6-14-1994

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Citation Information
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THE FIFTH AMENDMENT AND THE RETAINED SOVEREIGNTY DOCTRINE:

A STUDY OF THE ENDANGERED SPECIES ACT AND THE CENTRAL VALLEY PROJECT IMPROVEMENT ACT AS APPLIED TO CENTRAL VALLEY PROJECT WATER SERVICE CONTRACTS

BRIAN E. GRAY

PROFESSOR OF LAW
UNIVERSITY OF CALIFORNIA
HASTINGS COLLEGE OF THE LAW
I. THE WATER QUALITY REQUIREMENTS


"The Secretary [of the Interior], immediately upon enactment of this title, shall operate the Central valley Project to meet all obligations under state and federal law, including but not limited to the federal Endangered Species Act . . . and all decisions of the California State Water Resources Control Board establishing conditions on applicable licenses and permits for the project. The Secretary, in consultation with other State and Federal agencies, Indian tribes, and affected interests, is further authorized and directed to:

* * *

(2) upon enactment of this title dedicate and manage 800,000 acre-feet of Central Valley Project yield for the primary purpose of implementing the fish, wildlife, and habitat restoration purposes and measures authorized by [the Act]; to assist the State of California in its efforts to protect the waters of the San Francisco Bay/Sacramento-San Joaquin Delta Estuary; and to help meet such obligations as may be legally imposed upon the Central Valley Project under state or federal law following the date of enactment of this title, including but not limited to additional obligations under the federal Endangered Species Act." CVPIA § 3406(b).


"[The Bureau of] Reclamation's declaration of available supplies for water year 1993 is as follows:

CONTRACTORS PERCENT SUPPLY
Agricultural contractors north of the Delta 100
Agricultural contractors south of the Delta 50
Urban contractors south of the Delta 100
Urban contractors south of the Delta 75*
Wildlife refuges north of the Delta 100
Wildlife refuges south of the Delta 75
Fish and Wildlife 100
Sacramento River water rights holders and San Joaquin River exchange contractors 100

* Percentage of historic use.

The forecasted operations meet Endangered Species Act requirements and the requirements of Public Law 102-575 (the Central Valley Project Improvement Act). Two conditions influencing the availability of water for CVP contractors are the cumulative effects of 6 previous years of dry conditions and the practical and regulatory limits of moving water to CVP facilities south of the Delta under the current conditions."

II. THE LAW

A. The Fifth Amendment.

"No person shall . . . be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation."

B. Madera Irrigation District v. Hancock, 985 F.2d 1397, 1400 (9th Cir. 1993).

"Congress can change federal policy, but it cannot write on a blank slate. The old policies deposit a moraine of contracts, conveyances, expectations and investments. Lives, families, businesses, and towns are built on the basis of old policies. When Congress changes course, its flexibility is limited by those interests created under the old policies which enjoy legal protection. Fairness toward those who relied on continuation of past policies cuts toward protection. Flexibility, so that government can adapt to changing conditions and changing majority preferences cuts against. Expectations reasonably based upon constitutionally protected property rights are protected against policy changes by the Fifth Amendment. Those based only on economic and political predictions, not property rights, are not protected."


"It has long been held . . . that the United States when sued as a contractor cannot be held liable for an obstruction to the performance of the particular contract resulting from its public and general acts as a sovereign."

III. THE CASES

A. Westlands Water District v. United States, No. CV-F-93-5327 OWW (U.S. Dist. Ct., E.D. Calif.).

1. 50% reduction in water service to agricultural contractors south of the Delta, based on the Bureau of Reclamation's compliance with ESA and the CVPIA. This reduction occurred during a 150% of normal water year.

2. Fish, Wildlife & Habitat Restoration Fund Surcharge of $6 per acre foot for irrigation water and $12 per acre foot for M&I water. See CVPIA § 3407(d)(2).

3. Alleged contract rights to water service of a fixed quantity and at a fixed price:

   a. Westlands Contract:

      Article 3(f): "The right to the beneficial use of water furnished to the District pursuant to the terms
of this contract and any renewal hereof shall not be disturbed so long as the District shall fulfill all of its obligations under this contract and any such renewal."

Article 11(a): "There may occur at times during any year a shortage in the quantity of water available for furnishing to the District through and by means of the Project, but in no event shall any liability accrue against the United States or any of its officers, agents, or employees for any damage, direct or indirect, arising from a shortage on account of errors in operation, drought, or any other causes. . . ."

Article 26: "In the event that the Congress of the United States repeals the so-called excess-land provisions of the Federal reclamation laws, Articles 23, 24, and 25 of this contract will no longer be of any force or effect, and, in the event that Congress amends the excess-land provisions or other provisions of the Federal reclamation laws, the United States agrees, at the option of the District, to negotiate amendments of appropriate articles of this contract, all consistently with the provisions of such repeal or amendment."

b. **Shortage Provisions of the Other San Luis Unit Contracts:**

"In its operation of the Project, the United States will use all reasonable means to guard against a condition of shortage in the quantity of water available to the Contractor pursuant to this contract. Nevertheless, if a shortage does occur during any year on account of drought, or other causes which, in the opinion of the Contracting Officer are beyond the control of the United States, no liability shall accrue against the United States or any of its officers, agents, or employees for any damage, direct or indirect, arising therefrom . . . ."

4. Remaining terms of the contracts are between 9 and 15 years.

5. The San Luis Unit contractors--the Westlands, San Benito, San Luis, and Panoche Water Districts--have claimed that the United States has breached their water service contracts in violation of the Fifth Amendment by operating the CVP to comply with ESA and the CVPIA.

6. On February 10, 1994, Judge Oliver W. Wanger granted motions to dismiss Westlands' due process and takings claims, but denied motions to dismiss the Fifth Amendment claims of the other San Luis Unit plaintiffs.


2. The Reclamation Act of 1902.
   b. Small, family farms--160 acre limitation.
   c. Subsidized water.

3. Leased lands loophole:

   "By 1981, only 23\% of the land receiving federal reclamation project water was farmed in operations of 160 acres or less. Three percent of the farming operations receiving reclamation benefits controlled 30\% of all of the irrigated lands in the program. The largest farms, which comprised 20\% of the irrigated acreage in the program, averaged 3,721 irrigable acres. The greatest individual beneficiaries of the practice of unlimited leasing were large corporate farming operations located in California's San Joaquin Valley." \textit{Peterson}, 899 F.2d at 805.

   "The federal subsidy to these large farming operations was enormous. The contract price of water delivered to the Water Districts ranged from $2.00 to $7.50 per acre foot. In contrast, the actual cost to the United States of providing this water was between $8.43 and $55.61. The value of the water subsidy provided to Southern Pacific Land Company alone was estimated at $6 million per year." \textit{Id.}

   "By 1982, the Congressional Budget Office calculated that the United States would in the next five years spend roughly $3.8 billion on Bureau of Reclamation water projects, but would recoup only $275 million as a result of existing reclamation repayment policies." \textit{Id.} at 804.

   a. 960 acre limitation for subsidized water.
   b. Landholdings in excess of the new acreage limitation must pay full cost for project water.
   c. Closure of leasing loophole: The RRA defines landholding as the "total irrigable acreage of one or more tracts of land . . . owned or operated under a
5. The Hammer Clause, 43 U.S.C. § 390cc(b):

Contractors and recipients of project water must elect to amend their existing contracts to conform to the new acreage limitations and pricing provisions - or - effective April 12, 1987, they must pay "full cost" for all water supplied to landholdings of any kind in excess of 160 acres.

6. CVP contractors claimed that the Hammer Clause breached their contracts and therefore violated the due process and takings clauses of the Fifth Amendment.

7. The Court of Appeals held that the contractors did not have explicit contract rights to subsidized water for leased lands in excess of the 160 acre limitation.

8. The contracts provided, however, that no project water would be delivered to excess lands, which were defined as land "in excess of 160 acres held in beneficial ownership of any private individual."

Did the term "beneficial ownership" mean only fee title or all types of ownership of real property, including leasing arrangements? The United States, acting through the Bureau of Reclamation, had interpreted the term "beneficial ownership" to mean only fee interests. This interpretation would support the contractors' claims that they had a right to subsidized project water for leased lands in excess of the 160 acre limitation on land owned in fee.

9. Nevertheless, the Court ruled against the plaintiffs' impairment of contract and Fifth Amendment claims.

10. Interpretational Principles:

"The first step in both due process and taking analysis is to determine whether there is a property right that is protected by the Constitution. * * *

"There is no question that the federal government, 'as sovereign, has the power to enter contracts that confer vested rights, and the concomitant duty to honor those rights.'" Nonetheless, when interpreting the federal government's contractual agreements, we are guided by three paramount principles:
First, "sovereign power, even when unexercised, is an enduring presence that governs all contracts subject to the sovereign's jurisdiction, and will remain intact unless surrendered in unmistakable terms." Thus, "contractual arrangements, including those to which a sovereign itself is party, 'remain subject to subsequent legislation' by the sovereign."

Second, governmental contracts "should be construed, if possible, to avoid foreclosing exercise of sovereign authority."

Third, governmental contracts should be interpreted against the backdrop of the legislative scheme that authorized them, and our interpretation of ambiguous terms or implied covenants can only be made in light of the policies underlying the controlling legislation."

Peterson, 899 F.2d at 807 (quoting Bowen v. Public Agencies Opposed to Social Security Entrapment, 477 U.S. 41, 52 (1986)).

11. The Court also rejected the plaintiffs' claim that a contract term that is commonly used in the CVP contracts waives Congress' sovereign power to change the law and to apply the new law to existing CVP contracts.

"In our view, the clause granting the Districts the option of renegotiating their contracts cannot reasonably be interpreted as a 'surrender[] in unmistakable terms' of the sovereign's power to make changes in the federal reclamation laws. Such an interpretation would do violence to the principle that government contracts should be construed, whenever possible, 'to avoid foreclosing exercise of sovereign authority.' In light of this principle, we believe that a more reasonable interpretation of Article 21 is that it grants the Water Districts the option of renegotiating the terms of their contracts to conform to Congress's amendments to the excess land provisions of the reclamation law. This option does not, however, give the Water Districts the right to continue to receive reclamation water under the terms of the pre-existing contracts if those terms violate the newly amended law." Id. at 812.
C. Madera Irrigation District v. Hancock, 985 F.2d 1397 (9th Cir. 1993)

   
   In all renewal contracts, CVP contractors must repay to the United States any accumulated deficit of O&M expenses not paid under their existing contracts.

2. The O&M deficit was caused by the use of long-term, fixed rate contracts and drastically increased O&M costs from the mid-1960's to present.

   By 1986, the system-wide O&M deficit for the CVP was $38 million.

3. Madera has a permanent contract right to water service at rates that "shall not exceed charges to others than the District for the same class of water and service" within the Friant Unit of the CVP.

4. Madera claimed that the 1986 statute breached this contract right, because rates under Madera's renewed contract would include repayment of its accumulated O&M deficit and therefore would be higher than other Friant Unit contractors' rates, some of which have no O&M deficit. Madera alleged that this breach of contract violated both the due process and takings clauses of the Fifth Amendment.

5. The Court of Appeals rejected Madera's Fifth Amendment claims, concluding that Madera's contract rights were not sufficiently clear and categorical:

   "Congress decided in the plainest terms to change its policy, so that instead of buying subsidized water, purchasers of the new water will have to pay its full operation and maintenance costs, plus an increment measured by the subsidy furnished to purchasers of the old water. We are unable to say that by the words, 'shall not exceed charges made to others than the District for the same class of water and service,' the government's sovereign authority to charge more for water service with a higher operation and maintenance cost was 'surrendered in unmistakable terms.'" Madera, 985 F.2d at 1404.
IV. EVALUATION OF THE PRESERVED SOVEREIGN POWER DOCTRINE

A. The Power to Tax.

1. CVPIA § 3407(d)(2)--The Restoration Fund Surcharge.

   a. Long-term coal leases at fixed royalty payments to the Tribe.
   b. According to the contracts, "No change may be made in the rate of royalty or annual rental without written consent of the parties."
   c. The Tribe subsequently enacted a severance tax.
   d. The coal companies claimed that the tax violated their contract rights to fixed royalty payments and therefore was illegal.
   e. The Supreme Court unanimously rejected the coal companies' breach of contract claim. The Court applied the retained sovereignty principle and concluded that

B. Other Substantive Statutory Changes.

1. ESA and CVPIA § 3406(b)--"The Regulatory Water Shortage."

2. Separation of Powers.
   a. Madera Irrigation District v. Hancock, 985 F.2d at 1407 (Hall, J., concurring): "It is doubtful that the Secretary of the Interior could, by contract, waive the right of Congress to pass laws . . . ."
   b. Transohio Savings Bank v. Director, Office of Thrift Supervision, 967 F.2d 598, 621 (D.C. Cir. 1992):

"[W]e assume without expressing a view that Congress might delegate to an agency the power to contract away Congress' regulatory power--though the Supreme Court has never considered such a congressional delegation.

"Even if such a delegation is permissible, however, Congress cannot be found to have delegated to an agency the power to preclude subsequent regulatory legislation unless the delegation was explicit. In the context of
contracts entered into by administrative agencies, in other words, the [retained sovereignty] doctrine has two components: the contract relinquishes Congress' power to regulate only when (1) the agency, in the contract has unmistakably waived Congress' regulatory authority, and (2) Congress, in a statute, has unmistakably delegated to the agency the power to surrender Congress' regulatory authority.

3. Frustration of Congressional Purposes.
   a. The contention that new laws may not be applied to existing contracts is a substantive due process claim. See Western Fuels-Utah, Inc. v. Lujan, 895 F.2d 780, 789-90 (D.C. Cir. 1990).
   b. Rejection of the retained sovereignty doctrine "would allow federal agencies to supplant congressional policymaking by contracting away Congress' power to regulate. . . . [A]gencies would be making laws not pursuant to congressional direction, but over Congress' objections. The framers, however, 'fully recognized that nothing would so jeopardize the legitimacy of a system of government that relies upon the ebbs and flows of politics to "clean out the rascals" than the possibility that those same rascals might perpetuate their policies simply by locking them into binding contracts.'" Transohio, 967 F.2d at 622 (quoting United States Trust Co, v. New Jersey, 431 U.S. 1, 45 (1977) (Brennan, J., dissenting)).

   a. Forced subsidies at amounts greater than the public's representatives have authorized.
   b. Forced water deliveries at costs that the public has chosen not to bear--water pollution, declining fisheries, loss of wetlands and riparian habitat.
   c. Forced transfers of public resources to private use that the public no longer supports.

C. Two Criticisms.
   1. The "public" resources have been effectively converted to private resources by the contracts in question.

By applying new laws to existing contract rights, the United States has violated the proscription articulated by the Supreme Court in Lucas v. South
Carolina Coastal Council, 112 U.S. 2886 (1992), that "[t]he state by ipse dixit may not transform private property into public property without compensation."

2. As the Court of Appeals stated in Madera, 985 F.2d at 1401: "Too liberal an interpretation of the residual sovereign power of the government to override its contractual commitments would eviscerate the government's power to bind itself to contracts."

D. Responses.

1. These cases stand primarily for the proposition that the courts should scrutinize carefully the contract right asserted as a bar to the application of the amended law. The Fifth Amendment only protects "property," which is defined formally by the precise terms of the contracts and applicable law. It does not protect expectations or inferences that are not based on the express and unequivocal terms of the contracts.

This is consistent with the holding in Lucas that restrictions that "inhere in the title itself" may be enforced even if the result is the complete elimination of the value or benefits associated with the contract or real property in question. See 112 U.S. at 2900.

2. If the contract has created property rights enforceable under the Fifth Amendment, a distinction must be drawn between prospective and retrospective application.

As the Supreme Court observed in Public Agencies, 477 U.S. at 51: "Congress' exercise of the reserved power has a limit in that Congress could not rely on that power to take away . . . the fruits [of the contract] already reduced to possession."

Prospectively, the "private rights" retain their public character insofar as the public is not constitutionally required to honor contractual requirements for future transfers of resources to private ownership that would conflict with the new law.

3. The concern that the retained sovereignty doctrine will impair the ability of the United States to enter into contracts ignores several important facts.

a. Many contracts and other licensed activities in the natural resources area embody federal subsidies—e.g., water service contracts, timber sales agreements, mineral leases, and grazing permits.
As the Supreme Court stated in *Irrigation District v. McCracken*, 357 U.S. 275, 296 (1958) (quoting *Wickard v. Filburn*, 317 U.S. 111, 131 (1942)), "'It is hardly lack of due process for the Government to regulate that which it subsidizes.'"

b. The parties to more traditional government contracts—those that are the products of arm's length negotiations—can take the risk of changes in the governing law into account in bargaining over the terms of the contracts.

c. Ultimately, this concern is more properly addressed to the Congress and the Executive.

V. CONCLUSION

The retained sovereignty doctrine may be controversial, or even counterintuitive. It represents, however, a salutary means of ensuring that what Charles Wilkinson has called the "Lords of Yesteryear"—the predominantly developmental and exploitative resource policies of the General Mining Law, the Forest Service Organic Act, the Reclamation Act, and other laws—do not frustrate modern efforts to accommodate resource develop with contemporary values, embodied in contemporary laws, supported by contemporary scientific understanding.

VI. RELATED CASES OF INTEREST


*Swanson v. Babbitt*, 3 F.3d 1348 (9th Cir. 1993) (mining patent application—retained sovereignty doctrine not needed).