

## Client Alert

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# Challengers Double Down on Opposition to California's Carbon Allowance Auctions

By Peter Hsiao, William Sloan, and Sue Landsittel

A second lawsuit has been filed challenging one of the centerpieces of California's innovative cap-and-trade climate change regulatory program: the auction process implemented by the California Air Resources Board (CARB) to distribute carbon emission allowances. The suit, *Morning Star Packing Co. et al. v. CARB*, filed on April 16, 2013, in Sacramento County Superior Court, mirrors an earlier November 2012 lawsuit by the California Chamber of Commerce<sup>1</sup> in alleging that the auction process imposes an unconstitutional tax on regulated entities.

California's cap-and-trade program mandates that certain covered entities acquire allowances for each metric ton of greenhouse gas (GHG) they emit during specified compliance periods. The first compliance period began on January 1, 2013. The total number of allowances available will decline until 2020 to achieve the statewide emissions reductions required by AB 32, the "California Global Warming Solutions Act of 2006."<sup>2</sup> CARB's regulations provide that approximately half of the allowances, which are tradable, will be initially distributed to covered entities for free. The other half will be distributed through a competitive auction process.

The *Morning Star* lawsuit, like the *California Chamber of Commerce* suit before it, raises two general claims aimed at CARB's auction process. First, it asserts that AB 32 does not permit CARB to hold a revenue-raising auction because AB 32 provides only for the collection of regulatory fees sufficient to cover the program's administrative costs. Second, the lawsuit claims that the revenue-raising auction process, even if authorized by AB 32, is void as an unconstitutional "tax" that was not passed by two-thirds of the state legislature as required by Propositions 13 and 26. The California Constitution defines a "tax" as a "levy, charge, or other exaction" that is more than necessary to cover the reasonable costs of government activity, or that is not reasonably related to the burdens imposed on the state by the payor. Cal. Const., art. XIII A, §3.

So far, CARB has held two auctions, which have generated a total of approximately half of a billion dollars in revenue.<sup>3</sup> Under state bills signed into law in 2012, auction revenue is allocated to a "Greenhouse Gas Reduction Fund," but a portion of it may also be used for general fund expenditures. The California Legislative Analyst's Office has estimated that allowance auctions will generate \$1 billion to \$14 billion per year, and up to \$75 billion in total by 2020. CARB has recently begun deliberations on how to spend the revenue from the first auctions.

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<sup>1</sup> See our prior alert, "[California Drops the Hammer on First Carbon Auction Despite Lawsuit.](#)"

<sup>2</sup> See our prior alert, "[California Adopts Historic Cap-and-Trade Program for Greenhouse Gas Emissions.](#)"

<sup>3</sup> See our prior alerts, "[Sold! High Volume, Low Prices Mark California's First Carbon Allowance Auction.](#)" "[CARB Restates Its Cap-and-Trade Auction Results.](#)" and "[Picking Up Steam? CARB Reports that California's Second Carbon Auction Exceeds Price Expectations.](#)"

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One of the potential issues with the *California Chamber of Commerce* lawsuit is whether those plaintiffs have suffered an injury sufficient to establish legal standing to bring their challenge. In this case, plaintiff Morning Star Packing Company alleges that it has already spent a total of approximately \$380,000 to purchase 31,000 allowances at CARB's first two auctions. The other plaintiffs, which include companies and associations from the petroleum, trucking, logging, and farming industries, as well as residential electricity consumers, have not purchased allowances but allege that the costs imposed by the auction of allowances are passed down to them through their purchases of fuel, electricity, and other products and services.

As does the *Chamber of Commerce* suit, *Morning Star* asks the court to halt only the auctioning of allowances for revenue, not the entire cap-and-trade program. Until a court decision is issued in either case,<sup>4</sup> CARB's quarterly auctions will continue, with the next slated for May 16, 2013. The Sacramento Superior Court is scheduled to hear arguments in the Chamber of Commerce's lawsuit on May 31, 2013.

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Morrison & Foerster's Environment and Energy Group has more than four decades of experience in Clean Air Act and climate change issues, both nationally and in California. Along with the firm's Cleantech Group, we are closely following the implementation of AB 32, including CARB's cap-and-trade program, and can provide additional detailed analysis upon request. To learn more about our Environment and Energy Group, [click here](#).

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<sup>4</sup> Given the similarities between the two lawsuits, there is also the possibility that they will be consolidated with each other and heard together.