CASE NO. S150518

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.

NCWA PETITIONERS' ANSWER TO STATE'S MERITS BRIEF

After Decision by the
Court of Appeal, Third Appellate Dist., No. C050289

From Judgment
of the Sacramento County Superior Court, Case No. 03CS01776
The Honorable Raymond M. Cadei, Judge

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NCWA PETITIONERS' ANSWER TO STATE'S MERITS BRIEF

Plaintiffs and Petitioners Northern California Water Association, Central Valley Project Water Association, and approximately 200 individually named water right permit and license holders (collectively "NCWA Petitioners") hereby answer Respondent California State Water Resources Control Board, et al.'s Brief on the Merits ("State's Merits Brief").

I.

INTRODUCTION AND SUMMARY

The State's Merits Brief presents three issues, two regarding the strict limits on government taxation and spending contained in the California Constitution, and the third arising under the United States Constitution. The discussion of these issues diminishes the role of the State Water Resources Control Board's ("SWRCB") Division of Water Rights ("Division"), misstates the nature of water right permits and licenses, misconstrues the federal "contractors" role in the massive federal Central Valley Project ("CVP") and misinterprets the Court of Appeal's decision.

A. Opinion Below

The Court of Appeal held that the statutes underlying the challenged fee scheme were constitutional,[1] but determined that the SWRCB's regulations were enacted in violation of the California Constitution and the United States Constitution. In upholding the constitutionality of the statutes, the Court held, notwithstanding the express language contained in Water Code section 1525, that the charges at issue were not imposed on the "ownership" of a water right, but instead on the "use" of water. (Opinion of the Court of Appeal, Third Appellate District, filed January 17, 2007 ("Opinion") at pp. 35-36.) The Court of Appeal characterized the water right as usufructuary (a right to use) and that the fee was associated with the "use" and not the "property right" in water. The Court of Appeal also upheld the so-called "pass through" of the charges imposed on the water rights held by the United States to the CVP Contractors, opining that the fees are not imposed on the United States. At the same time, however, the Court of Appeal affirmed that the CVP contractors have "no property rights" in the permits and licenses of the United States Bureau of Reclamation held by the United States

[1] NCWA Petitioners disagree with the Court of Appeal and believe the problems with the revenue-raising scheme are deep-rooted in the statutes.

for the operation of the CVP. NWCA Petitioners agree with the Court of Appeal's decision that the regulations enacted by the SWRCB to implement the new charges run afoul of the California Constitution.

The Court of Appeal properly determined that the SWRCB's implementing regulations create an unconstitutional tax. In doing so, the Court of Appeal rejected the SWRCB's repeated justification as being a "zero sum game," instead requiring a "reasonable relationship" between a fee charged and the burdens the payor places on, or the benefits the fee payor receives from, the "regulatory program." Thus, in holding the revenue-raising scheme unconstitutional, the Court of Appeal noted that the following aspects were "unfair" or "unreasonable":

- The SWRCB cannot charge existing water right permit and license holders to pay the costs associated with processing new applications or petitions.

- The approximately 38% of water diverted pursuant to rights other than permits and licenses result in more than a de minimis burden or benefit.

- Fully one-third of the Division's activities are for the express purpose of benefiting the public generally.

- The SWRCB cannot impose the entire federal burden on the CVP Contractors who collectively have a "contractual" right to only 6.6 million acre feet of the 116 million acre feet authorized by the permits and licenses held by the United States.

- The SWRCB cannot rely upon the "polluter pays" rationale to charge a small subset of water right holders for the costs of "regulating" all water right holders.

B. The State's Merits Brief and Background on the Work of the Division

The State's Merits Brief does nothing to counter the significant problems recognized by the Court of Appeal. Instead, the State argues that the Court of Appeal should not have looked so closely at the revenue-raising scheme and should have simply deferred to the SWRCB's "expertise" and "discretion" in developing this unconstitutional scheme.

The SWRCB recognizes that the challenged fee scheme is intended to cover essentially all of the activities that comprise the SWRCB's Division of Water Rights program. (State's Merits Brief at p. 2.) Accepting this as true would mean that all of the Division's functions are simply regulatory in nature, thereby stripping the SWRCB of its historic, adjudicatory, statutory, and constitutional role in providing more fundamental, core governmental function,

which transcend mere "regulation." (See, e.g., *State Water Resources Control Board Cases* (2006) 136 Cal.App.4th 674, 720 ["[i]n undertaking to allocate water rights, the Board performs an adjudicatory function", [citations omitted]; *United States v. State Water Resources Control Board* (1986) 182 Cal.App.3d 82, 129 ["[a]ll water rights, *including appropriative*[2], are subject to the overriding constitutional limitation that water use must be reasonable. [Citations.] The Board is expressly commissioned to carry out that policy." (Emphasis added.)]; *Bank of America v. State Water Resources Control Bd.* (1974) 42 Cal.App.3d 198, 206-207 ["[t]he Board itself and its functions partake of both constitutional and statutory characteristics . . . it pursues . . . those broad policy expressions and directives contained in article XIV, section 3, of the Constitution, leading one authority to the conclusion that the origin of the Board's power to issue or deny permits to appropriate water is both constitutional and statutory. [Citation.]"]; *Imperial Irrigation District v. State Water Resources Control Board* (1990) 225 Cal.App.3d 548, 566-567 ["[l]ike many other federal and state

[2] As the SWRCB's role in carrying out the constitutional limitations on reasonable and beneficial use *includes* appropriative rights, it is not limited to appropriative rights. Instead, this limitation, and the SWRCB's role in carrying out this "policy," extends to *all water rights*, including those not subject to the annual charges at issue.

agencies, however [citation omitted] the Board's powers and responsibilities are a blend of judicial, legislative and administrative concepts . . . the Board has power to enforce the constitutional requirement of 'reasonableness' in water use, and to investigate and act upon allegations of waste or misuse of water. [Citations omitted.]")

That the SWRCB plays more than a simple "regulatory" role is also evidenced by the SWRCB's express admissions that its functions include protection of the public interest and the 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, all pursuant to article X, section 2 of the California Constitution and the public trust doctrine. (State's Merits Brief at p. 4.) These later roles extend far beyond mere regulation and involve a much broader array of governmental responsibilities than are employed in a mere regulatory program. (*Bank of America v. State Water Resources Control Bd., supra*, 42 Cal.App.3d at pp. 206-207.) Mere fiscal convenience cannot be used as an excuse to overlook the broader purposes and duties of the SWRCB in regard to the State's water resource, and cannot support an end-run around the California Constitution's taxing and spending limitations.

C. The Unreasonable and Unfair Allocation of Costs

The State argues that the annual charges at issue here are imposed on a group of water right users — users of water held under state permits and licenses — that account for about 95 percent of the Division's regulatory effort; and that it spends only de minimis time regulating the water rights of pueblo, pre-1914 and riparian water rights. (State's Merits Brief at p. 3.) Yet within a few paragraphs the State proclaims that it regulates a complex system of water rights (presumably including pueblo, pre-1914 and riparian water rights) to bring order and certainty to the system, including the protection of the public interest and implementation of the public trust doctrine and the above-referenced constitutional provisions and mandates, all of which are as applicable to pueblo, riparian and pre-1914 water rights as they are to permitted and licensed water rights. (*United States v. State Water Resources Control Board, supra*, 182 Cal.App.3d at p. 129 ["[a]ll water rights, *including appropriative*, are subject to the overriding constitutional limitation that water use must be reasonable. (Cal. Const., art. X, § 2 [citations omitted].)" (Emphasis added.)]) The State also ignores that greater than 50 percent of the efforts of the Division are geared towards processing *new* applications and petitions. (See,

e.g., Opinion at p. 41 [identifying the allocation of the Division's resources[3]].)

The State admits that a substantial cost of processing water right applications and petitions is for the purpose of protecting other water right holders, including those with pueblo, riparian and pre-1914 water rights. (State's Merits Brief at p. 6.) In spite of this, it chose not to charge the applicant or petitioner anything near the full cost, but rather subsidized these costs by imposing higher fees on a small sub-set of water right holders that have permits and licenses. (*Ibid.*)

Moreover, not only did the SWRCB impose the entire burden of the fee scheme on a small sub-set of water right holders, but it imposed

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[3] This breakdown, provided by the SWRCB, explains that 25 percent of the Division's resources are spent processing applications and petitions, 18 percent allocated to environmental review (which is for the purpose of complying with CEQA when considering applications and petitions), and 11 percent on hearings (associated with applications and petitions). Twenty-one percent is allocated to "licensing and compliance." Activities involved in "licensing" are geared towards a particular water right holder. Issuing a license is the final administrative step for the SWRCB with regard to the "paper" water right. Beneficial use of water perfected under the statutory structure is confirmed with a "license" issued by the SWRCB. (Wat. Code, §§ 1605, 1610.) The license is, in essence, the title or deed to the water right, recorded in the county in which the diversion takes place. (Wat. Code, § 1650.) All of these activities, under the SWRCB's revenue-raising scheme, are funded through charges imposed on existing permit and license holders, and those receiving direct benefits (i.e., new applicants and petitioners) do not pay the costs associated with the burdens they create, or benefits they receive.

the fee based upon the "face value" of the right which, it conceded, "exceeds the actual amount of water that can be used or diverted – sometimes vastly so . . . ."[4] (State's Merits Brief at p. 7.) The State, in this context, admits imposing fees on quantities of water that far exceed the amount of water actually used, in any years, and further concedes that it is the SWRCB's own "regulation" that precludes the greater use. (*Ibid.*) Part of the logic used is the absolutely unsupported claim that "the more water under permit, the greater the regulatory burden." (*Id.* at p. 8.[5])

D. The Unprecedented Allocation of Costs Associated with Regulating the Federal Government

Regarding the fees imposed on the water right permits and licenses held by the United States and collected from "federal contractors," there is no case, California or otherwise, that recognizes a state's right to impose regulatory fees associated with regulating the

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[4] Importantly, in upholding the constitutionality of Water Code section 1525, the Court of Appeal explained that "[p]otentially conflicting water rights claims and *uses*, not real property ownership, give rise to the need for regulation . . . ." (Opinion at p. 36, emphasis added.) If, indeed, the *use* of water is the basis for the charge, the SWRCB cannot charge for the "face value" of a water right if there are strict and real limitations that limit "use" to significantly less water.

[5] The Court of Appeal expressly recognized that the State made this claim "without citing factual support." (Opinion at p. 42.)

United States.[6] Without question, the "SWRCB regulates the [United States Bureau of Reclamation] as the CVP's permit holder." (Opinion at p. 11.) Thus, the "burdens" on the water right program are created by the United States, *not* the CVP Contractors. As NCWA Petitioners have argued in their Opening Brief, imposing charges on the water right permits and licenses held by the United States is fatal to Water Code sections 1540 and 1560, leaving nothing to "pass through," or otherwise allocate to federal contractors. (NCWA Petitioners' Opening Brief at p. 44.)

In any event, the State argues that a state can "allocate" the fee imposed on the United States to "federal contractors," based upon federal cases recognizing a state's ability to impose a "possessory tax" on the discreet possessory interest a "federal contractor" has in federal property.

Assuming, *arguendo*, that a state may collect regulatory fees imposed on the United States from federal contractors, the amount that may be exacted is absolutely limited to the contractor's possessory interest in federal property. (*United States v. Nye County* (9th Cir.

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[6] Courts universally hold that a state cannot impose a "fee," tax, or other charge on the United States, even in the water rights context. (See *United States v. Idaho* (1993) 508 U.S. 1, 8; *United States v. Oregon* (9th Cir. 1994) 44 F.3d 958, 770.)

1991) 938 F.2d 1040.) Here, the Court of Appeal properly struck down the regulations as unconstitutional because the SWRCB did not segregate the contractual interest held by the CVP Contractors but instead imposed the entire federal burden upon them. (Opinion at p. 50.)

Finally, the SWRCB argued below and now in this Court, that the Court should simply defer to the SWRCB's expertise and allow the SWRCB to craft a revenue-raising scheme as it sees fit in order to ensure stable funding for all of the activities of the Division. As explained in more detail below, and to preserve sound state and federal constitutional principles, each of the SWRCB's arguments must be rejected.

II. ARGUMENT

A. The State Cannot, Consistent with Article XIII A of the California Constitution, Redistribute Costs Associated with a "Regulatory" Program So That a Small Group Is Required to Shoulder the Burdens Created by, and Benefits That Accrue to, a Large Group

In its Merits Brief, the State properly articulates the basic "test" for determining whether a charge falls within the judicially created exception to the strict taxation limitations contained in article XIII A of the California Constitution, the "regulatory fee." (State's Merits Brief at p. 12.) From there on, however, the State misconstrues the nature of the activities of the Division and mischaracterizes those that create the

"burden" on and receive the "benefits" of this purported regulatory program.[7]

1. The State Failed to Present Evidence to Support the Cost of the "Regulatory" Program and Completely Failed to Carry Its Burden of Demonstrating That the Charges Allocated to Fee Payors Bear a Fair or Reasonable Relationship to the Payor's Burdens on or Benefits from the Regulatory Program

The State argues that the estimated cost of the regulatory activity is the estimated cost of the "*entire* water right program." (State's Merits Brief at p. 13, emphasis in original.) The State then argues that the Legislature sets the Division of Water Right's budget through the Budget Act – so their burden is met. The test for determining whether a charge is constitutional, however, is not so superficial. If Proposition 13 has any teeth left at all with regard to limitations on the ability of the State to exact revenue, the State cannot simply say all the costs are regulatory because the Legislature says so.

The annual fees imposed by the regulations raise revenue unrelated to a discrete regulatory program and, therefore, are invalid. (*Sinclair Paint Co. v. State Board of Equalization* (1997) 15 Cal.4th 866, 876 ("*Sinclair Paint*"). The lumping together of all of the

[7] As NCWA Petitioners explained in their Opening Brief, not all of the activities of the SWRCB's Division of Water Rights are "regulatory," either in the classical sense, or in the context of Proposition 13 and the subsequent development of the regulatory fee.

functions of the Division and treating them as one "regulatory program" for which the annual fees are charged defies logic, common sense and the actual evidence that exists in the record. The State devotes much of its brief to describing the myriad functions and programs of the Division, some of which are arguably regulatory, some of which are adjudicatory, some of which directly relate to burdens imposed by persons seeking services of the Division, many of which have no relation to requested services. (State's Merits Brief at pp. 6-7, 15, 19, 23-26.) Others arise under the constitutional policies overseen by the SWRCB. (*Id.* at p. 4.) While some of the functions could perhaps legitimately be subject to a regulatory fee, all of them certainly cannot. It is improper to amalgamate all of the functions together in order to term the product a universal "regulatory program."

Under the State's scheme, existing water right permit and license holders pay nearly all of the costs associated with processing new water right applications; they pay nearly all of the costs for processing petitions submitted by others to change their existing water rights; they pay all of the costs associated with resolving disputes among those that pay no fees; and they pay all of the costs to cover the activities of the Division implementing the broad constitutional policies and general statutory policies with regard to the State's water resources.

Importantly, there is nothing in the Budget Act that provides any evidence to demonstrate that the challenged fees are related to the burden on or benefits of the regulatory system. The failure of the Budget Act to provide an adequate breakdown of costs is not an excuse for failure to meet the State's burden of proof nor is it grounds for "widen[ing] still further the hole [the courts] have cut in that protective fence which the people of California thought they had constructed around their collective purse." (*Rider v. County of San Diego* (1991) 1 Cal.4th 1, 14, citing *City and County of San Francisco v. Farrell* (1982) 32 Cal.3d 47, 57 [dis. opn. by Richardson, J.].)

a. The Water Right Fund Is the Primary Source of Revenue for the Division of Water Rights

The State argues that there are various sources of funds available to the Division of Water Rights for administering the water right program. This is misleading at best.

The Cigarette and Tobacco Products Surtax and the Federal Trust Fund held out by the State as providing funds for the "water right program" (State's Merits Brief at p. 14) are actually designated for specific purposes and are not part of the funds available to cover general costs of the regulatory program. (Rev. & Tax. Code, § 30122; Gov. Code, § 16360 et seq.) The "reimbursements" identified by the State

are also imposed to cover specific costs and cannot be used to offset the general costs of the water right program.

The State's discussion of the Fiscal Year 2003-2004 Budget is also misleading. As the Court of Appeal properly recognized, the new fees "cover $4.4 million needed for the *second half* of the fiscal year." (Opinion at p. 13, emphasis added.) In any event, this discussion is academic, as the State asserts that "the water right fee statute would allow *all* program expenditures to be supported solely from [fees]. (State's Merits Brief at p. 14, emphasis added.)

b. The Lack of Information Contained in the Budget Act Does Not Save the SWRCB's Unconstitutional Fee Scheme

The State seems to rely on the fact that, in the Budget Act, the Legislature does not distinguish between types of water rights "involved" in the general "activity" of water right regulation. (State's Merits Brief at p. 15.) However, the State cites no authority to support the argument that the Legislature's failure to lawfully define distinct regulatory activities would free the State from otherwise meeting its burden of proof.

c. The Need to "Collect Adequate Funding" Does Not Excuse Compliance with the Constitution

The State argues that, because the Legislature does not set a "target" for the one-time (application and petition) fees and other reimbursable

activities (because they are "erratic"), the Constitution permits the State to collect revenue from water right holders to cover the costs associated with regulating others, to cover the costs of processing new water applications and petitions to change others, and to cover the costs of implementing the broad policies embodied in the statutes and in article X, section 2 of the California Constitution. (State's Merits Brief at pp. 16-17.)

The need to collect adequate funding, however, does not transmute an otherwise unconstitutional revenue-raising scheme into a lawful regulatory fee. Once again, the regulatory fee is a judicially created exception to the otherwise strict limitations of Article XIII A of the California Constitution. The State cannot sidestep the constitutional protections for administrative convenience, accounting efficiency, or ease of collection. Notwithstanding what the State sees as a need to raise adequate revenue through a stable funding source – to be constitutional, and to fall within the exception to the general rule, the "charges allocated to a payer [must] 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; *California Assn. of Professional Scientists, et al. v. Department of Fish & Game, et al.* (2000) 79 Cal.App.4th 935, 945 ("*CAPS*").)

The State's assertion that the charges at issue here do not surpass the cost of the regulatory program ignores how the budget is, in fact, established and assumes that the Division's annual budget is allocated entirely to regulatory activities. The fact that the Legislature authorized recovery of the amount of money set forth in the Budget Act is irrelevant. The State has the burden to demonstrate that the fees do not exceed the costs of the regulatory program. (*CAPS, supra*, 79 Cal.App.4th at p. 945.) Demonstrating only that the fees are designed to recover the Division's annual budget, without proving that the entire annual budget is allocated to the regulatory program, does not meet this burden. The State's discussion of the complexity of the Budget Act and the need for stable funding are in large part irrelevant to the issues before this Court.

2. The Regulations Are Unconstitutional

As the Court of Appeal properly recognized, the Division engages in many different activities, some of which are identified in Water Code section 1525, subdivision (c). In upholding the statute, the Court of Appeal determined that the State could not recover the entire cost of the Division through regulatory fees, but only those activities

specifically enumerated in Water Code section 1525, subdivision (c).[8] (Opinion at pp. 30-31.) The Court of Appeal further properly determined that the State had failed to demonstrate that the charges allocated to a fee payor bear a fair or reasonable relationship to the payor's burdens on or benefits from the regulatory activity. (Opinion at pp. 41-42.) The SWRCB's unconstitutional scheme improperly forces existing water right permit and license holders, and some who hold contracts with the federal government, to shoulder the entire burden of the water right "program," including, but not limited to, burdens created by *new* applicants for water rights, and for burdens created by those who are not subject to the fee scheme. The Court of Appeal properly found this scheme to be unfair and unreasonable.

a. The Primary Focus of the "Water Right Program" Is Not Existing Permit and License Holders

The State argues that the annual fees, charged to existing permit and license holders, and to CVP Contractors, are "intended to support water right program activities," and that those activities "primarily" relate to existing water right permits and licenses. (State's Merits Brief

[8] NCWA Petitioners do not concede that all of the enumerated activities are "regulatory" or that the State can recover these costs through "fees." As explained in NCWA Petitioners' Opening Brief, much of the work of the Division cannot be attributed to any group, but instead is more akin to general governmental functions. (NCWA Petitioners' Opening Brief at pp. 28-37.)

at pp. 18-20.) On that basis, the State argues that it is proper to charge existing water right holders an annual fee to cover all of the costs of the Division of Water Rights. The State is wrong.

As the Court of Appeal correctly noted, a significant portion of the work of the Division is for the benefit of, or needed because of the burden created by, other types of water right holders or those filing new applications and petitions. (Appendix of Appellants California Farm Bureau Federation, et al. and Northern California Water Association, et al. ("AA") at pp. 646-652, 870-873, 875-876, 879, 947-948, 959-960, 1556, 1599-1601, 1696, 1703, 1731-1736.) For example, the Court of Appeal noted that the SWRCB collects only 10% of the cost of processing a new application with the remainder of the cost being borne by existing permit and license holders. (Opinion at p. 40.) Based upon the rough breakdown of the Division's activities, as outlined on page 41 of the Court of Appeal's Opinion, at a minimum, more than 50% of the Division's activities are aimed at new applications and petitions. (Processing applications and petitions – 25%; environmental review [for applications and petitions] – 18%; hearings [on applications and petitions] – 11%, licensing and compliance – 21%.) Forcing existing permit and license holders and CVP Contractors to pay these costs is a tax.

The Court of Appeal also noted that pre-1914 and riparian water right holders receive benefits from the activities of the SWRCB through complaint resolution and "protection" of water rights, yet those water right holders pay no fee. (Opinion at pp. 23, 40.) Requiring existing water right permit and license holders and CVP Contractors to shoulder this economic burden is a tax. The evidence in the record demonstrates that the Division spends considerable time addressing complaints involving water rights other than licenses and permits, and taking action against those who divert without a basis of right. (Opinion at p. 40.) These activities are not at all related to existing water right permit and license holders, let alone "reasonably" related.

In this regard, the State's arguments regarding what it sees as a de minimis burden from, or benefit to, non-fee payors is simply not true. Moreover, the State's de minimis argument completely ignores that annual fee payers subsidize new applications and petitions. The Court of Appeal noted that, while the State made these arguments, albeit late in the day, it provided *no* evidence in the record to support them.[9]

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[9] For example, the Court of Appeal noted that the SWRCB offered "no breakdown of cost or other evidence to demonstrate that the services and benefits provided to non-paying water rights holders was de minimis." (Opinion at p. 41.) The Court of Appeal then found that the State's justification for apportioning fees based upon the size of the diversion was "without factual support." (*Id.* at p. 42.) The Court of

FOOTNOTE CONTINUED ON FOLLOWING PAGE

b. The Court of Appeal Properly Held That the SWRCB's Revenue Raising Scheme Was Unfair and Unreasonable

The State argues that it only need look to those that create the "burden on," or need for, the regulation in order to set a valid regulatory fee. Based upon that logic, the State argues that those that create an "insignificant social or economic burden" can be excused from paying the regulatory fee, even though they create some burden on the regulatory program.

While certain regulatory programs, and regulatory fee schemes, may have exempted those who create little "burden" on the regulatory program, there is simply no authority to support the State's argument that the costs associated with regulating those that are not required to pay can be foisted upon others that do not create that burden.

In support of its argument that those who impose an "insignificant social or economic burden" need not contribute to the cost of the program, the State cites *Sinclair Paint, supra*, 15 Cal.4th 866, and *CAPS, supra*, 79 Cal.App.4th 935. These cases are inapposite. In fact,

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Appeal also held that the SWRCB "did not provide any evidence to show the allocation of the actual cost of Division services provided" to water right holders who do not pay fees. (*Ibid.*) Nor was there any evidence of the actual costs of services provided to the United States Bureau of Reclamation. (*Ibid.*) Last, the Court of Appeal expressly recognized that the SWRCB offered no evidence to support such a fee. (*Id.* at p. 43.)

in neither of these cases does the court sanction charging fee payers for the burdens created by non-fee payers.

For example, the State argues that this Court, in *Sinclair Paint*, upheld fee statutes that provided for an exemption of "manufacturers whose products may be responsible for some cases of lead poisoning." (State's Merits Brief at p.21.) The State overstates the issue before this Court in *Sinclair Paint*. This Court explained, in *Sinclair Paint*, that:

> Sinclair, in moving for summary judgment, did not contend that the fees exceed the reasonable cost of providing the protective services for which the fees are charged, or that the fees were levied for unrelated revenue purposes. [citations] Moreover, Sinclair has not yet sought to establish that the amount of the fees bears no reasonable relationship to the social or economic "burdens" that Sinclair's operations generated. [citations] Sinclair does contend, however, that the Act is not *regulatory* in nature, being primarily aimed at producing revenue. (*Sinclair Paint, supra*, 15 Cal.4th at pp. 876-877, emphasis in original.)

Thus, the *only* issue in *Sinclair Paint* was whether the Childhood Lead Poisoning Prevention Act of 1991 was "regulatory." This Court found that it was regulatory, and that the charges at issue were valid regulatory fees, imposed as a "mitigating effects" measure to help mitigate or "clean up" poisonous lead. (*Sinclair Paint, supra*, 15 Cal.4th at p. 877.) While there was a recognized "exemption" for those not contributing to the problem of lead contamination, there is nothing in this Court's opinion that sanctions charging a sub-set of the regulated

community to pay the costs associated with the burdens caused by others. That is, in essence, the classical definition of taxation.

The State also argues that the *CAPS* court upheld a fee allocation that "exempted 68 percent of all projects from payment" of the challenged fees. (State's Merits Brief at p. 22.) The question before the court in *CAPS* was whether "a flat regulatory fee" was, "in legal effect a tax subject to the supermajority requirement of California Constitution, article XIII A." (*CAPS, supra,* 79 Cal.App.4th at p. 939.) The court did note that 68 percent of the projects at issue were found to have a "de minimis" impact on fish and wildlife and no fee was required. (*Id.* at p. 943.) This is far, however, from suggesting the costs associated with the work on those matters could be charged, under the guise of "regulatory fees," to others. Indeed, the court also noted that "$11 million had been collected in fees, but the cost of the reviews was in excess of $20 million." (*Id.* at p. 946.) Had the fee payers paid the entire $20+ million cost of the entire regulatory program, the result would have been quite different.

The State's reliance on *United Business Commission v. City of San Diego* (1979) 91 Cal.App.3d 156 ("*United Business*") is equally unavailing. First, *United Business* is not a case arising under article XIII A of the California Constitution, although the State suggests the court approved the fee scheme as not "violating Proposition 13."

(State's Merits Brief at p. 22.) The court noted that the challenged fees did not cover the cost of conducting the sign inspections, and that, where inspections were not made, fees were refunded. (*United Business, supra*, 91 Cal.App.3d at pp. 167-168.)[10]

In any event, those that are not required to pay the "fee" do not create a de minimis burden on the water right program. As the Court of Appeal noted, the SWRCB failed to provide any breakdown of costs or other evidence to demonstrate that the services and benefits provided to non-paying water right holders was de minimis and noted that it would be difficult to do, given the evidence in the record regarding the role of the Division with regard to other types of water rights. (Opinion at p. 41.)

It is also interesting, and perhaps ironic, that the State argues that water right holders not subject to the fees, who receive "protection" from the SWRCB, should not be required to pay a fee for that protection. (State's Merits Brief at p. 23.) Indeed, in its Merits Brief, the State suggests that the fact that some of the Division's regulatory effort is to "protect" water right holders is "*irrelevant.*" (State's Merits

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[10] The State, in passing, also cites to *Sea & Sage Audubon Society, Inc. v. Planning Commission of the City of Anaheim* (1983) 34 Cal.3d 412 ("*Sea & Sage*"). In that case, however, in the same footnote cited by the State, this Court noted that it had "no opinion as to the actual reasonableness or validity of the appeal fee at issue." (*Id.* at p. 422, fn. 5.)

Brief at p. 21, emphasis in original.) However, the State used this same "protection" of water rights logic in an attempt to justify charging existing water right holders the costs of processing new water right applications and petitions. (See, e.g., Respondent's Brief, filed on Jan. 6, 2006 before the Court of Appeal, at p. 18 ["remaining two thirds of [the Division's] time is spent on activities that protect existing right holders"]; p. 37 ["A substantial portion of the cost of processing applications and petitions is devoted to protecting other water right holders"]; p. 38 ["The Water Board's review of petitions ensures that [the petitioner's] activities . . . will not adversely affect third party water right holders . . . . Other permittees and licensees benefit from this petition review because it protects their rights from injury."]; p. 37 ["All of these activities . . . benefit permittees and licensees."].) The State cannot, on one hand, argue this "protection" justifies forcing existing water right permit and license holders, and CVP Contractors, to pay the cost of processing new applications, yet the same protection afforded other water right holders is "irrelevant." The State cannot have it both ways and, indeed, the Constitution demands more.

The State also argues that the costs associated with prosecuting illegal diverters (those without water rights) should be borne by existing water right holders because these actions force illegal diverters to file applications to obtain permits. (State's Merits Brief at p. 24.) The State

fails to produce any evidence that would suggest that existing fee payors create the need or "burden" for these activities. Instead the State turns its previous arguments on their heads and argues that existing fee payors "benefit" from these activities through some illusory reduction in burden on existing water right holders and should therefore bear all of the costs associated with these activities. (*Ibid.*) There is simply no evidence that the fees charged to any fee payors bear any relationship to the burdens on or benefits from the Division's "regulatory" activities.

c. The Court of Appeal Properly Identified the Nature of the Regulatory Activity

The State argues that all of the work the Division does with regard to water rights not subject to the annual fees is not truly "regulating," but is instead "evaluating" those rights in the context of other water right proceedings. (State's Merits Brief at pp. 24-25.) The State goes on to cite various statutes that require it to engage in activities regarding pre-1914 and riparian water rights, but which are "necessary for the regulation of persons subject to permits and licenses." (*Id.* at p. 25.)

Importantly, much of what the State cites involves activities related to processing new water right applications and petitions. As admitted by the State, and recognized by the Court of Appeal, those submitting new applications do not pay the costs associated with the

burden they create. (AA at pp. 1550:10–1555:20, 1557:11-20; Opinion at p. 40.) Instead, existing water right permit and license holders shoulder these costs. (*Ibid.*) There is no evidence and no support for the proposition that existing water right permit and license holders create any of the "need" for these activities. The Court of Appeal correctly determined that the fee scheme at issue "crossed the line," and that the State failed to meet its burden of demonstrating that the charges allocated to those paying the fees bore a fair or reasonable relationship to the burdens and benefits related to those fee payors. A revenue-raising scheme that targets a select few to pay the costs associated with a broader system of "regulation" cannot be said to fit within the narrow exception to Proposition 13.

III.

THE COURT OF APPEAL APPLIED THE CORRECT STANDARD OF REVIEW

The Court of Appeal conducted an independent review of the challenged statutes and regulations, noting that the question of whether the statutes and regulations violate the constitution is a question of law. (Opinion at p. 30.) The State argues that the Court of Appeal ignored the SWRCB's policy decisions, arguing the Court applied the incorrect standard of review. (State's Merits Brief at p. 27.) The State argues that the Court should have deferred to the SWRCB's policy

determinations in weighing the significant constitutional questions before it. (*Id.* at pp. 28-29.)

As this Court explained in *Sinclair Paint*, "[t]he cases agree that whether impositions are 'taxes' or 'fees' is a question of law for the appellate courts to decide on independent review of the facts." (*Sinclair Paint, supra*, 15 Cal.4th at 874, citing *Bixel Associates v. City of Los Angeles* (1989) 216 Cal.App.3d 1208, 1216; *California Bldg. Industry Assn. v. Governing Board* (1988) 206 Cal.App.3d 212, 234; *Russ Bldg. Partnership v. City and County of San Francisco* (1987) 199 Cal.App.3d 1496, 1504.)

As the court in *Bixel Associates* explained:

> '[T]he purpose of Proposition 13 being to impose a broad constitutional restriction on the power of local agencies to impose special taxes, subject to the limited statutory exception contained in Government Code section 50076, it rightfully follows that the local agency which seeks to avoid the general rule should have the burden of establishing that it fits the exception.' [Citing *Beaumont Investors v. Beaumont-Cherry Valley Water Dist.* (1983) 165 Cal.App.3d 227, 235, emphasis omitted.] . . . .
>
> The primary issues [the constitutionality of a fire hydrant "fee" under article XIII A of the California Constitution] in the case at bench were questions of law. . . . The interpretation and application of ordinances, like statutes, also raise primarily legal issues. These matters are peculiarly the province of an appellate court, which conducts independent review under these circumstances. As to the facts presented to the trial court on a summary judgment motion, an appellate court independently determines their effect as a matter of law. (*Bixel Associates v. City of Los Angeles, supra*, 216 Cal.App.3d at p. 1216.)

The State attempts to muddy the waters, by relying on cases wholly inapplicable to constitutional challenges arising under article XIII A, and by relying on cases passing upon the consistency of regulations with controlling statutes. The State's argument, however, does not change the "solemn duty of the courts to jealously guard and effectuate the initiative process, it being one of the most precious rights of our democratic process." (*Beaumont Investors v. Beaumont-Cherry Valley Water Dist., supra*, 165 Cal.App.3d at p. 235, citing *Amador Valley Joint Union High School Dist. v. State Bd. of Equalization* (1978) 22 Cal.3d 208, 248, internal citations omitted.) The State provides no compelling reason to deviate from well-established case law mandating an independent review when determining whether a charge is a "tax" or "fee" for the purposes of article XIII A of the California Constitution, or in determining whether a charge violates the Supremacy Clause of the United States Constitution.

A. The SWRCB's Factual Determinations and Policy Considerations Do Not Change the Burden of Proof in Passing Upon the Constitutionality of the Challenged Statutes and Regulations

The State argues that, where a party makes a facial challenge to a rulemaking decision, judicial review is limited to determining whether there was an "abuse of discretion." (State's Merit Brief at p. 28.) The crux of the State's argument is that, to the extent the SWRCB made the

policy determination that the water right program "primarily regulates state permits and licenses," that determination can only be reviewed for abuse of discretion. (State's Merits Brief at pp. 29-30.) At the same time, however, Respondents recognize that whether a regulation is consistent with the Constitution is ultimately a question of law and that issues of law are subject to the "independent judgment" standard of review. (State's Merits Brief at p. 33.)

Most of the cases cited by the State arise in the context of an agency's interpretation of a statute for which the particular agency has been granted authority by the Legislature. The others are equally distinguishable from the instant case. For example, *San Francisco Fire Fighters Local 798 v. City and County of San Francisco* (2006) 38 Cal.4th 654 involved a challenge to a provision in City Charter requiring disputes between City and Firefighter unions to be submitted to binding arbitration after bargaining to impasse. *Western States Petroleum Assn. v. Superior Ct.* (1995) 9 Cal.4th 559 involved evidentiary questions arising in the context of the California Environmental Quality Act. In *Pulaski v. California Occupational Safety and Health Bd.* (1999) 75 Cal.App.4th 1315, the question was whether defendant had complied with the APA in adopting regulations. In *California Hotel and Motel Assn. v. Industrial Welfare Com.* (1979) 25 Cal.3d 200, the question was whether a defendant's "Order" was

properly adopted within the meaning of the applicable statute. In each of these cases, the issue was whether the agency's action was permissible under the scope of the controlling statute. In these circumstances, courts provide a certain amount of deference to the agencies' actions.

The same circumstances, however, are not present in the instant action. Here, the question is whether the statutes and regulations were adopted in violation of the California and United States Constitutions. The question is a pure question of law and no amount of agency discretion or deference can cure the constitutional deficiency. In that regard, the cases relied upon by the State are inapposite.

A court exercises its independent review in determining whether regulations comport with constitutional limitations. (See *20th Century Ins. Co. v. Garamendi* (1994) 8 Cal.4th 216, 271-272 ("*Garamendi*") ["[w]hether the . . . regulations actually adopted, including the incorporated generic determinations, are consistent with Proposition 103[11]--and with the law generally--is also examined independently."]; accord *Sinclair Paint, supra*, 15 Cal.4th at p. 874 ["[t]he cases agree that whether impositions are 'taxes' or 'fees' is a question of law for

[11] Proposition 103 added, among other things, Insurance Code sections 12900, 1861.01, and 1861.05. (*Garamendi, supra*, 8 Cal.4th at p. 242.)

the appellate courts to decide on independent review of the facts." (Citations omitted.)].)

B. The Proper Standard of Review Is the Independent Review

Section II.C. of the State's Merits Brief continues on the same path, arguing that the SWRCB's policy determinations, regarding the allocation of costs, should be left within the agency's discretion. The State argues that the constitutional issues are of no import and should not change the discretion sometimes afforded agencies when engaged in discretionary rulemaking within the ambit of a statute.

The cases relied upon by the State under this new permutation of the State's argument are equally unavailing. For example, the State cites *Wallace Berrie & Co. v. State Bd. of Equalization* (1985) 40 Cal.3d 60, which involved the legality of a regulation adopted pursuant to a delegation of legislative power. (*Id.* at p. 65.) *Shapell Industries, Inc. v. Governing Bd.* (1991) 1 Cal.App.4th 218 addressed the question of a resolution adopted pursuant to legislative authority granted by

Government Code sections 53080 and 65995.[12] (*Shapell, supra,* at p. 231.) The common theme running through these cases is, again, whether the challenged actions were consistent with the enabling legislation. (See *Aerospace Corp. v. State Bd. of Equalization* (1990) 218 Cal.App.3d 1300, 1310-1311 [whether regulation was consistent with statute]; *General Business Systems, Inc. v. State Bd. of Equalization* (1984) 162 Cal.App.3d 50, 54-55 [whether regulation was consistent with statute]; *Henry's Restaurants of Pomona, Inc. v. State Bd. of Equalization* (1973) 30 Cal.App.3d 1009, 1020 [whether regulation was consistent with controlling statute]; *Yamaha Corp. of America v. State Bd. of Equalization* (1998) 19 Cal.4th 1, 7-8 [court defer to agency action where agency is interpreting a statute under which it is authorized to act].)

The State's reliance on *Garamendi* is equally misplaced. There, the question was whether regulations adopted by the Insurance Commissioner were consistent with the *statutes* created by Proposition

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[12] It is, perhaps, worth noting that the court, in *Shapell*, cautioned that, even where the agency's rulemaking occurs within the confines of a grant of legislative authority, an agency's action is not immune from judicial review. As the court explained, and as is particularly relevant here, "[i]f courts shun evidentiary review as beyond their province, the reasonableness of the agency's action is relegated to the agencies themselves, whose primary interest is in financing their own projects." (*Shapell, supra*, 1 Cal.App.4th at p. 232.)

103. This Court has previously considered the constitutionality of those statutes in *Calfarm Ins. Co. v. Deukmejian* (1989) 48 Cal.3d 805. In *Garamendi*, the question was whether the regulations adopted by the Insurance Commissioner were "necessary and proper" for the implementation of the underlying statutes. (*Garamendi, supra*, 8 Cal.4th at p. 279, fn. 13.) Whether regulations adopted are necessary and proper for the implementation of a statute is scrutinized for arbitrariness and/or capriciousness. (*Garamendi, supra*, 8 Cal.4th at p. 272.) That is not the issue here. "If by contrast, the inquiry requires critical consideration, in a factual context, of legal principles and their underlying value, the question is predominately legal and its determination is reviewed independently." (*Id.* at p. 271, quoting *Crocker National Bank v. City and County of San Francisco* (1989) 49 Cal.3d 881, 888.) The latter is the situation in the instant case.

Arguing that courts should defer to agency "expertise" in matters arising under the Federal and State Constitutions is nothing less than an attempt to usurp the power of the Court to determine the constitutionality of legislative enactments and agency regulations. The fallacy of this argument is epitomized by considering the State's disagreement with the Court of Appeal's decision disapproving the regulations' subsidization of new applications through fees imposed on existing water right holders. (See, e.g., Respondents' Petition for

Rehearing at p. 7.) Accepting the State's argument, had this otherwise unconstitutional scheme been mandated by statute, the Court of Appeal could have properly exercised its independent judgment and invalidated the statute. However, because the otherwise unconstitutional scheme was developed based upon "agency expertise," this Court should defer to that "expertise" and *then* apply its independent judgment. Thus, what is otherwise unconstitutional is inexplicably transformed into a valid scheme through "agency expertise." An argument of this sort would allow the rule of independent review to be swallowed up by the arbitrary and capricious exception. (Cf. *Garamendi, supra*, 8 Cal.4th at p. 279, fn. 13.)

> '... Administrative regulations that violate acts of the Legislature are void and *no protestations that they are merely an exercise of administrative discretion can sanctify them.*' Acknowledging that the interpretation of a statute by one charged with its administration was entitled to great weight, we nonetheless affirmed: 'Whatever the force of administrative construction . . . final responsibility for the interpretation of the law rests with the courts. [Citations.] Administrative regulations that alter or amend the statute or enlarge or impair its scope are void and courts not only may, but it is their obligation to [,] strike down such regulations.' (*Ontario Community Foundation, Inc. v. State Bd. of Equalization* (1984) 35 Cal.3d 811, 816-817, citations omitted, emphasis added.)

Respondents' argument, which would hamstring this Court and cause it to accept all of an agency's findings and "policy determinations" as valid, turns the concept of an "independent review"

completely on its head. Nevertheless, even if the "arbitrary and capricious" standard applied to the regulations at issue, the regulations would still fail. As the Court of Appeal noted throughout its decision, the SWRCB offered little or no evidence to support its unconstitutional allocation of fees.[13] Indeed, and as the Court of Appeal further noted, given the evidence actually in the record, it would be "difficult" for the SWRCB to establish a post-hoc rationalization of the otherwise unlawful scheme. (Opinion at p. 41.) Simply put, the Court of Appeal applied the proper standard of review, properly framed the nature of the challenge to the regulations, and properly determined that the State completely failed to meet its burden.

[13] For example, the Court of Appeal noted that the SWRCB offered "no breakdown of cost or other evidence to demonstrate that the services and benefits provided to non-paying water rights holders was de minimis." (Opinion at p. 41.) The Court of Appeal then found that the State's justification for apportioning fees based upon the size of the diversion was "without factual support." (*Id.* at p. 42.) The Court of Appeal also held that the SWRCB "did not provide any evidence to show the allocation of the actual cost of Division services provided" to water right holder who do not pay fees. (*Ibid.*) Nor was there any evidence of the actual costs of services provided to the United States Bureau of Reclamation. (*Ibid.*) Last, the Court of Appeal expressly recognized that the SWRCB offered no evidence to support such a fee. (*Id.* at p. 43.)

IV.

THE REGULATIONS VIOLATE THE SUPREMACY CLAUSE

The State acknowledges that the Court of Appeal held that the fee regulations violate the Supremacy Clause because they require "the federal contractors to pay for the entire amount of fees that would otherwise be imposed on the Bureau." (State's Merits Brief at p. 37.) The State spends the next ten pages of its Merits Brief discussing federal law and the nature of the Central Valley Project but it never refutes the holding of the Court of Appeal or the fact that under the challenged fee regulations the federal contractors pay for the entire amount of the fees that are imposed on the United States. In fact, the SWRCB essentially admits that the *entire* federal fee is "allocated" to the contractors (State's Merits Brief at pp. 43-47) and uses its Merits Brief to attempt to justify that "allocation" by claiming (without *any* support in the record, relevant statutory provisions, or relevant case law) that all of the federal water rights benefit only the federal contractors. In making this claim the SWRCB ignores the fact that much of the federally permitted water benefits the environment, non-water contractor power users, and other federal interests such as navigation and flood control, even to the deprivation of any water to the federal contractors. The SWRCB's analysis of the federal issues in this case exhibits, at best, a profound misunderstanding of the federal law.

A. California Code of Regulations title 23 section 1073 Violates Federal Law

The State claims that Water Code section 1540 allows the SWRCB to "allocate the fee or an appropriate portion of the fee or expense" to contractors. (State's Merits Brief at p. 38.) Here, of course, the entire federal fee (and not a "portion of the fee") is allocated to the federal contractors. By allocating the entire fee, and not an "appropriate portion of the fee" as permitted by the statute, the regulation runs afoul of the Supremacy Clause. (*U.S. v. County of Fresno* (1977) 429 U.S. 452 ("*Fresno County*"); *United States v. Nye County, supra*, 938 F.2d 1040; *United States v. Hawkins County* (6th Cir. 1988) 859 F.2d 20.)

The State rhetorically asks why the federal contractors should not pay their proper share of the fees? (State's Merits Brief at p. 38.) The question, as posed by the State, among other things, ignores the fact that, as mere contractors for water owned by the United States, federal contractors already pay a "proper share" for the water they receive, as is mandated in each Reclamation contract. These payments include the cost of capital repayment of the CVP and operational and maintenance costs. Included within operational and maintenance costs are all costs associated with contract administration, which would include any fees

paid to the SWRCB.[14] That the United States refuses to pass payments made by the federal contractors on to the SWRCB is beyond the ability of the federal contractors to control. Moreover, the question, as posed by the State, begs the very question that might properly be posed in light of the Court of Appeal's decision: Whether, even under the State's analysis, federal contractors are being asked to pay only their "proper share." The answer to that more proper question is, without question, "no." Where, as here, the regulations, by their literal terms, simply allocate the entire federal fee to contractors who use only a small portion of the water under federal permits, those regulations violate the Supremacy Clause.

The State asserts that "the allocation of fees to the federal contractors *ensures* that they receive similar treatment as other contractors, such as state water contractors. (State's Merits Brief at p. 38, emphasis added.) The sole support for this allegation is a citation to AA at page 2443, which itself is a statement without any support or evidence in the record that the SWRCB determined that State Water Project fees will be passed through to state water contractors. There is no indication in the record of how this determination was made:

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[14] (See CVP Form Contracts at http://www.usbr.gov/mp/cvpia/lt_contracts/index.html.)

whether contractual provisions allowed the pass through; what proportion of the State Water Project fees would be passed through; whether the state contractors would be paying $0.37 or $0.03 for each acre-foot contracted for, etc. In short, there is no basis in the record that *"ensures"* that the federal contractors have received similar treatment to contractors with the State Water Project contractors.

The State also claims that the fee is not levied on the federal government or any federal instrumentality and that the fees are not imposed on the property of the United States. (State's Merits Brief at p. 39, heading to subsection A on that page, and p. 42.) In fact, however, the plain language of the statute imposes the fee on the United States. "Each person or entity *who holds a permit or license to appropriate water* . . . shall pay an annual fee according to a fee schedule adopted by the Board." (Wat. Code, § 1525(a), emphasis added.) "The fees and expenses established under this chapter [including Water Code section 1525] apply to the United States . . . to the extent authorized under federal . . . law." (Wat. Code, § 1560(a).)[15] The fees are imposed on the United States because it holds the permits and licenses to appropriate water. The Court of Appeal concluded that

[15] Obviously if not authorized by federal law, there can be no fee. (See NCWA Petitioners' Opening Brief at p. 44.)

the usufructuary nature of water rights transformed the right into something other than real property. However, the law is that despite the fact that a user of water does not own the corpus of the water, the *right* to the water is itself a real property right:

> Although there is no private property right in the corpus of the water while flowing in the stream, *the right to its use is classified as real property*. [Citations omitted.] The concept of an appropriative water right *is a real property interest* incidental and appurtenant to land. [Citations omitted.] (*Fullerton v. State Water Resources Control Board* (1979) 90 Cal.App.3d 590, 598, emphasis added.)

The State's position that no fee is imposed on the federal government or its property[16] simply ignores the plain language of the statute and hornbook California water law.

The statutory scheme does provide that if the federal government is likely to decline to pay the fee the SWRCB may do a number of things, one of which is to *"allocate"* the fee or expense or an *appropriate portion* in accordance with section 1540. (If the "entity on whom a fee or expense is imposed will not pay the fee or expense based on the fact that the *fee payer* has sovereign immunity . . . the board may *allocate* the fee or expense, or an *appropriate portion* of the fee or expense, to persons or entities who have contracts for the delivery of

[16] See NCWA Petitioners' Opening Brief at pages 21-27 for a complete discussion of the case law as to why the statute by its terms imposes the fee on the United States and its property.

water from the person or *entity on whom the fee or expense was initially imposed.*" (Wat. Code, § 1540, emphasis added.)) Thus, the statutory scheme, without question, *"imposed"* the fees on the federal government as holder of its water right permits and licenses – its real property – and then the SWRCB regulations *allocated* all of the federal fees to the contractors. In this regard, no fee is *imposed* directly on the federal contractors and, in any event, no apportionment of the *appropriate portion* of the *allocated* fees is ever made by the regulations.

Moreover, to claim that *Fresno County* supports the *allocation* of fees to the contractors is to not only ignore the plain language of the statute, which does not allocate costs, but also ignores the fact that the regulations also fail to *allocate* an *appropriate portion* of the entire fee that the statute imposes on the United States. In short, the facts at issue here are not the same as those in *Fresno County*, and the theory of *Fresno County* consequently has no application here.

While the *Fresno County* line of cases allows the statute to *tax* a user of federal property on its possessory interest in the federal property, no case has allowed *all* of the tax imposed on federal property to be *allocated* to non-federal entities with but a limited interest in only a *portion* of the property. The fact that the water right is held by the United States, far from being "irrelevant" (State's Merits Brief at p. 41),

provides the only possible nexus for the imposition of a fee on the federal contractors.

Moreover, the SWRCB completely ignores the fact that what is at issue here is a regulatory "fee," not a "tax." The SWRCB cites no authority at all for the proposition that a regulatory fee imposed on the United States for the use of water can be imposed on the non-regulated federal contractors. Indeed, the only law at all touching on this issue is that the United States itself is just as immune from "fees" as it is from "taxes." (*United States v. Anderson Cottonwood Irrigation Dist.* (N.D.Cal. 1937) 19 F.Supp. 740.)

B. The Central Valley Project Serves Many Disparate Purposes Not Represented by Federal Contractors

The SWRCB attempts to justify the allocation of the entire federal fee to contractors that use less than 5% of the permitted diversions by claiming without citation that "need for and benefits of the entire regulatory programs may be attributed to either the water right holder or the contractor." (State's Merits Brief at p. 43.) This statement ignores federal law which requires state taxes on a federal contractor to be based only upon the contractors' use of or possessory interest in the federal property. (*United States v. Nye County, supra*, 938 F.2d 1040; see also Opinion at pp. 49-51 and 47-49.) Again, no cases endorse the notion that a regulatory fee imposed on the United States can be

allocated, all or part, on federal contractors. Additionally, there is no federal decision that allows allocation of regulatory fess based upon a benefit/burden analysis. The Court of Appeal's analysis on this issue is not refuted by the State's arguments.

Moreover, the claim that the fees are justified because the federal contractors are the "primary purpose" for the federal water supply projects is simply wrong.

It has long been noted by the courts and argued by the SWRCB itself that the primary purpose of the CVP is not for water contractors but, rather, for "river regulation," which includes flood control, navigation and water quality protection. (See *United States v. State Water Resources Control Board, supra*, 182 Cal.App.3d at pp. 91-99.) Moreover, the United States has asserted to the SWRCB, and the SWRCB has agreed, that no federal contractor is entitled to a fixed supply of CVP water every year and that Congress has, in fact, directed that the very water that is subject to the regulatory fees in this case be used for other purposes, including for the primary purposes noted above, as well as for uses associated with fish and wildlife protection. Indeed, the courts have indicated that the federal contractors have no right to water allocated to fish and wildlife under the Central Valley Project Improvement Act. (See *State Water Resources Control Board Cases, supra*, 136 Cal.App.4th at pp. 804, 806; see also *O'Neill v.*

United States (9th Cir. 1995) 50 F.3d 677.) For the State to ignore this long history and its own long stated position that the federal contractors are *not* the primary beneficiaries of CVP water is inexcusable.

C. The SWRCB's "Proportional Share" Argument Ignores the Supremacy Clause

The State attempts to explain at length the method it used to allocate fees to the federal contractors. (State's Merits Brief at pp. 45-58.) This discussion obfuscates the underlying fact that the *entire* fee chargeable to federal permits is allocated, one way or another, to the federal contractors. No attempt whatsoever is made by the regulations to segregate and tax (or "fee") any possessory interest the federal contractors may have in the federal permits or the federal contractors' beneficial use of the permits. Under any proper application of the Supremacy Clause this failure dooms the fee regulations, as the Court of Appeal determined. No amount of obfuscation or post hoc justification can save these regulations from the noted constitutional violations. To the extent the State can allocate a "fee" to federal contractors, the Court of Appeal's analysis (Opinion at pp. 43-50) of this issue is correct and should be affirmed.

V.

CONCLUSION

For the foregoing reasons, this Court should affirm the Court of Appeal's decision to the extent it held the SWRCB's regulations were unconstitutional and invalid.

Respectfully submitted,

SOMACH, SIMMONS & DUNN
A Professional Corporation

DATED: July 10, 2007

By _____
Robert B. Hoffman

Attorneys for Petitioners
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WORD COUNT CERTIFICATION

(California Rules of Court, Rule 28.1(d))

The text of NCWA Petitioners' Opening Brief consists of 10,359 words according to the "word count" feature of the Word processing program utilized in creating this document.

SOMACH, SIMMONS & DUNN
A Professional Corporation

Dated: July 10, 2007

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PROOF OF SERVICE

I am employed in the County of Sacramento; my business address is 813 Sixth Street, Third Floor, Sacramento, California; I am over the age of 18 years and not a party to the foregoing action.

On July 10, 2007, I served the following document(s):

NCWA PETITIONERS' ANSWER TO STATE'S MERITS BRIEF

_X_ (by mail) on all parties in said action, in accordance with Code of Civil Procedure §1013a(3), by placing a true copy thereof enclosed in a sealed envelope in a designated area for outgoing mail, addressed as set forth below. At Somach, Simmons & Dunn, mail placed in that designated area is given the correct amount of postage and is deposited that same day, in the ordinary course of business, in a United States mailbox in the City of Sacramento, California.

_____ Via facsimile transmission.

_____ (by overnight delivery) on all parties in said action, by placing a true copy thereof enclosed in a sealed envelope in a designated area for outgoing, same-day pickup by Federal Express at the offices of Somach, Simmons & Dunn for overnight delivery, billed to Somach, Simmons & Dunn, and addressed as set forth below.

SEE ATTACHED SERVICE LIST

I declare under penalty of perjury that the foregoing is true and correct under the laws of the State of California. Executed on July 10, 2007, at Sacramento, California.

Susan Bentley

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