Case No. _______________

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

CALIFORNIA CHAMBER OF COMMERCE, et al.,

Plaintiffs and Appellants,

vs.

STATE AIR RESOURCES BOARD, et al.,

Defendants and Respondents;

NATIONAL ASSOCIATION OF MANUFACTURERS,

Intervener and Appellant;

ENVIRONMENTAL DEFENSE FUND, et al.;

Interveners and Respondents.

Third Appellate District, Case No. C075930
Sacramento County Superior Court, Case No. 34-2012-80001313
The Honorable Timothy M. Frawley

PETITION FOR REVIEW OF THE CALIFORNIA CHAMBER OF COMMERCE, *ET AL.*

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To the Honorable Chief Justice and the Honorable Associate Justices of the Supreme Court of the State of California:

Plaintiffs and Appellants California Chamber of Commerce and Larry Dicke respectfully petition for review of the published, non-unanimous decision of the Court of Appeal, Third Appellate District, filed April 6, 2017. Pursuant to Rule of Court 8.504, subd. (b)(4), a copy of the majority's opinion and Justice Hull's dissent are attached as Appendix A.

I.

ISSUES PRESENTED.

This case presents the following issues for review:

(1) Whether the Court of Appeal's revolutionary and unprecedented standard for determining whether a governmental exaction, that will pour billions of dollars into the State's coffers to be used for virtually any purpose, is a "tax" within the meaning of Proposition 13, contradicts this Court's existing jurisprudence, including *Sinclair Paint Co. v. State Bd. of Equalization* (1997) 15 Cal.4th 866 ("*Sinclair Paint*")?

(2) Whether Assembly Bill 32's grant of authority to the Air Resources Board ("ARB") to design regulations to accomplish greenhouse gas (GHG) reductions somehow empowers ARB to impose unlimited charges on GHG emitters and raise unlimited revenue by selling GHG emissions allowances, even though the statutory language and legislative history are silent as to revenue-raising?

(3) Whether AB 32 should be construed not to grant unlimited revenue-raising power to ARB, to avoid the serious constitutional question of whether the auction regulations violate Proposition 13?

II.

WHY REVIEW IS NECESSARY.

Some cases cry out for Supreme Court review, because they turn on serious questions of constitutional law that have widespread statewide impact and importance. Other cases warrant Supreme Court review because the Court of Appeal decision creates substantial inconsistencies with past precedent and legal uncertainty that only this Court can resolve. This case presents both circumstances.

The majority's decision below, if allowed to stand, would mark a revolution in the established law governing taxation in this State, which has been the subject of much analysis by this Court over the 40 years since Proposition 13 passed. Proposition 13 requires that a tax enacted by the state Legislature must be approved by a two-thirds vote. Though this Court has recognized certain narrow exceptions to the definition of "taxes" subject to this $^2/_3$ rule—for regulatory fees, development fees, user fees, and assessments—each of those categories of charges has been carefully defined and circumscribed in such a way as to prevent the exceptions from entirely swallowing Proposition 13's $^2/_3$ rule.

The majority below, however, abandoned this Court's measured approach and opened the door to the effective nullification of Proposition 13. The majority held that the Legislature could authorize ARB to engraft onto a regulatory program a massive revenue-raising device that results in billions of dollars to the State, and can do so without complying with the $^2/_3$ vote requirement that Proposition 13 imposes on taxes, or the limitations applicable to "fees."

Among other fundamental departures from precedent, the majority:

- Created an entirely new category of government exactions that are neither a "fee" nor a "tax," but some wholly unspecified "other" type of charge. That conclusion casts doubt on the continuing vitality of this Court's decision in *Sinclair Paint*, which has long been understood (including by the Legislative Analyst's Office ("LAO"), and trial court in this case) to prescribe the test for determining whether an exaction imposed by a regulatory agency, for regulatory purposes, is a "tax" within the meaning of Proposition 13.
- Created and applied a new two-part test for defining a tax—that the exaction must be "compulsory" and must "not grant any special benefit to payor"—that is inconsistent with extensive case law from this Court and would call into question whether many charges that have always previously been understood to be "taxes," such as sales and use taxes, business license taxes, franchise taxes, and real property transfer taxes, among others, actually are "taxes."
- Holds that use of the proceeds derived from the exaction is irrelevant to the characterization of the charge when, under this Court's precedents, the use of the funds has been treated as a crucial hallmark of the inquiry into whether a charge is a "tax" under Proposition 13.

The majority decision for the first time allows open-ended exactions by administrative agencies, putting no limits on what money

can be exacted and providing a roadmap for the evasion of Proposition 13's limits. If allowed to stand, it would result in a world in which the only constraint on the government's ability to extract funds from taxpayers' wallets would be the creativity and boldness of adopting agencies. Proposition 13 would be dead letter.

Of course, the foregoing constitutional issue is only presented here because the lower court also erred in concluding that AB 32 authorized ARB to establish a massive and unprecedented revenue-raising program, despite a complete absence of any expression of such an intention in the legislation itself and the legislative record. At the very least, the doctrine of constitutional doubt counsels in favor of adopting a plausible interpretation of AB 32—that it did not intend to authorize such a massive revenue-raising scheme—to avoid the serious constitutional question presented.

Review by this Court is necessary because a major sea-change in such an important area of the law should not be permitted to take place without consideration by the state's highest Court. Review should be granted to address these essential questions of public law, and to resolve the inconsistencies that the appellate court majority's opinion creates. (See Cal. R. Ct. 8.500, subd. (b)(1) & (2).)

III.

STATEMENT OF THE CASE.

A. Factual Background.

AB 32 was approved by majority vote in both houses of the Legislature in August 2006. (Joint Appendix ["JA"] 107.) On September

27, 2006, the Governor signed AB 32 into law. (2006 Cal. Stats., ch. 488; Health and Safety Code, sections 38500-38599.)

AB 32's stated objective is to reduce GHG emissions in the state to 1990 levels by 2020. (Section 38550.)[1] The Legislative Counsel's Digest states: "The bill would require [ARB] to adopt a statewide greenhouse gas emissions limit equivalent to the statewide greenhouse gas emissions levels in 1990 to be achieved by 2020, as specified."[2]

AB 32 requires ARB to: (1) implement a GHG emissions monitoring program (Section 38530); (2) determine what the statewide GHG emissions level was in 1990, and then achieve that level by 2020 (Section 38550); and (3) adopt a regulatory program to achieve the required GHG reductions in the "maximum technologically feasible and cost-effective" way. (Sections 38560 & 38562.)

In designing regulations, ARB was authorized to consider "direct emission reduction measures, alternative compliance mechanisms, market-based compliance mechanisms, and potential monetary and nonmonetary incentives for sources" to achieve "the maximum feasible and cost-effective reductions of greenhouse gas emissions by 2020." (Section 38561(b).)

A "market-based compliance mechanism" means either:

> (1) A system of market-based declining annual aggregate emissions limitations for sources or categories of sources that emit greenhouse gases.

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[1] Unless otherwise indicated, "section(s)" refers to the Health & Safety Code.

[2] ARB's Administrative Record ("AR") at A-000001.

> (2) Greenhouse gas emissions exchanges, banking, credits, and other transactions, governed by rules and protocols established by the state board, that result in the same greenhouse gas emission reduction, over the same time period, as direct compliance with a greenhouse gas emission limit or emission reduction measure adopted by the state board pursuant to this division.

(Section 38505(k).)

AB 32 required the regulations to be operative by January 1, 2012. (Section 38562(a).) In adopting regulations, ARB was directed to minimize costs, consider the cost effectiveness of the regulations and minimize the administrative burden of complying with the regulations. (Sections 38562(b)(1), (5) & (7).)

The only revenue-raising authority specified in AB 32 is in section 38597, which authorizes ARB to adopt "a schedule of fees to be paid by the sources of greenhouse gas emissions" to pay program administration costs.[3]

B. The Regulations In Dispute.

On January 1, 2012, ARB's regulations took effect. (Cal. Code Regs., tit. 17, Div. 3, Ch. 1, subch. 10, Art. 5 [§ 95801 et seq.].)

The regulations impose a "cap and trade" system, placing a cap on GHG emissions from entities that emit at least 25,000 metric tons of GHG per year. (17 CCR, §§ 95810-95814.) These entities are "covered entities." (17 CCR, §§ 95802(a); 95811; & 95812.)[4]

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[3] The costs are limited and must be consistent with Health and Safety Code, section 57001, the California EPA's fee accountability program.

[4] Covered industries include petroleum refining, cement production, cogeneration, glass production, hydrogen production, iron

Under the regulations, ARB issues "allowances," each of which gives the holder the right to emit one ton of carbon dioxide equivalent. (17 CCR, §§ 95802(a)(8), (41), & (55); see also section 38505(a).) A covered entity must possess, and then surrender back to ARB, one allowance for each ton of carbon dioxide emissions it produces within a given compliance period. (17 CCR, § 95856.) There are three compliance periods: 2013-14, 2015-17, and 2018-20. (17 CCR, § 95840.) The cap declines during each compliance period, reducing statewide emissions. (17 CCR, §§ 95811-12; 95841; and 95850-58.)

The Regulations specify that GHG allowances are not "property or a property right" but are tradable. (17 CCR, §§ 95802(a)(8); 95820(c); & 95921.) A covered entity may increase its GHG emissions by acquiring additional allowances from other covered entities without increasing overall statewide GHG emissions since the total number of allowances is capped.[5] This declining "cap" on the allowances in circulation, along with the ability to "trade" allowances among covered entities, are features of a cap and trade program.

ARB adopted additional regulations empowering itself to impose an unprecedented, multi-billion dollar revenue-generating program. It allocated to <u>itself</u> a substantial portion of the allowances, to sell them to the highest bidders to generate state revenue. (17 CCR, §§ 95870, 95910-

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and steel production, petroleum and natural gas systems, electricity generating facilities, pulp and paper manufacturing, and other consumers and suppliers of electricity, natural gas, and petroleum. (17 CCR, § 95811.)

[5] The rules applicable to trading GHG allowances are in 17 CCR, §§ 95920 and 95921.

95914.) The regulations initially directed the revenue to the Air Pollution Control Fund and now to the Greenhouse Gas Reduction Fund. (17 CCR §§ 95912(k) and 95913(i).)[6]

ARB initially allocated to itself 10% of all allowances issued, and between 2012 and 2020, ARB allocates to itself half of all GHG allowances. (17 CCR, §§ 95870 & 95910.)

During the regulatory process, ARB acknowledged "Traditionally, cap and trade programs have favored freely allocating allowances to the covered entities." (JA 0235.) ARB cited no instance of a cap and trade program auctioning emissions allowances to generate government revenue, let alone tens of billions of dollars.

ARB's initial auction of allowances occurred in November 2012; quarterly auctions have occurred since. (17 CCR, § 95910.) These auctions have generated over $4.4 billion in state revenue,[7] which will increase substantially as self-allocated allowances increase.

These revenues are being appropriated for general governmental purposes such as the bullet train, transportation, affordable housing, agricultural energy and operational efficiency, water efficiency, wetlands restoration, sustainable forests, and waste diversion.

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[6] To spend this windfall, the Legislature in 2012 adopted Stats. 2012, ch. 39, § 25 (SB 1018) which created a "Greenhouse Gas Reduction Fund" and required all moneys collected from auctions to be deposited into that fund "for appropriation by the Legislature." (Gov. Code, § 16428.8(a) & (b).)

[7] See Legislative. Analyst, "The 2017-18 Budget: Cap-and-Trade," p. 10, http://www.lao.ca.gov/reports/2017/3553/cap-and-trade-021317.pdf (last visited May 11, 2017.)

The LAO estimated that ARB's auctions will produce $12 billion to $70+ billion in revenue for the state by 2020 (JA 0082), which would be one of the largest revenue-generating programs in State history. Nothing in the legislative history of AB 32 suggests that revenue generation was a purpose of the bill.

AB 32's objective to reduce GHG emissions to 1990 levels by 2020 can be achieved without the challenged revenue-raising regulations. (JA 0238, 0242-0244, 0235.) ARB has not disputed this.

C. Procedural Background.

California Chamber of Commerce v. ARB, No. 34-2012-80001313 (Sacramento Super. Ct). Appellants California Chamber of Commerce and Larry Dicke ("CalChamber") filed their verified complaint on November 13, 2012. ARB and its executive director and board-members were named as respondents (sometimes collectively "ARB").

The complaint challenged the legality of ARB regulations 17 CCR sections 95870 and 95910–95914, which impose massive financial burdens on a small segment of California's business community and anticipated raising tens of billions of dollars of state revenue. The petition alleged the regulations were *ultra vires* and not authorized by AB 32; and the regulations impose a tax not enacted by a 2/3 vote in each house of the Legislature, in violation of Cal. Const. article XIIIA. (JA 0001-0010.)

The National Association of Manufacturers intervened as petitioners; the Environmental Defense Fund and Natural Resources Defense Council intervened as respondents. (JA 0307-0324; JA 0262-0294.)

Morning Star Packing Co. v. ARB, No. 34-2013-80001464 (Sacramento Super. Ct.). Appellants Morning Star Packing Co., *et al.* ("Morning Star"), filed their verified complaint on April 16, 2013, naming the same respondents, and challenging ARB regulations 17 CCR sections 95830–95834, 95870, and 95910–95914, on substantially the same grounds as CalChamber. (JA 0549-0572.)

The *CalChamber* and *Morning Star* cases were deemed related and assigned to Judge Timothy F. Frawley. (JA 0579-0581.) They were argued together in the Superior Court on August 28, 2013. (Reporters Transcript dated 8/28/13 ["RT"] at pp. 1-75.)

The Superior Court issued its Joint Ruling on Submitted Matters ("Ruling") on November 12, 2013, upholding the regulations. (JA 1566-1588.) Judgment was entered in both cases on December 20, 2013; the Ruling was attached and its reasoning adopted. (JA 1589-1617; JA 1618-1645.) Notices of Entry of Judgment were served in both cases on January 9, 2014. (JA 1646-1680; JA 1681-1714.)

Timely notices of appeal were filed. (JA 1738-1741; JA 1742-1745; JA 1746-1779.) The Court of Appeal consolidated the *CalChamber* and *Morning Star* cases. (JA 1953-1983.)

The Court of Appeal issued its 2-1 decision on April 6, 2017. (See Appx. A.)

IV.

THE MAJORITY'S DECISION MARKS A MAJOR REVOLUTION IN THE LAW OF TAXATION UNDER PROPOSITION 13.

Over the thorough dissent of Justice Hull, the majority below held that the auction program does not impose a tax based on the following

chain of reasoning: (1) the test set forth by this Court in *Sinclair Paint,* which has historically governed cases like this, and under which the auction charges are indisputably invalid, is inapplicable; (2) to be a tax a charge must be "compulsory" (and participation in the auction is "voluntary" rather than compulsory); (3) the payor of a tax must receive no special benefit in exchange for the tax (and those participating in the auctions do receive benefits); and (4) the use to which the revenues are put is irrelevant to the inquiry. (See Maj. Op., p. 35.)

Not one link in this chain of reasoning can bear the weight the majority below placed on it. The majority's decision invents new law that strays far from this Court's jurisprudence and, if left intact, would provide endless opportunities for mischief, creating a gaping loophole in the protections of Proposition 13.[8]

A. The Majority's Rejection Of *Sinclair Paint* Threatens The Vitality Of That Decision.

The majority's first major departure from established law, with potentially far-reaching consequences, was in concluding that this Court's decision in *Sinclair Paint* was inapplicable to this case.

In *Sinclair Paint,* this Court set forth the test for determining whether a charge imposed by the State as part of an environmental regulatory program—like the auction and reserve charges—is a fee or a tax. This Court held that if the charge (1) bears a reasonable relationship

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[8] Though this case deals with a tax at the state level under Proposition 13, it would equally have implications for the voter-approval requirements of local taxes under Propositions 13 and 218. (See *Bay Area Cellular Telephone Co. v. City of Union City* (2008) 162 Cal.App.4th 686, 695-696 ["*Bay Area Cellular*"].)

between the amount charged and the burdens imposed by the fee payer's operations, (2) the charge is not used for unrelated revenue purposes, and (3) the remedial measures funded with the charge have a causal connection or nexus to the fee payer's operations, then the charge is a regulatory fee. If the charge is lacking in *any* of those respects, it is a tax. (See 15 Cal.4th at p. 881.)

There is no question that if the *Sinclair Paint* test applies, the auction fails to comply with its requirements. The amount of the auction charges lacks a reasonable relationship to the costs of regulating the payers' operations, the charges are used for unrelated revenue purposes, and the broad programs funded have no causal connection to the business activities of the payers. ARB essentially conceded as much below.[9] Consequently, the charges constitute taxes that are unlawful

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[9] In its opening brief below, CalChamber devoted a significant portion of its brief—15 pages—to establishing the trial court's errors on this point and showing that the auction and reserve sale charges fail each of *Sinclair Paint*'s requirements. Tellingly, ARB made no attempt in its Respondent's Brief to show otherwise, implicitly admitting that if the *Sinclair Paint* test applies, it must lose. (See *People v. Ferguson* (2011) 194 Cal.App.4th 1070, 1092 [Attorney General's failure to respond to Appellant's point was an implicit concession of its merit].) In its supplemental brief, ARB only argued that the societal costs of pollution exceeded the auction revenues, but that misstates the test. The "costs" to which a regulatory fee must be tailored are "those incident to the issuance of the license or permit, investigation, inspection, administration, maintenance of a system of supervision and enforcement." (*Cal. Farm Bureau Fed'n v. State Wat. Res. Control Bd.* (2011) 51 Cal.4th 421, 438.) It does not include offsetting broad societal costs. (*Morning Star Co. v. Bd. of Equalization* (2011) 201 Cal.App.4th 737, 755 [hazardous waste charge that was a tax, rather than a regulatory fee, where it was designed to pay "for the remediation, cleanup, disposal and

because they were not passed by a two-thirds vote in each house of the Legislature.

The Legislative Analyst's Office (and by the LAO's reference, the Office of Legislative Counsel) agreed that the auction revenues are subject to and must satisfy the *Sinclair Paint* test. (JA 0060.) So did the trial court (though it applied the *Sinclair Paint* test incorrectly). (See JA 1672 [for the auction charges "to be a valid regulatory fee and not a tax, the [*Sinclair Paint*] requirements must be met."].)

The majority below, however—applying the most cursory analysis—concluded otherwise. The substance of the majority's holding was as follows:

> *Sinclair Paint* did *not* hold that its analysis applied to any "revenue generating measure." Instead, it analyzed whether the exaction at issue was exempt from Proposition 13 as a purported regulatory fee. [Citations.] As the Board pointed out in oral argument, *Sinclair Paint* did not create "a binary world" where every payment to the government must be either a fee or a tax. The Board's regulations do not purport to impose a regulatory fee on polluters, but instead call for the auction of allowances, a different system entirely. [Citation.] Because the issue is different, *Sinclair Paint* does not control and we are not compelled to apply its test. Cases are not authority for propositions not considered therein. [Citation.]

(Maj. Op., pp. 36-37.)

While CalChamber agrees the auction charges are not *valid* regulatory fees (and are therefore taxes), it does not agree these are not

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control of hazardous materials generally, rather than for the regulation of the [payers'] business activities in using, generating or storing hazardous materials."].)

regulatory fees *at all*, subject to the *Sinclair Paint* analysis. The majority fails to explain the inherent contradiction in its decision—that the fees were imposed for a regulatory purpose but are not regulatory fees. After all, central to ARB's position below was the vigorous insistence that the auction and reserve charges were not a tax, because they "were created to regulate, rather than to increase revenues."[10] The trial court agreed that "the primary purpose of [ARB's] charge is regulatory." (JA 1584.) Yet, inexplicably, the majority concluded that, though these are fees purportedly imposed for regulatory purposes, they are somehow not "regulatory fees."

The confusion and uncertainty this holding will likely cause cannot be overstated. It effectively destroys *Sinclair Paint* as a guide for the public to understand when a charge imposed for regulatory purposes is legal under Proposition 13 (and Proposition 218, see footnote 8, *supra*).

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[10] Respondent ARB's Brief below at 43; see also *id.* at 2 ("ARB designed the auction to advance multiple regulatory functions…"); *id.* at 13 ("ARB auctions allowances to serve multiple regulatory objectives"); *id.* at 40 ("The auction and reserve sales are integral components of the cap and trade program and were designed to advance the regulatory objectives of AB 32."); *id.* at 42 ("[a] regulatory program may generate revenue without constituting a 'tax' that is 'enacted for the purpose of increasing revenues'"); *id.* at 50 ("ARB created the sales to regulate."); *id.* at 52 ("ARB designed the auction and reserve sales to regulate, consistent with the police power."); *id.* at 52 ("The incidental production of revenue does not negate the regulatory purpose of the auction and reserve sales."); *id.* at 53 ("The auction and reserve sales are regulatory measures enacted to advance the state objectives of AB 32."); *id.* at 60 ("the auction and reserve sales were designed to regulate…"); *id.* at 61 ("Unlike the auction and reserve sales, the charge in *Morning Star* was imposed specifically to generate revenue, not to regulate."); *id.* at 61 (charges "operate as integral components of a regulatory program.").

This decision also opens the door to a flood of *ad hoc* decisions that create ever-more fine-grained distinctions in what constitutes a regulatory fee, tax or "other" charge. Tellingly, though the majority held that the auction and reserve charges are not a tax and not a regulatory fee, it never says what these charges *are*. Administrative agencies will now have an incentive to test the bounds of their creativity in establishing new, purportedly *sui generis* charges that are exempt from Proposition 13. Review by this Court is needed to address the appellate majority's disregard for the ongoing vitality of *Sinclair Paint*.

B. The Majority's Two-Part Test For Identifying A "Tax" Is Unprecedented, and Would Cast Doubt on the Status of Many Exactions That Are Currently Regarded as Taxes.

The majority below also established a novel two-part test for identifying a "tax," holding that "the twin hallmarks of a tax are that it is compulsory, and that it conveys nothing of particular value to the payor. The auction system meets neither of these conditions, and therefore it is not a tax." (Maj. Op., p. 48.) This new test conflicts with established precedent, and its application calls into doubt whether sales and use taxes, business license and franchise taxes, gas taxes, or real property transfer taxes among others—charges that have historically been understood to be "taxes" within the meaning of Proposition 13—really are taxes at all.

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1. In holding that a charge must be "compulsory" to constitute a "tax," and in prescribing such a stringent application of that test, the majority's decision threatens to exempt a great many traditional "taxes" from Proposition 13.

While this Court has observed that "*[m]ost* taxes are compulsory rather than a response to a voluntary decision to develop or to seek other government benefits or privileges" (see *Sinclair Paint, supra*, 15 Cal.4th at p. 874; emphasis added), it has never held such compulsion is an indispensable, defining characteristic of every tax without regard to the broader context. That is an unwarranted extension of the case law by the majority below.

More fundamentally, however, the majority's concept of "voluntariness" is inconsistent with long-standing case law holding that when a business is required to pay money to the government, and its only alternative is to cease its business altogether, the levy cannot reasonably be characterized as "voluntary." In holding otherwise, the majority below charted a new course that is, again, inconsistent with established case law.

a. "Compulsion" as a hallmark of a tax. Regarding the conclusion that "compulsion" is an indispensable "hallmark" of a tax, the majority's decision conflicts with the unanimous decision in *Bay Area Cellular, supra,* 162 Cal.App.4th at p. 696. In that case, the court of appeal sustained a taxpayer's challenge to the city's "Emergency Communication System Response Fee" on the ground that the fee was, in actuality, a tax. (*Id.*) Significantly, for purposes of this case, *Bay Area Cellular* expressly rejected the city's contention that "the Fee [wa]s not a special tax because

it was voluntary," on the theory that "those subject to the Fee voluntarily consented to pay it when they chose to obtain telephone service." (*Id.* at pp. 696-697.) Key to that rejection was the recognition that "voluntariness" must refer to a "voluntary decision to seek a governmental service," rather than a voluntary decision to engage in private enterprise that is subjected to charges by the government.

The rationale of *Bay Area Cellular* contradicts the majority's ruling below that covered entities are subject to auction charges only because they have "voluntarily" decided to engage in private economic activity that the State, in an exercise of its police powers for the benefit of the broader public, now says requires GHG emissions credits.

The majority's holding also conflicts with case law holding that development fees *are indeed taxes* if they exceed the cost to the government of providing the benefits or services. (*Beaumont Investors v. Beaumont-Cherry Valley Water District* (1985) 165 Cal.App.3d 227, 234 ("*Beaumont*"); *Bixel Associates v. City of Los Angeles* (1989) 216 Cal.App.3d 1208, 1218 ("*Bixel*").) This is so even though *Sinclair Paint* identified development fees as a "voluntary" charge in observing that "*[m]ost* taxes are compulsory rather than a response to a voluntary decision to develop or to seek other government benefits or privileges."

Finally, federal law is persuasive on this point as well. As the Supreme Court observed in *National Federation of Independent Business v. Sebelius* (2012) 567 U.S. 519 ("*NFIB*"), taxes are often "intended to affect individual conduct" (*id.* at p. 567), and "imposition of a tax nonetheless leaves an individual with a lawful choice to do or not do a

certain act, so long as he is willing to pay a tax levied on that choice." (*Id.* at p. 574.)

b. "Voluntariness" of compliance with AB 32. Moreover, to say that participation in the auctions is "voluntary" does considerable violence to any normal understanding of that term. As established by the undisputed Declaration of Janet Rabo, admitted into the trial court record without objection (JA 1396-1402), for most covered entities, the only *choice* under AB 32—especially in the early years of the program—will be to purchase emissions allowances or go out of business in California. To suggest that such a situation is not "compulsory" is unrealistic. Simply put, the government cannot avoid the conclusion that a multi-billion dollar exaction on businesses statewide is a "tax" simply because all such businesses could avoid the tax by ceasing to exist.[11]

The trial court correctly rejected this understanding of voluntariness, noting that "[v]irtually every tax is in some sense 'voluntary' in that one can choose to avoid the tax by not engaging in the taxed activity. Taken to its logical extreme, 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. Yet no one would dispute that these are taxes." (JA 1610, n.10.) The same could be said of business license taxes or franchise taxes—one can choose not to engage in business in a given jurisdiction. In dissent, Justice Hull

[11] The majority appears to disbelieve Ms. Rabo's declaration, but—as Justice Hull noted—an appeals court is not a finder of fact (Dissenting Opinion, p.8), and the Rabo declaration was not disputed, not objected to, and not rebutted.

agreed with the trial court's conclusion. (See Dissenting Opinion of Hull, p. 8.) Ample case law supports Justice Hull's and the trial court's rejection of the premise that the auction charges are "voluntary."

For example, in *Whyte v. State* (1930) 110 Cal.App. 314 (*"Whyte"*), the plaintiff sought a refund of a franchise tax that had been declared unconstitutional, though "no written protest was filed at the time of payment." (*Id.* at p. 315.) Generally speaking, the law of the State at the time was that—absent a specific statutory refund scheme—illegal taxes paid "voluntarily" (*i.e.*, without "duress, coercion or compulsion") could not be recovered. (*So. Serv. Co. v. County of Los Angeles* (1940) 15 Cal.2d 1, 7.)[12] Nevertheless, citing the severe penalties imposed for failure to pay a protested tax, the Court ruled the franchise taxes were recoverable because the payment was not voluntary. In words equally applicable here, *Whyte* said:

> "Payment is never voluntary when made under coercion and duress. Under the penalties provided for by the self-executing provisions of the act a *corporation is either compelled to comply with same or go out of business*. Payment is therefore compulsory and not voluntary..."

(110 Cal.App. at p. 316, italics added.) This contrasts sharply with the majority's assertion that a choice between buying allowances and "choos[ing] to leave the state" is voluntary, such that no tax is imposed. (Maj. Op., pp. 41-42.)

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[12] This is no longer the case, of course. (See *Franchise Tax Bd. v. Superior Court* (2011) 51 Cal.4th 1006, 1017.) But that does not change the underlying understanding of what constitutes "voluntariness."

In similar vein, this Court has held that "where, by reason of the peculiar facts a reasonably prudent man finds that in order to preserve his property or protect his business interests it is necessary to make a payment of money which he does not owe and which in equity and good conscience the receiver should not retain, he may recover it," despite the rule precluding recovery of "voluntary" tax payments. (*Flynn v. San Francisco* (1941) 18 Cal.2d 210.)

Under AB 32, the possible penalties for noncompliance are equally severe. Failure to meet a compliance obligation, or other violations under the cap-and-trade regulation, subjects regulated entities to penalties including civil fines and criminal penalties up to and including incarceration. (Cal. Code Regs., tit. 17, §§ 96013-14; Health & Safety Code, § 38580.)

The U.S. Supreme Court also has held that where a private party must pay the government or go out of business, the choice is not "voluntary." (See, e.g., *United States v. State Tax Com.* (1973) 412 U.S. 363, 368, fn. 11; see also *Swift & Co. v. United States* (1884) 111 U.S. 22, 28-29 ["The appellant had no choice. The only alternative was to submit to an illegal exaction, or discontinue its business."]; *NFIB, supra*, 567 U.S. at pp. 581-582 [opinion of the Court] [where one is presented with a "choice" of acceding to government conditions or accepting consequences that are sufficiently severe, the choice cannot be said—in a meaningful sense—to be voluntary]; *id.* at pp. 678-679 [Scalia, Kennedy, Thomas & Alito, JJ., dissenting, but nevertheless agreeing with this point re coercion].)

The same is true here. Covered entities face the untenable "choice" of participating in ARB auctions or going out of business. (See 6 JA 1400

[Rabo Declaration].) Or, if they were to continue in business without paying for necessary emissions allowances, AB 32 would subject them to severe penalties for noncompliance, including civil fines and criminal penalties. Accordingly, in deciding whether the auction charges are taxes, their participation in the auction cannot be characterized as voluntary. (Cf. *Cwynar v. City & County of San Francisco* (2001) 90 Cal.App.4th 637, 658 ["If a statute authorizes a compelled physical invasion of a landlord's property, it is no answer to say that the landlord can avoid the invasion by ceasing to be a landlord."], rev. den. (Cal., Sept 26, 2001) 2001 Cal.LEXIS 6617.)

2. The majority's holding that an exaction is not a "tax" if it conveys "value to the payor" is inconsistent with long-standing precedent and practice.

The majority's holding that a tax "conveys nothing of particular value to the payor" and the auctions do convey value (Maj. Op., p. 48) is equally worthy of review by this Court because (1) it would upend established understandings of what constitutes a tax, and (2) it ignores the fact that, under ARB's own regulations, the auction allowances do not confer a property right as the lower court majority suggests.

a. Many traditional "taxes" convey value to the payor, being payments for the privilege of engaging in some activity. The majority below rejected the premise that sales taxes would cease to be "taxes" under its ruling, because despite the apparently "voluntary" nature of such charges, "the buyer receives nothing of particular value *for the tax.*" (Maj. Op., p. 48.) However, this misunderstands the Sales Tax Law. The sales tax is an exaction imposed on retailers (not, as the majority mistakenly suggested, on "buyers") "[f]or the privilege of selling tangible

personal property at retail" in California. (Rev. & Tax. Code, § 6051.) Rightly understood, the taxpayer is receiving something of significant value in exchange for paying the tax—the right to engage in a retail business. That does not make a sales tax any less of a "tax" within the meaning of Proposition 13.

Many other traditional levies that no one would dispute are "taxes" are also regarded as a payment for a privilege or something of value. For example:

- The use tax "frames an excise tax upon the privilege of utilizing property within this state in a certain manner." (*Union Oil Co. v. State Bd. of Equalization* (1963) 60 Cal.2d 441, 453.)
- A transient occupancy tax (or "hotel tax") is a tax imposed "on the privilege of occupying a room under the conditions described..." (*Gowens v. Bakersfield* (1961) 193 Cal.App.2d 79, 83.)
- "A transfer tax attaches to the privilege of exercising one of the incidents of property ownership, its conveyance." (*Fielder v. Los Angeles* (1993) 1 Cal.App.4th 137, 145.)
- The State's motor vehicle fuel tax is a tax "for the privilege of storing, for the purpose of removal, sale, or use" of motor vehicle fuel. (Rev. & Tax. Code § 7361.)
- "A business or occupation tax is usually defined as a revenue-raising levy upon the privilege of doing business within the taxing jurisdiction." (*Weekes v. Oakland* (1978) 21 Cal.3d 386, 394.)

- "The franchise tax is a tax for the privilege of doing business within California and is imposed upon all banks and corporations doing business in California. The amount of the tax is the greater of: [1] California net income times the appropriate tax rate [; or] [2] The $800 minimum franchise tax."[13] The government sells the "privilege" of doing business for $800, whether one makes any income or not. If one does make income, it is taxed to the degree the liability exceeds $800.

As with a franchise tax or business license tax especially, the only real "privilege" or "benefit" received by covered entities that purchase GHG allowances is the privilege of staying in business. Without sufficient GHG allowances to cover their emissions, those entities will not be permitted to continue emitting GHG. Without the ability to emit GHG, their operations will cease. (See, e.g., Cal. Code Regs., tit. 17, §§ 96012-13 [authorizing penalties and injunctions against violators of the cap-and-trade program].)

In each of the foregoing cases, the government has the power to prohibit a person from engaging in an activity and it allows that activity only upon the payment of money to the government—just as is the case here. Moreover, no person is forced to engage in the foregoing activities. Selling goods at retail, operating a business, and transferring property

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[13] See Franchise Tax Bd., "Is my corporation subject to franchise tax or income tax?", *available online at* https://www.ftb.ca.gov/businesses/faq/734.shtml (last visited May 9, 2017).

are "voluntary" in the sense that one need not engage in them. Yet no one disputes that the foregoing charges are, nevertheless, "taxes." In establishing its two-part "hallmark" test, the majority's opinion runs directly contrary to decades upon decades of case law and practice in California.

b. Auction allowances as a "property right." The majority's conclusion that the auctions confer a thing of "value" on participants turns largely on its conclusion that such allowances convey a property right in the nature of a commodity (Maj. Op., pp. 44-49). This does violence to California Code of Regulations, title 17, section 95820, subdivision (c), which reads:

> "Each compliance instrument issued by the Executive Officer represents a *limited authorization* to emit up to one metric ton in CO2e of any greenhouse gas specified in section 95810, subject to all applicable limitations specified in this article. *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.*"

(Italics added.)

As Justice Hull cogently observed (see Dissenting Op., pp. 9-10), "in light of the plain language of section 95820, subdivision (c) which describes (1) an authorization to emit as 'limited,' (2) as something that can be terminated or limited at the sole discretion of the state and (3) as something that, by regulation does not convey a property right, the conclusion cannot be avoided that where, as here, entities such as Morning Star are required to purchase auction credits to stay in business, what they purchase is no more a 'thing of value' than is the payment of

property taxes to keep ownership of one's home. Whatever else these authorizations are, as to Morning Star and others similarly situated, their value as a 'property right' is ephemeral and the auction program cannot be said to convey a property right in the nature of a commodity or otherwise when emission authorizations can be limited or terminated by the state at any time."

Justice Hull's dissent squares with this Court's position in *Elk Hills Power, LLC v. Board of Equalization* (2013) 57 Cal.4th 593, whereas the majority's position does not. In *Elk Hills*, this Court held that emission reduction credits ("ERCs") issued by the San Joaquin Valley Unified Air Pollution Control District, which were similar to ARB's allowances, were not "property" because "[p]roperty interests are defined by independent sources of law; they are not defined by the inherent property-like characteristics of the alleged property," and so, because the "Clean Air Act mandates that ERCs 'shall not constitute instruments, securities, or any other form of property.' (Health & Saf. Code, § 40710.)," this Court held they were not. (*Id.* at p. 609, fn. 7.)

C. The Appeals Court Majority's Determination That The Uses Of The Auction Proceeds Are Irrelevant Disregards This Court's Case Law Treating Such Uses As A Critical Component Of The Analysis Of Whether The Charge Is A Tax.

Finally, the majority below departed significantly from established case law in holding that the uses to which the auction proceeds can be put is irrelevant to the question of whether the charges are a "tax." (See Maj. Op., pp. 50-51 & fn. 13.) As Justice Hull observed in dissent, "The use of the revenue from government exactions is a hallmark, probably the most important one, in determining whether that exaction is a tax. Although

not alone determinative, the use of the money must be factored into the analytical equation. If the state treats the revenue as general revenue to be used to pay for public services, that strongly suggests the exaction is a tax." (Dissenting Op., p. 13; see also *id.* at p. 1 ["the use of the auction proceeds, a hallmark, if not the gold standard, for determining if a state exaction is a tax must be considered."].)

The proceeds of the auction revenues are being used for a multitude of purposes. Health and Safety Code § 39710, AB 1532, makes auction proceeds available for the following programs: energy generation, transmission, and storage (subd. (c)(1)); energy infrastructure projects at public universities and local public buildings (subd. (c)(1)); transportation infrastructure projects (subd. (c)(2)); water use and supply infrastructure projects (subd. (c)(3)); transportation and housing (subd. (c)(4)); and municipal solid waste diversion projects (subd. (c)(5)). And, commencing in Fiscal Year 2015-16, the 2014-15 cap and trade budget trailer bill *continuously* appropriates 60 percent of all future cap and trade auction profits to be divided and spent as follows: high speed bullet train (25%), affordable housing (20%), transit and intercity rail (10%), and low carbon transit (5%). The cap and trade trailer bill also takes $400 million of the $500 million in cap and trade profits loaned to the General Fund in the 2013-14 Budget Act and redirects it to the high speed bullet train project. (Stats. 2014, ch. 36 [SB 862].)[14]

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[14] The bullet train project will *increase* GHGs for the next 30 years, so expenditures for it do not advance AB 32's stated goal of emissions reduction to 1990 levels by 2020. (See ARB, "California Climate

Moreover, as the dissent points out, "[s]ince an argument can be, and has been, made that nearly all human activity (and, apparently, some animal activity) increases greenhouse gases, *voilá*, auction funds can be used to address nearly any human activity without being considered a tax that generates general revenue, thus avoiding the prohibitions of Proposition 13, so long as the use of the funds has any tenuous connection to the reduction of greenhouse gases, connections that can always be found if one reaches far enough." (Dissenting Op., p. 21.)

The majority's disregard of the breadth of the authorized uses of auction revenues is plainly inconsistent with *Sinclair Paint*. (See *Morning Star Co., supra*, 201 Cal.App.4th at p. 751 [a valid regulatory fee under *Sinclair Paint* "must be related to the cost of the governmental regulation"], quoting *Cal. Farm Bureau Fed'n v. State Wat. Res. Control Bd.* (2011) 51 Cal.4th 421, 438; *Sinclair Paint, supra*, 15 Cal.4th at p. 881 [exactions charged for "unrelated revenue purposes," *i.e.*, expenditures that are unrelated to the activity *of regulating the fee payers themselves*" are taxes].)

It is also inconsistent with case law governing development fees (see *Beaumont, supra*, 165 Cal.App.3d at p. 235; *Bixel, supra*, 216 Cal.App.3d at p. 1216), user fees (see *Bay Area Cellular, supra*, 162 Cal.App.4th at p. 696 [phone line charge held to be a "tax" even though it was placed into a special fund, because the proceeds were used to

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Investments: Annual Report: Cap-and-Trade Auction Proceeds" (Mar. 2016), pp. 24-25, *available online at* http://arb.ca.gov/cc/capandtrade/auctionproceeds/cci_annual_report_2016_final.pdf [last visited May 9, 2017].)

provide services to the public generally, rather than just to those subject to the levy]), and special assessments (see *Silicon Valley Taxpayers' Assn., Inc. v. Santa Clara County Open Space Authority* (2008) 44 Cal.4th 431, 441-442).

Indeed, no case before this one has ever held that the purpose for which revenue is expended is irrelevant to the legitimacy of the charge, except where the charge was a tax, imposed for "general revenue purposes." (See, e.g., *County of Fresno v. Malmstrom* (1979) 94 Cal.App.3d 974, 983.) The majority opinion certainly cites no case to that effect. (See Maj. Op., pp. 50-52.)[15]

The majority's position is that the uses of the auction revenues can be disregarded because no party challenged specific expenditures, and thus consideration of those uses is not "ripe." (Maj. Op., p. 50.) But that is because no expenditures had been made at the time the case was filed, and when the Legislature began to appropriate the money, CalChamber apprised the court immediately.

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[15] Even the majority below rejected ARB's contention that Proposition 13 is not implicated because "the Board had no *purpose* to generate revenue, and therefore any auction revenue is merely a 'byproduct' of the regulations." (Maj. Op., p. 34, fn. 25.) The majority held, "the Board concedes it knew the auctions would generate revenue, and it adopted the regulations with such knowledge, therefore it intended to generate revenue, whether or not that was its prime motivation." (*Id.*)

V.

ABSENT AN EXPRESS AND UNEQUIVOCAL STATUTORY DELEGATION, AB 32 SHOULD NOT BE CONSTRUED AS VESTING ARB WITH THE UNPRECEDENTED POWER TO IMPOSE AN UNLIMITED REVENUE-RAISING PROGRAM.

The power of the purse is "probably the most vital" legislative power (*Watchtower Bible & Tract Soc. v. County of Los Angeles* (1947) 30 Cal.2d 426, 429), and the Legislature has never granted any agency the vast power to raise unlimited amounts of revenue. Yet the decision below interprets AB 32 as doing just that. Had the Legislature wanted AB 32 to grant such immense power to the ARB, it would have done so explicitly, with considerable discussion and debate. "The Legislature does not hide elephants in mouseholes." (*Cal. Redevelopment Assn. v. Matosantos* (2011) 53 Cal.4th 231, 260-261.) Instead:

- The statutory language contains no express mention of conveying such a vast revenue-raising power;
- AB 32's stated purpose, as reflected in substantial findings and declarations in the legislation itself, nowhere mentions creating a multi-billion dollar revenue-raising program.
- AB 32's legislative history makes no mention of authorizing a multi-billion dollar revenue-raising program. Not a word in any of the seven separate legislative reports and analyses prepared on AB 32 indicates an intention to authorize a massive revenue-raising program. (JA 0117-0155.)[16]

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[16] The only revenue-raising discussed is that AB 32 "[a]uthorizes ARB to adopt a schedule of fees to pay for the costs of implementing the program established pursuant to the bill's provisions." (JA 0142.)

Similarly, nothing in the Legislative Counsel's Digest indicates that AB 32 authorizes vast revenue-raising power. (ARB's Administrative Record at A-000001.)

- The floor debate shows that several legislators expressed concerns that under AB 32 the ARB could impose a very broad range of fees (JA 0814 at 12:22 and 50:32.) The Speaker (who also was the bill's author) directly and immediately replied to these concerns by assuring legislators that AB 32 only authorized narrow charges sufficient to pay program administration costs:

  > I apologize if there is language in this bill which you are interpreting in a different way. The intent of the fee is for program administration and costs only, and I have a letter to The Journal to specify that.

  (JA 0814 at 1:09:35.) The Speaker's statement plainly refers to all language "in this bill," and is not limited to section 38597. The bill passed minutes later.

- The Enrolled Bill Report to the Governor, *prepared by ARB* contemporaneously with AB 32's passage (JA 0157-0171), gives no indication that the bill grants the ARB unlimited revenue-raising power, including in sections on "Fee Authority" and "Fiscal Impact," and a chart titled "Fiscal Impact of AB 32." (JA 0159, 0163, 0166-0167.) In fact, ARB's Enrolled Bill Report included a draft SIGNING MESSAGE FOR AB 32 which stated: "I want to join the Speaker in assuring that any fees that may be collected from sources of global

warming emissions will only be used to support the essential and direct program costs associated with the bill." (JA 0168.)

The decision below explains away the silence of AB 32 itself and its legislative history about allowance-auctioning and revenue-raising on the rationale it was not known in 2006 whether the ARB would proceed with a cap-and-trade program or a command-and-control program. But if the Legislature had intended to authorize such an unprecedented, multi-billion dollar undertaking, there surely would have been some clear indication in the legislative history, as well as open and serious debate over the wisdom of giving an unelected agency such power. In sum, the question of whether the language of AB 32 should be construed as empowering a regulatory agency to engage in unprecedented revenue-raising, and the clarity of language necessary to delegate such enormous power, are important questions of law that should be settled by the state's highest court.

VI.

AB 32 MUST BE CONSTRUED TO AVOID CONSTITUTIONAL DOUBT

Statutes should be construed wherever possible so as to preserve their constitutionality. (*Dyna-Med, Inc. v. Fair Emp. & Housing Com.* (1987) 43 Cal.3d 1379, 1387.) Therefore, if a statute is susceptible of two constructions, one of which will render it constitutional and the other raises serious and doubtful constitutional questions, courts will adopt the construction that, without doing violence to the reasonable meaning of

the statutory language, renders it valid in its entirety, even though the other construction may also be reasonable. (*Ibid.*)

At a minimum there are at least two reasonable constructions of AB 32. Construing AB 32 as not authorizing the revenue-raising program would certainly avoid the need to address the serious and sensitive constitutional question of whether that program violates Proposition 13. Both the trial court and the appeals struggled with the Proposition 13 issue, and it could have been avoided had the constitutional doubt doctrine been applied.

VII.

REQUEST THAT THIS COURT ORDER THAT THE COURT OF APPEAL'S DECISION IS NOT CITABLE PENDING REVIEW (CAL. RULE OF COURT 8.1115, SUBD. (e)(3))

Given the significance of the issues presented herein, and the sweeping uncertainty the lower court's decision creates, Petitioners respectfully request that, upon granting review, this Court order that the Court of Appeal's decision not be citable as either binding or persuasive authority, except as permitted under Rule of Court 8.1115, subd. (b). (Rule of Court 8.115, subd. (e)(3).)

VIII.

CONCLUSION.

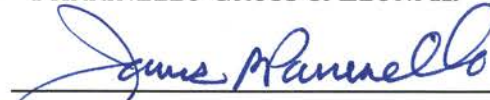
Given the undeniable statewide and constitutional importance of the issues presented herein, the unprecedented nature of many of the majority's holdings, the strong dissent, and the uncertainty the majority's

decision will engender in the law of public taxation, Petitioners respectfully request that this Court grant review.

Dated: May 15, 2017

Respectfully submitted,

NIELSEN MERKSAMER
PARRINELLO GROSS & LEONI LLP



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DECLARATION OF JAMES R. PARRINELLO
IN CERTIFICATION OF BRIEF LENGTH

James R. Parrinello, Esq., declares:

1. I am licensed to practice law in the State of California, and am the attorney of record for California Chamber of Commerce, *et al.*, in this action. I make this declaration to certify the word length of the Petition for Review.

2. I am familiar with the word count function within the Microsoft Word software program by which the Petition for Review was prepared. Applying the word count function to the Petition for Review, I determined and hereby certify pursuant to California Rules of Court Rule 8.504(d) that Petitioners' Petition for Review contains 8,277 words, and is within the word count limit imposed by Rule 8.504(d)(1).

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 15, 2017, at San Rafael, California.

James R. Parrinello

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 2350 Kerner Blvd., Suite 250, San Rafael, California. I am readily familiar with my employer's practices for collection and processing of correspondence for mailing with the United States Postal Service and for pickup by Federal Express.

On May 15, 2017, I served a true copy of the foregoing **PETITION FOR REVIEW OF THE CALIFORNIA CHAMBER OF COMMERCE, *ET AL.***, 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 2350 Kerner Blvd., Suite 250, California 94901 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 San Rafael, California, on May 15, 2017.

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

Paula Scott

SERVICE LIST

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California Court of Appeal Third Appellate District Clerk of the Court 914 Capitol Mall, 4th Floor Sacramento, CA 95814 ***Via E-Submission***	Sacramento County Superior Court Hon. Timothy M. Frawley 720 Ninth Street Sacramento, CA 95814 ***Via U.S. Mail only***