

STATE OF CALIFORNIA

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OFFICE OF ADMINISTRATIVE LAW

Bill Jones
BILL JONES
SECRETARY OF STATE

In re:)
 Request for Regulatory)
 Determination filed by JON) 1999 OAL Determination No. 9
 M. TARDINO and SAM R.)
 TARDINO regarding the STATE) [Docket No. 97-014]
 BOARD OF EQUALIZATION)
 policy of asserting tax, in) March 25, 1999
 cases where sales tax)
 reimbursement has been) Determination Pursuant to
 collected from customers,) Government Code Section
 against corporate officers-) 11340.5; Title 1, California
 stockholders of closely held) Code of Regulations,
 corporations that have been) Chapter 1, Article 3
 suspended by the Franchise)
 Tax Board)
 _____)

Determination by: CHARLENE G. MATHIAS, Deputy Director

HERBERT F. BOLZ, Supervising Attorney
DEBRA M. CORNEZ, Staff Counsel
Regulatory Determinations Unit¹

SYNOPSIS

The issue presented to the Office of Administrative Law ("OAL") is whether the State Board of Equalization ("Board") policy of asserting tax, in cases where sales tax reimbursement has been collected from customers, against corporate officers-stockholders of corporations that have been suspended by the Franchise Tax Board ("FTB") is a "regulation" which is without legal effect unless adopted in compliance with the Administrative Procedure Act ("APA").

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OAL has concluded that the Board's challenged policy is a "regulation" which must be adopted in accordance with the APA in order to be valid. If the Board wishes to exercise its discretion to issue rules of general application governing this topic, it may adopt regulations pursuant to the APA.²

ISSUE

OAL has been requested by Jon M. Tardino and Sam R. Tardino³ to determine⁴ whether a Board policy adopted in 1980 is a "regulation" that is without legal effect unless adopted in compliance with the APA.^{5,6} The policy is to assert tax, in cases where sales tax reimbursement has been collected from customers, against corporate officers-stockholders of closely held corporations, whose corporate powers, rights, and privileges have been suspended by FTB for failure to pay franchise tax on a timely basis.

BACKGROUND

The following is an excerpt from the minutes of the Board's June 30, 1980 meeting, showing the adoption of the challenged policy:

"J. D. Dotson, Assistant Executive Secretary, Business Taxes, recommended that the Board *reinstate the practice* of issuing dual determinations against corporate officers for liability incurred during the period in which corporate powers have been suspended by the Franchise Tax Board for failure to pay the franchise tax. He recommended that such determinations be issued *only* in cases where sales tax reimbursement has been collected from customers.

Upon motion of Mr. Reilly, seconded by Mr. Nevins, and unanimously carried (Mr. Bennett and Mr. Cory absent), the *Board adopted the policy of asserting tax against corporate officers-stockholders of closely held corporations which have failed to pay franchise tax on a timely basis and whose corporate powers, rights, and privileges have been suspended by the Franchise Tax Board, in cases where sales tax reimbursement has been collected from customers.* [Emphasis added.]"

In its response to the request for determination, the Board concedes that the policy that was adopted at the June 30, 1980 meeting, is a "regulation" within the meaning of the APA. The Board further asserts, however, that notwithstanding its failure to comply with the APA, the Board has the statutory obligation to **collect** sales taxes which may not be abrogated nor restricted by the absence of a **duly** adopted "regulation." The Board makes the following argument:

*"The Board agrees that the motion is a regulation within the meaning of the Administrative Procedures Act. However, the requester of the determination appears not only to be seeking a determination that the motion is an 'underground regulation,' but also a determination from OAL that the Board may not, without a regulation, make assessments against corporate office-stockholders under the circumstance set forth in this motion. A determination that this motion is a regulation does not **prohibit** the Board from making such assessments, for such a prohibition **would** impinge on the Board's duty and authority to enforce the Sales and Use Tax Laws. [Emphasis added.]"*⁷

Pursuant to Government Code section 11340.5, subdivision (b), OAL has jurisdiction to issue a determination as to whether the agency rule challenged in a request for determination is a "regulation" as defined in subdivision (g) of section 11342 of the Government Code. OAL will not address in this determination whether or not (1) administrative rulings based upon the challenged rule **should be** reversed or (2) the Board may make such assessments absent a **duly adopted** regulation. Those issues are matters for the courts.⁸

In its response, the Board further states:

*"[T]he Board . . . issued a Sales and Use Tax Memorandum Opinion that contained a thorough discussion of the legal basis for holding corporate officer-stockholders of suspended corporations liable. (Sales & Use Tax Memo. Opn., Jack Donald Freels, Sept. 10, 1997.) The Supreme Court in *Tidewater Marine Western, Inc. [v. Bradshaw]*, (1996) 14 Cal.4th 557], while noting that a policy manual summarizing such decisions would **not be** binding on the agency in subsequent agency proceedings or on the **courts** when reviewing agency proceedings, nonetheless held that 'interpretations that arise in the course of case-specific adjudication are not regulations,*

though they may be persuasive as precedents in similar subsequent cases.' (14 Cal.4th at 571.) [Emphasis added.]"

In this 1997 Sales and Use Tax Memorandum Opinion ["Memorandum Opinion"], the Board refers to *Decorative Carpets, Inc., v. State Board of Equalization* (1962) 58 Cal.2d 252, and Revenue and Taxation Code sections 6014, 6015, 6066, 25962.1 and 23301 as the legal basis for its policy.⁹ The Memorandum Opinion states in part:

"There is both a statutory basis and a basis in California case law upon which to assert personal liability for tax assessments against the officers-shareholders of a closely held corporation which has been suspended by the Secretary of State [at the direction of the Franchise Tax Board] but continues to conduct selling activities and collects sales tax reimbursement from customers. In *Decorative Carpets, Inc. [supra,]* the California Supreme Court concluded that excessive sales tax reimbursement collected by a retailer gave rise to an involuntary trust with the retailer acting as the involuntary trustee of the funds. When these funds were paid to the Board of Equalization, the Board could insist on the retailer refunding the excess tax reimbursement to the customers as a condition to the Board's refunding of the overpayments to the retailer. The court noted that the Board 'has a vital interest in the integrity of the sales tax . . .', and that '[t]o allow (the retailer) a refund without requiring it to repay its customers the amounts erroneously collected from them would sanction a misuse of the sales tax by a retailer for his private gain.' (at page 255) Therefore, officers-shareholders of a closely held corporation who continue to operate a business which has had its corporate powers suspended and continue to collect sales tax reimbursement from the customers of that business are involuntary trustees of those funds. For the Board to permit the corporate officers-shareholders to retain those funds sanctions a misuse of the sales tax by them for their private gain and undermines the integrity of the sales tax. These funds are collected as sales tax reimbursement from customers and are a debt owed by the business to the State of California.

"Under the statutory provisions of the Sales and Use Tax Law there is further authority to hold officers-shareholders of a suspended corporation liable for the sales tax which the business owes the State and has already

collected from customers as sales tax reimbursement. The officers of a corporation are the persons who conduct the business of the corporation, and if the Board were to pursue someone other than the corporation for liabilities generated during the period of suspension the persons to pursue are the persons who conduct the business.

"Revenue and Taxation Code section 25962.1 [repealed effective January 1, 1994; see now section 19719] makes it a crime for any person to purport to exercise the powers of a corporation which has been suspended [by the Franchise Tax Board] pursuant to Revenue and Taxation Code section 23301. When corporate officers-shareholders conduct selling activities during a period in which the corporate powers are suspended they are not exercising the corporate powers but are acting as individuals. Revenue and Taxation Code sections 6014, 6015, and 6066 indicate that the officers-shareholders as individuals are sellers within this state and must hold a seller's permit. As the Sales and Use Tax Law, by its own terms, applies to claimant's actions of engaging in selling activities during the period of suspension of the corporation's powers, it is appropriate to treat claimant as one engaged in an activity requiring the holding of a seller's permit. The reason for the corporate suspension will not affect this conclusion. It is the fact that the corporation is suspended and yet the officers-shareholders as individuals continue the selling activities that triggers the officers-shareholders' responsibility as sellers to obtain a seller's permit and to report and remit sales tax to the State."¹⁰

Revenue and Taxation Code sections 6014, 6015, 6066, 19719 (former section 25962.1) and 23301, cited in the Memorandum Opinion, provide the following:

Section 6014

“‘Seller’ includes every person engaged in the business of selling tangible personal property of a kind the gross receipts from the retail sale of which are required to be included in the measure of the sales tax. . . .”

Section 6015

"(a) 'Retailer' includes:

- (1) Every seller who makes any retail sale or sales of tangible personal property, and every person engaged in the business of making retail sales at auction of tangible personal property **owned by** the person or others.
- (2) Every person engaged in the business of making sales for **storage**, use, or other consumption or in the business of making sales at auction of tangible personal property owned by the person or **others** for storage, use, or other consumption. . . ."

Section 6066

"Every person desiring to engage in or conduct business as a seller **within** this state shall file with the board an application for a permit for **each place** of business. . . ."

Section 19719 (former section 25962.1)

"(a) Any person who attempts or purports to exercise the powers, **rights**, and privileges of a corporation that has been suspended pursuant to **Section 23301** . . . is punishable by a fine of not less than two hundred fifty **dollars** (\$250) and not exceeding one thousand dollars (\$1,000), or by imprisonment not exceeding one year, or both fine and imprisonment. . . ."

Section 23301

"Except for the purposes of filing an application for exempt status or amending the articles of incorporation as necessary either to perfect that application or to set forth a new name, the *corporate powers*, **rights and** privileges of a domestic taxpayer *may be suspended*, and the **exercise of the** corporate powers, rights and privileges of a foreign taxpayer in this state may be forfeited, if any of the following conditions occur:

(a) If any tax, penalty, or interest, or any portion thereof, that is due and payable . . . is not paid [as required by this section]"
[Emphasis added.]

Revenue and Taxation Code section 6051 is also pertinent to this determination.¹¹
It provides:

Section 6051

"For the privilege of selling tangible personal property at retail a tax is hereby imposed upon all retailers"

Though the Board has conceded that the challenged policy "is a regulation that was not adopted pursuant to the procedures set forth in the Administrative Procedures Act,"¹² OAL is nonetheless required to consider all written information or evidence submitted in compliance with title 1, California Code of Regulations ("CCR"), sections 122, 124 and 125 in regards to the request for determination and issue a written determination, along with the reasons supporting the determination, concerning whether the challenged state agency rule is a "regulation."¹³ The following is OAL's analysis regarding the challenged policy adopted by the Board on June 30, 1980.

ANALYSIS

I. IS THE APA GENERALLY APPLICABLE TO THE BOARD'S QUASI-LEGISLATIVE ENACTMENTS?

For purposes of the APA, Government Code section 11000 defines the term "state agency" as follows:

"As used in this title [Title 2. Government of the State of California (which title encompasses the APA)], 'state agency' includes every *state* office, officer, department, division, bureau, *board*, and commission. [Emphasis added.]"

The APA further clarifies or narrows the definition of "state agency" from that in Section 11000 by specifically excluding "an agency in the judicial or legislative

department of the state government."¹⁴ The Board is in neither the judicial nor legislative branch of state government.¹⁵ Clearly, the Board is a "state agency" within the meaning of the APA, and unless the Board is expressly exempted from the APA,¹⁶ the APA is generally applicable to the Board. Since no specific exemption has been enacted, the APA is generally applicable to the Board.

II. DOES THE CHALLENGED POLICY CONSTITUTE A "REGULATION" WITHIN THE MEANING OF GOVERNMENT CODE SECTION 11342?

Government Code section 11342, subdivision (g), defines "regulation" as:

"... *every* rule, regulation, order, or standard of general application *or* the amendment, supplement, or revision of any rule, regulation, order or standard adopted by *any* state agency to implement, interpret, or **make** specific the law enforced or administered by it, or to govern its **procedure** ... [Emphasis added.]"

Government Code section 11340.5, authorizing OAL to determine whether agency rules are "regulations," and thus subject to APA adoption requirements, **provides** in part:

"(a) *No* state agency shall issue, utilize, enforce, or attempt to enforce *any* guideline, criterion, bulletin, manual, instruction, order, standard of **general** application, or other rule, which is a ["]regulation["] as defined in subdivision (g) of Section 11342, *unless* the guideline, criterion, bulletin, manual, instruction, order, standard of general application or other rule **has** been adopted as a regulation and filed with the Secretary of State pursuant to [the APA]. [Emphasis added.]"

In *Grier v. Kizer*,¹⁷ the California Court of Appeal upheld OAL's two-part test¹⁸ as to whether a challenged agency rule is a "regulation" as defined in the key provision of Government Code section 11342, subdivision (g):

First, is the challenged rule either:

- a rule or standard of general application, *or*
- a modification or supplement to such a rule?

Second, has the challenged rule been adopted by the agency to either:

- implement, interpret, or make specific the law enforced or administered by the agency, *or*
- govern the agency's procedure?

If an uncodified rule satisfies both parts of the two part test, OAL must conclude that it is a "regulation" and subject to the APA. In applying the two-part test, OAL is mindful of the admonition of the *Grier* court:

" . . . because the Legislature adopted the APA to give interested persons the opportunity to provide input on proposed regulatory action (*Armistead*, . . . , 22 Cal.3d at p. 204, 149 Cal.Rptr. 1, 583 P.2d 744), we are of the view that *any doubt as to the applicability of the APA's requirements should be resolved in favor of the APA.* [Emphasis added.]"¹⁹

Three California Court of Appeal cases provide additional guidance on the proper approach to take when determining whether an agency rule is subject to the APA.

According to *Engelmann v. State Board of Education* (1991), agencies need not adopt as regulations those rules contained in "a statutory scheme which the Legislature has [already] established. . . ." ²⁰ But "to the extent [that] any of the [agency rules] depart from, or embellish upon, express statutory authorization and language, the [agency] will need to promulgate regulations. . . ." ²¹

Similarly, agency rules properly promulgated *as regulations* (i.e., California Code of Regulations ("CCR") provisions) cannot legally be "embellished upon" in administrative bulletins. For example, *Union of American Physicians and Dentists v. Kizer* (1990)²² held that a terse 24-word definition of "intermediate physician service" in a Medi-Cal regulation could not legally be supplemented by

a lengthy seven-paragraph passage in an administrative bulletin that went "far beyond" the text of the duly adopted regulation.²³ Statutes may legally be amended only through the legislative process; duly adopted regulations--generally speaking--may legally be amended only through the APA rulemaking process.

The third case, *State Water Resources Control Board v. Office of Administrative Law (Bay Planning Commission)* (1993), made clear that reviewing authorities

are to focus on the *content* of the challenged agency rule, not the *label* placed on the rule by the agency:

" . . . the . . . Government Code [is] careful to provide OAL authority over regulatory measures whether or not they are designated 'regulations' by the relevant agency. In other words, *if it looks like a regulation, reads like a regulation, and acts like a regulation, it will be treated as a regulation whether or not the agency in question so labeled it.* . . . [Emphasis added.]"²⁴

A. IS THE CHALLENGED POLICY A "STANDARD OF GENERAL APPLICATION"?

For an agency rule or standard to be "of general application" within the meaning of the APA, it need not apply to all citizens of the state. It is sufficient if the rule applies to all members of a class, kind or order.²⁵

The challenged 1980 policy of assessing sales tax against officers-stockholders of corporations suspended by FTB, only where sales tax reimbursement has been collected from customers, is a rule of general application. The challenged policy applies to all officers-stockholders of corporations suspended by FTB where sales tax reimbursement has been collected, i.e., the challenged policy applies to all members of a class, kind or order.

B. DOES THE CHALLENGED POLICY INTERPRET, IMPLEMENT, OR MAKE SPECIFIC THE LAW ENFORCED OR ADMINISTERED BY THE AGENCY OR GOVERN THE AGENCY'S PROCEDURE?

In its response, citing to Revenue and Taxation Code section 7051, the Board argues that:

" . . . [it] has a positive duty to enforce the Sales and Use Tax Laws. . . . The Sales and Use Tax Laws are *self-implementing* and do not require a regulation by the Board to be enforceable."²⁶

Revenue and Taxation Code section 7051 provides:

"The board shall enforce the provisions of this part [part 1, titled 'Sales and Use Tax,' of Division 2 of the Revenue and Taxation Code] and may *prescribe, adopt, and enforce rules and regulations relating to the administration and enforcement of this part*. The board may prescribe the extent to which any ruling or regulation shall be applied without **retroactive effect**. [Emphasis added.]"

The Legislature's enactment of section 7051 does not support the Board's argument (nor does OAL agree with the Board's argument). If the sales and use tax laws were "self-implementing," which OAL assumes means "self-executing," then there would be no need for the Legislature to have delegated quasi-legislative authority to the Board to "prescribe, adopt, and enforce rules and regulations relating to the *administration and enforcement*" of the sales and use tax laws. Statutes are self-executing if no further action by the Legislature or the rulemaking agency is necessary to give the statutes effect. Hence, in enacting section 7051, the Legislature must have contemplated the need for the Board to adopt regulations to implement, interpret and make specific the sales and use tax laws because the sales and use tax laws are not always self-executing ("self-implementing"). Furthermore, in delegating rulemaking authority to the Board, the Legislature empowered the Board to use its discretion when interpreting, implementing, and making specific the tax law, as long as the Board exercises its discretion within the scope of the statute and in compliance with the APA.

In its analysis, OAL also considered whether the Board's policy is the only legally tenable interpretation of applicable law. If there is more than one legally tenable interpretation of applicable law, then that underlying law is not self-executing on the specific issue in question. OAL concludes that the challenged policy is not the only legally tenable interpretation for the following three reasons.

One, the Board formally adopted the challenged policy during a Board meeting. In this meeting, the assistant executive secretary of the Board's Business Taxes division recommended:

" . . . that the Board *reinstate the practice* of issuing dual determinations against corporate officers for liability incurred during the period in which the corporate powers have been suspended by the Franchise Tax Board" ²⁷

If the Board needed to *reinstate* the policy, then at one time, the Board's policy must have been something else. Perhaps the previous policy was to never issue dual determinations against corporate officers under the specified circumstances. Regardless of what the previous policy may have been, this 1980 language is evidence of the fact that there must have been an alternative interpretation of the tax law previous to the June 30, 1980 adoption of the challenged policy.

Two, the Board argues that the Memorandum Opinion "contain[s] a thorough discussion of the legal basis for holding corporate officer-stockholders of suspended corporations liable."^{28,29} (See excerpt from Memorandum Opinion discussing *Decorative Carpets, Inc.* and Revenue and Taxation Code sections 6014, 6015, and 6066, set forth above under "Background.") In the Memorandum Opinion, the Board concludes that, pursuant to *Decorative Carpets, Inc.* and statutory law, officers-shareholders of a suspended corporation:

" . . . will be held personally liable for sales taxes incurred by the business during the period of the suspension if they continue to conduct selling activities and collect sales tax reimbursement from customers. *The reason for the corporate suspension will not affect this conclusion.* . . ." ³⁰

The challenged 1980 policy, however, authorizes tax assessment against officers-shareholders of corporations *only* when the corporation's powers have been suspended by the Franchise Tax Board *for failure to pay franchise tax on a timely basis*. The Board's ruling in the Memorandum Opinion is a modification of the challenged policy and *illustrates yet another interpretation* of the same statutes and case law that were cited by the Board as the legal basis for the challenged policy.

And, three, the Memorandum Opinion concludes with the following:

" . . . To the effect that any Board publications, policies, or annotations are inconsistent with this Memorandum Opinion, we further conclude that this Memorandum Opinion will have precedence."

The Board's declaration that the Memorandum Opinion will have precedence suggests that there are other contrasting interpretations of the tax law on the issue of officers-shareholders being held personally liable for sales tax incurred by the corporation during the period of suspension. The three reasons stated above are also evidence that the statutes are not self-executing, but rather are capable of more than one interpretation.

For the reasons set forth above, OAL concludes that the challenged policy is not the only legally tenable interpretation of the applicable tax law.

Clearly, the challenged policy interprets, implements, or makes specific the tax laws administered and enforced by the Board, in particular, Revenue and Taxation Code sections 6014, 6015, 6051, 6066 and 7051.

Furthermore, the challenged policy not only interprets, implements, and makes specific Revenue and Taxation Code sections related to sales and use tax, but also governs the Board's procedures. The challenged policy sets forth the "procedure" (see Government Code section 11342, subdivision (g)), that the Board will follow when confronted with the situation in which a corporation has been suspended, tax has been collected from customers, but not paid to the Board. Pursuant to the challenged procedure, the Board will find the corporate officers-shareholders personally liable for sales tax collected during the period of suspension and will assess the tax against them.

Having concluded that the challenged policy meets both parts of the two-part test, and therefore is a "regulation," OAL must determine whether the challenged policy falls within any exemptions to the requirements of the APA.

III. DOES THE CHALLENGED POLICY FOUND TO BE A "REGULATION" FALL WITHIN ANY RECOGNIZED EXEMPTION FROM APA REQUIREMENTS?

Generally, all “regulations” issued by state agencies are required to be adopted pursuant to the APA, unless expressly exempted by statute.³¹ In *United Systems of Arkansas v. Stamison* (1998),³² the California Court of Appeal rejected an argument by the Director of the Department of General Services that language in the Public Contract Code had the effect of exempting rules governing bid protests from the APA.

According to the *Stamison* Court:

“When the Legislature has intended to exempt regulations from the APA, it has done so by clear, unequivocal language. (See, e.g., Gov. Code, section 16487 [‘The State Controller may establish procedures for the purpose of carrying out the purposes set forth in Section 16485. These procedures are exempt from the Administrative Procedure Act.’]; Gov. Code, section 18211 [‘Regulations adopted by the State Personnel Board are exempt from the Administrative Procedure Act’]; Labor Code, section 1185 [orders of Industrial Welfare Commission ‘expressly exempted’ from the APA].) [Emphasis added.]”³³

Express statutory APA exemptions may be divided into two categories: **special** and **general**.³⁴ *Special* express statutory exemptions typically: (1) apply **only to a** portion of one agency’s “regulations” and (2) are found in that agency’s **enabling** act. *General* express statutory exemptions typically: (1) apply **across the board** to all state agencies and (2) are found in the APA. An example of an express *special* exemption is Penal Code section 5058, subdivision (d)(1), which **exempts** pilot programs of the Department of Corrections under specified conditions. An example of an express *general* exemption is Government Code section 11342, subdivision (g), part of which exempts “internal management” regulations of **all** state agencies from the APA.

A. DOES THE CHALLENGED POLICY DECISION FALL WITHIN ANY SPECIAL EXPRESS APA EXEMPTION?

The Board does not contend that any special statutory exemption applies. Our independent research having also disclosed no special statutory exemption, we conclude that none applies.³⁵

B. DOES THE CHALLENGED POLICY DECISION FALL WITHIN ANY GENERAL EXPRESS APA EXEMPTION?

Generally, all "regulations" issued by state agencies are required to be adopted pursuant to the APA, unless *expressly* exempted by statute.³⁶ Rules concerning certain specified activities of state agencies are not subject to the procedural requirements of the APA.³⁷

The Board states in its response that:

“[It has] issued a Sales and Use Tax Memorandum Opinion that contained a thorough discussion of the legal basis for holding corporate officer-stockholders of suspended corporations liable. (Sales & Use Tax Memo. Op., *Jack Donald Freels*, Sept. 10, 1997.) The Supreme Court in *Tidewater Marine Western, Inc.*, *supra*, while noting that a policy manual summarizing such decisions would not be binding on the agency in subsequent agency proceedings or on the courts when reviewing agency proceedings, nonetheless held that ‘interpretations that arise in the course of case-specific adjudication are not regulations, though they may be persuasive as precedents in similar subsequent cases.’ (14 Cal.4th at 571.)”

OAL interprets this statement by the Board as arguing that the challenged policy, holding corporate officer-stockholders of suspended corporations personally liable, is not a “regulation” because it arose as an interpretation in the course of case-specific adjudication, i.e., Sales and Use Tax Memo. Op., *Jack Donald Freels*, Sept. 10, 1997. The Board's argument fails for the following reasons.

The *Memorandum Opinion* was issued in 1997 in response to a specific taxpayer case (in the matter of a claim for refund). The challenged *policy*, however, was *not* issued in response to a specific taxpayer case, i.e., it was not an interpretation arising in the course of a case-specific adjudication. The policy was adopted in 1980 by the Board during a Board hearing pursuant to Board vote. It is clear from the hearing transcript that the Board intended the policy to be a rule of general application.

The ruling of the Memorandum Opinion is stated as follows:

“When a closely held corporation is suspended by the Secretary of State, the officers-shareholders will be held personally liable for sales taxes incurred by the business during the period of the suspension if they continue to conduct selling activities and collect sales tax reimbursement from customers. The reason for the corporate suspension will not affect this conclusion. When the officers-shareholders of a suspended corporation continue to do business, they do so as individuals. As such, if they continue the selling activities of the suspended corporation, they are themselves sellers required to obtain a seller’s permit and to report and remit sales tax to the State.”³⁸

At the end of the opinion, the Board states:

“... To the effect that any Board publication, policies, or annotations are inconsistent with this Memorandum Opinion, we further conclude that this Memorandum Opinion *will have precedence*. [Emphasis added.]”³⁹

The Board does not argue that the challenged policy is not a “regulation,” and therefore exempt from the APA pursuant to Government Code section 11425.60, which establishes a procedure for designating decisions as precedent decisions that are expressly exempt from the APA, but instead appears to rely solely upon the quoted language of *Tidewater*. Unless the Board is in full compliance with section 11425.60 with respect to the Memorandum Opinion, the express exemption afforded under section 11425.60 does not apply.

OAL finds, however, that even if the Board properly designated the opinion as a “precedent decision,” in full compliance with section 11425.60, it would not cause OAL to reach a different conclusion in this determination.⁴⁰ The June 30, 1980 policy is the subject of this request for determination, not the rule stated in the Memorandum Opinion that was issued on September 10, 1997. It is important to keep in mind that the rule in the Memorandum Opinion is a modification of the

challenged policy; it is substantively different from the policy that is at issue in this determination. (See difference noted above under heading II., B.)

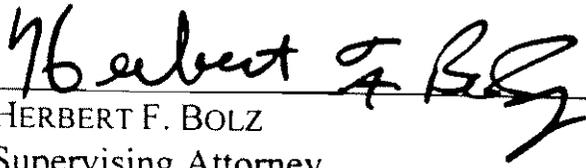
When analyzing a request for determination, OAL considers the law as it existed at the time the request for determination was filed with OAL (in this case, the request was received by OAL on March 11, 1996), as well as the law as it exists when the determination is issued. If a state agency subsequently codifies a challenged rule, or there is a change in statutory or case law, or a "precedent decision" issued pursuant to Government Code section 11425.60, then OAL will note this change in the law in its determination.

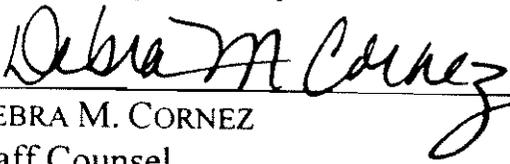
OAL also considered whether the challenged policy was "directed to a specifically named person or to a group of persons and [did] not apply generally throughout the state" (Gov. Code sec. 11343, subd. (a)(3)), and therefore was exempt from the APA. Such a rule may be exempt in case-specific circumstances, but not when applied generally throughout the state as the Board voted to do. OAL finds that the challenged policy does not fall within the "specifically named person" exemption.

CONCLUSION

For the reasons set forth above, OAL has concluded that the Board's policy of asserting tax, in cases where sales tax reimbursement has been collected from customers, against corporate officers-stockholders of closely held corporations, whose corporate powers, rights, and privileges have been suspended by the Franchise Tax Board for failure to pay franchise tax on a timely basis, is a "regulation" that is without legal effect unless adopted in compliance with the APA.

DATE: March 25, 1999


HERBERT F. BOLZ
Supervising Attorney


DEBRA M. CORNEZ
Staff Counsel
Regulatory Determinations Unit
Office of Administrative Law
555 Capitol Mall, Suite 1290
Sacramento, California 95814
(916) 323-6225, CALNET 8-473-6225
Telecopier No. (916) 323-6826
Electronic mail: staff@oal.ca.gov

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ENDNOTES

1. Ray Saatjian, while Staff Attorney at OAL, contributed substantially to this determination.
2. If an uncodified agency rule is found to violate Government Code section 11340.5, subdivision (a), the rule in question may be validated by formal adoption "as a *regulation*" (Government Code section 11340.5, subd. (b); emphasis added) or by incorporation in a statutory or constitutional provision. See also *California Coastal Commission v. Quanta Investment Corporation* (1980) 113 Cal.App.3d 579, 170 Cal.Rptr. 263 (appellate court authoritatively construed statute, validating challenged agency interpretation of statute.) An agency rule found to violate the APA could also simply be rescinded.
3. This request for determination was submitted by Richard S. Cohen, Attorney at Law, 301 East Colorado Boulevard, Suite 602, Pasadena, CA 91101, (626) 584-3061, on behalf of Jon M. Tardino and Sam R. Tardino, in a letter dated March 7, 1996. The Board's response, dated December 4, 1998, was submitted by Timothy W. Boyer, Chief Counsel, Board of Equalization, P.O. Box 942879, (916) 445-4380.

This determination may be cited as "**1999 OAL Determination No. 9.**"

Pursuant to Title 1, CCR, section 127, this determination becomes effective on the 30th day after filing with the Secretary of State, which filing occurred on the date shown on the first page of this determination.

Government Code section 11340.5, subdivision (d) provides that:

"Any interested person may obtain judicial review of a given determination by filing a written petition requesting that the determination of the office be modified or set aside. A petition shall be filed with the court within 30 days of the date the determination is published [in the California Regulatory Notice Register]."

Determinations are ordinarily published in the Notice Register within two weeks of the date of filing with the Secretary of State.

4. Title 1, California Code of Regulations ("CCR") (formerly known as the "California Administrative Code"), subsection 121 (a), provides:

"'Determination' means a finding by OAL as to whether a state agency rule is a 'regulation,' as defined in Government Code section 11342(g),

which is *invalid and unenforceable* unless

(1) it has been adopted as a regulation and filed with the Secretary of State pursuant to the APA, or,

(2) it has been exempted by statute from the requirements of the APA. [Emphasis added.]"

See *Grier v. Kizer* (1990) 219 Cal.App.3d 422, 268 Cal.Rptr. 244, review denied (finding that Department of Health Services' audit method was *invalid* because it was an underground regulation which should be adopted pursuant to the APA); and *Planned Parenthood Affiliates of California v. Swoap* (1985) 173 Cal.App.3d 1187, 1195, n. 11, 219 Cal.Rptr. 664, 673, n. 11 (citing Gov. Code sec. 11347.5 (now 11340.5) in support of finding that uncodified agency rule which constituted a "regulation" under Gov. Code sec. 11342, subd. (b)--now subd. (g)-- yet had not been adopted pursuant to the APA, was "*invalid*"). We note that a 1996 California Supreme Court case stated that it "disapproved" of *Grier* in part. *Tidewater Marine Western, Inc. v. Bradshaw* (1996) 14 Cal.4th 557, 577, 59 Cal.Rptr. 2d 186, 198. *Grier*, however, is still authoritative, except as specified by the *Tidewater* court. *Tidewater* itself, in discussing which agency rules are subject to the APA, referred to "the two-part test of the Office of Administrative Law," citing *Union of American Physicians & Dentists v. Kizer* (1990) 223 Cal.App.3d 490, 497, 272 Cal.Rptr. 886, a case which quotes the test from *Grier v. Kizer*.

5. According to Government Code section 11370:

"Chapter 3.5 (commencing with Section 11340), Chapter 4 (commencing with Section 11370), chapter 4.5 (commencing with Section 11400), and Chapter 5 (commencing with Section 11500) constitute, and may be cited as, the *Administrative Procedure Act*. [Emphasis added.]"

OAL refers to the portion of the APA which concerns rulemaking by state agencies: Chapter 3.5 of Part 1 ("Administrative Regulations and Rulemaking") of Division 3 of Title 2 of the Government Code, sections 11340 through 11359.

6. OAL does not review alleged underground regulations for compliance with the APA's six substantive standards of Necessity, Authority, Clarity, Consistency, Reference, and Nonduplication. However, in the event regulations were proposed by the Department under the APA, OAL would review the *proposed* regulations for compliance with the six statutory criteria. (Government Code sections 11349 and 11349.1.)

7. Board's response, page 1.

8. Parts of the Board's argument on these issues give us pause, however. The Board argues:

"In light of the California Supreme Court's decision in *Tidewater Marine Western, Inc. v. Bradshaw* (1996) 14 Cal.4th 557, the Board concedes that its motion . . . is a regulation that was not adopted pursuant to the [APA]. The requester, however, also argues against the merits of the motion and, although not altogether clear, appears to be seeking a determination that the Board may not make such assessments . . . without a regulation. . . . (See page 5 of the request: 'This section 11347.5 [sic] of the Government Code makes it clear that the board must in general formally adopt regulations which govern dual assessments against taxpayers.')

"Under Government Code section 11340.5(b), OAL has the authority to make a determination that an agency standard of general application is a regulation. However, the only consequence of a determination that a standard of general application is an underground regulation is that the standard is void and is not entitled to any [judicial] deference. (*Tidewater Marine Western, Inc.*, *supra*, at 577.) Such a determination in this matter does not mean that the Board cannot enforce the Sales and Use Tax Laws in the circumstances described in its motion. As noted in *Tidewater Marine Western, Inc.*, *supra*, at 576-77:

'Nevertheless, while we do not defer to the DLSE's interpretation of the IWC wage orders, we do not necessarily reject its decision to apply the wage orders to maritime employees working in the Santa Barbara Channel. If, when we agreed with an agency's application of a controlling law, we nevertheless rejected that application simply because the agency failed to comply with the APA, then we would undermine the legal force of the controlling law. Under such a rule, an agency could effectively repeal a controlling law simply by reiterating all its substantive provisions in improperly adopted regulations. Here, for example, if *Tidewater* and *Zapata* violate applicable IWC wage orders, they should not be immune from suit simply because the DLSE adopted an invalid policy. The DLSE's policy may be void, but the underlying wage orders are *not* void. Courts must enforce those wage orders just as they would if the DLSE had never adopted its policy" (Response, p. 3.)

We have six thoughts in response to the Board's argument.

First, we agree with the Board that the request does not clearly ask OAL to determine "that the Board may not make such assessments . . . without a regulation."

Second, whether or not the requester made such a request, only a court has the power to enforce Government Code section 11340.5 by enjoining a state agency from issuing or utilizing a rule determined to be an underground regulation. *Engelmann v. State Board of Education* (1991) 2 Cal.App.4th 47, 62, 3 Cal.Rptr.2d 264, 275, review denied, upheld a trial court decision to issue a writ of mandate regarding procedures and criteria under which textbooks were evaluated and rejected by State Board of Education. *Engelmann* stated:

“The trial court agreed that these procedures and criteria were regulations under the APA’s definition (Gov. Code sec. 11342, subd. (b) [now (g)] and were void since they had not been promulgated in accordance with the APA. The court therefore issued a writ of mandate commanding the Board to refrain from using those procedures and criteria until they had been promulgated as prescribed by the APA. The court also directed the Board to develop regulations for the development of learner verification plans. The trial court subsequently awarded \$52,436.15 in attorneys’ fees to plaintiff.” (3 Cal.Rptr.2d at 266.)

The Court of Appeal upheld these trial court rulings (3 Cal.Rptr.2d at 275).

Similarly, only a court can overturn an administrative decision on the ground it was based upon an underground regulation. *United Systems of Arkansas v. Stamison* (1998) 63 Cal.App.4th 1001, 74 Cal.Rptr.2d 407, review denied (administrative decision denying bid protest reversed on grounds that state did not give matter proper hearing due to reliance on underground regulation). *Stamison* stated: “Section 5210.2 of the State Administrative Manual is a regulation subject to the APA. *Since it was not adopted as a regulation, it cannot be enforced.* (Gov. Code sec. 11340.5.)” (74 Cal.Rptr.2d at 412; emphasis added.)

OAL determinations are only advisory opinions, in any event.

Third, we disagree with Board’s assertion that “the *only* consequence of a determination that a standard of general application is an underground regulation is that the **standard is void** and is not entitled to any deference.” (Emphasis added.)

Possible consequences, depending upon the facts and the law, include (1) an injunction barring the agency from using the underground regulation, (2) administrative decisions reversed insofar as based on the underground regulation, (3) matters remanded by the court to the agency for rehearing without reliance upon the underground regulation, (4) assessment of attorney’s fees against the agency, (5) additional litigation, (6) denial of meaningful public participation in the development of agency policy, (7) heightened legislative oversight, and (8) in rare cases, agency liability for damages.

Procedural rules (such as the policy challenged in this determination) that have not been

properly adopted pursuant to the APA may stimulate litigation which, even though the issuing agency may prevail in the end, can result in substantial costs to the court system and to the agency (both out-of-pocket costs and staff time). See, e.g., *Freels v. Board of Equalization*, unpublished opinion of the Court of Appeal, Third District, Case No. CO28956, Feb. 2, 1999 (“a significant part of this dispute centers around the Board’s so-called ‘dual determination policy,’ under which the Board imposes liability on the controlling officers of a corporation for the sales and use tax obligation of a company which has been suspended by the Secretary of State.”) (p. 4.) The Court of Appeal (note 1, page 4) confessed some difficulty in dealing with this issue because the record before it did “not contain a copy or description of the . . . policy.” One of the bedrock purposes of the APA is to collect agency rules in one widely available publication (the California Code of Regulations), so that courts and other interested parties can quickly and easily locate these rules. Thus, an additional consequence of agency reliance on underground regulations is that all concerned, including reviewing courts, may have difficulty even locating the official text of the agency rule.

Finally, it is always to an agency’s advantage to have the judicial deference accorded to a *duly adopted* regulation, i.e., one adopted pursuant to the APA and printed in the CCR. Not having the benefit of such deference is significant.

Fourth, only a court can directly enforce the underlying law. *Tidewater* stated: “Courts must enforce those wage orders just as they would if the DLSE had never adopted such a policy. . . .” (14 Cal.4th at 577; emphasis added.) This principle applies in the context of appellate-level *judicial* review of an agency rule which has been challenged as an underground regulation, and has been found to constitute a “regulation.” *Tidewater* did not state that *state agencies* are equally free to directly enforce laws without adopting regulations where required.

Fifth, the Board’s position may tend to undermine the APA, to make it appear as though APA compliance is a waste of time if an agency has a duty to enforce any particular law, when in fact it is an agency’s duty to enforce a law that brings the APA into play; the agency must often interpret, implement, and make the law specific *in order to carry out its duty to enforce the law*.

Sixth, we disagree with certain statements in *Tidewater*’s explanation of its decision that the wage orders under review did in fact apply to maritime transportation activities in the Santa Barbara Channel. Given the court’s definitive resolution of the complex legal question of what were the seaward boundaries of California, the holding that activities occurring in the Santa Barbara Channel are in general subject to wage orders was clearly the correct decision, because that Channel is clearly within the state law boundaries of California. However, the court went on to state:

“If when we agreed with an agency’s application of a controlling law, we

nevertheless rejected that application simply because the agency failed to comply with the APA, then we would undermine the legal force of the controlling law. *Under such a rule, an agency could effectively repeal a controlling law simply by reiterating all its substantive provisions in improperly adopted regulations.*" (4 Cal.4th at 577; 59 Cal.Rptr.2d at 198; emphasis added.)

Though rhetorically effective and superficially logical, the emphasized statement has a significant flaw. If a document issued by an agency contains a rule which does no more than repeat a provision of a statute without quotation marks (or repeat the statute in substance), *the repeated provision is not a "regulation"* within the meaning of the APA (Government Code section 11342, subd. (g)). (*Gefstakys v. State Personnel Board* (1982) 138 Cal.App.3d 844, 868 (manual provision not a "regulation" because challenged accounts receivable procedure for recouping overpayments to state employees was expressly spelled out in statute.) Because such a repeated statutory provision is *not* a "regulation," the agency pronouncement containing it is therefore *not* void under Government Code section 11340.5. Since an agency pronouncement which does no more than repeat a statutory provision would not be void, it would thus be impossible for an agency to "effectively repeal a controlling law simply by reiterating all its substantive provisions in improperly adopted regulations."

Next, we will discuss in more detail why an agency pronouncement repeating a statute does not constitute a "regulation" for purposes of the APA.

Merely repeating a statutory provision does not constitute "the exercise of . . . quasi-legislative power conferred by . . . statute . . ." (Government Code section 11346.) As noted in **1988 OAL Determination No. 2**, typewritten version, p. 6; CRNR 88, No. 10-Z, March 4, 1988, p. 720, at p. 725:

"We agree with the Department [of Corrections] that those portions of the [Departmental Administrative Manual] which *repeat or paraphrase existing statutes or regulations without adding anything of substance* do not constitute exercises of quasi-legislative power." [Emphasis added.]

Though an agency rule which does no more than repeat a statute does literally constitute a "standard of general application" within the meaning of Government Code section 11342 (g), such an agency rule invariably fails the second part of the two-part "regulation" test. According to *Tidewater*, the second part of the two-part test is as follows:

" . . . the rule must 'implement, interpret, or make specific the law enforced or administered by [the agency], or . . . govern [the agency's] procedure.' (Gov. Code, sec. 11342, subd. (g).)" (4 Cal.4th at 571; 59 Cal.Rptr.2d at 194.)

Clearly, an agency rule that merely repeats a statute does not "implement, interpret, or make specific" the statute that it repeats. The clear legislative intent is to focus on agency pronouncements that *supplement* a duly adopted law, such as "a blanket interpretation that the agency memorialize[s] in a policy manual intending to apply it in all cases of a particular class or kind." (4 Cal.4th at 573; 59 Cal.Rptr.2d at 196.)

To interpret section 11342 any other way would lead to the absurd result that all statutes must be readopted by the responsible agency as regulations pursuant to the APA. (Such "indiscriminate incorporation of statutory language in a regulation" is, however, expressly prohibited by Government Code section 11349, subdivision (f), except insofar as repetition is needed for purposes of clarity.)

As noted above in section II of this determination, *Engelmann v. State Board of Education* held that agencies need not adopt as regulations those rules already contained in a statutory scheme, but would need to adopt as regulations those rules which depart from or embellish upon express statutory language. The full discussion of this point in *Engelmann* follows:

"This leaves the Board's claim it should not have to submit the entirety of its procedures and criteria for textbook selection to the OAL. This argument simply misconstrues the extent of its obligation under the writ of mandate issued by the trial court. All the court ordered the Board to do was 'adopt, in compliance with the procedural requirements of the [APA] . . . for the adoption of regulations, any and all rules of general application, including but not limited to policies, procedures, standards, criteria, regulations and evaluation instruments used by the [b]oard to carry out its responsibility to adopt textbooks and instructional materials.' If certain policies and procedures contained in the 1988 publication are, as the Board asserts, 'essentially[] a reiteration of the extensive statutory scheme which the Legislature has established' in the Education Code, then there is obviously no duty on the part of the Board to enact regulations to cover such reiterations, since the sixth commandment of 'nonduplication' prescribes 'that a regulation does not serve the same purpose as a state . . . statute. . . .' (Gov. Code, sec. 11349, subd. (f).) But to the extent any of the contents of the 1988 publication depart from, or embellish upon, express statutory authorization and language, the Board will need to promulgate regulations, as the writ prohibits the Board 'during the process of adopting textbooks . . . from using or relying on any policies, procedures, standards, criteria, regulations or evaluation instruments which have not been adopted in compliance with the procedural requirements of the [APA]. . . ." (2 Cal.App.4th at 62, 3 Cal.Rptr.2d at 274-75.)

9. OAL also considered the applicability of *Decorative Carpets, Inc. v. State Board of Equalization* ((1962) 58 Cal.2d 252). In *Decorative Carpets, Inc.*, the president of a carpet business overpaid to the Board, on behalf of the business (plaintiff), taxes owed for

the sale and installation of carpeting, and therefore, filed a claim for refund for the excessive amount paid. The plaintiff stated that it was seeking the refund for itself only and did not intend to return the amount refunded back to the customers who paid the excess amount. The California Supreme Court remanded the case back "to the trial court with directions to enter judgment for plaintiff only if it submits proof satisfactory to the court that the refund will be returned to plaintiff's customers from whom the excess payments were erroneously collected." (At p. 256.) The Court stated in part:

"[The Board] . . . has a vital interest in the integrity of the sales tax [citations omitted], and may therefore insist as a condition of refunding overpayments to plaintiff that it discharge its trust obligations to its customers. To allow plaintiff a refund without requiring it to repay its customers the amounts erroneously collected from them would sanction a misuse of the sales tax by a retailer for his private gain. [At p. 255.]"

While *Decorative Carpets, Inc.* may support the principle that misuse of the sales tax for private gain should not be allowed, the case is not dispositive of the issue at hand. The facts in the case are easily distinguishable from the provisions of the challenged rule. In *Decorative Carpets, Inc.*: (1) there was an erroneous computation of tax reimbursements and payments giving rise to a refund claim, (2) there was no tax assessment against an officer-shareholder of the business and (3) the business had not been suspended by the FTB for failure to pay any franchise tax owed, nor suspended for any other reason, during which any sales activity occurred. None of the provisions of the challenged rule were addressed or analyzed in the case. Whether an officer-shareholder should be held personally liable for taxes incurred after the corporation has been suspended by FTB is a question for the courts to decide. This question was not decided by the court in *Decorative Carpets, Inc.*

10. Sales & Use Tax Memo. Opn., *Jack Donald Freels*, Sept. 10, 1997, *Business Taxes Law Guide*, p. 5585, M99-1.
11. OAL also reviewed Revenue and Taxation Code section 6829 (added by Stats. 1981, c. 337, p. 1496), and Title 18, CCR, section 1702.5 (operative 2/8/97), which was adopted by the Board to interpret and implement section 6829. Section 6829 provides, in part, that

". . . upon termination, dissolution, or abandonment of a partnership, . . . or a domestic or foreign corporate or limited liability company business, any [officer-shareholder], or other person having control or supervision of, or who is charged with the responsibility for the filing of returns or the payment of tax, . . . shall be personally liable for any unpaid taxes and interest and penalties on those taxes"

Title 18, CCR, section 1702.5 provides, in general, that any responsible person who wilfully fails to pay any taxes due from the corporation or company "shall be personally liable for any unpaid taxes . . . not so paid *upon termination, dissolution, or abandonment* of the corporate or limited liability company business." According to these two provisions, personal liability will be imposed only upon the termination, dissolution or abandonment of the corporation/business, e.g., for tax obligations incurred up to the time of termination, dissolution, or abandonment. Whereas, the challenged rule in this determination imposes personal liability during the period of the corporation's *suspension* by the Franchise Tax Board, i.e., the liability will be imposed *after* the corporation/business has been suspended for taxes incurred *during* the period of suspension. OAL notes that neither the Board's response nor the Memorandum Opinion argue that section 6829 applies to the factual situation of the challenged policy, e.g., holding corporate officers-shareholders of corporations suspended by the Franchise Tax Board liable.

12. Board's response, pages 2-3.
13. Title 1, CCR, sections 122, 123, 124, 125, and 126.
14. Government Code section 11342, subdivision (a).
15. See *Winzler & Kelly v. Department of Industrial Relations* (1981) 121 Cal.App.3d 120, 126-128, 175 Cal.Rptr. 744, 746-747 (unless "expressly" or "specifically" exempted, all state agencies not in legislative or judicial branch must comply with rulemaking part of APA when engaged in quasi-legislative activities); *Poschman v. Dumke* (1973) 31 Cal.App.3d 932, 942, 107 Cal.Rptr. 596, 603 (agency created by Legislature is subject to and must comply with APA).
16. Government Code section 11346; Title 1, CCR, section 121 (a)(2).
17. (1990) 219 Cal.App.3d 422, 440, 268 Cal.Rptr. 244, 251. OAL notes that a 1996 California Supreme Court case stated that it "disapproved" of *Grier* in part. *Tidewater Marine Western, Inc. v. Bradshaw* (1996) 14 Cal.4th 557, 577. *Grier*, however, is still good law, except as specified by the *Tidewater* court. Courts may cite cases which have been disapproved on other grounds. For instance, in *Doe v. Wilson* (1997) 57 Cal.App.4th 296, 67 Cal.Rptr.2d 187, 197, the California Court of Appeal, First District, Division 5 cited *Poschman v. Dumke* (1973) 31 Cal.App.3d 932, 107 Cal.Rptr. 596, on one point, even though *Poschman* had been expressly disapproved on another point nineteen years earlier by the California Supreme Court in *Armistead v. State Personnel Board* (1978) 22 Cal.3d 198, 204 n. 3, 149 Cal.Rptr. 1, 3 n. 3. Similarly, in *Economic Empowerment Foundation v. Quackenbush* (1997) 57 Cal.App.4th 677, 67 Cal.Rptr.2d 323, 332, the California Court of Appeal, First District, Division 4, nine months after *Tidewater*, cited *Grier v. Kizer* as a distinguishable case on the issue of the futility exception to the exhaustion of

administrative remedies requirement.

Tidewater itself, in discussing which agency rules are subject to the APA, referred to "the two-part test of the Office of Administrative Law," citing *Union of American Physicians & Dentists v. Kizer* (1990) 223 Cal.App.3d 490, 497, 272 Cal.Rptr. 886, a case which quotes the test from *Grier v. Kizer*.

18. The *Grier* Court stated:

"The OAL's analysis set forth a two-part test: 'First, is the informal rule either a rule or standard of general application or a modification or supplement to such a rule? [Para.] Second, does the informal rule either implement, interpret, or make specific the law enforced by the agency or govern the agency's procedure?' (1987 OAL Determination No. 10, *supra*, slip op'n., at p. 8.) [*Grier*, cited above, disapproved on other grounds in *Tidewater*.]"

OAL's wording of the two-part test, drawn from Government Code section 11342, has been modified slightly over the years. The cited OAL opinion--1987 OAL Determination No. 10--was published in California Regulatory Notice Register 96, No. 8-Z, February 23, 1996, p. 292.

19. (1990) 219 Cal.App.3d 422, 438, 268 Cal.Rptr. 244, 253.

20. 2 Cal.App.4th 47, 62, 3 Cal.Rptr.2d 264, 275, review denied.

21. *Id.*

22. 223 Cal.App.3d 490, 501, 272 Cal.Rptr. 886, 891.

23. *Id.*

24. (1993) 12 Cal.App.4th 697, 702, 16 Cal. Rptr.2d 25, 28.

25. *Roth v. Department of Veterans Affairs* (1980) 110 Cal.App.3d 622, 167 Cal.Rptr. 552.

26. Board's response, page 3.

27. Excerpt from transcript of Board's June 30, 1980 meeting.

28. Board's response, page 3.

29. The Board appears to be arguing that there is no need to adopt a regulation because, as the Memorandum Opinion demonstrates, the challenged policy is *consistent with* underlying law. The fact that the challenged policy may be consistent with statutory and

case law, however, does not obviate the need for adopting the policy pursuant to the APA. It is necessary, but not sufficient, for regulatory agency policies to be consistent with agency enabling acts. The Board is required by the APA not only (1) to adopt the policy as a regulation, but also (2) to ensure that the policy proposed for adoption as a regulation is consistent with statutory and case law. Government Code sections 11349, subdivision (d), and 11349.1.

There may well be several differing agency policies that are all consistent with the underlying law. One key purpose of the APA is to ensure that the regulated public has an opportunity to comment upon the various legal alternatives. Members of the public often have valuable information and insights that can assist the agency in developing appropriate procedures and policies.

30. Sales & Use Tax Memo. Opn., *Jack Donald Freels*, Sept. 10, 1997, *Business Taxes Law Guide*, p. 5584, M99-1.
31. Government Code section 11346.
32. 63 Cal.App.4th 1001, 1010, 74 Cal.Rptr.2d 407, 411-412, review denied.
33. 63 Cal.App.4th at 1010, 74 Cal.Rptr.2d at 411.
34. Cf. *Winzler & Kelly v. Department of Industrial Relations* (1981) 121 Cal.App.3d 120, 126, 174 Cal.Rptr. 744, 747 (exemptions found either in prevailing wage statute or in the APA itself).
35. OAL considered whether the challenged policy would be exempt under the APA as a legal ruling of counsel issued by the Board. Government Code section 11342, subdivision (g) states "'Regulation' does not mean or include legal rulings of counsel issued by the Franchise Tax Board or State Board of Equalization. . . ." The challenged policy was formally adopted by the Board during a Board meeting; it was not issued by counsel in direct response to a specific question from a taxpayer. The challenged policy, therefore, is not excluded from the definition of "regulation."
36. Government Code section 11346.
37. The following provisions of law may permit rulemaking agencies to avoid the APA's requirements under some circumstances:
 - a. Rules relating *only* to the internal management of the state agency. (Gov. Code, sec. 11342, subd. (g).)
 - b. Forms prescribed by a state agency or any instructions relating to the use of the form, *except* where a regulation is required to implement the law under which

effect.)

Government Code section 11425.60 has the effect of legalizing the use of precedent decisions, if certain conditions are met. Had precedent decisions been exempt from the APA prior to the enactment of section 11425.60, there would have been no need for enactment of this express statutory exemption.

The *Tidewater* court does not cite section 11425.60. Several portions of *Tidewater* might well have been drafted differently had the court taken the enactment of section 11425.60 into account. For instance, the following passage must be read with the knowledge that it appears to have been written *without* considering the significance of section 11425.60:

" . . . [I]nterpretations that arise in the course of case-specific adjudication are not regulations, though they may be persuasive as *precedents* in similar subsequent cases. [citations] . . . Thus, if an agency prepares a policy manual that is no more than a restatement or summary, without commentary, of the agency's prior decisions in specific cases, . . . the agency is not adopting regulations. [Emphasis added.]"

The quoted passage likely cannot be reconciled with Government Code section 11425.60. This statute creates an express APA exemption. It supersedes prior statutory and decisional law.

Looking at an example of how the new statute might apply, let us consider a policy manual containing the following sort of rule: Decision 89-1 (a spouse who resigns a job in order to move to another city with the other spouse is not entitled to unemployment benefits). An issuance of a rule of general application, first developed in a quasi-judicial proceeding, would violate Government Code section 11340.5. It would not matter if the decision were restated without commentary: the statement of the decision by itself contains a prospectively applicable standard of general application. However, the issuing agency could under section 11425.60 elect to designate it as a precedent decision. If this were done, the decision could be freely written up in departmental publications and could be used in lieu of a duly adopted regulation.

- the form is issued. (Gov. Code, sec.11342, subd. (g).)
- c. Rules that "[establish] or [fix], *rates, prices, or tariffs*." (Gov. Code, sec. 11343, subd. (a)(1).)
 - d. Rules directed to a *specifically named* person or group of persons *and* which do not apply generally throughout the state. (Gov. Code, sec. 11343, subd. (a)(3).)
 - e. Legal rulings *of counsel* issued by the Franchise Tax Board or the State Board of Equalization. (Gov. Code, sec. 11342, subd. (g).)
 - f. There is weak authority for the proposition that contractual provisions previously agreed to by the complaining party may be exempt from the APA. *City of San Joaquin v. State Board of Equalization* (1970) 9 Cal.App.3d 365, 376, 88 Cal.Rptr. 12, 20 (sales tax allocation method was part of a contract which plaintiff had signed without protest). The most complete OAL analysis of the "contract defense" may be found in **1991 OAL Determination No. 6**, pp. 168-169, 175-177, CRNR 91, No. 43-Z, October 25, 1991, p. 1458-1459, 1461-1462. In *Grier v. Kizer* ((1990) 219 Cal.App.3d 422, 437-438, 268 Cal.Rptr. 244, 253), the court reached the same conclusion as OAL did in **1987 OAL Determination No. 10**, pp. 25-28 (summary published in California Administrative Notice Register 87, No. 34-Z, August 21, 1987, p. 63); complete determination published belatedly on February 23, 1996, CRNR 96, No. 8-Z, p. 293, 304-305), rejecting the idea that *City of San Joaquin* (cited above) was still good law.
- 38. Sales & Use Tax Memo. Opn., *Jack Donald Freels*, Sept. 10, 1997, *Business Taxes Law Guide*, p. 5584, M99-1.
 - 39. *Id.*, at p. 5588, M99-1.
 - 40. Furthermore, though the *Tidewater* opinion does contain a significant discussion of quasi-judicial precedent decisions, this discussion appears to have been superseded by a subsequent statutory change. Several months after the opinion was filed, an express statutory exemption covering precedent decisions became effective.

OAL's position since 1986 has been that, absent an express statutory exemption from the APA, agency precedent decision systems violate the APA. Under the law as it existed until July 1, 1997, a general rule developed in a quasi-judicial proceeding could not be used from that point on in similar factual settings in lieu of a duly adopted regulation unless the rule had first been adopted as a regulation. The new statutory provision, Government Code section 11425.60, took effect on July 1, 1997. (The *Tidewater* opinion was filed December 19, 1996, over six months before the new provision went into

effect.)

Government Code section 11425.60 has the effect of legalizing the use of precedent decisions, if certain conditions are met. Had precedent decisions been exempt from the APA prior to the enactment of section 11425.60, there would have been no need for enactment of this express statutory exemption.

The *Tidewater* court does not cite section 11425.60. Several portions of *Tidewater* might well have been drafted differently had the court taken the enactment of section 11425.60 into account. For instance, the following passage must be read with the knowledge that it appears to have been written *without* considering the significance of section 11425.60:

" . . . [I]nterpretations that arise in the course of case-specific adjudication are not regulations, though they may be persuasive as *precedents* in similar subsequent cases. [citations] . . . Thus, if an agency prepares a policy manual that is no more than a restatement or summary, without commentary, of the agency's prior decisions in specific cases, . . . the agency is not adopting regulations. [Emphasis added.]"

The quoted passage likely cannot be reconciled with Government Code section 11425.60. This statute creates an express APA exemption. It supersedes prior statutory and decisional law.

Looking at an example of how the new statute might apply, let us consider a policy manual containing the following sort of rule: Decision 89-1 (a spouse who resigns a job in order to move to another city with the other spouse is not entitled to unemployment benefits). An issuance of a rule of general application, first developed in a quasi-judicial proceeding, would violate Government Code section 11340.5. It would not matter if the decision were restated without commentary: the statement of the decision by itself contains a prospectively applicable standard of general application. However, the issuing agency could under section 11425.60 elect to designate it as a precedent decision. If this were done, the decision could be freely written up in departmental publications and could be used in lieu of a duly adopted regulation.