COURT OF APPEAL OF THE STATE OF CALIFORNIA

THIRD APPELLATE DISTRICT

CALIFORNIA CHAMBER OF COMMERCE, ET AL., Plaintiffs and Appellants, v. **CALIFORNIA AIR RESOURCES BOARD, ET AL.,** Defendants and Respondents, **NATIONAL ASSOCIATION OF MANUFACTURERS,** Intervener and Appellant; **ENVIRONMENTAL DEFENSE FUND, ET AL.,** Interveners and Respondents.	Case No. C075930 Sacramento County No. 34201280001313 CUWMGDS Hon. Timothy M. Frawley
MORNING STAR PACKING COMPANY, ET AL., Plaintiffs and Appellants, v. **CALIFORNIA AIR RESOURCES BOARD, ET AL.,** Defendants and Respondents, **ENVIRONMENTAL DEFENSE FUND, ET AL.,** Interveners and Respondents.	Case No. C075954 Sacramento County No. 34201380001464 CUWMGDS Hon. Timothy M. Frawley

SUPPLEMENTAL BRIEF OF CALIFORNIA CHAMBER OF COMMERCE IN RESPONSE TO THE COURT'S QUESTIONS

NIELSEN MERKSAMER PARRINELLO GROSS & LEONI, LLP
*JAMES R. PARRINELLO (SBN 063415)
CHRISTOPHER E. SKINNELL (SBN 227093)
2350 Kerner Blvd., Suite 250
San Rafael, CA 94901
Telephone: (415) 389-6800
Fax: (415) 388-6874
jparrinello@nmgovlaw.com

NIELSEN MERKSAMER PARRINELLO GROSS & LEONI, LLP
STEVEN A. MERKSAMER (SBN 66838)
ERIC J. MIETHKE (SBN 133224)
KURT R. ONETO (SBN 248301)
1415 L Street, Suite 1200
Sacramento, CA 95814
Telephone: (916) 446-6752
Fax: (916) 446-6106

Attorneys for Plaintiffs and Appellants
CALIFORNIA CHAMBER OF COMMERCE, et al.

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The California Chamber of Commerce respectfully submits this supplemental brief in response to the Court's questions.

1. What is the rationale for and purpose of regulations stating the auction credits confer no property right? (See Cal. Code Regs., tit. 17, §§ 95802(a)(299); 95820(c).)

The purpose of these regulations is to ensure that the ARB can change the emissions allowances at will and at no public cost, even after entities have acquired them via auction or otherwise. As the ARB explained in its Initial Statement of Reasons, "property rights cannot attach to the compliance instruments because, in the event of federal preemption in the cap-and-trade market or other conditions, California must have the ability to revoke the compliance instruments without creating a loss to the people of California." (Administrative Record (AR) at C-000247.) In its Final Statement of Reasons, the ARB also said it needed broad authority to limit or terminate GHG allowances "to ensure that, in the event of any violations, fraud, or other malfeasance in the conduct of the allowance market, it can be immediately addressed." (AR at H-001264.) And, since the cap-and-trade regime is a new program, the ARB wants to be able to discount issued allowances in the event of oversupplies. (AR at H-000878, 000893.)

If the allowances were treated as "property," they likely could not be discounted, extinguished or withdrawn without providing just compensation to their owners for a "taking" of private property. (See *Elk Hills Power, LLC v. Board of Equalization* (2013) 57 Cal.4th 593, 609, fn. 7 [crediting air quality district's concession that if the "emission reduction credits" at issue in that case were deemed

property, then reducing or extinguishing their value "might be subject to the takings clause"].)[1]

2. Describe the relationship, if any, between the probable environmental impacts caused by covered entities and the revenue generated from the auctions, and whether the record shows the Board established a *reasonable* relationship between the two.

Not only has the ARB failed to establish a "reasonable relationship" between the probable environmental impacts caused by covered entities and the revenue generated from auctions, the record shows there is absolutely no relationship between them. Tellingly, the ARB has never suggested otherwise in this litigation.

First, by its very nature, the auction of GHG emissions allowances abrogates any possible relationship between the revenues generated and the impacts of the purchasing entities' activities. The price paid for the allowance is not related to the burden of the payer's operations because the price will vary based on factors affecting the competitive demand for the limited number of allowances available. (See CalChamber's Opening Br., p. 39.)

This effect is further exacerbated by the fact that non-covered entities—speculators—are permitted to bid on the credits, driving up the prices. Thus, the price fee payers will pay, individually or in the aggregate, is not fixed by the burdens imposed by their business

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[1] In agreeing that the ERCs were not "property" in *Elk Hills*, the Supreme Court noted, "Property interests are defined by independent sources of law; they are not defined by the inherent property-like characteristics of the alleged property," and so, because "the California Clean Air Act mandates that ERCs 'shall not constitute instruments, securities, or any other form of property.' (Health & Saf. Code, § 40710.)," the Court held they were not. (*Elk Hills Power, supra,* 57 Cal.4th at p. 609, fn. 7.)

operations, but is related to fluctuating factors such as the marketplace, the relative profitability of the various bidders, and the cost and availability of means to otherwise reduce the amount of GHGs the bidder is producing.

Additionally, as the program is structured, the lack of relationship will only grow. As the ARB has recognized, the auction price is expected to "escalate over time" (AR at H-001920) as the number of available allowances shrink, meaning the prices will go up as the cap declines.

Second, the administrative record does not contain any support for such a relationship as a matter of fact, and the agency cannot supply it post hoc. (See *So. Cal. Edison Co. v. Public Utilities Com.* (2000) 85 Cal.App.4th 1086, 1111 [courts "may not affirm an agency's action on a basis not embraced by the agency itself" and may not accept post hoc rationalizations]; *Bixel Associates v. City of Los Angeles* (1989) 216 Cal.App.3d 1208, 1218 ("*Bixel*") [administrative agency's post hoc interpretation of ordinances to provide safeguards required under Proposition 13 not adequate to prevent charge from being deemed a "tax," rather than a development fee].)

Third, for a regulatory charge to not be a tax, *Sinclair Paint* requires "a causal connection or nexus" between the fee payer's activities or products and the adverse effects that the regulatory program is mitigating. (*Sinclair Paint v. State Bd. of Equalization* (1997) 15 Cal.4th 866, 877-878 ("*Sinclair Paint*"); *Morning Star Co. v. State Board of Equalization* (2011) 201 Cal.App.4th 737, 755 ("*Morning Star Co.*").) In other words, the regulatory program must be aimed at mitigating the damage done by the *fee payer* and not damage caused by others.

The revenues generated by ARB's self allocation and auctioning of emissions allowances, however, are being spent on mitigating greenhouse gases from any source—not just covered entities' operations. California is impacted by the total level of GHGs in the global atmosphere, including many emitters that are not "covered entities." For example, the agriculture industry, which is a "significant source[] of GHG emissions" is "an uncapped sector and does not have a compliance obligation." (AR at H-000696.) Yet the funds from the auctions are being used to mitigate GHG emissions on a societal level—not just those emitted by the covered entities themselves.[2]

Simply put, the auction charges lack the nexus required by *Sinclair Paint* and its progeny. The charges are imposed on one group—certain GHG emitters covered by the ARB's regulations—whereas revenues generated are used to fund programs that either benefit society at large *or benefit other groups of GHG emitters*. Indeed, the ARB has never argued the auction charges comply with *Sinclair Paint*.

3. Can the auction system be defended against the Proposition 13 challenge on the ground it is akin to a development fee? Address what standards apply when assessing the legality of such fees and how the auction system does or does not meet them.

No, the auction system cannot be defended against the Proposition 13 challenge on the ground that it is akin to a development fee. ARB has never suggested otherwise.

The auction charge for GHG emissions allowances is nothing like a development fee, which is "an exaction imposed as a

[2] In 2011, for example, California produced less than 1% of GHG worldwide emissions. (See CalChamber's Opening Brief, p. 47, n.26.)

precondition for the privilege of developing . . . land" previously not being used for the development's purposes. (See *Russ Bldg. P'ship v. City & County of San Francisco* (1987) 199 Cal.App.3d 1496, 1504.)

More fundamentally, courts have recognized that, for purposes of Proposition 13, "development fees" are just a species of "user fee" more generally (see *Isaac v. City of Los Angeles* (1998) 66 Cal.App.4th 586, 596 fn. 10, citing *Carlsbad Mun. Wat. Dist. v. QLC Corp.* (1992) 2 Cal.App.4th 479 [using "development fee" and "user fee" interchangeably]), which the auction charge is not, for the following reasons.

The ARB's auction system does not have the fundamental characteristics that distinguish a "development fee" or "user fee" from a "tax" for purposes of Proposition 13. To be exempt from Proposition 13's tax approval provisions, a user fee or development fee—just like a regulatory fee—"*must not exceed the reasonable cost of providing the service or regulatory activity for which the fee is charged*." (*Beaumont Investors v. Beaumont-Cherry Valley Water District* (1985) 165 Cal.App.3d 227, 234 ("*Beaumont*") [invalidation of excessive fire hydrant fee as a special tax], emphasis added; *Bixel, supra,* 216 Cal.App.3d at p. 1218 [invalidation of water system hookup fee as a special tax].)

And, as with a regulatory fee, the government bears the burden of demonstrating, before it enacts a user or development fee, that the amount of the fee represents the costs to the government of the service provided to the fee payor. (*Beaumont, supra,* 165 Cal.App.3d at p. 235; *Bixel, supra*, 216 Cal.App.3d at p. 1216; *Cal. Assn. of Prof. Scientists v. Dept. of Fish & Game* (2000) 79 Cal.App.4th 935, 945

("*Prof. Scientists*") [assigning the burden of proof to the government in the context presented here: a challenge to a state-imposed regulatory fee, challenged as an improper "tax" under Proposition 13].) No such showing was made by the ARB for the auction charge.

Additionally, a development fee—like a regulatory fee—must not exceed the amount necessary to mitigate the impacts to the community of the developer's specific project; such fees may not be imposed to ameliorate a society-wide problem. Accordingly, *Bixel* invalidated a fire hydrant/water main fee imposed on new development. The scheme there took a percentage of new construction value as reflected in building permits, without tying it to actual needs generated by the projects, and did not limit the use of fees so collected to offsetting new, as opposed to preexisting, citywide costs. (216 Cal.App.3d at pp. 1219-1220.)

That is why the statutes authorizing development fees require public agencies to identify, in advance, the uses for which the fees are to be put, and to conduct a study to establish the necessary nexus between the charge and the specific impacts of a given development. (See, e.g., Gov. Code § 66001.) In this case, however, no effort to establish such a nexus was made before imposing the auction charges. Covered entities are being singled out to pay huge sums of money to ameliorate GHG emissions that are a broad societal problem.

As set forth at length in CalChamber's opening brief (at pp. 39-48) and above, the lack of even a remote relationship between the amount charged to covered entities and the State's costs to regulate those entities, or to mitigate their specific impacts, is one of the chief reasons the auction charges fail the *Sinclair Paint* test for determining a legitimate regulatory fee. For one thing, Government Code § 38597 was enacted to permit the ARB to defray its regulatory costs in

enforcing AB 32. The proceeds of the auctions, by contrast, are used for countless purposes that are unrelated to the cost of regulating the covered entities. Moreover, as discussed above (in response to Question #2), because the price is set by auction, there is no coherent, logical connection between the government's costs and the amount paid.

The lack of a reasonable relationship between the amount charged and the costs to the government of regulating or providing a benefit/service is fatal to a defense that the auction charge is akin to a "development fee," just as the lack of such a relationship is fatal to a defense that the charges are valid regulatory fees.

Moreover, in distinguishing between taxes and user/development fees, the courts have rejected the approach taken by the ARB here, in which the ARB (and the Legislature) decided what its "regulatory program" would be (*i.e.*, how the money would be spent) *after* determining how much money it could raise, instead of working backwards from the estimated costs. *Beaumont* illustrates the proper test. In that case, the reviewing court had to decide whether a "facilities fee" imposed for connection to the local water district's system was an invalid special tax. The developer argued that the fee exceeded the reasonable cost of construction of the water system improvements required by the development and was, therefore, a special tax. The reviewing court agreed, finding the fee was invalid. (165 Cal.App.3d at pp. 234-235 & 238.) In so doing, it held that:

> Such a showing would require, at the minimum, evidence of (1) the estimated construction costs of the proposed water system improvements, and (2) the District's basis for determining the amount of the fee allocated to plaintiff, i.e., the manner in which defendant apportioned the contemplated construction costs among the new users, such that the charge allocated to plaintiff

> bore a fair or reasonable relation to plaintiff's burden on, and benefits from, the system. (*Id*.)

The *Beaumont* court held that the water district in that case had failed to properly consider specific data regarding the costs of the proposed capital improvements because the report containing the data wasn't submitted until after adoption of the ordinance. (*Id*. at p. 237 and fn.5.)

Likewise, in *Shapell Industries, Inc. v. Governing Board* (1991) 1 Cal.App.4th 218, taxpayers challenged a school board's approval of two resolutions compelling the payment of school-impact fees. Shapell, a developer, filed a petition for a traditional writ of mandate attacking the resolutions as arbitrary, capricious and without evidentiary support and, in support of its petition, presented a report challenging the fee nexus which was not before the Board at the time the resolutions were passed. The trial court granted Shapell's petition, and on appeal the Board claimed the trial court should not have considered the report because it was not considered when the resolutions were adopted. The Court of Appeal agreed, holding: "'[T]he determination whether the decision was arbitrary, capricious or entirely lacking in evidentiary support must be based on the "evidence" considered by the administrative agency.' [Citations.] Consideration of reports prepared long after the agency has acted would therefore be improper." (*Id*. at p. 233.) As the government has the burden of proof under Proposition 13,[3] it can hardly be the case that the challenging taxpayer is precluded from submitting *post hoc* evidence, while the public agency is permitted to do so.

Simply put, the government cannot adopt the charge first, then identify the program to be funded and the related costs after the fact.

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[3] See *Prof. Scientists, supra*, 79 Cal.App.4th at p. 945.

That approach is a hallmark of a tax, rather than a valid regulatory, user, or development fee.

The courts have also held that a charge imposed without sufficient consideration of the costs of providing a service to the taxpayer, which is thus a tax, cannot retroactively be converted into a legitimate user charge or development fee by the *post hoc* adoption of limitations on the purposes for which the auction proceeds will be spent.

Thus, the *Bixel* court concluded that the ordinances adopting the fire hydrant/water main fees "as they presently read, *do not* contain language which limits the use of the fire hydrant fees and the fund established by the ordinances to solely those installations and repairs necessitated by new development, although such limitation is mandated by the California Constitution." (216 Cal.App.3d at pp. 1219-1220.) The City argued that "that the ordinances are being interpreted by City officials 'as if' they contained the limitation that the fees collected in the fund are to be used only to meet the burden placed on the public by new development." (*Id*. at p. 1220.) The Court of Appeal, however, held that "We are not persuaded that City's administrative interpretation of the ordinances would provide the safeguard envisioned by the voters when they enacted Proposition 13. Nowhere within the ordinances, or in the new municipal code section or the administrative code section has this court found adequate words of limitation." (*Ibid*.)

In sum, the auction proceeds cannot be defended on the basis of an analogy to a "development fee" or "user fee" for many of the same reasons it is not a "regulatory fee."

4. Can the auction system be defended against the Proposition 13 challenge on the ground it essentially sells to covered entities the privilege to pollute?

No, the auction system cannot be defended against the Proposition 13 challenge on the ground it essentially sells to covered entities the "privilege" to pollute.[4]

Such a defense would be inconsistent with *Sinclair Paint*, in which both the Court of Appeal and Supreme Court declined to uphold a lead remediation fee on the purported ground that it was a fee for the privilege to pollute. (See 15 Cal.4th at pp. 875 [the fees imposed on manufacturers and others responsible for identifiable sources of lead" "are not analogous to either special assessments or development fees, for they neither reimburse the state for special benefits conferred on manufacturers of lead-based products *nor compensate the state for governmental privileges granted to those manufacturers*"].) Instead, the Supreme Court upheld the charges on the ground that "the challenged fees fall squarely within a third recognized category not dependent on government-conferred benefits or privileges, namely, *regulatory fees* imposed under the police power, rather than the taxing power." (*Id*., underline added.)

To treat GHG allowances as a "privilege" within the meaning of *Sinclair Paint* would essentially abolish "regulatory fees" as a separate category of charge, because—given its virtually all-encompassing authority to regulate economic activity under the police power—the government could almost always recharacterize the ability to engage in a regulated activity as a "privilege" subject to being levied.

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[4] The ARB has insisted that the auction charges are not a "tax" because the "allowances provide a valuable benefit or privilege that the auction participants would not otherwise have, because California law provides no right to pollute." (ARB Br. at 54.)

In any event, characterizing GHG allowances as a "privilege" does not make the auction charges any less of a tax. For example, development fees imposed for the privilege of developing the land *are taxes* if they exceed the cost to the government of providing the benefits or services. (*Beaumont, supra*, 165 Cal.App.3d at p. 234; *Bixel, supra*, 216 Cal.App.3d at p. 1218.) As explained above and in CalChamber's other briefing, the auction charges in this case are taxes because of the lack of a reasonable relationship between the charges and the cost of any benefit provided by the government.

There are any number of other levies imposed for "privileges," yet no one would dispute that they are, indeed, "taxes":

- The sales tax is an exaction imposed on retailers "[f]or the privilege of selling tangible personal property at retail" in California. (Rev. & Tax. Code, § 6051.)
- The use tax "frames an excise tax upon the privilege of utilizing property within this state in a certain manner." (*Union Oil Co. v. State Bd. of Equalization* (1963) 60 Cal.2d 441, 453.)
- A transient occupancy tax (or "hotel tax") is a tax imposed "on the privilege of occupying a room under the conditions described..." (*Gowens v. Bakersfield* (1961) 193 Cal.App.2d 79, 83.)
- "A transfer tax attaches to the privilege of exercising one of the incidents of property ownership, its conveyance." (*Fielder v. Los Angeles* (1993) 1 Cal.App.4th 137, 145.)
- "A business or occupation tax is usually defined as a revenue-raising levy upon the privilege of doing business within the taxing jurisdiction." (*Weekes v. Oakland* (1978) 21 Cal.3d 386, 394.)

- "The franchise tax is a tax for the privilege of doing business within California and is imposed upon all banks and corporations doing business in California. The amount of the tax is the greater of: [1] California net income times the appropriate tax rate [; or] [2] The $800 minimum franchise tax."[5] The government sells the "privilege" of doing business for $800, whether one makes any income or not. If one does make income, it is taxed to the degree the liability exceeds $800.

As with a franchise tax or business license tax, in particular, the only real "privilege" or "benefit" received by covered entities that purchase GHG allowances is the privilege of staying in business. Without sufficient GHG allowances to cover their emissions, those entities will not be permitted to continue emitting GHG. Without the ability to emit GHG, their operations will cease. (See, e.g., Cal. Code Regs., tit. 17, §§ 96012-13 [authorizing penalties and injunctions against violators of the cap-and-trade program]; response to Question #6, *infra*.)

At bottom, acceptance of the ARB's "it's a privilege not a right" argument as the test for whether a levy is a tax or fee would threaten to convert innumerable traditional taxes into "fees," exempt from the protections of Proposition 13, effectively neutralizing the fundamental protections of that measure. It would open the door to the abuses Proposition 13 was designed to prevent.

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[5] See Franchise Tax Bd., "Is my corporation subject to franchise tax or income tax?", *available online at* https://www.ftb.ca.gov/businesses/faq/734.shtml (last visited Apr. 22, 2016).

5. Although the current petitions do not seek to invalidate any particular expenditures of the auction revenue, the record shows the revenue is used for a wide variety of programs. The plaintiffs suggest that the auction proceeds—at least in part—are being used to replace what otherwise would be general fund expenditures.

Each of the questions below must be answered in the context of the following key principles.

Proposition 13 must be interpreted broadly to accomplish in full measure its objective; thus, exceptions to Proposition 13's "stringent" tax limitation provisions must be narrowly construed. To do otherwise would "eviscerate" Proposition 13. (*Howard Jarvis Taxpayers Assn. v. County of Orange* (2003) 110 Cal.App.4th 1375, 1384; see also *Amador Valley Joint Union High Sch. Dist. v. State Bd. of Equalization* (1978) 22 Cal.3d 208, 244-245.)

And the government bears the burden of demonstrating that a challenged levy is a legitimate "fee" and not a "tax." (*Prof. Scientists, supra,* 79 Cal.App.4th at p. 945; *Beaumont, supra,* 165 Cal.App.3d at p. 235; *Bixel, supra,* 216 Cal.App.3d at p. 1216.)

a. How directly must a particular expenditure of auction revenue be related to the goal of reducing greenhouse gases?

AB 32's stated purpose is to reduce GHG emissions in this State to 1990 levels *by 2020*. (See Health & Saf. Code § 38550.) Thus, under AB 32 the ARB's "authority to adopt a regulation that establishes the cap-and-trade program is 'applicable' only until December 31, 2020."[6] Notwithstanding this clear statutory directive, the ARB

[6] See Ops. Cal. Legis. Counsel, No. 1609054 (Apr. 19, 2016) California Global Warming Solutions Act of 2006: Executive Branch

acknowledges the great majority of auction revenues are being spent to reduce GHGs between 2025 - 2095. ARB further acknowledges the hundreds of millions of dollars already appropriated will reduce GHGs by only 14.3 million metric tons *in the aggregate* through 2095. This is in stark contrast to the more than 450 million metric tons of GHGs California produces *every year*.[7]

Nor is the auction revenue necessary to meet AB 32's stated purpose of reducing GHG emissions to 1990 levels by 2020. This is borne out by the fact that few, if any, of the expenditures in question will reduce GHGs before 2020,[8] and some of the projects being funded actually *increase* GHGs during that time.[9]

Authority, *available online at* http://cmta.net/multimedia/04-22_leg_counsel_opinion_ggrf_4-19-2016.pdf (last visited May 6, 2016), p. 6, citing Health & Saf. Code § 38562, subd. (c).

[7] Cal. Air Res. Bd., "California Climate Investments: Annual Report: Cap-and-Trade Auction Proceeds" (Mar. 2016), pp. 24-25, *available online at* http://arb.ca.gov/cc/capandtrade/auctionproceeds/cci_annual_report_2016_final.pdf (last visited May 20, 2016); see also CalChamber's Opening Brief, p. 47, n. 26.

[8] *See* LAO 1/21/16 Report, "Cap-and-Trade Revenues: Strategies to Promote Legislative Priorities," *available at* http://www.lao.ca.gov/reports/2016/3328/cap-trade-revenues-012116.pdf (last visited May 6, 2016), p. 3 ("spending auction revenue on GHG reductions is likely not necessary to meet the state's GHG goals and likely increases the overall costs of emission reduction activities. This is because, in certain cases, spending on GHG reductions interacts with the regulation in a way that changes the types of emission reduction activities, but not the overall level of emission reductions").

[9] Ironically, the LAO states that use of auction proceeds for bullet train construction "would not help achieve AB 32's primary goal" and "construction and operation of the [bullet train] system would emit more GHG emissions than it would reduce for approximately the first 30 years." (See LAO 4/17/12 Report, "The 2012-13 Budget: Funding Requests for High Speed Rail," *available at*

In addition to the fact that the expenditures of auction revenues are not tied to meeting the stated objectives of AB 32, the undisputed record in this case is that AB 32's objectives can be achieved without the challenged revenue-raising regulations (JA 0238, 0242-0244, 0235); the declining emissions cap accomplishes that objective. The ARB has not disputed this.

More fundamentally, for purposes of Proposition 13 the relationship between a particular expenditure of auction revenue and the goal of reducing greenhouse gases *generally* does not determine whether the auction charges are "taxes" subject to a 2/3 legislative vote, instead of a regulatory fee. The ARB's attempt to suggest otherwise is a red herring.

Rather, the correct test is whether the charges are levied for "unrelated revenue purposes," *i.e.*, expenditures that are unrelated to the activity *of regulating the fee payers themselves.* (*Sinclair Paint*, *supra*, 15 Cal.4th at p. 881.)

Morning Star Co., which held a hazardous waste fee to be a tax and not a regulatory fee, is instructive on this point. In that case, the Legislature imposed an annual charge on "those types of businesses, with at least 50 employees, which use, generate, store, or conduct activities in California related to hazardous materials." (201 Cal.App.4th at p. 742.) Recognizing that a valid regulatory fee "must be related to the cost of the governmental regulation" (*id.* at p. 751, quoting *Cal. Farm Bureau Fed'n v. State Wat. Res. Control Bd.* (2011) 51 Cal.4th 421, 438), the Court of Appeal further held that "Such costs ... '"include all those incident to the issuance of the license or permit,

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http://www.lao.ca.gov/analysis/2012/transportation/high-speed-rail-041712.aspx [last visited May 6, 2016].)

investigation, inspection, administration, maintenance of a system of supervision and enforcement."'" (*Id.*, quoting *California Farm Bureau*, *supra*, 51 Cal.4th at p. 438.) Because the disputed hazardous waste charge, by contrast, "d[id] not seek to regulate the Company's use, generation or storage of hazardous material but to raise money for the control of hazardous material generally [, t]he charge [wa]s therefore a tax" instead of a regulatory fee. (*Id*. at p. 755.)

In this case as well, the proceeds of the auction revenues are being used for a multitude of purposes that are entirely unrelated to costs involved in regulating the covered entities. Health and Safety Code § 39710, AB 1532, makes auction proceeds available for the following purposes: energy generation, transmission, and storage (subd. (c)(1)); energy infrastructure projects at public universities and local public buildings (subd. (c)(1)); transportation infrastructure projects (subd. (c)(2)); water use and supply infrastructure projects (subd. (c)(3)); transportation and housing (subd. (c)(4)); and municipal solid waste diversion projects (subd. (c)(5)). And, commencing in Fiscal Year 2015-16, the 2014-15 cap and trade budget trailer bill *continuously* appropriates 60 percent of all future cap and trade auction profits to be divided and spent as follows: high speed bullet train (25%), affordable housing (20%), transit and intercity rail (10%), and low carbon transit (5%). The cap and trade trailer bill also takes $400 million of the $500 million in cap and trade profits loaned to the General Fund in the 2013-14 Budget Act and redirects it to the high speed bullet train project. (Stats. 2014, ch. 36 [SB 862].)[10]

[10] The bullet train project will *increase* GHGs for the next 30 years, so it hardly advances AB 32's stated goal of emissions reduction to 1990 levels by 2020. (See fn. 7 above.)

Thus, it is indisputable that the auctions seek "to raise revenue to pay for a wide range of governmental services and programs related to [greenhouse gas] control...generally, rather than for the regulation of the [covered entities]' business activities in ... generating ... [greenhouse gases]." (*Morning Star Co., supra*, 201 Cal.App.4th at p. 755.) As such, regardless of how closely-related the expenditures are to greenhouse case abatement *generally*, the fact remains that the auction charges are an illicit tax.

Nor can the government define its regulatory program with such generality that it effectively neutralizes Proposition 13 as a tax limitation mechanism. Instructive on this point is *Howard Jarvis Taxpayers Assn. v. County of Orange, supra*, 110 Cal.App.4th at p. 1375, which addressed an exception to Proposition 13's prohibition against imposition of property taxes in excess of 1 percent of the cash value of property. The Court of Appeal rejected the City of Huntington Beach's claim that its adoption of a new charter providing for an excess tax sufficient to meet the city's obligations for its retirement system fell within Proposition 13's exemption for indebtedness approved by voters prior to July 1, 1978. (Cal. Const., art. XIII A, § 1, subd. (b)(1).) Noting that when voters adopted Proposition 13, the city already had a retirement system with obligations to persons in the retirement program, the Court held: "Under City's interpretation [of the exception], it would have virtually unfettered power to spend whatever sum of money and levy excess taxes to obtain the revenue, as long as the expenditure was designated 'retirement.' This was one of the very things Proposition 13 was enacted to combat." (*Id*. at pp. 1383-1384.) "As one court explained in another context, 'If we were to accept the City's interpretation ..., we would be turning [Proposition 13] on its head, by narrowly construing the ... requirements and

broadly construing the statutory exceptions to it. [Citation.]" (*Id*. at p. 1383, quoting *Shapiro v. San Diego City Council* (2002) 96 Cal.App.4th 904, 924.)

Here, in a similar vein, the ARB seeks to raise billions of dollars of state revenue without complying with Proposition 13's vote requirements, and spend it on a wide-ranging list of society-benefitting projects so long as those projects are somehow connected to the general purpose of mitigating "greenhouse gases"—a purpose that reaches into every possible corner and crevice of economic activity in the State. Like the interpretation proposed by the City of Huntington Beach, the ARB's approach—if accepted by this Court—would "eviscerate[] Proposition 13." (*Id*.)

b. What standards should the judiciary apply in reviewing expenditures that are alleged to be replacements for general revenue expenditures?

A "fee" is a disguised "tax" if the amount charged "exceed[s] the reasonable cost of regulation with the generated surplus being used for general revenue collection. An excessive fee that is used to generate general revenue becomes a tax." (*Morning Star Co., supra,* 201 Cal.App.4th at p. 751, quoting *California Farm Bureau, supra,* 51 Cal.4th at p. 438; *Tomra Pacific, Inc. v. Chiang* (2011) 199 Cal.App.4th 463, 487.)

Whether the levy's proceeds are being used as "general revenue" is essentially a question of fact (see *Weisblat v. City of San Diego* (2009) 176 Cal.App.4th 1022, 1038), on which the government bears the burden of proof (*Prof. Scientists, supra,* 79 Cal.App.4th at p. 945). Thus, it is significant that the trial court made the following factual findings:

- "The Budget Act assumes that these proceeds will be used to offset General Fund costs of existing GHG mitigation programs." (JA1569.)

- "[S]ince nearly every aspect of life has some impact on GHG emissions, it is difficult to conceive of a regulatory activity that will not have at least some impact on GHG emissions.... Thus, in practice, the allowance proceeds likely can be used for 'general government purposes.'" (JA1582.)

The latter finding was based on the vast breadth of programs to be funded by the auction revenues: "For example, the Three-Year Investment Plan has identified numerous GHG reduction strategies, including such things as energy efficiency and weatherization retrofits, rail modernization, expanded transit and ridership programs, transit-oriented development and 'livable community' strategies, water system use and efficiency, forests and eco-system management, recycling, reduction, and waste diversion, conservation easements, and agricultural management practices." (JA1582.)[11]

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[11] This has resulted in a lobbying and spending frenzy, as reported by the *Sacramento Bee*'s Dan Morain:

> For about two hours one morning last week, lobbyists representing glass makers, bicyclists, forest land owners, dairies, bio-digesters, PG&E, car makers, bus makers, bird watchers, recyclers and many more earnestly and sincerely asked for money.
>
> They wanted $40 million to replace wood stoves, $20 million to make new glass from old glass, $140 million to improve forest health, $50 million to plant trees, $100 million for active transportation, also known as walking and biking, and $500 million for low-carbon modes of transportation, also known as trains and buses, or maybe it was $650 million. ...

In fact, ARB itself described its scheme as "green tax reform" allowing the state to use auction proceeds "as a substitute for distortionary taxes such as income and sales taxes." (AR C-001777-78.) Likewise, ARB frequently emphasized that auction proceeds would "provide revenue that can be reinvested for public benefit." (AR C-000028.) **This is an apt description of a tax**.

To be clear, however: it is not necessary for plaintiffs to show that auction proceeds are being used as "replacements" for existing general fund expenditures. While a fee is indeed a disguised tax if it is being used to replace general revenue (*Morning Star Co., supra*, 201 Cal.App.4th at p. 751), that is not the standard for determining whether a fee violates Proposition 13.[12]

Rather, the test for distinguishing a tax from a fee, as set forth in *Sinclair Paint*, is whether the charges are levied for "unrelated revenue purposes," meaning revenue purposes that are unrelated to

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> Lawmakers have earmarked $224 million for bus and rail lines, and $154 million for housing built close to transit and employment, plus money for many smaller programs. But the Air Resources Board says programs funded by the cap-and-trade revenue so far would remove 14.3 million metric tons of greenhouse gas. However, that reduction won't be fully realized until 2095. That's not a typo. Nor is this: Each year, California emits 459 million metric tons of greenhouse gases.

Morain, "Jerry Brown's lofty aspirations come face to face with the law," SAC. BEE (Apr. 22, 2016), *available online at* http://www.sacbee.com/opinion/opn-columns-blogs/dan-morain/article73409747.html (last visited May 20, 2016).

[12] Whether proceeds are used for "general governmental purposes" is the test used to distinguish between different types of taxes – "general taxes" and "special taxes" at the local level, as they are subject to different voter approval thresholds (majority vs. two-thirds). (See, e.g., Cal. Const., art. XIIIC, § 1, subds. (a) & (c).)

the activity of regulating the fee payers themselves. (15 Cal.4th at p. 881; see also *Morning Star Co., supra,* 201 Cal.App.4th at p. 755.)

If, without a two-thirds vote, the government levies a charge that exceeds the reasonable cost of regulating the fee payers' operations, places the revenues into a special fund (rather than a general fund), and then uses the surplus proceeds to fund new programs that are unrelated to the narrow purpose of regulating or mitigating the fee payers' operations, the levy is an unlawful tax. (See *Bay Area Cellular Telephone Co. v. City of Union City* (2008) 162 Cal.App.4th 686, 696 ("*Bay Area Cellular*") [phone line charge held to be a "tax" even though it was placed into a special fund, because the proceeds were used to provide services to the public generally, rather than just to those subject to the levy]; *Morning Star Co., supra*, 201 Cal.App.4th at p. 744 [charges were a tax, though placed in the Toxic Substances Control Account].)

c. What, as a practical matter, would be the remedy, if, under the applicable standards a court finds a particular program is not sufficiently tethered to the goals of Assembly Bill No. 32?

As a practical matter, the appropriate remedy would be a declaration that the ARB's practice of imposing charges and retaining revenues for GHG emissions allowances sold at auction is an unlawful tax, and a writ of mandate prohibiting same. "An excessive fee that is used to generate general revenue becomes a tax." (*California Farm Bureau, supra,* 51 Cal.4th at p. 438.) A tax that is adopted in violation of Proposition 13 is invalid, and cannot be enforced. (*Beaumont, supra*, 165 Cal.App.3d at p. 238; *Bixel, supra*, 216 Cal.App.3d at p. 1220.)

Because the administrative costs that can permissibly be funded by regulatory fees are covered by, and limited to, the fees imposed under section 38597 of the Government Code, 100% of the auction charges are excessive, and thus invalid taxes, because they are for purposes other than regulating the covered entities' regulatory operations.

The defect cannot be cured by the post-enactment expedient of changing the purposes for which the funds will be spent. (See *Bixel, supra*, 216 Cal.App.3d at pp. 1219-1220 [post hoc interpretations to limit uses of funds to proper purposes could not validate illegal fee under Proposition 13].) Such an approach would turn Proposition 13 and *Sinclair Paint* on their heads, by permitting the government to determine the scope of its regulatory program by the success of its revenue raising, rather than determining the amount of revenue needed by reference to the cost of the planned regulatory program.

Nor could a court hold the fee only partially invalid, as in *Shapell, supra*, 1 Cal.App.4th at pp. 241-245. First, there is no statutory authority for that course of action, unlike in *Shapell*. Second, in light of Government Code § 38597, none of the amounts collected pursuant to the auctions would be a legitimate administrative "fee," as opposed to a "tax" that was enacted without the requisite two-thirds vote. (See *Northwest Energetic Svcs, LLC v. Cal. Franchise Tax Bd.* (2008) 159 Cal.App.4th 841, 860 [invalidated levy "more closely resembles a tax" than a fee, in part because the cost of implementing the law in question was funded from other sources].) And finally, unlike in *Shapell*, but like in *Beaumont* and *Bixel*, which invalidated illegal taxes in their entirety, the ARB has not established a record relating the auction charges to the regulatory costs and cannot do so post hoc. (See *Shapell, supra*, 1 Cal.App.4th at p. 243 [distinguishing

Beaumont and *Bixel* on this basis, and noting that "the amount of a reasonable fee must be determined, if possible, on the basis of the evidence before the Board at the time it enacted Resolution No. 87.12"].)

6. Address the proper test for voluntariness in the context of determining whether a payment is or is not voluntary for purposes of deciding whether it is a compulsory exaction or freely-entered transaction. Apply the test to explain whether or not the auction payments are voluntary. As part of the discussion, assume for purposes of argument only that the trial court credited the Rabo declaration, and that Morning Star (purely as a hypothetical case) will be forced out of business due to the lack of feasible, affordable, technology to reduce its greenhouse gas emissions, if it must continue to obtain emissions credits in order to operate its tomato processing facilities.

When a business is required to pay money to the government, and its only alternative is to cease its business altogether, as set forth in the Rabo Declaration, the levy cannot reasonably be characterized as "voluntary." (See 6 JA 1300 ["Morning Star has absolutely no choice but to participate in the auctions if it wants to stay in business in California. ... The notion that, as a Covered Entity, Morning Star's participation in the CARB auctions is somehow 'voluntary' is both false and ridiculous."].)

For example, in *Whyte v. State* (1930) 110 Cal.App. 314 ("*Whyte*"), the plaintiff sought a refund of a franchise tax that had been declared unconstitutional, though "no written protest was filed at the time of payment." (*Id*. at p. 315.) Generally speaking, the law of the State at the time was that—absent a specific statutory refund scheme—illegal taxes paid "voluntarily" (*i.e.*, without "duress, coercion or compulsion") could not be recovered. (*So. Serv. Co. v.*

County of Los Angeles (1940) 15 Cal.2d 1, 7.)[13] Nevertheless, citing the severe penalties imposed for failure to pay a protested tax, the Court ruled the franchise taxes were recoverable because the payment was not voluntary.

In words equally applicable here, *Whyte* said: "Payment is never voluntary when made under coercion and duress. Under the penalties provided for by the self-executing provisions of the act a *corporation is either compelled to comply with same or go out of business*. Payment is therefore compulsory and not voluntary..." (110 Cal.App. at p. 316, italics added; see also *Flynn v. San Francisco* (1941) 18 Cal.2d 210 ["where, by reason of the peculiar facts a reasonably prudent man finds that in order to preserve his property or protect his business interests it is necessary to make a payment of money which he does not owe and which in equity and good conscience the receiver should not retain, he may recover it," despite the rule precluding recovery of "voluntary" tax payments].) Under AB 32, the possible penalties for noncompliance are equally severe. Failure to meet a compliance obligation, or other violations under the cap-and-trade regulation, subjects regulated entities to penalties including civil fines and criminal penalties up to and including incarceration. (Cal. Code Regs., tit. 17, §§ 96013-14; Health & Safety Code § 38580.)

The U.S. Supreme Court also has held that where a private party must pay the government or go out of business, the choice is not "voluntary." (See, e.g., *United States v. State Tax Com*. (1973) 412 U.S. 363, 368, fn. 11; see also *Swift & Co. v. United States* (1884) 111 U.S. 22, 28-29 ["The appellant had no choice. The only alternative was to

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[13] This is no longer the case, of course. (See *Franchise Tax Bd. v. Superior Court* (2011) 51 Cal.4th 1006, 1017.)

submit to an illegal exaction, or discontinue its business."]; *Nat'l Fed'n of Indep. Bus. v. Sebelius* (U.S. 2012) 132 S. Ct. 2566, 2604-2605 [opinion of the Court] [recognizing where one is presented with a "choice" of acceding to government conditions or accepting consequences that are sufficiently severe, the choice cannot be said—in a meaningful sense—to be voluntary]; *id.* at pp. 2661 [Scalia, Kennedy, Thomas & Alito, JJ., dissenting, but nevertheless agreeing with this point re coercion].)

The same is true here. Covered entities face the untenable "choice" of participating in the ARB auctions or going out of business. (See 6 JA 1300 [Rabo Declaration].) Or, if they were to continue in business without paying for necessary emissions allowances, AB 32 would subject them to severe penalties for noncompliance, including civil fines and criminal penalties. Accordingly, in deciding whether the auction charges are taxes, their participation in the auction cannot be characterized as voluntary.

In any event, *even if* the auction charges were characterized as levies for the option of "voluntarily" engaging in a transaction, this would not be dispositive of the "tax vs. fee" question.

For example, in *Bay Area Cellular, supra*, the Court sustained a taxpayer's challenge to the city's "Emergency Communication System Response Fee" on the ground that the fee was, in actuality, a tax, though the revenues were used only for the expenses of a 911 communications system; were not commingled with general city funds; and were only expected to recover 75% of the operating, improvement and maintenance costs for the 911 system. The court concluded: "The Fee inures to the benefit of the public as a whole, not to any particular group within the public." (162 Cal.App.4th at p. 696.)

And, significantly for purposes of discussion in this case, *Bay Area Cellular* also rejected the contention that "the Fee [wa]s not a special tax because it was voluntary," on the theory that "those subject to the Fee voluntarily consented to pay it when they chose to obtain telephone service." (*Id*. at pp. 696-697.) Key to that rejection was the recognition that "voluntariness" must refer to a "voluntary decision to seek a governmental service," rather than a voluntary decision to engage in private enterprise that is subjected to charges by the government without direct benefit to the taxpayer.

The rationale and holdings of *Bay Area Cellular* apply equally to the ARB's effort to defend its auction charges on the ground that covered entities are subject to them only because they have "voluntarily" decided to engage in private economic activity that the State, in an exercise of its police powers for the benefit of the broader public, now says requires GHG emissions credits.

To hold otherwise would effectively nullify Proposition 13 as a limitation on tax increases because, as the trial court noted: "Virtually every tax is in some sense 'voluntary' in that one can avoid the tax by choosing not to engage in the taxed activity. Taken to its logical extreme, even income, sales, and property taxes would not be 'compulsory' because they must be paid only if one 'voluntarily' earns income, purchases goods, or owns property. Yet no one would dispute these are taxes." (JA1581.)

Cwynar v. City & County of San Francisco (2001) 90 Cal.App.4th 637, which addressed a local government restriction on a property owner's ability to evict a tenant from a residential rental unit, is also instructive. The Court noted: "If a statute authorizes a compelled physical invasion of a landlord's property, it is no answer to say that the landlord can avoid the invasion by ceasing to be a

landlord." (*Id*. at p. 658.) In other words, "the fact that the property was voluntarily rented at some time in the past does not preclude the plaintiffs from pleading and proving government coercion." (*Id*. at p. 659.) Similarly, the fact that a business owner "voluntarily" chooses to engage in a given occupation does not mean the owner "voluntarily" chooses to be subject to unlawful government charges.

7. If this court finds the auction is deemed to be an invalid tax, what is the remedy regarding the regulations, *other than* a declaration invalidating the auction component?

The remedy at issue in this appeal is a determination that the ARB's self-allocation and auctioning of emissions allowances to generate billions in state revenues is illegal because it was not authorized by a 2/3 vote of the Legislature. Permitting the State to raise billions of dollars without a 2/3 vote of the Legislature, would effectively neuter Proposition 13 as a tax limitation device.

If the ARB's self-allocation and revenue-generating sale of emissions allowances are found to be an invalid tax, the judgment entered by the superior court should be reversed, and the matter should be remanded to the superior court for further proceedings consistent with this Court's decision. More specifically, the superior court should be directed to: (a) issue a peremptory writ of mandate prohibiting the ARB from self-allocating and auctioning emissions allowances to generate revenue; (b) order the ARB that within 90 days after remand it shall receive public comment, propose, and seek court approval of a plan for the lawful distribution of all remaining unallocated emissions allowances in a cost-effective manner not inconsistent with this Court's decision; (c) seek the views of the parties on the ARB's plan and (d) issue further orders consistent with this decision, AB 32 and the public interest. Ordering compliance within

90 days after remand is necessary to avoid hindering the achievement of AB 32's emissions reduction goals and uncertainty in the marketplace.

As for the revenue already collected, the California Chamber of Commerce's complaint did not seek a refund of taxes paid for emissions allowances; consequently that question is not before this Court.

Dated: May 23, 2016

Respectfully submitted,

NIELSEN MERKSAMER
PARRINELLO GROSS & LEONI LLP

JAMES R. PARRINELLO
CHRISTOPHER E. SKINNELL
Attorneys For Appellants and Petitioners
California Chamber of Commerce and Larry Dicke

DECLARATION OF JAMES R. PARRINELLO
IN CERTIFICATION OF BRIEF LENGTH

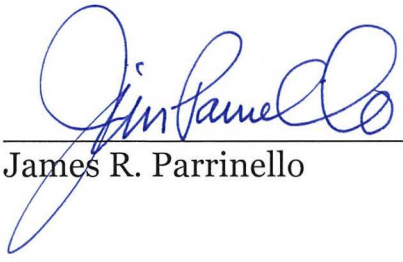
James R. Parrinello, Esq., declares:

1. I am licensed to practice law in the state of California, and am the attorney of record for California Chamber of Commerce in this action. I make this declaration to certify the page length of Supplemental Brief of California Chamber of Commerce in Response to the Court's Questions.

2. I certify that, excluding Tables, the Supplemental Brief of California Chamber of Commerce in Response to the Court's Questions is less than 30 pages in length.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct and of my own personal knowledge except for those matters stated on information and belief and, as to those matters, I believe them to be true. If called as a witness, I could competently testify thereto.

Executed on May 23, 2016, at San Rafael, California.



James R. Parrinello

Cal Chamber v. California Air Resources Board
Morning Star v. California Air Resources Board
CA Court of Appeal, 3rd Appellate District
Case Nos. C075930 and C075954

PROOF OF SERVICE

I, the undersigned, declare under penalty of perjury that:

I am a citizen of the United States employed in the County of Marin. I am over the age of 18 and not a party to the within cause of action. My business address is 2350 Kerner Blvd., Suite 250, San Rafael, California. I am readily familiar with my employer's practices for collection and processing of correspondence for mailing with the United States Postal Service and for pickup by Federal Express.

On May 23, 2016, I served a true copy of the foregoing **SUPPLEMENTAL BRIEF OF CALIFORNIA CHAMBER OF COMMERCE IN RESPONSE TO THE COURT'S QUESTIONS** on the following parties in said action, by serving the parties on the attached "Service List"

X **BY ELECTRONIC SERVICE**: By transmitting via TrueFiling to the party(ies) listed on the Service List.

Executed in San Rafael, California, on May 23, 2016.

I declare under penalty of perjury, that the foregoing is true and correct.

Paula Scott

Paula Scott

SERVICE LIST

Roger R. Martella (pro hac vice) Paul J. Zidlicky (pro hac vice) Eric McArthur (pro hac vice) Sidley Austin LLP 1501 K Street NW Washington, DC 20005 pzidlicky@sidley.com Attorneys for Intervener & Appellant *National Association of Manufacturers* ***Via U.S. Mail only***	Anthony L. Francois (SBN 184100) James S. Burling (SBN 113013) Pacific Legal Foundation 930 G Street Sacramento, CA 95814 Tel.: (916) 419-7111 tfrancis@pacificlegal.org Attorneys for Plaintiffs & Appellants *Morning Star Packing Company, et al.*
Sean A. Commons (SBN 217603) Sidley Austin LLP 555 West Fifth Street Los Angeles, CA 90013 Tel: (213) 896-6600 scommons@sidley.com Attorneys for Intervener & Appellant *National Association of Manufacturers*	Robert E. Asperger (SBN 116319) Deputy Attorney General 1300 I Street P.O. Box 944255 Sacramento, CA 94244-2550 Tel. (916) 327-7582 Bob.Asperger@doj.ca.gov Attorneys for Defendants & Respondents *California Air Resources Board, et al*
Robert W. Byrne Sr. Asst. Attorney General Molly K. Mosley Supervising Deputy Attorney General *David A. Zonana (SBN 196029) M. Elaine Meckenstock (SBN 268861) Bryant B. Cannon (SB N 284496) Deputy Attorneys General California Department of Justice 1515 Clay Street, Suite 2000 P.O. Box 70550 Oakland, CA 94612-0550 Tel.: (510) 622-2145 David.Zonana@doj.ca.gov Attorneys for Defendants & Respondents *California Air Resources Board, et al.*	Matthew D. Zinn (SBN 214587) Joseph D. Petta (SBN 286665) Shute, Mihaly & Weinberger, LLP 396 Hayes Street San Francisco, CA 94102 Tel.: (415) 552-7272 Zinn@smwlaw.com Attorneys for Interveners & Respondents *Environmental Defense Fund*

Erica Morehouse Martin (SBN 274988) Timothy J. O'Connor (SBN 250490) Environmental Defense Fund 1107 9th Street, Suite 1070 Sacramento, CA 95814 Tel.: (916) 492-4680 emorehouse@edf.org Attorneys for Interveners & Respondents *Environmental Defense Fund*	David Pettit (SBN 067128) Alexander L. Jackson (SBN 267099) Natural Resources Defense Council 1314 2nd Street Santa Monica, CA 90401 Tel.: (310) 434-2300 ajackson@nrdc.org Attorneys for Interveners & Respondents *Natural Resources Defense Council*
Sean H. Donahue Donahue & Goldberg 2000 L Street, NW, Suite 808 Washington, DC 20036 Attorneys for Interveners and Respondents *Environmental Defense Fund* ***Via U.S. Mail only***	Gavin G. McCabe Office of the Attorney General 1515 Clay St Fl 20 P.O. Box 70550 Oakland, CA 94612-0550 gavin.mccabe@doj.ca.gov Attorneys for Defendants and Respondents *California Air Resources Board, et al.*
Eric Biber (SBN 218440) UC Berkeley School of Law 699 Simon Hall Berkeley, CA 94720-7200 Eric.biber.environmental.law@gmail.com Counsel for Amicus Curiae *Dallas Burtraw, et al.*	Cara A. Horowitz (SBN 220701) Frank G. Wells Environmental Law Clinic, UCLA School of Law 405 Hilgard Avenue Los Angeles, CA 90095 horowitz@law.ucla.edu Counsel for Amicus Curiae *The Nature Conservancy*
Luke A. Wake, Esq. NFIB Small Business Legal Center 921 11th Street, Suite 400 Sacramento, CA 95814 Luke.wake@nfib.org Counsel for Amicus Curiae *NFIB Small Business Legal Center, et al.* ***Via U.S. Mail only***	Bradley A. Benbrook, Esq. Benbrook Law Group, PC 400 Capitol Mall, Suite 1610 Sacramento, CA 95814 brad@benbrooklawgroup.com Counsel for Amicus Curiae *NFIB Small Business Legal Center, et al.*

Kevin M. Fong, Esq. Pillsbury, Winthrop, Shaw, Pittman, LLP Four Embarcadero Center, 22nd Fl. San Francisco, CA 94111 Kevin.fong@pillsburylaw.com Counsel for Amicus Curiae *California Taxpayers Association* ***Via U.S. Mail only***	Damien M. Schiff, Esq. Alston & Bird, LLP 1115 11th Street Sacramento, CA 95814 Damien.schiff@alston.com Counsel for Amicus Curiae *California Manufacturers and Technology Assn.* ***Via U.S. Mail only***
California Supreme Court Clerk of the Court 350 McAllister Street San Francisco, CA 94102 ***Via E-Submission***	Sacramento County Superior Court Hon. Timothy M. Frawley 720 Ninth Street Sacramento, CA 95814 ***Via U.S. Mail only***