IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

CALIFORNIA FARM BUREAU FEDERATION, ET AL.

Plaintiffs and Appellants,

v.

CALIFORNIA STATE WATER RESOURCES CONTROL BOARD, ET AL.,

Defendants and Respondents.

S 150[illegible]

Court of Appeal, Third Appellate District, Case No. C050289
Sacramento County Superior Court Case Nos. 03CS01776, 04CS00473
The Honorable Raymond Cadei, Judge

REPLY TO ANSWER TO PETITION FOR REVIEW

EDMUND G. BROWN JR.
Attorney General of the State of California
AMY J. WINN
Acting Senior Assistant Attorney General
GORDON BURNS
Deputy Solicitor General
WILLIAM L. CARTER
Supervising Deputy Attorney General
MATTHEW J. GOLDMAN
MOLLY K. MOSLEY, SBN 185483
Deputy Attorneys General
1300 I Street
P.O. Box 944255
Sacramento, California 94244-2550
Telephone: (916) 445-5367
Facsimile: (916) 327-2247

Attorneys for the California State Water Resources Control Board, the California State Board of Equalization, et al.

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REPLY TO ANSWER TO PETITION FOR REVIEW

Under California Rules of Court, Rule 8.500, the California State Board of Equalization (BOE) and the California State Water Resources Control Board (SWRCB) (SWRCB and BOE, collectively, the State) submit the following Reply to the California Farm Bureau Federation's (Farm Bureau's) Answer to Respondents' Petition for Review.

I. The Court of Appeal corrupted the test for a regulatory fee by considering the benefits received by water right holders who are not subject to the SWRCB's core regulatory authority.

The second prong of the *Sinclair Paint* test requires the state to show "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 Paint Co. v. State Bd. of Equalization et al.* (1997) 15 Cal.4th 866, 878.) As the State has already pointed out in its reply to the Answer of the Northern California Water Association, et al. (NCWA), an agency would *never* be able to construct a fee system that places the cost of regulation on the regulated community if it must allocate a portion of the fee to the general public and others who benefit from that regulation.

The Farm Bureau points to several "admissions" by the SWRCB to support its position that the Court of Appeal struck down the fee regulations because water right holders who are not subject to the SWRCB's permitting and licensing authority receive significant benefits from, *and* impose significant *burdens* on, the SWRCB's water right program, causing the annual fee payers to pay an unfair share of

the regulatory program's costs. The claim that these other water right holders also impose significant burdens on the water right regulatory program is new. Nothing supports this new position.

While the other water right holders may receive the same benefits from the regulatory program as do the permittees and licensees, they *do not impose the same burdens on the regulatory program and the Court of Appeal did not so find.* The Court of Appeal found significant the SWRCB's "admission" "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." (Slip op., p. 23.)

The Court of Appeal recognized that water right holders who do not hold their rights under state-issued permits and licenses do not impose a significant burden on the regulatory program. The court recognized that the SWRCB's "core regulatory program, the administration of water right permits and licenses, does not apply" to riparian and pre-1914 water rights. (Slip op., p. 9.) The Court of Appeal recognized that the pre-1914 and riparian water right holders' "use is not routinely supervised by the Board." (Slip op., p. 40.) The Court of Appeal did *not* find that the SWRCB devotes a significant amount of resources regulating water rights other than permitted and licensed water rights.

The so-called "*suggestion* that the SWRCB spends 95 percent of its time regulating feepayors" is *not* "wholly contrary to the findings by the Court of Appeal and the record." (Farm Bureau Answer, pp. 8-9 [italics added].) Rather, the Court of Appeal ignored this fact. It focused on the fact that other water right holders held a

large amount of water and received the same kind of benefit from the regulation as did permittees and licensees.[1] The "admission" that non-permitted and non-licensed water right holders receive some benefits from the regulation says nothing about the burden they impose.

The "admission" that "an estimated one-third of the Division of Water Rights' resources are spent on the public interest or public trust purposes – all of which is funded by the annual feepayers" (Farm Bureau, p. 9) says nothing about how much of the SWRCB's resources are devoted to regulating (addressing the burdens imposed by) water right holders who are *not* subject to state permitting and licensing. The SWRCB regulates permittees and licensees to protect the public trust, as well as to protect other water right holders, regardless of how they hold their water rights.

The "admission" that "only 10 percent of the costs associated with one-time services are paid by one-time feepayors, and the remaining costs are funded by the annual feepayors" (Farm Bureau, p. 9) does not mean that permittees and licensees are

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[1] Referring to the lack of an exemption for small permit and license holders, the Farm Bureau claims "The Court did not hold that a de minimis exception could not be appropriate." (Farm Bureau, p. 16.) True: the Court of Appeal upheld the fee allocation *among* the feepayers. (Slip op., pp. 36, 43.) But the de minimis burden to which the Petition for Review refers, at pages 10-11, is the de minimis regulatory burden imposed by water right holders who are *not subject to the permitting and licensing program.*

The SWRCB does not exempt "small" permit and license holders from a minimis $100 annual fee because they are subject to the same regulation as other permit and license holders and make up the majority of the regulated community. (Appellants' Appendix, 2304-2307 [explaining fee allocation rationale].) Moreover, while they are not exempt from this minimum fee, the SWRCB uses the annual fees to keep the one-time filing fees (to which they are also subject) low. (Appendix, 2305.)

subsidizing riparian and pre-1914 water right holders seeking "services" from the SWRCB. One-time filing fees and annual fees are two different ways of allocating costs among the *same* general category of persons: persons subject to the permit and license system. (See Wat. Code, § 1525, subd. (b)(3)-(5).)

The fees that are not being paid by the federal government are paid by the federal contractors, not other permittees and licensees. (Cal. Code Regs., tit. 23, § 1073; see Farm Bureau, pp. 9-10.) And just because some permit and license holders refuse to pay the fees (Farm Bureau, p. 11) does not make the fee schedule invalid; the SWRCB takes collection action against such scofflaws. (See Wat. Code, § 1535, subd. (b).)

On the *same page* as the Court of Appeal found the estimates it relied upon to show the allocation of the program's resources to protecting the public trust, etc., the SWRCB also estimated that it spent "approximately five percent of its resources protecting the water rights of parties who hold rights not subject to permit or license." (Appendix 2298.) That is, the SWRCB estimates that it spends only about five percent of its time *solely* addressing the rights of pre-1914 and riparian water right holders.

A review of the SWRCB's water right authority under the Water Code and implementing regulations supports this estimate. NCWA went so far as to claim that the SWRCB had *no* regulatory authority over water right holders who did not hold their rights pursuant to state-issued permits and licenses. (Reporter's Transcript Hearing on Writ of Mandamus (RT), p. 14:28 - p. 15:23 [italics added]; see Appendix

1199:2-3; 1200:9-10 [NCWA's brief asserting SWRCB has no authority over other types of water rights].) The Legislative Analyst's Office (LAO) also understood the SWRCB to spend most of its time regulating water right holders subject to its permitting and licensing jurisdiction. (Appellants' Appendix 2290 [Analysis of the 2003-2004 Budget Bill, describing water rights program and stating that the SWRCB's enforcement authority applies only to water rights established after 1914].)

Finally, the SWRCB asserted that it could set the fee based on the amount of water held *under permit or license* because "the 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 [under permit or license], the greater the regulatory job." (Slip op., p. 42 [quoting Respondents' Brief].) The Court of Appeal rejected this "polluter pays" rationale as to those *not subject to the permit and license system because of the significant amount of water held under those types of water rights.* (Slip op., p. 42.) The amount of water held, however, has *nothing* to do with the amount of regulation required *if they are not subject to the core regulatory program in the first place.*

The "polluter pays" principle applies here, not because the permittees and licensees are (necessarily) "polluters," or because the fee schedule "is intended to offer an incentive to water right holders to reduce the amount of water diverted" (Farm Bureau, p. 12, fn. 3) but because their activities require regulation. The Court of Appeal upheld the fee *statutes* as imposing valid regulatory fees because they involve "an annual fee imposed on a regulated community, holders of water right permits and

licenses, and in the case of the [Central Valley Project], those who contract with the federal government, which also holds water rights." (Slip op., pp. 28-29.) Further, the Court of Appeal held that "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." (Slip op., pp. 36.) The Court of Appeal should have upheld the fee regulations because they reasonably allocate the majority of these program costs among those who are the primary subject of this regulation. It struck down the regulations, however, because of the *benefits* that other water right holders receive, although they are not subject to the SWRCB's permitting and licensing authority. *That* is the corruption of the *Sinclair Paint* test that merits review.

II. The Farm Bureau argues the Court of Appeal applied the correct standard of review to the SWRCB's quasi-legislative rulemaking based on inapposite cases reviewing quasi-adjudicative decisions implicating fundamental, vested rights.

The Court of Appeal upheld the governing fee statutes, but struck down the SWRCB's quasi-legislative rulemaking that set up the fee schedule. The State asserts that the Court of Appeal struck down the SWRCB's regulations, in part, based on its lack of deference to the factual determinations and policy judgments the SWRCB made in deciding how best to allocate the fees. The Farm Bureau answers, like NCWA, that "Courts exercise independent review in determining whether regulations promulgated by agencies comport with Proposition 13 or any part of the Constitution." (Farm Bureau, p. 3.) Of course. As Respondents have stated numerous times, *issues of law*, such as whether the regulation is consistent with the statute *or the constitution*,

or exceeds the authority granted by law, are reviewed under the independent judgment standard; however, an agency's determinations of fact or policy judgments are reviewed with deference. (See Petition for Review, p. 14 and Farm Bureau, p. 2.)

The Farm Bureau cites *Lungren v. Superior Court* (1996) 14 Cal.4th 294, 309 for the proposition that the "arbitrary and capricious" standard applies to the determination of whether an agency "exceeded the authority granted by its enabling statute in promulgating regulations." (Farm Bureau, p. 3.) Not so; the question of whether a regulation is consistent with, and not in conflict with, the authority granted by the enabling statute is a question of law. *Lungren v. Superior Court* did not address an agency's quasi-legislative determinations: it addressed a ruling on demurrer regarding the proper interpretation of the language of the statute (the phrase, "source of drinking water"). (*Lungren v. Superior Court, supra,* 14 Cal.4th at pp. 299-300.) No formal regulation defining the term existed. As such, *Lungren* addressed a question of law – i.e., the interpretation of a statute – and it did not hold that the "arbitrary and capricious" standard is applicable to the question.

Missing the point, the Farm Bureau cites to *Association for Retarded Citizens v. Department of Developmental Services* (1985) 38 Cal.3d 384, 390 for the same well-established proposition that if "administrative action transgresses the agency's statutory authority, it need not proceed to review the action for abuse of discretion." (Farm Bureau, p. 5.) Again, the court did not even reach matters subject to the agency's discretion: it addressed only the language of the statute, and the agency's *interpretation* of that statute. The court found that the agency did not have

the authority to promulgate the regulations at issue. (*Association for Retarded Citizens v. Department of Developmental Services, supra,* 38 Cal.3d at pp. 391-392; accord, *Solid Waste Agency of N. Cook County v. United States Army Corps of Eng'rs* (2001) 531 U.S. 159, 173-174 [also refusing to defer to agency's *interpretation of statute*].)

Like NCWA, the Farm Bureau seems to be saying that because it claims that the regulations are in conflict with a constitution, as opposed to the statute, the "arbitrary and capricious" standard of review does not apply. But whether the regulation is consistent with (and not in conflict with) either the statute *or* the constitution, the applicable standard of review to such a question of law is independent review, insofar as the issue is one of interpreting the statute or constitution.

Here, the Court of Appeal found that the SWRCB had the authority to promulgate the regulations imposing a regulatory fee on permit and license holders, and upheld the fee statutes. It struck down the regulations based on its own findings of fact (outside the record) and because it substituted its judgment for that of the agency in matters uniquely within the agency's expertise. (See Petition for Review, p. 15; see Farm Bureau, pp. 9-11 [listing factual findings made by the Court of Appeal].)

It is well-established that the factual findings and policy judgments made by the agency in carrying out its legislative authority are entitled to review under the deferential "arbitrary and capricious" standard of review. (See Petition for Review, pp. 14-15.) In other words, the courts take the facts that the agency determined in the first instance, just as they would in reviewing a motion for summary judgment or the trial court's determination of the facts.

The State has already explained in its reply to NCWA's Answer that the standard of review does not change simply because the issues involved are of constitutional dimension, and incorporates its discussion at pages 5 through 10 herein to avoid further repetition. The Farm Bureau takes this argument further, suggesting that the standard of review should be upheld because some fundamental and vested right is at issue. Accordingly, the Farm Bureau cites *Kerrigan v. Fair Employment Practice Comm.* (1979) 91 Cal.App.3d 43, which holds that under the Code of Civil Procedure, section 1094.5, the independent judgment standard must be applied in actions reviewing quasi-adjudicative decisions if the right at issue is a fundamental, vested right. (*Kerrigan, supra,* 91 Cal.App.3d at pp. 48-49 [equal employment opportunity is fundamental, vested right].) *Kerrigan* is inapposite. The SWRCB's rulemaking is quasi-legislative, not quasi-adjudicative. And no case has ever held that the determination of whether a fee is an unconstitutional tax under Proposition 13 implicates a fundamental, vested right calling for heightened constitutional scrutiny.

Here, the Court of Appeal has failed to distinguish the separate analyses to be made under the *Sinclair Paint* test, that is, whether an agency has adequately supported its quasi-legislative determinations regarding "the basis for determining the manner in which the costs are apportioned," and the quasi-adjudicative determination of whether the "charges allocated to a payor bear a fair or reasonable relationship to the payor's burdens on or benefits from the regulatory activity." (*Sinclair Paint Co. v. State Bd. of Equalization et al., supra,* 15 Cal.4th at p. 878.) *Sinclair Paint* is not a departure from the courts' traditional deference to agency fact-finding.

CONCLUSION

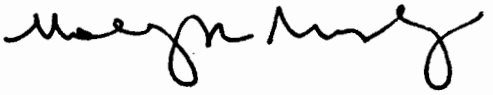
For the foregoing reasons, and for the reasons stated in Respondents' Petition for Review, the State urges this Court to grant its Petition for Review.

Dated: March 26, 2007

Respectfully submitted,

EDMUND G. BROWN JR.
Attorney General of the State of California

AMY J. WINN
Acting Senior Assistant Attorney General
GORDON BURNS
Deputy Solicitor General
WILLIAM L. CARTER
Supervising Deputy Attorney General
MATTHEW J. GOLDMAN



MOLLY K. MOSLEY, SBN 185483
Deputy Attorneys General

Attorneys for the California State Water Resources Control Board and the California State Board of Equalization, et al.

CERTIFICATION OF WORD COUNT

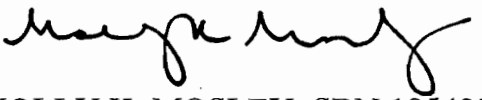
The text of the State's Reply to the California Farm Bureau Federation's Answer to Respondents' Petition for Review consists of 2,757 words according to the word processing program used to prepare the brief.

Dated: March 26, 2007

Respectfully submitted,

EDMUND G. BROWN JR.
Attorney General of the State of California

AMY J. WINN
Acting Senior Assistant Attorney General
GORDON BURNS
Deputy Solicitor General
WILLIAM L. CARTER
Supervising Deputy Attorney General
MATTHEW J. GOLDMAN



MOLLY K. MOSLEY, SBN 185483
Deputy Attorneys General

Attorneys for the California State Water Resources Control Board and the California State Board of Equalization, et al.

DECLARATION OF SERVICE BY OVERNIGHT COURIER AND HAND-DELIVERY

Case Name: **California Farm Bureau Federation et al. v. California State Water Resources Control Board, et al.**

No.: **S 150518**

I declare:

I am employed in the Office of the Attorney General, which is the office of a member of the California State Bar, at which member's direction this service is made. I am 18 years of age or older and not a party to this matter; my business address is: 1300 I Street, Suite 125, P.O. Box 944255, Sacramento, CA 94244-2550.

On March 26, 2007, I served the attached **RELY TO ANSWER TO PETITION FOR REVIEW** by placing a true copy thereof enclosed in a sealed envelope with the **Golden State Overnight**, addressed as follows:

David A. Battaglia
Gibson Dunn & Crutcher
333 South Grand Avenue
Los Angeles, CA 90071

Nancy N. McDonough
California Farm Bureau Federation
2300 River Plaza Drive
Sacramento CA 95833

Stuart L. Somach
Somach Simmons & Dunn
813 Sixth Street, Third Floor
Sacramento CA 95814-2403

Kevin M. O'Brien
Downey Brand
555 Capitol Mall, 10th Floor
Sacramento, CA 95814

Jason Everett Resnick
Western Growers Law Group
17620 Fitch Street
Irvine, CA 92614

Tim O'Laughlin
O'Laughlin & Paris
2580 Sierra Sunrise Terrace, Suite 210
Chico CA 95928

Clerk of the Court
Superior Court of California
County of Sacramento
720 9th Street, Appeals Unit
Sacramento, CA 95814

Courtesy Copy:
Anthony S. Epolite, Senior Tax Counsel
Board of Equalization
Legal Department
P.O. Box 942879
Sacramento, CA 94279-0082

Courtesy Copy:
Erin Mahaney, Staff Counsel
CA State Water Resources Control Board
Office of the Chief Counsel
1001 I Street, Post Office Box 100
Sacramento, CA 95812

Hand Delivered To:
Clerk of the Court
The Court of Appeal of the State of California
Third Appellate District
900 N Street, #400
Sacramento, CA 95814-4869

I declare under penalty of perjury under the laws of the State of California the foregoing is true and correct and that this declaration was executed on March 26, 2007, at Sacramento, California.

D. Burgess
Declarant

D. Burgess
Signature