

1 Roger R. Martella, Jr. (*pro hac vice*)  
Paul J. Zidlicky (*pro hac vice*)  
2 Eric D. McArthur (*pro hac vice*)  
SIDLEY AUSTIN LLP  
3 1501 K Street NW  
Washington, DC 20005  
4 Tel: 202-736-8000  
Fax: 202-736-8711  
5 Email: [rmartella@sidley.com](mailto:rmartella@sidley.com)  
Email: [pzidlicky@sidley.com](mailto:pzidlicky@sidley.com)  
6 Email: [emcarthur@sidley.com](mailto:emcarthur@sidley.com)

7 Sean A. Commons (SBN 217603)  
SIDLEY AUSTIN LLP  
8 555 West Fifth Street  
Los Angeles, CA 90013  
9 Tel: 213-896-6010  
Fax: 213-896-6600  
10 Email: [scommons@sidley.com](mailto:scommons@sidley.com)

11 *Attorneys for Petitioner/Plaintiff-Intervenor*  
*National Association of Manufacturers*

12 **SUPERIOR COURT OF THE STATE OF CALIFORNIA**

13 **COUNTY OF SACRAMENTO**

14 CALIFORNIA CHAMBER OF COMMERCE, )  
15 a nonprofit business association, and LARRY )  
DICKE, a State of California Taxpayer, )  
16 Petitioners/Plaintiffs, )

17 vs. )

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

23 Respondents/Defendants. )  
24  
25  
26  
27  
28

Case No.: 34-2012-80001313

**REPLY IN SUPPORT OF VERIFIED  
COMPLAINT IN INTERVENTION OF  
THE NATIONAL ASSOCIATION OF  
MANUFACTURERS**

Department: 29

Judge: Hon. Timothy M. Frawley

Hearing Date: Aug. 28, 2013

Date Action Filed: Nov. 13, 2012

**TABLE OF CONTENTS**

	<b>Page</b>
INTRODUCTION .....	1
ARGUMENT .....	4
I. AB 32 DOES NOT AUTHORIZE THE BOARD TO RAISE REVENUE BY SELLING GHG EMISSIONS ALLOWANCES.....	4
A. The Legislature Did Not Grant ARB Authority to Generate Revenue by Selling and Auctioning Allowances.....	4
B. Even If AB 32 Were Ambiguous, that Ambiguity Must Be Resolved to Avoid the Serious Constitutional Questions that Arise from ARB Raising Billions In Revenues. ....	8
II. IF CONSTRUED TO AUTHORIZE ARB TO RAISE REVENUE BY SELLING ALLOWANCES, AB 32 WOULD IMPOSE AN UNCONSTITUTIONAL TAX. ....	12
A. <i>Sinclair Paint</i> Establishes the Framework for Determining Whether a Revenue-Generating Regulatory Fee Is a Tax. ....	13
B. The Allowance Revenues Are Unconstitutional Taxes under <i>Sinclair Paint</i> . ....	16
C. The Auction and Reserve Sale Revenues Bear All the Indicia of a Tax. ....	20
CONCLUSION.....	26

## TABLE OF AUTHORITIES

### Page(s)

#### CASES

<i>Alamo Rent-A-Car, Inc. v. Bd. of Supervisors,</i> 221 Cal. App. 3d 198 (1990) .....	15
<i>Am. Coatings Ass'n v. S. Coast Air Quality Mgmt. Dist.,</i> 54 Cal. 4th 446 (2012) .....	8
<i>Ass'n for Retarded Citizens v. Dep't of Developmental Servs.,</i> 38 Cal. 3d 384 (1985) .....	10
<i>Barratt Am., Inc. v. City of Rancho Cucamonga,</i> 37 Cal. 4th 685 (2005) .....	15
<i>Brydon v. E. Bay Mun. Util. Dist.,</i> 24 Cal. App. 4th 178 (1994) .....	15
<i>Cal. Bldg. Indus. Ass'n v. Governing Bd.,</i> 206 Cal. App. 3d 212 (1988) .....	15
<i>Cal. Bldg. Indus. Ass'n v. San Joaquin Valley Air Pollution Control Dist.,</i> 178 Cal. App. 4th 120 (2009) .....	15
<i>Cal. Farm Bureau Fed'n v. State Water Res. Control Bd.,</i> 51 Cal. 4th 421 (2011) .....	13, 14, 17, 19
<i>Cal. Redevelopment Ass'n v. Matosantos,</i> 53 Cal. 4th 231 (2011) .....	2, 5
<i>Cal. Taxpayers' Ass'n v. Franchise Tax Bd.,</i> 190 Cal. App. 4th 1139 (2010) .....	16
<i>Cal. Teachers Ass'n v. Bd. of Trs.,</i> 82 Cal. App. 3d 249 (1978) .....	11
<i>Capitol Industries-EMI, Inc. v. Bennett,</i> 681 F.2d 1107 (9th Cir. 1982) .....	9
<i>Carlsbad Mun. Water Dist. v. QLC Corp.,</i> 2 Cal. App. 4th 479 (1992) .....	15
<i>Citizens to Save Cal. v. FPPC,</i> 145 Cal. App. 4th 736 (2006) .....	9
<i>Collier v. City &amp; Cnty. of San Francisco,</i> 151 Cal. App. 4th 1326 (2007) .....	15

1	<i>Crowell v. Benson,</i>	
2	285 U.S. 22 (1932) .....	10
3	<i>Del Costello v. State,</i>	
4	135 Cal. App. 3d 887 (1982) .....	7
5	<i>Dyna-Med, Inc. v. Fair Emp't &amp; Hous. Comm'n,</i>	
6	43 Cal. 3d 1379 (1987) .....	9
7	<i>Evans v. City of San Jose,</i>	
8	3 Cal. App. 4th 728 (1992) .....	15, 25
9	<i>Goldin v. Pub. Utils. Comm'n,</i>	
10	23 Cal. 3d 638 (1979) .....	9
11	<i>Habitat &amp; Watershed Caretakers v. City of Santa Cruz,</i>	
12	213 Cal. App. 4th 1277 (2013) .....	12
13	<i>Harrott v. Cnty. of Kings,</i>	
14	25 Cal. 4th 1138 (2001) .....	2, 9
15	<i>Hernandez-Carrera v. Carlson,</i>	
16	547 F.3d 1237 (10th Cir. 2008) .....	10
17	<i>In re Johnson,</i>	
18	3 Cal. 3d 404 (1970) .....	19
19	<i>Knox v. City of Orland,</i>	
20	4 Cal. 4th 132 (1992) .....	15
21	<i>Mills v. Cnty. of Trinity,</i>	
22	108 Cal. App. 3d 656 (1980) .....	15
23	<i>Morning Star Co. v. Bd. of Equalization,</i>	
24	201 Cal. App. 4th 737 (2011) .....	18, 19
25	<i>Myers v. Philip Morris Cos.,</i>	
26	28 Cal. 4th 828 (2002) .....	11
27	<i>Nat'l Fed'n of Indep. Bus. v. Sebelius,</i>	
28	132 S. Ct. 2566 (2012) .....	23
	<i>Nat'l Mining Ass'n v. Kempthorne,</i>	
	512 F.3d 702 (D.C. Cir. 2008) .....	10
	<i>Newton v. Clemons,</i>	
	110 Cal. App. 4th 1 (2003) .....	12, 14, 15, 18
	<i>Nw. Energetic Servs., LLC v. Cal. Franchise Tax Bd.,</i>	
	159 Cal. App. 4th 841 (2008) .....	17

1	<i>Oakland Raiders v. City of Berkeley,</i>	
2	65 Cal. App. 3d 623 (1976) .....	23
3	<i>Pajaro Valley Water Mgmt. Agency v. Amrhein,</i>	
4	150 Cal. App. 4th 1364 (2007) .....	16
5	<i>Peralta Cmty. Coll. Dist. v. Fair Emp't &amp; Hous. Comm'n,</i>	
6	52 Cal. 3d 40 (1990) .....	2, 6, 7
7	<i>Perkey v. Dep't of Motor Vehicles,</i>	
8	42 Cal. 3d 185 (1986) .....	11
9	<i>Russ Bldg. P'ship v. City &amp; Cnty. of San Francisco,</i>	
10	199 Cal. App. 3d 1496 (1987) .....	15
11	<i>San Diego Gas &amp; Elec. Co. v. San Diego Cnty. Air Pollution Control Dist.,</i>	
12	203 Cal. App. 3d 1132 (1988) .....	15
13	<i>Sinclair Paint Co. v. State Board of Equalization,</i>	
14	15 Cal. 4th 866 (1997) .....	<i>passim</i>
15	<i>Solid Waste Agency v. United States Army Corps of Eng'rs,</i>	
16	531 U.S. 159 (2001) .....	10
17	<i>Sonzinsky v. United States,</i>	
18	300 U.S. 506 (1937) .....	23
19	<i>Terminal Plaza Corp. v. City &amp; Cnty. of San Francisco,</i>	
20	177 Cal. App. 3d 892 (1986) .....	15
21	<i>Tomra Pac., Inc. v. Chiang,</i>	
22	199 Cal. App. 4th 463 (2011) .....	13, 15
23	<i>Trent Meredith, Inc. v. City of Oxnard,</i>	
24	114 Cal. App. 3d 317 (1981) .....	15
25	<i>United Farm Workers of Am. v. Agricultural Labor Relations Bd.,</i>	
26	41 Cal. App. 4th 303 (1995) .....	6
27	<i>United States ex rel. Att'y Gen. v. Delaware &amp; Hudson Co.,</i>	
28	213 U.S. 366 (1909) .....	11
	<i>W. Sec. Bank v. Superior Court,</i>	
	15 Cal. 4th 232 (1997) .....	7
	<i>Washington v. Confederated Tribes of Colville Indian Reservation,</i>	
	447 U.S. 134 (1980) .....	23
	<i>Williams v. Babbitt,</i>	
	115 F.3d 657 (9th Cir. 1997) .....	10

1	<i>Yamaha Corp. of Am. v. State Bd. of Equalization,</i>	
2	19 Cal. 4th 1 (1998) .....	2, 8

### CONSTITUTION AND STATUTES

4	Cal. Const., art. III, § 3.5 .....	9
5	Cal. Const., art. XIII A, § 3 (2006).....	20
6	Cal. Const., art. XIII A, § 3.....	19, 20, 24
7	42 U.S.C. § 7651o.....	7, 11
8	Cal. AB 2013-110, ch. 20 (2013).....	24
9	Cal. Gov't Code § 16428.8(d).....	24
10	Cal. Health & Safety Code § 38562(b).....	1, 2, 5
11	Cal. Health & Safety Code § 38570.....	5
12	Cal. Health & Safety Code § 38597.....	2, 5
13	Cal. Health & Safety Code § 39712.....	18
14	Cal. Health & Safety Code § 39713.....	18

### REGULATIONS

16	17 CCR § 95870.....	18
17	17 CCR § 95911.....	25
18	17 CCR § 95913(e) .....	25

### OTHER AUTHORITIES

20	<i>American Heritage Dictionary of the English Language</i> 1773 (4th ed. 2009).....	24
21	<i>Black's Law Dictionary</i> 1496 (8th ed. 2004).....	24

## INTRODUCTION

Contrary to the main rebuttal arguments advanced by the Air Resources Board (“ARB”) and respondent-intervenors (collectively, “respondents”), this litigation does not call into question whether the Legislature can adopt statutes to address environmental issues or even challenge ARB’s authority to adopt a California cap-and-trade system designed to reduce greenhouse gas (“GHG”) emissions. Nor does the NAM’s position require that all emissions allowances be freely allocated. Respondents advance these strawmen positions that avoid the true legal issues in this case.

The threshold question presented is whether the Legislature authorized ARB to create a massive revenue-raising program to fund activities that respondents admit are not “directly related to state agencies’ development, administration and implementation of AB 32 regulations.” ARB Br. 27. Such a vast and unfettered grant of revenue-raising authority to ARB is not supported by the language of AB 32, is inconsistent with AB 32’s structure and purpose, and would, if accepted, unquestionably raise serious doubts about the validity of AB 32 under the California Constitution. Indeed, if, as respondents argue, the Legislature intended to authorize ARB to generate billions in revenues through auctions and reserve sales, such an unconstrained grant of authority to raise revenue would qualify as a tax adopted without a supermajority vote of the Legislature, as required by the California Constitution.

I. Application of settled principles of statutory construction confirms that the Legislature did not authorize ARB to raise billions in revenues for the State through auctions and reserve sales of emissions allowances. Nothing in AB 32 supports the conclusion that the Legislature granted ARB the authority to decide whether to raise billions in revenues through the auction or sale of allowances. Respondents rely on subsection 38562(b)(1) in arguing that ARB has authority to “[d]esign the regulations, including distribution of emissions allowances where appropriate . . . .” *E.g.*, ARB Br. 1 (quoting Health & Safety Code § 38562(b)(1)) (ellipsis added by ARB); Intvr. Br. 3 (same). Subsection (b)(1), however, does not grant authority to generate billions in revenues. To the contrary, subsection (b)(1) *constrains* ARB’s generic rulemaking authority by requiring that ARB “[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*

1 encourages early action to reduce greenhouse gas emissions.” Health & Safety Code § 38562(b)(1)  
2 (emphasis added). Language limiting a generic grant of rulemaking authority cannot be read as an  
3 affirmative grant to ARB of *carte blanche* authority to enact a vast revenue-collecting mechanism  
4 for the State’s coffers. The Legislature does not “‘hide elephants in mouseholes.’” *Cal.*  
5 *Redevelopment Ass’n v. Matosantos*, 53 Cal. 4th 231, 260–61 (2011).

6 Further, the structure of AB 32 reflects that the Legislature knew how to authorize ARB to  
7 impose revenue-generating fees, but did not grant ARB the unprecedented authority to generate  
8 billions in revenues through auctions and reserve sales. Section 38597 of AB 32—a provision upon  
9 which respondents do not and cannot rely here—expressly authorizes ARB to generate revenues  
10 through fees paid “by the sources of greenhouse gas emissions regulated pursuant to [AB 32]” “for  
11 purposes of carrying out this division.” Health & Safety Code § 38597. Given the constitutional  
12 concerns raised when an unelected agency imposes revenue-generating fees, the Legislature  
13 mandated compliance with detailed procedures that limit ARB’s discretion to ensure that the fees  
14 would not qualify as unconstitutional taxes. Given these limitations, it strains credulity to conclude  
15 that the Legislature gave ARB unconstrained discretion to generate massive revenues from private  
16 parties that dwarf the fees expressly authorized and carefully cabined elsewhere in AB 32. *See*  
17 *Peralta Cmty. Coll. Dist. v. Fair Emp’t & Hous. Comm’n*, 52 Cal. 3d 40, 51 (1990).

18 Even if AB 32 were ambiguous on this issue, controlling canons of construction require the  
19 Court to deny ARB authority to compel private parties to pay the State billions in auction and  
20 reserve sale revenues. Contrary to respondents’ arguments, an agency is entitled to no deference  
21 when it construes the scope of its authority under a statute. Likewise, ARB has no special  
22 competence in deciding constitutional questions. In contrast, California courts have the obligation to  
23 determine independently the scope of an agency’s authority, *Yamaha Corp. of Am. v. State Bd. of*  
24 *Equalization*, 19 Cal. 4th 1, 11 n.4 (1998), and, in doing so, must adopt any reasonable interpretation  
25 that would avoid the necessity of resolving a serious constitutional challenge, *Harrott v. Cnty. of*  
26 *Kings*, 25 Cal. 4th 1138, 1153 (2001). Respondents’ argument that AB 32 grants ARB authority to  
27 generate revenues through allowance auctions and reserve sales would raise serious questions about  
28



1 whether those revenues constitute impermissible taxes adopted without a supermajority vote as  
2 required by the California Constitution.

3 II. Alternatively, to the extent AB 32 were construed to authorize ARB to raise revenue by  
4 selling allowances, that grant of authority would be unconstitutional because it would impose a tax  
5 not authorized by the necessary two-thirds vote of the Legislature under the California Constitution.  
6 Because (1) AB 32 imposes no restrictions on the use of auction and reserve sale revenues, and (2)  
7 the billions of dollars in revenue generated by ARB's auctions and reserve sales are not reasonably  
8 related to the cost of any regulatory program or to any burdens imposed by the payers, the auction  
9 and reserve sale revenues constitute taxes under the controlling framework adopted by the Supreme  
10 Court in *Sinclair Paint Co. v. State Board of Equalization*, 15 Cal. 4th 866 (1997).

11 Respondents' failure even to argue that the allowance revenues satisfy the requirements of  
12 *Sinclair Paint* effectively concedes that they cannot satisfy those requirements. Instead, respondents  
13 argue that *Sinclair Paint* does not apply here because the purpose of the auctions and reserve sales is  
14 to regulate rather than to raise revenue. But respondents cannot circumvent *Sinclair Paint* simply by  
15 saying a tax is not a tax. The *Sinclair Paint* criteria are designed to determine whether a fee that is  
16 purportedly imposed for a regulatory purpose is in fact an impermissible tax. Indeed, the *Sinclair*  
17 *Paint* Court found that the fees at issue there served a valid regulatory purpose but nonetheless held  
18 that they would constitute unconstitutional taxes if the resulting revenues were used for unrelated  
19 revenue purposes or did not bear a reasonable relationship to the cost of the regulatory program or  
20 the burdens imposed by the payers' operations. Here, neither requirement is met. Moreover,  
21 respondents cite no case in which a regulatory fee was upheld without satisfying the *Sinclair Paint*  
22 criteria. At a minimum, therefore, the applicability of *Sinclair Paint* raises a serious constitutional  
23 question, which, as noted above, AB 32 must be construed to avoid.

24 Even apart from *Sinclair Paint*, the administrative record shows that the auction and reserve  
25 sale revenues are taxes that were enacted for the purpose of raising revenue. Respondents' contrary  
26 contention—that the billions of dollars in new revenues generated by ARB's auctions and reserve  
27 sales are “incidental” byproducts of regulation—is difficult to take seriously and, in any event, does  
28 not survive even a cursory review of the administrative record. Throughout the administrative

1 proceedings, both ARB and the advisory committees on which it relied repeatedly cited the  
2 additional state revenues that would be generated by selling allowances as a prime advantage of the  
3 proposed auctions and reserve sales over free allocation. ARB itself described its approach as a type  
4 of “green tax reform,” which would allow California to “rely on ... the proceeds from allowance  
5 auction ... as a substitute for distortionary taxes such as income and sales taxes.” ISOR, App. J, at J-  
6 64–J-65. Regardless of whether the auctions and reserve sales *also* serve valid regulatory purposes,  
7 the billions of dollars in revenues they generate bear all the indicia of a tax. Because that tax was  
8 not authorized by the requisite two-thirds majority of the Legislature, it is unconstitutional.

### 9 ARGUMENT

#### 10 **I. AB 32 DOES NOT AUTHORIZE THE BOARD TO RAISE REVENUE BY SELLING** 11 **GHG EMISSIONS ALLOWANCES.**

12 As shown in the NAM’s opening brief, the text, structure, purpose, and legislative history of  
13 AB 32 establish that AB 32 does not authorize ARB to generate revenues by auctioning and selling  
14 GHG emissions allowances. NAM Br. 11–15. Respondents’ principal response is that the  
15 Legislature delegated to ARB general authority to “design the regulations,” including “the  
16 distribution of emissions allowances where appropriate . . . .” ARB Br. 1; *see* Intvr. Br. 3 (same).  
17 They argue that ARB’s adoption of revenue-generating auctions and reserve sales is “consistent”  
18 with AB 32 as a whole, and is supported by post-AB 32 statutes adopted in 2012 that purport to  
19 expend the allowance revenues. As explained below, these arguments should be rejected.

#### 20 **A. The Legislature Did Not Grant ARB Authority to Generate Revenue by Selling** 21 **and Auctioning Allowances.**

22 At the outset, respondents admit that nothing in AB 32 obligates ARB to conduct allowance  
23 auctions and reserve sales to generate billions of dollars in revenues for the State. *See* ARB Br. 25  
24 (“AB 32 has no prescriptive enumerated list of emission reduction measures”); Intvr. Br. 27 (“AB 32  
25 did not need to specifically authorize an auction”); *id.* at 28 (the Legislature did not “explicitly  
26 requir[e] or prohibi[t] any [distribution methods]”); FSOR at 732 (admitting that “AB 32 does not  
27 direct ARB to use any particular method to distribute allowances, and does not specify that some  
28 methods are allowed and others are not”). Accordingly, they must argue that AB 32 delegated to  
ARB the authority to decide whether to adopt a program that would generate billions in revenues for

1 the State from private parties. ARB. Br. 20; Intvr. Br. 22; *see also* ARB Br. 15 (recognizing that the  
2 auctions held in 2012 and 2013 already have raised \$260 million in revenue for the State). Upon  
3 examination, it is clear that AB 32 does not grant ARB such unfettered discretion.

4 *First*, respondents' core argument "suffers from a surface implausibility" because the  
5 language on which they rely cannot reasonably be read as *carte blanche* power to transform AB 32  
6 into an administrative mechanism for generating billions in revenue for the State. *See Matosantos*,  
7 53 Cal. 4th at 260–61. To be sure, § 38562(b) grants ARB generic rulemaking authority to  
8 implement "market-based compliance mechanisms" under Part 5 of AB 32. Health & Safety Code  
9 § 38570(a). Respondents, however, rely on different statutory language, in subsection 38562(b)(1),  
10 which requires that ARB "[d]esign the regulations, including distribution of emissions allowances  
11 where appropriate, *in a manner that is equitable, seeks to minimize costs and maximize the total*  
12 *benefits to California, and encourages early action to reduce greenhouse gas emissions.*" *Id.*  
13 § 38562(b)(1) (emphasis added). This language does not grant ARB additional authority, but instead  
14 imposes *limitations* (including limitations on the "distribution of emissions allowances") on ARB's  
15 generic rulemaking authority. This language of limitation cannot reasonably be construed to grant  
16 ARB authority to raise billions of dollars in new revenue. As explained by the Supreme Court, "the  
17 drafters of legislation "d[o] not, one might say, hide elephants in mouseholes." *Matosantos*, 53 Cal.  
18 4th at 260–61 (internal quotation marks omitted). That is, "[i]t would be unusual in the extreme" for  
19 the Legislature to smuggle "such a fundamental change" in the scope of AB 32 through such vague  
20 or ancillary statutory language. *Id.*

21 *Second*, interpreting this language to grant ARB authority to generate billions in revenues is  
22 contrary to the structure of AB 32. Specifically, § 38597 of AB 32 expressly "authorize[d] the state  
23 board to adopt a schedule of fees to be paid by regulated sources of greenhouse gas emissions," but  
24 then imposed procedural and substantive limitations such that the revenues generated would be  
25 available only "for the purposes of carrying out [AB 32.]" Health & Safety Code § 38597. In  
26 adopting regulations to implement § 38597 of AB 32, ARB explained that "California law requires  
27 that a 'nexus' must exist between a fee and the program funded by the Fee" and that "[i]f an  
28 adequate nexus does not exist, this Fee could be determined to be a tax." ARB, Staff Report: Initial

1 Statement of Reasons for Rulemaking: Proposed AB 32 Cost of Implementation Fee Regulation 34  
2 (May 8, 2009). Thus, ARB concluded that the Legislature intended to limit ARB's authority to  
3 generate revenues under § 38597 so that the regulatory fees generated would not be viewed as taxes.

4 In light of that inherent limitation, it is implausible that AB 32 elsewhere gave ARB blanket  
5 authority to generate billions in revenues that would dwarf the regulatory fees carefully limited in  
6 § 38597. *See, e.g., Peralta*, 52 Cal. 3d at 51 ("Statutes must be harmonized, both internally and with  
7 each other, to the extent possible"); *United Farm Workers of Am. v. Agricultural Labor Relations*  
8 *Bd.*, 41 Cal. App. 4th 303, 316 (1995). Respondents argue that § 38597 should have no bearing on  
9 ARB's authority to generate revenues through auctions and reserve sales because those revenues will  
10 not be "used to pay for the cost of activities directly related to state agencies' development,  
11 administration and implementation of AB 32 regulations." ARB Br. 27; Intvr. Br. 29–30.<sup>1</sup> That  
12 admission is precisely the fundamental flaw in respondents' argument. It is inconceivable that the  
13 Legislature in AB 32 (1) granted ARB express, but carefully constrained, authority to generate  
14 regulatory revenues in § 38597 so as to avoid any argument that those fees were impermissible  
15 taxes, but (2) then gave ARB blanket authority to generate billions in additional revenues for  
16 purposes other than (the constitutionally permissible) implementation of AB 32 notwithstanding the  
17 serious constitutional questions such an interpretation would entail.

18 *Third*, respondents acknowledge that the Legislature was silent as to how billions in revenues  
19 generated through auctions and reserve sales would be treated. ARB Br. 28 ("It would have been  
20 premature for the Legislature to address this *detail*") (emphasis added); Intvr. Br. 28–29 n.16 (same).  
21 They argue that the Legislature's silence as to this "detail" should be treated as consent because, at  
22 the time of AB 32's enactment, cap-and-trade programs included auctions and sales of allowances,  
23 including "the first large-scale cap-and-trade program" adopted by Congress in 1990 to address acid  
24 rain. ARB Br. 6; *see* Intvr. Br. 8 n.3 (explaining that the "cap-and-trade program" adopted by  
25 Congress in 1990 "resulted in substantial and efficient reductions in acid rain"). Respondents

26 <sup>1</sup> According to ARB, the "revenue from the sale of allowances must be invested in programs to  
27 reduce the emissions of GHGs pursuant to the Investment Plan" released on May 13, 2013. ARB Br.  
28 27 (citing ARB RJN Ex. L).

1 ignore, however, that the federal acid-rain program has no bearing on whether the California  
2 Legislature intended to authorize ARB to create a massive revenue-generating program for the State.

3 In sharp contrast to ARB's revenue-raising scheme, the federal acid-rain program was  
4 *revenue-neutral*. That is, the federal government was required to "transfer the proceeds from the  
5 auction . . . on a pro rata basis" to the regulated parties such that "[n]o funds transferred from a  
6 purchaser to a seller of allowances shall be . . . treated for any purpose as revenue to the United  
7 States or the Administrator." 42 U.S.C. § 7651o(d)(3)(A); *accord id.* § 7651o(c)(6) (addressing  
8 similar treatment of proceeds from direct sales). Thus, the 1990 federal acid-rain program provides  
9 no support for the conclusion that the Legislature authorized ARB to generate billions in revenues  
10 through allowance auctions and reserve sales.<sup>2</sup>

11 Finally, the Legislature's adoption in 2012 of statutes designed to spend the revenues  
12 generated from ARB's allowance auctions and reserve sales does not support ARB's claimed  
13 authority under AB 32. ARB Br. 28–30; Intvr. Br. 30–32. Under California law, "[t]he declaration  
14 of a later Legislature is of little weight in determining the relevant intent of the Legislature that  
15 enacted the law." *Peralta*, 52 Cal. 3d at 52; *see also Del Costello v. State*, 135 Cal. App. 3d 887,  
16 893 n.8 (1982) (a legislature "has no legislative authority simply to say what it *did* mean" (emphasis  
17 in original)). Here, the statutes adopted by the Legislature in 2012 do not reflect the intent of a prior  
18 legislative body, comprised of different members, as to the meaning of AB 32 adopted in 2006.  
19 Indeed, unlike the authority relied upon by respondent-intervenors, the 2012 enactments do not  
20 purport to resolve a judicial dispute over the meaning of a previously adopted statute. *See, e.g., W.*  
21 *Sec. Bank v. Superior Court*, 15 Cal. 4th 232, 245 (1997) (statutory amendment adopted to abrogate  
22 court of appeal's contrary interpretation of original statute). The Legislature's 2012 enactments say  
23 nothing about whether ARB has authority to generate billions in revenues. Rather, the statutes  
24

25  
26 <sup>2</sup> In addition, respondents fail to show that, when it enacted AB 32 in 2006, the Legislature was even  
27 aware of any of the cap-and-trade programs respondents cite, let alone that these cap-and-trade  
28 programs would have alerted the Legislature to the possibility that allowance auctions could be used  
to generate billions of dollars in revenue for the State from regulated parties.

1 adopted by the Legislature in 2012 simply acknowledge and seek to appropriate the substantial  
2 revenues that ARB's allowance auctions and reserve sales are predicted to generate.

3 **B. Even If AB 32 Were Ambiguous, that Ambiguity Must Be Resolved to Avoid the**  
4 **Serious Constitutional Questions that Arise from ARB Raising Billions In**  
5 **Revenues.**

6 Respondents argue, in the alternative, that if AB 32 were ambiguous, "the Court should  
7 resolve any remaining uncertainty in favor of ARB's interpretation." Intvr. Br. 21; *see* ARB. Br 1  
8 ("[T]o the extent there is any ambiguity in the text of AB 32, ARB's interpretation . . . is entitled to  
9 great weight"). These arguments should be rejected.

10 *First*, courts do not defer to agencies on the question whether a challenged agency regulation  
11 is authorized by statute. Respondents disagree, arguing that *American Coatings Association v. South*  
12 *Coast Air Quality Management District*, 54 Cal. 4th 446, 469 (2012), and *Yamaha Corp. of America*  
13 *v. State Board of Equalization*, 19 Cal. 4th at 12, stand for the proposition that "courts will 'accord[]  
14 great weight and respect to the administrative construction' of a statute." ARB Br. 19; *see* Intvr. Br.  
15 20. That argument is mistaken because the issue presented here is whether the challenged  
16 regulations adopted by ARB are *authorized* under AB 32. As to that issue, the Supreme Court in  
17 *Yamaha Corp.* has explained:

18 [E]ven quasi-legislative rules are reviewed independently for consistency with  
19 controlling law. A court does not, in other words, defer to an agency's view  
20 when deciding whether a regulation lies within the scope of the authority  
21 delegated by the Legislature. The court, not the agency, has final  
22 responsibility for the interpretation of the law.

23 19 Cal. 4th at 11 n.4 (internal quotation marks omitted); *see also Am. Coatings*, 54 Cal. 4th at 462  
24 ("the proper interpretation of a statute is ultimately the court's responsibility"). Thus, the standard  
25 of review for challenges to the "fundamental legitimacy" of a quasi-legislative regulation is  
26 "'respectful nondeference.'" *Yamaha Corp.*, 19 Cal. 4th at 11 n.4 (quoting *Envtl. Prot. Info. Ctr. v.*  
27 *Dep't of Forestry & Fire Protection*, 43 Cal. App. 4th 1011, 1022 (1996)). Here, petitioners  
28 challenge the fundamental legitimacy of ARB's regulations authorizing auctions and reserve sales to  
raise revenues for the State that ARB concedes will *not* be used to implement AB 32.

On this point, ARB makes the same error in addressing the NAM's reliance on *Citizens to*  
*Save California v. California Fair Political Practices Commission*, 145 Cal. App. 4th 736, 747

1 (2006) (“*Citizens*”). It argues that *Citizens* supports deferential review because it says that an  
2 agency’s “‘view of ... the statutes ... is entitled to great weight unless clearly erroneous or  
3 *unauthorized.*’” ARB Br. 19 (quoting *Citizens*, 145 Cal. App. 4th at 747) (emphasis added). In the  
4 very same paragraph quoted by ARB, however, the *Citizens* court goes on to explain that on the  
5 issue whether a regulation is “unauthorized,” a reviewing court “does not defer to an agency’s view  
6 when deciding whether a regulation lies within the scope of authority delegated by the Legislature.”  
7 145 Cal. App. 4th at 747. Indeed, relying upon *Yamaha Corp.*, the court in *Citizens* confirms that  
8 “[t]he court, not the agency, has ‘final responsibility for the interpretation of the law’ under which  
9 the regulation was issued.” *Id.* (quoting *Yamaha Corp.*, 19 Cal. 4th at 11 n.4).

10       *Second*, deference to ARB’s interpretation in the face of a serious constitutional challenge  
11 would be particularly inappropriate because ARB lacks any institutional expertise in interpreting the  
12 Constitution. *See* Cal. Const., art. III, § 3.5 (“An administrative agency . . . has no power: . . . (a) To  
13 declare a statute unenforceable, or refuse to enforce a statute, on the basis of it being unconstitutional  
14 unless an appellate court has made a determination that such statute is unconstitutional; [or] (b) To  
15 declare a statute unconstitutional”); *see Goldin v. Pub. Utils. Comm’n*, 23 Cal. 3d 638, 669 n.18  
16 (1979) (“[S]ection 3.5 . . . places certain restrictions on administrative agencies relative to their  
17 refusal to enforce statutes on constitutional grounds . . .”) (emphasis omitted); *see also Capitol*  
18 *Industries-EMI, Inc. v. Bennett*, 681 F.2d 1107, 1116 (9th Cir. 1982) (“The California Constitution  
19 prevents a state administrative agency from passing on constitutional questions.”). The Court should  
20 not defer to ARB’s interpretation where ARB lacks the power or institutional expertise to conclude  
21 that AB 32 violates the California Constitution.

22       *Third*, although courts unquestionably have the power to assess a statute’s constitutionality,  
23 they are obligated to exercise that power as a last resort by avoiding resolution of constitutional  
24 questions whenever reasonably possible. *E.g., Harrott v. Cnty. of Kings*, 25 Cal. 4th at 1153  
25 (explaining that courts presume “that the Legislature intended, not to violate the Constitution, but to  
26 enact a valid statute within the scope of its constitutional powers”); *Dyna-Med, Inc. v. Fair Emp’t &*  
27 *Hous. Comm’n*, 43 Cal. 3d 1379, 1387 (1987) (rejecting agency interpretation of ambiguous statute  
28 and explaining that “a statute should be construed whenever possible so as to preserve its

1 constitutionality”); accord *Crowell v. Benson*, 285 U.S. 22, 62 (1932) (“When the validity of an act  
2 of the Congress is drawn in question, and even if a serious doubt of constitutionality is raised, it is a  
3 cardinal principle that this Court will first ascertain whether a construction of the statute is fairly  
4 possible by which the question may be avoided.”).

5 The California Supreme Court has applied the constitutional avoidance canon to reject  
6 agency interpretations even where it assumed that the statute at issue was ambiguous. For example,  
7 in *Association for Retarded Citizens v. Department of Developmental Services*, the Supreme Court  
8 addressed a California agency’s adoption of spending “priorities” which qualified as “quasi-  
9 legislative act[ion].” 38 Cal. 3d 384, 391 n.4 (1985). The Supreme Court rejected the agency’s  
10 reading of a statute to “authoriz[e] the issuance of the Priorities,” and held that “[e]ven if this  
11 [statutory] language were ambiguous, we would not read it in any other way” because “[w]hen faced  
12 with a statute reasonably susceptible of two or more interpretations, of which at least one raises  
13 constitutional questions, we should construe it in a manner that avoids any doubt about its validity.”  
14 *Id.* at 394 (citing *United States ex rel. Att’y Gen. v. Delaware & Hudson Co.*, 213 U.S. 366, 407–08  
15 (1909); *Carlos v. Superior Court*, 35 Cal. 3d 131, 147 (1983); *Cal. Hous. Fin. Agency v. Elliott*, 17  
16 Cal. 3d 575, 594 (1976)). Because the agency’s proposed interpretation “would raise serious  
17 constitutional questions,” the Supreme Court rejected that interpretation “[i]n order to avoid any  
18 doubt about the validity of the [statute].” *Id.*<sup>3</sup>

19 ARB’s brief ignores the canon of constitutional avoidance. For their part, respondent-  
20 intervenors acknowledge that “courts should read statutes, if possible, to avoid constitutional

21  
22 <sup>3</sup> Federal courts likewise have held that the canon of constitutional avoidance “trumps” an agency’s  
23 argument that its views as to an ambiguous statute warrant deference. See *Solid Waste Agency v.*  
24 *United States Army Corps of Eng’rs*, 531 U.S. 159, 172 (2001) (rejecting agency’s claim to  
25 deference based on need “not to needlessly reach constitutional issues”); *Williams v. Babbitt*, 115  
26 F.3d 657, 662–63 (9th Cir. 1997) (holding that courts should not defer to an agency’s interpretation  
27 that “raises serious constitutional concerns”); *Hernandez-Carrera v. Carlson*, 547 F.3d 1237, 1249  
28 (10th Cir. 2008) (“It is well established that the canon of constitutional avoidance does constrain an  
agency’s discretion to interpret statutory ambiguities, even when *Chevron* deference would  
otherwise be due.”); *Nat’l Mining Ass’n v. Kempthorne*, 512 F.3d 702, 711 (D.C. Cir. 2008) (“This  
canon of constitutional avoidance trumps *Chevron* deference ... and we will not submit to an  
agency’s interpretation of a statute if it ‘presents serious constitutional difficulties.’” (quoting  
*Chamber of Commerce v. FEC*, 69 F.3d 600, 605 (D.C. Cir. 1995)) (citation omitted)).



1 problems,” but argue that this canon does not assist petitioners. Intvr. Br. 32–33. Specifically,  
2 respondent-intervenors contend that the canon *supports* ARB’s decision to hold revenue-raising  
3 auctions and reserve sales because “a rigid rule mandating a full giveaway of allowances to emitters  
4 would be an unjustified wealth transfer from the public to private interests.” *Id.* at 32 (citing Cal.  
5 Const., art. XVI, § 6). That argument is frivolous. Under Article XVI of the California Constitution,  
6 “the primary question to be considered in determining whether an appropriation of public funds [or  
7 thing of value] is to be considered a gift is whether the funds [or things of value] are to be used for a  
8 public or private purpose.” *Cal. Teachers Ass’n v. Bd. of Trs.*, 82 Cal. App. 3d 249, 257 (1978).  
9 Respondent-intervenors acknowledge that “[f]ree allocation of some allowances serves public  
10 purposes in some circumstances,” Intvr. Br. 32, but offer no principled explanation why the free  
11 distribution of allowances in other circumstances would not serve a “public purpose.”<sup>4</sup>

12 Equally meritless is respondent-intervenors’ suggestion that the “constitutional doubt  
13 principle does not aid Petitioners” because “their ‘unconstitutional tax’ argument is meritless.” *Id.* at  
14 33. That argument is wrong both legally and factually. As to the law, the canon of constitutional  
15 avoidance applies so that courts can *avoid* resolving a serious constitutional challenge on the merits.  
16 As the United States Supreme Court explained long ago:

17 [U]nless this rule be considered as meaning that our duty is to first decide that a  
18 statute is unconstitutional and then proceed to hold that such ruling was unnecessary  
19 because the statute is susceptible of a meaning which causes it not to be repugnant to  
20 the Constitution, the rule plainly must mean that where a statute is susceptible of two  
21 constructions, by one of which grave and doubtful constitutional questions arise and  
22 by the other of which such questions are avoided, our duty is to adopt the latter.  
23 *Delaware & Hudson Co.*, 213 U.S. at 407–08. California courts apply this same standard. *See, e.g.*,  
24 *Myers v. Philip Morris Cos.*, 28 Cal. 4th 828, 847 (2002) (following *Delaware & Hudson*); *Perkey v.*  
*Dep’t of Motor Vehicles*, 42 Cal. 3d 185, 194 (1986) (“[S]tatutes are to be construed, if possible, so  
as to avoid *potential constitutional problems*”) (emphasis added). As to the facts, ARB’s adoption

25 <sup>4</sup> Moreover, they ignore that petitioners challenge ARB’s regulations because they generate *revenues*  
26 for the State, and therefore ARB could retain auctions and reserve sales, for example, by following  
27 the example of the federal government, which requires that proceeds from allowance auctions and  
28 reserve sales be returned pro rata to regulated parties. *See* 42 U.S.C. § 7651o(d)(3); *accord id.*  
§ 7651o(c)(6).

1 of allowance auctions and reserve sales to generate billions of dollars in revenues that ARB  
2 acknowledges will not be expended on the implementation of AB 32 plainly raises serious questions  
3 under the California Constitution. Indeed, respondents' unprecedented efforts to avoid the  
4 controlling standards set forth by the Supreme Court in *Sinclair Paint*, at a minimum, create a  
5 serious constitutional question. Controlling canons of construction require avoidance of that  
6 question *unless* the Legislature has left the reviewing Court with no other reasonable alternative.

7 Here, such an alternative plainly is available because ARB has admitted that "AB 32 does not  
8 direct ARB to use any particular method to distribute allowances," FSOR at 732, and concluded that  
9 it is "the limit on GHG emissions"—rather than the method of distribution—that "determines the  
10 environmental effectiveness of the cap-and-trade program." ISOR at ES-3.

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

13 To the extent AB 32 is construed to grant ARB authority to raise revenue by selling  
14 allowances, that grant of authority is unconstitutional and must be severed from the statute because  
15 the billions of dollars in revenues generated by ARB's auctions and reserve sales are taxes that were  
16 not authorized by the necessary two-thirds vote of the Legislature.

17 Respondents do not even attempt to defend the auction and reserve sale revenues as valid  
18 regulatory fees under the established framework adopted by the Supreme Court in *Sinclair Paint Co.*  
19 *v. State Board of Equalization*, 15 Cal. 4th 866 (1997). Respondents have thus waived any argument  
20 that they can satisfy *Sinclair Paint*. See, e.g., *Newton v. Clemons*, 110 Cal. App. 4th 1, 11 (2003); cf.  
21 *Habitat & Watershed Caretakers v. City of Santa Cruz*, 213 Cal. App. 4th 1277, 1292 n. 6 (2013).

22 That concession is fatal: No case has ever upheld a regulatory fee without concluding that  
23 the criteria set forth in *Sinclair Paint* were satisfied. Indeed, ARB's own Economic and Allocation  
24 Advisory Committee concluded that revenues from allowance auctions "would face constraints  
25 imposed under a principle of California law known as the *Sinclair [Paint]* rule." ISOR, App. L, at  
26 L-39. Respondents cannot now evade the *Sinclair Paint* criteria simply by asserting that the auctions  
27 and reserve sales are designed to serve regulatory purposes rather than to raise revenue. At a  
28 minimum, given respondents' concession that they cannot satisfy the requirements of *Sinclair Paint*,

1 the question whether the auction and reserve sale revenues constitute a tax raises serious  
2 constitutional concerns calling for application of the canon of constitutional avoidance.

3 Respondents' efforts to justify the allowance revenues as regulatory fees outside the *Sinclair*  
4 *Paint* framework fare no better. The billions of dollars in revenues generated by ARB's auctions  
5 and reserve sales are not "incidental" byproducts of regulation. Rather, the administrative record  
6 makes clear that the auctions and reserve sales were designed to raise revenue, and the billions of  
7 dollars in revenues they generate bear all the indicia of a tax. Because that tax was not approved by  
8 the necessary two-thirds majority of the Legislature, it is unconstitutional.

9 **A. *Sinclair Paint* Establishes the Framework for Determining Whether a Revenue-**  
10 **Generating Regulatory Fee Is a Tax.**

11 Effectively conceding that the allowance revenues do not satisfy the requirements of *Sinclair*  
12 *Paint*, respondents argue that *Sinclair Paint* does not apply because the purpose of the auctions and  
13 reserve sales is to regulate, not to raise revenue. ARB Br. 34–41; Intvr. Br. 37–41. Respondents are  
14 wrong. As shown below, regardless of its purported purpose, a charge imposed in connection with a  
15 regulatory program that does not satisfy the *Sinclair Paint* criteria is a tax, not a valid regulatory fee.  
16 See *Cal. Farm Bureau Fed'n v. State Water Res. Control Bd.*, 51 Cal. 4th 421, 438 (2011); *Sinclair*  
17 *Paint*, 15 Cal. 4th at 881. Contrary to respondents' contention, *Sinclair Paint* cannot be evaded  
18 simply by asserting that the primary purpose of a revenue-raising measure is to regulate. Rather, the  
19 *entire point* of the *Sinclair Paint* criteria is to determine whether a fee purportedly imposed for a  
20 regulatory purpose "is, in fact, a bona fide regulatory fee and not a disguised tax." *Tomra Pac., Inc.*  
21 *v. Chiang*, 199 Cal. App. 4th 463, 487 (2011). Even if a fee serves valid regulatory purposes, it  
22 "becomes a tax" if it "exceed[s] the reasonable cost of regulation with the generated surplus used for  
23 general revenue collection." *Cal. Farm Bureau*, 51 Cal. 4th at 438.

24 Respondents seize on *Sinclair Paint*'s observation that "if regulation is the primary purpose,  
25 the mere fact that revenue is also obtained does not make the imposition a tax." 15 Cal. 4th at 880.  
26 This is a straw man. No one contends that all measures that raise revenues necessarily are taxes.  
27 However, respondents erroneously read *Sinclair Paint* to hold that if a fee's purpose is to regulate,  
28 then it necessarily is a valid regulatory fee and the analysis is at an end. See ARB Br. 34 (arguing

1 that “[t]he essential lesson of *Sinclair Paint* is that charges imposed primarily for the purpose of  
2 regulation, rather than to increase revenues, are not taxes”). This interpretation of *Sinclair Paint*  
3 cannot be squared with the Court’s analysis or holding.

4 The *Sinclair Paint* Court concluded that the fees at issue there served a “bona fide”  
5 regulatory purpose because they “require[d] manufacturers and other persons whose products have  
6 exposed children to lead contamination to bear a fair share of the cost of mitigating the adverse  
7 health effects their products created.” 15 Cal. 4th at 877. Despite this valid regulatory purpose, the  
8 Court nonetheless held that the fees would be unconstitutional taxes if it were shown that “the  
9 amount of fees assessed and paid exceeded the reasonable cost” of regulation, “the fees were levied  
10 for unrelated revenue purposes,” or “the amount of the fees bore no reasonable relationship to the  
11 social or economic ‘burdens’ [the payers’] operations generated.” *Id.* at 881.

12 Thus, a valid regulatory purpose is a *necessary* but not alone *sufficient* condition for finding  
13 that a charge imposed in connection with a regulatory program is a valid regulatory fee and not a tax.  
14 Once a fee is shown to have a regulatory purpose, it must *also* satisfy the *Sinclair Paint* criteria. As  
15 explained in *Sinclair Paint*, fees may be imposed “for the purpose of legitimate regulation, and not  
16 mere revenue-raising, *if the fees do not exceed the reasonably necessary expense of the regulatory*  
17 *effort.*” *Id.* at 879 (emphasis added); accord *Cal. Farm Bureau*, 51 Cal. 4th at 437 (“a fee may be  
18 charged by a government entity so long as it does not exceed the reasonable cost of providing  
19 services necessary to regulate the activity for which the fee is charged” and is not “imposed for  
20 unrelated revenue purposes”). Respondents do not address the application of this test to the auction  
21 and reserve sale revenues here, and have thus waived any argument that they can satisfy *Sinclair*  
22 *Paint*. See, e.g., *Newton*, 110 Cal. App. 4th at 11.

23 Respondents also argue that not all charges that result in government revenues must be either  
24 regulatory fees or taxes. ARB Br. 35–37; Intvr. Br. 37–38. No one contends otherwise. *Sinclair*  
25 *Paint* itself recognized that there are other types of permissible fees besides regulatory fees. 15 Cal.  
26 4th at 874–75. For example, many of the cases on which respondents rely involved special  
27 assessments and development fees, the two other types of permissible fees identified in *Sinclair*  
28

1 *Paint*.<sup>5</sup> Yet respondents make no attempt to justify the allowance revenues as special assessments or  
2 development fees. Nor could they, since the allowance revenues are not “in amounts reasonably  
3 reflecting the value of the benefits conferred by improvements,” *id.* at 874, and do not “bea[r] a  
4 reasonable relation to [any] development’s probable costs to the community and benefits to the  
5 developer,” *id.* at 875. Here too, respondents have waived any argument that they can satisfy the  
6 *Sinclair Paint* test. See, e.g., *Newton*, 110 Cal. App. 4th at 11.

7 Critically, moreover, respondents cite no case in which a regulatory fee was upheld without  
8 satisfying the *Sinclair Paint* criteria. In each case cited by respondents involving a regulatory fee,  
9 the court applied the *Sinclair Paint* criteria and found that they were met.<sup>6</sup> Respondents cite several  
10 cases stating that one cannot conclude by “reverse logic” that a fee that fails to meet the *Sinclair*  
11 *Paint* criteria is necessarily a tax, but those cases did not involve regulatory fees.<sup>7</sup> They also  
12 predated *Sinclair Paint*; to the extent they suggest that regulatory fees need not satisfy the *Sinclair*  
13 *Paint* criteria, they did not survive *Sinclair Paint*.<sup>8</sup>

14  
15  
16 <sup>5</sup> See *Evans v. City of San Jose*, 3 Cal. App. 4th 728, 736–39 (1992); *Knox v. City of Orland*, 4 Cal.  
17 4th 132, 141–50 (1992); *Carlsbad Mun. Water Dist. v. QLC Corp.*, 2 Cal. App. 4th 479, 485–91  
18 (1992); *Cal. Bldg. Indus. Ass’n v. Governing Bd.*, 206 Cal. App. 3d 212, 233–37 (1988); *Russ Bldg.*  
*P’ship v. City & Cnty. of San Francisco*, 199 Cal. App. 3d 1496, 1504–06 (1987); *Trent Meredith,*  
*Inc. v. City of Oxnard*, 114 Cal. App. 3d 317, 327–28 (1981).

19 <sup>6</sup> See *Tomra Pac.*, 199 Cal. App. 4th at 487–88; *Cal. Bldg. Indus. Ass’n v. San Joaquin Valley Air*  
20 *Pollution Control Dist.*, 178 Cal. App. 4th 120, 131–35 (2009); *Collier v. City & Cnty. of San*  
21 *Francisco*, 151 Cal. App. 4th 1326, 1337–49 (2007); *Terminal Plaza Corp. v. City & Cnty. of San*  
*Francisco*, 177 Cal. App. 3d 892, 905–07 (1986); *San Diego Gas & Elec. Co. v. San Diego Cnty. Air*  
*Pollution Control Dist.*, 203 Cal. App. 3d 1132, 1145–49 (1988); *Mills v. Cnty. of Trinity*, 108 Cal.  
App. 3d 656, 659–63 (1980).

22 <sup>7</sup> See *Brydon v. E. Bay Mun. Util. Dist.*, 24 Cal. App. 4th 178, 190–95 (1994) (utility rate for water  
23 usage); *Carlsbad Mun. Water Dist.*, 2 Cal. App. 4th at 485–91 (development fee); *Alamo Rent-A-*  
*Car, Inc. v. Bd. of Supervisors*, 221 Cal. App. 3d 198, 202–06 (1990) (fee paid by rental car agencies  
24 for use of airport).

25 <sup>8</sup> Respondents also cite *Barratt American, Inc. v. City of Rancho Cucamonga*, 37 Cal. 4th 685  
26 (2005), but that case also applied the *Sinclair Paint* criteria and found them met. *Id.* at 701. The  
27 Court held only that any excessive portion of the regulatory fee at issue did not transform the fee into  
28 a tax because the City was required to “make a prospective fee adjustment by using that surplus, in  
lieu of a fee revenue, to cover future expenses,” and could not “transfer [the surplus] to the City’s  
general fund to replace or augment tax revenue.” *Id.* at 700–01. No such restriction exists here.

1 Nor would applying the *Sinclair Paint* criteria here call into doubt other measures that  
2 produce revenue such as tax penalties<sup>9</sup> or fees charged for government-provided goods or services  
3 such as oil and gas leases, escheated property, water extraction services, or lottery tickets.<sup>10</sup> ARB  
4 Br. 38–39. These measures are not regulatory fees because they are not designed to support or  
5 effectuate any regulatory program. Accordingly, *Sinclair Paint* would not apply.

6 Here, by contrast, the auction and reserve sale revenues are raised in connection with a  
7 regulatory program and thus fall squarely under *Sinclair Paint*. To hold otherwise would open a  
8 gaping loophole in the constitutional restrictions on raising taxes. Under respondents’ logic, the  
9 *Sinclair Paint* standards, which are designed to ensure that regulatory fees do not become vehicles  
10 for raising revenue beyond that necessary to fund the regulatory program and then using those  
11 excess revenues for other governmental purposes, could be evaded simply by declaring, as here, that  
12 the fees are not designed to fund the regulatory program.

13 At a minimum, given respondents’ concession that the auction and reserve sale revenues do  
14 not meet the *Sinclair Paint* criteria, the absence of any case in which a regulatory fee was upheld  
15 without satisfying those criteria, and the sweeping implications of respondents’ arguments, the  
16 question whether the allowance revenues constitute a tax raises grave constitutional doubts calling  
17 for application of the canon of constitutional avoidance. *See supra*, 9–12.

18 **B. The Allowance Revenues Are Unconstitutional Taxes under *Sinclair Paint*.**

19 As shown previously, under *Sinclair Paint*, the revenues generated from ARB’s auctions and  
20 reserve sales are taxes because (1) the amount of revenue generated bears no relationship to the cost  
21 of the regulatory program or any burdens imposed by the payers, NAM Br. 23–26, and (2) AB 32  
22 permits the allowance revenues to be used for purposes unrelated to the AB 32 regulatory program,  
23 *id.* at 20–22. Each of these facts is *independently* sufficient to show that the allowance revenues are  
24

25 <sup>9</sup> *See, e.g., Cal. Taxpayers’ Ass’n v. Franchise Tax Bd.*, 190 Cal. App. 4th 1139, 1145–46 (2010).

26 <sup>10</sup> *See, e.g., Pajaro Valley Water Mgmt. Agency v. Amrhein*, 150 Cal. App. 4th 1364, 1379–81  
27 (2007).

1 not valid regulatory fees but are instead unconstitutional taxes.<sup>11</sup> Respondents make no effort to  
2 rebut *either* showing that the allowance revenues violate the requirements of *Sinclair Paint*.

3 1. Respondents do not even contend—let alone demonstrate—that the revenues generated by  
4 ARB’s auctions and reserve sales are necessary to fund the Cap-and-Trade Program or even AB 32  
5 more generally. Nor could they: The billions of dollars in revenue generated by the sale of  
6 allowances dwarf the \$35 million annual cost of implementing the entire AB 32 program. RJN Ex.  
7 10. And, as respondents concede, the “full administrative cost of implementing AB 32” is already  
8 fully funded by a separate fee. Intvr. Br. 38 n.20; ARB Br. 27 (citing § 38597). As a result, the  
9 revenues from allowance auctions and reserve sales are an unconstitutional tax. *See Nw. Energetic*  
10 *Servs., LLC v. Cal. Franchise Tax Bd.*, 159 Cal. App. 4th 841, 859 (2008) (levy was a tax where the  
11 revenue it generated “far exceed[ed] any reasonable cost of regulating or providing services”).

12 Nor do respondents attempt to defend the auctions and reserve sales as “mitigation fees”  
13 under *Sinclair Paint*. To qualify as mitigation fees, the amount of revenue generated must bear a  
14 reasonable relationship to any burdens imposed by the payers. Here, respondents agree that the  
15 amount of revenue that will be generated is unpredictable and depends on the number of allowances  
16 ARB makes available and market forces that have nothing to do with any environmental harms in  
17 California caused by those who provide the revenues. *See* ARB Br. 42 (“the price for each  
18 allowance is determined by the operation of the market”); Intvr. Br. 46 (the “allowance purchase  
19 price reflects principles of supply and demand”). As a result, the allowance revenues are taxes under  
20 the standards set forth in *Sinclair Paint*.

21 2. AB 32 separately violates *Sinclair Paint* because it imposes no restrictions on the use of  
22 the allowance revenues.<sup>12</sup> Respondents do not dispute that fact, but instead rely exclusively on post-

23 <sup>11</sup> *See Cal. Farm Bureau*, 51 Cal. 4th at 438 (“What a fee cannot do is exceed the reasonable cost of  
24 regulation with the generated surplus used for general revenue collection. An excessive fee that is  
25 used to generate general revenue becomes a tax.”); *Sinclair Paint*, 15 Cal. 4th at 881 (holding that a  
26 regulatory fee is a tax if (1) “the fees were levied for unrelated revenue purposes,” (2) “the amount  
of fees assessed and paid exceeded the reasonable cost of providing the [regulatory] services for  
which the fees were charged,” or (3) “the amount of the fees bore no reasonable relationship to the  
social or economic ‘burdens’ [the payers’] operations generated”).

27 <sup>12</sup> Respondents cite a provision of the Cap-and-Trade Regulation providing that “[t]he proceeds from  
28 the sale of these allowances will be deposited into the Air Pollution Control Fund and will be

1 AB 32 enactments—SB 1018, AB 1532, and SB 535—to argue that the revenues may be used only  
2 for GHG emission reductions and not for general governmental purposes. ARB Br. 44–45; Intvr. Br.  
3 47–48.<sup>13</sup> These statutes adopted in 2012 do not and cannot satisfy *Sinclair Paint*.

4       First, the spending limitations that the 2012 laws impose do not satisfy *Sinclair Paint*  
5 because they continue to permit the allowance revenues to be used for a wide variety of purposes  
6 unrelated to the regulation of the payers’ activities under AB 32. AB 1532 provides broadly that the  
7 “[m]oneys shall be used to facilitate the achievement of reductions of greenhouse gas emissions in  
8 this state.” Health & Safety Code § 39712(b). However, because virtually every human activity  
9 emits GHGs, the purposes for which the allowance revenues may be used are virtually unlimited. As  
10 AB 1532 itself makes clear, these purposes include, among other things, the funding of public  
11 transportation such as high-speed rail; the development of advanced technology vehicles and  
12 biofuels; investments in sustainable housing and infrastructure; improvements to municipal solid  
13 waste disposal; and funding for land and natural resource conservation and management, forestry,  
14 and sustainable agriculture. *Id.* § 39712(c). In addition, under SB 535, 25 percent of the allowance  
15 revenues must be spent to provide benefits to disadvantaged communities. *Id.* § 39713.

16       Accordingly, the 2012 laws do not require the allowance revenues to be used to implement  
17 AB 32 or regulate the fee payers’ activities but instead authorize the funds to be spent on a wide  
18 variety of programs unrelated to the conduct of the fee payers. The allowance revenues are thus  
19 indistinguishable from the hazardous materials charge that was held to be a tax in *Morning Star Co.*  
20 *v. Bd. of Equalization*, 201 Cal. App. 4th 737 (2011), because it was used “to pay for a wide range of

21  
22 available upon appropriation by the Legislature for the purposes designated in [AB 32].” 17 CCR  
23 § 95870(f); see ARB Br. 9. But respondents do not and cannot argue that this regulation constrains  
24 the Legislature’s use of the revenues. ARB has no authority to direct the Legislature with respect to  
the expenditure of state funds. See FSOR at 724 (“All revenue collected through auction will be  
appropriated at the discretion of the Legislature, not ARB.”); *id.* at 1900 (“The Governor and  
Legislature have the ultimate authority on directing the use of auction revenue.”).

25 <sup>13</sup> In enacting these statutes in 2012, the Legislature was advised that the allowance revenues were  
26 “mitigation fee revenues” subject to *Sinclair Paint*’s requirements. RJN Ex. 6, at 27; RJN Ex. 7, at  
27 4, 8; RJN Ex 8, at 4. As noted, respondents have abandoned any attempt to defend the allowance  
28 revenues as mitigation fees under *Sinclair Paint*. That argument is thus waived. See, e.g., *Newton*,  
110 Cal. App. 4th at 11.



1 governmental services and programs related to hazardous waste control that are unrelated to the  
2 activity for which the [hazardous material] charge [was] made.” *Id.* at 755. Like the hazardous  
3 material charge in *Morning Star*, the allowance revenues are a tax because they are used to fund the  
4 “control of [GHGs] generally, rather than for the regulation of the [fee] payers’ business activities.”  
5 *Id.* Respondents have no answer to this point.

6       *Second*, the 2012 statutes also cannot save AB 32 because they were enacted after  
7 Proposition 26 took effect. Proposition 26 became effective on November 3, 2010, and amended  
8 section 3 of Article XIII A of the California Constitution to provide that “[a]ny change in state statute  
9 which results in any taxpayer paying a higher tax must be imposed by an act passed by not less than  
10 two-thirds of all members elected to each of the two houses of the Legislature.” Cal. Const., art.  
11 XIII A, § 3(a). Proposition 26 defined “tax” to include “any levy, charge, or exaction of any kind  
12 imposed by the State,” with limited exceptions that respondents do not and could not argue apply  
13 here. *Id.* § 3(b). Under Proposition 26, “[t]he State bears the burden of proving by a preponderance  
14 of the evidence that a levy, charge, or other exaction is not a tax, that the amount is no more than  
15 necessary to cover the reasonable costs of the governmental activity, and that the manner in which  
16 those costs are allocated to a payor bear a fair or reasonable relationship to the payor’s burdens on,  
17 or benefits received from, the governmental activity.” *Id.* § 3(d).

18       Because AB 32, as enacted, contained no restrictions on the use of allowance revenues, any  
19 grant of authority to ARB to raise revenue by selling allowances was unconstitutional. *See Cal.*  
20 *Farm Bureau*, 51 Cal. 4th at 421; *Sinclair Paint*, 15 Cal. 4th at 881. “An unconstitutional law is  
21 void, and is as no law.” *In re Johnson*, 3 Cal. 3d 404, 417 (1970) (internal quotation marks omitted).  
22 ARB contends that this particular constitutional defect was cured in 2012 when the Legislature  
23 enacted laws “prohibit[ing] auction proceeds from being treated as general revenues.” ARB Br. 44.  
24 Those 2012 statutes, however, must be judged against the constitutional provisions in effect when  
25 they were enacted, including Proposition 26.

26       Respondents are therefore mistaken in asserting that “[p]etitioners do not argue that  
27 [Proposition 26] applies here.” Intvr. Br. 36 n.19. To the extent the spending restrictions imposed  
28 by SB 1018, AB 1532, and SB 535 were necessary to render AB 32 constitutional—and they plainly

1 were—then those enactments constituted a “change in state statute which result[ed] in ... a higher  
2 tax” and are unconstitutional because they were not enacted by the requisite two-thirds majority.  
3 Cal. Const., art. XIII A, § 3(a). It does not matter that “the post-AB 32 legislation only concerns the  
4 use of the auction and reserve revenues, and not the manner in which auction and reserve revenues  
5 are obtained.” ARB Br. 33. The critical point is that, before those laws were enacted, ARB could  
6 not constitutionally raise revenue by selling allowances because the use of the funds was  
7 unrestricted. Accordingly, to the extent the 2012 laws remedied that defect, they authorized a new  
8 “levy, charge, or exaction of any kind imposed by the State,” and thereby “result[ed] in any taxpayer  
9 paying a higher tax” under section 3 of Article XIII A as amended by Proposition 26.

10 As a result, respondents are wrong in contending that the Court can uphold ARB’s  
11 interpretation of AB 32 without addressing “whether the cap-and-trade auction and reserve sales  
12 would violate article XIII A if it lacked any spending limitations.” ARB Br. 45 n.24. The  
13 constitutionality of any authority granted to ARB to raise revenue by selling allowances must be  
14 judged either (1) by the law as it existed in 2006 when AB 32 was enacted, in which case AB 32 is  
15 unconstitutional under Proposition 13 because it does not restrict the use of the revenues as required  
16 by *Sinclair Paint*, or (2) by the law as it existed when SB 1018, AB 1532, and SB 535 were enacted  
17 in 2012, in which case those laws are unconstitutional under Proposition 26 because they “result[ed]  
18 in ... a higher tax” without the necessary two-thirds majority vote. Either way, any purported grant  
19 of authority to ARB to raise revenue by selling allowances is an unconstitutional tax.

20 **C. The Auction and Reserve Sale Revenues Bear All the Indicia of a Tax.**

21 Even if *Sinclair Paint* did not control, the allowance revenues still would constitute an  
22 unconstitutional tax. If AB 32 were construed to authorize ARB to raise billions of dollars in  
23 revenue by auctioning or selling allowances, then it would constitute a “chang[e] in State taxes  
24 enacted for the purpose of increasing revenues.” Cal. Const., art. XIII A, § 3 (2006).

25 Respondents’ contrary argument rests principally on their assertion that the auctions and  
26 reserve sales “incidentally produce revenue,” ARB Br. 33, “as a byproduct of their regulatory  
27 function,” *id.* at 41. No court, however, has ever upheld a multi-billion dollar revenue-raising  
28

1 measure as an incidental byproduct of regulation. The generation of billions of dollars in revenues  
2 from the auction and sale of allowances is not “incidental.”

3 Indeed, the administrative record makes clear that the allowance revenues are not incidental  
4 byproducts of regulation. As ARB explained, raising revenue by selling allowances is not necessary  
5 to achieve GHG reductions because “[t]he limit on GHG emissions—the program ‘cap’—determines  
6 the environmental effectiveness of the cap-and-trade program.” ISOR at ES-3. The Market  
7 Advisory Committee concurred, explaining that “[t]he method by which emission allowances are  
8 distributed under a cap-and-trade program does not affect total greenhouse gas emissions under the  
9 program,” *id.*, App. H, at H-9, and thus “has no effect on the environmental outcome,” *id.* at H-66;  
10 *see also* RJN Ex. 8, at 2 (LAO letter explaining that “an allowance auction is not necessary to meet  
11 the AB 32 goal of reducing GHG emissions” because “it is the declining cap on emissions that will  
12 reduce the state’s overall level of GHGs”).

13 At the same time, ARB repeatedly emphasized that “reliance on auctioning” would “provide  
14 revenue that can be reinvested for public benefit.” ISOR at ES-4; *see also, e.g.*, FSOR at 199; ISOR  
15 at II-24, II-29 (“The value of allowances ... is represented by the money paid to the State, which  
16 would then have the opportunity to use the revenue for public benefit”). Throughout the  
17 administrative proceedings, the revenues that would be generated by auctioning allowances were  
18 touted as a significant advantage of auctions over free allocation. For example, the Economic and  
19 Allocation Advisory Committee (EAAC)—whose recommendations ARB endorsed, *e.g.*, FSOR at  
20 1129, 1149, 1901, 1904—explained that, “[i]n contrast with free provision, auctioning yields  
21 revenue and thereby can reduce the extent of the government’s reliance on ordinary taxes for  
22 financing expenditures.” ISOR, App. L, at L-6. According to the EAAC, an “important attraction of  
23 auctioning is that auction revenues can be used to finance cuts in existing taxes or to avoid future tax  
24 increases.” *Id.* at L-18. Thus, California could “effectively substitut[e] auction revenue for other  
25 taxes as a way of meeting the state’s spending needs.” *Id.* at L-62; *see also id.* at L-37, L-63.

26 Likewise, in discussing the disadvantages of free allocation compared to auctioning, the  
27 Market Advisory Committee explained that “[s]ince free allocation does not bring in revenues,  
28 unlike auctioning it cannot be used to finance reductions in existing income or sales taxes, or to pay

1 consumer rebates.” ISOR, App. H., at H-69; *see also id.* at H-68 (emphasizing that “some of the  
2 revenue from the auction can be used to finance reductions in State tax rates, or can be returned to  
3 taxpayers directly through rebate checks”). The Market Advisory Committee further observed that  
4 one of the “key advantages of auctioning over allocation” is that “auction revenues can be used more  
5 directly and transparently to advance program goals,” and that “[i]f converted to cash through an  
6 auction, the value of allowances could more easily be used for purposes unrelated to the goals of the  
7 program.” *Id.* Thus, auctions were preferred because “the influx of revenue to the government  
8 poses many opportunities to complement the program and achieve related goals.” *Id.* at H-70.<sup>14</sup>

9 ARB agreed with these assessments, concluding that “[a]n important feature of the cap-and-  
10 trade program is the distribution of proceeds from the auction of emissions allowances.” ISOR,  
11 App. J, at J-63. In discussing the “advantages of auctioning as an allocation method,” *id.* at J-62  
12 (capitalization omitted), ARB emphasized that “[p]roceeds from the auction could be put toward a  
13 number of different areas,” including “capital investments,” “job training,” and “projects centered on  
14 disadvantaged communities,” *id.* at J-64. In addition, the revenues could be used “for tax-rate  
15 reduction, which could lower the costs of the cap-and-trade program by increasing the efficiency of  
16 the tax system.” *Id.* “In effect,” ARB explained, “California could rely on a non-distortionary  
17 source of proceeds—the proceeds from allowance auction—as a substitute for distortionary taxes  
18 such as income and sales taxes.” *Id.* In this way, according to ARB, “[u]sing auction proceeds is  
19 like green tax reform,” *i.e.*, “the substituting of environmental taxes ... for ordinary taxes.” *Id.* at J-  
20 65; *see also* RJN Ex. 4, at 12 (ARB resolution recommending that allowance revenues be used to  
21 finance “cuts or avoided increases in the State’s individual income or sales tax rates”).

22 The administrative record thus makes clear that revenue-generation was a principal  
23 motivating factor underlying ARB’s adoption of auctions and reserve sales; it was not simply that  
24 ARB was “awar[e] that revenue would result from the auction and reserve sales.” ARB Br. 41. In

25  
26 <sup>14</sup> Likewise, EPA’s guide to designing cap-and-trade programs—on which ARB relied, ARB Br. 6–  
27 7—observed that a leading reason to use auctions as a distribution method is that they “[c]reate a  
28 source of revenue that can be used,” among other ways, “to replace existing distortionary taxes.”  
AR, at Add-A-008515.

1 asserting that “[n]othing in the record shows that the auction and reserve were enacted for the  
2 purpose of increasing revenues,” *id.*, respondents simply ignore these and numerous other statements  
3 in the record showing that ARB considered the revenues that would be generated by selling  
4 allowances to be a key advantage of its auctions and reserve sales. As a result, ARB unquestionably  
5 adopted the auctions and reserve sales for the purpose of increasing revenues.

6 Respondents’ claim that the auctions and reserve sales *also* serve regulatory purposes is  
7 irrelevant. “[A] tax is not any the less a tax because it has a regulatory effect.” *Sonzinsky v. United*  
8 *States*, 300 U.S. 506, 513 (1937); *accord Oakland Raiders v. City of Berkeley*, 65 Cal. App. 3d 623,  
9 628 (1976). Many taxes serve regulatory purposes in addition to raising revenue. *See, e.g., Nat’l*  
10 *Fed’n of Indep. Bus. v. Sebelius*, 132 S. Ct. 2566, 2596 (2012) (“Today, federal and state taxes can  
11 compose more than half the retail price of cigarettes, not just to raise more money, but to encourage  
12 people to quit smoking.”); *Washington v. Confederated Tribes of Colville Indian Reservation*, 447  
13 U.S. 134, 158 (1980) (“taxes can be used for distributive or regulatory purposes, as well as for  
14 raising revenue”). Thus, if it were enough to show that a revenue-raising measure serves regulatory  
15 purposes, the constitutional restrictions on imposing new taxes could be evaded at will. Under  
16 respondents’ logic, for example, the Legislature could impose a carbon tax without a two-thirds  
17 majority on the ground that the tax was designed to regulate GHG emissions rather than to raise  
18 revenue. *See* RJN Ex. 6, at 5–7 (explaining that a cap-and-trade program and carbon tax are the  
19 most common market-based mechanisms for reducing GHGs).

20 Moreover, respondents have not shown that *raising revenue* is necessary to achieve the  
21 regulatory objectives they identify, *i.e.*, that those objectives could not be adequately achieved  
22 through a revenue-neutral auction. For example, respondents argue that “ARB learned from U.S.  
23 EPA’s experience” in the Clean Air Act acid-rain program that “auctions can create a transparent  
24 short-term and long-term price signal.” ARB Br. 14. As discussed above, however, the auctions  
25 conducted in connection with EPA’s acid-rain program were *revenue-neutral*, thus showing that an  
26 auction can be designed to create a price signal without raising revenue. *See supra*, 7; *see also* RJN  
27 Ex. 8, at 3 (discussing how the “small annual revenue-neutral auction” under the acid-rain program  
28 “played a valuable role in identifying the market-clearing price”). Respondents have not shown that

1 ARB considered and rejected such revenue-neutral auctions as a viable regulatory alternative. *See*  
2 ISOR at IV-7 (listing the “specific alternatives to the design of the cap-and-trade regulation” that  
3 ARB analyzed, not including revenue-neutral auctions).

4 ARB’s auctions and reserve sales thus have both the purpose and effect of raising billions of  
5 dollars in revenue. Contrary to respondents’ contentions, those revenues fall squarely within the  
6 ordinary understanding of the term “tax,” *i.e.*, “[a] monetary charge imposed by the government on  
7 persons, entities, transactions, or property to yield public revenue.” *Black’s Law Dictionary* 1496  
8 (8th ed. 2004); *see also American Heritage Dictionary of the English Language* 1773 (4th ed. 2009)  
9 (“[a] contribution for the support of a government required of persons, groups, or businesses within  
10 the domain of that government”). Indeed, after Proposition 26, Article XIII A now defines the term  
11 “tax,” which was previously undefined, and does so in such a way that the allowance revenues  
12 unquestionably constitute a tax. *See* Cal. Const., art. XIII A, § 3(b) (defining “tax” as “any levy,  
13 charge, or exaction of any kind imposed by the State” with exceptions not applicable here).<sup>15</sup>

14 There is also no merit to respondents’ contention that the allowance charges are not  
15 compulsory because they must be paid only if a party chooses to participate in an auction or reserve  
16 sale. ARB Br. 43–44; Intvr. Br. 41–44. Virtually every tax can be avoided by choosing not to  
17 engage in the taxed activity. On respondents’ logic, income and property taxes would not be  
18 compulsory because they must be paid only if one voluntarily chooses to work or own property.  
19 Moreover, respondents do not and cannot contend that their proffered alternatives, such as reducing  
20 emissions or acquiring allowances in the secondary market, will eliminate the need for regulated  
21 parties to purchase allowances in ARB’s auctions and reserve sales. Otherwise the auctions and  
22 reserve sales would not be projected to raise billions of dollars in revenue. Respondents understand

23 <sup>15</sup> Further, as discussed above, AB 32 does not restrict the purposes for which the allowance  
24 revenues may be spent, and the 2012 statutes cannot cure that defect because they are subject to  
25 Proposition 26 and were enacted by less than a two-thirds majority. Even under the 2012 statutes,  
26 moreover, the purposes for which the allowance revenues may be used are so broad as to make them  
27 functionally indistinguishable from general governmental revenues, particularly given that the  
28 allowance revenues may be loaned to the General Fund. Gov’t Code § 16428.8(d); *see* AB 110,  
stats. 2013, ch. 20 (authorizing a \$500 million loan to the General Fund in fiscal year 2013–14).

1 well that, for many parties, the only alternative to purchasing allowances from ARB is to go out of  
2 business. Only by ignoring reality could such a charge be deemed “voluntary.”

3 Nor does it matter that the “rates” parties must pay to acquire allowances in ARB’s auctions  
4 are determined by a “metho[d] of computation” that relies in part on private bidding. ARB Br. 42–  
5 43; Intvr. Br. 46–47. As ARB acknowledges, the regulation establishes an auction “price floor,”  
6 thus setting “by government fiat” a minimum charge for acquiring allowances at auction. ARB Br.  
7 42; *see* 17 CCR § 95911(b) (providing that “[e]ach auction will be conducted with an auction reserve  
8 price” and that “[n]o allowances will be sold at bids lower than the auction reserve price”); *id.*  
9 § 95911(c) (setting forth a formula for computing the auction reserve price). Likewise, the charge  
10 for acquiring an allowance at a reserve sale is set by regulation. *Id.* § 95913(e)(3)–(4).

11 Finally, an allowance is not the sort of “benefit or privilege” in return for which the  
12 government may legitimately charge a fee. ARB Br. 42; Intvr. Br. 44–46. Unlike other benefits or  
13 privileges that create a “mercantile quid pro quo,” Intvr. Br. 45, an allowance has no value  
14 independent of the regulatory scheme, *see id.* (“Th[e] value is ... created ... by the emissions cap ...  
15 which creates demand for and scarcity of emission allowances.”). Furthermore, unlike in other cases  
16 in which fees have been upheld as a quid pro quo for a benefit or privilege, here the allowance  
17 revenues are not used for the benefit of the “discrete group” that must pay the fee, but rather for the  
18 benefit of “[t]he public as a whole.” *Evans v. City of San Jose*, 3 Cal. App. 4th 728, 738 (1992).  
19 Under respondents’ logic, property taxes would not be taxes because they confer on the taxpayer the  
20 “benefit or privilege” of owning a valuable, tradable commodity.

21 Indeed, if an allowance to emit GHGs could be deemed a government-conferred “benefit or  
22 privilege” for which ARB could impose a “fee,” there would be virtually no limit to what ARB  
23 could tax under the guise of regulating GHG emissions. For example, nothing would prevent ARB  
24 from capping the number of miles that may be driven every year in California and requiring drivers  
25 to purchase tradable allowances from ARB for the “benefit or privilege” of driving. No one would  
26 doubt that such a scheme would impose a tax on driving. Likewise here, the charge that ARB  
27 imposes for the “benefit or privilege” of acquiring GHG emissions allowances is not “an exchange  
28

1 for equal value,” ARB Br. 38, but rather a tax on emitting GHGs. Because that tax was not  
2 approved by the necessary two-thirds majority of the Legislature, it is unconstitutional.

3 **CONCLUSION**

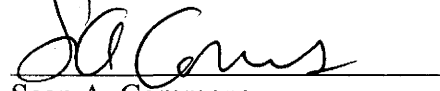
4 For these reasons, and those stated in the NAM’s opening brief, the relief sought should be  
5 GRANTED.

6 Dated: August 7, 2013

Respectfully submitted,

7 SIDLEY AUSTIN LLP  
8 Roger R. Martella, Jr.  
9 Paul J. Zidlicky  
Sean A. Commons  
Eric D. McArthur

10 By:

11   
12 Sean A. Commons  
13 *Counsel for the National Association of*  
14 *Manufacturers*