SUPREME COURT

3rd petition

S150518

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.

PETITION FOR REVIEW

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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PETITION FOR REVIEW

To the Honorable Chief Justice of the California Supreme Court, and the Associate Justices of the Supreme Court of California:

Northern California Water Association and Central Valley Project Water Association, et al., plaintiffs, appellants and petitioners here ("NCWA Petitioners"), respectfully petition for review following the opinion of the Court of Appeal, Third Appellate District, Justice Blease, Acting P.J., filed on January 17, 2007. (A copy of the opinion is attached hereto as Exhibit A ("Opinion").)

ISSUES PRESENTED FOR REVIEW

This case presents the following issues for review:

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

    a. As the State of California ("State") has conceded, the statutory scheme does not permit the adoption of regulations that meet constitutional requirements;

b. Water rights are real property rights and, therefore, the statutory scheme results in imposition of an unconstitutional ad valorem tax on real property;

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

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

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

SUMMARY OF BASIS FOR REVIEW

This case concerns an important question of law regarding the constitutionality of a fee scheme to fund the SWRCB's Division of Water Rights. NCWA Petitioners contend that the fee scheme devised by the Legislature and the regulatory program developed by the SWRCB are both unconstitutional. The Court of Appeal agreed with NCWA Petitioners that the regulations promulgated by the SWRCB were, indeed, unconstitutional. The Court of Appeal, however, found that the statutory structure was not, in itself,

unconstitutional and consequently directed the SWRCB to develop regulations that comported with the guidance provided in its opinion.

The Court of Appeal was absolutely correct in its determination that the SWRCB's regulations are unconstitutional and NCWA Petitioners do not challenge that conclusion. Indeed, NCWA Petitioners argued in favor of and support the Court of Appeal's decision, in that regard. NCWA Petitioners' concern, and this Petition for Review, derive from a belief that no set of regulations the SWRCB can concoct will cure the constitutional defect because, in fact, the constitutional defect is statutory at its root. Indeed, the State's Petition for Rehearing before the Court of Appeal is replete with statements conceding that it cannot develop a set of regulations to meet the constitutional standard. (See, e.g., Petition for Rehearing filed by the SWRCB Feb. 1, 2007 ("Petition for Rehearing") at pp. 9-18, 28.)

If this case is not reviewed and is instead sent back to the SWRCB for the purpose of developing regulations (regulations that the SWRCB has conceded it cannot develop), the result will be

adverse to the public interest.[1] The SWRCB will be caught in a never-ending cycle of revising fee regulations to comply with a statute that does not itself meet the test of constitutionality.[2] NCWA Petitioners seek to avoid this result. Accordingly, NCWA Petitioners respectfully request this Court determine the futility of the regulatory effort, and require that the State Legislature fix this problem either by restoring General Fund funding for the SWRCB or by revising the legislation to allow for a constitutional regulatory fee scheme.

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[1] Repeatedly throughout the history of this case, NCWA Petitioners have underscored the importance of the SWRCB and its functions. NCWA Petitioners have maintained that the SWRCB's role of protecting the State's water supplies for the benefit of the people of the State is significant and important. It is the NCWA Petitioners' view that the State's repeated assertions that the SWRCB merely performs a regulatory function trivializes and denigrates the SWRCB's true function.

[2] Indeed, this cycle is already occurring. The statute at issue was adopted in 2003. The fee schedule for fiscal year 2003-2004 is the subject of this action. The statute requires the SWRCB to adopt new fee regulations each year. As a result, three other lawsuits are pending in Sacramento County Superior Court, challenging the fee schedules for fiscal years 2004-2005, 2005-2006 and 2006-2007. Each of these lawsuits was preceded by a Petition for Reconsideration to the SWRCB, as required by the SWRCB regulations. (23 Cal. Code Regs., tit. 23, §§ 1077 and 768 et seq.) Until the constitutional deficiencies are cured, this cycle will continue each year upon adoption of new fee regulations.

STATEMENT OF THE CASE

A. New Water Right Fees

In 2003, in an attempt to curb California's budget crisis, the Legislature passed a law to shift many state general funded programs to fee-based programs. The law, known as SB 1049, was passed in the Assembly and the Senate by simple majority (53%). (Stats. 2003, ch. 741; Appendix of Appellants California Farm Bureau Federation, et al. and Northern California Water Association, et al. ("AA") at p. 1988.) SB 1049 was signed by then Governor Gray Davis and took effect January 1, 2004. (*Ibid.*)

Included in SB 1049 was a provision directing the SWRCB to impose fees to cover all costs incurred by the SWRCB's Division of Water Rights. (Wat. Code, § 1525(c).) The water right fee structure set out in SB 1049 has two basic parts. First, it establishes one-time charges for services rendered in response to specific applications, requests or petitions by water rights holders. (Wat. Code, § 1525(b).) Second, it establishes an "annual fee" levied upon, for all relevant purposes, "each person or entity who holds a permit or license to appropriate water." (Wat. Code, § 1525(a).)

The Legislature commanded the SWRCB to develop a fee schedule sufficient that the total amount collected equaled the revenue level set forth in the annual Budget Act. (Wat. Code,

§ 1525(d).) The SWRCB adopted the implementing regulations and the fee schedule through Resolution No. 2003-0077. In order to develop a more stable funding source, the SWRCB set the "one-time" filing fees for new applications and petitions to change existing water rights artificially low, and shifted the cost-burden to existing water right holders through annual fees. (AA at pp. 1676-1677; 1683-1685; 1696-1697.) The annual fees are charged on a per acre-foot basis. (Cal. Code Regs., tit. 23, § 1066(a).)

One-time fees for applications and petitions are paid directly to the SWRCB and annual fees are billed by and payable to the State Board of Equalization. (Wat. Code, §§ 1535, 1536.) Failure to pay the annual fee for a period of five years may result in the revocation of the water rights. (Wat. Code, §§ 1539, 1241.)

One of the many problems facing the monumental shift to a fee-based system is that the United States holds approximately 35% of all licensed and permitted diversions in California. (AA at pp. 1686-1687.) Notwithstanding the Legislature's prior recognition that the State could not impose fees on the United States, SB 1049 does so. (Compare former Wat. Code, § 1560 (2002) with current Wat. Code, § 1560(a).) Where the United States refuses to pay, or the SWRCB determines that the United States is *likely to refuse to pay*, the SWRCB was provided the authority to "allocate" the fees

imposed on the water rights held by the United States to "persons or entities who have contracts for the delivery of water from the person or entity *on whom the fee was initially imposed.*" (Wat. Code, §§ 1540, 1560, emphasis added.) Thus, SB 1049 provided the SWRCB with the authority to collect the fees imposed on the United States' water rights from federal contractors who are "legal strangers" to the water rights at issue.

The SWRCB adopted regulations providing for such collection from federal contractors *only* for the Central Valley Project ("CVP") and not from any other federal project. (See Cal. Code Regs, tit. 23, § 1073.)

B. Proposition 13

Proposition 13, set forth in the California Constitution, provides for limitations on real property tax rates, real property assessment limitations, and restrictions on state and local taxes. (Cal. Const., art. XIIIA; *Sinclair Paint Co. v. State Bd. of Equalization* (1997) 15 Cal.4th 866, 872 ("*Sinclair Paint*").) Specifically, article XIIIA, section 3 provides:

> [A]ny changes in state taxes enacted for the purpose of increasing revenues collected pursuant thereto whether by increased rates or changes in methods of computation must be imposed by an Act passed by not less than two-thirds of all members elected to each of the two houses of the Legislature, except that no new ad valorem taxes on real property, or sales or

> transaction taxes on the sales of real property may be imposed. (Cal. Const., art. XIIIA, § 3.)

Proposition 13 was, in effect, a "*legislative battering ram* which [was] used to tear through the exasperating tangle of the traditional legislative procedure and strike directly towards the desired end," tax relief. (*Amador Valley Joint Union High School Dist. v. State Bd. of Equalization* (1978) 22 Cal.3d 208, 228, emphasis in original.) Proposition 13 was structured in such a way as to ensure that the tax savings that resulted through the property tax rate and assessment limitations were not withdrawn or depleted by additional levies and exactions. (*Id.* at p. 231.) Nonetheless, an exception to Proposition 13's stringent limitations on government exactions has been created – the so called "regulatory fee." Regulatory fees are imposed pursuant to the police power and are valid only if 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*." (*California Assn. of Professional Scientists v. Department of Fish & Game* (2000) 79 Cal.App.4th 935, 945 ("*CAPS*"), emphasis added.) The charges at issue in this case are not valid regulatory fees but are instead taxes levied on the mere ownership of real property and without connection to a regulatory purpose.

C. Background on Water Rights

The unprecedented nature of the charges at issue in this case results, in part, from the unique nature of the property being assessed – water rights.

The SWRCB's actual role with regard to water rights is defined and limited by statute and is itself a natural extension of California water law. California recognizes a myriad of rights to water, making the California law of water rights, at best, complex. California law identifies two distinct categories of water: (1) water flowing in known and definite channels, otherwise known as "surface water" and (2) percolating water found underground known as "groundwater." The SWRCB has been delegated regulatory responsibilities only with regard to limited categories of surface water rights. Percolating groundwater is wholly outside of the SWRCB's jurisdiction (Wat. Code, §§1200, 1201) and the SWRCB has taken no action to extend its "fee" structure on those who hold rights to percolating groundwater. (See Cal. Code Regs., tit. 23, § 1066 [requiring annual fees only for water right permits and licenses].)

California surface water law begins with the basic premise that one cannot take water from a stream without acquiring some type of water right. (Wat. Code, § 102.) While a water right is

usufructuary in nature, once it is perfected it becomes a vested real property right. (*Ivanhoe Irr. Dist. v. All Parties* (1957) 47 Cal.2d 597, 623, revd. on other grounds, *Ivanhoe v. McCracken* (1958) 357 U.S. 275; *United States v. Gerlach Live Stock Co.* (1950) 339 U.S. 725, 752-754.) California's current system of water rights is a dual, or hybrid system of water rights. (*People v. Shirokow* (1980) 26 Cal.3d 301, 307.) Under this dual system, both riparian and appropriative rights to surface water are recognized. (*Id.* at p. 307.)

The riparian doctrine essentially provides that a person owning land bordering a stream has the right to divert and use water on lands bordering the stream. (*City of Los Angeles v. Aitken* (1935) 10 Cal.App.2d 460.) All landowners bordering the stream are vested with a common ownership of the waters of the stream and in times of shortage, all riparians must share in the shortage proportionately. (*Prather v. Hoberg* (1944) 24 Cal.2d 549, 559-560.) The SWRCB has taken no action to extend its "fee" structure on those who hold riparian rights. (See Cal. Code Regs., tit. 23, § 1066 [applying annual fees only to water right licenses and permits].)

California's gold rush and mining industry resulted in water being diverted from streams and used on non-riparian lands. The doctrine of prior appropriation is the legal recognition of the right to use water on non-riparian lands. (*Irwin v. Phillips* (1855) 5 Cal.

140.) Under the prior appropriation doctrine, one who actually diverts and beneficially uses water obtains the continued right to do so, so long as the water is surplus to the needs of riparians and earlier, or prior, appropriators. (Wat. Code, § 1240; *People v. Shirokow, supra*, 26 Cal.3d at p. 308.)

Appropriative rights are themselves divided into two general categories: pre-1914 appropriative rights; and permitted or licensed water rights. Prior to the enactment of the Water Commission Act in 1913, one could acquire the right to divert water by simply diverting and using water. (*Nevada County & Sacramento Canal Co. v. Kidd* (1869) 37 Cal. 282, 311.) These rights are commonly referred to as "pre-1914" appropriative rights. The SWRCB has taken no action to extend its "fee" structure on those who hold pre-1914 appropriative rights. (See Cal. Code Regs., tit. 23, § 1066(a) [requiring annual fees only for persons who hold a water right permit or license].)

The Water Commission Act of 1913 provided, among other things, for a more orderly method of appropriating surface water through an application process. Today, and since 1914, anyone seeking to obtain an appropriative water right is required to file an application with what is now known as the SWRCB. (*People v. Shirokow, supra*, 26 Cal.3d 301; Wat. Code, § 1225 et seq.) Beneficial use of water perfected under this post-1914 statutory

structure is confirmed with a license issued by the SWRCB. (Wat. Code, §§ 1605, 1610.) The license is, in essence, the title or deed to the water right, recorded in the county in which the diversion takes place. (Wat. Code, § 1650.) The SWRCB has placed the entire burden of its "fee" structure on this limited sub-set of water rights.

Recognizing the need to put all waters of the State to reasonable and beneficial use to the fullest extent possible, the people of the State of California enacted article X, section 2 of the California Constitution, which provides, in pertinent part:

> It is hereby declared that because of the conditions prevailing in this State *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*, and that the waste or unreasonable use or unreasonable method of use of water be prevented, and that the conservation of such waters is to be exercised with a view to the reasonable and beneficial use thereof in the interest of the people and for the public welfare. (Cal. Const., art. X, § 2, emphasis added.)

The policy, therefore, inherent in California water law, "is to utilize all water available; to *encourage* the impounding and distribution of storm and flood waters whenever it may be done without substantial damage to existing rights; and to *require the greatest number of beneficial uses that the water supply can yield.*" (Hutchins, The Cal. Law of Water Rights (1956) at p. 11, emphasis added; AA at p. 1257.) Through the 1928 Constitutional

Amendment and through the Water Code, the people and the Legislature have declared that the people of the State of California have a paramount interest in the use of all the water of the State and that interest includes the *maximization* of the use of water. (See Hutchins, *supra*, at pp. 11-13; AA at pp. 1257-1259.) The reasonable beneficial use of water is a good thing to be encouraged; it is not a bad thing to be deterred. Those that hold water rights and divert water from California's rivers and streams are implementing the very policy embodied by the California Constitution and expressed by the Legislature. These diversions *collectively* supply nearly all of California with water for municipal and industrial uses, among others, and supply water to California's agricultural industry, the very backbone of the state's economy.

D. The United States Bureau of Reclamation, the Central Valley Project, and Central Valley Project Contracts

1. Operation of the Central Valley Project

The United States Bureau of Reclamation ("USBR"), a division of the Department of the Interior, holds permitted and licensed water rights for and operates the Central Valley Project ("CVP"). The USBR, in the operation of the CVP, diverts and stores water from various sources for a multitude of purposes pursuant to

its appropriative water rights issued by the SWRCB. Indeed, the CVP serves many purposes, including to:

> [I]mprove navigation, regulat[e] the flow of the San Joaquin River and the Sacramento River, control[] floods, provid[e] for storage and for the delivery of the stored waters thereof, for the reclamation of arid and semiarid lands and lands of Indian reservations, and other beneficial uses, and for the generation and sale of electric energy. Act of August 26, 1937, Pub. L. No. 75-392, 50 Stat. 844, 850. To accomplish the project's purposes, CVP's construction includes a series of many dams, reservoirs, hydro-power generating stations, canals, electrical transmission lines, and other infrastructure. [*United States v. Gerlach Live Stock* (1950) 339 U.S. at 733.] (*Westlands Water District v. United States* (9th Cir. 2003) 337 F.3d 1092, 1095-1096.)

The USBR, in the administration of Reclamation law and for the operation of the CVP, is like any other applicant for water rights in California and can only obtain rights to divert and deliver water within the CVP through the application of relevant provisions of state law. (*California v. United States* (1978) 438 U.S. 645.) Thus, the underlying water rights permits for the CVP were granted by the State of California in accordance with SWRCB Water Rights Decisions 893, 990 and 1020. The United States, pursuant to its permits and licenses for the CVP, is entitled to divert approximately 111 million acre-feet of water. (AA at pp. 1720.02-1720.03.) The USBR delivers water to many entities, for many purposes. However, it is undisputed that *only* 6.6 million acre-feet out of the over 111 million acre-feet that the USBR has under permit is under

contract with the various public agencies and others who receive water from the USBR through the CVP. (AA at pp. 1594-1598; 1535:11; 1545:21.) This group of federal contractors receiving CVP water is comprised of various public agencies colloquially referred to as "CVP Contractors."[3] Less than 6 percent of all water diverted by the United States pursuant to these permits or licenses is available to the CVP Contractors. The remaining water diverted and stored pursuant to these permits and licenses is used by the USBR for hydroelectric, fish and wildlife and other purposes. (AA at pp. 1545:1-20, 1595, 1701, 1720.02.)

2. The SWRCB's Relationship to the CVP

The SWRCB, in the administration of the water rights for the CVP, regulates the United States as the "permit holder." The SWRCB does not regulate CVP Contractors. The Legislature indeed expressly provided that "[t]he allocation of the fee or expense to these contractors does not affect ownership of any permit, license, or

[3] The group of public agencies identified as "federal contractors" includes the City of Roseville, El Dorado Irrigation District, Sacramento County Water Agency, City of Tracy, Contra Costa Water District, City of Fresno, County of Fresno, County of Tulare, Sacramento Municipal Utility District, Westlands Water District, County of Colusa, City of Redding, City of Shasta Lake, City of Coalinga, Panoche Water District, and the Placer County Water Agency, among others.

other water right, and does not vest any equitable title in the contractors." (Wat. Code, § 1540.) Thus, in the eyes of the Legislature, CVP Contractors have *no* property interest in the United States' CVP water rights, and cannot avail themselves of the SWRCB's regulatory process to protect their interest in the CVP water rights. They are "strangers" to those water rights with no more relation to them, from the regulatory perspective, than any other member of the public.

E. Proceedings Below

NCWA and CVPWA filed a Verified Complaint for Declaratory and Preliminary and Permanent Injunctive Relief (Code Civ. Proc., §§ 1060, 526, 527); Taxpayers Injunctive Relief (Code Civ. Proc., § 526); Petition for Writ of Mandate (Code Civ. Proc., § 1085); and Validation Action (Code Civ. Proc., § 863) ("Complaint") on December 17, 2003, just two days after the SWRCB adopted Resolution No. 2003-0077. (AA at p. 1.) Because the controversy involved the fees imposed on the water rights held by the United States, NCWA Petitioners named the United States as a real party in interest. The United States specially appeared, notifying the trial court that it had not waived its immunity for the purpose of the pending action. (AA at pp. 123-126.)

Subsequent to NCWA Petitioners' action, the State Board of Equalization issued water rights bills as required by SB 1049 and the implementing regulations. NCWA Petitioners, along with over 200 individual petitioners, filed a petition for reconsideration with the SWRCB, which was denied. (AA at p. 297.) The Complaint was amended to include all named petitioners and to add a challenge to the SWRCB's denial of the petition, along with a request for refund of all fees paid. (AA at p. 127.) NCWA Petitioners' case was consolidated with a similar action filed by the California Farm Bureau Federation. (AA at p. 360.)

A hearing on the merits was held on April 15, 2005. The trial court upheld the water right fees as "valid regulatory fees." The court further held that the fees did not violate the Supremacy Clause by imposing a tax on the United States because the statute provided that the fee "may be allocated to another party." (AA at p. 3358:15-25.) The trial court also upheld the allocation of the fees both to and among the CVP Contractors.

Subsequent to the April 15, 2005 hearing, on April 28, 2005, the United States forwarded a letter and memorandum to the SWRCB, expressing the official position of the United States that the water right fees were illegal taxes imposed on the United States in violation of the United States Constitution. (AA at pp. 3152-

3159, a copy of which is attached hereto as Exhibit B.) On May 3, 2005, NCWA Petitioners provided the trial court with a copy of the letter and memorandum as part of NCWA Petitioners' Motion for Reconsideration. (AA at p. 3142.) The trial court granted NCWA Petitioners' motion, and reconsidered and affirmed its prior ruling, notwithstanding the official opinion of the United States on this issue. (AA at pp. 3368-3370.)

The Court of Appeal reviewed this matter and concluded that while the statutory structure at issue was facially valid, the annual fee structure was unconstitutional as applied. NCWA Petitioners here do not seek review of the Court of Appeal's determination that the subject regulations are unconstitutional and support the Court of Appeal's decision in this regard. This Petition for Review, however, challenges the Court of Appeal's determination that the challenged statutory structure is facially constitutional.

The Court of Appeal's Statement of the Case is itself detailed and is found at pages 3-26 of its Opinion.

ARGUMENTS IN SUPPORT OF REVIEW

A. Water Code Section 1525 Is Unconstitutional on Its Face

The Court of Appeal upheld Water Code section 1525 as constitutional on its face but held that Water Code section 1525 was unconstitutional as applied, through the SWRCB's regulations. The

Court of Appeal reasoned that because the statute only provided for covering the costs associated with the benefits and burdens tied to permits and licenses, that it must have been the regulations which improperly imposed charges on permits and licenses for the costs associated with providing the broader benefits and addressing the broader burdens associated with all water rights and with the benefits bestowed upon the public generally. (Compare Opinion at pp. 30-31, [upholding Wat. Code, § 1525(a), with Opinion at p. 39 [striking the regulations].) In other words, the Court read Water Code section 1525(a), not as permitting the recovery of the entire costs of the Division of Water Rights, but only those costs associated with the benefits and burdens tied to water right permits and licenses. They reasoned that the regulations failed to pass constitutional muster because they imposed charges on water right permit and license holders to pay for the benefits and burdens tied to water rights *other than* permits and licenses, for the costs of processing new applications and change petitions, and for the benefits and burdens associated with protecting the broad public trust and public interest in the people of the State of California in the State's water resources.

Indeed, in striking the regulations, the Court of Appeal rightly found that many of those who *directly* benefit and/or *directly* burden

the water right program were not required to shoulder any of the burden of the cost of the Division of Water Rights. (Opinion at pp. 39-42.) NCWA Petitioners do not argue with this conclusion and agree that the regulations are invalid for the reasons articulated by the Court of Appeal. The Court of Appeal, however, erred in its attempt to salvage Water Code section 1525 by suggesting that the statute was not at the root of the constitutional problem because it did not permit the SWRCB to recover *all* costs incurred by the Division of Water Rights. (Opinion at p. 31.)

NCWA Petitioners' view that the statutes at issue are facially invalid appears to be supported by the State's current litigation position. After receiving an unfavorable Court of Appeal decision, the State changed its argument, and through its Petition for Rehearing, attempted to jettison its failed position in favor of a new mix of concepts from California's regulatory fee law. In doing so, however, the State essentially admitted that Water Code section 1525 is unconstitutional on its face. There, the State admitted that everything the Court of Appeal found unconstitutional about the SWRCB's regulations actually stems from the statute.

For example, the State, in its Petition for Rehearing, admitted that Water Code section 1525 required the SWRCB to recover the "entire cost of the water right program." (See Petition for Rehearing

at p. 9.) Without doubt, the Legislature, through Water Code section 1525, left the SWRCB with the impossible task of developing a fee scheme targeted at a select few, for benefits bestowed upon and burdens created by a much larger group. While the Legislature purported to provide for certain recoverable costs, Water Code section 1525, subdivision (d)(3), nonetheless provides that the SWRCB is required to collect an amount equal to the "revenue levels set forth in the annual Budget Act." As the State admits, "[t]he Legislature understood – as Plaintiffs and the SWRCB both understand – that the activity potentially subject to fees under section 1525 represented essentially all of the water rights program." (Petition for Rehearing at p. 17.)

While the regulations were properly found unconstitutional because of the significant inequities present in the fee scheme, as the State readily admits, those inequities have their genesis in Water Code section 1525, and those inequities are only mirrored by the regulations. (See Petition for Rehearing at p. 28 ["[t]he statute, not the regulation, mandates that the SWRCB set the section 1525 fees to meet the fee revenue 'target' set forth in the Budget Act for the Water Right Fund . . ."].) This Court must grant review of the Appellate Court's determination that Water Code section 1525 was constitutional on its face.

B. The Charges at Issue Are an Unconstitutional Tax on Real Property

It is black letter law that water rights are real property. (See, e.g., *United States v. State Water Resources Control Board* (1986) 182 Cal.App.3d 82, 101; and 4 Witkin, Summary of Cal. Law (10th ed. 2005) Real Property, § 3(6), at p. 217 [defining real property as "all freehold interests, together with such things closely associated with land as fixtures, growing crops and *water*."[4] (Internal quotations omitted, emphasis added)].) The California Constitution, in article XIII, section 11, entitled "Taxation of local government *real property*," specifically includes the right to use and divert water as part of real property: "Lands owned by a local government that are outside its boundaries, *including rights to use or divert water* from surface or underground sources and any other interests in lands, are taxable . . . ." (Emphasis added; see also *Stanislaus Water Co. v. Bachman* (1908) 152 Cal. 716, 725.)

It is also undisputable that for the purposes of taxation, water rights are real property entitled to the protections embodied in Proposition 13. (See *Scott-Free River Expeditions, Inc. v. County of*

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[4] In California, a water right is considered appurtenant to the land for which it is appropriated. (*Inyo Consolidated Water Co. v. Jess* (1911) 161 Cal. 516, 520; *Tulare Irr. Dist. v. Lindsay-Strathmore Irr. Dist., supra*, 3 Cal.2d at pp. 546-547.)

El Dorado (1988) 203 Cal.App.3d 896, 904; *Jurupa Ditch Co. v. County of San Bernardino* (1967) 256 Cal.App.2d 35, 40; *North Kern Water Storage Dist. v. County of Kern* (1960) 179 Cal.App.2d 268, 271; Hutchins, The Cal. Law of Water Rights, *supra*, at p. 122; AA at p. 1260 ["For purposes of taxation, appropriative water rights constitute land as that term is used in [former] art. XIII, sec. 1, of the State Constitution"] and 9 Witkin, Summary of Cal. Law (10th ed. 2005) Taxation, § 178, at pp. 272-273 [right to divert water for nonriparian use is real property].)[5] Water Code section 1525, subdivision (a), imposes a charge on real property, based solely upon the ownership of real property.

While NCWA Petitioners challenged Water Code section 1525(a) on its face as impermissibly imposing a charge based solely upon the ownership of real property, the Court of Appeal disagreed, explaining "[t]he property interests at issue here 'are usufructuary only and confer no right of private ownership in the watercourse, which belongs to the state. (Opinion at pp. 35-36, citing *People v. Shirokow, supra*, 26 Cal.3d at p. 307, Wat. Code, § 102.) The Court

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[5] The SWRCB has argued, at various times, that water rights in California are not real property rights within the meaning of Proposition 13 because they are usufructuary. (AA at p. 1627.) This appears to be the view adopted by the Court of Appeal. (Opinion at pp. 35-36.)

dismissed NCWA Petitioners' argument, explaining that "[p]otentially conflicting water right claims and uses, not real property ownership, give rise to the need for regulation . . . ." (Opinion at p. 36.) While it may be true that property ownership gives rise to the need for regulation, it does not follow that Proposition 13 permits imposing charges based upon the ownership of real property for the sake of regulating real property.

In that regard, the fact that the right to water is "usufructuary" in nature is not relevant to its status as real property for the purposes of the instant case. Indeed,

> [a]lthough there is no private property right in the corpus of the water while flowing in the stream, *the right to its use is classified as real property.* [Citations omitted.] The concept of an appropriative water right *is a real property interest* incidental and appurtenant to land. [Citations omitted.] (*Fullerton v. State Water Resources Control Board, supra*, 90 Cal.App.3d at p. 598, emphasis added.)

Moreover, and perhaps more importantly, the Court of Appeal's Opinion is contrary to the plain statutory language contained in Water Code section 1525, subdivision (a), which provides

> [e]ach person or entity who *holds a permit or license to appropriate water* . . . shall pay an annual fee according to a fee schedule established by the board. (Wat. Code, § 1525(a), emphasis added.)

The charge is plainly based solely upon the ownership of a water right and is not based upon any concept of "use." Water is real property under California law, and has been recognized as such through over 160 years of caselaw, and is confirmed in the California Constitution. This Court should grant review to correct the error made by the Court of Appeal and find that the charges at issue *are* based solely upon the ownership of real property, in direct contravention of the California Constitution.

C. The Statute Imposing the Fees on Federal Contractors Is Unconstitutional on Its Face

The SWRCB's statutorily mandated task of developing a fee structure to cover all of the costs of running the Water Rights Division is exacerbated by the fact that about 35% of the permitted and licensed post-1914 water rights under its jurisdiction are held by the United States. (AA at p. 1687.) The Legislature obviously was aware that it could not force the United States to make fee payments to the SWRCB. As the Court of Appeal correctly noted, the federal government is immune from taxation by a state and, under federal law, there is no distinction between "fees" and taxes for purposes of a Supremacy Clause analysis. (Opinion at pp. 43-45.)

The Legislature attempted to address this problem in two ways. First, while clearly levying the fee on the United States with

clear and unambiguous language,[6] it attempted to avoid the consequence of this action through Water Code section 1560 which, in addition to other things, provides that the application of the fee request to the United States shall only be "to the extent authorized under federal . . . law." (Wat. Code, § 1560(a).) There is no dispute that there is no law that authorizes the imposition of the challenged fee on the United States. The consequence of this is that the fee, as against the United States, is void. Any other conclusion would result in fees being maintained and, thus, the fee would be unconstitutional.

The Court of Appeal, however, concluded that because of the limiting language of Water Code section 1560(a), the statutes (Wat. Code, §§ 1525 and 1560) could never be unconstitutional. (Opinion at p. 44.) This conclusion is simply wrong and is akin to saying that "the statutes are constitutional because the Legislature says they are constitutional." In fact, the only way to save the language of Water

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[6] Water Code section 1525(a) imposes the annual fee on "[e]ach person or entity who holds a permit or license to appropriate water . . ." and Water Code section 1560(a) confirms the fact that the fees at issue here are directed at the United States by stating that "[t]he fees and expenses established . . . [under the statute] apply to the United States . . . ." Without question, the United States is an entity who holds a permit or license to appropriate water. (Opinion at p. 11.)

Code sections 1525 and 1560 is to conclude that no fee can be imposed upon the appropriative water rights of the United States.

The Legislature further attempted to deal with the fee problem posed by the United States water rights by authorizing the fee on the United States appropriative water rights to be collected from federal water Contractors, instead of the United States. This does not, at all, cure the problem because what is being collected from the federal contractors is, by legislative edict, the fee imposed on the United States. Water Code section 1540 provides: "If the board determines that the person or entity *on whom a fee or expense is imposed* will not pay the fee or expense based on the fact that the fee payer has sovereign immunity ... the [SWRCB] may allocate the fee or expense ... to persons or entities who have contracts for the delivery of water from the person or entity on *whom the fee or expense was initially imposed*." (Wat. Code, § 1540, emphasis added).[7]

Passing on the fee imposed on the United States water rights does not at all cure the constitutional defect in the statute. The fees are still imposed on the United States water rights. This is simply

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[7] The SWRCB concedes that the fees are imposed on the water rights of the United States. (See Respondents' Brief filed by the SWRCB on Jan. 6, 2006 at p. 19.)

unconstitutional. The Court of Appeal was wrong in upholding the constitutionality of the statutes.

The Court of Appeal did hold, however, that the challenged regulations were unconstitutional because they pass the entire federal fee to users of less than 5% of the federal water rights subject to the State fee. While NCWA Petitioners agree with the Court of Appeal that the regulations are invalid, the court's holding that sections 1525, 1540 and 1560 are constitutional is wrong.

The first fallacy in the court's reasoning is, as noted above, that the statutes (in addition to the regulations) impose the fees in question on the water rights of the United States and not on the possessory interest of the user of the water. Thus, the statute is unlike the statute challenged in *United States v. County of Fresno* (1977) 429 U.S. 452, and is more like the challenged statutes in *United States v. Hawkins County, Tennessee* (6th Cir. 1988) 859 F.2d 20, and *United States v. Colorado* (10th Cir. 1980) 627 F.2d 217. (See the comparison made in *United States v. Nye County* (9th Cir. 1991) 938 F.2d 1040, 1042-1043.) Because under the statute and the regulations a fee, if any, is charged against the property interest of the United States, it is an ad valorem property charge

which violates the Supremacy Clause.[8] The statute is not saved by sections 1560(a)(2) and 1540 allowing the so-called "pass-through" of the fee on the United States water rights to federal contractors. The fee is invalid at its inception and there is nothing to be passed through assuming, arguendo, that federal law would allow a pass-through.[9]

The second fallacy in the Court of Appeal's reasoning is rooted in the nature of the State's justification that these are "regulatory fees" and therefore not violative of Proposition 13. If the fees are, in fact, regulatory, as the State contends, then the regulated entity in the context of the challenged statutes and regulations is the holder of the water right — the United States. The SWRCB has no regulatory authority over the federal contractors or over their contracts with the federal government. Therefore, there is

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[8] In a carefully reasoned letter filed with the trial court, the United States set forth its position that the fees violated the Supremacy Clause. (AA at pp. 3152-3159, attached hereto as Exhibit B.)

[9] The Court of Appeal never reached the issue of unequal treatment of federal contractors and the consequent violation of the Supremacy Clause by the statutory and regulatory scheme. (See NCWA Petitioners' Reply Brief, filed Feb. 9, 2006, at pp. 46-48.) This argument is another side of the Supremacy Clause coin and is another basis for invalidating the statute on its face. NCWA Petitioners assert the argument here, also, to preserve the argument for purposes of potential federal review of the case by means of a writ of certiorari.

absolutely no regulatory nexus upon which to justify imposing the fee on such contractors. Without the regulatory nexus, the fees cannot possibly be "related to the services performed." (Opinion at p. 31.) Thus, for the federal contractors the fee cannot be regulatory and, therefore, must be a "tax" on the contractors' property interests which runs afoul of Proposition 13. (See *Leslie's Pool Mart, Inc. v. Dept. of Food & Agriculture* (1990) 223 Cal.App.3d 1524, 1594.)

NCWA Petitioners' quarrel in regard to the federal contractors is not hypothetical, but real. Under the Court of Appeal's decision, the SWRCB will attempt to pass through the federal fee to federal contractors based upon the ratio their contractual rights bear to the entire federal right. As advocated by the SWRCB in its Petition for Rehearing, this would be comparing apples to oranges. (Petition for Rehearing at p. 25.)

In any event, the only justification that is utilized to justify the statutes and allow for the pass-through of the United States fee obligation to federal contractors is based upon case law that justifies the taxation of the possessory interest, i.e., the property interest, that a non-federal person or entity may have in federal property. (Opinion at pp. 45-50; *United States v. Nye County, supra*, 938 F.2d 1040; *United States v. Colorado, supra*, 627 F.2d 217; *United States v. County of Fresno, supra*, 429 U.S. 452.) This, of course, would

be an ad valorem tax in violation of the State Constitution. Recognizing this, the State has gone to great lengths (and the Third District Court of Appeal has concurred) to justify a conclusion that the charge levied here is not on a property interest but, rather, a fee tied to use of a right. Assuming arguendo that what is involved is not a tax on a possessory interest in federal rights, but rather some "fee" on a possessory interest or use, then there is absolutely no authority that would support this kind of levy. No case provides for or allows a "possessory fee." What is, in fact, at issue, is a tax on a possessory interest and such a tax is simply unconstitutional and the statutes at issue must be stricken.

D. The SWRCB Did Not Sustain Its Burden to Justify the $100 Fee

The court of Appeal correctly held that it is the State's burden to provide the evidence to show the costs of the regulatory service and the basis for allocation of such costs so that the charges "bear a fair or reasonable relationship to the payors' burdens on or benefits from the regulatory activity." (Opinion at p. 29.) The Court of Appeal held that, in most instances, the State simply failed to meet that burden. With respect to the $100 minimum fee, the Court of Appeal acknowledged that "the SWRCB did not offer evidence of the actual cost of billing the annual fees," therefore again failing to

meet its burden of proof. The Court of Appeal, however, opined that it could not say that the $100 fee was unreasonable. (*Id.* at p. 43.) Thus, the Court of Appeal, while finding that the SWRCB offered no evidence to support this $100 fee, the Court of Appeal appeared to sanction it. This conclusion is simply arbitrary and not supported anywhere in the record, or even in the Court of Appeal's opinion. This Court should review the Court of Appeal's decision in this regard and find that the Court of Appeal is in error in sustaining the minimum $100 fee.

CONCLUSION

Based upon the foregoing, NCWA Petitioners respectfully request that this Court grant the requested review.

Dated: February 23, 2007

SOMACH, SIMMONS & DUNN
A Professional Corporation

By _____
Stuart L. Somach

Attorneys for Petitioner
Northern California Water
Association, et al.

WORD COUNT CERTIFICATION

(California Rules of Court, Rule 28.1(d))

The text of Northern California Water Association, et al.'s Petition for Review consists of 7,153 words according to the "word count" feature of the Word processing program utilized in creating this document.

Dated: February 23, 2007

SOMACH, SIMMONS & DUNN
A Professional Corporation

By _____
Stuart L. Somach

Attorneys for Petitioner
Northern California Water
Association, et al.

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CERTIFIED FOR PUBLICATION

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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

THIRD APPELLATE DISTRICT

(Sacramento)

FILED

JAN 17 2007

COURT OF APPEAL - THIRD DISTRICT
DEENA C. FAWCETT
BY _____ Deputy

CALIFORNIA FARM BUREAU FEDERATION et al.,

Plaintiffs and Appellants,

v.

CALIFORNIA STATE WATER RESOURCES CONTROL BOARD,

Defendant and Respondent.

C050289

(Super. Ct. Nos. 03CS01776, 04CS00473)

APPEAL from a judgment of the Superior Court of Sacramento County, Cadei, J. Reversed with directions.

Gibson, Dunn & Crutcher, David A. Battaglia and Eileen M. Ahern; Nancy N. McDonough, Carl G. Borden, for Plaintiff and Appellant California Farm Bureau Federation.

Somach, Simmons & Dunn, Stuart L. Somach, Kristen T. Castanos, Robert B. Hoffman and Daniel Kelly, for Plaintiffs and Appellants Northern California Water Association and Central Valley Project Water Association.

Bill Lockyer, Attorney General, David S. Chaney, Senior Assistant Attorney General, William L. Carter, Supervising Deputy Attorney General, Matthew J. Goldman and Molly K. Mosley, Deputy Attorneys General, for Defendants and Respondents.

O'Laughlin & Paris, Tim O'Laughlin and William C. Paris for San Joaquin River Group Authority as Amicus Curiae.

Downey Brand, Kevin M. O'Brien, Jennifer L. Harder and Joseph S. Schofield for Amicus Association of California Water Agencies as Amicus Curiae.

Jason E. Resnick for Western Growers Association, California Cattlemen's Association, and California Grape and Tree Fruit League as Amici Curiae.

In this appeal we consider whether the State Water Resources Control Board's (SWRCB) imposition of new annual fees on holders of water right permits and licenses under Water Code section 1525 and implementing emergency regulations constituted lawful regulatory fees or unlawful taxes adopted in violation of article XIIIA of the California Constitution (Proposition 13).[1] Also challenged as unconstitutional are new annual fees imposed on persons and entities that contract for water from the United States Bureau of Reclamation (Bureau) pursuant to Water Code sections 1540 and 1560,[2] and the emergency regulations.

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[1] Proposition 13 was adopted by the voters in the June 6, 1978 primary election. (2A West's Ann. Cal. Const. (1996 ed.) foll. art. 13A, § 1, p. 477; Ballot Pamp., Primary Elec. (June 6, 1978), p. 56.)

We grant the unopposed requests for judicial notice filed by the SWRCB on January 19, 2006, and March 10, 2006, and by the Northern California Water Association (NCWA) and the Central Valley Project Water Association (CVPWA) on February 9, 2006. (Evid. Code, §§ 452, subds. (b) & (c), 459, subd. (a).) We also take judicial notice of trial court documents attached to the letter brief filed by the NCWA and CVPWA on August 11, 2006. (Evid. Code, §§ 452, subd. (d), 459, subd. (a).)

[2] The Legislature enacted Water Code sections 1525, 1540 and 1560 as part of Senate Bill No. 1049. (Stats. 2003, ch. 741, § 85.)

Hereafter, undesignated statutory references are to the Water Code.

The California Farm Bureau Federation (Farm Bureau), Northern California Water Association (NCWA), Central Valley Project Water Association (CVPWA) and individual fee payers filed this action against the SWRCB for declaratory and injunctive relief, and writ of mandate (Code Civ. Proc., §§ 526, 863, 1060, 1085) after the SWRCB denied their requests for reconsideration and refund of annual fees billed in January 2004. Among other things, plaintiffs seek invalidation of the allegedly unconstitutional statutes, rescission of the emergency regulations, and refund of fees paid.

Applying the independent standard of review in our analysis of the constitutionality of the statutes and emergency regulations, we reject plaintiffs' claim that sections 1525, 1540 and 1560 are facially invalid. We conclude instead that the annual fees are unlawful as applied through the emergency regulations. Accordingly, we shall reverse the judgment in part, and remand with directions regarding the adoption of new fee schedules and refund of the annual fees unlawfully imposed.

FACTUAL AND PROCEDURAL BACKGROUND

A. *The Parties*

Plaintiff Farm Bureau alleges the state and county farm bureaus, named as plaintiffs in its complaint, are membership organizations authorized to take judicial action to protect the rights of farm families that hold water rights subject to the fees imposed by Senate Bill No. 1049 and the emergency regulations. Farm Bureau alleges the individuals named as

plaintiffs in its complaint hold water rights and were assessed the challenged fees.

Plaintiff NCWA alleges it represents over 70 agricultural water districts within the Sacramento River Basin, some of which hold water rights, some of which receive water under contract with the Bureau of Reclamation, and others that operate hydroelectric plants licensed or regulated by the Federal Energy Regulatory Commission (FERC).

The CVPWA alleges it represents "the interests of the 300 agricultural and municipal districts, agencies and communities that are located in the Central Valley . . . and the Santa Clara Valley . . . that have contracts for water from the federal Central Valley Project (CVP) . . . ." The complaint names in an appendix the persons and entities who paid the annual fees under protest. Both the NCWA and CVPWA allege they are authorized to sue on behalf of their member agencies.

Defendant SWRCB is charged with the "orderly and efficient administration of the water resources of the state . . . ." (§ 174.) It exercises both adjudicatory and regulatory functions in connection with water rights. (*Ibid.*) The water in California's streams and rivers belongs to the people of the state, but individuals may acquire the right to use the water under common and statutory law. (§§ 102, 1201.) The California Constitution sets forth the state policy of reasonable use: "It is hereby declared that because of the conditions prevailing in this State 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, and that the waste or unreasonable use or unreasonable method of use of water be prevented, and that the conservation of such waters is to be exercised with a view to the reasonable and beneficial use thereof in the interest of the people and for the public welfare. The right to water or to the use or flow of water in or from any natural stream or water course in this State is and shall be limited to such water as shall be reasonably required for the beneficial use to be served, and such right does not and shall not extend to the waste or unreasonable use or unreasonable method of use or unreasonable method of diversion of water. . . ." (Cal. Const., art. X, § 2.) Beneficial uses include, but are not limited to "use for domestic, irrigation, municipal, industrial, preservation and enhancement of fish and wildlife, recreational, mining and power purposes . . . ." (§ 1257; see also Cal. Code Regs., tit. 23, § 659 et seq.)

The SWRCB's Division of Water Rights (the Division) is responsible for administering the water rights program. It issues permits and licenses, and maintains records of the appropriation and use of all waters within the state. The Division nominally oversees post-1914 permitted and licensed water rights, and publicly held water rights. The Division has no statutory authority over riparian, pueblo and pre-1914 appropriative water rights represented by "Statements of Water

Diversion & Use" that account for 38 percent of the state's water subject to water rights.[3]

B. *The Division*

The Division is divided into three sections: permitting, licensing, and hearings and special projects. The permitting section "processes water right applications, petitions to change terms in water right permits and water right licenses. Groundwater recordations, [and] statements of water diversion and use, which are a recordation function . . . ." The licensing section enforces existing permits and licenses and handles work associated with licensing a permit. The hearings and special projects section assists the SWRCB with various types of administrative hearings, reviews environmental documents filed in support of water rights applications and petitions, assists with the implementation of the Bay-Delta Water Quality Control Plan, and certifies water quality in projects licensed by FERC and in diversions under water right permits or licenses.

The resources of the Division are allocated as follows:

(1) Processing applications and petitions - 25 percent;

(2) Environmental review - 18 percent;

(3) Bay-Delta Project - 6 percent;

(4) Licensing and compliance - 21 percent;

(5) Hearings - 11 percent;

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[3] See Appendix.

(6) Overhead - 19 percent.

The record contains no breakdown of the specific Division services used by each category of water right holders. As we will explain there are at least three types of water rights holders: riparian, pre-1914 appropriative, and post-1914 permit and license holders. However, the SWRCB states that one-third of the Division's work is for the benefit of the general public to protect the public trust and the environment.

C. *California Water Rights*

Before discussing the specific legal issues raised by the parties, we shall describe the historical development of California water rights. Four types of water rights are relevant to the issues in this appeal.

1. Riparian Rights

Under the common law riparian doctrine, a person owning land bordering a stream has the right to reasonable and beneficial use of water on his or her lands. (*People v. Shirokow* (1980) 26 Cal.3d 301, 307 (*Shirokow*); see also *Miller & Lux, Inc. v. Enterprise Canal & Land Co.* (1915) 169 Cal. 415, 441-444.) A riparian owner must share the right to use water with other riparian owners. (See *Harris v. Harrison* (1892) 93 Cal. 676, 681.) The SWRCB acknowledges that its, "core regulatory program, the administration of water right permits and licenses, does not apply" to holders of riparian water rights. The SWRCB has "[o]nly the authority to take action if

the use by a pre-14 or riparian holder is wasteful or unreasonable."[4]

2. Pre-1914 Appropriative Rights

The appropriation doctrine arose under the common law during the California gold rush when miners diverted water from streams to work their placer mining claims. (*Shirokow, supra,* 26 Cal.3d at p. 308; see also *Irwin v. Phillips* (1855) 5 Cal. 140, 145-147.) As between appropriators, the rule was "[the] first in time [is the] first in right." (*Shirokow, supra,* at p. 308.) The Legislature enacted the first appropriation statute in 1872 under which a person could establish the appropriative right to water use by posting and recording notice. (*Ibid.*) Thereafter, for some 40 years, both the common law and statutory methods were used to acquire appropriative water rights. (*Ibid.*)

Together, riparian and pre-1914 appropriative water rights account for the 38 percent of the water subject to water rights under "Statements of Water Diversion & Use."[5]

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[4] In its opening brief, the Farm Bureau refers to pueblo rights along with riparian rights. "The pueblo water right . . . is the paramount right of an American city as successor of a Spanish or Mexican pueblo (municipality) to the use of water naturally occurring within the old pueblo limits for the use of the inhabitants of the city." (Hutchins, The California Law of Water Rights (1956) p. 256.) In California, the cities of Los Angeles and San Diego hold pueblo water rights. (*Ibid.*)

[5] See Appendix.

3. Post-1914 Permitted and Licensed Rights

The two methods of acquiring appropriative water rights were superseded by the Legislature's enactment of the Water Commission Act in 1913 "to provide an orderly method for the appropriation of [unappropriated] waters." (*Temescal Water Co. v. Dept. of Public Works* (1955) 44 Cal.2d 90, 95; Stats. 1913, ch. 586, § 45, p. 1033; *Shirokow, supra*, 26 Cal.3d at p. 308.) Effective on December 19, 1914 (*Shirokow, supra,* at p. 309), the 1913 legislation created a Water Commission and provided a procedure for the appropriation of water for useful and beneficial purposes. (Stats. 1913, ch. 586, §§ 1, 15, 20, pp. 1013-1014, 1021, 1024, 1025.) Section 1201, derived from the 1913 Act, now provides: "All water flowing in any natural channel, excepting so far as it has been or is being applied to useful and beneficial purposes upon, or in so far as it is or may be reasonably needed for useful and beneficial purposes upon lands riparian thereto, or otherwise appropriated, is hereby declared to be public water of the State and subject to appropriation in accordance with the provisions of this code." (Note on Derivation, 68 West's Ann. Water Code (1971 ed.) fol. § 1201, p. 284.) A 1923 amendment to the Water Commission Act made the statutory application procedure the exclusive means of acquiring appropriative water rights. (Stats. 1923, ch. 87, § 1, p. 162; § 1225.) The authority of the original Water Commission to regulate appropriative water rights is now vested in the SWRCB. (*Shirokow, supra*, at p. 308, fn. 8; see § 179.)

After adoption of the 1913 Act, appropriative water rights were divided into two general categories: pre-1914 appropriative rights and post-1914 permitted and licensed rights. The SWRCB's permit and license system applies only to appropriations initiated after the December 19, 1914, effective date of the 1913 Act, and only to diversions from surface waters or subterranean streams in known and definite channels. (§§ 1200, 1202, subd. (c), 1225, 1250; *Shirokow, supra*, 26 Cal.3d at p. 309.) Post-1914 permits and licenses represent 40 percent of California water subject to water rights.[6]

4. Publicly Held Rights

Public entities and public utilities account for the largest diversions of water under post-1914 licenses and permits. These public permit and license holders include the Central Valley Project (CVP), the State Water Project (SWP), hydroelectric power companies, large irrigation districts, and municipal water suppliers. Together, the CVP and SWP service areas cover most of the state. (*Central Delta Water Agency v. State Water Resources Control Bd.* (2004) 124 Cal.App.4th 245, 252-253 (*Central Delta*).)

The SWP is a water storage and delivery system created by statute which consists of dams, reservoirs, and power and pumping plants operated by the California Department of Water Resources which holds the water rights for the project. Its

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[6] See Appendix.

operation is coordinated with the Bureau's operation of the CVP. Like the Bureau, the Department of Water Resources contracts to supply water to agricultural and urban water contractors throughout the state. (*Central Delta*, *supra*, 124 Cal.App.4th at p. 254, fn. 4.) SWP water rights are included in the 40 percent of existing water rights held under post-1914 permits and licenses.[7]

Listed by the SWRCB separately from other public holders of post-1914 permits and licenses, the United States government holds rights to 22 percent of the water subject to water rights under the Division.[8] The United States Bureau of Reclamation (Bureau) operates the CVP under permits granted by the SWRCB, and contracts out its care, operation and maintenance. The SWRCB regulates the Bureau as CVP's permit holder. Federal contractors are responsible for the control, distribution and use of all water delivered under CVP contracts. However, these federal contracts affect only 6.6 million acre-feet of water out of 116 million acre-feet allocated under the Bureau's permits.[9]

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[7] See Appendix.

[8] See Appendix.

[9] See Appendix. An acre-foot is "[t]he volume of water, 43,560 cubic feet, that will cover an area of one acre to a depth of one foot." (American Heritage Dict. (2d college ed. 1982, 1985) p. 75.)

5. Characteristics of California Water Rights

"Both riparian and appropriative rights are usufructuary only and confer no right of private ownership in the watercourse," which belongs to the state.[10] (*Shirokow, supra*, 26 Cal.3d at p. 307; see § 102.) At the same time, California courts recognize that "once rights to use water are acquired, they become vested property rights" appurtenant to the land. (*United States v. State Water Resources Control Bd.* (1986) 182 Cal.App.3d 82, 101; see *Fullerton v. State Water Resources Control Bd.* (1979) 90 Cal.App.3d 590, 598.)

In the eyes of the Legislature and the SWRCB, federal contractors have no property rights in the permits and licenses held by the Bureau and their standing to challenge changes in permits and licenses is no greater than that of the general public. (§ 1540; Cal. State Water Resources Control Bd. Dec. No. 1641 (March 15, 2000) at p. 129.)[11]

D. *Senate Bill No. 1049*

Senate Bill No. 1049, inter alia, affected the Water Code by repealing certain sections and enacting sections 1525, 1530, 1535, 1536, 1537, 1540, 1551 and 1560. Even though the parties

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[10] "Usufructuary" relates to a "usufruct" which is "[a] right to use another's property for a time without damaging or diminishing it . . . ." (Black's Law Dict. (7th ed. 1999), pp. 1542, 1543.)

[11] Section 1540 reads in part: "The allocation of the fee or expense to these contractors does not affect ownership of any permit, license, or other water right, and does not vest any equitable title in the contractors."

challenge only sections 1525, 1540 and 1560, a brief overview of the background and relevant provisions of the challenged legislation is useful in our analysis.

1. The Legislative Analyst's Recommendations

Historically, the General Fund has supported most of the cost of the Division's program, with fees supplying only 0.5 percent of the total program cost of the Division. In an effort to reduce the state's budget shortfall, the Legislative Analyst's Office (LAO) recommended reduction of General Fund support for the water rights program in fiscal year 2003-2004. The LAO proposed that the General Fund support the water rights program for the first half of the fiscal year, and fee increases cover the $4.4 million needed for the second half of the fiscal year. The LAO also recommended that the entire Division program be fee supported in fiscal year 2004-2005.

The SWRCB strongly objected to the proposed change in the Division's funding source, arguing: "The LAO's recommendation is based on an assumption that all water right actions benefit [] the regulated community (water right permit and license holders). *This assumption is not true.* In many instances, the prior rights that are protected by the imposition of permit conditions in new permits or by the enforcement of permits and licenses are rights that are held by parties other than post-1914 appropriative right holders. *If the goal is that the party receiving the benefit pay their proportional share of the costs of the program, individuals who use groundwater and those who use surface water under some other basis of right should pay a*

portion of the program costs. The SWRCB's responsibility over non-permit holders is not included in the LAO recommendation. Certainly a portion of the SWRCB's regulatory/supervision function can and should be logically supported by the General Fund." (Italics added.) Victoria Whitney, the Division's current chief, testified under oath at her deposition that the response to the LAO recommendations was a correct statement.

The SWRCB also argued that "[m]any of the Division's activities also support the State's public trust resources benefiting all Californians. These activities should be supported by the State's General Fund."

The Division's budget in the 2003 Budget Act reflected the LAO's recommendations. (Stats. 2003, ch. 157 [Item No. 3940-001-0001], pp. 234-235.) The Legislature adopted Senate Bill No. 1049, to implement the fee program. (Stats. 2003, ch. 741, § 85.) It contained the statutes that authorize and implement the Division's imposition of annual fees on the holders of water right permits and licenses.

2. The Fee Legislation

The SWRCB fee legislation enacted as part of Senate Bill No. 1049 is found in Division 2 of the Water Code in a chapter titled "Water Right Fees." Division 2 broadly concerns the determination of water rights, and the appropriation and distribution of water in watermaster service areas. (See listing of parts in 68 West's Ann. Water Code (1971 ed.) before § 1000, p. 223.)

a. Section 1525

Section 1525 sets forth the parties and entities subject to the new fees. It contains three subdivisions. Subdivision (a) requires the SWRCB to adopt a schedule of annual fees to be paid by each holder of a permit or license to appropriate water and each lessor of certain leased water. Subdivision (b) requires the SWRCB to establish a schedule of one-time fees to be paid by applicants for permits to appropriate water and to approve leases, and for petitions relating to those applications. Subdivision (c) requires that the fee schedules generate fees in an amount necessary to "recover [the] costs incurred" in performing the services described in subdivisions (a), (b) and (c). These services include the "issuance, administration, review, monitoring, and enforcement" of water right permits and licenses. Subdivision (d) requires that the SWRCB collect the fees authorized by subdivisions (a), (b) and (c) "at an amount equal to the revenue levels set forth in the annual Budget Act for *this activity*," namely, the "activity" of issuing the permits and licenses, and carrying out the tasks identified in those subdivisions. (§ 1525, italics added.)[12]

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[12] Section 1525 reads in its entirety:

"(a) Each person or entity who holds a permit or license to appropriate water, and each lessor of water leased under Chapter 1.5 (commencing with Section 1020) of Part 1, shall pay an annual fee according to a fee schedule established by the board.

"(b) Each person or entity who files any of the following shall pay a fee according to a fee schedule established by the board:

"(1) An application for a permit to appropriate water.

"(2) A registration of appropriation for a small domestic use or livestock stockpond.

"(3) A petition for an extension of time within which to begin construction, to complete construction, or to apply the water to full beneficial use under a permit.

"(4) A petition to change the point of diversion, place of use, or purpose of use, under a permit or license.

"(5) A petition to change the conditions of a permit or license, requested by the permittee or licensee, that is not otherwise subject to paragraph (3) or (4).

"(6) A petition to change the point of discharge, place of use, or purpose of use, of treated wastewater, requested pursuant to Section 1211.

"(7) An application for approval of a water lease agreement.

"(8) A request for release from priority pursuant to Section 10504.

"(9) An application for an assignment of a state-filed application pursuant to Section 10504.

"(c) The board shall set the fee schedule authorized by this section so that the total amount of fees collected pursuant to this section equals that amount necessary to recover costs incurred in connection with the issuance, administration, review, monitoring, and enforcement of permits, licenses, certificates, and registrations to appropriate water, water leases, and orders approving changes in point of discharge, place of use, or purpose of use of treated wastewater. The board may include, as recoverable costs, but is not limited to including, the costs incurred in reviewing applications, registrations, petitions and requests, prescribing terms of permits, licenses, registrations, and change orders, enforcing and evaluating compliance with permits, licenses, certificates, registrations, change orders, and water leases, inspection, monitoring, planning, modeling, reviewing documents prepared for the purpose of regulating the diversion and use of water, applying and enforcing the prohibition set forth in Section 1052 against the unauthorized diversion or use of water subject to this division, and the administrative costs incurred in connection with carrying out these actions.

"(d)(1) The board shall adopt the schedule of fees authorized under this section as emergency regulations in accordance with Section 1530. . . ." [¶] . . . [¶]

"(3) The board shall 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

b. Section 1530

Section 1530 directs the SWRCB to set the fees by emergency regulation.

c. Section 1535

Section 1535 requires that fees for filing an application, request or proof of claim, other than an annual fee, be paid to the SWRCB.

d. Section 1536

Section 1536 provides that annual fees, other than initial filing fees, be paid to the State Board of Equalization (BOE).

e. Section 1537

If a section 1525, subdivision (b) fee is not paid, the SWRCB may cancel the related application, request or proof of claim, and refer the matter to the BOE for collection. (§ 1525, subd. (b).) The Board of Equalization (BOE) collects and refunds annual fees collected under the Fee Collection Procedures Law, part of the Revenue and Taxation Code, as limited by subdivisions (b)(2) through (b)(4) of section 1537. (§ 1537.) Subdivision (b)(2) of section 1537 provides that a determination by the SWRCB that a "person or entity" is required

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Budget Act for this activity. The board shall review and revise the fees each fiscal year as necessary to conform with the revenue levels set forth in the annual Budget Act. If the board determines that the revenue collected during the preceding year was greater than, or less than, the revenue levels set forth in the annual Budget Act, the board may further adjust the annual fees to compensate for the over or under collection of revenue.

"(e) Annual fees imposed pursuant to this section for the 2003-04 fiscal year shall be assessed for the entire 2003-04 fiscal year."

to pay a fee, or regarding the amount of the fee, is subject to the administrative adjudication procedures of section 1120 et seq., which governs reconsideration, amendment and judicial review of water right decisions and orders.[13] Section 1126 provides for judicial review of SWRCB's decisions relating to state water law.[14] Subdivision (b)(3) provides that the BOE

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[13] Section 1122 provides: "The board may order a reconsideration of all or part of a decision or order on the board's own motion or on the filing of a petition of any interested person or entity. The petition shall be filed not later than 30 days from the date the board adopts a decision or order. The authority of the board to order a reconsideration on its own motion shall expire 30 days after it has adopted a decision or order. The board shall order or deny reconsideration on a petition therefor not later than 90 days from the date the board adopts the decision or order."

Section 1123 defines the scope of a petition for reconsideration: "The decision or order may be reconsidered by the board on all the pertinent parts of the record and such argument as may be permitted, or a further hearing may be held, upon notice to all interested persons, for the purpose of receiving such additional evidence as the board may, for cause, allow. The decision or order on reconsideration shall have the same force and effect as an original order or decision."

[14] Section 1126 reads in part:

"(a) It is the intent of the Legislature that all issues relating to state water law decided by the board be reviewed in state courts, if a party seeks judicial review. It is further the intent of the Legislature that the courts assert jurisdiction and exercise discretion to fashion appropriate remedies pursuant to Section 389 of the Code of Civil Procedure to facilitate the resolution of state water rights issues in state courts.

"(b) Any party aggrieved by any decision or order may, not later than 30 days from the date of final action by the board, file a petition for a writ of mandate for review of the decision or order. Except in cases where the decision or order is issued under authority delegated to an officer or employee of the board, reconsideration before the board is not an administrative

shall not accept any claim for a refund under the Fee Collection Procedures Law on the ground the fee was "incorrectly determined" or "improperly or erroneously calculated" unless "that determination has been set aside by the [SWRCB] or a court reviewing the determination of the Board." Subdivision (b)(4) then provides that the administrative adjudication provisions of section 1126 shall not be construed to apply to "the adoption of [quasi legislative] regulations" pursuant to section 1530. Subdivision (b)(4) does not appear to apply to a facial challenge to the regulations. As we shall explain, the BOE has no role in reviewing refund claims under section 1537 or the emergency regulations.

f. Sections 1540 and 1560

Sections 1540 and 1560 concern the allocation of annual fees, or an appropriate portion of the fees, to persons who have contracts with fee payers who decline to pay based on their sovereign immunity.[15]

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remedy that is required to be exhausted before filing a petition for writ of mandate. . . ."

[15] Senate Bill No. 1049 amended former section 1540 and now reads:

"If the board determines that the person or entity on whom a fee or expense is imposed will not pay the fee or expense based on the fact that the fee payer has sovereign immunity under Section 1560, the board may allocate the fee or expense, or an appropriate portion of the fee or expense, to persons or entities who have contracts for the delivery of water from the person or entity on whom the fee or expense was initially imposed. The allocation of the fee or expense to these contractors does not affect ownership of any permit, license, or other water right, and does not vest any equitable title in the contractors." (Stats. 2003, ch. 741, § 85, pp. 60-61.)

g. Section 1551

Section 1551 creates a Water Rights Fund into which the BOE must deposit the fees it collects on behalf of the SWRCB. The Water Rights Fund is separate from the General Fund and the fees collected may be used only for programs specified in section 1552. These include the expenditures by the BOE in connection with collecting the SWRCB fees, payment of refunds pursuant to the Revenue and Taxation Code, and expenditures by the SWRCB

Senate Bill No. 1049 amended former section 1560 and now reads:

"(a) The fees and expenses established under this chapter and Part 3 (commencing with Section 2000) apply to the United States and to Indian tribes, to the extent authorized under federal or tribal law.

"(b) If the United States or an Indian tribe declines to pay a fee or expense, *or the board determines that the United States or the Indian tribe is likely to decline to pay a fee or expense*, the board may do any of the following:

"(1) Initiate appropriate action to collect the fee or expense, including any appropriate enforcement action for failure to pay the fee or expense, if the board determines that federal or tribal law authorizes collection of the fee or expense.

"(2) Allocate the fee or expense, or an appropriate portion of the fee or expense, in accordance with Section 1540. The board may make this allocation as part of the emergency regulations adopted pursuant to Section 1530.

"(3) Enter into a contractual arrangement that requires the United States or the Indian tribe to reimburse the board, in whole or in part, for the services furnished by the board, either directly or indirectly, in connection with the activity for which the fee or expense is imposed.

"(4) Refuse to process any application, registration, petition, request, or proof of claim for which the fee or expense is not paid, if the board determines that refusal would not be inconsistent with federal law or the public interest." (Stats. 2003, ch. 741, § 85, p. 62, italics added.)

"for the purposes of carrying out" the work of the Water Rights Division.

3. The Emergency Regulations

The SWRCB faced numerous problems in establishing the new fee schedule mandated by section 1525. First, the SWRCB had to raise $4.4 million immediately to cover the cost of the water rights program in the second half of the 2003-2004 fiscal year.[16] Second, the funding source had to be "relatively stable." Third, because of time constraints, SWRCB had to rely on its existing data base in calculating the amount of fees to be assessed. Fourth, although it cost SWRCB between $17,000 and $20,000 to process an application to appropriate water, SWRCB expected people would not seek SWRCB services if the one-time service fees were too high. Fifth, because most persons and entities subject to the annual fee held permits or licenses for less than 10 acre-feet of water, a minimum fee was necessary to cover the cost of sending out the fee bills. Sixth, SWRCB anticipated that 40 percent of the water right permit and license holders would refuse to pay annual fees. Seventh, the SWRCB did not have permitting authority over certain holders of

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[16] Section 1525 et seq. and emergency regulations became effective January 1, 2004, halfway through the 2003-2004 fiscal year. (Stats. 2003, ch. 741, § 85, p. 1; Cal. Const., art. IV, § 8, subd. (c); Cal. Code Regs., tit. 23, §§ 1061-1078, Register 2003, No. 52 (Dec. 23, 2003).) The General Fund covered the cost of the water rights program for the first half of fiscal 2003-2004, approximately $4.6 million in a budget of approximately $9 million.

water rights (specifically the holders of riparian, pueblo and pre-1914 appropriative rights) amounting to approximately 38 percent of the water diverted in the state.

California Code of Regulations, title 23, sections 1066 and 1073 (regulations 1066 and 1073) established formulas for calculating the annual fees imposed on holders of water right permits and licenses and the federal contractors.

a. Annual Fee Formula For Permit and License Holders

Subdivision (a) of regulation 1066 provides: "A person who holds a water right permit or license shall pay an annual fee that is the greater of $100 or $0.03 per acre-foot based on the total annual amount of diversion authorized by the permit or license." (Cal. Code Regs., tit. 23, § 1066, subd. (a), Register 2003, No. 52 (Dec. 23, 2003).)

The SWRCB based the annual fee "on the total annual amount of diversion authorized by the permit or license, without regard to the availability of water for diversion or any bypass requirements or other conditions or constraints that may have the practical effect of limiting diversions but do not constitute a condition of the permit or license that expressly sets a maximum amount of diversion." (Cal. Code Regs., tit. 23, § 1066, subd. (b).) If a person or entity held "multiple water rights that contain[ed] an annual diversion limitation that [was] applicable to the combination of those rights, but the person [could] still divert the full amount authorized under a particular right, then the fee [was] based on the total annual

amount for that individual right." (Cal. Code Regs., tit. 23, § 1066, subd. (b)(3).)

To determine how much permit and license holders should be charged in annual fees under regulation 1066, the SWRCB began with the $4.4 million budget amount and assumed it would be unable to collect 40 percent of billed revenues from water right holders who claimed sovereign immunity or simply refused to pay their bills. It divided the $4.4 million mandated by the Legislature by 0.6 to account for the estimated 40 percent non-collection rate, increasing the target revenue to around $7 million.

The SWRCB admitted that the permit and license holders paid for benefits received by a significant number of water right holders not required to pay the annual fees. The estimated 40 percent of water right holders who did not pay the annual fee based on claims of sovereign immunity or simple refusal benefited from the Division's activities "[t]he same way that everybody else benefits." Holders of riparian, pueblo, and pre-1914 appropriative water rights, representing approximately 38 percent of all water diverted, also benefited from SWRCB activities. However, the SWRCB had no permitting authority over riparian, pueblo and pre-1914 appropriative water right holders, and did not impose on them the annual fees required by section 1525, subdivision (a).

According to the SWRCB, 45 percent of those holding water right permits and licenses diverted less than 10 acre-feet of water, and 70 percent of the permit and license holders diverted

less than 100 acre-feet of water. However, the SWRCB imposed the $100 minimum annual fee on all these water right holders. (Cal. Code Regs., tit. 23, § 1066, subd. (a), Register 2003, No. 52 (Dec. 23, 2003).) Thus, regulation 1066 effectively charged persons who diverted less than 10 acre-feet of water under a SWRCB permit or license the same as those who diverted 3,333 acre-feet of water.

b. Annual Fee Formula For Federal Contractors

Subdivision (b)(2) of regulation 1073 supplied the formula for calculating the annual fee imposed on federal contractors "[i]f the [Bureau] decline[d] or [was] likely to decline to pay the fee or expense . . . for the CVP." (Cal. Code Regs., tit. 23, § 1073, subd. (b)(2).)

The SWRCB provided the following description of how it calculated the fee: "For FY 2003-2004 the annual fees associated with the Bureau water rights were calculated based on the greater of $100 or $0.03 per acre-foot, similarly to the way fees were calculated for all other permit and license holders. The total amount authorized for diversion under the Bureau's permits and licenses was calculated at 116 million acre-feet (MAF). The regulations also provide a 50 percent discount for all hydropower permits and licenses. . . . [W]ith the discount, this total amount of water under the Bureau's water rights subject to fees was reduced to 86 MAF. The total annual fee associated with all of the Bureau's permits for FY 2003-2004 was $2,593,343. The amount assessed for permits and licenses for the CVP was $2,452,716.

"The regulations provide that the contractors for each of the Bureau's projects will be prorated a share of the annual fees associated with that project based on the amount of water the contractor has contracted for. The sum of all project supply contracts for the CVP was 6.6 MAF. Therefore, each CVP contractor was assessed a fee equal to his or her individual contracted project supply divided by 6.6 MAF with the quotient multiplied by $2,452,716. This resulted in fees of approximately $0.37 per acre-foot of the contracted amount."

In other words, the SWRCB assessed annual fees against federal contractors based on a prorated portion of the total amount of annual fees associated with all the Bureau permits and licenses.

E. *Plaintiffs' Response To the Imposition of Annual Fees*

In January 2004, the BOE sent notices of determination (water right fee bills) to the persons and entities described in section 1525, and to the federal contractors. SWRCB collected $7.4 million in water right fees for fiscal year 2003-2004. The Budget Act set a target of only $4.4 million in fee revenue because the balance for the first half of 2003-2004 was paid from General Fund revenue.

The NCWA and CVPWA plaintiffs filed their complaint for declaratory and injunctive relief and petition for writ of mandate in Sacramento County Superior Court case No. 03CS01776 on December 17, 2003. Two months later the NCWA, CVPWA and Farm Bureau unsuccessfully petitioned for reconsideration and refund of annual fees pursuant to sections 1120 et seq. and 1537,

subdivision (b)(2), and California Code of Regulations, title 23, section 768 et seq., in accordance with the procedure described by the SWRCB. Thereafter, on April 13, 2004, the Farm Bureau filed its complaint for declaratory and injunctive relief and petition for writ of mandate case No. 04CS00473. The NCWA and CVPWA amended their complaint and petition on May 7, 2004 to allege denial of its petition before the SWRCB and to add additional named plaintiffs pursuant to a stipulation with the SWRCB.[17] The court consolidated the two actions for all purposes.

Following a hearing on April 15, 2005, the trial court denied plaintiffs' petitions for writ of mandate. The trial court ruled the fees imposed under section 1525 and the emergency regulations were valid regulatory fees. It also rejected plaintiffs' other constitutional claims. This appeal ensued.

DISCUSSION

I

Lawful Regulatory Fees and Unconstitutional Taxes

In 1978, California voters approved Proposition 13, a constitutional amendment promising property tax relief. (Cal. Const., art. XIII A, §§ 1-4, added by initiative, Primary Elec.

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[17] The stipulation also states: "The Parties agree that should Plaintiffs prevail in this litigation, the Parties named in the Amended Complaint will be entitled to a refund of paid fees in a manner and to the extent this is consistent with the decision of the Court after the exhaustion of all appeals."

(June 6, 1978); Ballot Pamp., Primary Elec. (June 6, 1978, argument in favor of Prop. 13, pp. 58, 59.) Proposition 13's interlocking provisions limit real property tax rates and assessments, and place restrictions on state and local government's power to tax real property. (*Amador Valley Joint Union High Sch. Dist. v. State Bd. of Equalization* (1978) 22 Cal.3d 208, 218, 231.)

With respect to the state power to tax, article XIII A, section 3 of the California Constitution provides: "From and after the effective date of this article, any changes in state taxes enacted for the purpose of increasing revenues collected pursuant thereto whether by increased rates or changes in methods of computation must be imposed by an Act passed by not less than two-thirds of all members elected to each of the two houses of the Legislature, except that no new ad valorem taxes on real property, or sales or transaction taxes on the sales of real property may be imposed."

Regulatory fees are an exception to the requirements of Proposition 13. Such fees are valid only if they "'"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." [Citations.]' [Citations.]" (*Sinclair Paint Co. v. State Bd. of Equalization* (1997) 15 Cal.4th 866, 876 (*Sinclair*); *Cal. Assn. of Prof. Scientists v. Dept. of Fish & Game* (2000) 79 Cal.App.4th 935, 945 (*CAPS*).) "Ordinarily, 'taxes are imposed for revenue purposes, rather than in return for a specific benefit conferred

or privilege granted' and '[m]ost taxes are compulsory rather than imposed in response to a voluntary decision to develop or to seek other government benefits or privileges.'" (*CAPS*, *supra*, at p. 944, quoting *Sinclair*, *supra*, at pp. 873-874.)

As we explained in *CAPS*, *Sinclair* was the first published post-Proposition 13 case to consider whether a fee imposed by the *state* was in effect a tax that violated article XIII A, section 3 of the California Constitution. (*CAPS*, *supra*, 79 Cal.App.4th at p. 944.) The *Sinclair* court made two distinctions relevant to the case before us.

First, because there is a "close, 'interlocking' relationship" between the tax limitation sections of Proposition 13 (Cal. Const., art. XIII A, §§ 3 & 4), cases involving local exactions "may be helpful, though not conclusive" in deciding whether a fee imposed by the state is an unlawful tax. (*Sinclair*, *supra*, 15 Cal.4th at p. 873.)

Second, *Sinclair* also identified "three very different kinds of fees" routinely challenged under Proposition 13: special assessments based on the value of benefits conferred on property, development fees exacted in return for permits or other government privileges, and regulatory fees -- "an entirely different animal" -- enacted under the police power. (*CAPS*, *supra*, 79 Cal.App.4th at p. 944.) In *CAPS*, we alerted the parties to the danger in "extract[ing] general principles from cases involving one type of fee and apply[ing] them to cases involving a completely different type of fee." (*CAPS*, *supra*, at p. 944.) The issue in this case involves an annual fee imposed

on a regulated community, holders of water right permits and licenses, and in the case of the CVP, those who contract with the federal government, which also holds water rights. Thus, this case, like *Sinclair* and *CAPS*, involves regulatory fees.

II

Burden of Proof and Standard of Review

When challenged on grounds a fee is an unlawful tax, the state must show: "'(1) the estimated costs of the service or regulatory activity, and (2) the basis for determining the manner in which the costs are apportioned, so that charges allocated to a payor bear a fair or reasonable relationship to the payor's burdens on or benefits from the regulatory activity.'" (*Sinclair*, *supra*, 15 Cal.4th at p. 878; *CAPS*, *supra*, 79 Cal.App.4th at p. 945.) Language in the court's order suggests the court erroneously placed the burden of proof on plaintiffs. This misallocation of the burden left open the possibility that the SWRCB did not adduce all evidence at its disposal at trial. Accordingly, we requested supplemental briefing, and the parties submitted supplemental briefs on the question "whether the parties adduced all relevant evidence at their disposal in the trial court." The SWRCB responded that it had not adduced all relevant evidence at its disposal but had satisfied the burden of proof. Because the issues in the case were "primarily legal rather than factual," the SWRCB concluded, "any further evidence at trial would have been either irrelevant or cumulative . . . ." We perceive no prejudice to any party from the trial court's misallocation of the burden of proof.

On appeal, 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. (*Sinclair, supra*, 15 Cal.4th at p. 874.) 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 in *Shapell Industries, Inc. v. Governing Bd.* (1991) 1 Cal.App.4th 218, 225, 230-233, is inapplicable here.

III

The Regulated Community: Permit and License Holders

A. *Section 1525 Is Constitutional On Its Face*

Plaintiffs argue the fees the SWRCB collected in the 2003-2004 fiscal year pursuant to section 1525 are unconstitutional taxes because they were excessive, that is, amounted to more than the cost of the regulatory activity. We reject plaintiffs' argument that the mere collection of excess fees by the SWRCB renders the authorizing legislation unconstitutional.

Preliminarily, we note that plaintiffs do not challenge subdivision (b) of section 1525, which authorizes adoption of a fee schedule for permit applicants and petitioners for various changes in their permits, nor the part of the emergency regulations that impose a one-time filing fee. Plaintiffs apparently do challenge section 1525, subdivision (c), but only on the view that it "direct[s] the SWRCB to impose fees to cover

all costs incurred by the SWRCB's Division of Water Rights." (Italics added.) It does not, as we shall explain.

Regulatory fees are valid only if they "'"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." [Citations.]' [Citations.]" (*Sinclair, supra*, 15 Cal.4th at p. 876; *CAPS, supra*, 79 Cal.App.4th at p. 945.) The second point is critical, because, regardless of whether the annual fees in this case exceed the reasonable cost of the services performed, they are related to the services performed and are not imposed for general revenue purposes. This bears on the remedy available.

"Simply because a fee exceeds the reasonable cost of providing the service or regulatory activity for which it is charged does not transform it into a tax." (*Barratt American, Inc. v. City of Rancho Cucamonga* (2005) 37 Cal.4th 685, 700, citing the "reverse logic" analysis of *Alamo Rent-a-Car, Inc. v. Board of Supervisors* (1990) 221 Cal.App.3d 198, 205-206 (*Alamo*).) It is an analytical error to conclude by reverse logic that if a regulatory fee does not meet the reasonable cost requirements of Government Code section 50076,[18] "then it must be a special tax." (*Alamo, supra*, at pp. 205-206.) "In short,

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[18] Government Code section 50076 applies to local agencies and states that "[a]s used in this article, 'special tax' shall not include any fee which does not exceed the reasonable cost of providing the service or regulatory activity for which the fee is charged and which is not levied for general revenue purposes."

article XIII A does not apply to every regulatory fee simply because, as applied to one or another of the payor class, the fee is disproportionate to the service rendered." (*Brydon v. East Bay Mun. Utility Dist.* (1994) 24 Cal.App.4th 178, 194 (*Brydon*).)

The purpose of the legislation is determined by examining the language of section 1525 and the succeeding sections, and not, as suggested by Farm Bureau plaintiffs, the SWRCB's musings to the Legislative Analyst or the Legislative Analyst's recommendations to the Legislature. The annual fees imposed under section 1525 are manifestly not collected for general revenue purposes.

It is clear that the statutory structure of section 1525 concerns only the costs of the functions or activities described in section 1525 and that the fees collected for those functions or activities are to be deposited in the Water Rights Fund, not in the General Fund. (§§ 1551, 1552.) Section 1551 lists the fees to be deposited into the Water Rights Fund including all fees collected by the SWRCB or the State Board of Equalization. Section 1552 describes for what purpose the money in the Water Rights Fund is available for expenditure. The fees come from various sources, including some that do not involve the services described in section 1525.[19] (§ 1551.) It cannot be argued that

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[19] Section 1551 provides: "All of the following shall be deposited in the Water Rights Fund:

"(a) All fees, expenses, and penalties collected by the board or the State Board of Equalization under this chapter and Part 3 (commencing with Section 2000).

because sections 1551 and 1552 list a variety of items to be deposited in the Water Rights Fund, some of which do not involve the services, activities or functions for which fees are collected under section 1525, that the fees are excess fees.

Section 1552 does not describe how the various fees deposited in the Water Rights Fund are to be allocated, but there is nothing in section 1552 that precludes the segregation and application of the fees collected pursuant to section 1525 to services described in that section.[20] This is an accounting

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"(b) All funds collected under Section 1052, 1845, or 5107.

"(c) All fees collected under Section 13160.1 in connection with certificates for activities involving hydroelectric power projects subject to licensing by the Federal Energy Regulatory Commission."

[20] Section 1552 provides:

"The money in the Water Rights Fund is available for expenditure, upon appropriation by the Legislature, for the following purposes:

"(a) For expenditure by the State Board of Equalization in the administration of this chapter and the Fee Collection Procedures Law (Part 30 (commencing with Section 55001) of Division 2 of the Revenue and Taxation Code) in connection with any fee or expense subject to this chapter.

"(b) For the payment of refunds, pursuant to Part 30 (commencing with Section 55001) of Division 2 of the Revenue and Taxation Code, of fees or expenses collected pursuant to this chapter.

"(c) For expenditure by the board for the purposes of carrying out this division, Division 1 (commencing with Section 100), Part 2 (commencing with Section 10500) of Division 6, and Article 7 (commencing with Section 13550) of Chapter 7 of Division 7.

"(d) For expenditures by the board for the purposes of carrying out Sections 13160 and 13160.1 in connection with activities involving hydroelectric power projects subject to licensing by the Federal Energy Regulatory Commission.

issue that concerns how the monies are treated within the Water Rights Fund.

As noted, there is no challenge to the constitutionality of subdivision (b) of section 1525. And there is nothing in the "total amount" or "total revenue" provisions of subdivisions (c) and (d) that requires the SWRCB to set the fees so as to collect anything more than the administrative "costs incurred" in carrying out the permit functions authorized in subdivisions (a), (b) and (c). Thus, subdivision (c) directs the SWRCB to set the fee schedules so that the "*total amount* of fees collected . . . equals that amount necessary to recover *costs incurred* in connection with" the administration of the provisions of subdivisions (a) and (b). (Italics added.) Subdivision (d)(3) directs that the SWRCB "shall 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 *for this activity*. . . ."[21]

"(e) For expenditures by the board for the purposes of carrying out Sections 13140 and 13170 in connection with plans and policies that address the diversion or use of water."

[21] The SWRCB cites the $4,399,000 listed in the 2003-2004 Budget Act (Stats. 2003, ch. 157, schedule 21.5 [item 3940-001-3058], p. 235) in support of its argument the fees do not exceed the cost of the regulatory program. This, amount, however, does not state the total amount from the "activity" referred to in section 1525, subdivisions (a), (b) and (c). That is because the amount for the "activity" of issuing permits and the like are contained within item 3940-001-3058 (the $4,399,000) by virtue of the somewhat peculiar way in which the budget is enacted.

The budget enactment consists of two parts, the summary of total amounts allocated by items, as shown in the Budget Act in

(Italics added.) In addition, subdivision (d)(3) provides a fail-safe by authorizing the SWRCB to "further adjust the annual fees" if it "determines that the revenue collected during the preceding year was greater than, or less than, the revenue levels set forth in the annual Budget Act . . . ."

Read in this manner, the purpose of section 1525 et seq. is not to raise general revenues but to defray the costs of performing the services for which the fees are collected. Since the legitimate charging of fees for these services is not challenged by the plaintiffs, it cannot be claimed the legislation has any other purpose. Accordingly, plaintiffs' facial challenge to section 1525 is reduced to the equation that an excess of fees collected over that necessary to defray the costs is equal to a tax, a conclusion not warranted by case law.

We also reject the plaintiffs' argument the SWRCB fees were imposed "solely on the basis [the fee payers] own[ed] real property" and therefore are unconstitutional ad valorem taxes. The property interests at issue here "are usufructuary only and

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item 3940-001-3058 cited by the SWRCB, and the supporting data that is contained in a document that accompanies the Budget Act that spells out the detail under each of the items listed in the Budget Act. These data are taken from the Governor's budget, a detailed accounting that includes all of the detailed functions and the employee positions required to carry them out, as modified by the Legislature. The document containing the detail of item 3940-001-3058 is not in the record and hence we do not know the specific "revenue level" for "the fees authorized by" section 1525, subdivision (d)(3). That is, the SWRCB has not supplied the evidence from which the amounts allocated to the functions or activities set forth in subdivisions (a) through (c) can be calculated.

confer no right of private ownership in the watercourse," which belongs to the state. (*Shirokow, supra*, 26 Cal.3d at p. 307; § 102.) Potentially conflicting water right claims and uses, not real property ownership, give rise to the need for regulation through the system of permits and licenses administered by the Division.

B. *The Fees Are Unlawful As Applied By Regulation 1066*

Plaintiffs' contention the annual fees imposed under section 1525 do not bear a fair or reasonable relationship to the fee payers' burdens on or benefits from regulatory activity challenges the SWRCB's application of section 1525 through the fee schedule formula set forth in regulation 1066. Plaintiffs cite at least two ways the annual fees are unlawful as applied. First, although the Division provides services to holders of riparian, pueblo and pre-1914 appropriative water rights, and those claiming sovereign immunity, collectively representing 60 percent of the water held under water rights, section 1066 mandates collection of annual fees from holders of water right permits and licenses that account for only 40 percent of the water held under water rights. Second, plaintiffs contend that regulation 1066 "impermissibly impose[s] costs disproportionately amongst the annual feepayors [*sic*] themselves, such that some feepayors [*sic*] pay vastly more than others on a per acre-foot basis. . . ."

As we explained, in regulatory fee cases, the state also has the burden of showing "'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, supra*, 15 Cal.4th at p. 878, quoting *San Diego Gas & Electric Co. v. San Diego County Air Pollution Control Dist.* (1988) 203 Cal.App.3d 1132, 1135 (*SDG&E*).) Proportionality need not be proved on an individual basis. (*Pennell v. City of San Jose* (1986) 42 Cal.3d 365, 375, fn. 11 [fact that fee payers may not believe they benefit from regulatory program does not transform a regulatory fee into an unlawful tax].)

As we noted in *CAPS*, "*Sinclair* is noteworthy for its expansive legitimation of regulatory fees . . . based on [the paint manufacturers'] market share or their past and present responsibility for environmental lead contamination . . . . [¶] As broad as the implications of *Sinclair* are, the Supreme Court did not have to reach the troublesome issue of proportionality" given the factual and procedural circumstances of that case. (*CAPS, supra*, 79 Cal.App.4th at p. 947.) We addressed the question of proportionality in *CAPS* and we must address it here.

In *CAPS*, we upheld against a constitutional challenge to fees charged by the Department of Fish and Game to cover a portion of the cost of meeting environmental review obligations under the California Environmental Quality Act (CEQA) and the Z'Berg-Nejedly Forest Practice Act of 1973 (Fish & Game Code, § 711.4; Pub. Resources Code, §§ 4511, 21000 et seq.) (79 Cal.App.4th at pp. 939-940.) The fee statute at issue required

flat fees, that is, a $1,250 filing fee for projects with negative declarations and $850 for projects with environmental impact reports. (*Id.* at p. 940.) The statute exempted from the filing fee projects with de minimis effect on fish and wildlife. These latter projects amounted to 68 percent of the projects potentially subject to agency review. (*Id.* at p. 943.) In *CAPS*, the principal issue was whether the flat fees passed constitutional muster. (*Id.* at p. 939.)

Two mitigating effects cases, *SDG&E*, *supra*, 203 Cal.App.3d 1132, 1147-1148 [approving apportionment based in part on amount of emissions on premise that the more emissions, the greater the regulatory job of the district] and *Brydon*, *supra*, 24 Cal.App.4th 178 [approving new structure of water rates to increase price per cubic foot for increased usage to meet conservation objectives], informed our decision in *CAPS* to apply "a flexible assessment of proportionality within a broad range of reasonableness in setting fees." (79 Cal.App.4th at p. 949.) Rejecting a user fee analysis, we observed that, "[r]egulatory fees, unlike other types of user fees, often are not easily correlated to a specific, ascertainable cost. This may be due to the complexity of the regulatory scheme and the multifaceted responsibilities of the department or agency charged with implementing or enforcing the applicable regulations; the multifaceted responsibilities of each of the employees who are charged with implementing or enforcing the regulations; the intermingled functions of various departments as well as intermingled funding sources; and expansive accounting systems

which are not designed to track specific tasks." (*Id.* at p. 950.) However, the phrase "fair or reasonable relationship" implies that there may exist a fee scheme that bears an *un*fair and *un*reasonable relationship to the payers burdens on and benefits from the regulatory program - in other words, where it is impossible to apply "a flexible assessment of proportionality." We believe the fee structure in this case crosses the line.

The case before us lacks some of the complexities we described in *CAPS*. Here, the regulatory activities are those of a single Division with three component parts within the SWRCB; a single Division specifically charged with issuing water right permits and licenses, and maintaining records of the appropriation and use of all waters within the state. There is a clear assignment of roles within each section or component of the Division and only a dual, now single, funding source.

However, this case presents complexities of a different sort. By quirk of historical development, the SWRCB lacks authority to impose annual fees on the holders of riparian, pueblo and pre-1914 appropriative rights that account for 38 percent of the water subject to water rights. Nor does the SWRCB demand that the Bureau pay annual fees on the water rights it holds for 22 percent of California water subject to water rights.[22] But unlike *CAPS* where the 68 percent of projects

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[22] See Appendix.

potentially subject to filing fees were properly exempted because they had de minimis effect on fish and wildlife, here the Division's regulatory program protects the non-paying holders of prior rights (riparian, pueblo and pre-1914 appropriative water right holders) as against all post-1914 applications and permits regarding appropriations. As Whitney told the LAO, "Approximately 30 percent of the appropriated water in California is held by the federal government, which refuses to pay [service] fees. . . . Of the total water beneficially used, 30 percent or more may be held by pre-1914 and riparian water right holders whose use is not routinely supervised by the Board. 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. . . ." In addition, the SWRCB admits that the holders of water rights representing 40 percent of California's water and were assessed the annual fee subsidized the cost of processing certain applications and petitions thereby reducing the one-time fees assessed under section 1525, subdivision (b) and California Code of Regulations, title 23, §§ 1062-1064. Indeed, the SWRCB collected only 10 percent of that cost in one-time service fees and the rest was borne, in part, by annual fee payers. The proportionality assessment in this case is further complicated by the SWRCB's admission that one-third of the work of the Division is for the benefit of the general public to protect the public trust and the environment.

In *CAPS*, the Department of Fish and Game demonstrated that the flat rate filing fees allocated to those seeking environmental review bore "'a fair or reasonable relationship to the payor's burdens on or benefits from the regulatory activity.'" (79 Cal.App.4th at pp. 945, 950-955.) The 68 percent of projects exempted from the filing fee placed no burden on the Department of Fish and Game's environmental review process because those projects had de minimis impact on fish and wildlife. (*Id.* at p. 943.) Here, the SWRCB offered no breakdown of costs or other evidence to demonstrate that the services and benefits provided to the non-paying water right holders were de minimis. Indeed, it would be difficult to make the de minimis argument, given the evidence in the record regarding the role of the Division in protecting pre-1914 water rights and the allocation of Division resources. As previously noted, the resources of the Division are allocated as follows:

(1) Processing applications and petitions - 25 percent;

(2) Environmental review - 18 percent;

(3) Bay-Delta Project - 6 percent;

(4) Licensing and compliance - 21 percent;

(5) Hearings - 11 percent;

(6) Overhead - 19 percent.

Accordingly, we conclude the SWRCB failed to sustain its burden to show "'the basis for determining the manner in which the costs [were] apportioned [under California Code of Regulations, title 23, section 1066], so that charges allocated to a payor [bore] a fair or reasonable relationship to the

payor's burdens on or benefits from the regulatory activity.'" (*Sinclair, supra*, 15 Cal.4th at p. 878, quoting *SDG&E, supra*, 203 Cal.App.3d at p. 1135.)

The SWRCB argues that the "polluter pays" rationale of SDG&E applies to justify the annual fee allocation in this case because "[t]he regulatory activities the fees support serve an important public purpose and so constitute a valid exercise of the police power." The SWRCB stresses that fulfilling the constitutional mandate to maximize the beneficial use of water (Cal. Const., art. X, § 2) also means preventing waste and unreasonable use. Paraphrasing the language of SDG&E, but without citing factual support, SWRCB asserts that "[t]he purpose for the Division's existence is to regulate the diversion and use of water, and it is reasonable to allocate its costs based on the premise that the greater the diversion authorized, the greater the regulatory job." (See *SDG&E, supra*, 203 Cal.App.3d at pp. 1147-1148.) The SWRCB did not provide any evidence to show the allocation of the actual cost of Division services provided to the holders of riparian, pueblo and pre-1914 appropriative water rights which hold 38 percent of the water subject to water rights. Nor was there evidence of the actual cost of Division services provided to the Bureau which holds 22 percent of the water subject to water rights. Without any evidence to show the allocation of actual costs of Division services to those collectively representing 60 percent of water diverted, we reject the claim the "polluter pays" rationale justifies imposing annual fees on the license and permit holders

who represent the remaining 40 percent. At the same time, however, we reject plaintiffs' argument there was an inequitable apportionment of fees among the designated annual fee payers. Although the SWRCB did not offer evidence of the actual cost of billing the annual fees, we cannot say a $100 minimum annual fee was an unreasonable estimate of that cost.

IV

Federal Contractors

As we explained, the Bureau operates the CVP under water rights permits issued by the SWRCB. Various public agencies contract with the Bureau for the care, operation and maintenance of the CVP. These federal contractors are responsible for the control, distribution and use of the water subject to their contracts. Federal contracts account for only 6.6 million acre-feet of the nearly 116 million acre-feet of water held under the Bureau's permits.

A. *Sections 1540 and 1560 Are Constitutional On Their Face*

The NCWA and CVPWA plaintiffs challenge the annual fees imposed on the federal contractors pursuant to sections 1540 and 1560 and regulation 1073 on grounds the fees violate the Supremacy Clause of the United States Constitution. (See *McCulloch v. Maryland* (1819) 4 Wheat. 316 [4 L.Ed. 579].) They also argue that the classifications drawn by the Legislature and the SWRCB in assessing annual fees against the federal contractors are irrational and arbitrary in violation of the state and federal rights of equal protection and substantive due

process. (U.S. Const., 14th Amend.; Cal. Const., art. I, § 7; 42 U.S.C. § 1983.)

Under the doctrine of sovereign immunity, the federal government is immune from taxation by a state. (*New York State Dept. of Environmental Conservation v. United States Dept. of Energy* (N.D.N.Y. 1991) 772 F.Supp. 91, 95.) Section 1540 provides that if "the fee payer has sovereign immunity under section 1560," the SWRCB "may allocate the fee . . . , or *an appropriate portion* of the fee . . . , to persons or entities who have contracts for the delivery of water" from the fee payer. (Italics added.) Section 1560, subdivision (a) states that fees may be collected only "to the extent authorized under federal law . . . ." Given this language, we conclude neither section 1540 nor 1560 sanctions imposition of a fee that violates the Supremacy Clause or state and federal rights to equal protection and due process. Once again, the difficulty is in the application of the statutes.

B. *The Fees Are Unlawful As Applied by Regulation 1073*

Citing several federal cases, the NCWA and CVPWA plaintiffs argue the SWRCB violated the Supremacy Clause by charging the federal contractors annual fees at the rate of $0.03 per acre-foot for close to the entire 116,331,177 acre-feet of water the Bureau holds under its permits and licenses.[23] Plaintiffs point out that "nowhere in the brief or in the record is there any

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[23] See computation of the federal contractors' annual fees at pages 23 to 24, *ante*.

evidence that any effort was made to determine what share of the claimed federal regulatory costs were fairly allocable to the CVP contractors. Instead, the entire federal burden was meted out proportionately to water uses that amount to less than 5% of water subject to federal permits and licenses." The SWRCB responds that it is justified in basing annual fees on the face value of the Bureau's water rights because limitations on the federal contractors' use of the water "are due to restrictions on the permits and licenses themselves, and not the contracts." The SWRCB offers nothing to support this claim. We conclude the fee schedule formula included in regulation 1073 is unlawful.

"[A]bsent its consent, the federal government and its instrumentalities are absolutely immune from direct taxation by a State. [Citations.]" (*New York State Dept. of Environmental Conservation v. United States Dept. of Energy, supra,* 772 F.Supp. at p. 95.) In other words, a state may not impose a fee or tax on federal property interests.[24] *(See City of Detroit v. Murray Corp.* (1958) 355 U.S. 489, 492 [2 L.Ed.2d 441, 445].) To successfully defend a Supremacy Clause challenge to a tax on persons or entities that contract with the federal government, the state or local taxing authority must segregate and tax only the possessory interest the contractor has in the property.

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[24] Federal cases make no distinction between fees and taxes for purposes of Supremacy Clause analysis because "both have their common source in the sovereign power of taxation." (See *United States v. Anderson Cottonwood Irrigation Dist.* (N.D. Cal. 1937) 19 F.Supp. 740, 741.)

(See *United States v. County of Fresno* (1977) 429 U.S. 452, 453 [50 L.Ed.2d 683, 686] (*County of Fresno*); *compare United States v. Nye County Nevada* (9th Cir. 1991) 938 F.2d 1040, 1043 (*Nye County*); *United States v. Hawkins County, Tennessee* (6th Cir. 1988) 859 F.2d 20, 24 (*Hawkins County*); and *United States v. State of Colorado* (10th Cir. 1980) 627 F.2d 217, 221 (*State of Colorado*).)

In *County of Fresno*, the United States Supreme Court upheld imposition of an annual use or property tax on federal employees on their possessory interest in housing owned by the United States Forest Service. The Forest Service required the affected employees to live in the housing it provided so they would be nearer their job sites and therefore better able to perform their duties in the national forests. (429 U.S. at p. 454 [50 L.Ed.2d at p. 686].) The Forest Service viewed occupancy of the houses as partial compensation for the work of its employees. It deducted from their paychecks an amount fixed by "estimating the fair rental value of a similar house in the private sector and then discounting that figure to take account of" other factors relating to location, absence of customary amenities and the Forest Service's exercise of rights as owner of the housing. (*Id.* at pp. 454-455.) The employees challenged an annual use or property tax imposed by Fresno and Tuolomne Counties based on the annual estimated fair rental value of the houses. (*Id.* at pp. 456-457.) The United States Supreme Court ruled that a state may, "in effect, raise revenues on the basis of property owned by the United States as long as that property is being

used by a private citizen . . . and so long as it is the possession or use by the private citizen that is being taxed." (*Id.* at p. 462.) Stated differently, "The use of property of the United States may be taxed to a private contractor, even if the economic burden of the tax is ultimately borne by the United States, *but only to the extent that the contractor has the beneficial use of the property*. That is, the contractor may not be taxed beyond the value of his use. The use of property in connection with commercial activities carried on for profit is a separate and distinct taxable activity." (*Hawkins County, supra,* 859 F.2d at p. 23, italics added.)

State of Colorado involved a county's attempt to impose a "user" tax on Rockwell International Corporation (Rockwell), which operated the Rocky Flats nuclear weapons plant under contract with the United States government. The challenged statute stated that the user of real property was "'subject to taxation in the same amount and to the same extent as though the lessee . . . were the owner of such property. . . .'" (627 F.2d at p. 218.) The county assessor based Rockwell's tax on the assessed value of the land, improvements, and machinery and equipment at Rocky Flats. (*Ibid.*) The Tenth Circuit observed that Rockwell provided managerial services at Rocky Flats but did "not have any lease, permit or license to the property in question, which is owned in fee simple by the United States." (*Id.* at p. 219.) It ruled the tax unconstitutional, concluding that "the 'substance' of the . . . procedure is not to tax Rockwell's 'use' of government owned property, but to lay an ad

valorem general property tax on property owned by the United States." (*Id.* at p. 221.) Rockwell had no property interest separate from that of the United States.

The Sixth Circuit reached a similar result in *Hawkins County*. In that case, Holston Defense Corporation, a private contractor, operated and maintained the Holston Army Ammunition Plant under a cost-plus contract with the United States government. (859 F.2d at pp. 21-22.) The Tennessee Legislature enacted a statute which assessed property of the United States to the user of the property "at its real property value, minus a deduction for any contractual restrictions on its use, unless the property [was] used for an exclusively public purpose, or the user [was] an agent or instrumentality of the United States." (*Id.* at p. 22, fn. omitted.) The county assessor calculated the tax based on the replacement cost of real and personal property at the munitions facility. (*Ibid.*) Acknowledging that a private contractor may be taxed on its use of federal property -- but only to the extent of its beneficial use -- the Sixth Circuit concluded that the Tennessee statute "fairly cannot be said to impose a tax on Holston's beneficial use . . . ." (*Id.* at p. 23.) Instead, the statute assessed the purported user tax "at a value determined pursuant to other sections of the code which spell out the procedure for calculating the value of real property for purposes of the state's ad valorem tax." (*Ibid.*) "Since Holston [was] determined not to have a real property interest in the facility,

Tennessee's attempt to tax Holston resulted in what was, in reality, a tax upon the United States itself." (*Id.* at p. 24.)

In *Nye County*, the United States successfully challenged imposition of a personal property tax against Arcata Associates, Inc. (Arcata), an independent federal defense contractor at an Air Force installation in Nevada. (938 F.2d at p. 1041.) The court noted that "[t]he Air Force directs Arcata's operation of all government-owned equipment. Arcata does not have the right to use the equipment for its own account or business. It has no property interest in the equipment. Its only access to the equipment is at the time and place and in the manner directed by the United States." (*Ibid.*) The Ninth Circuit ruled the tax violated the Supremacy Clause by comparing tax measures that have survived with those that have perished in the face of constitutional challenge. (*Id.* at p. 1042.) Citing County of Fresno, it emphasized that "[t]he survivors have been tax measures imposed on an isolated possessory interest or beneficial use of United States property. The perished have been tax measures levied on the property itself." (*Ibid.*) The Ninth Circuit struck down the *Nye County* tax, stating, "Here, the property belongs to the United States. Arcata has no leasehold interest in it, but merely has the privilege, terminable at the will of the government, to use the property at the time and place and in the manner directed by the United States. *Nye County makes no attempt to segregate and tax any possessory interest Arcata may have in the property, or Arcata's beneficial use of the property. Nye County* simply taxes Arcata

as if it were the owner of the property. The tax effectively lays 'an ad valorem general property tax on property owned by the United States.'" (*Id.* at p. 1043, italics added & omitted.)

These four cases demonstrate that the SWRCB has authority to impose a regulatory fee on the federal contractors, but only to the extent of the federal contractors' contractual interest in the Bureau's water rights permits. Sections 1540 and 1560 do not impose an unlawful levy on the federal contractors, but regulation 1073's formula for allocating annual fees violates the Supremacy Clause by requiring the federal contractors to pay for the entire amount of annual fees that would otherwise be imposed on the Bureau.

V

Remedies

A. *Declaratory Relief*

Based on the foregoing analyses, we declare the fee schedule formulas set forth in regulations 1066 and 1073 unconstitutional and invalid. To avoid serious disruptions of the work of the Division, on remand the superior court shall issue an order staying further proceedings before the SWRCB or BOE and otherwise maintaining the fee schedule formula as presently interpreted and implemented by the SWRCB, such order to remain in effect until the SWRCB adopts new fee schedule formulas in accordance with the views expressed in this analysis. However, the SWRCB must correct the deficiencies and adopt new fee schedule formulas within 180 days of the finality

of this opinion. (*See Morning Star Company v. State Board of Equalization* (2006) 38 Cal.4th 324, 340-342.)

B. *Refunds of Annual Fees*

The fee adjustment authorized by section 1525, subdivision (d)(3) provides an adequate mechanism to compensate annual fee payers when the SWRCB collects more revenue than required under the Budget Act to cover the Division's costs. Our challenge is to construct a remedy to refund fees, if any, that were unlawfully imposed on individual permit and license holders and federal contractors under the fiscal year 2003-2004 fee schedule formulas set forth in regulations 1066 and 1073. We are mindful that any disruption in the collection of annual fees would seriously undermine the Division's program. We are also aware of the need to provide a simple and accessible refund process for individual fee payers within the existing statutory and regulatory structure. We requested and received supplemental briefing from the parties on the remedies available.

The procedure for challenging the fees bears on the remedy available. As we explained, the SWRCB contracts with the BOE to collect and refund annual fees.[25] Sections 1126 and 1537 and regulations 1074 and 1077 limit the BOE's typical role under the Fee Collection Procedures Law (Rev. & Tax. Code, §§ 55001 et seq.) Thus it is for the SWRCB, not the BOE, to determine whether "a person or entity is required to pay a fee" and

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[25] See pages 17-18, *ante*.

whether the amount of the fee was incorrectly calculated. (Cal. Code Regs., tit. 23, § 1077, subd. (c).) Although the SWRCB lacks power to rule a statute unconstitutional or unenforceable unless an appellate court has made that determination (Cal. Const., art III, § 3.5), the SWRCB advises that the California Constitution "does not prohibit a party from raising a constitutional issue as part of [a] petition challenging a decision or order applying the statute, however, and any constitutional issues should be raised before the administrative agency if a party wants to preserve those issues for judicial review." Review is by writ of mandate in the superior court, not by petition for redetermination by the BOE. (§ 1537, subd. (b)(2).) However, persons or entities seeking refunds must first exhaust their remedies before the SWRCB: "A person may not maintain a suit in any court for the recovery of a fee assessed by the State Board of Equalization unless the person has filed a petition for reconsideration in accordance with this chapter and has either paid the fee in accordance with subdivision (d) or pays the fee within 30 days of the issuance of a reassessment of the fee pursuant to subdivision (h). The petition and payment of the fee in accordance with this subdivision constitute a claim for refund within the meaning of section 55242 of the Revenue and Taxation Code." (Cal. Code Regs., tit. 23, § 1074, subd. (j), as added in Register 2004, No. 42 (Oct. 14, 2004).) The BOE is authorized to accept a refund claim only after the SWRCB or a reviewing court has set the fee determination aside. (§ 1537, subd. (b)(3).)

Because this court has declared unconstitutional and invalid the fee schedule formulas set forth in regulations 1066 and 1073, the BOE is authorized to accept refund claims from persons or entities who filed petitions for reconsideration with the SWRCB. However, in addition to staying further proceedings before the SWRCB and BOE, and directing the SWRCB to adopt new fee schedule formulas for fiscal year 2003-2004, on remand the trial court shall direct the SWRCB to utilize the recalculated fee schedule formula and determine if refunds are due to persons and entities who paid annual fees and filed petitions for reconsideration under the invalid fee schedule formula. The SWRCB shall provide the refund formula to the BOE for refund to the aforementioned parties with interest within 180 days of the finality of this opinion.

DISPOSITION

The judgment denying plaintiffs' petition for writ of mandate is reversed in part. The fee schedule formulas set forth in California Code of Regulations, title 23, regulations 1066 and 1073 are declared unconstitutional and invalid. The cause is remanded to the superior court with directions to: (1) stay further proceedings before the SWRCB and/or BOE until the SWRCB adopts new fee schedule formulas and a procedure for calculating refunds if any; (2) order the SWRCB to adopt valid fee schedule formulas within 180 days of the finality of this opinion; (3) order the SWRCB to determine the amount of annual fees improperly assessed under regulations 1066 and 1073 for the 2003-2004 fiscal year and establish a procedure for calculating

refunds, if any, due within 180 days of the finality of this opinion; and (4) order the Board of Equalization, through the SWRCB, to refund any annual fees unlawfully collected to fee payers who filed timely petitions for reconsideration with the SWRCB and/or are subject to the January 20, 2004, stipulation between the NCWA, CVPWA, SWRCB and BOE. In all other respects, the judgment is affirmed. The parties shall bear their own costs on appeal. (Cal. Rules of Court, rule 8.276.)

CANTIL-SAKAUYE, J.

We concur:

BLEASE, Acting P.J.

SIMS, J.

APPENDIX

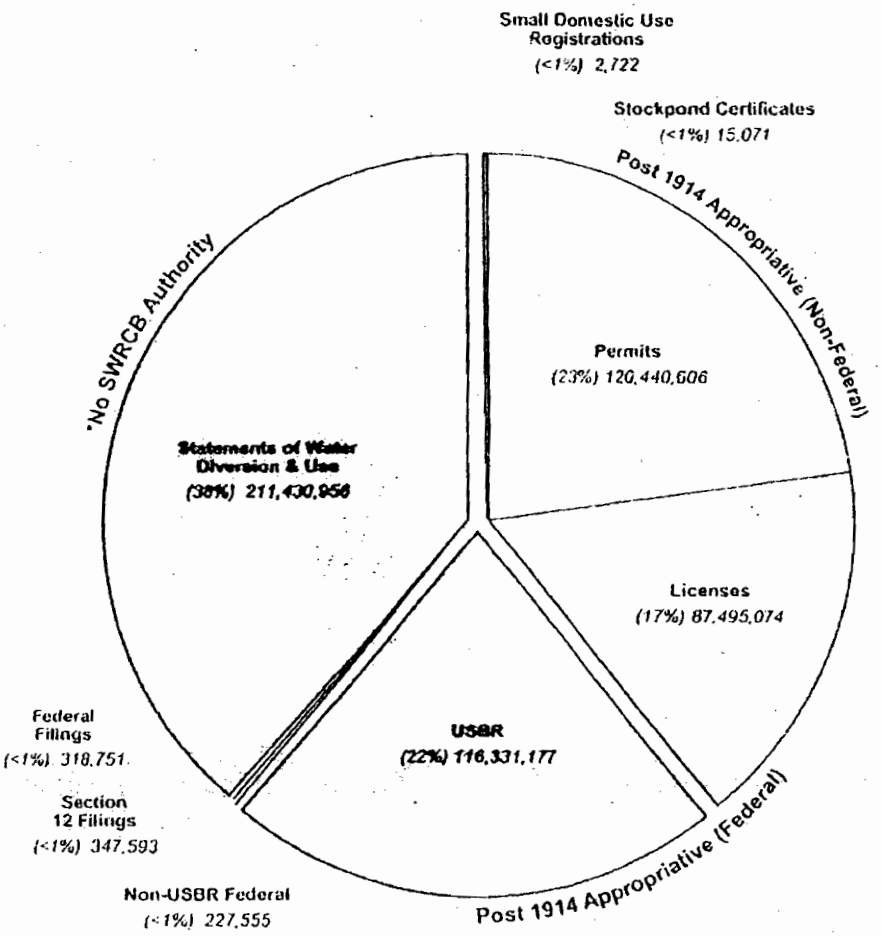

Figure 1
Amount of Water Held by Water Rights
(Acre-Feet)

* In addition, recordations of groundwater use submitted by some users and adjudicated water rights fall into this category but are not quantified in the SWRCB data base

00473

Handout at Stakeholder Meeting, November 6, 2003.

United States Department of the Interior

OFFICE OF THE SOLICITOR
Pacific Southwest Region
2800 Cottage Way
Room E-1712
Sacramento, California 95825-1890

RECEIVED
APR 29 2005

IN REPLY
REFER TO:

APR 28 2005

Ms. Victoria A. Whitney
State Water Resources Control Board
Division of Water Rights
1001 I Street, 14th Floor
Sacramento, California 95814

Subject: Water Rights Fees, Senate Bill 1049

Dear Ms. Whitney:

On behalf of the United States Department of the Interior bureaus, including the Bureau of Reclamation (USBR), the Bureau of Indian Affairs, the Bureau of Land Management, the Fish and Wildlife Service, and the National Park Service (collectively, the Interior agencies), we follow up on our previous letter of May 20, 2004, and now provide a substantive response to your letter dated January 9, 2004, regarding the payment of water rights fees associated with state Senate Bill 1049 (SB 1049). In recent months, the Interior agencies have received billing statements from the State Water Resources Control Board (SWRCB), as well as delinquency statements from the California Board of Equalization.

For the reasons stated in the attached memorandum and as further supported by federal case law, it is the position of the Interior agencies that the California's water rights fee is a tax on the United States of America, in violation of the United States Constitution. With additional consultation of the Office of the United States Attorney, I have instructed the aforementioned federal agencies not to pay this tax.

If you have any further questions, please contact Mr. Edmund Gee in our office, at (916) 978-6134. Thank you.

Sincerely,

Daniel G. Shillito
Regional Solicitor

Enclosure

cc: J. Davis, U.S. Bureau of Reclamation - Mid Pacific
K. Parr, U.S. Bureau of Reclamation - Lohantan
F. Fryman, U.S. Bureau of Indian Affairs – Pacific Region
M. Eberle, U.S. Fish and Wildlife Service - Oregon
P. Fahmy, U.S. National Parks Service - Colorado
K. Verburg, Office of the Solicitor – Phoenix

Office of the Regional Solicitor, PSW
Memorandum, April 27, 2005

I. BACKGROUND

SB 1049 was signed by the Governor on October 8, 2003. It requires the SWRCB to significantly increase existing fees and to assess new fees pertaining to the administration of water rights. As a result of state budget cuts, the annual Budget Act requires the SWRCB's water rights program to be supported by $4.4 million in revenues outside of the state general fund. SB 1049 directs the SWRCB to adopt regulations to implement fees to support the water rights program, i.e., to generate $4.4 million.[1] The fees collected are to be deposited in a Water Rights Fund established as part of the state treasury. SB 1049, Art. 3, § 1550-52. Money from the Water Rights Fund is available "for expenditure, upon appropriation by the Legislature" to cover costs incurred by the SWRCB in administering water right permits and licenses, and in connection with any certificate that is required or authorized by any federal law, including the Federal Water Pollution Control Act, with respect to the effect of any existing or proposed facility, project, or construction work upon the quality of water. SB 1049, § 1552. The statute provides that the fees are supposed to be set so as to cover the SWRCB's costs:

> in connection with the issuance, administration, review, monitoring, and enforcement of permits, licenses, certificates, and registrations to appropriate water, water leases, and orders approving changes in point of discharge, place of use, or purpose of use of treated wastewater. The board may include as recoverable costs, *but is not limited to* including, the costs incurred in reviewing applications, registrations, petitions and requests, prescribing terms of permits, licenses, registrations, and change orders, enforcing and evaluating compliance with permits, licenses, certificates, planning, modeling, reviewing documents prepared for the purpose of regulating the diversion and use of water, applying and enforcing the prohibition . . . against the unauthorized diversion or use of water subject to this division, and the administrative costs incurred in connection with carrying out these activities.

SB 1049, § 1525(c) (emphasis added).

In addition to filing fees required whenever an entity files a petition, application, or registration with the SWRCB, SB 1049 requires a person or entity that holds a permit or license to appropriate water, and a lessor of leased water, to pay an annual fee according to a fee schedule established by the SWRCB. SB 1049, § 1525(a). The SWRCB adopted regulations to implement SB 1049, which provide in part that "[a] person who holds a water right permit or license shall pay a minimum annual fee of $100 [and an additional $0.025 for each acre-foot in excess of 10-acre feet] . . . The [SWRCB] shall calculate the annual fee based on the total annual amount of diversion authorized by the permit or license, *without regard to the availability of water for diversion . . .*" CAL. CODE REGS. tit. 23, § 1066 (2005) (emphasis added).

[1] SB 1049 explicitly directs the SWRCB to adjust the amount of the fee on the basis of the revenue levels specified in the annual Budget Act: "The board shall review and revise the fees each fiscal year as necessary to conform with the revenue levels set forth in the annual Budget Act. If the board determines that the revenue collected during the preceding year was greater than, or less than, the revenue levels set forth in the annual Budget Act, the board may further adjust the annual fees to compensate for the over or under collection of revenue." SB 1049, § 1525.

SB 1049 devotes an entire article addressing sovereign immunity. Section 1560 provides that the new water rights fees "apply to the United States and to Indian tribes, to the extent authorized under federal and tribal laws." SB 1049, § 1560(a). Section 1560(b) provides:

> If the United States or an Indian tribe declines to pay a fee or expense, or the board determines that the United States or the Indian tribe is likely to decline to pay a fee or expense, the board may . . . (1) Initiate appropriate action to collect the fee or expense . . . (2) Allocate the fee or expense, or an appropriate portion of the fee or expense, [to persons or entities who have contracts for the delivery of water from the person or entity on whom the fee or expense was initially imposed] . . . (3) Enter into a contractual arrangement that requires the United States or the Indian tribe to reimburse the board, in whole or in part, for services furnished by the board . . . (4) Refuse to process any application, registration, petition, request, or proof of claim for which the fee or expense is not paid . . .

SB 1049, § 1560(b).

The USBR's permits and licenses for the Central Valley Project (CVP) alone consist of approximately 52 million acre-feet for non-hydropower uses, and approximately 60 million acre-feet for hydropower uses. The total quantity of water authorized for diversion under permits and licenses for the CVP is approximately 112 million acre-feet. Other USBR water right permits and licenses in California account for an additional 3.8 million acre-feet. At $0.025 per acre-foot, USBR's annual water rights fee would be approximately $2.9 million.

II. DISCUSSION

1. The Federal Government is immune from state taxation.

In general, the Federal Government is immune from state requirements, including state taxes.[2] This sovereign immunity derives from the Supremacy Clause, U.S. CONST. art. VI, cl. 2, and the Plenary Powers Clause, U.S. CONST. art. I, § 8, cl. 17. *See McCulloch v. Maryland*, 4 Wheat. 316, 406 (1819) (establishing that the Constitution and the laws made in pursuance thereof are supreme and control the laws of the respective states, and cannot be controlled by them). Although states are also protected by sovereign immunity, federal tax immunity is greater than state tax immunity. *See S. Carolina v. Baker*, 485 U.S. 505, 523 (1988) (holding that some nondiscriminatory federal taxes can be collected directly from the states even though a parallel state tax could not be collected directly

[2] Prior California law recognized that the federal government is exempt under sovereign immunity, from paying a state water rights fee. *See* Porter Stacey, *Enrolled Bill Report* for AB 992, Resources Agency, State Water Resources Control Board (Aug. 20, 1970) (recognizing "the basic exemption of the United States from the payment of fees to states") (stating that "[t]he Bureau [of Reclamation] at present lacks authority to pay any water rights fees . . .") (recommending the signing of AB 992 to add Cal. Water Code § 1560, *repealed by* SB 1049: "No fee shall be required from the United States on applications, permits, or licenses to appropriate water to use in furtherance of projects under the supervision of [USBR]").

from the Federal Government).[3] The recognition of a heightened standard for waiving the immunity of the federal government counters an imbalance in our federal structure: Whereas all the people of the states have representation at the federal level, all the people of the nation are not represented in particular states. *See id.* at 518 n.11 (collecting cases illustrating the application of a heightened standard for waiving federal sovereign immunity). This heightened standard implies a duty on the part of federal agencies to guard against state efforts to raid the federal fisc. *See State of Maine v. Dept of Navy*, 973 F.2d 1007, 1012 (1st Cir. 1992) (opinion by Breyer) (noting that state regulatory fees induce "fears of unjustified raids on the federal treasury . . . or attempts by states to discourage federal activity within their borders").

2. The SWRCB water rights fee is an impermissible tax on the Interior agencies.

The threshold question here is whether the water rights fee imposed under SB 1049 is an impermissible tax or a reasonable, legitimate fee. In *National Cable Television*, 415 U.S. 336, 340-41 (1974), the United States Supreme Court explained the difference between taxes and fees, emphasizing that while taxes must be imposed by a legislative body, fees can be assessed by public agencies:

> Taxation is a legislative function, and Congress, which is the sole organ for levying taxes, may act arbitrarily and disregard the benefits bestowed by the Government on a taxpayer and go solely on ability to pay, based on property or income. A fee, however, is incident to a voluntary act, e.g., a request that a public agency permit an applicant to practice law or medicine or construct a house or run a broadcast station. The public agency performing those services normally may exact a fee for a grant which, presumably, bestows a benefit on the applicant, not shared by other members of society.

Id. at 340-41. The Court struck down an FCC fee that was set with no regard to the value of the regulatory services to the regulated entity, noting that a fee structure set so as to collect revenue recovering the entire cost of regulating the industry was invalid, because "[c]ertainly some of the costs inured to the benefit of the public, unless the entire regulatory scheme is a failure, which we refuse to assume." *Id.* at 343. Thus, *National Cable Television* establishes that user fees (1) must bear some relationship to the benefit received by the payer in return for paying the fee, and (2) are usually assessed by public agencies charged with providing a discrete service to identifiable beneficiaries.

The United States Supreme Court again addressed the distinction between taxes and fees in *Massachusetts v. United States*, 435 U.S. 444 (1978).[4] *Massachusetts* decided what

[3] The sources of state and federal immunities are different; state immunity is grounded in a constitutional structure predicated upon the States' status as sovereign entities, whereas federal immunity arises from the Supremacy Clause. *See S. Carolina v. Baker*, 485 U.S. at 518, n.11.

[4] The three-prong test in *Massachusetts* case involved the circumstance of a federal agency imposing a user fee on a state entity. Here, a water rights fee is imposed by the SWRCB, a state instrumentality, on federal Interior agencies. Recognizing that the contours of federal and state tax immunities are different, federal circuit courts of appeals differ on whether the *Massachusetts* test, or a more stringent standard, should be applied in cases where a state "fee" is imposed on a federal agency. *See, e.g., Novato Fire Protection*

circumstances make it permissible for federal agencies to assess "taxes that operate as user fees" against state entities, even when states have not passed laws specifically waiving their sovereign immunity. *Id.* at 463. The *Massachusetts* court laid out a three-prong test for distinguishing a legitimate, federal regulatory fee from an impermissible tax, the imposition of which would violate state sovereign immunity. To qualify as a user fee, the charge must (1) be imposed in a nondiscriminatory manner; (2) represent a fair approximation of the benefit received by the payer; and 3) be structured to produce revenues that will not exceed the regulator's total cost of providing the benefits supplied. *Massachusetts*, 435 U.S. at 464-67.

To the extent the *Massachusetts* test is applicable here, the characteristics of the water rights fee under SB 1049 do not satisfy all the foregoing three elements of a legitimate fee. With regard to the first prong, it is not clear that the water rights fee has been imposed in a nondiscriminatory manner on all similarly situated entities. Since the Interior agencies have abstained from paying the fee, the SWRCB has sought payment from federal water contractors pursuant to section 1560(b) of SB 1049. Section 1560(b) allows the SWRCB to pass the fee otherwise imposed against the United States or an Indian tribe through to certain federal water contractors. *See* § 1560(b), *supra*. Section 1560(b) appears discriminatory against federal water contractors, because SB 1049 does not authorize a pass-through between other similarly-situated parties.

SB 1049 also fails the second prong of the *Massachusetts* test. This prong requires that the levy be based on a fair approximation of the costs of the benefits to the payer -in other words, that the exaction be related to the value of the service that the regulator is providing to the entity paying the fee. The annual water rights fee is a flat fee assessed on the bare possession of a water right permit or license; it is not based on any particular service being provided by the SWRCB to the water right holder. The annual fee is assessed regardless of whether any SWRCB services are required or provided with respect to the water right being subjected to the fee. Moreover, the historical cost of actual services rendered by SWRCB for the USBR's benefit is grossly disproportionate to the $2.9 million annual fee that the SWRCB now seeks to assess against the USBR.[5]

District v. United States, 181 F.3d 1135 (9th Cir. 1999)(citing approvingly *City of Huntington*, 999 F.2d 71, *infra*, rather than applying *Massachusetts* test); *United States v. City of Huntington, Mo.*, 999 F.2d 71, 73 n.4 (4th Cir. 1993) (holding *Massachusetts* case inapplicable); *State of Maine v. Dept of Navy*, 973 F.2d 1007, 1011 (1st Cir. 1992) (applying *Massachusetts* test); *United States v. City of Columbia, W.V.*, 914 F.2d 151, 154 (8th Cir. 1990)(holding *Massachusetts* case inapplicable). *See also S. Carolina v. Baker, id.*

[5] In the past, USBR has entered into cost-reimbursable contracts with the SWRCB, whereby –pursuant to 31 U.S.C. § 6303 and other federal law- USBR is authorized to pay SWRCB for the cost of services that the SWRCB actually performed for USBR's benefit, e.g., processing water rights applications and petitions filed by USBR; processing protests filed by USBR; issuing permits, licenses, and change orders to USBR; responding to requests by USBR for information, data, and services; and notifying USBR of applications and petitions by other parties that might affect the rights of the United States. Actual payments by USBR were $48,890 in 2002; $125,088 in 2003; and $124,830 in 2004. On April 11, 2005, USBR entered into a cost-reimbursable contract (No. 05CS203029) with the SWRCB, not to exceed $130,000 per year through March 31, 2009.

The third prong of the *Massachusetts* test requires the fee to be structured to produce revenues that do not exceed the total cost to the state government of administering the regulatory program. It is unclear whether the SWRCB's water right fee satisfies the third prong. SB 1049 specifies that if the Water Rights Fund ends with a surplus in a given year, the following year the fees will be adjusted downward (or, *vice versa*, following years where there was under collection of revenue, the board is directed to adjust the annual fees upward). SB 1049, § 1525(d)(3). Federal water user organizations contend that the fee structure, which includes a 40% non-collection surcharge, will enable the SWRCB to collect funds in excess of the amounts necessary to meet the expenses of implementing the regulatory program. Although the SWRCB sought to collect fees sufficient to shore up a budget shortfall of $4.4 million in the state fiscal year 2003-2004, it collected over $7 million. The method by which the SWRCB assesses the water rights fee appears to far exceed the cost of the regulatory service.

Failing each of the three prongs, California's water rights fee would be characterized as an unconstitutional "tax" under the *Massachusetts* test. As a result, federal sovereign immunity from state taxation operates as a shield, and the Interior agencies cannot pay the fee.

3. Even if the water rights fee is deemed a reasonable fee, rather than a tax, there is no clear and unambiguous waiver of federal sovereign immunity to subject and authorize the Interior agencies to pay the fee.

Assuming *arguendo* that the water rights fee imposed under SB 1049 is deemed to be a reasonable and legitimate fee, Congress nevertheless must authorize federal agencies to pay the fee under a clear and unambiguous waiver of federal sovereign immunity. *See Hancock v. Train*, 426 U.S. 167, 178-79 (1976); *see also United States v. Idaho*, 508 U.S. 1, 6 (1993)(holding that waivers of federal sovereign immunity must be unequivocally expressed in the statutory text); *Environmental Protection Agency v. California ex rel State Water Resources Control Bd.*, 426 U.S. 200, 211 (1976)(holding that federal installations are subject to state regulation only when and to the extent Congressional authorization is clear and unambiguous); *United States v. Orr Water Ditch Co.*, 309 F.Supp.2d 1245, 1254-55 (2004)(holding that federal sovereign immunity preempts state law requiring the payment of fees in connection with a water rights change application)(citing *United States v. Idaho*).

Indeed, Congress knows how to make such specific waivers of immunity, via federal statutes.[6] Yet, even where language in the statutory text would appear to authorize the

[6] For example, authority to pay a regulatory service charge or fee is expressed in the Federal Water Pollution Control Act (33 U.S.C. § 1323(a)), the Resource Conservation and Recovery Act (42 U.S.C. § 6961(a)), the Safe Drinking Water Act (42 U.S.C. § 300j-6(a)), and the Clean Air Act (42 U.S.C. § 7418(a)). In contrast, Section 8 of the Reclamation Act of 1902 (43 U.S.C. § 383) does not contain a specific waiver of sovereign immunity to clearly and expressly authorize USBR to pay an administrative fee such as the SWRCB water rights fee.

payment of a state fee, the United States Supreme Court has looked for an express waiver of federal sovereign immunity to subject the federal government to payment of the charge. *See, e.g., United States v. Idaho*, 508 U.S. 1, 6 (finding federal sovereign immunity not waived [in the McCarran Amendment] with regard to payment of a state court filing fee in a state water right adjudication); *Environmental Protection Agency v. California ex rel State Water Resources Control Bd.*, 426 U.S. 200, 217 (finding "the 'service charge' language [in the Federal Water Pollution Control Act] hardly satisfies the rule that federal agencies are subject to state regulation only when and to the extent Congress has clearly expressed such a purpose"). Therefore, any doubt that may exist as to whether a federal law does or does not waive immunity with regard to the payment of a state regulatory fee "should be resolved in favor of immunity." *See, e.g., Austin v. Alderman*, 74 U.S. (7 Wall.) 694 (1869).

III. CONCLUSION

Based on the foregoing, the Interior agencies find that the SWRCB water rights fee constitutes an impermissible and unconstitutional tax. In the absence of a clear and unambiguous waiver of sovereign immunity in a federal statute expressly authorizing federal agencies to pay the water rights fee, the Interior agencies are immune from the imposition of the fee and cannot pay the fee.

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 February 26, 2007, I served the following document(s):

PETITION FOR REVIEW

_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.

_____ Via facsimile transmission.

_____ (by overnight delivery) on all parties in said action, by placing a true copy thereof enclosed in a sealed envelope in a designated area for outgoing, same-day pickup by Federal Express at the offices of Somach, Simmons & Dunn for overnight delivery, billed to Somach, Simmons & Dunn, and addressed as set forth below.

SEE ATTACHED SERVICE LIST

I declare under penalty of perjury that the foregoing is true and correct under the laws of the State of California. Executed on February 26, 2007, at Sacramento, California.

Susan Bentley

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