



United States Department of the Interior

OFFICE OF THE SOLICITOR

Pacific Southwest Region

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Sacramento, California 95825-1890

IN REPLY
REFER TO:

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 (SB 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,

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 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).

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.

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. 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

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]").

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").

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

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.

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*

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 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

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.*

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.

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 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

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.

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 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.