DEPARTMENT OF THE NAVY
COMMANDER NAVY REGION SOUTHWEST
937 NO. HARBOR DR.
SAN DIEGO, CALIFORNIA 92132-0058

IN REPLY REFER TO:
5090
Ser N40JRR.cs/0014
June 28, 2011

Mr. James Goldstene
Executive Officer
California Air Resources Board
1001 I Street
Sacramento, California 95814

Dear Mr. Goldstene:

Subj: DEPARTMENT OF DEFENSE REQUEST FOR EXEMPTION FROM COMPLIANCE OBLIGATIONS AND COVERED ENTITY STATUS UNDER AB32 CAP-AND-TRADE PROGRAM

On behalf of the Military Component Services and acting for the Department of Defense (DoD) Regional Environmental Coordinator (REC), let me express our appreciation for the leadership of the California Air Resources Board (CARB) and your staff's willingness to work with us to address our mutual interests in fighting Global Climate Change (GCC). We share your desire to mitigate the effects of GCC. These effects adversely impact the people of the State of California as well as the mission of the DoD. We look forward to our continued partnership in addressing these impacts as well as other air quality issues in California.

In our letter of January 20, 2010, we noted the policy and legal constraints that might preclude our participation in a cap-and-trade program, including fiscal law mandates. In our letter of December 14, 2010, we requested an exemption from the program based on those concerns. In addition to the discussion contained in those letters, we have participated in and testified before workshops and hearings as the cap-and-trade program took shape.

The purpose of this letter is to capture these discussions along with the dialogue between CARB staff and DoD representatives in an effort to secure a modification to the cap-and-trade regulations adopted by the CARB on December 16, 2010. The Attachment contains our supplemental analysis explaining the legal constraints that will prohibit our participation in, and regulation under, the cap-and-trade portion of the program. We welcome the opportunity to discuss

these matters further with you, the Board or your staff.

Before these regulations become final, we hope you will strongly consider either modifying them to remove the legal constraints of our participation or acknowledge that federal facilities have no compliance obligation under the regulations as they are currently drafted by including one of the following new provisions:

SUBSECTION 95852.2(g) (Emissions without a Compliance Obligation): Emissions from Federal Facilities that meet the definition of a covered entity as set forth in Subsection 95802(a)(44).

OR

SECTION 95815. Military Facilities. *Military facilities that qualify as a "covered entity" pursuant to Section 95811 and that exceed the applicability threshold herein are exempt from this regulation.*

We thank you for your consideration of these very important issues. Feel free to direct any questions or comments you may have to our governmental affairs representatives, Randal Friedman, at 619-572-5037, or Ned McKinley, at 916-930-5606.

Sincerely,

C. L. STATHOS
By Direction

Attachment: Supplemental Analysis Supporting DoD Request for Exemption from California Cap and Trade Program

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SUPPLEMENTAL ANALYSIS SUPPORTING
DoD REQUEST FOR EXEMPTION FROM CALIFORNIA CAP-AND-TRADE PROGRAM

Three important points support this request. First, internal DoD commitments to reduce greenhouse gas (GHG) emissions will accomplish much greater reductions while maintaining military flexibility to accomplish those reductions without threatening National Security. Second, the charges for participating in the cap-and-trade program constitute a tax on the federal treasury. It is impermissible to obligate federal funds to pay state taxes. Therefore, no DoD comptroller may allow the purchase of allowances or compliance certificates with federal dollars. Third, the cap-and-trade regulation has the perception of discriminating against the military and the federal government because it does not apply to federal entities "in the same manner and to the same extent" as other nongovernmental entities. As such, it does not fit within the conditional waiver of sovereign immunity in the Clean Air Act (CAA).

BACKGROUND

At its current applicability threshold, the cap-and-trade program will impact at least one military installation in Twentynine Palms, California. The Marine Corps Air Ground Combat Center (hereafter The Combat Center) is home to a 7 megawatt (MW) combined heat and power cogeneration (COGEN) plant. This existing facility uses tri-efficiency technology to supply about 60% of The Combat Center's electricity demand. The Combat Center is the largest training site in the Marine Corps inventory and can effectively accommodate sustained combined-arms, live-fire, and maneuver training. It is the only facility that can accommodate the full spectrum of task force operations required of the Marines.

Over one-third of the total Marine Corps forces train at The Combat Center in a given year. The U.S. National Security Strategy leverages the Marine Corps as the nation's "Force in Readiness" to respond rapidly to crises around the globe. The Combat Center is a critical component of maintaining that capability.

By 2012, The Combat Center's load capacity will produce over 25 MW of its own power, with 10 MW being produced from a PV solar array. The energy produced by the COGEN plants and the

ATTACHMENT (1)

solar installations will represent substantial reductions in GHG emissions over energy purchased from the grid because grid energy is produced from multiple sources, including coal, plants with considerably higher emissions profiles.

It is important to note that in terms of potential future impacts, CARB has proposed amending California's GHG mandatory reporting rule to include facilities that emit in excess of 10,000 MT of CO_2e emissions.[1] Air Force installations in California that meet the new reporting threshold include Travis AFB, CA (15,974 MT reported emissions in 2009), Edwards AFB, CA (22,749 MT reported emissions in 2009) and Vandenberg AFB, CA (2010 emissions exceeded 19,000 MT, but final figures are not available as of the date of this letter). The Army installation of Fort Irwin, Naval Medical Center San Diego, Naval Air Weapons Station China Lake, and Naval Air Station Lemoore would be similarly impacted. In the event California modifies the cap-and-trade program's applicability thresholds to 10,000 MT, then Travis, Edwards, Vandenberg and Fort Irwin would face the same issues that now face The Marine Corps Combat Center with respect to cap-and-trade program compliance. The issues raised in the following analysis would have broader impacts, particularly if participation in the cap-and-trade program is extended to facilities that emit more than 10,000 MT, but less than 25,000 MT of qualifying pollutants.

DoD MANDATES SIGNIFICANT REDUCTIONS IN GHG EMISSIONS

The DoD commitment to reduction of GHG emissions is most comprehensively set forth in our Strategic Sustainability Performance Plan (SSPP). In Section 8 of Executive Order 13514[2], the President directed "Each agency shall develop, implement, and annually update an integrated Strategic Sustainability Performance Plan that will, (among many other requirements) [achieve] the sustainability goals and targets, including greenhouse gas reduction targets, established under section 2 of this order." The White House Counsel on Environmental Quality and the Office of Management and Budget has approved the DoD SSPP as the most effective plan for reducing DoD GHG emissions.

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[1] CARB Resolution 10-43 of December 16, 2010 at Attachment A, § 95101(b)(1).

[2] 74. F.R. 52117 (October 8, 2009).

The DoD SSPP mandates aggressive reductions in nearly every contributing factor to GCC. The SSPP requires GHG emission reductions for Scope 1, 2 and 3 GHG emissions, as well as improvements in energy intensity of federal buildings, land management practices, and waste management. The SSPP includes requirements primarily from Executive Order 13423 and 13514 as well as the Energy Policy Act of 2005 and the Energy Independence and Security Act of 2007.

Early examples of DoD leadership in energy sustainability include Fort Irwin in California's Mojave Desert. There the Army is building a 500 MW solar plant which when complete will be DoD's largest solar installation and one of the largest in the country. The project is expected to be completed by 2022 and will provide enough energy to supply the base.[3] The Marine Corps Combat Center already utilizes a 2.5 MW solar farm to produce approximately 4% of its electricity needs. Each of these projects, funded by federal appropriations brought into California, is driven by the mandates of the SSPP.

By executing the federal plan, Marine Corps Installations-West (MCI-W), based almost entirely in California, will emit approximately 150,407 **fewer** MT of CO2E than it did in 2008. This represents a 34% reduction in Scope 1 and 2 emissions and a 14.5% reduction in Scope 3 emissions. The 2008 baseline of MCI-W emissions is over 515,000 MT.

The cap-and-trade regulation, as currently designed, will require only one facility in MCI-W to reduce its emissions. The total reduction associated with this requirement is estimated at only 7,200 tons of CO2E. At this facility alone, the SSPP will reduce over 5,000 additional tons of CO2E. **Region-wide, the SSPP will reduce twenty-one times more GHG emissions than the cap-and-trade program in 2020.**

Allowing the DoD to address GCC through its own internal planning allows for a more comprehensive approach and it gives flexibility to the commanders of troops on the ground to determine how to achieve reductions without compromising National Security. It is important to note that while the federal plan achieves greater GHG reductions, those reductions might not derive solely from facilities that exceed the cap-and-

[3]http://www.whitehouse.gov/sites/default/files/microsites/20100128-ceq-agency-stories.pdf

trade applicability threshold. The SSPP does not guarantee any one facility will meet the same goals as cap-and-trade, but it does guarantee that GCC mitigation goals will be achieved across DoD.

SUMMARY OF LEGAL ISSUES

(1) Whether the allowance charge is an approximation for the benefits received by the government facility? No, the charge is derived from the per capita allowance for the right to emit GHGs. Moreover, the sale of allowances at auction will necessarily generate revenues that exceed the costs of the program and have already been proposed by the California legislature to be set aside for community benefit funds.

(2) Whether the allowance charge is structured to produce revenues that will not exceed the total costs to the government of the benefits to be provided? No, the charge for the right to emit GHGs is designed to produce revenue that may be appropriated later by the State of California for purposes to be determined after the revenues from the auction are received. The Resolution 10-42 specifically describes returning allowances to disadvantaged households and legislation like SB 535 and AB 1405 demonstrate the State of California's intent to leverage funds generated under the cap-and-trade program against costs outside of the program itself.

(3) Whether the program is implemented in a non-discriminatory manner? No, the program has the practical effect of discriminating against Federal agencies because it does not allow for full participation of Federal agencies given their contracting and appropriation constraints under the Antideficiency Act and implementing regulations. The GHG allowance allocation portion of this program has been significantly influenced by the goal to eliminate economic risk, and as a result is outside the CAA §118 waiver of sovereign immunity, which only allows state authority over Federal agencies for the control and abatement of air pollution.

(4) Whether some aspects of the allowance allocation scheme directly discriminates against federal agencies? Yes. As illustrated in Figure J-5 (p. J-20) and Table J-7 (p.J-32), in the On-site Fuel Combustion and Process Emissions category and the Heat Purchased, Electricity Purchased, or Combined Heat and Power

(CHP or COGEN) produced on-site category, federal facilities that become a "covered entity" must purchase all allowances required to cover their GHG emissions from on-site fuel combustion to comply with the program. Yet under Table 8-1 industrial facilities will receive free allocations of allowances to cover their benchmarked direct costs for GHG emissions from these source categories.

ANALYSIS

FEDERAL LAW PROHIBITS DoD PARTICIPATION IN CALIFORNIA'S CAP-AND-TRADE PROGRAM

According to the Anti-Deficiency Act (ADA), "An officer or employee of the United States [Government] may not [involve] (the Government) in (an) obligation for the payment of money before an appropriation is made unless authorized by law."[4] Unless a statutory authority exists which authorizes the obligation of U.S. Government funds for the purchase of compliance instruments, then no federal agency can make such an obligation.

The CAA's Federal Facilities Section 118 which conditionally waives sovereign immunity authorizes the payment of reasonable regulatory fees in support of air pollution abatement program.[5] According to the text of the statute, "[T]he Federal Government [shall] be subject to… any requirement to pay a fee or charge imposed by any State or local agency to defray the costs of its air pollution regulatory program."[6] There are many aspects of the cap-and-trade program, but the heart of the program is a trading of emissions allowances. This trading will generate revenues for both the State of California and for some covered entities. These revenues will bear no relationship to the costs of the regulatory program. These excess costs are the signature feature of the program that renders its costs as taxes rather than reasonable regulatory fees. Under the Supremacy Clause[7], the United States and its instrumentalities are immune from direct taxation by state and local governments.[8]

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[4] 31 U.S. Code § 1341(a)(1).
[5] 42 U.S. Code § 7418(a).
[6] 42 U.S. Code § 7418(a)(B) (*hereafter* "Clause (B)").
[7] U.S. Const., Article VI, cl. 2.
[8] McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316, 4 L.Ed. 579 (1819).

Appropriated funds are not available to pay tax assessments without a specific act of Congress waiving sovereign immunity.[9]

THE CAP-AND-TRADE PROGRAM DOES NOT COMPORT WITH THE CONDITIONAL WAIVER OF SOVERIEGN IMMUNITY UNDER §118 OF THE CLEAN AIR ACT

THE COST OF AN ALLOWANCE IS A TAX

Section 118 of the CAA operates as a conditional waiver of sovereign immunity and subjects Federal agencies to Federal and state laws regarding the control and abatement of air pollution. Waivers of sovereign immunity, however, are construed strictly in favor of the sovereign, and may not be enlarged beyond what the express language requires.[10] The Federal Facilities Section contains only one reference to a waiver for financial costs other than penalties and sanctions: Clause (B). The express language of Clause (B) limits its application to fees and charges that "defray the costs of the air pollution program". The excess revenues generated by the cap-and-trade auctions fall outside the scope of this conditional waiver.

On December 16, 2010, the CARB adopted Resolution 10-42. Resolution 10-42 outlines the framework of the cap-and-trade program. The cap-and-trade program relies on a system of allowances, gradually reduced over time, to control the emission of GHG in the state. While some allowances will be directly allocated to certain industries for free, other allowances will be auctioned. These auctions will generate revenue, which is then subject to appropriation by the State of California. This revenue, and the method by which the revenue is expended, for purposes to be determined by the legislature, represents both a tax on carbon emissions to the emitter and an intrinsic monetary value to the State of California.

Resolution 10-42 recognizes the work of the Economic and Allocation Advisory Committee (EAAC) which the CARB appointed to study the best use of the allowance value (i.e. tax revenue to the State of California). The CARB agreed with the EAAC that among the good uses of allowance value include the following:

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[9] Domenech v. National Bank of New York, 294 U.S. 199, 205 (1935).

[10] Library of Congress v. Shaw, 478 U.S. 310, 319 (1986)(*quoting* Ruckelshaus v. Sierra Club, 463 U.S. 680, 685-6 (1983)).

"Returning allowance value to households either through lump-sum rebates (as under the cap and dividend proposal) or through cuts or avoided increases in the State's individual income or sales tax rates; if allowance value is returned to households through tax rate cuts, a small fraction of the allowance value should be reserved to finance income transfers to low-income households to avoid disproportionate economic impacts on such households."[11]

Resolution 10-42 directs 10% of the revenues generated from allowances be deposited in a fund. This fund, among other things, "(promotes) green collar employment opportunities in the most impacted and disadvantaged communities in California." The contours of a 'disadvantaged community' are subject to state determination in the appropriations process. When funds go to such non-pollution control programs, these are outside the conditional waiver of sovereign immunity in the CAA.

The vast majority of allowances to emit GHGs under the proposed regulation are to be obtained by sealed bid auction. Federal Facilities that are covered entities would be required to obtain these allowances through the auction process. The proceeds from the auctions that are held quarterly are to be deposited into the California Air Pollution Control Fund and these funds may be appropriated by the California legislature to support the AB 32 program.[12]

In the CARB's Initial Statement of Reasons (ISOR) supporting the cap-and-trade regulation, the following discussion appears: "The value of the allowances is represented by the money paid to the State, which would then have the opportunity to use the revenue for public benefit."[13] "Allowance value can be used in many ways, including use for the public benefit or to ease the cost of regulation."[14] "Regulating greenhouse gas emissions will probably stimulate economic growth in some sectors and may slow growth in others. Worker training programs funded with allowance value can help Californians shift jobs if necessary."[15]

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[11] CARB Resolution 10-42 of December 16, 2010 (Res. 10-42), p. 12.
[12] Res. 10-42, Attachment A (Att. A), § 95870(f).
[13] ISOR, p. D-20.
[14] ISOR, p. D-22.
[15] ISOR, p. D-22.

Massachusetts v. United States[16] is the seminal Supreme Court opinion regarding the distinction between a fee and a tax. 'The *Massachusetts* Test' has been cited throughout the years in cases such as *United States v. City of Huntington*[17] and *United States v Maine*[18]. The U.S. Government Accountability Office (GAO) and the Department of Justice (DoJ) Office of Legal Counsel (OLC) have relied on the development of the *Massachusetts* Test in reviewing fee-tax questions and issuing binding opinions on this topic which DoD is required to follow.[19]

In the *Massachusetts* case, the Supreme Court laid out the following three part test: "[s]o long as the charges do not discriminate ..., are based on a fair approximation of use of the system, and are structured to produce revenues that will not exceed the total cost ... of the benefits to be supplied..."[20] Put another way, "The law has long distinguished between reasonable state regulatory fees that apply to the federal government and unreasonably high fees. The law typically treats unreasonably high regulatory charges as 'taxes' that the Constitution forbids the state to assess against the federal government without explicit consent."[21]

In *San Juan Cellular Telephone Company v. Public Service Commission of Puerto Rico*[22], Supreme Court Justice Steven Breyer,

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[16] 435 U.S. 444, 466-67, 98 S.Ct. 1153, 1167 (1978).
[17] 999 F.2d 71(4th Cir. 1993).
[18] 524 F.Supp. 1056 (D.Me. 1981).
[19] *Whether the District of Columbia's Clean Air Compliance Fee may be Collected from the Federal Government*, 20 Op. O.L.C. 12 (1996)(*available at:* http://www.justice.gov/olc/parking.op1.htm) ("Clean Air Fee Memo"); Decision in the Matter of: Forest Service-Surface Water Management Fees from Anthony H. Gamboa, General Counsel, Government Accountability Office, B-306666 (June 5, 2006)("Forest Service Surface Water Decision"); and Letter for Peter J. Nickles, Attorney General of the District of Columbia, from Lynn H. Gibson, Acting General Counsel, Government Accountability Office, B-320795 (Sept. 29, 2010) ("Nickles Letter").
[20] Massachusetts, 435 U.S. at 466-67, 98 S.Ct. at 1167.
[21] Maine v. Navy, 973 F. 2d 1007, 1012 (1st Cir. 1992)(Breyer, C.J.).
[22] 967 F.2d 683 (1st Cir. 1992).

then sitting as Chief Judge of the First Circuit Court of Appeals, noted:

> Courts facing cases that lie near the middle of (the) spectrum (between a classic 'tax' that raises money, contributed to a general fund, and spent for the benefit of the entire community, and a classic 'fee') have tended [to] emphasize the revenue's ultimate use, asking whether it provides a general benefit to the public, of a sort often financed by a general tax, or whether it provides more narrow benefits to regulated companies or defrays the agency's costs of regulation."[23]

Because the fee in the *San Juan Cellular* case was placed in a special fund distinct from other funds on the books of Puerto Rico's Treasury and separate from any other funds received by Puerto Rico's Public Service Commission and because "The money is not used for a general purpose but rather to defray the expenses generated in specialized investigations and studies, for the hiring of professional and expert services and the acquisition of the equipment needed for the operations provided by law for the Commission," Breyer and the panel ruled it was not a 'tax.'

For similar reasoning, the opposite is true of the revenues generated by the cap-and-trade program. These revenues will be deposited in a fund for appropriation by the California legislature. The adopting resolution expressly identifies community benefit purposes to which the revenues should be dedicated. The revenues will not be used to defray any program costs associated with the control and abatement of GHG emissions. Rather, they will be used to ease the economic burdens of this program on the California economy at the expense of the federal taxpayer.

As Justice Steven Breyer has noted, "The concerns that led to the development of this case law, such as fears of unjustified raids on the federal treasury by states or attempts by states to discourage federal activity within their borders, would seem applicable in the present context."[24] Resolution 10-

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[23] San Juan Cellular, 685.

[24] Maine, 1012 (*citing* McCulloch v. Maryland, 426-27; Public Util. Comm'n v. United States, 355 U.S. 534, 543-44, 78 S.Ct. 446, 452-53 (1958).

42 recommends **lump sum** rebates be disbursed from the fund into which allowance value is deposited. Giving cash to California residents does not benefit the federal government as required for the waiver of sovereign immunity set forth in CAA § 118(a) to apply. Under the caselaw, reasonable services charges or fees must be for a service provided to the Federal agency.

"A regulatory, or licensing, fee, insofar as it is reasonable, seems properly viewed as a kind of charge for a regulatory, or administrative 'service'."[25] Examples of a reasonable regulatory fee include a permit application fee or an annual emissions fee and many such fees can be found in places such as Rule 40 of the San Diego Air Pollution Control District.[26] According to Rule 40, "The Initial Application Fees for an Authority to Construct/Permit to Operate application shall include (*inter alia*) Air Contaminant Emissions Fee [which] shall be based on the total expected emissions (for) that calendar year, multiplied by (a rate) of $116 per ton." In exchange for the payment of sum-certain costs, the applicant receives a permit to operate or an authority to construct.

The revenues generated from the payment of these fees goes directly back into the Air District's operating budget to administer its permit and other programs. None of this money has been set aside to improve lump sum cash rebates or "green collar jobs" or other environmental justice initiatives. Importantly, the amount of the fee is tied directly to the amount of emissions being regulated. When contrasted with a fee structure tied to the market price of an allowance in an open auction, the distinction between a reasonable regulatory fee and a tax are clear.

In addition, both OLC and GAO have issued opinions on behalf of Federal agencies which further support the conclusion that the proceeds that are produced by the auction system established by the program are the result of a tax on Federal agencies by the State of California, not a fee to support the air pollution program in California.[27] Among the purposes of the program is to ensure that it "minimizes costs and maximizes benefits for California's economy, improves and modernizes California's energy infrastructure and maintains electric system

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[25] Maine, 1012.
[26] *Available at:* http://www.sdapcd.org/rules/Reg3pdf/R40.pdf.
[27] *See* fn. 18, *supra*.

reliability, maximizes additional environmental and economic co-benefits for California, and complements the state's efforts to improve air quality."[28] Clearly, the cap-and-trade program is intended to achieve environmental justice as well as abatement of air pollution.

The OLC and GAO opinions relied on *United States v. City of Huntington, supra,* in analyzing whether the CAA and the CWA require the United States to pay a tax that the local entities alleged to be a fee. In the *Huntington* case, the City of Huntington, WV assessed against buildings owned by the General Services Administration and the United States Postal Service a "municipal service fee."[29] The fee was "assessed on the basis of square footage of the buildings in the City."[30] The Fourth Circuit relied on the three part *Massachusetts* Test in determining whether or not an assessment charged by a government was a "fee" or a "tax." The Fourth Circuit stated that the United States was not liable for the fee that City of Huntington sought to impose.

In the OLC opinion, the City Government of the District Columbia imposed on parking spaces a "Clean Air Fee" that the city could not otherwise charge, to support Mass Transit (and support the CAA) in the Washington, DC area. OLC concluded that the fee was a tax which could not be paid by the Federal Government. OLC stated as follows:

> The Clean Air Fee cannot qualify as a user or service fee because the revenue from the Fee is used to provide an undifferentiated benefit to the entire public. The Fee is indistinguishable for present purposes from the assessment to support community-wide services that was held to be a tax in Huntington. It is not a charge for any identifiable District services provided specifically to the owners of parking spaces upon their request. Rather, it is a charge to support the mass transit services the District provides to all inhabitants (permanent and temporary) of the District. Such services, as was the case with the "[f]ire and flood protection and street maintenance [services at issue in Huntington,] are core government services"

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[28] CAL. HEALTH & SAFETY CODE § 38501(h).
[29] United States v. City of Huntington, 999 F.2d 71, 72 (4th Cir. 1993).
[30] Huntington, 72.

available to all inhabitants of the city.[31]

While the GAO has not issued a similar opinion on application of the CAA, GAO has issued an opinion which dealt with the fee-tax distinction in the Clean Water Act (CWA) context. The CWA's sovereign immunity waiver is practically identical to §118 in the CAA. King County Washington imposed a surface water management fee (SWM fee) to fulfill King County's obligations under the County's National Pollution Discharge Elimination System (NPDES) permit.[32]

The SWM fee was based on a per acre fee depending on the extent of the development of the property against which the fee was assessed.[33] According to the GAO Opinion:

[The] SWM fees were necessary for various reasons: (1) to promote the public health, safety, and welfare by minimizing uncontrolled surface and storm water, erosion, and water pollution; (2) to preserve and utilize the many values of the county's natural drainage system including water quality, open space, fish and wildlife habitat, recreation, education, urban separation and drainage facilities; and (3) to provide for the comprehensive management and administration of surface and storm water.[34]

GAO concluded that the SWM fee was a tax and thus not authorized by the CWA, which has a similar sovereign immunity waiver as the CAA, even though the fee had indicia of a fee to support CWA requirements.

GAO issued a letter in 2010 on the issue of whether stormwater fees charged by the District of Columbia were payable by GAO.[35] The stormwater fee in question was charged against all property owners and was used generally to support the District's MS4 water permit activities.[36] Following the precedent established in the King County decision, GAO reiterated that assessments characterized as "fees" are still deemed taxes if

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[31] Clean Air Fee Memo (*citing* Huntington, 999 F.2d at 73).
[32] Forest Service Surface Water Decision.
[33] Forest Service Surface Water Decision.
[34] Forest Service Surface Water Decision (*citing* K.C.C. § 9.08.040).
[35] Nickles Letter.
[36] Nickles Letter.

the fund benefits the population at large and determined that the fee assessed to support the MS4 permit was not payable by GAO to the DC Government.[37]

In light of the fact that existing statutory authorities bar this fee, Congress executed its Constitutional prerogative and changed the statute. On January 4, 2011, the President signed S. 3481,[38] amending Section 313 of the Clean Water Act, which was intended to reverse the GAO decision on payment of storm water fees. The analysis of the principles set forth in the GAO letter to the DC Attorney General, at least with respect to the status of authorities in the CAA to pay state taxes remains the same. Like the cases cited above, the CAA does not authorize state taxation of the Federal government in the form of the payment of fees, which are categorized as taxes by application of the *Huntington* test.

By applying the tests used in the *Huntington* case, the OLC Opinion, the GAO decision and letter to the DC Attorney General, it is clear that the AB 32 program and Proposed Regulation operate as a tax on the Federal government in two ways. First, the cap-and-trade program creates a personal property interest in the right to emit a GHG allowance and then confiscates the property interest by requiring the possessor of the allowance to surrender the interest to the State of California for the general health and welfare. Second, the state then requires covered entities to go back into the market through auction to reacquire an allowance that was surrendered to the state. The revenues for the auction are then to be used for the general health and welfare as determined by the legislature of the State of California.

Finally, the disposal of personal property is governed by rules against augmentation and for returning profits to the general fund of the United States. These restrictions are unique to federal fiscal law and have no corollary in the business practices of for-profit industries. For-profit industries can immediately reinvest proceeds from the sale of allowances in technology that will aid them in future compliance. Federal agencies are not authorized to make

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[37] Nickles Letter, 17 ("If the revenue of the special fund is used to benefit the population at large, then the segregation of the revenue to a special fund is immaterial.").
[38] P.L. 111-378.

reinvestments since they are authorized to spend funds after Congress appropriates money to the various Federal agencies. This forms yet another restriction against the participation of federal agencies in the proposed cap-and-trade program. Moreover, it regulates the federal government in a different manner and to a greater extent than non-governmental entities. This discrimination places the cap-and-trade program outside the scope of the conditional waiver of sovereign immunity in the Federal Facilities Section of the CAA, Section 118.

Military Comptrollers are required to follow all binding legal opinions, as well as those rendered by the DoJ and the GAO. Put plainly, Congress has not authorized the use of appropriated funds to participate in a market-based commodity exchange of pollution permissions where the generated revenues do not exclusively support the air pollution control program. Congress has authorized federal agencies to pay fees commensurate with the services performed for and benefits accrued to the federal pollution programs. Auction sales do not meet that definition.

THE CAP-AND-TRADE PROGRAM REGULATIONS AS DRAFTED DO NOT APPLY TO DoD IN THE SAME MANNER AND TO THE SAME EXTENT AS ANY NONGOVERNMENTAL ENTITY

Under §118(a) of the CAA, Federal agencies are only subject to state requirements and authority "respecting the control and abatement of air pollution in the same manner, and to the same extent as any nongovernmental entity."[39] The California cap-and-trade program discriminates against Federal facilities. The program does not impose air pollution control and abatement requirements on Federal facilities in the same manner and to the same extent, because certain industrial facilities and distribution utilities operating the same type of emission units will be regulated differently.

For example, Federal facilities that produce or purchase combined heat and power (COGEN) on-site that become covered entities, such as MCAGCC Twenty-Nine Palms does under an Energy Savings Performance Contract, must purchase the entire allocation of allowances required to comply with program requirements. However, per § 95870 (c) and the discussion in Appendix J, electric distribution utilities that have long-term

[39] 42 U.S. Code § 7418(a)(emphasis added).

COGEN purchase contracts will purportedly receive free allocations of allowances.[40] Also, per § 95870 (d) and Appendix J, particularly the discussion associated with Figure J-5 and Table J-7, other nongovernmental entities listed in Table 8-1 that purchase heat, electricity, or COGEN on-site - such as paper manufacturing (NAICS322121) and food manufacturing (NAICS 311)[41] - will receive free allocations of allowances. In addition, the industries in Table 8-1 will receive a free allocation of allowances to effectively cover their benchmarked on-site fuel combustion emissions, while Federal facilities that become covered entities due to emission from their similar on-site fuel combustion emissions - such as Edwards, Travis, and Vandenberg AFBs - will have to purchase their entire required allocation. So, therefore, the cap-and-trade program as currently approved by the CARB effectively subjects Federal facilities to adverse discriminatory treatment and creates separate classes of GHG emitters that are not regulated, or are regulated more favorably than similar Federal sources that are subject to the approved regulations.

This disparate treatment places the regulation outside of the scope of the conditional waiver of sovereign immunity found in Section 118(a) of the CAA. As the Chief Counsel of the CARB has previously recognized, the CAA waiver of sovereign immunity prohibits disparate treatment against Federal entities. When the Chief Counsel reviewed the sovereign immunity issues associated with CARB's Public and Utility Fleets Regulation of 2006, he concluded that rule fell outside the scope of the CAA sovereign immunity conditional waiver because it did not regulate federal agencies in the same manner and to the same extent as private ones.[42] The cap-and-trade program similarly fails to regulate a substantial portion of non-governmental entities in the same manner and to the same extent as military facilities with the same category of emission sources.

CONCLUSION

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[40] Appendix J of the Staff Report at page J-15 says the "Staff is continuing to evaluate the options for defining this portion of the allowance allocation to distribution utilities."

[41] "Cogeneration in California: Now More than Ever," California Onsite Generation Regulatory and Policy Update (March 20, 2004), listing investor-owned utilities, food processors, and paper manufacturers among the sources of cogeneration in the State.

[42] CARB Chief Counsel letter of November 9, 2006.

Without an applicable waiver of sovereign immunity to pay taxes, any obligation of federally appropriated funds to purchase allowances and participate in the market-based cap-and-trade program would be a violation of the ADA and the CAA. In light of the binding opinions that interpret these restrictions and prevent federal participation in the cap-and-trade program, we respectfully request the regulations either be modified to remove all legal constraints discussed above. Possible modifications that could remove the limits on our participation and regulation include, but are not limited to, the following:

- Provide Federal facilities an initial allowance budget with a modestly declining balance over the three compliance periods and provide Federal facilities with appropriate mechanisms to allow compliance in the case of a national emergency or military operations outside of normal day-to-day operations; or
- Add "NAICS 928110 National Security" to "Table 8-1: Industry [and Military] Assistance" and expand the related discussion to include national security activities. The expanded discussion could address the fact that military installations may not have the benefit of moving across state lines to minimize regulation due to their extensive infrastructure investments in close proximity to existing airspace and ranges in California. It could also address the fact that the military cannot pass along the cost to consumers, and without equitable assistance, the cost to taxpayers either increases or training and readiness activities suffer.

In the alternative, one of the following additional new sections could be added to the existing regulations to simply acknowledge that military facilities have no compliance obligation under the regulations as drafted as follows:

SUBSECTION 95852.2(g) (Emissions without a Compliance Obligation): Emissions from Federal Facilities that meet the definition of a covered entity as set forth in Subsection 95802(a)(44).

OR

SECTION 95815. Military Facilities. Military facilities that qualify as a "covered entity" pursuant to Section 95811 and that exceed the applicability threshold herein are exempt from this regulation.