(9/23-24/14) Board Meeting- Item 7
Water Rights Fees
Deadline: 9/18/14 by 12:00 noon

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SWRCB Clerk

September 18, 2014

Via Electronic Mail to: commentletters@waterboards.ca.gov

Jeanine Townsend, Clerk to the Board
State Water Resources Control Board
P.O. Box 100
Sacramento, CA 95812-2000

Re: **9/23-24/14 BOARD MEETING, Item 7 (Water Right Fees)**

Dear Ms. Townsend and Board Members:

These comments are being provided by the Northern California Water Association (NCWA), the Central Valley Project Water Association (CVPWA), the Imperial Irrigation District (IID), and Petitioners in the existing action pending before the Third District Court of Appeal, entitled *Northern California Water Association et al. v. State Water Resources Control Board et al.*, Case No. C075866, and Petitioners in actions filed in subsequent years[1], in response to a State Water Resources Control Board Meeting Notice regarding proposed emergency regulations revising the State Water Resources Control Board's (SWRCB) fee schedules for the water right program. The stated purpose of the meeting is to consider a resolution adopting proposed emergency regulations revising the SWRCB's water right fee schedule.

The current fee regulations are those originally adopted by the SWRCB in December 2003 and revised in certain years to conform to the Budget Act. In developing the regulations, the SWRCB held public workshops and many parties, including petitioners, submitted comments and proposed revisions to those regulations. Those parties have participated and commented each year as fee schedules are revised, and have challenged the fees in court. To date, the SWRCB has not wavered from its original

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[1]NCWA, CVPWA and other individually named petitioners have challenged the fees in each year, as set forth in the controlling statutes and regulations. (*Northern California Water Assn., et al. v. State Water Resources Control Board, et al.*, Sacramento Superior Court Case No. 04CS01467; *Northern California Water Assn., et al. v. State Water Resources Control Board*, et al., Sacramento Superior Court Case No. 05CS01488; *Northern California Water Assn., et al. v. State Water Resources Control Board, et al.*, Sacramento Superior Court Case No. 06CS01517; *Northern California Water Assn., et al. v. State Water Resources Control Board, et al.*, Sacramento Superior Court Case No 34-2008-00003004; *Northern California Water Assn., et al. v. State Water Resources Control Board, et al.*, Sacramento Superior Court Case No. 34-2009-80000183, and *Northern California Water Assn., et al. v. State Water Resources Control Board, et al.*, Sacramento Superior Court Case No. 34-2010-80000461; *Northern California Water Assn., et al. v. State Water Resources Control Board, et al.*, Sacramento Superior Court Case No. 34-2011-80000828.) These cases are all stayed pending resolution of the case before the Supreme Court.

improper fee scheme. In that regard, petitioners fully incorporate herein the comments previously submitted by NCWA and CVPWA in connection with the adoption of the original and revised fee regulations, the arguments made in Superior Court, the Court of Appeals, and the California Supreme Court regarding the Water Right Fees.[2] The existing action pending in the Third District Court of Appeal, identified above, is a result of the SWRCB's appeal of an adverse decision in the Sacramento Superior Court where the Court invalidated the SWRCB's fee regulations as violating Article XIIIA of the California Constitution, violating the Supremacy Clause of the United States constitution, and being otherwise arbitrary. For the SWRCB Board's information, the Superior Court's Final Statement of Decision ("Decision") is attached hereto.

COMMENTS

1. The SWRCB's Proposed Regulations Impose a Tax on Water Users in Violation of Proposition 13

The SWRCB's proposed regulations result in an unlawful tax, passed in violation of the California Constitution. Further, the SWRCB's proposed regulations impose an unlawful tax because the charges assessed exceed the reasonable cost of the SWRCB's regulatory activity. The SWRCB's proposed regulations, imposing the entirety of the cost of the Division of Water Rights on licensed and permitted water right holders ignores the Division's activities related to pre-1914 and riparian water rights, among others, not subject to the fees, and the substantial time and money spent by the Division on issues related to the public generally, including, but not limited to, public trust, wildlife, recreation, and carrying out the Constitutional mandate that waters of the State be put to beneficial use to the greatest extent possible. The SWRCB has not met its burden of demonstrating that the amounts charged are reasonably related to the service provided.

2. The SWRCB's Proposed Regulations Unconstitutionally Impose Charges on Water Rights Held by the United States and Unlawfully Assess Federal Contractors

Water Code Section 1540 authorizes the SWRCB to pass through an appropriate portion of the fee "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 SWRCB's regulations recognize that the United States may claim sovereign immunity and refuse to pay the assessment and authorize the Division Chief to levy assessments

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[2] Petitioners have made these arguments in each year to the SWRCB through comments, Petitions for Reconsideration, and through court actions. The SWRCB has repeatedly rejected Petitioners' arguments and, as such, Petitioners are not required to exhaust administrative remedies to preserve a right to a refund. (See *Coachella Valley Mosquito & Vector Control Dist. v. California Public Employment Relations Bd.* (2005) 35 Cal.4th 1072, 1080-1081.)

otherwise payable by the United States on persons or entities who have contracts for Central Valley Project (CVP) water. The SWRCB's proposed regulations impermissibly pass through the charges unlawfully imposed on the United States to federal contractors.

The SWRCB's regulations fail to segregate the beneficial interest of federal contractors to which the fees imposed on the United States are "passed through." Instead, the SWRCB simply and impermissibly imposed the entirety of the fees charged against the water rights held by the United States Bureau of Reclamation (USBR) for the CVP on federal water contractors. As SWRCB staff testified at the trial on the fees, the SWRCB *never* conducted a beneficial interest analysis to determine what interest, if any, the water service contractors had in the water rights for the CVP. The SWRCB simply ignored the multiple purposes of the CVP, the fact that half of the water rights are held for power purposes, and that the water rights are held for purposes other than providing water supplies. The fact that the CVP operates in an "integrated" fashion is not relevant in determining the federal contractors beneficial interest. As set forth in the Decision, imposing the entirety of the fees charged to the USBR on the federal water contractors violates the Supremacy Clause of the United States Constitution.

In addition, because the SWRCB failed to consider the beneficial interest of the federal contractors, the SWRCB acted arbitrarily in imposing the entirety of the fees charged to the USBR on the federal contractors. This is particularly evident in a year like this year, where most federal contractors received a zero percent (0%) allocation of water deliveries, yet the SWRCB proposes to *increase* the fees charged to those contractors by $387,249 this year and nearly $1.2 million over the next several years.

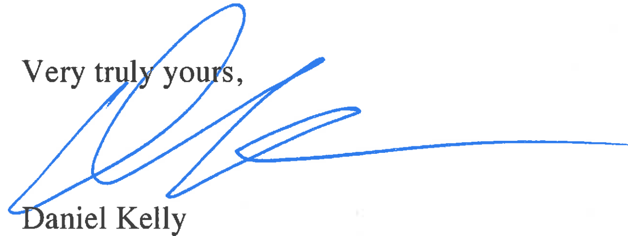
3. The Regulations Are Arbitrary

The regulations impose fees on water right holders based solely on the "face value" of a water right. Such a scheme ignores cumulative limitations contained in the water rights themselves, and treats water right holders differently, depending on how the SWRCB or its predecessors issued permits. Imposing fees on *some* water right holders over and over again for the rediversion of the *same* water is arbitrary. Under the fee scheme, certain water right holders pay an exponentially higher fee for the same or less regulatory burden than others. In addition, and as explained above, forcing the federal water contractors to pay the entirety of the water right fees imposed on the USBR, without considering the actual beneficial interest of the contractors, ignoring others who receive benefit from the water rights held by the USBR, and ignoring the multiple purposes of the CVP is arbitrary.

CONCLUSION

The SWRCB's regulations imposing water right fees, and the proposed fee increase, constitute a tax and are otherwise arbitrary. This is so because the fee structure does not allocate costs to water rights holders based on their burden on, or benefit from, the regulatory activities of the Division and because the fees are unlawfully charged to federal contractors.

Very truly yours,



Daniel Kelly

DK:yd

Enclosure

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COURTS
DEPT. #54

SUPERIOR COURT OF CALIFORNIA

COUNTY OF SACRAMENTO

California Farm Bureau Federation, et al.,

vs.

State Water Resources Control Board

Department Number: 54

Case Number: 03CS01776
Consolidated w/ 04CS00473

Final Statement of Decision

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 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.

[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.

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. (*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

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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.
[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".

any, should be made pursuant to Rule of Court 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]

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

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 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.

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[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.

On remand, this court is directed to address the constitutionality of these fee statues 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 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 payors. (*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 flexibility in calculating the amount and distribution of a regulatory fee. Focusing on the

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[7] *Id.*, 51 Cal. 4th at 428.
[8] *Id.*, 51 Cal. 4th at 438.
[9] *Id.*, 51 Cal. 4th at 441.
[10] *Id.*

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 payors 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 payor'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 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 overassessing 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]

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

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[11]*Id.*, 51 Cal. 4th at 442.
[12]*Id.*
[13]*Id.*, 51 Cal. 4th at 428.
[14]*Id.*, 51 Cal. 4th at 445.

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 contracts themselves.[16]

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).*)

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 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.)

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].

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[15] *Id.*
[16] *Id.*, 51 Cal. 4th at 446.
[17] *Id.*, 51 Cal. 4th at 436-437.

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 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, 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.

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

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 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 Payors

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

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[19] *Id.*, 51 Cal. 4th at 432.
[20] *Id.*, 51 Cal. 4th at 442.
[21] See, e.g., Trial Exhibit 1005.

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 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 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 non-trivial, 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.

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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.

[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.

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 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 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

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[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 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.

[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.

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 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 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.

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

Moreover, the estimate does not appear to be consistent with estimates contained in a memorandum Ms. 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." 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 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

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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."

[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.

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 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

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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.

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]

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.

C. <u>Validity of Fees Assessed to Central Valley Project Contractors</u>

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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.*
[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."

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

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

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]

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

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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 (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.

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

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 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

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

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 "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 <u>some</u> amount of water not actually under contract <u>may</u> be fairly attributable to the value of the contractors' delivery contracts. It does not necessarily follow that <u>100%</u> of the water not actually under

[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.

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' 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 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

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[52] See, Trial Transcript, p. 1380.
[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 impacts 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 fees among all water supply contractors with contracts for CVP water." (A.R., pp. 3063-3064.)

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 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

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[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.)

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

4 Petitioners established this point through testimony and documentary evidence regarding the fees
5 charged to the Imperial Irrigation District ("IID").[56] The evidence demonstrated that IID obtains water from
6 the Colorado River and transports it through the All-American Canal for eventual delivery to its customers.
7 IID's rights to take water from the Colorado River are regulated under federal law, under a body of law known
8 as the "Law of the River", with little or no regulatory involvement by the Board. IID does have a permit from
9 the Board for the water it takes from the Colorado River.[57] It also has six additional permits from the Board for
10 the same water involving its use for hydroelectric power generation at various drop structures along the All-
11 American Canal.[58] The Board charges IID a fee based on the face amount of all seven permits, even though all
12 seven permits involve the same water originally diverted from the Colorado River. This resulted in a total fee
13 to IID of over $770,000.

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

23 The disparity between the two cases is obvious. It is clear that IID's fees are much greater than those
24 charged to DWR largely because the former has separate permits and the latter does not. The Board offered no
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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.
[59] See, Trial Exhibits 148, 229.

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 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.

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' 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.

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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.
[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.)

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 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).

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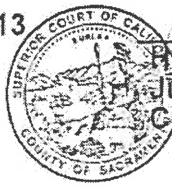
5 Date: November 18, 2013



6 Honorable Raymond M. Cadei
Judge of the Superior Court of California,
County of Sacramento
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CERTIFICATE OF SERVICE BY MAILING
(C.C.P. Sec. 1013a(3))

I, the Clerk of the Superior Court of California, County of Sacramento, certify that I am not a party to this cause, and on the date shown below I served the foregoing Final Statement of Decision by depositing true copies thereof, enclosed in separate, sealed envelopes causing postage to be fully prepaid, in the United States Mail at Sacramento, California, each of which envelopes was addressed respectively to the persons and addresses shown below:

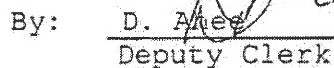
Stuart L. Somach
Somach Simmons & Dunn
500 Capitol Mall, Suite 1000
Sacramento, CA 95814

Molly Mosley
Office of the State Attorney General
P.O. Box 944255
Sacramento, CA 94244-2550

I, the undersigned deputy clerk, declare under penalty of perjury that the foregoing is true and correct.

Dated: November 12, 2013

Superior Court of California,
County of Sacramento



By: D. Ames
Deputy Clerk