Yesterday, Ann and Cara gave their initial reactions to the California Chamber of Commerce lawsuit against California's cap-and-trade auction. The main thrust of that lawsuit is that the auction (that happens today) is an unconstitutional tax because, according to the lawsuit, AB 32 gave the California Air Resources Board (CARB) no authority to withhold and sell the allowances at auction, as opposed to giving away allowances to industry for free. Ann's first reaction is that an auction is not a tax, but more like the selling of state property, and therefore the lawsuit should be dismissed. I agree that the auction is not a tax, and I think it is worth going into more detail on why.

The Chamber of Commerce's Memorandum assumes, but never really tackles directly, the question of whether the auction of greenhouse gas (GHG) allowances would be a tax. Here is a summary of the litigation from the Memorandum itself: "The only thing this lawsuit challenges is the portion of the Board's regulatory program that seeks to permit the Board to allocate to itself GHG emissions allowances and to profit by selling them to GHG emitters . . . when the Board has no statutory authorization to do so and the charge would be an unconstitutional tax." Their Memorandum goes on to argue that CARB lacked authority under AB 32 to establish an auction and that AB 32 lacked the requisite supermajority vote to establish a tax. The Chamber of Commerce apparently believes that the question of whether the auction is in fact a tax is too clearcut to warrant a discussion in their initial Memorandum.

I think the reason the Chamber of Commerce fails to consider whether the auction is a tax is because the Chamber of Commerce incorrectly believes that the businesses it represents are entitled to receive free GHG allowances. The Chamber correctly perceives that businesses that pollute will need to either purchase allowances, either at auction or later on the open market, or get them for free. The Chamber then incorrectly ties that expenditure of revenue to the concept of a tax.

This line of reasoning is faulty because, at least in California, there is no right to pollute. In *Communities for a Better Environment v. SCAQMD*, the California Supreme Court found that Conoco-Phillips had

> no vested right to *pollute the air* at any particular level.

This finding goes back to a 1976 case, *Mobil Oil Co. v. Superior Court*, in which the California Court of Appeal found that oil companies do not have a vested right to release gasoline vapors from their gas pumps. And more recently, the Court of Appeal found that the owner of a vested mining right must still comply with air pollution laws because the mining right does not confer a vested right to pollute. *Hardesty v. SMAQMD.*

Because industries represented by the Chamber of Commerce have no right to pollute, they similarly have no right to be given free GHG pollution allowances from the state of California.

To simplify matters somewhat, imagine that CARB had imposed typical command-and-control technology regulations on industry GHG pollution. California taxpayers would likely be upset if CARB offered to pay to acquire and install that pollution abatement technology for free. And I am sure the Chamber of Commerce would happily accept free abatement technology. But the more likely scenario is that CARB would require, as a condition of a permit to pollute, that regulated entities purchase and install pollution abatement technology. And I would not expect the Chamber to file a lawsuit describing the imposition of technology regulations as an unconstitutional tax just because industry, not California taxpayers, would be required to pay to acquire and install the technology. (Nor would I expect such a lawsuit to win.)

In the more complex scenario of cap-and-trade, the allowances represent a valuable state property—as Ann put it—that is sold to industry participants at fair market value. In other words, the auction does not result in a tax to industry, because auction participants are purchasing a valuable allowance at fair market value. By definition, the auction results in the exchange of two items of equal market values and thus the net loss to an auction participant is zero. Therefore, this exchange is very much unlike a tax or even a regulatory fee, where value is extracted from the taxed entity. And because industry has no vested right to pollute, it has no right to get those valuable allowances for free.

Without a doubt, there is a cost to industry. But that cost comes later, when a regulated entity is required to retire valuable GHG allowances to account for its emitted pollution. And the retirement of GHG allowances is very similar to the purchase and use of technology under a command-and-control regulation. Both impose costs on regulated entities in order to account for their harmful pollution that harms society and the environment as a whole. Imposition of either a permit with technological restrictions or a market-based mechanism—such as GHG allowances—are both acceptable ways to account for harmful pollution precisely because there is no right to pollute in California.