INTRODUCTION

In the early 1960's, the State of California began entering into long-term contracts with its water districts. The contracts obligated the State to provide an annual entitlement of water from the State Water Project to the water districts for a fee based on the amount of water the districts receive. [No. 1]

The purpose of this paper is to analyze the extent to which the California legislature may enact legislation that will effect changes to those contracts from the stand point of the due process and the takings clauses of the Fifth Amendment. [No. 2] This paper will examine whether the water districts, through their contractual agreements, have a property interest in receiving their full entitlements of water. In addition, this paper will examine whether the State's subsequent legislation affecting their water entitlements constitutes a taking of property within the meaning of the Fifth Amendment.

Under the doctrine of vested rights, according to Professor Corwin, "[t]he effect of legislation on existing property rights was a primary test of its validity, for if these were essentially impaired then some clear constitutional justification must be found for the legislation or it must succumb to judicial condemnation." E. Corwin, Liberty Against Government, 72 (1948). One constitutional justification mentioned by Professor Corwin is "the inherent right of state and local governments to enact legislation protecting the
health, safety, morals or general welfare of the people within their jurisdictions." \textit{Id.}

With Professor Corwin's view in mind, this paper will conclude that the water districts' contractual rights do not rise to the level of property within the meaning of the Fifth Amendment. Further, the State, by its sovereign power, has an inherent right to enact legislation protecting the health, safety, morals or general welfare of its people within its jurisdiction, even if the legislation may affect the water districts' contractual rights.

For the purposes of this paper, the contract between the Metropolitan Water District of Southern California and the State of California, Department of Water Resources will be used as a template.

\textbf{DISCUSSION}

\textit{Does the contract between the Metropolitan Water District of Southern California and the State of California, Department of Water Resources created any vested property rights within the meaning of the Fifth Amendment?}

1. Generally


While the Federal Government, as sovereign, has the power to enter contracts that confer vested rights, and the concomitant duty to honor those rights, we have declined in the context of commercial contracts to find that a "sovereign forever waives the right to exercise one of its sovereign powers unless it expressly reserves the right to exercise that power in" the contract. Rather, we have emphasized that "without regard to its source, 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." ... Therefore, contractual arrangements, including those to which a sovereign itself is party, "remain subject to subsequent legislation by the sovereign."

477 U.S. at 52 (1986) (citations omitted, emphasis added).

In \textit{Bowen}, Congress abrogated the right a state previously had to withdraw from the Social Security system. \textit{Id.} at 48. The Federal government had to enact the statute preventing the state from withdrawing from the system to protect the integrity of the system. \textit{Id.} at 47. The Court stated that "contracts should be construed, if possible, to avoid foreclosing the exercise of sovereign authority." \textit{Id.} at 52-53. The Court held that the contractual right the state had "did not rise to the level of 'property.'" \textit{Id.} at 55. Since there was no "property," the subsequent legislation "did not effect a taking within the meaning of the Fifth Amendment." \textit{Id.} at 55-56.

The Court in \textit{Bowen} set a high standard before a sovereign authority could be prevented from exercising its sovereign power. In our case, we deal with the State as a sovereign authority entering into a contract with its water district. The State, as a sovereign authority, is bound by the Fifth Amendment's takings and due process clauses incorporated into the Fourteenth Amendment. [No. 3] With similar limitations and status as a sovereign authority, the State is in the same position as the Federal government
with respect to the need to enact legislation that arguably may affect a property right.

With guidance from Bowen, we will determine whether the entitlement rights of the water district rise to the level of property interests within the meaning of the Fifth Amendment.

2. The District's contractual rights do not rise to the level of property within the meaning of the Fifth Amendment.

Under the contract, the Metropolitan Water District is entitled to a specified quantity of the State Water Project supply annually. Article 18 of the contract anticipates shortages of water beyond the State's control. Under Article 18, in certain circumstances, the State may reduce the District's annual entitlements.

For example, Article 18 subsections (a) and (b) deal with temporary and permanent water shortages that may occur beyond the State's control. Also a relevant provision under Article 18 subsection (f) provides that:

Neither the State nor any of its officers, agents, or employees shall be liable for any damage, direct or indirect, arising from shortages in the amount of water to be made available for delivery to the District under this contract caused by drought, operation of area of origin statutes, or any other cause beyond its control.

With such provisions in place, arguably, the district's contractual rights do not rise to the level of property interests because the State does not surrender in unmistakable terms its sovereign authority to enact subsequent legislation that may affect the contract. To support our conclusion, we will look into case law decisions that deal with subsequent legislation affecting a sovereign authority's contractual obligation.

In several cases decided after Bowen, the courts have applied the high Bowen standard to permit a sovereign authority to enact subsequent legislation without violating the Constitution. In the first, a clause similar to Article 18 subsection (f) mentioned above was subject to litigation in Barcellos and Wolfsen, Inc. v. Westlands Water District, 849 F. Supp. 717 (1993). In Westlands, the Westlands water district entered into a water service contract with the United States in 1963 under which the United States, through the Bureau of Reclamation, agreed to make available for Westlands' purchase 900,000 acre-feet of water from the San Luis Unit of the Central Valley Project. Id. at 717. The clause in Article 11 of the Westlands contract provided that "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." Id. at 728. For water year 1993-94, the Bureau of Reclamation announced that the districts would receive fifty percent of their contractual supply because the Endangered Species Act (ESA) and the Central Valley Project Improvement Act (CVPIA) had a significant impact on the amount of water available to the Central Valley Project. Id. 720-721. The United States indicated that the shortages arose from its mandatory compliance with federal statutes and stated that mandatory compliance with federal statutes was neither unlawful nor unreasonable. Id. 723-724. Westlands argued that the government should not be able to modify a government contract by subsequent legislation and to use Article 11 as its protection. Id. at 729.

The district court agreed with the United States and rejected Westlands' arguments stating that "[a] reading of the 1963 Contract revealed no language or intent that 'Congress surrendered in clear and absolute language its right' to adjust the amount of
water supplied under the contract. To the contrary, Article 11 specifically allowed such adjustments when shortages occur." Id. at 730. The court cited the decision by the Supreme Court in Cisneros v. Alpine Ridge Group, 123 L. Ed. 2d 572, stating that when a plain reading of a government contract made it clear that no contract right existed, the issue of subsequent legislation should not be analyzed. Id. at 730. The court then applied the unmistakable terms doctrine of Bowen, requiring the surrender of the government’s sovereign authority in clear and absolute language before any vested property right existed. Id. (emphasis added).

In our case, the State is in a similar position to that of the United States in Westlands. The State can enact subsequent legislation that may affect the contract because the State does not surrender its sovereign authority in unmistakable terms. Therefore, the District’s contractual rights do not rise to the level of property within the meaning of the Fifth Amendment.

An argument could be made by the fact that under Article 18 subsection (f) the State would be limited to excuses beyond the State's control; thus, any subsequent state legislation would arguably be within the State’s control. The State will agree that enacting a subsequent legislation is within the State’s control. In addition, the State will probably agree that if the sole motivation of enacting a subsequent legislation is to escape from its contractual obligation, then the state will probably violate the provisions under Article 18 subsection (f). However, the State, as a sovereign authority, has not surrendered its power and may enact legislation protecting the health, safety, morals or general welfare of the people, even if the legislation may affect the water district’s contractual rights.

Several other cases also support the State’s position and show the difficulty faced by the non-sovereign parties to meet the Bowen standard. The United States Court of Appeals of the Ninth Circuit accepted a general proposition that a valid contract right of an irrigation district against the United States could become a property protected by the Fifth Amendment. Madera Irrigation District v. Hancock, 985 F.2d 1397, 1401 (9th Cir. 1993). However, “[t]o demonstrate a wrongful taking or impairment, Madera must establish that it has cognizable property rights arising out of its contracts with the government, and that the government has abrogated its contractual rights." Id.

In Madera, the Madera Irrigation District, in 1939, sold land and San Joaquin River water rights to the United States. Id. at 1399. As part of the consideration, the United States promised to build the Friant Dam and the Madera Canal and entered into contracts to sell Madera a permanent supply of 270,000 acre-feet of water annually. Id. When the construction was done in 1951, Madera and the government entered into a forty year contract for purchase and sale of water. Id. As the end of the forty year term approached, the parties began negotiation of the renewals. Id. Madera claimed that two provisions in the proposed new contract violated its rights under the previous contracts. Id. In the first provision, the government insisted upon an addition to the rate in the renewal contract of an amount which would recoup the excess of operation and maintenance costs under the 1951 contract over the rates charged during that forty year term. Id. In the second, the government insisted upon a term in the renewal contract which might require an environmental impact statement and Endangered Species Act consultation, with possible subsequent modifications to the contract. Id. The court had to determine whether those renewal provisions violated Madera’s Fifth Amendment property rights. Id. at 1400.

The court in Madera was faced by the tension between the ability of the government to change federal policy and the interests created under the old policy, which might exist in
contracts, conveyances, expectations, and investments. Applying the unmistakable terms doctrine of Bowen, the court’s decisions fell on the side of the government. Id. Under the contracts, the government maintained its sovereign authority. Id. With regard to the first provision, the court reasoned that "[a]lthough Congress could not take back a subsidy for which it had bound itself by contract, it might nevertheless quit subsidizing, and even tax the previously subsidized activity, once its contractual obligation to subsidize ended." Id. at 1403.

The court determined that Madera’s claim that its renewal rights could not be burdened with the government’s new policies "goes too far." Id. at 1405. Again, applying the unmistakable terms doctrine from Bowen, the court stated that "[t]he government had not ‘surrendered in unmistakable terms’ its power to impose any environmental laws on the contractual relationship, so the required clause was not necessarily violative of Madera’s contractual rights. Id. at 1406.

The court in Madera requires the Bowen standard to be met before accepting that there will be a valid contractual right protected by the Fifth Amendment. In our case, since the Bowen standard could not have been met by the language of the contract, the water district did not have a valid contractual right protected by the Fifth Amendment.

In another example of the application of the Bowen standard, Congress’ enactment of Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), which changed the capital standards for savings association to remedy the thrift industry crisis, was held not to constitute a taking without just compensation in violation of the Fifth Amendment. Winstar Corp. v. United States, 994 F.2d 797 (Fed. Cir. 1993).

In Winstar, the appellees, Winstar Corp., Statesman Savings, and Glendale Federal, claimed, inter alia, that FIRREA’s regulatory capital requirements took away their contractual rights with the government by repudiating the regulatory treatment of goodwill that they had been promised by the Federal Home Loan Bank Board (Bank Board). Id. at 806. The appellees acquired ailing thrifts under the approval of the Bank Board and the Federal Savings and Loan Insurance Corporation (FSLIC). Id. at 802. Prior to FIRREA, the appellees, with the approval of the Bank Board and the FSLIC, were allowed to count the capital shortfall of the ailing thrifts as supervisory goodwill to be amortized over thirty five years. Id. at 804. FIRREA was enacted in response to the Savings & Loan industry crisis in the 1980’s. Id. FIRREA abolished both the Bank Board and the FSLIC and replaced them with the newly created Office of Thrift Supervision (OTS) and the preexisting Federal Deposit Insurance Corporation (FDIC) to handle the insurance function. Id. at 805. Under FIRREA, the capital standards requirements for savings associations were severely restricted. Id. FIRREA excluded intangible assets such as goodwill from its definition of tangible capital and limited the quantity of supervisory goodwill that could be included in capital, gradually reducing it to zero by the end of 1994. Id. In addition, supervisory goodwill existed in the interim period could be amortized over only twenty years. Id.

The U.S. Court of Appeals for the Federal District reversed the Claim Court’s judgment for the appellees and held that the appellees "had no contract right to have the goodwill generated by their acquisitions treated as regulatory capital." Id. at 813. In particular, the court rejected the appellees' "constitutional claims for just compensation for the taking of their property." Id.

The court in Winstar reasoned that "FIRREA was not a modification of their contracts. It
was a sovereign act of Congress that modified the regulatory environment in which the 
thrifs and the OTS (the Bank Board's successor) would act." *Id.* at 811. In addition, the 
court applied the unmistakable terms doctrine derived from *Bowen*. *Id.* at 810 (please 
refer to subsection 1 above). Under the doctrine, without the surrender of the sovereign 

power in an unmistakable terms, the appellees bore the risk of such change. *Id.* at 809.

Applying the court's finding in *Winstar*, the State could argue that it never surrendered to 

the water project contracts its sovereign authority. In fact, the State gave the District 
some cautions under Article 18 that the State would not be liable for water shortages that 

occur beyond its control. By maintaining its sovereign authority, the State can enact 

legislation that may affect the contract. The District's annual entitlements do not rise to 

property interests. The Water District bears the risk of change of its contractual rights 

from the State's subsequent legislation.

In a more compelling example of a sovereign authority's right to enact subsequent 

legislation, the United States Court of Appeals for the District of Columbia upheld Federal 

legislation that made readjustments of royalty fees on existing coal mine leases. *Western 

Fuels-Utah, Inc. v. Lujan*, 895 F.2d 780 (D.C. Cir. 1990). In *Western Fuels*, the Bureau of 

Land Management (BLM) was compelled to apply the Federal Coal Leasing 

Amendments Act of 1976 (FCLAA) to make readjustments to coal mining leases on 

federal land, including leases made prior to 1976. *Western Fuels-Utah, Inc. v. Lujan*, 895 

F.2d 780 (D.C. Cir. 1990). The original federal coal leases dating back to the 1920's 

required the coal mining companies to pay a royalty of not less than five cents per ton of 

coal extracted. *Id.* 782. The leases contained a right of readjustment by the lessor at 

twenty-year intervals. *Id.* Applying the 1976 FCLAA, the BLM readjusted the royalty fee 

from 5 cents per ton of coal extracted to 12.5% of coal extracted. *Id.* 783. In addition, the 

readjustment provided that subsequent readjustment of royalty fees would take place at 

ten-year intervals. *Id.* The coal companies claimed that the readjustments amounted to 

an unconstitutional takings of their contractual rights. *Id.* 788.

Rejecting the coal companies' claims, the court, applying the unmistakable terms 

doctrine, held that "Congress had the power to provide by law for such lease 

readjustments as it saw fit." *Id.* at 790. The court stated that "[o]ne who wishes to obtain a 

contractual right against the sovereign that is immune from the effect of future changes in 

law must make sure that the contract confers such a right in unmistakable terms." *Id.* at 

789.

Similarly in our case, the State has not surrendered in unmistakable terms its sovereign 

authority. Therefore, with the provisions of Article 18, the State might in certain 

circumstances change the District’s annual entitlements.

**CONCLUSION** To prevent a sovereign authority from enacting subsequent legislation 

that affects its contractual obligations, the sovereign authority must relinquish in 

unmistakable terms its rights to exercise its sovereign power. A self imposed limitation as 

found in Article 18 (limited to excuses beyond the State’s control) does not constitute a 

relinquishment of the State's sovereign power. The standard set out by the Supreme 

Court in *Bowen* is applicable. The water districts bear the risks of subsequent legislative 

changes that may occur. Therefore, the State, as a sovereign authority, can enact 

subsequent legislation that may affect the Water Districts' contractual rights.
NOTES

[No. 1] The PLRI has done several papers on the State Water Project contracts. For a more detailed discussions of these contracts please see David Call's paper from Fall 1994.

[No. 2] The Fifth Amendment, which contains the due process and the takings clause, provides that "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." U.S. Const. amend. V.

[No. 3] The Due Process Clause of the Fourteenth Amendment, which applies to the State, provides that "[n]o State shall deprive any person of life, liberty, or property without due process of law."