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 CALIFORNIA FARM BUREAU FEDERATION, ET AL.

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I.

The fees reasonably apportion water right program costs.

A. The Farm Bureau misrepresents the water right program.

The Farm Bureau contends the public and other water right holders – whose use is not routinely supervised by the SWRCB – should be paying for the costs "associated" with protecting them through the regulation of permit and license holders. If the rule is that costs may not be "associated with" non-feepayers, then all regulatory fees are invalid.

But this Court has not established that rule. Under *Sinclair Paint,* the charges allocated to a fee payer must bear a fair or reasonable relationship to the payor's burdens on or benefits from the regulatory activity. (*Sinclair Paint Co. v. State Bd. of Equalization* (1997) 15 Cal.4th 866, 878.) The SWRCB can validly allocate the majority of its water right regulatory costs to persons subject to the water right permit and license system because these costs are primarily due to the administration of the permit and license system.

1. The de minimis argument is amply supported by the entire record.

The State argues that Proposition 13 allows the annual fees to be charged only to permit and license holders because persons who are exempt from the water right permit and license program are subject to significantly less, and qualitatively different, state regulatory authority than permittees and licensees. (State's Brief on the Merits, pp. 3-5 and 19-27.) The State's position from the beginning has been that the

regulation of permittees and licensees is the very subject of the water right program. (See discussion, State's Reply to NCWA, pp. 5 and 9-10.)

The State does not rely on the five percent estimate "*for the very first time in this Court.*" (Farm Bureau, p. 4 [italics original]; compare *ibid.* with Petition for Review, p. 3, Petition for Rehearing, pp. 19-20, Respondents' Brief, p. 18 and pp. 15 et seq. [describing activities], and Appendix 2019:21-23 and 2044:17-19 [trial brief].) It is true the State did not make much of the five percent figure until the Petition for Rehearing, but that is because no one seriously argued that the SWRCB devoted significant resources to other water right holders. All parties understood the primary subject of the water right program to be the regulation of permits and licenses. The Farm Bureau's administrative petition for reconsideration did not claim the SWRCB devoted any significant resources to other water right holders. (See Clerk's Augmented Transcript on Appeal (CATA) 145-167.) And NCWA argued the SWRCB had *no* regulatory authority over other water rights. (See Opening Brief, p. 19.)

Then the Court of Appeal issued its decision, relying heavily on a pie chart in the record, which shows what proportion of water is held under the different types of water rights but *does not purport to represent the resources spent to regulate those rights.* It also relied on *selective* estimates (i.e., Application/Petition Processing, 25 %, Environmental Review, 18%, etc.) of the program resources devoted to various functions. (Slip op., pp. 6-7 and 41; see Appendix 2298.) These estimates, including the five percent figure, were set forth together in Respondents' Brief. (Respondents' Brief, p. 18.) The court also mused that the amount of resources devoted to enforcing

public trust requirements and protecting the environment and others did not appear to support the State's de minimus argument, apparently accepting plaintiffs' characterization of such actions as having little to do with the regulation of permit and license holders. (Slip op., p. 41.)

The court ignored all of the other evidence in the record, including the five percent figure. The same estimates of the SWRCB's water right resource allocations (but not the five percent figure) are also found at page 2287 of the Appendix. But that document notes the SWRCB has "not spent much" on what it calls its "additional duties" (i.e., statutory adjudications and court references), and that the work is all reimbursable by statute. (Appendix 2286.) It reflects, like all of the documents in the rulemaking record, as well as those in the administrative record and those received from the SWRCB through discovery (and available pursuant to the Public Records Act), the understanding that the primary focus of the program is the regulation of permitted and licensed water rights. As noted in the State's Reply to NCWA, there is no unit in the Division devoted to regulating riparians or pre-1914 water right holders.

The Farm Bureau also argues that, based on the context, the five percent estimate does not stand for what the State says it does. (Farm Bureau, p. 12.) Not so.

The paragraph begins: "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." (Appendix 2298.) It goes on to describe the benefits the exempt water right holders receive through the protection afforded by the regulation of permits and licenses. The next

sentence states that the SWRCB "estimates its spends approximately five percent of its resources protecting the water rights of parties who hold rights not subject to permit or license." Then, it states that "These resources (direct protection of other water rights) are expended in the areas of application/petition processing and in investigation of complaints." (Appendix 2298.) If the SWRCB has no statutory authority over other water right holders, and does not routinely supervise their activities, their rights would be most likely to come to the SWRCB's attention because of complaints or during the application or petition process. The SWRCB has rarely taken enforcement action against other water right holders, and neither plaintiff has pointed to any such action as support for its position. (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].)

A review of the basic statutory structure governing the SWRCB's water right work also supports the State's position. The SWRCB administers the statutory water right system, involving the issuance and oversight of water right permits and licenses. The SWRCB's core authority, consisting of well over 200 separate code sections, is in Part 2 (commencing with section 1200) of Division 2 of the Water Code.

To avoid any confusion in reviewing these statutes, it should be noted that the Division of Water Rights is not a separate state agency like the Department of Water Resources (known as "DWR"). (Farm Bureau, p. 9.) Like the name says, the Division is a *division* of the SWRCB and does its work. (Wat. Code, § 186 [SWRCB's work divided into at least two divisions, one of which is the Division of Water Rights].) The

Farm Bureau's use of the acronym "DWR" only serves to confuse.[1]

The water right program also includes statutory adjudications and water quality certification for hydroelectric projects, which apply to diversions under all bases of right. But these activities are supported by their own fees, set to cover the entire cost of these activities. (Wat. Code, §§ 1528, 13160.1.) The SWRCB administers a few other Water Code sections that apply to both permitted and licensed rights and to other rights, most notably section 275, but to characterize these sections as even five percent of the SWRCB's statutory authority would be an exaggeration.

If the State seems to rely on the five percent estimate heavily, it is only because the Court of Appeal did not seem to understand (or accept) all of the State's previous evidence and argument regarding the nature of the regulatory program, preferring to rely on some figures to the exclusion of others. The Court of Appeal did not invalidate the fee regulations based "on the undisputed evidence that fee payors paid for substantial costs associated with others not subject to the 'fees.'" (Farm Bureau, p. 7.) Ignoring the evidence in the record, including the five percent estimate, the Court of Appeal based its decision on the supposed *lack of any evidence* to support the allocation of the costs of the water right program between those persons whose diversion and use are subject to state permitting and licensing and other water right holders. (Slip op., p. 42.)

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[1] The Department of Water Resources has different statutory duties. (See Wat. Code, §§ 128, 130, 150-166, 229, 231, 235, 250-260, 300-311, 340, 345, 462-465.) For example, the Department, not the SWRCB, is the entity responsible for flood control. (Wat. Code, § 8300 et seq.)

The weight of the entire record supports the five percent estimate. The Farm Bureau relies on the Court of Appeal's erroneous factual conclusions, not the record, to contend the estimate is unsupported. (Farm Bureau, pp. 4-5.)

2. The State's arguments are consistent.

There is no inconsistency in the State's characterization of the benefit provided or burden imposed. The benefits that result from the regulation of permits and licenses can be characterized as benefits to the permit and license holders, the general public, and other water right holders whose rights are not routinely supervised. But that does not change the fact that the costs are primarily due to the SWRCB's administration and oversight of the permit and license system, not the regulation of the public or other water right holders. If the Legislature's decision to charge water right fees only to those who are subject to the permit and license system is reasonable, the SWRCB's decision to allocate the fees *among* those subject to the permit and license system, taking into account additional factors such as the benefits of the program and enforcement concerns, does not make the Legislature's decision arbitrary.

The Farm Bureau, like NCWA, contends that it is unfair to keep application and petition fees low, placing more of the burden on existing permit and license holders. It characterizes those filing applications as "*individual members of the general public*" (E.g., Farm Bureau, p. 12.)[2] This argument is specious. Unlike the public generally,

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[2] It should be noted that the fee for a water right application is the "greater of either $1,000 or $10 per acre-foot based on the total annual amount of diversion sought by the application." (Cal. Code Regs., tit. 23, § 1062, subd. (a)(1).) This could be a very large number indeed.

applicants, permittees, and licensees are subject to water right fees, and if the application is approved, the applicant becomes a permittee, subject to annual fees. Moreover, a water right permit differs from a building permit because the latter is not an operating permit and neighbors are not subject to continuing oversight. It is not unreasonable to use the annual fees of existing members of the regulated community to govern admission into the regulated community. (See e.g., *In re Attorney Discipline System* (1998) 19 Cal.4th 582 [State Bar regulates admission, discipline and disbarment of attorneys].)

The water right program is a classic regulatory program. The basic purpose of the regulation is the protection of the public *and* members of the regulated community from the activities of the regulated entities. (See *In re Attorney Discipline System, supra,* 19 Cal.4th at pp. 608-609.) The licensing process (beginning with the permit application) ensures certainty and order to those who already have their permit or license. (See *id.* at pp. 608-613 [discussing the need for licensing and oversight of the practice of law].) Sending out notices to those filing statements of diversion (filed by water right holders not subject to the permit and license system) during the application process (Farm Bureau, p. 30) provides the SWRCB with necessary information about the universe of water diversions and use, enabling it to more effectively manage existing permits and licenses. Members of the regulated community may reasonably be required to pay fees that pay for the ongoing cost of administering the permit and license system, including enforcement actions against persons who divert and use water without a valid basis of right. (See Gov. Code, § 6126.3, subd. (b) [State Bar has

authority to take enforcement action in response to the unauthorized practice of law].)

B. The State has demonstrated the "estimated costs" of the regulatory activity.

Like NCWA's Answer, the Farm Bureau's Reply generally dodges the State's arguments by misstating them, misrepresenting the record, and misinterpreting the law. The Farm Bureau makes contentions it cannot and does not back up regarding the nature of the water right program and asserts concessions the State has not made. (See e.g., p. 2 [claiming the State "conceded" that "*all* the activities" of the water right program are included in Water Code section 1525, subdivision (c)'s description of activities the fees may be used to cover].)

The Farm Bureau relies on *Beaumont Investors v. Beaumont-Cherry Valley Water Dist.* (1985) 165 Cal.App.3d 227 to support its contention that the SWRCB has failed to show that the estimated costs do not exceed the regulatory activity. (Farm Bureau, pp. 38-39.) This case, like the case of *San Diego Gas & Electric Co. v. San Diego County Air Pollution Control Dist.* (1988) 203 Cal.App.3d 1132 (*SDG&E*), is distinguishable from *Beaumont,* where there was "*no evidence in the record* showing how the estimated costs of the anticipated government activity were ascertained or apportioned." (*SDG&E, supra,* 203 Cal.App.3d at p. 1147 [italics added].) In contrast here, the SWRCB has shown how the costs of the government activity were ascertained through the State Budget and its rulemaking record details the apportionment method and its rationale.

Undeterred by the fact that the $7 million collected in fees is less than the $9 million cost of the program, the Farm Bureau asks the court to treat expenditures from

sources other than fee revenues as though they were fee revenues, arguing that the fee revenues plus the amount budgeted for expenditure from sources other than the Water Rights Fund exceeded $9 million. (Farm Bureau, p. 38 et seq.) The State has already answered the Farm Bureau's arguments regarding "over-collection" and refunds, and will not repeat the arguments here. (State's Answer to Farm Bureau's Opening Brief on the Merits, pp. 26-31.)

II.

Proposition 13 does not warrant "heightened judicial scrutiny" of an agency's quasi-legislative regulations.

The second issue is whether the Court of Appeal applied the correct standard of review to the validity of the SWRCB's fee allocations, set forth in the California Code of Regulations, title 23, sections 1066 and 1073, and adopted through emergency rulemaking. The Farm Bureau fails to distinguish between the ultimate legal issue and the factual and policy judgments that are relevant to that ultimate legal issue.

The State argues that "the SWRCB's legal interpretation of the fee statutes and the California Constitution is subject to the court's independent judgment. However, the SWRCB's factual determinations and policy considerations – including its determination that the water right program primarily regulates state permits and licenses – can be reviewed only for abuse of discretion." (Opening Brief, pp. 29-30.) The Court of Appeal refused to apply the deferential standard of review "applied to the review of quasi-legislative actions by ordinary mandamus" (slip op., p. 30), and gave no deference to the SWRCB's factual determinations and policy considerations.

Rather than acknowledge the erroneous fact finding of the Court of Appeal, the Farm Bureau contends none of the findings had to do with disputed facts, and in any case, none of them are material. (Farm Bureau, pp. 53-56.) This contention is untrue. These "facts" were only undisputed because no party contended they were true, and they were of substantial consequence to the Court of Appeal's decision to invalidate the regulations.

The Court of Appeal assumed the statute required the SWRCB to apportion costs between fee payers subject to the annual permit and license fees and other types of water right holders who are not, but who "benefit" from the regulatory program (slip op., pp. 40-43), based on the following incorrect assumptions of fact: (1) the Water Rights Fund provides the funding for the entire water right program (slip op., p. 39) and (2) additional detail exists in the budget "from which the amounts allocated to the functions or activities set forth in subdivisions (a) through (c) [of Water Code section 1525] can be calculated." (Slip op., p. 35, fn. 21.)

The Farm Bureau itself now contends there must be "at least some evidence of the amount of resources expended on the various categories of water right holders. . . ." (Farm Bureau, p. 56.) The State has shown that the Budget contains no such evidence. (See State's Request for Judicial Notice.) As has already been discussed, the weight of the evidence in the record -- ignored by the Court of Appeal -- demonstrates that only a de minimis amount of the SWRCB's resources are devoted to regulating other water right holders.

In *Bixel Associations v. City of Los Angeles* (1989) 216 Cal.App.3d 1208 (governed by statute inapplicable here), the court held only that "As to the facts presented to the trial court on a summary judgment motion, an appellate court independently determines their effect as a matter of law." (*Id.* at p. 1216.) A reviewing court does not "weigh conflicting evidence and determine who has the better argument." (*Western States Petroleum Assn. v. Superior Ct.* (1995) 9 Cal.4th 559, 574.) Of course, "the courts are not and should not be bound by an administrative finding of fact that is obviously a subterfuge for an erroneous finding of law, nor when the evidence on the face of it is clearly unbelievable." (*Board of Supervisors of Modoc County v. Archer* (1971) 18 Cal.App.3d 717, 723-724 [rejecting as unbelievable the board of equalization's determination that the right to pasture cattle on government land has no cash value].) But that is not the case here.

The Farm Bureau fails to distinguish its constitutional challenge to the fee from the cases cited by the State. The Farm Bureau contends "none of the cases . . . involve the refund of fees challenged as *illegal* or *unconstitutional,* but rather involve claims regarding the scope of an agency's discretion." (Farm Bureau, p. 51 [italics original].) Not so. In *Shapell Industries, Inc. v. Governing Bd.* (1991) 1 Cal.App.4th 218, the plaintiff challenged the fee on grounds that the Board's action was arbitrary and capricious and without evidentiary support, *thus making the fee illegal and in violation of the Due Process and Equal Protection Clauses* because of the lack of "nexus." (*Id.* at pp. 228-229.)

In analyzing the due process and equal protection claims, the *Shapell* court did not apply any "heightened scrutiny" to the to the facts and policy judgments it had given deference to in analyzing whether the fee bore a reasonable relationship to the need for which it was imposed. The court held "Our conclusion that the fee imposed . . . bears a reasonable relationship to the need for school facilities . . . also disposes of Shapell's claims that those fees were invalid as special taxes and violated the Due Process and Equal Protection Clauses of the United States and California Constitutions." (*Shapell Industries, Inc. v. Governing Bd., supra,* 1 Cal.App.4th. at p. 247.)

Contrary to the Farm Bureau's contention, this Court made clear in *20th Century Ins. Co. v. Garamendi* (1994) 8 Cal.4th 216 that constitutional issues do not change how the court should review an agency's factual determinations and policy considerations. (Farm Bureau, p. 50, fn. 8.) This Court noted that *any* regulation can be challenged on constitutional grounds, and to apply a less deferential standard of review in every case involving constitutional issues would create an exception that swallows the rule. (*20th Century Ins. Co. v. Garamendi, supra,* 8 Cal.4th at p. 279, fn. 13.)

The Farm Bureau also misstates the law when it claims that the deferential standard applies only where an agency allegedly has overstepped its authority or the mandate of an enabling statute in promulgating regulations." (Farm Bureau, p. 48.) Whether a regulation is consistent with the statute is a question of law. (*Yamaha Corp. of America v. State Bd. of Equalization* (1998) 19 Cal.4th 1, 11, fn. 4.)

The fee regulations are properly promulgated regulations that made choices among many options. They are "the substantive product of a delegated *legislative* power conferred upon the agency." (See *Yamaha Corp. of America v. State Bd. of Equalization, supra,* 19 Cal.4th at p. 8.) The State most emphatically does not think that Legislative enactments should be subject to less deference than the regulations. (Farm Bureau, p. 46, fn. 7.) Rather, an agency making a quasi-legislative decision authorized by statute should be given the same deference the Legislature is given in enacting a statute. Giving no deference to the administrative agency undermines the Legislature's delegation of rule-making authority and makes the same fee schedule subject to very different standards of review depending on whether it is enacted by statute or by regulation, although the legal issues are identical. (Sen. Don Perata, Amicus Letter in Support of Petition of the California State Board of Equalization and the California State Water Resources Control Board for Review, April 4, 2007.) The State does not ask for an "arbitrary and capricious" review of its legal conclusions, only of its factual and policy judgments.

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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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CERTIFICATION OF WORD COUNT

The text, including footnotes, of the State's Reply Brief on the Merits to the Answer Brief of the Farm Bureau consists of 3,591 words according to the word processing program used to prepare the brief.

Dated: July 31, 2007

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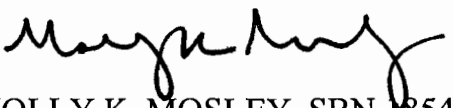

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DECLARATION OF SERVICE BY U.S. MAIL

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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.

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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 31, 2007, at Sacramento, California.

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