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The Honorable Harry E. Hull, Jr.
Acting Administrative Presiding Justice
Third District Court of Appeal
914 Capitol Mall, 4th Floor
Sacramento, California 95814-4814

***California Chamber of Commerce, et al. v. California Air Resources Board, et al.*,**
Case No. C075930, Consolidated With Case No. C075954
Letter Brief of *Amicus Curiae* the International Emissions Trading Association

Dear Acting Administrative Presiding Justice Hull and Associate Justices:

The International Emissions Trading Association ("IETA") respectfully submits this letter brief in response to the Court's *sua sponte* Order of April 8, 2016 directing the parties to submit supplemental letter briefs. IETA has followed this litigation with interest and respectfully requests leave to file this *amicus curiae* letter brief in support of Respondents.

Pursuant to California Rule of Court 8.200(c)(1), the Court may allow submission of an *amicus curiae* brief within 14 days after the last appellant's reply brief is filed or at any time for good cause. (Cal. R. Ct. 8.200(c)(1).) Such good cause exists here. On April 8, the Court requested supplemental briefing on seven specific questions. Until that Order, IETA was unaware of the Court's specific concern for three issues addressed in this *amicus* brief: (1) can the auction permissibly sell a "privilege to pollute"?; (2) to what extent do compliance instruments confer a property right?; and (3) what is the appropriate remedy should this Court determine that the allowance auction system constitutes an illegal tax? These issues correspond with Questions 4, 1, and 7 in the Court's Order, and we address them in this *amicus* brief in that order.

IETA, as a trade association with diverse membership and a strong interest in this case and the future of the Global Warming Solutions Act of 2006 ("AB 32"), is well

positioned to provide additional perspective on the questions posed by the Court. IETA has worked diligently to prepare and submit this *amicus* letter brief on the same day that all parties' supplemental letter briefs are due. We believe that the context, information, and arguments provided by IETA in this brief will assist the Court in answering these three important questions. We respectfully ask the Court to consider IETA's *amicus curiae* brief in accordance with California Rule of Court 8.200(c).

I. Interest of *Amici*

IETA represents a large and diverse coalition of commercial and business interests. Both IETA and each entity joining this amicus brief – even those that face compliance costs under California's Cap-and-Trade Program – share the view that this Court should deny the Petitioners' request to invalidate the current allowance auction system developed and implemented by the California Air Resources Board ("ARB").

IETA is the leading global voice of the business community on the design, implementation, and evaluation of mechanisms that harness the marketplace and private sector innovation to address climate change, which many believe to be the greatest challenge facing the planet. Worldwide, IETA's team and multi-sector membership work closely with governments, leading academics, and environmental groups to inform the design, expansion and overall functionality of these critical mechanisms. IETA's 150+ member companies include some of North America's – and the world's – largest power, industrial, and financial corporations, including leaders in oil and gas, electricity, manufacturing, mining, chemicals, and paper. IETA members also include leading firms in sectors that support and enhance carbon markets, such as data assurance and certification; brokering, trading and finance; engineering and clean technology; offset project development, aggregation, and registries; and legal and advisory services.

Most if not all of IETA's members have an interest in both the outcome of this litigation and the correct interpretation of AB 32 and its associated regulations. The business enterprises of many IETA members are subject to substantial compliance obligations and costs under ARB's Cap-and-Trade Program. Indeed, according to ARB's 2014 greenhouse gas ("GHG") emissions data, IETA members along with the others joining this brief account for a substantial percentage of the Cap-and-Trade Program's compliance obligation. Others that are joining this brief, both IETA members and non-members, are part of the carbon value chain, bringing jobs into California while creating real and verifiable GHG emission reductions by creating and marketing compliance offsets. Still other IETA members are commercial entities that facilitate the carbon market, thereby

furthering the goals of AB 32, while generating substantial employment and business opportunities within the State. Included within the coalition supporting this brief are many businesses that are either based in California or have significant operations in the State, including large oil companies; small and mid-sized energy businesses; many California public utilities (both those regulated by the California Public Utilities Commission and Municipal Utilities); international non-governmental organizations; and a variety of other disparate businesses.

IETA's effort to submit this brief has been led by several of its members that are based in California, and IETA is joined in this brief by numerous other businesses and organizations that have major interests in California's Cap-and-Trade program. These leading IETA members and other entities in this broad, IETA-led coalition of businesses include the following:

- **American Carbon Registry** ("ACR") is a nonprofit California offset project registry and an IETA member; ACR has issued over half of the Registry Offset Credits that have been converted to ARB Offset Credits including a majority of those from forestry, ODS destruction, and mine methane capture projects;

- **Compliance Offset Developers Association** ("CODA"), a forum for offset project developers and owners to provide input to regulators and offset registries;

- **Forest Carbon Partners, L.P.**, an investment fund managed by New Forests Inc., which has financed and developed multiple forest carbon offset projects in California with family forest landowners and Native American Tribes that have generated offsets for compliance use in the Cap and Trade Program;

- **Northwest & Intermountain Power Producers Coalition** ("NIPPC"), a coalition comprised of thermal and renewable independent power producers, power marketers and independent transmission companies; many NIPPC members deliver power into California and face compliance obligations under the Cap-and-Trade Program;

- **Pacific Gas & Electricity Inc.** ("PG&E"), an IETA member, incorporated in California in 1905, PG&E provides electric and gas service to Northern and Central California; it is one of the largest combined natural gas and electric utilities in the United States, and has a CO_2 emissions rate for delivered electricity that is roughly two thirds cleaner than the national utility average;

- **Sacramento Municipal Utility District** ("SMUD"), is a political subdivision of the state of California formed pursuant to the Municipal Utility District Act (Cal. Pub. Utility Code §§ 811501 *et seq*.) to acquire, generate, transmit, and distribute electric energy; SMUD serves 1.4 million people in Sacramento and Placer Counties, and as such is the sixth largest community-owned electric utility in the United States; about one-half of SMUD's retail electricity comes from GHG-free resources;

- **Southern California Edison Company**, which is more than 125 years old, is one of the largest electric utilities in the United States, serving more than 15 million people in Southern California; it is committed to reducing CO_2 emissions from its fleet and throughout its portfolio, and;

- **The Climate Trust**, an IETA member, is a non-profit that has been working in domestic carbon markets for over 18 years, during which it has invested over $32 million into projects, founded the Offset Quality Initiative, and launched an investment fund focused on projects generating California Compliance Offsets.[1]

Many IETA members, along with the other entities joining this brief, have made substantial investments that depend on the continued existence of ARB's Cap-and-Trade program, of which the auction system is a critical component. Based solely on the value of the allowances purchased at auction to date, market participants have invested some fourteen billion dollars ($14,000,000,000). To date, entities have used allowances valued at just under four billion dollars ($4,000,000,000) for compliance purposes, meaning that roughly ten billion dollars ($10,000,000,000) of allowances are owned by various entities and remain outstanding assets in the marketplace. Entities bank these allowances, either for future compliance surrender or for other purposes such as trade. Entities routinely engage in transactions to buy or sell allowances in the form of bilateral forwards, or exchange based futures and options contracts. These contracts remain binding until they are closed or are fulfilled. Excluding options (which would add greatly to the total), there already have been

[1] No party or counsel for any party in this appeal authored this proposed *amicus* brief, in whole or in part, or made any monetary contribution intended to fund the preparation or submission of it. IETA led the effort to organize and prepare this *amicus* brief and is the primary funder of it. The following entities assisted IETA in this effort and supported the preparation of this *amicus* brief: A-Gas Americas, Inc., Amerex Energy, ClimeCo Corporation, CODA, Diversified Pure Chem, LLC, Forest Carbon Partners, L.P., Origin Climate Inc., Sacramento Municipal Utility District, and Southern California Edison Company.

more than nine thousand (9,000) futures transactions on the Intercontinental Exchange, with a transaction value in excess of ten billion dollars ($10,000,000,000). Another 1.25 billion dollars ($1,250,000,000) in futures contracts remain outstanding for future delivery. Within this sizable secondary market, parties rely on auction prices to inform their forward, option, and futures deals. The market signals sent by each auction are an integral part of that process. Auctions also serve as a primary source of supply for the secondary market with allowances bought at auction being delivered into forward and futures commitments. Many tens of thousands of Californians are employed by the holders of these allowances, and the outcome of this case will have a direct effect on the companies that have made these investments. In short, IETA and the other entities joining this brief are heavily invested in the program and represent a sizable segment of the California economy.

In addition to their investment in the program, IETA and the other entities joining this brief bring direct experience with the subject matter at issue. Through its work in monitoring and advocating for public policy to combat climate change around the world, IETA has gained specialized expertise in emissions trading markets. IETA believes that its knowledge and unique perspective will aid the Court in its efforts to develop a fuller understanding of the issues in play as it considers the fate of ARB's allowance auctions. As set forth in the body of this *amicus* brief, this IETA-led coalition believes that upholding ARB's auction mechanisms is the correct outcome as a matter of law. It also is the correct conclusion as a matter of policy. Disrupting ARB's Cap-and-Trade market at this juncture would harm California's economy by stranding AB 32 compliance investments made in reliance on the auction system, and by creating significant regulatory uncertainty for many industries in the state. It also would frustrate the legislative purpose of AB 32 and the State's efforts to combat climate change.

II. Introduction and Overview.

As noted above, this *amicus* brief addresses three of the Court's questions in its April 8 Order: Questions 4, 1, and 7. First, we explain that the allowance auction program is a legitimate exercise of the State's police power to manage and allocate scarce natural resources. Because purchasers of allowances at auction acquire something of value in return – what some have characterized as "a permit to pollute" – the auction is not a tax and thus not subject to challenge under Proposition 13. Next, we turn to the character of the allowance that is purchased, addressing the Court's question about the Regulation's statement that compliance instruments do not constitute property. We urge the Court to narrowly construe this ambiguous statement such that: (i) compliance instruments do not constitute property as between the State and private entities with compliance obligations but

(ii) compliance instruments *do* constitute property when held by and traded between private entities. Such a construction is truer to the intent of the legislature in AB 32, as revealed by the plain text of the statute, is not inconsistent with the rulemaking history of the Regulation, and is supported by a wide body of case law in similar contexts.

If, however, the Court concludes that the auction program is an improper tax, then we urge this Court to remand the program to ARB without vacating, and with instructions to correct it or replace it beginning in 2021. This will give ARB (or the legislature should it opt to act) time to fashion a remedy, something that will take time as this is a very large program in which both the State and countless stakeholders are heavily invested. To require action prior to the conclusion of the existing program in 2020 would disrupt significant portions of the California economy and frustrate the environmental goals of AB 32.

III. *Response to Question 4*: Yes, the Auction System Can Be Defended Against the Proposition 13 Challenge on the Ground that it Essentially Sells to Covered Entities the Privilege to Pollute.

A. California's Inherent Police Power Carries With It the Right to Manage and Allocate Scarce Natural Resources.

It is well-settled that California law does not provide regulated entities with an inherent "right to pollute." (*Communities For A Better Env't v. South Coast Air Quality Mgmt. Dist*. (2010) 48 Cal.4th 310, 323–324 [companies have "no vested right to pollute the air at any particular level."], citing *Mobil Oil Corp. v. Superior Court* (1976) 59 Cal.App.3d 293, 305 [oil companies' right "to continue releasing gasoline vapors into the atmosphere is neither fundamental nor vested"].) The government has the responsibility to protect natural resources and also has the inherent right to regulate the protection of the environment. (*Ctr. for Biological Diversity, Inc. v. FPL Group, Inc.* (2008) 166 Cal.App.4th 1349, 1365, *as modified on denial of reh'g* (Oct. 9, 2008) [noting that "[t]he concept of a public trust over natural resources unquestionably supports exercise of the police power by public agencies. [Citation.] But the public trust doctrine also places a duty upon the government to protect those resources"].)

California's right to regulate its natural resources flows from the State's police power. As noted by Respondents in this matter, the "police power is simply the power of sovereignty or power to govern – the inherent reserved power of the state to subject individual rights to reasonable regulation for the general welfare." (*Sinclair Paint Co. v. State Bd. of Equalization* (1997) 15 Cal. 4th 866, 878, quoting 8 Witkin, Summary of Cal.

Law (9th ed. 1988) Constitutional Law, § 784, p. 311.; Resp't. Br. at 42.) The State exercises this police power to protect and regulate natural resources through its various agencies and their enabling statutes. (See, e.g., Health & Saf. Code, § 38560 ["The state board shall adopt rules and regulations . . . to achieve the maximum technologically feasible and cost effective greenhouse gas emission reductions . . ."].)

California, like the federal government and other states, often chooses to carry out this legitimate government function of natural resource management by controlling the right to use or exploit the State's air, water, land, and wildlife. Regulated entities pay various fees in exchange for a limited right to discharge wastewater or emit pollution into the State's water and air. Familiar examples are the issuance of permits under the National Pollution Discharge Elimination System ("NPDES") and the Clean Air Act. (Cal. Code Regs., tit. 23, § 2200 [Annual NPDES Fee Schedules]; Health & Saf. Code § 42311 [Annual Air Permit Fee Schedules].) Some of these fees are volume-based. For example, the State Water Resources Control Board assesses flow-based fees on certain facilities, assessing a $2,840 fee for each million gallons of wastewater the facility is designed to discharge each day. (See State Water Resources Control Board, *NPDES Program Report to the Legislature* at 3 (May, 2013).)[2] Some of these fees may exceed a half-million dollars annually. (*Id.* at 5.)

B. Auctions And Emission Allowances Are an Increasingly Common Way to Manage Access to Scarce Resources and Compensate the Public for their Use.

Controlling access to limited natural resources through auctions is an increasingly common feature of the exercise of governmental police powers. For example, the federal government routinely auctions the right to use public land for energy production. The U.S. Department of the Interior's Bureau of Land Management ("BLM") holds auctions to allocate rights to extract coal, gas, and oil from public lands. Under the Federal Coal Leasing Amendments Act of 1976, BLM must allocate all public lands available for coal leasing on a competitive basis. The Onshore Oil and Gas Leasing Reform Act of 1987 similarly requires BLM to offer public lands available for oil and gas leasing through a competitive leasing process. In both cases, auctions are used to allocate the right to exploit a shared natural resource to the highest bidder. In a non-extractive context, the Outer Continental Shelf Lands Act requires the federal government to award leases for offshore

[2] *Available at*: http://www.waterboards.ca.gov/publications_forms/publications/legislative/docs/2013/npdes_legislative_report.pdf.

renewable energy projects competitively, which has resulted in auctions for the right to use submerged public lands for the development of offshore wind power. Most leases also are transferrable: oil and gas leases are routinely bought and sold by energy companies, and in recent years even offshore wind leases have been the subject of transactions.[3] Revenues collected from energy leases take several forms, including "bonus" payments from the winning auction bidder or bidders, annual rents, and royalties on extracted minerals. These payments serve to compensate the owner of the resource – the American people – for its exploitation.

The Regional Greenhouse Gas Initiative ("RGGI"), a cap-and-trade program regulating GHG emissions from utilities across nine northeastern states, employs auctions to sell carbon dioxide ("CO_2") emissions allowances to regulated entities and qualified buyers.[4] As of August, 2015, RGGI auctions had created about 2.5 billion dollars ($2,500,000,000) in revenue that is used by member states for a variety of GHG mitigation programs, as well as other purposes.[5] Just like auctions to exploit energy resources, RGGI auctions compensate the public for use of a valuable resource – in this case, the atmosphere. RGGI conducted its first auction of emission allowances in 2008; despite being challenged, no court in any of RGGI's member states has held the program to be invalid.

California's Emission Reduction Credits program also creates a fee-based mechanism for allocating the right to emit air pollutants. (Health & Saf. Code § 40709 [directing each district board to establish an Emission Reduction Credits system].) Through this system, facilities quite literally purchase the right to pollute under a State-sanctioned regulatory scheme designed to protect California's natural resources. The program is similar to the federal Acid Deposition Control program created under the 1990 Clean Air Act Amendments. (42 U.S.C.A. § 7651 *et. seq.*) The Acid Rain Program, as it is commonly known, has achieved remarkable reductions in sulfur dioxide ("SO_2") and

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[3] For example, in 2015, the Bureau of Ocean Energy Management auctioned two leases off the coast of Massachusetts that were subsequently transferred (with agency approval) to a third party, for an undisclosed sum. The two leases themselves generated over $400,000 in "bonus payments" at auction, money that is paid to the U.S. Government in exchange for the right to develop wind energy on the areas covered by the leases. For more information on offshore wind leasing, visit: http://www.boem.gov/Lease-and-Grant-Information/.

[4] Qualified buyers include corporations, individuals, non-profit corporations, environmental organizations, brokers, and other interested parties that meet RGGI qualification standards. Post auction, RGGI allowances are bought and sold on the secondary market.

[5] RGGI Auction Results, https://www.rggi.org/market/co2_auctions/results.

nitrogen oxide ("NOx") emissions while keeping compliance costs low. Under the Acid Rain Program, if a regulated source reduces SO_2 emissions below a certain level, it will receive "emission allowances" that it may bank or sell. (42 U.S.C.A. § 7651b.) EPA allocates some allowances under the Acid Rain Program and then oversees private-party transactions related to those allowances. (See generally 40 C.F.R. Parts 72–78.) EPA also manages an annual SO_2 Allowance Auction, much like that administered under AB 32 by ARB.[6]

California also sells the right to exploit natural resources by holding lotteries that are very similar to auctions. (Cal. Code Regs., tit. 14, § 708.16.) Specifically, state law authorizes the California Department of Fish and Wildlife to run a fund-raiser (its actual name) where participants have the chance to win hunting licenses for wild game such as elk and bighorn sheep by purchasing lottery tickets for a random drawing. (*Id*.) There is no limit on the number of lottery tickets a participant may purchase for a set fee, and winners who are awarded a tag must also purchase a California hunting license. (*Id*.) This type of lottery is no different than an auction: participants can increase their odds of winning a wild game tag by purchasing more lottery tickets, just as participants in an emissions allowance auction can increase their chances of obtaining allowances if they increase their bids. In either scenario, parties who pay more almost certainly will obtain more rights to exploit natural resources than those who pay less.[7]

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[6] For more information on EPA's SO_2 allowance auctions and trading system, visit https://www.epa.gov/airmarkets/allowance-markets. EPA also manages various other air quality programs that rely on a system of tradeable, saleable emissions allowances that confer a "privilege to pollute." General information on these programs is available at https://www.epa.gov/airmarkets.

[7] Outside of the environmental context, auctions are an oft-used tool to allocate access to various public resources. For example, the Federal Communications Commission ("FCC") runs auctions to distribute broadcasting licenses. As with allowances under the ARB program, which are mandated and a requirement to operate a significant GHG emitting business in California, a business that uses the electromagnetic spectrum in its operations requires an FCC broadcast license issued by the government. Under authority from Congress, the FCC has conducted auctions of licenses for electromagnetic spectrum since 1994. (Omnibus Budget Reconciliation Act of 1993, Pub.L. No. 103–66, § 6002(a), 107 Stat. 312, 387, codified at 47 U.S.C. § 309(j); Balanced Budget Act of 1997 § 3002(a)(1), Pub.L. No. 105-33, 111 Stat. 251, amending 47 U.S.C. § 309(j).) The auctions are conducted online and are open to any company or individual found to be a qualified bidder by the commission.

C. ARB's Auction Program is Simply Another Example of the State's Power to Allocate Scarce Resources and Compensate the Public for the Use of the State's Natural Resources.

The use or exploitation of natural resources is a privilege, not a right. (*Communities For A Better Env't*, 48 Cal.4th at 323–324). As the above examples amply demonstrate, both state and federal sovereigns routinely and properly exercise their police power by requiring users of shared public resources to compensate the public for use of that valuable resource by (i) collecting permit fees, (ii) issuing emission allowances, and (iii) holding auctions to allocate the relatively scarce right to emit a particular pollutant.

ARB's GHG emission allowance auction is a legitimate exercise of California's inherent right and obligation to regulate the State's scarce natural resources. California law authorizes the right to "pollute" or to exploit state resources through permits, direct sales of allowances, and a lottery system with many hallmarks of an auction. ARB's auction program is simply one of many diverse regulatory mechanisms the State employs to manage its natural resources by selling a limited right to use or exploit a particular resource. As with many other scarce resources (such as air emissions credits under the Acid Rain Program or the right to drill for oil), ARB has determined that an auction is the most efficient method of allocating the right to emit GHGs into the atmosphere.

The parties' "fee vs. tax" dispute largely ignores California's inherent right to allocate the State's natural resources through the sale of a limited privilege to pollute or exploit those resources. Indeed, as this Court has previously observed, "[i]n California, the right to pollute the air can be bought and sold." (*Jopson v. Feather River Air Quality Mgmt. Dist*. (2003) 108 Cal.App.4th 492, 494, *as modified on denial of reh'g* (June 2, 2003) [observing that "[a]ir quality management districts have created a valuable commodity, the [Emission Reduction Credits]"].) ARB's GHG emission allowance auction program is the sale of a right to exploit state resources similar to the regulatory schemes outlined above.

The revenue received from these auctions is neither a tax nor a fee. Rather, it is *compensation*, paid to the people of California, for the right to exploit a valuable natural resource: our atmosphere.[8] Appellants' arguments against the auction mechanism are

[8] This is no different than revenue received from oil or offshore wind leases, Clean Air Act emissions allowance programs, RGGI allowance auctions, broadcast license auctions, or "fund raising" lotteries for hunting licenses: in all cases – and regardless of whether the program is a federal, regional, or California one – the buyer of the right is compensating the public for the privilege to exploit a limited, common resource.

premised on an assumption that it necessarily creates either a fee or a tax, implicating Article 13A of the California Constitution and the body of case law interpreting it. (See *Sinclair Paint Co.*, 15 Cal. 4th 866 [interpreting Cal. Const., art. XIII A, § 3]; Appellants' Opening Br. at 3–4 [relying heavily on *Sinclair Paint* to argue that the auction creates an illegal tax under Cal. Const., art. XIII A, § 3].)

Courts in California are required "to avoid deciding a case on constitutional grounds unless absolutely necessary; nonconstitutional grounds must be relied on if they are available." (*Sanchez v. City of Modesto* (2006) 145 Cal.App.4th 660, 671 [*citing People v. Pantoja* (2004) 122 Cal.App.4th 1, 10].) Interpreting AB 32 as creating neither a tax nor a fee – but compensation for exploitation of a natural resource – is not only correct as a matter of law, it avoids implicating the California Constitution and comports with the judicial doctrine of constitutional avoidance.

IV. *Response to Question 1*: The Court Should Interpret the Property Right Provisions in the Cap-and-Trade Regulation Narrowly and Recognize a *De Facto* Property Right in Compliance Instruments when Traded Between Private Entities.

The substantial business and market participant interests represented by this *amicus* brief welcome the Court's important question relating to the significance of Section 95820(c) of the Cap-and-Trade Regulation. The legal analysis of this question provides perhaps the best example of why allowance auctions are not an improper tax under Proposition 13. Various government-issued licenses have given rise to a body of jurisprudence recognizing a bifurcation in the treatment of such licenses: on the one hand, they are considered "non-property" for purposes of determining and evaluating rights between private parties and the government; but on the other hand, the same license is considered "property" for purposes of determining and evaluating rights between private parties. It is this latter treatment established under analogous case law that is particularly instructive here.

Apart from recognizing the auction allowances as the legitimate purchase of a right to exploit a shared natural resource, the Court may resolve the legality of ARB's allowance auctions by means of another finding outside the "fee vs. tax" paradigm. Respondents have thoroughly outlined compelling arguments for why the auction program is not a tax and why the requirements that govern "fees" are not helpful in resolving this matter. (Resp't Br. at 40–61.) IETA respectfully submits that the Court should find that the auction program is legal because the sale of allowances imposes neither a fee nor a tax, but instead gives rise to

a limited property interest between private parties – though not vis-à-vis regulated entities and ARB. Such a finding would free the Court from the inapposite "fee vs. tax" framework and allow it to recognize the established principle of a narrow public/private property rights distinction that upholds the government's regulatory authority while preserving the market-based solution California sought to implement when AB 32 was adopted by the Legislature.[9]

The Cap-and-Trade Regulation contains overly broad and therefore ambiguous provisions stating that compliance instruments do "not constitute property or a property right." We urge the Court to narrowly construe this language and confine it to its primary regulatory purpose as far as ARB is concerned: to limit ARB's exposure to 5th Amendment takings claims. This interpretation makes sense in light of the broader structure of the Cap-and-Trade Regulation. The Regulation recognizes that the holders of allowances and offsets have an "ownership interest" in them and establishes means by which allowances may be bought and sold. As between private parties, compliance instruments have every indicia of property. When an emissions allowance is purchased at auction, the winning bidder acquires something of value and thus is not paying a tax; the entity is purchasing a right to exploit a valuable resource, as explained in response to Question 4 above. At the same time, ARB's regulatory authority is not threatened because regulated entities take no property interest in the auction credit as between themselves and the agency.

We urge the Court to recognize this public/private distinction in the property characteristics of compliance instruments, one that market participants and regulators recognize every day in practice, and one that, as detailed below, is not inconsistent with the Regulation and is well-supported by a significant body of law.

[9] As noted above, California courts should avoid deciding cases on constitutional grounds when other outcomes are available. (*Sanchez*, 145 Cal.App.4th at 671.) This court should apply that principle here, by finding that ARB's allowance auctions give rise to a limited property right that is sold to a private party (at auction) in exchange for the market value of that property. Just as the state can sell property that it owns (*e.g.*, real estate, vehicles, old office furniture, etc.) or lease its real property (*e.g.*, student dorms at California state universities, excess office space, etc.), it can sell an instrument conveying a limited property interest for purposes of regulating GHG emissions.

A. The Cap-and-Trade Regulation Recognizes a Public/Private Distinction in the Indicia of Property that Adhere to Compliance Instruments.

As noted in the Court's Order Directing Submission of Supplemental Letter Briefs, the Cap-and-Trade Regulation provides that a "compliance instrument issued by the Executive Officer does not constitute property or a property right." (Cal. Code Regs., tit. 17, § 95820(c); see also § 95802(a)(299) [defining "Property Right" as "any type of right to specific property whether it is personal or real property, tangible or intangible."].) ARB's attempted exclusion of property rights in the compliance instruments was for the purpose of shielding the State from regulatory takings claims under the 5th Amendment of the U.S. Constitution. Specifically, the 5th Amendment precludes the taking of private property by the government without just compensation, and has been interpreted to encompass certain regulatory takings. (*Penn Central Transp. Co. v. New York City* (1978) 438 U.S. 104, 124.) By defining the compliance interests as "not property" ARB is shielding itself from an unworkable exposure to an endless stream of 5th Amendment takings challenges (*i.e.* in the event it takes regulatory action to reduce or eliminate the value of the auction credit). This is necessary not only to protect the State[10] but also is integral to the environmental purpose of AB 32.

IETA appreciates the rationale of Section 95820(c) as an effort to limit the State's potential liability and fulfill the environmental purpose of AB 32. Yet, as the Regulation also recognizes, compliance instruments have the essential hallmarks of property as between private parties. California defines property in terms of ownership as "the right of one or more persons to possess and use it to the exclusion of others." (Cal. Civ. Code § 654.) As this Court has noted, and as it is commonly understood across jurisdictions, "[t]he right to exclude others, and to sell, assign or otherwise transfer ownership are traditional hallmarks of property." (*Bronco Wine Co. v. Jolly* (2005) 129 Cal.App.4th 988,

[10] ARB explains its concern for takings claims in its October 28, 2010 Initial Statement of Reasons for the Cap-and-Trade Regulation ("ISOR") as follows:

> It is necessary for the Executive Officer to retain authority to terminate or limit the "authorization to emit" so that in the case of fraud or market manipulation, ARB has a mechanism to protect the market. Additionally, property rights cannot attach to the compliance instruments [with respect to ARB] because, in the event of federal preemption in the cap-and-trade market or other conditions, California must have the ability to revoke the compliance instruments without creating a loss to the people of California.

(CARB CALCH C-000247 (ISOR at IX-18).)

1030 [29 Cal.Rptr.3d 462, 493], *as modified on denial of reh'g* (June 20, 2005) [citations omitted].) This collection of individual rights is commonly referred to as a "bundle of sticks" that, in certain combinations, equate to property. (*U.S. v. Craft* (2002) 535 U.S. 274, 278, citations omitted.)

A regulated entity that owns allowances purchased at auction possesses this bundle of property rights: it has exclusive rights to the allowance, other regulated entities are excluded from ownership, and the holder of the allowance can sell it, assign it, or transfer it to a third party. (Cal. Code Regs., tit. 17, § 95920 and 95921.) In fact, the operation of the Cap-and-Trade Program depends on these characteristics and an active marketplace in which allowances are bought, sold, and traded.

At the same time, the Cap-and-Trade Regulation does not vest regulated entities with the full "bundle of sticks" vis-à-vis ARB. This makes sense when understanding the nature of ARB's responsibility to administer the Regulation and ensure both short term and longer term environmental objectives of AB 32 are met. ARB must have ability to limit or otherwise restrict the use of allowances consistent with the purpose of AB 32. After all, the core concept of the program is that the cap will be ratcheted down over time in order to bring the State's GHG emissions down to 1990 levels by 2020, resulting in fewer and fewer allowances released by ARB into the market. Similarly, the Cap-and-Trade Regulation includes transition assistance for certain energy intensive, trade exposed sectors and allocates a limited number of free allowances to these sectors. Over time, however, the free allocation will decline and those companies must procure allowances through the auction like other compliance entities. Absent the language in Section 95820(c), ARB would have opened itself up to a 5th Amendment takings claims from every such entity (as it slowly "takes away" their free allowances), merely by administering the program as designed and in accordance with the requirements of AB 32.

At the same time, Sections 95832(a)(2) and (3) expressly recognize that the holders of compliance instruments have "ownership interest with respect to the compliance instruments." These limited property rights are consistent with ARB's clear intention that the compliance instruments *have value* in the private market, while also preserving the State's authority to regulate that market. The public/private distinction as it pertains to the legal nature of the compliance instruments as "property" is entirely consistent with ARB's clear intention that the compliance instruments have value in the private market while preserving the State's authority to regulate.

B. The Rulemaking History of Section 95820(c) Reveals that ARB Recognized the Public/Private Distinction in the Indicia of Property that Adhere to Compliance Instruments.

The Cap-and-Trade Regulation recognizes that property rights adhere to compliance instruments when held by private entities prior to being used for their regulatory purpose. (See Sections 95832(a)(2) and (3).) This regulatory intention was further explained by ARB in its October 1, 2012, Final Statement of Reasons for the Cap-and-Trade Regulation (the "FSOR"). ARB clarified this distinction between the "ownership interest" in compliance instruments when used between private parties and their rights with respect to ARB:

> *The references to "ownership interests" refers to any participating entity's right relative to other private parties to direct the use of allowances or offset compliance instruments held in accounts in the California cap-and-trade program.* As clearly stated in Section 95820(c), "[a] compliance instrument issued by the Executive Officer does not constitute property or a property right." The mention of "ownership interests" in Section 95832(a)(3) and elsewhere is not intended to and does not alter this fundamental characteristic of compliance instruments.

(CARB CALCH H-001296 (October 1, 2011); FSOR at 759 (emphasis added).) In the italicized sentence, ARB recognizes that private parties "own" compliance instruments when they "direct their use" "relative to other private parties" – that is, when they opt to trade them rather than surrender them to meet a compliance obligation. The next sentence emphasizes the "fundamental characteristic" set forth in Section 95820(c), but as discussed above, that applies solely to their function of being used to meet compliance obligations under AB 32. As ARB here recognizes, that characteristic does not prevent private parties from having an ownership interest in the compliance instruments when used for other purposes prior to their being surrendered to meet compliance obligations.

This public/private distinction was not first created by ARB under the Cap-and-Trade Regulation. Rather, it has been recognized by many courts in other, similar contexts, and we call upon this Court now to recognize this well established legal principle in ARB's Cap-and-Trade Regulation.

C. A Significant Body of Law Supports the Recognition of the Public/ Private Distinction in the Indicia of Property that Adhere to Compliance Instruments.

The case law from which this public/private distinction arises pertains largely to questions of whether certain government issued licenses can be pledged by a licensee as collateral for credit under the Uniform Commercial Code, Article 9 ("UCC9"). In order for a borrower to pledge collateral under UCC9, the collateral must first be property. Courts have analyzed this question when considering the propriety of such pledges. The case law has followed three outcomes based on the structure of the enabling statute, as follows.

- Scenario 1: Where the enabling statute is silent on whether the government issued license constitutes property, but recognizes a right of transfer: the license itself is property and thus fully pledgeable under UCC9. (See *Bogus v. American National Bank* (10th Cir. 1968) 401 F.2d 458, 461 [the fact that liquor licenses could be sold under certain circumstances meant that "such characteristics stamp a liquor license as an item of property" pledgeable as collateral under UCC9]; *In re O'Neill's Shannon Village* (8th Cir. 1984) 750 F.2d 679, 683 [South Dakota liquor license is a general intangible in which a security interest can be taken, noting that the "South Dakota liquor control statute does not state that a liquor license is not property, nor does it contain an express prohibition against encumbrance of a liquor license." *Id*. at 683].)

- Scenario 2: Where the enabling statute is clear and express that the government-issued license does not constitute property: courts respect the express intent of the legislature and deem the license not to be property and thus neither it nor the proceeds from it, can be pledgeable under UCC9. (See *In re Revocation of Liquor License No. R-2193*, 456 A.2d 709, 711–12 (Pa. Commw. 1983) (holding that the Pennsylvania license was not sufficient property to pledge under UCC9 where statute expressly provided that "[t]he license shall continue as a personal privilege granted by the board and nothing herein shall constitute the license as property."); *21 West Lancaster Corp. v. Mainline Restaurant, Inc.*, 790 F.2d 354 (3rd Cir. 1986) (holding that under Pennsylvania's express law, a liquor license is not property and thus cannot be collateral.)[11]

[11] Subsequent to *Liquor License No. R-2193* and *21 West Lancaster Corp.*, Pennsylvania foreshadowed the public/private distinction by amending its liquor code in 1987 to provide that "The license shall constitute a privilege between the board and the licensee. As between

- Scenario 3: Where the enabling statue expressly limits the transferability of such government issued license but does ***not*** expressly state that such license is ***not*** property: the courts recognize property rights in such licenses as between private parties and also respect the government's articulated limitations in such licenses, restricting the pledging of the license itself, but allowing the pledging of the *proceeds* from the authorized sale of such license. This third scenario warrants further discussion below.

The California Legislature was silent on the question of whether AB 32 creates a property interest, but granted ARB authority to create "market-based compliance mechanisms" that necessarily involves transfers of the "government licenses,"[12] and directed ARB to "identify and make recommendations" regarding such "market-based compliance mechanisms." Through rulemaking, ARB has limited the nature of the allowances and offsets while preserving the integrity of the market-based program by providing for their transferability. Based on the discussion above, we believe the most applicable line of cases here is that of the hybrid, public/private property rights described by Scenario 3 above, with one critical caveat: Because the Cap-and-Trade Regulation expressly intends for auction allowances to be transferred between market participants, the allowances *themselves* are transferable property for private holders with full rights to pledge them, along with their proceeds.[13]

The Scenario 3 public/private distinct creating *de facto* property is borne out of cases analyzing the pledgeability of FCC broadcast licenses under UCC9. FCC cases have found a limited property interest in the proceeds of FCC broadcast licenses. FCC laws and cases

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the licensee and third parties, the license shall constitute property." (47 P.S. § 4–468(d); see also *In re Ciprian Ltd.* (Bankr. W.D. Pa. 2012) 473 B.R. 669, 674 [applying Pennsylvania law and 47 P.S. § 4–468(d) to find that "as the [liquor] license constitutes property, a security interest can be created."].)

[12] AB 32 defines "market-based compliance mechanisms" to include, "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." Cal. Health & Safety Code Section 38505(k)(2).

[13] For a full discussion of this topic, see S. Kramer and R. Saines, *"Taking an Interest in Carbon: Secured Financing and the Legal Nature of Carbon Credits,"* Oxford University Press 2010 (book chapter).

also limit property rights in broadcast licenses. For example, the Communications Act provides that the purpose of broadcast licensing is:

> to provide for the use of such channels, but not the ownership thereof, by persons for the limited periods of time, under licenses granted by the Federal Authority . . . no such license shall be construed to create any right, beyond the terms, conditions, and periods of the license.

(Communications Act of 1934, 47 U.S.C. § 301.) The Communications Act also limits the transfer of licenses to parties approved by the FCC, and courts have held that a license does not vest any true ownership rights or property interests in the license. (See *F.C.C. v. Sanders Bros. Radio Station* (1940) 309 U.S. 470, 475.) This lack of any property interest in the license precluded private parties from granting a security interest in the license to creditors under UCC9. (*In re Merley*, 94 F.C.C.2d 829 (1983).) But in *In re Ridgley Communications*, the court upheld a security interest in the *proceeds* of the sale of a broadcasting license. (139 B.R. 374, 378–80 (1992).) Specifically, the court held that the creditor was asserting only a right to the proceeds of the transfer of the license as between private parties, not any interest in the rights of the license as against the FCC. (*Id*. at 378).

After *Ridgley*, the FCC expressly held that a secured creditor may take a security interest in the proceeds of a broadcasting license but receives no rights in the license itself. (*In re Cheskey*, 9 F.C.C.R. 986, 987 (1994).) The agency explicitly adopted the public/private rights distinction outlined in *Ridgley*: "If a security interest holder were to foreclose on the collateral license, by operation of law, the license could transfer hands without prior approval of the Commission. In contrast, giving a security interest in the proceeds of the sale of a license does not raise the same concerns." Federal courts have recently upheld the limited property right in FCC license proceeds.[14]

These cases established a public/private framework for limited property rights that may be associated with broadcast licenses or other scarce resources. The broadcast licenses are vested with limited property rights vis-à-vis themselves and other private parties. At the same time, however, the licensees do not have a complete property interest in the license

[14] *MLQ Investors, L.P. v. Pacific Quadracasting, Inc.* (9th Cir. 1998) 146 F.3d 746 [citing *Ridgley* and *Cheskey* to recognize that a security interest may attach to the proprietary right in proceeds from a sale of an FCC license]; *In re Tracy Broadcasting Corp.* (10th Cir. 2012) 696 F.3d 1051 [holding that a security interest may extend to the proceeds of the sale of an FCC broadcast license].

itself that could interfere with the government's authority to regulate the airwaves. This framework preserves government's inherent authority to regulate limited resources while allowing private transactions to operate legally and efficiently.

There is a key distinction between the FCC broadcast license cases and how the Court should analyze the ARB auction allowance program. Because the Communications Act expressly limits the transfers of FCC broadcast licenses, courts have concluded that only the proceeds (which are property) from such licenses are pledgeable under UCC9. Here, express legislative language and intent authorizes ARB to create a "market-based" program, and the express regulatory intent is to allow for transfers of compliance instruments between and among private participants in the market. Accordingly, auction allowances should be fully pledgeable under UCC9 as general intangibles – not merely the proceeds from their sale.

This outcome will protect the government's inherent authority to regulate natural resources through the use of the auction program while reducing ARB's risk of "takings" liability under the 5th Amendment. At the same time, by recognizing a limited property interest in the license as between private parties, this interpretation preserves the market-based regulatory scheme and the statutory language and legislative intent of AB 32.

D. The Federal Government and Markets Treat Environmental Compliance Instruments as a Commodity Subject to Ownership.

The market treats allowances as a traded commodity subject to exclusive ownership and the right to transfer between private parties. Various business and commodity trading organizations, including IETA, have developed models and master trading agreements based on existing precedents in the commodity trading arena.

The federal government has analyzed other emission credits under the commodities trading rules and has reached a similar conclusion. The Commodity Futures Trading Commission ("CFTC") treats emission allowances and offsets as intangible property subject to physical delivery and with an ownership interest transferable between parties. In a rulemaking related to the interpretation of the term "nonfinancial commodity," the CFTC observed that "market participants often engage in environmental commodity transactions in order to transfer ownership of the environmental commodity" to comply with environmental regulatory programs. (Further Definition of "Swap," "Security-based Swap," and "Security-based Swap Agreement"; Mixed Swaps; Security-based Swap Agreement Recordkeeping, Securities Act Release No. 9338, 2012 WL 2927796 at *43 (July 18, 2012).)

The CFTC further noted that the ownership and consumption features of these transactions "distinguish such environmental commodity transactions from other types of intangible commodity transactions that cannot be delivered." (*Id*.) Importantly, the agency stated that these features "render such environmental commodity transactions similar to tangible commodity transactions that clearly can be delivered, such as wheat and gold." (*Id*.) As a result, the CFTC has concluded that over-the-counter transactions of environmental commodities, such as auction allowances, when subject to physical delivery are not "swaps" under the Dodd Frank Act.

The CFTC's analysis is instructive. The underlying characteristics of environmental commodities – such as the emission allowances that trade in compliance markets, including in California's Cap-and-Trade market – are analyzed alongside and analogized to wheat and gold. The basic framework of this analysis shows how the CFTC and the federal government recognize the inherent property characteristics of allowance offsets and environmental commodities.

As the broadcast licenses and CFTC scenarios demonstrate, there is ample precedent for determining that the inherent characteristics of intangible allowances auctioned by ARB create a property interest between private parties who buy and sell those allowances in the marketplace. ARB's actions in distributing those allowances via an auction mechanism is fundamentally distinct from a taxing scheme. Instead, it is a market-based approach to achieving an important environmental regulatory purpose – addressing climate change – by leveraging the private sector and economic efficiencies of the market to reduce overall costs to California while reaching the important goals of AB 32.

This interpretation is consistent with the body of law established by the FCC cases outlined above, and is a more appropriate legal framework through which to view the auction program than the "fee vs. tax" framework. As outlined by Respondents, the allowance auction does not satisfy the requirements of a tax and the Court need not find that the program is a fee to uphold the rule in Respondent's favor. Instead, however, we urge the Court to resolve the program's legality by finding a limited property interest in compliance credits as between private parties. This simpler resolution flows naturally from the inherent nature of compliance instruments as things of value that may be bought and sold in a market-based system. We submit as well that this resolution is also closer to the intent of the Legislature as revealed by the plain language of AB 32, is not inconsistent with the Regulation as revealed by the rulemaking history, and is well-supported by established case law.

V. *Response to Question 7*: If the Court Finds that the Auction Constitutes an Invalid Tax, the Appropriate Remedy is to Direct ARB to Revise the Cap-and-Trade Regulation without Immediately Invalidating the Auction Itself, which Would Place Both the Economy and the Goals of AB 32 at Risk.

Now in its tenth year of implementation, AB 32 touches all sectors of the California economy. Its vital purpose – reducing GHG emissions – is not challenged by Petitioners. Instead, the heart of their complaint is that ARB is simply charging too much for emissions allowances, moving auction proceeds from the province of a "fee" into the realm of a "tax." ARB's auction mechanism is the only target of this argument. As discussed above and ably argued by others, IETA believes that the auction proceeds are *not* an illegal tax and strongly encourages this Court to uphold the auction mechanism and ARB's related regulations. But if this Court disagrees, it should allow ARB time to design a compliant system for allowance allocation without disrupting both a significant portion of the California economy and the State's efforts to combat climate change.

Many California entities are fully committed to the current allowance auction system implemented by ARB. As noted in Section I, *supra*, many of IETA's members and other entities have invested significant resources in planning for compliance within the auction-based system, both by taking steps to reduce GHG emissions and by securing allowances and offsets. After purchasing allowances at auction or on the secondary market, many entities have "banked" unused compliance instruments for future compliance. Entities also have hedged future costs by engaging in long-term offset purchase agreements and forward allowance purchases. Importantly, parties engaged in such transactions have done so in reliance on the current allowance auction system and the price signals that past auctions have sent to the marketplace. As noted above, market participants have already invested over $14 billion in allowances and another $10 billion worth of allowances have been traded on the secondary market, and all with the expectation that they are making cost-effective investments for compliance with AB 32. Abruptly altering this paradigm would strand these assets, damage portions of the State's economy, and harm California's efforts to implement AB 32 in an orderly manner.

Importantly, California's Cap-and-Trade Program is linked to a similar program in the Canadian province of Québec. Since 2014, entities in both California and Québec may acquire emissions allowances from the same pool to satisfy compliance with each jurisdiction's cap-and-trade program. Entities regularly trade allowances across the programs, creating an international market-based program to reduce GHG emissions. Invalidating ARB's auctions will have a severe impact on this international program as a

whole, potentially disrupting Québec's economy and frustrating international efforts to stem climate change.

Simply vacating or invalidating the auction program also would create numerous legal problems. How would regulated entities obtain allowances for the upcoming compliance period? How would they comply with AB 32? How would the State meet its mandate to reduce GHG emissions by 2020? What is the legal status of existing allowances and offsets? What happens to businesses that have acted as "good citizens" by investing in compliance with AB 32 in its current form? These and other important questions must be answered before the current auction system is simply scrapped.

The current Cap-and-Trade Program is currently set to end by December 31, 2020 – the date by which the State must attain AB 32's GHG reduction mandate. As part of the Scoping Plan required by AB 32, ARB is now working on new rules to implement AB 32 post-2020. If the Court finds that the auction mechanism is an illegal tax in its current form, it should not simply vacate or invalidate it. Instead, the Court should leave the auction program – in which much of the State's economy is already invested – in place until the post-2020 program begins, while directing ARB to modify the program consistent with the Court's decision or to craft an appropriate replacement. This approach will avoid serious harms to both the California economy and the environment. It also will allow the Legislature to weigh in if it so choses, potentially clarifying whether it intended to authorize the current auction system.

A. <u>This Court has Broad Discretion to Fashion an Appropriate Remedy, and the California Supreme Court Endorses Interlocutory Remands In Similar Cases</u>.

This Court has broad discretion to craft a remedy appropriate to the task at hand. (*Voices of the Wetlands v. State Water Res. Control Bd.* (2011) 52 Cal.4th 499, 526 [C.C.P. § 187 "broadly provides" California courts with "all the means necessary to carry [their jurisdiction] into effect."].) Actions seeking a writ of mandate, such as this one, ask the Court to exercise its inherent authority to command a government agency to act. Regardless of whether the action seeks an "administrative" writ under Civil Procedure Code Section 1094.5 or an "ordinary" writ under Section 1085, the law grants this Court jurisdiction to craft a writ suitable to the circumstances, or to delay issuance of a writ until an appropriate time. (C.C.P. §§ 1085, 1094.5; 52 Cal.4th 499, 527.) A writ is a discretionary action of the Court, and nothing in the statutes or common law of California commands a particular outcome.

California courts increasingly employ "interlocutory remand" as a mechanism for allowing agencies to correct regulatory flaws without causing undue disruption to important programs. Interlocutory remand allows a court to remand a rule for further agency action to "fix" problems with the rule, without disrupting the status quo, and the California Supreme Court has endorsed this approach in cases with significantly less import than this one. (*Voices of the Wetlands* at 526–27 [collecting cases applicable to both original and administrative writs of mandate under Sections 1085 and 1094.5, respectively]; see also *Millview Cnty. Water Dist. v. State Water Res. Control Bd.* (2014) 229 Cal.App.4th 879, 908 [citing *Voices of the Wetlands* with approval, noting that it displaced prior case law, and remanding an agency decision with instructions to the agency to set aside its prior rule and craft a compliant alternative.].)

Interlocutory remand is particularly appropriate when the defect at issue relates to a "single, discrete facet" of a rule or program. In *Voices of the Wetlands*, the California Supreme Court held that interlocutory remand of a Clean Water Act discharge permit was appropriate when the responsible California agency erred with respect to a single aspect of that permit. (See 52 Cal.4th at 529.) A similar scenario presents itself here. Petitioners allege that ARB's implementing regulations for AB 32 contain a single defect: the current method of auctioning allowances creates an illegal tax. Of course, that argument presupposes that the action is not merely collecting a permissible fee, which Petitioners admit is within ARB's authority. (See Appellants' Opening Br. at 16–18.) If the Court determines that the auction mechanism may constitute an impermissible tax, it should remand to ARB with instructions to reconsider the auction mechanism in accordance with the Court's ruling. In that scenario, the outcome of ARB's reconsideration could take many forms. Among other possibilities, ARB's post-2020 Cap-and-Trade Program could:

- Demonstrate that some or all of the auction revenue is a proper fee used to administer and further the purposes of AB 32;
- Revise the auction mechanism to create an appropriate system to assure that ARB collects only an appropriate level of fees, consistent with implementing AB 32 and/or;
- Replace the auction mechanism with another form of allowance allocation.

An interlocutory remand will also allow this Court to retain continuing jurisdiction, creating both regulatory and judicial efficiency by providing a swift avenue for judicial review of any replacement-allowance allocation method developed by ARB. Retaining jurisdiction over that narrow issue during remand will allow an orderly process for

development and implementation of a suitable replacement, without disrupting the California economy or frustrating the goals of AB 32.

B. Federal Courts Similarly Employ "Remand Without Vacatur" Where Vacating or Invalidating a Rule would have Significant Adverse Effects.

Federal courts also frequently remand rules for further agency action without vacatur when simply vacating the offending rule would have a significant impact on the economy and/or the environment. (See *Allied-Signal, Inc. v. NRC* (D.C. Cir. 1993) 988 F.2d 146, 150–51 [collecting cases and explaining that remand without vacatur is appropriate when (i) vacatur could cause serious disruption and (ii) the agency has a viable way to remedy the rule's failings]. See also *Davis Cnty. Solid Waste Mgmt. v. EPA* (D.C. Cir. 1997) 108 F.3d 1454, 1458–60; *California Communities Against Toxics v. U.S. EPA* (9th Cir. 2012) 688 F.3d 989, 993–94.)

In *California Communities Against Toxics*, the Ninth Circuit declined to vacate a rule that allowed construction of a power plant, instead remanding the "flawed rule" for correction. (688 F.3d 989, 993–94.) In doing so, the Ninth Circuit noted that "[w]hether agency action should be vacated depends on how serious the agency's errors are 'and the disruptive consequences of an interim change that may itself be changed.'" (*Id.* at 992, quoting *Allied–Signal*, 988 F.2d 146, 150–51.) Notably, at issue in *California Communities Against Toxics* was EPA's approval of a rule issued by California's South Coast Air Quality Management District (the "District") that authorized the transfer of emissions credits to the power plant project. (688 F.3d 989, 991–93.) The court found EPA's rule (which approved the District's rule) substantively flawed because it violated the Clean Air Act. (*Id.* at 993.) Despite determining that the rule was invalid, the Court refused to vacate EPA's rule or the underlying action of the District in transferring the emissions credits. Instead, the court remanded the rule without vacatur, because the Ninth Circuit believed that delaying construction of the plant would result in environmental harm (through increased blackouts) and would be "economically disastrous" because the project cost over a billion dollars and employed 350 workers. (*Id.* at 993–94). If vacatur was inappropriate in a case involving a single power plant, it is surely appropriate here where billions of dollars have been invested in compliance with AB 32 and in reliance upon ARB's auctions, and where the GHG emissions of the entire state of California are at stake.

Courts have employed remand without vacatur in other significant cases involving broad emissions trading programs. In *North Carolina v. EPA*, the D.C. Circuit held that EPA's Clean Air Interstate Rule ("CAIR") suffered from "several fatal flaws" related to the

way in which it allocated emissions allowances and non-compliance with the Clean Air Act. (*North Carolina v. EPA* (D.C. Cir. 2008) 531 F.3d 896, 901.) To address air pollution across 28 states, EPA created a system of "emissions budgets" for SO_2 and NOx; EPA issued allowances for emissions of these pollutants, which were then bought, sold, and traded for compliance purposes in the affected states. *Id.* at 903–04. Although CAIR suffered from "several fatal flaws," the D.C. Circuit remanded CAIR to EPA without vacating the rule. As the D.C. Circuit explained, "it is appropriate to remand without vacatur in particular occasions where vacatur 'would at least temporarily defeat . . . the enhanced protection of the environmental values covered by [the rule at issue].'" (*North Carolina v. EPA* (D.C. Cir. 2008) 550 F.3d 1176, 1178 [quoting *Envtl. Def. Fund, Inc. v. Adm'r of the United States EPA* (D.C. Cir. 1990) 898 F.2d 183, 190].)

The same environmental and economic concerns adhere in this case. AB 32 created a massive, economy-wide program to reduce harmful GHG emissions in California. Simply vacating the auction mechanism would create significant disruption to that program, undermining compliance with AB 32 and its goals while harming entities that have already invested in auction-based compliance mechanisms. If the Court agrees with Petitioners that the auction creates an invalid tax in its present form, remanding that issue to ARB – without vacating the auction – is the appropriate remedy. As with CAIR and other rules, the agency will have guidance from the court and can create a program that complies with that guidance in an orderly fashion, addressing the underlying flaw while "preserv[ing] the environmental values" of AB 32. (*North Carolina*, 550 F.3d at 1178.)[15]

[15] Recently, the D.C. Circuit took a similar approach with the Mercury Air Toxics Rule ("MATS"), which affects power plants across the country by compelling reductions in hazardous air pollutants. (See generally *White Stallion Energy Ctr., LLC v. EPA* (D.C. Cir. 2014) 748 F.3d 1222.) After the D.C. Circuit initially upheld MATS, the U.S. Supreme Court reversed, ruling that EPA incorrectly interpreted the Clean Air Act when it "deemed cost irrelevant to the decision to regulate power plants." (*Michigan v. EPA*, 135 S.Ct. 2699, 2711–12 (2015).) Upon remand, the D.C. Circuit remanded the rule to EPA without vacatur to allow EPA to develop a replacement rule in an orderly fashion. (*White Stallion Energy Center, LLC v. EPA*, No. 12-1100, Doc. No. #1588459 (D.C. Cir. Dec. 12, 2015) (order remanding MATS to EPA without vacatur); citing *Allied-Signal, Inc.*, 988 F.2d at 150–51.))

C. In the Event that the Court Concludes that the Auctions Program Creates an Illegal Tax, to Avoid Disrupting the Economy and Frustrating the Objectives of AB 32, it Should Remand the Program to ARB to be Re-designed for the Post-2020 Period in Accordance with this Court's Decision.

"The harms associated with climate change are serious and well recognized." (*Massachusetts v. EPA* (2007) 549 U.S. 497, 521.) California is the world's eighth-largest economy and emits a significant portion of all anthropogenic GHG emissions. A significant portion of the California economy is now invested in a sweeping program aimed squarely at addressing the threat of climate change. But neither the environment nor the economy nor ARB can turn on a dime. "Agencies, like legislatures, do not generally resolve massive problems in one fell swoop . . . but instead whittle away over time, refining their approach as circumstances change and they develop a more nuanced understanding of how best to proceed." (*Id.* at 522.)

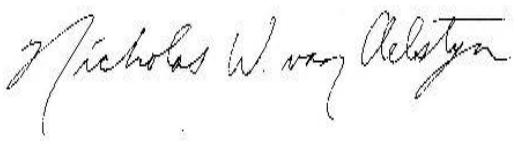
If this Court determines that the current auction mechanism creates an illegal tax, it should allow ARB and the legislature sufficient time to craft a program that addresses any problems identified by the Court. Remanding the rule and the auction mechanism, without vacating or invalidating either, will accomplish that purpose and best serve the interests of justice in this case. This Court has the authority and obligation to craft a remedy that allows ARB to address any underlying flaws in the allowance auction while preserving the environmental goals of AB 32 and avoiding disruption of the California economy. (C.C.P. §§ 187, 1085, 1094.5; *Millview County Water Dist.* (2014) 229 Cal.App.4th 879, 908; *Voices of the Wetlands* (2011) 52 Cal.4th 499, 527; *Allied-Signal, Inc.*, 988 F.2d at 150–51; *California Communities Against Toxics*, 688 F.3d at 993–94; *North Carolina*, 550 F.3d at 1178.) An interlocutory remand of the auction mechanism to ARB for correction – without invalidating or vacating the auction mechanism in the meantime – fulfills these goals and serves the interests of justice in this case.

VI. Conclusion.

For the reasons set forth above, IETA and the others joining this *amicus* brief urge this Court to uphold the allowance auction program as a legitimate exercise of the State's police power to manage and allocate scarce natural resources, and also to construe Section 95820(c) narrowly such that compliance instruments do not constitute property as between the State and those with compliance obligations but do constitute property when held by and traded between private entities. If, however, the Court concludes that the auction program does constitute an illegal or improper tax, then we urge this Court to remand the program to

ARB without vacating and with instructions to correct it or replace it beginning in 2021. To require action prior to the conclusion of the existing program, in which private parties have invested many billions of dollars, would disrupt the California economy and frustrate the environmental goals of AB 32.

Respectfully submitted,



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PROOF OF SERVICE

I, the undersigned, declare that I am employed in the County of San Francisco; I am over the age of eighteen years and not a party to the within entitled action; my business address is Beveridge & Diamond, P.C., 456 Montgomery Street, Suite 1800, San Francisco, CA 94104-1251.

I further declare that on May 24, 2016, I served the following document(s):

Letter Brief of *Amicus Curiae* the International Emissions Trading Association including Application to File Letter Brief.

on the interested party(ies) in this action as follows:

SEE ATTACHED SERVICE LIST

The document(s) were served by the following means:

☑ **BY ELECTRONIC TRANSMISSION:** I transmitted a PDF version via the TrueFiling electronic service to the persons at the addresses set forth above.

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☑ **BY UNITED STATES MAIL.** I enclosed the documents in a sealed envelope or package addressed to the persons at the addresses set forth above.

☑ deposited the sealed envelope with the United States Postal Service, with the postage fully prepaid.

☑ placed the envelope for collection and mailing, following our ordinary business practices. I am readily familiar with the firm's business practice for collecting and processing correspondence for mailing. On the same day that correspondence is placed for collection and mailing, it is deposited in the ordinary course of business with the United States Postal Service, in a sealed envelope with postage fully prepaid.

I am a resident or employed in the county where the mailing occurred. The envelope or package was placed in the mail at San Francisco, California.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Executed on May 24, 2016, at San Francisco, California.

Sue M. Querubin

SERVICE LIST

***California Chamber of Commerce, et al. v. California Air Resources Board, et al.*,**
Case No. C075930, Consolidated With Case No. C075954

PARTY	ATTORNEY
Supreme Court of California 350 McAllister Street San Francisco, CA 94102-4797 ***Via Electronic Transmission Through TrueFiling***	
The Honorable Timothy M. Frawley Sacramento Superior Court 720 9th Street, 4th Floor Sacramento, CA 95814 ***Via U.S. Mail***	
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The Nature Conservancy : *Amicus curiae for respondent*	Cara Ann Horowitz Frank G. Wells Environmental Law Clinic UCLA School of Law 405 Hilgard Avenue Los Angeles, CA 90095 ***Via Electronic Transmission Through TrueFiling***