App. 1

Court of Appeal of California, Third Appellate District

March 2, 2018, Opinion Filed

C075866

NORTHERN CALIFORNIA WATER ASSOCIATION et al., Plaintiffs and Respondents, v. STATE WATER RESOURCES CONTROL BOARD et al., Defendants and Appellants. CALIFORNIA FARM BUREAU FEDERATION et al., Plaintiffs and Respondents, v. STATE WATER RESOURCES CONTROL BOARD et al., Defendants and Appellants.

Counsel: Kamala D. Harris and Xavier Becerra, Attorneys General, Kathleen A. Kenealy Acting Attorney General, Robert W. Byrne, Senior Assistant Attorney General, Eric M. Katz, Helen G. Arens, and Carol A. Z. Boyd, Deputy Attorneys General, for Defendants and Appellants.

Somach Simmons & Dunn, Stuart L. Somach, Daniel Kelly, Robert B. Hoffman, Sacramento, Brittany K. Lewis-Roberts, and Lauren D. Bernadett for Plaintiffs and Respondents.

Judges: Opinion by Blease, Acting P. J., with Robie and Butz, JJ., concurring

Opinion by: Blease, Acting P. J.

BLEASE, Acting P. J.—This appeal involves challenges to the State Water Resources Control Board's (Board) imposition of a new annual fee on water right permit and license holders in fiscal year 2003–2004 to cover a portion of the costs of the Board's

Division of Water Rights (Division or Water Rights Division).

In 2003, the Legislature enacted Water Code[1] section 1525, which requires the holders of permits and licenses to appropriate water to pay an annual fee according to a fee schedule established by the Board. (§ 1525, subd. (a).) At the same time, the Legislature enacted sections 1540 and 1560, which allow the Board to allocate the annual fee imposed on a permit or license holder who refuses to pay the fee on sovereign immunity grounds to persons or entities who contracted for the delivery of water from that permit or license holder.

To implement section 1525's fee requirement, the Board adopted California Code of Regulations, title 23, sections 1066 and 1073 (regulation 1066 & regulation 1073). Regulation 1066 sets forth a fee formula for permit and license holders. Regulation 1073 sets forth a formula for allocating the annual fee "for projects within the Central Valley Project" (CVP) when the Board determines that the United States Bureau of Reclamation (USBR), which operates the CVP, will not pay the fee. (Regulation 1073, subd. (b).)

Plaintiffs Northern California Water Association, California Farm Bureau Federation, and individual fee payors claimed that the annual fee imposed in fiscal year 2003–2004 constituted an unlawful tax, as opposed to a valid regulatory fee, under article XIII A,

[1] Further undesignated statutory references are to the Water Code.

section 3, of the California Constitution (Proposition 13)[2] because it required fee payors to pay more than a de minimis amount for regulatory activities that benefited non-fee-paying right holders. Plaintiffs also claimed that the fees allocated to the water supply contractors violated the supremacy clause of the United States Constitution because they exceeded the contractors' beneficial interests in the USBR's water rights.

Our Supreme Court has already ruled that sections 1525, 1540, and 1560 are constitutional on their face. (*California Farm Bureau Federation v. State Water Resources Control Bd.* (2011) 51 Cal.4th 421, 428, [121 Cal. Rptr. 3d 37, 247 P.3d 112] (*Farm Bureau II*).) The court, however, found that the record was unclear as to (1) "whether the fees were reasonably apportioned in terms of the regulatory activity's costs and the fees assessed," and (2) "the extent and value of the [contractors' beneficial] interests." (*Id.* at p. 428.) Accordingly, the court directed this court to remand the matter to the trial court to make findings on those issues. (*Ibid.*)

Following a 10-day bench trial, the trial court issued a statement of decision that determined inter alia that the statutory scheme as applied through its implementing regulations imposed a tax, as opposed to a valid regulatory fee, by allocating the entire cost of the Division's regulatory activities to permit and license

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[2] California Constitution, article XIII A, section 3, was originally approved by initiative as Proposition 13, on June 6, 1978.

holders, while non-paying-water-right holders who benefit from and place burdens on the Division's activities pay nothing.[3] The trial court likewise found that the fees passed through to the water supply contractors in fiscal year 2003–2004 pursuant to regulation 1073 ran afoul of the supremacy clause "because the allocation of fees [was] not limited to the contractors' beneficial or possessory use of the [USBR's] water rights." In addition, the trial court found that the fee regulations were invalid because they operated in an arbitrary manner as to a single payor, Imperial Irrigation District. Accordingly, the trial court invalidated regulations 1066 and 1073, "as adopted by Resolution 2003-0077 in 2003–2004."[4]

The Board appeals, contending the trial court erred in invalidating the fee regulations.

We shall conclude that the trial court's central premise—that the Board allocated the entire cost of the Division's regulatory activities to permit and license holders—is wholly incorrect because it fails to recognize the role that general fund money played in

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[3] At the remand trial, the parties and trial court agreed that the Supreme Court had directed the trial court to make findings concerning "[t]he fee structure and the administrative actions taken as of 2003 and 2004, not the current state of affairs." Accordingly, the trial court limited its findings and the judgment to the fee regulations "as adopted by Resolution 2003-0077 in 2003–2004."

[4] The trial court also invalided regulation 1071, which sets forth a fee formula for activities involving the diversion or use of water for the purpose of diverting water for hydropower generation. (Cal. Code Regs., tit. 23, § 1071.)

fiscal year 2003–2004. That year the Legislature appropriated roughly $9 million dollars [sic] for the Water Rights Division, roughly 51 percent of which was paid from the Water Rights Fund (fee revenue), while 43 percent was paid from the state's general fund, and 6 percent from reimbursements and other funds. Moreover, the record shows that roughly 90 percent of the Division's costs were attributable to permit and license holders, while 10 percent were attributable to non-fee-paying right holders. Thus, the fees assessed on permit and license holders were proportionate to the benefits derived by them or the burdens they placed on the Division. Plaintiffs' assertion that the water right fee was imposed for the second half of the fiscal year is at odds with the evidence and the language of section 1525, subdivision (e), which provides that the fees "imposed pursuant to this section for the 2003–04 fiscal year shall be assessed *for the entire 2003–04 fiscal year*," and section 1552, which states that "moneys in the Water Rights Fund are available for expenditure, *upon appropriation* by the Legislature." (Italics added.)

We shall further conclude that the Board's decision to allocate all of the USBR's annual fee for projects within the CVP to the water supply contractors was reasonable. The record and the case law establish that the USBR provides the contractors with all available water after satisfying its obligations under state and federal law. Because the CVP contractors received everything the USBR had to give under its CVP permits and licenses, the Board reasonably valued the CVP contractors' beneficial interest in those permits and

licenses at 100 percent. Finally, we shall conclude that the trial court erred in determining that the fee regulations were invalid based on their application to a single payor. Accordingly, we shall reverse the judgment invalidating the fee regulations.

FACTUAL AND PROCEDURAL BACKGROUND[5]

"The water in California belongs to the people, but the right to use water may be acquired as provided by law." (*Farm Bureau II*, *supra*, 51 Cal.4th at p. 428, citing §§ 102, 1201, italics omitted.) The Board is

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[5] Plaintiffs moved to strike portions of the Board's opening brief on the ground that the brief "cites to and relies on materials, as substantive evidence, that were not before the Trial Court." Having deferred ruling on the motion pending assignment of a panel and filing of the opinion in this court, we now deny it. All of the materials that are the subject of the motion to strike are from the appendix for the prior appeal in this case, which, in turn, are from the original trial court writ proceedings. As the trial court acknowledged, the remand trial was not a "separate trial," it was a "further trial" on the writ. Moreover, California Rules of Court, rule 8.124(b)(2) provides that "[a]n appendix may incorporate by reference all or part of the record on appeal . . . in a prior appeal in the same case." It also bears noting that while plaintiffs' motion to strike addresses several items, the focus of the motion is on one document, an April 15, 2004, letter from Arthur G. Baggett, Jr., to Assemblymember Joseph Canciamilla (Baggett Letter). As the Board correctly notes in its opposition to the motion to strike, the Board does not rely on the Baggett Letter as substantive evidence in its opening brief. And we have not considered the Baggett Letter for any purpose in resolving the issues raised in this appeal.

Plaintiffs also moved to strike portions of the Board's supplemental letter brief. We shall deny the motion as moot because we did not rely on either parties' supplemental briefs in determining the issues raised in this appeal.

responsible for the "orderly and efficient administration of the water resources of the state" and exercises "the adjudicatory and regulatory functions of the state in the field of water resources." (§ 174, subd. (a).) The Water Rights Division administers the water rights program, but its authority is limited. (*Farm Bureau II*, *supra*, 51 Cal.4th at pp. 429–430) The Board regulates all appropriative water rights[6] acquired since 1914 through a system of permits and licenses. (*Id.* at p. 429.) It does not have jurisdiction to regulate riparian,[7] pueblo,[8] and pre-1914 appropriative rights (RPP right). (*Id*. at p. 429.) It does, however, "have authority to prevent illegal diversions and to prevent waste or unreasonable use of water, regardless of the basis under which the right is held." (*Ibid.*; *see also* § 275.) At all relevant times herein, RPP right holders accounted for approximately 38 percent of all surface water rights, the USBR accounted for 22 percent, and permit and license holders (other than the USBR) accounted for 40 percent.

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[6] An appropriative right is the right to take water from a watercourse that does not run adjacent to a landowner's property. (*Farm Bureau II*, *supra*, 51 Cal.4th at p. 429.)

[7] "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 land." (*Farm Bureau II*, *supra*, 51 Cal.4th at p. 429, fn. 7.)

[8] "'A 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 use of the inhabitants of the city.'" (*Farm Bureau II*, *supra*, 51 Cal.4th at p. 429, fn. 8.)

Prior to fiscal year 2003–2004, the operation of the Water Rights Division was supported primarily by the state's general fund, with less than one percent of Division costs covered by fees. The Governor's budget proposal for fiscal year 2003–2004 proposed expenditures of $8.7 million to support the water rights program, $7.2 million of which was to be payable from the general fund. In its analysis of the fiscal year 2003–2004 budget bill, the Legislative Analyst's Office (LAO) recommended that general fund support for the water rights program be *fully* replaced with "a new annual compliance fee assessed on all water rights holders under the board's jurisdiction." The Board opposed the LAO's recommendation, arguing that the LAO's analysis incorrectly assumed that "all water right actions benefit . . . the regulated community (water right permit and license holders)" and failed to take into account water-right holders outside of the Board's jurisdiction who also benefit from the Division's activities but would not be assessed a fee (i.e., RPP right holders).

The final budget act, which took effect on August 2, 2003, appropriated roughly $9 million for the Water Rights Division, $4.4 million of which was payable from the Water Rights Fund, which had yet to be established. The final change book to the Governor's fiscal year 2003–2004 budget stated in pertinent part: "Adopt trailer bill language to establish an annual water right fee. Fee revenues would be deposited in the newly created Water Rights Fund and used to offset General Fund expenditure *reductions*." (Italics added.)

In September 2003, the Legislature passed Senate Bill No. 1049 (2003–2004 Reg. Sess.) (Senate Bill 1049) by a simple majority (53 percent). (Stats. 2003, ch. 741, p. 5549 et seq.) Senate Bill 1049 was signed by the Governor on October 8, 2003, and took effect on January 1, 2004. Senate Bill 1049 repealed certain sections of the Water Code and enacted sections 1525 through 1560, which among other things, imposed an annual fee on water right permit and license holders (§ 1525) and established the Water Rights Fund (§§ 1550 & 1551).

As relevant here, section 1525, subdivision (a) requires water right permit and license holders to pay an annual fee according to a fee schedule established by the Board.[9] Subdivision (c) of section 1525 requires the Board to set the fee schedule "so that the total amount of fees collected pursuant to this section equals that amount necessary to recover costs incurred in connection with" the Division's activities.[10] Subdivision (d)(1) of section 1525 directs the Board to adopt the fee schedule as emergency regulations in accordance with section 1530, while former subdivision (d)(3) required the Board to "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

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[9] Subdivision (b) of section 1525 sets forth a series of mandatory filing fees. Those fees are not at issue in this appeal.

[10] Subdivision (c) of section 1525 sets out "recoverable costs" in substantial detail, but the costs recoverable are "not limited to" the activities identified.

the annual Budget Act for this activity."[11] Finally, subdivision (e) of section 1525 specifies that "[a]nnual fees imposed pursuant to this section for the 2003–04 fiscal year shall be assessed for the entire 2003–04 year."

Section 1540 allows the Board to allocate the annual fee (or a portion thereof) of a person or entity who refuses to pay it based on sovereign immunity to persons or entities who have contracts for the delivery of water from the person or entity upon whom the fee was initially imposed. Section 1560 sets out the options that may be pursued when the United States or an Indian tribe declines to pay the annual fee by relying on sovereign immunity.

Sections 1550 and 1551 establish the Water Rights Fund into which all fees, expenses, and penalties collected by the Board must be deposited. Section 1552 sets forth the purposes for which the money in the Water Rights Fund may be used and provides that such funds are available for expenditure "upon appropriation by the Legislature."

To establish a fee schedule as directed in section 1525, the Board began with the $4.4 million figure set forth in the fiscal year 2003–2004 budget—the amount

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[11] Subdivision (d)(3) was amended in 2011. As amended, it provides that 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 amounts appropriated by the Legislature for expenditure for support of water rights program activities from the Water Rights Fund established under Section 1550, taking into account the reserves in the Water Rights Fund." (Stats. 2011, ch. 579, § 9.)

of the Division's $9 million budget that was to be paid from the Water Rights Fund. The Board determined that most of the fee revenue should come from annual fees because it believed that annual fees would provide a more stable funding source, and most of the Division's work is related to overseeing and protecting water rights.

The Board assumed that 40 percent of permit and license holders would not pay the annual fee because 40 percent of permit and license holders failed to comply with the existing mandatory reporting requirements. To account for the estimated 40 percent noncollection rate, the Board divided $4.4 million by 0.60, which generated a revised billing target of over $7 million.

The Board elected to apportion the fees among permit and license holders based on the face value of their permits and licenses, i.e., the total annual amount of diversion authorized by the permit or license,[12] reasoning that the more water held under a permit or license, the greater the regulatory burden to the Division because larger projects generally have greater environmental impacts, involve more controversial issues, and affect a greater number of people. The Board elected not to base the fees on the water

[12] More precisely, the face value of a permit is the amount of water the applicant has estimated it can put to beneficial use, including reasonable conveyance losses (Cal. Code Regs., tit. 23, § 696), while the face value of a license—the perfected water right—is the amount of water the Board has determined the licensee was able to put to beneficial use (§ 1610).

actually used because it did not have complete or reliable records concerning actual water used. As previously noted, only 60 percent of permit and license holders complied with annual reporting requirements, and the Board had no way of accurately monitoring use. The Board also rejected a fee-for-service approach as too costly, beyond the capability of its accounting system, and unpredictable.

The Board reduced the face value of the permits and licenses for hydroelectric projects because the Division expends fewer resources administrating those water rights.[13] As a result of these reductions, the face value of all water right permits and licenses was reduced from 322 million to 200 million acre-feet.

After running several calculations, the Board set annual fees at the greater of $100 or $0.03 per acre-foot based on the face value of the permit or license.[14]

The Board used the same methodology for calculating the USBR's annual water right fee as it did for other permit and license holders. The face value of all the USBR permits and licenses was 116 million

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[13] The face value of permits and licenses for projects licensed by the Federal Energy Regulatory Commission (FERC) was reduced by 70 percent, and the face value of permits and licenses for non-FERC projects was reduced by 50 percent.

[14] The Board also imposed one-time filing fees on applications for new permits and licenses and petitions to change terms and conditions of existing permits and licenses. (*See* Cal. Code Regs., tit. 23, §§ 1062, 1064.) It assumed that filing fees would generate $207,400 annually, which correspondingly reduced the amount of revenue to be assessed through annual fees.

acre-feet. After adjustments for hydropower, the face value of the USBR's permits and licenses was reduced to 86 million acre-feet, which in fiscal year 2003–2004 amounted to an annual fee of roughly $2.58 million (86 million acre-feet multiplied by $0.03).

Once the Board determined that the USBR would not pay the fee based on sovereign immunity, the Board elected to allocate the portion of the USBR's fee attributable to its CVP permits and licenses, 81.7 million acre-feet, to the CVP contractors. (§§ 1540, 1560, subd. (b)(2).) The 81.7 million-acre feet amounted to $2.45 million in annual fees (81.7 million acre-feet multiplied by $0.03). The Board divided the $2.45 million among the projects within the CVP according to each project's water rights, and using records provided by the USBR, the Board grouped the CVP contractors by the project serving them. It then assessed the CVP contractors a prorated share of the amount of fees associated with the projects serving them, based on the amount of water specified in their contracts.

To implement the fee schedule as directed in section 1525, the Board adopted regulation 1066 and regulation 1073. Regulation 1066 applies to water right permit and license holders. Regulation 1066, former subdivision (a), provided: "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." (Reg. 1066, subd. (a), Register 2003, No. 52 (Dec. 23, 2003).) The Board adopted regulation 1073 to implement sections 1540 and subdivision (b)(2)

of section 1560, which among other things, authorized the Board to allocate an annual fee imposed on the United States to persons or entities who contract with the United States for the delivery of water when the United States declines to pay the annual fee based on sovereign immunity. As relevant here, regulation 1073 provides that if the USBR declines or is likely to decline to pay fees or expenses for projects within the CVP, the Division Chief shall allocate those fees or expenses to the USBR's water supply contractors. (Regulation 1073, subd. (b)(2).) The regulation further provides that "[t]he fee or expense for projects of the [CVP] shall be prorated among the contractors for the [CVP] based on either the contractor's entitlement under the contract or, if the contractor has a base supply under the contract, the contractor's supplemental supply entitlement."[15] (Regulation 1073, subd. (b)(2).)

In January 2004, the Board of Equalization[16] sent fee notices to water right permit and license holders and to those who contracted with the USBR for the delivery of CVP water. (§§ 1536 & 1537, subd. (a).) The Division collected nearly $7.4 million in fees but

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[15] "'Base supply' means the amount of water delivered to a water user by USBR from the Central Valley Project that is designated as base supply in a water supply contract between the user and the USBR." (Regulation 1073, subd. (e)(1).) "'Supplemental supply entitlement' means the amount of water exceeding base supply delivered from the Central Valley Project to a water user." (Regulation 1073, subd. (e)(2).)

[16] The Board of Equalization has since been reorganized and for purposes of this appeal is now the California Department of Tax and Fee Administration.

expended just over $4.6 million of that amount. The remainder was deposited into a new fund and became the starting balance of the Water Rights Fund for the next fiscal year.

The Division's actual adjusted operational costs and funding sources for fiscal year 2003–2004 were as follows:

WATER RIGHTS

State Operations

General Fund	$3,865*
Public Resources Account, Cigarette and Tobacco Products Sales Tax	$0.355
Federal Trust Fund	$0.150
Reimbursements	$0.088
Water Rights Fund	$4,608
Totals, State Operations	**$9,066**

*Dollars in millions

Roughly 51 percent of the Division's costs were paid from the Water Rights Fund, while 43 percent were paid from the state's general fund, and 6 percent from reimbursements and other funds.

Plaintiffs challenged the imposition of the annual water right fee, seeking declaratory and injunctive relief and a writ of mandate. They alleged that the statutory scheme enacted by the Legislature was unconstitutional on its face and "as applied" through the emergency regulations adopted by the Board. The trial court initially denied the writ of mandate, ruling that the money collected constituted valid regulatory

fees, rather than taxes. It also rejected plaintiffs' other constitutional claims.

We reversed in part, holding that the statutory scheme was constitutional on its face, but that it was unconstitutional as applied through the fee formulas set forth in the emergency regulations. (*California Farm Bureau Federation v. California State Water Resources Control Bd.* (2007) 146 Cal.App.4th 1126, 1132 [53 Cal. Rptr. 3d 445] (*Farm Bureau I*).) We therefore remanded the matter to the trial court with instructions to order the Board to adopt valid fee formulas. (*Id.* at pp. 1160–1161.)

Our Supreme Court affirmed our judgment holding that the statutory scheme was constitutional on its face, but reversed our determination that the statutes were unconstitutional as applied through the regulations. (*Farm Bureau II*, *supra*, 51 Cal.4th at p. 428.) The court found that the record was inadequate and that the trial court's order lacked sufficient factual findings and remanded the matter to this court with directions to remand the matter to the trial court to make additional findings. (*Id.* at pp. 428, 437, 441–442, 446–447.)

Following a 10-day bench trial, the trial court issued a statement of decision that concluded inter alia that "the statutory scheme and its implementing regulations improperly require the permit and license holders to pay more than a de minimis amount for regulatory activities that benefit non-paying water right holders, or that result from burdens non-paying water

right holders placed on the Water Rights Division" and therefore must be invalidated. The court also determined that plaintiffs "demonstrated that the allocation of the [USBR's] fees to [CVP] contractors is unconstitutional under the supremacy clause, because the allocation of fees is not limited to the contractors' beneficial or possessory use of the [USBR's] water rights." The Supreme Court's decision in *Farm Bureau II* and the trial court's findings on remand are set forth in more detail below in the discussion of the Board's claims on appeal.

DISCUSSION

I

The Trial Court Erred in Determining That the Water Right Fee Imposed in Fiscal Year 2003–2004 Pursuant to Regulation 1066 Was Not Properly Allocated, and Thus, Constituted an Unlawful Tax

The trial court determined that the annual water right fee imposed in fiscal year 2003–2004 operated as a tax, not a valid regulatory fee, because "the evidence establishes that the statutory scheme and its implementing regulations do not provide a fair, reasonable, and substantially proportionate assessment of all costs related to the regulation of affected payors." The trial court's determination is predicated on its finding that "the statutory scheme and its implementing regulations improperly require the permit and license holders to pay more than a de minimis amount for regulatory activities that benefit [RPP] right holders,

or that result from burdens [RPP] right holders place on the Water Rights Division."

The Board does not dispute that RPP right holders were not assessed any water right fees even though they benefited from and placed burdens on the Division's activities. Rather, the Board claims that the trial court ignored substantial evidence in the record that established that only 10 percent of the Division's costs were attributable to RPP right holders, and that there was more than enough "non-fee" support for the Division to cover such costs. According to the Board, had the trial court considered such evidence, it would have concluded that holders of permits and licenses were not required to pay for costs attributable to RPP right holders. The Board therefore contends that the trial court erred in determining that the statutory scheme and its implementing regulations do not provide a fair, reasonable, and substantially proportionate assessment of all costs related to the regulation of affected payors. The Board is correct.

A. *Applicable Law*

"The California Constitution provides that any act to increase taxes must be passed by a two-thirds vote of the Legislature. On the other hand, statutes that create or raise regulatory fees need only the assent of a simple majority." (*Farm Bureau II*, *supra*, 51 Cal.4th at p. 428, fns. omitted.) Senate Bill 1049 "passed the Legislature with only a 53 percent majority. Thus, if the amount charged under section 1525 [(as applied

through the fee schedule in regulation 1066)] is a tax, it is invalid. If it is a regulatory fee, it is not. . . ." (*Farm Bureau II*, at p. 437.)

"'[F]ees charged in connection with regulatory activities which fees do not exceed the reasonable cost of providing services necessary to the activity for which the fee is charged and which are not levied for unrelated revenue purposes'" are valid regulatory fees. (*Farm Bureau II*, *supra*, 51 Cal.4th at p. 441, quoting *Sinclair Paint Co. v. State Bd. of Equalization* (1997) 15 Cal.4th 866, 876 [64 Cal. Rptr. 2d 447, 937 P.2d 1350] (*Sinclair Paint*).) "[T]o determine the tax or fee issue, . . . courts [must] examine the costs of the regulatory activity and determine if there was a reasonable relationship between the fees assessed and the costs of the regulatory activity." (*Farm Bureau II*, at p. 441, citing *Sinclair Paint*, *supra*, 15 Cal.4th at pp. 870, 878.) "A regulatory fee does not become a tax simply because the fee may be disproportionate to the service rendered to individual payors. [Citation.] The question of proportionality . . . is measured collectively, considering all rate payors." (*Farm Bureau II*, *supra*, 51 Cal.4th at p. 438.)

"[A] regulatory fee, to survive as a fee, does not require a precise cost-fee ratio. A regulatory fee is enacted for purposes broader than the privilege to use a service or to obtain a permit. Rather, the regulatory program is for the protection of the health and safety of the public. The legislative body charged with enacting laws pursuant to the police power retains the discretion to apportion the costs of regulatory programs

in a variety of reasonable financing schemes. An inherent component of reasonableness in this context is flexibility." (*California Assn., of Professional Scientists v. Department of Fish and Game* (2000) 79 Cal.App.4th 935, 950 [94 Cal. Rptr. 2d 535].)

"The plaintiff challenging a fee bears the burden of proof to establish a prima facie case showing that the fee is invalid." (*Farm Bureau II*, *supra*, 51 Cal.4th at p. 436.) "[O]nce plaintiffs have made their prima facie case, the state bears the burden of production and 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."'" (*Id.* at pp. 436–437, quoting *Sinclair Paint*, *supra*, 15 Cal.4th at p. 878.)

"Whether section 1525 imposes a tax or a fee is a question of law decided upon an independent review of the record." (*Farm Bureau II*, *supra*, 51 Cal.4th at p. 436.) We review the trial court's foundational factual findings for substantial evidence. (*City of Arcadia v. State Water Resources Control Bd.* (2011) 191 Cal.App.4th 156, 170 [119 Cal. Rptr. 3d 232].)

B. *The Proceedings on Remand*

In *Farm Bureau II*, our Supreme Court concluded that it could not resolve the "'tax or fee' question" because the trial court's order lacked sufficient factual findings for it to determine "whether the fees, as

imposed, were reasonably proportional to the costs of the regulatory program." (*Farm Bureau II*, *supra*, 51 Cal.4th at p. 441.) Accordingly, it remanded the matter and directed the trial court "to make detailed findings focusing on the Board's evidentiary showing that the associated costs of the regulatory activity were reasonably related to the fees assessed on the payors." (*Id.* at p. 442.) More particularly, the trial court was instructed to make findings on (1) whether "the fees are reasonably related to the total budgeted cost of the Division's 'activity' (*see* § 1525, subd. (c))" and (2) whether "the statutory scheme and its implementing regulations provide a fair, reasonable, and substantially proportionate assessment of all costs related to the regulation of affected payors." (*Ibid.*)

On remand, the trial court determined that plaintiffs did not establish a prima facie case that the fees collected exceeded the total budgeted cost of the Division's operations, while "the Board presented evidence demonstrating that the total amount raised in fees was less than the cost of supporting the Water Rights Division." In doing so, the court observed that plaintiffs "did not focus their challenge on the actual cost of the Division's regulatory activities in comparison to the aggregate amount of fees raised under the regulations. Instead, they focused on the distinct issue of whether the fees were properly apportioned to and among the payors (actual and potential), contending that the fees allocated to payors did not bear a fair and reasonable relationship to those payors' burdens on or benefits from the regulatory activity." As to that issue, the trial

court found that plaintiffs "established a prima facie case that the statutory scheme and its implementing regulations do not 'provide a fair, reasonable, and substantially proportionate assessment of all costs related to the regulation of affected payors' " by producing evidence that RPP right holders, whose rights accounted for 38 percent of all water rights in the state and who are not charged fees, "receive a benefit from the Division's regulatory activities, and also impose some burden on the agency." The trial court further determined that the Board failed to rebut plaintiffs' prima facie case by producing evidence that showed " 'the estimated costs of the service or regulatory activity [and] the basis for determining the manner in which the costs are apportioned, so that the charges allocated to a payor bear a fair or reasonable relationship to the payor's burdens on or benefits from the regulatory activity.' " More particularly, the trial court found that "there is no documentary evidence that would support any particular estimate or finding regarding the proportion of the Division's resources that are devoted to water right holders other than the holders of permits and licenses." It also determined that "the Board did not present any evidence that established that funds other than fees paid for regulatory activities related to non-fee paying rights holders," and "absent any evidence that could quantify the amount of such activities as a proportion of the Division's total regulatory activities, it would not be possible to make any such showing."

C. *Analysis*

The salient question is not whether "non-fee paying rights holders," i.e., RPP right holders, received something for nothing, but whether the fees allocated to the affected payors, i.e., permit and license holders, were reasonable and substantially proportionate to all costs related to the regulation of *those payors*. (*Farm Bureau II*, *supra*, 51 Cal.4th at p. 442.) That RPP right holders were not charged fees but benefited from or placed burdens on the Division's regulatory activities is relevant only if the regulatory costs attributable to RPP right holders necessarily were allocated to the affected fee payors. If other sources of funding, such as the state's general fund, were sufficient to cover the regulatory costs attributable to RPP right holders, it does not matter that RPP right holders were not charged a fee. To the extent the trial court based its determination that plaintiffs established a prima facie case by producing evidence that "holders of water rights that are not charged fees nevertheless receive a benefit from the Division's regulatory activities, and also impose some burden on the agency," it erred.

In any event, the Board presented evidence that at most 10 percent of Division resources were spent on matters involving RPP right holders, and that funding sources other than water right fee revenue more than covered the Division's expenditures on such matters. To support its assertion that the administration of the water right permit and license system constituted the vast majority of the Division's activities, the Board relied on a draft report prepared by consultants for

Westlands Water District (Westlands), a plaintiff herein, and correspondence between Victoria Whitney, chief of the Water Rights Division, and Thomas Birmingham, general counsel and general manager of Westlands, concerning that draft report. The draft report states in pertinent part: "An estimate from [Board] staff . . . indicates that the [Board] may spend as much as 10 percent of Division time on riparian and pre-1914 water rights. This time may more appropriately be funded by others or the general fund." Westlands submitted a copy of the draft report to the Board for the purpose of "initiat[ing] discussions about a resolution to the issues that [it] hoped would avoid this litigation."[17] Whitney responded to the report in a letter to Birmingham, stating in relevant part: " . . . Westlands discusses the Division's activities involving riparian and pre-1914 water rights. . . . The report discusses why these activities should be paid by the General Fund. Westlands identified specific percentages of Division time spent on activities. These percentages may be incorrect because they include activities related directly to an existing permit or license." Birmingham replied to Whitney's comments by letter, stating in relevant part: "Our consultants have spent considerable time working with the [Board] and the Division. They provided their best estimate of time the Division spend[s] working on riparian and pre-1914 water right issues. We do believe though that whatever

[17] Birmingham testified that he thought "the report was in sufficient form and content that we could transmit it to the Water Board to initiate discussions about a resolution to the issues that we hoped would avoid this litigation."

time spent on these issues should not be charged to the water appropriators. *We have provided an educated estimate of 10% of the Division's time is spent on these and related issues*. We recognize that the Division does not keep an account of time spent on these issues, but it would be helpful for the [Board] to submit an estimate for use in our report if you disagree with ours." (Italics added.) Shortly thereafter, Westlands provided the Board with a revised draft report, which states in pertinent part: "Unfortunately the Division does not have an accurate method for determining the amount of time spent on riparian and pre-1914 water rights. . . . However a rough estimate from [Board] staff indicates that the [Board] may spend as much as 10 percent of Division time on riparian and pre-1914 water rights. In addition, our consultants, who have spent considerable time working with the [Board] and the Division, concur with the 10% estimate."

The trial court failed to discuss any of this evidence in its statement of decision. Plaintiffs assert that the trial court rejected the Board's reliance on the draft report because the court "recognized that the Draft Report was not even a 'Westlands' report, accepting Mr. Birmingham's testimony that he and the Westlands Water District actually disagreed with certain aspects of the Draft Report."[18] We need not determine whether

[18] Birmingham testified that the first draft report was prepared by outside technical consultants retained by Westlands, and that the views contained therein were those of the individuals who prepared it. During the Board's cross-examination of Birmingham concerning the draft report, the trial court observed: "You're asking [Birmingham] to interpret what somebody else's

the trial court rejected the Board's reliance on the draft report because even assuming for argument's sake that it did, Birmingham, in his capacity as Westland's general counsel and general manager, adopted the consultants' "educated estimate of 10%" in his letter to Whitney. That letter is evidence the Division devoted 10 percent of its resources to RPP right holders. Thus, the trial court's finding that "there is no documentary evidence that would support any particular estimate or finding regarding the proportion of the Division's resources that are devoted to water right holders other than the holders of permits and licenses" is not supported by substantial evidence.[19]

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words mean in a document that's in evidence and the document speaks for itself, and regardless of what you and he think it means, the court will consider what the words in a document in evidence means."

[19] Citing evidence of "Board decisions involving [RPP] water rights," the trial court found that plaintiffs "demonstrate[d] that the Division devotes an unquantified, but clearly non-trivial, proportion of its resources to issues involving those classes of fee-exempt water right holders." The Board disputes the trial court's finding that the decisions involved RPP water rights and argues that 9 of the 11 decisions were outside the relevant time period. We need not address the Board's claims because the trial court's finding that the "Division devotes an unquantified, but clearly non-trivial, proportion of its resources to issues involving . . . [RPP] right holders" is consistent with evidence the Division devotes 10 percent of its resources to RPP right holders. Moreover, the trial court relied on the Board decisions in finding that plaintiffs established a prima facie case that the fees were not properly allocated. At that point, the burden of production shifted to the Board (*Farm Bureau II*, *supra*, 51 Cal.4th at pp. 436–437), which the Board satisfied in part by producing evidence the Division devotes 10 percent of its resources to RPP right holders.

The trial court's reliance on a memorandum Whitney prepared, dated April 7, 2004, entitled "Errata to Memorandum Dated December 29, 2003 Regarding the Water Right Fee Program Summary and Recommended Fee Schedule for Fiscal Year 2003–2004," for the proposition that the Division spends "significantly more than five percent" of its time on resources or activities that benefit RPP right holders, is misplaced. That memorandum states in pertinent part: "In fact, as a portion of the Division's overall administration of water rights, approximately one-third of the Division's time is spent for the purpose of protecting the environment and the public interest and two-thirds of the time is spent on activities that protect prior right holders. Some of the Division's time is spent on efforts to protect parties who claim and appear to have water rights that are not within the [Board]'s permitting authority. Furthermore, once a permit or license is issued, most of staff's efforts are associated with ensuring that the permit or license holder complies with the conditions of the water right permit and with issuing a license to water right permit holders." Whitney's statement that *some* of the Division's time is spent on activities that protect RPP right holders does not suggest that any particular amount of time on such efforts, only that it spends *some* time. To the extent the trial court equated "prior right holders" with RPP right holders, and interpreted Whitney to suggest that the Division spends two-thirds of its time on activities that protect RPP right holders, such an interpretation is unsupported in the record or the law. In the memorandum, Whitney distinguishes between "prior right holders" and

"parties who claim and appear to have water rights that are not within the [Board]'s permitting authority," i.e., RPP right holders. Moreover, while the term "prior right holder" may include RPP right holders, it is by no means limited to those right holders. It also may include permit and license holders. (*See generally El Dorado Irrigation Dist. v. State Water Resources Control Bd.* (2006) 142 Cal.App.4th 937, 961–962 [48 Cal. Rptr. 3d 468] [discussing rule of priority].) The memorandum supports a finding that the Division spends some time on efforts to protect RPP right holders, a fact the Board does not dispute.

Having found that the Board produced evidence the Division devoted roughly 10 percent of its resources to RPP right holders, we now turn to whether those resources came from the water right fee assessed in fiscal year 2003–2004. To support its assertion that the Division received substantial funding from sources other than the challenged water right fees, the Board relied on the Governor's proposed budget for fiscal year 2003–2004, the final budget act for fiscal year 2003–2004, and related documents. The Governor's proposed budget for fiscal year 2003–2004, which ran from July 1, 2003, through June 30, 2004, and was presented prior to the enactment of Senate Bill 1049, proposed $8.7 million for the water rights program, $7.2 million of which was to come from the state's general fund. Under the final budget act, the program's total appropriation was increased to $9 million, and $4.4 million of that amount was to come from the new Water Rights Fund, thereby reducing the amount payable from the

state's general fund. As explained in the final change book to the Governor's fiscal year 2003–2004 budget, "[f]ee revenues would be deposited in the newly created Water Rights Fund and used to offset General Fund expenditure *reductions*." (Italics added.) In fiscal year 2003–2004, the Division's actual costs totaled $9.066 million. Roughly 51 percent of that amount was paid for by water right fees ($4.608 million), 43 percent from the state's general fund ($3.865 million), and the remaining 6 percent from the tobacco tax fund ($355,000), federal trust fund ($150,000), and reimbursements ($88,000). Thus, the water right fee reduced, but did not replace, general fund support for the Division's regulatory activities in fiscal year 2003–2004, and there was more than enough general fund support to cover the costs attributable to RPP right holders.

Plaintiffs dispute the Board's claim that the water right fee accounted for only half of the Division's budget for fiscal year 2003–2004, arguing that "[t]he fees were imposed for the second half of the fiscal year after [Senate Bill] 1049 was enacted." Plaintiffs, however, fail to point to any evidence in support of their argument. Rather, they cite the following statement from the factual and procedural background in *Farm Bureau II*: "The *proposal* called for General Fund support for the first half of the 2003–2004 fiscal year with fee increases covering the second half of the year." (*Farm Bureau II*, *supra*, 51 Cal.4th at p. 430, fn. 10, italics added.) The statement refers to the LAO's proposal, which recommended "that legislation be enacted

that . . . establishes a new annual compliance fee assessed on all water rights holders under the board's jurisdiction, in order to *fully replace* the General Fund support proposed for the board's water rights program." The proposal says nothing about general fund support being used for any part of the year.[20] To the contrary, the proposal recommended reducing general fund support for the water rights program in fiscal year 2003–2004 to zero. Moreover, what the LAO proposed and what the Legislature in fact did are not the same thing. As detailed above, the water right fee did not fully replace general fund support for the Division's regulatory activities in fiscal year 2003–2004.[21]

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[20] Plaintiffs also cite to a document entitled "Frequently Asked Questions Regarding Water Right Fees," which says nothing about the fees being imposed to support the second half of the fiscal year. Rather, it states in pertinent part: "In an effort to reduce the state's current budget deficit, the Legislature this year decreased General Fund support for the water right program by almost 30 percent. In addition, the Legislature determined that the funding source for almost half the remaining allocation in Fiscal Year 2003-2004 should be shifted from the General Fund to a special fund financed by water right holders." This is consistent with the Board's claim that the water right fee accounted for roughly half of the Division's budget for fiscal year 2003–2004.

[21] The factual and procedural background in *Farm Bureau II* "is largely adopted" from our opinion in *Farm Bureau I* (*Farm Bureau II*, *supra*, 51 Cal.4th at p. 428, fn. 4), which states that "[t]he 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" (*Farm Bureau I*, *supra*, 146 Cal.App.4th at p. 1137.) As set forth above, the proposal says nothing about general fund support for any portion of the year. While this court may have assumed such was the case based on the timing of the passage of Senate Bill

In addition, plaintiffs' claim that the fees were imposed for the second half of the fiscal year is at odds with the language of section 1525, subdivision (e), which provides: "Annual fees imposed pursuant to this section for the 2003–04 fiscal year shall be assessed *for the entire 2003–04 fiscal year*." (Italics added.) It is also inconsistent with section 1552, which states in pertinent part that "moneys in the Water Rights Fund are available for expenditure, *upon appropriation* by the Legislature. . . ." (Italics added.) In fiscal year 2003–2004 money in the Water Rights Fund was appropriated and available for expenditure on August 2, 2003, the day the final budget took effect, which was well within the first half of the fiscal year, which ran from July 1, 2003, through June 30, 2004. Thus, while the fee was not assessed until the second half of the fiscal year, the monies appropriated by the Legislature for the Water Rights Fund were available for expenditure in the first half of the fiscal year. At the remand trial, the Board produced evidence showing that Division expenditures were charged against the Water Rights Fund appropriation during the first half of fiscal year 2003–2004, and that as of December 31, 2003, 56.7 percent of that appropriation had been spent. The Board's budget officer explained that it is common for expenses to be paid from a "clearing account" until special fund revenues are received.

Plaintiffs' reliance on statements by the Board to support their assertion that the water right fee was

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1049, evidence presented during the 10-day remand trial establishes otherwise. (At p. 157, *post*.)

used solely to support the Division's activities in the second half of fiscal year 2003–2004 is misplaced. Whether the water right fee imposed in fiscal year 2003–2004 accounted for all or nearly all of the Division's funding in the second half of the fiscal year is determined by examining the statutory language and evidence related to appropriations and expenditures from the Water Rights Fund, not by the Board's musings.[22]

Finally, we reject the trial court's finding that the Board failed to consider "proportional allotment in enacting the fee regulations," and that the annual fee is invalid on that basis alone. The record shows that the Board did consider whether the fee represented a fair, reasonably, and substantially proportionate assessment of all costs related to the regulation of affected payors. When the LAO recommended that general fund support for the water rights program be fully

[22] In any event, none of the statements relied on by plaintiffs explicitly states that the water right fee was in fact used to support the Division's activities in the second half of fiscal year 2003–2004. The statements are as follows: "*In practical effect*, the budget provided general fund support for the first six months of the year, with fee support for the balance of the fiscal year." (Italics added.) "[T]he general funding to support the Division will expire as of December 31st." "In an effort to reduce the state's current budget deficit, the Legislature this year decreased General Fund support for the water right program by almost 30 percent. In addition, the Legislature determined that the funding source for almost half the remaining allocation in Fiscal Year 2003–2004 should be shifted from the General Fund to a special fund financed by water right holders. As a result, the Legislature has directed the [Board] to implement fees to raise revenues of $4.4 million."

replaced with "a new annual compliance fee" assessed permit and license holders, the Board objected on the ground that allocating Division costs entirely to permit and license holders was unfair because permit and license holders would necessarily be paying for costs attributable to RPP right holders, who also benefited from the Division's activities but would not be assessed a fee. As detailed above, general fund support for the water rights program was not fully replaced by the new annual fee in fiscal year 2003–2004. Under the final budget act, the Division's total appropriation was $9 million, only $4.4 million of which was payable from the new Water Rights Fund. The remainder of the Division's funding came primarily from the state's general fund. The trial court appears to have faulted the Board for failing to consider that permit and license holders necessarily would be paying for costs attributable to RPP right holders—a situation that did not exist. In any event, even assuming for argument's sake that the Board had failed to consider proportionality in developing the fee regulations, that alone would not be a sufficient basis on which to invalidate the regulations. Plaintiffs must show that they were prejudiced by the Board's action. The Board's adoption of the water right fee regulations involved a quasi-legislative action that is reviewed under the standards of ordinary mandamus. (*Home Builders Assn. of Tulare/Kings Counties, Inc. v. City of Lemoore* (2010) 185 Cal.App.4th 554, 561 [112 Cal. Rptr. 3d 7].) "'[A] party seeking review under traditional mandamus must show the public official or agency invested with discretion acted arbitrarily, capriciously, fraudulently, or without due

regard for his rights, *and that the action prejudiced him*.'" (*California Public Records Research, Inc. v. County of Yolo* (2016) 4 Cal.App.5th 150, 181 [209 Cal. Rptr. 3d 26], italics added, quoting *Gordon v. Horsley* (2001) 86 Cal.App.4th 336, 351 [102 Cal. Rptr. 2d 910].) Thus, contrary to the trial court's finding, the failure to consider "proportional allotment in enacting the fee regulations" alone is not a basis for invalidating the fee regulations. Plaintiffs must also establish that they were prejudiced by the Board's actions. Because, as detailed above, the water right fee represented a fair, reasonable, and substantially proportionate assessment of all costs related to the regulation of affected payors, plaintiffs are unable to make such a showing here.

In sum, even assuming that plaintiffs made their prima facie case, the Board satisfied its burden of production by producing evidence that the charges allocated to permit and license holders in fiscal year 2003–2004 did not exceed the cost of the regulatory activities attributable to them. In other words, they were not required to pay for activities attributable to RPP right holders who paid no fees. Accordingly, the trial court erred in concluding that the water right fee imposed in fiscal year 2003–2004 is a tax within the meaning of article XIII A, section 3, of the California Constitution and in invalidating the regulations on that basis.

II

The Trial Court Erred in Concluding That Regulation 1073 Violated the Supremacy Clause

The trial court determined that regulation 1073, which allocates the USBR's annual fee for projects within the CVP to the CVP contractors, is unconstitutional under the supremacy clause because the allocation is not limited to the contractors' beneficial or possessory use of the USBR's water rights. The Board contends that because CVP contractors "get all available project water after all legal requirements are satisfied," it fairly and reasonably valued the CVP contractors' beneficial interests in those rights at 100 percent. We agree with the Board.

A. *The Applicable Law*

"Under established principles of sovereign immunity, the federal government is immune from state taxation absent its consent." (*Farm Bureau II*, *supra*, 51 Cal.4th at p. 443.) A state, however, "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 or corporation and so long as it is the possession or use by the private citizen that is being taxed." (*United States v. County of Fresno* (1977) 429 U.S. 452, 462 [50 L.Ed.2d 683, 692, 97 S. Ct. 699].) "To successfully defend a supremacy clause challenge to a tax on persons or entities that contract with the federal government, the taxing authority must segregate and tax only the beneficial or possessory interest in the

property." (*Farm Bureau II*, at p. 445.) While we concluded above that the annual water right fee is not a tax for purposes of Proposition 13's supermajority requirement, "[w]hen conducting a supremacy clause analysis, federal courts do not distinguish between fees and taxes." (*Farm Bureau II*, at p. 444, fn. 27.)

B. *The Proceedings on Remand*

In *Farm Bureau II*, our Supreme Court agreed with the Board "that a fair determination of the [CVP] contractors' beneficial interest must include consideration of the system that supports and ensures the delivery of the amount contracted, not just the amount of water contracted for delivery." (*Farm Bureau II*, *supra*, 51 Cal.4th at p. 446.) However, "due to conflicting factual assertions and an inadequate record," the court could not "determine how much of the total water in question is used to support the water delivered and can thus be allocated to the [CVP] contractors' beneficial interest." (*Ibid.*) Accordingly, the court remanded the matter "for the trial court to determine the contractors' beneficial interest and the value of that interest" and "make findings as to whether the Board has fairly evaluated the federal contractors' beneficial interest, such that water not actually under contract for delivery is fairly attributable to the value of the delivery contracts themselves." (*Ibid.*, fn. omitted.)

On remand, the trial court concluded that (1) plaintiffs "established a prima facie case that the fee regulations as applied to [CVP] contractors are invalid

because the regulations are not based on a fair evaluation of the contractors' beneficial or possessory interests," and (2) the Board "failed to refute that prima facie case by producing evidence that would permit the Court to determine that the contractors' beneficial or possessory interests, in the aggregate, are equal to [the USBR's] total water rights, and that all water not actually under delivery to contractors is fairly attributable to the value of the delivery contracts themselves." In doing so, the court found that there was "no evidence whatsoever that the Board considered the beneficial interests of contractors, as defined by the Supreme Court, in adopting the fee regulations," and concluded that "[t]he fee regulations must be invalidated on this basis alone." In addition, the trial court dismissed the Board's assertion that all of the USBR's CVP water rights above contract amounts were necessary to deliver water to the contractors as "an attempt at *post hoc* validation of an arbitrary decision," noting that "the complete lack of any evidence that could support an accurate quantification of the contractors' beneficial or possessory interests, reinforces this impression." It also rejected the Board's rationale on the merits, reasoning, "The concept of the [CVP] as an integrated project serving multiple uses, with contractors not in the highest priority, is not really disputed in this case. But accepting this concept really only established that *some* amount of water not actually under contract *may* be fairly attributable to the value of the contractors' delivery contracts. It does not necessarily follow that *100%* of the water not actually under contract *should* be so attributed." (Fn. omitted.) The

court found it significant that the Board had never "done an analysis of the contractors' beneficial or possessory interests in the [USBR's] [CVP] permits," (fn. omitted) finding that without any such analysis, the Board's rationale that all of the USBR's water rights were necessary to support deliveries to contractors "lacks any convincing evidentiary basis." Finally, the court concluded that plaintiffs "presented significant probative and persuasive evidence that the beneficial or possessory interests of the [CVP] contractors could not be valued at 100% of [the USBR's] water rights for the Project" by demonstrating that "the contractors in reality have no actual guaranteed right to delivery of any amount of water, regardless of the face amounts of their contracts, and . . . frequently receive far less water than those face amounts." (Fn. omitted.)

C. *Analysis*

Whether regulation 1073 violates the supremacy clause by allocating the entire annual fee for the USBR's CVP permits and licenses to the CVP contractors turns on whether the Board fairly and reasonably valued the CVP contractors' beneficial interests in the USBR's water rights at 100 percent.

As a preliminary matter, the trial court's finding that there is no evidence the Board considered the contractors' beneficial interests in adopting the fee regulations is not supported by substantial evidence. The Board's decision to limit the fees it passed through to the contractors to those for projects within the CVP

(regulation 1073, subd. (b)(2)) shows that it considered the contractors' beneficial interest in the USBR's water rights in adopting the fee regulations. Moreover, at the remand trial, Whitney testified that she considered how much of the USBR's annual fee for projects within the CVP should be passed through to the contractors and recommended 100 percent.[23] Since her understanding was that the CVP was built as a water supply project, her initial recommendation was that 100 percent of the water right fees that support the CVP should be passed through to the contractors. After receiving comments at workshops that the Board "should not pass through [one] hundred percent of [the USBR's] fees to the CVP contractors," she solicited information from the USBR concerning the CVP's allocated costs "regarding the various uses for which the CVP had been authorized as compared to the uses that [the Board] approved in [its] water rights permits." Ultimately, however, she did not change her recommendation. Both the language of regulation 1073 and Whitney's testimony are evidence the Board considered the contractors' beneficial interests in the USBR's CVP water rights in enacting the fee regulations. The trial court's contrary finding is not supported by substantial evidence. Moreover, even assuming for argument's sake that the Board had failed to take into

[23] To the extent plaintiffs claim that the trial court found all of Whitney's testimony lacked credibility, they are mistaken. The trial court found that her testimony that the Division spends approximately five percent of its resources protecting the rights of RPP right holders "lack[ed] credibility or any reasonable foundation" due to the lack of documentary evidence to support it.

account the CVP contractors' beneficial interests in adopting the fee regulations, that alone would not warrant invalidating the regulations. As previously discussed, plaintiffs also must establish that they were prejudiced by the Board's actions. (*See California Public Records Research, Inc. v. County of Yolo*, *supra*, 4 Cal.App.5th at p. 181.) Because, as we shall explain, the Board's decision to allocate all of the USBR's annual fee for projects within the CVP to the water supply contractors was reasonable, plaintiffs are unable to make such a showing.

We now turn to whether the Board fairly and reasonably evaluated the contractors' beneficial interest in the USBR's CVP water rights at 100 percent. An understanding of the history of the CVP, which is well chronicled, is essential to the resolution of this issue.

"The CVP is a federal reclamation project built within the major watersheds of the Sacramento and San Joaquin River systems and the Sacramento-San Joaquin Delta (Delta), providing water storage and distribution to the Central Valley of California. A recent federal opinion noted the following legal and factual background: 'Reclamation projects are indispensible features of agriculture in the Western United States. "The Reclamation Act of 1902 set in motion a massive program to provide federal financing, construction, and operation of water storage and distribution projects to reclaim arid lands in many Western States." [Citations.] . . . [¶] The [CVP] is "a system of dams, reservoirs, levees, canals, pumping stations, hydropower plants, and other infrastructure [that] distributes

water throughout California's vast Central Valley." [Citation.] The CVP was originally "taken over and executed" by the United States under the Reclamation Act and was reauthorized by the Rivers and Harbors Act of 1937, Pub. L. No. 75-392, 50 Stat. 844, 850 ("the CVP Act"). [Citation.]' (*San Luis Unit Food Producers v. U.S*. (9th Cir. 2013) 709 F.3d 798, 801 (*San Luis Unit)*.)" The [USBR] is the agency within the United States Department of the Interior charged with administering the CVP. (*Westlands Water District v. U.S.* (9th Cir. 2003) 337 F.3d 1092, 1096; *San Luis Unit*, *supra*, at p. 801.)

"As built and operated, the CVP is 'the nation's largest water reclamation project and California's largest water supplier.' (*In re Bay-Delta etc.* (2008) 43 Cal.4th 1143, 1154 [77 Cal. Rptr. 3d 578, 184 P.3d 709], fn. omitted.) It operates 21 reservoirs, 11 powerplants, and 500 miles of major canals and aqueducts. With total storage capacity of more than 12 million acre-feet, the CVP delivers approximately seven million acre-feet of water annually to over 250 water contractors, primarily for agricultural use in the Central Valley. (*Id.* at p. 1154, fn. 1.) The CVP ' "supplies two hundred water districts, providing water for about thirty million people, irrigating California's most productive agricultural region and generating electricity at [numerous] powerplants.' " (*San Luis & Delta-Mendota Water Authority v. U.S.* (9th Cir. 2012) 672 F.3d 676, 682 (*San Luis & Delta-Mendota)*, quoting *Westlands Water Dist. v. U.S. Dept. of Interior* (9th Cir. 2004) 376 F.3d 853, 861.)" (*North Coast Rivers Alliance v. Westlands Water*

Dist. (2014) 227 Cal.App.4th 832, 840 [174 Cal. Rptr. 3d 229] (*North Coast)*.)

"In the original 1937 CVP act, Congress prioritized the purposes of the CVP as '"first, for river regulation, improvement of navigation, and flood control; second, for irrigation and domestic uses; and, third, for power.'" (*San Luis Unit*, *supra*, 709 F.3d at 801, quoting the 1937 CVP act, § 2.)" (*North Coast*, *supra*, 227 Cal.App.4th at p. 842.)

In 1978, to take account of the combined effects of the CVP and state water project upon the Sacramento-San Joaquin Delta (Delta), the Board modified the USBR's permits to require the USBR to meet new water quality standards in the Delta and Suisun Marsh by either releasing water from storage or curtailing diversions, so that outflow from the Delta would be sufficient to prevent sea water from intruding into the Delta. (*United States v. State Water Resources Control Bd.* (1986) 182 Cal.App.3d 82, 97–98 [227 Cal. Rptr. 161] (*U.S. v. SWRCB)*.) The primary purpose underlying the revised water quality standards "was salinity control in order to protect consumptive uses (agricultural, industrial and municipal) of the Delta waters." (*Id.* at p. 115.) As relevant here, the Court of Appeal rejected the USBR's assertion that the Board-imposed conditions for salinity control were inconsistent with congressional directives, holding that river regulation, the first priority stated, includes salinity control. (*Id.* at pp. 135–136.)

"In 1992, Congress passed the Central Valley Project Improvement Act (the CVPIA; Pub.L. No. 102-575 (Oct. 30, 1992) 106 Stat. 4706), which, among other things, amended the original CVP act to reprioritize the objectives of the CVP. The CVPIA elevated the protection of fish and wildlife to one of the main purposes of the CVP, alongside of irrigation and domestic uses, and it reserved 800,000 acre-feet of CVP water for environmental and wildlife protection purposes. (CVPIA, §§ 3406(a) & (b)(2), 3404(c); *see In re Bay-Delta etc.*, *supra*, 43 Cal.4th at p. 1154; *San Luis Unit*, *supra*, at pp. 801–802.)" (*North Coast*, *supra*, 227 Cal.App.4th at p. 842, fn. omitted.) The Central Valley Project Improvement Act (Pub.L. No. 102-575 (Oct. 30, 1992) 106 Stat. 4706; hereafter CVPIA) further required the Secretary of the Interior to provide water to certain wildlife refuges in amounts equal to historical water deliveries to the refuges. (CVPIA, § 3406(d)(1).) These refuges receive between 400,000 and 500,000 acre-feet of CVP water each year. "The CVPIA also expressly required the [USBR] to operate the CVP to 'meet all obligations under state and federal law, including but not limited to the federal Endangered Species Act, [title] 16 [United States Code section] 1531, et seq., and all decisions of the California [Board] establishing conditions on applicable licenses and permits for the project.' (CVPIA, § 3406(b).)" (*North Coast*, at p. 842, fn. omitted.)

"As this regulatory overview confirms, the [USBR] operates the CVP and allocates CVP water subject to a comprehensive scheme of environmental statutes and

regulations, including the environmental requirements of the CVPIA, the federal Endangered Species Act of 1973 (16 U.S.C. § 1531 et seq.), and various state and federal regulations of Delta waterflow and water quality. (*San Luis & Delta-Mendota*, *supra*, 672 F.3d at pp. 682–683 [noting the [USBR's] control of the CVP water is subject to a 'plethora of federal statutes and regulations governing' such matters as 'the CVP yield,' 'water quality,' and 'the impact of the releases on the environment and wildlife']; *San Luis Unit*, *supra*, 709 F.3d at p. 802.)" (*North Coast*, *supra*, 227 Cal.App.4th at p. 843.)

The USBR operates the CVP under water right permits and licenses issued and regulated by the Board, administers CVP water, and enters into contracts to provide that water to contractors. (*North Coast*, *supra*, 227 Cal.App.4th at pp. 839, 841; *U.S. v. SWRCB*, *supra*, 182 Cal.App.3d at pp. 102, 105; § 1391.)

"CVP water is available only through a water service contract between the water user and the [USBR]. There are three categories of contracts for the provision of CVP federal water supply. The first category is comprised of 'Exchange Contracts' that give express contractual priority to designated 'Exchange Contractors' on the basis of their pre-1914 riparian and appropriative rights to the San Joaquin River. [Citation.] These Exchange Contractors 'traded' their preexisting water rights to the [USBR]. [Citation.] The [USBR] obtained water permits from the [Board] that were coextensive with the exchanged water rights. The

[USBR] in turn entered into water service contracts with the Exchange Contractors for CVP federal water supply on a priority access basis." (*Tehama-Colusa Canal Auth. v. United States DOI* (9th Cir. 2013) 721 F.3d 1086, 1091 (*Tehama-Colusa)*.) The cooperation of the exchange contractors made possible the expansion of the CVP and the San Luis Unit. (*Westlands Water Dist. v. United States* (E.D. Cal. 2001) 153 F.Supp.2d 1133, 1146–1147.) In 2004, the exchange contracts totaled roughly 0.84 million acre-feet. The Board did not assess any water right fees on exchange contractors because those contractors had exchanged water to which they were entitled under pre-existing riparian or pre-1914 appropriative water rights for project water.

"The second category of CVP contracts encompasses 'Settlement Contracts' that grant a contractual priority to CVP water supply through the inclusion of provisions limiting the extent of shortage amounts. These contracts typically arose from preexisting water rights." (*Tehama-Colusa*, *supra*, 721 F.3d at p. 1091.) The settlement contractors are entities along the Sacramento River that hold pre-existing direct diversion water rights. Prior to Shasta Dam being built, there were high flows in the wintertime and low flows in the summertime. Sometimes the flows were so low that junior rights holders would not be able to divert any water. Once the Shasta Dam was in place and the Sacramento River was regulated, these entities "received a full supply, but [the USBR] knew that some of the water that they were diverting under certain circumstances was there because of the projects." Accordingly,

the USBR and these entities negotiated "settlement contracts" pursuant to which the settlement contractors receive a certain amount of "base supply water" annually without any fee, and other "project water" for which they do pay a fee. The base supply water may only be reduced by 25% in critically dry years, and the duty to deliver it is mandatory. (*Id.* at p. 1099.) In 2004, the base supply for the settlement contracts totaled roughly 1.8 million acre-feet. The Board did not assess any water right fees on settlement contractors for base supply water because those contractors held pre-existing rights to divert that water *before* the CVP was constructed; it did, however, assess water right fees for any supplemental entitlement, i.e., project water, under those contracts. (Regulation 1073, subd. (b)(2).)

"The third category contains contracts held by CVP contractors north-of-Delta, in-Delta, and south-of-Delta. This category of CVP contractors . . . held no pre-existing water rights to offer as consideration, and therefore receives no priority access to CVP water supply." (*Tehama-Colusa*, *supra*, 721 F.3d at p. 1091.) The CVP contractors in this case are members of this third category.

The Board's characterization of the CVP as a "water supply project" was not only reasonable, it was accurate. Water delivery is the *raison d'être* of the CVP. As the cases cited above recognize and the United States Supreme Court explained in *United States v. Gerlach Live Stock Co.* (1950) 339 U.S. 725, 728, [94 L.Ed. 1231, 1237, 70 S. Ct. 955] (*Gerlach*), the Sacramento River has almost twice as much water as the

San Joaquin River but the Sacramento Valley has very little tillable soil, while about "three-fifths of the [San Joaquin] valley lies in the domain of the less affluent San Joaquin." "To harness these wasting waters, overcome this perversity of nature and *make water available where it would be of greatest service*, the State of California proposed to re-engineer its natural water distribution. This project was taken over by the United States in 1935 and has since been a federal enterprise." (*Ibid.*, italics added.) "As built and operated, the CVP is 'the nation's largest water reclamation project and California's largest water supplier.' " (*North Coast*, *supra*, 227 Cal.App.4th at p. 840, quoting *In re Bay-Delta etc.*, *supra*, 43 Cal.4th at p. 1154; *see also Gerlach*, *supra*, 339 U.S. at p. 728 [describing CVP as "a gigantic undertaking to redistribute the principal fresh-water resources of California"].)

That the CVP has other congressionally authorized purposes, some of which Congress has prioritized over irrigation and domestic uses, does not alter CVP's fundamental status as a water supply project. For example, as previously discussed, salinity control is prioritized over irrigation and domestic uses (*U.S. v. SWRCB*, *supra*, 182 Cal.App.3d at pp. 135–136), yet no one would describe the CVP as a salinity control project. Indeed, the USBR itself recognized this fact in its 2004 CVP operations criteria and plan. While recognizing the various "[a]uthorized project purposes" the USBR acknowledged that "[t]he primary purpose of the CVP was to provide water for irrigation throughout California's Central Valley."

The fact that permit conditions such as those at issue in *U.S. v. SWRCB*, or other obligations imposed on the USBR by the state and federal governments, have reduced the amount of CVP water available for delivery to the CVP contractors does not diminish the contractors' beneficial interest in the CVP permits and licenses. As detailed above, the USBR operates the CVP and allocates CVP water *subject to* a comprehensive scheme of environmental statutes and regulations, and various state and federal regulations. (*North Coast*, *supra*, 227 Cal.App.4th at p. 843.) The USBR must comply with these statutes and regulations in order to deliver water to the CVP contractors. Stated another way, such compliance is necessary to deliver the CVP contractors their water. Moreover, the CVP contractors take their interest in the USBR's water rights subject to these legal obligations, (*State Water Resources Control Bd. Cases* (2006) 136 Cal.App.4th 674, 806, fn. 54 [39 Cal. Rptr. 3d 189]), and the USBR cannot give away more than it has. (*Ibid.*) Because the CVP contractors received all available water under the USBR's CVP permits and licenses after meeting its legal obligations, the Board reasonably valued the contractors' interest in those permits and licenses at 100 percent.[24]

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[24] To support their claim that the fees assessed on the CVP contractors exceeded their beneficial interest in the CVP permits and licenses, plaintiffs compare the face value of the CVP permits and licenses (112 million acre-feet) with the face value of the contractors' contracts (6.6 million acre-feet). Such a comparison is misleading because it suggests that CVP has 112 million acre-feet of water available when that is not the case. As detailed above,

The trial court erred in concluding that the CVP contractors' beneficial interest in the USBR's CVP water rights could not be valued at 100 percent because "the contractors in reality have no actual guaranteed right to delivery of any amount of water, regardless of the face amounts of the contracts, and . . . frequently receive far less water than those face amounts." (Fn. omitted.) The beneficial interest at issue here is in the USBR's water rights, not the water itself. "The issuance of a permit gives [the USBR] the right to take and use water only to the extent and for the purpose allowed in the permit." (§ 1381) The right conferred is the "right to *use* the water—to divert it from its natural course." (*U.S. v. SWRCB*, *supra*, 182 Cal.App.3d at p. 100.) The right is usufructuary only and confers no right of private ownership of water in a watercourse.[25] (*People v. Shirokow* (1980) 26 Cal.3d 301, 307 [162 Cal. Rptr. 30, 605 P.2d 859]; 13 Witkin, Summary of Cal.

CVP's total storage capacity is roughly 12 million acre-feet. (*In re Bay-Delta, etc.*, *supra*, 43 Cal.4th at p. 1154, fn. 1; *see also North Coast*, *supra*, 227 Cal.App.4th at p. 840.) At the remand trial, plaintiffs' expert testified that the annual flow of the Sacramento River is around 20 million acre-feet, and the CVP has 9 million acre-feet of water available for all of its long-term contracts, including refuge, exchange, and settlement contracts. He also testified that "there's a major quantitative difference between the face value of the [USBR's] permits maintained to operate the CVP on the one hand and the amount of water under contract to contractors on the other. . . ." Thus, while it is unclear precisely how much water is available for all CVP purposes, it is nowhere near 112 million acre-feet.

[25] "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.)

Law (10th ed. 2005) Personal Property, § 1, p. 15; 12 Witkin, *supra*, Real Property, § 917, pp. 1106–1107.) "Unlike real property rights, usufructuary water rights are limited and uncertain." (*U.S. v. SWRCB*, at p. 104.) That the CVP contractors are not guaranteed any particular amount of water under their contracts with the USBR or frequently receive less water than the face value of their contracts has no bearing on the extent of their interest in the USBR's permits and licenses, without which they would receive no water at all. As detailed above, the CVP contractors received *all* available water under the USBR's CVP permits and licenses after it satisfied its legal obligations. Because they received everything the USBR had to give under its CVP permits and licenses, the Board reasonably valued the CVP contractors' beneficial interest in those permits and licenses at 100 percent.

In sum, even assuming for argument's sake that plaintiffs established a prima facie case that "the regulations are not based on a fair evaluation of the contractors' beneficial or possessory interests," the Board refuted that prima facie case by establishing that the CVP is a water supply project, and the CVP contractors receive *all* available project water after the USBR satisfies its legal obligations. Accordingly, the trial court erred in concluding that the allocation of fees is not limited to the CVP contractors' beneficial or possessory use of the USBR's water rights, and invalidating regulation 1073 on that basis.

III

The Trial Court Erred in Concluding That the Fee Regulations Are Invalid Because They Operate in an Arbitrary Manner as to One Fee Payor

The trial court also determined that the fee regulations, as applied to Imperial Irrigation District (IID), "operate in an arbitrary and capricious manner as a result of the fact that fees are calculated strictly on the basis of the face amount of water covered by permits and licenses," and are invalid on that basis. The trial court based its determination on the following: " . . . IID obtains water from the Colorado River and transports it though the All-American Canal for eventual delivery to its customers. . . . IID does have a permit from the Board for the water it takes from the Colorado River. It also has six additional permits from the Board for the same water involving its use for hydroelectric power generation at various drop structures along the All-American Canal. The Board charges IID a fee based on the face amount of all seven permits, even though all seven permits involve the same water originally diverted from the Colorado River. . . . [¶] By contrast, . . . the California Department of Water Resources ("DWR"), is treated quite differently with regard to the water rights it holds for operation of the State Water Project. One of those water rights is a permit allowing DWR to divert and store water behind Oroville Dam, release that water from storage, and redivert the same water at 16 separate diversion facilities from Oroville to Perris Dam, in Riverside County. As the water travels southwards, it is used to generate

power at nine separate power plants, which is quite similar to what IID does with the water in the All-American Canal. In DWR's case, however, the water is covered by a single permit, instead of seven separate permits as in the case of IID, and DWR is charged a fee only on the face amount of that single permit." (Fns. omitted.)

Lack of uniformity alone is insufficient to establish that a regulatory fee is unreasonable and thus unlawful. (*Brydon v. East Bay Mun. Utility Dist.* (1994) 24 Cal.App.4th 178, 197 [29 Cal. Rptr. 2d 128].) Moreover, as set forth above, "A regulatory fee does not become a tax simply because the fee may be disproportionate to the service rendered to individual payors. [Citation.] The question of proportionality is not measured on an individual basis. Rather, it is measured collectively, considering all rate payors." (*Farm Bureau II*, *supra*, 51 Cal.4th at p. 438.) Thus, assuming without deciding that basing the fee assessment on the face value of the permit and licenses had a disproportionate impact on IID, the trial court erred in invaliding the fee regulations on this basis.

DISPOSITION

The judgment invaliding the fee regulations is reversed. The Board is entitled to its costs on appeal. (Cal. Rules of Court, rule 8.278(a)(1) & (2).)

Robie, J., and Butz, J., concurred.

SUPERIOR COURT OF CALIFORNIA

COUNTY OF SACRAMENTO

California Farm Bureau Federation, et al.,	**Department Number: 54**
vs.	**Case Number: 03CS01776 Consolidated w/ 04CS00473**
State Water Resources Control Board	**Final Statement of Decision**
	(Filed Nov. 12, 2013)

I. Introduction

In these consolidated actions, plaintiffs/petitioners Northern California Water Association and California Farm Bureau Federation challenge fees imposed by respondent/defendant State Water Resources Control Board under the authority of amendments to the Water Code enacted by the Legislature in 2003 and emergency regulations subsequently promulgated by the Board.[1] The petitioners are associations of farm families, agricultural water districts and other entities that are required to pay the fees.

Petitioners filed their petitions for writ of mandate and complaints for declaratory and injunctive relief in

[1] These parties will be referred to collectively as "petitioners" in this proposed statement of decision for the sake of convenience, except where it is necessary to identify either of them individually.

2003 and 2004, shortly after the fees went into effect. This Court denied petitioners' request for relief and found the fees to be valid in a ruling issued in April, 2005. Judgment was entered in favor of the Board.

Petitioners subsequently filed an appeal. In January, 2007 the Third District Court of Appeal issued a published decision which reversed this court's judgment in part, holding that Water Code section 1525, which imposed the fees, was constitutional on its face, but that the fee statutes and their implementing regulations were unconstitutional as applied.[2] The Court of Appeal also remanded the case to this court with instructions to order the Board to adopt valid fee schedule formulas.

Petitioners then sought review by the California Supreme Court, which granted their petition for review and ultimately issued a decision affirming the Court of Appeal's judgment that the fee statutes at issue were facially constitutional, but reversing that Court's judgment determining that the statutes and their implementing regulations were unconstitutional as applied. The Supreme Court remanded the matter to the Court of Appeal with directions to remand it to this Court to make findings related to the "as applied" challenge as described in the Supreme Court's opinion.

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[2] The opinion was published as *California Farm Bureau Federation v. California State Water Resources Control Board* (2007) 146 Cal. App. 4th 1126.

(*California Farm Bureau Federation v. State Water Resources Control Board* (2011) 51 Cal. 4th 421.[3])

Following remand, this matter was tried to the Court without a jury over ten days, with the final day of trial on December 19, 2012. The Court received oral testimony and documentary evidence as well as the administrative record that originally had been lodged in connection with the first round of trial court proceedings.[4]

At the close of trial, the Court established a post-trial briefing schedule with the agreement of the parties. The briefing schedule was to commence with receipt of the Official Court Reporter's Transcript. The case would be taken under submission as of the filing of the final brief.

The parties also stipulated to a post-trial procedure that, after consideration of the briefs and the evidence, the Court would issue its Proposed Statement of Decision pursuant to Rule of Court 3.1590 without having previously issued a Tentative Decision or received a request from any party for a Statement of Decision. The parties further agreed that objections by the parties to the Proposed Statement of Decision, if any, should be made pursuant to Rule of Court

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[3] The Supreme Court's opinion, which is of fundamental importance to this ruling, will be referred to herein as "*California Farm Bureau*".

[4] All references in this ruling to the administrative record will be designated "A.R.", and all references to the trial transcript will be designated "Trial Transcript".

3.1590(g), and that the Court would thereafter schedule a hearing on the Proposed Statement of Decision under subdivision (k) of that Rule.

The Court issued a minute order on May 14, 2013 stating that the briefing schedule had commenced with the receipt of the Official Court Reporter's Transcript on May 1, 2013. The parties filed their post-trial briefs according to the agreed-upon schedule. Upon receipt of the final post-trial briefs on July 1, 2013, the Court ordered the matter to be taken under submission.

On September 6, 2013, the Court issued a Proposed Statement of Decision. The Court subsequently received the Board's objections to the Proposed Statement of Decision, petitioners' response to the objections, and briefing from the parties on the issue of potential remedies. The Court held a hearing on the objections to the Proposed Statement of Decision and on the issue of potential remedies on October 30, 2013.

The Court has read and considered all of the briefing submitted by the parties and has heard and considered the oral and documentary evidence received at trial, including the original administrative record. The Court also has read and considered the Board's objections to the Proposed Statement of Decision and the briefing submitted by the parties regarding remedies, and has heard and considered the arguments presented by the parties at the hearing on the Proposed. Statement of Decision on October 30, 2013. Having considered all such argument and evidence, the Court now issues its Final Statement of Decision.

II. Scope of Proceedings on Remand

The facial constitutionality of the Water Code statutes under which the challenged fees were imposed is no longer at issue in this case, the Supreme Court having upheld the statutes against petitioners' facial challenge. On remand, this court's inquiry is focused on the constitutionality of the statutes and the implementing regulations "as applied".[5]

The fees that are challenged in this case were authorized by the Legislature through the enactment of Water Code section 1525(a), which provides that " . . . each 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."[6]

The Board set the amount of the fee by regulation in California Code of Regulations, Title 23, Section 1066(a). The regulation established a fee of " . . . the greater of $100 or $0.03 per acre-foot based on the total annual amount of diversion authorized by the permit or license." This regulation applies generally to all permit and license holders. The validity of these annual fees is one of two critical issues in this case.

Another critical issue is the validity of annual fees assessed to so-called "federal contractors". This issue

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[5] See, *California Farm Bureau*, 51 Cal. 4th at 446-447.

[6] Water Code section 1525(b) authorizes the Board to charge one-time fees for certain activities such as applying for a permit to appropriate water. Those fees are not at issue in this case.

arises because the United States Bureau of Reclamation holds a substantial percentage (approximately 22%) of total water rights held under permits and licenses in California. Application of the fees to the Bureau's water rights would yield a substantial fee. However, as all parties to this case recognize, the Bureau has taken the position that it is not required to pay water fees to the Board under the doctrine of sovereign immunity.

To address the issue of the Bureau's refusal to pay fees, the Legislature enacted Water Code sections 1540 and 1560. These statutes permit the Board to allocate a " . . . fee and expense or an appropriate portion of the fee or expense . . . " that otherwise would be charged to the United States to persons or entities who have contracts for the delivery of water from the United States, if the United States either declines or is likely to decline to pay.

The Board implemented these statutes in California Code of Regulations, Title 23, Section 1073. Subsection (b)(2) of the regulation established a formula to calculate the annual fee to be imposed on federal contractors. The formula assesses fees based on a prorated portion of the total amount of annual fees associated with all Bureau permits and licenses, rather than the portion of water delivery contract rights the contractors have available under their contracts. Those rights are substantially less in acre-foot terms than the total of the Bureau's water rights.

On remand, this court is directed to address the constitutionality of these fee statues [sic] and regulations as applied. Petitioners also contend that the fees are arbitrary in several respects.

In its opinion, the Supreme Court identified two general areas of inquiry in which it directed this Court to make detailed factual findings.

The first general area of inquiry involves the issue of " . . . whether the fees were reasonably apportioned in terms of the regulatory activity's costs and the fees assessed".[7] The Supreme Court's opinion, read in connection with prior decisions of that Court, directs this court to address two issues of fact within this first general area.

The first issue of fact is whether the aggregate amount of fees charged to all fee payors exceeds the reasonable cost of the regulatory program the fees are intended to support. As the Supreme Court stated:

> [A] fee may be charged by a government entity so long as it does not exceed the reasonable cost of providing services necessary to regulate the activity for which the fee is charged. A valid fee may not be imposed for unrelated revenue purposes. [. . .] Thus, permissible fees must be related to the overall cost of the governmental regulation. They need not be finely calibrated to the precise benefit each individual fee payor might derive. What a fee cannot do is exceed the reasonable cost of

[7] *Id.*, 51 Cal. 4th at 428.

> regulation with the excess used for general revenue collection. An excessive fee that is used to generate general revenue becomes a tax.[8]

Thus, the Court explained, " . . . the question revolves around the scope and the cost of the Division's regulatory activity and the relationship between those costs and the fees imposed."[9] The Court found that this court's prior order denying relief lacked sufficient factual findings permitting a determination as to " . . . whether the fees, as imposed, were reasonably proportional to the costs of the regulatory program."[10] The Supreme Court accordingly remanded the matter for additional fact-finding, as follows:

> The trial court is directed to make detailed findings focusing on the Board's evidentiary showing that the associated costs of the regulatory activity were reasonably related to the fees assessed on the payers. *(Sinclair Paint*, *supra*, 15 Cal.4th at p. 870.) Of course, [petitioners] are free to renew their claim that the fees assessed exceeded the reasonable cost of the Division's services. (*Id.* at p. 881.)
>
> The trial court's findings should include whether the fees are reasonably related to the total budgeted cost of the Division's "activity" (see § 1525, subd. (c)), keeping in mind that a government agency should be accorded some

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[8] *Id.*, 51 Cal. 4th at 438.

[9] *Id.*, 51 Cal. 4th at 441.

[10] *Id.*

> flexibility in calculating the amount and distribution of a regulatory fee. Focusing on the activity and its associated costs will allow the trial court to determine whether the assessed fees were reasonably proportional and thus not a tax. (*Sinclair Paint*, *supra*, 15 Cal.4th at p. 870.)[11]

The second issue of fact is whether the fees, even if reasonably proportionate to the overall cost of the regulatory program the fees support in the aggregate, are allocated to and among actual and potential fee payers on a reasonably proportionate basis. As the Supreme Court stated in *Sinclair Paint Company v. State Board of Equalization* (1997) 15 Cal. 4th 866, 878:

> [T]o show a fee is a regulatory fee and not a special tax, the government should prove . . . 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 payer's burdens on or benefits from the regulatory activity.

In the *California Farm Bureau* opinion, the Supreme Court directed this court to address that issue of allocation as well:

> The court must determine whether the statutory scheme and its implementing regulations provide a fair, reasonable, and substantially

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[11] *Id.*, 51 Cal. 4th at 442.

> proportionate assessment of all costs related to the regulation of affected payors.[12]

The second general area of inquiry relates to the issue of whether the Water Code amendments, or their implementing regulations, violate the supremacy clause of the United States Constitution by over-assessing the beneficial interests of those who hold contractual rights for delivery of water from the federally administered Central Valley Project, referred to in this case as "federal contractors".

The Supreme Court found that " . . . the constitutionality of the implementing regulations depends on whether they fairly assess and apportion the federal contractors' beneficial interests."[13] The Court noted:

> To successfully defend a supremacy clause challenge to a tax on persons or entities that contract with the federal government, the taxing authority must segregate and tax only the beneficial or possessory interest in the property. (See*County of Fresno*, *supra*, 429 U.S. at p. 462; *NyeCounty*, *supra*, 938 F.2d at pp. 1042-1043; *HawkinsCounty*, *supra*, 859 F.2d at p. 23.) Thus, although the SWRCB has the authority to impose regulatory costs on the federal contractors, it can do so only to the extent of the contractors' interest.[14]

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[12] *Id.*

[13] *Id.*, 51 Cal. 4th at 428.

[14] *Id.*, 51 Cal. 4th at 445.

The Court accepted the Board's contention that " . . . a fair determination of the federal contractor's beneficial interest must include consideration of the system that supports and ensures the delivery of the amount contracted, not just the amount of water contracted for delivery", stating: "We agree with the SWRCB."[15] However, the Court found the factual record inadequate to resolve the issue of whether the fees imposed under the regulations properly reflected consideration of that support system:

> [A]gain due to conflicting factual assertions and an inadequate record, we cannot determine how much of the total water in question is used to support the water delivered and can thus be allocated to the federal contractors' beneficial interest. Accordingly, we remand for the trial court to determine the contractors' beneficial interest and the value of that interest. The trial court shall make findings as to whether the Board has fairly evaluated the contractors' beneficial interest, such that water not actually under contract for delivery is fairly attributable to the value of the delivery contacts themselves.[16]

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[15] *Id.*

[16] *Id.*, 51 Cal. 4th at 446.

III. Standard of Review

In its *California Farm Bureau* opinion, the Supreme Court defined the standard of review applicable to this case as follows:

> Whether section 1525 imposes a tax or a fee is a question of law decided upon an independent review of the record. (*Sinclair Paint Co. v. State Bd. of Equalization* (1997) 15 Cal.4th 866, 874 [64 Cal.Rptr.2d 447, 937 P.2d 1350] (*Sinclair Paint*).)
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> The plaintiff challenging a fee bears the burden of proof to establish a prima facie case showing that the fee is invalid. (See *Sea & Sage Audubon Society, Inc. v. Planning Com.* (1983) 34 Cal.3d 412, 421 [194 Cal.Rptr.375, 668 P.2d 664]; *Sargent Fletcher, Inc. v. Able Corp.* (2003) 110 Cal.App.4th 1658, 1668 [3 Cal.Rptr.3d 279] (*Sargent Fletcher*).) In other words, the plaintiff bears the burden of proof "with respect to all facts essential to its claim for relief." (*Home Builders Assn. of Tulare/Kings Counties, Inc. v. City of Lemoore* (2010) 185 Cal.App.4th 554, 562 [112 Cal.Rptr.7]; see Evid. Code § 500.) The plaintiff "must present evidence sufficient to establish in the mind of the trier of fact or the court a requisite degree of belief (commonly by a preponderance of the evidence.) [Citations.] The burden of proof *does not shift* . . . it remains with the party who originally bears it." (*Sargent Fletcher*, *supra*, 110 Cal.App.4th at p. 1667, original italics.)

> This burden of persuasion is different from the "burden of producing evidence" (see Evid. Code § 110), which may shift between the parties. "[T]he burden of producing evidence as to a particular fact rests on the party with the burden of proof as to that fact. [Citations.] If that party fails to produce sufficient evidence to make a prima facie case, it risks nonsuit or other unfavorable determination. [Citations] But one [sic] that party produces evidence sufficient to make its prima facie case, the burden of producing evidence *shifts* to the other party to refute the prima facie case." (*Sargent Fletcher*, *supra*, 110 Cal.App.4th at p. 1667-1668, original italics.)
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> Thus, once plaintiffs have made their prima facie case, the state bears the burden of production and must show "'(1) the estimated costs of the service of 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 or benefits from the regulatory activity.'" (*Sinclair Paint*, *supra*, 15 Cal.4th at p. 878; see *California Assn. of Prof Scientists v. Department of Fish & Game* (2000) 79 Cal.App.4th 935, 945 [94 Cal.Rptr2d 535] (*Prof. Scientists*)[17].

Additionally, as stated in *Home Builders Association of Tulare/Kings Counties, Inc. v. City of Lemoore* (2010) 185 Cal. App. 4th 554, 561 (cited in the excerpt

[17] *Id.*, 51 Cal. 4th at 436-437.

from the *California Farm Bureau* opinion set forth above), the adoption of fees pursuant to statute is a quasi-legislative action. Judicial review of such action is limited to an examination of the proceedings before the agency to determine whether its action was arbitrary, capricious, or entirely lacking in evidentiary support. The action will be upheld if the agency " . . . adequately considered all relevant factors and demonstrated a rational connection between those factors, the choice made, and the purposes of the enabling statute."

IV. Discussion

A. Relationship Between Total Fees Charged and the Cost of the Regulatory Program

The first area in which the Supreme Court directed this court to make findings was " . . . whether the fees are reasonably related to the total costs of the Division's 'activity' ".[18]

As the Supreme Court pointed out, the "activity" to be supported by the fees is described in Water Code section 1525(c), as follows:

> The board shall set the fee schedule authorized by this section so that the total amount of fees collected pursuant to this section equals the amount necessary to recover costs incurred in connection with the issuance,

[18] *Id.*, 51 Cal. 4th at 442.

> 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, petitioner and requests, prescribing terms of permits, licenses, 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.

Water Code section 1525(d)(3) requires the Board to " . . . 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." It is undisputed that the revenue level set forth in the annual Budget Act for the Water Rights Fund for the 2003-2004 fiscal year was approximately $4.4 million, and that this amount represented the "target" that the Board used in establishing the regulations.

As the Supreme Court stated: "In other words, the statute requires that the total budgeted cost of the

Division's operations be recovered from the fees."[19] The issue before the court, then, is whether the amount of fees the Board collected under the regulations exceeded the total budgeted costs of the Division's operations. If so, the fees would be invalid as a tax because, in effect, those fees would have been levied for unrelated revenue purposes, as provided in *Sinclair Paint Co. v. State Board of Equalization*, *supra*, 15 Cal. 4th 866, 870.

The Court finds that petitioners did not establish a prima facie case that the fees were invalid on this basis. At trial, petitioners did not focus their challenge on the actual cost of the Division's regulatory activities in comparison to the aggregate amount of fees raised under the regulations. Instead, they focused on the distinct issue of whether the fees were properly apportioned to and among the payors (actual and potential), contending that the fees allocated to payors did not bear a fair and reasonable relationship to those payors' burdens on or benefits from the regulatory activity. Thus, although the Supreme Court observed that petitioners were " . . . free to renew their claim that the fees assessed exceeded the reasonable cost of the Division's services"[20], they did not do so.

By contrast, the Board presented evidence demonstrating that the total amount raised in fees was less

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[19] *Id.*, 51 Cal. 4th at 432.

[20] *Id.*, 51 Cal. 4th at 442.

than the cost of supporting the Water Rights Division.[21]

The Court accordingly finds that petitioners have not carried their burden of proof on the issue of whether the fees are invalid because they exceed the reasonable cost of the Division's regulatory activities, and on that basis finds in favor of the Board on that issue.

B. Allocation of Fees Among Actual and Potential Favors

The second critical area of factual inquiry is whether the fees were properly allocated among all of the actual and potential payors. In this area, petitioners contend that the fees fail to pass constitutional muster because the fees allocate the entire cost of the Water Rights Division's activities entirely to a subset of potential payors, those holding licenses and permits. At the same time, other potential payors that place burdens on, and receive benefits from, the activities of the Division pay no fees and thus contribute nothing to paying the costs of the Division's activities.

The Court finds that petitioners have established a prima facie case that the statutory scheme and its implementing regulations do not "provide a fair, reasonable, and substantially proportionate assessment

[21] See, e.g., Trial Exhibit 1005.

of all costs related to the regulation of affected payors".[22]

The deficiency arises out of the fact that no fees are assessed against the holders of approximately 38% of all water rights in California as expressed in acre-feet. As demonstrated in a chart prepared by the Board in May, 2003 for discussions with the Legislative Analyst's Office regarding the proposed fees, 38% of California water rights (representing. 211,430,956 acre-feet) are held under Statements of Water Diversion and Use rather than permits and licenses.[23] This substantial proportion of total water rights in the State represents, as all parties recognize, riparian, pueblo and pre-1914 appropriative rights.[24] These are rights over which the Board has no authority to impose fees. At the same time, however, as the Supreme Court stated: " . . . riparian, pueblo, and pre-1914 rights (collectively, RPP rights) are protected by conditions in new (post-1914) permits and through the Water Rights

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[22] *California Farm Bureau*, 51 Cal. 4th at 442.

[23] See, A.R., p. 473; Testimony of Division Chief Whitney, Trial Transcript, pp. 841:22-842:14. Exhibit 473 also shows that an additional 22% of all water rights (116,331,177 acre-feet) is held by the U.S. Bureau of Reclamation, which refuses to pay fees to the State on that water. As discussed below, the fees the Bureau otherwise would pay are "passed through" to Central Valley Project contractors. The validity of those fees is addressed below.

[24] The history of California water rights and the different types of water rights that developed over time, such as riparian, pueblo, pre-1914 appropriative and post-1914 appropriative rights, is discussed in detail in the *California Farm Bureau* opinion and is familiar to the parties and the Court, and need not be discussed in detail here.

Division's enforcement of [sic] activity . . . ".[25] Those rights holders thus receive a benefit from the Division's regulatory activity. At trial, petitioners presented evidence of Board decisions involving riparian, pueblo or pre-1914 water rights, demonstrating that the Division devotes an unquantified, but clearly nontrivial, proportion of its resources to issues involving those classes of fee-exempt water right holders.[26] This evidence is sufficient to establish that holders of water rights that are not charged fees nevertheless receive a benefit from the Division's regulatory activities, and also impose some burden on the agency.

Indeed, the Board has admitted as much. As the Supreme Court stated, when the Legislative Analyst originally recommended that the Division's operating costs should be shifted from the General Fund and covered instead by user fees imposed on permit and license holders, "[t]he SWRCB strongly opposed the recommendation [and] argued that while permit and license holders should pay their share, proportional fees on them could not cover the total cost of the Division's operation."[27] The Legislative Analyst's Office

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[25] *California Farm Bureau*, 51 Cal. 4th at 430.

[26] See, for example, Trial Exhibits 127, 128, 155, 230, 231, 234, 235, 237, 238, 239, 241.

[27] *California Farm Bureau*, 51 Cal. 4th at 430. The opinion of the Third District Court of Appeal discussed the Board's opposition to the LAO's fee proposal in more detail: "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 rights actions benefit . . . the regulated community (water right permit and license holders). *This*

evidently agreed. In a report entitled "Water Rights Fees" dated May 22, 2003 and presented to Senate Budget Subcommittee No. 2, the LAO recognized that 38 percent of the water under water rights in the state

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assumption is not true. In many instances, the prior rights that are protected by the imposition of permits and licenses are rights that are held by parties other than post-1914 appropriative rights 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 recommendation was a correct statement. [. . .] 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 uses received 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." (See, *California Farm Bureau Federation v. CaliforniaState Water Resources Control Board* (2007) 146 Cal. App. 4th 1126, 1137, 1153.) The Court's citation to the opinion of the Court of Appeal is only for the purpose of providing background facts that are not disputed by the parties.

were outside the Board's jurisdiction, and stated: "The board's water rights program does provide benefits to these water rights holders, which presents an additional issue concerning equity among fee payers since fee payers would be paying for work performed by the board for the benefit of water rights holders outside the board's jurisdiction."[28]

Because the petitioners established a prima facie case that the fees were not properly allocated because holders of a substantial proportion of water rights received a benefit from the Division's regulatory activities, or placed a burden on its resources, the Board then was required to assume the burden of producing evidence to demonstrate " . . . the estimated costs of the service or regulatory activity [and] the basis for determining the manner in which the costs were 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".[29]

In its trial briefs, the Board argued that it properly allocated most of the costs of the water rights program to users of water held under permits and licenses because administering the permit and license system constitutes the vast majority of water right program

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[28] See, Trial Exhibit 65, page SB-FB#1-00679. The LAO noted a similar equity issue with regard to the federal government, which controls 22 percent of the water under water rights in the state.

[29] *California Farm Bureau*, 51 Cal. 4th at 436-437.

activities".[30] Specifically, the Board argued that administration of the permit and license system constitutes approximately 95 percent of the water right program's activities.[31]

At trial, the Board attempted to satisfy its burden of producing evidence to support this 95 percent figure through the testimony of Division Chief Whitney. This attempt was unpersuasive and ultimately unsuccessful.

Ms. Whitney testified regarding a written estimate she had developed that the Division " . . . spends approximately five percent of its resources . . . " protecting water rights parties that do not hold rights subject to permits or licenses, i.e., riparian or pre-1914 water right holders.[32] Although Ms. Whitney reviewed the document containing the estimate at trial, which was referred to as Exhibit 1131, the document was never actually offered or admitted into evidence.[33] No

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[30] See, the Board's Post-Trial Brief (filed June 17, 2013), p. 2:3-6.

[31] *Id.*, p. 3:20-22.

[32] See, Trial Transcript, pp. 842:19-844:10.

[33] Counsel explicitly stated: " . . . and I'm not moving 1131 into evidence, Your Honor . . . " (See, Trial Transcript, p. 844:12-13.) It is not clear whether Exhibit 1131 is the document that Justice Moreno referred to in his concurring opinion in the *California Farm Bureau* case, which the Board produced to support its contention that "some 95 percent of its time and expense are directed toward servicing and regulating those licensees and permittees against whom the challenged fees were assessed". Justice Moreno described the document as being of "uncertain reliability". (51 Cal. 4th at 447-448.)

other documentary evidence or testimony was offered at trial to support this estimate, and there is no documentary evidence in the administrative record to support it, either. In fact, there is no documentary evidence that would support any particular estimate or finding regarding the proportion of the Division's resources that are devoted to water right holders other than the holders of permits and licenses.[34] Given the complete lack of documentary evidence to support it, the Court views the 5 percent estimate Ms. Whitney presented as lacking credibility or any reasonable foundation.

Moreover, the estimate does not appear to be consistent with estimates contained in a memorandum Ms. Whitney prepared, dated April 7, 2004, entitled

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[34] As the Third District Court of Appeal commented in its opinion in this case: "Here, the SWRCB offered no breakdown of costs or other evidence to demonstrate that the services and benefits provided to the nonpaying 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. [¶] 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 [of Reclamation] which holds 22 percent of the water subject to water rights." (See, *California Farm Bureau Federation v. California State Water Resources Control Board*, *supra*, 146 Cal. App. 4th at 1153, 1154.) As petitioners stated in their Closing Trial Brief, p. 20:13-14: "Nothing presented at the evidentiary trial in this matter differs in any significant way from what was before the Third District Court of Appeal when it overturned the regulations."

"Errata to Memorandum Dated December 29, 2003 Regarding the Water Right Fee Program Summary and Recommended Fee Schedule for Fiscal Year 2003-2004." In that document, Ms. Whitney stated:

> In fact, as a portion of the Division's overall administration of water rights, approximately one-third of the Division's time is spent for the purpose of protecting the environment and the public interest and two-thirds of the time is spent on activities that protect prior right holders. Some of the Division's time is spent on efforts to protect parties who claim and appear to have water rights that are not within the SWRCB's permitting authority. Furthermore, once a permit or license is issued, most of staff's efforts are associated with ensuring that the permit or license holder complies with the conditions of the water right permit and with issuing a license to water right permit holders.[35]

The statements in this document strongly suggest that the Water Rights Division spends significantly more than five percent of its time and resources in activities that benefit water right holders not subject to the fees, or that benefit the public in general.

Also, the Board did not present any evidence that established that funds other than fees paid for

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[35] See, A.R., pp. 3144-3145. In her trial testimony, Ms. Whitney stated that she estimated that 18-20% of the Division's workload in 2003-2004 involved doing environmental review. This testimony highlights the shifting and unreliable nature of the Board's estimates.

regulatory activities related to non-fee paying rights holders. Indeed, absent any evidence that could quantify the amount of such activities as a proportion of the Division's total regulatory activities, it would not be possible to make any such showing.

The Court accordingly finds that the evidence establishes that the statutory scheme and its implementing regulations do not provide a fair, reasonable, and substantially proportionate assessment of all costs related to the regulation of affected payors. The evidence does not establish that the associated costs of the Water Rights Division's regulatory activity were reasonably related to the fees assessed on the payors. (See, *Sinclair Paint*, *supra*, 15 Cal. 4th at 870.) Instead, the statutory scheme and its implementing regulations improperly require the permit and license holders to pay more than a de minimis amount for regulatory activities that benefit non-paying water right holders, or that result from burdens non-paying water right holders place on the Water Rights Division. The fees petitioners pay also pay more than a de minimis amount for activities that benefit the public in general. The fees accordingly must be invalidated.

The fees are invalid for another reason as well. As shown by the Supreme Court's decision, the issue of whether the fees represent a fair, reasonable and substantially proportionate assessment of all costs related to the regulation of affected payors is a relevant factor the Board was required to consider in establishing the fee regulations. There is no evidence in the administrative record, however, that the Board considered this

factor prior to enacting the regulations.[36] Instead, the Board apparently simply determined that it would impose the entire cost of operating the Water Rights Division on permit and license holders, solely because the fee statutes only authorized fees to be charged to permit and license holders.[37] Because there is no evidence that the Board considered the relevant factor of proportional allotment in enacting the fee regulations, the Court finds that the Board acted in an arbitrary manner and therefore abused its discretion. (See, *Home Builders Association of Tulare/Kings Counties, Inc. v. City of Lemoore*, *supra*, 185 Cal. App. 4th at 561.) The fee regulations must be invalidated on this basis alone.

In its objections to the Proposed Statement of Decision, the Board argued that the fee regulations

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[36] See, for example, A.R., p. 1 (Water Right Fee Program Summary and Recommended Fee Schedule – Document Transmitted to Harry Schuller on 9/29/03); A.R., p. 781 (Memorandum from Division Chief Victoria Whitney to "File" dated December 29, 2003 re: Water Right Fee Program Summary and Recommended Fee Schedule for Fiscal Year 2003-2004). Neither document addresses the issue.

[37] See, testimony of Division Chief Whitney, Trial Transcript, p. 783:9-13: "Q. All right. So why did you recommend that the Board adopt a fee approach based on permit holders? A. Because the statute contains a section that specifies what kind of things we can assess fees for and it specified annual fees for permits and licenses." The other Board witnesses who testified at trial, John O'Hagan and William Damian, said nothing that would establish that the Board considered the proportionality issue in establishing the fees.

should be upheld based on the so-called "polluter pays" rationale.

As the Court of Appeal pointed out in its opinion in this case, the "polluter pays" rationale derives from the case of *San Diego Gas & Electric Co. v. San Diego County Air Pollution Control District* (1988) 203 Cal. App. 3rd 1132. In the proceedings before the Court of Appeal, the Board argued that this rationale supported the challenged fee regulations, because " . . . the purpose for the [Water Rights] 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."[38] The Court of Appeal found that the Board 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, or of the actual cost of Division services provided to the Bureau of Reclamation, which holds 22 percent of the water subject to water rights. The Court commented: "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."[39]

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[38] See, *California Farm Bureau Federation v. State Water Resources Control Board*, *supra*, 146 Cal. App. 4th 1126, 1154.

[39] *Id.*

The Supreme Court declined to address this issue, stating: "Because we remand, we need not address the SWRCB's contention that the 'polluter pays' rationale justifies the annual cost allocation because the money collected supports regulatory activities that serve an important public purpose and are a valid exercise of the police power."[40]

This Court concludes that the Board may not rely on the "polluter pays" rationale to justify the challenged fees. The "polluter pays" rationale, as expressed in the *San Diego Gas & Electric Co.* case, dealt with the allocation of emission-based fees for indirect costs of regulation among those already identified as fee payors (in that case, the "polluters").[41] As the Court of Appeal concluded in this case, it does not deal with or justify the allocation of fees solely to one group of potential payors, where those not subject to the fees also benefit from, and place burdens on, the activities of the regulating agency charging the fees. Here, where this Court has concluded that the challenged fee regulations do not represent a valid allocation of fees among actual and potential payors, the Court further concludes that the "polluter pays" rationale does not apply, and does not justify the challenged fees.

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[40] See, *California Farm Bureau*, *supra*, 51 Cal. 4th at 442, footnote 26.

[41] See, *San Diego Gas & Electric Co. v. San Diego County Air Pollution Control District*, *supra*, 203 Cal. App. 3rd at 1142, where the Court of Appeal stated that its opinion addressed " . . . the methods by which a district may allocate program costs between permit holders."

C. Validity of Fees Assessed to Central Valley Project Contractors

In the *California Farm Bureau* opinion, the Supreme Court described the manner in which the fee regulations at issue assessed fees on the Central Valley Project's federal contractors:

> Regulation 1073, which implemented the provisions of Water Code sections 1540 and 1560, addressed rights held by the Bureau of Reclamation, but contracted out to federal contractors. Regulation 1073, subdivision (b)(2) applies a formula to calculate the annual fee imposed on those contractors "[i]f the [Bureau of Reclamation] declines or is likely to decline to pay the fee or expense . . . for the [Central Valley Project]." In general, regulation 1073 assesses annual fees against contractors based on a prorated portion of the total amount of annual fees associated with all Bureau permits and licenses, rather than the portion available under the terms of their contracts. [. . .] Under regulation 1073, the SWRCB assessed annual costs against the federal contractors, prorating among them the amount of annual fees associated with *all* of the Bureau of Reclamation's permits and licenses – over 116 million acre-feet. However, while the Bureau holds all the permits and licenses, the contractors have contractual rights for water delivery over only 6.6 million

> acre-feet or about 5 percent of all rights held by the Bureau.[42]

The Supreme Court's description of how the regulation operated with regard to the Central Valley Project contractors is not disputed by the parties and is in accord with the evidence presented to this court in the administrative record and at trial. In effect, the Board required the contractors to pay fees for the entire amount of the Bureau of Reclamation's permits and licenses (116 million acre-feet), dividing the fees among the contractors based on each contractor's percentage share of the 6.6 million acre feet to which the contractors as a group held contractual rights.

As the Supreme Court held in the *California Farm Bureau* decision, this method of assessment may be valid only if it represents a fair assessment of the contractors' actual beneficial interests in the Bureau's water rights, which include not just the water actually under contract, but also water not actually under contract for delivery that is fairly attributable to the delivery contracts themselves. The Supreme Court thus identified the actual value of the contractors' beneficial interests as a relevant factor that the Board was required to consider in adopting its fee regulations.

The Court has reviewed the evidence in the administrative record and the evidence introduced at trial, and finds no evidence whatsoever that the Board considered the beneficial interests of contractors, as

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[42] *Id.*, 51 Cal. 4th at 434 and 444.

defined by the Supreme Court, in adopting the fee regulations.

The regulations were adopted and filed as emergency regulations on December 23, 2003, and became operative on January 1, 2004. There is simply no documentation in the administrative record pre-dating the adoption of the regulations that demonstrates that the Board considered the beneficial interests of Central Valley Project contractors at all. All explanations of the fees put on record before enactment of the regulations simply described the manner in which the fees that otherwise would have been allocated to the Bureau of Reclamation for the total amount of its water rights would be passed through in their entirety to the Central Valley project contractors based on their percentage share of the contractors' total contractual allotments.[43]

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[43] See the following relevant documents in the administrative record, all of which explain the basis for the proposed fees, but contain no discussion or recognition of the concept of the contractors' beneficial interests: Water Right Fee Program Summary and Recommended Fee Schedule (A.R., pp. 1-28); Frequently Asked Questions Regarding Water Right Fees (A.R., pp. 79-82); Water Right Fee Proposal Power Point Presentation by Division Chief Victoria Whitney at October 27, 2003 and November 3, 2003 workshops (A.R., pp. 177-200); Agenda for SWRCB Meeting of December 15, 2004 (A.R., pp. 535-564); Economic and Fiscal Impact Statement (A.R., pp. 618-624); Memorandum from Division Chief Victoria Whitney to "File" dated December 29, 2003 re: "Water Right Fee Program Summary and Recommended Fee Schedule for Fiscal Year 2003-2004" (A.R., pp. 781-795); Transcripts of workshops regarding proposed fees held on October 27, 2003

Emblematic of the complete lack of evidence that the beneficial interests of contractors was ever considered is the following statement from a file memorandum prepared by Division Chief Whitney, dated December 29, 2003, " . . . to explain the basis for the regulations adopted by the SWRCB on December 15, 2003". The memo stated the following as the basis for assessing fees on Central Valley Project contractors:

> Staff recommended passing the USBR's fees on to its Central Valley Project contractors by prorating the fee or expense of the Central Valley Project among the contractors for the project based on either the contractor's entitlement under the contract or, if the contractor has a base supply under the contract, the contractor's supplemental supply entitlement.[44]

Nowhere in this memorandum is there any discussion of the Central Valley Project contractor's actual beneficial interests, or any attempt to value those interests.

Similarly, a letter Ms. Whitney sent to representatives of the U.S. Bureau of Reclamation, dated January 9, 2004, simply stated that the Board had "prorated the USBR's fees among its water supply contractors" without providing any explanation of the basis for such

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(A.R., pp. 3173-3238), November 3, 2003 (A.R., pp. 3240-3273), and December 15, 2003 (A.R., pp. 3275-3293).

[44] A.R., p. 787.

proration or any analysis of the contractors' beneficial interests.[45]

Ms. Whitney's testimony at trial further confirmed that no consideration was given to the actual beneficial interests of Central Valley Project contractors in determining how fees would be assessed on those entities. Notably, she testified that the Board does not use the term "beneficial interest".[46] When asked specifically whether the Board had segregated the beneficial interest of the federal contractors in the permits and licenses of the United States from the beneficial interest of the United States in those permits and licenses, she testified that she did not know what the term "beneficial interest" meant in that context, and therefore could not answer the question.[47] There could be no clearer indication that the actual beneficial interests of the contractors was never evaluated or even considered. Indeed, Ms. Whitney's testimony showed that an initial determination was made to pass 100% of the Bureau of Reclamation's fees through to the contractors based simply on the concept that the Central Valley Project was a water supply project, and that this initial determination never changed.[48]

John O'Hagan, formerly the manager of the Board's licensing section, also testified regarding the calculation of the fees for Central Valley Project

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[45] A.R., pp. 999-1000.

[46] See, Trial Transcript, p. 759:6-8.

[47] See, Trial Transcript, p. 883:10-21.

[48] See, Trial Transcript, pp. 810:3-10; 819:16-25.

contractors. Nothing in his testimony indicated that there was any consideration or determination of the contractors' beneficial interests.[49]

Similarly, there is no evidence in the administrative record or in the evidence admitted at trial that would indicate that the Board ever considered what amount of water not actually under contract for delivery to the Central Valley Project contractors was fairly attributable to the value of the delivery contracts themselves.

Because there is no evidence that the Board considered these relevant factors in enacting the fee regulations, the Court finds that the Board acted in an arbitrary manner and therefore abused its discretion. (See, *Home Builders Association of Tulare/Kings Counties, Inc. v. City of Lemoore*, *supra*, 185 Cal. App. 4th at 561.) The fee regulations must be invalidated on this basis alone.

At trial after remand, the Board attempted to demonstrate that the allocation of the Bureau of Reclamation's fees to Central Valley Project contractors was legitimate, essentially on the basis that all of the Bureau's water rights above the contract amounts (i.e., all of the water not actually under contract for delivery to the contractors) is fairly attributable to the value of the delivery contracts themselves. In effect, the Board attempted to save the regulatory "pass through" of the Bureau's fees to its contractors by showing that this

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[49] See, Trial Transcript, pp. 1145-1153.

"pass through" approach represented a reasonable evaluation of the contractors' beneficial interests even though the concept of beneficial interest had never been considered prior to adoption of the regulations.

The linchpin of the Board's attempt was the testimony of John Renning, a retired employee of the U.S. Bureau of Reclamation who testified as an expert witness for the Board regarding the operation and administration of the Central Valley Project. Mr. Renning described the Project as an "integrated operation", which means that it operates as an integrated whole, and that all parts of the project are operated to meet the common demands of the project. Those common demands include not only delivery of water to contractors, but also making water available for environmental protection purposes, such as satisfaction of Bay-Delta water quality standards and the allocation of water for environmental purposes under the Central Valley Project Improvement Act (referred to as "(b)(2) water"). Use of water for these environmental protection purposes has resulted in significant reductions in how much water may be delivered to contractors in certain years, depending upon hydrological conditions, because the water service contractors do not have first priority rights. Based on the multiple purposes the Central Valley Project serves, and the hierarchy of interests in which contractors are not in first position, Mr. Renning testified that water stored in all of the Central Valley Project's reservoirs meets all of the demands of the Project, not in the sense that " . . . all of the water is delivered for any one of those particular

uses, but [because] the operation of the CVP [as a] whole supports the delivery to each one of those uses. So you can say that the operation of the CVP as a whole is necessary to deliver the water that is indeed delivered to the CVP contractors."[50]

The concept of the Central Valley Project as an integrated project serving multiple uses, with contractors not in the highest priority, is not really disputed in this case.[51] But accepting this concept really only establishes that some amount of water not actually under contract may be fairly attributable to the value of the contractors' delivery contracts. It does not necessarily follow that 100% of the water not actually under contract should be so attributed. The Court notes that Mr. Renning also testified that he never had done an analysis of the contractors' beneficial or possessory interests in the Bureau's Central Valley Project permits.[52] Without any such analysis, his conclusion that all of the Bureau's water rights were necessary to support deliveries to contractors, and therefore represent the true value of the contractors' beneficial or possessory interests, lacks any convincing evidentiary basis. indeed, the Board has not presented any evidence that would permit the Court to determine the contractors'

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[50] See, Trial Transcript, pp. 1336-1365. The quoted portion of Mr. Renning's testimony appears on page 1365:3-8.

[51] See, for example, the testimony of Thomas Birmingham, counsel and general manager for the Westlands Water District, which is one of the Central Valley Project contractors, Trial Transcript, pp. 554-561; 574-585; 623-624.

[52] See, Trial Transcript, p. 1380.

beneficial interests and the value of those interests at any quantified level of water rights or water delivery.

The Court further notes that the Board's rationale supporting the allocation of fees to contractors, as expressed in Mr. Renning's testimony, lacks credibility. As discussed above, the Board made its determination to pass the Bureau's fees through to its contractors without any prior analysis or consideration of the beneficial interests of the contractors, apparently based solely on Division Chief Whitney's assumption that the Central Valley Project was a water supply project.[53] The "integrated project" rationale now offered to support that approach did not emerge until after the fee regulations had been enacted and challenged.[54] The

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[53] See, Trial Transcript, p. 819.

[54] The first version of this rationale that the Court has been able to identify appeared in the Board's Order Denying the Petition for Reconsideration of Northern California Water Association, dated April 7, 2004, three months after the regulations went into effect, and after the regulations had been challenged. In this Order the Board stated: "The amount of water that the Bureau can appropriate under its CVP water rights exceeds the amount that it actually delivers to its water supply contractors, just as the amount that a water right holder can appropriate exceeds the amount that it actually puts to beneficial use. The difference between the amount available under the water rights and the amount delivered under the contract is due to factors that include hydrological variation, the need to hold some water in storage for future dry years, conveyance and evaporation losses, and water releases to mitigate for project impact on fish and wildlife. These considerations do not decrease the amounts of water that are authorized to be diverted under the Bureau's CVP water rights, and do not decrease the proportionate share of those fees that may be passed through to CVP contractors based on a proration of those

current rationale thus appears to be little more than an attempt at *post hoc* validation of an arbitrary decision already made, rather than a description of the evidentiary basis on which the decision actually rests. The lack of convincing evidence to support the current rationale, specifically, the complete lack of any evidence that could support accurate quantification of the contractors' beneficial or possessory interests, reinforces this impression.

Finally, the Court notes that petitioners presented significant probative and persuasive evidence that the beneficial or possessory interests of the Central Valley Project contractors could not be valued at 100% of the Bureau's water rights for the Project. Petitioners convincingly demonstrated that the contractors in reality have no actual guaranteed right to delivery of any amount of water, regardless of the face amounts of their contracts, and that contractors frequently receive far less water than those face amounts.[55] Thus, even if the aggregate face amounts of the contractors' allocations could be taken as theoretically "standing in" for the entirety of the Bureau's rights, petitioners' evidence demonstrates that fees assessed on that theoretical equivalency bear no relationship to actual fact as

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fees among all water supply contractors with contracts for CVP water." (A.R., pp. 3063-3064.)

[55] See, testimony of Thomas Birmingham, including his expert opinion that water service contractors have no beneficial interests in the permits and licenses held by the Bureau of Reclamation for operation of the Central Valley Project, and have no possessory interest in water from the Project until it actually is delivered. (See, Trial Transcript, pp. 664-666.)

reflected in water deliveries. Indeed, assessment at the full amount of the contractors' facial contractual allotments, let alone assessment at the full amount of the Bureau's permits and licenses, would appear substantially to overassess any actual beneficial or possessory interests the contractors have, based on evidence of actual water deliveries.

Based on the administrative record and the evidence admitted at trial, the Court therefore finds that petitioners have established a prima facie case that the fee regulations as applied to Central Valley Project contractors are invalid because the regulations are not based on a fair evaluation of the contractors' beneficial or possessory interests. The Board has failed to refute that prima facie case by producing evidence that would permit the Court to determine that the contractors' beneficial or possessory interests, in the aggregate, are equal to the Bureau's total water rights, and that all water not actually under delivery to contractors is fairly attributable to the value of the delivery contracts themselves.

The Court therefore concludes that petitioners have demonstrated that the allocation of the Bureau's fees to Central Valley Project contractors is unconstitutional under the supremacy clause, because the allocation of fees is not limited to the contractors' beneficial or possessory use of the Bureau's water rights. (See, *California Farm Bureau Federation*, 51 Cal. 4th at 444; *United States v. County of Fresno* (1977) 429 U.S. 452, 462; *U.S. v. Nye County, Nevada*

(9th Cir. 1991) 938 F.2d 1040, 1042-1043; *U.S. v. Hawkins County, Tennessee* (6th Cir. 1988) 859 F.2d 20, 23.)

D. Arbitrary Operation of the Fee Regulations

In addition to the deficiencies discussed above, petitioners also established that, at least as to some payors, the fee regulations operate in an arbitrary manner as a result of the fact that fees are calculated strictly on the basis of the lace amount of water covered by permits and licenses.

Petitioners established this point through testimony and documentary evidence regarding the fees charged to the Imperial Irrigation District ("IID").[56] The evidence demonstrated that IID obtains water from the Colorado River and transports it through the All-American Canal for eventual delivery to its customers. IID's rights to take water from the Colorado River are regulated under federal law, under a body of law known as the "Law of the River", with little or no regulatory involvement by the Board. IID does have a permit from the Board for the water it takes from the Colorado River.[57] It also has six additional permits from the Board for the same water involving its use for hydroelectric power generation at various drop structures along the All-American Canal.[58] The Board charges IID a fee based on the face amount of all seven

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[56] Testimony at trial was presented by Jesse Silva, the Manager of the Water Department of IID.

[57] See, Trial Exhibit 1272.

[58] See, Trial Exhibits 1273-1278.

permits, even though all seven permits involve the same water originally diverted from the Colorado River. This resulted in a total fee to IID of over $770,000.

By contrast, petitioners demonstrated that a similarly situated agency, the California Department of Water Resources ("DWR"), is treated quite differently with regard to the water rights it holds for operation of the State Water Project. One of those water rights is a permit allowing DWR to divert and store water behind Oroville Dam, release that water from storage, and redivert the same water at 16 separate diversion facilities from Oroville to Perris Dam, in Riverside County. As the water travels southwards, it is used to generate power at nine separate power plants, which is quite similar to what IID does with the water in the All-American Canal. In DWR's case, however, the water is covered by a single permit, instead of seven separate permits as in the case of IID, and DWR is charged a fee only on the face amount of that single permit. This results in a fee of $41,807.[59]

The disparity between the two cases is obvious. It is clear that IID's fees are much greater than those charged to DWR largely because the former has separate permits and the latter does not. The Board offered no reasonable explanation for why the two agencies should be treated so differently, and indeed did not explain why IID had separate permits for power generation while DWR did not, or why separate permits

[59] See, Trial Exhibits 148, 229.

justified multiple charges for the same water.[60] Instead, the Board's briefing and evidence focused on demonstrating that the Water Rights Division expended some significant effort and resources on regulating matters related to IID's water rights. While that showing is certainly relevant to the issue of whether IID should be subject to fees at all, it does not establish any rational basis for assessing IID fees seven times for the same water.

The Court therefore concludes that petitioners have established that the fee regulations, as applied to IID, operate in an arbitrary and capricious manner, and are invalid on that basis.

E. Validity of $100 Minimum Fee

The evidence also demonstrated that the Board charged a minimum annual fee of $100 for the 2003-2004 fiscal year under Regulation 1066(a). The Court of Appeal's decision stated that even though the Board 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."[61] The Supreme Court's decision did not explicitly address the issue of the $100 minimum fee.

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[60] In their post-trial brief, petitioners describe IID's case as being the result of " . . . perhaps an historical quirk in the way the SWRCB used to issue permits . . . ".(See, Petitioners' Closing Trial Brief, p. 30:16-17.)

[61] See, *California Farm Bureau Federation v. State Water Resources Control Board*, *supra*, 146 Cal. App. 4th at 1154.

At trial, petitioners did not present specific evidence regarding the $100 minimum fee, or present argument specifically challenging that fee.[62] The issue of whether a $100 minimum fee for fee payors with relatively small amounts of water rights represents a reasonable estimate of the cost of billing the fees is distinct from the issue of whether the fees, in general, were appropriately allocated to the actual payors. Petitiners' [sic] evidence and argument at trial did not address the issue of whether the $100 minimum fee was reasonable. The Court accordingly finds that petitioners have not established that a $100 minimum fee is invalid. The judgment entered in this case shall specifically provide that the Court has not found a $100 minimum fee to be invalid.

V. Conclusion

Based on the findings set forth above. the Court finds that petitioners are entitled to a declaratory judgment that the annual fees based on the challenged 2003-2004 fiscal year regulations are invalid.

The Court finds that issuance of a writ of mandate and injunction directing the Board not to apply or enforce the 2003-2004 fiscal year regulations or collect annual fees under those regulations is unnecessary, because those regulations are no longer in effect in exactly the form they were during that fiscal year. The

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[62] Indeed, petitioners' counsel stated at trial: "The hundred dollar fee is no longer an issue in this case. It's been decided by the Supreme Court." (See, Trial Transcript, page 1050:12-14.)

Board has amended the regulations in subsequent years, and the content and effect of those regulations, i.e., whether the amended regulations are substantively and materially different from those involved in this case, was not addressed at trial. Instead, fee regulations promulgated and in effect in years subsequent to the 2003-2004 fiscal year are the subject of separate actions for each year, all of which have been stayed by stipulation of the parties pending final resolution of this case. Therefore, no relief should be ordered in this case with regard to fee regulations in effect in subsequent years. Those fee regulations should be addressed in the context of the currently-stayed actions focusing on those subsequent years.

At the hearing on the Proposed Statement of Decision, the Court asked the parties to address the issue of additional remedies potentially flowing from the Court's ruling, including the possibility of ordering refunds of fees paid by some or all individual petitioners for the 2003-2004 fiscal year. The parties agreed on the record that they had stipulated in 2004 (before the first hearing in this matter) that the issue of remedies, including the availability of full or partial refunds for individual petitioners, would be deferred until final determination of the issue of the validity of the 2003-2004 fee regulations, including all appeals. In accordance with that stipulation, the Court's judgment will not include any provision regarding refunds, but shall provide that any proceedings regarding refunds for the 2003-2004 fiscal year, including any necessary administrative proceedings regarding such refunds, will

take place after the judgment in this case becomes final.

Counsel for petitioners is directed to prepare a judgment consistent with this Final Statement of Decision, submit it to opposing counsel for approval as to form in accordance with Rule of Court 3.1312(a); and thereafter submit the judgment to the Court for signature and entry in accordance with Rule of Court 3.1312(b).

Date: November 12, 2013

[SEAL] /s/ Raymond M. Cadei

Honorable Raymond M. Cadei
Judge of the Superior Court of
California, County of Sacramento

[Certificate Of Service By Mailing Omitted]

Filed 1/31/11

IN THE SUPREME COURT OF CALIFORNIA

CALIFORNIA FARM BUREAU FEDERATION et al. Plaintiffs and Appellants, v. STATE WATER RESOURCES CONTROL BOARD, Defendant and Respondent.	S150518 Ct.App. 3 C050289 Sacramento County Super. Ct. Nos. 03CS1776 & 04CS00473

The California Constitution provides that any act to increase taxes must be passed by a two-thirds vote of the Legislature.[1] On the other hand, statutes that create or raise regulatory fees need only the assent of a simple majority.[2] In 2003, the Legislature passed amendments to the Water Code[3] by a 53 percent majority. Current section 1525 was enacted as part of these amendments. The threshold issue here is whether section 1525, subdivision (a) imposes a tax or a fee. We hold that the amendments and section 1525

[1] California Constitution, article XIII A, section 3, originally approved by initiative as Proposition 13, sometimes referred to as the "People's Initiative to Limit Property Taxation," on June 6, 1978.

[2] On November 2, 2010, the voters approved Proposition 26, which requires a two-thirds supermajority vote of the Legislature to pass certain fees. None of the parties have asserted that the law enacted by Proposition 26 applies to this case.

[3] Hereafter, undesignated statutory references are to the Water Code.

do not explicitly impose a tax and, therefore, are not facially unconstitutional. However, because the record is unclear as to whether the fees were reasonably apportioned in terms of the regulatory activity's costs and the fees assessed, we direct the Court of Appeal to remand the matter to the trial court to make these findings.

A second issue is whether the Water Code amendments, or their implementing regulations, violate the supremacy clause of the United States Constitution by over-assessing the beneficial interests of those who hold contractual rights to delivery of water from the federally administered Central Valley Project (hereafter, the federal contractors). We conclude that the statutes are not facially unconstitutional. We further determine that the constitutionality of the implementing regulations depends on whether they fairly assess and apportion the federal contractors' beneficial interests. However, because of conflicting factual assertions and an unclear record concerning the extent and value of those interests, we also direct remand to the trial court for findings on this issue.

I. FACTUAL AND PROCEDURAL BACKGROUND[4]

The State Water Resources Control Board (SWRCB or Board) is responsible for the "orderly and efficient administration of . . . water resources" and exercises

[4] The factual and procedural background is largely adopted from the Court of Appeal opinion.

"adjudicatory and regulatory functions of the state." (§ 174.) The water in California belongs to the people, but the right to *use* water may be acquired as provided by law. (§§ 102, 1201.) The SWRCB's Division of Water Rights (Water Rights Division or Division)[5] administers the water rights program, but its authority is limited. The SWRCB regulates all appropriative water rights acquired since 1914. An appropriative right is the right to take water from a watercourse that does not run adjacent to a landowner's property. Since 1914, all appropriative rights have been acquired through a system of permits and licenses[6] that the SWRCB or its predecessor state entities have issued. Before 1914,

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[5] The Division consists of three sections: permitting, licensing, and hearings and special projects. As noted by the Court of Appeal, "[t]he 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 [*sic.*]. . . .' 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. . . ." Although the SWRCB has other divisions in its organization, we are concerned only with the Water Rights Division.

[6] Anyone seeking to obtain an appropriative water right files an application with the SWRCB (§ 1225 et seq.), which issues a water right permit. (§ 1380 et seq.) Beneficial use of water perfected under this post-1914 statutory scheme is confirmed by a license issued by the SWRCB. (§§ 1605, 1610.) The license is, in effect, a title or deed to the water right and is recorded in the county in which the diversion takes place. (§ 1650.)

appropriative rights were acquired under common law principles or earlier statutes. The Water Rights Division has no permitting or licensing authority over riparian[7] or pueblo[8] rights, or over appropriative rights acquired before 1914. The SWRCB does have authority to prevent illegal diversions and to prevent waste or unreasonable use of water, regardless of the basis under which the right is held. (§ 275.) Riparian, pueblo, and pre-1914 appropriative rights account for 38 percent of currently held water rights.

Rights regulated under SWRCB licenses and permits include about 40 percent of state water subject to water rights. The federal government holds the remaining 22 percent of water rights. The United States Bureau of Reclamation (Bureau of Reclamation or Bureau) holds the permits and licenses to, and operates, the Central Valley Project (CVP or Project.) The Project diverts and stores water from numerous sources.[9]

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[7] 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 land. (*People v. Shirokow* (1980) 26 Cal.3d 301, 307 (*Shirokow*).) A riparian owner must share the right to use water with other riparian owners. (See *Harris v. Harrison* (1892) 93 Cal. 676, 681.)

[8] "The pueblo water right—a distinctive feature of California water law—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 Cal. Law of Water Rights (1956) p. 256.)

[9] "In 1933, primarily to control flooding in the Central Valley, the California Legislature approved the Central Valley Project (CVP), which is the nation's largest water reclamation project and California's largest water supplier. [Citation.] Originally a state

The Bureau contracts out the responsibility to control, distribute, and use water under the permits it holds. However, these federal contracts involve use of less than 6 percent of the water over which the Bureau holds rights. The remaining water is diverted and stored by the Bureau for hydroelectric, wildlife and other purposes.

Historically, the operation of the Water Rights Division was supported by the state's general fund (General Fund), with only 0.5 percent of costs covered by fees. In 2003, the Legislative Analyst recommended that the Division's operating costs be shifted from the General Fund and covered instead by user fees imposed on permit and license holders.[10] The SWRCB strongly opposed the recommendation. The SWRCB pointed out that its authority to impose fees did not extend to those holding water rights that were not based on its permits and licenses. While riparian, pueblo, and pre-1914 rights (collectively, RPP rights) are protected by conditions in new (post-1914) permits and through the Water Rights Division's enforcement of activity, the Division did not have authority to

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project, the CVP was turned over to the federal Bureau of Reclamation, which operates the CVP under rights granted by the SWRCB." (*In re Bay-Delta etc.* (2008) 43 Cal.4th 1143, 1154, fn. omitted.) To achieve its purposes, "[t]he CVP operates 21 reservoirs, 11 power plants, and 500 miles of major canals and aqueducts." (*Id.* at p. 1154, fn. 1.)

[10] The proposal called for General Fund support for the first half of the 2003-2004 fiscal year with fee increases covering the second half of the year. Thereafter, total Water Rights Division operations would be fee supported.

impose fees on those RPP rights holders. As noted, the RPP holders comprise 38 percent of water rights holders in California. The SWRCB argued that while permit and license holders should pay their share, proportional fees on them could not cover the total cost of the Division's operation. Additionally, as explained in greater detail below, the federal Bureau of Reclamation and Indian tribes resist paying fees, relying on the principle of sovereign immunity.

These difficulties notwithstanding, the Legislature adopted the Legislative Analyst's recommendation and passed Senate Bill No. 1049 (2003-2004 Reg. Sess.), repealing certain sections of the Water Code and enacting sections 1525-1560. Together, these statutes are designed to make the Water Rights Division entirely fee supported.

A. The Fee Legislation

We begin with a summary of the relevant statutes.

Section 1525

Section 1525 sets forth the parties and entities subject to the new fees.[11] Section 1525, subdivision (a)

[11] In relevant part, section 1525 provides:

"(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

requires the SWRCB to adopt a schedule of *annual fees* to be paid by each permit or license holder. This group does not include riparian, pueblo, or pre-1914 rights holders. Subdivision (b) of section 1525 requires the SWRCB to establish the schedule for a *one-time application fee* for permits to appropriate water, for approval of leases, and for petitions relating to those applications.

Section 1525, subdivision (c) provides that the SWRCB "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" of the Division's activities. Subdivision (c) sets out "recoverable costs" in substantial detail but the costs recoverable are "not limited to" those activities identified. (§ 1525, subd. (c).) Subdivision (d)(3)

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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 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."

similarly requires the SWRCB to "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." (§ 1525, subd. (d)(3).)

In other words, the statute requires that the total budgeted cost of the Division's operations be recovered from the fees. The SWRCB is to review and revise the fees each year as necessary, to ensure they conform with the revenue levels set in the annual budget act (Budget Act). If the revenue collected during the preceding year is either greater or less than the revenue levels set forth in the Budget Act, the SWRCB may adjust the annual fees to compensate for the disparity. (§ 1525, subd. (d)(3).) The SWRCB is also authorized to adopt "emergency regulations" to implement the fee schedule. (§ 1525, subd. (d)(1).)

Section 1537

Section 1537 generally covers collection. While the Board sets the fees, the money is actually collected by the Board of Equalization (BOE). The BOE collects and refunds annual fees collected under the Fee Collection Procedures Law, part of the Revenue and Taxation Code, as limited by subdivision (b)(2) through (4) of section 1537. The BOE has no role in reviewing refund claims under section 1537 or the emergency regulations.

Sections 1540 and 1560

Section 1540 concerns the allocation of annual fees to federal contractors. Section 1560 sets out the options that may be pursued when the federal Bureau of Reclamation or an Indian tribe declines to pay a fee by relying on sovereign immunity.[12] As relevant here, the

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[12] 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 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."

Section 1560 provides:

"(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

federal government and Indian tribes are the entities eligible to assert sovereign immunity.

Sections 1550, 1551, and 1552

Sections 1550 and 1551 establish the Water Rights Fund, into which the BOE must deposit fees collected on behalf of the SWRCB. The Water Rights Fund is separate from the General Fund. Money in the Water Rights Fund may be used only for purposes set out in section 1552, which includes SWRCB expenditures necessary to carry out the work of the Water Rights Division, BOE expenditures in connection with collecting the SWRCB fees, and the payment of refunds. (§ 1552.)

B. The Emergency Regulations

To implement section 1525's fee requirement, the SWRCB adopted California Code of Regulations, title 23, sections 1066 and 1073 (regulation 1066 and regulation 1073). These regulations set formulas to calculate annual fees for permit and license holders, and for the federal contractors. Fees for issuance, supervision, and modification of permits and licenses, i.e., the

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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."

revenue-producing activities now required to cover the entire cost of the Division's operations, were to be paid by the permit and license holders regulated by the SWRCB. No money would come from the General Fund. The Court of Appeal explained the difficulty the SWRCB had in setting the fees: "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. 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,[13] 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 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."

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[13] 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) p. 75.)

C. Annual Fee Formula for Post-1914 Permit and License Holders

Regulation 1066 applies to post-1914 permit and license holders. Regulation 1066, subdivision (a)[14] set the minimum annual fee as the greater of $100, or $.03 for each acre-foot based on the total annual amount of diversion authorized by the permit or license.

To determine the annual fees, the Board started with the $4.4 million budget amount and assumed it would be unable to collect 40 percent of billings from water right holders who claimed sovereign immunity or who 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. This increased its targeted revenue to approximately $7 million.

D. Annual Fee Formula for Federal Contractors

Regulation 1073, which implemented the provisions of Water Code sections 1540 and 1560, addressed rights held by the Bureau of Reclamation, but contracted out to federal contractors. Regulation 1073, subdivision (b)(2) applied a formula to calculate the annual fee imposed on those contractors "[i]f the

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[14] Regulation 1066, subdivision (a) provided: "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).)

[Bureau of Reclamation] decline[d] or [was] likely to decline to pay the fee or expense . . . for the [Central Valley Project]." In general, regulation 1073 assessed annual fees against contractors based on a prorated portion of the total amount of annual fees associated with all Bureau permits and licenses, rather than the portion available under the terms of their contracts.

E. Proceedings Below

In January 2004, the BOE sent fee notices to the section 1525 permit and license holders and to the federal contractors. The Budget Act set a target of $4.4 million in fee revenue because the balance for the first half of 2003-2004 was paid from General Fund revenue. $7.4 million in water rights fees was collected for fiscal year 2003-2004. The imposition of water rights fees was challenged by several groups of plaintiffs representing various water rights holders.[15]

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[15] Plaintiff California Farm Bureau Federation (Farm Bureau) asserts it is 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 (2003-2004 Reg. Sess.) and the emergency regulations. The individuals named in its complaint hold water rights and have been assessed the section 1525 fees. Plaintiff Northern California Water Association represents over 70 agricultural water districts within the Sacramento River Basin, some of which hold water rights. Other members receive water under contracts with the Bureau of Reclamation, and others operate hydroelectric plants licensed or regulated by the Federal Energy Regulatory Commission.

Plaintiff Central Valley Water Project Association represents the interests of some 300 agricultural and municipal districts, agencies and communities within the Central and Santa Clara

Plaintiffs sought declaratory and injunctive relief and a writ of mandate. They alleged that the statutory scheme adopted by the Legislature and the emergency regulations adopted to implement the scheme were unconstitutional both on their face and as applied. The trial court denied the writ of mandate, ruling that the money collected constituted valid regulatory fees, rather than taxes. It also rejected plaintiffs' other constitutional claims.

The Court of Appeal reversed in part, holding that section 1525 was constitutional on its face, but that "as applied" under the emergency regulations, it imposed illegal levies. It remanded the matter to the trial court with instructions that it "(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

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Valleys that have contracts for water from the Central Valley Project.

filed timely petitions for reconsideration with the SWRCB. . . ."[16]

II. DISCUSSION

A. Standard of Review

Whether section 1525 imposes a tax or a fee is a question of law decided upon an independent review of the record. (*Sinclair Paint Co. v. State Bd. of Equalization* (1997) 15 Cal.4th 866, 874 (*Sinclair Paint*).)

The plaintiff challenging a fee bears the burden of proof to establish a prima facie case showing that the fee is invalid. (See *Sea & Sage Audubon Society, Inc. v. Planning Com.* (1983) 34 Cal.3d 412, 421; *Sargent Fletcher, Inc. v. Able Corp.* (2003) 110 Cal.App.4th 1658, 1668 (*Sargent Fletcher*).) In other words, the plaintiff bears the burden of proof[17] "with respect to all facts essential to its claim for relief." (*Home Builders Assn. of Tulare/Kings Counties, Inc. v. City of Lemoore* (2010) 185 Cal.App.4th 554, 562; see Evid. Code, § 500.) The plaintiff "must present evidence sufficient to establish in the mind of the trier of fact or the court a requisite degree of belief (commonly proof by a preponderance of the evidence). [Citation.] The burden of proof *does not shift* . . . it remains with the party who originally bears

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[16] The terms "payor" and "payer" are synonymous and are used variably in case law.

[17] The terms "burden of proof" and "burden of persuasion" are synonymous. (1 Witkin, Cal. Evidence (4th ed. 2000) Burden of Proof and Presumptions, § 3, p. 157.)

it." (*Sargent Fletcher*, *supra*, 110 Cal.App.4th at p. 1667, original italics.)

This burden of persuasion is different from the "burden of producing evidence" (see Evid. Code, § 110), which may shift between the parties.[18] "[T]he burden of producing evidence as to a particular fact rests on the party with the burden of proof as to that fact. [Citations.] If that party fails to produce sufficient evidence to make a prima facie case, it risks nonsuit or other unfavorable determination. [Citations.] But once that party produces evidence sufficient to make its prima facie case, the burden of producing evidence *shifts* to the other party to refute the prima facie case." (*Sargent Fletcher*, *supra*, 110 Cal.App.4th at pp. 1667-1668, original italics.)

Thus, once plaintiffs have made their prima facie case, the state bears the burden of production and 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 Paint*, *supra*, 15 Cal.4th at p. 878; see *California Assn. of Prof. Scientists v. Department of Fish & Game* (2000) 79 Cal.App.4th 935, 945 (*Prof. Scientists*).)

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[18] The "burden of producing evidence" has also been referred to as the "burden of production" and the "burden of going forward." (*Sargent Fletcher*, *supra*, 110 Cal.App.4th at p. 1667.)

B. Valid Fee or Invalid Tax?

Facial challenge

Plaintiff Farm Bureau contends that section 1525's annual fee requirement is unconstitutional on its face because it imposes a tax, not a valid regulatory fee.[19] We reject this contention.

California Constitution, article XIII A, section 3 requires that "any changes in state taxes enacted for the purpose of increasing revenues" be approved by a two-thirds majority of the Legislature. Senate Bill No. 1049 (2003-2004 Reg. Sess.) passed the Legislature with only a 53 percent majority. Thus, if the amount charged under section 1525 is a tax, it is invalid. If it is a regulatory fee, it is not subject to the supermajority requirement.

We have recognized that " 'tax' has no fixed meaning, and that the distinction between taxes and fees is frequently 'blurred,' taking on different meanings in different contexts. [Citations.]" (*Sinclair Paint*, *supra*, 15 Cal.4th at p. 874.) Ordinarily taxes are imposed for revenue purposes and not "in return for a specific benefit conferred or privilege granted. [Citations.] Most taxes are compulsory rather than imposed in response to a voluntary decision to develop or to seek other government benefits or privileges. [Citations.] But compulsory fees may be deemed legitimate fees rather than taxes. [Citation.]" (*Ibid.*)

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[19] Plaintiffs do not challenge the one-time fees set forth in section 1525, subdivision (b).

In contrast, a fee may be charged by a government entity so long as it does not exceed the reasonable cost of providing services necessary to regulate the activity for which the fee is charged. A valid fee may not be imposed for unrelated revenue purposes. (*Sinclair Paint*, *supra*, 15 Cal.4th at p. 876; *Pennell v. City of San Jose* (1986) 42 Cal.3d 365, 375.)[20]

The scope of a regulatory fee is somewhat flexible and is related to the overall purposes of the regulatory governmental action. "'A regulatory fee may be imposed under the police power when the fee constitutes an amount necessary to carry out the purposes and provisions of the regulation.' [Citation.] 'Such costs . . . include all those incident to the issuance of the license or permit, investigation, inspection, administration, maintenance of a system of supervision and enforcement.' [Citation.] Regulatory fees are valid despite the absence of any perceived 'benefit' accruing to the fee payers. [Citation.] Legislators 'need only apply sound judgment and consider "probabilities according to the best honest viewpoint of informed officials" in determining the amount of the regulatory fee.' [Citation.]" (*Prof. Scientists*, *supra*, 79 Cal.App.4th at p. 945.) "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.) A regulatory fee does not become a tax simply because the fee may be disproportionate to

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[20] This case does not involve a special assessment or a development fee, two types of fees that are routinely challenged under Proposition 13. (*Prof. Scientists*, *supra*, 79 Cal.App.4th at p. 944.)

the service rendered to individual payors. (*Brydon v. East Bay Mun. Utility Dist.* (1994) 24 Cal.App.4th 178, 194.) The question of proportionality is not measured on an individual basis. Rather, it is measured collectively, considering all rate payors. (*Prof. Scientists*, *supra*, 79 Cal.App.4th at p. 948.)

Thus, permissible fees must be related to the overall cost of the governmental regulation. They need not be finely calibrated to the precise benefit each individual fee payor might derive. What a fee cannot do is exceed the reasonable cost of regulation with the generated surplus used for general revenue collection. An excessive fee that is used to generate general revenue becomes a tax.

Reference to the statutory language reveals a specific intention to avoid imposition of a tax. By its terms, section 1525 permits the imposition of fees only for the costs of the functions or activities described, and not for general revenue purposes. Section 1525, subdivision (c) carefully sets out that the fees imposed shall relate to costs linked to issuing, monitoring, enforcing and administering licenses and permits, and lists the recoverable costs in some detail. Section 1551 directs that the fees collected be deposited in the Water Rights Fund, not in the General Fund. Section 1552 describes the purposes for which the money in the Water Rights Fund may be expended.[21] Although the fees set forth in

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[21] Section 1552 provides:

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

section 1551 come from various sources, including some that do not involve the services described in section 1525,[22] it cannot be argued that the fees are excessive just because sections 1551 and 1552 list a variety of revenues to be deposited in the Water Rights Fund.

"(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.

"(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."

[22] 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).

"(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."

Section 1552 does not describe how the various revenues deposited in the Water Rights Fund should be allocated. However, no statutory language precludes the segregation and application of collected fees to fund services described in that section.[23]

Section 1525 does not require the SWRCB to collect anything more than the administrative "costs incurred" in carrying out the functions authorized in its subdivisions (a), (b) and (c). Also, section 1525, 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 Division's administration of the provisions of subdivisions (a) and (b). Similarly, section 1525, subdivision (d)(3) requires the SWRCB to "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*." (Italics added.) Although the "activity" subject to fees under this section could represent all of the Division's activities, the Court of Appeal correctly noted, "[T]here 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)." Also, there is a safeguard in subdivision (d)(3)

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[23] The Court of Appeal referred to the situation as "an accounting issue that concerns how the monies are treated within the Water Rights Fund."

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. . . ." (§ 1525, subd. (d)(3).) Thus, the fees charged under section 1525 are linked to the activities the Division performs.

"As applied" challenge

Plaintiffs also contend section 1525 is unconstitutional as applied through the fee schedule in regulation 1066 because the fees are so disproportionate that they are unreasonable. Central to the resolution of this issue is an understanding of the extent and costs of the Division's regulatory "activity." (§ 1525, subd. (d)(3).) The parties diverge in their approach.

As noted, on its face the statutory scheme appears simply to permit the recovery of costs the SWRCB incurs in annual supervision of water usage and the processing of applications for new or modified rights. However, plaintiffs argue the following: (1) While the Division engages in a variety of activities that benefit all water rights holders, and the general public, it is only authorized to impose fees on 40 percent of rights holders. (2) Because the statutory scheme requires that 100 percent of the Division's annual budget must be recovered through fees, the result is that 40 percent of rights holders are charged for the entire cost of operations that benefit all rights holders and the public at large. This disparity is brought to bear not on the face of the statutes, but in the regulations authorizing

fee collection. Plaintiffs claim the regulations impose unreasonable fees because they are so disproportionate to the benefit derived by the fee payors or the burden they place on the regulatory system. (See *Sinclair Paint*, *supra*, 15 Cal.4th at p. 878.) Therefore, plaintiffs contend the fees operate as a tax and are unconstitutional because the authority for their imposition was not approved by a two-thirds vote of the Legislature.

On the other hand, the SWRCB claims that the fees are proportional and that plaintiffs' focus on the benefits of the regulatory program is misplaced. It argues that the broad benefits of the program must be distinguished from its costs. The Board contends that it can allocate the majority of its regulatory costs to persons subject to the water rights permit and license system because its costs flow primarily from the administration of that permit and license system. It acknowledges that the benefits that result from the regulation of permits and licenses may be characterized as benefits not only to permit and license holders, but also to the general public, and other water rights holders not subject to its fee system. But, the Board argues, that does not alter the fact that its costs are largely due to its oversight and administration of the permit and license system and not the regulation of the public or other water rights holders. The Board claims that some 95 percent of its time and expense are directed toward servicing and regulating those licensees and permittees against whom the challenged fees were assessed. As we explain below, however, the trial court made no findings on this claim.

In weighing these arguments, we look to our decision in *Sinclair Paint*, *supra*, 15 Cal.4th at page 866. There, the plaintiff challenged the fee in question on the basis that the fee was not regulatory in nature, but rather was aimed at raising revenue.[24] We acknowledged that "the term 'special taxes' . . . '"does not embrace fees charged in connection with regulatory activities which fees do not exceed the reasonable cost of providing services necessary to the activity for which the fee is charged and which are not levied for unrelated revenue purposes." [Citations.]'" (*Sinclair Paint*, *supra*, 15 Cal.4th at p. 876.) We held that the fee in question was a regulatory fee and not a tax because it was "imposed . . . to mitigate the actual or anticipated adverse effects of the fee payers' operations." (*Id.* at p. 870.) Thus, in *Sinclair Paint*, to determine the tax or fee issue, we directed courts to examine the costs of the regulatory activity and determine if there was a reasonable relationship between the fees assessed and the costs of the regulatory activity. (*Id.* at pp. 870, 878.)[25]

Thus, the question revolves around the scope and the cost of the Division's regulatory activity and the relationship between those costs and the fees imposed.

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[24] The plaintiff also did not contend that the fees exceeded the reasonable cost of the services provided or that they were charged for unrelated revenue purposes. (*Sinclair Paint*, *supra*, 15 Cal.4th at p. 876.)

[25] On remand, we also allowed plaintiffs "to prove . . . that the amount of fees assessed and paid exceeded the reasonable cost of providing the . . . services for which the fees were charged, or that the fees were levied for unrelated revenue purposes." (*Sinclair Paint*, *supra*, 15 Cal.4th at p. 881.)

It is further complicated by the fact that not all those who hold water rights are required to pay the fee. Unfortunately, the record before us is insufficient to resolve the "tax or fee" question. The trial court's order lacks sufficient factual findings for us to determine whether the fees, as imposed, were reasonably proportional to the costs of the regulatory program. In fact, at the hearing on plaintiffs' motion for a peremptory writ of mandate, the trial court stated it did not believe it was required to make detailed findings.

We have previously noted that "[i]t has long been the general rule and understanding that 'an appeal reviews the correctness of a judgment as of the time of its rendition, upon a record of matters which were before the trial court for its consideration.' [Citation.] This rule reflects an 'essential distinction between the trial and the appellate court . . . that it is the province of the trial court to decide questions of fact and of the appellate court to decide questions of law. . . .' [Citation.] The rule promotes the orderly settling of factual questions and disputes in the trial court, provides a meaningful record for review, and serves to avoid prolonged delays on appeal." (*In re Zeth S.* (2003) 31 Cal.4th 396, 405.) Here, the trial court erred by failing to provide a sufficient record to rule on the question of law. Accordingly, this matter must be remanded. The trial court is directed to make detailed findings focusing on the Board's evidentiary showing that the associated costs of the regulatory activity were reasonably related to the fees assessed on the payors. (*Sinclair Paint*, *supra*, 15 Cal.4th at p. 870.) Of course, plaintiffs

are free to renew their claim that the fees assessed exceeded the reasonable cost of the Division's services. (*Id.* at p. 881.)[26]

The trial court's findings should include whether the fees are reasonably related to the total budgeted cost of the Division's "activity" (see § 1525, subd. (c)), keeping in mind that a government agency should be accorded some flexibility in calculating the amount and distribution of a regulatory fee. Focusing on the activity and its associated costs will allow the trial court to determine whether the assessed fees were reasonably proportional and thus not a tax. (*Sinclair Paint*, *supra*, 15 Cal.4th at p. 870.) The court must determine whether the statutory scheme and its implementing regulations provide a fair, reasonable, and substantially proportionate assessment of all costs related to the regulation of affected payors.

C. Federal Contractors

Plaintiffs Northern California Water Association and Central Valley Water Project Association contend that section 1525, subdivision (a), is unconstitutional because it improperly imposes an ad valorem tax on real property. This argument assumes that water rights are real property rights, and that the fee

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[26] Because we remand, we need not address the SWRCB's contention that the "polluter pays" rationale justifies the annual cost allocation because the money collected supports regulatory activities that serve an important public purpose and are a valid exercise of the police power.

imposed by section 1525 is based upon the ownership of real property. Because the assumption is faulty, the argument fails.

The water rights at issue are "usufructuary" only and do not confer a right of private ownership in a watercourse.[27] (*Shirokow*, *supra*, 26 Cal.3d at p. 307.) California's water is owned by the people and the right to use water is prescribed by law. (§ 102.) We agree with the Court of Appeal that "[p]otentially 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." Appropriative riparian rights are incidental and appurtenant to the land upon which they are used. (*Fullerton v. State Water Resources Control Bd.* (1979) 90 Cal.App.3d 590, 598.) It is the right to *use* the water that gives rise to the fee. On its face, section 1525's scheme is not an ad valorem tax on a real property interest.

Facial challenge

These same plaintiffs also contend that sections 1540 and 1560 are unconstitutional on their face because they violate the supremacy clause of the United States Constitution. (See *McCulloch v. Maryland* (1819) 17 U.S. (4 Wheat.) 316, 425-437.) Under established principles of sovereign immunity, the federal

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[27] A "usufructuary" right is a right to use something, not to hold title to it. (12 Witkin, Summary of Cal. Law (10th ed. 2005) Real Property, § 917, pp. 1106-1107.)

government is immune from state taxation absent its consent. (See *Davis v. Michigan Dept. of Treasury* (1989) 489 U.S. 803, 812-813.)

Section 1540 provides in relevant part: "If the board determines that the person or entity on whom a fee or expense is imposed will not pay the fee . . . 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."

Section 1560 states that the fees imposed under section 1525 apply to the United States and Indian tribes "to the extent authorized under federal or tribal law." (§ 1560, subd. (a).) Also, section 1560, subdivision (b)(2) provides that the SWRCB should allocate the fees as provided in section 1540 should the United States or an Indian tribe refuse to pay them.

Thus, the plain language of section 1540 provides that if a federal or tribal obligee asserts sovereign immunity under section 1560, the SWRCB may allocate the fee, or a portion of the fee, to persons or entities that have water delivery contracts with the obligee. This practice is permitted under federal law when a private contractor's use of United States property may

be taxed.[28] But the allocation is limited to the extent the contractor has beneficial or possessory use of the property. (See *United States v. County of Fresno* (1977) 429 U.S. 452, 462 (*County of Fresno*); *United States v. Nye County Nevada* (9th Cir. 1991) 938 F.2d 1040, 1042-1043 (*Nye County*); *United States v. Hawkins County, Tennessee* (6th Cir. 1988) 859 F.2d 20, 23 (*Hawkins County*).)[29] We reject the contention that the statutory scheme imposes the fees on water rights of the United States and not the private contractors. Clearly, any attempt to impose fees on the federal government would be resisted on sovereign immunity grounds.

Accordingly, neither section 1540 nor section 1560 authorizes imposition of a fee that facially violates the supremacy clause or state and federal rights to equal protection and due process.

"As applied" challenge

We next address the implementing regulation. Under regulation 1073, the SWRCB assessed annual costs against the federal contractors, prorating among them the amount of annual fees associated with *all* the Bureau of Reclamation's permits and licenses—over

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[28] When conducting a supremacy clause analysis, federal courts do not distinguish between fees and taxes. (See *Novato Fire Protection Dist. v. United States* (9th Cir. 1999) 181 F.3d 1135, 1138-1139; *United States v. Anderson Cottonwood Irrigation Dist.* (N.D.Cal. 1937) 19 F.Supp. 740, 741.)

[29] Also, section 1560, subdivision (a) provides that the fees are only to be collected "to the extent authorized under federal or tribal law."

116 million acre-feet. However, while the Bureau holds all the permits and licenses, the contractors have contractual rights for water delivery over only 6.6 million acre-feet or about 5 percent of all rights held by the Bureau. The Court of Appeal held that regulation 1073 violated the supremacy clause because it required "the federal contractors to pay for the entire amount of annual fees that would otherwise be imposed on the Bureau."

To successfully defend a supremacy clause challenge to a tax on persons or entities that contract with the federal government, the taxing authority must segregate and tax only the beneficial or possessory interest in the property. (See *County of Fresno*, *supra*, 429 U.S. at p. 462; *Nye County*, *supra*, 938 F.2d at pp. 1042-1043; *Hawkins County*, *supra*, 859 F.2d at p. 23.) Thus, although the SWRCB has the authority to impose regulatory costs on the federal contractors, it can do so only to the extent of the contractors' interest.

Regulation 1073's formula required the federal contractors to pay for the entire amount of annual costs that would be imposed on the Bureau of Reclamation despite the fact that their contractual rights represented a small proportion of the whole. Plaintiffs claim that the result is a disproportionate assessment of fees, thereby making regulation 1073 unconstitutional under the supremacy clause.[30] (*County of Fresno*,

[30] We reject plaintiff Northern California Water Association's contention that because the federal government is immune from the fee under federal law there should be no fee imposed on the federal contractors. (*County of Fresno*, *supra*, 429 U.S. at p. 453.)

supra, 429 U.S. at p. 462.) They contend that the fees should be based on the amount of water they contracted to deliver.

The SWRCB counters that the imposition of the fee should not be limited to the amount of water actually deliverable under the federal contracts. The SWRCB argues that it correctly calculated the fees using the face value of the permitted and licensed water rights. The face value is the total annual amount of water diversion authorized by the federally held permit or license. The SWRCB argues that the amount of diversions authorized by the federally held permits and licenses generally exceeds the amount of the water delivery contracts. The difference between the amount available for diversion and the amount actually delivered is due to factors that include hydrological variation, the need to hold water in storage for future dry years, conveyance and evaporation losses, and water releases to mitigate for project impacts on fish and wildlife.

In addition, the SWRCB argues the following. The Bureau of Reclamation controls the CVP water under permits and licenses issued and regulated by the Water Rights Division. The water is held for two primary purposes: hydroelectric power generation and water

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Plaintiffs also argue that the annual fee is unconstitutional because the SWRCB failed to provide any evidence showing that this amount is reasonably related to the cost of the regulatory burden. This argument fails. The SWRCB presented evidence to the trial court in support of the amount charged for the annual fee.

supply. The SWRCB sought to apportion a fair share of the regulatory costs associated with these permits and licenses to those water users who benefit through their water delivery contracts with the Bureau. As a result, the SWRCB initially discounted the value of the permits and licenses by approximately 50 percent to account for hydroelectric power generation use, then allocated to the federal contractors a pro rata share of the regulatory costs to the remaining value of the Bureau's permits and licenses that related to water supply. Accordingly, the Board argues, these charges were reasonably calculated because they apportioned the Division's costs of administering the Bureau's permits and licenses, exclusive of those costs related to hydroelectric generation, to the federal contractors who benefited from the receipt of the water.

The SWRCB asserts that this is a fair apportionment of costs that withstands a supremacy clause challenge. It argues the federal contractors' beneficial interest is not properly valued by a simple calculation of the proportion of total CVP water the contractors are entitled to receive under their contracts. It claims that a fair determination of the federal contractors' beneficial interest must include consideration of the system that supports and ensures the delivery of the amount contracted, not just the amount of water contracted for delivery. Thus, the SWRCB proposes that the federal contractors have a taxable interest in the "face value" of the Bureau's water rights held under permits and licenses, less any amounts used for hydroelectric generation.

We agree with the SWRCB. However, again due to conflicting factual assertions and an inadequate record, we cannot determine how much of the total water in question is used to support the water delivered and can thus be allocated to the federal contractors' beneficial interest. Accordingly, we remand for the trial court to determine the contractors' beneficial interest and the value of that interest. The trial court shall make findings as to whether the Board has fairly evaluated the federal contractors' beneficial interest, such that water not actually under contract for delivery is fairly attributable to the value of the delivery contracts themselves.[31]

DISPOSITION

We affirm the Court of Appeal's judgment holding that the fee statutes at issue are facially constitutional. However, the Court of Appeal's judgment is reversed as to its determination that the statutes and their implementing regulations are unconstitutional as applied. We remand this matter for the Court of Appeal to remand to the trial court for proceedings consistent with this opinion.

CORRIGAN, J.

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[31] Because we reverse the Court of Appeal's judgment and remand this matter to the trial court so it can make findings and a determination as to whether the fees were improperly imposed, we need not address plaintiffs' claim that the Court of Appeal erred by limiting refunds.

WE CONCUR:

KENNARD, Acting C. J.
BAXTER, J.
WERDEGAR, J.
CHIN, J.
MORENO, J.
GEORGE, J.*

CONCURRING OPINION BY MORENO, J.

I concur in the majority opinion. I write separately to offer these additional reflections on the "as applied" challenge to the fee as a tax.

A charge that is labeled a regulatory fee may indeed be a tax in disguise if "the amount of fees assessed and paid exceeded the reasonable cost of providing the [regulatory] services for which the fees were charged, or [if] the fees were levied for unrelated revenue purposes." (*Sinclair Paint Co. v. State Bd. of Equalization* (1997) 15 Cal.4th 866, 881.) Here, there is no allegation that the fees in question are being used for unrelated revenue purposes. Rather, it is contended that only 40 percent of water rights holders are being charged a fee that by right should be charged to all water rights holders, and therefore the fee is not sufficiently linked to the regulatory costs generated by those on whom the fee is imposed and constitutes a tax.

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* Retired Chief Justice of California, assigned by the Chief Justice pursuant to article VI, section 6 of the California Constitution.

Every government entity that imposes a regulatory fee must decide who should be subject to the fee and who should not. A number of factors may go into that decision, including assessments of the regulatory burdens imposed by the various actors and the administrative convenience of imposing the fee. As the majority states: "'Legislators "need only apply sound judgment and consider 'probabilities according to the best honest viewpoint of informed officials' in determining the amount of the regulatory fee." [Citation.]'" (Maj. opn., *ante*, at p. 16.) So, too, legislators and regulators need only make reasonable decisions about who should be subject to a regulatory fee.

In the present case, the State Water Resources Control Board claims that "some 95 percent of its time and expense are directed toward servicing and regulating those licensees and permittees against whom the challenged fees were assessed." (Maj. opn., *ante*, at p. 20.) The support for this contention stems primarily from a document produced by the board on April 15, 2004, shortly after the present litigation commenced. Because of the uncertain reliability of this document, as well as the trial court's lack of findings, remand is appropriate to determine whether the board's decisions regarding who would be subject to the fee were reasonable.

MORENO, J.

I CONCUR: WERDEGAR, J.

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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)

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

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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.)

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.

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

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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.

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

[3] See Appendix.

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;

(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

[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*.)

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]

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

[5] See Appendix.

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]

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[6] See Appendix.

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 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)

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[7] See Appendix.

[8] See Appendix.

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]

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

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[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.)

[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.)

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 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

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[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."

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 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

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)

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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."

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 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 shall

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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.

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]

> "(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 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.)

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

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 "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

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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.)

[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.

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 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.

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[17] The stipulation also states: "The Parties agree that should Plaintiffs prevail in this litigation, the Parties named in the

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. (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

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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."

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, 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

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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."

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 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

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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).
>
> "(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."

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 issue that

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[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.

"(e) For expenditures by the board for the purposes of carrying out Sections 13140 and 13170 in connection

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] (Italics added.)

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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 item 3940-001-3058 cited by the SWRCB, and the supporting data

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 confer no right of private ownership in the watercourse," which

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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.

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 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

[22] See Appendix.

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

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

out that "nowhere in the brief or in the record is there any 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

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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.)

segregate and tax only the possessory interest the contractor has in the property. (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

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

a fee" and 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

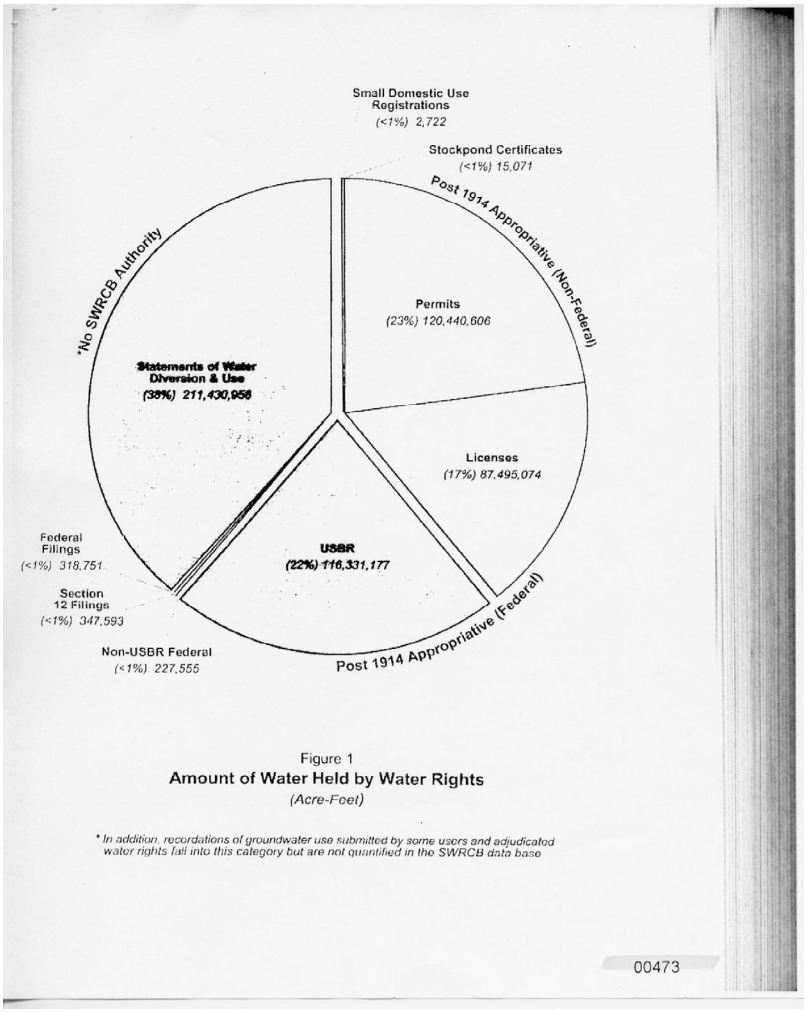

Figure 1
Amount of Water Held by Water Rights
(Acre-Feet)

* 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.

SUPERIOR COURT OF CALIFORNIA
COUNTY OF SACRAMENTO

DATE/TIME	**:**	**April 26, 2005**
JUDGE	**:**	**Raymond M. Cadei**
REPORTER	**:**	**None**
DEPT NO	**:**	**25**
CLERK	**:**	**Cindy Jo Miller**
CT ATTNT	**:**	**M. Jeremiah**

NORTHERN CALLIFORNIA [sic] **WATER ASSOCIATION; CENTRAL VALLEY PROJECT WATER ASSOCIATION,**
Petitioners and Plaintiffs,

vs.
Case No. – Lead Case: 03CS01776 ***(cons w/ 04CS00473)***

STATE WATER RESOURCES CONTROL BOARD; EDWARD C. ANTON, CHIEF, DIVISION OF WATER RIGHTS; STATE BOARD OF EQUALIZATION; and DOES 101 – 200,
Respondents and Defendants,

COUNSEL OF RECORD:

Stuart L. Somach, Esq.
Daniel Kelly, Esq.

Matthew J. Goldman, Deputy Attorney General

Molly Mosely, Deputy Attorney General (Board of Equalization

William L. Carter, Supervising Deputy Attorney General, (Board of Equalization)

David A. Battaglia, Esq.
(Ca. Farm Bureau Fed.)

UNITED STATES OF AMERICA, BY AND THROUGH THE DEPARTMENT OF THE INTERIOR, BUREAU OF RECLAMATION, **Real Parties in Interest.**	**Nancy N. McDonough, Esq. (Ca. Farm Bureau Fed.)**
CALIFORNIA FARM BUREAU FEDERATION, Petitioner/Plaintiffs, vs. *(04CS00473)* CALIFORNIA STATE WATER RESOURCES CONTROL BOARD, Respondent.	

Nature of Proceedings: **RULING ON SUBMITTED MATTER – PETITIONERS' MOTION FOR PERMPTORY** [sic] **WRIT OF MANDATE OF PROHIBITION (Taken Under Submission 4/15/05)**

This matter came on regularly for hearing on Friday, April 15, 2005. Stuart L. Somach appeared and argued the matter on behalf of petitioners Northern California Water Association, et al. David A. Battaglia appeared and argued the matter on behalf of petitioners California Farm Bureau Federation, et al. Deputy Attorney General Matthew J. Goldman appeared and argued the matter on behalf of respondents California

State Water Resources Board, et al. The Court heard oral argument and took the matter under submission.

Having considered the written and oral arguments of the parties and the matters in the pleadings and the administrative record, the Court rules as follows:

As a matter of clarification of the tentative ruling, the Court has exercised its independent judgment on issues of law presented by the motion as required by law. References to agency discretion and deference thereto in the tentative ruling applied to the issue of the allocation of fees among payors, as set forth in *California Association of Professional Scientists v. Department of Fish and Game* (2000) 79 Cal. App. 4th 935.

The Court finds that the statutes implementing the challenged fees do not violate the supremacy clause of the United States Constitution by imposing a tax on the United States. Although Water Code section 1525(a) imposes a fee on "each person or entity who holds a permit or license to appropriate water", which in this case includes the federal Central Valley Project, Water Code section 1560(a) explicitly provides that "the fees and expenses established under this chapter . . . apply to the United States . . . to the extent authorized under federal law." The applicable statutes further provide that if a fee payor (such as the United States) will not pay the fee based on the assertion of sovereign immunity, the fee may be allocated to another party. (Water Code sections 1540, 1560.) The statutes therefore do not, on their face, violate the

supremacy clause by imposing a tax on the United States.

With regard to the allocation of fees to Central Valley Project contractors, the Court has reviewed and considered the federal court cases of *U.S. v. Nye County* (9th Cir., 1991) 938 F. 2d 1040 and *U.S. v. County of San Diego* (9th Cir., 1992) 965 F. 2d 691, which were discussed extensively by Mr. Somach during oral argument. The Court finds that those cases dealt with pure ad valorem taxes imposed by a state or county on federal property used by private contractors, and not with the issue of whether a party that takes water under contract from the federal government for its own or commercial use may be allocated a valid regulatory fee that, but for sovereign immunity, would be assessed against the federal government. On that basis, the Court finds that the cited cases are not controlling authority holding that the regulatory fees challenged in this case are void under the supremacy clause of the United States Constitution, either on a facial basis or as applied in this case.

The tentative ruling is hereby confirmed as the final ruling of the Court, as follows: The motion for peremptory writ of mandate or prohibition is denied.

Counsel for the parties are directed to meet and confer regarding the scheduling of further proceedings in this matter and thereafter to set a status conference at a mutually-agreeable time after confirming the Court's availability with the Clerk.

Counsel for respondent is directed to prepare a formal order and judgment denying the petition for writ of mandate, submit them to counsel for petitioner for approval as to form, and thereafter submit them to the Court for signature and entry of judgment pursuant to Rule of Court 391.

For informational purposes, the tentative ruling issues [sic] by the Court April 14, 2005 is stated below:

"The following shall constitute the Court's tentative ruling on the Motion for Peremptory Writ of Mandate and Prohibition, set for hearing on Friday, April 15, 2005. The tentative ruling shall become the ruling of the Court unless a party desiring to be heard so advises the clerk of this Department no later than 4:00 p.m. on the court day preceding the hearing, and further advises the clerk that such party has notified the other side of its intention to appear.

The Requests for Judicial Notice of plaintiffs/petitioners Northern California Water Association, et al., filed on February 1, 2005, and March 29, 2005, are granted. No objection has been made by respondents, and the matters contained in the Requests are proper subjects for judicial notice pursuant to Evidence Code section 452(c) as official acts of the legislative department of this State.

With regard to respondents' Request for Judicial Notice filed March 9, 2005, to which certain objections have been filed, the Court makes the following rulings:

1. The objections to Exhibits A, F, J, K and M are sustained on the ground that these materials do not fall within the scope of permissive judicial notice under Evidence Code section 452. The Request is therefore denied as to these items.

2. The objections to Exhibits B, C, D, E, G, H, I L, N P,Q R and S are sustained in part and overruled in part. These materials are subject to judicial notice pursuant to Evidence Code section 452(c) in that they are official acts of the executive or legislative departments of this State and the United States. While the Court may take judicial notice of the fact that the orders, reports, decisions and resolutions were issued, and of their contents, the Court may not take judicial notice of the truth of the facts stated in those documents. (See, *Shaeffer v. State* (1970) 3 Cal. App. 3d 348, 354.)

In this matter, plaintiffs/petitioners have mounted a broad-based challenge to the system of fees respondent enacted pursuant to Water Code section 1525. The fee system, which is set forth in 23 C.C.R. sections 1061, et seq., is intended to fund the operations of respondent's Division of Water Rights. Plaintiffs/petitioners allege numerous deficiencies in the fee program and in the details of its structure. Among these alleged deficiencies, the principal ones are that the fees constitute an illegal ad valorem property tax, that the fees are not charged for a valid regulatory program, that the gross amount of the fees collected exceeds the cost of any regulatory program that may exist, and

that the allocation of the fees among the payors is improper. Other deficiencies are also alleged as a basis for invalidating the fee program. Many of those alleged deficiencies are related to or flow from the principal points listed above; the fact that the Court has not described or ruled on all of the myriad of arguments raised by plaintiffs/petitioners specifically in this tentative ruling should not be taken as an indication that the Court has not considered them in detail in rendering this ruling.

Distilled to its essence, this is a dispute over whether the charges imposed by respondent are valid fees or an invalid tax that violates the State Constitutional provisions commonly referred to as Proposition 13. (Constitution, Article 13A.)

The parties have cited the Court to a number of reported cases that deal with the distinction between taxes and fees. Although none of the cases appear to be directly on point, certain basic principles can be drawn from them that provide a framework for resolving this case. The overriding principle that emerges from the case law is that a charge imposed by a governmental entity that may be characterized as a legitimate regulatory fee is not a tax within the scope of Article 13A. (See, *Sinclair Paint Co. v. State Board of Equalization* (1997) 15 Cal. 4th 866.) Flowing from this basic concept is the principle that a charge may be found to be a valid regulatory fee when three conditions are satisfied: 1) the charge is imposed to pay the costs of a legitimate regulatory program; 2) the gross amount collected through the charge from all payors does not

exceed the cost of the program; and 3) the allocation of charges among the payors is done on a reasonable basis that bears some relationship to the benefits the payors receive from the system and the burdens they impose upon it. (See, *Sinclair Paint Co. v. State Board of Equalization* (1997) 15 Cal. 4th 866; *California Association of Professional Scientists v. Department of Fish and Game* (2000) 79 Cal. App. 4th 935.)

The Court has applied these principles to the issue of respondent's fee structure and finds that the three conditions described above have been satisfied. The charge [sic] respondent has imposed pursuant to Water Code section 1525 and applicable regulations therefore constitute a valid regulatory fee.

The Court finds that the activities of respondent's Division of Water Rights for which the charges are imposed constitute a legitimate regulatory program. The specific activities, which the charges are intended to support, are listed in Water Code section 1525(c). All such activities appear to the Court to be clearly related to the regulation and supervision of the legal system of water rights and water appropriation in California. With its reference to such classically regulatory activities as "issuance, administration, review, monitoring and enforcement of permits, licenses, certificates and registrations to appropriate water, water leases", etc., Section 1525 specifically limits the charges to funding a program of regulation. On its face, therefore, the statute does not violate the law by imposing an improper tax; nor do the fee regulations that implement the statute by providing the specifics of the charge.

The Court further finds that the gross amount collected through the charge from all payors does not exceed the cost of the regulatory program. From the material contained in the record submitted to the Court, it is apparent that the total budget of the Division of Water Rights for fiscal year 2003-2004 was approximately $9,000,000. The record further demonstrates that respondent was directed by the Legislature to collect approximately $4,400,000 in charges during that fiscal year, and that respondent actually collected approximately $7,600,000. Neither amount exceeded the budget of the Division of Water Rights. Plaintiffs/petitioners have not demonstrated that the gross amount collected will exceed the budget of the Division of Water Rights in the current fiscal year or thereafter. At most, they have suggested that collections may exceed the target figure set forth in the Budget Act and thereby temporarily exceed the budget in a given fiscal year. Given the procedure set forth in Water Code section 1525(d)(3) for adjustment of the fees to compensate for any over-collection, the Court does not find that the fee program is intended to or, or will in effect, collect more than is needed to fund the regulatory program and on that basis generate revenue for unrelated purposes.

Plaintiffs/petitioners argue that the Division of Water Rights engages in activities that are not properly characterized as regulatory and that as collections approach the total budget of the Division, the charges are therefore being used as a general revenue-raising tool. The Court finds that the record does not

support this contention. Although the record demonstrates that the Division of Water Rights does engage in activities that appear to be of a general planning or environmental protection nature, such as Bay-Delta planning and protection of public trust resources, these activities appear to bear a sufficiently close relation to the regulation of water rights that they may be legitimately considered to be part of the water rights regulatory program. The Court notes from the record that the budget of the Division of Water Rights is only a minor part of the budget and expenditures of respondent State Water Resources Control Board as a whole. This suggests that any planning or public trust activities the Division of Water Rights engages in are related to its own regulatory mission rather than to more generalized policy matters as suggested by plaintiffs/petitioners. Certainly, plaintiffs/petitioners have not persuasively demonstrated otherwise.

The Court further finds that the allocation of charges among the payors has been made on a reasonable basis that bears some relationship to the benefits the payors receive from the system and the burdens they impose upon it. Under *California Association of Professional Scientists v. Department of Fish and Game* (2000) 79 Cal. App. 4th 935 ("*CAPS*"), a decision from the Third District which appears to be one of the most recent and extensive discussions of this issue, a state agency is permitted a fair degree of latitude in developing a system of regulatory fees, and in setting up a system of charges is permitted to consider factors such as the administrative burden of allocating costs

to certain services, the difficulty of quantifying benefits, and practical issues of collection and enforcement. The primary requirement that may be distilled from CAPS opinion, as well as other cases in this area, is that agencies are entitled to exercise discretion in setting up a regulatory fee structure and they may do so based on a variety of reasonable financing schemes, with flexibility being an inherent component of reasonableness, provided that they apply sound judgment, engage in reasoned analysis and consider probabilities according to the best honest view of informed officials. Exact apportionment is not required, and apportionment need not be based on a precise cost-fee ratio. Thus, whether an agency has acted appropriately in setting up a fee structure must be evaluated under a flexible analytic approach that takes into account the particular circumstances of that agency. (See, e.g., *Pennell v. City of San Jose* (1986) 42 Cal. 3d 365; *San Diego Gas and Electric Co. v. San Diego Air Pollution Control District* (1988) 203 Cal. App. 3d 1132; *Shapell Industries, Inc. v. Governing Board of Milpitas Unified School District* (1991) 1 Cal. 4th 218; *City of Oakland v. Superior Court* (1996) 45 Cal. App. 4th 740.)

The Court finds that respondent satisfied the requirements of the law in developing its fee structure. The Memorandum of Division Chief Victoria Whitney that is part of the record of this matter (AR 781-794) articulates the basis on which respondent adopted the fee structure set forth in 23 C.C.R. sections 1061, et seq. That Memorandum demonstrates that the fee structure that is challenged here was not adopted on a

merely arbitrary basis, but was developed after careful consideration of factors specific to the regulatory program of the Division of Water Rights. In reviewing respondent's exercise of its discretion in this matter, it is significant that the water rights regulatory program presented unique challenges that appear to be unprecedented in the case law regarding regulatory fees. Perhaps the greatest of these challenges was the fact that a significant portion of overall California water rights are held by the federal government. Although such rights may be within the reach of state regulation to the extent not inconsistent with Congressional directives regarding federal water projects in California (see, *California v. U.S.* (1978) 438 U.S. 645 and *US. v. California* (9th Cir., 1982) 694 F. 2d 1171), it is unclear whether respondent may be able to impose fees on the U.S. due to sovereign immunity. From the record, it appears that the federal government, through the Department of the Interior and the Bureau of Reclamation, has taken the position that respondent may not do so (and on that basis respondent made a reasonable determination, as provided by Water Code section 1560, that the federal government likely would not pay fees). The record demonstrates that respondent carefully considered this problem in developing its fee structure, and that its approach to overcoming the difficulties presented by these issues, for example, by providing for the allocation of fees to federal government contractors pursuant to Water Code section 1560(b)(2), was reasonable. Similarly, the Court finds that respondent appropriately considered relevant factors and articulated a reasonable basis for other

aspects of the system, including: imposing a two-tiered system of annual fees in combination with fees for certain activities; setting the fees for petitions, etc. below the actual average cost of acting on such petitions; setting a minimum annual fee of $100; setting a fee above the minimum annual fee based on the size of the regulated water right; and in all other respects challenged by the plaintiffs/petitioners. Respondent therefore acted within the legitimate scope of its discretion. The fact that other approaches might have been chosen or that reasonable minds might differ regarding the method chosen suggests that respondent acted within the legitimate scope of its discretion. (See, *Shapell Industries, Inc. v. Governing Board of Milpitas Unified School District* (1991) 1 Cal. 4th 218.)

On the basis of the foregoing, the Court finds that the fees that are challenged in this action are legitimate regulatory fees and that the allocation of those fees was not improper. Because the fees in question are legitimate regulatory fees, the Court finds that they do not constitute ad valorem taxes on real property within the scope of Article 13A. A regulatory fee is not an ad valorem tax on real property merely because it is imposed on real property. (See, e.g., *Pennell v. City of San Jose* (1986) 42 Cal. 3d 365; *Garrick Development Co. v. Hayward Unified School District* (1992) 3 Cal. App. 4th 320.)

The Court has considered the plaintiff/petitioners' remaining constitutional arguments and finds that in light of the fact that the fee structure has a reasonable basis and a legitimate regulatory function, no violation

of the due process, equal protection or takings clauses of the U.S. or State Constitutions have been established. The Court also finds that the provisions of the Water Code permitting fees for federal government water rights to be allocated to contractors do not violate Constitutional prohibitions against state taxation of federal property. Under the "pass through" provisions, the fee does not fall on the United States itself or on an agency so closely connected to the government that the two cannot realistically be viewed as separate entities. (See, *U.S. v. New Mexico* (1982) 455 U.S. 720.)

The Court therefore denies the motion for a peremptory writ of mandate and prohibition."

Superior Court of California
County of Sacramento

BY: Cindy Jo Miller,
Deputy Clerk

[Certificate Of Service By Mailing Omitted]

SUPREME COURT MINUTES
WEDNESDAY, MAY 16, 2018
SAN FRANCISCO, CALIFORNIA

S248150	C075866 Third Appellate District	**NORTHERN CALIFORNIA WATER ASSOCIATION v. STATE WATER RESOURCES CONTROL BOARD**

Petition for review denied
Cantil-Sakauye, C.J., was recused and did not participate.

U.S. Const. art. VI, cl. 2

This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

California Water Code (2003)

§ 1525. Schedule of fees; Adoption of schedule by board

(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.

(2) For filings subject to subdivision (b), the schedule may provide for a single filing fee or for an initial filing fee followed by an annual fee, as appropriate to the type of filing involved, and may include supplemental fees for filings that have already been made but have not yet been acted upon by the board at the time the schedule of fees takes effect.

(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 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.

§ 1540. Allocation of fee to contractor of sovereign immunity fee payer

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.

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§ 1560. Applicability of fees to United States and to Indian tribes; Powers of board

(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.

California Code of Regulations (2004)

§ 1073. Allocation of Fees and Expenses

(a) The Chief, Division of Water Rights (Division Chief), is delegated the authority to apply Water Code section 1560, subdivision (b).

(b) The Division Chief's determination under Water Code section 1540 whether the United States Bureau of Reclamation (USBR) is likely to decline to pay fees or expenses for projects within the Central Valley Project, and any allocation of those fees or expenses, shall be consistent with the following criteria:

> **(1)** The Division Chief first shall consult with the USBR to ascertain whether the USBR will pay the applicable amount or agree to contractual arrangements that, in the opinion of the Division Chief, provide an adequate substitute for payment of the fee or expense.
>
> **(2)** If the USBR declines or is likely to decline to pay the fee or expense or to agree to contractual arrangements acceptable to the Division Chief, the Division Chief shall allocate the fee or expense to the USBR'S water supply contractors in accordance with subdivision (b)(2) of Water Code section 1560. The fee or expense for projects of the Central Valley Project shall be prorated among the contractors for the Central Valley Project based on either the contractor's entitlement under the contract or, if the contractor has a base supply under the contract, the contractor's supplemental supply entitlement. This formula is expressed mathematically as follows:

[See Illustration In Original]

Where: i = individual contractor

x = supplemental water entitlement under the contract or total contract amount if there is no base supply under the contract n = number of contractors

FeeUSBR = fee or expense apportioned to the USBR for the Central Valley Project

(c) If a fee or expense or portion thereof is allocated, pursuant to subdivision (b)(2) of Water Code section 1560 or subdivision (b) of this section, to an individual water supply contractor that is a federal agency or Indian tribe who has declined, or is likely to decline, to pay the fee or expense, the Division Chief may apply subdivision (b) of Water Code section 1560 to the fee or expense or portion thereof allocated to that contractor.

(d) If a water supply contractor allocated a portion of an annual fee pursuant to subdivision (b)(2) of section 1560 of the Water Code or subdivision (b) of this section successfully petitions the board to reduce or eliminate that allocation, the board's action on the petition shall not provide a basis for recalculation or reapportionment of the annual fee for that fiscal year as apportioned to any other contractor that has not filed a petition for reconsideration of its allocation.

(e) The following definitions apply to this section:

(1) "Base supply" means the amount of water delivered to a water user by USBR from the Central Valley Project that is designated as base supply in

a water supply contract between the user and the USBR.

(2) "Supplemental supply entitlement" means the amount of water exceeding base supply delivered from the Central Valley Project to a water user.

[SEAL] United States Department
of the Interior

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

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 (SE 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,

/s/ Daniel G. Shillito
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

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

[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.

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).

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.*

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[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]").

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 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").

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[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.

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 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

[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 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.*

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]

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

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[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; $126,088 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.

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 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

[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. § 300j6(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.

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.