



November 7, 2008

Ms. Mary Nichols
Chair, California Air Resources Board
Via E-mail

Subject: AB 32 Scoping Plan: Comments Regarding Auction Proposal

Dear Ms. Nichols:

The California Taxpayers' Association (Cal-Tax) respectfully submits the following comments in response to the Air Resources Board's proposal to implement an auction mechanism for distributing greenhouse gas (GHG) emissions allowances under AB 32. Cal-Tax is a nonpartisan, nonprofit association that opposes unnecessary taxes and promotes efficient, quality government services. Cal-Tax has represented the interests of California taxpayers regarding state and local tax policy since 1926. Its membership consists of large and small taxpayers from virtually all of California's diverse industries.

While the auction proposal contains no overt taxes on businesses, the mechanism imposes substantial hidden taxes in violation of Article XIII A of the California Constitution. Moreover, these taxes cannot be characterized as fees under the California Supreme Court's decision in *Sinclair Paint Co. v. State Bd. of Equalization*, 15 Cal. 4th 866 (1997).

Article XIII A, Section 3 states in relevant part:

From and after the effective date of this article, any changes in state taxes enacted for the purpose of increasing revenues collected pursuant thereto whether by increased rates or changes in methods of computation must be imposed by an Act passed by not less than two-thirds of all members elected to each of the two houses of the Legislature....

Case law interpreting Article XIII A requires that fees bear a "fair and reasonable relationship to the payor's burdens on or benefits from the regulatory activity" in order to avoid characterization as a tax. *San Diego Gas & Elec. Co. v. San Diego County Air Pollution Control Dist.*, 203 Cal.App.3d 1132, 1145 (4th Dist. 1988). The *Sinclair* Court stated "the police power is broad enough to include mandatory remedial measures to mitigate the past, present, or future adverse impact of the fee payer's operations, at least where, as here, the measure requires a causal connection or nexus between the product and its adverse effects" (emphasis in original). *Sinclair*, *supra* at 877-78.

After *Sinclair*, the Third District Court of Appeal upheld a flat fee for each environmental review by the Department of Fish and Game in *Ca. Ass'n. of Professional Scientists v. Dep't of Fish and Game*, 79 Cal.App.4th 935 (3rd Dist. 2000). The Court concluded that "as long as the cumulative amount of the fees does not surpass the cost of the regulatory program or service


and the record discloses a reasonable basis to justify distributing the cost among payors, a fee does not become a tax simply because each payor is required to pay a predetermined fixed amount." *Id.* at 939. Specifically, the Court reasoned: "a regulatory fee does not violate California Constitution, Article XIII A when the fees collected do not surpass the costs of the regulatory programs they support and the cost allocations to individual payors have a reasonable basis in the record." *Id.* at 950.

These cases lay the framework for structuring a market-based AB 32 compliance mechanism that will avoid characterization as a tax necessitating a two-thirds majority vote of the Legislature. According to the above cases, the two-part test for determining whether a regulatory exaction is characterized as a tax and not a fee is whether the total exactions collected exceed the costs of the regulatory programs they support and whether apportionment of the costs among payors is reasonable. Unfortunately, the proposed auction does not meet this test, as an auction likely will generate far more revenue than necessary to administer AB 32's regulatory requirements and will arbitrarily impact some industries more than others.

An auction could generate billions in new revenue in addition to proposed carbon fees that will be imposed for administering AB 32. It is unlikely that the cost of administering AB 32 would approach the amount of revenue raised cumulatively by the auction and the carbon fee. Moreover, unless all sectors of industry are covered by the auction mechanism, the mechanism will fail the test of reasonable apportionment among payors, allowing some to escape the auction process, while subjecting others to the substantial costs of participation. Under the auction mechanism, CARB will raise revenue beyond what is necessary to administer AB 32 and impose the exaction on some industries but not others. Thus, the auction mechanism is a hidden tax, requiring a two-thirds majority vote of the Legislature for enactment. CARB does not have the authority to enact a tax without legislative approval.

For the foregoing reasons, we urge you to reconsider the implementation of an auction mechanism absent approval by a two-thirds majority of both houses of the Legislature.

Respectfully submitted,



Michele Pielsticker
Vice President and General Counsel

cc: Members, California Air Resources Board
Linda Adams, Secretary, California Environmental Protection Agency
Eileen Tutt, Deputy Secretary, California Environmental Protection Agency
Cindy Tuck, Undersecretary, California Environmental Protection Agency
Dan Pellisier, Deputy Secretary, California Environmental Protection Agency
Susan Kennedy, Chief of Staff, Governor Arnold Schwarzenegger
Victoria Bradshaw, Deputy Chief of Staff and Cabinet Secretary, Governor Arnold Schwarzenegger
David Crane, Special Advisor for Jobs & Economic Growth, Governor Arnold Schwarzenegger
John Moffat, Deputy Legislative Secretary, Governor Arnold Schwarzenegger