

# Client Alert

Latham & Watkins

Environment, Land & Resources Department

## ***California Chamber of Commerce v. California Air Resources Board***

Yesterday, the California Chamber of Commerce (Chamber) initiated litigation in the Sacramento County Superior Court against the California Air Resources Board (ARB) seeking to invalidate the auction regulations promulgated under the Global Warming Solutions Act of 2006 (AB 32) — the California statute requiring that greenhouse gas (GHG) emissions be reduced to 1990 levels by 2020.

### • **The Litigation is Limited to the Auction Regulations**

- AB 32 directed ARB to adopt regulations to achieve GHG emission reductions, including the use of “market-based compliance mechanisms.” In response, ARB created a cap-and-trade program. ARB has interpreted AB 32 to allow it to auction off a portion of the allowances (each allowance a permit to emit one metric tonne of GHGs) to covered entities. The first auction is scheduled for November 14, 2012 and bids must be submitted between 10 a.m. and 1 p.m., Pacific Time.
- The Chamber’s petition challenges only the auction regulations, not the cap-and-trade program as a whole. Specifically, this petition does not raise arguments based on the Commerce Clause, the Federal Power Act or Proposition 26.

### • **The Chamber’s Arguments: Lack of Statutory Authority and Unconstitutional Tax**

- Administrative agencies, such as ARB, cannot take actions or implement regulations beyond the authority provided by the enabling statute. The Chamber asserts that AB 32 does not permit ARB — either explicitly or implicitly — to withhold for itself a percentage of the annual allowances available and then auction off those allowances to the highest bidder.
- Rather, the only fee authorized by AB 32 is a fee reimbursing ARB for its costs of implementing the GHG emission program. The Chamber argues that when the legislature authorizes only specific fees, the inference is that other fees are prohibited and may not be imposed by the agency. Moreover, ARB has conceded that AB 32’s statutory purposes can be met by providing allowances for free to covered entities. As a result, the ability to sell allowances for profit is not an implicit authority granted to ARB.

“The Chamber’s challenge to the auction process creates additional uncertainty in the carbon market and may impact the bidding strategy of market participants in the November 14 auction.”

- According to the Chamber, the auction process effectively creates a tax on covered entities that was not approved by a two-thirds vote of both legislative bodies, which is required by the California constitution. Agencies cannot implement a statute through unlawful means. Since the auction “tax” is unconstitutional, the Chamber alleges that the auction process must be enjoined and vacated.
- **Timing and Next Steps**
  - *Nature of Relief:* Writ of Mandate (Code Civ. Proc. § 1085) and declaratory relief (Code Civ. Proc. § 1060). The combination of these two causes of action is typical of petitions challenging agency action as unlawful under the enabling statute; the two causes of action go hand-in-hand. If the writ of mandate were to be issued, any action subject to the writ (*i.e.*, the auctioning of allowances) would be prohibited.
  - *Timing:* The typical timeline to resolve this action would be approximately three to nine months.
  - *Proceedings:* The proceedings will focus on a review of the administrative record. The Chamber and ARB will exchange briefs, similar to proceedings upon a motion for summary judgment. The deadlines for filings would be agreed upon by the parties and the court, but the Chamber has essentially jump-started the process by filing both their “Verified Petition for Writ of Mandate and Complaint for Declaratory Relief” and their “Memorandum of Points and Authorities in Support” at the same time. Ordinarily, only the former would need to be filed to initiate the action.
  - *Appeal:* The decision of the Superior Court would be subject to appeal to the 3rd District Court of Appeal.
- **Potential Implications for Covered Entities**
  - It appears that the auction will take place as initially planned. While the Chamber’s prayer for relief includes “a writ of mandate prohibiting [ARB] from allocating to the ARB and/or State a portion of the annual available GHG emission allowances and conducting the auctions” the Chamber does not appear to have filed a motion for expedited review or preliminary relief. Consequently, unless such a motion is filed before the auction begins, we anticipate that ARB will conduct the auction.
  - If the auction occurs as scheduled and the Chamber ultimately succeeds in having the court declare that AB 32’s auction regulations are illegal, the effect on allowances acquired by covered entities during the November 14 auction is unclear. The court might rule that since the auction process was invalid, any action taken under that auction process is null and void. Conversely, given the severability clause in AB 32’s regulations, the court could hold that the allowances acquired are valid, but that ARB must refund the payments made by covered entities for those allowances.
  - The Chamber’s challenge to the auction process creates additional uncertainty in the carbon market and may impact the bidding strategy of market participants in the November 14 auction. Lower participation in the auction could result in a lower clearing price and lower revenues coming to the State.

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