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WATER TRANSFERS AND EXCHANGES: USING THE MARKET
TO IMPROVE WATER USE--A LEGAL/INSTITUTIONAL VIEW

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I. Introduction: Putting the Market in its Place--One
Relocation Mechanism Among Many

A. The Rellocation Phenomenon: Something Old, Something
New

Water was allocated initially in the West as a free good, but became subject to relocation from the earliest days of settlement through the transfer of appropriative water rights, normally in connection with the conveyance of the land to which the water right was attached. Many western towns and cities so established or expanded their water supplies, and that legacy goes on.

B. Rellocative Mechanisms: Some Illustrative Cases

There are numerous ways to reallocate the rights to use water, some of which are market oriented, others of which are more aligned with regulatory intervention.

1. Voluntary Transfers of Water Right Interests for Compensation

The various kinds of water rights -- fee title, shares, contract rights -- are normally transferable in whole or part, subject to occasional constraints, such as public agency review and third party rights.

a. Sales

The transfer of the total fee property interest of a water right normally occurs in conjunction with a land conveyance, but a severance is allowable in most western states.

b. Leases for Set Term

The leasing of water rights for a season, year or many years is usually possible and provides an attractive alternative to a sale, particularly where a risky venture or fixed-life use is involved.

c. Dry Year or Emergency Option to Lease

An option to lease senior rights under drought or other emergency conditions can offer flexibility and security to municipal and industrial water users. The pooling of such options holds promise as a means of helping to drought-proof communities.

Example: Utah city and farmers.

d. Foregoing Priority for Shortage-Sharing

Holders of senior rights may be able to effectively market their seniority by agreeing to share shortages during dry years. Example: San Juan-Chama diversion.

2. Conservation Offsets to Create Usable Surplus

If a municipal or industrial user buys or already holds a junior water right and wants greater assurance of supply under scarcer conditions, it may be able to achieve that end by making water conservation investments in a senior use, creating surplus available for the junior use. Example: Proposed contract between Metropolitan Water District and Imperial Irrigation District.

3. Exchanges

An agreement to exchange one water supply for another temporarily, seasonally or permanently can leave all parties better off. Through multiple exchanges it may be possible in some settings to serve remotely located new users. Example: Utah plans regarding Bear River.

4. Contractual and Regulatory Drought Priorities

Water delivery contracts in large projects can specify reallocative priorities which take effect during droughts. Municipal uses and orchards, for example, can be preferred over annual crops.

Example: California Water Project contracts and the 1976-77 drought.

5. Involuntary Transfers of Water Right Interests

a. Abandonment and Forfeiture

All or part of a water right can be lost to a holder who abandons or forfeits under state law, with the benefit inuring to junior right

holders, new appropriators or the public.

b. Eminent Domain

Where authorized, public agencies and utilities can condemn existing water rights, transferring their title and use. This reallocation mechanism is constrained by politics and limited funds.

C. The Changing Context of Choice

The conditions which influence the availability and choice of a reallocative mechanism are changing markedly in many areas. Declining agricultural commodity prices, for example, have put some farmers behind legislative and regulatory reforms making it easier to transfer water rights.

II. Legal-Institutional Factors Influencing the Reallocative Choice

A. Transferability of the Right

The water right needs to be of a kind legally regarded as transferable. Most are so regarded, but some, such

as riparian rights in California, are not.

B. Salvage Rights

More water can become available for reallocation when right holders are allowed to transfer rights to water which they conserve. This permits a user to yield up water for money without relocation or dislocation. California Water Code 1011.

C. Acquisition, Transaction and Treatment Costs

Asking prices for water rights vary markedly and can fluctuate. Additional expenses, such as those associated with obtaining public agency approval of the change in use and point of diversion, or with the upgrading of the quality of the water to meet the new intended use, bear on the decision of the would-be buyer or lessee.

D. Origin and Destination Conditions

In large-scale transfers, the precondition of first conserving existing supplies or of meeting area-of-origin requirements can face the water purchaser. Example: California legislative

provisions, existing and proposed (Proposition 13; 1982).

E. Access to Plumbing and Facilities

Reallocation involves transporting water in a natural or man-made distribution system. The feasibility of a transaction can turn on whether access can be gained to existing water works controlled by a third party.

Example: Proposed carriage of Yampa River water to San Diego via the Colorado River Aqueduct; pending Katz bill in California, Assembly Bill 2746.

F. Risk: Legal, Economic, Social and Political Uncertainty

Uncertainties and risks underlie many water reallocations. For example, the quantum or value of the right may later be determined to be less than represented, the terms of an agreement may be socially or politically dishonored over time, a third party may become injured and sue, or an unforeseen regulatory restraint may arise.

III. Water Markets: Definitions, Examples, Opportunities and Needed Reforms

Enthusiasm over the belated judicial recognition of water as a commodity may be leading to some inflated expectations as to the extent and rate of private water marketing in the West. Standards for comparison and analysis are needed.

A. Definitional Issues

What definition of "market" is appropriate for describing what is happening or is expected to happen in the transfer of water rights in the West? How much access, information, price equilibration, volume or privatization is necessary for a "water market" to exist?

B. Examples: Real and Potential

To highlight the definitional problems, several examples of contemporary transfers or proposed transfers, reflecting different features, can be cited.

1. Colorado Front Range

Water right "units" covering Colorado Big Thompson project water in the Northern Colorado Conservancy District are marketed through centralized listings

of bids and offers. Specialized brokers operate in the area. Appropriative rights are being sold in many instances through noncompetitive bargaining.

2. New Mexico

Controversy surrounding the transfer of water rights from within to without the Middle Rio Grande Conservancy District, which encompasses Albuquerque, illustrates the role water districts can play in transfers: Middle Rio Grande Conservancy District v. Cox.

3. Utah

The Intermountain Power Project near Lynndyl, Utah, involved the acquisition of shares in local mutual water companies at a price of \$1,775/acre foot, with the sellers being responsible for obtaining approval or the change of use and arranging protection for third-party rights.

4. Arizona

The City of Scottsdale in 1984 purchased a large

ranch and several farms totaling about 184,000 acres for their water rights, paying \$11.6 million. The City of Tucson reportedly has purchased more than 20,000 acres of farm land over recent years, specifically for the water rights. Transfers of "grandfathered" grand water rights are occurring in the active management areas established under the 1980 Groundwater Act. The water contracts for The Central Arizona Project, however, prohibit transfers for profit.

5. California

Short-term transfers occurred during the 1976-77 drought, reform legislation has encouraged transfers, and there is an increasing willingness among some financially-pressed farmers to sell, but this has not yet led to significant increases in water marketing. Transfer from San Joaquin Valley to Los Angeles and San Diego areas appear more promising than transfer from the Sacramento Valley across the Delta to the south.

6. Indian Nations

The permanent transfer of reserved rights is not

authorized. On-reservation leasing of water in connection with farm land leasing, however, does occur and leasing for off-reservation use may become a reality selectively (e.g., Arizona and Montana).

7. Interstate

Notwithstanding Sporhase, some interstate transfers (e.g., in basins covered by federally approved compacts which allocate surplus and define state entitlements in terms of consumptive use) face legal constraints.

C. Selective Legal Reforms Needed to Accommodate and Encourage the Rise and Effectiveness of Water Markets

1. Right to Market Conserved Water

There has been a legal bias against the transfer of conserved water in the West, but there are selective signs of change. Changes in attitudes toward both appurtenancy and the protection of holders of rights in return flows can be expected over time. Change in California law and policy during the 1980's may be illustrative (California

Water Code, 109, 382-87, 1011, 1244, 1735-39).

2. Right to Store and Transfer or Exchange Recharge Waters

Legislation allowing one to retain rights to water used for recharging aquifers can encourage conjunctive management and creative exchange arrangements.

3. Right of Access to Public Storage and Carriage Capacity

Where water works are monopolized but under-used, procedures for allowing access to facilitate transfers and exchanges, while safeguarding existing users, ought to be considered.

4. Redefinition and Enforcement of Beneficial Use, Reasonable Use, Abandonment and Forfeiture Provisions

Traditional water law contains workable doctrines for combating waste, which, if defined more clearly in contemporary terms and enforced more vigorously, could increase the amount of water

available for transfer.

5. Removal of Consumptive Use Requirement for State Entitlements

If state entitlements in interstate waters were not dependent on in-state consumptive use, interstate transfers would be encouraged because states could obtain economic rents without developing the water or while waiting to develop the water. Statutory or interstate compact provisions would be required in the Colorado River Basin.

6. Allowance of Profit in Sale or Lease of Water Rights in Federal Reclamation Projects

Resistance to the profitable transfers of appropriative or contract rights exercised in Federal Reclamation projects persists because of concern over private windfalls made possible by public subsidy, although support for greater marketability has been rising.

7. Removal of Geographical Limits in Water Delivery Contracts

Protectionist areal boundaries are imposed upon the right to transfer in some water delivery contracts. Such restraints may be modified or removed through renegotiation.

8. Redefinition of Anti-Speculation Provisions

In some settings the public interest may be served by the passive holding -- pooling -- of water rights to meet contingencies ranging from low or contaminated drinking water supplies to low fishery flows, perhaps demanding a redefinition of the anti-speculation provisions of some western laws.

9. Other Possibilities

Other legal incentives encouraging transfers, addressed particularly to water districts and agencies, ought to be considered.

IV. The Challenge: Reallocating Water to Serve a Desirable Mix of Efficiency, Equity and Environmental Quality Values

A. The Multiple-Value Context of Western Water Management

and the Myth of Single-Value Solutions -- Market or Otherwise

Reallocation must variously serve the efficiency, equity and environmental quality values held by the public. Some of the current reallocation involves correcting historic neglect of efficiency and environmental quality, and the equitable claims of Indians.

B. Modes of Conflict and Consensus

Water marketing may marginally facilitate consensus building and the management of conflict, but public modes of decision making will continue to dominate water reallocation and management for the foreseeable future.

C. Adaption of Laws and Institutions to Changing Conditions and Values

The transition from development to management, including reallocation, is dynamic, testing the capacity of water institutions and water laws to adapt to forces which are largely outside their effective control.

