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## **Court Upholds Auction of Greenhouse Gas Emissions Allowances**

The California Global Warming Solutions Act of 2006 (AB32) was passed by a simple majority vote of both legislative houses. AB32's general purpose is to reduce greenhouse gas (GHG) emissions to protect the environment. Plaintiffs and Appellants in *California Chamber of Commerce v. State Air Resources Board* (Case No. CO75930; April 6, 2017) do not quarrel with AB32 or its goals, but attack one part of the implementing regulations adopted by the state Air Resources Board (ARB). ARB created a "cap-and-grade" program that includes the auction sale of some—but not all—GHG emissions allowances. Covered entities—generally large emitters of GHGs—must either surrender sufficient compliance instruments (emissions allowances or offset credits) to cover the amount of pollutants they discharge, or face monetary penalties or other negative consequences. ARB distributes some emissions allowances for free, but sells others at quarterly auctions. A covered entity that cannot reduce its emissions below the amount authorized by its free allowances and any offset credits it has obtained must purchase more allowances at ARB's quarterly auctions, or on a secondary market where allowances are sold or traded without ARB control.

As in the trial court, on appeal appellants asserted (1) the auction sales exceed the Legislature's delegation of authority to ARB to design a market-based emissions reduction system, and (2) the revenue generated by the auction sales amounts to a tax that violates the two-thirds supermajority vote requirement of Proposition 13.

Appellants raised seven points in support of their argument that the Legislature did not give ARB sufficient discretion to adopt an auction component if it adopted a cap-and-trade program, each of which was rejected by the court of appeal. As to a lack of explicit authorization, the court found that AB32 gave ARB "great flexibility". "If the Legislature had wanted to direct who would receive the constraint value *if* ARB chose a cap-and-trade system, it was free to do so, but did not. Thus, it seems clear that the Legislature meant for ARB to decide whether to create a cap-and-trade system including an auction for some emissions allowances."

The court similarly found that the absence of any specific discussion of an auction in the legislative history and that other cap-and-trade programs did not include auctions had no impact on the flexibility inherent in AB32. Appellants also contended that the existence of an administrative fee provision precluded ARB from generating any other revenue under AB32. The court dismissed their argument, quoting the trial court that "[i]t only proves the Legislature intended to ensure ARB could collect fees to pay for the administrative costs directly incurred in carrying out the provisions of AB32".

Additional claims raised by appellants were that certain floor debates indicated that AB32 would not provide “an open checkbook” to ARB. The court concluded that “[n]one of these statements individually, nor all of them in combination, speak to ARB’s ability to adopt an auction component within its cap-and-trade program”. Finally, the court was unpersuaded by arguments that AB32 did not specifically address the disposition of auction revenue and that earlier, unenacted, versions of AB32 explicitly authorized auctions.

In conclusion, the court stated: “We agree with the trial court that the Legislature conferred on ARB extremely broad discretion to craft a distribution system, and the fact the Legislature did not explicitly refer to an auction of allowances does not mean such an auction falls outside the scope of the delegation. Moreover, by later specifying how the proceeds of auctions would be used, the Legislature effectively ratified the auction system created by ARB”.

In upholding the trial court’s determination that the auction system does not equate to a tax subject to Proposition 13, the court held: “This is so for two interrelated reasons: First the purchase of emissions allowances, whether directly from ARB at auction or on the secondary market, is a business-driven decision, not a governmentally compelled decision; second, unlike any other tax to which we have been referred by the parties, the purchase of an emissions allowance conveys a valuable property interest—the privilege to pollute California’s air—that may be freely sold or traded on the secondary market. Thus, the trial court correctly identified the two facts we find make the auction system unlike a tax, (1) participation is voluntary, and (2) entities receive a thing of value in exchange for obtaining allowances”.

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