CALIFORNIA'S CAP-AND-TRADE PROGRAM UNDER JUDICIAL REVIEW

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On September 27, 2006, California enacted the Global Warming Solutions Act (AB 32), which aimed to reduce California's greenhouse gas (GHG) emissions to 1990 levels by 2020. AB 32 delegates to the California Air Resources Board (ARB) the responsibility to adopt regulations to achieve the statewide GHG emissions limit. AB 32 authorized ARB to include the use of a "market-based compliance mechanism" to reduce GHG emissions.

In January 2013, ARB launched a cap-and-trade program to cut greenhouse gas pollution. Under this program, covered entities must acquire an "allowance" for every ton of GHG emissions they emit. ARB distributes about half of the allowances to covered entities free of charge, and sells the remainder primarily through a quarterly auction. By limiting the total number of allowances to a specific amount, the government ensures that the aggregate emissions do not exceed the cap's set level. At the end of each compliance period, the entities must surrender allowances back to the government sufficient to cover their emissions. Entities failing to meet compliance requirements must pay penalties. Every year, the total number of available allowances decreases, which drives emissions down over time. The Legislative Analyst's Office has estimated that over the life of the program the sales will raise as much as $12 to $70 billion in revenues for the State.

Shortly after the program's launch, a coalition of twelve companies, trade associations, and individuals sued the ARB. The lawsuit, *The Morning Star Packing Company v. California Air Resources Board*, seeks to rescind the cap and trade regulations related to allowance auctions and force ARB to refrain from enforcing or implementing the cap and trade regulation, conducting further auctions, or collecting revenues from those auctions. Petitioners challenge the auction process on two grounds. First, they contend that the auction provisions are void because they exceed the scope of authority conferred on ARB in AB 32. Specifically, petitioners argue that nothing in AB 32 authorizes creation of an auction process to sell carbon dioxide emission allowances for billions of dollars, nor does it authorize the creation of a new tax. Rather, AB 32 only authorizes a "schedule of fees." Petitioners also claim that the funds generated by the auctions grossly exceed what is needed to administer the program. Second, petitioners argue that the auction process is an unconstitutional state tax because it was not enacted by two-thirds of the members of the Legislature, as required for new taxes by the California Constitution under Proposition 13.

Respondents counter that the Legislature expressly delegated to ARB the authority to promulgate regulations to implement AB 32, including the choice of whether to adopt a cap-and-trade program, and if adopted, how to distribute emission allowances. Further, Respondents counter that the program is a fee, not a tax, and is therefore constitutionally sound. Respondents claim that Proposition 13 only applies to taxes enacted for the purpose of increasing revenues, and that the sale of allowances was enacted for regulatory reasons, not to increase revenue. Respondents also assert that the auctions were fundamentally different from a tax—for example, unlike taxes, the auction is not compulsory.

On a petition for a writ of mandate, the lower court denied both challenges to the auction process and found in favor of ARB. First, the court held that although AB 32 does not explicitly authorize the sale of allowances, it specifically delegates to ARB the discretion to adopt a cap-and-trade program and design the system of distribution of allowances. The court concluded that the sale of allowances

was within the broad scope of authority delegated to ARB in AB 32. Second, although it was a close question, the court held that the auction provisions did not constitute an illegal tax because the charges were more like traditional fees than taxes.

The case is now on appeal at a California Court of Appeal. In early April, the court issued two orders indicating that it might soon hear the appeal. First, the court granted a motion to expedite scheduling for evaluating the appellate briefs and setting the date for oral argument. Second, the court directed the parties to file simultaneous supplemental briefing on seven detailed and narrowed questions:

1. What is the rationale for and purpose of regulations stating the auction credits confer no property right?
2. Describe the relationship, if any, between the probable environmental impacts caused by covered entities and the revenue generated from the auctions, and whether the record shows the Board established a reasonable relationship between the two?
3. Can the auction system be defended against the Proposition 13 challenge on the ground it is akin to a development fee?
4. Can the auction system be defended against the Proposition 13 challenge on the ground it essentially sells to covered entities the privilege to pollute?
5. A three-pronged question regarding the expenditures of auction revenues for purposes unrelated to the goals of AB 32:
    1. How directly must a particular expenditure of auction revenue be related to the goal of reducing greenhouse gases?
    2. What standards should the judiciary apply in reviewing expenditures that are alleged to be replacements for general revenue expenditures?
    3. What, as a practical matter, would be the remedy, if, under the applicable standards a court finds a particular program is not sufficiently tethered to the goals of Assembly Bill No. 32?
6. Whether the auction payments are voluntary or involuntary?
7. If this court finds the auction is deemed to be an invalid tax, what is the remedy regarding the regulations, other than a declaration invalidating the auction component?

Briefing is due May 23, 2016. If the cap-and-trade is found unconstitutional, the State will lose billions of dollars in revenue generated from the program. That money is expected to help pay for things like high-speed rail, but it also means the fees for oil companies would disappear, which could lower prices at the pump. It is possible that this matter will be taken to the California Supreme Court for final adjudication.