

In the Supreme Court of the State of California

CALIFORNIA CHAMBER OF COMMERCE et al.,
Plaintiffs and Appellants,
v.
STATE AIR RESOURCES BOARD et al.,
Defendants and Respondents;
NATIONAL ASSOCIATION OF MANUFACTURERS,
Intervener and Appellant;
ENVIRONMENTAL DEFENSE FUND et al.,
Interveners and Respondents.

Case No. S241948

MORNING STAR PACKING COMPANY et al.,
Plaintiffs and Appellants,
v.
STATE AIR RESOURCES CONTROL BOARD et al.,
Defendants and Respondents;
ENVIRONMENTAL DEFENSE FUND et al.,
Interveners and Respondents.

Court of Appeal, Third Appellate District, No. C075930, C075954
Sacramento County Superior Court No. 34-2012-80001313, 34-2013-80001464
The Honorable Timothy H. Frawley, Judge

**RESPONDENT AIR RESOURCES BOARD’S COMBINED
ANSWER TO PETITIONS FOR REVIEW**

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INTRODUCTION

The three petitions for review fail to establish that review is “necessary to secure uniformity of decision or to settle an important question of law.” (Cal. Rules of Court, rule 8.500(b)(1).)

The legal questions addressed by the Court of Appeal arise in the context of the state’s greenhouse gas cap-and-trade program, the unique circumstances of which are unlikely to recur. The Court of Appeal’s decision also turns on the interpretation of “tax” as used in Proposition 13. In 2010, the voters approved Proposition 26 to amend Proposition 13, adding a new definition of “tax,” meaning that the pre-amendment interpretation of “tax” will become less relevant over time. And, rather than creating new law, the Court of Appeal merely applied the language of Proposition 13 and existing precedent to the facts presented. The decision is consistent with *Sinclair Paint Co. v. State Bd. of Equalization* (1997) 15 Cal.4th 866 (*Sinclair Paint*) and created no other split in authority, and it is well-reasoned and legally correct. The petitions for review should be denied.

BACKGROUND

In the Global Warming Solutions Act of 2006 (AB 32) (Health & Saf. Code, § 38500 et seq.), the Legislature established statutory objectives to address climate change, including reducing greenhouse gas emissions to 1990 levels by 2020 and putting the state on track for further reductions. (Health & Saf. Code, §§ 38550, 38551, 38562.) The Legislature delegated to the California Air Resources Board the authority to design regulations to achieve those objectives, consistent with certain established criteria. (*Id.*, §§ 38562, 38570.) The Legislature instructed the Board to rely on “the best available economic and scientific information,” including relevant information from programs in other jurisdictions. (*Id.*, § 38561, subd. (c);

38562, subd. (e).) The Legislature expressly authorized the Board to adopt “market-based compliance mechanisms,” which includes a cap-and-trade program. (*Id.*, §§ 38562, subd. (c); 38570, subd. (a).) The Board ultimately issued regulations to establish the cap-and-trade program. (Cal. Code Regs., tit. 17, § 95801 et seq.)

A cap-and-trade program is designed to achieve overall emissions reductions in the most cost-effective and efficient way possible. (*Association of Irrigated Residents v. California Air Resources Bd.* (2012) 206 Cal.App.4th 1487, 1498, fn. 6.) Rather than prescribing a particular technology that emitters must use, or prescribing a level of emissions reductions that each emitter must achieve, a cap-and-trade program sets an overall cap on emissions from a set of regulated entities, reflected in annual tradable allowances to emit a specified quantity of greenhouse gas. It then allows individual regulated emitters to decide, based on business judgments and market forces, how emissions will be brought under that overall cap. (See also, U.S. Environmental Protection Agency, Tools of the Trade (2003), Administrative Record (AR) Add-A-8485.)¹

Under California’s cap-and-trade program, the Board first establishes the overall cap, which determines how many emissions allowances the Board can issue during a compliance period. (Cal. Code Regs., tit. 17, § 95841.) Each emissions allowance is a tradable permit to emit up to one ton of carbon dioxide equivalent. (*Id.*, §§ 95802, subd. (a)(9); 95820, subd. (c).) For each successive compliance period after 2014, the cap declines, so the number of allowances distributed declines as well. (*Id.*, § 95841.) The Board distributes some of the allowances to emitters for free

¹ The administrative record is divided into parts A through I. Citations to the record include both the part and the Bates number. Citations to the addendum to the record include a prefix “Add-A” or “Add-B” and the Bates number.

and distributes other allowances by auction. (*Id.*, §§ 95870, 95890, 95910.) The Board also places a small number of allowances into a “price containment reserve,” which creates a reserve supply of allowances to meet any sudden constraint in supply or escalation of market prices. (*Id.*, § 95870, subd. (a); AR C-69.)

Emitters must surrender a sufficient number of allowances to cover their emissions during each compliance period. (Cal. Code Regs., tit. 17, § 95856, subd. (a).) Emitters may rely on allowances the Board distributes for free, use allowances they have saved from earlier compliance periods, acquire allowances through the auction system, or acquire allowances from private parties in the secondary market. (*Id.*, § 95856, subd. (h); see slip opn., p. 39.) Emitters also may use emissions offsets to meet part of their compliance obligations. (Cal. Code Regs., tit. 17, § 95856, subd. (h)(1)(A))² And emitters may comply with the law by reducing their emissions to the point where they do not need to surrender any allowances at all. (§§ 95850, 95853, 95855, 95856.) The variety of compliance options available to emitters helps ensure that emissions reductions will be achieved in a cost-effective way. (Tools of the Trade, AR Add-A-8485-8486; see *Association of Irrigated Residents v. California Air Resources Bd.*, *supra*, 206 Cal.App.4th at p. 1498, fn. 6.)

The Legislature instructed the Board to “design...the distribution of emissions allowances...in a manner that is equitable, seeks to minimize costs and maximize the total benefits to California, and encourages early action to reduce greenhouse gas emissions.” (Health & Saf. Code, § 38562,

² In brief, offsets are tradable credits that represent verified greenhouse gas emissions reductions made in areas or sectors not covered by the cap-and-trade program. (AR C-28-29; see *Our Children’s Earth Foundation v. California Air Resources Board* (2015) 234 Cal.App.4th 870, 877.)

subd. (b)(1).) Consistent with that mandate, the Board considered the following factors in deciding to include an auction system as one component of the method for distributing allowances:

- The auction system would encourage investment and innovation in emissions reductions by helping to prevent allowance prices from becoming too low, unpredictable, or unstable. (AR H-897-899.)
- The auction system would make the distribution of allowances more equitable, because unlike an entirely free distribution, the auction would treat new sources and existing sources the same way. (AR C-48, C-1776.)
- The auction system would reduce volatility in allowance prices and would reduce transaction costs for emitters who buy or sell allowances. (AR C-1724, C-1727, C-1775.)
- The auction system would make the distribution of allowances more efficient, because the auction establishes a single forum in which all bidders have the same opportunity to purchase allowances, minimizing the opportunities for market manipulation and further reducing transaction costs. (AR C-1775-1776, H-880.)
- The auction would avoid windfall gains to firms at consumers' expense of the kind observed in other cap-and-trade programs, where some firms enjoyed gains from increased market prices for their products without bearing any increased costs. (AR C-1721-1722, H-692, H-759-762, H-770-780.)
- By imposing an immediate price on some allowances, the auction system would encourage businesses to act promptly to reduce their emissions. (AR C-1776, Add-A-7772.)

Over the life of the cap-and-trade program, the Board expects to distribute about half of the allowances to emitters for free, rather than through the auction system. (2 Joint Appendix (JA) 457.) The Board reasoned that providing some free allowances to industrial sources would allow for a smooth transition to the cap-and-trade program and would minimize “leakage,” which can occur when industrial production shifts from California to a jurisdiction that does not limit greenhouse gas emissions. (AR C-70, C-1724.) The Board also determined that providing free allowances to utility sources would help protect utility ratepayers from sudden increases in their natural gas and electricity bills. (AR C-72, C-1724.)

The plaintiffs—the California Chamber of Commerce (Cal Chamber), Morning Star Packing Company (Morning Star), and the National Association of Manufacturers (NAM)—contended in the trial court that the auction system was not authorized by AB 32 and, in addition, that the auction system constituted a “tax” that violated Proposition 13 because AB 32 was not enacted with a two-thirds legislative majority. The trial court rejected both contentions. The Court of Appeal affirmed.

WHY REVIEW SHOULD BE DENIED

I. THE ISSUES PRESENTED ARE UNLIKELY TO ARISE IN FUTURE CASES

A. The Cap-and-trade Program Is a Unique Regulatory Regime

The cap-and-trade program is an innovative regulatory program created to address one of the state’s most pressing environmental concerns. (See Tools of the Trade, AR Add-A-8484 [“emission trading mechanisms are increasingly considered and used worldwide for the cost-effective management of national, regional, and global environmental problems, including...climate change”].) A cap-and-trade program cannot operate

without some system for the distribution of emissions allowances, and the Board included auctions as an important component of its distribution system to improve the fairness and efficiency of the entire program, as explained above.

Given the unique nature of both the cap-and-trade program and the auction system, the precise questions of law addressed by the Court of Appeal are not likely to arise in future cases. A cap-and-trade program can only function properly if the costs and methods for controlling emissions vary among the regulated emitters, if those emitters are sufficiently numerous to ensure an active market for allowances, and if other conditions are also met. (Tools of the Trade, AR Add-A-8488-8491.) The plaintiffs offer no reason to believe that the Legislature will create similar cap-and-trade programs with auction components to address any other state concerns. Supreme Court review is not necessary to further review a case with facts so unlikely to recur.

B. Proposition 26, Which Amended Proposition 13 and Expressly Defines “Tax,” Limits the Effect of the Court of Appeal’s Decision on Future Cases

The ultimate question presented by this case is whether the creation of the auction system was a “change[] in state taxes” for purposes of Proposition 13. (Former Cal. Const., art. XIII A, § 3, added by initiative, Primary Elec. (June 6, 1978), commonly known as Prop. 13 (hereafter Proposition 13); amended by initiative, Gen. Elec. (Nov. 2, 2010), commonly known as Prop. 26.) Proposition 13 was amended in 2010 by Proposition 26, which adds a new definition of the term “tax.” (Cal. Const., art. XIII A, § 3, subd. (b).) The plaintiffs do not identify any other current programs that may be affected by the Court of Appeal’s decision, and, going forward, litigation is much more likely to center on interpretation of Proposition 26 and its new definition of “tax.”

C. Rather than Establishing any New Constitutional Test, the Court of Appeal Based Its Decision on the Application of Established Law to the Specific Facts of this Case

The plaintiffs erroneously assert that the Court of Appeal created a new test to determine whether a revenue-generating measure is a tax. (NAM petn., pp. 6, 30-31; Cal Chamber petn., pp. 9, 23; Morning Star petn., pp. 14-15.)

Rather than creating any new test, the Court of Appeal merely applied existing precedent. (Slip opn., pp. 4-5, 37-39.) The Court of Appeal acknowledged that “the term ‘tax’ has different meanings in different contexts.” (Slip opn., p. 37; cf. *Sinclair Paint*, *supra*, 15 Cal.4th at p. 874 [“The cases recognize that ‘tax’ has no fixed meaning,...”].) But “generally speaking, a tax has two hallmarks: (1) it is compulsory, and (2) it does not grant any special benefit to the payor.” (Slip opn., p. 37.) These points are affirmed by a wide range of authorities, including decisions of this court. (Slip opn., pp. 37-38, 48, citing *California Farm Bureau Federation v. State Water Resources Control Bd.* (2011) 51 Cal.4th 421, 437; *Sinclair Paint*, at p. 874; *People v. Naglee* (1850) 1 Cal. 232, 253.) The Court of Appeal then determined that since emitters are not compelled to participate in the auction system, and since they receive a valuable, tradable commodity in exchange for their auction payments, the auction system exhibits neither of those hallmarks and is not a tax. (Slip opn., pp. 39-50.)

The plaintiffs do not appear to dispute that most taxes are compulsory or that most taxes do not grant any special benefit to the taxpayer. Instead, the plaintiffs contend that the Court of Appeal misapplied both principles to the facts of this case. (NAM petn., pp. 30-36; Cal Chamber petn., pp. 23-32; Morning Star petn., pp. 26-30.) But the court’s application of settled legal principles to these facts did not create any new constitutional test and does not present an important question of law for the Supreme Court’s review.

II. THE PLAINTIFFS FAIL TO IDENTIFY ANY CONFLICT IN RELEVANT AUTHORITY

Review is not necessary to secure uniformity of decision, and the plaintiffs fail to identify any genuine conflict between the Court of Appeal’s opinion and existing law.

No conflict arises from the Court of Appeal’s unanimous conclusion that the constitutionality of the auction system is not controlled by the test established by *Sinclair Paint, supra*, 15 Cal.4th 866. (Slip opn., pp. 35-36; dis. opn., pp. 1-2.) The plaintiffs misconstrue *Sinclair Paint* as prescribing that test not only for fees, but for any revenue-generating measure enacted without a two-thirds legislative majority. (See *Morning Star petn.*, pp. 19-24; *NAM petn.*, pp. 19-20; *Cal Chamber petn.*, pp. 19-23.) But Proposition 13 requires a two-thirds vote only for “changes in state *taxes* enacted for the purpose of increasing revenues.” (Italics added.) If the auction system is not a tax, Proposition 13 does not apply, and the *Sinclair Paint* test is not relevant.³ *Sinclair Paint* analyzed only whether a payment was exempt from Proposition 13 *as a fee*. As the Court of Appeal correctly observed, “*Sinclair Paint* did not create ‘a binary world’ where every payment to the government must be either a fee or a tax.” (Slip opn., pp. 35-36.)

The courts have never held that a revenue-generating measure is necessarily a tax merely because the measure does not satisfy all the requirements of a cost-shifting fee. The courts have instead held to the contrary. For example, in *California Taxpayers’ Ass’n v. Franchise Tax Bd.* (2010) 190 Cal.App.4th 1139, the plaintiff challenged the constitutionality of a penalty imposed on corporate taxpayers that had grossly understated

³ Again, the case involves “tax” as defined under Proposition 13 and not Proposition 26.

their tax liability. (*Id.* at p. 1143.) The penalty was projected to generate \$1.4 billion in revenue during its first year. (*Id.* at p. 1148.) Like the plaintiffs here, the plaintiff argued that the penalty required an act approved by a two-thirds majority of the Legislature unless the penalty satisfied the requirements of *Sinclair Paint*. (*California Taxpayers' Ass'n*, pp. 1145-1146.) The court disagreed and upheld the penalty. Rather than finding it necessary to classify the penalty as either a tax or a fee, the court “employ[ed] the traditional analytical framework for determining a statute’s constitutionality,” under which “[a] statute is presumed to be constitutional and the burden is on the challenger to show otherwise.” (*Id.* at p. 1146.) The court distinguished the penalty from a tax and characterized the plaintiff’s binary “tax/fee argument” as “misguided.” (*Id.* at p. 1148.)

The plaintiffs disregard that the *Sinclair Paint* test is specially designed for cost-shifting fees, and it is not useful in other contexts. The defining characteristic of any fee, including a regulatory fee, is that the fee reasonably shifts the costs of a governmental activity from the taxpaying public to those who benefit from the activity or make the activity necessary. (See *Sinclair Paint*, *supra*, 15 Cal.4th at p. 879 [the “shifting of costs” of a regulatory program “from the public to those persons deemed responsible” for the regulatory burden is a “reasonable police power decision” and not a tax]; *California Tow Truck Association v. City and County of San Francisco* (2014) 225 Cal.App.4th 846, 859 [“In broad strokes, taxes are imposed for revenue purposes, while fees are collected to cover the cost of services or regulatory activities”].) The purpose of the *Sinclair Paint* test is to determine whether a fee shifts the costs of a program *reasonably*. (See *California Farm Bureau Federation v. State Water Resources Control Bd.*, *supra*, 51 Cal.4th at pp. 437-438 [describing the requirements of the test]; *Sinclair Paint*, *supra*, 15 Cal.4th at pp. 876-880 [same]; slip opn., pp. 31-32.) The test is logically irrelevant in the context of any measure that is not

a cost-shifting fee. Thus, contrary to the plaintiffs’ contentions (NAM petn., pp. 20-21; Morning Star petn., pp. 21-24; Cal Chamber petn., pp. 21-22), the *Sinclair Paint* test does not apply to every measure that helps *fund* a regulatory program or that is *associated* with a regulatory program; the test only applies to measures that *shift the costs* of a program.

If the auction system is not a tax—as the Court of Appeal properly determined—it does not matter whether the auction system is a cost-shifting fee that satisfies the requirements of *Sinclair Paint*. The Court of Appeal’s decision creates no conflict.

III. THE PLAINTIFFS IDENTIFY NO ERROR IN THE COURT OF APPEAL’S WELL-REASONED OPINION

Even without any conflict of authority, a significant legal error in a decision affecting a large statewide program might in some circumstances warrant this court’s intervention. But the Court of Appeal’s opinion was well-reasoned, and there is no error to correct.

Review is not necessary, for example, to consider the plaintiffs’ assertion that the revenue generated by the auction system is being used for general revenue purposes, which, they assert, transforms the auction into a taxing mechanism. (NAM petn., pp. 36-37; Morning Star petn., pp. 30-32; Cal Chamber petn., pp. 33-36; see also, dis. opn., pp. 11-22.) Their legal premise is wrong. The courts have observed that unlike fees, “ ‘[t]axes are raised for the general revenue of the governmental entity to pay for a variety of public services.’ ” (*Sinclair Paint, supra*, 15 Cal.4th at pp. 874, quoting *County of Fresno v. Malmstrom* (1979) 94 Cal.App.3d 974, 983.) But taxes are not the *only* sources of state revenue that may be used for general revenue purposes. (See, e.g., *California Taxpayers’ Ass’n v. Franchise Tax Bd., supra*, 190 Cal.App.4th at pp. 1147-1150 [civil tax penalties]; *Ventura County v. Southern Cal. Edison Co.* (1948) 85 Cal.App.2d 529, 533-534 [statute holding parties responsible for fire

suppression costs attributable to negligence]; Pub. Resources Code, §§ 6501-7062 [governing various oil and mineral leases]; Gov. Code § 11011 et seq. [governing the sale or lease of surplus state property].) Proposition 13 only affects “changes in state *taxes*.” (Italics added.) If the source of revenue is not a tax, Proposition 13 does not apply and does not speak to how the revenue may be used.

Not only is the plaintiffs’ legal premise wrong on that issue, but so is their factual assertion that auction revenues may be used for general revenue purposes. The Legislature requires auction proceeds to be deposited into a special fund and used to facilitate the reduction of greenhouse gas emissions. (Gov. Code, §§ 12894 & 16428.8 et seq.; Health & Saf. Code, § 39710 et seq..) A variety of government programs can serve to reduce greenhouse gas emissions, but that only shows the importance of reducing emissions. (See generally, Carlson, *Designing Effective Climate Policy: Cap-And-Trade and Complimentary Policies* (2012) 49 Harv. J. on Legis. 207, 213 [“the reduction of emissions from the generation of GHGs implicates virtually all aspects of the economies of the developed and developing worlds”].) If the plaintiffs believe particular expenditures are not reasonably related to reducing emissions, the plaintiffs’ remedy is to use the statutory spending limitations to challenge those expenditures. (See slip. opn., pp. 50-52.)

Review is also unnecessary to consider the plaintiffs’ argument that emissions allowances are not “property.” (Morning Star petn., pp. 28-30; Cal Chamber petn., pp. 32-33; see also, dis. opn., pp. 9-11.) The Court of Appeal’s decision did not pass on whether allowances are property for all conceivable purposes. Rather, it noted that they have economic value and are tradable. Those qualities explain why even some non-emitters choose to purchase allowances, and, as the Court of Appeal held, they help distinguish the auction system from a tax. (See slip opn., p. 39.) Whether

allowances are property in any other sense of the word is beside the point. (See slip opn., pp. 44-48.)

Only two of the plaintiffs continue to dispute that AB 32 granted the Board statutory authority to create the auction system. (Cal Chamber petn., pp. 37-40; NAM petn., p. 5, fn. 1.) The Court of Appeal unanimously rejected their arguments, adding that the Legislature “effectively ratified the auction system” by enacting later legislation specifying how the auction proceeds would be used. (Slip opn., pp. 11-27; dis. opn., p. 1.) The issue of statutory authority relates solely to the language of AB 32 and was correctly resolved by the Court of Appeal. The issue does not warrant Supreme Court review.

CONCLUSION

The plaintiffs disagree with the Court of Appeal's application of familiar legal principles, but they do not identify any issue or conflict with existing authority that justifies Supreme Court review. The petitions for review should therefore be denied.

Dated: June 12, 2017

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CERTIFICATE OF COMPLIANCE

I certify that the attached Combined Answer to Petitions for Review uses a 13-point Times New Roman font and contains 3,334 words.

Dated: June 12, 2017

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