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California Court of Appeal Upholds Cap-and-Trade Program

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On Thursday, April 06, 2017, California's Court of Appeal for the Third Appellate District upheld California's Cap-and-Trade Program, the cornerstone of California's climate change policy, by a 2-1 vote.

In the case, *California Chamber of Commerce et al. v. California Air Resources Board* (case no C075930), plaintiffs challenged the Cap-and-Trade Program as an unconstitutional tax. The California constitution requires the Legislature to adopt all taxes by a two-thirds vote in the Assembly and Senate. AB 32, the bill that created the Cap-and-Trade Program, did not clear that threshold. The Chamber of Commerce and other parties argued that AB 32 never authorized auctions to sell greenhouse gas emissions allowances, and even if it did the auctions conducted by CARB amount to the imposition of an unauthorized tax. In response, CARB and various other *amicus* parties argued that the auctions are more akin to regulatory fees than a tax, which would be permitted under California law.

The court sided with CARB. In doing so, the court reasoned that no tax is imposed in part because (i) no covered entity is actually forced to buy allowances at auction and (ii) allowances have value to the owner (*i.e.*, they can be sold, traded, or used for compliance). By contrast, the court reasoned, taxes are compulsory and nothing of particular value is received in exchange for any particular tax payment. The court was not persuaded by plaintiffs' arguments that regulated entities are, in fact, compelled to buy allowances, since there is no "vested legal right to continue polluting" in California. In other words, payments for allowances purchase that right to pollute.

An *amicus* brief on behalf of the International Emissions Trading Association has been filed, arguing (in part) that emissions allowances represent a form of property akin to a commodity. In reaching today's decision, the Court of Appeal appeared to agree, holding that allowances sold by CARB are "valuable commodities" that confer "a valuable right to pollute."

Today's ruling is a victory for proponents of the Cap-and-Trade Program, and may reinvigorate California's carbon market—at least in the short term. But today's ruling also is unlikely to end the matter: lawyers for both sides have previously indicated they would appeal an adverse decision. In addition, the California Legislature is currently considering whether to extend the program past 2020 (its current expiration date), and CARB is in the midst of overhauling its Cap-and-Trade Program regulations. We will keep you apprised of these and other developments related to California's Cap-and-Trade Program.

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Article By [Kenneth B. Finney](#)
[Brook J. Detterman](#)
[Beveridge & Diamond PC](#)
[Environmental Law Portal](#)
[Environmental, Energy & Resources](#)
[Litigation / Trial Practice](#)
[California](#)