Federal Circuit Endorses Two Theories for Protecting Water Rights—Takings and Contract

Introduction

Perhaps no other area of natural resources and environmental law is as challenging as Western water law. Competing demands from urban growth, industrial growth, and agricultural uses put unprecedented pressure on our reservoirs and streams, as well as on our legal regimes. And water rights conflicts in arid parts of the country have been exacerbated by drought conditions that have plagued the West in recent years.

Just as the West is the epicenter of many water rights disputes, the U.S. Court of Appeals for the Federal Circuit and its companion trial court, the U.S. Court of Federal Claims (CFC), have become the forum for water rights litigation involving federal claims of contract breach and takings. Water rights disputes come to the CFC because of its unique jurisdictional statute, the Tucker Act, which grants the CFC exclusive jurisdiction over all claims for monetary damages against the federal government. For example, any lawsuits against the Bureau of Reclamation, the National Marine Fisheries Services (NMFS), or the U.S. Fish and Wildlife Service (FWS) seeking payment of just compensation for a taking or damages for a contract breach must be brought in the CFC and cannot be brought in a federal district court.

And because the CFC is a national court, there are no geographic limitations on its jurisdiction. So although a takings claim may arise out of facts that occurred in California, if the claims are against the federal government and seek a monetary remedy, they must be brought in the CFC in Washington, DC. All appeals from the CFC go to the Federal Circuit Court of Appeals, which is also in Washington. And because the U.S. Supreme Court rarely grants certiorari involving takings claims or breach of contract claims from the Federal Circuit, the appellate court has the final word in disputes involving water rights and federal claims of breach or taking.

Just this year the Federal Circuit issued two decisions with far-reaching implications for water rights involving federal reclamation policy and the federal Endangered Species Act. In both of these cases, the Federal Circuit ruled squarely in favor of protecting the water rights and contract rights of the local water district vis-à-vis the federal government.

Casitas Municipal Water District

The Casitas Municipal Water District is located on the central coast of California and provides both municipal drinking and agricultural irrigation water to most of Ventura County. Casitas holds a water right issued by the State and the water is stored in Lake

Casitas, a Bureau of Reclamation facility. Congress authorized construction of the Ventura River Project in 1956.

In 1956, the United States and Casitas entered into a contract providing for the construction of the project by the United States in exchange for a commitment by Casitas to repay the construction costs over a 40-year period and to assume all operation and maintenance costs. In addition, Article 4 of the contract provided that Casitas "shall have the perpetual right to use all water that becomes available through the construction and operation of the project." In addition, Casitas has a water permit from the California State Water Board to divert 107,800 acre-feet of water each year from the Ventura River and to put to beneficial use 28,500 acre-feet of that water each year. From that, Casitas provides drinking water to about 65,000 residents of Ventura County and agricultural water for about 6,000 acres of farm and ranch land.

In 1997, roughly 40 years after completion of the Ventura Project, NMFS listed the Southern California evolutionary significant unit of the west coast steelhead trout as an endangered species in the Project watershed. In 2003, NMFS issued a biological opinion establishing bypass flows from the Casitas Project, and in accordance with that opinion, Reclamation ordered Casitas to physically divert water from the Project to a newly constructed fish ladder, resulting in a permanent loss of about 3,000 acre-feet of Casitas's water each year to facilitate the upstream migration of the steelhead trout.

Casitas complied with the biological opinion and then filed a takings and breach of contract suit in the U.S. Court of Federal Claims. On summary judgment the court dismissed Casitas' contract claim, upholding the government's sovereign act defense and denying Casitas recovery of the $9 million cost of constructing the fish ladder.

Then on a second summary judgment motion decided just before trial, the court ruled that Casitas's taking claim should be decided using the multi-factor regulatory taking analysis (under which Casitas admitted it could not prevail) rather than the physical taking analysis (under which Casitas would win). Agreeing with the government's argument that this result was compelled by the Supreme Court's 2002 decision in *Tahoe-Sierra Preservation Council Inc. v. Tahoe Regional Planning Agency,* 535 U.S. 302 (2002), the trial judge held that water rights cases should be decided using a multi-factor regulatory takings test, rather than the per se, physical takings test heretofore applied by courts in every other water rights takings case.

On appeal, the Federal Circuit flatly rejected the government's argument that the per se physical takings test should not be applied. In fact, the argument was rejected twice by the Federal Circuit, once by the original panel, *Casitas Municipal Water District v. United States,* 543 F.3d 1276 (Fed. Cir. 2008), and once by the Federal Circuit en banc, *Casitas Municipal Water District v. United States,* 556 F.3d 1329 (Fed. Cir. 2009) (en banc). The panel found a physical taking analysis was compelled because the

government's requirement that Casitas divert a specific quantity of water to the fish ladder actively caused Casitas to physically divert the water away from storage, diminishing Casitas's water supply:

> The government also admits that the operation of the fish ladder required water, which prior to the fish ladder's construction flowed into the Casitas Reservoir via the Robles-Casitas Canal, to be physically diverted away from the Robles-Casitas Canal and into the fish ladder. Specifically, the government admits that the operation of the fish ladder includes closing the overshot gate, see Figure 2, which is located in the Robles-Casitas Canal, and that the closure of this gate causes water that would have gone into the Casitas Reservoir via the Robles-Casitas Canal to be diverted into the fish ladder. These admissions make clear that the government did not merely require some water to remain in stream, but instead actively caused the physical diversion of water away from the Robles-Casitas Canal—after the water had left the Ventura River and was in the Robles-Casitas Canal—and towards the fish ladder, thus reducing Casitas' water supply.

Casitas, 543 F.3d at 1291.

In rejecting the government's motion for rehearing, which challenged the panel's decision as inconsistent with Supreme Court precedent, the Federal Circuit ruled that nothing in the *Tahoe-Sierra* decision had changed the law regarding the proper taking test to be applied in a water rights taking case:

> *Tahoe-Sierra* concerns a taking claim arising from the application of a temporary moratorium on land development. The Court held that such a temporary moratorium did not constitute a *per se* taking because "[l]ogically, a fee simple estate cannot be rendered valueless by a temporary prohibition on economic use, because the property will recover value as soon as the prohibition is lifted." *Tahoe-Sierra* does not answer the questions posed by this case. It did not involve a physical taking claim, and it did not address or purport to cut back on the Court's water rights cases. In *Tahoe-Sierra,* the temporary moratorium at issue preserved the status quo for 32 months, and then returned the land to its owner. In our case, the government diverts the water out of the Robles-Casitas Canal and sends it down the fish ladder to the Ventura River below the Robles Dam. That water will never flow to Lake Casitas, and it is permanently taken from Casitas.

Casitas, 556 F.3d at 1332–1333 (citation omitted).

The Federal Circuit remanded Casitas for trial, which is set for May 10, 2010.

Stockton East/Central Water Districts

A few months later, a different panel of the Federal Circuit decided another California water rights case, *Stockton East Water District v. United States,* 583 F.3d 1344 (Fed. Cir. 2009). In the *Stockton East* decision, the court did not overlook the fact that California occupies a preeminent place in the water wars:

> In the history of the western United States, the fight for water rights is a central theme. California, because a goodly part of the state shares the desert-like conditions that lie at the root of the fight, since before its founding has been one of the locales for this battle. This case is another chapter in that state's long-running history of water disputes.

Stockton East, 583 F.3d at 1348.

The plaintiffs in the case were two Central Valley water districts, Stockton East and Central San Joaquin. The state legislature set up these agencies to distribute surface water in order to alleviate the relentless draw-down of aquifers by farmers and municipalities in San Joaquin County (south of Sacramento). The districts held nearly identical contracts with the Bureau of Reclamation that entitled them to up to 155,000 acre-feet of water a year from the New Melones reservoir, a unit of the massive California Valley Project. Most of Stockton East's water went to the City of Stockton and surrounding towns, while Central's supply was aimed at San Joaquin farmers.

The two water districts together had spent upwards of $60 million to build facilities, including a three-mile-long tunnel drilled through solid mountain granite, to transport the water from this Sierra foothills reservoir to their districts in the Central Valley. But, just as the tunnel was being completed and the districts readied to receive their water, in 1992 Congress passed the Central Valley Project Improvement Act, a statute ordering the Bureau of Reclamation to re-allocate 800,000 acre-feet of Central Valley Project water from irrigation to help stem the decline of fish populations in the Sacramento delta. Reclamation chose to annually satisfy a large chunk of this reallocation requirement with water in the New Melones reservoir earmarked (but never delivered to) Central and Stockton, rather than supply it to the districts.

Because this reallocation of water to fish protection left little or no water to satisfy their contracts, the districts sued the United States asserting breach of their contracts and taking of their water rights. Following an eight-day trial, the Court of Federal Claims found for the government and the districts appealed. On September 30, 2009, a few months after handing down the *Casitas* opinion, the Federal Circuit handed the government a second loss, reversing the trial court's decision and remanding the case for a determination of damages.

In a split opinion, the Court of Appeals first noted that the trial court had found that in each year from 1993 to 2004, Reclamation breached the 1983 contracts by not making available the amounts of water in the annual minimum purchase and supply schedule set out in the contracts. But the trial court concluded that Reclamation's failure to deliver the required water was excused by two other provisions of the contracts. One provision provided that Reclamation would not be liable if, in the opinion of the contracting officer, the non-delivery of water was due to drought or other causes beyond the control of the United States. And the other required that decisions of the contracting officer be reasonable, rather than arbitrary and capricious. Both provisions are fairly standard (with minor variations) in Bureau of Reclamation contracts.

Reversing the trial court's holding, the Federal Circuit identified and rejected three arguments the government made on appeal. First, the government claimed that the contracts were entered into in light of federal reclamation law and state permits and any changes in law, even changes such as those Congress made years after the contracts were entered into, are incorporated as a matter of fundamental law into the contracts. This, the Federal Circuit called the "inherency" defense. Second, the government asserted that specific provisions of the contracts provide the government with a valid defense, which the court termed the "contract provision" defense. Finally, the court discussed and upheld the trial court's determination that the sovereign acts defense did not shield the government in this case.

The court characterized the government's inherency defense, based as it was on recitals that the contracts were entered into pursuant to the Reclamation Act of 1902 and its implementing regulations, as amended, as arguing for an illusory contract of adhesion that the government could change at any time. The court went so far as to say that this defense raises a "question whether such a construction would also make the Government subject to a claim of unfair dealing and fraud for in inducing a party to enter into such a contract and expend substantial sums in compliance with it." *Stockton East*, 583 F.3d at 1357. Most importantly, the court found that specific exculpatory provisions in the contracts that did not include the inherency defense undermined the government's argument that changes in law or regulation were, in fact, additional grounds for escaping contractual liability.

Next, the court took up the exculpatory provision that the United States would not be liable for shortages due to drought or other cause beyond its control. The court rejected the government's argument that "changes in law, or changes in government policy, or changes in management practices brought about by the Government's changes in law or policy," are causes beyond the government's control. *Stockton East*, 583 F.3d at 1362. The court distinguished the Ninth Circuit's decision in *O'Neill v. United States*, 50 F.3d 677 (9th Cir. 1995), holding that a similar (but not identical) exculpatory provision in the Westlands Water District contract did relieve the United States of liability for non-delivery of water due to any cause.

Third, the court rejected the government's sovereign act defense, holding that Reclamation's water management decisions at New Melones were discretionary, while the sovereign act defense requires the government to demonstrate that contract performance was made impossible by the statute. The court recognized that this holding is in tension with the *Casitas* decision upholding the government's sovereign act defense, but did little to resolve the conflict.

Finally, the Federal Circuit reversed the trial court's dismissal of the water districts' Fifth Amendment takings claims for the two years in which they could not recover on their contract claims. Rejecting the trial court's holding that the existence of a government contract automatically precludes a taking claim based on the same facts, the court relied on standard rules of alternative pleading:

> It cannot be understood as precluding a party from alleging in the same complaint two alternative theories for recovery against the Government, for example, one for breach of contract and one for a taking under the Fifth Amendment to the Constitution. That is expressly permitted by the Federal Rules, and the fact that the theories may be inconsistent is of no moment.

Stockton East, 583 F.3d at 1368.

Conclusion

Interestingly, both decisions were rendered by two entirely different panels of judges and in one case—*Casitas*—the Solicitor General declined to petition for certiorari and the case is now back before the trial judge on damages. And in the second case, *Stockton East/Central*, the Solicitor General has not yet determined if it will petition Supreme Court review. Regardless of the eventual outcome of these cases, the Federal Circuit's decisions certainly underscore that local water rights, be they water rights or contract rights, cannot be ignored in federal reclamation and environmental decision-making.

Nancie G. Marzulla helps water districts, local entities, and private parties protect their water rights in her practice in the Washington, DC-law firm of Marzulla Law, LLC. She was involved in the litigation and appeal of the *Casitas* and *Stockton East* cases.