Case No. S200475

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

WESTERN STATES PETROLEUM ASSOCIATION,
Plaintiff and Respondent,

v.

CALIFORNIA STATE BOARD OF EQUALIZATION,
Defendant and Appellant

On Appeal from the Court of Appeal,
Second District, Division 8
Appellate Court Case No. B225932

RESPONDENT'S ANSWER TO BRIEF ON THE MERITS

C. STEPHEN DAVIS (No. 93674)
CRIS K. O'NEALL (No. 126160)
ANDREW W. BODEAU (No. 183600)
CAHILL, DAVIS & O'NEALL, LLP
550 S. Hope Street, Suite 1650
Los Angeles, California 90071
Telephone: 213/622-0600 / Facsimile: 213/622-9825

Case No. S200475

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

WESTERN STATES PETROLEUM ASSOCIATION,
Plaintiff and Respondent,

v.

CALIFORNIA STATE BOARD OF EQUALIZATION,
Defendant and Appellant

On Appeal from the Court of Appeal,
Second District, Division 8
Appellate Court Case No. B225932

RESPONDENT'S ANSWER TO BRIEF ON THE MERITS

C. STEPHEN DAVIS (No. 93674)
CRIS K. O'NEALL (No. 126160)
ANDREW W. BODEAU (No. 183600)
CAHILL, DAVIS & O'NEALL, LLP
550 S. Hope Street, Suite 1650
Los Angeles, California 90071
Telephone: 213/622-0600 / Facsimile: 213/622-9825

CERTIFICATION OF INTERESTED ENTITIES OR PERSONS

S200475 - WESTERN STATES PETROLEUM ASSOCIATION v. STATE BOARD OF EQUALIZATION

Full Name of Interested Entity/Person	Party	Non-Party	Nature of Interest
BP West Coast Products LLC, a subsidiary of BP*	[ ]	[x]	Owner/operator of a California refinery
Phillips 66 Company, a subsidiary of Phillips 66*	[ ]	[x]	Owner/operator of a California refinery
Chevron Products Company, a division of Chevron USA Inc., a subsidiary of Chevron Corporation*	[ ]	[x]	Owner/operator of a California refinery
Equilon Enterprises LLC dba Shell Oil Products US*, a subsidiary of Royal Dutch Shell PLC	[ ]	[x]	Owner/operator of a California refinery
Valero Refining Company - California, a subsidiary of Valero Energy Corporation*	[ ]	[x]	Owner/operator of a California refinery
Tesoro Refining and Marketing Company*, a subsidiary of Tesoro Corporation	[ ]	[x]	Owner/operator of a California refinery
ExxonMobil Oil Corporation, a subsidiary of ExxonMobil Corporation*	[ ]	[x]	Owner/operator of a California refinery
	[ ]	[ ]	
	[ ]	[ ]	
	[ ]	[ ]	

* WSPA Member

Submitted by: Charles Stephen Davis

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Constitutional Provisions

Statutes

Regulations

Cases

State Board of Equalization

Other Authorities

CERTIFICATE OF LENGTH

Pursuant to California Rules of Court Rule 8.520(c), I certify that the following Respondent's Answer to Brief on the Merits is 13,938 words in length (exclusive of tables) as determined by the Microsoft Word word-processing software used to prepare the brief.

Dated: December 14, 2012 CAHILL, DAVIS & O'NEALL, LLP

By: _____
C. Stephen Davis
Cris K. O'Neall
Andrew W. Bodeau
Attorneys for Plaintiff and Respondent
Western States Petroleum Association

INTRODUCTION

The underlying Opinion[1] correctly determined that the California State Board of Equalization ("Board") violated the Administrative Procedures Act[2] ("APA") when it adopted its new regulation 474 (18 Cal. Code Regs., § 474) ("Rule 474").[3] *Western States* should be affirmed in all respects.

Rule 474 changes the method used to assess petroleum refineries by consolidating depreciating machinery and equipment (fixtures) into the same appraisal unit with appreciating land. This consolidation allows assessors to offset declines in fixture values resulting from depreciation with appreciating land values that would otherwise not be assessable due to Article XIIIA, section 3 of the California Constitution ("Proposition 13" or "Prop. 13.")

It is undisputed that refinery fixtures were assessed separately from land pursuant to Rule 461(e)[4] and Revenue and Taxation Code section 51(d) ("R&T 51(d)")[5] until Rule 474 was adopted. (Opinion 9; Brief on the Merits ("Opening Brief" or "OB") 4.)

---

1 *Western States Petroleum Assn. v. State Board of Equalization,* 202 Cal.App.4th 1092, review granted May 16, 2012, S200475 ("*Western States*" or the "Opinion").

2 Gov. Code, § 11370 et seq. References to statutes codified in the Government Code will be referred to as "Section."

3 References to any Board regulation codified in Title 18 of the *Code of California Regulations* will be referred to as "Rule."

4 Rule 461(d) was renumbered 461(e) February 25, 1998 without change.

5 References to statutes codified in the Revenue and Taxation Code will be referred to as "R&T."

The Board attempts to justify eliminating the separate assessment of fixtures when taxing refineries on the grounds that doing so is necessary to implement the "marketplace" principle for determining fair market value. This is wrong for two reasons.

First, Proposition 13 changed California's current market value system that prevailed before 1978 to an "acquisition value system." Under a current value system, assessed values are determined annually based on prevailing market values as those values fluctuate from year to year. Under an acquisition value system, assessed values are instead established at the time property is purchased, and thereafter capped (except for an annual inflationary adjustment and new construction) until the next change in ownership ("adjusted base-year value"). Taxable value is the lesser of fair market value or the adjusted base-year value. The Board ignores the change to an acquisition value system of assessment by focusing on current aggregate market values.

Second, refineries are primarily composed of two types of property, fixtures and land. This is true of all heavily fixturized businesses, that is, businesses that require machinery and equipment to operate, such as breweries, wind farms, sound stages, computer component manufacturers, amusement parks and ski resorts. Fixtures and land have different characteristics. Fixtures tend to wear out through use or become technologically obsolete (depreciate). Land tends to appreciate. These differing characteristics have always required that fixtures and land be assessed separately. Thus, under Prop. 13, fixtures tend to be assessed at current market value reflecting depreciation and land tends to be assessed at its adjusted base-year value.

Because fixtures are already assessed at current depreciated value, the "marketplace" standard advocated by the Board increases land assessment by allowing land appreciation that was formerly not assessable under Prop. 13 to offset declines in fixture values. In effect, this converts some or all of the land value assessments back to a "current value" system of assessment. The Board's contention that Rule 474 is necessary to implement a "marketplace" appraisal concept defies Prop. 13's change in California's property tax system from a current value system to an acquisition value system, and ignores the characteristics of the property at issue.

STATEMENT OF THE CASE

The operative feature of Rule 474 is the elimination of the separate assessment of fixtures and land, thereby "masking" declines in fixtures values caused by depreciation for assessment purposes. This new method of assessment increases property taxes by using appreciated land value that was formerly non-taxable under Prop. 13 to eliminate or reduce the depreciation adjustment, which in turn, increases taxable value.

The Board contends that reducing assessed values for fixture depreciation is improper because real property (fixtures, land and improvements) should be assessed on the same basis as it sells for in the marketplace, and the marketplace does not typically distinguish between land and fixtures.

The contrary view is that fixtures and land have always been assessed separately in order to account for fixture depreciation. This was so before and after Propositions 13 and 8 were adopted, before and after Rule 461 was amended to implement Proposition 8, and before and after

Revenue and Taxation Code section 51 was enacted to implement Propositions 13 and 8. The Board still agrees with these principles for all property except for refineries. (RT-24:7-14 to 27:6-17.)[6] The Board now contends its segregation of only refinery fixtures for assessment has been wrong for thirty years. (RT-27:18 to 28:8.)

Thus, Rule 461(e) has expressly segregated land and fixtures for decline-in-value purposes since 1979: "For purposes of this subsection, fixtures and other machinery and equipment classified as improvements constitute a separate appraisal unit."

And, R&T 51 expressly requires that assessments account for depreciation (which affects fixtures but not land) (R&T 51(c)), and also bifurcates the definition of real property into two separate appraisal units as follows: "(d) ... that appraisal unit that persons in the marketplace commonly buy and sell as a unit, or that is normally valued separately." Fixtures are "normally valued separately" as mandated by Rule 461(e).

The Board now claims, for the first time, the power to dictate which definition of the real property appraisal unit governs the assessment of a particular class of property, without considering whether doing so will eliminate or reduce consideration of depreciation when assessing fixtures. *Western States* correctly held that "SBE's argument ignores the history of assessment practices including the history of accounting for depreciation in

---

[6] References to the Reporter's Transcript are abbreviated as "RT" followed by page and line references.

fixtures, and ignores the legislative history of section 51(d)." (Opinion 20.)[7]

Three aspects of the historical materials bear emphasis: (1) current Rule 461 was amended to implement Prop. 8 and to correct then-existing Board Rule 461 (June 28, 1978), which *prohibited* reducing fixture values for depreciation; (2) R&T 51 followed the Task Force Report recommendations for implementing Props. 13 and 8, which Report expressly recommended that fixtures continue to be segregated for assessment after Prop. 13; and (3) The Board always interpreted Rule 461 and R&T 51 to require bifurcated assessment of fixtures and land.

Rule 461

Initially, Prop. 13 did not did not address how to assess real property when its market value declined below the adjusted base-year value. The Board's original version of Rule 461, adopted immediately after Prop. 13 was approved, expressly prohibited considering fixture depreciation. (8-AA-2186 ["... the taxable value of real property shall not reflect any actual market value depreciation ...."].)

The issue of what to do when property values declined was addressed in the next election after Prop 13 was adopted, when the voters adopted Proposition 8 to provide that values may be reduced to reflect

---

[7] Western States Petroleum Association ("WSPA") provided a detailed 31-page chronology of fixtures assessment in its motion for summary judgment. (Appellant's Appendix ("AA"), Vol. 8, pp. 2300-2331. References to the Appellant's Appendix are abbreviated as "AA" followed by page references.) Judge Hess condensed this chronology in the Order on Submitted Motion ("Trial Court Decision"). (11-AA-3266-3271.)

declines in value. (Opinion 5.) Thereafter, the Board rewrote Rule 461 to remove the prohibition against recognizing depreciation and expressly differentiated land and fixtures for assessment purposes. (1-RA-153; see also 1-RA-133.)[8]

The Board's reaction to Prop. 13 is described by *State Bd. of Equalization v. Board of Supervisors* (1980) 105 Cal.App.3d 813. That case held that the original version of Rule 461, which prohibited consideration of depreciation, was unconstitutional, and clarified that recognizing declines in value was mandatory under article XIII, section 1 of the California Constitution. Rule 474 is, in effect, a partial re-adoption of the Board's original, unconstitutional version of Rule 461.

The Board expressly intended the replacement version of Rule 461 (January 25, 1979) to implement Prop. 8 ("Enclosed are proposed changes to the Board Rules intended to reflect the impact of Proposition 8...").[9]

The Board now says that Prop. 8 requires assessors to ignore fixture depreciation based on a "marketplace" appraisal unit, but the Rule the Board adopted in January 1979 to implement Prop. 8 did just the opposite by expressly designating fixtures to be a separate appraisal unit. Rules 461 and 474 cannot both be correct because they interpret Prop. 8 inconsistently.

---

[8] References to the Respondent's Appendix are abbreviated as "RA" followed by page and line references.

[9] 1-RA-141 (Letter to Assessors No. 78/218); 1-RA-150 (Letter to Assessors No. 79/33 ["Enclosed is a copy of Property Tax Rules 460-471 ... adopted by the State Board of Equalization to reflect the provisions of Proposition 8..."]).

Task Force Report

The Task Force formed to recommend how the Legislature should implement Prop. 13 expressly addressed how fixture depreciation was handled before Prop. 13 and the importance of continuing that practice unchanged. In its January 22, 1979 Report to the California Assembly Committee on Revenue and Taxation ("Task Force Report"), the Task Force specifically addressed Prop. 8's "decline-in-value" aspects and recommended use of a bifurcated appraisal unit concept. Declines in value would be "measured by *the appraisal unit which is commonly bought or sold in the market place,* ***or which is normally valued separately***."[10] (7-AA-2050, emphasis added; Opinion 5-6.)

The Task Force's bifurcated definition of the appraisal unit was subsequently incorporated into R&T 51 verbatim.

The Task Force observed that "[t]he purpose of the appraisal unit concept was to ensure that these increases or declines in value be measured in the same manner as such property was appraised prior to Prop. 13." (7-AA-2076.) Subsequent legislative materials confirmed the historical practice of bifurcating land and fixture assessments. Following the enactment of R&T 51, the Assembly Revenue and Taxation Committee issued a report entitled "Implementation of Prop. 13 – Property Tax Assessment," dated October 29, 1979 ("Assembly Report"). The Assembly

---

[10] The Task Force Report has long been considered the definitive statement of intent when interpreting statutes or regulations implementing Prop. 13 and Prop. 8. (See *Auerbach v. Assessment Appeals Board No.1 for County of Los Angeles* (2006) 39 Cal.4th 153, 161; *Pacific Southwest Realty Co. v. County of Los Angeles* (1991) 1 Cal.4th 155, 161.)

Report confirmed that fixtures were "normally valued separately" from land:

> Fixtures, however, are normally appraised separately, thus owners may claim a decline based on depreciation of the fixture without regard to the value of the surrounding land or improvements.

(2-RA-479, emphasis original.)[11]

Alexander Pope, the Los Angeles County Assessor and a Task Force member, also confirmed the existing practice for fixtures assessment in his letter dated December 4, 1979 to David Doerr, Chief Consultant for the Assembly Revenue and Taxation Committee concerning the Task Force Recommendation. Mr. Pope emphasized the importance of continuity in implementing Prop. 8, observing:

> With respect to the question of the appraisal unit to which the Proposition 8 test should be applied, *we believe fixtures and personal property should, in accordance with past practice, be treated separately from land and buildings.* Anything else would be administratively unworkable at this time.

(2-RA-472, emphasis added.)

The Board's current interpretation of R&T 51 emphasizes the "marketplace" prong of R&T 51(d)'s definition of "real property," and ignores the "normally valued separately" prong, thus contradicting the

---

[11] The Assembly Report also reflects Prop. 13/8's legislative intent. (See *Osco Drug, Inc. v. County of Orange* (1990) 221 Cal.App.3d 189, 194; *Pueblos Del Rio South v. City of San Diego* (1989) 209 Cal.App.3d 893, 905-906.)

legislative history as well as the statute's plain language requiring consideration of depreciation.

Board Practice

The Board itself consistently interpreted Rule 461 and R&T 51 to require the separate assessment of fixtures. (OB 4, 7.) Three of many sources highlight the Board's three-decade long uniform interpretation.

The Board's *Assessors' Handbook* expressly directs how fixtures should be treated for purposes of declines in value. *Assessors' Handbook*, Section 502, "Advanced Appraisal" (Dec. 1998) ("AH-502") advises that "[a] decline in value of fixtures cannot be offset by an increase in value of land and improvements." (3-AA-720.)

In 2002, only five years before adopting Rule 474, the Board published *Assessors' Handbook,* Section 504, "Assessment of Personal Property and Fixtures" (Oct. 2002) ("AH-504"), which expressly continues the requirement to consider fixtures as a separate appraisal unit. (6-AA-1656.)

The Board's 1992, 1996 and 2002 *Los Angeles County Assessment Practices Surveys* all specifically emphasize the importance of treating fixtures as separate appraisal units *for refineries*. (1-RA-252, 262, 266, 274-275, 286, 288.)

The Los Angeles County Assessor responded to the 1996 survey by stating that he believed Rule 461(d) conflicts with R&T 51. (1-RA-73.) The Board addressed and rejected this contention: "*There is no evidence of conflict between Section 51 and Rule 461(d).*" (1-RA-274-275, emphasis added.)

STANDARD OF REVIEW

The APA establishes the standards for judicial review of administrative rulemaking. New regulations may be invalidated for failure to comply with *any* of the APA's requirements (Section 11350(a)), including the requirement of "consistency."

When evaluating whether a regulation is "consistent" with existing law, the Court exercises its independent judgment, and does not simply defer to the agency's interpretation of the law. (Sections 11342.2, 11349(d); *Aguiar v. Superior Court* (2009) 170 Cal.App.4th 313, 323.) The Board concurs that consistency is reviewed de novo. (OB 10, 36.)

An agency's negative determination that the action will not have a significant, statewide adverse economic impact directly affecting business is reviewed under a substantial evidence standard. (Section 11350(b)(2).)

A. THE BOARD IS NOT ENTITLED TO DEFERENCE.

Western States correctly rejected the Board's contention that it should enjoy a narrow or deferential review. (Opinion 21.) The Board continues to claim that its rulemaking process is entitled to deferential review. (OB 10, 36-37.) This is untrue for two reasons: first, the new interpretation of R&T 51 is contrary to the Board's longstanding administrative interpretation of that statute; and second, Rule 474 is an interpretive – not a quasi-legislative – regulation.

1. Rule 474 conflicts with the Board's longstanding interpretation of R&T 51.

Whether an agency has consistently followed the interpretation in question and whether the interpretation was contemporaneous with

enactment of the interpreted statute are factors influencing the degree of deference, if any, accorded a rulemaking agency. (*Slocum v. State Bd. of Equalization* (2005) 134 Cal.App.4th 969, 975-976; *Yamaha Corp. of America v. State Bd. of Equalization* (1998) 19 Cal.4th 1, 11-12.)

The general rule is that "[c]ourts often do not defer to an abrupt change in an administrative interpretation [of a statute] when such a change vitiates statutory meaning, established and relied upon for many years." (2B Singer, *Sutherland Statutory Construction* (7th ed. 2012), § 49.4, p. 87.) Moreover, "when ... the [administrative] construction in question is not 'a contemporaneous interpretation' of the relevant statute and in fact 'flatly contradicts the position which the agency had enunciated at an earlier date, closer to the enactment of the statute[,]' it cannot command significant deference." (*Henning v. Industrial Welfare Com.* (1988) 46 Cal.3d 1262, 1278.)

In this case, the Board's new interpretation flatly contradicts not only its original interpretation of R&T 51, but also existing Rule 461(e). Rule 474 was adopted almost three decades after Rule 461 and the operative statute (R&T 51), and the new Rule is inconsistent with almost three decades of uniform interpretation of that regulation and statute. Rule 474 should receive *no* deference.

2. Rule 474 is not a quasi-legislative regulation entitled to deference.

R&T 51 is the controlling statute. Rule 474 interprets and purports to implement the statute.

The Board admitted that Rule 474 was an interpretive exercise in its Motion for Summary Judgment (6-AA-1723:21-23) as was the rulemaking.

(1-AA-113 ["proposed rule merely *interprets* and clarifies existing statutory provisions," emphasis added]; 1-AA-136 ["Proposed Rule 474 corrects this *misinterpretation* of Rule 461 and section 51"]; and 2-AA-582 ["... proposed Rule 474 *interprets*, clarifies and advances Rule 461 and section 51," emphasis added].)

"[A]n agency's interpretation does not implicate the exercise of a delegated lawmaking power; instead, it represents the agency's view of a statute's legal meaning and effect, which are questions lying within the constitutional domain of the courts." (*Yamaha*, *supra*, 19 Cal.4th at 11.) "Because an interpretation is an agency's *legal opinion*, however 'expert,' rather than the exercise of a delegated legislative power to make law, it commands a commensurably lesser degree of judicial deference." (*Ibid.*, emphasis original.) "The quasi-legislative standard of review 'is *inapplicable* when the agency is not exercising a discretionary rule-making power, but merely *construing* a controlling statute.'" (*Id.* at 12, emphasis original.) "[F]ormal interpretive rules do not command the same weight as quasi-legislative rules.... [T]he ultimate resolution of ... legal questions rests with the courts." (*Id.* at 13, internal punctuation omitted.)

The Board contends that Rule 474 was required to "fill the gaps" in R&T 51(d), citing *California Forestry Assn. v. California Fish & Game Com.* (2007) 156 Cal.App.4th 1535, 1554. *California Forestry* explains that a regulation may be "necessary to effectuate the purpose of a statute ... if the statute is not entirely self-implementing. In other words, if the purpose of the statute cannot be fully effectuated without the promulgation of implementing regulations." (*Ibid.*) *California Forestry* concluded that a necessity challenge would never lie with respect to the regulations implementing the statute considered in that case because it

expressly required adoption of implementing regulations. (*Ibid.*) In contrast, R&T 51 does not expressly require implementing regulations, and no implementing regulations have been adopted in the more than thirty years R&T 51 has been in effect. Rule 461 pre-dates R&T 51. The Board does not explain what factors have arisen to create a statutory "gap" that now requires "filling."

The Board contends that it promulgated Rule 474 pursuant to delegated lawmaking powers because it is empowered to instruct county assessors on appropriate appraisal methodology under Section 15606, and so Rule 474 is actually a legislative rule entitled to deferential review. (OB 11.) The Board cites no authority. The courts considering Board regulations do not recognize this sweeping exception to the accepted standard for reviewing interpretive regulations. (*Slocum*, *supra,* and *Yamaha*, *supra.*)[12]

---

[12] Even if Rule 474 were a quasi-legislative regulation, the Board is still not entitled to deference. If Rule 474 is a "legislative regulation," then so also is existing Rule 461(e). Generally speaking, "[a] legislative rule is also binding on the agency that issues it." (1 Pierce, *Admin. Law Treatise* (4th ed. 2002), § 6.6, "The Binding Effect of Legislative Rules," p. 354.) The Board cites no authority for the proposition that it is authorized to issue two inconsistent "legislative rules" addressing the same subject.

ARGUMENT

A. RULE 474 VIOLATES THE APA'S CONSISTENCY REQUIREMENTS.

1. Rule 474 Is Based on the Unsupported Contention that for "*Most Types* of Properties, Fixtures Sell Separately From Land in the Marketplace."

The Board asserts that, "[f]*or most types of properties*, fixtures typically sell separately from land and improvements in the marketplace." (OB 4, 12, emphasis added. See also 2-AA-577, 579, 589.) This "typical" experience contrasts, according to the Board, with refineries that commonly sell as an operating unit. There is no evidence in the Rulemaking File supporting this assertion, and the Board does not cite any supporting evidence in its Opening Brief.

No evidence was presented that other heavily fixturized facilities sell without the fixtures required to operate. It was not shown, for example, that an amusement park would sell without rides; that a brewery would sell without brew kettles and bottling lines; that an ice cream manufacturing plant would sell without packaging lines, mixers, and refrigerated storage facilities; that a power plant would sell without generators; or that a ski resort would sell without chair lifts. Judge Hess observed that the Rulemaking File contained "assertions" that refiners were "somehow" different, but there was no support for that bare assertion. (11-AA-3274 [Trial Court Decision].)

Fixtures can be and are sold separately from time to time, but operating enterprises are typically sold as a unit. There is no evidence that fixtures and land for "most types of properties" are sold separately. The

factual assumption supporting the Board's reliance on the "marketplace" criteria is wholly without evidentiary support.

2. Rule 474 Is Invalid Because it Fails to Satisfy the APA's Consistency Criteria.

The APA is necessarily a compromise. The Legislature could not require agencies to exercise good judgment or good faith when adopting regulations, but it could require agencies to defer to the Legislature and refrain from undermining or contradicting the Legislature's own acts.

Rule 474 violates the APA's "consistency" requirements. The "consistency" standard provides that "[n]o regulation adopted is valid or effective unless consistent and not in conflict with the statute." (Sections 11342.2, 11349.1.) "Consistency" means "being in harmony with, and not in conflict with or contradictory to, existing statutes, court decisions, or other provisions of law." (Section 11349(d).) An administrative regulation that is inconsistent with a statute is void. (*Morris v. Williams* (1967) 67 Cal.2d 733, 737; *Ontario Community Foundations, Inc. v. State Bd. of Equalization* (1984) 35 Cal.3d 811, 816.)

a. Rule 474 is inconsistent with Proposition 13 and R&T 51 because it taxes unrealized increases in land value.

Propositions 13 and 8 established two constitutional imperatives: (1) prohibiting assessment of unrealized increases in property values (*Amador Valley Joint Union High Sch. Dist. v. State Bd. of Equalization* (1978) 22 Cal.3d 208, 235); and, (2) mandating accounting for declines in value (*State Bd. of Equalization, supra*, 105 Cal.App.3d at 822-823; see also Prop. 8).

The mandate to account for declines in value resulting from depreciation is expressly codified in R&T 51. R&T 51(a) implements California Constitution, article XIIIA, section 2(b) (a portion of Prop. 13):

> [T]he taxable value of real property shall ... be the lesser of: (1) Its base-year value, compounded annually since the base-year by an inflation factor, ... [or] (2) Its full cash value, as defined in section 110, as of the lien date, taking into account reductions in value due to damage, destruction, ***depreciation***, obsolescence, removal of property or other factors causing a decline in value.

(Emphasis added.) In other words, under R&T 51 and Prop. 13, taxable value is the lesser of the adjusted base-year value or current market value, accounting for reductions in value resulting from depreciation.

R&T 51(d) ensures that depreciation is accounted for by segregating land from depreciating fixtures: "... 'real property' means that appraisal unit that persons in the marketplace commonly buy and sell as a unit, *or that is normally valued separately*." (Emphasis added.)

As Board Staff noted during the Rule 474 rulemaking process: "Fixtures typically depreciate in value. Land typically appreciates in value." (1-AA-168.) Consequently, R&T 51(d)'s "or that is normally valued separately" language was intended to ensure that fixture depreciation is recognized under R&T 51(a)(2). (See 3-AA-807, 810 [Assembly Report]; 1-RA-226; 2-RA-495; 1-RA-274, 275.)

The Board acknowledges that using a single unit of appraisal that includes both fixtures and land will eliminate consideration of fixture depreciation: "Under Propositions 13 and 8, when properties are included in a single appraisal unit with different useful lives, the declines in value of

the shorter-lived assets due to depreciation may be masked by the overall fair market value of the combined unit as a whole." (OB 18.) Thus, the Board concedes that its "marketplace" test is inconsistent with the mandate to account for depreciation.

Rule 474 eliminates ("masks") any accounting for depreciation contrary to the constitutional mandate to account for declines in value, as implemented by R&T 51, and so violates constitutional and statutory standards.

The assessment method established by Rule 474 violates constitutional standards for a second reason as well. Proposition 13 allows the reassessment of land, in whole or in part, under only three circumstances: a change in ownership, new construction, and a capped inflation adjustment. Rule 474, however, allows unrealized increases in land and improvements value, not assessable under Prop. 13, to offset actual declines in fixture value resulting from depreciation even if none of the three exceptions occur. In so doing, Rule 474 violates a central tenet of Prop. 13, as well as R&T 51(d) and Rule 461(e), by allowing land value in excess of the base-year value cap on land to be assessed. As bluntly recognized by the Board Staff in a similar context: "Essentially this treatment eliminates any value reduction with respect to the machinery and equipment due to depreciation...." (1-RA-219.) This offsetting effect was also acknowledged by the Board's lawyers at the March 19, 2010 hearing in the trial court. (RT-175:19-25.)

Rule 474 is necessarily inconsistent with article XIIIA, section 2(b) of the California Constitution and R&T 51, and is thus void.

b. Rule 474 is inconsistent with Rule 461(e) because it eliminates the consideration of fixtures as a separate appraisal unit for decline-in-value purposes.

Rule 461(e) expressly segregates land and fixtures to reflect factors causing declines in value: "*For purposes of this subsection fixtures and other machinery and equipment classified as improvements* ***constitute a separate appraisal unit***." (Emphasis added.)

As chronicled earlier in this Answer, the Board has historically interpreted R&T 51's "normally valued separately" language as codifying Rule 461(e). A list of seventeen specific quotes from Board materials stating that fixtures are a separate appraisal unit for decline-in-value purposes is assembled at 9-AA-2467 to 2471.

In 1998, while efforts to revise AH-502 were underway, the California Assessors Association inquired whether Rule 461 was inconsistent with R&T 51(d). In response, Board Counsel Kris Cazadd, subsequently the Board's Chief Counsel and then the Board's Acting Executive Director, concluded that Rule 461 was consistent with R&T 51(d), and that R&T 51 was drafted to "accommodate" and "reflect" Rule 461. (2-RA-324; see also 1-RA-226 [1996 memorandum to Board Member D. Andal that R&T 51(d) "is an explicit exception that results from Rule 461(d)"].)

Fixtures have been uniformly considered as a separate appraisal unit *by the Board* for more than thirty years, under the "normally valued separately" language in R&T 51 and Rule 461. Rule 474 is inconsistent with both laws.

c. The Board's "marketplace" appraisal unit is inconsistent with R&T 51(d)'s legislative intent and renders the second clause of R&T 51(d) mere surplusage.

There is no historical support for the Board's assertion that the Legislature intended the phrase "normally valued separately" to refer to the unit of property transferred in the marketplace. (OB 6 ["proper appraisal unit is ... one that persons in the marketplace ... 'buy and sell' separately"].) To the contrary, the documented intent of R&T 51 and Rule 461 has always been to treat fixtures as a separate appraisal unit in order to account for depreciation. R&T 51 has been in effect for over three decades and has been amended six times (1981, 1984, 1985, 1995, 1998 and 2000) with no substantive change to R&T 51(d) and without a change in this intent. (See *Yu v. University of La Verne* (2011) 196 Cal.App.4th 779, 788 ["We presume that the Legislature, when enacting a statute, was aware of existing related laws and intended to maintain a consistent body of rules"], internal punctuation omitted.) Taxation must, of course, be uniform and the tax laws uniformly applied. (See *Trabue Pittman Corp. v. County of Los Angeles* (1946) 29 Cal.2d 385, 392-393, 397-398.)

The Board's longstanding consistent interpretation of R&T 51(d) and Rule 461(e), in the absence of contrary legislative action, establishes a presumption that the Legislature approved the Board's historical construction of Section 51(d). (*Moore v. California State Bd. of Accountancy* (1992) 2 Cal.4th 999, 1017-1018.) The Legislature has not amended R&T 51(d) to "defeat" Rule 461(e). (*Id.* at 1017.)

The test for consistency starts with the plain words of the statute (*Californians Against Waste v. Department of Conservation* (2002) 104 Cal.App.4th 317, 321). The Board's omission of the second clause of

the definition established by R&T 51(d) from Rule 474 is *prima facie* evidence of inconsistency and renders that clause mere surplusage.

Alternatively, the marketplace concept is already expressly recognized by the first clause of the definition in R&T 51(d) (*i.e.*, "that persons in the marketplace commonly buy and sell as a unit"), and so the second clause must have a separate and different meaning – interpreting the phrase "normally valued separately" to refer to the marketplace concept would be redundant.

The Board concedes that fair market valuations must account for depreciation, but only if doing so is consistent with the "marketplace," which is the "overriding principle," citing *McDonnell Douglas Corp. v. County of Los Angeles* (1990) 219 Cal.App.3d 715, 726; *Exxon Mobil Corp. v. County of Santa Barbara* (2001) 92 Cal.App.4th 1347, 1353; and *City of San Diego v. Neumann* (1993) 6 Cal.4th 738, 756. (OB 22.) These cases do not involve fixtures assessment or distinguish between land and fixtures. None of these cases holds that, or even considers whether, the "marketplace" clause of R&T 51(d) "overrides" the "normally valued separately" clause of the same subdivision.

The Board also miscites Davis, Valuation Opinion Must be Based on Appraisal Practices Mimicking the Market: A Criticism of *Texaco Producing, Inc. v. County of Kern,* California Tax Lawyer, Winter 2000, pp. 4, 7 (10-AA-2779, 2782) for the proposition that the marketplace principle overrides the necessity of accounting for fixture depreciation. (OB 22.) That article does not address fixture assessment or appraisal units.

d. The Board confuses the appraisal unit and California's property tax value standard.

The "appraisal unit" (the unit being valued) is conceptually distinct from the property tax assessment *value standard*. The Board asserts that real property tax valuations must be based upon the fair market/full cash value of real property, citing California Constitution, article XIII, section 1, article XIIIA (Prop. 13), section 2, and R&T 51 and 110. (OB 2.) These legal authorities refer to the fair market value/full cash value of property, and simply articulate the assessment value standard (value in exchange/willing buyer-willing seller).

The Court of Appeal has rejected the concept that statutory provisions addressing "full cash value" require property to be appraised as a single unit for decline-in-value assessments. (*County of Orange v. Orange County Assessment Appeals Bd.* (1993) 13 Cal.App.4th 524, 530-533.) There, the Court rejected the notion that subdivisions (a) and (b) of R&T 51, both of which refer to the term "full cash value" as defined in Section R&T 110, compelled the appraisal of a cable television system as a single unit, holding "[t]hose subdivisions say nothing about the propriety of dividing the appraisal unit into components to determine its value .... Taken as a whole, neither section 51 in general, nor subdivision [d] in particular, mandate appraisal of the property as a single unit." (*Id.* at 530.)

e. Rule 324(b) is consistent with R&T 51(d) and Rule 461(e). Rule 474 is not.

The Board relies heavily on Rule 324(b)'s "normally valued in the marketplace separately" language to support its assertion that Rule 474 is consistent with existing law. In fact, the Board would have the Court read the "in the marketplace" language from Rule 324(b) into Section 51

(OB 24-25) to support its "composite or unitary marketplace appraisal unit" concept.

The Board recites Rule 324(b) as follows: "An appraisal unit of property is a collection of assets that functions together, and that persons in the marketplace commonly buy and sell as a single unit or that is normally valued *in the marketplace* separately from other property, or that is specifically designated as such by law." (OB 24, emphasis original.) The Board, however, ignores the operative clause, "or that is specifically designated as such by law," which was added to Rule 324(b) in 1990. That operative clause refers to Rule 461, which specifically designates fixtures as a separate appraisal unit: "For purposes of this subsection fixtures and other machinery and equipment classified as improvements constitute a separate appraisal unit." (Rule 461(e).) Rule 461(e) and R&T 51(d) (second clause) are the "law" referred to at the end of Rule 324(b).

Contrary to its current position, six years after Rule 324 was amended to include the "or that is specifically designated as such by law" language, the Board was advised by its counsel that Rule 324(b) is consistent with Rule 461. (1-RA-226.)

The Board cites *Exxon Mobil*, *supra*, 92 Cal.App.4th 1347 as endorsing the marketplace unit of appraisal concept articulated by Rule 324(b). (OB 25). Reliance on *Exxon Mobil* fails because that case considered assessment of oil and gas property, which "required specialized appraisal techniques" (*id.* at 1356) and because it did not consider the second clause in Rule 324(b) ("or that is specifically designated as such by law").

Rule 474's "marketplace" principle may define the economic unit, but it is inconsistent with R&T 51(d) and Rule 461(e) because it masks fixture depreciation which must be accounted for as a matter of law.

3. The Analogy to Property Tax Rules for Natural Resource Extraction Industries Does Not Support Rule 474.

The Board states, "Rule 474 is just another exception to the general rule of Rule 461(e)." (OB 20.) There are no analogous exceptions to Rule 461(e).

The Board refers to its Rules 468, 469 and 473 as analogous exceptions to Rule 461(d). Rules 468, 469 and 473 all relate to extractive industries (oil and gas, hard minerals like gold, and geothermal production). While these rules do establish exceptions to the requirement of Rule 461(d) that fixtures be treated as a separate appraisal unit, these three exceptions result from the unique characteristics of mineral extraction properties, which characteristics are not shared by refiners or other manufacturing enterprises.

Extractive properties are fundamentally different from manufacturing. Mineral properties have unique characteristics: the taxable interest is a profit à prendre, *i.e.*, a right to remove (explore for, develop and produce) minerals from property, the value of which is inextricably tied to the mineral reserves. (*Lynch v. State Bd. of Equalization* (1985) 164 Cal.App.3d 94, 102.) Further, Rules 468, 469 and 473 are all designed to address the depleting nature of mineral properties, which prevents them from being "treated in a manner identical to other types of property"

because the mineral interests "have no real parallel with other types of property." (*Id.* at 115, 117 [discussing Prop. 8 reductions under R&T 51].)

In contrast, the taxable property interest in a refinery is not the "right to remove" found in mineral properties, and refineries have no depleting or extractive aspect.

Each of the three cited rules provides that value declines are recognized when the market value of the appraised unit, which is expressly defined to mean land, improvements *and mineral reserves*, is less than the taxable value of the same unit. In other words, each of the three rules follows the "single appraisal unit" theory for accounting for declines in value. (See Rule 468(c)(6), Rule 469(e)(2)(C) and Rule 473(e)(4)(C).) This means that depreciation for production equipment (fixtures) is measured by depletion of the minerals that the equipment extracts. The reason for the deviation from Rule 461(d) for mineral extraction properties is tied to the unique requirements of those properties for calculating depreciation.

The Board's Staff rejected the analogy to Rules 468 and 469 as support for Rule 474 for this very reason. (4-AA-1111-1114 [petroleum refineries are not extractive/depletive in nature, and unlike extractive/depletive properties, refineries do not have unique features that warrant an exception to Rule 461].) The value of production equipment is tied to the value of the mineral rights, which in turn derive from the amount of the minerals that can be removed. (1-RA-120 [AH-566, p. 7-2].) Production "equipment is valued for its utility without consideration for its age or condition...." (1-RA-121 [AH-566, p. 7-3]. See also *Exxon Mobil, supra,* 92 Cal.App.4th at 1356.)

Finally, there was no evidence in the Rulemaking File that mineral extraction properties have a high proportion of fixture values, one of the Board's questionable rationales for Rule 474.

B. RULE 474 IS INCONSISTENT WITH ARTICLE XIIIA, SECTION 3 OF THE CALIFORNIA CONSTITUTION BECAUSE IT INCREASES AN EXISTING TAX WITHOUT THE REQUIRED TWO-THIRDS VOTE OF THE LEGISLATURE.

Rule 474 is inconsistent with Proposition 13 for a second reason. Prop. 13 prohibits changes in state taxes that might thwart the purposes of the Proposition and strictly regulates changes in state taxes enacted for purposes of increasing revenues. Article XIIIA, section 3 of the California Constitution requires two-thirds legislative approval to change the method of calculating property taxes. Rule 474 was adopted for the purpose of increasing revenue.

Rule 474 constitutes a change in the method of computing property taxes by eliminating the segregation of fixtures to calculate declines in value. The resulting increase in assessable value and thus tax revenues constitutes a new tax or an increase in the existing tax due to the new method by which the assessed values are determined.

Whether value should be determined as a single appraisal unit consisting of land, improvements, fixtures, or instead whether the fixtures can be valued separately, raises an issue of the method of valuation. (*County of Orange*, *supra*, 13 CalApp.4th at 529.)

While the amount of increased tax under Rule 474 was not reasonably determined by the Board, the *direction* or general impact of the rule change is clear: increased taxes. The Economic and Fiscal Impact

Statement for Rule 474 includes a section relating to "Estimated Benefits." This segment is structured in a question and answer format that provides in pertinent part: "1. Briefly summarize the benefits that may result from this regulation and who will benefit: The increased property tax revenues would benefit schools and county and local governments." (2-RA-365.) Thus, the intended purpose was to generate increased revenue.

The Board members recognized the impact of the new rule. Member Steele commented during the hearing conducted on August 14, 2007:

> [Y]ou know, this is really [a] tough one because it seems like we try to put the fixture[s] and land together, that is going to raise taxes no matter what.

(2-RA-384:16-19.)

Below, the Board claimed that:

> In essence, Rule 461 has ... provided a property tax windfall for petroleum refineries where none was intended by the Legislature. This is supported by the assessors' testimony and other evidence presented to the Board during the rulemaking process, which testimony ultimately was accepted and acted upon by the Board.

(2-RA-365; 9-AA-2530:9-13.) This text is a blunt admission that Rule 474 was intended to increase revenues by closing what the Board now asserts was a tax loophole. The Board even conceded that Rule 474 constitutes a change in method: "Rule 474 merely creates a reasonable *method* of ensuring that an appropriate appraisal unit is utilized ...." (9-AA-2533:28-2534:1, emphasis added.)

The prohibitions established by Prop. 13 were not limited to increasing tax *rates* without a super-majority vote, but also included changes in *methods* of taxation. (*Sinclair Paint Co. v. State Bd. of Equalization* (1997) 15 Cal.4th 866, 873 (citing *Amador, supra*, 22 Cal.3d at 231 [fees]); *AB Cellular LA, LLC v. City of Los Angeles* (2007) 150 Cal.App.4th 747, 759-762 (City's decision to expand cellular telephone tax to cover all airtime was revision of methodology and thus required voter approval under Proposition 218: "a taxing methodology must be frozen in time until the electorate approves higher taxes;" "In practical terms, a tax is increased if the math behind it is altered so that either a larger tax rate or a larger tax base is part of the calculation."). See also Opinion 6, fn. 3.)

Western States firmly grasped these principles (although it did not address this issue in light of its other determinations): "The Legislature well reasoned that, if the manner in which real property was understood and valued did not remain constant in the transition from the prior real property tax system to the new real property tax system, then the voters' intended goal of restricting real property taxes might prove elusive.... SBE would interpret [R&T] section 51(d) to allow for the adoption of new valuation formulas by which the framework governing real property could be manipulated to avoid the restrictions on real property taxes imposed by the voters when they approved Prop. 13 and Prop. 8." (Opinion 21.)[13]

---

[13] *Western States,* having found Rule 474 to be inconsistent with R&T Section 51(d), declined to address whether the Rule also conflicted with Article XIIIA. (Opinion 27.)

C. THE ECONOMIC IMPACT STATEMENT PREPARED BY THE STATE BOARD OF EQUALIZATION WAS INADEQUATE.

The Board erred in two respects: it did not prepare an adequate record documenting the basis for its determination and it did not fairly determine the impact of and/or costs imposed by Rule 474.

1. The APA Requires Agencies to Create Rulemaking Files Adequate to Support Meaningful Review by the Courts. The Board's Economic Impact Statement Failed to Satisfy this Requirement.

The APA requires administrative agencies to create a record of regulatory activity sufficient for meaningful judicial review. (*California Optometric Assn. v. Lackner* (1976) 60 Cal.App.3d 500, 506 ("*Optometric Assn.*") The Courts are tasked to "determine whether the agency's [rulemaking] action was arbitrary, capricious, or without evidentiary support, and/or whether it failed to conform to the law." (*Association of Irritated Residents v. San Joaquin Valley Unified Air Pollution Control Dist.* (2008) 168 Cal.App.4th 535, 542.)

An adequate administrative record is essential for judicial review: "We must know what a decision means before the duty becomes ours to say whether it is right or wrong." (*California Assn. of Nursing Homes etc., Inc. v. Williams* (1970) 4 Cal.App.3d 800, 811 ("*Nursing Homes*").) There, the agency failed to hold a hearing establishing an evidentiary record, and the Court of Appeal invalidated the regulation. The APA requires a meaningful opportunity for judicial review, which

> ... rest[s] upon the assumption that a body of relevant evidentiary material will be compiled at

> the hearing, considered by the agency in formulating its order, preserved by it and transmitted to the court for the latter's use when and if review is sought. That assumption is unfulfilled here.

(*Id.* at 812.)

In the case at bar, both the Superior Court and the Court of Appeal determined that the Board failed to make *any* meaningful determination of economic impact susceptible to review.

Judge Hess ordered a special hearing for the Board "[t]o explain why the Economic and Fiscal Impact Statement, and in particular [how] page 0172 in the Rulemaking file, represents an accurate calculation of the increased taxes to be expected from Rule 474's implementation." (11-AA-3214 [Order to Appear].) Judge Hess explained that he had read the economic impact conclusion documented by the Rulemaking File and asked the Board's counsel to explain it. (RT-152:12-20.) The trial court observed that there was "zero analysis of, I mean zero analysis of what happens with fixtures. How the fixtures change." (RT-172:19-21; see also RT-157:6-7.) The Board's counsel responded that the depreciation assumption is "implicit" (RT-157:23-24), and Judge Hess responded without contradiction that "there is no number that I can examine." (RT-157:14-15.) Judge Hess asked to be pointed to the portion of the record where this information exists, and the Board's counsel responded, "We will. We want to." (RT-172:28.) But nothing was ever identified.

The Trial Court Decision reflects the trial court's frustration with the Board's non-responsiveness:

> Frankly – despite extended oral argument on this point on March 19th – the Court is utterly unable to understand why this calculation is correct as a measure of increased taxes from treating refineries as a single assessment unit for decline in value purposes. Even as a theoretical matter, surely there should be some quantification of the effect of depreciation of fixtures on assessed value. The [economic impact] methodology actually used is so incomprehensible that it suggests three possibilities: (1) that no one knew how to do a real estimate; (2) that doing an estimate using comparative numbers from an actual year was too much trouble; or (3) it was a deliberate attempt to minimize the apparent effect of the change to disguise its actual effect. Whatever the reason, the Economic Impact Statement lacks any believability, and appears actually misleading.

(11-AA-3276 [Trial Court Decision].)

The Court of Appeal was equally plain:

> The Statement is without any reference to supporting facts or evidence.... The "calculations" are little more than a numbers dump, with no explanation of how or from where the numbers are derived. It is not altogether clear in our view whether the numbers used in the "calculations" reflect actual facts.... The EIS [Economic Impact Statement] leaves a reader without an understanding of what the taxes on a representative refinery would have been under the formerly applicable Rule 461(e) and what the taxes would be under the new Rule.

(Opinion 24-25.) The Court of Appeal found that the Economic Impact Statement ("EIS") was not supported by adequate facts as required by the APA and that it "lacked a meaningful quantification" of "real world" impact. (Opinion 25.)

Both reviewing courts correctly determined that the EIS could not be explained by the agency promulgating the regulation and defied meaningful review.

2. The Board's Economic Impact Statement Is Not Supported by Any Evidence, Much Less Substantial Evidence.

The Board erroneously contends the EIS was supported by substantial evidence. (OB 37-39.)

The Board was obligated to assess the potential for adverse economic impact on California business enterprises. (Sections 11346.2(b)(4), 11346.3(a).) It was also required to base its determination on "adequate information concerning the ... consequences of ... proposed governmental action" (Section 11346.3(a)(1), and the "proposal's impact on business." (Section 11346.3(a)(1) and subd. (a)(2).)

The Board was also required to disclose its efforts in its notice of proposed adoption, amendment or repeal of a regulation (Section 11346.5) and was required to "provide in the record facts, evidence, documents, testimony, or other evidence upon which the agency relies to support its initial determination." (Section 11346.5(a)(8).)

Additionally, the Board was required to prepare and maintain a rulemaking file, the contents of which:

> ... *shall include* ... (4) The determination [of economic impact], *together with the supporting data* ...; (5) The estimate [of compliance costs], *together with the supporting data and calculations* ...; (6) All data and other factual information, any studies or reports, and written comments submitted to the agency ...; [and,]

> (7) All data and other factual information, technical, theoretical, and empirical studies or reports, if any, on which the agency is relying ... including any economic impact assessment.

(Sections 11347.3(b)(4)-(7), emphasis added.)

The APA therefore requires that the Board prepare an EIS satisfying three requirements: (1) meaningfully determine and quantify the economic impact of a new regulation; (2) support that determination by facts; and (3) disclose the basis for that determination.

The APA imposes upon the promulgating agency the unusually stringent requirement to "prove a negative," that is, to demonstrate that a new regulatory action *will not* have an adverse impact if that is the case, and to do so based on facts. (Section 11346.5(a)(8) [If an agency makes an initial determination that the action "will not have a significant statewide adverse economic impact directly affecting business," then "it shall provide *in the record* facts, evidence, documents, testimony or other evidence upon which the agency relied to support its initial determination"], emphasis added.)

The sole basis for the EIS is found in a single paragraph on a single page of a Revenue Estimate prepared in 2005, which reads, under the heading "Preparation": "This revenue estimate was prepared by Aileen Takaha Lee, Research and Statistics Section and reviewed by Mr. David E. Hayes, Manager, Research and Statistics Section." (3-AA-611.) The Board re-dated the 2005 estimate ("Current as of June 7, 2006") and made a few immaterial edits, but the 2005 estimate was otherwise copied into the 2006 Revenue Estimate (compare 6-AA-610-611 with 6-AA-626-627)

without change. (OB 38.)[14] There is no "evidence, documents, testimony" or any other verifiable or reviewable evidence supporting the assumptions contained in the 2005 or 2006 version of the EIS *in the record* as expressly required by Section 11347.3(b). Thus, the Board purports to rely on a private report not available for review or comment by the public.

The Board represents that "[t]he tax estimate was based on information received from both the county assessors and WSPA during the public rulemaking process. (3-AA 626-627.)" (OB 38.) The record only includes the 2006 EIS, not information from WSPA or assessors. The information purportedly received is not identified.

The Board asserts that "[t]he the testimony and evidence submitted by the county assessors and industry constituted *substantial evidence supporting the Board's adoption of Rule 474*" (OB 38), which assertion is followed by ten citations to the Rulemaking File, one of which is the 2006 Revenue Estimate itself. (3-AA-626.) But all of the citations to the Rulemaking File offered by the Board as "substantial evidence" supporting the EIS relate to testimony and letters developed *after* June 2006 and so could not have been considered in preparing the 2005 or 2006 economic impact analysis, and none relate to the Board's calculations or factual or methodological support for the Board's tax calculations.[15]

---

[14] The Board's estimate is repeated over and over throughout the Rulemaking File. (See, e.g., 1-AA-162-168; 1-AA-113-114; 3-AA-610-611, 626-627, 633, 636, 638-639.) The rote repetition of the same estimate unsupported by facts or calculations is not a statutorily sufficient substitute for actual factual information, studies or reports.

[15] One citation, 2-AA-368, is to the Board's response to WSPA's comment that the EIS understated the amount of the tax increase that

The Board states that it prepared the EIS after "analyzing relevant data" (OB 40), citing approximately twenty pages from the Rulemaking File. None of those citations contain a meaningful tax projection.

An "agency ... may not base its decision on evidence outside the record and not made available for rebuttal by the affected parties." (*Nursing Homes*, *supra*, 4 Cal.App.3d at 811.) Further, "[j]udicial review frequently focuses upon claims of arbitrariness, that is, that the regulation has no evidentiary support.... The body of evidence upon which the agency acted is indispensible to pursuit of that inquiry. Unmarked exhibits and influential, off-record staff reports are inimical to informed judicial review." (*Optometric Assn.*, *supra*, 60 Cal.App.3d at 510-511, citation omitted.)

No evidence is not "substantial evidence." The EIS is the Board's opinion about the amount of tax increase that would result from the change in assessment methodology required by Rule 474. The Board's opinion is based solely on an undisclosed and undated analysis prepared by a staff member undertaken before the rulemaking process commenced, and the conclusion based on that analysis does not disclose or explain the economic impact of compliance.

This deficiency in the Board's Rulemaking File not only violates the express requirements of the APA, but it violates well accepted definitions of "substantial evidence." An opinion without a factual foundation is not "substantial evidence." (*San Diego Gas & Electric Co.* v. *Sinclair* (1963)

---

would result from the assessment method changed by the Rule. The Board's response is merely another reference to its 2006 Revenue Estimate.

214 Cal.App.2d 778, 783; *Pacific Gas & Electric Co.* v. *Zuckerman* (1987) 189 Cal.App.3d 1113, 1135-1136 ("Where an expert bases his conclusion upon assumptions which are not supported by the record ... then his conclusion .... cannot rise to the dignity of substantial evidence.").)

"An action is arbitrary when it is based on no more than the will or desire of the decision-maker and not supported by a fair or substantial reason." (*Nursing Homes*, *supra*, 4 Cal.App.3d at 810, fn. 10, citations omitted.) The Board's failure to provide any evidentiary support for its declaration that Rule 474 would not have a meaningful adverse impact rendered that determination arbitrary.

a. WSPA proffered a correct economic impact analysis at trial to show that the EIS was incomplete.

One challenging an administrative regulation is not limited to the rulemaking file for all purposes. Additional evidence may be submitted to a reviewing Court if it is "[a]n item that is required to be included in the rulemaking file but is not included in the rulemaking file, for the sole purpose of proving its omission." (Section 11350(d)(3).) WSPA expressly addressed the omitted economic impact analysis by preparing an analysis that quantified an economic impact of more than $100 million.[16]

The EIS grossly understates the revenue impact of the new regulation. The reality is that a representative refinery will incur a tax increase over a five-year period of approximately $7,900,000. (See Oil

---

[16] The Board's EIS estimated an increase in tax of $1.4 million in the first year, increasing thereafter. (3-AA-644.)

Refinery Hypothetical Effect of Rule 474 on Decline in Value.)[17] If this amount is extrapolated to actual California refinery capacity in 2006, the six-year tax increase for California refineries, is almost $114,000,000. The Board's estimate was off by a factor of more than 100. The impact on a refinery with a 1975 base-year value would be much greater than for the "representative refinery," but these distinctions were not considered by the Board. The Board never contended, much less demonstrated, that WSPA's analysis of Rule 474's impact was wrong, or that this method of estimating the impact was inaccurate. Neither does the Board attempt to show that its own estimate was reasonable.

b. WSPA's submission of a correct economic analysis was proper.

The Board contends that *if* an agency's initial determination is supported by substantial evidence, then "a party's belated showing that the EIS or Initial Determination were incorrect or inaccurate is insufficient to overturn the regulation," citing 6 pages from *California Assn. of Medical Products Suppliers v. Maxwell-Jolly* (2011) 199 Cal.App.4th 286 ("*California Assn.*"). (OB 38-39.) The plaintiff in *California Assn.* did not,

---

[17] See 8-AA-2354 to 2356 (demonstrative exhibit attached to Plaintiff's Motion for Summary Judgment). Judge Hess erroneously granted the Board's objection to this foundational declaration on grounds that it was not included in the Rulemaking File. (9-AA-2632-2633 [SBE Objections to Declaration of K. Spletter, Objection Nos. 1c, 2c and 3c)] and 11-AA-3265, fn. 2 [Trial Court Decision].) The Board did not, however, object to the method used to calculate the amount of new tax or contend that the method or conclusion was wrong. The Board even refers to this analysis to impeach WSPA's request during rulemaking that the Board provide the public with the basis for its $1.4 million impact calculation, in which WSPA stated the impact could be "as much as $10 million or more." (2-AR-313; OB 43.)

however, offer additional evidence at trial and so that case does not address the applicability of Section 11350(d)(3).

The Board also contends, without citation of authority, that some sort of estoppel prevents one challenging a regulation from showing the insufficiency of the Rulemaking File if controverting evidence was not submitted during the rulemaking process. (OB 39.) The Board does not consider Section 11350(d)(3), which expressly allows the introduction of additional evidence at trial to show omissions or gaps in the Rulemaking File.

The APA imposes compliance obligations solely on the agency desiring to adopt a new regulation. The Board cites Sections 11346.5(a)(8) and 11350(b)(2) to support its assertion that a regulated industry has an affirmative obligation to provide information and participate in the rulemaking process (OB 39), but neither law supports that statement. The first statute merely identifies materials to be included in a rulemaking file; the second states that a court may invalidate a regulation if the determination that a regulation will not have a significant statewide impact is not supported by substantial evidence. Neither statute places affirmative obligations on the regulated industry to provide information to the promulgating agency or to participate in the rulemaking process. The Board cannot excuse its failure to comply with an APA mandate by suggesting that some other party did not perform the Board's duties.

Finally, the Board contends that a regulation can only be declared invalid under Section 11346.5(a)(8) if the "agency's determination conflicts with substantial evidence in the rulemaking record. *The Rule 474 rulemaking record does not contain conflicting evidence.*" (OB 39,

emphasis added.) The Board goes so far as to say that "if an agency's Initial Determination is supported by substantial evidence," then "regardless of the accuracy or inaccuracy of the EIS," it would be valid if there is no conflicting evidence. (OB 43.) The Board does not address how the cited language is applied where the agency has not compiled any evidence or analysis that can be compared to other material in the record, or even reviewed for internal consistency. Here, the Board failed to develop a meaningful record. The Board's own failure to create a record does not render the Board immune from review. (See also Opinion 25.)

3. Requiring the Board to Fully Explain How the New Regulation Would Actually Operate Was Reasonable.

The Board asserts that *Western States* impermissibly required the Board to determine the actual economic impact of the new regulation. (OB 7-8, 46.) The Board specifically quotes the language from *Western States* to which it objects: "We agree with the trial court's conclusion that SBE's economic impact analysis lacked meaningful quantification of Rule 474's 'real world' impact. That is, an economic impact based on data concerning fixture depreciation on assessed values." (OB 47, citing Opinion 25.)

The APA expressly obligated the Board to assess and report the potential for adverse economic impact on California business enterprises (Sections 11346.2(b)(4), 11346.5(a)(8)), including the compliance cost for "a representative ... business." (Section 11346.5(a)(9).) This requirement is not limited or qualified. The statute does not require an agency to provide its "best guess" about the potential for adverse economic impact.

The Board asserts that it substantially complied with the requirement to determine the adverse economic impact of Rule 474 (OB 39-43), but provides no explanation that allows the determination of "how substantial" its compliance was or even what degree of compliance would be sufficiently "substantial."

The analysis of economic impact and identification of the compliance costs should bear a reasonable relationship to the intended purpose of the regulation. Where a regulation, such as a tax regulation, will require that calculations be made and sums paid, then it cannot be unreasonable to require the agency to actually make sample calculations illustrating how the regulation would operate. This kind of plain disclosure is inherent to the requirement that the agency determine and disclose the "compliance requirements" of a new regulation (Section 11346.5(a)(7)(B)), a description of "statewide adverse economic impact directly affecting business" (Section 111346.5(a)(8)), and "cost impacts" (Sections 11342.535 and 11346.5(a)(9)), meaning direct compliance costs of a representative business. The APA requires that these consequences be disclosed, regardless of how substantial or insubstantial, on a "macro" statewide basis and on a "micro" representative business basis. Considered cumulatively, the Legislature created a comprehensive and stringent obligation to determine the actual impact of a new regulation.

Requiring an accurate determination of economic impact is particularly crucial for regulations which change the method used to assess property taxes. The Legislature has found that: "Taxes are a sensitive point of contact between citizens and their government, and disputes and disagreements often arise as a result of misunderstandings or

miscommunications" and that "the proper assessment and collection of property taxes is essential to local government and the health and welfare of the citizens of this state." (Legislative Findings, R&T 5901, "Morgan Property Taxpayer's Bill of Rights.") It is the Legislature's intent that "Taxpayers are provided fair and understandable explanations of their rights and duties with respect to property taxation ...." (R&T 5911(a).)

The special sensitivity of tax proceedings is reflected in special rules of interpretation: "[A]ll proceedings in the assessment of property for taxation and all proceedings in levying and collecting taxes are *in invitium* [against an unwilling party] and are to be strictly construed in favor of the taxpayer." (*Shell Western E & P, Inc. v. County of Lake* (1990) 224 Cal.App.3d 974, 984, citation omitted.)

These same considerations should apply to the rulemaking used to establish tax methodology and require more stringent compliance with the APA, not less.

The Board, citing Section 15606, repeats throughout its brief that it is responsible for explaining how the property tax system is administered and ensuring uniform application of that system, which of course would include Rule 474. (OB 6, 11, 30.) Yet, having wrapped itself in this mantle of authority, the Board's EIS was unintelligible and the Board could not explain how the EIS quantified the economic impacts and direct costs associated with the Rule. The Board's obligation to supervise implementation of the regulation by county assessors dictates more rather than less diligence in quantifying a regulation's impact and explaining how a new tax regulation will work.

Finally, a change in taxing methodology has constitutional implications unique to a property tax regulation. Article XIIIA, section 3 of the California Constitution expressly prohibits changes in methods of computation for purposes of increasing taxes without a two-thirds vote of the Legislature. (*Supra*, at 25.) A determination that a change in the method of taxation will or will not increase taxes is elevated to a constitutional determination that alone could stop or invalidate the rulemaking process if properly evaluated. The accurate assessment of whether a change in computation method will increase taxes is essential to preventing evasion of Prop. 13. The possibility of an agency miscalculating the actual impact of a tax regulation to avoid the constitutional bar is too immediate to permit undocumented "not-real-world" estimates.

The Board's plea to be allowed to use undefined "reasoned estimates" (OB 46) or "implicit" assumptions instead of fact-based analysis, or to base its estimate of impact on the vague standard of "some factual basis" (OB 48) and to be accorded "flexibility" (OB 8, 30, 46) should be rejected. The product of the factors the Board advocates was unintelligible and insufficient to provide a meaningful opportunity for comment or review.

a. *California Assn.* supports WSPA in part, but is otherwise erroneous and should be disapproved.

The Board places great weight on selected portions of *California Assn.*, *supra*, 199 Cal.App.4th 786 for the proposition that it was not required to determine the actual economic impact of Rule 474. (OB 40, 46-49.)

California Assn. correctly articulates a number of legal principles governing review of administrative actions under the APA, but the holding of that case violates those same principles and misinterprets the APA. The holding of *California Assn.* cannot be reconciled with *Pulaski v. California Occupational Safety and Health Standards Board* (1999) 75 Cal.App.4th 1315, *infra*, *Nursing Homes*, *Optometric Assn.*, or *Western States*. *California Assn.* should be disapproved.

California Assn. addresses how the APA applied to a regulation adopted by the California Department of Health Care Services (the "Department") which changed the formula used to determine the amount of reimbursement payable to providers of medical supplies for Medi-Cal recipients. The regulation was intended to prevent fraud and abuse by medical suppliers that were obtaining supplies for free or at significant discounts, but obtaining reimbursement from Medi-Cal using a formula that did not account for the original cost (or lack of original cost) of the supplies. The new regulation tied the amount of reimbursement to the cost of acquisition and allowed a "mark-up" of that acquisition cost.

The Department's "Economic and Fiscal Impact Statement" (also "EIS") concluded that the regulation would not have a significant adverse economic impact, but did not actually determine how the new reimbursement formula would impact the private sector or support its determination with an evidentiary basis.

A number of medical suppliers questioned the Department's conclusion on grounds that the reimbursement formula would not be appropriate for suppliers that had a low net acquisition cost, and because the formula excluded inventory costs from being considered as part of

acquisition costs, which would prejudice large suppliers using warehousing and inventory tracking systems. (*California Assn.*, *supra*, 199 Cal.App.4th at 296.) These concerns were not addressed by the Department.

The California Association of Medical Products Suppliers ("CAMPS") challenged the regulation on grounds that the Department did not make any evidentiary determinations to support its conclusion that the regulation would not have a significant economic impact affecting a business as required by Sections 11350(b)(2), 11346.5 (a)(8) and 11346.3(a) of the APA. (*California Assn.*, *supra*, 199 Cal.App.4th at 303.) CAMPS contended that the Department's mere "belief" was not sufficient to comply with the APA. CAMPS also contended that an agency must do more than just "consider" a possible impact. (*Id.* at 305.)

California Assn. correctly accepted CAMPS' main points. It holds that an agency is required to base its determination on "adequate information concerning the ... consequences of" the proposed action (*California Assn.*, *supra*, at 304), and that the agency must support that determination by "facts, evidence, documents, testimony, or other evidence," quoting the APA. (*Id.* at 305.) The Court of Appeal also agreed that the agency must do more than just "consider" a proposal's impact (*ibid.*), that "mere speculative belief is not sufficient to support an agency declaration of its initial determination about economic impact," and that the agency must specifically "assess" the potential adverse impact. (*Ibid.*) The Court of Appeal concluded its review of CAMPS' contentions with the plain statement that, "These provisions plainly call for an evaluation based on facts." (*Id.* at 306.) To this extent, *California Assn.* and *Western States* are entirely consistent.

But then the Court of Appeal concludes that none of these factors was significant for three main reasons, which are: (1) that even if the regulation has an undocumented adverse impact it *may* still be valid; (2) that the "Initial Determination" is just an 'initial" and not a "conclusive" determination; and, (3) that the regulation may only be declared invalid for "substantial failure" to comply with APA requirements and technical deviations are not to be given the stature of non-compliance. (*California Assn.*, *supra*, 199 Cal.App.4th at 306-307.) Each of these three reasons for excusing the Department's failure to base its negative declaration on evidence was error.

(1) The term "may" is not permissive when such construction is inconsistent with a public purpose.

California Assn. states: "[T]he APA instructs that 'a regulation ... *may* be declared invalid if ... [t]he agency declaration ... is in conflict with substantial evidence in the record. ([Section] 11350(b)(2).)" (199 Cal.App.4th at 306.) In this context, the word "may" is directory. *California Assn.*, however, interprets this language to excuse documenting a determination that a regulation will not result in an adverse impact. The holding is not limited to allowing an agency to resolve conflicts in evidence. Rather, it excuses nonfeasance:

> It is a well established rule of statutory construction that the word "shall" connotes mandatory action and "may" connotes discretionary action." (*In re Marriage of Fossum* (2011) 192 Cal.App.4th 336, 348.) Thus, courts are not *required* to declare a regulation invalid if an agency's declaration regarding negative economic impact on business is in conflict with substantial evidence in the record.

(*California Assn.*, *supra*, at 306, emphasis original.) *California Assn.* concludes, in substance, that whether an agency's determination of economic impact is unsupported by evidence is, as a practical matter, simply not material because a court retains discretion to disregard the inconsistency in the record and uphold the regulation even if evidence would have shown the regulation would cause an adverse economic impact.

California Assn. misinterprets the term "may" to be permissive in Section 11350. *California Assn.* necessarily assumes that a negative declaration, i.e., a finding that a regulation has no adverse economic impact, which is unsupported by adequate evidence or reasoning, can still be consistent with the APA.

The issue *California Assn.* should have expressly considered, but did not, was whether Section 11350(b)(2) was "directory" or "mandatory." The rule is well established that "[w]here permissive use of the word 'may' renders criteria in a statute illusory, particularly one involving a public duty, 'may' means 'must.'" (*California Correctional Peace Officers Assn. v. Tilton* (2011) 196 Cal.App.4th 91, 99.) Also, "[w]here persons or the public have an interest in having an act done by a public body '*may*' in a statute means '*must.*'..." (*Id.* at 96, citing *Hollman v. Warren* (1948) 32 Cal.2d 351, 355, emphasis original.)

The term "may" can be construed to be either directory or mandatory, and so "[g]iven this definitional diversity, it is impossible to conclude with sufficient certainty what the Legislature intended by its use of "may" if we consider the word in isolation. We must therefore focus more broadly on the language, context, and history of the statute." (*People*

v. Ledesma (1997) 16 Cal.4th 90, 95.) *California Assn.* did not consider the context of Section 11350(b)(2).

The context of Section 11350(b)(2) establishes that "may" is directory in that statute. Identification of compliance costs and economic impacts are sufficiently important to be addressed by a separate statute, Section 11346.3. That statute is mandatory, providing that "State agencies proposing to adopt ... any administrative regulation *shall* assess the potential for adverse economic impact on California business enterprises and individuals...." (Section 11346.3(a), emphasis added.) Further, the analysis "*shall* be based on adequate information concerning ... the consequences of proposed governmental action." (Section 11346(b)(1), emphasis added.) The Notice of Adoption "*shall*" include a description of all cost impacts that a representative business or private person would necessarily incur in reasonable compliance with the statute. (Section 11346.5(a), and subd. (9).) To paraphrase the Supreme Court in *People v. Ledesma*, *supra*, construing the term "may" in Section 11350(b)(2) to be mandatory comports with the purpose of the APA ***requiring*** that the economic impact of regulations and the cost of complying with those regulations be clearly identified.

On the other hand, construing the term "may" in Section 11350 as discretionary eliminates the rulemaking safeguards created by the APA and removes any ascertainable standard by which the courts can review the sufficiency of the rulemaking process under Section 11350. Where the compliance standards are mandatory and go to the very purpose of the act being interpreted or implemented by the regulation at issue, then the reviewing court should have the reciprocal duty to declare non-complying agency action void. Granting the reviewing court the discretion to ignore

mandatory performance requirements, without any standards by which to measure the reasonableness of the court's forbearance from enforcing the APA requirements, leads to wildly inconsistent outcomes as illustrated by *California Assn.* and *Western States.*

(2) An "Initial Determination" is not a final determination and is required to be updated.

California Assn. found that "... [S]ection 11346.3's terms focus on an early, rather than in-depth, assessment" and "[t]he qualifying adjective 'initial' indicates the agency's determination need not be conclusive...." (*Id.* at 307.) This assessment overlooks important purposes of the rulemaking process, which are for the agency to gather additional information and to act on that information to update the initial statement of reasons, and to alert the public to the anticipated impact of the proposed regulation, which in turn would affect the degree of public participation in the rulemaking process.

An Initial Determination is made at the beginning of the rulemaking process.[18] In fact, it is typically made before the rulemaking process even starts, before any public comment is obtained and before any evidence is gathered. *California Assn.* would relieve the agency from making any meaningful attempt to gather evidence during the rulemaking process, or act on evidence actually gathered.

The Initial Statement is just that -- the starting point. The APA requires that a process be followed which includes issuing a notice of

---

[18] The EIS was prepared before the 2006-2007 rulemaking process began. An Interested Parties Meeting was conducted August 23, 2005, but the Public Comment Period did not begin until August 2006. (1-AA-180 [Regulation History].)

proposed regulatory action (Section 11346.4) and a notice of proposed adoption (Section 11346.5) to solicit public comment and additional information. The public is required to be given the opportunity to comment and obtaining and considering such comment is an important purpose of the APA. (See *Nursing Homes*, *supra*, 4 Cal.App.3d at 811-812.)

The agency cannot simply ignore the information received during this effort: instead, it must prepare a "final statement of reasons" which contains an "update of the information contained in the initial statement of reasons." (Section 11346.9(a) and subd. (a)(1).)

Under *California Assn.*, the initial statement of reasons is treated as the end result. The agency is relieved of any duty to update the EIS to reflect information received during the mandated public comment period, and even relieved of any obligation to insure that "adequate information" to determine the economic impact of the proposed regulation is developed. *California Assn.*'s consideration of an agency's obligation to identify economic impacts was incomplete because it focused on only the first step of the process, and disregarded all subsequent steps.

(3) "Substantial Compliance" is not a catch-all that eliminates any compliance.

Substantial compliance "means *actual* compliance in respect to the substance essential to every reasonable objective of the statute .... Where there is compliance as to all matters of substance, technical deviations are not to be given the stature of noncompliance.... Substance prevails over form." (*Pulaski, supra*, 75 Cal.App.4th at 1328, emphasis original, internal punctuation and citation omitted.) *Pulaski* addressed whether the Occupational Safety and Health Standards Board failed to assess the economic impact of a regulation because it did not "cite facts, testimony,

documents, or other evidence to support its finding of no adverse economic impact." (*Id.* at 1329, fn. 7.) The Court of Appeal concluded that while the Standards Board had technically violated this requirement, studies were included in the rulemaking file which supported the Standards Board's conclusions, and so there was substantial compliance with the APA's requirement to document the EIS determination. (*Id.* at 1331.)

The substantial compliance doctrine was quoted in *California Assn.*, *supra*, 199 Cal.App.4th at 307, but not actually applied. This is so because there was *no evidence* in the record, or identified in the EIS, supporting the Department's determination that there would be no adverse economic impact. *California Assn.* states that "the Department's statements demonstrate a reliance on the facts and circumstances before it, and the logical inferences that can be drawn from them" (*id.* at 309), but does not identify any such facts. *California Assn.* refers to *assertions* made by the Department (*id.* at 308-309 ["[T]he Department stated ...," "The Department also stated ...," "According to the Department ...," and "The Department concluded ...."]), but does not indicate whether there were any *facts, evidence or testimony* supporting the Department's assertions, statements and conclusions. Finally, part of the rationale supporting "substantial compliance" in *California Assn.* was consideration of the fact that participation in the reimbursement program was voluntary (*id.* at 309) and so, presumably, the economic impact need not have been ascertained because any adverse economic impact could be avoided by withdrawing from the Medical reimbursement program. Yet the impact on a representative business withdrawing from the reimbursement program was not quantified either.

In contrast, *Pulaski* specifically identifies a study made by the federal government's National Institute for Occupational Safety and Health, complete with dates and web references, reports from companies, the endorsement of the regulation by specifically identified major employers and a survey of three studies "analyzing the cost of ergonomics control measures," all of which supported the Department's conclusion. (*Pulaski*, *supra*, 75 Cal.App.4th at 1329.) No such studies are found in the Board's Rule 474 Rulemaking File. When the agency does not reveal an evidentiary basis for its action, the "claim of substantial compliance is untenable." (*Nursing Homes*, *supra*, 4 Cal.App.3d at 813.)

"Substantial compliance" still requires "actual compliance." *Pulaski*, not *California Assn.*, correctly implements the substantial compliance doctrine. *Western States* and *Pulaski* are consistent.

4. *Western States* Correctly Equates "Cost" With the Amount of New Tax. The APA Does Not Limit the Term "Cost" to Administrative Costs.

The Board contends that it was not obligated to determine the actual cost the regulation would impose on a representative business because the term "cost" in Section 11346.5(a)(9) refers to compliance costs such as recordkeeping requirements, not the broader economic impact, and no compliance costs were anticipated. (OB 45.)

Promoting an artificially narrow definition of the term "cost" is important to the Board because if the term "cost" can be construed narrowly, then the obligation to calculate the full cost of compliance for a "representative business" is avoided. Conversely, if the term "cost" means

all compliance costs, then that determination must be made for a "representative business," which the Board did not do.

A narrow definition means the Board will *never* have to comply with Section 11346.5(a)(9) because the nature of the Board's work always deals with taxes.

The Board's effort to narrowly interpret "cost" in subdivision (a)(9) fails for two reasons. First, the Board itself interpreted the word "cost" contained in subsection (a)(9) to refer to the increase in taxes that would result from the change in the method of taxation required by the new regulation. Second, the term "cost" is broadly defined by the APA to mean the cost of complying with the proposed regulation without limitation to recordkeeping or administrative costs. (Section 11342.535.)

a. The Board itself interpreted the term "cost" broadly during the rulemaking process.

The Board itself equated "cost" with the increase in taxes that would result from Rule 474. The Board concedes this to be true in a footnote:

> Board Staff incorrectly listed the estimated $1.4 million increase in property taxes as a "cost" impact under Section 11346.5, subdivision (a)(9), in Section B of the Board's EIS, and in a few of the Board's notices to the public even though there are no compliance costs associated with the adoption of Rule 474 ....

(OB 37, fn. 11.)

The "few public notices" included the "Notice of Proposed Regulatory Action" contained in Letter to Assessor's No. 2006/032 (3-AA-644); the California Regulatory Notice Register 2006 (3-AA-636); the Notice of Publication/Regulations Submission (3-AA-639); Initial

Statement of Reasons (1-AA-114); Economic Impact Statement (1-AA-165); and Final Statement of Reasons (2-AA-368 [referring to Revenue Estimate, Issue 06-001], 3-AA-625-627). The Board now attempts to sweep all its official public notices under the rug on grounds that "Staff incorrectly" characterized the tax impact quantification as a "cost."

Completing one or two forms incorrectly is a mistake; completing every public notice and official document uniformly is policy.

b. The APA defines the term "cost" broadly to mean all compliance costs, not just administrative costs.

Section 11346.5 requires the Notice of Proposed Adoption to include a "description of all *cost impacts* ... that a representative private person or business would necessarily incur in reasonable compliance with the proposed action." (Section 11346.5(a)(9).) Subdivision (a)(9) is not expressly limited to reporting or recordkeeping costs, and Section 11346.5 does not even mention such costs. The term "cost impact" should be construed consistently with definitions provided by the APA and with reference to other provisions of the APA.

The term "cost impact" is separately defined in Section 11342.535 to mean the "reasonable range of direct costs, or a description of the type and extent of direct costs" that will be incurred complying with the new regulation. Thus, the concept of "costs" includes all "direct" costs, and is not limited to reporting or recordkeeping costs.

Recordkeeping "requirements" are mentioned in a different statute, Section 11346.3(a), which refers to "unnecessary or unreasonable reporting, *recordkeeping*, or compliance requirements" as adverse impacts to be

avoided. Thus, the concern about recordkeeping and reporting burdens is tied to the concept of "adverse economic impact" which is the subject of Section 11346.5(a)(8), not the broader "cost impacts" under subdivision (a)(9).

The Board cannot avoid determining the "cost" impact of Rule 474 on a "representative business" as required by subdivision (a)(9) by limiting the term "costs" to recordkeeping and reporting requirements and finding that, as so narrowed, there were no such cost impacts.

5. The Board Was Not Excused from Making Meaningful Estimates of Economic Impact Because Some of the Information It Could Have Used to Do So Was Confidential to the Public.

The Board asserts that requiring use of actual information to determine the economic impact is impractical because it could result in disclosure of confidential taxpayer data. (OB 49.) The Board does not identify the confidential information it contends would have been disclosed, or how failure to use that information affected the rulemaking process.

The Board had access to all of the California refineries' confidential data pursuant to R&T 408(b). The Board routinely accesses this data for purposes of auditing local assessment practices, the results of which audits are published without violating a taxpayer's confidentiality rights. (1-RA-252. 262. 266. 274-275. 286, 288; see Sections 15640 to 15645 and Rules 370, 371.)

The Board also had access to non-confidential public assessment roll data showing actual assessed values and the allocation of value between land, improvements, fixtures and personal property. As Judge Hess observed: "At oral argument on March 19th, the Court understood that

actual assessed values were publicly available. Why were the actual numbers not used to calculate the impact at least for comparative purposes?" (11-AA-3276, fn. 14 [Trial Court Decision].)

There is no record that the Board made any effort to obtain data required to calculate the economic impact of Rule 474 during the several month period the rulemaking process was conducted.

The Board's implicit assertion that use of actual information was prevented because that information was confidential fails for two reasons: (1) no confidential information was required to calculate the economic impact of the Rule; and (2) the confidential information was accessible to the Board as a matter of law and could have been used in a de-identified manner to establish realistic assumptions, and to support a realistic analysis.

D. THE BOARD WAIVED THE ISSUE OF NECESSITY BY NOT REQUESTING REVIEW. THE COURT SHOULD AFFIRM THE OPINION ON THAT GROUND.

In both the trial court and court of appeal proceedings below, WSPA contended that Rule 474 was invalid because it failed to satisfy the APA's "necessity" standard. (WSPA's Respondent's Brief ("RB") 18-19.) WSPA asserted that Rule 474 failed to satisfy the "necessity" standard because the Rule was inconsistent with existing law (RB 24-34), and also because there was no substantial evidence in the rulemaking record that Rule 474 was necessary to effectuate R&T 51's purpose. (RB 34-41.)

The Court of Appeal held that: "There was no evidence that market factors affecting refineries had changed between the 1970's and 2000's" (Opinion 11), and that there was "no evidence that there has been an actual

change in circumstances in the marketplace, rather than merely a change in SBE's perspective of the marketplace." (Opinion 20.) In other words, the Court of Appeal determined that there was no evidence, let alone substantial evidence, that supported the Board's assertion that Rule 474 was "necessary."

The SBE waived any claim of error on that point by failing to raise the issue in its Petition for Review. Because Rule of Court 8.516(b)(1) authorizes the Court to decide "any issues that are raised or fairly included in the petition," it is possible for a petitioner to waive issues by omitting them from the petition. (*PLCM Group, Inc. v. Drexler* (2000) 22Cal.4th 1084, 1094, fn. 3.)

The Court "need not address portions of the opinion as to which the parties did not seek review, and the Court of Appeal's opinion remains determinative on those matters." (*Agricultural Labor Relations Bd. v. Tex-Cal Land Management, Inc.* (1987) 43 Cal.3d 696, 709, fn. 12; 9 Witkin, Cal. Proc. (5th ed. 2008) Appeal, § 952.) The Court of Appeal's determination of this matter and the SBE's waiver of the "necessity" issue alone support affirmance.

CONCLUSION

Rule 474 is the poster child regulation for the APA. Had the Board complied with the APA in good faith instead of trying to bob, dodge and weave around it, the Rule could not have been adopted. The Board treats the APA as an impediment to be avoided by using the right combination of strategies. The Board simply refuses to consider the APA as a serious

instrument of public policy, compliance with which is in the public interest. This misperception should be corrected and *Western States* affirmed.

Dated: December 14, 2012

Respectfully submitted,

CAHILL, DAVIS & O'NEALL, LLP

By: 

C. Stephen Davis
Cris K. O'Neall
Andrew W. Bodeau
Attorney for Plaintiff and Respondent
WESTERN STATES PETROLEUM ASSOCIATION

DECLARATION OF SERVICE

Code of Civ. Proc., § 1013

State of California)
) ss.
County of Los Angeles)

Annette P. Siulagi states: I am and at all times herein mentioned have been a citizen of the United States and a resident of the County of Los Angeles, over the age of eighteen years and not a party to or interested in the within action; that my business address is 550 South Hope Street, Suite 1650, Los Angeles, CA 90071.

On **December 14, 2012**, I served the foregoing document described as: **RESPONDENT'S ANSWER TO BRIEF ON THE MERITS** on the parties or attorneys for parties in this action as identified below, using the following means of service.

BY U.S. MAIL. I placed a true copy of the foregoing document in a sealed envelope individually addressed to each of the parties on the attached service list, and caused each such envelope to be deposited in the mail at 550 S. Hope Street, Suite 1650, Los Angeles, CA 90071. Each envelope was mailed with postage thereon fully prepaid.

I am readily familiar with this firm's practice of collection and processing of correspondence for mailing.

Under that practice, mail is deposited with the United States Postal Service the same day that is it collected in the ordinary course of business.

SEE ATTACHED SERVICE LIST

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Executed on **December 14, 2012**, at Los Angeles, California.

Annette P. Siulagi

SERVICE LIST

Kamala D. Harris, Attorney General
David S. Chaney, Chief Assistant
Felix E. Leatherwood, Supervising Deputy
Brian D. Wesley, Deputy Attorney General
Office of Attorney General
State of California
300 S. Spring Street, Suite 1702
Los Angeles, CA 90013

Clerk of the Court of Appeal
California Court of Appeal
Second District, Division 8
300 S. Spring Street
North Tower, Second Floor
Los Angeles, CA 90013

Civil Clerk, Appellate Division
Los Angeles County Superior Court
111 N. Hill Street
Los Angeles, CA 90012