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 REPLY BRIEF ON THE MERITS TO ANSWER BRIEF OF NORTHERN CALIFORNIA WATER ASSOCIATION ET AL.

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ARGUMENT

I.

Permit and license holders are not a "small group" required to shoulder costs that should be attributed to others.

The key question is whether it is reasonable to impose the fee on parties that account for 95 percent of the regulatory burden and exempt persons who are not subject to the SWRCB's "core" regulatory program and who are regulated only to a de minimis extent. The State does not suggest that costs may be "foisted upon others" that do not create the burden. (NCWA, p. 21.) The State argues that persons who are exempt from the water right permit and license program are subject to significantly less, and qualitatively different, state regulatory authority than permittees and licensees. (State's Brief on the Merits, pp. 3-5 and 19-27.)

A. Whether program activities include "core governmental functions" is irrelevant to determining the validity of a regulatory fee.

The State does not argue that "all costs are regulatory because the Legislature says so." (NCWA, p. 12.) However, the Legislature has control over program costs through the state's budget. When the estimated cost of a regulatory program is set forth in the state budget, the estimated cost of the regulatory program is readily apparent. Where the Legislature also uses the budget to set fee revenues, whether fees are set in amounts estimated to equal or be less than the cost of the regulatory program is also readily apparent.

NCWA, however, contends the State must first show the fees cover regulatory costs, and proceeds to define "regulatory" so narrowly that few, if any, regulatory fees

could survive. (NCWA, p. 12.) NCWA contends the water right fees improperly raise "revenue unrelated to a discrete regulatory program" because the water right program carries out many different "functions." (*Ibid.*)

In *Sinclair Paint*, the court upheld a fee as "regulatory" although it supports a broad program to prevent childhood lead poisoning in California, including the evaluation, screening, and case management of children at risk, identifying sources of lead contamination, and providing educational services to the medical community and the public. (*Sinclair Paint Co. v. State Bd. of Equalization* (1997) 15 Cal.4th 866, 871 (*Sinclair Paint*).) In *San Diego Gas & Electric Co. v. San Diego County Air Pollution Control Dist.* (1988) 203 Cal.App.3d 1132 (*SDG&E*), the court upheld an annual permit renewal fee that distributed the indirect costs of "ongoing implementation, enforcement and related activities" of the district's stationary source permit programs, including "personnel matters, rule development, correspondence, complaint investigations, hearing board participation, consultation with other agencies, etc." (*Id.* at p. 1136.)

NCWA contends that the SWRCB provides "fundamental, core governmental function[s], which transcend mere 'regulation.'" (NCWA pp. 5-6.) NCWA does not explain why the SWRCB's "historic, adjudicatory, statutory, and constitutional role" differs from the SWRCB's "regulatory" role. (See Code Com. notes, 68 West's Ann. Wat. Code (1970) foll. former § 1050 [SWRCB acts pursuant to police powers].)

All of the SWRCB's water right program activities fall within the rubric of "regulatory activities" that may be subject to a fee. For example, the annual fees pay

for "adjudicative" functions that are part of, and reasonably necessary to carry out, the SWRCB's program to regulate water diversion and use based on the permit and license system.[1] (See generally *McHugh v. Santa Monica Rent Control Bd.* (1989) 49 Cal.3d 348, 372 ["An administrative agency may constitutionally hold hearings, determine facts, apply the law to those facts, and order relief . . . so long as . . . such activities are authorized by statute or legislation and are *reasonably necessary* to effectuate the administrative agency's *primary, legitimate regulatory purposes*. . . ."] (italics in original).)

NCWA seems to be arguing that if a government activity is important, the Legislature cannot fund the activity through fees. NCWA does not explain why the relative importance of the activity matters to the validity of a fee.

B. Other sources of revenue reduce the amount of annual fees the SWRCB must collect from year to year.

The State explained that the Water Rights Fund is only one fund of several that provide support to the water right program, and that the Water Rights Fund itself contains more than annual fees and filing fees. These other revenue sources reduce the amount of annual fees that must be collected from year to year. NCWA responds that the other sources of funding do not provide funds for "the water right program" (notwithstanding the Budget Act) and are not available to cover "general" regulatory program costs. (NCWA, p. 14.) The code sections cited do not support this assertion.

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[1] Where the SWRCB performs as a court referee or special master, these activities are subject to separate fees and reimbursements, and set to cover the entire cost. (Wat. Code, §§ 1528, 2040 et seq., 2850 et seq.)

These funds support activities *within* the water right program, thereby *reducing* costs that might otherwise be imposed on the annual fee payers. For example, the Cigarette and Tobacco Products Surtax Fund may be used by the water right program for the general protection of environment and the public trust. (Rev. & Tax. Code, § 30122, subd. (a); *id.*, § 31022, subd. (b)(5)(a) [funds may be used to support "programs to protect, restore, enhance, or maintain fish, waterfowl, and wildlife habitat"].) In other words, these funds mitigate the effect of water right holders' diversion and use of water on the environment and the public trust, a large part of the water right program's regulation of permit and license holders.

Similarly, the Federal Trust Fund (Gov. Code, § 16360 et seq.) provides funds directly from the Bureau of Reclamation for water right work accomplished on Bureau projects. (Appendix 2284.) Thus, the Bureau pays some of the cost of regulation related to its projects.

NCWA contends that the existing permit and license holders pay "all of the costs associated with resolving disputes among those that pay no fees . . . [and] all of the costs to cover the activities of the Division implementing the broad constitutional policies and general statutory policies. . . ." (NCWA, p. 13.) These statements are groundless.

NCWA ignores the provisions requiring full payment by the parties for statutory adjudications of rights, court references, or the provisions for penalties and administrative civil liability for violations. (Opening Brief, p. 23.) By statute, administrative proceedings to determine proposed changes to water rights are not

available to other water right holders. (Compare Wat. Code, § 1700 et seq., 1725 et seq., 1735 et seq. [setting forth procedure for changes, including expedited procedures for short term changes] with Wat. Code § 1706 [providing no administrative procedure for changes to pre-1914 rights].) And the Cigarette and Tobacco Products Surtax Fund pays for some of the SWRCB's environmental protection and public trust activities.

C. The contention that the SWRCB spends significant resources regulating other water rights is unfounded.

1. NCWA's references to the record do not support its position.

NCWA provides no support for its contentions that "a significant portion of the work of the Division is . . . needed because of the burden created by . . . other types of water right holders. . ." (NCWA, p. 19) and that "the Division spends considerable time addressing complaints involving water rights other than licenses and permits. . . ." (NCWA, p. 20). Ironically, NCWA's argument is directly contrary to NCWA's position at trial. (State's Brief on the Merits, p. 19 [discussing NCWA's claims].) The State has never argued it had *no* authority over other types of water rights, only that the water right permit and license system is its core regulatory program, taking up most of its resources. (E.g., Appendix 2011:17 to 2017:14 [trial brief].)

The references on page 19 of NCWA's brief do not support NCWA's contention. For example, pages 646 to 652 merely explain how the fees were determined. Pages 870 to 873 (as well as pages 875 to 879 and page 1556) briefly describe the *limits* of the SWRCB's authority over other water right holders and the *benefits they may receive* from the existence of the program. For example, the SWRCB

usually dismisses complaints filed by riparians "immediately as being outside of our jurisdiction." (Appendix 873:11.) Pages 947 to 948 discuss "work done by the Division that's on behalf of the public trust," (Appendix 947:21-23), not burdens expressly created by other water right holders. None of the references describe burdens created by other water right holders (see e.g., Appendix 960:2-4; Opening Brief, pp. 24-26); they discuss benefits received by others or assume difficulties that did not materialize (Appendix 1696, 1703) or generally describe the CVP (Appendix 1731-1736). The letter from the sponsor of a bill seeking "to enact an equitable methodology for imposing water right fees" (Appendix 1599) does not support the claim that a significant portion of the Division's work is "needed because of the burden created by" other water right holders.

The Court of Appeal's opinion does not support NCWA's contention that the SWRCB spends considerable time regulating other water rights. (NCWA, p. 20.) In fact, the Court of Appeal itself recognized that pre-1914 and riparian water right holders' "use is not routinely supervised by the Board." (Slip op., p. 40.) Finally, "taking action against those who divert without a basis of right" (NCWA, p. 20) means taking action against those who should have applied for a water right permit, making them subject to the water right fees.

2. The amount of "protection" other water right holders receive is irrelevant to the issue if the SWRCB devotes only five percent of its resources to regulating them.

As support for its position that the State spends a significant amount of its time regulating water rights *other* than those of the annual fee payers, NCWA claims the "existing" annual fee payers are "subsidizing" persons filing applications for permits or petitions to change their permit or license. These persons, however, already are, or seek to become, annual fee payers. The State has explained the sound, practical reasons it chose to spread the cost of applications and petitions through the annual fee. (Opening Brief, pp. 5-7.)

Managing existing permitted and licensed water rights represents a substantial portion of the cost of processing water right applications and petitions. (Appendix 2304 [Administrative Record 00782].) NCWA claims this statement is both unsupported and that the State's arguments are inconsistent; on the one hand, the State justifies charging existing water right holders the costs of processing applications and petitions based on the "protection" they receive, and on the other, argues it is irrelevant that some regulatory effort goes to protect other water right holders. (NCWA pp. 24-25.)

NCWA misses the point. The amount of "protection" other water right holders receive is irrelevant if the SWRCB devotes only five percent of its resources to them. Because only five percent of the Division's time is spent on efforts to protect parties who claim and appear to have water rights that are not within the SWRCB's permitting authority (Appendix 2298), the resources directed are de minimis.

D. The record demonstrates the SWRCB's resources are primarily devoted to the regulation of permits and licenses.

The main focus of the water right program is the water right permit and license system over which SWRCB has comprehensive jurisdiction. The record demonstrates that the primary focus of the water right program's resources is the regulation of permitted and licensed water rights. The organization chart for the Division of Water Rights does not contain any section entitled "Riparian Water Right Section" or "Pre-1914 Water Right Section." (AA 2275.) The three main sections on the chart are entitled "Permitting Section," "Hearings and Special Project Section," and "License Section." (*Ibid.*) None of the units within those sections focuses on the regulation of other water rights.

Based on the record presented, the SWRCB lacks the resources to prosecute more public trust or reasonable use proceedings where the primary focus is on riparian or pre-1914 diversions. (See e.g., Appendix 2016-2017 [trial brief discussing evidence of infrequent conduct of public trust or reasonable use proceedings where the primary focus is riparian or pre-1914 diversion]; *id.*, 2203:6-10 [position of assistant chief of Division of Water Rights unfilled because of insufficient funding]; *id.*, 2280-2282 [responding to Legislative Analyst Office questions about the backlog of work, prioritization of work, and statutory requirements for compliance inspections]; Administrative Record 00181-00182 [staffing at a historic low].)

The process to obtain a water right is very involved, and may include a protest based on prior right or environmental concerns, a hearing, and a field investigation.

(Appendix 2278.) There is no similar procedure under which someone claiming a riparian or other right not subject to fees can obtain an SWRCB approval confirming the right. Similarly, most administrative proceedings to determine proposed changes to water rights are not available to other water right holders. (Compare Wat. Code, § 1700 et seq., 1725 et seq., 1735 et seq. [setting forth procedure for changes, including expedited procedures for short term changes] with Wat. Code § 1706 [providing no administrative procedure for changes to pre-1914 rights].)

The filing of a water right application or a petition for a change to a permitted or licensed water right does not occur in a vacuum. The existence of large numbers of permits and licenses contributes to the high cost of processing applications for new permits. Careful scrutiny is required even for small projects because of the impact of the diversion in combination with diversions authorized under previously issued permits and licenses.

In sum, the water right program's resources are primarily directed to the regulation of permits and licenses. (See generally Appendix 2013:19 to 2023:1.)

E. The State's "de minimis" argument is not new.

It is not true that the State provided no evidence to the Court of Appeal to support its de minimis argument, and it is unfair to state this argument was made "late in the day." (NCWA, p. 20, fn. 9 and accompanying text.) Neither NCWA nor the Farm Bureau argued in their petitions for reconsideration or in their trial briefs that SWRCB devoted significant resources to other water right holders. (E.g., Appendix 2044:15-17 [describing their arguments].)

The State provided the following evidence in its brief to the Court of Appeal and in its trial brief:

> Only about five percent of the Division's time is spent on efforts to protect parties who claim and appear to have water rights that are not within the Water Board's permitting authority. (Appendix 2298.)

(Respondents' Brief, p. 18; Appendix 2019:21-23 [trial brief].) The State's briefs below demonstrate the de minimis argument is not new. (See Appendix 2044:17-19 ["the use and diversion of water pursuant to water right permits and licenses issued by the Water Board is the very subject of the Water Board's water rights regulatory program"]; Respondents' Brief to the Court of Appeal, p. 47 ["Because the water right program exists to regulate the use and diversion of water under permitted and licensed water rights, it is reasonable to allocate the majority of program costs using diversion-based annual fees levied against all permits and licenses"].) The State emphasized the five percent figure to the Court of Appeal in its Petition for Rehearing, at pages 19 through 20.

F. The level of proof NCWA demands is not required.

NCWA does not explain why it is unreasonable to assume that on average, permits with a greater face value will involve greater diversions and a greater regulatory burden. NCWA's argument is identical to the plaintiff's unsuccessful argument in *SDG&E,* where plaintiff argued "the district has not specifically shown how the amount of emissions generated by a pollution source increase the district's indirect costs. . . ." (*SDG&E, supra,* 203 Cal.App.3d at p. 1147.) In response, the court distinguished *Beaumont Investors v. Beaumont-Cherry Valley Water Dist.* (1985) 165

Cal.App.3d 227 and rejected the idea that further proof was required:

> There is no reason to require the district to show precisely how more emissions generate more costs to justify the emissions-based apportionment formula. The purpose for the district's existence is to achieve and maintain air quality standards, thus from an overall perspective it is reasonable to allocate costs based on a premise that the more emissions generated by a pollution source, the greater the regulatory job of the district.

(*Id.* at pp. 1147-1148 [internal citation omitted, italics added].) Here, the purpose of the SWRCB's existence is regulate the diversion and use of water through a permit and license system. Based on its experience, SWRCB concluded it is reasonable to assume that the greater the diversion authorized under permit or license, the greater the regulatory job. (Appendix 2304-2305 [discussing annual fees].) Absolute precision is not required. (*California Assn. of Professional Scientists v. Department of Fish and Game* (2000) 79 Cal.App.4th 935, 950-951 (*CAPS*).)

Like the Court of Appeal, NCWA argues there is no evidence to support the SWRCB's fee regulations, when there is substantial evidence. They dismiss the evidence presented because they demand precision far greater than is required or even possible.

II.

A reviewing court does not act as the fact finder.

The second issue is whether the Court of Appeal applied the correct standard of review to the validity of the SWRCB's fee allocations. The State does not argue "the Court should have deferred to the SWRCB's policy determinations in weighing the significant constitutional questions before it." (NCWA, pp. 27-28, compare *ibid.* with

Opening Brief, pp. 29-30.) The State's point is that it is not the court's function to second-guess the agency's rulemaking conclusions or resolve conflicting views in an area committed to the discretion of the rulemaking agency.

III.

The annual fees imposed on the federal contractors do not violate the Supremacy Clause.

The SWRCB's allocation of the cost of the regulation of the permits and licenses held for federal reclamation projects does not violate the Supremacy Clause. NCWA contends the State "never refutes the . . . fact that . . . the federal contractors pay for the entire amount of the fees that are imposed on the United States." (NCWA, p. 37.) To the contrary, the State explained that (a) the fees *are not imposed on the United States* or any federal instrumentality; (b) the contractors have a separate interest in the Bureau's permits and licenses; (c) the annual fees are based on the regulatory costs associated with the permits and licenses held to support the contractors' contractual right to the water's use; and (d) the contractors pay *only the annual fees associated with the permits and licenses held to support their projects*. (Opening Brief, pp. 37-48.)

A. The "plain language of the statute" does not impose the fee on the United States.

NCWA contends the "plain language of the statute imposes the fee on the United States." (NCWA, p. 40.) However, the fees are imposed only "to the extent authorized under federal . . . law." (Wat. Code, § 1560, subd. (a).)

The *paramount* consideration in a Supremacy Clause case is "the closeness of

the interrelationship between the contractor and the United States Government." (*U.S. v. Hawkins County* (E.D. Tenn. 1987) 661 F.Supp. 857, 859.) The annual fees are not levied on the federal government or any federal instrumentality "so closely connected to the Government that the two cannot realistically be viewed as separate entities, at least insofar as the activity being taxed is concerned." (*United States v. New Mexico* (1982) 455 U.S. 720, 730.) (Opening Brief, pp. 39-41.)

B. The federal contractors do not "already pay a 'proper share' for the water they receive."

NCWA contends that the regulations allocate the "entire fee" to the contractors. (NCWA, p. 38.) The contractors do not pay all regulatory fees associated with the Bureau's projects: they pay only the annual fees associated with the project that provides their water deliveries. (Opening Brief, pp. 45-48.) NCWA disputes this position, stating "federal contractors already pay a 'proper share' for the water they receive" pursuant to the terms of their contract. (NCWA, p. 38.) The money the contractors pay pursuant to the contract does not cover the annual fees because the annual fees *are not paid by the Bureau.*

C. The regulations do not discriminate against the federal contractors.

NCWA contends the State provides no basis for its conclusion that the allocation of fees to the federal contractors ensures that they will be treated similarly to other contractors, such as the state water contractors. (NCWA, pp. 39-40.) It claims the reference provided "is a statement without any support or evidence in the record" to indicate how the determination was made. (NCWA, p. 39.) NCWA's Answer marks

the first time it has ever objected to this information. NCWA's own brief admits that *if* the Bureau paid annual fees, it would include them in the operational and maintenance costs charged to the contractors. (NCWA, pp. 38-39, fn. 14 [and accompanying text].)

The statement memorializes the research done in connection with the NCWA petition for reconsideration to determine whether the annual fees for permits and licenses held by the Department for Water Resources (DWR) for the State Water Project (SWP) would be passed through to the state water contractors. (Appendix 2553, AR 03704.) NCWA alleged the regulations discriminated against federal contractors. NCWA relied only on legal argument, claiming the statute and regulations "single out" federal contractors unfairly based on federal case law where other non-federal public property was exempted. (AR 2464-2465.)

The SWRCB order distinguished the legal authority, noting that in this case, the law did not exempt other non-federal public property. (Appendix 314-315, fn. 25.) The law avoids discrimination by allowing the fees to be allocated to the water supply contractors if the water right holder declines to pay based on a legitimate claim to a legal status that makes it exempt from the fee.

D. The regulations allocate the appropriate portion of the fee.

NCWA contends the regulations "fail to allocate an appropriate portion of the entire fee that the statute imposes on the United States." (NCWA, p. 42 [italics omitted].) NCWA bases this contention on the assertion "no case has allowed all of the tax imposed on federal property to be allocated to non-federal entities with but a limited interest in only a portion of the property." (*Ibid.* [italics omitted].) That is not the case

here. (Opening Brief, pp. 43-48.)

The Supremacy Clause is not violated by imposing on the federal water contractors the annual fees that support the regulation required to provide the water deliveries for which they contract. (Opening Brief, pp. 37-48.) "The SWRCB determined that the federal water contractors' share of the regulatory cost should be equal to the face value -- discounted for hydropower generation -- of the federal permits and licenses related to their contracts because these permits and licenses are held primarily to support the contract deliveries." (Opening Brief, p. 44.) For this proposition, the State references several cases, federal statutes, and the record [the federal water supply contracts themselves]. (*Id.*, p. 44-45.) Having overlooked this evidence and legal authority, NCWA did not respond to it.

All of the regulatory costs represented by the annual fees associated with the contractors' water deliveries can be attributed to the contractor's use – the water supply. The "beneficial purposes" for which the water right program may issue a water right permit do not include flood control or navigation and, consequently, the SWRCB does not regulate these matters. (See State's Answer to NCWA, pp. 26-27.)

The fees are based on the regulation of the water rights.[2] Thus, no fees were charged for the navigation and flood control purposes of the CVP. Nor is "river regulation" a purpose of use under any of the permits or licenses for the CVP. (And NCWA provides no evidence to the contrary; indeed, NCWA never raised these

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[2] A direct regulatory relationship with the contractors is unnecessary to uphold the fees. (Opening Brief, p. 43.)

contentions in its petition for reconsideration or any of its briefs below.)

These functions are, however, closely related to the contractors' water deliveries. The CVP must ensure the water quality of the water the contractors receive. (*United States v. State Water Resources Control Bd.* (1986) 182 Cal.App.3d 82, 134.) Water from CVP facilities is also used to meet requirements imposed to mitigate the adverse environmental impacts of the project. (See *State Water Resources Control Bd. Cases* (2006) 136 Cal.App.4th 674, 710-711, 759 [describing how releases from New Melones Reservoir are used to meet water quality requirements imposed to mitigate CVP impacts.) The mitigation requirement does not convert a water supply project into an environmental enhancement project. It illustrates one of the reasons why the face value of the permits and licenses for the CVP vastly exceeds the amount of water available for delivery, as is the case for any other, non-federal project.

/ / /

CONCLUSION

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

Dated: July 31, 2007

Respectfully submitted,

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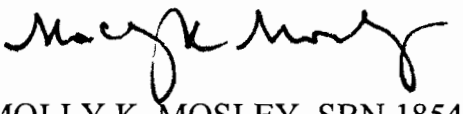

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CERTIFICATION OF WORD COUNT

The text, including footnotes, of Respondents' Opening Brief on the Merits consists of 4,135 words according to the word processing program used to prepare the brief.

Dated: July 31, 2007

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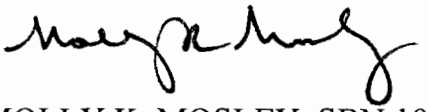

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DECLARATION OF SERVICE BY U.S. MAIL

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 30, 2007, I served the attached **STATE'S REPLY BRIEF ON THE MERITS TO ANSWER 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 30, 2007, at Sacramento, California.

D. Burgess	D. Burgess
Declarant	Signature

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