

TAXES, TAKINGS, AND GROUNDWATER
(notes from 8-29-13 presentation to Texas Alliance of Groundwater Districts)

I. INTRODUCTION: ONLY A PRELIMINARY DRAFT OF THOUGHTS

At the beginning, please keep in mind that these are simply notes, most of them raised by the *Day* decision. They shouldn't be taken as a definitive statement, even by me, of the law on any of the topics covered. This should be treated as only a draft, and nothing I say should be attributed to any of my clients. What is said may not be the same as what I ultimately conclude upon further research, analysis, and thought.

II. DAY

You've already heard a lot about the *Day* decision, *Edwards Aquifer Authority v. Day*, 369 S.W.3d 814 (Tex. 2012). It's a critical piece of the analytical puzzle, though, for the two topics I'll be focusing on. Here are some pertinent points I take from the decision.

A. Rule of capture issue differs from the groundwater-in-place ownership issue

It distinguished the question of ownership of groundwater in place from the rule of capture as announced in the 1904 *East* decision—*Houston & T.C. Railway v. East*, 98 Tex. 146, 81 S.W. 279 (1904). *Day* at 823-29 (finding rule of capture is not antithetical to ownership of groundwater in place). This means that title to groundwater that has been drained from someone's property, then brought to the surface by someone else, rests with the drainer not the draine. And, unless there is malice or waste in the drainage, the draine has no tort claim against the drainer.

B. Groundwater is treated the same as oil and gas insofar as in-place ownership is concerned; they are part of the realty.

Groundwater is treated the same as oil and gas insofar as ownership in place is concerned. *Day* at 829-32. This means that groundwater in place is part of the realty, which means it is real property, not personal property.

C. A landowner’s interest in groundwater in place is constitutionally compensable in appropriate circumstances.

The Supreme Court specifically says that landowners “have a constitutionally compensable interest in groundwater,” by which I can only presume is meant groundwater in place. *Day* at 838.

D. “Fair share” regulation of groundwater cannot focus solely on owned surface area, and a solitary focus on non-exempt historical use may be questionable.

Regulation to provide landowners a fair share of groundwater in a common pool “must take into account factors other than surface area.” *Day* at 841. The Court, in what is only dictum, calls into question a sole focus on historic use in permitting decisions, contrasting such a focus with Chapter 36’s requirement that several factors—including proposed use, effect on supply and other permittees, and the approved management plan—be taken into account. *Day* at 841. It implies that one problem with the focus on historic use is its disregard of preservation for “future use” and its consequent incentive to waste water. *Day* at 841-42. Non-use of a limited resource during a given historical period cannot justify deprivation of “all beneficial use” of the groundwater below his property. *Day* at 843.

E. Authority to regulate and validity of the regulation are separate questions from paying compensation for their impact

The Court quotes from Section 1.07 of the Edwards Aquifer Authority Act, where the Legislature said that, if implementation of the law causes a taking, then just compensation should be paid. It then says that the regulations themselves wouldn’t be affected; it would just make regulation “more expensive.” *Day* at 843.

F. Some broad questions raised by *Day*

- Why isn’t more consideration given to the 1917 Conservation Amendment (Tex. Const. Art. XVI, § 59) to the Texas Constitution in the context of regulatory takings? It came long after — 41 years — inclusion of the Just Compensation

Clause (Tex. Const. Art. I, § 17). In the context of the United States Constitution, the Supreme Court has explained that a later-enacted constitutional amendment (the 14th Amendment) “necessarily limited” the reach of an earlier amendment (the 11th Amendment) when there was “appropriate” legislation enacted under authority of the later amendment. *Fitzpatrick v. Bitzer*, 427 U.S. 445, 456 (1976). It seems that the language of subsection (a) of the Conservation Amendment—declaring that conservation of Texas water resources is a “public” right and duty and authorizing the Legislature to enact “appropriate” legislation—put legislation enacted under the Texas Conservation Amendment in the same relation to the Texas Just Compensation Clause as legislation enacted under the federal Fourteenth Amendment is to the federal Eleventh Amendment. Could some aspect of this be what the Court was getting at when it remarked that “[t]he Legislature can discharge its responsibility under the Conservation Amendment *without triggering the Takings Clause*,” *Day* at 843?

- If the basic rule is that a private person can take groundwater from beneath a neighboring landowner’s property for his own private use without owing the landowner any compensation, why is it that a governmental body’s rule limiting the landowner’s withdrawal rights in the interest of long-term preservation of the resource might require payment of compensation?
- Does this passage (*Day* at 841), de-legitimizing the EAA argument that permitting based on historical use is sound policy in recognizing landowner investments and implying that it is a water-wasting policy, make any sense?

But had the permit limitation been anticipated before the EAAA was passed, landowners would have been perversely incentivized to pump as much water as possible . . . to preserve the right to do so going forward.

Of course, this is *not* what happened. The act was *after* the pumping had happened, and there is no reasonable basis in the facts for concluding that the historical pumpers pumped based on the expectation that, years hence, the state would tie future pumping rights to historic pumping. And, besides, waste is not normally treated as an element of historic pumping.

- Doesn’t *Day* mean that virtually the entirety of the Edwards Aquifer is privately owned, and that the number of those owning the aquifer is equal to the number of landowners in the jurisdictional boundaries of the Edwards Aquifer Au-

thority? What if every one of them applied to the EAA for a permit and was denied? What kind of compensation would be owed in an ensuing takings claim?

III. REGULATORY TAKINGS (JUST COMPENSATION)

I won't discuss formal condemnations; the focus is on what is called "inverse condemnation." It is "inverse" because, in contrast to formal condemnations, it is brought by the property owner.

Taken at its word, *Day* certainly sets things up for a flood of takings claims. I'm not sure there's much solace in the fact that the EAA could only identify three takings claims against it, pre-*Day*. *Day* at 843.

A. Basic policy: Don't make individuals bear public burdens without the "public" paying

The basic public policy behind this constitutional principle is that government should not be able to force "some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole." *Armstrong v. U.S.*, 264 U.S. 40, 49 (1960). But doesn't the Conservation Amendment say that conservation of resources is for the public and is a public right?

B. Requires more than just negligent action

If the harm inflicted on property by the government is a result of negligence, rather than an intentional act, there is not a compensable taking.

C. Three categories of inverse condemnations

There are three categories of governmental takings in the inverse condemnation context. One is when the government imposes a "permanent physical occupation" of someone's property. A second is when a regulation completely deprives an owner of all economically beneficial use of the owner's property. The third is a "regulatory taking."

D. Police power and property

All property is held subject to the police power of government, *see, e.g., Sheffield Dev. Co. v. City of Glenn Hts.*, 140 S.W.3d 660, 670 (Tex. 2004)—and by “police power,” I’m referring to the broad authority government holds to take steps to protect and promote the health, safety, and welfare of the public. It is only when the exercise of this police power goes “too far” that a regulation is said to constitute a taking. *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 415 (1922).

E. *Penn Central* factors

The courts have developed a rough set of standards to help them gauge whether a regulation goes “too far.” They are known as the *Penn Central* factors, after *Penn. Cent. Transp. Co. v. City of New York*, 438 U.S. 104, 124 (1978). Under them, a court is to evaluate:

1. The *economic impact* of a regulation.
2. The extent to which the regulation interferes with a landowner’s distinct *investment-backed expectations*.
3. The *character of the government action*.

There is no set formula for applying these standards to the particular facts before the court.

F. Protectable property interest

Establishing a takings claim requires showing that what has been harmed or affected is a “protectable property interest.” *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1000 (1984). The main source for determining whether there is such an interest is state law. *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1030 (1992). This, of course, is where *Day* comes in. It held that groundwater-in-place is a protectable property interest.

G. *Bragg*

As of August 28th, we just happen to have received the Texas courts' fullest exposition to date of how *Day* and the takings rules apply to regulation of groundwater-in-place. The San Antonio Court of Appeals decided *EAA v. Bragg*, No. 04-111-00018-CV. It held that the EAA had made an uncompensated taking of the Braggs' groundwater-in-place when it did not give them a certain level of permitted rights. Here is a summary of what I quickly gleaned to be the main points of the decision. They're stated pretty much without analysis or criticism.

Taking

1. It said that the local authority is answerable for an uncompensated taking, even if it was simply following state law.
2. It said that the taking occurred when the permit was issued, not when the rule or statute was passed which set the permitting standards.
3. It treated the taking as a regulatory taking and applied the *Penn Central* factors.
4. It considered the "use" baseline, for measuring the degree of impact of the permit, to be the "highest and best use" for the property in its location, independent of what the permit allowed. And it measured the degree of economic impact by working from a baseline of the "unrestricted right to the use of the water beneath their land." Working from this, it found a "significant, negative impact."
5. It found that the Braggs' invested a lot of money in the property and that the expectations associated with these investments was reasonable because they thought they owned the groundwater when they bought it and there was no regulatory system in place or on the near-horizon. Also, it said that even when the regulatory system was enacted, its implementation was delayed and investments in the face of that situation still were reasonable since a local government cannot use the threat of regulation to diminish the value of property.

6. It found that the nature of the regulation was to conserve the resource and, therefore, that this factor weighed in the EAA's favor, "heavily against a finding of a compensable taking."

Compensation

7. The court held that valuation was to be at the time of taking, not the time of trial, and that the time of taking was the time of the permit decisions. It rejected application of Tex. Prop. Code § 21.0421—which measures value at the time of trial—to inverse condemnation claims, holding that the situation is quite different in a formal condemnation initiated by the government as compared to an inverse condemnation initiated by the property owner.
8. It rejected the principle that the value of water rights should be valued separate from the land. It held that, since the Braggs did not buy, sell, or lease water as a commodity, but instead used it to benefit their surface-based business, the measure of compensation was the difference between the value of the commercial pecan orchard immediately before and immediately after the permitting actions. The court refused, however, to include in the calculation the added value that came with creation of a market for water right permits (which it likened to rejected "project enhancement" arguments in condemnation cases).

IV. TAXES

I'm not sure it is widely recognized yet, but there is a strong relation between *Day* and taxes. Specifically, I think *Day* may be fairly viewed as a decision in favor of increased taxation of property in Texas.

A. Groundwater-in-place is real property.

Day specifically established this as the rule in Texas. (Is it merely a common law rule of property, as determined by the courts, or is it a creature of statute? *Day* reminds us, citing *Sipriano v. Great Spring Waters of America, Inc.*, 1 S.W.3d 75, 78-79 Tex. 1999), that the Conservation Amendment makes groundwater regulation primarily a *legislative* matter.)

B. Groundwater-in-place and oil and gas in place are alike in terms of their attributes as real property.

Day rests its ruling on this basic proposition.

C. Groundwater estates *may* be severable from the surface estate.

Oil and gas estates may be severed from the surface estate. *Texas Co. v. Dougherty*, 107 Tex. 226, 176 S.W. 717 (1915). Texas law has said in the past that groundwater is a sub-surface substance that “belong[s] to the surface estate as a matter of law.” *Moser v. U.S. Steel Corp.*, 676 S.W.2d 99, 102 (Tex. 1984). But *Day*’s formulation, equating estates in oil and gas with estates in groundwater, may be read to suggest that there is a such a thing as a “groundwater estate” which, like oil and gas, can be severed from the surface estate.

D. Groundwater-in-place is real property subject to separate taxation.

Day seems to make this clear. In earlier days, in *Stephens County v. Mid-Kansas Oil & Gas Co.*, 113 Tex. 160, 254 S.W. 290 (1923), the Supreme Court held that oil and gas in place and leased for production of the minerals are separately taxable interests. *Id.* at 295. As later explained, *Stephens County* held that an oil and gas lease is an “interest in realty that was separately taxable from the surface estate.” *Matagorda County App. Dist. v. Coastal Liquids Ptnrs.*, 165 S.W.3d 329, 332 (Tex. 2005).

E. The Texas Constitution requires that private property *must* be taxed.

Article 8, § 1, of the Texas Constitution requires equal and uniform taxation of all real property in proportion to its value. The Supreme Court has held that this provision means that there is no option about whether to tax private property; it *must* be taxed. *City of Beaumont v. Fertitta*, 415 S.W.2d 902, 909 (Tex. 1967).

F. *Day*’s tax implications in light of current Texas case law

1. Local property taxes are being illegally foregone every day. Central appraisal districts are legally obligated to value those groundwater-in-place properties and place them on the local tax rolls. Failure to take these steps, which

are necessary prerequisites to assessing and collecting taxes on property which *must* be taxed, is legally actionable, certainly by local political subdivisions and maybe by others.

2. The owner of a severed groundwater estate who fails to “render” his property to the local appraisal district should be judicially estopped from asserting that inadequate compensation has been made for any taking by a local groundwater district limiting the property owner’s right to pump.
3. Even for those situations—which probably predominate—in which the groundwater estate has *not* been severed from the surface estate, there are likely to be major disconnects between the valuation (taking into account the real property value of the groundwater-in-place) of the property and, from the other side, the claimed loss of value to the landowner of the right to pump. Shouldn’t they be commensurate? That is, if the lost value attributable to the permit restrictions is said to be quite large, shouldn’t that same value show up in the valuations for the property that are done by the appraisal districts? And how do leases of the groundwater estate play into this? Shouldn’t the lessees be subject to property taxes during the lease term?
4. This taxation issue also highlights the need for a clean and efficient mechanism for severed groundwater estates and for leased groundwater rights. Right now, my impression is that there is a hodge-podge, with no uniform system and that many conveyances of the groundwater estates are going unrecorded, or are recorded so sloppily that they cannot be traced in the future.
5. Finally, why is it that there appears to be no attention being paid to it by local taxing authorities, by appraisal districts, or by the Comptroller’s office which could, but hasn’t, send out notices to local appraisal districts about the problem? Why are local groundwater districts being cowed by excessive claims for compensation when permit limitations are applied without fighting back by highlighting the disconnect between what happens to the landowners on the taxation side concerning groundwater and what’s claimed on the regulation side about the very same groundwater?