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STATE OF OREGON
LEGISLATIVE COUNSEL COMMITTEE

March 20, 2019

[redacted]
900 Court Street NE [redacted]
Salem OR 97301

Re: Constitutional implications of moneys raised by HB 2020

Dear [redacted]:

You asked why House Bill 2020 (2019), a cap-and-trade bill, "is not a bill for raising revenue but nevertheless requires the state to deposit significant revenues into the Highway Fund." You also asked why HB 2020 is not a bill for raising revenue even though "certain industries have no choice but to pay fees rather than install equipment that reduces emissions."

Oregon courts have interpreted the term "tax" differently under different constitutional provisions,[1] including the provisions dedicating revenues to the Highway Fund and identifying bills as bills for raising revenue—respectively, Article IX, section 3a, of the Oregon Constitution, and Article IV, sections 18 and 25 (2), of the Oregon Constitution.

We conclude that the Oregon Supreme Court would likely hold that HB 2020 imposes a "tax" on motor vehicle fuel for purposes of Article IX, section 3a, under which the court has broadly interpreted the term "tax" to include motor vehicle fuel-related fees,[2] so motor vehicle fuel-related revenues raised by HB 2020 likely must be constitutionally dedicated to the Highway Fund.

However, we believe the court would likely conclude that HB 2020 is not a bill for raising revenue under Article IV, sections 18 and 25 (2), because the court has held that a law that imposes a charge for which the payor receives an "equivalent in return" and under "which the party may pay and obtain the benefits under the law, or let it alone, as he chooses" did not constitute a bill for raising revenue.[3] Under HB 2020, covered entities that purchase allowances at state auctions will arguably receive an equivalent in return—a tradable authorization to emit one ton of carbon dioxide—and they may forego the auctions and obtain allowances elsewhere.

HB 2020—A cap-and-trade program

A cap-and-trade program is a market-based regulatory approach that provides an economic incentive for private businesses and consumers to reduce greenhouse gas emissions. House Bill 2020 establishes the Carbon Policy Office (CPO) and directs CPO to set an overall limit (a "cap"), expressed in tons of carbon dioxide equivalent, on the aggregate greenhouse gas

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[1] *Scappoose Sand & Gravel, Inc. v. Columbia County*, 161 Or. App. 325, 336 (1999), *citing Automobile Club of Oregon v. State of Oregon*, 314 Or. 479, 485 (1992).
[2] *Automobile Club of Oregon*, 314 Or. at 487.
[3] *Northern Counties Trust v. Sears*, 30 Or. 388, 401-403 (1895).

emissions from a group of covered entities.[4] The cap declines over time, ultimately arriving at a target level that is at least 80 percent below 1990 levels by the year 2050.[5]

As a type of cap-and-trade, HB 2020 establishes a "cap-and-investment" program. In a cap-and-investment program, a government sells allowances at auctions and invests auction proceeds in activities that provide environmental benefits. Under HB 2020, the state will be required to expend auction proceeds to reduce greenhouse gas emissions or promote carbon sequestration, adaptation or resiliency.[6]

To implement HB 2020, CPO will annually issue carbon allowances in an amount equal to the applicable annual cap.[7] Each allowance is a "tradable authorization to emit one metric ton of carbon dioxide equivalent."[8] House Bill 2020 directs CPO to allocate free allowances and administer auctions.[9] After CPO distributes allowances, covered entities will be able to trade the allowances on a secondary market—such secondary market activity is the "trade" component of a cap-and-trade program.

Covered entities can also purchase "offset credits." Offset credits are generated by projects that reduce or remove greenhouse gas emissions that are not emissions regulated under the cap-and-trade program.[10] House Bill 2020 limits how many offset credits an entity can use to demonstrate compliance.[11]

To meet their obligations under HB 2020, covered entities will be required to surrender "compliance instruments" (allowances plus offset credits) to CPO that are equal to the covered entity's total emissions for a compliance period.[12] For example, a covered entity might be allocated some free allowances but still need to make up a shortfall in its compliance obligation by reducing emissions, purchasing allowances at auction, purchasing allowances on the secondary market or purchasing offset credits, singly or in any combination.

Of note, under HB 2020, the state does not receive proceeds from entities buying and selling allowances on the secondary market or from the generation and sale of offset credits. Rather, the state receives proceeds only by selling allowances at state-run auctions.

Interpreting the term "tax" under the Oregon Constitution

As an initial matter, we note that the term "tax" does not have the same meaning under different constitutional provisions. Rather, when a court evaluates the meanings of the terms "tax" and "assessment" in the Oregon Constitution,

> the import and application of the terms vary from one context to another and . . . their meaning in any particular context is ascertainable largely by reference to the purposes of the provisions in which they are used or to which they are applied.[13]

[4] HB 2020, section 9 (1)(a)(A); *see id.* section 4 (establishing CPO).
[5] *Id.* section 9 (1)(b)(C).
[6] *Id.* section 31.
[7] For example, if the cap for a given year is 50 million tons of carbon dioxide equivalent across all covered entities, the state will issue 50 million allowances for that year.
[8] *Id.* section 8 (2).
[9] *Id.* section 9.
[10] *Id.* section 8 (19).
[11] *Id.* section 19 (2).
[12] *Id.* section 8 (5), (6), (26); section 9 (4)(a).
[13] *Scappoose Sand & Gravel, Inc.*, 161 Or. App. at 336, *citing Automobile Club of Oregon*, 314 Or. at 486.

Consistent with that conclusion, Oregon courts interpret the term "tax" differently for purposes of Article IX, section 3a, and Article IV, sections 18 and 25 (2)—that is, more broadly under the former and more narrowly under the latter.

Dedication of revenues to the Highway Fund

In relevant part, Article IX, section 3a, dedicates revenues from certain taxes on motor vehicle fuel to the Highway Fund:

> (1) Except as provided in subsection (2) of this section, revenue from the following shall be used exclusively for the construction, reconstruction, improvement, repair, maintenance, operation and use of public highways, roads, streets and roadside rest areas in this state:
>
> (a) *Any tax levied on, with respect to, or measured by the storage, withdrawal, use, sale, distribution, importation or receipt of motor vehicle fuel or any other product used for the propulsion of motor vehicles*; and
>
> (b) Any tax or excise levied on the ownership, operation or use of motor vehicles.

(Emphasis added.)

The Oregon Supreme Court has established a broad interpretation of the term "tax" in Article IX, section 3a (1)(a). In *Automobile Club of Oregon v. State of Oregon*, the court determined that, despite its name, an "assessment" the state collected from persons taking delivery of gasoline for resale into underground storage tanks was a "tax" under this provision:

> We hold that the underground storage tank assessment is a "tax" under Article IX, section 3a(1)(a), and that, no matter what label the legislature may attach to a tax on motor vehicle fuel, whether it be "fee," "excise," "tithe," "assessment," or some other term, the revenues derived therefrom must be dedicated to the listed purposes.[14]

As the court explained, voters adopted Article IX, section 3a, "to ensure that revenue from motor vehicles and motor vehicle fuel would be devoted solely to specified highway purposes."[15]

House Bill 2020 will address regulated emissions that are attributable to the combustion of fuel imported, sold or distributed for use in Oregon, thus likely covering emissions from the transportation sector by placing the point of regulation on entities that are upstream in the motor vehicle fuel supply chain.[16] Under HB 2020, an allowance is a tradable authorization to emit one ton of carbon dioxide equivalent.[17] The auction price that a covered entity pays for an allowance from the transportation sector thus reflects the auction price that the market is willing to bear for obtaining authorization to emit one ton of carbon dioxide equivalent through the combustion, or use, of motor vehicle fuel.

[14] *Automobile Club of Oregon*, 314 Or. at 487.
[15] *Id.* at 486.
[16] *See* HB 2020, section 9 (2)(f) (requiring CPO to designate as covered entities persons not described in section 9 (d) and (e) as necessary to address regulated emissions that are attributable to the combustion of fuel that is imported, sold or distributed for use in this state).
[17] *Id.* section 8 (2).

Because the court has interpreted the term "tax" broadly for purposes of Article IX, section 3a, we conclude that the court would likely hold that proceeds the state receives from its sale at auction of allowances related to motor vehicle fuel constitute "revenue from . . . [a] tax . . . with respect to, or measured by the . . . use . . . of motor vehicle fuel" for purposes of Article IX, section 3a (1).

Identification of bills for raising revenue

Article IV, section 18, requires "bills for raising revenue" to originate in the House of Representatives. Article IV, section 25 (2), provides that "bills for raising revenue" must receive a three-fifths majority of votes in favor in each chamber. The court has held that the phrase "bill for raising revenue" has the same meaning for purposes of both constitutional requirements.[18]

In *Bobo v. Kulongoski*, the court adopted a two-pronged test for determining whether a bill is a bill for raising revenue:

> [1] The first is whether the bill collects or brings money into the treasury. If it does not, that is the end of the inquiry. [2] If a bill does bring money into the treasury, the remaining question is whether the bill possesses the essential features of a bill levying a tax. As *Northern Counties Trust* makes clear, bills that assess a fee for a specific purpose are not "bills raising revenue" even though they collect or bring money into the treasury.[19]

The court has broadly interpreted the first prong, holding in *City of Seattle v. Department of Revenue* that a bill repealing a tax exemption "[w]ithout question" brought money into the treasury.[20] Given the court's conclusion in *City of Seattle*, we believe the court would hold that HB 2020 "collects or brings money into the treasury."[21]

House Bill 2020 will require covered entities to obtain compliance instruments, and CPO must distribute at least some allowances—one type of compliance instrument—by auction. With a declining cap, demand for compliance instruments throughout the life of the program will likely be high enough that at least some covered entities will need to purchase allowances from the state, even if most allowances are initially distributed for free. Thus, HB 2020 all but guarantees that the state will collect auction proceeds.

In contrast to the first prong, the court has interpreted the second prong narrowly. Under the second prong, the court considers "whether the bill possesses the essential features of a bill levying a tax."[22] To interpret that phrase, the court has adopted a restrictive standard under which application of the revenue origination provision in Article IV, section 18—that is, that bills for raising revenue must originate in the House of Representatives—"has been confined to bills to levy taxes *in the strict sense of the words*, and has not been understood to extend to bills for other purposes, *which may incidentally create revenue.*"[23] As noted, the court has interpreted the phrase "bills for raising revenue" in the same way under Article IV, section 25 (2), which requires a three-fifths vote for such bills.[24]

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[18] *Bobo v. Kulongoski*, 338 Or. 111, 123 (2005).
[19] *Id*. at 122, *citing Northern Counties Trust*, 30 Or. at 402.
[20] *City of Seattle v. Department of Revenue*, 357 Or. 718, 732 (2015).
[21] *Bobo*, 338 Or. at 122.
[22] *Id.*
[23] *City of Seattle*, 357 Or. at 732-733 (emphasis in original), *quoting Northern Counties Trust*, 30 Or. at 402.
[24] *Bobo*, 338 Or. at 123.

In addition, under *Northern Counties Trust v. Sears*, the "controlling feature" of bills for raising revenue is that they

> impose taxes upon the people, either directly or indirectly, or lay duties, imposts, or excises, for the use of the government, *and give to the persons from whom the money is exacted no equivalent in return, unless in the enjoyment, in common with the rest of the citizens, of the benefit of good government*.[25]

Consequently, the court has held that a law establishing a fee "which the party may pay and obtain the benefits under the law, or let it alone, as he chooses" was not a bill for raising revenue.[26]

Under a state constitutional provision analogous to Article IV, section 25 (2), a California court held in 2017 that auction proceeds from that state's cap-and-trade bill do not constitute a tax because purchasing allowances is voluntary and a payor receives a benefit in the form of an allowance.[27] According to the California Court of Appeals,

> the auction sales do not equate to a tax. As we shall explain, the hallmarks of a tax are: (1) that it is compulsory and (2) that the payor receives nothing of particular value for payment of the tax, that is, the payor receives nothing of specific value for the tax *itself*. Contrary to plaintiffs' view, the purchase of allowances is a voluntary decision driven by business judgments as to whether it is more beneficial to the company to make the purchase than to reduce emissions. Reducing emissions reduces air pollution, and no entity has a vested right to pollute. Further, once purchased, either from the [State Air Resources Board] or the secondary market, the allowances are valuable, tradable commodities, conferring on the holder the privilege to pollute. Indeed, speculators have bought allowances seeking to profit from their sale, and as one party puts it, taxes do not attract volunteers. These twin aspects of the auction system, voluntary participation and purchase of a specific thing of value, preclude a finding that the auction system has the hallmarks of a tax.[28] (Emphasis in original.)

Moreover, the California Court of Appeals emphasized the availability of a secondary market for allowances, observing that "the purchase of emissions allowances, whether directly from the Board at auction or on the secondary market, is a business-driven decision, not a governmentally compelled decision," and that "unlike any other tax to which we have been referred by the parties, the purchase of an emissions allowance conveys a valuable property interest—the privilege to pollute California's air—that may be freely sold or traded on the secondary market."[29]

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[25] *Northern Counties Trust*, 30 Or. at 401-402 (emphasis added), quoting *United States v. James*, 26 F. Cas. 577 (1875).
[26] *Id.* at 403.
[27] *California Chamber of Commerce v. State Air Resources Board*, 10 Cal. App. 5th 604, 614 (2017). The court considered whether California's cap-and-trade auctions constitute a tax subject to Article XIII A, section 3(a), of the California Constitution (2006 Edition), which required that "any changes in State taxes enacted for the purpose of increasing rates or changes in methods of computation 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 . . . ."
[28] *Id.* at 614.
[29] *Id*. at 634.

The program established by HB 2020 will be similar to California's cap-and-trade program, and covered entities will have access to a secondary market on which they can trade allowances. Accordingly, although California case law has no precedential value in Oregon, we believe an Oregon court would likely find the California case persuasive.

Under HB 2020, as under the California program, participation in state auctions is voluntary, and a person that purchases an allowance will receive a tradable, valuable asset: an authorization to emit one ton of carbon dioxide equivalent. Pursuant to *Northern Counties Trust*, winning bidders at auctions thus arguably will receive an "equivalent in return" other than "the enjoyment, in common with the rest of the citizens, of the benefit of good government."[30] Furthermore, a covered entity may pay for an allowance at auction and "obtain the benefits under the law, or let it alone," as the entity chooses.[31]

House Bill 2020 will require each covered entity to surrender to the state, for each compliance period, a number of compliance instruments equal to the covered entity's emissions for that period. To meet that requirement, each covered entity has a variety of options.

A covered entity may reduce its emissions, thus reducing the amount of compliance instruments it must submit. The covered entity may also obtain compliance instruments from a variety of sources: it can purchase offset credits, or it can purchase allowances from the state at auction or on the secondary market. In addition, some covered entities will receive free allowances from the state that they can use for compliance or to monetize via trade on the secondary market. Although HB 2020 requires each covered entity to prove compliance with the cap for each compliance period, the bill *does not* require any covered entity to purchase allowances at auction from the state. A covered entity thus could conceivably forgo the benefit conferred by the auction scheme under HB 2020.

Our conclusion that HB 2020 likely does not possess the "essential features of a bill levying a tax,"[32] and thus is not a bill for raising revenue, is not free from doubt, and we acknowledge that HB 2020 might raise substantial revenues. However, according to the Oregon Supreme Court, "the revenue effect of a bill, in and of itself, does not determine if the bill is a 'bill[ ] for raising revenue.'"[33]

Furthermore, we recognize that jurisprudence interpreting Article IV, sections 18 and 25 (2), is limited, and that a cap-and-trade program is unlike the factual situations the court has considered. In particular, a challenger may argue that HB 2020 has the essential features of a bill levying a tax because the primary purpose in requiring CPO to auction allowances is to exact revenues from auction participants for the use of government—that is, for activities that reduce greenhouse gas emissions and promote carbon sequestration, adaptation and resiliency—and that those benefits will be enjoyed in common by all citizens, rather than as an equivalent in return for a bidder's payment. Nevertheless, under *Bobo* and *City of Seattle*, the court's "task is not to determine the primary legislative purpose" for enacting a bill."[34]

Because winning bidders at allowance auctions will receive an equivalent in return for their payment in the form of tradable allowances, and because a covered entity may forgo the benefit conferred by state auctions, we believe the court would likely hold that HB 2020 does not possess the essential features of a bill levying a tax and thus is not a bill for raising revenue.

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[30] *Northern Counties Trust*, 30 Or. at 401-402, *quoting James*, 26 F. Cas. 577.
[31] *Id.* at 403.
[32] *Bobo*, 338 Or. at 122.
[33] *City of Seattle*, 357 Or. at 736, *quoting Bobo*, 338 Or. at 122.
[34] *Id.* at 735, *citing Bobo*, 338 Or. at 122.

Conclusion

The Oregon Supreme Court has interpreted the term "tax" differently for purposes of Article IX, section 3a, and Article IV, sections 18 and 25 (2). Under Article IX, section 3a, the court has held that "tax" includes certain motor vehicle fuel-related fees, and we conclude that the court would likely hold that motor vehicle fuel-related auction revenues raised by HB 2020 must be dedicated to the Highway Fund. In contrast, the court has held that a law the provides a payor with an equivalent in return for payment, and under which the payor can opt out, does not have the essential features of a tax and thus is not a bill for raising revenue under Article IV, sections 18 and 25 (2). Accordingly, we believe the court would likely conclude that the tradable allowances and optional participation in state auctions provided by HB 2020 render the bill devoid of the essential features of a tax.

Please let us know if we can be of any further assistance.

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Very truly yours,

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