SUPREME COURT COPY

CASE NO. S150518

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

CALIFORNIA FARM BUREAU FEDERATION, et al.,

Plaintiffs and Appellants,

v.

CALIFORNIA STATE WATER RESOURCES CONTROL BOARD, et al.,

Defendants and Respondents.

NCWA PETITIONERS' RESPONSE TO 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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NCWA PETITIONERS' RESPONSE TO RESPONDENTS' 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 and Appellants, and Petitioners before this Court ("NCWA Petitioners"), hereby answer Respondents State Water Resources Control Board and State Board of Equalization's Petition for Review of the opinion of the Court of Appeal, Third Appellate District, filed January 17, 2007 ("Opinion").

I.

INTRODUCTION

The Appellate Court's determination that the State Water Resources Control Board's ("SWRCB") Water Rights Division fee structure is constitutionally defective is correct. The only difference that NCWA Petitioners have with the Court of Appeal's determination is its focus on the unconstitutionality of the SWRCB's regulations. While the challenged regulations are, without question, unconstitutional, the underlying statutory structure is also, on its face, unconstitutional. This question of whether the statutory structure is facially invalid is the subject of NCWA Petitioners' own Petition for Review and those arguments will not be repeated here.

Respondents' Petition, in itself, is unremarkable. It flails against an Appellate Court decision that merely follows or is a result of an application of clear constitutional limitations and well-established case law. There is nothing in the Respondents' Petition that warrants review by this Court. Accordingly, NCWA Petitioners respectfully request that Respondents' Petition be denied.

II.

THE COURT OF APPEAL'S OPINION IS CONSISTENT WITH *SINCLAIR PAINT*[1] AND OTHER SUPREME COURT AND APPELLATE COURT AUTHORITY

Respondents argue that review is appropriate because the Court of Appeal's opinion conflicts with the intent of *Sinclair Paint* and other relevant case law. Respondents base this argument on their assertion that the Court of Appeal incorrectly required Respondents to demonstrate that the fee at issue bears a fair or reasonable relationship to *both* the benefits *and* the burdens of the regulatory program. (Respondents' Petition for Review at p. 8.) In fact, however, the Court of Appeal correctly applied the *Sinclair Paint* test, requiring the Respondents to show (1) "the estimated costs of the service or regulatory activity, and (2) the basis for

[1] *Sinclair Paint Co. v. State Board of Equalization* (1997) 15 Cal.4th 866 ("*Sinclair Paint*").

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." (Opinion at p. 29, citing *Sinclair Paint, supra*, 15 Cal.4th at p. 878, emphasis added; see also, Opinion at pp. 36, 37, 41, 42.)

While the Respondents assert that "[t]he SWRCB based its fee on the financial *burdens* of the regulation" (Respondents' Petition for Review at p. 8), the record demonstrates that the SWRCB attempted to justify its fee based on *burdens* in some instances, and *benefits* in other instances. (Respondents' Brief at pp. 25-26, 33-40, 50, 54, 56-57, 58; Oral Argument at 46:02–46:13; 54:56–55:17; 59:04–59:22; 1:00:48–1:00:55.[2]) Indeed, even in its Petition for Review, Respondents argue that the fee is based on *burdens* with respect to permit and license holders (Respondents' Petition for Review at pp. 8-9), but that the fee is based on *benefits* with respect to contractors with the United States who are assessed the United States' share of the fees (*Id.* at p. 17). Respondents have

[2] The official record of the Oral Argument in this matter is a digital audio recording made by the Court. NCWA Petitioners use the following convention for citation to this digital recording: Minute:Second – Minute:Second, or Hour:Minute:Second – Hour:Minute:Second. This designation indicates the time stamp on the digital recording that appears when listening to the CD ROM of the digital recording provided by the Court.

consistently presented a mixed argument relying on benefits in some instances and burdens in others, in order to suit Respondents' apparently shifting positions.

The Court of Appeal was not mislead by Respondents' ever-shifting justification for its fee scheme. Rather, the Court of Appeal focused first on the benefits of the regulatory program and determined that the regulatory fees were not reasonably related to those benefits. (Opinion at pp. 39-42.) Upon finding that the fee allocation was not justified by the benefits of the regulatory program, the Court of Appeal examined the record to determine whether the fee allocation was justified by the fee payors' burdens on the regulatory program. (*Id.* at pp. 42-43.) The Court determined that the record demonstrated that the fee allocation is not justified by either the fee payors' benefits from *or* burdens on the regulatory program. (*Id.* at pp. 39-43.)

In response to Respondents' current assertion that the fee allocation is justified by the *financial* burdens that fee payors place on the regulatory program, the Court of Appeal found that the record does not support this position. (Opinion at p. 41 ["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"]; see also, Opinion at p. 42 ["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.... Nor was there evidence of the actual cost of Division services provided to the Bureau...."].) Respondents' own administrative record demonstrates that the work the SWRCB undertakes on non-permit and license holders is not de minimis. (Respondents' Brief at p. 18, citing Appendix at pp. 2294-2295 ["about one-third of the time is spent protecting the environment and the public interest and the remaining two-thirds of its time is spent on activities that protect existing water right holders."].) Moreover, Respondents admit that the fees are not based on actual costs and that "the SWRCB rejected a 'fee-for-service' approach as infeasible." (Respondents' Petition for Review at p. 3; see also, Respondents' Petition for Rehearing, filed on Feb. 1, 2007, with the Third District Court of Appeal, at p. 31; Respondents' Brief at pp. 25, 49.) The Court of Appeal further considered whether the so-called *societal* burden (i.e., the polluter-pays theory) justified the allocation of fees, and concluded that it did not. (Opinion at pp. 42-43.)

The Court of Appeal, therefore, carefully considered the record and the arguments to determine whether the allocation of fees was reasonably related to *either* the burdens on *or* benefits from the

regulatory program, consistent with *Sinclair Paint* and other relevant authority.

Respondents' assertion that its fee allocation is based on the *financial* or *administrative burdens* is, in fact, a new position crafted for this Court and presumably developed to address the fact that the Court of Appeal overturned the regulatory scheme. As noted, Respondents consistently argued that both benefits and burdens supported the fee scheme. Not until the Court of Appeal issued its decision did the Respondents focus on *financial* or *administrative* burden to support its fee structure.[3] This argument first surfaced in Respondents' Petition for Rehearing. The Court of Appeal reviewed this argument and denied Respondents' Petition for Rehearing. Respondents now assert this position here.

Respondents summarize several cases to support their position that their fee allocation meets legal requirements and that the fees are reasonably related to the burdens imposed by the fee payors. A careful review of these cases is appropriate. Respondents cite *Sinclair Paint, supra,* 15 Cal.4th 866; *San Diego Gas & Electric*

[3] As noted, however, Respondents have focused on financial burden only with respect to permit and license holders. They continue to argue that the benefits justify the pass-through of fees to those who contract with the United States. (Respondents' Petition for Review at p. 17; see also, Respondents' Petition for Rehearing at pp. 25-26.)

Co. v. San Diego County Air Pollution Control District (1988) 203 Cal.App.3d 1132 (*"SDG&E"*); *Pennell v. City of San Jose* (1986) 42 Cal.3d 365 (*"Pennell"*); *California Assn. of Professional Scientists, et al. v. Department of Fish & Game, et al.* (2000) 79 Cal.App.4th 935 (*"CAPS"*); and *United Business Com., et al. v. City of San Diego* (1979) 91 Cal.App.3d 156 (*"United Business"*). (Respondents' Petition for Review at pp. 8-12.) In each of these cases, the courts upheld a fee scheme based on the conclusion that the fees bore a reasonable relationship to the fee payors' burdens on the regulatory program. The courts, however, relied on two different types of burdens: (1) economic or administrative burdens, and (2) societal burdens.[4] *Sinclair Paint*, *CAPS*, and, in part, *SDG&E*[5] all upheld regulatory fees based on the conclusion that the fees bore a reasonable relationship to the *societal burden* created by the fee payors. (*Sinclair Paint, supra,* 15 Cal.4th at p. 878; *CAPS, supra,* 79 Cal.App.4th at p. 950; *SDG&E, supra,* 203 Cal.App.3d at

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[4] As discussed further below, in *Pennell*, the Court examined both the benefits and the economic burdens.

[5] In *SDG&E*, the fee at issue was divided into separate components. One component of the fee was based on the financial burden and set a fee based on actual costs using a labor-tracking system. (*SDG&E, supra,* 203 Cal.App.3d at p. 1136.) The other component of the fee was based on the societal burden and allocated fees based on amount of pollution emitted by fee payors. (*Ibid.*)

pp. 1146-1148.) These courts applied the so-called "polluter-pays" theory to conclude that the pollution or societal burden created by the fee payors justified the allocation of the fees to the fee payors. In the present case, the Court of Appeal concluded that the polluter-pays theory does not support the fee allocation because the fee payors are not the only parties creating the societal burden. (Opinion at pp. 42-43.)

United Business, and, in part, *SDG&E* upheld regulatory fees based on the *economic or financial burden* created by the fee payors. This is the approach Respondents now attempt to take to justify the water right fees. In both *United Business* and *SDG&E,* however, the courts were presented with specific evidence of the actual costs of the regulatory program, which provided support for or justification of the fees, based on economic burden. In *United Business*, the fees imposed were based on a field study and cost analysis of the regulatory program and "took into consideration the actual cost involved in the inventory and the varying amounts of time required in the field to inventory the different types of signs." (*United Business*, *supra*, 91 Cal.App.3d at pp. 167-168.) Similarly, in *SDG&E,* with respect to that portion of the fee based on economic burden, the fee was calculated based on actual costs using a labor-tracking system. (*SDG&E, supra,* 203 Cal.App.3d at p. 1136.)

In the present case, Respondents failed to present any evidence about either the estimated or actual cost of the regulatory program (Opinion at p. 34, fn. 21, p. 42), and admit that they cannot provide such information. (Respondents' Petition for Rehearing at pp. 10, 18; Respondents' Petition for Review at p. 9, fn. 1.) Respondents also admit that the SWRCB's fee structure is *not* based on actual costs because such a basis would result in exorbitant one-time fees. (Respondents' Petition for Review at p. 3; Respondents' Petition for Rehearing at p. 31; Respondents' Brief at pp. 25, 49.) Instead, the permit and license holders who pay annual fees are subsidizing the one-time fees so that the one-time fees do not reach levels that the Respondents deem too high. (Respondents' Petition for Review at pp. 3-4.) Certainly, to the extent Respondents attempt to base their fee structure on the *economic* or *financial* burden created by the fee payors, they must be able to demonstrate the actual or, at least, estimated costs of regulating the fee payors. Respondents have not made this demonstration. Moreover, the fact that Respondents admit that the annual fee payors are paying costs that result from regulatory activities associated with one-time applications is clear evidence that the fees are not related to the

economic burdens created by the annual fee payors.[6] The Court of Appeal was correct in concluding that the Respondents had failed to meet the test to demonstrate that the fees were allocated such that they bore a reasonable relationship to the economic burdens created by the fee payors.

Finally, in *Pennell*, the Court concluded that "[t]he relatively minor unit fee imposed here does not 'exceed the sum reasonably necessary to cover the costs of the regulatory purpose sought.'" (*Pennell, supra*, 42 Cal.3d at p. 375, citing *United Business, supra,* 91 Cal.App.3d at p. 165.) The Court found that the fee was to be paid on each rental unit and was designed to defray the costs of providing and administering the hearing process. (*Pennell, supra,* 42 Cal.3d at p. 375.) The Court suggests that the fee is reasonable based on the financial burden created by the fee payors. (*Id.* at p. 375, fn. 11 ["It is well settled that a municipality under the police power may impose a regulatory fee when, as here, the fee constitutes an amount necessary to carry out the purpose and provisions of the

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[6] As noted, the Court of Appeal also recognized that other water right holders who do not pay fees contribute to the administrative or economic burden of the regulatory program. (Opinion at p. 42.) Moreover, Respondents admit that one-third of the SWRCB's time is spent protecting the environment and the public interest. (Respondents' Brief at p. 18, citing Appendix at pp. 2294-2295.)

regulation."].) As noted above, the Court of Appeal in the present case properly found that the evidence did not support a conclusion that the fee was reasonably related to the fee payors' economic burden on the regulatory program. The *Pennell* Court also suggested that the allocation of the fee was appropriate based on the *benefits* received by the fee payors. (*Ibid.* ["Contrary to plaintiffs' view, the fact that landlords may not believe they 'benefit' from the rental unit fee does not transform a regulatory fee into a 'special tax.'"] Again, in the present case, the Court of Appeal properly determined that the fee payors are not the only beneficiaries of the regulatory program and, therefore, the fees could not be fairly allocated only to them. (Opinion at pp. 39-42.)

Contrary to Respondents' contention, the Court of Appeal did not improperly require Respondents to demonstrate that the fees bore a fair and reasonable relationship to the fee payors burdens on *and* benefits from the regulatory program. Rather, the Court of Appeal evaluated whether the fee structure met either test. Upon concluding that the fee structure was not reasonably related to the fee payors' benefits from the regulatory program, the Court of Appeal then evaluated whether the fee structure was reasonably related to the fee payors' burdens on the regulatory program. The Court of Appeal

found that the fee structure did not meet *either* test and, therefore, the fee regulations are invalid.

III.

THE COURT OF APPEAL DID NOT ADOPT A "MORE STRINGENT" STANDARD OF REVIEW AND THE COURT OF APPEAL'S DECISION DOES NOT THREATEN THE STATE'S ABILITY TO FUND ANY PROGRAM

Respondents recognize that "[w]hether a regulation is consistent with the constitution [sic] is ultimately a question of law . . . subject to independent review." (Respondents' Petition for Review at p. 14.) Nevertheless, Respondents argue that the Court of Appeal should have jettisoned this venerable standard and deferred to the SWRCB's determination that the regulations at issue fit within the narrow judicially created exception to Proposition 13. (See *ibid.* [discussing deference to agency findings and policy determinations].) As the Court of Appeal properly held, the instant action is not about whether the SWRCB "overstepped its quasi-legislative rulemaking authority," rather, the question here is whether the challenged statutes and regulations comport with the Constitution. (Opinion at p. 30.) It should be without dispute that constitutional issues trigger an independent review.

Under Respondents' theory, while it would be proper for this Court, in determining the constitutional question, to conduct an

"independent review" of the Legislature's act in adopting the statutes, this Court would be limited to an "abuse of discretion" standard when passing upon the constitutionality of the regulations. Such an argument has no basis in the law.

The fallacy of Respondents' argument is apparent when one considers Respondents' disagreement with the Court of Appeal's Opinion disapproving the regulations' subsidization of new applications through fees imposed on existing water right holders. (Respondents' Petition for Rehearing at p. 7.) Under Respondents' argument, had this otherwise unconstitutional scheme been mandated by statute, the Court of Appeal could have properly exercised its independent judgment and invalidated the statute. However, because the otherwise unconstitutional scheme was developed based upon "agency expertise," the Court of Appeal should have deferred to that "expertise" and *then* applied its independent judgment. Thus, what is otherwise unconstitutional is inexplicably transformed into a valid scheme through "agency expertise." The Court of Appeal properly rejected this argument.

None of the cases cited by Respondents mandates a different result or supports review. Each of the cases cited by Respondents discusses deference to administrative agencies within the context of the "reasonableness" of administrative action in light of statutory

language. The question posed here is different and more significant – whether the SWRCB imposed a charge that violates the California Constitution's prohibitions on new taxes. That is a determination that cannot be left to the "discretion" of an administrative agency.

To be certain,

> '... [a]dministrative regulations that violate acts of the Legislature are void and *no protestations that they are merely an exercise of administrative discretion can sanctify them.*' Acknowledging that the interpretation of a statute by one charged with its administration was entitled to great weight, we nonetheless affirmed: "Whatever the force of administrative construction . . . final responsibility for the interpretation of the law rests with the courts." [Citations.] Administrative regulations that alter or amend the statute or enlarge or impair its scope are void and courts not only may, but it is their obligation to [,] strike down such regulations.' (*Ontario Community Foundation, Inc. v. State Bd. Of Equalization* (1984) 35 Cal.3d 811, 816-817, first emphasis added, add'l emphasis omitted; accord *Woods v. Superior Court (Siebert)* (1981) 28 Cal.3d 668, 679.)

Respondents' argument would hamstring the Appellate Court and cause it to accept all of an agency's findings and "policy determinations" as valid and would turn the concept of an

"independent review" completely on its head.[7] The Court of Appeal applied the correct standard, properly framed the nature of the challenge to the regulations, and determined that Respondents completely failed to meet their burden. Nothing contained in Respondents' Petition for Review warrants additional review.[8]

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[7] Unsurprisingly, even if the "arbitrary and capricious" standard applied to the regulations at issue, the regulations would still fail. As the Court of Appeal noted throughout its decision, the SWRCB offered little or no evidence to support its unconstitutional allocation of fees. For example, the Court noted that the SWRCB offered "no breakdown of cost or other evidence to demonstrate that the services and benefits provided to non-paying water rights holders was de minimis." (Opinion at p. 41.) The Court of Appeal then found that the State's justification for apportioning fees based upon the size of the diversion was "without factual support." (*Id.* at p. 42.) The Court of Appeal also held that the SWRCB "did not provide any evidence to show the allocation of the actual cost of Division services provided" to water right holder who do not pay fees. (*Ibid.*) Nor was there any evidence of the actual costs of services provided to the United States Bureau of Reclamation. (*Ibid.*) Last, the Court of Appeal expressly recognized that the SWRCB offered no evidence to support such a fee. (*Id.* at p. 43.)

[8] Respondents' warnings of the impending peril that would result from requiring state agencies to meet their evidentiary burden rings hollow. Requiring an agency to provide the evidence to demonstrate or substantiate the regulatory nature of a fee in order to sustain its constitutionality is not remarkable or out of the ordinary. As shown by the case law, many agencies have achieved that result. The failure of the SWRCB to make such a demonstration stems from the statute itself and the nature of the SWRCB's statutory responsibilities.

IV.

THE SUPREMACY CLAUSE IS VIOLATED BY REGULATIONS PASSING THROUGH FEDERAL FEES ON OVER 116 MILLION ACRE-FEET OF WATER TO FEDERAL CONTRACTORS WHO MAKE USE OF LESS THAN SEVEN MILLION ACRE-FEET OF WATER

In urging this Court to review the Court of Appeal's decision that the regulations are invalid in their treatment of federal contractors, Respondents attempt to conflate federal and state law. While Respondents acknowledge that federal law determines whether the fees violate the Supremacy Clause,[9] Respondents attempt to justify the fees by reference to the "benefit or burden" test under *Sinclair Paint.* (See Respondents' Petition for Review at p. 18.) Under federal law, however, there is no "burden or benefit" test. Federal law permits the imposition of a tax[10] on federal contractors only in the limited circumstances described in the cases cited at length in the Court of Appeal's opinion at pages 45-50. Of

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[9] The Respondents have never disputed the argument in NCWA Petitioners' Opening Brief filed with the Court of Appeal at page 43, footnote 15, that whether the impost is characterized as a "fee" or a "tax" under California law, for federal law purposes the analysis under the Supremacy Clause is the same. (See NCWA Petitioner's Opening Brief at p. 44, fn. 20, filed Oct. 5, 2005, with the Third District Court of Appeal.)

[10] Federal law addresses only the pass-through of taxes to federal contractors and does not address the pass-through of regulatory fees. NCWA Petitioners maintain, as set forth in their Petition for Review, that regulatory fees may not be passed through to federal contractors under any circumstances.

note, a federal contractor can only be assessed a tax based on the contractor's limited possessory interest in the underlying federal property. (*United States v. County of Fresno* (1977) 429 U.S. 452, 455-456; *United States v. Nye County* (9th Cir. 1991) 938 F.2d 1040, 1043; *United States v. Hawkins County* (6th Cir. 1988) 859 F.2d 20, 24.) Assuming, arguendo, that any pass-through of a regulatory fee to federal contractors is valid where, as here, the regulations impose the entire charge levied on the United States' interest on a sub-set of federal contractors and in so doing fail completely to segregate those federal contractors' "possessory" interest from the totality of the United States' water rights and permits, such regulations are, as the Court of Appeal determined, clearly invalid under the Supremacy Clause. In this regard, Respondents offer absolutely no contrary authority.

The decision of the Court of Appeal, having reached the correct result (with regard to the regulations), provides this Court no basis on which to accept review of that decision. Indeed, contrary to the Respondents' claim, the Court of Appeal's decision on the regulations applicable to federal contractors has *no* "serious ramifications" (Respondents' Petition for Review at p. 19) for fee-based programs other than those ramifications extant under existing

federal law. Because the Court of Appeal's decision is fairly based on that federal law, there is nothing to review in this regard.

V.

CONCLUSION

Based upon the foregoing, NCWA Petitioners respectfully request that the Petition for Review filed by Respondents be denied.

Dated: March 13, 2007

SOMACH, SIMMONS & DUNN
A Professional Corporation

By_____
Stuart L. Somach

Attorneys for Petitioner
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WORD COUNT CERTIFICATION

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

The text of Northern California Water Association, et al.'s Response to Petition for Review consists of 3,863 words according to the "word count" feature of the Word processing program utilized in creating this document.

Dated: March 13, 2007

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A Professional Corporation

By _____
Stuart L. Somach

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PROOF OF SERVICE

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

On March 13, 2007, I served the following document(s):

NCWA PETITIONERS' RESPONSE TO RESPONDENTS' 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.

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_____ (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 March 13, 2007, at Sacramento, California.

Susan Bentley

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