From *Tulare Lake* to *Orff*: Regulatory Takings and Water Rights

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One of the most interesting recent developments in property rights litigation has been the series of cases asserting a Fifth Amendment taking of western water rights. These cases have a venerable pedigree, stretching back to Justice Holmes' opinion in *International Paper Co. v. United States*, 282 U.S. 399, 407 (1931)("The petitioner's right was to the use of the water; and when all the water that it used was withdrawn from the petitioner's mill and turned elsewhere by government requisition for the production of power it is hard to see what more the Government could do to take the use.... The Government purported to be using its power of eminent domain to acquire rights that did not belong to it and for which it was bound by the Constitution to pay.") *See also United States v. Gerlach Live Stock Co.*, 339 U.S. 725, 739 (1950)("[W]hether required to do so or not, Congress elected to recognize any state-created rights and to take them under its power of eminent domain."); and *Dugan v. Rank*, 372 U.S. 609, 625 (1963)(citations omitted.)("[T]he United States was empowered to acquire the water rights of respondents by physical seizure … such rights could be acquired by the payment of compensation 'either through condemnation or, if already taken, through action [for just compensation] of the owners in the courts.")

The current crop of water rights/taking cases arises from the government's diversion of water (to which the plaintiffs are entitled under state law) for environmental purposes—generally the protection of endangered fish. The thrust of these cases is summed up in the pithy holding that "The federal government is certainly free to preserve fish; it must simply pay for the water it takes to do so." *Tulare Lake Basin Water Storage Dist. v. United States*, 49 Fed. Cl. 313, 324 (2001).

Because water rights are a somewhat unusual type of property, these cases have forced the court to reach deeply into the fundamental nature of property rights and to articulate explicitly the kinds of government actions (e.g., "reasonable and prudent alternatives" contained in a biological opinion) which can constitute a taking. See e.g. *Tulare Lake Basin Water Storage Dist. v. United States*, 59 Fed. Cl. 246 (2003). *See also Hage v. United States*, 35 Fed. Cl. 147, 172 (1996)(citations omitted.)("[T]he right to appropriate water can be a property right. *Amici* provide no reason within our constitutional tradition why water rights, which are as vital as land rights, should receive less protection. . . This court holds that water rights are not 'lesser or diminished' property rights unprotected by the Fifth Amendment. Water rights, like other property rights, are entitled to the full protection of the Constitution.).

In another case recently decided by the U.S. Supreme Court, California water users brought suit alleging that the federal government breached its contract with Westlands Water District and took their water rights under the Fifth Amendment when it reduced the contracted-for allocation of water for the benefit of fish. The Court, however, never reached the merits of the case. Affirming the district courts decision, the Ninth Circuit held that the district court lacked jurisdiction over the Plaintiffs' claims because the plaintiffs were not the intended third-party beneficiaries of the contract between the federal government and the water district. *Orff v. United States*, 358 F. 3d 1137 (9th Cir. 2004). The Supreme Court agreed that the district court lacked jurisdiction over the plaintiffs' claims, but for a different reason. *Orff v. United States*, 125 S. Ct. 2606 (2005). The Supreme Court held that the statute under which the plaintiffs were asserting jurisdiction, the Reclamation Reform Act, 43 U.S.C. §390uu, constituted a waiver of

sovereign immunity only for actions in which the United States is joined as a necessary party, not for actions brought directly against the United States. *Orff v. United States*, 125 S. Ct. 2606, 2609 (2005). The property owners in that case are considering whether to pursue it in the Court of Federal Claims.

A number of other water rights compensation cases are currently pending at various stages of development. In *Klamath Irrigation District et al v. United States*, case number 01-591L, a motion for summary judgment on liability is pending before Judge Francis Allegra. In *Stockton East Water District et al v. United States*, case number 04-541L, the parties are currently briefing cross motions for summary judgment with oral argument set for December 19, 2005 before Judge Christine Miller. Initial discovery on liability closes October 31 in *Casitas Municipal Water District v. United States*, 05-168L, which is pending before Judge John Weiss, who decided *Tulare Lake.* Decisions in these cases, which should be forthcoming shortly, should shed significant light on issues of takings liability, damages and interest calculation.

Tulare Lake Basin Water Storage District et al v. United States

"The federal government is certainly free to preserve fish; it must simply pay for the water it takes to do so." *Tulare Lake Basin Water Storage Dist. v. United States*, 49 Fed. Cl. 313, 324 (2001).

BACKGROUND

The lawsuit challenged the pumping restrictions imposed by the National Marine Fisheries Service and the federal Fish and Wildlife Service under the Endangered Species Act during water years 1992-1994 on the ground that the water loss was an unconstitutional taking of private property without just compensation. Plaintiffs were Tulare Lake Basin Water Storage District, Hansen Ranches, Kern County Water Agency, Lost Hills Water District, H.P. Anderson & Sons, Wheeler Ridge-Maricopa Water Storage District, and several individual water users, individually and on behalf of all other water users in the districts.

KEY ISSUES DECIDED BY THE COURT

The court rejected the federal government's claim that plaintiffs had no right to recover for their water loss, deciding each of the important legal issues in plaintiffs' favor. Key issues raised by the parties, and decided by the court, include:

- Whether plaintiffs' right to receive water is a property right protected against uncompensated taking by the Fifth Amendment?

- Whether the government's diversion of water merely frustrates the purpose of plaintiffs' water contracts, rather than appropriating plaintiffs' right to receive water?

- Whether the federal government's taking of plaintiffs' water rights does no more than exercise a limit on plaintiffs' title that the background principles of state law would otherwise require?

- Whether the constitutionality of the taking of water rights is properly analyzed pursuant to the per se test used for physical takings or pursuant to the three-part factual inquiry used for regulatory takings?

- Whether the federal government may impose the water costs of its protection of winter-run Chinook salmon and delta smelt under the Endangered Species Act on the plaintiffs?

- The appropriate measure of damages for the water taken.

- The appropriate interest rate to be applied for the delay in payment of just compensation.

SIGNIFICANCE OF THE COURT'S HOLDINGS

- **Plaintiffs' Right to Receive Water is Property Protected by the Fifth Amendment.**

The court held that plaintiffs possessed a property right to receive water that is protected against uncompensated taking by the Fifth Amendment's Just Compensation Clause. The court rejected the government's argument that because plaintiffs' right to receive water was pursuant to contract, plaintiffs right did not rise to the level of a protected property interest. The court stated:

> Plaintiffs can claim an identifiable interest in a stipulated volume of water. While under California law the title to water always remains with the state, the right to the water's use is transferred first by permit to DWR, and then by contract to end-users, such as the plaintiffs. Those contracts confer on plaintiffs a right to the exclusive use of prescribed quantities of water, consistent with the terms of the permits. . . . Thus, we see plaintiffs' contract rights in the water's use as superior to all competing interests.

Tulare Lake Basin Water Storage Dist. v. United States, 49 Fed. Cl. 313, 317-18 (2001).

- **The Taking of Water Is Properly Analyzed as A Physical Taking.**

The court held that the taking of water is properly analyzed as a physical taking of property, rejecting the government's argument that the taking should be analyzed as a regulatory taking: "In the context of water rights, a mere restriction on use — the hallmark of a regulatory action — completely eviscerates the right itself since the plaintiffs' sole entitlement is to the use of the water." *Id.* at 319. The court further explained:

> Unlike other species of property where use restrictions may limit some, but not all of the incidents of ownership, the denial of a right to the use of water accomplishes a complete extinction of all value. Thus, by limiting plaintiffs' ability to use an amount of water to which they would otherwise be entitled, the government has essentially substituted itself as the beneficiary of the contract rights with regard to that water and totally displaced the contract holder. . . . To

> the extent, then, that the federal government, by preventing plaintiffs from using the water to which they would otherwise have been entitled, has rendered the usufructuary right to that water valueless, they have thus effected a physical taking.

Id. at 319.

- **The State of California Has the Primary Say Over How Its Water Will Be Used and Allocated.**

The federal government argued that its actions taken to protect the salmon and the smelt were consistent with state law, and that the doctrines of reasonable use and public trust, specifically barred plaintiffs' right to divert water to the detriment of wildlife. The court rejected this argument holding instead that only the State Water Resources Control Board and the California courts, and not the federal government, have the right to determine "[w]hether a particular use or method of diversion is unreasonable or violative of the public trust . . . ." *Id.* at 321. The court further stated that:

> Once an allocation has been made – as was done in D-1485 – that determination defines the scope of plaintiffs' property rights, pronouncements of other agencies notwithstanding. While we accept the principle that California water policy may be ever-evolving, rights based on contracts with the state are not correspondingly self-adjusting. Rather, the promissory assurances they recite remain fixed until formally changed. In the absence of a reallocation by the State Water Resources Control Board, or a determination of illegality by the California courts, the allocation scheme imposed by D-1485 defines the scope of plaintiffs' contract rights.

Id. at 322.

Pointing "to a myriad of state and federal actions as evidence that either the SWRCB or the California courts would have deemed plaintiffs' proposed use unreasonable," the government urged the court to "step into the shoes" of the State and declare that plaintiffs' proposed use of the water would have been unreasonable. *Id.* at 322. The court, however, flatly rejected the government's invitation that it anticipate "how the Board or the California courts would apply the doctrine of reasonable us if the issue were before them. . . . ." *Id.* The court instead held that "[t]he public trust and reasonable use doctrines each require a complex balancing of interests – an exercise of discretion for which this court is not suited and with which it is not charged. To the extent that water allocation in California is a policy judgment – one specifically committed to the SWRCB and the California courts – a finding of unreasonableness by this court would be tantamount to our making California law rather than merely applying it. This is especially true where, as here, the Board charged with such determinations has responded, and continues to respond, to the concerns about fish and wildlife that the government was seeking to address through the implementation of the ESA." *Id.* at 323-24.

Finally, the court emphasized the role of the State in determining the allocation of use of water:

> D-1485 is a comprehensive balancing of interests that recognized that while the "full protection" of fish was perhaps possible, it was not ultimately in the public interest. The SWRCB chose not to revisit that in-depth balancing of water needs and uses even as it reviewed the salinity standards it had set in response to NMFS's biological opinion. We need not attempt to discern the state's response to the threat, then, because the state has in fact spoken.

Id. at 324.

- **The Federal Government Will Be Obligated to Pay for Any State Water it Takes.**

The court recognized that the federal government's decisions to divert plaintiffs' water was based on the government's concerns that the delta smelt and the winter-run Chinook salmon were in jeopardy of extinction. Under the Endangered Species Act, the U.S. Fish and Wildlife Service and National Marine Fisheries Service are required to protect endangered fish and to "halt and reverse the trend toward species extinction, whatever the cost." *Id.* at 315 (quoting *Tennessee Valley Auth. v. Hill*, 437 U.S. 154, 184 (1978)). The court did not purport to limit the government's ability to carry out its responsibilities under the Endangered Species Act: "At issue, then, is not whether the federal government has the authority to protect the winter-run Chinook salmon and delta smelt under the Endangered Species Act, but whether it may impose the costs of their protection solely on plaintiffs." *Id.* at 316. The court's answer to this question is clear: "The federal government is certainly free to preserve the fish; it must simply pay for the water it takes to do so." *Id.* at 324.

- **The Fair Market Value of the Water Taken.**

The court held that "[t]he first step in calculating plaintiffs' recovery is determining the quantity of water taken from each of the plaintiffs. That determination in turn depends on three factors: the overall amount of pumping foregone, the portion of that loss properly attributable to ESA restrictions, and the method by which that quantity would otherwise have been distributed." *Tulare Lake Basin Water Storage Dist. v. United States*, 59 Fed. Cl. 246, 250 (2003). Following a two-week trial, the court rejected the government's contention that the plaintiffs had actually lost no water as a result of federal actions, and found plaintiffs' total water loss to be 307,334 acre-feet.

The court went on to adopt plaintiffs' valuation of roughly $68 per acre-foot, based on 1992 and 1994 Drought Water Bank sales, as the most accurate indicator of fair market value of the water taken. *Id*. at 263-64. The court flatly rejected the government's testimony that "Drought Water Bank sales represented the upper range of the market value for water as evidenced by the fact that the amount of groundwater pumped in the Kern County/Tulare service areas during the years 1992--1994 far exceeded Drought Water Bank purchases. Had the Drought Water Bank prices been truly competitive … water users would have purchased far

more water from the Drought Water Bank rather than relying on pumped groundwater." *Id*. at 263. The value of plaintiffs' water was thus established at $14,599,164.78.

Finally, on a motion for rehearing, the court reversed its initial decision that interest should be measured by the Treasury bill rate, and adopted plaintiffs' contention that interest required to afford complete just compensation should be based on the "prudent investor rule"—how "'a reasonably prudent person' would have invested the funds to 'produce a reasonable return while maintaining safety of principal.'" *Tulare Lake Basin Water Storage Dist. v. United States*, 61 Fed. Cl. 624, 627 (2004) (citations omitted). And because a reasonably prudent investor would have diversified, the court concluded "that the best measure of compensation … is the rate of return achieved on plaintiffs' state-sanctioned accounts—accounts whose mix of investment interests … provides a reasonable rate of return consistent with a high level of safety." *Id.* at 628.

Orff v. United States

In 1963, the U.S. Bureau of Reclamation entered into a water service contract with Westlands Water District, a political subdivision of the state of California, to furnish a specified annual quantity of water. In the early 1990s, the Bureau of Reclamation concluded that to avert harm to fish and other species, it would need to reduce Westlands' water deliveries. Westlands and the Bureau of Reclamation eventually settled. However, a group of California farmers and farming entities who had intervened as plaintiffs in the original Westlands suit, refused to settle and pursued their Fifth Amendment just compensation and breach of contract claims as third-party beneficiaries of the Westlands contract.

The merits of the plaintiffs claims were never reached. Instead, the Ninth Circuit on appeal upheld the district court's holding that it lacked jurisdiction over the plaintiffs' claims because plaintiffs were not the intended third-party beneficiaries of the contract between the U.S. Bureau of Reclamation and the water districts. *Orff v. United States*, 358 F. 3d 1137 (9th Cir. 2004). Orff appealed its claim to the Supreme Court, which held that the district court lacked jurisdiction over the plaintiffs' claims, but for a different reason. *Orff v. United States*, 125 S. Ct. 2606 (2005). The Supreme Court held that the statute under which the plaintiffs were asserting jurisdiction, 43 U.S.C. § 390uu, constituted a waiver of sovereign immunity only for actions in which the United States is joined as a necessary party, not for actions brought directly against the United States. *Id.* at 2609. The Supreme Court did not reach, nor did it discuss, the issue of third-party beneficiary status. Rather, the Supreme Court simply affirmed the Ninth Circuit's dismissal for lack of jurisdiction, holding that Section 390uu did not waive the United States' sovereign immunity for actions brought directly against it.

In finding that 43 U.S.C. § 390uu constitutes a waiver of sovereign immunity only for actions in which the United States is joined as a necessary party, the Supreme Court noted the difference between the language of Section 390uu's and the language of the Tucker Act. *Id*. at 2611.

> Our conclusion draws force from the contrast between § 390uu's language, which speaks in terms of joinder, and the broader phrasing of statutes that waive immunity from suits against the United States alone. For example, the Tucker Act grants the United States Court of Federal Claims "jurisdiction to render judgment upon any claim against the United States founded … upon any express or implied contract with the United States." 28 U.S.C. § 1491(a)(1).

Id.

Plaintiffs in the *Orff* case are considering whether to pursue their claims in the Court of Federal Claims, which has jurisdiction over Tucker Act cases.

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