Montana's Response to Interjurisdictional Marketing Challenges

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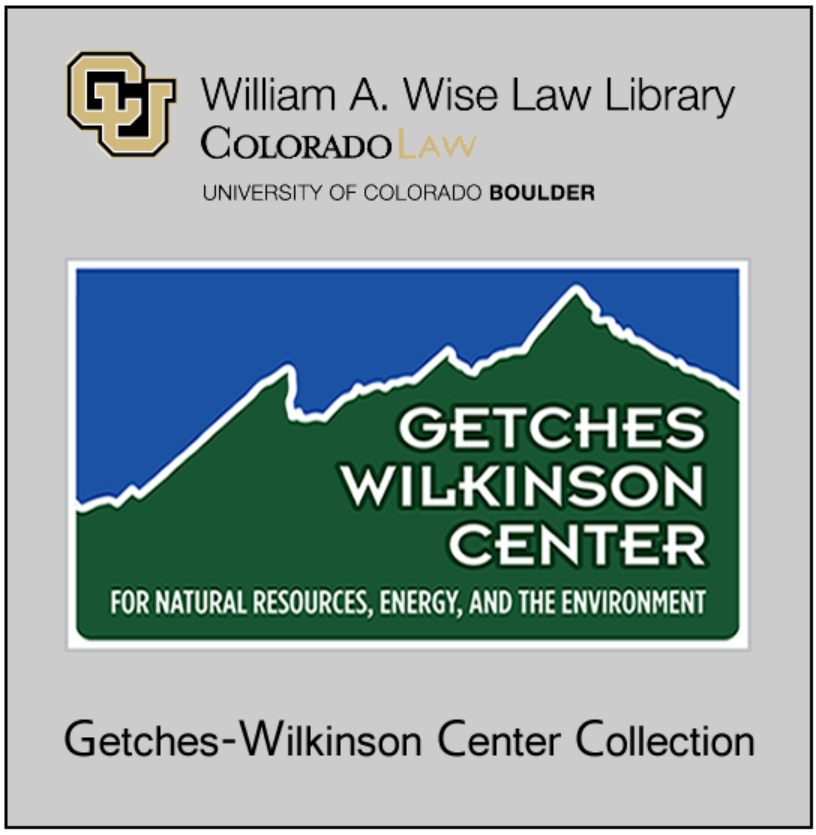

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June 5 - 7, 1989

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I. Introduction

A. Summary

In 1985 Montana modified its water policy to respond to interjurisdictional marketing challenges and opportunities. Four years later, this effort to integrate public interest and market approaches awaits stronger economic demand for implementation of these innovations.

Meanwhile, several parallel developments involving cross-jurisdictional water transfers and related water management issues have arisen to provide new challenges to policy makers. These include tribal marketing agreements and negotiations, management of shortages caused by severe drought, public trust considerations of supplies adequate to maintain fish, wildlife, and recreational values, and legislative response to market demands for preserving instream beneficial uses.

In 1989, the legislature responded more cautiously to intrajurisdictional transfer opportunities than it did to external threats and opportunities in 1985. While economic demand for these intrajurisdictional transfers is relatively

strong, almost no demand currently exists for interjurisdictional marketing.

Policymakers may now be better advised to adopt the approaches employed in 1985 that allowed state participation in interjurisdictional water transfer opportunities while strongly safeguarding in-state beneficial uses. Instead they have resisted efforts to apply those same principles to internal transfer opportunities.

B. General References

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2. Smith, Rodney T. Trading Water: An Economic and Legal Framework for Water Marketing, Council of State Policy and Planning Agencies, 1988.

3. Rundle, Marcia. Summary of Provisions Contained Within the Fort Peck-Montana Compact, Reserved Water Rights Compact Commission, Helena, Montana.

4. Lawson, Mike. "Pick-Sloan and the Tribes," Boundaries Carved in Water, Northern Lights Institute, No. 10, April 1988.

5. Janklow, William. "High Noon in the Missouri River Basin," Boundaries Carved in Water, Northern Lights Institute, No. 4, February 1988.

6. Colby, Bonnie. "Water Markets, State Water Transfer Policies and Economic Consequences," American Bar Association Water Resources Workshop, February 1988.

7. Morandi, Larry. "Reallocating Western Water: Equity, Efficiency, and the Role of Legislation, National Conference of State Legislatures, October 1988.

8. Thorson, John. "Portraits on the Missouri: Past, Present, and Future--A Legal Analysis of State Options to Manage an Interstate Resource," National Conference of State Legislatures, December 1986.

II. Montana's Response to Post-Sporhase Opportunities and Constraints

A. As the state at the headwaters of two major river systems, the Missouri and the Columbia, Montana faces both opportunities and the need for considered restraint in the management of those waters. Montana's modern water policy, highlighted by its legislation relative to interjurisdictional transfers, thus developed against the backdrop of several converging events and trends:

1. Predictions of rapid and full-scale development of Montana's vast coal reserves that would require huge amounts of water from the

Yellowstone River, one of the last free-flowing major western rivers.

2. Perceptions of increased demand from downstream states, some involving interstate transfers, that transformed earlier complacency based on abundance.

3. Strong initiatives to assert federal and Indian water claims reserved in a state with major proportions of tribal and public lands.

4. The 1982 U.S. Supreme Court decision in Sporhase v. Nebraska 458 U. S. 953 (1982) indicating, along with other important elements, that water is a commodity not unlike other commercial goods that move relatively unimpeded.

5. The 1982 announcement by South Dakota that it had sold 50,000 acre-feet of water per year to the ETSI coal slurry pipeline consortium for a prospective $1.4 billion.

6. Efforts within Montana to remove statutory restraints on the exportation of water so that Montana could also profit from ETSI-type deals.

7. Increasing conflict among the states in the Missouri River Basin that fueled both a "race to the waters" and instability in management.

B. The years just preceding the issuance of the Sporhase decision had brought fear to Montana legislators of massive energy development and

conversion of agricultural water use to industrial consumptive uses both within and outside Montana's borders. They responded in 1979 with enactment of a ban on the exportation of water and a provision specifically determining that use of water for coal slurry was not a beneficial use under Montana's water law.

But by the commencement of the 1983 legislature, post-Sporhase events coincided to produce mounting urgency on the part of many policymakers, including then Governor Ted Schwinden, to sell water to produce revenues to fund the water development projects necessary to save Montana's water. Widely cited as justification for this paradoxical approach was a study done by Frank Trelease and Wright Water Engineers for the Montana Department of Natural Resources and Conservation entitled "A Water Protection Strategy for Montana" setting forth a strategy to protect Montana's options for future instate development of Missouri River waters in the face of expanding use by downstream states.

During the 1983 legislative session, three bills were introduced concerning water marketing. Only one of them passed: HB 908, which temporarily patched up Montana's clearly unconstitutional anti-export ban and created a Select Committee on Water Marketing.

The Select Committee was directed by HB 908 to undertake a comprehensive study of economic, tax, administrative, legal, social, and environmental advantages and disadvantages of water marketing. But the Select Committee soon saw the need to broaden its scope of study to incorporate many more features of a water policy that could withstand and accommodate competing interests. In its final report, the Select Committee emphasized the importance of a comprehensive state water policy to maximize and reserve for the present and future use of its citizens Montana's fair share of the water in interstate rivers and streams--particularly those of the Missouri. To give authority to this policy, the Select Committee introduced HB 680, which was enacted on April 19, 1985. (Ch. 573, Mont. Laws 1985)

C. HB 680 made significant changes in several areas of Montana water policy and attempted to assert the maximum constitutional authority of the state over the intra- and interstate movement of water.

1. The legislature applied increasingly stringent public interest criteria to applications for new water permits. Because drafters of the legislation feared that these permit criteria would encourage potential appropriators to purchase existing rights and change the type or location of use or to secure water under the state's water

reservation system, these public interest criteria were added to those methods of obtaining water as well.

Three levels of review are applied to increasingly larger and more consumptive amounts of water to be appropriated. The first level requires only the traditional examination of the potential effect of a new water use on other appropriators in a basin. This level applies to all appropriations, small and large, in-state and out-of-state. The second level, which is the first set of public interest criteria, applies to diversions in excess of 4000 ac-ft/yr and 5.5 cfs and dictates a more thorough evaluation for the broader statewide public interest as well as a higher burden of proof. The third level mandates an especially careful public welfare review of applications to appropriate water out-of-state use.

These special public interest, or conservation, criteria were designed to conform to the "window" left open in Sporhase for states to prefer their own citizens for water if necessary for "health and safety" purposes. The language of the criteria is based on a New Mexico statute adopted to respond to El Paso v. Reynolds, 563 F. Supp. 379 (D.N.M. 1983) and 597 F. Supp. 694 (D.N.M. 1984).

Varying treatment was given to permits and changes when a larger amount of water would be consumed. Change applications that would result in consumption of water in excess of 4000 ac-ft/yr and 5.5 cfs are allowed, but must be approved by the legislature. On the other hand, permits for an amount exceeding this threshold are disallowed, except if the Department of Natural Resources and Conservation is the appropriator.

2. The second major feature of the 1985 water policy legislation is an innovative limitation on the private ability to appropriate water. Applicants must now lease water from the state Department of Natural Resources and Conservation when they seek to consume unappropriated water in excess of 4000 ac-ft/yr and 5.5 cfs or to move water in any amount out of six specified water basins located wholly or partly within the state. Applicants must also satisfy the relevant public interest criteria and the requirements of the state Environmental Policy Act (75-1-101 et seq., Mont. Code Ann.) As noted earlier, only the Department of Natural Resources and Conservation may appropriate water in these large consumptive amounts.

The department administers the program and determines the price and other terms and conditions of the lease. The legislation authorizes

differential pricing. Water is to be leased from federal reservoirs or from reservoirs in adjudicated basins. The program limits leasing to no more than 50,000 ac-ft in total at the present time.

As the proprietor of the leased water, the state may be able to regulate the interstate movement of water in a manner that would be otherwise impermissible under the dormant Commerce Clause of the U.S. Constitution. See Hughes v. Alexandria Scrap Corp., 426 U.S. 794, 810 (1976).

3. Other elements of the comprehensive water policy revisions enacted in 1985 include an accelerated water reservation program, increased efforts toward negotiation among Missouri River Basin states and tribes, and the placing of large pipelines under the Montana Major Facility Siting Act (75-20-101 et seq., Mont. Code Ann.).

D. In an important side issue, Sporhase principles were also further developed in Intake Water Co. v. Yellowstone River Compact Commissioners, 769 F. 2d 568 (9th Cir. 1985), cert. denied, 476 U.S. 1163 (1983). This case tested the restraints on the interstate movement of water contained in the Yellowstone River Compact. Intake Water Company appropriated 80,000 ac-ft/yr of water from the Yellowstone for export out-of-state and out-of-basin. Intake challenged the unanimous consent provision of

the compact, saying it violated the commerce clause and equal protection clause of the U.S. Constitution. The courts held that the compact is immune from commerce clause scrutiny because it was approved by Congress and was therefore federal law. The equal protection argument was dismissed on the grounds that the clause protects people and corporations--not geographic areas.

III. State-Tribal Marketing Opportunities

A. With the passage of the water marketing legislation in 1985, Montana also entered an historic agreement for joint state-tribal water marketing with the Fort Peck Indian tribe. This agreement resulted from Montana's commitment to negotiate settlements of water controversies - not just with other states in the Missouri River Basin, but with tribal governments within its borders. Tribal commitment to the negotiation process contributed equally to its success.

The joint marketing agreement of the Fort Peck Compact, along with the implicit promise of future marketing agreements with the Sioux-Assiniboine and other tribal governments is set against the backdrop of two important factors:

1. The 1979 legislature adopted, and each subsequent legislature has affirmed, a policy of negotiating with the tribes and the federal

government for the quantification of those entities' reserved water rights within Montana. Occurring at the same time that state water rights are undergoing adjudication under a statewide program, these tribal and federal rights are the subject of negotiation by the Reserved Water Rights Compact Commission.

While the Montana Supreme Court held in State ex rel. Greely v. Confederated Salish and Kootenai Tribes 712 P. 2d 754 (Mont. 1985) that the state's adjudication program has been found adequate on its face for adjudicating both federal and Indian reserved water rights, Montana has chosen to attempt to first negotiate the settlement of those rights rather than face costly litigation. To date only one compact (the Fort Peck Compact) has been entered, although negotiations with several other tribes and federal agencies are underway.

2. The major source of water development in Montana derives from the Pick-Sloan Program embodied in the Flood Control Act of 1944 for the Missouri River Basin. However, states in the Upper Basin generally contend that they have received fewer benefits than downstream states, which have received considerable economic gain from navigation and flood control while the upstream states have reaped only small increases in irrigation. Tribes in the Upper Basin have received even fewer benefits.

Indeed, their economic and cultural losses from the Pick-Sloan Program have been severe throughout the basin. Only with the application of the Winters doctrine and its interpretation in the courts have tribes in Montana and the rest of the basin begun to recoup some of those losses.

The few (but massive) federal impoundments on the Missouri and its tributaries in Montana are the likely sources of any future interjurisdictional water marketing that might occur if economic conditions improve. Significantly, most of these reservoirs (e.g., Yellowtail, Fort Peck, and Tiber) are the subject of substantial tribal claims. The resolution of those claims is likely to involve agreements for joint state-tribal marketing similar to that entered in the Fort Peck Compact. Negotiations for joint marketing in each of these situations have commenced.

B. Ratified by the Fort Peck Tribes and adopted by the legislature in 1985, the Fort Peck Compact contains an allocation of 1,050,542 acre-feet or a consumptive use of 523,236 acre-feet, whichever is less, for the tribes from the Missouri River, its tributaries, and underlying groundwater. The Compact authorizes the tribes to market water off the reservation and to market jointly with the state. The tribes must give the state an opportunity to

participate in any marketing but may proceed on its own if the state declines.

As long as the state markets jointly with the tribes, any proposed marketing opportunity must meet the provisions of Montana law in effect at the time of the proposed transfer. Transfer of water outside the reservation is limited to 50,000 acre-feet and is tied to the statutory limit in the state water leasing program described above. As the state's leasing limit increases, however, so does that apply to the tribes. If the state does not have a marketing program, the tribes are subject either to limitations established in federal law or to limitations in state law that would apply to any appropriative right.

Opinions as to the relative advantages and disadvantages to both the state and the tribes conferred by the Compact differ. Some tribal advocates assert that the Compact limits the ability of the tribes to market water independent of state interference. Other critics contend that the state shortchanged itself and abrogated too much authority. None of these contentions has been vindicated, however, as the marketing provisions of the Compact have yet to be tested. But negotiations with other tribes are proceeding under the assumption that

similar provisions regarding joint marketing will be written.

IV. Post-1985 Developments

A. Montana's water leasing program, the Fort Peck Compact, and other elements of the state's water policy associated with the passage of HB 680 arose from a set of assumptions about the economic demand for those waters. But many of those assumptions have proved too optimistic (or pessimistic, depending on one's point of view). Full implementation of several of these policy initiatives stalled because of the reality of ensuing events and conditions.

Montana's economy, along with other states in the northern tier and Rocky Mountain regions, boomed in the seventies and early eighties. But the dream (or nightmare) of massive industrialization and growth through energy development never reached fruition. Declines in all of Montana's basic industries (mining, agriculture, forestry, oil and gas) except tourism have meant shrinking state revenues. The national demand for Montana's water simply hasn't materialized.

These economic realities have slowed implementation of nearly all of the water policy innovations adopted in 1985, yet the state's

commitment to them remains strong. These realities, along with recent climatalogical events, have refocused the attention of policy-makers and water managers to internal pressures to institute transfer mechanisms to respond to intrajurisdictional needs.

B. The decline of Montana's extractive industries has renewed interest in promoting Montana's high-quality environment for tourism and relocation of service-based businesses. An important component of that quality environment is the pristine, free-flowing river system that provides fish, wildlife, and recreational values for residents and tourists.

At the same time that these instream values have gained importance to Montana's economy, severe drought has weakened the state's agricultural base and placed increasing pressure on scarce water supplies. Montana's reliance on the prior appropriation doctrine dictates that agricultural beneficial uses, which generally hold senior rights, take priority in the allocation of these dramatically reduced streamflows.

This agricultural predominance is tempered by articulation of the public trust doctrine in three cases decided by the Montana Supreme Court since 1984. The three cases - Montana Coalition for Stream Access v. Curran 682 P. 2d 163 (1984), Montana

Coalition for Stream Access v. Hildreth 682 P. 2d 1088 (1984), and Galt v. State 731 P. 2d 912 (1987) - did not directly address the conflict between the public interest in using water recreationally and the prior appropriation doctrine. But such a direct conflict is likely to occur unless water users, administrators, and public policymakers work to develop consensus on reasonable and equitable sharing of the water resource during shortages.

This past summer saw many of Montana's high quality fishing streams dewatered while surrounding irrigation ditches drew any available water. On river systems where storage capacity existed, some irrigators negotiated with the Department of Natural Resources and Conservation and the Department of Fish, Wildlife, and Parks for the purchase of water for instream use downstream. But on many blue-ribbon streams where no storage existed, significant dewatering occurred, and valuable fisheries were lost.

Most legal experts believe that Montana water law does not allow the change and transfer of water rights to a use that does not involve a diversion. Thus, changes of irrigation rights to instream beneficial uses for the protection of water quality, fisheries, and recreation have not

occurred except in one instance where a small dam (a diversion structure) was involved.

The controversy that surrounds the issue of transfers for instream purposes within Montana is at least as strong as the water marketing frenzy that led to the enactment of Montana's interjurisdictional water leasing program in 1985. During the recent legislative session, angry ranchers filled the halls of the Capitol, fearful that lawmakers would steal the right to irrigate established by their grandfathers and held dear for generations. Equally vociferous were conservationists who threatened lawsuits based on the public trust doctrine, constitutional initiatives, and other legal attacks should the legislature fail to facilitate transfers for instream purposes.

C. The 1989 legislature responded even more cautiously to intrajurisdictional transfer opportunities than it did to external threats and opportunities in 1985. After several near-deaths, the bill that received eventual approval in the legislature calls for a limited pilot program of instream water leasing for a trial period that ends on July 1, 1993.

These pilot, voluntary, leases may be entered into only by the Department of Fish, Wildlife, and Parks on no more than five stream

reaches designated by the Board of Natural Resources and Conservation. The bill provides that a lease authorization must be obtained from the Department of Natural Resources and Conservation through a process similar to that provided for changes in appropriation rights. Other restrictions include approval by the citizen Fish and Game Commission before the Department of Fish, Wildlife and Parks proceeds to lease water rights. The legislation limits transfers for instream purposes to temporary leases and to a single public agency, the Department of Fish, Wildlife and Parks. In summary, this legislation is very tightly drawn, to the extent that whether it is workable may be questioned.

V. Future Prospects

A. Paradoxically, the only demand that currently exists for water transfers in Montana - instream flows - relates to that for which no institutional mechanism is in place.

B. Legislators, water managers, and water users must consider applying the same approaches that led to the adoption of Montana's innovative water marketing program in 1985 to the currently strong demand for intrajurisdictional transfers for instream uses. The model should balance public interest and market approaches for the enhancement of Montana's current economic realities.