Nos. C075930, C075954

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA THIRD APPELLATE DISTRICT

CALIFORNIA CHAMBER OF COMMERCE, *et al.*,

Appellants,

v.

CALIFORNIA AIR RESOURCES BOARD, *et al.*,

Respondents.

On Appeal from the Superior Court of California
County of Sacramento, Hon. Timothy M. Frawley
Nos. 34-2012-80001313, 34-2012-80001464

SUPPLEMENTAL BRIEF OF APPELLANT THE NATIONAL ASSOCIATION OF MANUFACTURERS

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INTRODUCTION

The National Association of Manufacturers ("the NAM") respectfully submits this supplemental brief in response to the Court's order of April 8, 2016, directing the parties to address a number of questions concerning the California Air Resources Board's ("ARB") auctions and reserve sales of greenhouse gas emissions allowances. The NAM's responses are set forth below.

ARGUMENT

I. What is the rationale for and purpose of regulations stating the auction credits confer no property right? (See Cal. Code Regs. tit. 17, §§ 95802(a)(299); 95820(c).)

In its Initial Statement of Reasons, ARB explained the "Rationale for Section 95820(c)" as follows:

> This provision is necessary to inform holders of compliance instruments of the properties of compliance instruments. … Compliance instruments are created by ARB through AB 32, and are to be used solely for use as a compliance credit in California's market. It is necessary for the Executive Officer to retain authority to terminate or limit the 'authorization to emit' so that in the case of fraud or market manipulation, ARB has a mechanism to protect the market. Additionally, property rights cannot attach to the compliance instruments because, in the event of federal preemption in the cap-and-trade market or other conditions, California must have the ability to revoke the compliance instruments without creating a loss to the people of California. (ISOR IX-18.)

Similarly, in its Final Statement of Reasons, ARB explained that "[t]he Executive Officer needs broad authority to limit or terminate the allowances to ensure that, in the event of any violations, fraud, or other malfeasance in the conduct of the allowance market, it can be immediately addressed." (FSOR 727.)

These statements by ARB, together with the regulation's plain language, make clear that ARB included Section 95820(c) to reserve for itself broad discretion to terminate, revoke, or limit allowances without the constraints that ordinarily restrict an agency's ability to confiscate private property. (*See* § 95820(c) ["No provision of this article may be construed to limit the authority of the Executive Officer to terminate or limit such authorization to emit. A compliance instrument issued by the Executive Officer does not constitute property or a property right."].) Among other things, if allowances created a property right, ARB would be subject to federal constitutional restraints on depriving persons of property without due process of law and taking private property for public use without just compensation. (*See* U.S. Const., amends. V, XIV.)

ARB's own regulations, therefore, undermine its argument that the allowance charges are not a tax because "[p]articipants in the

auction and reserve sales acquire allowances in exchange for their payment of the sales price." (ARB Br. 54.) Allowance buyers do not "acquire" an ordinary ownership interest in the allowances; they receive only the authorization to emit a specified volume of greenhouse gases. (*See* § 95856 [covered entities must surrender compliance instruments sufficient to cover their greenhouse gas emissions]; ISOR IX-18 ["Compliance instruments are created by ARB through AB 32, and are to be used solely for use as a compliance credit in California's market."].) And, according to ARB, even that limited authorization is subject to termination, revocation, or limitation at ARB's unilateral discretion.

The purchase of an allowance thus is not "an exchange for equal value," such as occurs when the state "sell[s] or leas[es] excess real and personal property." (ARB Br. 48.) Unlike real and personal property, "an allowance has no intrinsic value independent of the regulatory scheme—the value results from the 'cap' and the resulting scarcity of allowances that ARB makes available." (NAM Reply 34.) As the Superior Court explained, "allowances have value to covered

entities only because the government has forbidden covered entities from emitting GHG without an allowance." (JA 1581.[1])

II. 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.

At no point in this litigation has ARB attempted to establish a reasonable relationship—or *any* relationship—between any environmental impacts caused by covered entities and the billions of dollars in excess revenue generated by ARB's auctions and reserve sales. (*See* NAM Opening Br. 46.) This was a litigation burden borne by ARB. (*See, e.g., Cal. Farm Bureau Fed'n v. State Water Res. Control Bd.* (2011) 51 Cal.4th 421, 436–37 ["the state bears the burden of production and must show … 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 Paint Co. v. State Bd. of Equalization* (1997) 15 Ca1.4th 866, 878.) ARB's failure even to attempt to meet its burden in this regard—either below or in its

[1] "Thus, from the perspective of a covered entity, the purchase of allowances is little different from an emissions tax. In the case of an emissions tax, covered entities obtain the right to emit GHGs by paying the tax; in the case of the cap-and-trade auction, they obtain this right by purchasing allowances." (JA 1581.)

brief on appeal—is by itself grounds for reversal. (*See, e.g., Beaumont Inv'rs v. Beaumont-Cherry Valley Water Dist.* (1985) 165 Cal.App.3d 227, 234–38 [charge was a tax because the government failed to show it did not "exceed the reasonable cost" of regulation].) ARB should not now be permitted to defend the auctions and reserve sales based on a theory that it not only has failed to advance previously, but has affirmatively disavowed. (*See* ARB Br. 47 [calling *Sinclair Paint*'s requirements "no longer useful"]; JA 1837 ["We're not claiming to be a Sinclair-type fee so that analysis ... just doesn't apply here."].)

But ARB's failure goes deeper than its litigation strategy. To our knowledge, nowhere in the thousands of pages that comprise the administrative record did ARB attempt to quantify any environmental impacts caused by covered entities or to establish any relationship between those impacts and the billions of dollars it proposed to raise through its auctions and reserve sales. Indeed, ARB never established that covered entities' greenhouse gas emissions will cause *any* environmental impacts that would not otherwise occur due to emissions from sources in other states and countries around the globe. Unlike conventional pollutants, greenhouse gases do not act locally; they mix in the atmosphere, and "the amount that is measured in the

atmosphere is roughly the same all over the world, regardless of the source of the emissions." (EPA, *Overview of Greenhouse Gases*, at https://www3.epa.gov/climatechange/ghgemissions/gases.html.)

Thus, as ARB has elsewhere observed, "emissions generated outside of California pose the same risk to California citizens as those generated inside California." (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].) California's total greenhouse gas emissions make up a tiny fraction of global emissions.[2] Further, covered entities are not the only significant sources of greenhouse gas emissions in California. ARB has not shown that eliminating covered entities' emissions *entirely* would have *any* measurable impact on global climate change or any environmental impacts in California, let alone that covered entities' operations will impose tens of billions of dollars in "social or economic 'burdens'" on California over the life of the Cap-and-Trade Program. (*Sinclair Paint*, 15 Cal.4th at 881.)

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[2] *See* EPA, *Global Greenhouse Gas Emissions*, at https://www3.epa.gov/climatechange/science/indicators/ghg/global ghg-emissions.html (estimating global greenhouse gas emissions at "nearly 46 billion metric tons" in 2010]; ARB, *California Greenhouse Gas Emission Inventory—2015 Edition*, at http://www.arb.ca.gov/cc /inventory/data/data.htm (estimating total California greenhouse gas emissions at 459 million metric tons in 2013).

Moreover, ARB could not possibly have calibrated the revenue from its auctions and reserve sales to bear a reasonable relationship to any burdens generated by covered entities' operations, because the amount of revenue that would be generated was uncertain—the estimated range varied by as much as $58 *billion*. (NAM Opening Br. 47; JA 1566.) Among other things, ARB recognized that the amount to be raised depended on the price of the allowances sold at auction, which was "impossible to predict with precision" because "many factors influence the allowance price." (ISOR at VIII-14; *see also id.* at VIII-6–7.) The open-ended nature of the allowance revenues sharply distinguishes them from charges that have been upheld as regulatory fees; invariably those fees have been carefully calibrated to ensure that they raised no more than necessary to fund a predefined regulatory program. (*See* NAM Opening Br. 43–45 [citing cases].)

Because ARB did not—either in the Superior Court or during the administrative proceedings—establish a reasonable relationship between the allowance revenues and the cost of any regulatory program or any burdens imposed by covered entities' operations, that should end the matter: the allowance charges are unconstitutional taxes. (*See, e.g., Beaumont Inv'rs*, 165 Cal.App.3d at 237 [holding

that a charge imposed to finance improvements to water system facilities was an unconstitutional tax because the record did not contain "the facts necessary to establish a reasonable relation between the estimated cost of the capital improvements and the facilities fee imposed on plaintiff"].)

III. Can the auction system be defended against the Proposition 13 challenge on the ground it is akin to a development fee? Address what standards apply when assessing the legality of such fees and how the auction system does or does not meet them.

The allowance charges cannot be upheld as development fees, for three reasons.

First, ARB did not attempt to defend the allowance charges as development fees either in the Superior Court or in its brief on appeal. (*See* NAM Opening Br. 36 n.13; NAM Reply 21 n.8.) ARB has therefore waived this argument and should not be permitted to advance it for the first time now. (*See, e.g., Newton v. Clemons* (2003) 110 Cal.App.4th 1, 11 ["[I]t is fundamental that a reviewing court will ordinarily not consider claims made for the first time on appeal which could have been but were not presented to the trial court. Thus, we ignore arguments, authority, and facts not presented and litigated in the trial court."]; *Cleary v. Cty. of Alameda* (2011) 196 Cal.App.4th

826, 854 [arguments not raised in trial court or initial brief on appeal are waived].)

Second, the allowance charges are not development fees because they are not "exacted in return for building permits or other governmental privileges." (*Sinclair Paint*, 15 Cal.4th at 875; *see also Cal. Bldg. Indus. Ass'n v. San Joaquin Valley Air Pollution Control Dist.* (2009) 178 Cal.App.4th 120, 131 ["The ISR fees are not exacted in return for permits or other government privileges. Thus, the ISR fees are not development fees…"].) Development fees are designed to compensate the government for the cost of government services or expenditures that confer a distinct benefit on the developer or for the costs the development imposes on the community. (*See, e.g., Sinclair Paint*, 15 Cal.4th at 875; *Evans v. City of San Jose* (1992) 3 Cal.App.4th 728, 737–38; *Russ Bldg. P'ship v. City and Cty. of San Francisco* (1987) 199 Cal.App.3d 1496, 1504.) The allowance charges do not compensate the government for any services or expenditures that distinctly benefit regulated entities. Nor do they compensate the government for any burdens regulated entities impose on the community. (*See* Question II, *supra*.) Thus, as in *Sinclair Paint*, the allowance charges are not development fees because they

"neither reimburse the state for special benefits conferred on [regulated entities] nor compensate the state for governmental privileges granted to those [entities]." (15 Cal.4th at 875.)

Third, and in any event, the allowance charges cannot be *valid* development fees because the billions in revenue they generate do not "bea[r] a reasonable relation to [any] development's probable costs to the community and benefits to the developer." (*Id.*) The "reasonable relation" requirement cannot be evaded simply by reclassifying the allowance charges as purported development fees rather than purported regulatory fees: "regardless of the type of fee, it must bear some reasonable relation to the benefits and costs associated with the service." (*Bay Area Cellular Tel. Co. v. City of Union City* (2008) 162 Cal.App.4th 686, 694.) ARB has not shown that the allowance revenues bear a reasonable relation to *anything*. Instead, it has asserted unlimited authority to extract billions in revenue from regulated entities to be spent on a wide variety of projects that have nothing to do with regulating payers' activities. (*See* NAM Opening Br. 53; NAM Reply 25.) This unbounded—and unprecedented—assertion of revenue-raising authority should be rejected.

IV. Can the auction system be defended against the Proposition 13 challenge on the ground it essentially sells to covered entities the privilege to pollute?

Because the allowance charges cannot meet the requirements of *Sinclair Paint*, the auction system cannot be upheld on the ground that it "sells to covered entities the privilege to pollute." For example, in *San Diego Gas & Electric Co. v. San Diego County Air Pollution Control District* (1988) 203 Cal.App.3d 1132, the court upheld an emissions-based fee imposed on stationary sources of air pollution on the ground that the fee "shift[ed] the costs of controlling stationary sources of pollution from the tax-paying public to the pollution-causing industries themselves." (*Id.* at 1148.) But the court did so only *after* applying the criteria for regulatory fees and concluding that the "fees [we]re reasonably related to the district's costs of regulating a permit holder's air pollution." (*Id.* at 1145–48.) The *Sinclair Paint* Court likewise concluded that the fees at issue there, which were designed to mitigate lead pollution, could be upheld only if they met the requirements for regulatory fees. (*See* 15 Cal.4th at 878–79 (analogizing lead-pollution mitigation fees to the emission-based regulatory fees in *San Diego Gas & Electric*.) Under *Sinclair Paint*, the government cannot impose charges for the "privilege" of engaging

in activity that generates pollution unless those charges either garner the votes of the legislative supermajority necessary to impose new taxes or meet the requirements of valid regulatory fees.

A contrary rule would have sweeping implications—particularly in the context of greenhouse gas emissions. Virtually every human activity causes greenhouse gas emissions. Thus, if the government could impose charges for the "privilege" of emitting greenhouse gases, free and clear of the restrictions on either new taxes or regulatory fees, there would be no practical limit to the activities for which the government could charge or the amount of revenue it could raise. As the NAM has explained previously—without any response from ARB—under ARB's logic, nothing would prevent a bare legislative majority from imposing such a charge on all California citizens for the "privilege" of driving their cars. (*See* NAM Reply 35; JA1499).[3]

Nor does the logic of ARB's position stop with greenhouse gas emissions. On the same logic, the government could impose charges

[3] *See also* ARB, *California Greenhouse Gas Emission Inventory—2015 Edition*, at http://www.arb.ca.gov/cc/inventory/data/data.htm (showing that the transportation sector is the largest single source of greenhouse gas emissions in California).

for the "privilege" of engaging in any activity, or at least any activity that might be within the government's police power to prohibit or regulate. The government could evade the restrictions on property or business taxes by instead simply charging a fee for the "privilege" of owning property or operating a business in California. If there were no special restrictions on the Legislature's taxing power as opposed to its police power, this would be unproblematic. But in Proposition 13, the citizens of California determined that new taxes should be imposed only when two-thirds of the Legislature agree that they are necessary. And in order to prevent evasion of that requirement, the California Supreme Court in *Sinclair Paint* and other cases has held that regulatory fees may be imposed only when they satisfy the requirements set forth in *Sinclair Paint*; otherwise they are taxes. Because the allowance charges were not approved by the necessary supermajority of the Legislature and do not satisfy *Sinclair Paint*'s requirements for regulatory fees, they are unconstitutional taxes.

V. Although the current petitions do not seek to invalidate any particular expenditures of the auction revenue, the record shows the revenue is used for a wide variety of programs.

The plaintiffs suggest that the auction proceeds—at least in part—are being used to replace what otherwise would be general fund expenditures.

(a) How directly must a particular expenditure of auction revenue be related to the goal of reducing greenhouse gases?

In *Sinclair Paint*, the California Supreme Court explained that "regulatory fees in amounts *necessary* to carry out the regulation's purpose are valid despite the absence of any perceived benefit accruing to the fee holders." (15 Cal.4th at 876 [emphasis added].[4]) "[A] fee may be charged by a government entity so long as it does not exceed *the reasonable cost of providing services necessary to regulate the activity for which the fee is charged*." (*Cal. Farm Bureau*, 51 Cal.4th at 421, 437 [emphasis added] ["A valid fee may not be imposed for unrelated revenue purposes."].) "What a fee cannot do is exceed the reasonable cost of regulation with the generated surplus used for general revenue collection." (*Id.* at 438.) In assessing these

[4] *Sinclair Paint* cited *Pennell v. City of San Jose* (1986) 42 Cal.3d 365, 375, which upheld "rental unit fees that a city imposed under its rent control ordinance to assure it recovered the actual costs of providing and administering a rental dispute hearing process." (*Id.*)

issues, "the state bears the burden of production and must show … 'the estimated costs of the service or regulatory activity.'" (*Id.* at 436–37 [quoting *Sinclair Paint*, 15 Cal.4th at 878].)

Under these standards, the Court need not assess individual expenditures of auction and reserve sale revenue to determine whether those revenues are a tax. That is because the revenues generated from the sale of allowances at auctions and reserve sales are used for purposes unrelated to the costs of implementing and enforcing AB 32, and thus unquestionably "exceed the reasonable cost of providing services necessary to regulate the activity for which the fee is charged." (*Cal. Farm Bureau*, 51 Cal.4th at 437.) In particular, the California Global Warming Solutions Act of 2006 (AB 32), under which the Board adopted the Cap-and-Trade Program, already includes a separate regulatory fee provision through which the Board fully funds the implementation and enforcement of regulatory activities under AB 32. (NAM Opening Br. 13–14.)

Section 38597 provides that the Board may "adopt by regulation … a schedule of fees to be paid by the sources of greenhouse gas emissions regulated pursuant to [AB 32], consistent with Section 57001" and that "[t]he revenues collected pursuant to

this section, shall 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(a), in turn, requires the Board 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.*)

Consistent with these provisions, the Board has adopted a fee schedule, separate and apart from the revenues generated from the sale of allowances, that fully funds the implementation of AB 32. (NAM Opening Br. 14 [comparing annual fees required to implement and enforce AB 32 with revenues generated by a single quarterly auction].) This separate funding source within AB 32 confirms that proceeds from the sale of allowances are invalid taxes rather than regulatory fees. (*See Nw. Energetic Servs., LLC v. Cal. Franchise Tax Bd.* (2008) 159 Cal.App.4th 841, 860-61 [under *Sinclair Paint*, the “Levy more closely resembles a tax” because “the Legislature provided sources other than the Levy to compensate the [government] for the costs of implementing the LLC Act”].)

Any revenues generated for the State from the sale of allowances at auctions and reserves sales, by definition, are in excess

of the fees that are already "paid by the sources of greenhouse gas emissions regulated pursuant to [AB 32]," and that the Board determined were "necessary to fund the efficient operation of the activities or programs … for purposes of carrying out [AB 32]." The revenue collected by ARB from the sale of allowances at auctions and reserve sales necessarily "exceed[s] the reasonable cost of providing services necessary to regulate the activity for which the fee is charged." (*Cal. Farm Bureau*, 51 Cal.4th at 437.) These revenues are invalid taxes under controlling California law.

(b) What standards should the judiciary apply in reviewing expenditures that are alleged to be replacements for general revenue expenditures?

In *California Farm Bureau*, 51 Cal.4th at 438, the California Supreme Court explained that "permissible fees must be related to the overall cost of the governmental regulation" and that an "excessive fee that is used to generate general revenue becomes a tax." (*Id.*) Applying these standards, the Court highlighted that "the statutory language" of the program at issue there "reveal[ed] a specific intention to avoid imposition of a tax" by "permit[ing] the imposition of fees only for the costs of the functions or activities described, and not for general revenue purposes." (*Id.*) Thus, the relevant statutory

language did "not require [the agency] to collect anything more than the administrative 'costs incurred' in carrying out the functions authorized in its subdivisions." (*Id.* at 439.)

The allowance revenues are invalid taxes under these standards. (*See* NAM Opening Br. 45 [citing cases].) *First*, as discussed above, the revenues generated by the sale of allowances at auctions and reserve sales exceed the reasonable cost of providing service necessary to regulate covered entities under AB 32, which are separately funded under AB 32. (*See* Question V(a), *supra*; *Nw. Energetic Servs.*, 159 Cal.App.4th at 860.) As a result, those excess revenues—projected to be between $12 and $70 billion—are not used to fund the State's "reasonable cost of providing services" under AB 32, but instead are deposited in a separate fund that is subject to appropriation by the Legislature.

Second, as explained by the California Supreme Court, in assessing whether a charge is a tax, "the state bears the burden of production and must show … 'the estimated costs of the service or regulatory activity.'" (*Cal. Farm Bureau*, 51 Cal.4th at 436–37 [quoting *Sinclair Paint*, 15 Cal.4th at 878].) The excess revenues from auctions and reserve sales are replacements for general revenue

expenditures because nothing in AB 32 identifies or purports to limit the services or regulatory activities that these excess fees will fund. (*See* NAM Opening Br. 51.) Rather, well after AB 32 was adopted in 2006, the Legislature in 2012 directed that the revenues from the sale of allowances at auctions and reserve sales be deposited into "[t]he Greenhouse Gas Reduction Fund," where they are (i) "available for appropriation by the Legislature," and (ii) may be used by "the Controller … for cash flow loans to the General Fund." (Gov't Code § 16428.8(b), (d).[5])

It is no answer that the State has attempted to tie these programs to reductions in GHG emissions generally. Indeed, these circumstances are indistinguishable from the decision in *Morning Star Co. v. Board of Equalization* (2011) 201 Cal.App.4th 737, 755. There, this Court addressed the relevant standard for assessing whether the revenues generated are "replacements for general revenue expenses." The *Morning Star* Court explained that a charge applied to a company that used, generated, and stored *certain* hazardous waste

[5] These funds are available to fund a wide range of matters such as to construct high-speed rail, to develop advanced technology and biofuels, to improve municipal waste disposal, and to support land and natural resource conservation and management, forestry, and sustainable agriculture. (*E.g.*, Health & Safety Code § 39712(c).)

was a "tax" rather than a regulatory fee "because [the charge] does 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*." (*Id.* [emphasis added].) That holding applies directly to the excess revenues at issue here.

Finally, the purported restrictions imposed after-the-fact cannot satisfy *Sinclair Paint* for the additional reason that, as a practical matter, they impose no limitation on the ability to appropriate these excess funds for virtually any project. Section 39712 of the Health and Safety Code provides that revenues deposited in the Greenhouse Gas Reduction Fund are to be used to "further[] the regulatory purposes of [AB 32]" and to "facilitate the achievement of reductions of greenhouse gas emissions in this state consistent with [AB 32]." (Health & Safety Code § 39712(a)(2), (b).) As the Superior Court explained, "since … every aspect of life has some impact on GHG emissions, it is difficult to conceive of a regulatory activity that will not have at least some impact on GHG emissions." (JA1582.)

(c) 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?

To the extent the Court concludes that the programs funded by the allowance revenues are "not sufficiently tethered to AB 32"—which conclusion is inescapable, as explained above—then the NAM would be entitled to the relief it has sought: (1) a declaration that the revenues generated from the sale of allowances at auctions and reserve sales are unconstitutional taxes and (2) a writ of mandate enjoining enforcement of the specific regulations that allow the Board to conduct revenue-raising auctions and reserve sales. (*See Bay Area Cellular Tel.*, 162 Cal.App.4th 686 [affirming trial court's order granting declaratory relief for plaintiffs that "Fee" was an unconstitutional tax].[6]) Further, a program-by-program analysis is unwarranted here because the excess revenues generated from auctions and reserve sales all are in excess of the amounts necessary

[6] As discussed below, (*see* Question VII, *infra*), that relief would prevent the Board from conducting auctions and reserve sales that generate revenues over and above what the State already collects to fund the implementation and enforcement of AB 32. The NAM has not sought, on behalf of its members, particularized relief, including any refunds for any invalid tax. As a result, the NAM's Petition does not present the Court with any question about the appropriate remedy where covered entities seeks a refund of an unlawful tax.

to fund the implementation and enforcement of programs under AB 32, which contains a separate mechanism that ensures full funding of AB 32 by covered parties. *See Nw. Energetic Servs.*, 159 Cal.App.4th at 860.

VI. Address the proper test for voluntariness in the context of determining whether a payment is or is not voluntary for purposes of deciding whether it is a compulsory exaction or freely-entered transaction.

Apply the test to explain whether or not the auction payments are voluntary.

As part of the discussion, assume for purposes of argument only that the trial court credited the Rabo declaration, and that Morning Star (purely as a hypothetical case) will be forced out of business due to the lack of feasible, affordable, technology to reduce its greenhouse gas emissions, if it must continue to obtain emissions credits in order to operate its tomato processing facilities.

The California Supreme Court has explained that "[m]ost taxes are compulsory rather than imposed in response to a voluntary decision to develop or to seek other government benefits or privileges." (*Sinclair Paint*, 15 Cal.4th at 874.) The question of voluntariness generally arises in connection with the collection of

development fees which are "exacted in return for permits or other government privileges." (*Id.* [citing cases].[7])

Here, the purchase of allowances by covered entities is not in any practical sense "voluntary." *First*, as discussed above, (*see* Question III, *supra*), there is no claim that the proceeds from the sale of allowances are development fees of the sort charged by the government in exchange for permits or other government privileges. (ARB Br. 43 ["the auction and reserve sales differ from fees"]; Intvr. Br. 51 ["[T]he auction and reserve do not 'impose' a 'fee' at all."].) Rather, allowances are purchased by covered parties to avoid civil and criminal penalties that may apply for non-compliance. (*See* Cal. Code Regs., tit. 17, §§ 96013-14; Health & Safety Code § 38580).

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[7] For example, in *Shapell Industries, Inc. v. Governing Board of the Milpitas Unified School District* (1991) 1 Cal.App.4th 218, the Court upheld a levy imposed on "new residential development" which required developers to pay fees "as a condition of obtaining a building permit." (*Id.* at 240.) Similarly, *Russ Building Partnership*, 199 Cal.App.3d 1496, upheld a development fee that was "triggered by the voluntary decision of the developer to construct office buildings" and was "directly tied to the increase in ridership that this construction will possibly generate." (*Id.* at 1505.) And, in *Terminal Plaza Corp. v. City and County of San Francisco* (1986) 177 Cal.App.3d 892, the court upheld an ordinance which required residential hotel owners to make a one-for-one replacement of residential units which were lost through conversion or demolition as a condition for obtaining a building permit. (*Id.* at 906.)

Second, as set forth in the hypothetical example, covered entities have no realistic choice but to buy allowances. As explained by the Superior Court, "the allowances have value to covered entities only because the government has forbidden covered entities from emitting GHG without an allowance." (JA1581.) As a result, the "covered entity … must reduce its GHG emissions to zero—which, generally speaking, is impractical or impossible—or acquire allowances." (*Id.*) The "hypothetical" example identified by this Court tracks this analysis precisely because covered entities cannot realistically avoid purchasing allowances unless they cease business operations. That sort of Hobson's "choice" is no choice at all.

As explained by the Superior Court, "the purchase of allowances is little different from an emissions tax" where "covered entities obtain the right to emit GHGs by paying the tax." (*Id.*) Indeed, if covered entities had a practical alternative to purchasing allowances, then California could not have projected the sale of such allowances to generate tens of billions of dollars in revenue for the State. (*Cf. Cal. Taxpayers' Ass'n v. Franchise Tax Bd.* (2010) 190 Cal.App.4th 1139, 1149 [penalty was not a tax because revenues were projected to decline as taxpayers could avoid the penalty by

complying with the law, whereas a tax "raises revenue if [the law] is obeyed"].)

Finally, if the purchase of allowances were deemed "voluntary," then "even income, sales, and property taxes would not be 'compulsory' because they must be paid only if one 'voluntarily' earns income, purchases goods, or owns property." (JA1581 n.10.) In each of these instances, "one can avoid the tax by choosing not to engage in the taxed activity." (*Id*.)

VII. 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?

Through its Verified Complaint, the NAM has sought (1) "a writ of mandate [i] prohibiting the Respondents from allocating to the ARB and/or the State a portion of the annual available GHG emission allowances and [ii] conducting the auctions or selling off of those allowances under the purported authority of 17 CCR §§ 95870 and 95910–95914." (JA320.) Among other things, the NAM seeks (1) a "declaratory judgment that 17 CCR §§ 95870 and 95910–95914 impose an unconstitutional tax" and (2) a "writ of mandate prohibiting the unconstitutional tax contained in 17 CCR §§ 95870 and 95910–95914." (*Id*.)

The relief sought by the NAM is tailored to address the continued implementation of regulations that are projected to generate many billions of dollars in unconstitutional taxes for the State. Section 95870 addresses directly the disposition of allowances as well as proceeds from the sale or auction of allowances. Specifically, Section 95870(b)(3) addresses the disposition of revenue generated from the proceeds from the sale of allowances to be placed into "the Greenhouse Gas Reduction Fund" that would be available "for appropriation by the Legislature …." (*Id.*) Similarly, Section 95870(i)(2) directs that "proceeds from the sale of … allowances will be deposited into the Greenhouse Gas Reduction Fund … and will be available for appropriation by the Legislature …." (*Id.*) Finally, Section 95913(i)(2)(B) and (C) likewise require that proceeds from the sale of allowances from the allowance price containment reserve be deposited "into the Greenhouse Gas Reduction Fund." (*Id.*)

If the Court concludes that these proceeds constitute an unconstitutional tax, it should declare that these provisions in the Cap-and-Trade regulation are invalid and issue a writ of mandate precluding their enforcement. As the NAM has explained in its briefs, the relief it seeks would not foreclose ARB's ability to adopt

regulations through which it could administer a Cap-and-Trade Program that complied with the California Constitution. (NAM Opening Br. 20–21 [explaining that AB 32 does not mandate that ARB generate revenue through the sale of allowances]; *id.* at 25–27 [explaining that sale of allowances does not imply that ARB will generate revenue].)

Indeed, as ARB has recognized, "[m]any different methods can be used to distribute allowances free of charge." (JA 1573; FSOR 732; ISOR, App. H, at H-66 to H-67.) Even the sale of allowances at an auction or reserve sale may be permissible so long as it does not generate revenues for the State of California over and above those reasonably required to implement and enforce AB 32. For example, ARB would be free to consider adopting new regulations implementing a Cap-and-Trade Program that comply with the California Constitution. To be sure, adoption of regulations that eliminate the massive revenue-generating component of the current program could compel ARB to reconsider the manner in which it administers the Cap-and-Trade Program, including the manner in which allowances are allocated to covered entities.

A prime example is the federal acid rain cap-and-trade program administered by the Environmental Protection Agency, which authorizes the sale of allowances, but does so in a revenue-neutral manner. (*See* 42 U.S.C. § 7651o(b); 40 C.F.R. § 73.27; NAM Opening Br. 25–27.) Under that program, which was explicitly authorized by Congress in separate legislation, EPA allocates 97.2% of acid-rain allowances without charge and reserves 2.8% for sale or auction, while directing that all proceeds of the sales and auctions be returned to the covered entities in a prescribed formula. (*Id.*) Under that system, none of the revenues from the auctions is retained by the federal government.

These and many other legal and policy issues may be open to ARB going forward so long as its actions conform to the Constitution and this Court's Order. ARB, however, could not continue to implement and enforce the existing auction and reserve sale regulations because they improperly generate revenue for the State in violation of the California Constitution.

Finally, if this Court concludes that the auctions and reserve sales authorized by the Cap-and-Trade regulations violate the California Constitution, the NAM respectfully requests that the Court

also remand the case to the Superior Court to assess whether, in light of this Court's ruling, the NAM is entitled to "further relief as the Court shall deem appropriate." (JA320). For example, the Superior Court should be permitted to assess the practical impact of the ruling on the obligations of covered parties under the Cap-and-Trade Program in light of the Court's ruling. Because the Superior Court has not had addressed these issues previously, it should be given that opportunity in the first instance.

CONCLUSION

For these reasons, and the reasons set forth in the NAM's prior briefs, the judgment below should be reversed.

Respectfully submitted,

By: */s/ Sean A. Commons*

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DECLARATION OF SEAN A. COMMONS
IN CERTIFICATION OF BRIEF LENGTH

Sean A. Commons, Esq., declares:

1. I am licensed to practice law in the state of California, and am the attorney of record for Appellant in this action. I make this declaration to certify the word length of **SUPPLEMENTAL BRIEF OF APPELLANT THE NATIONAL ASSOCIATION OF MANUFACTURERS**.

2. In accordance with the Court's order, dated April 8, 2016, this Brief does not exceed 30 pages.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct and of my own personal knowledge except for those matters stated on information and belief and, as to those matters, I believe them to be true. If called as a witness, I could competently testify thereto.

Executed on May 23, 2016, at Los Angeles, California.

/s/ Sean A. Commons
Sean A. Commons

Cal Chamber v. California Air Resources Board
Morning Star v. California Air Resources Board
CA Court of Appeal, 3rd Appellate District
Case Nos. C075930 and C075954

PROOF OF SERVICE

I, the undersigned, declare under penalty of perjury that:

I am a citizen of the United States employed in the County of Marin. I am over the age of 18 and not a party to the within cause of action. My business address is 555 W. Fifth Street, Suite 4000, Los Angeles, California 90013. I am readily familiar with my employer's practices for collection and processing of correspondence for mailing with the United States Postal Service.

On May 23, 2016, I served a true copy of the foregoing **SUPPLEMENTAL BRIEF OF APPELLANT THE NATIONAL ASSOCIATION OF MANUFACTURERS** on the following parties in said action, by serving the parties on the attached Service List

X **BY U.S. MAIL:** By following ordinary business practices and placing for collection and mailing at 555 West Fifth Street, Suite 4000, Los Angeles, California 90013 a true copy of the above-referenced document(s), enclosed in a sealed envelope; in the ordinary course of business, the above documents would have been deposited for first-class delivery with the United States Postal Service the same day they were placed for deposit, with postage thereon fully prepaid.

Executed in Los Angeles, California, on May 23, 2016.

I declare under penalty of perjury, that the foregoing is true and correct.

Deborah J. Kelly

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