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

STATE'S ANSWER BRIEF ON THE MERITS TO BRIEF OF NORTHERN CALIFORNIA WATER ASSOCIATION

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ANSWER BRIEF ON THE MERITS

Under California Rules of Court, Rule 8.520, the California State Board of Equalization (BOE) and the California State Water Resources Control Board (SWRCB) (SWRCB and BOE, collectively, the State) submit the following Answer to the Northern California Water Association (NCWA) Petitioners' Opening Brief on the Merits.

ISSUES PRESENTED

NCWA states the issues as follows:

1. Whether Water Code section 1525 et seq., requiring adoption of regulations establishing a regulatory fee structure to fund the State Water Resources Control Board's (SWRCB) Division of Water Rights, is unconstitutional for the following reasons:

a. the statutory scheme does not permit the adoption of regulations that can meet constitutional requirements;

b. water rights are real property rights and, therefore, the statutory scheme results in imposition of an unconstitutional non-ad valorem [sic] tax on real property;

c. the statutory scheme permits imposition of an unlawful tax on the United States; and

d. the statutory scheme creates new federal law by permitting the pass-through of a regulatory fee imposed on the United States to contractors with the United States.

2. Whether the State has provided sufficient evidence to demonstrate that a minimum $100 fee bears a fair or reasonable relationship to the fee payer's burdens on or benefits from the regulatory activity.

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 only about half of the water right program's funding (although the fees may be used to pay for virtually all of the water right program's activities). (Appellants' Appendix ("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. (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 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

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[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.

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

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 based on 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 SWRCB 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 may 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

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[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.

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 provide 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 [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]; Appendix 2242:20-24 [explanatory testimony]; Administrative Record 2.)

To ensure that it collected no less than the amount set by the Budget Act, the SWRCB estimated the risk of non-collection, an administrative cost. For the first year of fee collection, the SWRCB conservatively assumed a 60 percent rate of collection based on staff's experience with return rates on required filings, initial resistance to the fees, and the accuracy of the billings. (Appendix 2304.)

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.

Water Code section 1525 is constitutional.

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 Co. v. State Bd. of Equalization* (1997) 15 Cal.4th 866, 878 (*Sinclair Paint*), quoting *San Diego Gas & Electric Co. v. San Diego County Air*

Pollution Control Dist. (1988) 203 Cal.App.3d 1132, 1146 (*SDG&E*).)

As explained in the State's other briefs, the SWRCB can validly allocate the majority of its water right regulatory costs to permitted and licensed water right holders because *it spends most of its time regulating the water rights that are made subject to the annual permit and license fees* by Water Code section 1525, subdivision (a). (Appendix 2298 [SWRCB spends only a de minimus amount of its time regulating other types of water rights that are not subject to the annual fees].)

A. Proposition 13 does not elevate the standard of review or alter the burden of proof.

NCWA describes regulatory fees as a judicially-created "exception to Proposition 13's stringent limitations on government exactions. . . .the so-called 'regulatory fee.'" (NCWA, p. 9.) Regulatory fees are not an "exception" to Proposition 13; rather, they further its purpose of general tax relief, by shifting the cost of regulation off the backs of the general public and onto the regulated entities. (*Sinclair Paint, supra,* 15 Cal.4th at p. 879.) Regulatory fees are not inventions of the courts to circumvent Proposition 13.

Proposition 13's requirement of a supermajority to pass new tax legislation does not also require a standard of review for fee legislation that is stricter or more stringent than for other economic regulation. The SWRCB bears the burden of proof only to the extent of providing an adequate rulemaking record for the court to determine whether the SWRCB's factual findings were arbitrary and capricious. For example, in *Beaumont Investors v. Beaumont-Cherry Valley Water Dist.* (1985) 165 Cal.App.3d 227, the court stated that local water district should bear the "burden of proof" as to whether a fee for

water hook-ups on new construction had been reasonably allocated. (*Id.*, 165 Cal.App.3d at pp. 235-236.) But the circumstances of the case were that the court had been provided with an insufficient record to understand the basis for the allocation. (*Id.*, 165 Cal.App.3d at pp. 236-237.) Thus, the impact of the court's holding was merely to require the agency to provide a sufficient record to explain its decision. To the extent that *Beaumont* stands for any broader shifting of the burden of proof, it has been limited to the context of development fees and otherwise questioned. (See, e.g., *Knox v. City of Orland* (1993) 4 Cal.4th 132, 147; *Brydon v. East Bay Municipal Utility Dist.* (1994) 24 Cal.App.4th 178, 191.)

Other decisions regarding fees have repeated *Beaumont*'s general statement that the government bears the burden of proof. (See, e.g., *California Assoc. of Professional Scientists v. Department of Fish and Game* (2000) 79 Cal.App.4th 935, 945 [allocation method was set entirely by statute, rather than by a regulation supported by a rulemaking record] (*CAPS*).) At most, these decisions should be construed to mean that the government should bear the burden of proof regarding facts that may be within the government's own special knowledge.

B. The nature of the property right at issue begs the question of whether the water right fees are valid regulatory fees.

NCWA claims that the water right fees are "taxes levied on the mere ownership of real property." (NCWA, p. 10.) Unless the fees are levied for unrelated revenue purposes, and without connection to regulatory activities, this argument entirely begs the question of whether the water right fees are valid regulatory fees. (See NCWA, p. 10.)

NCWA asserts that permits and licenses authorizing the diversion and use of water rights are real property, and on that basis, are different from permits to carry on a particular business activity, such as a building permit, a business license, an air pollution credit, or an activity that was legal but later found to be particularly harmful and costly to mitigate. (NCWA, p. 23.) NCWA does not explain, however, how that fact would distinguish the water right fees from other regulatory fees. NCWA necessarily assumes either 1) water right permit and licenses do not require regulation, or 2) because persons who divert and use water further the state's purposes through their reasonable and beneficial use, they should not be charged for the regulation that is necessary to ensure that they *are* diverting and using water in the most reasonable and beneficial manner. (See NCWA, p. 14.) Both assumptions are incorrect.

1. The water right program is a classic regulatory program.

The water right program is a classic regulatory program. NCWA does not explain how a permit to divert or use the *state's* water – in accordance with the terms and conditions provided by the permit or license and subject to the SWRCB's ongoing oversight – is different from carrying on any other regulated activity. NCWA claims that, unlike the per-rental unit fee imposed on landlords in *Pennell v. City of San Jose* (1986) 42 Cal.3d 365, which was imposed on the business activity of renting apartments, the water right fees are imposed solely because one holds the permit or license. (NCWA, p. 26.) This claim ignores the purpose of the fees in *Pennell*.

The fees in *Pennell* were not imposed for the privilege of carrying on the business of renting apartments. They were imposed, like the water right fees, to pay for

the cost of regulating the business. For NCWA's argument to hold water, the water right fees must be imposed simply for the privilege of holding the water right, and not to pay for the cost of regulating the diversion and use of water subject to permit and license.

2. Federal law is of no assistance to the analysis.

Federal law is of no assistance in determining whether a fee is an invalid tax under Proposition 13. Federal courts rely on criteria that vary substantially depending on the legal context (e.g., whether a charge is a tax in the context of the bankruptcy statutes, the Tax Injunction Act, etc.). (*Bidart Bros. v. California Apple Com.* (9th Cir. 1996) 73 F.3d 925, 929-930.) Different definitions of "tax" apply because the purposes of the law differ: "the bankruptcy laws' goal of equitably distributing the assets of a debtor has little to do with the protection of state budgets from an interruption in the flow of state revenues. . . ." (*Id.* at p. 930.) In contrast to the bankruptcy laws, the goals of the Tax Injunction Act lead the courts to distinguish between an assessment that "if enjoined would threaten the flow of central revenues of state governments" and one that is "not so critical to general state functions." (*Ibid.*)

Besides being highly subjective, this criterion is not the test for a Proposition 13 "tax." Is funding for the Department of Health Services' Childhood Lead Poisoning Prevention Program "not so critical"? Is funding for the regulation of landfill dumps "not so critical"? (Compare *Indiana Waste Systems, Inc. v. County of Porter* (N.D.Ind. 1992) 787 F.Supp. 859, 865 [fees on waste disposed in landfill are taxes in the context of the Tax Injunction Act because they are assessed on an annual basis and used to

further the proper administration of landfills] with *Kern County Farm Bureau v. County of Kern* (1993) 19 Cal.App.4th 1416 [annual land use fees supporting county's operation of landfill, including waste management planning and recycling efforts, are not taxes within the meaning of Proposition 13].)

3. Proposition 13 does not prohibit charging fees for important government activities.

NCWA asserts that some government activities simply must – somehow – be different, otherwise "all government activity would . . . elude Proposition 13." (NCWA, p. 28.) Proposition 13 case law does not distinguish between "core" governmental activities the way NCWA claims federal law does. (NCWA, p. 29.)

Over a quarter of a century ago, the California courts rejected the "public versus individual primary purpose test" as unworkable in a Proposition 13 analysis. (*Mills v. County of Trinity* (1980) 108 Cal.App.3d 656, 661.) Whether water right fees support an important ("core") state regulatory program is irrelevant because the Legislature – *in furtherance of Proposition 13's goal of tax relief* – may shift the cost of regulation off the back of the tax-paying public and onto members of the regulated community. (*Sinclair Paint, supra,* 15 Cal.4th at p. 879.)

Most of the "core" regulatory activities that NCWA lists in support of its argument (or activities very similar to them) could be supported by valid fees in California. (NCWA, p. 29.) For example, fees on developers to pay for increased costs on the local educational system (*Shapell Industries, Inc. v. Governing Bd.* (1991) 1 Cal.App. 4th 218); fees for processing zoning applications, etc. (*Mills v. County of*

Trinity, supra, 108 Cal.App.3d at pp. 661-663); charges for water (*Brydon v. East Bay Mun. Utility Dist.* (1994) 24 Cal.App.4th 178, 192-194 [approving an inclined rate structure for water customers as a valid regulatory fee]); and health care for lead-poisoned children (*Sinclair Paint*). They might not meet a federal test for a fee, however, because "[f]ederal courrts are not bound by the characterization given to a state tax by state courts." (*Novato Fire Protection District v. United States* (9th Cir.1999) 181 F.3d 1135, 1138.)

Many different kinds of commercial activities or public services may be considered good, if not essential, but nothing prevents the state from charging fees to regulate these activities. It is not public policy to discourage people from becoming doctors or lawyers or entering other regulated professions, but the state may still charge fees to regulate those who hold licenses to practice these professions.

NCWA quotes federal case law for the proposition that "[V]irtually all of what are now considered taxes could be transmitted into [regulatory] fees by the simple expedient of dividing what are generally known as taxes into constituent parts, e.g., a police fee." (NCWA, pp. 28-29 citing *Novato Fire Protection District, supra,* 181 F.3d at p. 1139.) But the fees at issue in *Novato Fire Protection District* were not regulatory fees. They were charges for fire and emergency medical protection, based on the value of the property, and the issue was whether those charges could be imposed on the federal government, not whether they were subject to a state law requirement for a two-thirds vote. (*Ibid.*)

Both regulatory fees and service charges *are* fees enacted pursuant to the state's police power. (*Sinclair Paint, supra,* 15 Cal.4th at p. 875 [regulatory fees imposed under the state's police power].) Of course, for many government activities, relying on fee revenues as the primary source of funding may not be seen as practical or consistent with social policy.

4. For purposes of a Proposition 13 analysis, the most important characteristic of a state-permitted or licensed water right is the pervasiveness of the regulation to which it is subjected.

For reasons that are unclear, NCWA spends a lot of time trying to prove that water rights are real property rights. For purposes of the issues presented, however, the most important characteristic of a state-permitted or licensed water right is the pervasiveness of the regulation to which it is subjected.

Water rights are a unique type of property. A water right permit or license does not confer an unconditional right to appropriate a specific quantity of water (i.e., the "face value") for the holder's own consumptive use. That is not the law in California and has not been for over 100 years. In California, water rights are and "have been the subject of pervasive regulation." (*People v. Weaver* (1983) 147 Cal.App.3d Supp. 23, 30.)

Water rights are highly qualified, subject to numerous inherent limitations that restrict the holder's ability to divert, use and store water for its own purposes. Unlike real property rights, water rights are, by their very nature, "limited and uncertain." (*People v. Murrison* (2002) 101 Cal.App.4th 349, 359.) The requirements of California water law limit the nature, scope and exercise of the permitted or licensed water right,

requiring the holder to exercise its water right at all times in a manner which is reasonable and in the public interest, taking into consideration other reasonable and beneficial uses of the water supply and public trust uses.

Water rights are not possessory interests, but rather are solely usufructuary. (*Eddy v. Simpson* (1853) 3 Cal. 249, 252.) "The right of property in water . . . consists not so much of the fluid itself as the advantage of its use." (*Ibid.*) A right may be acquired to its use . . . but . . . this right carries with it no specific property in the water itself." (*Kidd v. Laird* (1860) 15 Cal. 162, 180.) The legal principle that water cannot be privately owned is codified: "Nothing in [the Water Code] shall be construed as giving or confirming any right, title, or interest to or in the corpus of any water." (Wat. Code, § 1001.) Water is owned and controlled by the people of the State of California. (Wat. Code, § 102.) While a water right holder has the right to take and use the water, it does not own the water and cannot waste it. (*Central and West Basin Water Replenishment Dist. v. Southern California Water Co.* (2003) 109 Cal.App.4th 891, 905.)

Water is not static like land; water is constantly shifting, and the supply changes every day. What is a reasonable use, method of use or method of diversion of water "depends upon the circumstances of each case," and "cannot be resolved *in vacuo* isolated from statewide considerations of transcendent importance," including the paramount "ever increasing need for the conservation of water in this state." (*Joslin v. Marin Municipal Water Dist.* (1967) 67 Cal.2d 132, 140; accord, *Environmental Defense Fund, Inc. v. East Bay Municipal Utility Dist.* (1980) 26 Cal.3d 183, 194 [what

constitutes reasonable use "varies as the current situation changes"]; *Peabody v. City of Vallejo* (1935) 2 Cal.2d 351, 368 [what constitutes a waste or a reasonable use "depends upon the circumstances of each case and the time when waste is required to be prevented"].) Consequently, a use of water that was once reasonable may subsequently become unreasonable due to changed circumstances and their effects on other water users or the environment. (E.g., *Town of Antioch v. Williams Irrig. Dist.* (1922) 188 Cal. 451 [point of diversion became unreasonable because of new demands for consumptive uses of water]; *Imperial Irrig. Dist. v. State Water Resources Control Bd.* (1986) 186 Cal.App.3d 1160 [exercise of appropriative water rights deemed unreasonable in light of flooding caused by wasteful water delivery and irrigation practices].)

There is *no property right* in an unreasonable use of water, and a water user can never obtain a vested right to use water in a manner inconsistent with Article X, section 2 of the California Constitution. (*Joerger v. Pacific Gas & Elec. Co.* (1929) 207 Cal. 8, 22; accord, *In re Waters of Long Valley Creek* (1979) 25 Cal.3d 339, 348, fn. 3; *Allegretti v. County of Imperial* (2006) 138 Cal.App.4th 1261, 1279 [all holding no protectable property interest or vested property right in an unreasonable use of water].)

The public trust doctrine also imposes a significant limitation on water rights in California. The public trust doctrine applies to all of the state's tidelands and navigable waters and lands underlying those waters. (*Eldridge v. Cowell* (1854) 4 Cal. 80, 87.) Originally, the doctrine applied to protect the public's right to use the state's tidelands and navigable waterways for commerce, navigation and fishing; more recent decisions

also recognize the doctrine's inclusion of the public's right to use sovereign lands and waters for hunting, fishing, bathing, swimming, boating, and general recreational purposes, as well as to preserve trust lands and waters in their natural state. (*Marks v. Whitney* (1971) 6 Cal.3d 251, 259-260.)

In *National Audubon Society v. Superior Court* (1983) 33 Cal.3d 419, this Court held that the public trust doctrine applies directly to state appropriative water rights. The SWRCB has a continuing duty to seek an accommodation between competing interests and "to preserve, so far as is consistent with the public interest, the uses protected by the trust." (*Id.* at p. 447.) California water law promotes efficiency, not the maximum exploitation of water resources. In arguing the latter, NCWA ignores the last half century of water law and the irrefutable fact that water resources are in short supply. The law places greater emphasis on conservation and efficiency, and modifying project operations to reduce environmental impacts.

C. The State has shown the estimated cost of the regulatory program.

NCWA claims "the State has acknowledged" that it cannot demonstrate the estimated cost of the regulatory program. (NCWA, p. 38.) The State has done no such thing. NCWA misrepresents the State's discussion in its Petition for Rehearing of the Court of Appeal's assumption of nonexistent evidence and its misconstruction of the statute. The State observed, in both its Petition for Rehearing to the Court of Appeal and its Petition for Review, no fee system could pass the test created by the Court of Appeal.

As the State has already explained in its briefs, the Legislature sets the cost of the water right program in the Budget Act and determines how much of the program will be supported by the Water Rights Fund. (Wat. Code, § 1525, subd. (c) and (d)(3).) The Budget Act provides that the program is funded in part by an appropriation from the Water Rights Fund (the fund into which the fee revenues are deposited) and the SWRCB must set fees in the amount necessary to support that appropriation. (See Wat. Code, § 1551.) The State has shown the estimated cost of the regulatory program.

D. The annual fees are part of a fee schedule that reasonably allocates the cost of the water right program.

1. It is reasonable to allocate most of the water right program costs to permit and license holders because the water right program is primarily a permit and license regulatory program.

As explained in the State's other briefs, the SWRCB can validly allocate the majority of its water right regulatory costs to permitted and licensed water right holders because *it spends most of its time regulating the water rights that are made subject to the annual permit and license fees* by Water Code section 1525, subdivision (a). (Appendix 2298 [SWRCB spends only a de minimus amount of its time regulating other types of water rights that are not subject to the annual fees].) The State has always construed the Water Code section 1525, subdivision (c) to set forth the activities that essentially amount to the entire water rights program, and for the statute to set the fees to recover a lesser amount based on that portion of the program funded through the Budget Act appropriation from the Water Right Fund. It is and has been the State's position that both Water Code section 1525 and the implementing regulations are valid

because the SWRCB could validly impose most of the cost of water right regulation on the permitted and licensed water right holders through the annual permit and license fees, should the Legislature so direct through the budget appropriation.

2. The annual fees bear a reasonable relationship to the payor's burden on the regulatory activities.

The annual fees are reasonably related to the regulatory activities they support. 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, *CAPS, supra,* 79 Cal.App.4th at pp. 949-950.)

As explained in the State's other briefs, even if the Water Rights Fund were the sole source of revenue for the water right program, the annual fees would not bear the entire cost of the regulatory program. Filing fees, penalties, 401 certification fees, expenses of adjudication and court references collected during the year are also deposited in the Water Rights Fund with the annual fees. (Wat. Code, § 1551; Appendix 2304-2305.)

True, "the annual fees are used to spread the cost of a wide variety" of regulatory activities, all primarily related to the maintenance of the permit and license system. (NCWA, p. 39.) But that fact does not, by itself, mean that the fees are imposed "without regard to the burden imposed by, or benefit conferred upon, any fee payor or class of fee payor." (*Ibid.*) Numerous cases have recognized that a regulatory program does not lend itself to a "fee-for-service" format and have permitted annual or flat fees. (E.g., *In re Attorney Discipline System* (1998) 19 Cal.4th 582 [flat fee on all attorneys to

support State Bar disciplinary program]; *CAPS, supra,* 79 Cal.App.4th at p. 950 [regulatory fees are not easily correlated to specific, ascertainable costs]; *SDG&E, supra,* 203 Cal.App.3d at p. 1146 [allocation of cost of air quality regulation based on emissions fairly relates to permit holder's burden on the programs].)

The State has already dealt with NCWA's allegations that the SWRCB did not take into account the "actual costs associated with any of its activities" and did not consider the costs related to other types of water rights in developing the fee schedule. (See *supra,* discussion in the Statement of the reasons for the fee regulations; State's Opening Brief on the Merits, p. 18 et seq.; State's Answer to Farm Bureau's Opening Brief, p. 14 et seq.) The State will not repeat the discussion here.

E. The regulations, consistent with Water Code sections 1525, 1540, and 1560, validly impose the fees on the federal contractors.

1. The mere association of the fee with federal property does not violate the Supremacy Clause.

NCWA contends that because the fee cannot be imposed on the United States, it is void, and there is "no fee to be allocated to the federal contractors." (NCWA, p. 44.) This contention is similar to the argument that the fees are invalid property taxes because they are associated with a property right. The mere association of the water right fee with the United States' property does not cause the fee to violate the Supremacy Clause, and no state or federal case supports the proposition.

As explained in the State's Opening Brief, 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.)

2. The permits and licenses held by the federal government for the CVP are for the purpose of water delivery, *not* navigation, flood control, or a fish and wildlife enhancement project.

The State has already addressed the validity of the federal contractors' fees in detail in its Opening Brief on the Merits, pp. 37-48. California Code of Regulations, title 23, section 1073, consistent with Water Code Sections 1525, 1540, and 1560, validly imposes the fees associated with the permits and licenses held by the federal government for the purpose of water delivery on the federal contractors who hold the contractual right to the water developed under those permits and licenses.

NCWA contends, however, that much of the water at issue is devoted to activities associated with navigation and flood control. (NCWA, pp. 14-15.) Not one acre foot of the face value of CVP permits and licenses is devoted to such activities. The SWRCB declines to issue permits for these purposes, having concluded no permit is required for navigation or flood control. (SWRCB Decision 858 (1956) at p. 49; SWRCB Decision 935 (1959) p. 64; SWRCB Decision 990 (1961) p. 41; and SWRCB Decision 1100 (1962) pp. 14-15, all to be found at <<http://www.waterrights.ca.gov/hearings/Decisions.htm>>.) NCWA did not argue that the CVP's main purpose lies elsewhere than in delivering water to the contractors in its petition for reconsideration. (Administrative Record, 2450 et seq.; *id.*, 2464-2467.) Otherwise, the SWRCB might have addressed this issue in its order denying the petition. (See Appendix 297-357

[order denying petition].)

NCWA maintains, however, that it is "undisputed" that only 6.6 million acre feet of the 110 million acre-feet face value of the Bureau's permits and licenses are under contract for water deliveries, suggesting that the main purpose of the CVP lies elsewhere. (NCWA, pp. 16-17.) However, NCWA's citations to the record do not support its claim that the rest of the "water diverted and stored pursuant to these permits and licenses is used by the USBR for hydroelectric, fish and wildlife and other purposes." (NCWA, p. 17; see Appendix, p. 1545:10-12 [deposition testimony of Division Chief stating that the contractors associated with a particular water delivery project pay "for all of the water rights associated with that project"]; p. 1595 [SWRCB issue paper discussing and rejecting alternative fee formulas]; p. 1701 [discussing and rejecting claims similar to NCWA's, explaining that all permits and licenses are subject to inherent operational restrictions like flood control and environmental bypass flows]; p. 1720.02 [objections to interrogatory]; see p. 1720.03 [stating face value of Bureau's permits and licenses].) The CVP was not built as a fish and wildlife enhancement project.

3. Section 1525 imposes fees only to the extent authorized by law.

NCWA's claim that Water Code section 1525 is unconstitutional on its face because it provides for the imposition of an annual fee on everyone who holds a water right permit or license is simplistic and deficient. (NCWA, p. 42.) First, it is unclear why the contractors (described as "third parties" by NCWA) are paying the annual fees if the fees are actually "imposed" on the United States. (NCWA, p. 41.) The United

States is not before this Court claiming any violation of the Supremacy Clause. Second, the claim ignores Water Code Section 1560, providing that "the fees and expenses established under this chapter . . . apply to the United States" only "to the extent authorized under federal . . . law." (Wat. Code, § 1560, subd. (a).)

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) 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. 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. United States* (1983) 460 U.S. 536, 543, fn. 8.)

A fee may be imposed on federal contractors' beneficial *use* of the United States' water rights equivalent to the cost of the regulation that makes that use possible. The fact that the water right is held by the United States, rather than the contractors, is irrelevant. The federal employees living in federally-owned houses on federal property in *County of Fresno* did not need to own the houses for the pass through of the state tax to be valid. (*United States v. County of Fresno* (1977) 429 U.S. 452, 466 (*County of Fresno*).) The tax could be imposed on the basis of the contractors' *use*: "The use by the contractor of federal property for his own private ends – in connection with commercial activities carried on for profit – is a separate and distinct taxable activity." (*TRW Space and Defense Sector* (1996) 50 Cal.App.4th 1703, 1711 citing *United States*

v. Boyd (1964) 378 U.S. 39, 44; accord, *United States v. Nye County Nevada* (9th Cir. 1991) 938 F.2d 1040, 1042 [noting 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]; *United States 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].)

Nye, unlike this case, involved a federal contractor who was doing the business of the federal government; i.e., a federal instrumentality. As explained already, the federal government did not contract with the federal water supply contractors to carry out the business of the federal government. (State's Opening Brief on the Merits, pp. 44-45.)

The water right regulatory fees are imposed based on the cost of the regulation that makes possible the water deliveries to which the contractors are entitled. As the federal 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.

4. The federal contractors are not "third parties" having no relationship to the activities of the water right program.

The federal water projects have developed water for the use and benefit of the water contractors, and their use requires the existence of the water right regulatory program. The contractors are not regulated directly by the SWRCB except under unusual circumstances. But the contractors may only divert or use water as authorized

by the Bureau's permits or licenses. (Wat. Code, § 1225.) The contractors are "legal users" of water, responsible for putting the projects' water to beneficial use. (*State Water Resources Control Bd. Cases* (2006) 136 Cal.App.4th 674, 797-806.) Without their beneficial use of the water, the appropriator would have no right to take the water. (*Id.* at p. 804.) Finally, if the contractors divert or use water in a manner that is not authorized by the permits or licenses, the SWRCB may take enforcement action against them. (Wat. Code, § 1052.)

5. The fee law does not discriminate against the federal government.

It is untrue that Water Code sections 1540 and 1560 discriminate against the federal government. They apply to any entity that could claim sovereign immunity from the fees, that is, they allow the fees to be allocated to both federal contractors and those who contract with Indian tribes. Without this allocation, the fees would discriminate in favor of the federal contractors. Entities that contract with non-federal water right holders pay fees indirectly. But entities that contract with federal water right holders would pay no fees at all, directly or indirectly.

II.

The record supports the fee schedule's use of a minimum fee.

The Court of Appeal did not hold that the State failed to provide "any evidence of the cost of the regulatory program." (NCWA, p. 49.) It stated that the SWRCB "did not offer evidence of the actual cost of billing the annual fees." (Slip op., p. 43.)

Moreover, the SWRCB did not need to offer evidence of "the actual cost of billing the annual fees" to support the fee allocation. (*In re Attorney Discipline System*

(1998) 19 Cal.4th 582 [flat fee on all attorneys to support State Bar disciplinary program]; *CAPS, supra,* 79 Cal.App.4th at p. 950 [regulatory fees are not easily correlated to specific, ascertainable costs]; *SDG&E, supra,* 203 Cal.App.3d at p. 1146 [allocation of cost of air quality regulation based on emissions fairly relates to permit holder's burden on the programs].) As explained already in the Statement and other briefs, the SWRCB developed its fee structure after considerable review and careful consideration of many different options. It decided against collecting actual costs (Appendix 2423), and 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 actually used or delivered. (Appendix 2438, 2453.) 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.)

CONCLUSION

In short, the Court should uphold the constitutionality of the statutes and find the regulations to be valid.

Dated: July 11, 2007

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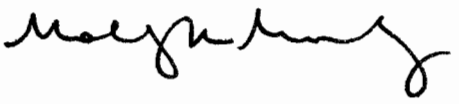

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CERTIFICATION OF WORD COUNT

The text of the State's Answer to NCWA Petitioners' Opening Brief consists of 8,528 words according to the wordprocessing program used to prepare the brief.

Dated: July 11, 2007

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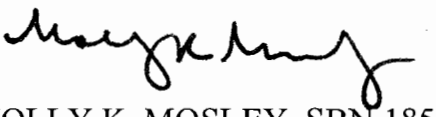

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DECLARATION OF SERVICE BY U.S. MAIL

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 July 11, 2007, I served the attached **STATE'S ANSWER BRIEF ON THE MERITS TO BRIEF OF NORTHERN CALIFORNIA WATER ASSOCIATION** 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:

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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 July 11, 2007, at Sacramento, California.

D. Burgess
Declarant

D. Burgess
Signature

Brief #2 pos.wpd