# REGULATORY TAKINGS:
# THE INTERSECTION OF TAKINGS AND PROPERTY RIGHTS

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★ **Profile**

Josh practices in the areas of environmental law, administrative law, water law, electric utility regulation, and related litigation. He represents municipalities, river authorities, water districts, and private entities in these and related matters before state and federal agencies and in state court.

★ **Representative Experience**

Josh has handled numerous environmental and property law litigation cases including groundwater rights cases, title and easement disputes, and land use disputes. He has represented clients in contested case hearings before Texas Commission on Environmental Quality (TCEQ) and Public Utility Commission (PUC), including electric and water utility rate cases and issues pertaining to municipal utility districts. He has drafted comments on behalf of clients in administrative rulemaking proceedings. He has participated in administrative proceedings regarding permitting and operations of municipal solid waste facilities, permitting of groundwater wells and surface water impoundments, siting of natural gas facilities, electric utility transmission, generation and cost recovery, and water utility compliance and operations. Josh has appellate experience, having briefed numerous cases before the Courts of Appeals in Texas, the Texas Supreme Court, and the Fifth Circuit Court of Appeals.

★ **Educational and Professional Background**

University of Houston Law Center (J.D. - cum laude); Rice University (B.A. - Economics and English); Chief Articles Editor, Houston Journal of Health Law and Policy, 2004-2005; President, University of Houston Environmental and Energy Law Society, 2003-2004.

Admitted to Practice: Supreme Court of Texas; United States Court of Appeals for the Fifth Circuit Court; United States District Court for the Western, Eastern, and Southern Districts of Texas.

Member, State Bar of Texas (Environmental and Natural Resources Law Section and Administrative and Public Law Section); Member, Austin Bar Association (Administrative Law Section and Natural Resources, Environmental, and Water Law Section).

Board of Directors Member - Austin Symphony BATS (Be At The Symphony); Treasurer, 2008-2010.

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It is a difficult time to be the general manager of a groundwater conservation district in Texas. In addition to the general work of a groundwater conservation district, which includes but is not limited to managing the groundwater resource in order to achieve Desired Future Conditions ("DFCs") – the recent Supreme Court decision in *Edwards Aquifer Authority v. Day*, 369 S.W.3d 814 (Tex. 2012) seemingly hands districts a contradictory and mutually exclusive mandate with regard to property rights and potential takings litigation. Consider the following language from the *Day* opinion:

- "Unquestionably, the State is empowered to regulate groundwater production." *Id*. at 840.
- "Regulation is essential to [groundwater's] conservation and use." *Id*.
- The rule of ownership must be considered in connection with the law of capture and is subject to police regulations. *Id*. at 832.
- Each landowner "owns separately, distinctly, and exclusively all the water under his land." *Id*. at 832.
- "[L]andowners do have a constitutionally compensable interest in groundwater." *Id*. at 839.
- "Groundwater rights are property rights subject to constitutional protection, whatever difficulties may lie in determining adequate compensation for a taking." *Id*. at 833.

The questions raised by *Day* are significant: What kind of regulation, if any, may a groundwater district enforce without incurring takings liability? How does a groundwater district balance its dual mandate to achieve DFCs but also respect property rights in groundwater? If a taking occurs, how does a court determine the amount of liability?

The Supreme Court in *Day* reversed the lower courts' grant of summary judgment in favor of the Edwards Aquifer Authority ("EAA") on the plaintiffs' claims that a taking of their groundwater occurred, and remanded the case to the district court to develop the record on whether the EAA's actions constituted a taking. However, this proceeding would never occur, as the parties settled prior to the continuation of the proceeding in district court. These questions therefore remained unsettled by the *Day* litigation.

Fortunately, another significant case on groundwater takings was waiting in the wings to provide one Court of Appeals' preliminary answers. On August 28, 2013, the San Antonio Court of Appeals issued its Judgment in *EAA v. Bragg*, __ S.W.3d __ 2013 WL 4535935.[1] The San Antonio Court in *Bragg* considered the principal question of whether a groundwater conservation district's denial (or substantial denial) of an application to produce groundwater constitutes a taking of property rights without compensation, and if so, the proper measure of compensation for that taking. Along the way, the Court also considered several ancillary issues: Whether the State of Texas or the EAA is liable for any taking resulting from implementation of the EAA's enabling act (Answer: The state might be a proper party, but the plaintiffs sued only EAA, which was a proper party), and the statute of limitations that applies to a claim for a regulatory taking of groundwater (Answer: 10 years, from the date the EAA acted on the permit applications).

The Braggs own two commercial pecan orchards located over the Edwards Aquifer near Hondo, Texas that are now within the territory of the EAA, but were not at the time of purchase. In 1979, they purchased the 60 acre Home Place Orchard, and planted 1,820 pecan tree seedlings. In 1980, they drilled an Edwards Aquifer well and installed an irrigation system at this orchard. In 1983, the Braggs purchased the nearby, 42 acre D'Hanis Orchard, which was already planted with 1,500 pecan trees. This orchard was initially irrigated by a shallow, non-Edwards well before in 1995 receiving a permit to drill an Edwards well from the regulatory authority in existence at that time, the Medina County Groundwater Conservation District.

The Edwards Aquifer Authority Act ("EAAA") was enacted by the Texas Legislature in 1993, creating the EAA to manage groundwater withdrawals from the Edwards Aquifer by a permit system and establishing an aquifer-wide cap on withdrawals. Due to several legal challenges, the EAAA did not become effective until 1996. Because the EAAA gave preference to existing users, permit applicants could seek an initial regular permit ("IRP") based on a declaration of their historical use during the historical period of June 1, 1972 through May 31, 1993.

The Braggs applied for IRPs for both orchards, in which they specified their use of groundwater for 1996 – after the end of the historical period – and sought 228.85 acre-feet per year for the Home Place Orchard and 193.12 acre-feet per year for the D'Hanis Orchard. They were awarded permits based on their historical

[1] The Braggs filed a Motion for Rehearing that was denied on Nov. 13, 2013. At the same time, the San Antonio Court withdrew its original opinion and judgment of August 28 and issued a new opinion and judgment in its place. The new opinion, however, is substantively almost identical to the original. *See* ___ S.W.3d __, 2013 WL 5989430 (Tex. App.—San Antonio 2013).

use, and were granted a permit for 120.2 acre-feet for the Home Place Orchard. However, their application was denied in its entirety for the D'Hanis Orchard, as they declared no use within the specified historical period. The Braggs filed their regulatory takings suit giving rise to this opinion in November 2006.

In reaching the regulatory takings question presented by the case, the Court formulated the central issue thusly: "The issue is whether the Act goes so far in restricting the Braggs' use of their water beneath their land that the restriction amounts to a taking and 'in all fairness and justice,' the burden of that restriction should be borne by the public. In this case, the 'use' of water is not the ability to sell or lease water under a permit. Rather, the 'use' of water is the Braggs' ability to operate and irrigate a pecan orchard . . . for the purpose of producing a sustainable pecan crop in Medina County." The intended use of the plaintiffs' property is therefore an important factor for courts to examine when determining the extent to which a regulation has interfered with the investment-backed expectations of a plaintiff and therefore whether the regulation constitutes a taking.

Regulatory takings challenges require an ad hoc, factual inquiry governed by a three-factor test[2] as set out by the United States Supreme Court in *Penn Central Transportation Co. v. New York City*, 438 U.S. 104 (1978). No single Penn Central factor is determinative; all must be evaluated together in a fact-specific and fairly subjective analysis. These factors analyzed by the Court are Economic Impact, Investment-Backed Expectations, and the Nature of the Regulation.

## I. ECONOMIC IMPACT

Under the first *Penn Central* factor, the Court considers the diminution in value of the Braggs' properties precipitated by the regulation in question – in this case, the denial or substantive denial of their IRP applications. Because all property is held subject to a valid exercise of police power,[3] the diminution of value cannot alone establish a taking, and the economic impact must be "substantial." Lost profits are one relevant factor to consider. The trial court found that the highest and best use of both properties was as commercial pecan orchards, and that the Braggs had invested considerable time and money installing irrigation systems and other infrastructure in order to produce a commercial pecan crop. After their applications were granted in a smaller amount (in the case of the Home Place Orchard) and denied (in the case of the D'Hanis Orchard), the Braggs had to take steps to reduce their number of trees by 30-50% and take other conservation measures based on the lack of water, which significantly reduced their yield. The Court determined that the Braggs were unable to raise a commercially viable pecan crop on their properties unless they purchased or leased water under the EAA's permit scheme, and therefore the EAA forced the Braggs to purchase or lease that which they owned prior to the regulation – an unrestricted right to the use of the water beneath their land. *Day*, 369 S.W.3d at 840. Therefore, the Court concluded that this factor "weighs heavily" in favor of finding a compensable taking of both orchards.

## II. INVESTMENT-BACKED EXPECTATIONS

The second *Penn Central* factor is the extent that the regulation interferes with investment-backed expectations – *i.e.*, the existing and permitted uses of the property. Knowledge of existing regulations is considered when determining whether the regulation interferes with these expectations. The purpose of this requirement is "to assess whether the landowner has taken legitimate risks with the reasonable expectation of being able to use the property, which, in fairness and justice, would entitle him or her to compensation." The regulatory scheme in place at the time a person purchases property helps determine the reasonableness of that person's investment-backed expectations. *Palazzolo v. Rhode Island*, 533 U.S. 606, 634 (2001).

The Court observed that the Braggs bought their two orchards in 1979 and 1983, respectively – well before the creation of the EAA – and invested significant time, money, and effort in developing the orchards. They bought their property specifically over the Edwards Aquifer with the intention of using as much groundwater as they wanted from that aquifer to irrigate their pecan trees, with the belief that they owned said groundwater. Because of the lack of regulations at the time the Braggs purchased their orchards, the Court concluded that their investment-backed expectations in the use of this water was reasonable, and that this factor also weighs heavily in favor of a finding of a compensable taking of both orchards.

## III. NATURE OF REGULATIONS

The third *Penn Central* factor focuses on the "nature of the regulation." Here, the conflict between property rights and the need to regulate a vital resource come into clear conflict. Citing *Day*, the Court notes that the State is "unquestionably" empowered to regulate groundwater production, that demand exceeds supply in the Edwards Aquifer, and that regulation is essential to its conservation and use. Each owner of a

[2] As we will see, it's actually a three and a half factor test when the final catch-all category, often referred to as "other considerations," is considered.

[3] *Sheffield Dev. Co. v. City of Glenn Heights*, 140 S.W.3d 660, 669-70 (Tex. 2004).

common subsurface reservoir is entitled to a fair share of the water. Given the importance of "protect[ing] terrestrial and aquatic life, domestic and municipal water supplies, the operation of existing industries, and the economic development of the state," the Court concluded that this factor weighs heavily against a finding of a compensable taking.

## IV. OTHER CONSIDERATIONS

The wildcard, unofficial fourth *Penn Central* factor, the Court here considers other "surrounding" and "relevant" circumstances. Here, the Court considered the fact that the Braggs' business is agricultural and therefore heavily dependent on water, and that rain is an inconsistent and unpredictable source thereof. These "other considerations" supported the Court's ultimate conclusion that the EAA's permitting system resulted in a regulatory taking at the Home Place and D'Hanis Orchards.

## V. COMPENSATION FOR TAKING

The important question remaining, therefore, is how to calculate the compensation owed for a regulatory taking of the Braggs' groundwater. The trial court adopted a bifurcated approach for the two orchards. For the Home Place Orchard, the trial court awarded the difference in market value of the permitted water rights requested by the Braggs compared to the permitted rights they actually received. The Braggs requested that this method be used to calculate the taking of both orchards, as water rights should be valued separately from the surface estate. For the D'Hanis Orchard, the trial court valued the taking as the difference between the market value price per acre for a dry land farm in this area to the market price per acre for irrigated farm land. The EAA favored an approach similar to this one, asking the Court to apply the "parcel as a whole" rule, under which a court compares the value that has been taken from the property due to the regulation with the value that remains in the property.

The Court of Appeals rejected both approaches. It placed great emphasis on defining the property actually taken by EAA. Because the Braggs' investment backed expectations in the purchase of their property (including the water underneath it) was to use that water to benefit their commercially viable pecan orchards, just compensation must be determined by reference to that highest and best use. The Court therefore concluded that the property actually taken was the unlimited use of water to irrigate a commercial pecan orchard, and that this taking must be valued by comparing the value of the Braggs' commercial pecan orchards immediately before and immediately after the provisions of the EAAA were applied to the Braggs' orchards (*ie*, the denial of their D'Hanis permit application, and the granting of the Home Place permit application for an amount less than requested). The Court of Appeals therefore remanded the case to the trial court to calculate the compensation owed to the Braggs based on this measure of their taking.

It is likely that, by the time this article is published, one or both of the parties will have petitioned the Texas Supreme Court for review of any of the holdings in the case, such as whether a taking occurred, and if so, what the proper measure of damages should be. Whether the Supreme Court agrees to hear a petition for review is anyone's guess, although the significant issues at stake suggest that it would. If no petition for review by the Supreme Court is filed, the case would be remanded for a proceeding to determine the value of the taking.

It is also possible that the case could settle first, as did *Day*, leaving the San Antonio Court's opinion in this case as the leading precedent on valuation of a taking of groundwater – but without providing an example from a district court on how to apply this measure of valuing takings damages.

A principal question that remains following *Bragg* is whether groundwater conservation districts are exposed to wide-ranging takings liability any time they do not grant a permit application for the production of groundwater in the full amount requested. Such a result could be financially ruinous for a groundwater district, and would render the fundamental task of a groundwater district – to manage and protect the groundwater resource, and achieve the district's DFCs – nearly impossible. In the author's personal opinion, this will not be the case. *Bragg* involved unique plaintiffs who purchased property well before a groundwater conservation district existed covering their property, and had well documented investment backed expectations in the unregulated use of that groundwater at the time of purchase. A small (but presumably not zero) number of potential plaintiffs would be similarly situated; a plaintiff would likely need to demonstrate that they purchased their land in an area without a groundwater conservation district and with the expectation of producing unlimited groundwater for a specific purpose in order to have reasonable investment-backed expectations to support a taking claim. Even a landowner who owned that land prior to the creation of a groundwater district could fail to demonstrate the specific investment backed expectations in the groundwater that are necessary under *Penn Central*. However, the fact-specific inquiry necessary to analyze a takings claim will add an air of uncertainty to the next takings suits to be filed against groundwater districts.

A secondary question following the *Bragg* opinion is whether a taking of groundwater can ever be measured based on the value of the water itself, valued

as a separate and independent estate from the surface. In *Bragg*, the Court focused on the investment backed expectations of the Plaintiffs, who purchased the property with the intent of using the groundwater to irrigate a commercial crop. The takings damages were therefore the diminution of value between a commercial pecan orchard in their area with the groundwater they need to irrigate compared to a commercial pecan orchard without access to that water. But what if a future Plaintiff purchased land with the specific expectation of marketing, transporting, and selling the groundwater underneath? If denied a permit, presumably the value of the taking would be the measure asked for by the Braggs – the amount of water rights denied by the groundwater conservation district multiplied by the prevailing market value of those rights. It's also possible that, if the Texas Supreme Court takes a petition to review the Court of Appeals' decision in *Bragg*, it could adopt such a measure of damages for the valuation of *all* groundwater takings claims.

*Bragg* is an important case for groundwater takings litigation, but what it means for both property owners and groundwater conservation districts can only be determined once we receive answers from future litigation.