No. S123481

IN THE
Supreme Court of the State of California

MORNING STAR COMPANY,

Plaintiff/Appellant,

v.

STATE BOARD OF EQUALIZATION and

DEPARTMENT OF TOXIC SUBSTANCE CONTROL,

Defendants/Respondents.

After Decision by the Court of Appeal Third Appellate District No. C033758
Sacramento County Superior Court No. 98AS03539
The Honorable John R. Lewis, Judge

REPLY IN SUPPORT OF PETITION FOR REVIEW

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REASONS FOR GRANTING REVIEW

Tens of thousands of businesses are being assessed millions per year in hazardous-materials fees imposed without the safeguards of the APA and in a shockingly irrational manner. With over $100 million in such fees already paid, and hundreds of millions more to be paid in the future, the procedural and constitutional validity of such fees present important legal issues that this Court should resolve. This case is an especially compelling vehicle for review of those issues because the court below erroneously upheld such fees based on reasoning that conflicts with case-law from this and other courts and that threatens substantial mischief in numerous other cases involving the APA and various constitutional challenges to state and local exactions.

Respondents concede the importance of the decision below, Answer at 2, and make only a thin attempt to defend the results below, ignoring most of the irrationalities highlighted by the Petition. Given both the

importance and the precedential damage of the decision below, and the substantive error of the decision as to the hazardous-materials fee itself, such arguments on the merits warrant full briefing and plenary consideration. This Court thus should grant the Petition for Review.

I. THE STANDARD FOR DETERMINING WHEN AGENCY ACTION IS SUBJECT TO THE APA IS AN IMPORTANT QUESTION OF LAW THAT WAS RESOLVED BELOW USING STANDARDS INCONSISTENT WITH THOSE APPLIED BY THIS AND OTHER COURTS.

Respondents do not materially dispute that the DTSC's determinations regarding the breadth of hazardous materials and the selection of SIC codes constitute determinations of general applicability that control future cases and that were not made in the context of an adjudication. Other than merely repeating portions of the decision below, their only defense of the DTSC's failure to follow APA procedures is the claim that the Legislature *required* the DTSC to include all SIC codes in its schedule and thus DTSC merely was performing a ministerial act, not adopting a regulation. Answer at 4-5. That claim cannot be squared with either the text or the history of § 25205.6. Once it is recognized that the statute not only allows, but expects, the DTSC to exercise quasi-legislative judgment regarding the nature of hazardous materials and the selection of SIC codes, the reasoning and the result below are indefensible and this Court's review is required.

The notion that § 25205.6 requires, as a matter of law, that the DTSC schedule essentially *all* SIC codes is amply belied by the statute. For example, the statute requires the DTSC to create and forward to the SBE "a schedule of codes, that consists of the types of corporations that use, generate, store, or conduct activities in this state related to hazardous materials." § 25205.6(a); *see also* § 25205.6(b) (applying fee to "[e]ach

corporation *of a type identified in the schedule adopted* pursuant to subdivision (a)") (emphasis added). Both the language and the grammar of that requirement leave no doubt that the Legislature understood and intended that less than *all* corporations used hazardous materials and tasked the DTSC with *distinguishing* among corporations according to industrial classification. Such intent is reflected in the phrase "the types of corporations that use" hazardous materials, which necessarily implies that some "types" of corporations do *not* use such materials.[1]

Similarly, the statutory requirement that the DTSC repeat the process "each year" makes plain that the Legislature expected the schedule to change over time, as different SIC codes were included or excluded according to changes in industry use of hazardous materials. The entirety of § 25205.6(a) simply makes no sense, and would be rendered a nullity, under the DTSC's interpretation that it has no discretion. Had that been the Legislature's intent, it would simply have said that the fee would be imposed on *all* corporations, without the need for meaningless intervening steps by the DTSC. The DTSC's nullifying construction of the actual language thus violates the fundamental principle of statutory interpretation that all words in a statute should be given meaning.

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[1] The language "corporations that use" hazardous materials is a restrictive or defining phrase isolating a *subset* of all corporations, not merely a descriptive phrase applicable to all corporations. Compare the sentence "You can borrow the bicycle *that* is out front," which defines which bicycle may be borrowed and distinguishes it from other possible bicycles, with the sentence "You can borrow the bicycle, *which* is out front," which merely describes the location of the bicycle, the identity of which is already understood. The Legislature having thus enumerated a subset of corporations that can be included on the SIC schedule.

The definition of hazardous materials likewise affords the DTSC considerable room for discretion and judgment. For example, § 25501(o) defines a hazardous material as one that, "because of its quantity, concentration, or physical or chemical characteristics, poses a *significant present or potential hazard* to human health and safety or to the environment if released." Surely the determination of what constitutes a "significant" hazard, and what circumstances present *de minimis* potential risks, calls for the exercise of quasi-legislative judgment and administrative expertise, which is precisely why the DTSC was inserted into the process at all. *See also id*. (including materials for which agency "has a *reasonable* basis for believing that it would be injurious to the health and safety of persons or harmful to the environment if released ") (emphasis added).[2] Had the legislature indeed made the unyielding determination that *every* business uses hazardous substances sufficient to subject them to the fee, there would have been no need whatsoever even to refer to the definition of hazardous materials or to ask the DTSC to determine which companies use such materials.[3]

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[2] DTSC's wildly overbroad reading of the definition of hazardous materials as *necessarily* including even *de minimis* quantities of mundane products makes no sense and would ultimately define essentially every substance in the world as a "hazardous material." Indeed, considered without any judgment regarding the significance of the risk, even ordinary *water* constitutes a hazardous material. Such an absurdly broad reading renders the definition meaningless.

[3] It is precisely because adopting a schedule of SIC codes involves complex issues that it was delegated to the DTSC. And the resolution of such issues necessarily calls for the developed record and explanation that comes from compliance with APA procedure and the ensuing judicial review under a substantial evidence standard. Gov't Code § 11350. The Court of Appeal's casual affirmation of the DTSC's substantive determinations regarding hazardous materials and the inclusion of all SIC codes was made without such a record and according to no recognizable standard of evidence.

The legislative history of § 25205.6 likewise confirms the discretion given by the plain language of the statute. For example, the Health and Welfare Agency noted that the fee "is to be levied against *specific* corporations (by [SIC] codes)," rather than against *all* corporations. [Resps. Exh. I, CT 1082] (emphasis added). Likewise, the repeated references to imposing the fee on "responsible" parties in the legislative analysis of the bill, *see infra* at 8-9, confirm that the Legislature intended the fee to be tailored to some reasonable determination about which companies indeed bore such responsibility and which did not. There is no point in targeting such responsibility if the Legislature had already preemptively determined, as DTSC claims, that every conceivable human activity uses hazardous materials and hence *everyone* is responsible.

Elementary principles of statutory interpretation thus demonstrate the Legislature's intent that the DTSC would exercise quasi-legislative judgment, both in the application of the hazardous materials definition and in the scheduling of SIC codes.[4] And once the agency's discretion is recognized, the remainder of the APA analysis is essentially unchallenged. Respondents do not dispute that DTSC's position regarding the scope of § 25205.6 is a prospective interpretation of the law declaring how a certain class of cases will be treated, is generally applicable to all corporations, and

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[4] Respondents' claim that the Legislature did not intend the DTSC to "waste its time and millions of taxpayer dollars in pointless public hearings," Answer at 5, merely displays contempt for APA proceedings, exaggeration of the costs of DTSC's doing its job, and a misunderstanding of the proper purposes to which its time should be devoted. What the Legislature surely did not intend was for the DTSC to perform the pointless role of a *scribe*, copying over a predetermined list of SIC codes and mailing it to the SBE. *That* would indeed have been a wasted of the vaunted expertise of an administrative agency.

was not made in the context of an adjudication. Petition at 13-15. And while merely repeating the Court of Appeal's claim that there was no "written policy of enforcement," Answer at 4, they concede that DTSC's position is embodied in the annual schedule of SIC codes that it issues, Petition at 14. Given such concessions and the plain expectation that the DTSC would exercise quasi-legislative judgment in the performance of its duties, DTSC's determinations regarding which SIC codes to include in the schedule constitute regulations subject to, but that have failed to comply with, the APA.

Furthermore, even aside from respondents' claims that they lacked discretion and exercised no judgment, the legal standard adopted by the court below did not turn on such supposed lack of discretion, but merely on the fact that DTSC was performing its statutory "obligation," without regard for whether such duties left room for quasi-legislative discretion. Opinion at 20 (administrative determination could not be a rule of general applicability if agency is "carry[ing] out its obligation under the statute").

As explained in the Petition, at 13-14, an agency's statutory "obligations" routinely require it to exercise some judgment or expertise – indeed, that is the very reason administrative agencies exist. The existence of *some* statutory obligation thus is not relevant to whether an agency's performance of its statutory duties will result in a regulation, and respondents essentially concede that point. But it is that standard that was applied by the court below, that constitutes plain error, and that will continue to cause mischief in all future APA cases. The correct approach is that where the agency's "obligation" under a statute involves the expectation that it will exercise judgment and discretion applicable to a broad class of persons or circumstances, the result of the agency's conduct is a regulation subject to the APA.

Regardless of whether respondents try to defend the *result* on other grounds, therefore, the Petition presents an important issue of law that will cause inconsistency with other decisions and that threatens to have a substantially adverse effect on the application of the APA. Indeed, it will create a gaping, near comprehensive, loophole in the APA that will undermine key structural safeguards against arbitrary administrative action. Such a result is especially troubling coming from the Third District Court of Appeal given that it covers Sacramento and hence the vast majority of APA challenges will be brought in that district. The Petition thus warrants review by this Court.

II. THE COURT OF APPEAL INCORRECTLY CATEGORIZED THE HAZARDOUS-MATERIALS FEE AS A TAX RATHER THAN A REGULATORY FEE, USING STANDARDS INCONSISTENT WITH THOSE USED BY THIS AND OTHER COURTS.

Whether the hazardous-materials fee is categorized as a tax or a regulatory fee is an important issue of law worthy of this Court's consideration. It is important because it will have a significant impact on the subsequent constitutional analysis in this case, and it is important because the approach taken by the court below will impact numerous other cases involving exactions challenged under equal protection and due process or under Article XIII A super-majority requirements for taxes.

Respondents necessarily admit that the sole use of the hazardous materials fee is for the "DTSC to fund hazardous waste and hazardous materials programs." Answer at 2. They make no attempt to defend the contradictory and erroneous assertion by the court below that the fee is used to fund "a wide range of remedial purposes *unrelated* to the activity for which the fee is charged." Opinion at 24 (emphasis added); *see* Petition at 20-21 (discussing contradictory findings by court below). They do not

deny that the categorization decision between a tax and a regulatory fee will affect numerous cases involving all manner of state and local fees on individuals, businesses, and property owners. They do not deny that the decision whether to categorize a particular exaction as a tax or a regulatory fee, and the ensuing difference in the standard of review, will be outcome determinative of equal protection and due process challenges in a substantial number of cases. And, while they attempt to distinguish Article XIII A super-majority cases as involving a narrower issue, Answer at 6, they do not deny that the decision below is likely to blow back into Article XIII A jurisprudence because just as the court below and all parties imported Article XIII A cases to drive the analysis here, this case would in turn affect the analysis in future Article XIII A cases as well.

As noted in the Petition, at 19-20, the reasoning applied by the Court of Appeal create a troubling lack of uniformity in the law by deviating from the well-established standards for distinguishing between fees and taxes set out by this Court in *Sinclair Paint Co.* v. *State Bd. Equalization*, (1997) 15 Cal.4th 866, 64 Cal. Rptr.2d 447, and its progeny. Respondents contend that the court below simply applied *Sinclair Paint* to the facts at hand and hence did nothing wrong. Answer at 6-7. But merely citing *Sinclair* is quite different from applying it, and in fact the court substantially ignored virtually every principle laid out in *Sinclair* and put a nullifying gloss on key aspects of that opinion.

For example, respondents repeat, though do not defend, the Court of Appeal's contention that the purpose of § 25205.6 was to raise revenue, Answer at 6, but in doing so ignore the overwhelming evidence to the contrary. The legislative analysis of the bill from which § 25205.6 derives was unambiguous in declaring that the "rationale has always been that the entities which handle hazardous waste and those which are responsible for

hazardous substance releases should pay for state efforts to regulate the handling of hazardous waste and to clean up the releases." [CT 209, at 211]. The Health and Welfare Agency similarly described the purpose as "cost recovery from responsible parties," and recognized that the fees were earmarked "to pay for the cost incurred by the State in performing a variety of clean-up and regulatory oversight activities." [Resps. Exh. I, CT 1082]; *see also id.* ("the legislation provides increased incentives for cost recovery activities with a greater share of the program costs borne by responsible parties"); *cf.* [CT 209, at 211] (SBE letter to Morning Star, May 21, 1997) (the fee under § 25205.6 "is an assessment by a regulatory agency to cover the cost of the regulation"). And the statute itself makes explicit that the funds raised by the hazardous materials fee are dedicated to hazardous-materials-related regulatory and remedial activities and respondents concede that the fees "fund hazardous waste and hazardous materials programs." Answer at 2. They thus concede that the Court of Appeal's conclusion that the fees would be used for "purposes *unrelated* to the activity for which the fee is charged," Opinion at 24 (emphasis added), was plain and unequivocal error.

Given the plain purpose of the fee, it is impossible to distinguish *Sinclair*'s holding that "bona fide regulatory fees" include those that require manufacturers and others to "bear a fair share of the cost of mitigating the adverse health effects their products created in the community." 15 Cal.4th at 877. That is precisely the purpose of the fee in this case, and it is precisely the reasoning abandoned by the Court of Appeal.

Respondents' only substantive point of contention is the claim that because the fee lacks any rational relation to its manifest and express purposes, it is therefore not a fee but a tax. Answer at 7. As already explained, however, an unconstitutional regulatory fee – *i.e.*, one that

cannot satisfy the "reasonable relationship" test – is not, *ipso facto* a tax subject to a more lenient test. Rather, it is an *invalid* regulatory fee. Petition at 20. Respondents' contrary interpretation that invalid fees are magically reconceptualized as valid taxes is nothing short of bizarre. It would indeed be a wonder that the consequence of a regulatory fee *failing* the rational relationship test under due process and equal protection would be to convert the fee into a tax subject to *lesser* equal protection scrutiny. That is mere sophistry and a truly novel assault on equal protection jurisprudence.[5]

Allowing such arbitrary disregard of uniform principles for distinguishing taxes from regulatory fees promotes precisely the type of *ad hoc* decision-making that threatens to bring the courts into disrepute and undermines public confidence in judicial integrity. The heads-the-government-wins-tails-the-citizens-lose approach offered by respondents would selectively free the government from either the constraints of Article XIII A or from the equal protection and due process clauses, as the case may require, and would make it impossible for ordinary citizens to have any faith in the courts to fairly redress their grievances. Correcting the erroneous result and reasoning of the Court of Appeal thus constitutes an important issue of law that this Court should resolve in order to bring uniformity to the categorization of taxes and regulatory fees and to ensure

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[5] Furthermore, given the DTSC's discretion in compiling the SIC schedule, *supra* at 2-6, it appears that the Legislature certainly *intended* that the imposition of the fee would be tailored to the purposes of the law. That the DTSC failed to implement such tailoring, or that the tailoring envisioned was inadequate for equal protection requirements, does not alter the fundamental *purpose* of the law.

the citizenry's confidence that neutral principles of adjudication will be applied even where the government is a litigant.

III. THE HAZARDOUS-MATERIALS FEE VIOLATES EQUAL PROTECTION AND DUE PROCESS BY IRRATIONALLY DISTINGUISHING AMONG BUSINESSES AND BY BEING WHOLLY UNRELATED TO THE NATURE OF THE BUSINESSES OR THE PURPOSES OF THE LAW.

The equal protection and due process claims themselves also present important legal issues that warrant the attention of this Court. By respondents' own calculations, 95% of businesses that "use" hazardous materials in precisely the same or greater way as those subject to the fee, and who thus are no less "responsible" for such materials, do not bear their share of that burden. Indeed, given the over- and under-inclusiveness of the statute, it is quite likely that the 5% of businesses subjected to the fee actually "use" less than 5% of the hazardous materials as defined by the DTSC.[6] Such arbitrary imposition of burdens, without even the pretense of genuine scrutiny, needs the considered attention and correction of this Court.

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[6] The suggestion that the classification was made for "administrative convenience" because 75% of the potential fee income is obtained from only 5% of the businesses, Answer at 10, is misguided. There is no inconvenience in applying the fee to all businesses regardless of size or form. In fact it would be more convenient to have a uniform rule. Likewise, the Legislature's intent to have businesses charged according to selective SIC codes shows that it viewed *that* method as being sufficiently convenient while still fulfilling the purposes of the statute. Under such circumstances, mere administrative laziness cannot serve as an excuse for failing to draw rational distinctions based on the *purpose* of the law. If it were otherwise, the agency could merely impose the entire fee on one or a handful of arbitrarily selected businesses, claim it was more convenient that way, and escape constitutional scrutiny.

On the merits of the constitutional claims, respondents make no effort to defend the challenged classifications under the ordinary scrutiny applied to regulatory fees. The numerous inconsistencies, the under- and over-inclusiveness of the categories, and the utter disconnect between the express purpose of the fees and the means selected to apply the fees readily establish that the classifications are not rationally or reasonably related to the purpose of imposing on responsible parties the cost of hazardous waste regulation and remediation. *See* Petition at 23-29. Equal protection prohibits legislative classifications, such as those at issue here, that are "grossly overinclusive" or "underinclusive." *Brown* v. *Merlo*, (1973) 8 Cal.3d 855, 877 & n. 17, 106 Cal. Rptr. 388. Government may not single-out a group for regulation, as it has done in this case, "wholly at its whim" but rather its "decision as to where to 'strike' must have rational basis in light of the legislative objectives." *Hayes* v. *Wood*, (1979) 25 Cal.3d 772, 790-91. The hazardous materials fee fails the above standards.

Unable to defend § 25205.6 as a regulatory fee, respondents place all of their hope in having the fee treated as a tax, subject to a more lenient – and, according to respondents, essentially non-existent – level of constitutional scrutiny. But whether viewed as a regulatory fee or a tax, the need for equal protection to provide an "effective practical guarantee against arbitrary and unreasonable government" and to deny officials the ability "to pick and choose only a few to whom they will apply legislation and thus to escape the political retribution that might be visited upon them if larger numbers were affected" remains constant. *Hayes*, 25 Cal.3d at 786-87 (quoting *Railway Express Agency* v. *New York*, (1949) 336 U.S. 106, 112-13 (Jackson, J., concurring)).

Ignoring the sweeping irrationalities of the classifications based on corporate form and number of employees without regard for the nature of

the businesses, respondents merely repeat the Court of Appeal's bare assertions of a rational relationship between the number of employees and use of hazardous materials and a rational distinction between corporations and individuals for purposes of taxation.

But as the numerous examples of gas stations, battery manufacturers, and even retail stores demonstrated, if the nature of the business is ignored, and if the incidental uses of non-significant materials is sufficient to make it to the SIC schedule, then number of employees necessarily loses any rational connection to hazardous-materials usage. A five-person gas station uses orders of magnitude more hazardous materials than does an ordinary office having hundreds of employees. Indeed, it is the very effort to expand the category of hazardous-materials use to the point of encompassing every human activity regardless of actual impact, and thus lump together wildly disparate businesses in a single classification, that makes the subsequent effort to distinguish such activities based on employees meaningless.

As for the ordinarily different taxation between *individuals* and corporations, respondents continue to ignore that *partnerships* engaged in business are unlike individuals and impossible to distinguish from corporations when it comes to the substantive impacts of their operations. Respondents' further suggestion that Morning Star's position somehow challenges the differences in income taxation between corporations and partnerships, Answer at 9, simply illustrates how badly they miss the point. The ordinary taxation of business entities is indeed designed to raise revenue rather than to accomplish any particular regulatory or remedial purpose. Give the revenue function of such taxes, it is not surprising that they would vary according to the means by which businesses raise capital, generate income, and distribute their earnings. Two businesses engaged in precisely the same substantive activity – running a football team, for

example – can have very different financial accounting and control structures.

While those differences are sufficient to allow different methods of ordinary taxation, they have absolutely nothing to do with the hazardous-materials impact of the substantive operations themselves, and hence have nothing to do with the purposes of the hazardous-materials fee. Indeed, while partnerships and corporations are treated differently for income and similar taxes, they are treated the same for license fees, permit fees, and even property taxes, all of which relate to the operations, not the form, of the business, and are paid by the business enterprise itself and not, in the case of partnerships, paid at the individual level.

CONCLUSION

For the foregoing reasons, this Court should grant the Petition for Review.

Respectfully Submitted,

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I hereby certify that, on this 22nd day of April, 2004, I caused a copy of the foregoing Petition for Review to be served by Overnight Federal Express, postage pre-paid, on:

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CERTIFICATE OF COMPLIANCE

I hereby certify that the foregoing Reply in Support of the Petition for Review complies with the 4,200 word type-volume limitation of Appellate Rule 28.1(d) in that it contains 3,997 words, excluding the table of contents, table of authorities, and certificates of counsel. The number of words was determined through the word-count function of Microsoft Word XP. Counsel agrees to furnish to the Court an electronic version of the brief upon request.

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APPENDIX