Case No. S150518

IN THE
SUPREME COURT OF CALIFORNIA

CALIFORNIA FARM BUREAU FEDERATION ET AL.,

Plaintiffs and Appellants,

v.

CALIFORNIA STATE WATER RESOURCES CONTROL BOARD ET AL.,

Defendants and Respondents.

After A Decision By The Court Of Appeal,
Third Appellate District, Case No. C050289

Sacramento County Superior Court
The Honorable Raymond M. Cadei
Case No. 03CS01776 consolidated with Case No. 04CS00473

ANSWER BRIEF ON THE MERITS OF CALIFORNIA FARM BUREAU FEDERATION ET AL.

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Plaintiffs and Appellants California Farm Bureau Federation et al. ("Farm Bureau") respectfully file this Answer Brief On The Merits in response to the Respondents' Brief On The Merits filed by Defendants and Respondents California State Water Resources Control Board et al. ("Respondents").

INTRODUCTION

The Court of Appeal correctly held that Water Code section 1525's[1] implementing Emergency Regulations violate Proposition 13. Respondents purport to appeal only this portion of the court's opinion, contending also that the Court of Appeal applied the wrong standard of review. But Respondents' arguments also apply to the validity of section 1525 on its face, and, when properly analyzed, confirm that that *neither* section 1525 *nor* its implementing regulations pass constitutional muster.

1. The "fees" mandated by section 1525 and the Emergency Regulations do not meet the test of a valid regulatory fee set forth in *Sinclair*.

Subdivision (a) of section 1525 requires the State Water Re-

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[1] All statutory references hereafter are to the Water Code.

sources Control Board (hereafter SWRCB) to impose an "annual fee" on each person or entity who holds a permit or license to divert water and on each lessor of water under a water lease. "On its face, section 1525, subdivision (c) is very broad, and includes essentially *all* water right regulatory activities. The activities listed under subdivision (c) of section 1525 *necessarily* include actions taken against other types of water right holders to protect permittees and licensees, and vice versa." (Respondents' Petition for Rehearing, p. 16.)

Respondents thus concede that subdivision (c) of section 1525 requires that the "fee" schedule generate "fees" in an amount necessary to "recover [the] costs incurred" in performing *all* the activities of the Division of Water Rights (hereafter DWR), including extensive work for the general public and for water rights holders who are not required to hold permits or licenses (cumulatively accounting for more than two-thirds of appropriated water in the State). Accordingly, if this Court finds that the costs of the burdens imposed and benefits received by the general public and non-permitted and non-licensed water right holders were improperly imposed upon "fee" payors, then this Court should not only affirm the unconstitutionality of the Emergency Regulations, but declare section 1525 unconstitu-

tional on its face as well.

Respondents devote much of their Opening Brief to arguing that, because the SWRCB does not have the same regulatory authority over non-permitted and non-licensed water right holders that it has over permitted and licensed water right holders, the annual "fees" justifiably are borne by the class of permit and license holders subject to the "fees." But this conclusion simply does not follow from the premise.

The Court of Appeal properly noted the substantial Water Rights Program benefits and burdens associated with non-permitted and non-licensed water right holders: "'Of the total water beneficially used, 30 percent or more may be held by [non-permitted and non-licensed water right holders (including holders of riparian, pre-1914 appropriative, and pueblo water rights) who are not subject to fees]. Nonetheless, such users receive benefits from the Water Rights Program in terms of complaint resolution, protection of existing rights, and on occasion, adjudication of present rights . . .'"—the costs of which are funded by the annual "fee" payors. (See *California Farm Bureau Federation et al. v. California State Water Resources Control Board*, No. C050289 (January 17, 2007) (hereafter slip opn.), p. 40.)

As a result and as the Court of Appeal properly found, the "fees" paid cannot possibly correlate to the benefits purportedly received or burdens created by the class of water right holders subject to the "fees," and Respondents thus cannot meet their burden under *Sinclair* to prove that the "'charges allocated to a payor [bear] a fair or reasonable relationship to the payor's burdens on or benefits from the regulatory activity.'" (Slip opn., p. 40, quoting *Sinclair Paint v. State Bd. of Equalization* (1997) 15 Cal.4th 866, 878 (hereafter *Sinclair*).)

Respondents rely heavily upon a "factual" assertion they make *for the very first time in this Court*: That permitted and licensed water right holders purportedly impose 95 percent of the "burden" upon the Water Rights Program, and thus that the costs of the program are properly allocated to permitted and licensed water right holders. But this eleventh-hour assertion directly contradicts both the evidence cited by Respondents and the undisputed facts that the Court of Appeal correctly identified:

(a) "'Approximately *30 percent* of the appropriated water in California is held by the federal government, which refuses to pay [regulatory] fees,'" and thus the "fees" of the annual "fee" payors were *inflated by 40 percent* to cover the costs of those who refuse to

pay the "fees," claiming sovereign immunity or otherwise (slip opn., p. 40, italics added; see also *id.* at p. 23);

(b) An estimated "*one-third* of [the DWR's work] is for the benefit of the general public to protect the public trust and the environment"—all of which is funded by the annual "fee" payors (slip opn., p. 40, italics added);

(c) "[T]he SWRCB collected only 10 percent of [the] cost [of one-time services] in one-time service fees" even though about *60 percent* of the DWR's costs are associated with one-time services, and "the SWRCB admits that the holders of water rights representing 40 percent of California's water [who] were assessed the annual fee subsidized" the remaining costs (slip opn., p. 40.)

Each of these facts contradicts Respondents' newfound justification for the "fees"—and each alone is enough to render the "fees" paid unconstitutionally disproportionate to the burdens imposed or benefits received by "fee" payors within the meaning of *Sinclair*.

In sum, neither section 1525 nor the Emergency Regulations impose valid regulatory fees under this Court's holding in *Sinclair*, and the Court therefore should affirm that the "fees" challenged in this suit are illegal taxes in violation of Proposition 13.

2. **The Court of Appeal applied the appropriate standard of review.** In *Sinclair*, this Court unequivocally held that whether a levy is a tax in violation of Proposition 13 is a "question of law for the appellate courts to decide on independent review of the facts." (*Sinclair*, *supra*, 15 Cal.4th at p. 874.) Here, the Court of Appeal followed this Court's guidance and appropriately held that "the question whether the annual fees imposed under section 1525, subdivision (a) are unconstitutional and the emergency regulations invalid are questions of law subject to our independent review." (Slip opn., p. 30.) The Court of Appeal also properly rejected Respondents' argument that a more deferential standard of review should apply: "Contrary to the SWRCB's suggestion, plaintiffs do not argue that the agency overstepped its quasi-legislative, rule-making authority under section 1525. Thus, the deferential standard applied to the review of quasi-legislative actions by ordinary mandamus . . . is inapplicable here." (*Ibid.*, citation omitted.)

Respondents nonetheless insist that the Court of Appeal erred by not reviewing what Respondents characterize as the SWRCB's "factual determinations and policy considerations" under a more deferential "arbitrary and capricious" or "abuse of discretion" standard of

review. (Respondent's Opening Brief on the Merits ("ROBM"), at pp. 27–28.) Respondents are clearly wrong. The Court of Appeal did not, in fact, reach its decision that the "fees" are illegal by disregarding any purported "factual determinations" or "policy considerations" by which Respondents sought to justify the "fees." Rather, the court properly based its conclusion that the "fees" are illegal on the undisputed evidence that "fee" payors paid for substantial costs associated with others not subject to the "fees." (Slip opn., pp. 39–40.) That is to say, the Court of Appeal properly reviewed independently the legal question of the whether the SWRCB's factual determinations and policy considerations *resulted in* levies violating Proposition 13.

In sum, the Court of Appeal properly applied an independent standard of review here, and this Court should reject Respondents' assertion to the contrary. Regardless, based on the undisputed evidence submitted, the levies are unconstitutional by any standard.

STATEMENT OF THE CASE

The Farm Bureau set forth the Statement of the Case in full in its Opening Brief on the Merits and incorporates it herein by reference, as repeating it would be duplicative here.

DISCUSSION

I. Section 1525 And The Emergency Regulations Do Not Impose A Valid "Regulatory Fee" Under The Test Set Forth In *Sinclair*.

As this Court stated in *Sinclair*, a levy is a valid regulatory fee and not a special tax where the "'fees do not exceed the reasonable cost of providing services necessary to the activity for which the fee is charged and [they] are not levied for unrelated revenue purposes.'" (*Sinclair*, 15 Cal.4th at p. 876, quoting *Pennell v. City of San Jose* (1986) 42 Cal.3d 365, 375; accord *San Diego Gas & Elec. Co. v. San Diego County Air Pollution Control Dist.* (1988) 203 Cal.App.3d 1132, 1145–1146 (hereafter *SDG&E*).) In contrast, "[i]n general, taxes are imposed for revenue purposes, rather than in return for a specific benefit conferred or privilege granted." (*Sinclair*, 15 Cal.4th at p. 874.)

This Court further explained in *Sinclair* that in order "'to show a fee is a regulatory fee and not a special tax, the government should prove (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*, 15 Cal.4th at p. 878, quoting *SDG&E*, *supra*, 203 Cal.App.3d at p. 1146.) Respondents have failed to meet this burden.

A. The Annual "Fees" Do Not Bear A Reasonable Relationship To The Burdens Or Benefits Of The Annual "Fee" Payors.

Respondents admit that section 1525 authorizes the SWRCB[2] to impose "fees" on permitted and licensed water right holders based on all costs incurred by the SWRCB in performing the activities described in section 1525, subdivision (c)—which "represent virtually all water right program activities." (ROBM, p. 19.) This is an important admission because, as Respondents themselves have pointed out, "[t]he activities listed under subdivision (c) of section 1525 *necessar-*

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[2] Respondents' Brief on the Merits treats the DWR and the SWRCB as though they are one and the same. In fact, they are separate. The SWRCB is tasked with exercising the "adjudicatory and regulatory functions of the state in the field of water resources," in the interest of providing "the orderly and efficient administration of the water resources of the state." (§ 174.) The DWR is a division of the SWRCB. (§ 186, subd. (b).) It is the agency tasked with administering the State's Water Rights Program (slip opn., p. 5), which establishes and maintains a system of water rights to protect vested rights, water quality, and the environment. In any event, for simplicity's sake, the Farm Bureau likewise refers to the SWRCB and the DWR as the "SWRCB" in this Answer Brief.

ily" include substantial activities performed on behalf of those who do not pay the annual "fees," including the general public and non-permitted and non-licensed water right holders. (See, e.g., Respondents' Petition for Rehearing at p. 16, italics added.)

Clearly, section 1525 mandates that permitted and licensed water right holders pay for essentially all of the costs imposed by the general public and non-permitted and non-licensed water right holders. Thus, Respondents make the centerpiece of their Opening Brief the assertion that these costs properly are allocated to permit and license holders because, supposedly, "regulation of [permit and license holders] claims roughly 95 percent of the SWRCB's water right program expenditures." (ROBM, p. 20; see also *id.*, pp. 3, 19.) But Respondents never made this argument before the trial court or the Court of Appeal, and it is utterly unsupported by the record. In fact, it directly *contradicts* the record, including *Respondents'* own admissions.

In support of their 95% figure, Respondents point only to one sentence in one memo written *months after* the Farm Bureau challenged the legality of the "fees" by filing this lawsuit. Furthermore, when read completely and in context, the memo simply does not say what Respondents now claim—that regulation of permittees and li-

censees accounts for 95 percent of the costs of the Water Rights Program.

The SWRCB wrote the memo in response to a letter from Assemblymember Joseph Canciamella, which asked, inter alia: "What portion of [Water Rights] program costs currently consist of stranded costs?" (10 AA2297.) Presumably, and as the SWRCB apparently assumed, "stranded costs" refers to those costs that are not recoverable from those to whom they are attributable. In response to this question, the SWRCB answered that, *among other costs*:

> Approximately one-third of water rights exercised in California are held by parties whose diversions are not governed by water right permits and licenses, for example, riparian and pre-1914 water right holders. [section 1525] does not authorize the SWRCB to impose fees on riparian or pre-1914 water right holders. However, the latter parties do indeed benefit from the water right program because the program protects third party water right holders from injury that might otherwise result from the activities of parties who apply for water right permits or hold permits and licenses administered by the SWRCB. The Division estimates it spends approximately five percent of its resources protecting the water rights of parties who hold rights not subject to permit or license. These resources are expended the areas of application/petition processing and in investigation of complaints.

(10 AA2298.) This statement is less than a model of clarity, and must be parsed to determine what it says, and what it does not say.

The memo says that the SWRCB spends approximately five percent of its resources protecting non-permitted and non-licensed water right holders "in the areas of application/petition processing and in investigation of complaints." (10 AA2298.) It does *not* say that this is the *only* activity undertaken by the SWRCB on behalf of non-permitted and non-licensed water right holders. As discussed *infra*, Respondents admit, and the law requires, that the SWRCB undertake substantial other activities on behalf of these water right holders.

More important, however, the memo does *not* say that the remaining 95 percent of the SWRCB's resources are spent "regulating" the class of permit and license holders who pay the "fees." Nor would such a statement make any sense because *on the very same page* the SWRCB lays out a detailed discussion of the fact that "the SWRCB is expending about *one-third of its resources* for public interest or public trust purposes." (10 AA2298, italics added.)

Furthermore, in the same paragraph, the SWRCB states that it expends resources protecting non-permitted and non-licensed water right holders from "the activities of parties who apply for water right permits"—that is, *individual members of the general public*—not the class of already-permitted and licensed water right holders subject to

the "fees." (10 AA2298.) And, in the next paragraph, the SWRCB identifies additional "stranded costs"—costs imposed by water right holders who might refuse to pay the "fees" claiming sovereign immunity or otherwise, and which Respondents admit the SWRCB charged to "fee" payors by inflating their "fees" by 40 percent. (10 AA2299.)

In other words, Respondents' eleventh-hour assertion that 95 percent of their costs are attributable to permitted and licensed water right holders is not supported by, and directly contradicts, the undisputed evidence in the record that the SWRCB does substantial work on behalf of the public and other water right holders who do not pay "fees." Respondents' last-ditch rationalization for the "fees" thus does not save them.

1. Respondents' Assertion Ignores The Significant Work The SWRCB Does On Behalf Of The General Public And In The Interest Of Preserving The Public Trust.

Respondents' assertion that the annual fees are properly borne by annual "fee" payors because they purportedly impose 95 percent of the costs on the Water Rights Program ignores their admission that at least *33 percent* of the work of the SWRCB is done for the benefit of the general public and in the interest of preserving the public trust.

(10 AA2298.) Such costs are not properly allocated to permitted and licensed water right holders because, as the Court of Appeal properly found, the "polluter pays" rationale has no application here. (Slip opn., p. 42.) Moreover, members of the public can receive any number of services from the SWRCB without paying a fee. (5 AA959–962, 964; 10 AA2299.)

a. At Least 33 Percent Of The Work Of The Water Rights Program Is For The Benefit Of The General Public And In The Interest Of Preserving The Public Trust.

Respondents admit that at least 33 percent of the work of the SWRCB is done for the benefit of the general public and in the interest of preserving the public trust. (4 AA903–904 ["about one-third overall" of SWRCB's work "is on behalf of the public trust"], 912–913 ["approximately one-third of the Division's time is spent for the purpose of protecting the environment and the public interest"], 917–918 ["defendants admit that the general public benefits substantially from the activities of the DWR"].)

Respondents nonetheless assert that the costs of work done on behalf of the public are properly allocated to permitted and licensed water right holders because this Court purportedly held in *Sinclair* that "[s]hifting the burden of taxation off the back of the general public

and onto the regulated community furthers Proposition 13's goal of tax relief." (ROBM, pp. 20–21, citing *Sinclair*, 15 Cal.4th at p. 879.) This is an overstatement of the holding in *Sinclair*, in which this Court stated:

> As the court observed in *SDG&E*, "Proposition 13's goal of providing effective property tax relief is not subverted by the increase in fees or the emissions-based apportionment formula. A reasonable way to achieve Proposition 13's goal of tax relief is to shift the costs of controlling stationary sources of pollution from the tax-paying public to the pollution-causing industries themselves . . . ." [Citation.] In our view, the shifting of costs of providing evaluation, screening, and medically necessary follow-up services for potential child victims of lead poisoning from the public *to those persons deemed responsible* for that poisoning is likewise a reasonable police power decision.

(*Sinclair*, *supra*, 15 Cal.4th at p. 879, second italics added.) In other words, the reasoning of this Court in *Sinclair* (and the court in *SDG&E*) was that where a societal ill was imposed upon the public, those who were responsible for it should have to pay for its mitigation rather than taxpayers. This does not mean that those who are regulated by a particular agency should have to pay for all of that agency's costs—especially where they are not responsible for much of those costs.

Respondents here attempt to analogize to the "polluter pays ra-

tionale," which allows the shifting of costs of regulation to polluters, rather than the general public, if the fees are apportioned so that polluters bear economic responsibility for their contribution to pollution and the fees offer an incentive to reduce pollution. The Court of Appeal properly found that the "polluter pays" rationale has no application here. (Slip opn., pp. 42–43.)

For example, *SDG&E*, relied upon in *Sinclair* and in which the "polluter pays" rationale was applicable, is readily distinguishable. (*SDG&E*, *supra*, 203 Cal.App.3d 1132.) There, a utility company challenged an air pollution control district's method of apportioning the actual costs of operating its permit programs that were "not reasonably identifiable with specific industrial polluters . . . among all monitored polluters according to a formula based on the amount of emissions discharged by a stationary pollution source." (*Id.* at p. 1135.) Under that fee program, costs that were susceptible of "labor tracking" were billed directly to the particular fee schedule to which they were attributable, while indirect costs were distributed among polluters by basing the annual fees on the average pollution generated by a facility within a specific industry. (*Id.* at pp. 1135–1136.) As a result of this fee structure, the Court noted, "*the emissions-based*

schedule does not charge a permit holder for work on another's permit." (*Id.* at p. 1144, italics added.)

Here, those costs that the SWRCB admits are susceptible of labor tracking, such as processing applications or petitions, are not billed even in substantial *part* to those to whom the costs are attributable. (3 AA646–652; 4 AA663.) Instead, the fees to support those activities were set artificially low, and the remainder of those costs are shouldered by the annual "fee" payors. (4 AA748–752.) As such, unlike in *SDG&E* where the fee structure was designed to *avoid* imposing costs attributable to others on fee payors, here the "fee" structure was designed to do precisely that.

Furthermore, the court in *SDG&E* observed, "[t]he purpose for the district's existence is to achieve and maintain air quality standards," and thus the emissions-based fee system was reasonable given that it "would provide an incentive to large polluters to reduce existing emissions to reduce fees." (*SDG&E*, *supra*, 203 Cal.App.3d. at p. 1147.) The court noted that the Legislative Analyst's Office advocated an emissions-based system because it would "impose[] a portion of the cost to control pollution on its sources and provide[] an incentive for emissions reduction." (*Id.* at pp. 1138–1139.)

Likewise, this Court in *Sinclair* also held that "the Act imposed bona fide regulatory fees, not taxes," because it required those "whose products have exposed children to lead contamination to bear a fair share of the cost of mitigating the adverse health effects their products created in the community." (*Sinclair*, *supra*, 15 Cal.4th at pp. 870, 877–879.) The "police power," this Court explained, "is broad enough to include mandatory remedial measures to mitigate the . . . adverse impact of the fee payer's operations, at least where, as here, the measure requires a causal connection or nexus between the product and its adverse effects." (*Id.* at pp. 877–78.) The Court reasoned that such fees "'regulate[]' future conduct by deterring further manufacture, distribution, or sale of dangerous products." (*Id.* at p. 877.)

Here, no such "incentives" are in play. The SWRCB's purpose is not to discourage "fee" payors' right to use water. Rather, as the SWRCB admits, it is "required by law" to "ensure that water is put to its fullest beneficial use." (9 AA2042.) Indeed, as the Court of Appeal recognized, the SWRCB enforces the constitutional mandate that "'the general welfare requires that the water resources of the State be put to beneficial use to the fullest extent of which they are capable . . . in the interest of the people and for the public welfare . . . .'" (Slip

opn., pp. 4–5, quoting Cal. Const. art. X, § 2.) Section 100 likewise mandates that "the water resources of the State be put to beneficial use to the fullest extent of which they are capable."

Given the mandate of the SWRCB, as well as the plain fact that many water right holders treat and deliver drinking water to the population of California and irrigate the crops that provide both food and economic strength to this State, the position that the "fee" schedule here is intended to offer an incentive to water right holders to reduce the amount of water diverted, or to "mitigate" their negative effects, is simply untenable and unsupported. Moreover, there is no connection between the "fee" payors' behavior and the "fees" assessed—the "fees" do not decrease if they waste (or even use) less water, nor do these "fees" increase if they waste or use more.

Moreover, as the Court of Appeal recognized, the "polluter pays" rationale also is inapplicable here because no evidence exists that the "fees" are allocated in a way that apportions responsibility for burdens imposed on the regulatory system. (See slip opn., pp. 42–43.) In both *Sinclair* and *SDG&E*, the logic underlying the fee scheme was that polluters would bear their "fair share" of the costs of burdens on the program. (See *Sinclair*, *supra*, 15 Cal.4th at pp. 878–79.) In con-

trast, here, as discussed in detail *supra*, the annual "fees" have been apportioned to one class of water right holders, i.e., permitted and licensed water right holders, which pays for essentially *all* of the burdens caused by and benefits accorded to all classes of water right holders and the general public who do not pay "fees." (5 AA1118, 1121–1124.) The Court of Appeal thus properly rejected Respondents' argument that the "polluter pays" rationale "justifies" the apportionment of "fees" here. (See slip opn., p. 42.)

b. Members Of The Public Impose Independent Burdens Upon The Water Rights Program, The Costs Of Which Are Inappropriately Borne By Permitted And Licensed Water Right Holders Subject To The "Fees."

Contrary to Respondents' suggestion, the public does not simply receive benefits either incidentally or secondarily as a result of "regulation" of permitted and licensed water right holders. (See ROBM, pp. 22–23, 25–26.) Rather, members of the general public impose their own independent burdens on, and receive substantial independent benefits from, the Water Rights Program. Indeed, as the chief of the DWR, Victoria Whitney, explained in her deposition, any member of the public, as well as any water right holder under any basis of right, receives any number of services from the SWRCB with-

out paying a fee:

> They don't pay a fee when they file a protest against somebody's application. They don't pay a fee when they file a complaint against somebody. They don't pay a fee when they file a statement of water diversion and use claiming a pre-[19]14 or riparian right. They don't . . . pay a fee when they call us and ask us questions. They don't pay a fee, other than a copying fee, of I think 15 cents a page when they make public information act requests. They don't pay for the staff time involved in making that request. They don't pay a fee when they participate in hearings or file documents associated with a hearing.

(5 AA960–964.)

Nor are these various tasks even necessarily related to permit and license holders such that the SWRCB could justify imposing such costs on them. Applications can be filed by any member of the public—not just by any member of the existing class of permit and license holders. Complaints may be filed against any member of the public illegally diverting water and against non-permitted or non-licensed water right holders. "Statements of water diversion and use claiming a pre-1914 or riparian right" are filed by non-permitted and non-licensed water right holders. Public information act requests and hearings can be related to any number of issues stemming from the acts both of the general public and non-permitted or non-licensed water right holders.

In other words, much of the costs imposed by members of the public are not even associated with permitted and licensed water right holders subject to the fees. Thus, the "fees" paid by permitted and licensed water right holders to fund such costs necessarily bear no reasonable relationship to the burdens of or benefits to "fee" payors.

2. Respondents' Position Ignores That The SWRCB Inflated "Fees" By 40 Percent To Account For Those Who Were Not Required To Pay Or Who Might Refuse To Pay "Fees."

Respondents' assertion that the annual "fees" are properly borne by the "fee" payors because they purportedly impose 95 percent of the costs on the Water Rights Program also ignores the SWRCB's admission that it grossly inflated "fees" to account for those who were not required to pay or otherwise might refuse to pay them. Indeed, as the Court of Appeal properly noted, the SWRCB assumed that *40 percent* of the "fees" would not be collected from water right holders who claim sovereign immunity or who violate the law by not paying their bills. (See slip opn., p. 23; 3 AA505.) The Court of Appeal further noted that the SWRCB admits that it simply increased the "target revenue" for the remaining "fee" payors to "account for" those who would not pay. (See *id.*, p. 23; 3 AA643.01–644.)

This had the effect of charging "fee" payors the *entire* cost of the benefits accorded to and burdens created by those who were not required to pay or refused to pay the "fees" based on sovereign immunity or otherwise. (Slip opn., p. 23.) Because the "fees" to be collected from the annual "fee" payors were increased by 40 percent to pay for the benefits to and burdens from non-paying water right holders, the annual "fees" necessarily exceed the benefits to or burdens created by paying water right holders by at least 40 percent. (4 AA664–665 ["Forty percent of billed revenues are not collectible. This is an important assumption because it drives up the amount that we would be billing people, and it seems like a high number."].)

Yet, as the Court of Appeal noted, and as the SWRCB admits, those water right holders who refuse to pay the "fees," whether delinquent or claiming sovereign immunity, still benefit from the SWRCB's activities "'[t]he same way that everybody else benefits.'" (Slip opn., p. 23, quoting 4 AA848.)

3. The Costs Associated With One-Time Fee Payors Are Not Properly Allocated To Permitted And Licensed Water Right Holders

Respondents' newfound assertion that 95 percent of the costs of the program are attributable to permitted and licensed water right

holders also ignores their concession that about *60 percent* of the SWRCB's costs are associated with services for one-time fee payors. (5 AA1015.) As the Court of Appeal noted, the SWRCB admits it set service fees artificially low based on the assumption that higher fees might discourage people from seeking services. (Slip opn., p. 21; 3 AA646–652; 4 AA663.) For example, the SWRCB admits it determined that the average cost of processing a water right application is about $17,000–$20,000, and yet it set the application fee at $1,000. (4 AA740–741, 748–752.). The SWRCB determined the remaining costs of one-time services would be paid for by the annual "fees."[3] (3 AA505; 4 AA748–752.)

The end result, as properly noted by the Court of Appeal, is that "the SWRCB collected only 10 percent of [the] cost [of one time services] in one-time service fees"—permitted and licensed water right holders who paid the annual fees "subsidized" the balance. (Slip opn., p. 40; 4 AA761.).

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[3] Cumulatively, these costs are significant—in half of Fiscal Year 2003–2004 alone, the SWRCB estimated it would spend more than $1.3 million of the $4.4 million to be collected in "fees" on application processing alone. (11 AA2598.)

For this additional reason, Respondents' assertion that 95 percent of program costs are attributable to permitted and licensed water right holders fails on its face, and the "fees" paid by these water right holders cannot be commensurate with their burdens or benefits.

4. The Costs Of Non-Permitted And Non-Licensed Water Rights Holders Are Not Properly Allocated To The Class Of Permitted and Licensed Water Right Holders Subject To The "Fees."

While it is true that the SWRCB does not have the authority to "regulate" non-permitted and non-licensed water right holders to the same extent as permitted and licensed water right holders, the SWRCB still, admittedly, does significant work on their behalf. (See 4 AA869–873, 875–879.) Pursuant to section 1525, non-permitted and non-licensed water right holders, who hold rights to about *38 percent* of all water diverted in California, are not subject to the "annual fees," and the costs of such work on their behalf is borne by permitted and licensed water right holders subject to the "fees." (3 AA567; 4 AA881–882.) As the Court of Appeal properly found, for this additional and independent reason, no "'reasonable relationship'" can exist between the amount of the "fees" and the burdens of or benefits to the "fee" payors." (Slip opn., pp. 42–43.)

a. The Challenged "Fee" Scheme Does Not Contain A "De Minimis" Exception.

In *Sinclair*, this Court upheld fees mandated by the Childhood Lead Poisoning Prevention Act of 1991, which provided medical services for children who were victims of lead poisoning, and which was entirely supported by fees paid by *all* those who had significantly contributed or were currently contributing to environmental lead contamination. (*Sinclair*, *supra*, 15 Cal.4th at pp. 870–871.) Those able to show that their industry did not contribute to lead contamination, or whose activities did not result in "'quantifiably persistent environmental lead contamination,'" were "exempt from paying the fees." (*Id.* at p. 872.) In other words, an exception existed for those whose impact on the environment was so slight as to be unquantifiable, and all who created a quantifiable burden on the regulatory system were responsible for their share of its costs. (*Id.* at pp. 870–872.)

As an initial matter, Respondents have admitted that this fee scheme provides no "de minimis exception" for anyone—even for those who hold permits or licenses for the smallest amounts of water, who do not divert water, and who do not request any services from the SWRCB. (5 AA1070–1074, 1116–1124.)

Yet in an apparent effort to fit this case within the *Sinclair*

framework of cases in which courts have upheld fee schemes that included a "de minimis" exception for those not quantitatively burdening the regulatory program, Respondents assert that non-permitted and non-licensed water right holders are not subject to the fees because they are "regulat[ed]" only to a "de minimis" extent. (ROBM, pp. 3–4.)

Respondents now suggest non-permitted and non-licensed water right holders were "exempted" from paying the fees because the SWRCB purportedly does so little work on their behalf. In fact they are not subject to the fees simply because the SWRCB does not have the statutory authority to impose fees on these water right holders. Indeed, section 1525 *mandates* that the "fees" be imposed only upon permit and license holders. (§ 1525, subdivision (a).)

The characterization by Respondents that non-permitted and non-licensed water right holders are not subject to the fees as a "de minimis exception" or "exemption" implies the SWRCB made some analytical determination that, in fairness, non-permitted and non-licensed water right holders should not be subject to the fees—and that permitted and licensed water right holders should bear the costs attributable to non-permitted and non-licensed water right holders.

But as the SWRCB admitted in a deposition, it simply has no justification for the imposition of "fees" on certain permitted and licensed water right holders to pay for benefits accorded to non-permitted and non-licensed water right holders. (4 AA901–902 ["Q: How [did the SWRCB] justify imposing fees on current water rights holders that would be used to pay for riparian and pre-1914 water rights holders? A: I don't think we did."], internal quotation marks omitted; see also 4 AA896–899.) Indeed, as the Court of Appeal noted, the SWRCB has admitted that "[i]f the goal is that the party receiving the benefit pay their proportional share of the costs of the program, [non-permitted and non-licensed water right holders] should pay a portion of the program costs." (Slip opn., pp. 13–14, quoting 3 AA588–589.)

Finally, even if non-permitted and non-licensed water right holders are "regulated" only to a limited extent, that does not mean that the SWRCB is not undertaking significant *work* on their behalf that does not amount to "regulation." Indeed, as discussed in detail *infra*, the SWRCB does significant work on their behalf even given its limited regulatory authority.

b. The Costs Associated With Non-Permitted And Non-Licensed Water Rights Are Not Fairly Accounted For.

As noted *supra*, Respondents assert that "[t]he SWRCB has estimated that only a de minimis amount of program activities (about five percent) *focus primarily* on [water right holders with] bases of right other than permit and license." (ROBM, p. 19, italics added.) However, even if only five percent of the SWRCB's activities "focus primarily" on non-permitted and non-licensed water right holders, Respondents admit they are doing work on their behalf in connection with other activities: "[M]any of the costs incurred in the administration of the water right permit and license system also address riparian and pre-1914 right holders." (ROBM, p. 24.)

Respondents assert that, nonetheless, permit and license holders properly bear these costs because they are not the costs of "regulating" these water right holders, but rather the "evaluation" of such water rights in the context of "regulation of applicants for, and holders of, water right permits and licenses." (ROBM, pp. 24–25.) The basic flaw in Respondents' logic is that activities that are not "regulation" of non-permitted and non-licensed water right holders are not *necessarily* "regulation" of permit and license holders. Indeed, each of Re-

spondents' purported "examples of program expenditures that may involve riparian and pre-1914 right holders, but are necessary for the regulation of persons subject to permits and licenses" fails on its face:

(1) Respondents assert that the costs of sending "notice by registered mail to each person the SWRCB believes may have an interest in a water right application, including *all types* of water right holders," as required by section 1321, is properly borne by permitted and licensed water right holders. (ROBM, p. 25.) The person causing the burden in this situation is the individual member of the public *applying* for a water right—not the class of already permitted and licensed water right holders subject to the "fees." The class of permitted and licensed water right holders and the class of non-permitted and non-licensed water right holders cause the same "burden" or receive the same "benefit" in this regard—receiving notice that a member of the public has filed a water right application. No reason thus exists that the class of permitted and licensed water right holders should bear all such costs.

(2) Respondents assert that the costs of processing the statements of water diversions and use, required by section 5101 to be filed by non-permitted and non-licensed water right holders, is prop-

erly borne by permitted and licensed water right holders because the statements are used "to send out notices of water right applications and petitions to all interested parties" (in accordance with section 5106) and because they provide the SWRCB with "[k]nowledge of the availability of water," which is "necessary to the SWRCB's ability to grant permits and approve changes in permits and licenses." (ROBM, pp. 25–26.) Again, what Respondents describe is not solely "regulation" of the class of water right holders subject to the fees. The statements filed by non-permitted and non-licensed water right holders are used again for, inter alia, "notices of water right applications" and to "grant permits." As with their first "example," these are costs caused by *applicants* for water right permits—not the existing class of permitted and licensed water right holders.

(3) Respondents assert that the costs of the SWRCB's activities undertaken pursuant to section 1052 to prevent illegal diversions are properly borne by permitted and licensed water right holders because "enforcement serves to make sure that those who should have permits and licenses obtain them—or cease diverting and using water . . . ." (ROBM, p. 26.) This rationale makes no sense. Permitted and licensed water right holders should not have to pay the costs associ-

ated with *policing* members of the public who are illegally diverting water: This is not a "burden" imposed by permit and license holders; this is a burden caused by illegal diverters. Indeed, the SWRCB has admitted that its functions in this regard are not only for the protection of other water right holders with any basis of right, but for the protection of the "public interest" because illegal diversions are a "trespass[] against the state." (4 AA933.) Furthermore, to the extent that existing water right holders illegally divert, waste, or unreasonably use water, such acts are not committed by permitted and licensed water right holders alone—such acts may be committed by any water right holder, including non-permitted and non-licensed water right holders. No justification exists for imposing all such costs on permitted and licensed water right holders.

Relatedly, Respondents also assert that costs imposed by non-permitted and non-licensed water right holders are properly borne by permitted and licensed water right holders because the former need "protection" from the latter: "A riparian seeking protection for its (senior) right is not necessarily required to pay a fee to receive the SWRCB's attention and protection, just as a member of the general public would not have to pay a fee to bring a permit or license viola-

tion to the SWRCB's attention." (ROBM, p. 23.) Again, the fundamental flaw in this argument is that it assumes that permittees and licensees are the *only* parties from whom any other water right holder or member of the general public would need "protection." But any member of the general public or any non-permitted or non-licensed water right holder could *also* illegally divert, waste, or unreasonably use water, and thus no evidence exists that it is only permitted and licensed water right holders who might cause the need for such "protection" in this regard.[4]

In sum, the record simply does not support Respondents' assertion that all but a "de minimis" amount of the SWRCB's work is attributable to the "fee" payors.

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[4] Respondents also make much of the fact that certain "regulatory actions" are paid for by those non-permitted and non-licensed water right holders as required by statute. (See ROBM, pp. 20, 23.) This is of no moment. While it is true that such water right holders generally pay for certain actions, as Respondents admit, *all* water right holders—including permittees and licensees—*also* must pay the expense for these same actions. (See *ibid.*; see also, e.g., §§ 2501, 2850 et seq.) Moreover, this does not change the fact that permitted and licensed water right holders subject to the fees pay other costs indisputably associated with non-permitted and non-licensed water right holders.

5. Respondents' Purported Distinction Between Who "Burdens" The Water Rights Program And Who "Benefits" From It Is Illusory.

Respondents also argue that the "fees" are properly allocated to permitted and licensed water right holders because they purportedly create all of the "burden" on the Water Rights Program, and the fact that "some of the SWRCB's regulatory effort is necessary to protect (i.e. for the 'benefit of') other types of water right holders . . . or the public trust is *irrelevant*. What matters is not who benefits from the program, but who imposes the burdens that make the program necessary." (ROBM, p. 21.) Respondents are wrong. The test of a valid fee is whether it corresponds to the burdens *or* benefits of a fee payor (see *Sinclair*, *supra*, 15 Cal.4th at p. 878)—the test is in the alternative because sometimes the fee payor receives a benefit and sometimes imposes a burden. (Compare *SDG&E*, *supra*, 204 Cal.App.3d at p. 1146 ["allocation of costs based on emissions fairly relates to the permit holder's burden on the district's program"] with *Pennell v. City of San Jose*, *supra*, 42 Cal.3d at 375, fn. 11 [upholding rental unit fee imposed on landlords to fund administration and implementation of hearing process, which benefited landlords and tenants alike regardless of whether individual landlords "believe[d] they 'benefit[ed]'

from" it].) Courts are charged with ensuring that a fee is reasonably related to the fee payor's burdens or benefits—whether costs are associated with one or the other or both. (See *Beaumont Investors v. Beaumont-Cherry Valley Water Dist.* (1985) 165 Cal.App.3d 227, 235 [fee must bear a "reasonable relation to plaintiff's burdens on, *and* benefits from, the system"], italics added.)

Moreover, in the context of the Water Rights Program, the SWRCB's purported distinction between who "benefits" from the program and who "burdens" the program is wholly illusory, self-serving, and makes no sense when taken to its logical conclusion for several reasons.

First, as explained in detail *supra*, other types of water right holders and members of the general public impose their own distinct and independent burdens upon the Water Rights Program—they do not simply get some derivative benefit in the form of "protection" from permit and license holders.

Second, as also explained in detail *supra*, water right holders are not polluters from whom the public or other water right holders need "protection." As such, this case is not analogous to *Sinclair* and other cases in which the "polluter pays" rationale applies, where one

party imposes a "burden" and another party receives a concomitant "benefit."

For example, annual "fee" payors pay the vast majority of the costs of processing water right applications because those who file applications for water right permits do not pay the full costs associated with those services. (3 AA646–652; 4 AA663, 748–752.) As noted, *supra*, the SWRCB admits it determined that the average cost of processing a water right application is about $17,000–$20,000, and yet it set the application fee at $1,000, and annual "fee" payors pay the remaining costs. (4 AA740–741, 748–752.)

These costs are part of the 95 percent of program costs that Respondents attribute to the "burden" of regulating permitted and licensed water right holders who pay the "fees." But, in this situation, the "fee" payors simply own a water right. While the SWRCB may "protect" that right as well as the rights of non-permitted and non-licensed water right holders and the public interest when *others* "burden" the SWRCB with an application for a new water right, those are not "burdens" imposed by the class of water right holders who *already* have permits and licenses.

Indeed, when a person files an application for a new water

right, it is analogous to when a property owner seeks a permit to build a new structure on his or her land. (See Respondents' Brief in the Court of Appeal at p. 11 ["The water right permit is analogous to a building permit: it gives permission to develop a project."].) Before the property owner is issued such a permit, the administrative agency tasked with issuing permits will consider whether the new structure will affect the property owner's neighbors by, for example, encroaching upon their property, as well as whether the new structure will have environmental implications such as the destruction of a protected type of tree. In this situation, it is not the neighbors who create the "burden" by already owning property abutting this person's land. As such, the costs associated with the permit properly are borne by the person seeking to build the new structure, not the neighbors.

In sum, Respondents' assertions that the "fees" need only correlate to "burdens" here, and that 95 percent of those "burdens" are imposed by the class of permitted and licensed water right holders subject to the "fees," have no basis in fact or law.

B. Respondents Cannot Demonstrate That The Fees Do Not Surpass The Costs For Which They Are Collected.

Respondents assert that the State must show "'the estimated

costs' of the services or regulatory activity," which "assists the court to determine whether the funds are raised to support the regulatory program, or for general revenue purposes." (ROBM, p. 13.) Conspicuously absent from their brief is any mention of *the only way* evidence of the "estimated costs" could assist the court in a determination of whether the fees are revenue raising: by showing that the fees do not exceed the costs of the activities they are intended to fund. (See, e.g., *Cal. Ass'n of Prof'l Scientists v. Dep't of Fish & Game* (2000) 79 Cal.App.4th 935, 939 (hereafter *CAPS*) ["It is well established that the amount of fees collected *must not surpass* the cost of the regulatory services or programs they are designed to support."], italics added.)

If the fees do in fact exceed the costs of the regulatory activity, then they are presumed to be revenue-raising taxes, not regulatory fees. Indeed, as explained by the court in *CAPS*:

> Fish and Game met its burden of showing that the amount of fees generated by section 711.4 was far less than the cost of the environmental reviews provided. There was evidence that $11 million had been collected in fees, but the cost of the reviews was in excess of $20 million. Thus, the fees were not revenue raising in that they did not generate income which surpassed the cost of the services provided.

(*Id.* at p. 946; see also *Beaumont Investors v. Beaumont-Cherry Valley*

Water Dist., *supra*, 165 Cal.App.3d at pp. 234–235 ["[T]he sole issue before us boils down to whether the record demonstrates that the facilities fee sought to be imposed by defendant does or does not 'exceed the reasonable cost' of constructing the water system improvements contemplated by the District. Such a showing would require, *at the minimum*, evidence of (1) the estimated construction costs of the proposed water system improvements, and (2) the District's basis for determining the amount of the fee allocated to plaintiff, i.e., the manner in which defendant apportioned the contemplated construction costs among the new users, such that the charge allocated to plaintiff bore a fair or reasonable relation to plaintiff's burden on, and benefits from, the system."], italics added.)

California law is clear: the purpose of showing the "estimated costs" is to ensure that the fees collected do not surpass them—a burden Respondents cannot meet here.

1. The "Fees" Collected Undisputedly Surpassed The Costs.

Respondents ironically remark that this prong of the test of a valid regulatory fee "is usually easy to satisfy." (ROBM, p. 13.) Here, however, there is no dispute that the "fees" actually collected

far surpassed the costs of the regulatory activities they were to fund. As Respondents admit, section 1525, subdivision (d)(3) and the Budget Act mandated that the SWRCB collect about $4.4 million in water right "fees" in Fiscal Year 2003–2004. (ROBM, pp. 2, 13–14.) But what Respondents' Opening Brief fails to address is that the SWRCB actually collected $7.4 million in "fees"—millions in excess of the amount the Legislature mandated it collect. (3 AA519; 4 AA655, 761.)

Respondents nonetheless suggest that the "fees" did not exceed the costs here because the budget for the Water Rights Program for Fiscal Year 2003–2004 was about $9 million, so the fees "have been set at an amount less than the total cost of the water right program." (ROBM, p. 13.) This argument is disingenuous at best. The only "costs" that the SWRCB was authorized to collect in "fees" were the $4.4 million mandated by the Legislature. The difference between the $9 million annual budget and the $4.4 million the "fees" were to raise was funded by the General Fund and other moneys. (3 AA531, 722.) The over-collection of the "fees" therefore caused the SWRCB to take in about *$12 million dollars* for the fiscal year—*far in excess of its $9-million budget.* (3 AA519–20, 576, 619; 5 AA1085–1088.)

Furthermore, as Respondents admit, the reason the "fees" were intended to fund only about half of the program costs in Fiscal Year 2003–2004 was because they could not be implemented in time to fund operations for the first half of the fiscal year. (3 AA575–576.) As such, the General Fund and other moneys funded roughly the first half of the year, and the $4.4 million that the Legislature mandated the SWRCB collect in "fees" was intended to fund essentially *all* of the costs of the Water Rights Program in the remaining portion of that year.[5] (*Ibid.*; 3AA526, 540–543 545–547, 549–552.) Instead of collecting about $4.4 million to fund the costs of the program for the second half of the fiscal year, the SWRCB collected $7.4 million—far in excess of those costs. (3 AA528–531.)

2. Over-collection Without A Refund Is Illegal.

Respondents argue that despite the over-collection of "fees," the "fees" do not surpass the costs for which they were levied because any "over-collection remains in the Water Rights Fund" to be used in

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[5] Consistent with this, as Respondents have admitted, the "fees" cover essentially all of the costs of the Water Rights Program going forward—90 percent of the funding for the program in Fiscal Year 2004–2005, and 94 percent of the funding in Fiscal Year 2005–2006. (ROBM, p. 14.)

future years, and "the SWRCB must adjust the amount of the annual fees each year to compensate for any [over-collection]." (ROBM, p. 17.) Respondents have not pointed to any case holding that where the "fees" collected surpassed the costs of the program, the State may keep that surplus as long as the funds are used in the future. Nor could they. By Respondents' logic, the SWRCB could charge any amount in "annual fees" purportedly to fund that fiscal year's costs, as long as it asserted that at some point in the future the funds would be used by the Water Rights Program—whether or not the water right holders who paid the "fees" benefit from any future State conduct.[6]

Collection under such a structure amounts to taxation, whereby the State accumulates surplus funds to be used at some point in the future, not necessarily for the benefit of those who paid the taxes. Indeed, such a levy simply would be a "special tax"—i.e., "taxes levied for a specific purpose rather than a levy placed in the general fund to

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[6] For example, persons who overpaid and then sold their water rights during Fiscal Year 2003–2004 did not and will not thereafter receive any further benefits or create any further burdens relating to water rights that they no longer possess, though the "fees" they overpaid in 2003–2004 continued to fund the Water Rights Program. (5 AA1090–1095.)

be utilized for general governmental purposes." (*Heckendorn v. City of San Marino* (1986) 42 Cal.3d 481, 489.) It is therefore immaterial that the over-collected "fees" remain in the Water Rights Fund.

The so-called "annual adjustment" provision in section 1525, subdivision (d)(3), whereby over-collected fees in the Water Rights Fund may be retained for use in future years, does not save the scheme for another reason. Contrary to Respondents' suggestion, it does not "compensate" the vast majority of "fee" payors for their overpayment in Fiscal Year 2003–2004. (See ROBM, p. 17.) As Respondents admit, *most "fee" payors* paid *the same or an even higher* fee in Fiscal Year 2004–2005, despite their overpayment in Fiscal Year 2003–2004. (5 AA990–1001, 1003–1007.) In other words, the vast majority of "fee" payors who overpaid do not receive any purported "compensation" as a result of any "annual adjustment."

Indeed, this "annual adjustment" provision bears no resemblance to true "refund" provisions in fee schedules in other cases, such as that in *Garrick Development Co. v. Hayward Unified School District* (1992) 3 Cal.App.4th 320 (hereafter *Garrick*). In *Garrick*, not only was the court satisfied that the fees did not surpass the costs because the challenged fees would generate "*only half*" of the estimated

costs of the services, but there was also a "guard against unjustified fee retention": "unexpended fees" were accounted for on an annual basis, and "if a use for them [could not] be shown, they [would be] refunded pro rata with interest." (*Id.* at p. 332; see also *United Bus. Com. v. City of San Diego* (1979) 91 Cal.App.3d 156, 173 [where original ordinance resulted in fees collected exceeding costs, and new ordinance reflected "actual costs," "sign users who paid higher fees under [earlier version of challenged ordinance] were refunded the difference by the City"].)

Respondents also purport to justify their over-collection of "fees" by arguing that they could not risk under-funding the program where section 1525, subdivision (d)(3) mandates that the SWRCB "set the amount of total revenue collected each year through the fees authorized by this section at an amount equal to the revenue levels set forth in the annual Budget Act." (ROBM, pp. 16–17.) Respondents may be correct—compliance with well-settled California law that fees may not exceed costs may risk non-compliance with the mandate of section 1525, subdivision (d)(3). But the solution lies in the hands of the Legislature, not this Court. "Fee" payors should not be made to pay inflated "fees" simply because Respondents have been handed a

poorly crafted piece of legislation which results in an unconstitutional levy.

In sum, to conclude that the SWRCB may grossly over-collect fees without providing a refund would render this requirement of a valid fee a nullity. Respondents have failed to show that the "fees" collected do not surpass the purported regulatory costs they were to fund, and thus they cannot meet the test set forth in *Sinclair* for a valid regulatory fee.

II. The Court Of Appeal Properly Applied Independent Review Here.

Respondents have admitted that "whether the water right fees are valid regulatory fees or in legal effect invalid 'taxes' under Proposition 13 is a question of law for the appellate courts to decide de novo." (Respondents' Brief in the Court of Appeal, p. 4.) Respondents likewise have admitted that the Farm Bureau brings a facial challenge to section 1525 and the Emergency Regulations, presenting "'the question of whether the statutes and regulations at issue are unconstitutional or unlawful,'" and thus "[n]o individual factual matters are at issue in this appeal." (ROBM, pp. 27–28.)

Nonetheless, Respondents assert that the Court of Appeal erred

in failing to review the SWRCB's "factual determinations and policy considerations" under a more deferential "arbitrary and capricious" or "abuse of discretion" standard of review.[7] (ROBM, pp. 27–28.) This assertion is wrong and is based upon: (1) a distortion of the nature of the Farm Bureau's challenge to section 1525 and the Emergency Regulations and (2) a mischaracterization of the Court of Appeal's opinion.

A. Decades Of Proposition 13 Case Law Confirm That Independent Review Was Proper Here.

This Court twice has expressly held that whether an assessment is an unconstitutional tax in violation of Proposition 13 is "a 'question of law for the appellate courts to decide on independent review of the facts.'" (*Apt. Ass'n of L.A. County, Inc. v. City of L.A.* (2001) 24 Cal.4th 830, 836, quoting *Sinclair*, *supra*, 15 Cal.4th at p. 874); cf. *20th Century Ins. Co. v. Garamendi* (1994) 8 Cal.4th 216, 271–272

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[7] The Court of Appeal applied the same "independent review" to both section 1525 and the Emergency Regulations. (Slip opn., p. 30.) Respondents challenge the court's application of that standard *only* as to the Emergency Regulations, and thus Respondents effectively concede that "independent review" was appropriate in determining the constitutionality of section 1525. (See, e.g., *Paulus v. Bob Lynch Ford, Inc.* (2006) 139 Cal.App.4th 659, 684–685 [issue not raised in opening brief deemed waived on appeal].)

["Whether the . . . regulations actually adopted . . . are consistent with Proposition 103—and with the law generally—is also examined independently."] (hereafter "*20th Century Insurance*").)

The Courts of Appeal regularly have adhered to this same independent standard of review in Proposition 13 cases. (See, e.g., *CAPS*, *supra*, 79 Cal.App.4th at p. 944 ["'independent review of the facts'"]; see also *Neecke v. City of Mill Valley* (1995) 39 Cal.App.4th 946, 953 ["independent review is appropriate" on "question of whether the tax at issue is a special tax for purposes of [Proposition 13]"]; *Bixel Associates v. City of L.A.* (1989) 216 Cal.App.3d 1208, 1216 ["independent review" of whether fire hydrant fee was a development fee or a "special tax" barred by Proposition 13]; *California Bldg. Industry Ass'n v. Governing Bd.* (1988) 206 Cal.App.3d 212, 234 ["Whether the exactions are development fees or special taxes [for purposes of Proposition 13] is an issue of law which we here resolve."], citation omitted.)

B. The Court Of Appeal Properly Rejected Respondents' Proffered "Arbitrary And Capricious" Standard Of Review.

Consistent with this Court's holdings, the Court of Appeal here properly ruled that "the question of whether the annual fees imposed

under section 1525, subdivision (a) are unconstitutional and the emergency regulations invalid are questions of law subject to our independent review." (Slip opn., p. 30.) The Court of Appeal correctly rejected Respondents' argument that an "arbitrary and capricious" or "abuse of discretion" standard of review should apply: "Contrary to the SWRCB's suggestion, plaintiffs do not argue that the agency overstepped its quasi-legislative, rule-making authority under section 1525. Thus, the deferential standard applied to the review of quasi-legislative actions by ordinary mandamus . . . is inapplicable here." (*Ibid.*, citation omitted.)

As the Court of Appeal properly noted, the deferential standard Respondents advocate applies only where an agency allegedly has overstepped its authority or the mandate of an enabling statute in promulgating regulations. (See, e.g., *Lungren v. Superior Court* (1996) 14 Cal.4th 294, 309; see also *San Francisco Fire Fighters Local 798 v. City & County of San Francisco* (2006) 38 Cal.4th 653, 668.) But no such claims are made here. Indeed, as the Court of Appeal correctly found, the Farm Bureau has not alleged that the SWRCB overstepped its authority or section 1525's mandate in promulgating the Emergency Regulations, but rather that the terms of

the mandate handed to the SWRCB in section 1525, the Emergency Regulations, and the resulting "fees" are illegal under Proposition 13. (Slip opn., p. 30.)

Furthermore, a court need not "defer" to an agency's adoption of regulations where the regulations violate the Constitution or law of this State. Under such circumstances, the regulations are void, "'and no protestations that they are merely an exercise of administrative discretion can sanctify them.'" (*Henning v. Div. of Occupational Safety & Health* (1990) 219 Cal.App.3d 747, 759, quoting *Morris v. Williams* (1967) 67 Cal.2d 733, 737.) As such, the SWRCB simply had no "discretion" to exceed the outer limits set by the Constitution or a statute; nor would any valid "policy considerations" justify such an action. (See *Ass'n for Retarded Citizens v. Dep't of Developmental Servs.* (1985) 38 Cal.3d 384, 391 ["if the court concludes that the administrative action transgresses the agency's statutory authority, it need not proceed to review the action for abuse of discretion; in such a case, there is simply no discretion to abuse"].)

The Court of Appeal thus properly identified the nature of the challenge to the statute and the regulations and properly applied an

independent standard of review here.[8]

C. This Case Warrants Heightened Judicial Scrutiny Because Of Proposition 13, Not Because Of The Refund Requests.

Respondents also assert that the Court of Appeal's decision would create an "exempt[ion of] refund suits from the 'abuse of discretion' standard of review" and single out tax and fee regulations for "heightened judicial scrutiny." (ROBM, p. 32.) While it is true that, ordinarily, courts apply an "abuse of discretion" standard in refund suits challenging a rulemaking decision (*id.*, p. 31), neither that general rule nor any of the cases cited by Respondents in support of it are relevant here.

An "independent review of the facts" is appropriate here be-

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[8] Respondents point to this Court's footnote in *20th Century Insurance*, *supra*, 8 Cal.4th at p. 279, fn.13, in arguing that "constitutional issues do not change how the court should review SWRCB's factual determinations and policy considerations." (ROBM, p. 33.) But in *20th Century Insurance*, the insurance companies argued that the regulations at issue were not "necessary and proper for the implementation of" the legislative mandate—a claim that is "scrutinized for arbitrariness and/or capriciousness." (*20th Century Ins.*, *supra*, 8 Cal.4th at pp. 272, 279, fn.13.) Accordingly, this Court's footnote says only that the insurers' vague references to the Constitution did not entitle them to heightened judicial scrutiny. (See *id.* at p. 279, fn.13.)

cause the Farm Bureau claims that the "fees" violate Proposition 13 (*Sinclair*, *supra*, 15 Cal.4th at p. 874), not because the Farm Bureau seeks refunds of the illegal "fees." That the Farm Bureau's constitutional challenge includes a request for refund relief is beside the point.

Indeed, consistent with the law set forth *supra*, none of the cases cited by Respondents involve the refund of fees challenged as *illegal* or *unconstitutional*, but rather involve claims regarding the scope of an agency's discretion. For example, in *Wallace Berrie & Co. Inc. v. State Bd. of Equalization* (1985) 40 Cal.3d 60, a taxpayer challenged a regulation as an unreasonable application of the Tax Code's distinction between a "sale" and a "use." (*Id.* at pp. 64–65.) The taxpayer claimed that the regulation was not authorized by the relevant legislation; this Court disagreed. (*Id.* at p. 70.) Similarly, in *Shapell Industries, Inc. v. Governing Bd.* (1991) 1 Cal.App.4th 218, the petitioner challenged the fee "on grounds that the Board's action was arbitrary and capricious and without evidentiary support." (*Id.* at p. 228; see also *ibid.* [petitioner claimed that school district had exceeded scope of discretion granted in its enabling legislation by failing

to examine the impact of future development on student enrollment].)[9]

D. The Court Of Appeal Properly Based Its Holding That The "Fees" Are Unconstitutional On The Undisputed Evidence That "Fee" Payors Paid For Costs Associated With Others Not Subject To The "Fees.

Contrary to Respondents' suggestion, the Court of Appeal did not reach its decision that the "fees" are illegal by disregarding any purported "factual determinations" or "policy considerations" by which Respondents sought to justify the fees. (See ROBM, p. 27.)

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[9] *Henry's Restaurants of Pomona, Inc. v. State Bd. of Equalization* (1973) 30 Cal.App.3d 1009, did involve a constitutional claim of sorts. In that case, the petitioner raised an equal protection challenge to a taxation statute, arguing that the Legislature had impermissibly discriminated between drive-in restaurants and conventional restaurants. (*Id.* at p. 1013.) As a matter of constitutional law, such claims warrant only "'rational basis'" review, meaning that legislative classifications are upheld unless "palpably arbitrary." (*Id.* at pp. 1016–1017; see also *Hernandez v. City of Hanford* (2007) 41 Cal.4th 279 [explaining the "rational basis" standard ordinarily applied to equal protection challenges].) The court found the Legislature's distinctions "perfectly proper" and thus the statute was valid. (*Henry's Restaurants of Pomona, Inc. v. State Bd. of Equalization*, *supra*, 30 Cal.App.3d at p. 1019). The court went on to consider the petitioner's *separate* claim that, in adopting a regulation to implement the challenged taxation statute, the Board of Equalization had failed to define certain key terms. (*Id.* at p. 1020.) As to *that* claim, the court concluded that the Board's decision was not "arbitrary, capricious, or patently unreasonable." (*Id.* at p. 1021.)

The Court of Appeal properly based its conclusion that the "fees" are illegal on the undisputed evidence that "fee" payors subsidized costs associated with others not subject to the "fees." (Slip. opn., pp. 39–40.) Indeed, the Court of Appeal properly ruled, not upon the SWRCB's discretionary decisions and policy judgments, but on the legal question of whether the *effects* of those considerations resulted in fees violating Proposition 13.[10]

Respondents further assert that a number of "material errors, both factual and highly technical" resulted from the Court of Appeal's purported "lack of deference" to the SWRCB's discretion and policy judgments. (ROBM, p. 35.) Respondents purport to set forth numer-

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[10] For example, Respondents have consistently argued that that the vast majority of the costs imposed by one-time fee payors are properly borne by annual "fee" payors because to impose the full costs on one-time fee payors would have a deterrent effect on regulatory compliance, while the lower fee gives the one-time fee payor a "regulatory incentive[]" to comply. (ROBM, p. 30; see also *id.* at pp. 6–7, 16.) Neither the Farm Bureau nor the Court of Appeal disputed that the SWRCB may have been motivated by laudable policy goals such as promoting regulatory compliance in apportioning the "fees," but the fact remains that such apportionment *necessarily* means that annual "fee" payors bear considerably more than their "fair share" of costs where they bear the lion's share of the costs associated with one-time actions. Thus, the "fees" violate the California Constitution—whatever the policy justification.

ous "examples" of the Court of Appeal's exercise of "its independent judgment regarding . . . issues of fact and agency discretion." (ROBM, pp. 35–37.) But not a single one of these "examples" is actually an exercise of independent judgment regarding a disputed factual issue or an issue in the SWRCB's discretion—nor are any of them even material to the Court's decision.

First, Respondents assert that the Court of Appeal mistakenly "assumed that the Water Rights Fund provides the funding for the entire water rights program." (ROBM, p. 35, citing slip opn., p. 39.) To the contrary, the Court of Appeal properly noted that General Fund moneys funded roughly the first half of Fiscal Year 2003–2004. (Slip opn., p. 25.) Furthermore, the Court of Appeal's reference to a "single funding source" for the program likely refers to the fact that, as Respondents have admitted, the "fees" cover essentially all of the costs of the Water Rights Program going forward—90 percent of the funding for the program in Fiscal Year 2004–2005, and 94 percent of the funding in Fiscal Year 2005–2006. (ROBM, pp. 14, 39.) This does not reflect any "lack of deference" to any "factual determination" or "policy consideration" of the SWRCB—the portion of the program funded by the "fees" is an undisputed fact.

Second, Respondents assert that the Court of Appeal erroneously "assumed the existence of additional detail in the Governor's budget (not provided by any party) that supplies additional information about the costs of the regulatory program not revealed in the Budget Act." (ROBM, p. 35, citing slip opn., p. 35, fn. 21.) Again, this does not reflect any "lack of deference" to the SWRCB—the fact that the Budget Act does not contain additional detail simply is not a "factual determination" or "policy consideration" and in any event is not material.

Third, Respondents assert that the Court of Appeal erred in "assuming that a pie chart in the record showing the amount of water claimed to be held under various water rights also represents the resources spent to regulate those rights." (ROBM, p. 36, citing slip opn., p. 42.) The court did no such thing. Rather, on page 42 of the slip opinion, it correctly identified the proportion of water the various classes of water rights "*held*": 38 percent held by riparian, pueblo, and pre-1914 appropriative right holders and 22 percent held by the Bureau of Reclamation (collectively 60 percent), meaning licensees and permittees (the annual "fee" payors) held the remaining 40 percent. (Slip opn., p. 42–43; see also *id.*, appendix.)

Finally, Respondents argue that the Court of Appeal should not have "expected a 'breakdown of the specific Division services used by each category of water right holders.'" (ROBM, p. 36, quoting slip opn., p. 7.) But without at least some evidence of the amount of resources expended on the various categories of water right holders, how could it possibly have been *reasonable* for the SWRCB to impose nearly all of the SWRCB's costs on only one of those categories within the meaning of the test set forth in *Sinclair*? Even under the deferential standard advocated by the SWRCB, the absence of such evidence would preclude a court from ensuring that the SWRCB "has adequately considered all relevant factors, and has demonstrated a rational connection between those factors, the choice made, and the purposes of the enabling statute." (*W. States Petroleum Ass'n v. Superior Court* (1995) 9 Cal.4th 559, 577, internal quotation marks omitted.) In any event, this does not reflect "lack of deference" to any "factual determination" or "policy consideration" of the SWRCB.

In sum, the SWRCB has identified no "lack of deference" to any "factual determination" or "policy consideration" of the SWRCB in the Court of Appeal's decision, let alone regarding any material issue. Regardless, as set forth in detail above, the subject "fees" are un-

constitutional based on the application of any standard of review, as the material facts are not controverted and indeed are conceded by the SWRCB in the voluminous record.

CONCLUSION

For all of the foregoing reasons, Water Code section 1525 should be declared unconstitutional on its face and as applied, and the Board of Equalization should be ordered to issue full refunds to all who paid the illegal taxes.

July 11, 2007

Respectfully submitted,

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Pursuant to Rule 8.520, subdivision (c), of the California Rules of Court, the undersigned hereby certifies that the foregoing Answer Brief On The Merits Of California Farm Bureau Federation is in 14 point Times New Roman font and contains 12,052 words, exclusive of those items identified in subdivision (c)(3) of Rule 8.520, according to the word count generated by the computer program used to produce the brief.

July 11, 2007

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