IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

CALIFORNIA FARM BUREAU FEDERATION, ET AL.

Plaintiffs and Appellants,

v.

CALIFORNIA STATE WATER RESOURCES CONTROL BOARD, ET AL.,

Defendants and Respondents.

S 150518

Court of Appeal, Third Appellate District, Case No. C050289
Sacramento County Superior Court Case Nos. 03CS01776, 04CS00473
The Honorable Raymond Cadei, Judge

RESPONDENTS' BRIEF ON THE MERITS

EDMUND G. BROWN JR.
Attorney General of the State of California
PAUL GIFFORD
Senior Assistant Attorney General
GORDON BURNS
Deputy Solicitor General
WILLIAM L. CARTER
Supervising Deputy Attorney General
MATTHEW J. GOLDMAN
MOLLY K. MOSLEY, SBN 185483
Deputy Attorneys General
1300 I Street
P.O. Box 944255
Sacramento, California 94244-2550
Telephone: (916) 445-5367
Facsimile: (916) 327-2247

Attorneys for the California State Water Resources Control Board, the California State Board of Equalization, et al.

TABLE OF CONTENTS

TABLE OF CONTENTS (continued)

TABLE OF CONTENTS (continued)

TABLE OF AUTHORITIES

Page

Cases

TABLE OF AUTHORITIES (continued)

TABLE OF AUTHORITIES (continued)

TABLE OF AUTHORITIES (continued)

TABLE OF AUTHORITIES (continued)

The California State Board of Equalization (BOE) and the California State Water Resources Control Board (SWRCB) hereby submit their opening brief on the merits.

ISSUES PRESENTED

1. Does *Sinclair Paint Co. v. State Bd. of Equalization* (1997) 15 Cal.4th 866 (*Sinclair Paint*), mandate invalidation of an annual permit and license fee to support a regulatory program as an unconstitutional tax under the California Constitution, art. XIII A, section 3 (Proposition 13), if some beneficiaries of the regulatory program are exempt from the assessment because they do not hold a permit or license and are subject to significantly less regulation?

2. When analyzing an assessment under Proposition 13, may courts substitute their own independent judgment for the quasi-legislative judgment of the regulatory agency in deciding how best to allocate costs among the regulated parties?

3. The Supremacy Clause (U.S. Const., art. VI, § 2) does not bar a state from imposing a tax or fee in connection with property held by the United States as long as that property is used by a non-federal entity and the charge is based on that use or interest. Is the Supremacy Clause violated when regulatory fees on permits and licenses held by the federal government for the purpose of water delivery are imposed on the contractors who have the contractual rights for those deliveries?

///

STATEMENT

A. The fee legislation.

The SWRCB and its Division of Water Rights (Division) are responsible for the regulation of water rights in California. New legislation that took effect in fiscal year 2003-2004 aimed to shift most of the burden of water right regulation from the General Fund to the regulated community of state water right permit and license holders by enacting new, annual permit and license fees and increasing the existing filing fees. (Wat. Code, § 1525, subd. (a) [establishing the annual permit and license fees]; Slip op., pp. 2, 13.) The fees cover essentially all of the activities that comprise the SWRCB's water right program. (Wat. Code, § 1525, subd. (c).) The fees are deposited in the Water Rights Fund. (*Id.*, § 1525, subd. (d)(1); *id.*, § 1550.) Monies in the Water Rights Fund are "available for expenditure, upon appropriation by the Legislature" to carry out the statutory purposes of the SWRCB's water right program. (*Id.*, § 1552.)

For fiscal year 2003-2004, the Legislature directed that the new fees would provide about half of the water right program's funding. (Appendix 2473.) The total cost of the program for fiscal year 2003-2004 was about $9 million. (Slip op., p. 21, fn. 16.) To implement the fee-based funding in fiscal year 2003-2004, the law required SWRCB to adopt emergency regulations immediately (slip op., p. 21) to collect a budget "target" for the Water Rights Fund of about $4.4 million. (Appellants' Appendix ("Appendix") 2341-2342; 2473 [Budget Act specifies $4.4 million in fee revenues].) Amounts payable from other funds covered the difference between the $9

million budget for the water right program (Appendix 2341 [schedule item 2] and the $4.4 million in regulatory fees deposited into the Water Rights Fund (Appendix 2342 [schedule item 21.5]).

B. The SWRCB's extensive regulation of permits and licenses, and its limited regulation of other water rights.

The annual fees at issue in this lawsuit are imposed on the group of water right users -- users of water held under state permits and licenses -- that account for about 95 percent of the SWRCB's regulatory efforts. (Appendix 2298; Water Code, §§ 102, 174, 1201-1202.) The lower court recognized, and plaintiffs concede, that the agency has very limited authority over various types of water rights that, under California law, exist independently of the permit and license scheme–including riparian,[1] pueblo, and appropriative rights acquired prior to 1914. (See slip op., p. 7 [SWRCB's "core regulatory program, the administration of water right permits and licenses, does not apply" to holders of other types of water rights]; see also Appendix 1200:9-10 [plaintiff's brief claiming SWRCB has *no* authority over pre-1914 water rights] and 3289:13-25 [transcript of trial court hearing discussing plaintiff's claim that SWRCB lacks jurisdiction over non-permitted and licensed water rights].) Indeed, the SWRCB estimates that it spends only a de minimis amount (about five percent) of its time

---

[1] A riparian water right "confers upon the owner of land contiguous to a water course the right to the reasonable and beneficial use of water on his land." (*People v. Shirokow* (1980) 26 Cal.3d 301 quoting *City of Pasadena v. City of Alhambra* (1949) 33 Cal.2d 908, 925.) The riparian right does not include a right to use water on parcels that are not adjacent to and in the watershed of the stream.

regulating the water rights that are not subject to the annual fees at issue in this lawsuit. (Appendix 2298; Wat. Code, § 1525.)

The SWRCB regulates the complex system of water rights in California to bring order and certainty to the system as well as to protect the public interest. (See Appendix 2679-2686.) The SWRCB must act to ensure that each permittee and licensee is obeying the terms and conditions of the permits or licenses under which they hold their water rights. The SWRCB may periodically reevaluate those terms and conditions because what constitutes both a reasonable and beneficial use can change over time. (Appendix 2100 [permit describing SWRCB's continuing authority over "all rights and privileges under this permit and under any license issued pursuant thereto"].) Even after the permittee has obtained a license, the SWRCB may revoke the license if it finds that the licensee has not put or has ceased to put the water to a useful and beneficial purpose or has not complied with any of the terms and conditions of the license. (Wat. Code, § 1675.)

The SWRCB also has authority to ensure that the waters of the State are put to full beneficial use and to prevent waste, unreasonable use, unreasonable method of use or unreasonable method of diversion (Cal. Const., art. X, § 2; Wat. Code, §§ 100, 275; *Joerger v. Pacific Gas & Elec. Co.* (1929) 207 Cal. 8, 22); protect the public trust (*National Audubon Society v. Superior Court* (1983) 33 Cal.3d 419); and avoid or minimize any harm to natural and public trust resources where feasible. (See, e.g., Appendix 2847-2854 [SWRCB Decision directing action to avoid adverse impact of water project on wildlife habitat and irreplaceable oak trees]; Appendix 2090-2101

[permit for diversion and use of water containing terms to protect recreational uses of various lakes involved and requiring mitigation plan to prevent wastewater discharges from the project from unreasonably affecting wildlife or aquatic habitat].)

C. The SWRCB's regulations implementing the fees.

After considerable review and two public workshops, the SWRCB decided to impose annual fees that are proportional to the "face value" of the permits or licenses (i.e., the total amount of water that theoretically could be diverted in any year under a permit or license). (Cal.Code Regs., tit. 23, § 1066.) In so doing, the SWRCB rejected several other options.

The agency decided against basing the fees on *actual* water usage, as opposed to the face value of the permit or license: "Staff also does not recommend basing the fee on the amount of water actually diverted or used, as this information is not submitted to the SWRCB on an annual basis, and the SWRCB cannot annually calculate or adjust fee revenues accurately using this approach." (Appendix 2305; *id.*, 2305-2306 [explaining the difficulties]; 2507-2520 [issue paper studying whether SRWCB could assess fees based on actual water usage].)

The SWRCB also rejected a "fee-for-service" approach, under which each water right holder or applicant is charged based on the time spent reviewing that person's proposals or activities, as infeasible because the program is a regulatory program and is not based on requested "services." (Appendix 2304-2305; 2473-2474 [Notice of Public Workshops].) Funding for the program must be stable because continuing regulatory oversight requires constant SWRCB administration. Sporadic, one-time

filing fees are insufficient to support an ongoing regulatory program.

Furthermore, water right regulation is necessarily complex because of the interlocking nature of water rights. (E.g., Slip op., pp. 4-12 [describing complex system of water rights]; Appendix 2508 [describing irrigation district claiming to hold 47 water rights including riparian, prescriptive, pre-1914 and appropriative rights, many of which combine water, making it impossible to segregate water use and determine annual use of a particular right].) Because of this complexity, the calculation of precise actual costs would be difficult, if not impossible, and unjustifiably increase the administrative costs of the fee. (Appendix 2249:11 - 2250:24.)

Moreover, collecting precise actual costs would entail much higher filing fees (e.g., $23,000 per application), increasing the likelihood of unauthorized diversions and a greater enforcement burden. (Appendix 2423.) Annual fees are less expensive to administer and provide certainty to the regulated community regarding the amount of fees to be assessed.

The SWRCB determined that protecting other water right holders represents a substantial portion of the cost of processing water right applications and petitions, including the consideration of protests from permit and license holders. (Appendix 2304.) More broadly, a substantial portion of the SWRCB's costs are related to actions that are for the primary purpose of managing existing permitted and licensed water rights.

For these reasons, the SWRCB determined that the annual fees would most reasonably apportion the costs of regulation and should provide most of the fee

funding. (Appendix 2304-2305; see *id.,* 2354-2377 [presentation at workshops explaining fee regulations].) It adopted fee regulations that, while substantially increasing the one-time filing fees related to the permit and license system (e.g., application and petition fees), kept these filing fees relatively low to encourage voluntary filings and to reduce enforcement problems associated with unauthorized diversions. (Appendix 2423.)

To meet the Legislature's target amount for fiscal year 2003-2004, $4.4 million, the SWRCB set the annual fees at the greater of $100 or $0.03 per acre-foot based on the "face value" of the permit or license, not the amount that was actually used or delivered. (Appendix 2438; *id.,* 2453 [former Cal. Code Regs., tit. 23, § 1066, subd. (a) (2004)];[2] see Wat. Code, § 1530, subd. (a) [permitting fee schedules to be "graduated in accordance with the number of diversions or the amount of water involved"]; Appendix 2429-2430.) It is important to note that the "face value" almost always exceeds the actual amount of water that can be used or diverted–sometimes vastly so–for a variety of reasons, including for example regulatory restrictions that require a permittee to allow a minimum flow downstream and limits on the availability of water. (Appendix 2121-2122; *id.*, 2306 [explaining "face value"]; see e.g., *id.*, 2093-2095

---

[2] In 2004, section 1066 was amended to change the way the fees were calculated: "A person who holds a water right permit or license shall pay a minimum annual fee of $100. If the total annual amount of diversion authorized by the permit or license is greater than 10 acre-feet, then the permittee or licensee shall pay an additional $0.025 for each acre-foot in excess of 10 acre-feet." The rate per acre-foot can change on a yearly basis to reflect the adjustment required under section 1525, subdivision (d)(3) of the Water Code.

[permit items 8-11] and 2099 [item 31].)

The SWRCB used the face value of the permit or license to set the annual fee, reasoning that, in general, the more water held under the permit or license, the greater the regulatory burden. In general, larger projects have greater environmental impacts, involve more controversial issues, and affect a greater number of people, correspondingly increasing the costs of regulation. (Appendix 2243:17 - 2244:15; Cal. Code Regs., tit. 23, § 1066, subd. (a).)

In setting the $100 minimum annual fee, the SWRCB took into consideration the cost of billing the fees as well as an estimate of the minimum amount of time spent regulating smaller water rights. (Appendix 2307, 2382-2427 [worksheets for fee system development]; 2242:20-24 [explanatory testimony]; Administrative Record 2.)

About 20 percent of the face value of all state permitted and licensed water rights are held by the United States Bureau of Reclamation ("Bureau") for the Central Valley Project ("CVP"). The Legislature addressed the likelihood that the Bureau would claim sovereign immunity and refuse to pay the fees by enacting statutes to allow for these fees to be imposed on the federal water contractors instead of the Bureau. (Slip op., p. 11; Wat Code, §§ 1540, 1560; slip op., p. 19, fn. 15.)

Accordingly, the SWRCB imposed the annual fees for permits and licenses held by the Bureau for the purpose of water delivery on the CVP contractors who hold the contractual right to the water developed under the Bureau's CVP permits and licenses. (Cal. Code Regs., tit. 23, §§ 1071, 1073; Appendix 2332 [main purpose of CVP is to supply water]; see Appendix 2322 et seq. [examples of contracts]; slip op.,

pp. 24-25 [describing the regulatory allocation to the CVP contractors].) The regulations also provide a fifty percent discount for all of the Bureau's hydropower permits and licenses (for pumping the water) not subject to licensing by the Federal Energy Regulatory Commission (FERC), effectively further reducing the face value of the Bureau's permits and licenses. (Appendix 2307-2308; *id.*, 2294 [errata to discussion].) The federal contractors pay only the annual fees for the permits and licenses associated with their projects; they do not pay any other fees, such as any application and petition filing fees associated with CVP water rights.

Together, sections 1066 [annual fees] and 1073 [imposition of annual fees on federal contractors] of the California Code of Regulations, title 23, impose annual fees on all water rights subject to permit and license. (Wat. Code, § 1525, subd. (a).) Regulation of appropriations subject to permit and license constitutes the core of the SWRCB water right program –accounting for about 95 percent of all expenditures -- and appropriations under permit and license amount to about 60 percent of all water diverted under all water rights. (Appendix 2298; see slip op., p. 55 [Appendix to Opinion].) The regulations impose annual permit and license fees on all permits and licenses, either directly (section 1066) or indirectly (section 1073). As it does for many other fee programs, BOE acts as the SWRCB's collector for the annual fees, but it does not have any authority to review SWRCB's fee determinations. (Wat. Code, § 1537, subd. (b)(2)-(3); slip op. p. 51.)

///

D. Trial court proceedings.

After the denial of their petitions for reconsideration challenging the fees, persons subject to the annual permit and license fees filed lawsuits against SWRCB and BOE to challenge the constitutionality of the statutes and the validity of the regulations. The consolidated action (brought as writs of administrative mandate and complaints for declaratory relief) alleges that the fee statutes and regulations are unconstitutional because they fail to meet the test for a valid regulatory fee. Plaintiffs contend: (1) the fees collected exceed the regulatory program costs they are designed to support; and (2) there are insufficient facts to support the basis for determining the manner in which the costs are apportioned, so that charges allocated have not been shown to bear a fair or reasonable relationship to the payer's burdens on or benefits from the regulatory activity. (Slip op., p. 26.) Plaintiffs allege, among other things, that requiring state permit and license holders to pay for most of the program, when 40 percent of all water rights in the state are held under other types of rights, is not reasonably related to the burdens imposed or the benefits received. They also allege that the SWRCB's fee schedule is invalid because it is not based on actual costs. Finally, they allege that the imposition of fees associated with the CVP on the water supply contractors violates the Supremacy Clause of the United States Constitution. (U.S. Const., art. VI, § 2.)

Plaintiffs seek declarations of the invalidity of the statutes and regulations imposing the annual water right fees, injunctive relief against their enforcement, and on that basis, refunds of all fees paid. (Appendix 25-26 [NCWA's Verified Complaint, Prayer for Relief]; Appendix 154 [NCWA's First Amended Verified Complaint, Prayer

for Relief]; Clerk's Augmented Transcript on Appeal 37-40 [Farm Bureau's Verified Complaint for Declaratory and Injunctive Relief and Petition for Writ of Mandate, Prayer for Relief].) The statutes require a writ of administrative mandamus to obtain the requested refunds. (Wat. Code, § 1537, subd. (b)(2)-(3).)

In 2005, the trial court entered its judgment denying the consolidated petitions for writ of mandate and complaints for declaratory and injunctive relief. The trial court held that all of the activities funded by section 1525 fees bear a "sufficiently close relation to the regulation of water rights that they may be legitimately considered to be part of the water rights regulatory program." (Appendix 3363:1-2.) Giving deference to the agency's factual findings and considerations in allocating the fees, the trial court found that the SWRCB satisfied the requirements of law in developing its fee structure: "[T]he fee structure . . . was not adopted on a merely arbitrary basis, but was developed after careful consideration of factors specific to the regulatory program of the Division of Water Rights." (Appendix 3364:7-10.)

E. Court of Appeal proceedings.

In January 2007, the Court of Appeal issued its opinion upholding the fee statutes but striking down the regulations based on its conclusion that the fee allocation made by the regulations failed to meet the test for a valid regulatory fee. (Slip op., pp. 30, 43, and 44.) Although the Court of Appeal held that the statutes imposed valid regulatory fees (slip op., p. 29), it invalidated the water right fee regulations because the court found (1) section 1066 violates Proposition 13 by failing to show the basis for apportioning costs as between fee payers subject to annual permit and license fees and

other types of water right holders who are not, but who "benefit" from the regulatory program (slip op., pp. 40-43); and (2) the allocation of most of the Bureau's fees to the federal water contractors under section 1073 violates the Supremacy Clause because the Court of Appeal found that the SWRCB did not determine what share of the costs of regulating the CVP should be allocated to the contractors (slip op., pp. 44-45).

ARGUMENT

I.

Proposition 13 allows the annual fees to be charged only to permit and license holders, because persons who are exempt from the water right permit and license program are subject to significantly less, and qualitatively different, state regulatory authority than permittees and licensees.

The test for a valid fee under Proposition 13 requires the state to show (1) "the estimated costs of the service or regulatory activity, and (2) the basis for determining the manner in which the costs are apportioned, so that charges allocated to a payor bear a fair or reasonable relationship to the payor's burdens on or benefits from the regulatory activity." (*Sinclair Paint, supra,* 15 Cal.4th at p. 878, quoting *San Diego Gas & Electric Co. v. San Diego County Air Pollution Control Dist.* (1988) 203 Cal.App.3d 1132, 1146 (*SDG&E*).)

In this case, the "regulatory activity" is the SWRCB's regulation of California water rights. The key question here is whether it is "reasonable" for the state to impose the fee on the parties that account for 95 percent of the regulatory burden and exempt persons who are not subject to the SWRCB's "core" regulatory program and who are regulated only to a de minimis extent. (See e.g., *Kern County Farm Bureau v. County*

of Kern (1993) 19 Cal.App.4th 1416, 1423 [stating the issue as whether fees may be assessed based on broad classifications].) The Court of Appeal misidentified the regulatory activity and struck down the SWRCB's allocation of the costs between state permittees and licensees and other types of water right holders who are exempt from the requirement for a permit or license.

A. The estimated cost of the regulatory activity is stated in the Budget Act.

The first prong of the *Sinclair Paint* test requires the state to show the "estimated costs" of the service or regulatory activity. (*Sinclair Paint, supra,* 15 Cal.4th at p. 878.) It assists the court to determine whether the funds are raised to support the regulatory program, or for general revenue purposes. This prong is usually easy to satisfy, as long as the regulatory activity is correctly identified.

In this case, the estimated cost of the "regulatory activity" is the estimated cost of the *entire* water right program. The activities for which fees may be charged -- all activities related to administration of the water right permit and licensing program -- amount to all but a de minimis portion of the water rights program. The projected cost of the water right program is shown in the Budget Act, setting forth the state's estimated revenues and expenditure goals for the fiscal year.

To date, the annual water right permit and license fees have been set at an amount less than the total cost of the water right program. As explained below, the regulations set the annual fees based on the entire amount shown in the Budget Act for the Water Rights Fund. The Water Rights Fund does not support the entire water right program, but it provides the program with all of its fee revenues.

1. The Water Rights Fund provides the source of fee revenue for the water right program.

The Water Rights Fund is only one source of funding for the water right program; it is not the water right program budget. To date, the Legislature has provided other funding for the water right program in addition to the amount appropriated from the Water Rights Fund in fees. Other sources that support the water right program include the Cigarette and Tobacco Products Surtax, the Federal Trust Fund, and various reimbursements. (Appendix 2284, 2341-2342; RJN, Ex. 3 [Governor's budget 2005-2006, EP 28].)

The Budget Act of 2003-2004 showed an appropriation of $9,049,000 for the water right program budget (Schedule 2). (Appendix, 2341.) The Water Rights Fund was expected to provide about half of the funding required to support the water right program's budget (Schedule 21.5, showing a negative $4,399,000). (Appendix, 2342; see Appendix 2105 [SWRCB Order WRO 2004-0011-EXEC].) Likewise, actual water right program expenditures for fiscal years 2004-2005 and 2005-2006 (Request for Judicial Notice (RJN), Ex. 3, p. EP 24, line 2) are all greater than the expenditures made from the Water Rights Fund to support the program:

		2004-05	2005-06
20	Water Rights	$10,937,000	$9,808,000
3058	Water Rights Fund	$9,813,000	$9,227,000

Clearly, the "Water Rights Fund" is not the same as the water right program in the Budget Act. Even though the water right fee statute would allow all program expenditures to be supported solely from the Water Rights Fund, the Legislature has

continued to provide other support for the program as well.

2. The Budget Act does not appropriate funding for the water right program by the type of water right involved in the activity.

The Legislature decides how much the SWRCB should expend annually from the Water Rights Fund for water right regulation by appropriating the amount in the Budget Act. The SWRCB must "set the amount of total revenue collected each year through [the section 1525 fees] at an amount equal to the revenue levels set forth in the annual Budget Act for this activity." (Wat. Code, § 1525, subd. (d)(3).) "This activity" necessarily refers to the water right program activities described in subdivision (c) of section 1525. (*Id.*, § 1525, subd. (c).) As explained, these activities include essentially all water right regulation.

The fees for "this activity" (water right regulation) are placed in the Water Rights Fund. (Wat. Code, §1551, subd. (a).) The Water Rights Fund is the fund in the Budget Act where the Legislature annually establishes the estimated revenue levels to be collected in section 1525 fees to support the water right program. There is no other fund or subaccount in the Budget Act for this purpose. (Appendix 2341-2342.)

The Final Change Book[3] describes the Legislature's implementation of the Water Rights Fee to support an appropriation of $4,399,000 "to establish an *annual* water rights fee." (RJN, Ex. 1, p. 198 [italics added].) It specifically states that these new fee revenues are to be "deposited in the newly created Water Rights Fund and *used*

---

[3] The Final Change Book shows the changes between the Governor's proposed budget (submitted in January) and the enacted budget. (Appendix 1727-1728 [relevant portion of the Budget Act].)

to offset General Fund expenditure reductions [to the water right program]." (*Ibid.*)

3. Consistent with the statutes and the Budget Act, the regulations use the amount set forth in the Budget Act for the Water Rights Fund to set the "target" revenue level to be collected in annual fees.

Filing fees, penalties, expenses of adjudication and court references collected during the year are also deposited in the Water Rights Fund with the challenged annual fees. (Wat. Code, § 1551; Appendix 2304-2305.) These sources are erratic. The Legislature cannot set the amount the SWRCB will collect from these other sources for it cannot reliably predict what filings or court references the SWRCB may receive or enforcement action the SWRCB may take in any given year. (Appendix 2379 [attempting to estimate other fees].) Consequently, the Legislature does not set a target for these other sources.

Unlike other fees deposited in the Water Rights Fund, the annual permit and license fees are a relatively stable source of funding that can generally be collected at the same time every year. (See Cal. Code Regs., tit. 23, § 1074; Appendix 2443 [annual fees will be collected once a year].) As explained above, the SWRCB had additional reasons for collecting most of the fee funding through the annual fees. These included the infeasibility of a "fee-for-service" format for a regulatory program and the likelihood that high fees would cause enforcement problems. (Appendix 2304-2305; 2473-2474.)

To ensure that it collects adequate funding, the SWRCB sets the annual fees (including the Bureau contractors' fees and fees for water quality certification of Federal Energy Regulatory Commission licensed hydroelectric projects) and the one-

time filing fees (a relatively small amount in estimated revenue) to meet the amount the Legislature sets for the *entire* Water Rights Fund (the fee "target"). (Appendix 2354-2376 [presentation by Chief of the SWRCB's Division of Water Rights at rulemaking Workshops]; *id.*, 2361-2369 [explaining how the fee schedule was adopted]; *id.*, 2304-2305 [excerpt from formal explanatory memorandum placed in the record].) If the SWRCB were to underestimate the collection of fees, it would collect less than the revenue level set for the Water Rights Fund in the annual Budget Act. (Wat. Code, § 1525, subd. (d)(3); § 1551.)

Plaintiffs contend that the fees are excessive because the SWRCB raised more than the target figure set forth in the Budget Act for the regulatory activity. (See Appendix 3395:7-21.) Although the SWRCB's methodology creates a risk of over-collection, any over-collection reduces annual fees in subsequent years. By statute, any over-collection remains in the Water Rights Fund. (Wat. Code, § 1552.) And the SWRCB must adjust the amount of the annual fees each year to compensate for any over- or under-collection. (*Id.*, § 1525, subd. (d)(3).)

For example, if the Legislature appropriates $9 million in fees to come from the Water Rights Fund to support the water right program, and the SWRCB collects a total of $11 million in fees, then $2 million will remain in the Water Rights Fund for the following fiscal year, lowering by $2 million the amount of fees that must be collected for the next fiscal year. To meet the revenue level set in the Budget Act (i.e., in the Water Rights Fund) for the following year, the SWRCB would set the fees based on that revenue level minus $2 million.

Thus, the other program-related fees, penalties, expenses of statutory adjudication and court references, as well as any collection of excess annual fees, reduce the amount of money the SWRCB must collect in annual fees from year to year. (Wat. Code, § 1551.) Even if the Water Rights Fund provided the entire support for the water right program, the fees related to permits and licenses would not pay for the entire program.

B. The law reasonably apportions water right program costs between permit and license holders and holders of other types of water rights.

The second prong of *Sinclair Paint* requires the state to show "the basis for determining the manner in which the costs are apportioned, so that charges allocated to a payor bear a fair or reasonable relationship to the payor's burdens on or benefits from the regulatory activity." (*Sinclair Paint, supra,* 15 Cal.4th at p. 878.) Again, the focus in this analysis must be on the nature of the regulatory activity.

The regulations, consistent with the statutes, satisfy the second prong of *Sinclair Paint*. They establish a reasonable manner of apportioning the costs of the regulatory activities between those who claim water rights under permit or license and those who claim under some other basis of right. The regulations reasonably allocate the majority of water right program costs to permittees and licensees because they account for all but a de minimis amount of the burden on the regulatory activity.

1. The annual fees are deposited in the Water Rights Fund and are intended to support water right program activities.

Section 1525 of the Water Code, subdivision (c) authorizes the SWRCB to set permit and license fees based on all costs incurred in administering the State's water

right permit and license system. The activities described in section 1525, subdivision (c), of the Water Code represent virtually all water right program activities, including planning, monitoring and enforcement of requirements applicable to activities subject to water right permits and licenses.

2. Because the water right program primarily regulates state permits and licenses, it is appropriate that fee revenue comes primarily from the annual permit and license fees.

For the reasons stated above, the annual permit and license fees established by Water Code section 1525, subdivision (a) (including those fees allocated to Bureau contractors by regulation) provide most of the revenue in the Water Rights Fund. Other deposits to the Fund, such as application fees, water quality certification fees, fees and expenses for statutory adjudications or court references, and fines, also provide funding for water right program activities, but they necessarily provide a much smaller portion of the fee revenue.

It is reasonable for permit and license holders to bear most of the program costs, because the SWRCB primarily regulates water rights held under state permits and licenses. Appellants themselves have claimed that the SWRCB has *no* authority over other types of water rights. (Appendix 1200:9-10 [plaintiff's brief claiming SWRCB has no authority over non-permitted and licensed water rights] and 3289:13-25 [transcript of trial court hearing discussing plaintiff's claim that SWRCB has no jurisdiction over pre-1914 water rights].)

The SWRCB has estimated that only a de minimis amount of program activities (about five percent) focus primarily on bases of right other than permit and license.

(Appendix 2298.) Sixty percent of the water in the state is held under permit and license; however, the regulation of those rights claims roughly 95 percent of the SWRCB's water right program expenditures. (AR 0473.)

Therefore, the SWRCB used the amount of water held under permit or license to estimate the regulatory burden imposed and to set the annual water right fees. The SWRCB could not use this same approach to estimate the costs of water right regulation attributable to every holder of water rights, because the SWRCB does not have the same regulatory authority over other types of water rights.

The regulatory actions that may address riparian or pre-1914 water right holders to determine their water rights are generally paid in full by the parties to those proceedings and the money deposited in the Water Rights Fund. The fees apportioned among the parties to a streamwide statutory adjudication, for example, apply to all claims under all bases of water right and pay for the entire expense the costs imposed on the water right program by the proceeding. (E.g., Wat. Code, §§ 2501; 2850 et seq. [entire expense for statutory adjudication, regardless of type of water right, apportioned among the parties].)

3. The law requires only a reasonable basis for regulatory program cost apportionment, not a precise one.

The courts have upheld fee allocations imposed only on those being regulated without requiring those who are protected by the regulation to be charged. Shifting the burden of taxation off the back of the general public and onto the regulated community furthers Proposition 13's goal of tax relief. (*Sinclair Paint, supra,* 15 Cal.4th at p.

879.) The fact that some of the SWRCB's regulatory effort is necessary to protect (i.e., for the "benefit of") other types of water right holders (usually senior water right holders) or the public trust is *irrelevant.* What matters is not who benefits from the program, but who imposes the burdens that make the program necessary.

A fee schedule need only bear a reasonable relationship to the benefit reaped or the burden imposed by the payor. (*Sinclair Paint, supra,* 15 Cal.4th at p. 878; accord, *California Assn. of Professional Scientists v. Department of Fish and Game* (2000) 79 Cal.App.4th 935, 949-950 (*CAPS*).) A fee schedule need not do both. Otherwise, it could cause double charging or raise extremely difficult accounting requirements.

This Court and the Courts of Appeal have permitted exemptions for those who impose an insignificant social or economic "burden." Whether such persons receive similar benefits or protections from the regulation has been irrelevant to the analysis.

For example, the statutes imposing the Childhood Lead Poisoning Prevention fee at issue in *Sinclair Paint* exempt those who have not *"significantly* contributed" to the chronic, ongoing exposure of children to lead in the environment. (Health & Saf. Code, § 105310, subd. (a).) This Court upheld the statutes, despite the fact that they allow the exemption of manufacturers whose products may be responsible for some cases of lead poisoning. (Stats. 1991, ch. 799, § 1, p. 3558 [finding that lead in soil and dust comes primarily from automobile exhaust from leaded gasoline, leaded paint, and industrial emissions]; see Cal. Code Regs., tit. 17, § 33001 et seq. [imposing fees only on manufacturers of architectural coating products, motor vehicle fuel distributors, and facilities releasing certain amounts of lead into the air].)

In *CAPS*, the court upheld a fee allocation that exempted 68 percent of all projects from payment of the Department of Fish and Game's review fees because *they could be presumed to be less of a burden to the state, requiring less regulation.* (*CAPS, supra,* 79 Cal.App.4th at p. 943.) These projects presumably received the *same* "benefit" from the review as did those that were subject to the fees; moreover, the projects *still required the state's review.*

CAPS' holding is consistent with fee law. In *United Business Comm. v. City of San Diego* (1979) 91 Cal.App.3d 156, the court reviewed a license fee for the costs of regulating on-premises signs in the city's commercial and industrial zones. It stated that an exemption of buildings or structures used exclusively for religious purposes from the sign inventory fee was "surely" permissible but not compelled, and that the exemption provided no support for the contention that the inventory fee must be presumed a tax. (*United Business Comm. v. City of San Diego, supra,* 91 Cal.App.3d 168.) Thus, it too found that a regulatory fee could make certain reasonable exemptions without violating Proposition 13.

The fee cases require only a reasonable allocation of regulatory fees, not a precise one. (See e.g., *CAPS, supra,* 79 Cal.App.4th at pp. 950-951.) Indeed, this Court has noted that "As in matters of fiscal planning generally, practical considerations dictate that a fee schedule be based on reasonable generalizations." (*Sea & Sage Audubon Society, Inc. v. Planning Com.* (1983) 34 Cal.3d 412, 422, fn. 5.)

Accordingly, the water right fees need not be equally apportioned among all water right holders when some are not subject to, or are subject to less, regulation. As

explained, riparians and pre-1914s are not subject to the same regulation as are permittees and licensees. A riparian seeking protection for its (senior) right is not necessarily required to pay a fee to receive the SWRCB's attention and protection, just as a member of the general public would not have to pay a fee to bring a permit or license violation to the SWRCB's attention.

In other actions, however, persons who divert and use water under claim of riparian or pre-1914 rights may be responsible for fees covering the entire cost of the activity, or held liable for fines or penalties, all of which go to the Water Rights Fund for the support of the water right program. (E.g., Wat. Code, §§ 2000, 2040 [expenses recovered for entire cost of SWRCB's action as referee in suit to determine water rights]; *id.*, §§ 2501; 2850 et seq. [requiring payment by parties of entire expense for statutory adjudication of rights]; *id.,* § 1052, subd. (e); *id.,* § 1538 [providing for *additional* liability in the amount of any annual fees that would have been required if unauthorized diversion or use had been authorized by permit or license]; *id.,* § 1845, subd. (d) [penalties for failure to comply with water right cease and desist order]; § 1551 [depositing fees and liabilities in Water Rights Fund]; see also *id.*, § 13160.1, subd. (e) [depositing water certification fee for FERC licensed hydroelectric project, which apply equally to projects that divert water based on riparian or pre-1914 water rights and projects that divert water under permit or license, in Water Rights Fund].)

Enforcement action against unauthorized diversions is legitimately part of the fee funded water right regulatory program. It forces illegal diverters to file applications and obtain permits. The prevention of waste or unreasonable use by parties who do not

hold permits or licenses frees up additional supplies and spreads the burden of protecting public trust resources, reducing the burden on permittees and licensees.

Setting up a fee schedule requires the Legislature or the agency to predict, based on its past experience and the scope of agency regulatory authority, how the agency's regulatory costs will be expended. Administrative feasibility -- such as whether a fee schedule based on actual instead of estimated costs is even possible -- must also be taken into consideration. "It is not to be expected that the figures will be exact. Nor will courts concern themselves with the [agency's] methods of marshalling and evaluating scientific data. Yet the court must be able to assure itself that before imposing the fee the [agency] engaged in a reasoned analysis designed to establish the requisite connection between the amount of the fee imposed and the burden created." (*Shapell Industries, Inc. v. Governing Bd.* (1991) 1 Cal.App.4th 218, 235 [internal citations omitted] (*Shapell*).)

4. The Court of Appeal did not correctly identify the nature of the regulatory activity.

Of course, many of the costs incurred in the administration of the water right permit and license system also address riparian and pre-1914 right holders. This is because the determination of whether water is available for appropriation by permit and license holders, and enforcing permit and license conditions designed to protect prior rights, necessarily involves consideration of how much water is needed to satisfy the reasonable needs of senior water right holders. In so doing, however, the SWRCB is not regulating or adjudicating the rights of pre-1914 or riparian right holders. (See

United States v. State Water Resources Control Bd. (1986) 182 Cal.App.3d 82, 102-103.) Rather, the SWRCB is evaluating the claims of pre-1914 and riparian right holders because the regulation of applicants for, and holders of, water right permits and licenses requires it.

Examples of program expenditures that may involve riparian and pre-1914 right holders, but are necessary for the regulation of persons subject to permits and licenses, include:

-- Section 1321 requires the SWRCB to send notice by registered mail to each person the SWRCB believes may have an interest in a water right application, including *all types* of water right holders.

-- Statements of water diversions and use (sections 5100 et seq.) are required to be filed by riparian and pre-1914 water right holders. (Wat. Code, § 5101.) These statements assist the SWRCB to regulate the diversion and use of water, and the cost of the SWRCB's review of these documents may be paid from the Water Rights Fund. (Wat. Code, § 1525, subd. (c).) The statements are used by the SWRCB to send out notices of water right applications and petitions to all interested parties, including riparians and pre-1914s. (Wat. Code, § 5106, subd. (b)(1).) A willful misstatement is a misdemeanor punishable by a fine or imprisonment and a material misstatement may result in civil liability. (Wat. Code, §5107; see Wat. Code, § 1551 [depositing such fees in the Water Rights Fund].) The statements provide information to the SWRCB that is important to the administration of the permit and license system, since permittees and licensees hold rights that are junior to riparian and pre-1914 water rights.

Knowledge of the availability of water for appropriation and the existence and extent of other beneficial uses of water is necessary to the SWRCB's ability to grant permits and approve changes in permits and licenses.

– Section 1052 prohibits the diversion or use of water for which a permit or license is required, except in compliance with the water right permit and license system. (This provision will apply to persons claiming under other bases of right only to the extent that their diversions are not authorized under those rights.) The costs incurred by the SWRCB in enforcing this requirement may be recovered through permit and license fees, because enforcement serves to make sure that those who should have permits and licenses obtain them – or cease diverting and using water – and thus helps ensure that those who should be paying permit and license fees are paying. (See Wat. Code, § 1525, subd. (c).)

Under *Sinclair Paint*, the fee allocated to the users of water under permit and license bears a fair and reasonable relationship to their burdens on the agency's regulatory program. Here, the Legislature identified the estimated cost of the program and approximately how much of that cost should come from fee revenue. The SWRCB determined that permittees and licensees impose about 95 percent of the burden on the regulatory program, and for the reasons stated above, chose to collect most of the fee revenue through the annual permit and license fees.

It is appropriate for the permitted and licensed water right holders to pay the majority of the fees that support the water right program through the annual permit and license fees. Persons whose water rights are not subject to the SWRCB's permitting

and licensing authority are not the focus of the water right program, and when the SWRCB does take action to regulate their rights in particular, they are required to pay their fair share of the costs. If it is reasonable to exempt parties from permitting and licensing requirements, it is reasonable to exempt them from the regulatory fees used to support the program.

II.

Courts do not apply a different standard of review to an agency's quasi-legislative judgments when a regulation is challenged under Proposition 13

The second issue is whether the Court of Appeal applied the correct standard of review to the validity of the SWRCB's fee allocations, set forth in the California Code of Regulations, title 23, sections 1066 and 1073, and adopted through emergency rulemaking. The court held that the "deferential standard applied to the review of quasi-legislative actions by ordinary mandamus . . . is inapplicable here." (Slip op., p. 30.) Accordingly, the Court of Appeal gave no deference to the SWRCB's factual determinations and policy considerations. Unlike the Court of Appeal, the trial court applied the appropriate standard of review, exercising its independent judgment on issues of law, and giving the appropriate deference to agency discretion in allocating the fees by regulation. (Appendix 3391:10-14.)

A. The appeal presents only a facial challenge to SWRCB's regulations.

Plaintiffs challenge what the regulations say and not how the SWRCB has interpreted them or applied them. The parties "agreed to bifurcate the factual issues involved with the individual [NCWA Petitioners] and proceed on the question of

whether the statutes and regulations at issue are unconstitutional or unlawful and whether the [SWRCB] otherwise abused its discretion in adopting the regulations." (Appendix 3410:14-18.) No individual factual matters are at issue in this appeal.

It does not matter that plaintiffs contend the regulations are unfair to a particular classification of water right users, because the challenged treatment of the classification is specified in the regulations themselves. An analogous case is *Alfaro v. Terhune* (2002) 98 Cal.App.4th 492, where the plaintiffs challenged a statute as being unconstitutionally overbroad. The plaintiffs were challenging the effects of the statute only upon certain kinds of individuals. Nevertheless, the court held that the plaintiffs were making a facial challenge to the statute, because the distinction between those individuals and others appeared on the face of the statute itself. (*Id.,* 98 Cal.App.4th at pp. 509-510.) Like the plaintiffs in *Alfaro*, NCWA and the Farm Bureau attack nothing about the allocation of the water right fees other than what is written in the statutes and the regulations.

B. SWRCB's factual determinations and policy considerations made during the emergency rulemaking process are subject to review only for "abuse of discretion."

When a party makes a facial challenge to a rulemaking decision, judicial review is limited to an examination of the proceedings before the agency to determine whether its action "has been arbitrary, capricious, or entirely lacking in evidentiary support, or whether [it] has failed to follow the procedure and give the notices required by law." (*San Francisco Fire Fighters Local 798 v. City and County of San Francisco* (2006) 38 Cal.4th 653, 667-668, quoting *California Assn. of Psychological Providers v. Rank*

(1990) 51 Cal.3d 1, 11-12; accord, *Yamaha Corp. of America v. State Bd. of Equalization* (1998) 19 Cal.4th 1, 11.)

The "court's task is not to weigh conflicting evidence and determine who has the better argument." (*Western States Petroleum Assn. v. Superior Ct.* (1995) 9 Cal.4th 559, 574 (*WSPA*), quoting *Laurel Heights Improvement Assn. v. Regents of the University of California* (1988) 47 Cal.3d 376, 392-393.) In particular, "It is not the court's function to second-guess [the agency's rulemaking] conclusions or resolve conflicting scientific views in an area committed to the discretion of the rulemaking agency. [Citation.]" (*Pulaski v. California Occupational Safety and Health Standards Bd.* (1999) 75 Cal.App.4th 1315, 1329.)

This highly deferential standard of review is based on both constitutional principles and practical ones:

> The courts exercise limited review of legislative acts by administrative bodies out of deference to the separation of powers between the Legislature and the judiciary, to the legislative delegation of administrative authority to the agency, and to the presumed expertise of the agency within its scope of authority.

(*California Hotel & Motel Assn. v. Industrial Welfare Com.* (1979) 25 Cal.3d 200, 211-212, fn. omitted; accord, *Pulaski, supra,* 75 Cal.App.4th at p. 1331.)

The same degree of deference does not apply to pure questions of law. "The court, not the agency, has 'final responsibility for the interpretation of the law' under which the regulation was issued." (*Yamaha Corp. of America v. State Bd. of Equalization, supra,* 19 Cal.4th at p. 11, fn. 4, quoting *Whitcomb Hotel, Inc. v. Cal. Emp. Com.* (1944) 24 Cal.2d 753, 757.) Consequently, the SWRCB's legal

interpretation of the fee statutes and the California Constitution is subject to the court's independent judgment. However, the SWRCB's factual determinations and policy considerations – including its determination that the water right program primarily regulates state permits and licenses – can be reviewed only for abuse of discretion.

The California Administrative Procedures Act (APA) echoes *WSPA*'s holding that reviewing courts must never substitute their own judgment for that of the agency:

> It is the intent of the Legislature that neither the Office of Administrative Law *nor the court* should substitute its judgment for that of the rulemaking agency as expressed in the substantive content of adopted regulations.

(Gov. Code, § 11340.1 [italics added].) The provisions of the APA apply where an agency is alleged to have exceeded its statutory authority; however, a regulation also violates the APA if it is contrary to *any* provision of law:

> Each regulation adopted, to be effective, shall be within the scope of authority conferred and in accordance with the standards prescribed by other provisions of law.

(Gov. Cod, § 11342.1.)

C. Nothing about this case justifies a different standard of review.

A court should not exercise its independent judgment on matters such as the effect of water right permit term conditions, water project operations, regulatory incentives and agency workload distribution, all involving the experience and technical expertise of the agency to which the Legislature has assigned responsibility to make the relevant decisions. For a court to second guess the SWRCB's determinations in these areas, with no deference whatsoever to the agency, is a radical departure from the

ordinary scope of judicial review.

1. The refund request does not affect the standard of judicial review.

While all of NCWA and the Farm Bureau's claims in this case could have been presented in a request for declaratory relief under Government Code section 11350, they had to file a petition for a writ of administrative mandate to receive the remedy of a refund. (Wat. Code, § 1537, subd. (b)(2)-(3); Wat. Code, § 1126.) Courts consistently apply the "abuse of discretion" standard of review in suits for refund where, as here, the suit relies on a challenge to a rulemaking decision. The refund is nothing more than a remedy for the alleged invalidity of the agency's decision. Unless the court determines the agency's decision was invalid, the court never concerns itself with the remedy.

For example, in *Wallace Berrie & Co. v. State Bd. of Equalization* (1985) 40 Cal.3d 60, this Court considered a facial challenge to a regulation in the context of a suit for refund of sales taxes. The court held that because the plaintiff challenged "the validity of the regulation itself, the proper standard of review is whether [the regulation] is arbitrary, capricious, or without rational basis." (*Id.* at pp. 65-66.)

Similarly, in *Shapell Industries, Inc. v. Governing Bd.* (1991) 1 Cal.App.4th 218, a developer sought a refund of development fees imposed by a school district. The complaint alleged that the school district failed to examine the impact of future development on student enrollment and that the fees exceeded the costs of the facilities for which they were imposed. (*Id.* at p. 228.) On appeal, the court found that only the administrative record before the school board was admissible and that "[c]onsideration

of reports prepared long after the agency has acted would therefore be improper. [Citations.]" (*Id.* at pp. 233-234.)

Other refund cases follow the same approach. (See, e.g., *Aerospace Corp. v. State Bd. of Equalization* (1990) 218 Cal.App.3d 1300 [sales tax regulation invalid under "arbitrary and capricious" standard of review because inconsistent with relevant law]; *General Business Systems, Inc. v. State Bd. of Equalization* (1984) 162 Cal.App.3d 50, 54-55 [regulation challenged as extending sales tax law beyond Legislature's intent; "arbitrary and capricious" standard of review held to apply]; *Henry's Restaurants of Pomona, Inc. v. State Bd. Of Equalization* (1973) 30 Cal.App.3d 1009, 1020-1021 [suit for refund of sales taxes based on constitutional grounds; court affirmed validity of statute and regulation under "arbitrary and capricious" standard of review]; see also, *Yamaha Corp. of America v. State Bd. of Equalization, supra,* 19 Cal.4th at pp. 7-8 [in suit for refund, agency's "annotations" analyzing tax consequences of various transactions do not constitute quasi-legislative decisions and are not entitled to the same deference as formal regulations].)

Challenges to taxes and fees are almost always presented in suits for refund, because "the sole legal avenue for resolving tax disputes is a postpayment refund action." (*State Bd. of Equalization v. Superior Court* (1985) 39 Cal.3d 633, 638; see Cal. Const., art. XIII, § 32.) To exempt refund suits from the "abuse of discretion" standard of review would mean that tax and fee regulations are singled out for heightened judicial scrutiny. No law or logic supports that result.

2. The constitutional issues do not change how the court should review SWRCB's factual determinations and policy considerations.

The standard of review is also unaffected by a plaintiff's reliance on constitutional issues. As in any case, SWRCB's interpretation of constitutional and statutory law is reviewed under the "independent judgment" standard of review. (See *Yamaha Corp. of America, supra,* 19 Cal.4th at p. 11, fn. 4.) However, this does not permit the court to second guess the agency's factual determinations.

Any possibility that a less deferential standard of review might apply when a regulation is challenged on constitutional grounds was rejected by this Court in *20th Century Ins. Co. v. Garamendi* (1994) 8 Cal.4th 216. The court recognized that *any* regulation can be challenged on constitutional grounds. To apply a less deferential standard of review in every case involving constitutional issues would create an exception that swallows the rule:

> The [claimants] may be understood to argue that the independent-judgment-on-the evidence standard is applicable . . . on the ground that the regulations in question implicate the United States and/or California Constitutions. *An argument of this sort would allow the rule of arbitrary-or-capricious review to be swallowed up by a purported "exception."* That is because *all* regulations involve the federal and/or state charters, at least to some degree.

(*Id.* at p. 279, fn. 13 [first italics added].) Both the process of finding facts and the findings themselves must be considered "quasi-legislative" and given deference accordingly. (*Id.* at pp. 278-279.) It does not matter that the agency's findings may have a bearing on constitutional issues.

This reasoning applies with full force in the context of taxes and regulatory fees.

Any fee regulation can be challenged under Proposition 13, and any tax or fee regulation can be challenged under the Due Process and Equal Protection clauses. To conclude that the presence of constitutional issues requires a less deferential standard of review would mean that *every* challenge to a tax or fee regulation could be pled in a way that requires the court to substitute its judgment on the facts.

3. Determining the reasonableness of a fee allocation does not require a different standard of review.

Regulatory fees must be allocated so that "charges allocated to a payor bear a fair or reasonable relationship to the payor's burdens on or benefits from the regulatory activity." (*Sinclair Paint, supra,* 15 Cal.4th at p. 878.) In a facial challenge to a regulation, the "reasonable relationship" requirement does not create a question of fact for the court. SWRCB's own constitutional and statutory responsibility was to make factual determinations and policy decisions based on its expertise. The court's role is essentially that of an appellate tribunal to review those findings under the abuse of discretion standard of review. (See *WSPA, supra,* 9 Cal.4th at p. 573 ["the factual bases of quasi-legislative administrative decisions are entitled to the same deference as the factual determinations of trial courts"].) *WSPA* was decided only two years before *Sinclair Paint.* Nothing in *Sinclair Paint* supports a departure from *WSPA's* constitutional analysis.

Just as the courts are precluded from second-guessing the factual bases for legislative enactments, the courts may not conduct their own evidentiary inquiry to second-guess an agency's findings of fact. To conclude otherwise would effectively

change the standard of review from abuse of discretion to de novo. Agencies' own factual determinations would retain little significance, and rulemaking would become as much a judicial function as an administrative one. Programs like the water right program or the Childhood Lead Poisoning Prevention Program (at issue in *Sinclair Paint*) would be required to spend too much of their resources in litigation defending their factual determinations, rather than in performing their intended purpose.

D. Application of the court's independent judgment resulted in material errors, both factual and highly technical.

The Court of Appeal's lack of deference is material to the court's holding that the regulations do not allocate the fees between types of water right holders in a fair and reasonable manner. The lack of deference results in erroneous findings on issues that are both factual and highly technical. For example, the Court of Appeal exercised its independent judgment regarding the following issues of fact and agency discretion:

-- The Court of Appeal assumed that the Water Rights Fund provides the funding for the entire water right program. (Slip op., p. 39.) This is what the Legislative Analyst recommended (see slip op., p. 13), but it is not what the Legislature decided to do, as explained above. By doing so, the court misidentified the cost of the program and the fee "target."

-- The court assumed the existence of additional detail in the Governor's budget (not provided by any party) that supplies information about the cost of the regulatory program not revealed in the Budget Act. (Slip op., p. 35, fn. 21.) This supposed evidence does not exist. By doing so, the court misconstrued Water Code section 1525

and the scope of the "regulatory activity" to be covered by the fees.

– The court assumed that a pie chart in the record showing the amount of water claimed to be held under various water rights also represents the resources spent to regulate those rights. (AR 0473; slip op., p. 42.) The pie chart shows what proportion of water is held under the different types of water rights but *does not purport to represent the resources spent to regulate those rights.* The court ignored the exemption of riparians and other water right holders from the SWRCB's "core" regulatory program and the significantly different nature of the SWRCB's authority over them. As a result, the court struck down as invalid the SWRCB's allocation of most of the costs of the regulatory program to permittees and licensees.

– The court described the SWRCB's oversight of permitted and licensed water rights in the state as "nominal" (slip op., p. 5.), i.e., "existing in name only" or "insignificantly small; trifling; *a nominal sum.*" (American Heritage Dict. (3rd college ed. 1997) p. 927 [italics original].) This assertion conflicts with the statutes, the SWRCB's understanding of its activities and authority, and the court's own earlier statement regarding the nature of the SWRCB's "core" regulatory activity. This finding would also contribute to the court's misunderstanding of the cost allocation.

– Ignoring the SWRCB's rejection of a fee-for-service format as infeasible, the court expected a "breakdown of the specific Division services used by each category of water right holders." (Slip op., pp. 7, 39.) The court also apparently believed that the SWRCB's water right regulatory activities could be broken out by the type of water right involved. (Slip op., p. 42 [SWRCB "did not provide any evidence to show the

allocation of the actual cost of Division services provided to the holders of riparian. . .water rights. . . ."].) Based on these mistaken assumptions (and others), the court saw no evidence to support the SWRCB's allocation of fees between permit and license holders and other water right holders.

– The court accepted appellants' position that only an insignificant portion -- less than six percent -- of the water rights for the CVP are used for the benefit of the water contractors who receive water from the CVP. (Slip op., p. 43.) Because the court accepted this position (confusing the "face value" of the projects' permits and licenses with the amount of water actually deliverable), it saw no evidence to support the SWRCB's allocation of the annual fees to the federal contractors.

Because the Court of Appeal applied the wrong standard of review, it also got the wrong result. The problem was not the lack of evidence, but the lack of deference.

III.

The state does not violate the Supremacy Clause by imposing on the federal water contractors the annual fees that support the regulation required to provide the water deliveries for which they contract.

The third and last issue is whether the SWRCB's allocation of the cost of the regulation of the permits and licenses held for federal reclamation projects as set forth in the California Code of Regulations, title 23, section 1073, violates the Supremacy Clause. The Court of Appeal held the regulation's formula for allocating the annual fees violates the Supremacy Clause because it requires "the federal contractors to pay for the entire amount of annual fees that would otherwise be imposed on the Bureau." (Slip op., p. 50.)

Water Code section 1560 recognizes that a fee payer may have sovereign immunity and that the fees may be imposed only to the extent authorized under federal or tribal law. (Wat. Code, § 1560, subd. (a).) Water Code section 1540 allows the SWRCB to "allocate the fee or expense, or an appropriate portion of the fee or expense" to those who contract for the delivery of water from permit or license holder. (*Id.*, § 1540.) The SWRCB does not assert that it has authority to impose the fees on the federal government.

Sovereign immunity "is a privilege of the Government, not an incident to the property." (*Scott-Free River Expeditions, Inc. v. County of El Dorado* (1988) 203 Cal.App.3d 896, 901.) Contractors do not hold the federal government's preemption right; they hold the valuable right to the use of the water deliverable under the permits and licenses. (See *Board of Supervisors v. Archer* (1971) 18 Cal.App.3d 717, 725.) Why should the contractors not contribute their proper share, according to the cost of the regulation made necessary by the permits and licenses held for the purpose of their water deliveries?

The allocation of the annual fees to the federal contractors ensures that annual fees are paid on all permitted and licensed water rights of the CVP and other federal projects operated for the benefit of the water supply contractors. The allocation of fees to the federal contractors ensures they receive similar treatment as other contractors, such as the state water contractors. (Appendix 2443 [stating SWRCB's determination that State Water Project fees will be passed through to the state contractors].) Otherwise, the state would never be able to recoup the cost of regulation in relationship

to the burdens imposed or benefits received by virtue of the permits and licenses held to deliver the water. As discussed below, the allocation of the annual fees associated with the Bureau's permits and licenses does not violate the Supremacy Clause, nor does it make the fee a tax under the California Constitution.

Absent its consent, the federal government and its instrumentalities are absolutely immune from direct taxation by the State. The Supremacy Clause, however, does not bar a state from imposing a "tax" (as defined under federal law, not Proposition 13) in connection with property held by the United States as long as that property is used by a non-federal entity and it is their use or interest that is taxed. (*U.S. v. Fresno County* (1977) 429 U.S. 452, 462 (*Fresno County*).) A state may accommodate for the fact that it cannot impose a tax on the federal government as the project owner by instead imposing a tax on the federal contractor. (*Washington v. U.S.* (1983) 460 U.S. 536, 543, fn. 8; see *Board of Supervisors v. Archer, supra,* 18 Cal.App.3d 717 [federal grazing permits held to be taxable interest despite being nonexclusive, temporary and revocable].)

A. The annual fees are not levied on the federal government or any federal instrumentality.

The Bureau's assertion of sovereign immunity does not prevent the state from imposing the fees on the Bureau's contractors who use water pursuant to the Bureau's water rights. Federal immunity from taxation applies "only when the state levy falls on the United States itself, or on an agency or instrumentality so closely connected to the Government that the two cannot realistically be viewed as separate entities, at least

insofar as the activity being taxed is concerned." (*U.S. v. New Mexico* (1982) 455 U.S. 720, 735 [upholding state use tax on finding that federal contractors who managed federal property and purchased materials with government funds were not constituent parts of government].)

The Bureau contractors are not so closely connected to the federal government that they can be viewed as one entity. The Bureau contracts "for the care, operation and maintenance" of the CVP. (Appendix 2322 [Contract with Orland Unit Water Users' Assoc. for irrigation works]; see AR 02567 et seq.) CVP contracts provide that the Bureau contractor is responsible for the "control, carriage, handling, distribution, and use of all water delivered or taken" under the contract. (Appendix 2328.) To permit the Bureau to "withdraw as completely as possible from the care, operation and maintenance of the transferred property," the contracts require Bureau contractors to keep accurate records of the water supply, and furnish reports as required. (Appendix 2329-2330.) The Bureau contracts foresee and provide for a water contractor's participation in administrative proceedings before the SWRCB involving the Bureau's water rights. (Appendix 2725:274-278.)

The Bureau's contracts, like the Department of Energy management contracts at issue in *U.S. v. New Mexico*, are "designed to facilitate long-term private management" of Bureau property." (*U.S. v. New Mexico, supra,* 455 U.S. at p. 723.) Their "complex and intricate contractual provisions make it virtually impossible to describe the contractual relationship in standard agency terms. While subject to the general direction of the Government, the contractors are vested with substantial autonomy in

their operations. . . ." (*Ibid.* [internal citations omitted].) In sum, the federal contractors are not federal instrumentalities.

B. The contractors have a separate interest in the Bureau's permits and licenses.

A fee associated with federal property rights may be imposed on federal contractors who have some separate interest in the property. (*U.S. v. New Mexico, supra,* 455 U.S. at pp. 734-734.) The fact that the water right is held by the United States, rather than the contractors, is irrelevant.

The Bureau contractors are in a position analogous to that of the *Fresno County's* federal employees. In that case, the United States Forest Service rented houses to park employees. The federal employees had rental contracts with the Forest Service. The federal employees' rights were set forth and limited by the terms of their rental contracts; while they did not hold title to the property, they could use it. Like those who contracted for the leasehold property interest in *Fresno County*, the Bureau contractors can use the water made available to them by the projects that hold those water rights. The federal employees in *Fresno County* did *not* need to own the houses for the state tax to be valid. (*Fresno County, supra,* 429 U.S. at p. 466.)

The contractors have a legal contractual right that they can enforce against the Bureau. This right allows them to obtain the water appropriated by the Bureau under its water rights permits and licenses. The contractual right does not consist of the water itself nor title to the permit or license. It is not the identical estate held by the United States. As the Bureau contractors have a separate interest in the use of the Bureau's

water subject to state permitted and licensed water rights, the "legal incidence" of the fee falls neither on the federal government nor on any federal property. (*Fresno County, supra,* 429 U.S. at p. 464.) Thus, the fee is valid.

1. The annual fees are not levied on the property itself.

Because the annual water right fees are not taxes levied on the property itself, they do not violate the Supremacy Clause. (*U.S. v. Nye County Nev.* (9th Cir. 1991) 938 F.2d 1040, 1042 [noting that tax measures imposed on an isolated possessory interest or on a beneficial use of government property survived, while tax measures levied on the property itself perished]; *U.S. v. County of San Diego* (9th Cir. 1992) 965 F.2d 691, 695-696 [upholding ad valorem tax on federal contractor's beneficial use characterized as possessory interest in public property].) Unlike a tax based on a contractor's profits from its use of federal property, the annual fees are based on the regulation required to allow the contractor to use it. The water right fees are based neither on the value of the Bureau's water rights nor the value of the federal contractors' interest.

A regulatory fee is not based on the value of any related property and need have nothing to do with property ownership. Under *Sinclair Paint*, fees are allocated so that they bear a fair or reasonable relationship to either the payer's burdens on or benefits from the regulatory activity.

There is no question that the State has authority to regulate the diversion and use of water subject to Bureau contracts. (*California v. U.S.* (1978) 438 U.S. 645; see *Environmental Defense Fund, Inc. v. East Bay Mun. Utility Dist.* (1980) 26 Cal.3d 183 [regulation of point of diversion where Bureau contractor takes water]; Appendix

2821-2836 [decision regulating waste or unreasonable use of water delivered under water supply projects with the Secretary of the Interior]; *Imperial Irrigation Dist. v. State Wat. Resources Control Bd.* (1990) 225 Cal.App.3d 548, 561 [upholding the SWRCB's authority to apply California Constitutional and statutory prohibition against the unreasonable use of water to Imperial Irrigation District's use of Colorado River water pursuant to "unique blend" of federal and state, statutory and contractual rights].) Moreover, a direct regulatory relationship with the Bureau's contractors is unnecessary to uphold the fees as valid regulatory fees. (*Sinclair, supra,* 15 Cal.4th at p. 877 [no need for regulatory relationship with paint producers to impose regulatory fees to support mitigation of the effects of their past activities]; *Kern County Farm Bureau, supra,* 19 Cal.App.4th 1416 [no requirement that the assessment be applied only to the landfill operator]; Appendix 2817-2819 [86 Ops. Cal. Atty. Gen. 176 (2003) (city may shift burden of annual business license fee to cover costs in processing license application and inspection of vendor's premises from the individual swap meet vendor to the swap meet operator)].)

2. The annual fees recover the regulatory costs of the permits and licenses held to support the federal contractors' contractual right to the water's use.

Where water is diverted under permits or licenses for use by the contractor, the need for and benefits of the regulatory program may be attributed to either the water right holder or the contractor. The SWRCB determined that the federal water contractors' share of the regulatory cost should be equal to the face value – discounted for hydropower generation -- of the federal permits and licenses related to their

contracts because these permits and licenses are held primarily to support the contract deliveries. (See Cal. Code Regs., tit. 23, § 1073; *id.*, § 1071.)

The contractors' demand for water is the primary purpose of the Bureau's water supply projects. (See *Natural Resources Defense Council v. Houston* (9th Cir. 1998) 146 F.3d 1118, 1123; *South Delta Water Agency v. U.S., Dept. of Interior, Bureau of Reclamation* (9th Cir 1985) 767 F.2d 531, 533-534.) The primary object of the Reclamation Law (43 U.S.C.A. § 317 et seq.) and the projects created under the Reclamation Law (including the CVP) "is the reclamation of arid lands through irrigation." (*Burley Irr. Dist. v. Ickes* (1940) 116 F.2d 529, 530.)

The United States constructed the structures and facilities of the reclamation projects, including the irrigation and power works, and recovers the costs of construction with money from the Reclamation Fund. (43 U.S.C.A. §§ 419, 461.) Persons benefitted by the project pay for the construction charges by installments over a long period of time; these payments are placed in the Reclamation Fund. (*Ibid.*; *Burley Irr. Dist. v. Ickes, supra,* 116 F.2d at pp. 531-532.)

The water contracts provide that the Bureau diverts, stores and delivers water under contract for the benefit of the Bureau contractors:

> WHEREAS . . . the United States has acquired water rights and other rights to the flows of the Chowchilla River, including without limitation the permits issued . . . by the California State Water Resource Control Board . . . pursuant to which the Contracting Officer develops, diverts, stores and delivers Project Water . . . in accordance with State and Federal law for the benefit of Project Contractors . . . .

(Appendix 2722 [Long-Term Renewal Contract Between the United States and Chowchilla Water District Providing for Project Water Service from Buchanan Unit].)

The projects' production of power is incidental to water delivery:

> The production of power for pumping in connection with irrigation is an important incident to this main object [of water delivery]. Disposition of surplus power, not required for pumping or other uses of irrigation, for commercial uses is authorized [under 43 U.S.C. § 522]. . . .But the development and sale of such power is authorized only as an incidental phase of reclamation, not as a primary or independent end in itself.

(*Burley Irr. Dist. v. Ickes, supra,* 116 F.2d at pp. 530-531; see *Westlands Water Dist. v. U.S. Dept. of Interior* (9th Cir. 2004) 376 F.3d 853, 861 ["The hydroelectric generators at Trinity Dam, Clear Creek Dam, and Clear Creek Tunnel supply power to CVP contractors."].) Money from the sale of surplus power "shall be covered into the reclamation fund and be placed to the credit of the project from which such power is derived. . . ." (*Id.* at p. 530, fn. 1), reducing the contractors' debt for the project's construction.

D. Project contractors pay only the annual fees associated with the permits and licenses held to support their project.

Determining that the Bureau would refuse to pay the fees, the SWRCB allocated annual fees to the federal water contractors based on the cost of the regulation of the permits and licenses held to support the water projects providing their contract deliveries. (Wat. Code, §§ 1540, 1560, subd. (b)(2); Cal. Code Regs., tit. 23, § 1073; Appendix 2309, 2370-2371, 2443, 2563; see Appendix 2560 [referencing Bureau's indication in previous meetings that it would not pay the fees and asking for written

response].) The annual fees for permits and licensed issued for federal projects having no water supply contracts were not passed through to contractors. (Appendix 2564.) Unlike permittees and licensees, the contractors do not pay the filing fees associated with the water rights under which they receive water.

Like all permittees and licensees, however, the Bureau contractors' annual fees are calculated based on the full face value of the permits and licenses held to support their contract deliveries even though they cannot receive delivery of all of that water, it being subject to limitations and conditions like water held under any other permit or license. The Court of Appeal, however, confused the "face value" of the projects' permits and licenses with the amount of water actually deliverable. But the amount of water delivered for use by a contractor is not the equivalent of the water right needed to support the delivery of that amount. Comparing contracted deliveries with the face value of permits and licenses is like comparing the amount of milk produced at a dairy with the amount of water used to irrigate the pasture and operate milking facilities. The units may be similar, but they measure very different things.

Annual fees associated with water right licenses or permits for projects owned or operated by the Bureau within California are allocated to the contractors, as provided by Water Code section 1540, based on a proportional share of the fee attributed to the Bureau's water right permits and licenses. (Wat. Code, § 1560, subd. (b)(2), *id.*, § 1540; Cal. Code Regs., tit. 23, § 1073.) The SWRCB used the amount of water deliverable under their water supply contracts to apportion their share of the fees. (Appendix 2537-2546; see *id.*, 2223:15 - 2226:5 [explaining calculation of fees]; 2549

[issue paper explaining calculation and exploring alternatives].) The SWRCB also discounted the Bureau's permits and licenses authorizing power use by fifty percent, reducing the face value amount of the Bureau's CVP permits and licenses to 86 million af. (Appendix 2549; Cal. Code Regs., tit. 23, § 1071.)

The result is a fee of approximately $0.37 per acre-foot *of the contracted amount*. (Appendix 2429.) The face value of all permits and licenses statewide exceeds the amounts actually delivered for irrigation or other consumptive uses by an order of magnitude, meaning that $0.37 per acre-foot of the contracted amount is consistent with the $0.03 per acre-foot of the face value charged to persons using water under their own permits and licenses. (Appendix 2122.) Many water right permit and license holders pay more per acre-foot of water delivered for use, because they are subject to the minimum fee of $100, while some of the contractors pay annual fees of less than $5.00. (Appendix 2429.)

Moreover, over half of the face value of the permits for the CVP represents permits and licenses for hydroelectric power use. Looking only at the water delivery contract amount ignores the fact that the power generated by the CVP, both the power required to pump the water and the surplus power that helps pay for the projects, benefits the contractors without increasing the amount of deliverable water.

Imposing the annual fees for the permits and licenses held by the Bureau of Reclamation for the purpose of water deliveries on persons who contract for the water that can be delivered under those permits and licenses does not violate the Supremacy Clause. The fees are not charged to the federal government. They are based on the use

of federal facilities for the benefit of the contractors, and they are non-discriminatory. The fees are charged to pay for the cost of the regulation required to protect the water deliveries and to mitigate the effects of the project created to produce those deliveries.

CONCLUSION

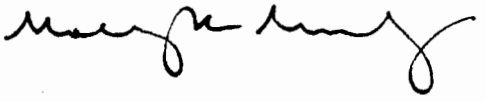
For the reasons stated, the Court should uphold the SWRCB's regulations as valid.

Dated: June 11, 2007

Respectfully submitted,

EDMUND G. BROWN JR.
Attorney General of the State of California

PAUL GIFFORD
Senior Assistant Attorney General
GORDON BURNS
Deputy State Solicitor General
WILLIAM L. CARTER
Supervising Deputy Attorney General
MATTHEW J. GOLDMAN



MOLLY K. MOSLEY, SBN 185483
Deputy Attorneys General

Attorneys for the California State Water Resources Control Board and the California State Board of Equalization, et al.

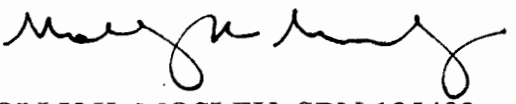
CERTIFICATION OF WORD COUNT

The text, including footnotes, of Respondents' Opening Brief on the Merits consists of 13,203 words according to the word processing program used to prepare the brief.

Dated: June 11, 2007

Respectfully submitted,

EDMUND G. BROWN JR.
Attorney General of the State of California
PAUL GIFFORD
Senior Assistant Attorney General
GORDON BURNS
Deputy Solicitor General
WILLIAM L. CARTER
Supervising Deputy Attorney General
MATTHEW J. GOLDMAN



MOLLY K. MOSLEY, SBN 185483
Deputy Attorneys General

Attorneys for the California State Water Resources Control Board and the California State Board of Equalization, et al.

SA2005300784
30277270.wpd

DECLARATION OF SERVICE BY U.S. MAIL

Case Name: **California Farm Bureau Federation v. SWRCB**

No.: **S150518**

I declare:

I am employed in the Office of the Attorney General, which is the office of a member of the California State Bar, at which member's direction this service is made. I am 18 years of age or older and not a party to this matter. I am familiar with the business practice at the Office of the Attorney General for collection and processing of correspondence for mailing with the United States Postal Service. In accordance with that practice, correspondence placed in the internal mail collection system at the Office of the Attorney General is deposited with the United States Postal Service that same day in the ordinary course of business.

On June 11, 2007, I served the attached **RESPONDENTS' BRIEF ON THE MERITS** by placing a true copy thereof enclosed in a sealed envelope with postage thereon fully prepaid, in the internal mail collection system at the Office of the Attorney General at 1300 I Street, Suite 125, P.O. Box 944255, Sacramento, CA 94244-2550, addressed as follows:

David A. Battaglia
Gibson Dunn & Crutcher
333 South Grand Avenue
Los Angeles, CA 90071

Attorneys for Plaintiffs and Appellants California Farm Bureau Federation, et al.

Nancy N. McDonough
California Farm Bureau Federation
2300 River Plaza Drive
Sacramento CA 95833

Attorneys for Plaintiffs and Appellants California Farm Bureau Federation, et al.

Stuart L. Somach
Somach Simmons & Dunn
813 Sixth Street, Third Floor
Sacramento CA 95814-2403

Attorneys for Plaintiffs and Appellants Northern California Water Assn. et al.

Clerk of the Court
Superior Court of California
County of Sacramento
720 9th Street, Appeals Unit
Sacramento, CA 95814

Clerk of the Court
The Court of Appeal of the State of
California
Third Appellate District
900 N Street, #400
Sacramento, CA 95814-4869

I declare under penalty of perjury under the laws of the State of California the foregoing is true and correct and that this declaration was executed on June 11, 2007, at Sacramento, California.

N. Christensen	N. Christenson
Declarant	Signature

30280446.wpd