The Emmett Center on Climate Change and the Environment has just released a new paper that describes how California law may limit the ability of California's legislature to allocate revenue from the upcoming cap-and-trade auctions. Written by fellow bloggers Cara Horowitz, Sean Hecht, Ann Carlson and myself, the paper is titled Spending California's Cap-and-Trade Auction Revenue: Understanding the *Sinclair Paint* Risk Spectrum.

This paper assesses legal constraints on AB 32 auction revenue allocation that derive from the statute itself or from California's constitutional restrictions on the use of regulatory fees (embodied in Proposition 13). Based on our findings, we make recommendations about the relative risks of approaches to allocating AB 32 state auction proceeds. The aim of our paper is to inform decisionmaking on revenue allocation; as such, we do not address broader questions about the legality of the cap-and-trade program as a whole, but focus on questions that are affected by allocation decisions.

You can download a copy of the paper here. Below, I describe the basic legal question surrounding cap-and-trade auction revenue in California.

California's first public auction under its landmark cap-and-trade program for greenhouse gases is scheduled for November 2012. Depending on the total number of allowances offered at auction (after taking into account allowances given away to industry) and the clearing price of the auction, the revenue from the auction could be significant. Projections suggest something on the order of $1 billion in the first year. When more allowances are offered at auction with the program expansion in 2015, that number could increase dramatically.

California's cap-and-trade program draws its regulatory authority from AB 32, a bill passed by a simple majority in 2008. According to Proposition 13 and its subsequent interpretation by the California Supreme Court in the *Sinclair Paint* line of cases, imposing "taxes" requires a 2/3 supermajority while imposing "regulatory fees" requires a simple majority. If the cap-and-trade auction revenue is considered within this paradigm, then CARB and the Legislature may only impose regulatory fees, not taxes, through the cap-and-trade program because AB 32 lacked a supermajority approval.

One of the tests to distinguish taxes from fees, used in *Sinclair Paint*, is to consider how the revenue will be used. Simply, the closer the use of revenue is to the goal of the regulatory program, the more likely it is that a court would find the revenue to be a constitutional regulatory fee. In the past, California courts have often found that shifting revenue from a specific regulatory program to the General Fund to be, in effect, an unconstitutional tax.

The California Legislature faces many options in choosing how to spend the cap-and-trade auction revenue. Our paper places these options on a risk scale, from likely to fail to low risk based on the possibility that a court would consider the option an unconstitutional tax. Options that support the regulatory goals of AB 32, such as funding energy efficiency projects, are less legally risky than options that go beyond the scope of AB 32.