

1-1-2017

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Thomas Witt, Legislative Report, In Support of Colorado House Bill 16-1392 - A Bill for an Act concerning the Administration of Water Banks, 20 U. Denv. Water L. Rev. 413 (2017).

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**IN SUPPORT OF COLORADO HOUSE BILL 16-1392 -
A BILL FOR AN ACT CONCERNING THE
ADMINISTRATION OF WATER BANKS**

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I. INTRODUCTION AND SUMMARY OF HOUSE BILL 16-1392

Colorado House Bill 16-1392 was introduced in March 2016 within the context of increasing water demands, which, without proper management will outpace the available supply by 2050.¹ The House Committee on Agriculture, Livestock, and Natural Resources postponed the bill indefinitely in April 2016.² To date, growing demand has largely been addressed through water conservation, construction of new water infrastructure, and the permanent transfer of water rights from agricultural areas to support municipal supplies.³ Unfortunately, conservation alone is insufficient, new storage projects are costly, and permanent acquisition of agricultural lands and water rights can have detrimental impacts on agricultural communities and may lead to habitat loss and impacts to recreational water uses.⁴

1. COLO. WATER CONSERVATION BD., THE COLORADO WATER PLAN, 1-9 (Nov. 2015), <https://www.colorado.gov/pacific/sites/default/files/CWP2016.pdf>. In Colorado, there is an increasing gap between supply and demand in municipal water supplies, particularly along the Front Range. The completion of new water projects is likely to be insufficient to address this gap, and by 2050 water shortfalls are predicted statewide. *Id.*

2. Hearing on H.B. 16-1392 Before the H. Comm. On Agric., Livestock & Nat. Res., 70th Gen. Assemb., 2nd Reg. Sess. (Colo. 2016) (voting to postpone indefinitely on April 11, 2016).

3. *Id.* at 6-1, 6-59, 6-115-116, 6-127.

4. *Id.* at 6-1, 6-8, 6-59, 6-142.

Colorado is a prior appropriation state, one of many across the American West.⁵ Prior appropriation means that the right to use water follows a “first in time, first in right” approach, giving the first person to appropriate water from a river or stream the right to use the water over all subsequent users.⁶ Unlike riparian systems in the Eastern United States, the Colorado system of prior appropriation does not limit an individual’s right to use water to those who own lands adjacent to the source. Therefore, water rights holders are free to transport water, sometimes great distances, to its intended place of use.⁷

In the prior appropriation system, rights can be transferred like any other property right.⁸ However, transfer of water rights in Colorado can come at a high cost. Water transfers require adjudication before a Colorado water court. Before approving the transfer, the water court will assess the historic consumptive use of the water right to ensure that the amount transferred does not injure other water right holders, which may decrease the amount of the original appropriation—and therefore the value of the right.⁹ That means if a farmer wants to transfer a water right originally decreed for one hundred acre feet of water, and the water court finds that he has only historically used seventy-five acre feet, his water right is reduced to seventy-five acre feet, significantly decreasing its value. The risk of this loss, along with the high transaction costs of the water court adjudication process, has limited the number of water transfers that take place.¹⁰

Legislators drafted House Bill 16-1392 to address some of these issues. The drafters of the bill intended to set rules for the creation of water banks and facilitate the temporary transfer of water rights at a reduced transactional cost, with limited court involvement.¹¹ The legislation would have placed the Colorado Water Conservation Board (“CWCB”) in charge of operating the water banks created under the program (consulting with the state engineer and with some responsibilities delegated to individual water districts).¹² The CWCB would have also been charged with establishing rules for their administration in accordance with specific guidelines for the rules in the proposed legislation.¹³

5. Chennat Gopalakrishnan, *The Doctrine of Prior Appropriation and Its Impact on Water Development: A Critical Survey*, 32 AM. J. ECON. & SOC. 61, 61 (1973).

6. Janis M. Carey & David L. Sunding, *Emerging Markets in Water: A Comparative Institutional Analysis of the Central Valley and Colorado-Big Thompson Projects*, 41 NAT. RESOURCES J. 283, 308 (2001).

7. *Id.* at 307-08.

8. JUSTICE GREG HOBBS, *THE PUBLIC’S WATER RESOURCE: ARTICLES ON WATER LAW, HISTORY, AND CULTURE*, 71-72 (2d ed. 2010).

9. Megan Hennessy, *Colorado River Water Rights: Property Rights in Transition*, 71 U. CHI. L. REV. 1661, 1670 (2004), *see also* David C. Taussig, *The Devolution of the No-Injury Standard in Changes Cases of Water Rights*, 18 U. DENV. WATER L. REV. 116, 117-18, 144 (2014).

10. ANNE J. CASTLE & LAWRENCE J. MACDONNELL, *AN ENHANCED WATER BANK FOR COLORADO 2* (Getches-Wilkinson Ctr. for Nat. Resources, Energy and the Env’t, Univ. of Colo. Law Sch. (2016), <https://www.colorado.edu/law/sites/default/files/An%20Enhanced%20Water%20Bank%20for%20Colorado.pdf>).

11. H.B. 16-1392 §§ 1 (37-80.3-102(1)(a),(b)(I)), 70th Gen. Assemb., 2nd Reg. Sess. (Colo. 2016).

12. H.B. 16-1392 §§ 1 (37-80.3-104(1),102(a)), 70th Gen. Assemb., 2nd Reg. Sess. (Colo. 2016).

13. H.B. 16-1392 §§ 1 (37-80.3-102(1)(a), 104(2)), 70th Gen. Assemb., 2nd Reg. Sess. (Colo.

There is no universal definition for a water bank, and in fact, states that have developed water banks tailor them specifically to the resources available and the needs of the state.¹⁴ In general, water banks are intended to pair water sellers with water users, to help facilitate the temporary exchange of water rights with reduced transaction costs, and decrease long-term liability for water right holders.¹⁵ While the form of water banks varies, their basic purpose has typically been to encourage the transfer of water from areas with low economic use to areas of high economic use and high demand.¹⁶

At a basic level, this is the goal of HB 16-1392. The bill, if enacted, would have provided a powerful tool for Colorado municipalities to manage their future water demands while protecting vested rights and preserving Colorado's agricultural heritage and local economies.

II. BENEFITS OF PASSING HB 16-1392

HB 16-1392 is favorable because it would: (A) provide a cost-effective mechanism for temporarily transferring water from consumptive agricultural uses to municipal use while reducing impacts on farming; (B) address specific issues with previous attempts at water banking in Colorado; and (C) reduce transaction costs and long time periods for transfers.

A. WATER BANKS ALLOW FOR TEMPORARY TRANSFERS OF WATER FROM AGRICULTURAL AREAS WHILE PRESERVING COLORADO'S AGRICULTURAL HERITAGE

Open water markets, where water is exchanged as any other fungible commodity, is conceptually appealing, particularly in the West where supplies are limited.¹⁷ Water markets prioritize higher value uses of water, specifically low consumption-high value municipal use over highly consumptive agricultural uses.¹⁸ The prior appropriation system, while bearing some resemblance to a market with the ability to sell and exchange water rights, actually works counter to the market favoring older priority uses over newer, growing demands.¹⁹

Open water markets, however, can have devastating effects on smaller farming communities. Allowing a market driven approach, especially given the disparity in value, may encourage "buy and dry" approaches, where water is sold

2016).

14. Amanda E. Cronin and Lara B. Fowler, *Northwest Water Banking: Meeting Instream and Out of Stream Water Needs in the Pacific Northwest*, 102 WATER REP. 10, 10., (Aug. 15, 2012), http://www.coloradowatertrust.org/images/uploads/resources/Northwest_Water_Banking.pdf.

15. *Id.*

16. See Loretta Singletary, *Water Banking: What it is and How Does it Work?*, W. RESOURCE ISSUES EDUC. SERIES, no. 6., (n.d.), <https://www.unce.unr.edu/publications/files/ho/other/fs9809.pdf>. (providing an overview of water banking).

17. *Id.*

18. Mark Squillace, *Water Transfers for a Changing Climate*, 53 NAT. RES. J. 55, 56 (2013) (stating that "[w]ater markets have special appeal in the western United States where the prior appropriation doctrine favors historic, low-value agricultural water rights over far more valuable domestic water rights").

19. *Id.*

or permanently transferred to municipal use.²⁰ “Dry” agricultural lands can be overcome with noxious, invasive species, and the permanent loss of agricultural land can have severe impacts on local farming communities that rely on agricultural production for a wide range of economic activities.²¹ As a result, while the market may incentivize individual farmers to sell their water rights for individual gain, the economic loss on the community as a whole may be far reaching.²²

The Colorado legislature agrees the danger of “buy and dry” approaches must be mitigated,²³ and the proposed HB 16-1392 attempts to mitigate that danger by restricting the market’s ability to fully control water transfers. Under the proposed legislation, transfer of a full water right would only be allowed for up to three years in a ten-year period, or alternatively, thirty percent of a water right could be transferred over a ten-year period.²⁴ The proposed legislation ensures that market incentives don’t result in the whole-sale transfer of agricultural water rights. This preservation of agricultural use will protect against encroachment of invasive species (and, therefore, protect agricultural economies) while still allowing transfers to supplement farmer’s incomes and supplement municipal water supplies.

B. HB 16-1392 IS SPECIFICALLY TAILORED TO ADDRESS COLORADO’S WATER NEEDS AND AGRICULTURAL TRADITIONS.

Previous attempts in Colorado, most notably the Arkansas River Water Bank (“ARWB”), have not been successful.²⁵ Stakeholders have identified several reasons for the failure of the ARWB, among them were the high prices of banked water, that fact that the ARWB was a virtual bank with no firm storage for physically banking the water, and uncertainty about the ARWB’s ability to deliver water to various regions.²⁶

HB 16-1392 is an attempt to rectify some of ARWB’s failings by better tailoring the approach to Colorado’s needs. First, by expanding the banking system to basins outside of the Arkansas River basin, it includes markets that can accommodate the higher cost of water, such as markets with larger urban

20. *Id.* at 62. *See also 26th Annual Water Law Conference: Twenty-First Century Water Supply,*

Use and Distribution: Do the Rules Still Apply?, 11 U. DEN. WATER L. REV. 389, 405–06 (2008) (“[B]uy and dry’ [is] the permanent transfer [of water] from agricultural use to municipal use that can dry the land. . . . [T]he transfer is a one-time deal where municipalities buy shares in a ditch company, often far from the municipality, and the water is permanently removed from irrigation use by the ditch company. The irrigator and the region then can suffer from the limited or lost agricultural productivity resulting from the water transfer.”).

21. Squillace, *supra* note 13A, at 62.

22. Peter D. Nichols, Leah K. Martinsson & Megan Gutwein, *All We Really Need to Know We Learned in Kindergarten: Share Everything (Agricultural Water Sharing to Meet Increasing Municipal Water Demands)*, 27 COLO. NAT. RES., ENERGY & ENVTL. L. REV. 197, 202–03 (2016).

23. *Id.*

24. H.B. 16-1392 § 1 (37-80.3-104(2)(i)), 70th Gen. Assemb., 2nd Reg. Sess. (Colo. 2016).

25. RALPH SCANGA, JR., UPDATE OF WATER BANKING IN THE ARKANSAS PRESENTED TO THE INTERIM WATER RESOURCES REVIEW COMMITTEE, (Aug. 21, 2013), <https://www.colorado.gov/pacific/sites/default/files/13WaterResourcesUpdateonWaterBanking.pdf> (stating that while some water “deposits” were made into the bank, no withdrawals were ever made).

26. *Id.*

populations.²⁷ Additionally, the transfers under HB 16-1392 will hopefully provide a stronger incentive for participation by allowing the transfer of surface water.

C. UNLIKE TRADITIONAL TRANSFERS, WATER BANK TRANSFERS UNDER HB 16-1392 WOULD HAVE LOWER TRANSACTION COSTS AND ARE LESS LIKELY TO RUN AFOUL OF THE “NO-INJURY RULE”.

One major impediment to traditional water transfers is the high transaction cost. In addition to the transaction costs of obtaining court approval, transfers are also forced to absorb any third-party costs intended to prevent material injury to other vested rights owners, and not run afoul of the “no-injury” rule.²⁸ In some markets, this “potential” for injury can add significant costs to a transaction and may eliminate the value of the transfer entirely.²⁹ Unlike other western states, under Colorado’s prior appropriation law, the transfer of a water right requires adjudication from a water court rather than an administrative agency.³⁰ Like many of Colorado’s water laws, this approach is highly protective of existing water users, but is costly, reduces flexibility in the system, and can discourage otherwise beneficial transfers. In order to file for a transfer, the water right holder must file an application with the water court, which allows any person to file a statement of opposition within two months of the application, forcing a public hearing.³¹ A final decree is not awarded until after the hearing. The result is that a single transfer can be costly and may take up to five or ten years.³²

Additionally, in order for any water transfer to be approved it must pass the “no-injury rule.” The “no-injury” rule states that changes in water type, place, or time of use can only be approved if it will have no injury to other users.³³ To determine if an injury may occur, the “historic consumptive use” must be calculated. In addition to being a time-consuming and possibly costly calculation, determining the historic consumptive use can result in a permanent reduction in the water right itself.³⁴ The uncertainty of how the court will calculate historic consumptive use can reduce the incentive for any temporary transfers.³⁵

27. Colorado is divided into seven different management division based on hydrological basins. STATE OF COLO. DEPT OF NAT. RES. DIV. OF WATER RES., COLORADO RIVER BASINS (2005), https://www.colorado.gov/governor/sites/default/files/documents/colorado_river_basins.pdf.

28. Hennessy, *supra* note 7, at 1670. (describing the operation of the “no injury rule” in water transactions).

29. *Id.*

30. Nichols, Martinsson & Gutwein, *supra* note 14, at 205.

31. *Id.* (If there is no opposition, or if a settlement can be reached with any opposing parties, the court can approve the transfer with stipulations, if necessary).

32. *Id.* at 206.

33. *See* Hennessy, *supra* note 7, at 1669-70.

34. *See* Taussig, *supra*, note 7, at 144.; *See* JUSTICE GREG HOBBS, *supra* note 6, at 72; *See* Empire Lodge Homeowners’ Ass’n v. Moyer, 39 P.3d 1139, 1157-58 (Colo. 2001) (The burden of showing no injury is on the party seeking the transfer. The challenge of proving a negative leads to both higher costs and greater uncertainty in the outcome of a hearing. In fact, in the Arkansas River Basin, the Colorado Supreme Court has held that there is a presumption of injury that must be overcome for some transfers).

35. *See* Hennessy, *supra* note 7, at 1670; *See, e.g.*, In Re Water Rights of Cent. Colo. Water Conservancy Dist., 147 P.3d 9, 20 (Colo. 2006) (a rather extreme example of how uncertainty regarding the calculation of historic consumptive use can result in the permanent reduction of

HB 16-1392 addresses the cost and injury issues raised by traditional water transfers. First, deposits and withdrawals from the bank would not require a court adjudication or a change of use approval.³⁶ However, the state engineer's would still need to certify water bank applications and would review each application to ensure beneficial use of the water and avoid potential injury.³⁷ Furthermore, notice is still required and interested parties can comment on deposit and withdrawal applications.³⁸ As opposed to a hearing, commenters are invited to have a conference with all parties and the state engineer to discuss ways in which the withdrawal or deposit can be structured so as to avoid material injury.³⁹ While the goal of the bill is to limit challenges and hearings, it preserves the rights of interested parties to challenge deposits and withdrawals that may injure their vested rights.

Second, the proposed 37-80.3-104(n)-(r), requires the CWCB to develop a streamlined process for calculating historic consumptive use, return flow obligations, and material injury.⁴⁰ CWCB must establish a website where users can confidentially review their historic consumptive use and return flow obligations.⁴¹ As further protection, "[p]articipation in the water bank cannot serve as a basis for a reduction of the historical consumptive use, loss, or abandonment of a water right."⁴² However, if a deposit is made and there is no withdrawal of the banked water after two years, then it may be considered a failure to put the water to beneficial use.⁴³ This provision is intended to prevent water users from using the bank as a means of preserving unused water rights when there is no demand for withdrawal.

The streamlined process is one of the key features of HB 16-1392, and is essential to water banking in general. While the adjudications place a higher burden on those challenging the transactions, that is inevitable when attempting to facilitate the quick and easy transfers and necessary to promote efficient water use and support the growing municipal need.

III. CONCLUSION

Although water banking is likely to serve as only one tool in meeting the growing needs for municipal water in the state, it can be a powerful means of making water available to growing cities without endangering local economies or Colorado's traditional agricultural heritage. Although the failure of the ARWB identified some of the problems facing water banking in Colorado, the specific approach proposed under HB 16-1392 should help address the issues that resulted in the previous failures. Although the Bill has been indefinitely postponed due to lack of support, water banking likely represents a necessary tool for Colorado's water future.

water rights).

36. H.B. 16-1392 § 1 (37-80.3-104(2)(e)), 70th Gen. Assemb., 2nd Reg. Sess. (Colo. 2016).

37. *Id.* at (g),(k).

38. *Id.* at (m)(II)-(III).

39. *Id.* at (m)(IV).

40. *Id.* at (n)-(r).

41. *Id.* at (s).

42. *Id.* at (8).

43. *Id.*