CALIFORNIA ENERGY RESOURCES
CONSERVATION AND DEVELOPMENT COMMISSION

In the Matter of:	)	
AB 32 Implementation: Greenhouse	)	Docket 07-OIIP-01
Gases	)	
	)	

ORDER DENYING REQUEST FOR REHEARING/RECONSIDERATION OF THE FINAL OPINION ON GREENHOUSE GAS REGULATORY STRATEGIES

February 25, 2009

Introduction and Summary

On November 21, 2008, the Los Angeles Department of Water and Power (LADWP) filed a document entitled "Request For Rehearing/Reconsideration of the Los Angeles Department of Water and Power on Final Opinion on Greenhouse Gas Regulatory Strategies" (hereafter the "Request") in this docket and in the parallel docket of the California Public Utilities Commission.[1] LADWP relies on Cal. Code Regs. tit. 20, § 1720.4 as authority for seeking reconsideration and makes four legal arguments in support of its request that the Final Opinion should be modified. For both procedural and substantive reasons, we deny the Request for reconsideration as set forth below.

Procedural Context

Neither the Energy Commission's organic statute, the Warren-Alquist Act (Pub. Resources Code §§ 25000 et seq.), nor AB 32 provide for reconsideration of the decisions the Commission has made in this proceeding, nor does AB 32 contemplate the provision of judicial review of those decisions. Requests for reconsideration are normally provided for in the law to allow agencies one last opportunity to consider whether a decision should be modified in light of legal arguments that will be raised in litigation seeking review of the decision. In this case, it is not surprising that the Legislature has not provided a reconsideration process because the very essence of the Commission's work in this proceeding is to provide a *recommendation* to the California Air Resources Board (CARB) for how it should proceed to regulate greenhouse gas (GHG) emissions in the electricity sector of the California economy, and that

[1] Consistent with the reference in the Request, we will refer to the Final Opinion on Greenhouse Gas Regulatory Strategies as the "Final Opinion."

recommendation has no operative effect unless and until it is implemented in CARB's upcoming rulemaking to adopt AB 32 regulations. Were LADWP to seek judicial review of the Final Opinion today, we believe that a reviewing court would find that the request for judicial review is premature because the Final Opinion has no operative effect until its recommendations are included in CARB regulations. Plainly judicial review at this time would be a waste of the court's time and resources because of the possibility that CARB may not follow the Commission's recommendations or may modify them in ways that mitigate or eliminate LADWP's concerns.

We also note that LADWP's reliance on Cal. Code Regs. tit. 20, § 1720.4 as authority for seeking reconsideration is misplaced. That section provides:

> For the purposes of implementing of sections 25530, 25531, and 25901 of the Public Resources Code, a decision or order is adopted, issued, final, and effective on the day when the decision or order is docketed, unless the decision or order states otherwise.

LADWP apparently cites this provision because the Commission's adoption order for the Final Opinion was approved by vote of the Commission on October 16, 2008 but the order was not received in the docket until October 28, 2008. Since sections 25530 and 25901 of the Public Resources Code both provide a 30 day period for the filing of a petition for reconsideration or a petition for a writ of mandate seeking judicial review of a Commission action, LADWP apparently cites section 1720.4 of our regulations for the purpose of showing that its Request, docketed on November 21, 2008, was timely. In fact, section 1720.4 has no bearing on this proceeding. Section 1720.4 very clearly deals exclusively with the time periods for filing for reconsideration or judicial review of decisions of the Commission relating to its facility siting authority. This is made clear in section 1701 subdivision (a) of the regulations which provides:

> Unless otherwise stated, the provisions of Article 1 of this chapter [which includes section 1720.4] shall apply to the consideration of all notices and applications for any site and related facility within the jurisdiction of this commission.

Because section 1720.4 does not apply to the Commission's action adopting the Final Opinion, the 30 day statute of limitations for actions under section 25901 of the Public Resources Code ran out on November 17th (the Monday after the 30th day following the Commission's vote) and the November 21st Request could have no tolling effect on that statute. However, as noted above, in this case a request for judicial review would be premature because the Commission's Final Opinion has no operative effect at this time. Thus we do not believe that LADWP's opportunity to raise the issues it has raised in its Request has been foreclosed by the 30 day statute of limitations; LADWP would still be

able to raise these issues in litigation challenging CARB rules if the recommendations in the Final Opinion are accepted, in whole or in part, and codified in CARB regulations.

We provide this extended discussion of the procedural context for consideration of this Request because it shows that on procedural grounds alone, the Commission has good reason to deny the Request. Nevertheless, because the substantive arguments set forth in the Request will no doubt be considered by CARB during its upcoming rulemaking under AB 32 and because these arguments may also be made in support of a request for judicial review of CARB's regulations should CARB accept the Commission's recommendations in whole or in part, we choose to address both the policy choice that is challenged in the Request and the four legal arguments made in the Request that contend that this policy choice is legally invalid. The remainder of this order is intended to assist CARB, and potentially a reviewing court, in its consideration of the substantive arguments LADWP has outlined in the Request.

Policy Context

The decision the Request seeks to have revised contains a broad-based suite of recommendations for the electricity sector, including a 33 percent renewable portfolio standard, all cost-effective energy efficiency, and CARB adoption of a cap and trade program, preferably at the regional level if the statutory requirements for such a program can be met.

LADWP's Request focuses on the cap and trade recommendations, which LADWP asserts will negatively impact LADWP if such a program is ultimately implemented by CARB as recommended in the Final Opinion.

With respect to the cap and trade recommendations at issue here, the decision the Request seeks to have revised contains a careful balancing of conflicting interests with a focus on both reducing the adverse economic effect on utilities that have historically depended on high-emitting resources in the early years of the program and creating the right, long-term incentives for ultimate achievement of AB 32 goals. Throughout the proceeding that led to this decision, the Commission examined the merits and potential impacts of several allocation methods. First, there are strong advocates for allocation of allowances based on historic fuel use and historic emissions. This allocation method most strongly mitigates the impact of a new regulatory regime on industry participants, but it also reduces the incentive to change the generation mix in a way that helps to achieve AB 32 goals. A second approach is to allocate allowances based on electricity output or sales. This creates the right incentive going forward to create and maintain the output of low-emitting resources, but it adversely affects entities that have made long term investments in high emitting resources. A variation on the second approach is to allocate allowances based on electricity output or sales, but to differentiate among fuels

such that electricity generated from high-emitting fuels (e.g. coal) receives more allowances than electricity generated from lower-emitting fuels. This variation, like allocation based on historical emissions, mitigates the impacts of the program on high-emitting industry participants. The Commissions also considered whether allowances should be allocated to deliverers[2] or retail providers of electricity, and whether they should be auctioned or freely allocated. If allowances are auctioned, the options for redistributing auction revenues are nearly identical to the options for allocating allowances (historical fuel use, output or sales based, and fuel-differentiated output or sales based) and have similar advantages and disadvantages.

Ultimately, the Commission settled on a compromise among these options, calling for initial allocation that combines a fuel-differentiated output-based approach and a historical fuel use approach in order to reduce near-term financial impacts on retail providers, and transitioning to allocation based purely on output (sales) by no later than 2020 in order to facilitate a rapid transition to less greenhouse gas intensive operations at all retail providers.[3] The essential recommendations that achieve this result are:

> 9. We recommend that, for 2012, ARB distribute 20% of the allowances allocated to the electricity sector to retail providers, with a requirement that they sell the allowances through a centralized auction undertaken by ARB or its agent, and distribute 80% of the allowances without cost to electricity deliverers.
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> 10. We recommend that ARB increase the portion of allowances allocated to the electricity sector that are distributed to retail providers and sold at auction by 20% each year, so that in 2016 and each year thereafter all of the electricity sector allowances are auctioned through a centralized auction undertaken by ARB or its agent.
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> 11. We recommend that for the portion of allowances distributed to deliverers, ARB distribute the allowances using a fuel-differentiated output based approach with distributions limited to deliverers of electricity from emitting generation resources (including electricity from unspecified sources, and regardless of whether the electricity is generated inside or outside of California), as described in this decision.
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> 12. We recommend that, if ARB either adopts less than 100% auctioning as the ultimate goal for electricity sector allowances or phases in 100% auctioning later than 2016, ARB phase out the weighting factors used to determine allowance

[2] Deliverers are defined as (1) generators in California and (2) those who own energy that is generated outside California when it is brought into the state.

[3] An additional transition from primarily free distribution of allowances to deliverers to auction-based distribution of allowances to retail providers of electricity by 2016 is also provided for in the Decision.

distributions to deliverers starting in 2016, so that the distribution methodology would transition to a pure output-based approach by 2020.

13. We recommend that, for electricity sector allowances that will be auctioned, ARB distribute all or almost all allowances to retail providers on behalf of consumers, with the requirement that each retail provider sell the allowances in a centralized auction undertaken by ARB or its agent and receive all resulting revenues. The recommendation that retail providers be required to sell their distributed allowances does not apply to allowances that a vertically integrated entity that is both a retail provider and a deliverer may receive based on its deliveries to the grid.

14. We recommend that ARB initially distribute electricity sector allowances to retail providers (which will be required to sell them through the centralized auction) in proportion to the historical emissions of the retail providers' portfolios, transitioning to a sales basis by 2020.

15. We recommend that ARB require that all allowance auction revenues be used for purposes related to Assembly Bill (AB) 32, and that ARB require all auction revenues from allowances allocated to the electricity sector be used to finance investments in energy efficiency and renewable energy or for bill relief, especially for low income customers.

16. We recommend that ARB allow the Public Utilities Commission for load serving entities and the governing boards for publicly-owned utilities to determine the appropriate use of retail providers' auction revenues consistent with the purposes of AB 32 and the restrictions recommended in Ordering Paragraph 15.

17. We recommend that ARB require each publicly-owned utility to demonstrate annually to the Energy Commission that its use of auction revenues during the prior year was consistent with the purposes of AB 32 and the restrictions recommended in Ordering Paragraph 15.

18. We recommend that ARB, in consultation with the Public Utilities Commission and the Energy Commission, condition free distribution of allowances to each retail provider on a demonstration of adequate progress in complying with energy efficiency and renewable energy procurement targets established for the retail provider.

Because LADWP is a vertically integrated utility, if these recommendations are adopted in a cap and trade program implemented by the ARB, it will mean that LADWP would receive nearly all of the allowances it needs to continue the use of its coal-fired resources outside California in 2012 but that in succeeding years there would be a rapid transition to allocation based on the output of LADWP's resource mix with less and less

allocation based on historic emissions. This would cause LADWP to have to choose between purchasing more allowances in order to keep its high-emitting resources in operation or replacing their output with lower emitting resources. It would also place a premium on achieving energy efficiency targets, thus lowering the total amount of allowances that LADWP needs for its generation operations. The exact formulae defining how quickly the transition would occur are not provided by the Final Opinion. It is presumed that these details will be worked out in the upcoming CARB rulemaking, though the Final Opinion does suggest that however fast the transition to output-based or sales-based allocation occurs, it should be completed no later than 2020.

In its Request, the essence of LADWP's argument is that this recommended method of distributing allowances and the revenues from the auction of allowances to retail providers of electricity should be revised because LADWP believes that the recommendations in the Final Opinion will place a more severe financial burden on LADWP than projected in the modeling and analysis that led to the Final Opinion. However, ARB is required to do its own detailed analysis of the impacts of any proposed cap and trade program prior to implementing it.

LADWP characterizes allocation of allowances based on output (MWh) as creating a "wealth transfer[4]" because LADWP anticipates that it will need to buy allowances from other utilities who have more than they need to cover the emissions resulting from serving their loads.[5] (See Request, p. 3 contending that our recommended allocation methodology "unfairly and unlawfully rewards utilities with legacy nuclear and hydro resources at the expense of utilities that have legacy coal.") But as noted by the Northern California Power Agency, representing other publicly owned utilities, an allocation system that grants more allowances to utilities with investments in high emitting resources can be just as easily characterized as "a 'wealth transfer' from [utilities with] low-emitting resources, to those with higher GHG emitting resources [if the high-emitting resourced utilities are] granted allowances based on historic

[4] The Final Opinion employs the terms "wealth transfer(s)" and "transfer of wealth." These terms are terms of art used by economists. The Final Opinion does not use these terms to mean an actual transfer of wealth in the manner alleged by LADWP, i.e. taking money from the pockets of LADWP and giving it to another retail provider, namely an investor-owned utility. Rather, the Final Opinion uses these terms of art as a short-hand for describing the different cost impacts on customers of retail providers who historically have had higher emission levels and customers of retail providers who have had lower emission levels in the past. As the Final Opinion concludes, each retail provider and their customers eventually (after the phase in period) will be responsible for bearing the actual costs of their emissions that result from the retail providers' decisions about the resources to use to provide electricity. Thus, LADWP's literal reading misconstrues how the Final Opinion utilizes these terms.

[5] In fact, if the recommendations in the Final Opinion are implemented, LADWP would not necessarily be purchasing allowances from other utilities. The cap and trade program is anticipated to include many sectors in addition to the electricity sector and LADWP could purchase allowances either from the centralized auction into which some allowances will be required to be contributed for sale or from any party that was willing to sell them.

emissions." (Response of the Northern California Power Agency to the Request for Rehearing/Reconsideration of D.08-10-037, p. 4.)

In the early years of AB 32 implementation, our Decision arguably recommends just such a "wealth transfer" to LADWP and other utilities that have historically relied on high-emitting resources in order to cushion the financial impact that would occur to such utilities if AB 32 were implemented based on pure output-based or sales-based allocations from the beginning. It also provides them a clear signal that they should commence immediately to transition their supply plans away from high-emitting resources and to achievement of the maximum cost effective efficiency among their customers. While there may be no party that is fully satisfied with the length of time we have recommended for this transition, we find that LADWP has not provided any compelling rationale for changing the compromise embodied in our recommendations, and we reiterate that this is a recommendation to ARB. Should ARB proceed with a cap and trade element, ARB will conduct extensive modeling and public rulemakings to formulate their conclusions on the appropriate balance across all regulated sectors.

The remainder of this order will respond to the specific legal arguments LADWP has raised in its Request. As detailed below, we find that all of those arguments lack merit.

Specific Responses to Legal Arguments

1. The Decision's Recommendations Do Not Violate Article XIIIA of the California Constitution (Proposition 13). LADWP argues that requiring it to purchase allowances at auction amounts to imposing a tax, in contravention of Article XIIIA of the California Constitution, because such auctions will yield revenues in excess of programmatic costs. (*Request*, pp. 5-6.) Article XIIIA of the California Constitution provides that "any changes in State taxes enacted for the purpose of increasing revenues . . . must be imposed by an Act passed by not less than two-thirds of all members elected to each of the two houses of the legislature." It is undisputed that AB 32 was not passed with a two-thirds majority.

However, the cap and trade system proposed in the Decision is not "enacted for the purpose of increasing revenues" and, thus, is not prohibited by Article XIIIA. If an imposition is intended as a regulatory measure, and the generation of revenue is not its primary objective, then the fact that revenue is ultimately generated does not make the imposition a tax. (*Sinclair Paint Company v. State Board of Equalization* 15 Cal.4th (1997) 866, 880.) The cap and trade system proposed in the Decision has the sole purpose of helping to reduce the total GHG emissions in the state to the mandated levels by 2020. (*Final Opinion*, p. 10.) The Decision clearly recommends that any revenues generated should be used to further this goal. (*Final Opinion*, p. 16.) Most important, the cap and trade program does not impose a monetary exaction at all; rather it caps

emissions, allocates allowances sufficient to allow economic activity that meets the cap, and then imposes a choice to all emitters to *either* reduce their emissions to match their allocation of allowances *or* acquire more allowances through an auction or a secondary market. It is therefore even more clearly a regulatory program than was the one the Supreme Court approved in *Sinclair Paint*.

In *Sinclair Paint*, the paint industry questioned the state's authority to impose fees on the paint industry to compensate for adverse impacts resulting from lead-based paints. The Supreme Court found that the state's police power is extensive enough to allow for the imposition of fees to mitigate for "the past, present, or future adverse impact of the fee payer's operations" where there is a "nexus between the product and its adverse effects" and held that such fees are not a tax under Article XIIIA. (*Sinclair Paint* at pp. 877-878.) Thus, LADWP's contention that revenues may only be generated from the sale of allowances to the extent that they do not exceed the administrative costs of implementing AB 32 is unfounded.[6] Additionally, the Court in *Sinclair Paint* acknowledged the value of imposing substantial fees as a means of regulating conduct by deterring the manufacture of products that create adverse impacts and encouraging the search for alternatives. (*Sinclair Paint* at p. 877.) Requiring utilities to purchase allowances for their GHG emissions, as proposed in the Final Opinion, is a means of encouraging them to reduce their emissions and pursue alternative means of generating electricity that does not result in GHG emissions. (*See Final Opinion*, pp. 9-10.) This approach is consistent with the *Sinclair Paint* holding, is supported by the record, and does not transform the imposition into a tax.

LADWP argues that the joint agencies have the burden of proving that the requirement to purchase allowances bears a "fair or reasonable relationship to the payor's burdens on or benefits from the regulatory activity," but fails to show how we have fallen short of meeting this burden. (*See* Request pp. 7-8.) In fact, the Final Opinion is replete with discussions concerning the proportionality of the electric sector's responsibility for reductions under a cap-and-trade system as compared to other sectors and analyses concerning how the various allowance allocation options compare in terms of equitability among the affected market participants. (*See* Final Opinion, pp. 120 and 129-131 [discussing proportionality and emphasizing "the need to allocate the allowances proportionally among the sectors in the cap-and-trade program…"]; pp. 137-147 and 202-205 [discussing equity among market participants as one of the criteria that guided the joint agencies' evaluation of allowance allocation options; p. 170 [determination that an auction system would "treat all deliverers, including new entrants, equally."]; and 206-218 discussing the joint agencies' recommendations for allowance allocation and how these recommendations best ensure equitable treatment.].)

[6] We note that the only support cited for the proposition that revenues must be so limited is LADWP's own comments in the proceeding.

Even assuming arguendo that Article XIIIA of the California Constitution applies to a regulatory requirement to purchase allowances at auction, the Final Opinion contains sufficient analyses to show that the auction design and allowance allocation system recommended bears a fair and reasonable relationship to LADWP's (and other market participants) burdens on and benefits from the regulation of GHGs. Additionally, as ARB considers and further refines these recommendations in its AB 32 rulemaking, it will also likely augment the analyses to provide additional proof of the equitableness of the final market design.

We also note that LADWP appears to be confusing the requirement for proportionality in the exactions of a pure regulatory fee program with CARB's indication in the AB 32 Scoping Plan that CARB will be looking to achieve approximately 40 percent of the needed GHG emissions reductions from the electricity sector compared with that sector's current contribution of approximately 25 percent of the GHG emissions. As noted above, CARB's Scoping Plan includes many programs, most of which are direct regulatory programs (i.e. the renewable portfolio standard and a variety of minimum efficiency standards) and only a portion of which relies on the possible cap and trade program. To the extent that the cap and trade program is held to be a *Sinclair*-type regulatory fee program with proportionality requirements, it may well be that CARB will have to ensure that the electricity sector is not treated significantly more harshly by the cap and trade program than other sectors, but that does not mean that CARB could not still reasonably and legally expect that the combination of direct regulatory programs together with the proportionally weighted cap and trade program would achieve a higher percent reduction in GHGs within the electricity sector than will be feasible in other sectors by 2020.

2. The Decision's Recommendations Do Not Violate Article XI, Section 5(a) of the California Constitution (Home Rule). In its Request, LADWP argues that if adopted, the Final Opinion's recommendations would be an unconstitutional violation of the home rule principle set forth in Article XI, Section 5(a). (*See* Request at p. 8-9.) Specifically, the LADWP states that "any allocation method that diverts significant resources from the LADWP will undermine its renewable procurement program," because, due to resource constraints, "if the LADWP is forced to make significant purchases of allowances for its operations, the LADWP will not at the same time be able to pursue the ambitious renewable procurement program (including an RPS of 35% in 2020) that the LADWP has adopted in the exercise of its home rule powers." (*Id.* at p. 8-9.)

The "municipal home rule" provision in the California Constitution reads:

> It shall be competent in any city charter to provide that the city governed thereunder may make and enforce all ordinances and regulations in respect

> to municipal affairs, subject only to restrictions and limitations provided in their several charters and in respect to other matters they shall be subject to general laws. City charters adopted pursuant to this Constitution shall supersede any existing charter, and with respect to municipal affairs shall supersede all laws inconsistent therewith.

(Cal. Const. Art. XI, Sec. 5(a)). Courts apply the following 3-part test to determine when state law (or practice) impermissibly infringes on municipal affairs, in violation of Section 5(a):

First, a court must determine whether there is a genuine conflict between a state statute and a municipal ordinance. Only after concluding there is an actual conflict does a court proceed with the second question; i.e., does the local legislation impact a municipal or statewide concern? Finally, if a genuine conflict is presented and the state statute qualifies as a matter of statewide concern, "we next consider whether it is both (i) reasonably related to the resolution of that concern, and (ii) 'narrowly tailored' to limit incursion into legitimate municipal interests." (*Cobb v. O'Connell* (2005) 134 Cal. App. 4th 91, 96 (citations omitted)); *Trader Sports, Inc. v. City of San Leandro* (2001) 93 Cal. App. 4th 37, 46 (quoting same language); *see Johnson v. Bradley* (1992) 4 Cal. 4th 389, 399 (explaining this test in detail).)

The LADWP's arguments fail this test in two ways.

A. The LADWP has identified no genuine conflict between municipal and state law.

At the threshold, "a court asked to resolve a putative conflict between a state statute and a charter city measure initially must satisfy itself that the case presents an actual conflict between the two. If it does not, a choice between the conclusions 'municipal affair' and 'statewide concern' is not required." (*Johnson v. Bradley, supra,* 4 Cal. 4th at p. 399-400.) Furthermore, "[t]o the extent difficult choices between competing claims of municipal state governments can be forestalled in this sensitive area of constitutional law, they ought to be; courts can avoid making such unnecessary choices by carefully insuring that the purported conflict is in fact a genuine one, unresolvable short of choosing between one enactment or another. (*Johnson v. Bradley*, 4 Cal. 4th at p. 399 (citing *California Fed. Savings & Loan Assn. v. City of Los Angeles* (1991) 54 Cal.3d 1, 16-17).)

Cases have recognized only express conflicts between state and municipal laws (or practices) as "genuine conflicts" for the purpose of Section 5(a). Examples include a state law which said a 2/3 majority was required to put a certain tax on the ballot, but municipal law said only a simple majority is required (*Trader Sports, Inc. v. City of San*

Leandro (2001) 93 Cal. App. 4th 37); a municipal charter provision providing for public campaign financing, while a state law expressly prohibited public financing of campaigns (*Johnson v. Bradley*, *supra*, 4 Cal. 4th 389); and a municipal contract for public work, with wage and hour terms that violated state law (*City of Pasadena v. Charleville*, (1931) 215 Cal. 384, 391-392).

A genuine conflict would exist if LADWP wished to provide utility services to its citizen ratepayers and the Legislature enacted a law requiring service by private companies. Obviously, this is not the case. LADWP is free to provide utility service subject to the same environmental regulations that every other California electric utility entity must follow. What LADWP seems to be arguing is that if those regulations make it more difficult for LADWP to successfully provide service at low rates that, in itself, constitutes a genuine conflict. It does not. The California Constitution does not guarantee municipalities that decide to enter the business of providing utility service a regulatory environment that will make it possible for them to provide their ratepayers services at low rates. When municipalities go into the business of providing electricity, they face the same general laws and market forces that private companies face with the exception that they enjoy certain tax advantages under current state and federal laws and, in some cases, they may enjoy priority access to low cost legacy federal hydro power. These advantages aside, municipal utilities, like investor-owned utilities, must make good judgments about how to build a generation and/or energy contract portfolio that will allow them to serve their customers at reasonable rates. And unfortunately, the risks attendant to any given fuel choice may not always be perfectly clear to any utility making that choice. For example, utilities that have invested in natural gas fired power for its relatively low capital cost have suffered economic pain when the price of natural gas has gone up. Utilities that have invested in nuclear power plants have suffered economic pain when there have been capital cost overruns or emerging safety concerns that adversely affect the amount of energy they can produce from such plants. Utilities like LADWP that have chosen to rely on coal-fired power have enjoyed relative fuel price stability, but for decades the scientific community has warned that carbon emissions could result in global climate change. (See e.g. National Academy of Sciences, Committee on Atmospheric Sciences Panel on Weather and Climate Modification (1966) *Weather and Climate Modification: Problems and Prospects (2 Vols.)*. Washington, DC: National Academy of Sciences [“We are just now beginning to realize that the atmosphere is not a dump of unlimited capacity.”]; Weinberg, Alvin (1974) "*Global Effects of Man's Production of Energy*" *Science* 186: 205 [“The problem of global effects of energy production…is everyone’s problem….”].) Thus the risk those utilities have run is that the lower costs they have enjoyed by burning coal in the past might not continue if carbon regulation became necessary, and their investment in that technology might or might not be amortized as they hoped it would be when that was their choice of fuel. That is what is happening in the implementation of AB 32.

LADWP identifies no city charter provision, municipal ordinance, or other law or practice in genuine conflict with the recommended implementation of AB 32 in the Final Opinion. Instead, LADWP asserts that requiring it to acquire allowances for its greenhouse gas emissions would divert financial resources from its renewable energy procurement program. LADWP does not explain how being required to purchase allowances for its greenhouse gas emissions would preclude it from acquiring renewable resources. It cites no authority for the proposition that a regulatory scheme of the state might create an "unresolvable conflict" with a municipal law or practice simply due to the municipality's limited financial resource and its desire not to raise its customers' rates. If anything, the recommendations in the Final Opinion (and the thrust of AB 32 generally) would *encourage* the acquisition of new renewable energy resources. Plainly, just as the choice utilities have made to rely on natural gas, nuclear, or coal to supply their customers has involved economic risk, so does the choice some utilities have made to rely on renewable generation which has tended to have higher capital costs and, in the absence of carbon regulation, higher overall costs per kilowatt hour. One of the main purposes of providing for a cap and trade program as part of the implementation of AB 32 is to provide low emission resources a level playing field as utilities make these investment choices today and in the future.

B. The Final Opinion reasonably relates to, and is narrowly tailored to, the resolution of a matter of statewide concern.

Even if LADWP's managed to identify a municipal law or practice in genuine conflict with the regulatory scheme proposed in the Final Opinion, its argument would still fail. Where a genuine conflict exists between a state law and a municipal law, the state law will prevail so long as it (1) reasonably relates to the resolution of a statewide concern, and (2) is narrowly tailored to that purpose. *See Johnson v. Bradley*, *supra*, 4 Cal. 4th at p. 399.

As the Supreme Court explained, this determination boils down to a question of policy:

> As applied to state and charter city enactments in actual conflict, "municipal affair" and "statewide concern" represent Janus-like, ultimate legal conclusions rather than factual descriptions. Their inherent ambiguity masks the difficult but inescapable duty of the court to, in the words of one authoritative commentator, "allocate the governmental powers under consideration in the most sensible and appropriate fashion as between local and state legislative bodies."

(Ibid, citing *California Fed. Savings & Loan Assn. v. City of Los Angeles*, *supra*, 54 Cal.3d at p. 17 (citation omitted)).

1) *Recommendations in the Final Opinion reasonably relate to resolution of a legitimate statewide concern.*

Determining the nexus between a state law that potentially infringes on a municipal activity and a legitimate statewide concern requires "the identification of a convincing basis for legislative action originating in extramunicipal concerns, one justifying legislative supersession based on sensible pragmatic considerations. In other words, we must be satisfied that there are good reasons, grounded on statewide interests, to label a given matter a statewide concern." (*Johnson v. Bradley, supra,* 4 Cal. 4th at p. 405 (quotations omitted)).

The California Supreme Court has found coordinated action to prevent environmental degradation to be a matter of statewide concern. In *People ex rel. Younger v. County of El Dorado* (1971) 5 Cal. 3d. 480, the Court rejected arguments that the establishment of the Tahoe Regional Planning Agency infringed on municipal affairs, finding that the protection of environment in Lake Tahoe was an extra-municipal concern. The Court wrote: "The air which the Agency must protect knows no political boundaries . . . . Only an agency transcending local boundaries can devise, adopt and put into operation solutions for the problems besetting the region as a whole." (*Id.* at pp. 493-94.) Similarly, the Court of Appeals rejected a objection to the Coastal Zone Conservation Act of 1972 on the ground it violated the home rule principle established in Section 5(a), reasoning that "it can be safely said that where the activity, whether municipal or private, is one which can affect persons outside the city, the state is empowered to prohibit or regulate the externalities." (*CEEED v. California Coastal Zone Conservation Com.* (1971) 43 Cal.App.3d 306, 320 (quotations omitted) (citing *People ex rel. Younger, supra*)).

Here, both AB 32 and the Final Opinion reasonably relate to a matter of statewide concern: minimizing the state's greenhouse gas emissions in order to avoid or mitigate the environmental degradation caused by global climate change. LADWP is an emitter of greenhouse gases, an externality that "knows no political boundaries," and "which can affect persons outside the city." (*See People ex rel. Younger, supra,* 43 Cal. 3d at p. 493; *CEEED, supra,* 43 Cal. App.3d at p. 320.) "The state is entitled to prohibit or regulate externalities" such as greenhouse gas emissions. (*See CEEED, supra,* at p. 320.) Furthermore, an externality such as greenhouse gas emissions is, by definition, an "extramunicipal concern," which "pragmatic considerations" dictate can only be regulated through coordinated statewide action. (*See Johnson v. Bradley, supra,* 4 Cal. 4th at p. 405; *CEEED, supra,* at p. 320).

Therefore, it is highly likely that California courts would conclude that the recommendations in the Final Opinion, if implemented in ARB regulations, reasonably relate to the resolution of a matter of statewide concern.

2) *Recommendations in the Final Opinion are "narrowly tailored" to resolution of a legitimate state purpose.*

According to the court in *Johnson v. Bradley*, the state statute must not only reasonably relate to a legitimate state interest, but be "narrowly tailored" to this purpose. The concern is that "the sweep of the state's protective measures may be no broader than its interest." (*California Fed., supra*, (1991) 54 Cal.3d 1, 25 (quoted by *Johnson v. Bradley*, *supra*, (1992) 4 Cal. 4th 389 at p. 400)).

LADWP no doubt takes comfort in the words "narrowly tailored" which would seem to suggest that the state bears a heavy, independent burden in showing that its laws intrude minimally on municipal affairs.[7] In fact, a comprehensive survey of cases considering state laws alleged to violate Section 5(a) of the California Constitution discloses no instance where a law was found to "reasonably relate" to a legitimate statewide interest, while also <u>not</u> being "narrowly tailored" to that purpose.[8] In contrast, each case that found a state law not "narrowly tailored" to a legitimate state purpose did so only after finding that the state and municipal laws related more to municipal affairs than a statewide concern. (*See e.g. Trader Sports, Inc. v. City of San Leandro* (2001) 93 Cal. App. 4th 37, 48).

In fact, courts seem to be quite deferential once a law is found to reasonably relate to resolution of a legitimate state interest. In *Cobb v. O'Connell* (2005) 134 Cal. App. 4th 91, 94, for example, the Court of Appeals rejected an argument that the state legislature's temporary seizure of Oakland's school board during a financial crisis was not narrowly tailored to the state's interest in education, because less intrusive means might have been available to the state. The court wrote: "We cannot say that the option appellants propose would have sufficiently dealt with the fiscal problems facing the Oakland school district. We are unable to second guess the legislature's judgment in this regard." (*Ibid*.)

In light of the above, we conclude it is unlikely that a court would second guess the CEC, the CPUC, and the ARB, and find that the proposed regulatory scheme proposed in the Final Opinion is not "narrowly tailored" to a legitimate state interest, particularly in light of the mandate of *City of Fresno v. Pinedale County Water Dist.* (1986) 184

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[7] For example, these same words form part of the strict scrutiny test courts use to evaluate laws that discriminate on the basis of race. (*See e.g. Korematsu v. United States* (1944) 323 U.S. 214 [affirming the constitutionality of Japanese internment]).

[8] The "narrowly tailored" concept is a relatively recent addition to home rule analysis. The words were first applied to Article XI, Section 5(a) in dicta by the Supreme Court *California Fed. Savings & Loan Assn. v. City of Los Angeles* , *supra*, (1991) 54 Cal.3d 1, 25, and were incorporated into the home rule test the following year by *Johnson v. Bradley*, *supra*, 4 Cal. 4th at p. 399.

Cal.App.3d 840, 846 (when there is a "fair, reasonable and substantial doubt whether a matter is a municipal or state affair, the doubt must be resolved in favor of the legislative authority of the state").

3. The Decision's Recommendations Do Not Violate Article XIII, Section 19 of the California Constitution. In its Request LADWP contends that the Final Opinion's recommendation that the electricity generators be required to acquire GHG emissions allowances violates article XIII, section 19 of the California Constitution ("Section 19") because it amounts to an imposition of a tax or license fee on public utilities that is different from that imposed on mercantile, manufacturing, and other businesses. (Request, pp. 11-12.) At the outset, we repeat that an allowance requirement is not a tax at all but is rather a regulatory mechanism that may or may not result in payment of money by LADWP and other utilities, depending on their success in helping their customers reduce their loads and also depending on their resource choices. Moreover, even if the allowance requirement were considered a tax, LADWP's argument ignores the limited scope of the taxes at issue in Section 19, is inconsistent with the California Supreme Court's interpretation of the scope and applicability of Section 19, and is, therefore, unsupported by law.

Article XIII, section 19 of the California Constitution provides, in relevant part:

> The Board shall annually assess (1) pipelines, flumes, canals, ditches, and aqueducts lying within 2 or more counties and (2) property, except franchises, owned or used by regulated railway, telegraph, or telephone companies, car companies operating on railways in the State, and companies transmitting or selling gas or electricity. This property shall be subject to taxation to the same extent and in the same manner as other property.
>
> No other tax or license charge may be imposed on these companies which differs from that imposed on mercantile, manufacturing, and other business corporations. This restriction does not release a utility company from payments agreed on or required by law for a special privilege or franchise granted by a government body.

As discussed above, the cap and trade system approved in the Final Opinion is not a revenue generating system at all, and the required purchase of emissions allowances is not the payment of a tax but rather more in the nature of a "tipping fee" for use of the atmosphere for disposal of a waste product.

Additionally LADWP's argument fails because the purpose of Section 19 is to prevent variation in *property* tax rates among different industries, not in *all* categories of taxes. (*ITT World Communications, Inc. v. City and County of San Francisco* (1985) 37 Cal.

3d 859, 862 ("In 1935 the current system of ad valorem unit taxation of public utility property, now defined by article XIII, section 19 of the California Constitution … came into effect.").) Indeed both the plain language of Section 19 and the historical facts giving rise to the present-day Section 19 affirm that Section 19 applies only to locally levied property taxes.

The California Supreme Court in 1985, in interpreting the proper scope and application of Section 19, recounted that Section's evolution and its varied prior iterations and scope. (*ITT World Communications, supra,* 37 Cal. 3d at 862-863, *citing* Bertane, *The Assessment of Public Utility Property in California* (1973) 20 UCLA L. Rev. 419 ("Bertane, *Public Utility Property*").) The high Court noted that, by a 1911 constitutional amendment, the State took over complete control of taxing public utility property from local governments and implemented a single, special gross receipts "in lieu" tax to be imposed by the State. (*Id.* at 862.) Pressed by the "crisis in taxation" during the Great Depression, the Legislature and voters in 1935 chose to again amend the Constitution. (*Id.* at 862-863.) The 1935 predecessor to current Section 19 (art. XIII, section 14) "completely revised this system of taxation" wherein the state "in lieu" tax was "repealed" (*id.* at 863), the State Board of Equalization was charged with *assessing* public utility property, and public utility property was then "subjected to taxation locally at the rates fixed for taxation of property in the respective taxing jurisdictions" (Bertane, *Public Utility Property*, at 425). In other words, only after the utility property was assessed by the State, a local government would then impose its property taxes on the public utility in the same manner as it imposed property taxes on other types of businesses within its jurisdiction (the "comparability requirement"). Section 19's comparability requirement, therefore, applies only to *property* taxes levied on public utilities and not to other types of tax, as LADWP argues. As the requirement to obtain and surrender emissions allowances matching a utility's actual emissions from its operations cannot by any fair stretch be characterized as an ad valorem-like tax on utility property, LADWP's reliance on Section 19 is misplaced.

Further, LADWP's Section 19 argument is contrary to the California Supreme Court's declaration on the scope and applicability of Section 19. In holding that the State's role in *valuing* public utility property is separate and distinct from a local government's role in *imposing and collecting* property taxes, the California Supreme Court so held that the comparability requirement of Section 19 on which LADWP relies (*i.e.*, "No other tax or license charge may be imposed on these companies which differs from that imposed on mercantile, manufacturing, and other business corporations") applies only to local governments, *not* to the State. (*ITT World Communications*, 37 Cal. 3d at 869-871.)

> As stated, the purpose of article XIII, section 19, is broadly to authorize the unit taxation of public utility property, and more narrowly to "[a]ssure [] adequate valuation of utility property."

> By requiring that public utility property be "subject to taxation to the same extent and in the same manner as other property," article XIII, section 19, does not impose a requirement of equal valuation between public utility and other property, but simply specifies that public utility property, after it has been placed on the local tax rolls, be levied on at the same *rate* as locally assessed property, instead of being subject to a special gross receipts "in lieu" tax. In other words, this comparability requirement was not intended to apply to the *valuation* of public utility property,[by the State] but only to its *taxation* after assessment [by local governments].

(*Id.* (emphasis in original; internal citations omitted).) The Court concluded, "Thus, the original language and structure of present article XIII, section 19, clearly separated the [State's] *assessment* of public utility property from the [local government's] *taxation* of such property, and required only that the property be *taxed* equally with other property and not that it be *valued* on the same basis." (*Id.* (emphasis in original); *see also id.* at 871, *quoting* Plan for Tax Relief presented in Sen. Const.Amend. No. 30 and Assem. Const.Amend. No. 68 to be Submitted as Prop. 1 on Ballot of June 27, 1933, p. 8 ("The Legislature's official analysis of former article XIII, section 14 []notes that public utility property will be 'return[ed] … to the *local* tax rolls to be *taxed in the same way as other property is taxed*…." (emphasis added)).) California case law since the 1935 amendment on the scope and applicability of Section 19 similarly focuses on limiting the "comparability requirement" to taxation by local municipalities and counties. (*Pacific Gas and Electric Co. v. City of Oakland* (2002) 103 Cal. App. 4th 364, 366, 370, *citing City of Oceanside v. Pacific Tel. & Tel. Co.* (1955) 134 Cal. App. 2d 361, 365-366 and *City of Livermore v. Pacific Gas and Electric Co.* (1981) 120 Cal. App. 3d 1001, 1005-1006.) "The purpose of section 14 [renumbered as Section 19 in 1974] was to prevent *local* taxing authorities from discriminating against public utilities." (*Id.* at 366 (emphasis added).)[9] Although LADWP quotes but a portion of Section 19 to suggest that the ARB's allocation of allowances is unconstitutional, "[w]hen the entire section [19] is read as a whole it is apparent that the section provides a limitation on the power of *municipalities* to tax public utilities." (*City of Oceanside, supra,* 134 Cal. App. 2d at 366 (emphasis added).)

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[9] California courts have held that the legal constructions of the 1935 version art. XIII, section 14 and of the current art. XIII, section 19 of the Constitution are identical. (*City of Oakland, supra,* 103 Cal. App. 4th at 367. *See also Indep. Energy Producers Assoc., Inc. v. State Bd. of Equalization* (2004) 125 Cal. App. 4th 425, 441.) "The history of section 19 and its predecessor former section 14 … prohibits municipalities from unfairly extracting excessive taxes from utilities by requiring that they be taxed in conformity with taxes imposed upon other business." (*Id.,* at 370, *citing City of Livermore, supra,* 120 Cal. App. 3d at 1005-1006.)

In short, in light if this case law, Article XII, Section 19, far from providing a broad constitutional rule that there can be no difference between taxes and license fees for utilities as are provided for other kinds of businesses, is narrowly limited to how utility property is taxed and its principal limitations apply only to local government, not to state taxes and regulatory fees.

Finally, even if Section 19 were not limited as described above, of course, it would not have any application to the cap and trade program being designed to implement AB 32. As noted above, the requirement to acquire and surrender allowances to match emissions, while it may well have an economic impact on the regulated entity, is not a tax at all but rather is better characterized as a fee for the use of the atmosphere as a dumping ground for GHGs. Moreover, the cap and trade program does not require utilities to pay a special license fee for being utilities; it simply requires them pay the same "fee" per ton of GHG emissions that every other industry will be required to pay. The economic impact of the need to acquire and surrender allowances will be proportional to each emitter's use of the atmosphere, and if the economic impact on a utility is greater than on other industries, that will be a function of the utility's choices of generation and the relative need for each industry to use the atmosphere for disposal of GHGs. In short, while some utilities may face a larger economic impact than some non-utility industries, that is not due to some form of discrimination in the cap and trade program against utilities but rather simply because the utilities may find it necessary to emit more GHGs than most non-utility industries. This sort of even-handed regulation, targeted at the problem the state is legitimately addressing, and applied in direct proportion to the contribution each entity is making to that problem is not the kind of governmental exaction that Section 19 was meant to prevent.

4. The Decision's Recommendations Do Not Violate Article XVI, Section 6 or Section 3 (No Gifts of Public Funds). In its Request, LADWP argues that implementation of the Final Opinion would result in a gift of public funds in contravention of Article XVI, section 6 of the California Constitution and would result in a violation of Article XVI, section 3's prohibition of appropriation of money for the benefit of a corporation not under the control of the state.

LADWP asserts that under the Final Opinion's proposal to transition relatively quickly to distribution of allowances on a sales basis, the state's investor-owned utilities will benefit because they will receive more allowances than they need (because their generation portfolios include low-emitting nuclear and hydro) while publicly-owned utilities will be forced to buy allowances from those investor-owned utilities (thus giving them money) through the auction process. LADWP argues that this will result in a gift of public funds in two ways: 1) requiring LADWP to purchase allowances from others to offset their carbon emissions is a gift of LADWP funds to whomever they are purchasing the allowances from at auction; and 2) the allowances themselves are things

of value and, thus, a gift from the state to the entity receiving the allowances.

LADWP's first argument is based on speculation that (1) publicly-owned utilities will have to buy allowances, (2) investor-owned utilities will have surplus allowances that they can sell, and (3) that this will force the publicly-owned utilities to pay money to the investor-owned utilities. In fact, it appears that some publicly-owned utilities have taken action or are taking action to position their generation portfolios in a way that will cause them to have surplus allowances and whether the investor-owned utilities actually do have surplus allowances to sell will depend on their generation portfolio choices in the coming years. It may well be that LADWP, because of its historic heavy reliance on coal, will be faced with the need to buy allowances from some entity that has them for sale, but that may or may not be an investor-owned utility. It could be a publicly-owned utility like the City of Riverside that has developed a generation portfolio that will include 50 percent renewable energy by 2013 or an entity completely outside the utility industry that is able to sell allowances based on its efforts to increase the efficiency of its operations or reduce its operations for unrelated business reasons. And the extent to which LADWP will be forced to buy allowances will depend heavily on its own actions in the coming years to assist its customers in reducing their use of energy and in acquiring low- and zero-emitting generation resources to replace its coal-fired generation. Nevertheless, for the purpose of addressing LADWP's constitutional analysis, we will assume that it has correctly concluded that it will need to buy allowances and that other utilities, including investor-owned utilities, may be able to sell surplus allowances. Even though this assumption may be seen as requiring a flow of LADWP funds to other entities, for many reasons, this is not a gift. As noted above, the requirement to acquire and submit allowances is part of a regulatory program, not a tax designed to raise public funds, so it is a cost of operation similar to the purchase of fuel or other materials (including criteria pollutant emission reduction credits) necessary to make and distribute electricity. Just as LADWP's contracts for the purchase of these raw materials are not a gift of public funds, neither is the money LADWP pays for allowances if they are necessary for LADWP to generate enough electricity to meet its loads while also complying with AB 32's requirements.

LADWP's second argument—that the distribution by the state of allowances themselves are a gift because they have value—is also without merit. As discussed below, there is case law that holds that where there is consideration for a state expenditure, there is no gift. (See, County of Los Angeles v. Southern Calif. Tel. Co. (1948) 32 Cal.2d 378 [where there is a binding agreement supported by valid consideration, there is no gift]; see also Pacific Tel. & Tel. Co. v. City and County of San Francisco (1962) 197 Cal.App.2d 133, 155 [the acceptance of an offer of a telephone franchise did not constitute a gift within the meaning of constitutional prohibitions because it resulted in a binding agreement supported by a valid consideration (citing County of Los Angeles v. Southern Cal. Tel. Co. (1948) 32 Cal.2d 378, 388)]; Allied Architects' Ass'n of Los

Angeles v. Payne (1923) 192 Cal. 431, 439 [to be a gift a voluntary transfer must be gratuitous – "a handing over to the donee something for nothing… 'something bestowed without return'…." (citing Miller v. Dunn (1887) 72 Cal. 462, 474).) If CARB follows the recommendations in the Final Opinion, the state's distribution of allowances to retail providers will be conditioned on the use of funds derived from their sale for the purpose of further reducing greenhouse gas emissions or providing bill relief. This condition provides consideration the state will receive for the distribution of allowances.

A. The Final Opinion does not violate Article XVI section 6.

Article XVI, relating to public finance, sets forth the common sense rule that those in positions of governmental power must not use funds that are collected from the public for public purposes to benefit private persons or entities where no legitimate public purpose is served. Section 6, in particular, has been identified as the main provision prohibiting a "gift of public funds." LADWP's interpretation of this rule is not consistent with California case law that has established a clear "public purpose" exception to the general rule that gifts of public funds are prohibited. (*California Employment Stabilization Commission v. Payne* (1947) 31 Cal.2d 210.) A gift is defined as the voluntary transfer of personal property without consideration. (Civ. Code, § 1146.) The expenditure of funds for a public purpose does not constitute a gift, even if private persons are incidentally benefited. (*Post v. Prati* (1979) 90 Cal.App.3d 626, 634.) The question whether an expenditure has a public purpose "is within the discretion of the legislature" (*Martin v. Santa Clara Unified School District* (2002) 102 Cal App 4th 241) and "will not be disturbed as long as it has reasonable basis." (*Community Memorial Hospital of San Buena Ventura v. County of Ventura* (1996) 50 Cal App 4th 199.)

The legislature, in AB 32, has declared that global climate change poses a serious threat to California's economy, public health, natural resources and environment. (Health and Saf. Code, §38501(a).) It has also authorized the Air Resources Board to implement a cap and trade program that includes some method of distribution of GHG emission allowances. (*Id.* § 38562(b)(1).) In addition, the legislature has specified that the method of achieving the cap on emissions must "minimize leakage" (*Id.* § 38562(b)(8)), which is defined as "a reduction of emissions of greenhouse gases within the state that is offset by an increase in emissions of greenhouse gases outside the state." (*Id.* § 38505(j).)[10] It can be inferred from this that the legislature believes implementation of AB 32 as directed would have the public benefit of reducing the adverse impacts that would otherwise occur. Thus even if the allocation of allowances to some entities

[10] Since LADWP's Intermountain Power Project coal-fired generators are in the State of Utah, the legislature's goal of minimizing leakage would be severely compromised if LADWP's operations as a vertically integrated utility were constitutionally exempt from this sort of statewide regulation.

followed by the purchase of those allowances by LADWP could be considered a "gift," rather than a simple purchase of necessary raw materials for making electricity, the well established public purpose exception is a complete answer to LADWP's contention that the state has no constitutional authority to provide for distribution of allowances if they will have market value.

Even if the court were to review the allowance distribution process recommended in the Final Opinion without any deference to the legislature, that process should be found to serve a public purpose by incentivizing utilities to reduce emissions so that they are required to purchase fewer allowances and by ensuring that any funds generated in the allowance auction go to either further emission reductions through investments in energy efficiency, renewable energy or toward bill relief for low-income customers. The bar for determining what constitutes a public purpose has been set fairly low and it is unlikely that the allowance distribution process would fail to qualify. (See, *Allied Architects Association of Los Angeles v. Payne* (1923) 192 Cal 431 [holding that a veteran's memorial served a public purpose by promoting patriotism]; *Post v. Prati* (1979) 90 Cal.App.3d 626 [holding that the development of geothermal resources served a public purpose]; *Bowers v. City of San Buenaventura* (1977) 75 Cal.App.3d 65 [requiring cities to grant military leave with pay for city employees served a public purpose]; *Community Memorial Hospital of San Buena Ventura v. County of Ventura* (1996) 50 Cal.App.4th 199 [the expenditure of money at County hospitals to compete with private hospitals for paying patients served a public purpose]; *Los Angeles County v. Southern California Telephone Co.* (1948) 32 Cal.2d 378 [allowing telephone company to use rights of way for free served a public purpose]; *Ransom v. Los Angeles City High School District* (1954) 129 Cal.App.2d 500 [the dedication by a school board of property to a city for a street right of way served a public purpose].)

B. LADWP is not helped by case law holding that the public purpose exception is limited to purposes of the donor agency.

Citing *Golden Gate Bridge and Highway Dist. v Luehring* (1970) 4 Cal. App. 3d 204, 208-09, LADWP argues that the public purpose exception is limited to situations in which the funds will be used to further the limited purpose of the donor agency and not for broader public purposes. *Golden Gate Bridge* held that a law transferring excess bridge toll collections from the Golden Gate Bridge District to the general funds of surrounding counties violated restrictions against gifts of public funds because the purpose of the Donor agency was to "bridge the Golden Gate" and funds collected for that limited purpose could not be donated to broader public purposes for the benefit of taxpayers who were not identical to the payers of the bridge tolls. LADWP argues that like the Golden Gate Bridge District, it is a public agency of limited purpose which it defines as "[being] a vertically integrated utility that provides reliable, safe power at reasonable rates." (Request at 14.) From this assertion, LADWP reasons that any state

regulatory requirement that causes LADWP to have to pay money to others, and particularly private entities, does not support this limited purpose and is therefore a prohibited "gift."

For three reasons, LADWP's argument is without merit. First, the essence of LADWP's gift argument is that any regulation that requires it to write a check to an entity that does not have the same limited purpose as LADWP is an invalid gift. We note that *Golden Gate Bridge* did not involve the validity of a state regulation that increased the cost of providing bridging services and thus required the District to pay money to private entities or other public entities. Yet that is what LADWP is implying that the case stands for. Had the case involved the validity of a state requirement that stronger bolts be used in bridge construction or that environmentally sensitive paints be applied, requiring the District to write checks to private entities to acquire those products, thus raising the cost of doing the business of the District, it could serve as a useful precedent for LADWP's argument. Instead, it only stands for the limited proposition that when a public entity with a very limited charter collects funds (in this case bridge tolls) to serve that limited purpose, it cannot transfer those funds to serve the broader purposes of other public entities. That is not the situation here. Moreover, as discussed below, LADWP's purpose is much broader than that of the Golden Gate Transit District.

LADWP's argument is also without merit because the court in *Golden Gate Bridge* itself took care to note that "the [California] Constitution does not inhibit an entity . . . of local government from collecting fees for services it performs and using the net proceeds of enterprises such as municipal utility systems for the benefit of its own general fund." (*Golden Gate Bridge and Highway Dist. v Luehring, supra,* at 215. In other words, far from being a limited purpose agency like the Golden Gate District, an organization like LADWP can be an enterprise that has as its purpose to pursue the full range of activities of a vertically integrated utility and even to generate surplus revenues for the host city. Indeed, in 2007-2008, LADWP transferred $175 million to the City of Los Angeles' general fund. (See LADWP Website at http://www.ladwp.com/ladwp/cms/ladwp000509.jsp.) If LADWP's purpose is to be "a vertically integrated utility that provides reliable, safe power at reasonable rates," that purpose carries with it the need to comply with the same laws and regulations that other vertically integrated utilities must follow in the conduct of their business. LADWP obviously cites no authority for the proposition that municipal utilities are free to operate at a profit by ignoring the state regulations they find to be inconsistent with their desire to provide their customers low rates and still generate income for their host cities. No such authority exists. When a city goes into the business of providing vertically integrated utility service, it cannot complain that regulations, uniformly applied to all entities that provide that same service, are invalid when they would increase the city's cost of doing business as a vertically integrated utility. (See *Department of Water and*

Power of City of Los Angeles v. Inyo Chemical Company (1940) 16 Cal.2d 744, 108 P.2d 410 ["Though it is true that the payment of funds of a municipal corporation is a municipal affair because it affects its fiscal policy and management, this does not mean that a state statute concerning a matter of general state concern is not applicable to a charter city. The controlling feature here is the *manner* in which the state statute affects the municipal affair. If the state statute affects a municipal affair only incidentally in the accomplishment of a proper objective of statewide concern, then the state law applies even as to 'autonomous' charter cities."].)

Finally, even if the *Golden Gate Bridge* case could be read to require some benefit specifically to the ratepayers of LADWP in order for a state regulation requiring the acquisition of GHG allowances to be found to have a valid public purpose, LADWP's customers will benefit in at least two ways from the purchase of allowances: 1) by purchasing allowances, LADWP will be able to continue producing power with its existing plants; and 2) the revenue from those allowances will be used to reduce California's GHG emissions, thereby potentially reducing the negative climate change effects felt by residents of the state, including LADWP's customers.

C. The Final Opinion does not violate Article XVI section 3.

LADWP also argues that the Final Opinion conflicts with California Constitution Article XVI, section 3, which provides "No money shall ever be appropriated or drawn from the State Treasury for the purpose or benefit of any corporation, association, asylum, hospital, or any other institution not under the exclusive management and control of the State as a state institution . . ." and then proceeds to provide a number of exceptions. Plainly neither the plan to distribute or auction allowances involves taking money from the State Treasury. Nor is it clear that allowances are the equivalent of "money" even though they may have value in the market. Most important, the recommended distribution of allowances is an integral part of a regulatory scheme designed to both provide the right economic signals for future utility planning and also to mitigate some of the near term economic hardship that the regulatory scheme may cause. The distribution scheme is thus in no way a gift but rather is a method of accomplishing the challenging goals of AB 32.

If Article XVI Section 3 applies at all, it would only be to ensure that the state maintains sufficient control over the use of the allowances for the planned public purposes. This section of the Constitution was intended to prevent the appropriation of state funds to be used for purposes foreign to the interests of the state and outside of its control and was not intended to bar the distribution of state funds for legitimate state purposes. (*California Family Bioethics Council v. California Institute of Regenerative Medicine* (2007) 147 Cal.App.4th 1319, 1353.) Thus, a private institution may receive money or property from the state to be used for a public purpose notwithstanding any benefit to

the entity itself, which is considered merely incidental to the public purpose. (*California Association of Retail Tobacconists v. California* (2003) 109 Cal.App.4th 792, 816.) In order to ensure that a public purpose is in fact being served by such expenditure, however, the courts require some showing that the state has control over how the funds are used. Some degree of autonomy is allowed, and the courts will look to see whether there are sufficient controls by the executive and legislative branches to ensure that state funds are used to further state purposes while still allowing for innovative programs that serve those purposes. (*California Association of Retail Tobacconists v. California* (2003) 109 Cal.App.4th 792, 817.) Despite LADWP's argument to the contrary, there is no specific test for determining whether sufficient control exists and each case is reviewed on its own merits.

The test that LADWP attempts to apply to this situation is a set of factors the court in *California Family Bioethics Council v. California Institute of Regenerative Medicine* applied to determine that the state's funding of the California Institute for Regenerative Medicine was constitutional. In that case the court based its decision on the fact that the institute, which was a brand new entity wholly funded by the state, had a board in which the majority of members were appointed by the executive and legislative branches, there were strict requirements on how the money it was given would be spent, and there were standards for public and financial accountability, including an auditing provision. LADWP argues that the Final Opinion does not establish the necessary level of state control because the governing boards of the investor-owned utilities are not made up mostly of elected officials, there is no specificity as to how the allowance proceeds will be spent, and there is no auditing provision. The latter two factors, however, are clearly a component of the Final Opinion, which recommends that the state distribute allowances with the strict requirement that they be auctioned and that the funds be used solely for programs to further the goals of AB 32 and the Energy Action Plan loading order, such as energy efficiency, renewable energy, or for bill relief. (Final Opinion, pp. 229-31.) Additionally, the Final Opinion recommends that the publicly-owned utilities provide an annual accounting to the Energy Commission, and that the investor-owned utilities provide a similar accounting to the PUC, showing that all expenditures of auction revenues will be consistent with AB 32. (Final Opinion, p. 231.) More specificity may be advisable and can be provided by the CARB during the rulemaking implementing these provisions.

5. The Final Opinion does not need to be reconsidered in response to LADWP's allegations that it was based on insufficient modeling.

Inexplicably, LADWP argues that the Commissions' statement that "Because of current modeling limitations, the fuel-differentiated option has not been modeled in this proceeding," the Final Opinion must be reconsidered. This option, of course, was developed in response to concerns by utilities such as LADWP that a pure output based

distribution of allowances would be unduly harsh. The Commissions admitted that further modeling should be performed before CARB settles on the exact formula for allowance distribution, and we will be working with CARB to ensure that such modeling is completed. Needless to say it is odd to see LADWP attack the Final Opinion for responding to LADWP's most urgent concerns simply because the modeling has not been completed when we have clearly agreed and stated that more detailed modeling is needed and will be done.

Conclusion

For all of the reasons set forth in this order, the Request for Reconsideration is denied.

February 25, 2009

ENERGY RESOURCES CONSERVATION
AND DEVELOPMENT COMMISSION

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