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2018's Most Influential Amendment: The First

By Scott C. Smith

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Katy Perry, Barack Obama, Ellen DeGeneres, and YouTube are among 2018's ten most followed Twitter users. However, if the First Amendment had its own Twitter account, its celebrity status would have made it a definite contender to crack the 2018 top ten. With a Kardashian-like omnipresence, the First Amendment popped up in all kinds of decisions, ranging from key cases on labor relations to homelessness to emerging media platforms. The government had to grapple with public

officials' increased ability to access and publish viewpoints in real time. Courts were forced to apply old tests for speech in parks and on street corners to newly emerging and innovative media platforms. Lawyers have always kept tabs on the First Amendment, but this year it was hard for anyone to avoid its publicity. This is a summary of the comings and goings of one of 2018's most interesting public law celebrities.

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Inverse Condemnation and Public Water Systems: A Legal Nexus of Complexity, Exposure, and Uncertainty

by Paul Fuller, CPCU

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INTRODUCTION

Inverse condemnation is a complex legal theory that imposes unique, opaque, and expansive liability on public water systems with the power of eminent domain.¹ Like the Greek mythological god Atlas, who was condemned by Zeus to stand at the western

1. Inverse condemnation applies to any entity with the power of eminent domain, e.g., public water systems structured as public entities. Public water systems structured as mutual water companies have eminent domain power, but only for irrigation operations and not for potable water purveyance.

edge of earth and hold up the sky on his shoulders, public water systems are burdened with inverse condemnation liability. However, their strain is not from holding up the sky, but from bearing the weight of a legal theory that is noble in concept yet predacious in practice. The principle underlying this theory is the constitutionally protected right against unlawful takings of private property by the government without just compensation.² Yet predation in the form of liability often results because the public water systems have few defenses, no governmental immunities, and immense financial exposure.

These public entities are vulnerable to inverse condemnation actions primarily because of their water delivery systems, as unlawful takings frequently occur with physical injuries to real property caused by problems with the delivery systems. These systems (i.e., infrastructure and/or public improvements) are inherently prone to accidental and temporary takings involving breaks, leaks, backups, releases, and overflows (i.e., uninvited water).

This article focuses on inverse condemnation with respect to public water systems, and discusses legal mechanics, available protections, and liability.³ It also examines containment strategies like insurance placement and corporate structure as means to effectively manage the risks from inverse condemnation actions.

LEGAL PRINCIPLES UNDERLYING INVERSE CONDEMNATION ACTS

The right to due process of law is the catalyst behind inverse condemnation lawsuits against public water systems that violate the takings clause of the federal and state constitutions. The Fifth Amendment to the United States Constitution states that “no person shall be...deprived of...property, without due process of law; nor shall private property be taken for public use, without just compensation.” The California Constitution is slightly broader and affirms “private property may be taken *or damaged* for public use only when just compensation...has first been paid...”⁴ Due process thus allows strict liability to be imposed in inverse condemnation actions involving water delivery systems. Accordingly, public water systems “may be liable in an inverse condemnation action for any physical injury to real property proximately caused by a public improvement as deliberately designed and constructed, whether or not that injury was foreseeable, and in the absence of fault by the public entity.”⁵

2. The federal and state governments can bestow eminent domain power on non-public entities like railroads, utilities, redevelopment agencies, as well as mutual water companies.

3. This article focuses on public water systems purveying potable water through water delivery systems, as opposed to public water systems engaging in flood control and irrigation operations. With respect to inverse condemnation, the operations of the former are subject to strict liability whereas the operations of the latter are bound by the standard of reasonableness.

4. Cal. Constitution, Art. I, Sec. 19, subsection (a) (emphasis added).

5. *Holtz v. Superior Court* (1970) 3 Cal.3d 296, 303-304; *Albers v. County of Los Angeles*



Water delivery systems are deemed public improvements built for the public benefit. Any trespass of their uninvited water will thus occur via a deliberately designed and constructed water delivery system, and any physical injury to real property will be a byproduct of such trespass. There is inverse condemnation, and therefore strict liability, whenever the resulting damage is proximately caused by the trespass and not an intervening cause. Such strict liability extends beyond trespass of uninvited water and also includes other intrusive activities linked to water delivery systems, as well as diminution of property value and loss of use. Common examples include nuisance (e.g., odors), existence (e.g., tanks), and policy (e.g., easements). The legal theory's low burden of proof, coupled with other reasons discussed herein, has facilitated its widespread and effective use against public water systems.

Inverse condemnation emanates from eminent domain, which means public water systems are only subject to the former if bestowed power of the latter. Both legal theories are predicated on the takings clause and the principle of due process. These protections "prevent the government from

forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole."⁶ Eminent domain (otherwise known as condemnation or direct condemnation) is the more commonly understood process involving the takings clause, and is initiated by: (1) establishing public projects for public benefit requiring the acquisition of private property; (2) notifying potentially affected property owners that their property is needed for this purpose; (3) offering to purchase the private property or requesting it be dedicated; and, if necessary, (4) filing suit to acquire the private property in exchange for just compensation.

The above-described roles with eminent domain actions are reversed in inverse condemnation actions. The condemnation occurs when public water systems appropriate private property through trespass of uninvited water or other intrusive activities linked to their water delivery systems. Because the property owner initiates the litigation, he or she must prove ownership of the affected property and demonstrate the public water system acquired the property (temporarily

Liability for inverse condemnation could include diminution of property value and loss of use.

or permanently) without payment of just compensation. Ownership is easy to prove. An unlawful appropriation is also a low bar to clear due to the expansive concept of proximate cause. There is no need to link water delivery systems to public improvements built for public benefit, as case law has already established that connection. Since strict liability applies to inverse condemnation actions, the plaintiff need not prove negligence. Public water systems may prudently choose to assert operational negligence of employees and not policy decisions as a legal tactic to accept liability under a tort, which is less financially onerous than inverse condemnation.⁷

6. *Williams v. Moulton Niguel Water Dist.* (2018) 22 Cal. App.5th 1198; *Richards v. Washington Terminal Co.* (1914) 233 U.S. 546, 557.

7. Inverse condemnation liability is not triggered by employee carelessness or operational negligence from the maintenance of a public improvement, but rather from the policies and decisions of the public entity. See, e.g., *CSAA v. City of Palo Alto* (2006) 138 Cal.App.4th 474; *Pacific Bell v. City of San Diego* (2000) 81 Cal.App.4th

(1965) 62 Cal.2d 250, 263-264.

“Where damage results from the acts of employees, and not from a policy decision, there is no [inverse condemnation] taking. Recovery, if any, lies in a tort action, such as negligence.”⁸

There are two types of unlawful takings: physical and regulatory. Public water systems are predisposed to the former type of taking. Such takings can be temporary or permanent, though public water systems are more frequently sued for temporary takings based on the limited trespass of uninvited water. Moreover, because takings litigation is constitutionally based, legislative and/or regulatory remedies are largely precluded. The litigation is also bifurcated: first is a bench trial to determine if an unlawful taking occurred, and if so, it is followed by a jury trial to determine just compensation. The California just compensation formula is the same for inverse condemnation and eminent domain. Plaintiffs, however, can recover their attorneys’ fees, expert witness fees, and pre-judgment interest and appraisal fees in an inverse condemnation case. The only compensation recoverable under inverse condemnation is for damages to real and personal property, as recovery for personal injuries is not allowed.

LITIGATION STRATEGIES FOR INVERSE CONDEMNATION ACTIONS

Since inverse condemnation involves strict liability as well as the attachment of fees and interest, it is necessary to immediately review the facts and determine whether proximate cause may be established. It is similarly important to promptly assess the plaintiff’s damages, as early settlement may be prudent to mitigate the loss. If a jury trial appears likely, then it is advisable to make an early settlement offer under Code of Civil

Procedure section 998 (“998 Offer”). From the defense perspective, this strategy shifts some of the trial exposure to the plaintiff: if the 998 Offer is rejected and the plaintiff fails to recover more damages than the amount of the 998 Offer, then the plaintiff may be bound to reimburse the defendant’s post-offer litigation costs. Because those outlays may include attorneys’ fees and expert witness fees incurred after the 998 Offer, the offer itself can induce settlement. The judgment may also be reduced should the settlement offer be higher than the just compensation awarded at trial.

Although public water systems are strictly liable for inverse condemnation, the absence of proximate cause is a defense for such actions. The plaintiff bears the burden of proving the defendant set in motion a chain of events that could reasonably be anticipated to lead to the claimed damages. Specifically, the plaintiff must prove a “substantial cause-and-effect relationship

factors are overlooked. Consequently, it is difficult for public water systems to avoid inverse condemnation liability unless there is a clear intervening break in the chain of causation, e.g., a mass inundation of rain preceding a water main break.¹⁰

It should be noted that public water systems are not liable for inverse condemnation for damages caused by “invited water,” i.e., voluntarily accepted water in private piping systems that complies with statutory and regulatory standards, including regulations and other express government approvals.¹¹ An example is compliance with state requirements, including permitting, for specified chemical usage associated with water treatment and distribution. Any alleged damage from the act or byproduct of such compliance will not trigger inverse condemnation liability, and instead the property owner may only attempt to impose tort liability on the public water system.¹²



POSSIBLE EXPANSION OF INVERSE CONDEMNATION LIABILITY

Inverse condemnation, however, is not a static legal theory limited to trespass of uninvited water. It is metastasizing to other operations tangentially connected to water delivery systems, e.g., a public water system’s alleged failure to protect property that is damaged during a wildfire. Plaintiffs claim inverse condemnation (and its attendant strict liability) because the fire suppression systems are embedded within water delivery systems, and therefore the systems should be considered public improvements. The fact that the wildfire was not started by the

which excludes the probability that other forces alone produced the injury.”⁹ That expansive definition renders most loss scenarios involving water delivery systems as unlawful takings since contributing

596; *Paterno v. State of California* (1999) 74 Cal.App.4th 68; *Hayashi v. Alameda County Flood Control* (1959) 167 Cal.App.2d 584; *Yox v. City of Whittier* (1986) 182 Cal. App.3d 347; *Customer Co. v. City of Sacramento* (1995) 10 Cal.4th 368; *Barham v. Southern Cal. Edison Co.* (1999) 74 Cal.App.4th 744.
8. *Paterno v. State of California* (1999) 74 Cal.App.4th 68.

9. See, e.g., *Souza v. Silver Development Co.* (1985) 164 Cal.App.3d 165; *Ingram v. City of Redondo Beach* (1975) 45 Cal.App.3d 628, 633-634.

10. *Goebel v. City of Santa Barbara* (2001) 92 Cal.App.4th 549 (confirming that inverse condemnation does not need to be foreseeable, but the public improvement must be a substantial cause of the injury; the resulting damage from massive rainfall was deemed to be an intervening chain in causation and superseded any damage from the water main break).

11. See fn. 7, supra; *Farmers Ins. Exchange v. State of California* (1985) 175 Cal.App.3d 494.

12. See fn. 7, supra; *Customer Co. v. City of Sacramento* (1995) 10 Cal.4th 368, 378.

public water system, or that the wildfire compromised the fire suppression system, is moot. Such plaintiffs narrow their focus on the following inverse condemnation factors: physical injury to real property proximately caused by a public improvement as deliberately designed and constructed, whether that injury was foreseeable, and in the absence of fault by the public entity.¹³ If these factors are met, plaintiffs assert that strict liability is the appropriate legal standard even though the resulting damage was from fire and not water.

While such arguments for strict liability stretch credulity, they formed the basis for a substantial award in a 2012 trial court case, *Itani v. Yorba Linda Water District*.¹⁴ In *Itani*, the 2008 Freeway Complex Fire was a wildfire was sparked by a disabled vehicle

and destroyed hundreds of homes in Orange County, primarily located in a subdivision serviced by the Yorba Linda Water District (“YLWD”). The homeowners sued YLWD under theories of negligence and inverse condemnation. Specifically, they argued that the failure of YLWD’s fire suppression system, including lack of water and inadequate pressure from their hydrants, was the proximate cause of their loss. They claimed that the wildfire’s ignition by a third party was irrelevant, as was its damage to YLWD’s fire suppression system. In addition, the court deemed as moot the argument that it was not feasible to augment the existing infrastructure to defend against wildfires, as opposed to single structure fires.



Plaintiffs’ inverse condemnation argument was narrow: YLWD’s public improvement failed, and that failure was the proximate cause of the loss. Since the fire suppression system was embedded within their water delivery system, plaintiffs asserted that strict liability should apply. The court dismissed the negligence cause of

13. See fn. 4, supra.

14. *Itani v. Yorba Linda Water Dist.* (Super Ct. Orange County, July 13, 2012, No. 30-2009-00124906-CU-EI-CXC).

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action based on firefighting immunities,¹⁵ but allowed the inverse condemnation action to proceed because of its constitutionally-protected status. The court linked the failure of fire suppression systems to the failure of flood control facilities: “There is no reason why a flood case should not be applied to a fire case for inverse condemnation through the simple substitution of appropriate nouns in the foregoing quotation.” The parties took the inverse condemnation action to binding arbitration where the judgment was split. The arbitrator ruled YLWD was not liable for the destroyed homes where its fire suppression system did not fail. However, the arbitrator ruled YLWD was liable for the destroyed homes where the fire suppression system did fail and issued a binding judgment for \$69 million.

The *Itani* decision applied the concept of strict liability by equating fire suppression

systems with water delivery systems. It is true fire suppression systems are embedded within water delivery systems, but their operational purposes are fundamentally different. The former is an ancillary service intended to assist emergency responders with a fire suppression tool, whereas the latter is a core service to provide potable water. The failure to protect during a wildfire does not involve an unlawful taking via water trespassing from a water delivery system. It arises from the failure of a fire suppression system to provide sufficient water flow during a wildfire. The physical injury to real property is from fire, not water.

Moreover, fire suppression systems are operationally aligned with flood control facilities in that they both protect the public against a common enemy, with one defending against fire and the other against water. In fact, the common enemy doctrine is the reason for using a legal standard of reasonableness for inverse condemnation

actions against flood control facilities.¹⁶ This standard is akin to negligence and based on just, rational, appropriate, ordinary, or usual actions or activities. It was purposely established to elevate the burden of proof for inverse condemnation actions against flood control facilities. Case law holds that “a public agency that undertakes to construct or operate a flood control project clearly must not be made the absolute insurer of those lands provided protection... [but] it must [at least] act reasonably and non-negligently.”¹⁷ Accordingly, plaintiffs must demonstrate the flood control facility’s design, construction, or maintenance posed an unreasonable risk of harm to the plaintiff’s property and that the unreasonable design, construction, or maintenance of the project was a substantial cause of the damage.

The standard of reasonableness that is applicable to flood control facilities is fundamentally different from strict liability. It provides meaningful defenses, similar to a tort, for public water systems when defending an inverse condemnation action involving their flood control facilities. The courts use the following factors when applying this standard: (1) the overall public purpose being served by the public improvement; (2) the degree to which the plaintiff’s loss is offset by reciprocal benefits; (3) the availability of feasible alternatives with lower risks; (4) the severity of the plaintiff’s damage in relation to risk-bearing capabilities; (5) the extent to which damage of the kind the plaintiff sustained is generally considered as a normal risk of land ownership; and (6) the degree to which similar damage is distributed at large over other beneficiaries of the public improvement or is peculiar only to the plaintiff.¹⁸ These factors align well with the operations of fire suppression systems and their purpose to protect the public against the common enemy. As the law

15. See, e.g., Gov. Code § 850 et seq. (creating immunities for failure to provide fire protection service, failure to maintain sufficient personnel or equipment, etc.).



16. The common enemy doctrine states that landowners can dispose of unwanted surface water in any way they see fit and without liability for any resulting damage to a neighbor.

17. *Holtz*, *supra*, 3 Cal.3d at 307, fn. 12.

18. *Locklin v. City of Lafayette* (1994) 7 Cal.4th 327.

applicable to inverse condemnation in fire suppression cases develops, this standard of reasonableness should apply.

RISK MANAGEMENT STRATEGIES FOR INVERSE CONDEMNATION

Public water systems must thoroughly understand and proactively manage the risk of inverse condemnation. Insurance is an integral containment measure for this liability, but is not a panacea. Most insurance providers do not wittingly offer inverse condemnation coverage or fully comprehend its impact. Therefore, the onus is on knowledgeable brokers to properly integrate inverse condemnation within their client's insurance placement. Brokers must ascertain which insurance policy, General Liability or Public Officials Liability, is best equipped to cover the exposure. A General Liability policy implants coverage for property damage claims resulting from the products, completed operations, and ongoing operations for which a public water system is legally liable.¹⁹ This policy is triggered by a tort, typically negligence, that is connected to the public water system's products, completed operations

Inverse condemnation is best structured as an endorsement to the Public Officials Liability policy.

or ongoing operations. A Public Officials Liability policy is fundamentally different than a General Liability policy. Its structure is similar to that of a Professional Liability

19. A general liability policy includes bodily injury, property damage, personal injury, advertising injury, fire legal liability, and medical payments. Inverse condemnation only applies to real and personal property, thus the discussion here is limited to the property damage part of the policy.

policy in that it comprises coverage for monetary damages resulting from wrongful acts for which the public water system is liable.²⁰ Examples of wrongful acts include powers, policies, and decisions of the public water system by its governing board.

Inverse condemnation is not a tort, however, but a constitutional violation of due process by the unlawful taking of property without just compensation founded on the legal ideal that "the cost of damage to a private property owner resulting from a public use that benefits the community should be spread among those benefited rather than allocated to a single member of the community."²¹ Unlawful takings are the result of wrongful acts via the public water system's powers, policies, and decisions.²² An unlawful taking without just compensation is an economic injury remedied with monetary damages; it is not deemed property damage or a tort. "Where damage results from the acts of employees, and not from a policy decision, there is no [unlawful] taking. Recovery, if any, lies in a tort action, such as negligence."²³ Consequently, the coverage unequivocally attaches to the Public Officials Liability policy.²⁴

Inverse condemnation is best structured as an endorsement to the Public Officials Liability policy. Silence is imprudent since

20. Per the International Risk Management Institute, Inc. (IRMI), a Public Officials Liability policy comprises liability for the governance of a public entity and encompasses wrongful acts (i.e., powers, policies, decisions) by the board of trustees, as well as executive management; it is usually defined as actual or alleged errors, omissions, misstatements, negligence, or breach of duty in the capacity as a trustee of the public entity.

21. See fn. 5, *supra*.

22. See fn. 7, *supra*.

23. *Customer Co. v. City of Sacramento* (1995) 10 Cal.4th 368.

24. A General Liability policy could be tendered for an inverse condemnation action involving property damage unless there is a Public Use of Property (i.e., inverse condemnation) exclusion. Since insurance policies are contracts of adhesion, coverage ambiguities inure to the benefit of the policyholder. As such, defense under a reservation of rights and possibly coverage could be afforded for an inverse condemnation action should there not be a public use of property exclusion in the General Liability policy.



inverse condemnation is neither a tort nor based on a singular fact pattern. These claims comprise overlapping actions of wrongful taking, economic injury, willful decisions, and property damage. Any failure to codify intent will invariably lead to reservation of rights or outright coverage disclaimers. Inverse condemnation is frequently grouped in an exclusion titled Public Use of Property. The exclusion contains eminent domain, condemnation, adverse possession, dedicated use, and inverse condemnation. An appropriate solution is a restatement of the Public Use of Property exclusion via endorsement with the words "inverse condemnation" purposely removed. An overt endorsement confirms the insurance provider's intent to cover such claims while retaining its right to deny other types of takings where the public water system initiated the litigation.

It is similarly important to be mindful of any restrictions to coverage, such as coverage for unintended takings but an exclusion for deliberate takings. Such a restriction would require confirmation that easements (e.g., loss of use), code violations (e.g., fixed equipment), project prioritizations (e.g., one neighborhood over another), and insufficient infrastructure (e.g., investing below an arbitrary level of protection) are not deemed deliberate takings. Some insurance



providers may exclude the attachment of attorney fees, expert witness fees, appraisal fees, and pre-judgment interest. Others may affirm inverse condemnation but only for resulting property damage

and not diminution of property value. Coverage may even be limited to negligence only, which is a hollow affirmation since condemnation claims are not torts. The complexity of inverse condemnation actions necessitates a clean coverage grant without restriction. Any qualifiers require attentive scrutiny, with meanings clearly and simply articulated.

The property damage exclusion, standard in all Public Officials Liability policies, does not impact coverage for an inverse condemnation claim should there be some element of property damage.

The federal and state constitutions, as well as case law, confirm that unlawful takings are wrongful acts involving economic injury.²⁵ Any property damage associated with an inverse condemnation claim is peripheral to the action and inapplicable to this legal theory. A suitable parallel is a Professional Liability policy, which is structurally similar to a Public Officials Liability policy in that both embody coverage for monetary damages resulting from wrongful acts.

For example, an engineering firm is hired to build a bridge that subsequently collapses due to the firm's design error. The proximate cause of loss is not property damage from the engineering firm's operational negligence but rather economic injury

²⁵. See fn. 5, *supra*.

PUBLIC LAW JOURNAL

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from its professional malpractice. As such, the claim would trigger the Professional Liability policy and involve monetary damages arising from the design error. Inverse condemnation is no different under a Public Officials Liability policy. The legal theory is based on a wrongful act resulting from an unlawful taking, and damages are economic via the appropriation of property without just compensation. A few ancillary, but important, areas of clarification remain to ensure a properly structured Public Officials Liability policy as respect to inverse condemnation. These factors include date of loss definition, manifestation provisions, retroactive date parameters, and restrictions associated with defense as well as limit obligations.²⁶

A more contested and permanent strategy for addressing inverse condemnation is a corporate structure transformation. As stated earlier, inverse condemnation actions can only be filed against public water systems with the power of eminent domain. The mutualisation of a public water system removes the exposure where a mutual water company does not provide service to irrigate land.²⁷ This strategy requires a cost-benefit analysis for maintaining public entity accoutrements versus eliminating inverse condemnation liability. Although the

necessity of eminent domain in established service areas is less important for public water systems, there are legitimate public entity structural advantages apart from the power of eminent domain. Examples include loan financing, bond issuance, tort immunity, grant availability, federal/state/county support, and system governance.

It is important to note the ability to participate in joint powers authorities (“JPAs”) is not a constraint, as mutual water companies have the power to participate in JPAs under Government Code Section 6525, as further expanded in 2016.²⁸ The mutualisation option will gain legitimacy should strict liability be applied against public water systems for inverse condemnation actions involving their tangential operations like fire suppression services. Support will strengthen if insurance providers’ drawdown, restrict, or remove their inverse condemnation coverage grants; especially with continued erosion in case law as well as expansion of claim scenarios from which inverse condemnation actions are alleged and defense obligations are subsequently extracted.

CONCLUSION

Inverse condemnation is an evolving exposure that may intensify in frequency, gravity, and consequence. The impact on public water systems is notably adverse because their water delivery systems align well with the liability standards imposed by this legal theory. With overwhelming financial ramifications, inverse condemnation represents an existential threat to public water systems. The situation will exacerbate should the standard of strict liability, as opposed to reasonableness,

be imposed for failure of fire suppression systems during wildfires. Insurance is an effective containment strategy, but it requires a properly structured Public Officials Liability policy.

A more holistic, but untested, solution is the mutualisation of public water systems where the power of eminent domain is explicitly removed. Such an approach requires careful consideration and legal guidance. Inverse condemnation containment is only possible if public water systems coalesce and articulate the consequences of contagion. Stakeholders must understand the legal impact of weaponizing due process against public water systems. The long-term solution lies in case law from which the calibration of rights for private property owners and public water systems, especially as respect to public improvements protecting against a common enemy, are clearly and fairly codified.



26. Date of loss for inverse condemnation actions is not the filing of the complaint but the date of the alleged appropriation. It is important to review restrictions associated with prior or pending knowledge of an occurrence that may give rise to a future claim. Manifestation provisions prevent stacking of limits and the trigger of coverage in a subsequent policy period for an action that originated in an earlier policy period. Retroactive date parameters are only applicable to claims-made policies and necessitate thorough review of restrictions. Limits of insurance and defense obligations should not be capped or artificially exhausted.

27. Mutual water companies do not have the power of eminent domain as it relates to potable water purveyance. Under Public Utilities Code section 2729, a mutual water company may exercise the power of eminent domain for water, water rights, canals, ditches, dams, poundings, flumes, aqueducts, and pipes for irrigation of lands furnished with water by such company.

28. Government Code section 990.8 authorizes mutual water companies to participate in joint powers agreements for the provision of insurance and risk-pooling, technical support, and other similar services for the purpose of reducing risk liability.