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FEATURE ARTICLE

LET'S GET PHYSICAL—WATER RIGHTS, TAKINGS, AND THE ENDANGERED SPECIES ACT

By Austin Cho

The turbulence of climate change has added a great deal of uncertainty to water rights throughout the arid West. Notwithstanding the recent flurry of winter storms, California is still held captive by one of the longest and driest droughts to occur since it became a state in 1850. The Pacific Institute's California Drought Monitor reports that while record precipitation may have eased drought conditions in some areas, 28 percent of the state is still classified as "extreme-to-exceptional." Many of the state's groundwater aquifers remain in overdraft. For the moment, Governor Brown's 2014 declaration of a drought state of emergency is still in effect. Similarly, the State Water Resources Control Board (SWRCB) has indicated it will likely maintain its drought conservation rules for urban water users. Moreover, a host of environmental protection statutes place additional pressures on government agencies to respond to the effects of climate change with conservation measures that can often further impact water users' diversion rights.

With so few assurances in place for water security, it is easy to see why water users are often at odds with environmental laws and regulations. A recent Federal Court of Claims decision, authored by Judge Marilyn Blank Horn, suggests right holders may be entitled to relief from government actions that limit the use of a water right without compensation, even when those actions are mandated by a statute like the federal Endangered Species Act (ESA). In holding that the U.S. Bureau of Reclamation's (Bureau) cessation of water deliveries should be viewed as a physical taking rather than a regulatory taking, the court in *Klamath Irrigation v. U.S.*, ___F.Supp.3d___, Case No. 1-591L (Fed. Cl. Dec. 21, 2016) brought farmers and irrigators one step closer to prevailing in a 16-year legal battle that exemplifies the challenges for diverters in the Klamath River Basin and other water-starved regions. Although critical issues remain in dispute, the decision may open the door for water right holders in California and elsewhere to challenge government actions under a physical takings theory when water is taken to meet environmental obligations.

The Endangered Species Act

The ESA was enacted in 1973 amid a national surge in the sentiment that humans, as the stewards of the natural world, are duty-bound to protect and preserve threatened wildlife species and their habitats. In no uncertain terms, the "plain intent of Congress in enacting this statute was to halt and reverse the trend toward species extinction, whatever the cost." *Tennessee Valley Authority v. Hill*, 437 U.S. 153, 184 (1978). With its strong directives and broad applicability, the ESA has been praised by its supporters and decried by its critics with equal fervor.

Under the ESA, federal agencies are tasked with providing:

> …a means whereby the ecosystems upon which endangered species and threatened species depend may be conserved … [and] a program for the conservation of such endangered species and threatened species. 16 U.S.C. § 1531(b).

Section 7(a)(2), in particular, requires all federal agencies to ensure that any actions they undertake, fund, or authorize are not likely to result in jeopardy to a listed species or in adverse modification to a listed or threatened species' critical habitat. Section 9 of the ESA prohibits any person, including government agencies, from "taking" a species that has been listed as endangered or threatened, though in this

context the term "take" means to:

> …harass, harm, pursue, hunt, shoot, wound, kill, trap, capture, or collect, or attempt to engage in any such conduct. 16 U.S.C. § 1532(19).

The ESA has operated to constrain the traditional exercise of water rights and limit or modify how proposed projects are carried out. Many of the Bureau's dams and reservoirs lie on waterways that serve as the habitats of fish and wildlife species listed as threatened or endangered under the ESA. Accordingly, the ESA requires the Bureau to evaluate the potential to adversely affect listed species in the course of its operational activities

The Takings Clause

The Fifth Amendment of the U.S. Constitution enshrines a core tenet of property ownership, providing in pertinent part: "…nor shall private property be taken for public use, without just compensation." The U.S. Supreme Court has maintained that the Takings Clause was "designed to bar Government from forcing some people alone to bear public burdens which, should be borne by the public as a whole," by securing compensation in the event of otherwise necessary interference. *Armstrong v. U.S.*, 364 U.S. 40, 49 (1960).

Courts engaging in takings analysis employ a two-part test: to prevail in a claim under the Takings Clause, a plaintiff must demonstrate i) a cognizable property interest that ii) the government took for public use without providing proper compensation. *See, Am. Pelagic Fishing Co. v. U.S.* 379 F.3d 1363, 1372 (Fed. Cir. 2004). Property rights do not stem from the Constitution; whether an asserted interest actually rises to the level of being property, and the nature and scope of those asserted interests, depend on some "independent source" such as state law. *Lucas v. South Carolina Coastal Council,* 505 U.S. 1003, 1030 (1992).

Establishing a Property Interest in Water

When it comes to water, the normally straightforward first prong of the takings analysis—property ownership—becomes slightly more complicated. Water rights are usufructuary—meaning one may be assigned the right to use water, but does not own the water outright. *See, Eddy v. Simpson*, 3 Cal. 249, 252 (1853) (noting the right of property in water "consists not so much of the fluid itself as the advantage of its use."). The right to the actual corpus of water is considered to be held by the people and managed in trust by the states involved. *See*, *e.g.*, *California Oregon Power Co. v. Beaver Portland Cement Co.*, 295 U.S. 142, 162 (1935) (holding unappropriated waters are to be held free for the use of the public). Indeed, both Oregon and California acknowledge their duties as trustees of the water resources of their citizenry. *See,* Or. Rev. Stat. § 537.110 ("[a]ll water within the state from all sources of water supply belongs to the public."); Cal. Wat. Code, § 102 ("All water within the State is the property of the people of the State, but the right to the use of water may be acquired by appropriation in the manner provided by law."). Thus, a takings analysis with regard to water rights can involve impairments on the right of use or the right to divert.

Physical Takings vs. Regulatory Takings

Under the second prong of the analysis, a court must determine whether the government took a property interest for some public benefit; however, this is typically much easier said than done. Takings can be divided into two categories: physical takings and regulatory takings. Physical takings occur when the government takes possession of or physically occupies property. In contrast, regulatory takings occur when the government's regulation indirectly restricts a particular use to which an owner may put his property to the point that the property loses all economic benefit.

In the context of environmental protections that can require water to be remain in stream for flow or temperature management, the distinction between a physical deprivation and regulatory limitation of water can be subtle. But the application of one framework over the other makes a significant difference. This is because physical takings are considered *per se* takings and impose a "categorical duty" on the government to compensate the owner. When an owner has suffered a physical invasion of his property, courts have held that:

> …no matter how minute the intrusion, and no matter how weighty the public purpose behind it, we have required compensation. *Lucas*, 505 U.S. at 1015.

On the other hand, regulatory takings generally require an ad hoc balancing of all facts considered in totality, utilizing the so-called *Penn Central* test,

before compensation is deemed appropriate. *Tahoe-Sierra Preservation Council, Inc. v. Tahoe Regional Planning Agency,* 535 U.S. 302, 323-324 (2002). The *Penn-Central* test employs a multi-factor analysis that weighs the economic impact of the regulation on private property, the extent to which the regulation interferes with distinct, investment-backed expectations, and the character of the government action. *Penn Central Transp. Co. v. City of New York,* 438 U.S. 104, 124 (1978). Despite the oft-cited articulation of *Penn Central*'s guidelines, the overall uncertainty and lack of bright-line rules, as well as a general deference to the government's justifications for its actions, can make it extremely difficult for plaintiffs to prevail under a regulatory takings analysis. In other cases, courts have refused to apply either framework. *See, Tulare Lake Basin Water Storage District v. U.S.,* 49 Fed. Cl. 313, 318 (2001) (the Fifth Amendment applies only to direct appropriations, not the consequential injuries resulting from the government's lawful actions).

The *Klamath Irrigation v. U.S.* Decision

The Klamath Irrigation Project

The setting for the present case is representative of the difficulties the Bureau often faces in trying to achieve its goal of supplying contractors with reliable water, while at the same time protecting endangered species under the ESA, the consequences of which tend to fall on water right holders. The Klamath River Basin is a vast watershed that stretches across southern Oregon and northern California, featuring distinct geologies, topographies, and agriculture throughout its upper and lower basins. Farming and ranching occupy much of the area, with many of the region's 3,000 farms owned by sole proprietors.

The Klamath Irrigation Project (Klamath Project) is a water management project operated by the Bureau of Reclamation to supply roughly 240,000 acres of irrigable farmland across the Oregon-California border with water from the Upper Klamath Lake and Klamath River. *Klamath Irrigation*, 2016 WL 7385039, at *1. The water is delivered pursuant to the terms of perpetual repayment contracts between various contractors and the Bureau by way of a system of diversion channels, canals, and tunnels. *Id.*

The Klamath Project also supplies water to the Tule Lake and Lower Klamath National Wildlife Refuges, which serve as habitats to over 400 wildlife species; including waterfowl, bald eagles, and endangered and threatened fish that include the Lost River sucker, the shortnose sucker, and the Southern Oregon Northern California Coast biological unit of coho salmon. *Id.* at *2. The ESA requires that if the Bureau determines an endangered or threatened species may be affected by a proposed action, it must consult with federal fisheries agencies and potentially modify its actions to avoid jeopardizing the protected species. *Id.*

Procedural History

The *Klamath Irrigation* litigation began in 2001 during a severe drought in the Klamath River Basin. For much of the Klamath Project's operation, landowners "generally received as much water for irrigation as they needed," with occasional reductions to deliveries in the event of severe droughts. *Id.* However, finding that its operation of the Klamath Project in drought conditions would jeopardize the continued existence of the two suckers and coho salmon, the Bureau all but completely halted its deliveries of irrigation water to contractors until after the irrigation season so that it could instead dedicate the water to satisfying its environmental objectives and preserving the listed species. *Id.* at *4.

The termination of deliveries sparked outrage, protests, and caused farmers and irrigation districts to sue the Bureau for withholding Klamath Lake water for fish conservation efforts to the complete exclusion of the contractors' water rights. The initial complaint alleged, among other things, that the government's shut-off of water deliveries amounted to a breach of contract and a taking of the contractors' water rights without just compensation. *Id.* at *5. Although the Court of Claims granted summary judgment in favor of the government, the case was evaluated on appeal, certified to the Oregon Supreme Court, and mandated back to the Court of Claims to determine whether a taking of water rights had indeed occurred. *Id.* On the eve of litigation, both parties submitted motions *in limine* asking the court to decide whether the proper legal framework for analyzing the plaintiffs' claim is the *per se* physical taking framework or the regulatory taking balancing test. *Id.* at *7.

Normally, a court would not address the framework question before first identifying and exploring the extent of the plaintiffs' property interests. Indeed, the Federal Circuit directed in its remand that the Court of Claims should first determine "whether plaintiffs have asserted cognizable property interests" and then

"determine whether … those interests were taken and impaired." *Id.* at *4. However, due to the limited focus of the cross-motions *in limine*, the Court of Claims addressed the second question in isolation from the existing disputes over the nature and extent of the plaintiffs' water rights.

Casitas and the 'Active Hand' of Government

Relying largely on the Federal Circuit's analysis in *Casitas Municipal Water District v. U.S.*, 543 F.3d 1276 (Fed. Cir. 2008), the Court of Claims found in the instant case that the Bureau's impoundment of water upriver from the Klamath Project diverters resembled a physical taking based on the "character of the government action." *Klamath Irrigation*, 2016 WL 7385039, at *8. In *Casitas*, a municipal district challenged the Bureau of Reclamation's requirement that it install a fish ladder to protect steelhead trout under the ESA and allow the use of its waters to operate the fish ladder, thereby reducing the district's available water supply. *Casitas*, 543 F.3d, at 1291-1292. The *Casitas* court rejected the government's contention that its actions merely constituted an indirect and reasonable regulation of water rights, instead finding an "active hand of the government" that physically deprived the plaintiff's water for another purpose. *Id.* at 1292.

The *Casitas* decision was itself guided by three Supreme Court cases in which a physical takings analysis was applied to deprivations of water that the government appropriated for its own use or use by a third party. *See, id.* at 1289-1290. In *International Paper Company v. U.S.*, 282 U.S. 399 (1931), the Supreme Court held that the federal government's diversion of a plaintiff's water for the purposes of power generation, even in the interest of national security during World War I, was a compensable physical taking. *Id.* at 405. As Justice Holmes concluded:

> ….when all the water that it used was withdrawn from the [plaintiff'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. *Id.* at 407.

In *U.S. v. Gerlach Live Stock Company*, 339 U.S. 725 (1950), riparian users along the San Joaquin River claimed the Bureau's construction of the Friant Dam for the Central Valley Project effected a physical taking by diverting waters into canals for export that would have otherwise flowed through the plaintiffs' lands downstream. *Id.* at 727-730.

Similarly, in *Dugan v. Rank*, 372 U.S. 609 (1963), San Joaquin River landowners successfully argued that the Bureau's storage behind the Friant Dam left insufficient water in the river to satisfy their riparian water rights. *Id.* at 614. The Supreme Court explained that:

> …[a] seizure of water rights need not necessarily be a physical invasion of land. It may occur upstream, as here. Interference with or partial taking of water rights in the manner it was accomplished here might be analogized to interference or partial taking of air space over land. (*Id.* at 625.)

The Court explained that where the government acted with the purpose and effect of subordinating the plaintiff's rights to suit its project needs, the "result of depriving the owner of its profitable use" was essentially an "imposition of such a servitude [as] would constitute an appropriation of property for which compensation should be made." *Id.* (alteration in original) (citation omitted).

The *Casitas* court concluded that by requiring the rerouting of water that would have otherwise flowed through the plaintiff's canal, the government's action was:

> …no different than … piping the water to a different location. It is no less a physical appropriation. *Id.* at 1294.

As the Federal Circuit noted, the "appropriate reference point" to determine whether the government effected a physical diversion is not before the project was constructed, "but instead the status quo before the fish ladder was operational." *Id.* at 1292, n. 13. The factual circumstances and analysis in *Casitas* and the Supreme Court cases were determined to be binding precedent for the instant case. *Klamath Irrigation*, 2016 WL 7385039, at *9.

Application of the *Casitas* Rationale

The Court of Claims found that the decision in *Casitas* was directly applicable in light of its similarities to the present facts. The government attempted to distinguish *Casitas* on the ground that the with-

holding of water in Upper Klamath Lake was more akin to merely requiring water to remain in stream than a fish ladder that diverted the plaintiff's water to another location. *Id.* at *10. Judge Horn held that while the Bureau's actions:

> …may not have amounted to as obvious a physical diversion as in *Casitas* … the government's retention of water … did amount to a physical diversion of water. *Id.* (citing *Dugan*, 372 U.S. at 625).

Judge Horn further emphasized the importance of the timing of the government action as a nexus for the physical taking determination:

> By refusing to release water from Upper Klamath Lake and Klamath River, the government prevented water that would have, under the *status quo ante*, flowed into the Klamath Project canals and to the plaintiffs. *Id.* (emphasis in original).

The government also argued that other takings cases "consistently applied a regulatory takings analysis to restrictions on the use of property, including property comprising natural resources that provide benefits for the common good," citing *Penn Central* and other cases in which statutes or regulations themselves imposed restrictions on the use of property. *Id.* Rejecting the government's assertion, Judge Horn noted that in the instant case it was not the ESA that mandated the termination of water deliveries, but the Bureau acting to satisfy its ESA obligations. *Id.* Thus:

> …it was the government actions which denied plaintiffs the use of water they otherwise allege they were entitled to use. *Id.*

Accordingly, the court held that *Casitas* and the supporting Supreme Court decisions were indeed controlling and granted the plaintiffs' cross-motion *in limine* that a physical takings framework should apply. *Id.* at 13.

Additional Litigation

Although the ruling grants the *Klamath Irrigation* plaintiffs a victory in asserting a physical taking, it is far from clear whether they will ultimately prevail in their takings claim. Judge Horn's ruling emphasizes that the plaintiffs' respective rights to the use of water have not yet been determined and therefore must be considered for the case to move forward. As the Federal Circuit held in its remand to the Court of Claims, the existence of a cognizable water right "is controlled by state law, in this case, that of Oregon, or perhaps, California." *Klamath Irrigation Dist.*, 67 Fed.Cl., at 516–517.

The subsequent outcome in *Casitas* illustrates the difficulties that lie ahead for the *Klamath Irrigation* plaintiffs. On remand and employing a physical takings framework, the Court of Claims ultimately determined that *Casitas*' claim was not ripe; the district could not show it had a right to the water in question. *Casitas Municipal Water District v. U.S.* 708 F.3d 1340, 1356-1357 (Fed. Cir. 2013). In its analysis of the scope of Casitas' claimed water rights, the Court of Claims reviewed an appropriative license that allowed the district to divert up to 107,800 acre-feet per year to storage, while only permitting 28,500 acre-feet per year to be put to use. *Casitas*, 708 F.3d at 1355. The district asserted that any deprivation of its storage rights constituted a compensable taking, but the court disagreed. Whether it is considered physical or regulatory, a taking is only compensable if it infringes upon an existing right. The water rights at issue were limited by the California constitutional doctrines of reasonable and beneficial use; a water right holder has no right to appropriate if the use itself is not beneficial. Cal. Const. art. X, § 2. Because California does not recognize the mere act of storing water in itself as a beneficial use, Casitas was precluded from claiming a taking for the restriction on the ability to divert up to that storage capacity. *Id.*

The determination and scope of the *Klamath Irrigation* plaintiffs' water rights under Oregon law will rest upon the three-part test as set forth by state's Supreme Court. *Klamath Irr. Dist. v. U.S.*, 635 F.3d 505, 518 (Fed. Cir. 2011). The Oregon Supreme Court concluded in its certification of the Federal Circuit's questions that the plaintiffs have satisfied the first part by taking Klamath Project water, applying it to their land, and putting it to beneficial use. *Id.* The second part, showing that the relationship between the United States as an appropriator of the Klamath Project water and the plaintiffs as water users is similar to that of a trustee and beneficiary, was also met. *Id.* As for the third part, the Court of Claims will need to analyze the parties' perpetual water deliv-

ery contracts to determine whether the contractual agreements:

> …have clarified, redefined, or altered the foregoing beneficial relationship so as to deprive plaintiffs of cognizable property interests for purposes of their takings … claims. *Id.* at 520.

If so, the *Klamath Irrigation* plaintiffs may find that they have more in common with the *Casitas* plaintiff than they would like.

Conclusion and Implications

The *Klamath Irrigation* decision brings to light the difficulties in achieving the admirable, but often-countervailing goals of meeting water supply demands and the needs for species and habitat conservation. The decision establishes a clear rule in an otherwise murky pool by highlighting the distinction between passive in stream restrictions and active government seizure of water rights. In ruling on the cross-motions *in limine*, Judge Horn has provided a potential path for plaintiffs to avoid situations in which they might spend years of litigation establishing the scope of their water rights, only to be defeated by a deferential balancing test under the regulatory takings analysis.

It bears repeating, however, that while the ruling established a physical takings framework for the second prong of the analysis, it did not address the merits of the preliminary threshold question of the validity of the plaintiffs' underlying water rights. Because the plaintiffs' water rights derive from the delivery contracts they hold with the Bureau, a finding of compensable taking will require proof of a cognizable property interest within the contract terms or other legal bases. Even if the court does eventually find that the *Klamath Irrigation* plaintiffs are due compensation, the quantification of "just compensation" under the Takings Clause as it applies to the right to use water is far from certain. There remains a question of whether the going market rate for a particular volume of water is sufficient, or if the court's assessment should incorporate qualitative factors such as the value of a farmer's water use in the context of the functions it serves for the community as well.

Despite the lingering uncertainty, the decision makes clear that compliance with ESA requirements does not necessarily afford special consideration as to whether a physical or regulatory taking has occurred. Rather, courts will look to the nature of the government action and whether it results in a physical loss of water to determine the appropriate framework.

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