DIVISION ONE
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IN THE COURT OF APPEALS
STATE OF ARIZONA
DIVISION ONE

MERWYN C. DAVIS, Trustee under the Merwyn C. Davis Trust dated July 27, 1981, Plaintiff/Counter-Defendant/Appellee, and CHINO GRANDE, L.L.C., Plaintiff/Intervenor/Counter-Defendant/Appellee, v. AGUA SIERRA RESOURCES, L.L.C., a Texas limited liability company, Defendant/Counter-Claimant/Appellant, and RED DEER CATTLE, INC., a Texas corporation; CJ PARTNERS, a Nevada limited partnership; and SEIBERT FAMILY LIMITED PARTNERSHIP, a Nevada limited partnership, Defendants/Appellants.	No. 1 CA-CV 06-0806 DEPARTMENT D **MEMORANDUM DECISION** (Not for Publication – Rule 28, Arizona Rules of Civil Appellate Procedure)

Appeal from the Superior Court in Yavapai County

Cause No. CV2004-0716

The Honorable David L. Mackey, Judge

AFFIRMED IN PART; REVERSED AND REMANDED IN PART

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J O H N S E N, Judge

¶1 In *Davis v. Agua Sierra Resources, L.L.C. (Davis I)*, 217 Ariz. 386, 174 P.3d 298 (App. 2008), we vacated the superior court's grant of summary judgment in favor of Merwyn C. Davis and Chino Grande, L.L.C. (collectively "Davis") because we concluded Agua Sierra Resources, L.L.C. and Red Deer Cattle, Inc. (collectively "Agua Sierra") held a valid reservation of commercial groundwater rights. The supreme court vacated our opinion, holding that "landowners outside of [Active Management Areas] do not have a real property interest in the potential

future use of groundwater that may be severed from the overlying land." *Davis v. Agua Sierra Resources, L.L.C. (Davis II)*, 220 Ariz. 108, ___, ¶ 34, 203 P.3d 506, 512 (2009).[1] On remand, we now consider Agua Sierra's additional arguments on appeal. *See Davis II*, 220 Ariz. at ___, ¶ 34, 203 P.3d at 512. For the reasons stated below, we affirm in part and reverse and remand in part.

DISCUSSION

¶2 Three issues remain for us on remand: (1) Whether limitations or the doctrine of laches barred Davis from challenging the validity of the purported water rights reservation; (2) whether the superior court erred in dismissing Agua Sierra's counterclaim for rescission; and (3) whether the court improperly denied Agua Sierra leave to amend its counterclaim.

A. Limitations and Laches.

¶3 In *Davis II*, the supreme court held Arizona law does not recognize a real property right to the potential future use of groundwater. *Id.* at __, ¶ 19, 203 P.3d at 509 (citing *In re the Rights to the Use of the Gila River Sys.*, 171 Ariz. 230, 239, 830 P.2d 442, 451 (1992)). Instead, a landowner only has

[1] The facts and procedural history of this case are reported in detail in *Davis I*, 217 Ariz. 386, 174 P.3d 298, and *Davis II*, 220 Ariz. 108, 203 P.3d 506.

what "is perhaps better described as an unvested expectancy" concerning "the potential future use of groundwater that has never been captured or applied." *Davis II*, 220 Ariz. at __, ¶ 22, 203 P.3d at 510. Accordingly, the court held that the deed reservation at issue was not valid because the grantor lacked a real property interest in the right purportedly reserved. *Id.* at ___, ¶ 24, 203 P.3d at 510. Nor, concluded the court, was the reservation valid as an attempt to sever and reserve to the grantor whatever rights the landowner might have to the future use of groundwater. *Id.* at ___, ¶¶ 24, 32, 203 P.3d at 510, 511-12.

¶4 Agua Sierra argues that notwithstanding the supreme court's decision, Davis's action to quiet title was barred by limitations and the doctrine of laches because Davis accepted the March 1984 deed with "full knowledge and actual notice" of the reservation but failed to pursue his legal claim until 2004. The superior court granted summary judgment to Davis on these defenses. Following issuance of the supreme court's decision, we directed the parties to brief whether the supreme court's opinion barred Agua Sierra's limitations and laches defenses. Upon review of the supplemental briefs and the authorities, we conclude that because the supreme court held in *Davis II* that the purported reservation was void as a matter of law, neither

limitations nor the doctrine of laches may bar Davis's action to invalidate the purported reservation.

¶5 When an agreement violates the law, a court may not enforce it. *See Olsen v. Union Canal & Irrigation Co.*, 58 Ariz. 306, 317, 119 P.2d 569, 573 (1941) (contract made in violation of public policy may not be enforced); *Red Rover Copper Co. v. Indus. Comm'n*, 58 Ariz. 203, 214, 118 P.2d 1102, 1107 (1941) (same); *cf. Elson Dev. Co. v. Ariz. Sav. and Loan Ass'n*, 99 Ariz. 217, 227, 407 P.2d 930, 937 (1965) (agreement to abandon property was contrary to public policy and therefore invalid and unenforceable).

¶6 By the same token, a contract that is void because it violates the law does not become enforceable because of the passage of the applicable limitations period or by virtue of laches. "No contractual consent, no statute of limitations, no laches nor estoppel can prevail against public policy, and any agreements made and any acts done in violation of it are necessarily void." *Red Rover Copper Co.*, 58 Ariz. at 214, 118 P.2d at 1107; *Olsen*, 58 Ariz. at 317, 119 P.2d at 573 (same); *see also Clark v. Tinnin*, 81 Ariz. 259, 263, 304 P.2d 947, 950 (1956) (plaintiff was not estopped to contest the illegality of an agreement because "the defenses of waiver and estoppel cannot be invoked against an agreement which is void as against public

policy"), *superseded by statute as recognized in Black v. Siler*, 96 Ariz. 102, 392 P.2d 572 (1964); *Nat'l Union Indem. Co. v. Bruce Bros., Inc.*, 44 Ariz. 454, 464, 467, 38 P.2d 648, 652, 653 (1934) (contract made in violation of public policy cannot be validated by ratification; such a contract "is one which never had any legal existence or effect, and it cannot in any manner have life breathed into it").

¶7 In arguing to the contrary, Agua Sierra relies on adverse possession cases that address ineffective deeds in the context of the element that requires a claimant to show possession "under color of title." *See*, *e.g.*, *Sparks v. Douglas & Sparks Realty Co.*, 19 Ariz. 123, 166 P. 285 (1917); *Rosborough v. Cook*, 194 S.W. 131 (Tex. 1917); *W. End API, Ltd. v. Rothpletz*, 732 S.W.2d 371 (Tex. App. 1987). Agua Sierra argues that under these cases, a recorded deed triggers the statute of limitations even when the deed is void or otherwise insufficient to convey title. But adverse possession claims arise only when the deed does not operate as an effective conveyance (because if it did, the claimant would have title rather than a claim by adverse possession). *See Sparks*, 19 Ariz. at 127, 166 P. at 287 ("If the deed actually conveyed a perfect title this would be title not color [of title].") For that reason, the cases Agua

Sierra cites do not stand for the proposition that limitations may bar any action to clear title.

B. Agua Sierra's Counterclaim for Rescission.

¶8 Davis's motion for summary judgment sought entry of judgment in his behalf on his claims for declaratory judgment and to quiet title and dismissal of Agua Sierra's counterclaim.[2] As to the counterclaim, Davis's motion for summary judgment stated:

> We note that Agua Sierra's Counterclaim seeks a declaration from this Court on the "commercial water rights" issue and requests the Court to quiet title to those "rights" as well, albeit in Agua Sierra. While we believe, and will explain why, Agua Sierra has no standing to make these requests, we note that there can be no dispute as to the nature or propriety of the same relief sought by [Davis] from this Court concerning the "commercial water rights" issue. We, however, will not here address the Agua Sierra alternative request for rescission since we believe that Agua Sierra's lack of standing disposes of its requests for relief.

¶9 Agua Sierra's response and cross-motion for summary judgment focused only on the validity of the reservation, did not address the substance of its counterclaim for rescission and only briefly responded to Davis's standing argument. Nor did

[2] We review the superior court's grant of a motion for summary judgment *de novo*. *Tierra Ranchos Homeowners Ass'n v. Kitchukov*, 216 Ariz. 195, 199, ¶ 15, 165 P.3d 173, 177 (App. 2007).

Davis's reply memorandum address the merits of the rescission claim.

¶10 As noted, the superior court granted Davis's motion for summary judgment on his claims for declaratory judgment and to quiet title and denied Agua Sierra's cross-motion. It also summarily dismissed Agua Sierra's counterclaim for rescission, not for lack of standing, but on the merits:

> Arizona does not recognize the reservation of commercial water rights or the right to develop commercial water rights as reserved in the deeds to the property in this case. Such reservations[,] however, do not invalidate the 1984 and 1999 deeds to Plaintiff. . . . Since the case law underlying that legal determination has been in existence since 1953 . . . the Court finds that the Defendants are not entitled to rescission of the deeds to the Plaintiff.

¶11 Because Davis explicitly had stated he was not seeking summary judgment on the merits of Agua Sierra's counterclaim for rescission and neither party briefed nor argued the merits of the counterclaim, Agua Sierra had no adequate opportunity before the court ruled to argue why its counterclaim should not be dismissed on the merits.

¶12 Summary judgment may be entered in favor of a non-moving party, provided, however, that the party against whom judgment is entered has a full opportunity to show there is a material factual dispute and that the non-movant was not

entitled to judgment as a matter of law. *Century Med. Plaza v. Goldstein*, 122 Ariz. 583, 585, 596 P.2d 721, 723 (App. 1979). In such event, however, "great care must be exercised to assure" that the party against whom judgment is to be entered has had an adequate opportunity to show why the other party is not entitled to judgment as a matter of law. *Kassbaum v. Steppenwolf Prods., Inc.*, 236 F.3d 487, 494 (9th Cir. 2000) (quoting *Ramsey v. Coughlin*, 94 F.3d 71, 74 (2d Cir. 1996)); *see also Fountain v. Filson*, 336 U.S. 681, 682-83 (1949) (improper to order summary judgment against a party on a claim other than that raised in its motion for summary judgment without providing an opportunity to dispute the facts material to that claim).

¶13 On appeal, Davis urges us to affirm the summary judgment on the ground that Agua Sierra lacked standing to enforce the reservation. Chino Ranch transferred the property in question to Red Deer in 1981 by a warranty deed in which it reserved the groundwater rights at issue. The 1984 warranty deed from Red Deer to Davis likewise purported to reserve "all commercial water rights" to Red Deer. Davis argues that because Chino Ranch had reserved the commercial water rights in the original sale to Red Deer, Red Deer never had those rights and thus Agua Sierra, as Red Deer's successor, cannot complain now of being deprived of them.

¶14 We decline to adopt Davis's standing argument. In the first place, because *Davis II* teaches that a grantor may not reserve commercial groundwater rights, we must conclude that the original reservation in favor of Chino Ranch was invalid, meaning that the water rights at issue were transferred along with other real property rights in the 1981 warranty deed to Red Deer. Under that reasoning, Red Deer plainly had standing to dispute Davis's assertion that the purported reservation in the 1984 deed was invalid. Second, when Chino Ranch merged with Red Deer in 1989, Red Deer acquired any water rights claims Chino Ranch might have owned. We understand from the record that Agua Sierra subsequently received transfers of those rights from Red Deer and other related parties, and in 2005 also received all of Red Deer's equitable claims relating to the property at issue. Because Agua Sierra owns all interests and claims once belonging to Chino Ranch and Red Deer, the standing argument Davis raises is moot.

¶15 In the alternative, Davis argues that Agua Sierra's counterclaim correctly was dismissed on the merits. We understand the superior court to have dismissed Agua Sierra's rescission claim because the court found Agua Sierra's predecessor should have known at the time of the 1984 warranty deed that the purported reservation was invalid. Without

expressing an opinion on the outcome of that issue, we conclude the counterclaim should not have been summarily dismissed without a full opportunity for briefing.[3] Although Davis argues the court granted Agua Sierra a sufficient opportunity to defend its counterclaim by its consideration of Agua Sierra's motion for reconsideration, that briefing did not comply with Arizona Rule of Civil Procedure 56. Accordingly, we remand to the superior court with instructions to reinstate Agua Sierra's counterclaim for rescission.

C. Agua Sierra's Motion for Leave to Amend Its Counterclaim.

¶16 Agua Sierra argues the superior court abused its discretion by denying its motion for leave to amend its counterclaim. We review the superior court's denial of leave to amend a pleading for clear abuse of discretion. *MacCollum, M.D. v. Perkinson*, 185 Ariz. 179, 185, 913 P.2d 1097, 1103 (App. 1996).

¶17 Pursuant to Arizona Rule of Civil Procedure ("Rule") 15(a), after service of a responsive pleading, a party may amend a complaint or counterclaim "only by leave of court or by written consent of the adverse party." Although leave to amend

[3] Agua Sierra's counterclaim for rescission was based on two theories, mutual mistake and/or material failure of consideration. The superior court's ruling appeared aimed at the first theory but did not address the latter.

is discretionary, it "shall be freely given when justice requires." Ariz. R. Civ. P. 15(a); *see also MacCollum*, 185 Ariz. at 185, 913 P.2d at 1103.

¶18 "Amendments will be permitted unless the court finds undue delay in the request, bad faith, undue prejudice, or futility in the amendment." *Id.* at 185, 913 P.2d at 1103. "If the underlying facts or circumstances relied upon by a [party] may be a proper subject of relief, he ought to be afforded an opportunity to test his claim on the merits" and leave to amend should be granted. *Spitz v. Bache & Co.*, 122 Ariz. 530, 531, 596 P.2d 365, 366 (1979). The merits or facts of a controversy are not properly decided in a motion for leave to amend and should instead be attacked by a motion to dismiss for failure to state a claim or for summary judgment. *Hernandez v. Maricopa County Superior Court*, 108 Ariz. 422, 422, 501 P.2d 6, 6 (1972). Finally, "[d]enial of leave to amend is generally an abuse of discretion where the amendment merely seeks to add a new legal theory." *MacCollum*, 185 Ariz. at 185, 913 P.2d at 1103; *see also Jung v. City of Phoenix*, 160 Ariz. 38, 41, 770 P.2d 342, 345 (1989) (dismissal of a complaint without leave to amend was error where, although action could not be maintained under one statute, "the plaintiffs' allegations in the complaint show that they may be entitled to relief under another legal theory").

¶19 Thirty-one days after the court granted summary judgment to Davis, Agua Sierra moved for leave to file a second amended counterclaim pursuant to Rule 15. The amendment was based on the same facts alleged in the prior pleading.[4] It added claims for "restitution/unjust enrichment" and reformation based on the court's ruling invalidating the purported reservation. In support of these claims, the pleading alleged that Davis received benefits at the expense of Agua Sierra's predecessors in interest without paying for those benefits. It alleged Davis should be ordered to fairly compensate Agua Sierra for the value of the commercial water rights, or that in the alternative, the 1984 deed should be reformed "to comport with the parties' intent to reserve" the water rights for the benefit of Agua Sierra's predecessor in interest.

¶20 Davis opposed the motion, arguing that the new claims were compulsory counterclaims that were barred by Agua Sierra's failure to allege them prior to summary judgment, pursuant to Rule 13(f). The superior court denied the motion, stating "The

[4] The second amended complaint added an allegation that, as discussed above, on May 2, 2005 (after the filing of the first amended counterclaim), Red Deer assigned to Agua Sierra any and all of its remaining rights with respect to the property at issue, including its purported rights to rescind the 1984 transaction and to reform the 1984 deed.

Court has already ruled against the Defendant/Counterclaimant upon the underlying claim it now seeks to amend."

¶21 The superior court did not find Agua Sierra's motion was untimely, made in bad faith or that it would result in undue prejudice to Davis. Rather, it appears the court denied the motion because it concluded the amendment would be futile given entry of summary judgment in favor of Davis on the issue of the purported reservation. The amended counterclaim, however, alleged new legal theories based on the court's ruling that the purported reservation in the 1984 warranty deed was invalid. Accordingly, the claims were not futile, and the proposed amendment should have been permitted. We reverse the superior court's denial of Agua Sierra's motion to amend its counterclaim and remand for proceedings consistent with this decision.

CONCLUSION

¶22 For the foregoing reasons, we affirm the superior court's conclusion that Davis's claims are not barred by limitations or laches, but reverse its dismissal of Agua Sierra's counterclaim for rescission and its denial of Agua Sierra's motion for leave to amend the counterclaim, and vacate

its award of costs and attorney's fees to Davis.[5] We remand to the superior court for proceedings consistent with this decision.[6]

__/s/_____
DIANE M. JOHNSEN, Presiding Judge

CONCURRING:

__/s/_____
JON W. THOMPSON, Judge

__/s/_____
ANN A. SCOTT TIMMER, Judge

[5] Because we reverse the superior court's award of Davis's costs, we do not address Agua Sierra's argument that the superior court erred by permitting Davis to recoup costs that are not taxable.

[6] Both parties request costs and attorney's fees on appeal pursuant to Arizona Revised Statutes sections 12-341 (2003), -341.01 (2003) and -1103 (2003). Given our disposition of this appeal, in our discretion, we deny both parties' requests for costs and attorney's fees.