



## OFFICE OF THE GOVERNOR

July 11, 2007

***Via Facsimile (916) 323-3387 & U.S. Mail***

Mr. Robert Lambert  
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State Board of Equalization  
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***Via Facsimile (916) 445-9515 & U.S. Mail***

Ms. Susan Lapsley  
Director  
Office of Administrative Law  
300 Capitol Mall, Suite 1250  
Sacramento, California 95814-4339

Re: In re Board of Equalization  
Office of Administrative Law File No. 07-0427-04 SR  
Title 18, California Code of Regulations: Proposed Section 474  
Board of Equalization Request for Review of Decision of Disapproval

Dear Mr. Lambert and Ms. Lapsley:

Pursuant to Government Code section 11349.5, this written decision is submitted in response to the Board of Equalization's request for review dated June 18, 2007. Based on our review of the record and the statements submitted by the Board of Equalization (BOE) and the Office of Administrative Law (OAL), the Governor's Office affirms OAL's Decision of Disapproval. We conclude that BOE's Initial Statement of Reasons did not substantially comply with the requirements of the Administrative Procedure Act.

### I

BOE originally submitted the proposed regulation to OAL on December 26, 2006. BOE proposed to add a new section 474 to Title 18 of the California Code of Regulations, pertaining to the valuation of property used for refining petroleum. However, on February 8, 2007, BOE withdrew the proposal before OAL took formal action on it.

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In a letter to OAL Deputy Director Linda Brown dated May 7, 2007, BOE's Acting Assistant Chief Counsel Robert Lambert said that earlier in the year, OAL had indicated that BOE could either voluntarily withdraw the original submission of the proposed regulation or OAL would reject it. The May 7 letter explained that the reason given by OAL was that the Initial Statement of Reasons was inadequate, and that BOE would need to redraft the Initial Statement of Reasons.

BOE withdrew the original submission. But BOE resubmitted the proposal on April 27, 2007, without revising the Initial Statement of Reasons. In fact, the resubmission was almost identical to the prior submission, except that in the text of proposed section 474, a citation to Revenue and Taxation Code section 53.5 was deleted as a Reference. BOE explained in its May 7 letter to OAL that after reviewing applicable law, BOE concluded that the originally submitted Initial Statement of Reasons was adequate, particularly when read in conjunction with the draft of section 474. The May 7 letter then provided several pages of legal analysis explaining why BOE believed OAL was incorrect regarding the alleged inadequacy of the Initial Statement of Reasons.

On June 8, 2007, OAL disapproved the regulation because BOE's Initial Statement of Reasons was deficient. In its Decision of Disapproval, OAL indicated that the Initial Statement of Reasons failed to adequately inform the public of the reasons that proposed section 474 is needed.

The Board of Equalization submitted its request for review of OAL's decision to the Governor's Legal Affairs Secretary on June 18, 2007, and OAL submitted its response on June 25, 2007.

## II

The California Administrative Procedure Act provides for the adoption and review of proposed state regulations. (Gov. Code, § 11340 et seq.) State agencies must follow specific procedures in adopting regulations. (See Gov. Code, § 11346 et seq.) Moreover, the regulations (along with the rulemaking record) are reviewed by OAL before they become final to ensure that the requirements set forth in the Government Code have been followed. (See Gov. Code, § 11349 et seq.)

BOE needed to follow "basic minimum procedural requirements" for the adoption of the proposed regulation. (Gov. Code, § 11346, subd. (a).) Among other things, BOE was required to prepare, submit to OAL, and make available to the public upon request, a copy of the

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proposed regulation and an Initial Statement of Reasons for proposing the adoption of the regulation. (Gov. Code, § 11346.2.) Government Code section 11346.2, subdivision (b), states that the Initial Statement of Reasons shall include, but not be limited to, all of the following:

(1) A statement of the specific purpose of the regulation and the rationale for the determination by the agency that the regulation is reasonably necessary to carry out the purpose for which it is proposed.

(2) Identification of each study, report or similar document, if any, upon which the agency relies in proposing the regulation.

(3) A description of reasonable alternatives to the regulation and the agency's reasons for rejecting those alternatives. (Nonetheless, an agency is not required to artificially construct alternatives, describe unreasonable alternatives, or justify why it has not described alternatives.)

(4) Facts, evidence, documents, or testimony on which the agency relies to support an initial determination that the regulation will not have a significant adverse economic impact on business.

(Gov. Code, § 11346.2, subd. (b).)

BOE was also required to maintain a rulemaking file that serves as the "record" of the rulemaking proceeding. (Gov. Code, § 11347.3.) The rulemaking file must be made available to the public for inspection and copying. (*Id.*, at subd. (a).) The rulemaking file must include the Initial Statement of Reasons. (*Id.*, at subd. (b)(2).)

Following public comment (see, e.g., Gov. Code, §§ 11346.45, 11346.8), BOE was required to prepare and submit to OAL, among other things, a Final Statement of Reasons. (Gov. Code, § 11346.9, subd. (a).) The Final Statement of Reasons must include, among other things, all of the following:

(1) An update of the information contained in the initial statement of reasons.

(2) A determination as to whether adoption of the regulation imposes a mandate on local agencies or school districts.

(3) A summary of each objection or recommendation made regarding the regulation, along with an explanation of how the regulation has been changed to accommodate each objection or recommendation, or the reasons for making no change.

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(4) A determination with supporting information that no alternative considered by the agency would be more effective in carrying out the purpose for which the regulation is proposed.

(Gov. Code, § 11346.9, subd. (a).) The Final Statement of Reasons must be placed in the rulemaking file. (Gov. Code, § 11347.3, subd. (b)(2).)

OAL must review all regulations adopted by state agencies. (Gov. Code, § 11349.1, subd. (a).) OAL must approve the regulation if it complies with the standards set forth in Chapter 3.5, which includes Government Code sections 11340 through 11365. (Gov. Code, § 11349.1, subd. (a).) Although OAL may not substitute its judgment for that of the agency regarding the substantive content of the proposed regulation (Gov. Code, § 11340, subd. (a)), OAL may disapprove a regulation based on failure to comply with the procedural requirements of Chapter 3.5. (Gov. Code, § 11349.3, subd. (b).)

### III

BOE's Initial Statement of Reasons did not substantially comply with the requirements of the Administrative Procedure Act. Among other things, an Initial Statement must describe the "specific" purpose of the regulation and the "rationale" for the determination by the agency that the regulation is reasonably necessary to carry out the purpose for which it is proposed. (Gov. Code, § 11346.2, subd. (b)(1).) BOE's Initial Statement consisted of a single page, and contained only a single sentence under the heading "Specific Purpose," stating that "[t]he purpose of the proposed rule is to implement and make specific the requirements for valuation of real property, personal property, and fixtures used to refine petroleum." Although that sentence indicates that the proposed regulation relates to certain unmentioned "requirements" pertaining to the valuation of property used to refine petroleum, it does not describe a "specific" purpose and it does not describe BOE's "rationale" for why the regulation is necessary. The remainder of the Initial Statement consists of four brief paragraphs under the heading "Factual Basis." Those paragraphs do not set forth any facts, however, and they do not specifically describe the problem that the regulation is intended to address, or why the regulation is necessary.

By way of comparison, BOE's Final Statement of Decision includes the explanations that were not included in the Initial Statement, although they could have been. The first five pages of the Final Statement describe, in specific detail, the purpose of the proposed regulation and the legal and factual reasons why the regulation is needed. The Final Statement explains that existing Property Tax Rule 461, subdivision (e) [18 Cal. Code Regs, § 461(e)] sets forth the general rule that for real property appraisals conducted to determine whether a decline in value has occurred, the fixtures and machinery classified as improvements on the real property are treated as a separate appraisal unit. The reason for this general rule, as explained in the Final Statement, is that for most types of property, the land and improvements are usually sold separately from the fixtures and equipment. Accordingly, the general rule provides for separate

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valuation. But the Final Statement explains that for some special types of property, fixtures and machinery are not treated as a separate appraisal unit. Thus, in order to be consistent with the marketplace, the land, improvements, fixtures and machinery should be valued as a single appraisal unit to determine whether there has been a decline in value. The Final Statement explains that existing property tax regulations 468, 469 and 473 already address some of these special properties. Those existing regulations pertain to oil and gas, mining, and geothermal properties. According to the Final Statement, proposed regulation 474 would do the same thing for properties used to refine petroleum, because those properties also generally treat land, improvements, fixtures and equipment as a single appraisal unit.

The detailed discussion in the Final Statement sets forth the specific purpose of the proposed regulation and explains BOE's rationale for determining that the regulation is reasonably necessary. But BOE did not include this explanation, or any similar type of explanation, in the Initial Statement. While it is reasonable to expect that BOE would have more facts and information after the public comment period, BOE is nonetheless required to prepare an Initial Statement that sets forth the specific purpose and rationale for the regulation. This is important, because the Initial Statement must be included in the rulemaking file, and must be made available to the public for inspection and copying. (Gov. Code, § 11347.3, subd's (a) and (b)(2).) BOE's Initial Statement could have explained the general rule established by Rule 461 for most properties, and it could have explained that some properties are different. BOE also could have explained the changes adopted by Rules 468, 469 and 473 to address this problem, and BOE could have explained that properties used to refine petroleum are also different, because the land, improvements, fixtures and equipment are treated as a single appraisal unit.

Government Code section 11346.2, subdivision (b), lists additional information that must be included in the Initial Statement, such as identification of each study or report relied upon, a description of reasonable alternatives to the regulation, the agency's reasons for rejecting those alternatives, and a description of the facts, evidence, documents, or testimony on which the agency relies to support its initial determination that the regulation will not have a significant adverse economic impact on business. These items are not contained in BOE's Initial Statement.

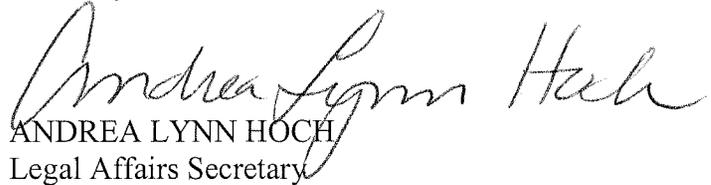
BOE contends that the Initial Statement is designed to be an initial brief statement that puts the public on notice of the subject matter of the rulemaking action. (BOE's Request for Review, p. 3.) BOE says that the Initial Statement can be supplemented with the Final Statement, and that a determination of necessity must take into account the totality of the record. (*Ibid.*) But the requirements of Government Code section 11346.2, subdivision (b)(1), indicate that the Initial Statement is intended to do more than simply put the public on notice of the general subject matter of the proposed regulation. And, following the public comment process, the Final Statement must include an "update" of the information contained in the Initial Statement. (Gov. Code, § 11346.9, subd. (a)(1).) However, the Final Statement's "update" is not intended to supersede a deficient Initial Statement. Finally, although "necessity" is

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determined based on the totality of the record, the record in this appeal demonstrates that when BOE resubmitted its proposed regulation in April, BOE could have provided sufficient detail in its Initial Statement to explain why Section 474 was being proposed and to articulate the problem it was intended to address.

It is unclear why BOE did not revise its Initial Statement before resubmitting the proposed regulation in April. In any event, BOE can begin again with a new submission, this time complying with the procedural requirements of the Administrative Procedure Act.

Sincerely,

  
ANDREA LYNN HOCH  
Legal Affairs Secretary