per allowance. Each year, the price of allowances at reserve sales will be "increased by five percent plus the rate of inflation." *Id.* § 95913(e). Like the allowances sold at auction, the proportion of allowances designated for reserve sales increases each compliance period. *Id.* § 95870(a).

F. The Cap-and-Trade Fee Regulation

Pursuant to Health and Safety Code § 38597, ARB promulgated an "AB 32 Cost of Implementation Fee" regulation ("Fee Regulation"), which took effect on July 17, 2010. As explained by ARB, "[t]he purpose of [the Fee Regulation] is to collect fees to be used to carry out the California Global Warming Solutions Act of 2006 as provided in Health and Safety Code section 38597." 17 CCR § 95200 (citations omitted). The Fee Regulation assesses fees on utility and industry sectors based on the amount of fuel combusted or distributed, the amount of CO_2 released,

or the amount of electricity generated or imported by a regulated party, depending upon the sector. *Id.* § 95201.

Under the Fee Regulation, the revenue collected "shall be the total amount of funds necessary to recover the costs of implementation of AB 32 program expenditures for each fiscal year," as well as "payments required to be made by [ARB] on the Debt incurred," and "any amounts required to be expended by [ARB] in defense of [the Fee Regulation] in court." *Id.* § 95203(a). "If there is any excess or shortfall in the actual revenue collected for any fiscal year, such excess or shortfall shall be carried over to the next year's calculation of the Total Revenue Requirement." *Id.*

The total required revenue under the Fee Regulation for fiscal year 2010–2011 was $62.1 million. RJN Ex. 10. For fiscal year 2012–13, ARB has concluded that the total revenue required to implement AB 32 was $62 million. *Id.* These annual fee estimates are dwarfed by the nearly $290 million generated at the first quarterly auction in November 2012.

STANDARD OF REVIEW

This complaint presents two legal questions that this Court reviews de novo: (1) whether AB 32 authorizes the Board to raise billions of dollars in new revenue for the State through selling allowances, and (2) if so, whether to that extent, such authorization is an unconstitutional tax. *Citizens to Save Cal. v. FPPC*, 145 Cal. App. 4th 736, 747 (2006) ("we do not defer to an agency's view when deciding whether a regulation lies within the scope of the authority delegated by the Legislature"); *Cal. Farm Bureau Fed'n v. State Water Res. Control Bd.*, 51 Cal. 4th 421, 436 (2011) ("Whether [a statute] imposes a tax or a fee is a question of law decided upon an independent review of the record.").

ARGUMENT

I. AB 32 DOES NOT AUTHORIZE THE BOARD TO RAISE REVENUE BY SELLING GHG EMISSION ALLOWANCES.

The Cap-and-Trade Regulation's provisions for raising enormous sums of revenue by auctioning and selling allowances are not authorized by AB 32 and therefore are unlawful. To offset the costs of implementing AB 32, the Legislature granted the Board carefully circumscribed authority to collect regulatory fees, and the Board has adopted the Fee Regulation accordingly. But

nothing in AB 32 empowers the Board also to collect billions of dollars in additional revenue that bear no nexus to the cost of the program's administration by selling allowances. The allowance auction and reserve sale provisions of the Cap-and-Trade Regulation therefore exceed the Board's statutory authority. This conclusion is compelled by AB 32's text, structure, purpose, and legislative history. The Board's contrary reading—that the Legislature, *sub silentio*, granted additional, unbridled revenue-raising authority in a section of AB 32 that does not even address revenues—is simply implausible. Finally, even if AB 32 could be considered ambiguous on this point, the Court must reject the Board's interpretation in order to avoid the serious constitutional doubts it raises.

A. AB 32's Text, Structure, Purpose, and Legislative History Show That ARB Lacks Authority To Raise Revenue by Selling Allowances.

It is "well settled that administrative agencies have only the powers conferred on them" by the Legislature. *AFL v. Unemployment Ins. Appeals Bd.*, 13 Cal. 4th 1017, 1042 (1996). "'[A]n administrative agency cannot by its own regulations create a [power] which the Legislature has withheld.'" *Id.* at 1035 (quoting *Dyna-Med, Inc. v. Fair Emp't & Hous. Comm'n*, 43 Cal. 3d 1379, 1389 (1987)). Consequently, "[a]dministrative regulations that alter or amend the statute or enlarge or impair its scope are void and courts not only may, but it is their obligation to strike down such regulations." *Dyna-Med*, 43 Cal. 3d at 1389 (internal quotation marks omitted); *see also AFL*, 13 Cal. 4th at 1042 ("actions exceeding those powers are void, and administrative mandate will lie to nullify the void acts").

Whether AB 32 authorizes the Board to raise revenue by selling allowances presents strictly an issue of statutory interpretation. When construing the statute, the Court's task is "is to ascertain the intent of the Legislature so as to effectuate the purpose of the law." *Dyna-Med*, 43 Cal. 3d at 1386. The Court "must look first to the words of the statute themselves, giving to the language its usual, ordinary import and according significance, if possible, to every word, phrase and sentence in pursuance of the legislative purpose." *Id.* at 1386–87. "'Statutes must be harmonized, both internally and with each other, to the extent possible,'" to avoid "'[i]nterpretive constructions which render some words surplusage.'" *Peralta Cmty. Coll. Dist. v. Fair Emp't & Hous. Comm'n*, 52 Cal. 3d 40, 51 (1990); *see also, e.g., Dyna-Med*, 43 Cal. 3d at 1387.

Courts apply these structural canons with particular force when, as here, an agency asserts a power that is not expressly articulated by the statute. *See, e.g.*, *Peralta*, 52 Cal. 3d at 51; *Dyna-Med* Cal. 3d at 1387. For example, in *United Farm Workers of America v. Agricultural Labor Relations Board*, 41 Cal. App. 4th 303 (1995), the Court of Appeal held that the California Table Grape Commission lacked authority to initiate a suit alleging a violation of the Labor Code, because it did not appear in the statute's list of actions the Commission could bring. *Id.* at 316. As the court explained, "the express enumeration ... of the types of actions the Commission is authorized to bring impliedly excludes the Commission from involving itself in other types of proceedings." *Id.* Moreover, "[a]n expansive interpretation of the Commission's power to" bring unenumerated actions "would render surplusage the narrow language" specifying particular actions within the Commission's power. *Id.* at 317. Similarly, in *B.C. Cotton, Inc. v. Voss*, 33 Cal. App. 4th 929 (1995), the Court of Appeal held that the Department of Agriculture's express statutory authority to require parties to *register* new plant varieties after their development excluded the unenumerated authority also to require parties to obtain a *license* before developing new varieties. *Id.* at 955–56.

Applying these principles here compels the conclusion that the Legislature did not grant ARB authority to raise billions of dollars in new revenue for the State through the allowance auction and reserve sale provisions of the Cap-and-Trade Regulation.

First and foremost, no provision of AB 32 expressly authorizes the Board to raise revenues through the sale of emission allowances. This absence is particularly conspicuous in light of AB 32's structure. AB 32 establishes a comprehensive regulatory regime, the centerpiece of which appears in Parts 4 and 5, authorizing the Board to adopt emission-reduction measures. Health & Safety Code §§ 38560–38574. Parts 4 and 5 provide AB 32's most detailed provisions and set forth numerous requirements and criteria that circumscribe the bounds of the Board's powers in adopting emission-reduction measures. *Id.* These requirements even address financial implications, requiring the Board to evaluate any reduction measure's costs and benefits, *id.* §§ 38561(d), 38562(b)(5), and repeatedly stating that the reduction measures must be "cost-effective," *id.* § 38562(a), (b)(5), (c), and "minimize costs ... to California," *id.* § 38562(b)(1). Yet nowhere in Parts 4 or 5 does AB 32 empower the Board to raise revenues by administering any emission-reduction program.

Second, by contrast, § 38597 of AB 32 demonstrates that when the Legislature intended to authorize the Board to raise revenues, it said so explicitly. *Id.* § 38597. In detailed terms, § 38597 grants the Board the power to adopt "a schedule of fees," from particular entities, to be deposited in a specific fund, to be "available upon appropriation, by the Legislature," according to established procedures, and in amounts not more than "reasonably necessary to fund" AB 32's operations. *Id.* (cross-referencing § 57001(a), which governs administrative fees and caps them to "reasonably necessary" amounts). This clear expression that the Board may raise revenue through § 38597's particular procedures precludes the inference that the Board also has implied authority to raise additional revenue through other procedures, such as the auction and sale of allowances. *See United Farm Workers*, 41 Cal. App. 4th at 317; *B.C. Cotton*, 33 Cal. App. 4th at 955–56.[4]

Importantly, the provisions in Parts 4 and 5 authorizing the Board to adopt emission-reduction measures include none of § 38597's detailed terms—no mention of "fees," no identification of the payers or the funds into which revenue would be deposited, and no limitation on the amounts to be collected or how they are to be used. The Legislature would not have authorized ARB to raise billions of dollars without specifying how those revenues were to be used. Moreover, inferring from this silence an open-ended authority to raise unlimited revenues, as the Board has done, renders § 38597's circumscribed fee provisions meaningless surplusage. *See Peralta*, 52 Cal. 3d at 51 (rejecting the agency's claim to "a legislative grant by implication of unbridled power ... to make monetary awards without guidelines or limitations"). Instead construing § 38597 to be the Board's exclusive revenue-raising power under AB 32 preserves § 38597's independent meaning and harmonizes the whole statute.

Third, other statutes, too, confirm that the Legislature speaks clearly and with precision when it intends to grant an unelected agency authority to impose charges on private parties. In fact, in two

[4] ARB did not and could not contend that § 38597 authorizes the generation of revenues through the sale of allowances at auctions or reserve sales. The auctions and reserve sales are not conducted pursuant to a "schedule of fees," and are not intended to cover AB 32's "reasonably necessary" implementation costs. Health & Safety Code §§ 38597, 57001(a). Rather, ARB has adopted an entirely separate, detailed Fee Regulation, with a schedule of fees that covered entities must pay to fund "the costs of implementation of AB 32 program expenditures" and related costs. 17 CCR § 95203(a). ARB's adoption of this Fee Regulation confirms that it does not, and could not, invoke § 38597 as authority to raise additional revenue by selling allowances.

other provisions, the Legislature has expressly authorized ARB to collect revenues by imposing particular fees. *See* Health & Safety Code § 39612(f)(1); *id.* § 39613. Like § 38597 of AB 32, both of these provisions clearly circumscribe the Board's fee authority. *See id.* § 39612(f)(1) (authorizing ARB to impose permit fees on nonvehicular sources of air pollution, up to $13 million, to be used for specific purposes); § 39613 (authorizing ARB to impose a fee for certain consumer products or architectural coatings, to be used for specified purposes). "'Where the [Legislature] has demonstrated the ability to make [its] intent clear, it is not the province of ... court[s] to imply an intent left unexpressed.'" *Peralta*, 52 Cal. 3d at 50.

Fourth, the sale of allowances is not remotely necessary to satisfy the legislative purpose of AB 32, *i.e.*, to reduce GHG emissions. As ARB has explained, the method of allocating GHG allowances does not affect the amount of GHG reductions the Cap-and-Trade Program achieves because "[t]he limit on GHG emissions—the program 'cap'—determines the environmental effectiveness of the cap-and-trade program." ISOR at ES-3; *see also supra* n.2. These comments by ARB embrace the Market Advisory Committee's conclusion that "the method of initial allowance distribution has no effect on the environmental outcome, that is, the achievement of the emissions cap." ISOR, App. H at H-66; *see also id.* at H-9 ("[t]he method by which emission allowances are distributed under a cap-and-trade program does not affect total greenhouse gas emissions under the program") (Statements of Market Advisory Committee).

Finally, AB 32's legislative history further confirms what is evident on the statute's face: The Legislature had no intention of allowing the Board to raise revenues other than through the fees expressly authorized in § 38597. Of the seven legislative reports and analyses prepared for AB 32, only one discusses a grant of revenue-raising powers. *See* Sen. Com. On Rules, Ofc. Of Floor Analyses, 3d reading analysis of AB 32 (2005–06 Reg. Sess.) as amended Aug. 30, 2006, at 3–4 (RJN Ex. 1). Consistent with AB 32's text, this report discusses only the Board's authority to "adopt

a schedule of fees to pay for the costs of implementing the program established pursuant to the bill's provisions." *Id.*[5]

The circumstances surrounding AB 32's enactment make this silence extremely probative. *See Dyna-Med*, 43 Cal. 3d at 1387 ("wider historical circumstances of [a statute's] enactment may be considered in ascertaining the legislative intent"). AB 32 was a highly visible and closely scrutinized bill, as its provisions affect numerous sectors of California's economy and raise the profile of California's climate change regulation program nationally. Tellingly, the legislative history reflects that AB 32's opponents *did* voice concerns about giving the Board "carte blanche authority to collect fees," but they concentrated their efforts on AB 32's fee provision, § 38597. *See* ARB, Enrolled Bill Report for AB 32 (2005–06 Reg. Sess.) as amended Aug. 30, 2006, at 3 (RJN Ex. 2). If legislators thought the bill could even possibly give ARB the unprecedented revenue-raising authority it now asserts in addition to the fee provision, surely the legislative history would reflect vigorous debate about that possibility. *See United Farm Workers*, 41 Cal. App. 4th at 316 (refusing to imply authorization for agency's action where "there is nothing in the legislative history to show any contemplation of any involvement" by the agency in the proposed action). The Board cannot now assert this sweeping authority, after the legislators cast their votes on the understanding that AB 32 conferred only § 38597's limited authority to raise fees to offset implementation costs.

B. ARB's Claim That AB 32 Authorizes It To Raise Revenue by Selling Allowances Is Without Merit.

In attempting to explain its asserted authority to raise revenue by selling allowances, ARB cited two statutory provisions in AB 32. FSOR at 732. *First*, ARB cited AB 32's general grant of authority to adopt a cap-and-trade system. *Id.* (citing Health & Safety Code § 38562(c), which authorizes ARB to "establis[h] a system of market-based declining annual aggregate emission limits"). *Second*, ARB cited AB 32's grant of authority to design such a cap-and-trade system,

[5] Likewise, the Board's own Enrolled Bill Report to the Governor includes a discussion of its "Fee Authority," which refers solely to § 38597's authority to collect fees "for program administration." ARB, Enrolled Bill Report for AB 32 (2005–06 Reg. Sess.) as amended Aug. 30, 2006, at 3 (RJN Ex. 2). Moreover, it describes a letter from AB 32's sponsor, who clarified that this "fee is limited to ARB's direct implementation costs only." *Id.* There is no other discussion of the Board having any other revenue-raising authority.

"including distribution of emissions allowances ..., in a manner that is equitable, seeks to minimize costs and maximize the total benefits to California and encourage early action to reduce [GHG] emissions." *Id.* (citing Health & Safety Code § 38562(b)(1)).[6]

By their plain terms, however, these provisions authorize the Board only to "distribut[e]" allowances. The term "distribute" in no sense implies a grant of revenue-raising authority. ARB itself acknowledged that AB 32 "does *not* direct ARB to use any particular method to distribute allowances, and does not specify that some methods are allowed and others are not." *Id.* (emphasis added). By contrast, the statutory provision of the federal Clean Air Act statutory creating a cap-and-trade system for acid rain (which was expressly referenced in AB 32's legislative history, *see* RJN Ex. 2 at 7) authorizes by statute the sale of allowances in terms that clearly establish that authority. *See* 42 U.S.C. § 7651*o*. That Congressional statute provides that allowances "shall be offered for direct sale ... in the amounts specified," and that the agency "shall conduct auctions at which the allowances ... shall be offered for sale." *Id.* § 7651*o*(c)(2), (d)(2). Despite that model, the California Legislature nowhere authorized ARB to "offer[] for sale" allowances.[7]

Nor does AB 32's purpose of reducing emissions, or the nature of a cap-and-trade system generally, require that the Board auction or sell the allowances. As the Market Advisory Committee advised ARB, "the method of initial allowance distribution has *no effect* on the environmental outcome, that is, the achievement of the emissions cap." ISOR, App. H at H-66 (emphasis added); *see also id.* at H-9. It is the cap on allowances that reduces emissions. *See id.* There are numerous revenue-neutral ways to allocate allowances in a cap-and-trade system. *E.g.*, FSOR at 732; ISOR, App. H at H-66–H-67.

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[6] To the extent ARB cites subsequently enacted legislation (such as SB 1018, Gov't Code § 16428.8, or AB 1532, Health & Safety Code § 39710) to justify its claimed authority to generate massive revenues, its arguments would fail. None of these laws addresses the Board's authority to raise revenue through the sale of emission allowances. Moreover, SB 1018 explicitly disclaims having any affect on the Board's authority. *See* Gov't Code § 16428.9(b).

[7] Also in contrast to ARB's Cap-and-Trade Regulation, the Clean Air Act's acid rain cap-and-trade program is revenue-neutral. It allocates 97.2% of allowances without charge and reserves 2.8% for sale or auction, directing that all proceeds of the sales and auctions be returned to covered entities in a prescribed formula (and not retained as revenue for the federal government). 42 U.S.C. § 7651*o*(b), (c)(6); *see also* 40 C.F.R. § 73.27.

Lacking any affirmative basis for its assertion of power to generate revenue through the sale of allowances, the Board ultimately fell back on the claim that "the Legislature did not intend to forbid ARB from choosing" to sell allowances. FSOR at 732. This precise form of argument was rejected by the Court of Appeal in *Diageo-Guinness USA, Inc. v. Board of Equalization*, 205 Cal. App. 4th 907 (2012). As the Court of Appeal explained, "the existence of a regulatory power" cannot be "based on the absence of a prohibition against the exercise of such a power." *Id.* at 915. Rather, the Board may only exercise regulatory powers the Legislature actually granted to it. *Id.*

Thus, AB 32's text, structure, purpose, and history make clear that the Legislature authorized the Board to raise revenue solely under § 38597's express fee provision. There is no basis to infer that the Legislature also intended to give the Board, by implication, unfettered revenue-raising power when it authorized the Board to "distribut[e]" allowances.

Indeed, courts have repeatedly rejected similar attempts by agencies to derive unbounded powers from "vague or ancillary" statutory language. *E.g.*, *Cal. Redevelopment Ass'n*, 53 Cal. 4th at 260–61 ("'[T]he drafters of legislation do not ... hide elephants in mouseholes'"); *accord Whitman v. Am. Trucking Ass'ns, Inc.*, 531 U.S. 457, 468 (2001) (the legislature "does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions—it does not, one might say, hide elephants in mouseholes"). For example, in a pair of cases, the California Supreme Court rejected claims by the Fair Employment and Housing Commission that statutory language empowering it to "take such action, including but not limited to" specified remedial actions on behalf of victims of discrimination, implied the additional powers to impose punitive and compensatory damages, respectively. *See Dyna-Med*, 43 Cal. 3d at 1387–88; *Peralta*, 52 Cal. 3d at 51. In both cases, the Supreme Court noted that the Legislature demonstrated its ability to expressly authorize damages remedies in other statutes, and therefore the Court refused to "infe[r] that the Legislature intended *sub silentio* to empower the commission to impose punitive damages." *Dyna-Med*, 43 Cal. 3d at 1389; *see Peralta*, 52 Cal. 3d at 51 (refusing to "infer that through the expansive language ... the Legislature intended by implication to grant the Commission the authority not only to award compensatory damages, but to award such damages without limit"); *see also, e.g.*, *AFL*, 13

Cal. 4th at 1034 (refusing to imply a power where the Legislature "could have easily" granted the power expressly, "as it has in other administrative contexts").

So also here, the Legislature demonstrated through § 38597's fee provision, as well as other fee provisions, that it carefully circumscribes an agency's authority to collect revenues. Ignoring the Legislature's regular manner of authorizing fees, and instead inferring an implied power to raise unlimited revenues in a section that has nothing to do with fees or revenues, would be manifestly contrary to legislative intent.

C. To Avoid Serious Doubt about AB 32's Constitutionality, It Must Be Construed Not To Authorize the Board To Raise Revenue by Selling Allowances.

For the foregoing reasons, AB 32 does not authorize ARB to raise revenue by selling allowances. But even if AB 32 were ambiguous—and it is not—the Court would still be bound to reject the Board's construction because it would call AB 32 into serious constitutional doubt as a tax enacted pursuant to a statute that did not garner a supermajority vote of the Legislature.

It is well settled that "[a] statute should be construed whenever possible so as to preserve its constitutionality." *Dyna-Med*, 43 Cal. 3d at 1387. Courts presume "'that the Legislature intended, not to violate the Constitution, but to enact a valid statute within the scope of its constitutional powers.'" *Harrott v. Cnty. of Kings*, 25 Cal. 4th 1138, 1153 (2001) (quoting *People v. Superior Court*, 13 Cal. 4th 497, 509 (1996)). Accordingly, "'[i]f a statute is susceptible of two constructions, one of which will render it constitutional and the other unconstitutional in whole or in part, or raise serious and doubtful constitutional questions, the court will adopt the construction which, without doing violence to the reasonable meaning of the language used, will render it valid in its entirety, or free from doubt as to its constitutionality.'" *Id.* This canon favoring the construction that avoids constitutional questions applies even when "'the other construction is equally reasonable.'" *Id.*

As demonstrated below, if AB 32 were construed to allow ARB to raise revenue by selling allowances, the allowance auction and reserve sale provisions of AB 32 would levy an unconstitutional tax, not adopted by a supermajority. These grave constitutional concerns must be avoided by adopting the straightforward interpretation—compelled by AB 32's language, structure, purpose, and legislative history—that AB 32 does not confer this authority upon the Board.

II. IF AB 32 WERE CONSTRUED TO AUTHORIZE ARB TO RAISE REVENUE BY SELLING ALLOWANCES, IT WOULD IMPOSE AN UNCONSTITUTIONAL TAX.

Because AB 32, properly construed, does not authorize ARB to raise revenue by selling allowances, the Court should resolve this case on that basis alone and need not decide any constitutional challenge to AB 32. If, however, AB 32 were construed to grant ARB authority to raise revenue by selling allowances, then AB 32 would impose an unconstitutional tax, and any such grant of authority would have to be severed from the statute as unconstitutional.

It is undisputed that AB 32 was not passed by the two-thirds supermajority required to enact new taxes under the California Constitution. The only question, therefore, is whether AB 32, if construed to allow ARB to raise revenue by selling allowances, imposes a tax. Because AB 32 permits revenues raised by selling allowances to be spent on purposes unrelated to the Cap-and-Trade Program, and because the amount of revenue raised does not bear a reasonable relationship to the costs of implementing the Cap-and-Trade Program or any burdens imposed by the payers, AB 32 imposes an unconstitutional tax.

A. A Charge Imposed in Connection with a Regulatory Program Is a Tax If the Revenues May Be Used for Unrelated Purposes or the Amount of the Charge Is Not Reasonably Related to the Cost of the Regulatory Activity.

"The California Constitution provides that any act to increase taxes must be passed by a two-thirds vote of the Legislature." *Cal. Farm Bureau*, 51 Cal. 4th at 428 & n.1 (citing Cal. Const., art. XIIIA, § 3). As a result, when the Legislature enacts a new fee or other revenue-raising measure by a simple majority vote, courts must determine whether "th[e] fees [are] in legal effect 'taxes' required to be enacted by a two-thirds vote of the Legislature." *Sinclair Paint Co. v. State Bd. of Equalization*, 15 Cal. 4th 866, 870 (1997). The supermajority requirement cannot be evaded by labeling what is in legal effect a tax as a "fee" or some other kind of charge. *See Nw. Energetic Servs., LLC v. Cal. Franchise Tax Bd.*, 159 Cal. App. 4th 841, 855 (2008) ("Labeling the Levy a fee is not determinative of its nature."). "Whether [a statute] imposes a tax or a fee is a question of law decided upon an independent review of the record." *Cal. Farm Bureau*, 51 Cal. 4th at 436.

Although "the distinction between taxes and fees is frequently 'blurred,'" *Sinclair*, 15 Cal. 4th at 874, the California Supreme Court has made clear that, at a minimum, a valid regulatory fee

must satisfy two conditions. *First*, "[a] valid fee may not be imposed for unrelated revenue purposes." *Cal. Farm Bureau*, 51 Cal. 4th at 437. That is, a valid regulatory fee must be "linked" to the regulatory activity for which it is levied and cannot be "used to generate general revenue." *Id.* at 438; *accord Sinclair*, 15 Cal. 4th at 881; *Pennell v. City of San Jose*, 42 Cal. 3d 365, 375 (1986). Accordingly, a statute imposes a tax if it does not require a "nexus between the Levy and the expense of any regulatory program," or if the revenues raised may be used "for general governmental purposes." *Nw. Energetic Servs.*, 159 Cal. App. 4th at 857–58; *see also Morning Star Co. v. Bd. of Equalization*, 201 Cal. App. 4th 737, 751–55 (2011).

Second, there must be a "reasonable relationship between the fees assessed and the costs of the regulatory activity." *Cal. Farm Bureau*, 51 Cal. 4th at 441. "A regulatory fee may be imposed under the police power when the fee constitutes an amount necessary to carry out the purposes and provisions of the regulation." *Id.* at 438 (internal quotation marks omitted). "What a fee cannot do is exceed the reasonable cost of regulation with the generated surplus used for general revenue collection." *Id.* To sustain a fee, the state must produce evidence showing "(1) the estimated costs of the service or regulatory activity, and (2) the basis for determining the manner in which the costs are apportioned, so that charges allocated to a payor bear a fair or reasonable relationship to the payor's burdens on or benefits from the regulatory program." *Id.* at 436–37 (internal quotation marks omitted); *accord Sinclair*, 15 Cal. 4th at 878.

If construed to authorize ARB to raise billions of dollars in revenue by selling allowances under the Cap-and-Trade Program, AB 32 satisfies neither of these conditions and therefore would impose an unconstitutional tax.

B. AB 32 Imposes a Tax Because It Permits Revenues Raised by Selling Allowances To Be Used for Purposes Unrelated to the Cap-and-Trade Program.

If AB 32 authorizes ARB to raise revenue by selling allowances, then the statute imposes an unconstitutional tax because it does not require the resulting revenues to be used solely for purposes related to the Cap-and-Trade Program. Indeed, AB 32 places *no restrictions whatsoever* on the use of revenues generated by selling allowances. As discussed above, the fact that AB 32 makes no provision for the use of revenues from the sale of allowances is powerful evidence that the

Legislature never authorized ARB to sell allowances to generate revenue. Indeed, the revenues from these auctions and reserve sales are projected conservatively to be billions of dollars. The absence of any restriction on the use of such revenues renders the statute unconstitutional to the extent it is construed to grant such authority. *See Cal. Farm Bureau*, 51 Cal. 4th at 438; *Sinclair*, 15 Cal. 4th at 881; *Pennell*, 42 Cal. 3d at 375.

AB 32 nowhere provides that revenues collected from the sale of allowances must be used exclusively for purposes related to the Cap-and-Trade Program, or even for purposes related to AB 32 generally. Nor does it link the revenues to specified regulatory costs or burdens; require revenues from the sale of allowances to be deposited in a separate fund; or impose any other restrictions on the use of the revenues.[8] AB 32 thus resembles the statute that was held to impose a tax in *Northwest Energetic Services* because it did not "identify any connection between the Levy and th[e] regulatory activity or its costs or benefits." 159 Cal. App. 4th at 855; *see also Morning Star*, 201 Cal. App. 4th at 751–55 (statute "reveal[ed] a specific intention to impose a tax" because it permitted revenues to be used for purposes unrelated to the regulation of payers' activities).

The administrative record makes clear that revenues from the sale of allowances are not restricted to the purpose of implementing the Cap-and-Trade Program. In deciding to adopt regulations mandating the sale of allowances at auctions and reserve sales, ARB followed the recommendation of the Market Advisory Committee, FSOR at 732, whose report emphasized that revenues from the sale of allowances could be used "for purposes unrelated to the goals of the program," including "to finance reductions in State tax rates," and that the proceeds of the sales could even "be returned to taxpayers directly through rebate checks," ISOR, App. H at H-68–H-69.

[8] In 2012, the legislature enacted new laws—SB 1018, AB 1532, and SB 535—providing that revenues from the sale of allowances must be deposited into a Greenhouse Gas Reduction Fund and used to facilitate reduction of GHG emissions and to benefit disadvantaged communities. Gov't Code § 16428.8; Health & Safety Code §§ 39711–12. These new laws cannot be argued to amend AB 32 to ratify ARB's authority to tax or to remedy the constitutional defect in AB 32 because they were enacted by a simple majority vote, rather than a two-thirds supermajority, after Proposition 26 took effect in 2010. Under Proposition 26's expanded definition of "tax," revenues from the sale of allowances plainly constitute an unconstitutional tax, regardless of how they are spent. *See* Cal. Const., art. XIIIA, § 3 (defining "tax" as "any levy, charge, or exaction of any kind imposed by the State" with exceptions not applicable here). In any event, for the reasons discussed in Part C, the new statutes do not transform the revenues from the sale of allowances into a valid regulatory fee even under the old definition.

ARB endorsed these recommendations in its Resolution 10-42, which recommended that revenues from the sale of allowances be used for a wide variety of purposes unrelated to the Cap-and-Trade Program, and even "[r]eturn[ed] ... to households either through lump-sum rebates ... or through cuts or avoided increases in the State's individual income or sales tax rates." RJN Ex. 4 at 12. Similar statements to the effect that allowance revenues may be used "at the discretion of the Legislature," FSOR at 724, "for a variety of purposes, including public benefit," ISOR at II-24, are repeated throughout the administrative record. *See also, e.g.*, ISOR at II-28–II-29; FSOR at 231, 1124–25, 1129, 1149, 1900–04. A charge that generates billions of dollars in revenue that may be used at the discretion of the Legislature for the public benefit is a tax.

In failing to require that revenues generated by selling allowances be used solely for purposes related to the Cap-and-Trade Program, AB 32 stands in stark contrast to other statutes that have been upheld as imposing valid regulatory fees. The statute upheld in *California Farm Bureau*, for example, "reveal[ed] a specific intention to avoid imposition of a tax," because it "permit[ted] the imposition of fees only for the costs of the functions or activities described, and not for general revenue purposes." 51 Cal. 4th at 438. In rejecting a facial challenge to the statute, the Court emphasized that the statute "carefully se[t] out that the fees imposed shall relate to costs linked to" the regulatory program; "direct[ed] that the fees collected be deposited in" a designated fund separate from the general fund; and "describ[ed] the purposes for which the money in [that fund] may be expended." *Id.* at 438–39 (citing provisions). Likewise, the statute upheld in *Sinclair* expressly provided that "the state must use the funds it collects [thereunder] *exclusively* for mitigating the adverse effects of lead poisoning of children, and not for general revenue purposes." 15 Cal. 4th at 881 (citing Health & Safety Code § 105310(f)).

Unlike these statutes, AB 32 does not require that revenues from the sale of allowances be used solely for purposes related to the Cap-and-Trade Program. Any grant of authority to raise revenue by selling allowances therefore imposes an unconstitutional tax.

C. The Amount of Revenue Generated by Selling Allowances Bears No Reasonable Relationship to the Cost of the Cap-and-Trade Program or the Burden Imposed by the Payers.

Independently, if AB 32 were construed to authorize ARB's auction and reserve sale regulations, then those provisions would impose an unconstitutional tax because the billions of dollars in revenue that ARB raises from selling allowances do not bear a reasonable relationship to the cost of the Cap-and-Trade Program or to any burdens imposed by the payers.

The amount of money ARB proposes to raise by selling allowances is staggering. At the first quarterly auction alone, ARB raised nearly $289 million dollars. RJN Ex. 9. According to the LAO, in fiscal year 2012–13, "ARB's auctions are estimated to generate roughly $660 million to upwards of $3 billion." LAO Budget Report at 1. These numbers will only increase in subsequent years as ARB shifts to greater reliance on auctions and reserve sales. The LAO estimates that, by 2015, ARB will be raising between $2 billion and $14 billion per year from the sale of allowances. LAO Policy Report at 13. This means that, over the life of the program, ARB will raise as much as $12 billion to $70 billion in additional revenue for the State. *Id.* Thus, even on a conservative estimate, "[b]illions of dollars in revenues from the auction of allowances will become available as the result of the ARB's cap-and-trade program." *Id.*

These amounts dwarf the cost of the Cap-and-Trade Program. According to ARB, the cost of implementing AB 32 in its entirety is approximately $35 million a year, plus about $27 million a year in repayment on program start-up loans that will be paid off by fiscal year 2013–14. RJN Ex. 10. In a single quarterly auction, therefore, ARB raised almost five times more in revenues from selling allowances than it needs to fund AB 32 for an entire year.

Further, the cost of implementing the Cap-and-Trade Program is already funded by the AB 32 Cost of Implementation Fee. 17 CCR § 95203(a) (providing that revenue collected under the Fee Regulation "shall be the total amount of funds necessary to recover the costs of implementation of AB 32 program expenditures for each fiscal year"). The revenues generated from the sale of allowances that are *over and above* the fees already collected for implementation are thus by definition more than necessary to fund the Cap-and-Trade Program. Accordingly, these additional revenues bear no relationship to the cost of the Cap-and-Trade Program.

By any measure, the revenues ARB generates from the sale of allowances far "exceed the reasonable cost of regulation." *Cal. Farm Bureau*, 51 Cal. 4th at 438. These revenues are therefore an unconstitutional tax. *See id.* ("permissible fees must be related to the overall cost of the governmental regulation"); *Sinclair*, 15 Cal. 4th at 876 (a regulatory fee must "'not exceed the reasonable cost of providing services necessary to the activity for which the fee is charged'"); *Nw. Energetic Servs.*, 159 Cal. App. 4th at 859 (charge was a tax because the revenue it generated "far exceed[ed] any reasonable cost of regulating or providing services" under the regulatory program); *cf. Griffith v. City of Santa Cruz*, 207 Cal. App. 4th 982, 996 (2012) (charge was not a tax because the amounts collected were "'no more than necessary to cover the reasonable costs of the governmental activity'").

ARB cannot escape this result by arguing that revenues from the sale of allowances may be expended on any measures designed to reduce GHG emissions. That would allow ARB to end-run any real limitation on the use of the funds, given that there is virtually no human, business, or societal activity that does not have some nexus to the emission of GHGs.

Importantly, the Court of Appeal recently rejected a virtually identical argument in *Morning Star*. The statute there imposed a charge on businesses that used, generated, stored, or conducted activities in California related to hazardous materials. 201 Cal. App. 4th at 742. The resulting revenues were deposited in the State's Toxic Substances Control Account to fund "various programs relating to the control of hazardous materials." *Id.* at 743. The Court of Appeal held that the charge was a tax because it sought "to raise revenue to pay for a wide range of governmental services and programs related to hazardous waste control," rather than for "the regulation of the ... payers' business activities in using, generating or storing hazardous materials." *Id.* at 755; *see also id.* (charge was "not regulatory because it d[id] not seek to regulate the Company's use, generation or storage of hazardous material but to raise money for the control of hazardous material generally"). Likewise, any effort to raise revenue to fund reduction of GHG emissions generally and more broadly, rather than to regulate the payers' activities specifically under the Cap-and-Trade Program, constitutes a tax that must be approved by a two-thirds vote of the Legislature.

Nor has ARB attempted to justify the charges as a "'mitigating effects' measure" under *Sinclair*. 15 Cal. 4th at 877. Any attempt to do so would fail because the Cap-and-Trade Program is fundamentally different from the program in *Sinclair*. The statute in *Sinclair* expressly authorized the agency to remediate the effects of environmental lead contamination, and the only way the agency could fulfill that statutory mandate was by imposing fees, which were expressly authorized by statute. *See id.* at 871–73. Here, by contrast, ARB has acknowledged that selling allowances is not required by AB 32, FSOR at 732, and is not necessary to reduce GHG emissions. ISOR, App. H at H-9.

In any event, revenues from the sale of allowances cannot be justified as a "mitigation fee" because they do not bear a "reasonable relationship to the social or economic 'burdens' [the payers'] operations generat[e]." *Sinclair*, 15 Cal. 4th at 881. The amount of the charge for an allowance is not calculated based on any purported adverse effects attributable to the payers' operations. Rather, it is set based on a "market" price that is determined by the supply of allowances made available by ARB and the demand for those allowances. There is no relationship between that price and any effects purportedly caused by the payers' operations. Indeed, under the Cap-and-Trade Regulation, the winning bidder at auction may be an organization that does not conduct any GHG-emitting operations at all, but instead purchases allowances in an effort to retire them. FSOR at 449.

Moreover, ARB has not even attempted to prove the "'estimated costs'" of mitigating the effects of the payers' GHG emissions or "'the basis for determining the manner in which the costs are apportioned, so that charges allocated to a payor bear a fair or reasonable relationship to the payor's burdens on or benefits from the regulatory activity.'" *Sinclair*, 15 Cal. 4th at 878. Unlike the manufacturers and other companies whose products contributed to lead contamination in *Sinclair*, the entities that must purchase allowances under the Cap-and-Trade Program are not solely or even primarily responsible for any "adverse effects" in California from GHGs. Any harms to California would be based on the total level of GHGs in the global atmosphere and are thus caused by virtually every human activity everywhere in the world. *See, e.g.*, Br. of Cal. Air Resources Board at 19, *Rocky Mountain Farmer's Union v. Goldstene*, Nos. 12-15131, 12-15135 (9th Cir. filed June 8, 2012) (recognizing that because "GHGs are well-mixed in the global atmosphere, emissions

generated outside of California pose the same risk to California citizens as those generated inside California"). The billions of dollars in new charges ARB seeks to impose on the subset of California industry that must buy allowances under the Cap-and-Trade Program do not bear a "fair or reasonable" relationship to the burdens the payers purportedly impose on ARB's regulatory activities.

In sum, there is no nexus between the billions of dollars in revenue generated from the sale of allowances and either the cost of the Cap-and-Trade Program or any alleged burdens imposed by the payers' operations. For this reason as well, the revenues from the sale of allowances are an unconstitutional tax, not a valid regulatory fee. Accordingly, to the extent AB 32 is read to authorize ARB to raise revenues by selling allowances, that grant of authority is unconstitutional.

CONCLUSION

For the foregoing reasons, the National Association of Manufacturers respectfully requests that the relief sought be GRANTED.

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