



**ARIZONA SUPREME COURT
ORAL ARGUMENT CASE SUMMARY**



**MERWIN C. DAVIS, et al. v. AGUA SIERRA RESOURCES, L.L.C.,
et al., No. CV-08-0163-PR**

PARTIES AND COUNSEL:

Petitioners: (1) Chino Grande, L.L.C., represented by Dale Danneman, Michael McNulty and Robert G. Schafer of Lewis and Roca, L.L.P.; and (2) Merwin C. Davis, represented by Robert S. Lynch and Anna Young.

Respondents: Agua Sierra Resources, L.L.C., Red Deer Cattle, Inc., CJ Partners, and Siebert Family Limited Partnership (collectively “Agua Sierra”), represented by Michael R. Ross and Cober C. Plucker of Gallagher & Kennedy.

Amici Curiae: (1) Salt River Project Agricultural Improvement and Power District, represented by M. Byron Lewis, John B. Weldon, Jr., and Mark A. McGinnis of Salmon, Lewis & Weldon, P.C.; (2) Town of Prescott Valley, represented by Rita P. Maguire and Michael J. Pearce of Maguire & Pearce; (3) Arizona Department of Water Resources, represented by W. Patrick Schiffer, Kenneth C. Slowinski, and Scott M. Deeny; and (4) Freeport-McMoRan Copper and Gold, Inc, Roosevelt Water Conservation District and the Town of Chino Valley, represented by Cynthia M. Chandley, L. William Staudenmaier III, and Jenny J. Pelton of Ryley, Carlock & Applewhite.

FACTS:

This case involves a series of conveyances of the CF Ranch located in the Big Chino groundwater sub-basin in Yavapai County. On February 11, 1981, Chino Ranch, Inc. conveyed the CF Ranch to Red Deer Cattle, Inc. by warranty deed that excluded from the conveyance “all mineral and oil rights and all commercial water rights.” By warranty deed dated April 2, 1984, Red Deer conveyed the CF Ranch to Merwyn Davis, who paid \$1,421,000 for the property. The 1984 deed expressly reserved to Red Deer the mineral, gas, oil, and commercial water rights associated with the Ranch. Chino Ranch later merged into Red Deer. After more transactions involving the reserved commercial water rights, in May 1998 Red Deer and CJ Partners, the two members of Agua Sierra Resources, LLC, each conveyed to Agua Sierra a one-half interest in commercial water rights associated with CF Ranch. On July 6, 1999, Chino Ranch executed a quit claim deed to clarify the reservations Red Deer made in the 1984 deed.

Prior to any of these conveyances, the City of Prescott began to study tapping groundwater in the Big Chino Valley to serve a growing population. City Council meeting minutes show that its interest began as early as 1976. In 1980, Arizona enacted the comprehensive Groundwater Management Act, A.R.S. §§ 45-401, *et seq.* (eff. June 12, 1980).

In 1988, Davis as owner of CF Ranch granted the City of Prescott an option to purchase property that

included the CF Ranch and all appurtenant water rights. The option price was \$3000; the price to exercise the option was \$15 million. The City did not exercise the option, and it expired in 1992. There is no indication whether Agua Sierra knew of or objected to this transaction.

Over ten years later on April 22, 2003, Davis granted the City a second option to purchase property, including the CF Ranch and all appurtenant water rights. This option contained an addendum expressly stating that Davis was unsure of the status of water rights associated with CF Ranch. The price of the second option for CF and nearby CV Ranches was \$250,000, and (according to the appellate court's opinion) the price of the associated water rights was \$30 million. An appraisal estimated the market value of the collective property at \$23 million, with the appraiser noting that the most probable current and future use of the water resources present on the subject property was transport to the City of Prescott.

In 2004, Agua Sierra sent a letter to the city of Prescott threatening to sue over its plans to acquire CF and CV Ranches. It threatened to sue for the withdrawal of groundwater from overlying land and trespass/inverse condemnation should any diminution or adverse impact occur to its "commercial water rights" from any groundwater extraction. The City asked Davis to seek to purchase those rights so it could exercise them if it purchased the CF Ranch. By letter dated April 29, 2004, Davis offered to pay Agua Sierra \$300,000 to acquire the rights. Agua Sierra declined, and the City let options on both ranches expire.

Davis sought to quiet title judicially to the property, and Agua Sierra sought in a counterclaim a declaration that its commercial water rights reservation was valid.

The superior court granted summary judgment in favor of Davis.

The appellate court reversed. It held that a landowner may reserve commercial groundwater rights when conveying overlying real property. However, it remanded to the trial court for a determination whether the reservation of rights also purported to include appropriable surface water rights, in which case the trial court was instructed to determine the validity of that portion of the reservation consistent with applicable law. It later denied Davis's motion for reconsideration, but also vacated its award of attorneys' fees to Agua Sierra until the trial court had made a determination.

ISSUES:

A. In Chino Grande's Petition for Review

" . . . The issue is whether landowners, merely by virtue of their land ownership, have a property interest in the potential, future use of groundwater such that they may sell their land but reserve the right to withdraw, transport and sell the underlying groundwater at some time in the future. In upholding such a 'reserved water right' (and reversing the trial court), the court of appeals seriously misunderstood this Court's cases and significantly departed from basic, well-accepted principles of Arizona law."

B. In Davis's Petition for Review

"[1.] Whether Arizona law recognized a groundwater right (a) to be exercised only in the future, (b) dissociated from land ownership, and/or (c) without demonstration of a quantified reasonable and

beneficial use.

[2.] Whether and to what extent this Court's pronouncements in the *Gila River* series of opinions may be considered *obiter dicta*, or conversely must be considered *stare decisis*, in water rights controversies being litigated outside those adjudication proceedings."

Davis also identifies an additional issue presented to, but not decided by, the appellate court:

"Whether the Superior Court correctly rejected Agua Sierra's defenses and counterclaim for rescission and post-judgment legal theories concerning the 1984 sale from Red Deer to Davis since the 'commercial water rights' claim was then still held by Red Deer's predecessor in interest."

Definitions:

In 1980, Arizona's Groundwater Code first provided at A.R.S. § 45-401, "Declaration of policy":

A. The legislature finds that the people of Arizona are dependent in whole or in part upon groundwater basins for their water supply and that in many basins and sub-basins withdrawal of groundwater is greatly in excess of the safe annual yield and that this is threatening to destroy the economy of certain areas of this state and is threatening to do substantial injury to the general economy and welfare of this state and its citizens. The legislature further finds that it is in the best interest of the general economy and welfare of this state and its citizens that the legislature evoke its police power to prescribe which uses of groundwater are most beneficial and economically effective.

B. It is therefore declared to be the public policy of this state that in the interest of protecting and stabilizing the general economy and welfare of this state and its citizens it is necessary to conserve, protect and allocate the use of groundwater resources of the state and to provide a framework for the comprehensive management and regulation of the withdrawal, transportation, use, conservation and conveyance of rights to use the groundwater in this state.

By Laws 1991, Ch. 212, § 1, the Legislature further provided:

- A. In addition to the legislative findings and policies set forth in § 45-401, Arizona Revised Statutes, the legislature finds that using land in areas outside initial active management areas with a management goal of safe-yield and withdrawing and transporting groundwater to those active management areas is an issue of statewide concern that requires regulation by this state, notwithstanding any provision of state law.*
- B. The legislature also finds that owning and using land by cities and towns in counties other than the county in which the city or town is located from which water is or may be withdrawn or diverted and transported that causes the removal of the municipal property from the tax roll of the county in which the land is located thereby reducing the taxing and bonding capacity of the county and other political subdivisions in*

- which the land is located is an issue of statewide concern that requires regulation by this state, notwithstanding any provisions of a city charter.*
- C. The legislature invokes its police power in this act to establish a framework to protect the taxing and bonding authority capacity of those political subdivisions and to regulate the withdrawal and transportation of groundwater to initial active management areas within a management goal of safe-yield.*
 - D. The legislature further finds that this legislation, together with the Groundwater Management Act of 1980 (Laws 1980, fourth special session, chapter 1, as amended), constitute statewide comprehensive legislation on groundwater transportation. The state of Arizona supports legislation in Congress to amend § 304(c) of the Colorado River Basin Project Act (P.L. 90-537).*

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