No.

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

PETITION FOR REVIEW

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MORNING STAR COMPANY,

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STATE BOARD OF EQUALIZATION and DEPARTMENT OF TOXIC SUBSTANCE CONTROL,

Respondents/Appellees.

ISSUES PRESENTED FOR REVIEW

Section 25205.6 of the California Health & Safety Code imposes a fee for the regulation and remediation of hazardous materials. The fee is imposed only on corporations with 50 or more employees, with rates increasing with the number of employees. The fee is not imposed on any other form of business enterprise, such as partnerships, LLPs, or sole proprietorships, and is not imposed on corporations having fewer than 50 employees. Despite the law's further requirement that the Department of Toxic Substance Control ("DTSC") annually adopt a schedule of the particular types of businesses – using Standard Industrial Classification ("SIC") codes – to which the fee should apply, the DTSC adopted a rule, without inquiry into the nature or involvement with hazardous materials of particular categories of corporations and without following APA procedures, that *all* corporations generated hazardous materials and consequently annually adopts a schedule of SIC codes encompassing

essentially every type of corporation for purposes of applying the fee. The issues presented by this petition are:

1. Whether the DTSC's determination that *all* corporations with 50 or more employees use hazardous materials within the purpose of § 25205.6, and its adoption of a schedule of SIC codes covering all businesses, constitute rules, regulations, or standards of general application subject to the requirements of the APA?

2. Whether the hazardous-materials fee is a "regulatory fee" or a "tax" for purposes of equal protection and due process analysis under the state and federal Constitutions?

3. Whether the hazardous-materials fee, however categorized, violates federal and state equal protection and due process protections where:

(A) the allocation of the fee among corporations of 50 or more employees has no connection to and is out of all proportion with the nature of the businesses, the magnitude of their use, generation, or disposal of hazardous materials, or the costs they impose on society or the DTSC in connection with hazardous material regulation and remediation; and

(B) the fee discriminates among businesses based on the irrelevant criteria of their number of employees and their corporate or non-corporate form of organization; and

STATEMENT OF THE CASE

A. NATURE OF THE CASE

This case involves a challenge to the hazardous-materials fee imposed on certain corporations by California Health & Safety Code § 25205.6, and the rules concerning implementation of that fee adopted by respondents the Department of Toxic Substance Control ("DTSC") and the State Board of Equalization (SBE).[1] Petitioner paid the hazardous-materials fee under protest, sought and was denied a refund of that fee, and then brought this action claiming that the fee and its implementation by respondents violated the equal protection and due process requirements of the United States and California Constitutions, U.S. CONST., amend. 14; CAL. CONST. art. I §§ 7, 15, art. IV § 16(a), and the California Administrative Procedures Act, CAL. GOV. CODE § 11340, *et seq.* ("APA").

B. PROCEEDINGS BELOW

Morning Star is a California corporation with over 50 employees that leases workers to other companies. In March 1998 it paid under protest a hazardous-material fee to respondent SBE for the years 1993 to 1996. It thereafter filed an administrative claim for a refund, which was denied. In July 1998 Morning Star filed this action in Superior Court for a refund and for a declaration that respondent DTSC's determination to submit essentially all of the SIC codes to SBE, and hence to subject all corporations with 50 or more employees to the hazardous-materials fee,

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[1] All statutory citations hereinafter will refer to the California Health & Safety Code unless otherwise noted.

violated the APA and the due process and equal protection guarantees of the federal and state Constitutions.

After answers to the complaint and discovery, the parties filed cross-motions for summary judgment. In August 1999, The Superior Court denied Morning Star's motion and granted summary judgment for respondents. Morning Star timely appealed.

C. DISPOSITION IN THE COURT OF APPEAL

On February 9, 2004, The Court of Appeal affirmed.

Regarding Morning Star's claim that the DTSC, without complying with the APA, adopted a rule of general applicability that all corporations used hazardous materials and hence that each year it would include all SIC codes in the schedule sent to the SBE for purposes of the hazardous-materials fee, the Court of Appeal held that such a determination was not a "regulation" subject to the APA. It instead concluded that "DTSC did no more than apply [§ 25205.6] to carry out its obligation under the statute" and its determination applicable to all businesses "simply involves a factual application of section 25205.6 to the activities of modern business establishments." Opinion at 20-21 (attached hereto as an Appendix).

The court also rejected Morning Star's claim that the DTSC's indiscriminate inclusion of all SIC codes in the schedule it forwarded to the SBE, and hence its failure to take into account the different natures of the businesses required to pay the fee, unconstitutionally failed to correlate the fee with the hazardous-materials burden imposed by such businesses. The court instead held that the hazardous-materials fee was a "tax" rather than a "regulatory fee," that as a tax it should be evaluated under a more lenient constitutional standard, and that it satisfied such a lenient standard.

Finally, the court rejected Morning Star's claim that application of the hazardous-materials fee only to corporations with more than 50 employees but not to corporations with fewer employees or to non-corporate business entities regardless of size was irrational and hence unconstitutional. Instead, the court held that the 50-or-more-employees distinction, "as a general measure of the size of the corporation and its use of hazardous material, is manifestly rationally related to [the purpose] of funding the disposal of hazardous material," and, somewhat off point, a "distinction between the taxation of corporations and individuals is broadly permissible." Opinion at 26.

The Court of Appeal decision became final on March 10, 2004, and Morning Star timely filed this Petition within 10 days thereof.

FACTS

Section 25205.6 of the Health and Safety Code establishes a mechanism for imposing fees on a limited group of businesses for the purpose of supporting various regulatory and remedial activities relating to hazardous materials, including hazardous wastes. That section, as amended,[2] provides in relevant part:

> **§ 25205.6. Identification codes (SIC or NAICS); fee; state payment for removal and remedial action**
>
> (a) On or before November 1 of each year, the [DTSC] shall provide the [SBE] with a schedule of codes, that consists of the types of corporations that use, generate, store, or conduct

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[2] Although the statute has been amended since the filing of the complaint in this case, those amendments are not material to the issues presented and hence, for convenience, the current rather than the former version of the statute will be used throughout this petition.

> activities in this state related to hazardous materials, as defined in Section 25501, including, but not limited to, hazardous waste. The schedule shall consist of identification codes from one of the following classification systems, as deemed suitable by the department:
>
> (1) The Standard Industrial Classification (SIC) system established by the United States Department of Commerce.
>
> (2) The North American Industry Classification System (NAICS) adopted by the United States Census Bureau.
>
> (b) Each corporation of a type identified in the schedule adopted pursuant to subdivision (a) shall pay an annual fee, which shall be set at two hundred dollars ($200) for those corporations with 50 or more employees, but less than 75 employees, [and progressively increasing to] … nine thousand five hundred dollars ($9,500) for those corporations with 1,000 or more employees.
>
> (c) The fee imposed pursuant to this section shall be paid by each corporation that is identified in the schedule adopted pursuant to subdivision (a) … and shall be deposited in the Toxic Substances Control Account. The revenues shall be available, upon appropriation by the Legislature, for the purposes specified in subdivision (b) of Section 25173.6.

Subsection (f) provides that the fees "are intended to provide sufficient revenues to fund the purposes of [§ 25173.6(b)], including appropriations in any given fiscal year of [$3,300,000] to fund the state's obligation pursuant to" § 104(c)(3) of the federal Comprehensive Environmental Response, Compensation, and Liability Act of 1980 ("CERCLA"), 42 U.S.C. § 9604(c)(3). That subsection also provides a process for the DTSC to recommend, and the Legislature to consider, increases in the fee rates if needed to fund a greater CERCLA obligation. A final subsection (g), added by amendment, expressly exempts from the fee certain nonprofit corporations described by SIC Code 8361, which provide residential care to children, the elderly, and special-needs persons.

The term "hazardous material" used in § 25205.6(a), and defined at § 25501(o), means:

> any material 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 into the workplace or the environment. "Hazardous materials" include, but are not limited to, hazardous substances, hazardous waste, and any material which a handler or the administering 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 into the workplace or the environment.

The purposes of the hazardous-materials fee is expressly set out in the statute itself – the fee must be used to fund the Toxic Substances Control Account, and may only be used for the hazardous-materials related regulatory and remedial purposes specified in § 25173.6(b). In addition to funding the State's remedial obligations under CERCLA, other purposes for which the funds may be used include activities relating to: the Carpenter-Pressly-Tanner Hazardous Substances Account Act, § 25300, *et seq.*; the California Expedited Remedial Action Reform Act of 1994, § 25396, *et seq.*; the Unified Hazardous Waste and Hazardous Materials Management Regulatory Program, § 25404, *et seq.*; the DTSC's responsibilities in connection with hazardous materials releases connected with railroad accidents; DTSC's Human and Ecological Risk Division, the Hazardous Materials Laboratory, the Office of Pollution Prevention and Technology Development, and the Office of Environmental Health Hazard Assessment; the purchase of hazardous substance response equipment and preparations; and the payment of hazardous substance remediation and oversight. § 25173.6(b)(1)-(14).

The regulatory and remedial purposes of the fee are confirmed by the legislative history of the law. For example, the legislative analysis of

Bill SB 475, from which § 25205.6 derives, describes the purposes of the fee as follows:

> Broadening the base. The established disposal, facility, and generator fees have supported the entire budget for the State's hazardous waste program. *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* to protect the general public and the environment.
>
> * * *
>
> This proposal … generally "broadens the base" of funding support for state hazardous waste programs. It does so by fixing the fees at existing levels (allowing them to increase only by the rate of inflation), by establishing a new environmental fee on corporations which conduct activities related to hazardous materials, and by appropriating $10 million from the general fund for the fiscal year 1989-90.

[CT 209, at 211] (Analysis by the Assembly Committee on Environmental Safety and Toxic Materials) (emphasis added).

The Health and Welfare Agency similarly recognized that the purpose of the fee was to place a "greater emphasis on cost recovery from responsible parties," and described the Bill as imposing

> a set of fees on *responsible parties* to pay for the cost incurred by the State in performing a variety of clean-up and regulatory oversight activities. … The environmental fee is *to be levied against specific corporations* (by [SIC] codes) which "use, generate, store or conduct activities related to hazardous materials, including hazardous waste.

[Resps. Exh. I, CT 1082] (Letter to Gov. Deukmejian, July 13, 1989, urging governor to sign the bill) (emphasis added). The agency continued by noting that "the legislation provides increased incentives for cost recovery activities with a greater share of the program costs borne by responsible

parties." *Id*.; *see also* [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").

Following the adoption of § 25205.6, the DTSC undertook to "adopt" a schedule of SIC codes as required by subsection (b). But rather than engage in the analysis of SIC business categories plainly contemplated by the statute, DTSC took the lazy way out and, ignoring APA procedures, determined that *all* businesses, regardless of their type or operations, used, generated, stored, or conducted activities related to hazardous materials. It construed the definition of hazardous materials as "broad enough to include many materials commonly found in the workplace," including "ink, toner, fluid, heavy metals on circuit boards inside computers, cleaning substances, mercury and polychlorinated biphenyl's ballasts in fluorescent light bulbs," as well as "lead batteries, oil, and fuel" associated with motor vehicles used by most businesses "to receive or deliver goods and services." [CT 207, at 210-211]. Given that sweeping construction of hazardous materials, and notwithstanding the wild discrepancies among businesses regarding the types and extent of supposedly hazardous materials used, the DTSC has each year adopted and forwarded to the SBE a schedule containing virtually all of the SIC codes for use in applying the environmental fee.[3]

Notwithstanding the DTSC's indiscriminate inclusion of all SIC codes in the schedule to be applied for corporations with 50 or more employees, those companies required to pay the fee still constitute only 5% of the business entities in California. [Resp. Exh. O, CT 1174, at 1187]

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[3] The only exception to the SIC schedule is for nonprofit corporations providing certain types of residential care, excluded by statute as described *supra* at 6.

(DTSC Task Force Report, Jan. 1997) (24,000 corporations, constituting 5% of all businesses, paid the 1994 environmental fee).

Morning Star is a California corporation that employs people to provide full-time and seasonal labor in the agricultural field by leasing those employees to other companies in the processed tomato business. Morning Star's own activities consist only of standard office functions involved in coordinating such leasing arrangements. It operates from a modest office having eight administrative employees using no more than the ordinary accoutrements of such an office, including telephones, computers, printers and fax machines, lights, pens, a microwave, and a refrigerator. Morning Star, however, does not use a materially greater amount of such mundane "hazardous materials" than any other business entity, including business entities with fewer than 50 employees and business entities organized in a non-corporate form. And it "uses" orders of magnitude less hazardous materials than business entities involved in manufacturing, selling, or otherwise handling goods such as batteries, light bulbs, medical supplies, computers, and automobiles. Morning Star has nothing whatsoever to do with hazardous wastes or hazardous materials as those terms are ordinarily understood.

Despite those undisputed facts, Morning Star was assessed, and paid under protest, the hazardous materials fee. Following payment of the fee, Morning Star promptly filed an administrative claim for a refund. That claim was rejected. According to the DTSC, even the mundane office supplies used by Morning Star constitute hazardous materials within the definition of the statute, and consequently Morning Star, as well as every other business in California, "uses" hazardous materials within the meaning of § 25205.6.

REASONS FOR GRANTING REVIEW

This Court should grant review because the decision below resolves important questions of administrative and constitutional law in a manner that undermines uniformity of the law, undermines important procedural and structural safeguards against arbitrary government action, and threatens to have effects well beyond the four corners of this case. Even within the confines of this case, the decision below involves important questions concerning the legality of the hazardous-materials fee affecting tens of thousands of businesses and millions of dollars in annual fees.

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.

One of the primary functions of administrative agencies is to investigate and set standards in complex areas of the law at a level of detail that the Legislature has neither the capacity nor the expertise to address. Subject to broad goals and criteria established by the Legislature, agencies are expected and required to add the necessary detail required to allow laws to operate sensibly in the real world. Given such quasi-legislative functions by agencies, however, the Legislature has imposed, through the APA, GOV'T CODE §§ 11340 *et seq.*, a set of procedural requirements to ensure that such administrative conduct in fact involves the appropriate detailed inquiry and rational conclusions and results expected. Far more than a set of mere technicalities, the APA stands as the primary assurance that agencies delegated a portion of legislative authority reach their decisions and impose their standards consistent with the goals and limitations of the relevant legislation, thus maintaining legislative supremacy and a healthy separation of powers.

When agencies adopt "regulations," the APA imposes a series of requirements involving public notice, an explanation of the proposed action, public comment and the possibility of a hearing, and review by the Office of Administrative Law. GOV'T CODE §§ 11343, 11346.4, 11346.5, 11346.7, 11346.8(a), 11346.14, 11346.53, 11346.55. The APA also provides for judicial review of an agency's adoption of a regulation, with the requirement that the agency action be supported by substantial evidence. GOV'T CODE § 11350.

The "regulations" subject to such procedures are broadly defined as "every rule, regulation, order, or standard of general application" by any state agency to implement, interpret, or make specific the law enforced or administered by it or to govern its procedure. GOV'T CODE § 11342(g); *Grier* v. *Kizer*, (1990) 219 Cal.App.3d 422, 438, 440, 268 Cal. Rptr. 244; *see also*, GOV'T CODE § 11346 (application to exercise of quasi-legislative powers). No state agency may "issue, utilize, enforce, or attempt to enforce … a regulation" without complying with the APA's requirements. GOV'T CODE § 11340.5(a).

On their faces, the DTSC's general determination that all businesses use hazardous materials and its annual adoption of a schedule of SIC codes for general application to California corporations constitute regulations, *i.e.*, "standards of general application" adopted to implement, interpret and make specific the requirements of § 25205.6.

Notwithstanding the seemingly plain application of the APA to the actions of the DTSC, the Court of Appeal rejected Morning Star's APA claim and held that the DTSC's determination was not a "rule, regulation, or standard of general application" subject to the APA. Instead it concluded that "DTSC did no more than apply [§ 25205.6] to carry out its

obligation under the statute. … The DTSC's view that all modern business activities involve the use, generation, or storage of hazardous material simply involves a factual application of section 25205.6 to the activities of modern business establishments." Opinion at 20-21.

The Court of Appeal's APA decision is worthy of review in this Court for several reasons.

First, the court below applied legal standards regarding the characterization of administrative conduct for APA purposes that conflicts with the decisions of this Court and other Courts of Appeal and that will sow confusion and inconsistency well beyond the four corners of this case.

As this Court held in *Tidewater Marine Western, Inc.* v. *Bradshaw* (1996) 14 Cal.4th 557, 571, 59 Cal. Rptr.2d 186, "a rule applies generally so long as it declares how a certain class of cases will be decided." This Court applied that standard to find that a policy that "interprets the law that [the agency] enforces" was a regulation. *Id*. at 572. Other Courts of Appeal likewise have recognized the straight-forward notion of what it means for an agency determination to be of "general application" and hence a regulation subject to the APA. *See, e.g.*, *California Advocates for Nursing Home Reform* v. *Bonta*, (2003), 106 Cal. App.4th 498, 130 Cal. Rptr.2d 823 (finding numerous policies interpreting or implementing statutes and regulations to be regulations).

The Court of Appeal below, however, applied a novel standard that an administrative determination could not be a rule of general applicability when the agency is "carry[ing] out its obligation under the statute." Opinion at 20. But by treating compliance with statutory obligations as a mere *ministerial* act in a case like this, the Court of Appeal turned administrative law on its head. Henceforth in the Third District, so long as

an agency is fulfilling its statutory directive, regardless of how much discretion or quasi-legislative authority that directive delegates, it can defend any non-compliance with the APA on the absurd ground that it was merely doing what was required of it by statute. Such a meaningless standard ignores the very nature of most statutory directives to agencies, and will create troubling inconsistencies in the application of the APA.

Second, the Court of Appeal's analysis makes no sense and constituted plain error as applied to this case. Every administrative agency promulgating rules, regulations, or standards acts in fulfillment of a statutory directive. What is important is not that the agency has been directed to do *something* by the Legislature, but rather whether it has been asked to exercise quasi-legislative judgment *within* the statutory bounds and does so by making determinations that will apply to multiple parties, *i.e.*, with a standard of general application. That is precisely what the DTSC did in connection with the hazardous-materials fee.

For example, in regard to the annual schedule of SIC codes, the agency rendered decisions regarding both the nature of hazardous materials use and the selection of all SIC codes that applied to all corporations of 50 or more employees. Those determinations were not made in the adjudication of an individual case, or even regarding a particular class of corporation. Rather, they were expressly made without regard for the individual details of the companies that would be subjected to the hazardous-materials fee and for the very purpose of having general application. And each year those determinations are embodied in the formal schedule of SIC codes "adopted" by the DTSC and forwarded to the SBE. The Court of Appeal's conclusion that such determinations "simply involve[] a factual application of section 25205.6 to the activities of modern business establishments," Opinion at 21, thus not only ignores the quasi-

legislative discretion delegated the DTSC in selecting SIC codes for inclusion on the schedule, but also ignores that the determinations were made at the level of "business establishments" in general, rather than as applied to only an individual business in particular. On the undisputed facts of this case, the DTSC plainly adopted a standard of general application subject to the APA.

The failure to follow APA requirements in this case is particularly troubling given that the DTSC seems to have ignored the requirements and the purposes of the statute, and any sensible notion of economics, in reaching its sweeping conclusions. As noted above, *supra* at 7-9, the purpose of the law was to spread the regulatory and remedial burden to those "responsible" for hazardous waste releases and cleanup obligations. The statute's requirement that the DTSC *select* from among the panoply of SIC codes when creating its schedule, and include the codes for *specific types* of corporations, strongly suggests that the Legislature intended some reasoned distinctions to be drawn among businesses *potentially* covered by § 25205.6 and that such distinctions further the statute's purposes of more accurately apportioning responsibility. The fact that the schedule of codes must be revisited on an annual basis makes perfectly clear that the Legislature contemplated that the schedule could change over time as businesses adapted their operations and hence their relative interactions with hazardous materials. But, having lumped all businesses into a single category unrelated to differences in business types, however, the DTSC has rendered meaningless the use of SIC codes as contemplated by the statute.

Those and similar issues are precisely the type of matters that would have been aired and explored under the required APA procedures, but which were overlooked and immunized from review when the DTSC took the lazy way out and refused to take a hard look at the task it was given.

Such short-circuiting of the very analysis directed by the Legislature is the inevitable consequence of ignoring the APA's safeguards for administrative conduct. The complex issues involved in selecting a schedule of SIC codes fairly scream for the developed record and explanation that comes from compliance with APA procedure and the ensuing judicial review.

Given the thousands of corporations now subject to the hazardous-materials fee, and the substantial proportion of them, including Morning Star itself, that have at best a tenuous and *de minimis* connection to the problems created by genuinely hazardous materials, it is especially important that respondent's decisions regarding the SIC schedule be made in a manner compliant with the APA. Even if viewed from the narrow confines of § 25205.6 alone, therefore, the Court of Appeal's APA ruling presents an important legal issue, affecting thousands of companies and millions of dollars, that warrants this Court's review.

Third, and finally, review is important not only to the procedural safeguards surrounding the imposition of this very expensive fee itself, but also for maintaining the procedural safeguards on administrative actions throughout the entire range of California agencies. The standard adopted by the Court of Appeals sets a dangerous precedent that would allow numerous agencies to circumvent APA procedural requirements. Given the breadth of state administrative action, the definitional question is likely to arise with some frequency, and the decision below is sure to cause considerable mischief.

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.

As a precursor to its constitutional analysis, the Court of Appeal held that the hazardous waste fee at issue in this case was a "tax" and that while regulatory fees under the state's police power "must bear a reasonable relationship to the fee payer's burdens on or benefits from the regulatory activity," a tax may be imposed "upon a class that may enjoy no direct benefit from its expenditure and is not directly responsible for the condition to be remedied." Opinion at 22. It subsequently used its characterization of the fee as a "tax" to minimize the degree of constitutional scrutiny it applied. Opinion at 25 ("Having determined that section 25205.6 imposes a tax, we reject [Morning Star's constitutional] claims under the deferential standard of review used to assess the constitutionality of a tax.").

In finding that the hazardous-materials fee was a tax, the court reasoned that "the purpose of the assessment imposed pursuant to section 25205.6 is to raise revenue *to pay for a wide range of governmental services and programs relating to hazardous waste control*. It is therefore a tax. The environmental fee charged Morning Star is not regulatory because it does not seek to regulate the use of hazardous material but to raise money for its disposal." Opinion at 24 (emphasis added). The court looked to cases involving the state Constitution's supermajority requirements for tax increases and purported to distinguish this case from others finding a fee to be regulatory rather than a tax by arguing that § 25205.6(f) "makes plain the purpose of the assessment is to raise sufficient revenues to fund the purposes of [§ 25173.6(b)] as well as to fulfill the state's federal obligation under" CERCLA and that § 25173.6(b) "authorizes the appropriation of funds for a wide range of remedial

purposes unrelated to the activity for which the fee is charged. The amount of the assessment does not bear a reasonable relationship to the adverse effects of the contamination generated by the payer and therefore has no regulatory deterrent effect." *Id*.

The approach applied by the court for classifying taxes and regulatory fees does considerable violence not only to the constitutional safeguards of due process and equal protection, but also to the standards for applying, or not applying, the additional constitutional requirements for tax increases. Several reasons thus support review by this Court.

First, the proper standards for classifying a legislative exaction as a regulatory fee or a tax affect numerous cases well beyond the confines of the current dispute. State and local governments impose all manner of fees on individuals, businesses, and property owners, and due process and equal protection analysis of such fees will be substantially impacted by their characterization as regulatory fees or taxes. Opinion at 22, 25. As a practical matter, 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 the constitutional questions in a substantial number of cases.

Furthermore, the standards for distinguishing regulatory fees from taxes also will affect the analysis of state and local exactions for purposes of the state Constitution's supermajority requirements for raising various taxes. Recognizing that the preliminary question was effectively the same, the Court of Appeal correctly looked to cases deciding whether an exaction was a tax for the supermajority requirements when deciding the issue in this case. Opinion at 22. The precise same recognition will run in the other direction as well, however, and the erroneous standards adopted in the

decision below threaten to carry into the analysis of future cases under Article XIII A. The prospective impact of the decision below thus reaches well beyond the particular hazardous materials fee involved and encompasses several types of constitutional analyses for all sorts of fees and taxes.

Second, the standards 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. This Court in *Sinclair* held that a fee imposed on manufacturers and others contributing to environmental lead contamination, and used for evaluation, screening and medical follow-up of children with potential lead poisoning, fell "squarely within a third recognized category not dependent on government conferred benefits or privileges, namely, *regulatory fees* imposed under the police power, rather than the taxing power." 15 Cal.4th at 874, 875.

Contrary to the Court of Appeal's decision below that the hazardous-materials fee's purpose "to raise revenue to pay for a wide range of governmental services and programs relating to hazardous waste control" rendered it a "tax," Opinion at 24, *Sinclair* squarely held that fees imposed on manufacturers and others requiring them to "bear a fair share of the cost of mitigating the adverse health effects their products created in the community" constituted "bona fide regulatory fees," 15 Cal.4th at 877; *see also California Ass'n of Professional Scientists* v. *Department of Fish & Game*, (2000) 79 Cal. App.4th 935, 94 Cal. Rptr.2d 535 (applying *Sinclair*). Such burden-bearing by responsible parties for the cost of mitigating the harms from hazardous materials is precisely the purpose of the hazardous-materials fee at issue here, and the aggregate amount of the fee is tailored

precisely to, and may not be used for any purposes other than, the funding of programs for regulating or mitigating the effect of such materials.[4]

Such inconsistency in the law, though itself enough to warrant this Court's review, also raises the troubling possibility that the coexistence of such disparate standards reflects and encourages a results-oriented approach under which a court will be free to pick and choose, *ad hoc*, whichever standard yields a desired result in any given case. If the Legislature lacks a 2/3's vote, not to worry, the law is a regulatory fee. Have the votes but lack a sufficient correspondence between the purposes of the fee and the classifications imposed? Still not to worry, the law is a tax. Such results-first-standards-later adjudication, particularly if used to minimize the constitutional constraints on government, undermines the very concept of neutral legal principles and cannot help but shake public confidence in the judicial system as a fair and neutral arbiter of disputes with the government and protector of constitutional rights. And that approach gets things entirely backwards and threatens to eviscerate constitutional constraints on both taxes and regulatory fees. 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.

Third, even within the four corners of this case, the Court of Appeal's analysis of the regulatory fee/tax issues is simply incoherent.

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[4] While the allocation of the fee among corporations may lack a similar precision, that deficiency is in large part attributable to the DTSC's failure to conduct a cogent and discriminating analysis of the SIC codes and the hazardous materials burden imposed by each type of business. But DTSC's failure to fulfill the reasonable expectations of the Legislature that it would tailor the fee through the selection of appropriate SIC codes does not convert what is otherwise a regulatory fee into a tax. Rather, it merely invalidates the regulatory fee. *See infra* at 22-29.

After noting that the hazardous-materials fee was imposed in order "to pay for a wide range of governmental services and programs *relating to hazardous waste control*," the court instantly reached the contradictory conclusion that the funds derived from the fee may be spent on a "wide range of remedial purposes *unrelated* to the activity for which the fee is charged." Opinion at 24 (emphasis added). It is difficult to imagine how those two statements can co-exist in the same opinion, much less the same paragraph.

The "activity" for which the hazardous-materials fee is charged is the "use, generat[ion], stor[age], or conduct [of] activities in this state related to hazardous materials." § 25205.6(a). The money is then required to be "deposited in the Toxic Substances Control Account," and may thereafter be used only "for the purposes specified in subdivision (b) of Section 25173.6." § 25205.6(c). As described above, *supra* at 7, each and every one of those purposes involves the regulation and remediation of hazardous materials and thus is directly and unequivocally *related* to the use, generation, storage and conduct of activities relating to hazardous materials – *i.e.*, the activities for which the fee was imposed.

The court's erroneous approach to the determining the constitutionality of the hazardous materials fee by itself represents an important question of law involving a substantial state program that imposes many millions of dollars in burden on thousands of corporations throughout the State. That such burden a be distributed in a manner that bears a reasonable relationship to the business activities of the companies affected, and that does not irrationally discriminate between similarly situated business entities, is an important interest in its own right and one deserving the attention of this Court.

III. THE WASTE 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.

In addition to the classifications and standards applied to the constitutional claims in this case, the merits of those constitutional claims also present important questions of law deserving of this Court's attention. The hazardous materials fee at issue applies – discriminatorily and irrationally – to thousands of businesses that pay millions of dollars a year. Ensuring that such a substantial exaction complies with the constitutional demands of equal protection and due process will serve as a significant check on arbitrary and unfair government action and likewise will serve to deter any similarly arbitrary and unfair exactions that might otherwise be expected to receive a free pass.

Having concluded that the hazardous materials fee was a tax rather than a regulatory fee, the Court of Appeal applied what it viewed as an especially "deferential standard of review used to assess the constitutionality of a tax." Opinion at 25. Reflecting the overly deferential standard it was applying, the court disposed of Morning Star's equal protection and due process claims with barely the waive of a hand:

> The taxing of corporations with 50 or more employees, as a general measure of the size of the corporation and its use of hazardous material, is manifestly rationally related to [the purpose] of funding the disposal of hazardous material. A distinction between the taxation of corporations and individuals is broadly permissible.

Opinion at 26. The court further suggested that to require the State to actually relate the fee to the hazardous-material burden imposed by particular corporations "would eviscerate the program." *Id*.

The Court of Appeal's casual disregard for the inequalities and irrationalities of the hazardous materials fee is troubling, incorrect, and worthy of review by this Court.

First, even viewing this as a "tax" case, the Court of Appeal's excessive deference – bordering on abdication – is inconsistent with the fundamental function of equal protection analysis in our society. As this Court recognized in *Hayes* v. *Wood*, (1979) 25 Cal.3d 772, 786-87, the "constitutional bedrock" and animating purpose of equal protection's requirement for a rational relationship "have never found clearer expression than the words of Justice Robert Jackson":

> "I regard it as a salutary doctrine" Justice Jackson stated, "that cities, states and the federal government must exercise their power so as not to discriminate between their inhabitants except upon some reasonable differentiation fairly related to the object of regulation. This equality is not merely abstract justice. The framers of the Constitution knew, and we should not forget today, that there is no more effective practical guarantee against arbitrary and unreasonable government than to require that the principles of law which officials would impose upon a minority must be imposed generally. Conversely, nothing opens the door to arbitrary action so effectively as to allow those officials 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. Courts can take no better measure to assure that laws will be just than to require that laws be equal in operation."

Id. at 786-87 (quoting *Railway Express Agency* v. *New York*, (1949) 336 U.S. 106, 112-13 (Jackson, J., concurring)). Those vital purposes cannot be served by the ephemeral scrutiny applied by the Court of Appeals. Indeed, such a non-existent hurdle has opened and would continue to "open the door to arbitrary action" and the unjust laws that would surely follow such immunity from judicial scrutiny.

Not surprisingly, the Court of Appeal's non-review is not the applicable standard and is not the law. Rather, equal protection requires "'a serious and genuine judicial inquiry into the correspondence between [a legislative] classification and the legislative goals.'" *Newland* v. *Board of Governors*, (1977) 19 Cal.3d 705, 711, 139 Cal. Rptr. 620 (internal citation omitted). And it 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. As this Court explained, government may not single-out a group for regulation "wholly at its whim" but rather its "decision as to where to 'strike' must have rational basis in light of the legislative objectives." *Hays*, 25 Cal.3d at 790-91. And *Warden* v. *State Bar*, (1999) 21 Cal.4th 628, 647, 88 Cal.Rptr.2d 283, 297, confirms that the rational basis test is not a paper tiger, but continues to require the "serious and genuine judicial inquiry" described in earlier cases. The U.S. Supreme Court similarly has held that a "state may not rely on a classification whose relationship to an asserted goal is so attenuated as to render the distinction arbitrary or irrational." *City of Cleburne* v. *Cleburne Living Center*, (1985) 473 U.S. 432, 446-447.[5]

Substantive due process under the state and federal Constitutions likewise "prevents government from enacting legislation that is 'arbitrary' or 'discriminatory' or lacks 'a reasonable relation to a proper legislative purpose.'" *Kavanau* v. *Santa Monica Rent Control Bd.* (1997) 16 Cal.4th 761, 771, 66 Cal. Rptr.2d 672 (citations omitted); *Morgan* v. *City of Chino* (2004), 115 Cal. App.4th 1192, 9 Cal. Rptr.3d 784, 788 (same).

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[5] Furthermore, equal protection under the California Constitution, like California's free speech protections, appears to provide even greater protection than its federal counterpart. *See Warden,* 21 Cal.4th at 661, *et. seq.*, 88 Cal. Rptr.2d at 307, *et seq*. (Brown, J., dissenting).

Second, under an appropriately "genuine" inquiry, the Court of Appeal's analysis of the substantive distinctions in the hazardous-materials fee is wholly inadequate. For example, Morning Star has maintained throughout this case that the distinction between corporations and other business enterprises was wholly irrational. The hazardous-materials impact of a business has absolutely nothing to do with its legal form, and hence the classification is grossly "underinclusive," has no rational connection to the purposes of § 25205.6, and defies the requirement that the law evince "some rationality in the nature of the class singled out." *Rinaldi* v. *Yeager*, (1966) 384 U.S. 305, 308-309.

Given that, according to the DTSC, all businesses in California – regardless of legal form – use, generate, store, or conduct activities relating to hazardous materials, it is difficult to imagine how the distinction based on incorporation is related to the purposes of the act. The sheer absurdity of the classification can be seen by the fact that the San Francisco 49ers, owned by a corporation, must pay the fee, while the Oakland Raiders, owned by a partnership, are not required to pay the fee. Similarly situated accounting firms likewise vary in their legal form and hence will likewise be covered or not under § 25205.6 without any rational basis in the purposes of the law. And there are literally thousands of non-corporation businesses that employ in excess of fifty persons that are not required to pay the environmental fee. [CT 244; and 91 ¶¶ 4-6; referencing CT 133-160]. Many of those businesses will be identically situated to Morning Star or other corporations that have no genuine connection to hazardous materials other than through the attenuated reasoning of the DTSC. Still more are likely to have a substantially *greater* hazardous-materials impact insofar as their businesses make genuine use of such materials, such as in the case of auto-repair operations, hardware stores, or manufacturing and

retail operations for the very same mundane office items that Morning Star uses only incidentally. Not only will the classification in those cases fail to have a rational basis in the purposes of the law, it will in fact be *antithetical* to those purposes by excluding businesses with far greater responsibility for hazardous materials and including those with considerably less responsibility.

The Court of Appeal had no explanation or defense for this aspect of the classification. Instead it merely observed, without citation or explanation, that it was "broadly permissible" to distinguish between individuals and corporations. Opinion at 26. While such a distinction may be defensible in some instances – given that individuals are indeed different from businesses for many purposes – that has absolutely nothing to do with distinctions *among* business enterprises themselves. Partnerships and other business forms are not analogous to individuals in this context. They operate for-profit enterprises, deduct their business expenses under the same rules as all other businesses, can limit their liability through the LLP form, can encourage investment through a general/limited partner structure, and otherwise are indistinguishable from corporations in any way that is meaningful in the hazardous-materials context. The Court of Appeal's off-point assertion regarding differential treatment of individuals thus is completely insufficient to sustain the challenged classification.

Yet another example of irrationality is § 25205.6's reliance on the number of employees as the basis for applying and raising the fee. Once again, such a criterion has nothing to do with a business' hazardous-materials impact. A 40-person hardware store with modern electronic cash registers, computer accounting, and inventory systems undoubtedly uses just as many computers, printers, faxes, light bulbs, and other ordinary business products as does any other modern business and certainly far more

than Morning Star does in its 8-person office. But such a hardware store also stores and sells numerous florescent light bulbs, power tools, motorized lawn and yard equipment, motor oil, insecticides, drain cleaner, and any number of other types of goods containing hazardous materials. Such an operation is excluded from the fee despite having a connection to hazardous materials that is orders of magnitude greater than Morning Star's connection. Similar points could be made about gas stations, electronics manufacturers, auto dealers, light-bulb or battery manufacturers, paint stores, furniture makers, photocopy stores, office supply manufacturers or dealers, or, for that matter, virtually any business that either sells or services any of hundreds of everyday products. Any such business, regardless of the number of employees, will have a far greater hazardous-materials impact than does Morning Star, which does little more than paperwork for leasing out employees to other companies. Yet thousands of such businesses will be excluded from paying the hazardous-materials fee. Such a result goes well beyond arbitrary and is in fact utterly antithetical to the purposes of the law.

The Court of Appeal's bare assertion that the number of employees is a reasonable proxy for a company's size and use of hazardous materials is pure speculation that is belied by the examples given above. Had the DTSC actually conducted the analysis expected of it and scheduled only those SIC codes of businesses having a genuine and significant connection to hazardous wastes, then the proxy of employees and size might have served as a rough approximation *within* such categories of the relative impact of a company. But having taken an absurdly expansive view of which companies use hazardous materials, and hence lumped together wildly disparate businesses in a single classification, the use of employees as a proxy for impact loses all meaning. Morning Star could have a

thousand employees and it still would not deal with as much hazardous material as an exempt 40-person company manufacturing batteries, or acetone, or any number of other products.

The combination of the classifications based on size and corporate form leads to the bizarre situation that, despite DTSC's contention that *all* businesses use hazardous materials contained in everyday goods, only 5% of all businesses in California paid the hazardous waste fee in 1994. [Resp. Exh. O, CT 1174, at 1187] (DTSC Task Force Report, Jan. 1997). While that still constitutes approximately 24,000 corporations, and hence raises an important issue for this Court, it certainly highlights the discriminatory nature of the fee. Perhaps by imposing the fee on such a small percentage of businesses the Legislature believed it could avoid what Justice Jackson described as the political "retribution" that would arise if the fee were imposed more generally.

Finally, the DTSC's inclusion of *all* SIC codes in its schedule of companies that have to pay the fee evinces irrationality in that it is grossly over-inclusive in treating materially different companies the same, which is an inequality in its own right. Given the legislative purpose of having responsible parties bear their share of the burden of hazardous materials, and given the statute's express directive that DTSC *select* types of companies from the list of SIC codes, the DTSC's refusal to take into account material differences among various types of businesses is arbitrary and capricious.

The Court of Appeal's suggestion that it would be impossible to evaluate each *individual* business misses the point, and ignores the fact that the Legislature in fact directed the DTSC to review businesses by SIC *category*. While a meaningful review of SIC codes in order to distinguish

different business types may well be beyond the reasonable capacity of the Legislature, such inquiries are precisely the reason we have administrative agencies in the first place. That the DTSC was unwilling to get its hands dirty and hence chose indiscriminate overinclusion as the easy way out hardly constitutes a rational basis for such overinclusion. It will always be less convenient to follow the Constitution; to make rational choices rather than simplistic ones. But in this case such inconvenience is a minor price to pay and will not even remotely overwhelm the purposes of the law. In fact, more accurately tailoring the fee to those genuinely responsible for hazardous wastes will further the purposes of the law by giving business groups an incentive to promote best practices within their SIC category in the prospect of being removed from the schedule in a subsequent annual review. Such an approach is far more consonant with the structure of § 2505.6 than is the DTSC's blunderbuss approach that only creates incentives to fire employees above the magic number 50 or to abandon the corporate form.

Overall, whether scrutinized with greater or lesser deference, the classifications used in applying the hazardous-materials fee are so utterly arbitrary and without relation to the purposes of the law that they cannot pass constitutional muster. The numerous troubling legal steps that led the Court of Appeal to sustain the fee present important legal issues, both for the many businesses affected by the fee and for the many other cases that will be affected by the precedent. This case thus stands as a prime and worthy candidate for review by this Court.

CONCLUSION

For the foregoing reasons, this Court should grant the petition for review.

Respectfully Submitted,

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CERTIFICATE OF SERVICE

I hereby certify that, on this 20th day of March, 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 Petition for Review complies with the 8,400 word type-volume limitation of Appellate Rule 28.1(d) in that it contains 8222 words, excluding the table of contents, table of authorities, certificates of counsel, and the attached Court of Appeal opinion. 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