CASE NO. S150518

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

CALIFORNIA FARM BUREAU FEDERATION, et al.,

Plaintiffs and Appellants,

v.

CALIFORNIA STATE WATER RESOURCES CONTROL BOARD, et al.,

Defendants and Respondents.

NCWA PETITIONERS' REPLY BRIEF ON THE MERITS

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

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

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NCWA PETITIONERS' REPLY BRIEF ON THE MERITS

Pursuant to California Rules of Court, Rule 8.520, Petitioners and Plaintiffs Northern California Water Association, Central Valley Project Water Association, and over 200 other water right holders in California (collectively, "NCWA Petitioners") submit this Reply to the State's Answer Brief on the Merits to Brief of Northern California Water Association ("State's Answer").

I. INTRODUCTION

Instead of addressing the distinct legal issues presented by NCWA Petitioners, the State broadly asserts that all of the "burdens" imposed on the State Water Resources Control Board's ("SWRCB") Division of Water Rights ("Division") are caused by water right permit and license holders. This assertion completely ignores the broader purposes, policies, and activities of the Division related to California's water resources.

The State's Answer also minimizes the standard for determining whether charges imposed by the State fall within or outside of article XIII A of the California Constitution's ("Article XIII A") prohibition or limitation on the imposition of new taxes, misconstrues the analysis of "regulatory fees" imposed *as an incident* of property ownership, grossly overstates the supposed "burden" created by existing water right holders, misstates and misconstrues the nature of the charges imposed

on the water rights held by the United States, and fails to bridge the gap between those federal cases allowing the "taxation" of a federal contractor's possessory interest in federal property and the State's attempt here to charge the federal contractors for all of the costs associated with regulating the United States.

II. ARGUMENT

A. Standard of Review and Burden of Proof

The State argues that "regulatory fees" are not a "loophole," or an exception to Article XIII A's strict limits on taxation, and, further, that the State should be required to bear the "burden of proof only to the extent of providing an adequate rulemaking record for the court to determine whether the SWRCB's factual findings were arbitrary or capricious." (State's Answer, p. 13.)

Principle case law has recognized repeated attempts to circumvent Article XIII A. Indeed, this Court recognized that attempts to circumvent Proposition 13 were government devised loopholes:

> As explained in *Howard Jarvis*, [*Taxpayers Assn. v. City of Riverside* (1999)] 73 Cal.App.4th 679, Proposition 218 is Proposition 13's progeny. Accordingly, it must be construed in that context. [Citations.] Specifically, because Proposition 218 was designed to close government-devised loopholes in Proposition 13, the intent and purpose of the latter informs our interpretation of the former. (*Apartment Assn. of Los Angeles County, Inc. v. City of Los Angeles* (2001) 24 Cal.4th 830, 838-839.)

The government's continued attempts to circumvent these constitutional limitations were recognized in *Los Angeles County Transportation Com. v. Richmond and City* and *County of San Francisco v. Farrell.* (See *Los Angeles County Transportation Com. v. Richmond* (1982) 31 Cal.3d 197, 209-210, Richardson, J. dissenting; and *City and County of San Francisco v. Farrell* (1982) 32 Cal.3d 47, 57, Richardson, J. dissenting.)

Regarding the second point, the State's burden is not simply to provide an "adequate rulemaking record."[1] (State's Answer, p. 13.) In this regard, the State invites this Court to significantly constrain a reviewing court's role involving constitutional challenge. The State's argument, that the various cases imposing the burden of proof on the government "should be construed to mean that the government should bear the burden of proof regarding facts that may be within the government's own special knowledge," must be rejected. Here, the State seeks to escape the strict limitations contained in Article XIII A and should be held to its burden of proving its actions fit within the exception. (*Sinclair Paint Co. v. State Bd. of Equalization* (1997) 15

[1] The Legislature directed the SWRCB to adopt and revise the challenged fees through emergency regulations and, as such, there is no statutory requirement to provide a "rulemaking record." (See Wat. Code, § 1530; Gov. Code, § 1134.6.1(a)(1).)

Cal. 866, 874; *Beaumont Investors v. Beaumont-Cherry Valley Water Dist.* (1985) 165 Cal.App.3d 227, 235; *Bixel Associates v. City of Los Angeles* (1989) 216 Cal.App.3d 1208, 1216; *San Diego Gas & Electric Co. v. San Diego County Air Pollution Control Dist.* (1988) 203 Cal.App.3d 1132, 1146.)

B. Water Code Section 1525 Imposes an Unconstitutional Tax on Real Property

In responding to the real property issue, as presented by NCWA Petitioners, the State argues that the question presented "entirely begs the question of whether the water right fees are valid regulatory fees." (State's Answer, p. 14.) The State altogether misses the point and is otherwise wrong.

1. That the Charges Are Used to "Regulate" Real Property Is Not Relevant

The question presented is not whether "water right permits and licenses . . . require regulation," as is postulated by the State, nor is it whether the Division should be properly funded to ensure the reasonable beneficial use of water.[2] (See State's Answer, p. 15.) *All* real property

[2] Of course, the Division's work associated with "reasonable" and "beneficial" use of water is undertaken as part of the SWRCB's constitutional mandate, emanating from article X, section 2 of the California Constitution. This work is not undertaken pursuant to a simple "regulatory" program. To suggest that it is trivializes the importance of the constitutional mandate.

is regulated. Yet, there is simply *no* authority that the State can impose a "regulatory" fee, *as an incident of ownership*, for the sake of regulating real property. The State cites no case that supports their novel argument. The relevant question posed here, to which the State never responds, is whether the State can impose a charge *as an incident of ownership of real property*, under the guise of a regulatory fee.

The State attempts to bootstrap its position by attempting to analogize the instant charges to those at issue in *Pennell v. City of San Jose* (1986) 42 Cal.3d 365. (State's Answer, p. 15.) The State likens those engaged in the business of renting apartments to those who hold water rights, suggesting that the charges at issue here are for the cost of regulating a "business." (State's Answer, pp. 15-16.) Oddly, the State argues that NCWA Petitioners' arguments only "hold water" if the charges are "imposed simply for the privilege of holding the water right . . . ." (State's Answer, p. 16.) That, however, is precisely what the challenged fees do. They are imposed *solely* because one "holds" a water right permit or license. (See Wat. Code, § 1525(a).) The State never addresses the statutory language, simply contending that the charges are imposed based upon the "use" of water.

It is noteworthy that the State writes at length about water rights being limited to reasonable beneficial use, yet the challenged fees do not at all relate to "use." (State's Answer, pp. 19-22.) Instead, the

challenged fees are based upon the "face value" of the right, which "almost always exceeds the actual amount of water that can be used or diverted – sometimes vastly so." (State's Answer, p. 8.) Placing a fee on the face value of the permit and license, without regard to actual use, is a levy directed simply for the privilege of holding the real property right[3] to water and bears no relationship to the actual "use" of water. As such, and to the extent that doing so is consistent with what appears to be the plain and unambiguous language of the statute, the statute is unconstitutional.

2. The "Pervasiveness" of Regulation Is Irrelevant

The State also argues that the "most important characteristic of a state-permitted or licensed water right is the pervasiveness of the regulation to which it is subjected." (State's Answer, p. 19.) The State argues that it can impose "fees" for the purpose of regulating real property. Yet, the State cites to no authority to support the argument

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[3] Initially, the State contended that water rights were not real property. (Appendix of Appellants California Farm Bureau Federation, et al. and Northern California Water Association, et al. ("AA" 310.) Later, the State changed it position, arguing that the fees were simply "associated with some sort of property right." (AA 2032.) The State apparently now recognizes that water rights are real property but suggests that, if the property right is in the "use" of water, the constitutional limitations somehow do not apply. The State fails to address the fact that over 100 years of California caselaw and the California Constitution recognize that water rights are real property, even for the purpose of taxation.

that the State can impose charges as an incident of ownership simply because the regulation is "pervasive." Indeed, *all* real property is subject to "pervasive" regulation, some more than others. Whether the real property consists of farmland in California's Central Valley (Gov. Code, § 51200 et esq.), coastal property (Pub. Resources Code, § 30008 et seq.), land along the shore of Lake Tahoe (Gov. Code, § 67000 et seq.), sensitive wetlands or vernal pools, timber or mineral resources (Pub. Resources Code, § 4511 et seq.; Pub. Resources Code, § 2710 et seq.), or residential property anywhere in California, it is all subject to "pervasive" regulation. The State's position amounts to nothing less than an absolute and total end run around the very specific purposes of Article XIII A.

Moreover, directly contrary to the States central point, much of what the State argues in pages 20 through 22 of its Answer is based upon cases referring to broader issues arising from the constitutional provisions on the diversion and use of water, and from the SWRCB's public trust duties – not from a simple "regulatory" program. (See State's Answer, p. 20, citing *Central and West Basin Water Replenishment Dist. v. Southern California Water Co.* (2003) 109 Cal.App.4th 891, 905 [discussing constitutional prohibition on "waste" of water]; p. 20, citing *Joslin v. Marin Municipal Water Dist.* (1967) 67 Cal.2d 132, 140 [discussing constitutional concepts of reasonable use,

method of use, or method of diversion]; p. 21, citing *Imperial Irrigation Dist. v. State Water Resources Control Bd.* (1986) 186 Cal.App.3d 1160 [discussing constitutional requirements related to pre-1914 water rights].)

Most of the cases cited by the State, regarding the "regulation" of water, involve *other than* water right permits or licenses. (See *Peabody v. City of Vallejo* (1935) 2 Cal.2d 351 [complaints by riparian right holders]; *Town of Antioch v. Williams Irrigation Dist.* (1922) 188 Cal. 451 [riparian and other rights]; *Imperial Irrigation Dist. v. State Water Resources Control Bd., supra*, 186 Cal.App.3d 1160 [pre-1914 appropriative rights]; *Joerger v. Pacific Gas & Elec. Co.* (1929) 207 Cal. 8 [riparian rights]; *In re Waters of Long Valley Creek* (1979) 25 Cal.3d 339 [authority to adjudicate future riparian water rights]; and *Allegretti v. County of Imperial* (2006) 138 Cal.App.4th 1261 [groundwater].). The State's reliance on these cases completely undermines the State's attempt to limit and trivialize the overarching duties, policies, and activities of the SWRCB with regard to the water resource as the mere "regulation" of permitted and licensed water rights.

In any event, simply because real property is "regulated" does not provide a basis for the State to impose charges as an incident of real property ownership under the guise of a "regulatory fee." Article XIII A cannot be perverted to allow such a funding scheme. The SWRCB

and the Legislature must comply fully with the Constitution's limits on taxation, including the two-thirds voting requirement.

3. The Charges Are Not Valid Regulatory Fees

The State argues that the challenged charges are valid regulatory fees because they support a "classic regulatory program," and that Article XIII A does not prohibit charging "fees" for many basic government services. (State's Answer, pp. 15, 17.) Both of these arguments are wrong. First, the water right "program" is *not* a "classic regulatory program," and second, the suggestion that the State can transmute taxes into "'user fees' by the simple expedient of dividing what are generally accepted as taxes into constituent parts . . .," has no support in the law. (See *United States v. City of Huntington* (4th Cir. 1993) 999 F.2d 71, 74.)[4]

a. The Division's Activities Are Not a "Classic Regulatory Program"

NCWA Petitioners', in their Merits Brief, at pages 31-33, and in their Answer to the State's Merits Brief, at pages 5-6, set forth the broad

[4] The State argues that "[f]ederal law is of no assistance in determining whether a fee is an invalid tax under Proposition 13." (State's Answer at p. 16.) NCWA Petitioners disagree. Federal caselaw is helpful because states have attempted to circumvent the constitutional principles set forth in *McCulloch v. Maryland* (1819) 17 U.S. (4 Wheat.) 316 since that decision was issued. Federal courts, jealously guarding this constitutional principle, have rejected these various attempts to simply rename a "tax" something other than a "tax."

role the SWRCB plays in overseeing California's water resource. The State's Answer confirms the broad nature of the State's water rights system and the fact that it could never properly be construed as a "classic regulatory program:"

> [T]he SWRCB regulates the complex system of water right in California to bring order and certainty to the system as well as protect the public interest. (State's Answer, p. 4.)
>
> [T]he SWRCB also has authority to ensure that the waters of the State are put to full beneficial use and to prevent waste, unreasonable use, unreasonable method of use or unreasonable method of diversion [citations]; protect the public trust [citations]; and avoid or minimize any harm to natural and public trust resources where feasible. (State's Answer, pp. 4-5.)
>
> [F]urthermore, water right regulation is necessarily complex because of the *interlocking nature of water rights*. (State's Answer, p. 6, emphasis added.)
>
> [T]he SWRCB determined that protecting other water right holders [presumably including riparian and pre-1914] represents a substantial portion of the cost of processing water right applications . . . (State's Answer, p. 6.)
>
> [W]hat is reasonable use, method of use of method of diversion of water depends on the circumstances of each case and cannot be resolved *in vacuo* isolated from statewide considerations of transcendent importance . . . . (State's Answer, p. 20, citations and quotations omitted, italics in original.)
>
> [U]se of water that was once reasonable may subsequently become unreasonable due to changed circumstances and their effects on other users of water or the environment. (State's Answer, p. 21, citations omitted.)

> [A] water user can never obtain a vested right to use water... inconsistent with Article X, section 2 of the California Constitution. (State's Answer, p. 21.)
>
> [T]he public trust doctrine also imposes a significant limitation on water rights in California. (State's Answer, p. 21.)

This broad description of the SWRCB's role is in consonance with the myriad of cases the State cites in support of its arguments. (See State's Answer, pp. 20-21, citing *Peabody v. City of Vallejo, supra*, 2 Cal.2d 351 [complaints by riparian water right holders], *Town of Antioch v. Williams Irrigation Dist., supra*, 188 Cal. 451 [riparian and other water rights], *Imperial Irrigation Dist. v. State Water Resources Control Bd., supra*, 186 Cal.App.3d 1160 [pre-1914 appropriative rights], *Joerger v. Pacific Gas & Elec. Co., supra*, 207 Cal. 8 [riparian water rights], *In re Waters of Long Valley Creek, supra*, 25 Cal.3d 339 [authority to adjudicate future exercise of riparian rights], and *Allegretti v. County of Imperial, supra*, 138 Cal.App.4th 1261 [groundwater].)

Contrary to the State's assertion, the SWRCB's role in overseeing California's water resource, including implementing article X, section 2 of the California Constitution, the public trust, and its role relating these principles to other types of water rights not subject to the challenged charges, establishes that the Division's work is *not* a "classic regulatory program."

b. The State Cannot Circumvent Article XIII A by Simply Changing the Label on the Impost

The State argues that the strict limitations in Article XIII A do not prohibit the State from imposing fees in order to fund "important government activities." (State's Answer, p. 17.) The State's argument renders Article XIII A meaningless.

To be certain, the State argues that "many different kinds of . . . public services may be considered good, if not essential, but nothing prevents the state from charging fees to regulate these activities." (State's Answer, p. 18.) Indeed, the only thing apparently stopping the State from simply charging "regulatory fees" to fund state government is that "it may not seem practical or consistent with social policy." (State's Answer, p. 19.) One cannot read Article XIII A to allow the State to so significantly erode the protections Californians thought they embodied in the Constitution and allow the State, simply by calling everything a "regulatory fee," to completely bypass the two-thirds majority requirement. The vitality of Article XIII A cannot depend upon the transient benevolence of the Legislature as it decides to name a charge as a "fee" or a "tax" depending upon whether it can or cannot obtain a two-thirds majority vote.

c. The State Has Not Demonstrated the Cost of the Regulatory Program

The State argues that it has met its burden of demonstrating the cost of the regulatory program because the Legislature has set the cost of the program in the Budget Act. This issue is addressed in Section II.A.1. of NCWA Petitioners' Answer to the State's Merits Brief and will not be repeated here.

d. The Annual Charges Pay for All Activities of the Division of Water Rights and Do Not Bear Any Relationship to the Benefit from or Burden on the Regulatory Program

The State argues that it may allocate the majority of the costs of *all* of its activities on existing water right permit and license holders, including the costs of processing new applications and petitions, the costs associated with fulfilling its constitutional and public trust obligations, the costs associated with its role related to other water rights, among other things. (State's Answer, p. 23.) In support of its argument, the State relies on one sentence from the administrative record, which consists of a single statement made in response to a request made by an Assemblymember Canciamilla. (AA 1599, 2297.) The California Farm Bureau Federation addressed this issue in its Answer Brief on the Merits, at pages 10 through 13. NCWA Petitioners agree and will not repeat those arguments here.

NCWA Petitioners add, however, that the SWRCB's response to Assemblymember Canciamilla was written after the existing action was initiated, as was expressly recognized in the SWRCB's notations made on the letter. (See handwritten notations, AA 1599.) Moreover, this single post hoc statement in an otherwise self-serving letter, drafted with the express intent of maintaining the otherwise unconstitutional fee scheme, cannot form the basis for upholding the fees. The overwhelming evidence in the record, as recognized by the Court of Appeal, demonstrates that the SWRCB spends significant time addressing issues other than those involving permittees and licensees. (Opinion, pp. 39-42.)

There is *no* relationship between the fees charged and the payors' burdens on or benefits from this purported "classic regulatory program."

C. Water Code Sections 1525, 1540, and 1560 Violate the Supremacy Clause of the United States Constitution

1. The Charges Are Imposed on the United States Water Rights.

The State argues, without citation, that the mere "association" of a fee with federal property does not violate the Supremacy Clause. (State's Answer, p. 25.) That, however, is not NCWA Petitioners' argument. (See NCWA Merits Brief, p. 44.) NCWA Petitioners' argument still unanswered by the State, is that the imposition of a fee on the property of the United States, as is done in Water Code section

1525, violates the Supremacy Clause. NCWA Petitioners have not argued that the State cannot impose a tax on the possessory interest on the use of federal property. However, that is not what the challenged statute does. The plain language of the statute imposes such a tax directly of the United States.[5]

Moreover, charging a "regulatory fee" on one who does not "hold" the water rights at issue undermines the whole notion that the charge is, in fact, "regulatory." If it were a "regulatory fee," as asserted by the State, the fee would, by definition, have to be imposed on those entities that the SWRCB regulates. If it is not imposed on the regulated community, the benefits or burdens test of *Sinclair Paint Co. v. State Bd. of Equalization, supra* 15 Cal.4th 866 cannot be met. In fact, and contrary to the State's contentions, the SWRCB does not regulate the

[5] The State questions how the challenged fees could violate the Supremacy Clause if the United States is not before this Court claiming any violation of the Supremacy Clause. (State's Answer, pp. 27-28.) First, California does not have jurisdiction over the United States. (See AA 123 [Special Appearance of United States Re: Non-Waiver of Sovereign Immunity].) Second – the United States did object to the charges and refused to pay them because they are unlawful taxes imposed on the United States in violation of the Supremacy Clause. (See AA 3152-3159.)

federal contractors in any way.[6] Thus, the language of the statute, of necessity, imposes the fee on the United States.

As pointed out in *United States v. Nye County* (9th Cir. 1991) 938 F.2d 1040 ("*Nye County*"), "the wording of a tax measure is significant. This does not mean we exalt form over substance. It means that when a statute says it taxes property it probably does." (*Id.* at p. 1042.)[7] Here, the statute unequivocally *imposes* the fee on the licenses and permits of the United States (Wat. Code, §§ 1525 and 1560) and *collects* the fee from the federal contractors. (Wat. Code, § 1540.) The imposition of the fee on the United States violates the Supremacy Clause. The "collection" of the fee from the federal contractors who impose no greater regulatory burden on the system and obtain no greater regulatory benefit from the system than by other members of the general public violates Article XIII A.

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[6] The fact that someone is a "legal user" of water does not constitute "regulation." If it did, everyone who drinks or otherwise use water in the State would be subject to direct regulation by the SWRCB. Being a "legal user" of water merely provides a basis to assert standing to protest certain SWRCB actions. (*State Water Resources Control Board Cases* (2006) 136 Cal.App.4th 674, 798-806.)

[7] The State's claim that *Nye County* involved a federal instrumentality issue is wrong. (State's Answer, p. 29.) The case turned purely on whether or not the statute imposed the tax on the property of the United States or whether the tax was on the federal contractor's possessory interest in that property. In any event, the federal contractors here are not claiming to be federal instrumentalities but only that the fee is, in fact, charged against the property of the United States.

2. The Central Valley Project Serves Many Purposes

The State claims that the Central Valley Project has no other purpose than the delivery of water to federal contractors. (State's Answer, p. 26.) The State, of course, ignores the fact that the federal permits and licenses permit a significant portion of their face value (upon which the fee is imposed) to be used for power generation. (AA 3155.) Moreover, SWRCB Decision D-1641, the proceeding that lead to the decision in *State Water Resources Control Bd. Cases, supra* 136 Cal.App.4th 674, involved, among other things, a change of use of the waters that are subject to the federal permits and licenses to environmental and fish and wildlife purposes. This point and extensive authority in this regard was provided in Section IV. B. of NCWA Petitioners' Answer to the State's Merits Brief and will not be repeated here. Nonetheless, the claim that the face value water uses of the federal permits and licenses are entirely devoted to the contractual rights of the federal water is absolutely wrong and inconsistent with the prior position of the United States, the SWRCB, itself, and state and federal court decisions. (See, e.g., *State Water Resources Control Bd. Cases, supra,* p. 715 [changing permits to add "fish & wildlife enhancement" to purpose of use]; *O'Neill v. United States* (9th Cir. 1995) 50 F.3d 677.)

3. Water Code Section 1560 Does Not Save the Statues

The State also claims that the fees meet constitutional muster because the statute that authorizes the fees is only effective "to the extent authorized under federal law," and that the collection of the fee imposed on the United States from federal contractors somehow cures the statute's constitutional deficiency. (State's Answer, p. 28.) The State, however, fails to point to a single case that could possibly support the contention that a regulatory fee imposed on the United States can be charged to a federal contractor. NCWA Petitioners recognize that a state can impose a tax on the discrete possessory interest of federal property by a contractor. (*United States v. County of Fresno* (1977) 429 U.S. 452.) However, that is not what the challenged statutes do.

CONCLUSION

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

Respectfully submitted,

SOMACH, SIMMONS & DUNN
A Professional Corporation

DATED: July 31, 2007

By_____
Daniel Kelly
Attorneys for Petitioners Northern California Water Association, et al.

WORD COUNT CERTIFICATION

(California Rules of Court, Rule 8.520(c).)

The text of NCWA Petitioners' Opening Brief consists of 4,142 words according to the "word count" feature of the Word processing program utilized in creating this document.

SOMACH, SIMMONS & DUNN
A Professional Corporation

Dated: July 31, 2007

By _____
Daniel Kelly

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PROOF OF SERVICE

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

On July 31, 2007, I served the following document(s):

NCWA PETITIONERS' REPLY BRIEF ON THE MERITS

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

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I declare under penalty of perjury that the foregoing is true and correct under the laws of the State of California. Executed on July 31, 2007, at Sacramento, California.

Yolanda De La Cruz

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