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Cal. Farm Bureau Fed'n v. State Water Res. Control Bd., 51 Cal. 4th 421 (2011)

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Cal. Farm Bureau Fed'n v. State Water Res. Control Bd., 51 Cal. 4th 421 (2011) (holding that revenue collected from water rights services was a fee and not a tax and that the state agency did not violate the Constitutional Supremacy Clause by collecting fees from federal contractors).

Under Proposition 13, passed in 1978, any tax increases in California required a two-thirds vote of the state legislature. Until Proposition 26 passed in 2010, fees were not subject to the two-thirds requirement. With tax increases a virtual political impossibility, and California facing a chronic budget crisis, the legislature turned to fees to offset losses in revenue to the general fund. In 2003, by a simple majority vote, the legislature passed a law ("2003 law") cutting funding to the State Water Resources Control Board ("SWRCB") and instructing SWRCB to replace the revenue through the imposition of fees on all water rights holders subject to its jurisdiction.

California had a hybrid water rights system of both riparian rights and prior appropriation. California law grandfathered all existing riparian rights, pueblo rights, and other appropriative rights in existence in 1914. These represent about thirty-eight percent of state waters and were not subject to SWRCB jurisdiction. Most rights acquired after 1914 were subject to the doctrine of prior appropriation and to SWRCB jurisdiction. The federal government and Native Americans hold much of the remaining twenty-two percent of state waters outside of SWRCB jurisdiction because of sovereign immunity. Thus, only about forty percent of the waters in the state were subject to SWRCB jurisdiction and, therefore, the 2003 law fees.

Under the 2003 law, SWRCB would assess an annual fee on water rights holders and charge additional fees for water rights applications, change of use applications, and registration of stock ponds, to name a few. The fee amounts were set based on the operational needs of SWRCB. SWRCB would no longer receive revenue from the general fund. In 2003, the SWRCB budgeted 4.4 million dollars for its operational needs. It determined that it would be unsuccessful in collecting fees from a significant numbers of parties (approximately forty percent), so it adjusted its revenue target to 7 million dollars to offset the likely losses from those parties who fail to pay. Furthermore, knowing that it could not levy a direct fee on the federal government, SWRCB assessed fees on private parties contracting with the federal government.

California Farm Bureau Federation ("Farm Bureau") and multiple other parties challenged these new fees. These parties represented persons who contracted with the federal Bureau of Reclamation ("Reclamation") for use of water from the Central Valley Project, which diverts water for flood control, hydroelectricity, storage, and wildlife protection. At trial, Farm Bureau argued: (1) the fees were an illegal tax because it did not receive a two-thirds vote in the legislature; (2) the fees were unconstitutional, as applied, because only forty percent of water rights holders were responsible for 100 percent of the

costs of the water rights program; (3) a fee on water rights amounts to an illegal tax on real property; (4) the Supremacy Clause of the U.S. Constitution gave sovereign immunity to the federal government from taxation (and imposition of fees) by states, and this sovereign immunity extends to private parties who contract with the federal government; and 5) the fees were unconstitutional as applied because contractors were responsible for the fees on all federal water despite only receiving a small proportion of that water.

Both the Superior Court of Sacramento County (“trial court”) and the Third Appellate District of the Court of Appeals (“court of appeals”) held that the fees were not a tax because the amount reasonably related to agency operating costs and was, therefore, constitutional. However, the court of appeals ruled that the fees on federal contractors were unconstitutional because they violated the sovereign immunity doctrine. The parties appealed the decision to the California Supreme Court (“court”).

The court noted that while it is not always clear what the difference between a fee and a tax is, there are some important distinctions. In general, taxes are for revenue collection, while fees cover the cost of providing a specific benefit or service, or regulatory enforcement. In addition, taxes are compulsory, whereas fees are optional and there is no requirement to purchase the service. There may be an actual benefit to the payers, but that was not a requirement. The amount of the fee must reasonably relate to the cost of the program for which the fee is charged. However, the relationship does not have to be exact — a fee that produces a surplus in revenue may still be valid so long as the government does not divert the revenue to the general fund.

The court held that the state legislature did not intend to impose a tax. In this case, SWRCB held all fee revenue in the Water Rights Fund, completely separate from the general fund. SWRCB used that revenue in the Water Rights Fund to completely support its operations and administrative costs. Therefore, the court held that the fees were not an illegal tax.

Farm Bureau’s second argument challenged the constitutionality of the fees as applied. While SWRCB provided a benefit to all water rights holders, only forty percent were subject to its jurisdiction and its fees. Since SWRCB met 100 percent of its budget needs through fees, those forty percent of water rights holders ended up paying for 100 percent of the program costs. Hence, Farm Bureau argued that the fees were unreasonable because they were disproportionate to the benefit they provided to those forty percent. According to Farm Bureau, an unreasonable fee was actually a tax. SWRCB countered that the fee was appropriate because about ninety-five percent of the program costs related to providing services for those forty percent that were subject to the fees.

The court held that the amount of the fees must reasonably relate to the cost of the activity regulated — but that was a matter of fact for the trial court to decide. Therefore, the court remanded that question

for the trial court to determine.

The third argument by Farm Bureau was that imposing fees on water rights amounted to a tax on real property and was, therefore, unconstitutional. The court rejected the argument, stating that water rights were not real property and the right is usufructuary only. California owned the water itself for the benefit of its citizens.

In the fourth argument, the Farm Bureau claimed that the Supremacy Clause of the U.S. Constitution prevented states from imposing taxes or fees on the federal government and that the prohibition extended to private parties who contracted with the federal government. Under the 2003 law, SWRCB could collect fees from any party who contracted with Reclamation for use of a water right that would otherwise be subject to fees. Essentially, this means that SWRCB was transferring the fee burden for each federal water right from Reclamation to the private contractors who used those rights. The court held that the fees were appropriate, so long as their application was limited to the extent of the use right that the private contractor possessed. Therefore, the fees did not violate the Supremacy Clause.

Finally, the court addressed the argument that the fees, as applied, violated the Supremacy Clause because private contractors were responsible for 100 percent of the fees imposed on Reclamation's water rights. Reclamation held 116 million acre feet in water rights from the Central Valley Project but only delivered 6.6 million of that for use by private contractors. However, the private contractors were responsible for the full amount of the fees assessed on the 116 million acre feet. Thus, according to Farm Bureau, the fee assessment was highly disproportionate. In order for a fee on contractors to be reasonable, it must be limited to the beneficial interest that party has in the property. SWRCB countered by stating that while the assessed federal rights far exceeded the actual delivery, other factors affected that amount, such as evaporative losses, diversions for storage, and water releases for wildlife. In addition, SWRCB said that its fees were appropriate because the cost was discounted fifty percent to reflect the fact that Reclamation diverted about half of the water for hydroelectricity. According to SWRCB, the fee amount should take into consideration the benefit derived from the use of a whole federal water project and not just the actual amount successfully delivered. SWRCB reasoned, therefore, that the fees appropriately considered the total amount of Reclamation's water rights minus the amount diverted for hydroelectricity.

The court agreed with SWRCB but noted that the trial court had not made a factual determination as to how much of the water Reclamation consumes during delivery to the contractors. The court remanded back to the trial court to determine whether SWRCB made a fair determination of the beneficial interest of the contractors.

Therefore, the court affirmed in part and reversed in part, remanding to the trial court to make the appropriate factual

determinations.

Michael L. Downey

COLORADO

Cherokee Metro. Dist. v. Upper Black Squirrel Creek Designated Ground Water Mgmt. Dist., 2011 WL 382377 (Colo. Feb. 7, 2011) (holding that a district's failure to comply with a stipulated decree's filing deadline to perfect its conditional groundwater rights resulted in abandonment of those rights).

Cherokee Metropolitan District ("Cherokee") and Upper Black Squirrel Creek Ground Water Management District ("UBS") entered into a stipulation on January 25, 1999, concerning Cherokee's use of two sets of wells in the Upper Black Squirrel Creek Designated Ground Water Basin ("the Basin"). The water court incorporated the stipulation into a conditional water rights diligence decree ("stipulated decree") in March of 1999. The stipulated decree required Cherokee to file an application to perfect its conditional groundwater rights in the Basin within a two-year period after diverting and applying the water to a beneficial use.

Cherokee first applied water from well 14 to a beneficial use in December of 2000 and applied water from wells 15 and 16 to beneficial use in April of 2002. Cherokee did not file an application to make absolute its conditional rights to these wells, which had been applied to beneficial use, until February of 2005. Cherokee applied water from well 17 to beneficial use on April 28, 2006. The parties disputed whether Cherokee filed to make a portion of well 17 absolute on April 30, 2008, when Cherokee filed its motion to amend its application, or on May 30, 2008, when Cherokee filed the amended application.

UBS and the Bookers ("the Objectors") filed a motion to dismiss Cherokee's application to make portions of wells 14-17 absolute in the District Court, Water Division 2. The water court ordered abandonment of the conditional portions of wells 14-17 and awarded attorney fees. Cherokee then appealed to the Colorado Supreme Court ("the court").

The court held that the Objectors' motion to dismiss was not subject to the three-year statute of limitations that governs contracts because the Objectors filed the motion in response to Cherokee's failure to comply with a stipulated water court decree. The court also held that Cherokee stipulated away a sexennial schedule of filing deadlines, notice prior to cancellation, and the ability to file within the same month of diversion when it entered the stipulated decree.

The court further held that Cherokee did not comply with the two-