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Comment
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*1039 COLORADO H.B. 14-1026--MODEL LEGISLATION OR A TROJAN HORSE?

INTRODUCTION

On February 3, 2014, the Colorado House of Representatives passed House Bill 14-1026, titled "A Bill for an Act Concerning the Authorization of Flexible Water Markets."[1] If the Colorado Senate passes the law, it would allow agricultural water right holders who choose to reduce their consumptive use of water to apply for a change in use for the unused portion of their water right. A change in use is a legal process that allows a holder of a water right to change the type of use historically associated with that water right. For example, if an alfalfa farmer historically uses 100 acre-feet of water annually to irrigate crops, the farmer could only use 80 acre-feet annually and reduce the amount of water she uses to irrigate her alfalfa by 20 acre-feet. Then, under the proposed legislation, the farmer could receive a flex decree for this unused portion; the alfalfa farmer would receive a flex decree for 20 acre-feet. The proposed legislation would then allow the farmer to transfer 20 acre-feet of her water right for use by a third-party without enumerating a specific beneficial use to which the water will be applied.[2]

In the case of the hypothetical alfalfa farmer, the proposed bill would allow her to transfer 20 acre-feet of her water right for use by a municipal water district, and this would be allowed even though she did not specify in her application that this specific municipality would be the end user of her flex water right. Critics of this pending legislation argue that the bill will encourage water speculation and serve to wreak havoc on Colorado's agricultural communities. However, proponents of the bill note that it will allow for more efficient consumption of state water resources, incentivize more sustainable agricultural practices, and establish a market-based approach to allocate the state's scarce water resources. After briefly summarizing relevant Colorado water law and exploring the content of this pending bill, this Comment argues that this bill should be celebrated as model legislation for future Western water policy, and that it should be commended as a creative legislative attempt to more efficiently allocate Colorado's scare water resources.

*1040 I. RELEVANT COLORADO WATER DOCTRINE

In Colorado, the doctrine of prior appropriation is the law of the land--first in time is first in right.[3] This is reflected in the state constitution: Colorado Const. Art. XVI, section 5 avows, "[t]he water of every natural stream, not heretofore appropriated, within the State of Colorado, is hereby declared to be the property of the public, and the same is dedicated to the use of the people of the state, subject to appropriation as hereinafter provided."[4] Further, Colorado Const. Art. XVI, section 6 declares, "[t]he right to divert the unappropriated waters of any natural stream to beneficial uses shall never be denied. Priority of appropriation shall give the better right."[5] Since Colorado ratified its Constitution in 1876, and as understood by Colorado's judiciary and legislature, a cognizable water right is established under Colorado law when the following elements are satisfied: (1) unapportioned water flows in a watercourse, (2) an appropriator demonstrates an intent

to use water, (3) an appropriator makes an actual diversion of water, and (4) an appropriator puts the diverted water to a beneficial use.[6] After an appropriator satisfies these requirements, she obtains a valid water right, which is "a defeasible property interest, subject to the constitutional protections guaranteed to vested property rights."[7]

But, in the words of the state Supreme Court, Colorado law "guarantees a right to appropriate, not a right to speculate."[8] By way of its 1979 decision in *Colorado River Water Conservation Dist. v. Vidler Tunnel Water Co.*, the Colorado Supreme Court created a judicial doctrine commonly referred to as the anti-speculation doctrine.[9] Soon after this decision, Colorado's General Assembly codified the Colorado Supreme Court's anti-speculation doctrine: "no appropriation of water, either absolute or conditional, shall be held to occur when the proposed appropriation is based upon the speculative sale or transfer of the appropriative rights to persons not parties to the proposed appropriation."[10] Colorado law also checks an appropriator's attempt to speculate in water by requiring that an appropriator demonstrate a "specific plan and intent to divert, store, or otherwise capture, possess or control a specific quantity of water for specific beneficial uses."[11]

***1041** While the anti-speculation doctrine generally prohibits a private appropriator from speculating in water, the doctrine has been softened for public, municipal entities under the so called "great and growing cities doctrine."[12] Under this theory, a municipal entity may acquire water rights in anticipation of growing future municipal demands. However, as stated by the Colorado Supreme Court, in order to obtain this species of "speculative" water right, a municipal entity must demonstrate "firm contractual commitments" and the municipal entity must "have a specific plan and intent to divert (or store) and control 'a specific quantity of water for specific beneficial uses.'"[13] Despite these varying types of water rights, when an appropriator, either private or municipal, obtains a water right for a certain beneficial use in Colorado, the water right is limited by the very scope of its original beneficial use. And, only in very narrow circumstances can a holder of a water right change the manner of use of the water right--a change in the manner of use can only be accomplished under Colorado law "by proper court decree," to "the extent of use contemplated at the time of appropriation," and a change in manner of use is "strictly limited to the extent of former actual usage."[14] However, Colorado's legislature is currently considering legislation that would amount to a modification of the State's anti-speculation doctrine.

II. COLORADO HOUSE BILL 14-1026

On February 3, 2014, by a margin of 47 to 13 the Colorado House of Representatives passed HB 14-1026, titled "A Bill for an Act Concerning the Authorization of Flexible Water Markets."[15] The bill now sits in the hands of the Colorado Senate, where it has been assigned to the Agriculture Committee.[16] The pending legislation would create a multiple-use or flex decree, which "would allow those who free up water through fallowing land, deficit irrigation (giving crops less water than they require) or planting less thirsty crops to ask the state engineer permission to change the use of that water without having to designate exactly what the new use will be."[17] In the bill's summary, the Colorado Water Resources Review Committee explains, "the bill creates a more flexible change-in-use system by allowing an applicant who seeks to implement fallowing, regulated deficit irrigation, reduced consumptive use cropping, or other alternatives to the permanent dry-up of ***1042** irrigated lands to apply for a change in use to any beneficial use, without designating the specific beneficial use to which water will be applied."[18]

If this bill passes in the Colorado Senate and becomes law, a flex decree will, in essence, allow for a species of water speculation. It will allow for a species of water speculation because the holder of the flex decree will not be required to designate the specific beneficial use to which the flex decree will be applied. Not surprisingly, HB 14-1026 has stirred criticism, mainly from the Colorado's rural agricultural communities. Ranchers and farmers are concerned that the law will encourage municipalities to buy agricultural water rights away from farmers and ranchers who operate as the lifeblood of local rural economies.

Despite its critics, however, HB 14-1026 should be applauded. If passed, it will likely serve as model legislation for other thirsty and growing western states to follow. HB 14-1026 would allow for a more market-driven approach to Colorado's water resource management regime. It would make it easier for "agricultural users to lease some of their water rights to other users as an alternative to permanent 'buy and dry.'"[19] Also, it would allow Colorado to take the first steps towards developing water markets more capable of efficiently pricing water on the basis of supply and demand, while also incentivizing more economically and socially productive water use by allowing market signals to dictate the highest and best use of Colorado's scarce water resources. Nonetheless, it remains unclear whether this pending legislation will pass into to law and, if passed into law, what effect the bill will have.

III. COLORADO-SPECIFIC ISSUES

Critics of HB 14-1026, namely members and representatives of Colorado's agricultural communities, fear that the legislation will lead to so called "buy and dry:" A situation where "thirsty cities buy water rights from farmers desperate for cash in times of severe drought, only to permanently parch cropland, shutter farms and hurt the tax bases of agricultural towns."[20] Colorado's agricultural communities are wary of the bill because it allows a holder of a water right to "designate ... water for any beneficial use without identifying an end user."[21] These communities believe the bill will encourage cities to buy up agricultural water rights, a process, they argue, which will eventually devastate local agriculturally-based economies.

A detractor of the bill, Jay Winner, general manager of the Lower Arkansas Valley Water Conservancy District, believes that the bill "could be a Trojan horse for municipalities ***1043** to come in and take water from farms."[22] He alleges the bill will allow "cities [to] take water off the land 80 percent of the time."[23] Further, the Pueblo Chieftain, a newspaper from the historically agriculturally-based community of Pueblo, Colorado, alleges that "[p]olitically powerful urban interests are flexing their muscles again in a greedy quest to take water from Colorado's farms and ranches. The convergence of money and political influence, both natural offspring of rising city and suburban populations, threatens to destroy Colorado's farm communities ..."[24]

In particular, the Pueblo-based newspaper takes aim at the Colorado Water Congress for supporting the pending legislation. The Colorado Water Congress "is a not for profit organization established in 1958 to provide leadership on key water resource issues and serve as the principal voice of Colorado's water community."[25] Asserting that "[i]n the past, the Colorado Water Congress might have been expected to blow the whistle on such a radical proposal as HB 14-1026," the Pueblo Chieftain quarrels, "the organization has changed[,] it has been taken over by a committee, mainly of Denver-area water lawyers, who represent lucrative urban markets."[26]

Despite claims like those from the Pueblo Chieftain that "the metro area's political and economic dominance pose a real threat to rural Colorado," the law would not force farmers and ranchers to sell their water rights to municipalities. Rather, participation in the proposed flex decree program would be completely discretionary. Instead of a threat to Colorado's agricultural communities, the legislation would present an opportunity for Colorado farmers and ranchers to gain financially from increasing municipal demand fueled by state population growth. Moreover, when viewed in light of Colorado's water consumption statistics, HB 14-1026 presents as an attractive solution to many of the inefficiencies and perverse incentives imbedded in Colorado and other western state's water law.[27]

In 2005, irrigation nationwide accounted for approximately 37% of America's total fresh water withdrawals, and from 2005 to 2012, farming accounted for .8 to 1.3% of the United State's gross domestic product.[28][29] But in Colorado, "about 80 to 85 percent of the ***1044** State's annual water use is attributable to agricultural production."[30] Over the last decade the gross value of revenues annually generated from Colorado farming, inclusive of livestock farm revenues, only amounted to a mere ~3% of Colorado's annual gross domestic product.[31] Furthermore, if revenues generated from livestock farming are excluded from the calculation, over the last decade the value added to the Colorado economy attributable to crop production amounts to barely ~1% of Colorado's annual gross domestic product.[32] With most of Colorado's future growth in water demand likely to come from its cities and with many of Colorado's rivers including the South Platte and the Arkansas being over appropriated, Colorado municipal water suppliers will face considerable challenges to meet growing urban water demand.[33]

Viewed in light of the economic contribution that agriculture, a very water intensive industry, provides to the Colorado economy, it is hard to justify in economic and political terms, the legal status quo that senior agricultural water rights enjoy. For instance, Colorado agriculture uses four out of every five gallons of water used in the state, but it contributes only a couple pennies out of every dollar of statewide economic output.[34] Moreover, the current system presents often-prohibitory transaction costs for agricultural water right holders to seek a change in manner of use.[35] Under current Colorado law these water right holders are often discouraged-- through the threat of forfeiture and the possibility of a reduction in their decreed water right--from implementing more efficient irrigation techniques.

In addition to the threat of losing water rights, high transaction costs also often prevent the implementation of a more efficient water allocation regimen. The pending law states that "under the anti-speculation doctrine, current water court proceedings governing an application to change the beneficial use of an irrigation water right require the applicant identify a

specific beneficial use at the time of the application."[36] If an appropriator who properly designated a beneficial use at the time of application at some later point discovers that part of her water right could be put to a more economically efficient, socially beneficial or lucrative application--a use not identified at the time of the application--then under the ***1045** anti-speculation doctrine the appropriator may not put her water to this more attractive application without first seeking a change in manner of use, a process fraught with uncertainty and riddled with often complex implied limitations and unnecessary, often prohibitory, transaction costs.[37]

These inherent uncertainties in Colorado's water law create a legal environment that often discourages the best and most efficient use of Colorado's scarce water resources. Additionally, after a transfer occurs "Colorado [law] authorizes [a] water court to maintain jurisdiction over transfer decrees [in order] to measure the extent of actual injury."[38] According to James N. Corbridge, Jr., Professor Emeritus at the University of Colorado Law School, "this means that the transferee may not be able to quantify the long-range prospects of water until the transfer has been made and observed. Such uncertainty has the potential to reduce the incentive to make the capital investment normally required for large water transfers."[39] HB 14-1026 would streamline the water transfer process while also incentivizing more sustainable and economically efficient use of Colorado's scarce water supplies.

CONCLUSION

Colorado's water law should not reward or allow the wasteful use of water, and it should not create barriers hindering a more efficient allocation of scarce state water resources. Rather, it should create an environment that rewards economic efficiency, aim to eliminate systemically imbedded perverse incentives, and create an environment of certainty enabling efficient water transfers. HB 14-1026 should be seen as a constructive step towards the furtherance of these goals, and the pending bill should be recognized as an attempt to create a more efficient means of allocating Colorado's scarce water supplies. In line with University of Colorado Law School professor Douglas Kenney's prediction of "a [coming] new era of water management", HB 14-1026 should be seen as a step towards this new era in Colorado. Perhaps it signals a new era for the west in general, an era where "[i]t should not take a drought to make people stop building paddy fields in the sand."[40]

Footnotes

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1 H.B. 14-1026, 69th Gen. Assemb., 2d Reg. Sess. (Co. 2014).

2 *Id.* Enumerating a specific beneficial is required under Colorado law because of the so-called anti-speculation doctrine, which is discussed in detail below.

3 *See Coffin v. Left Hand Ditch Co.*, 6 Colo. 443 (1882).

4 Colorado Constitution, Art. XVI, § 5.

5 Colorado Constitution, Art. XVI, § 6.

6 *Farmers' High Line Canal and Reservoir Co. v. Southworth*, 13 Colo. 111, 113, 21 P. 1028, 1028 (1885).

7 SARAH A. KLAHN, § 76:12. *Transfers and changes of water rights* 2A Colo. Prac., Methods Of Practice § 76:12 (6th ed.). A defeasible property interest is a property interest that the holder may enjoy until the occurrence of a condition. *See Black's Law Dictionary* 694 (9th Ed. 2010).

[8] *Colorado River Water Conservation Dist. v. Vidler Tunnel Water Co.*, 197 Colo. 413, 417, 594 P.2d 566, 568 (1979).

[9] *Id.*

[10] § 37-92-103(3)(a), C.R.S.

[11] § 37-92-103(3)(a)(II), C.R.S.

[12] *City and County of Denver v. Sheriff*, 105 Colo. 193, 96 P.2d 836 (1939).

[13] *Upper Yampa Water Conservancy Dist. v. Dequine Family L.L.C.*, 249 P.3d 794, 800 (Colo.2011) *citing* § C.R.S. 37-92-103(3)(a), (3)(a)(II).

[14] KLAHN, *supra* note 7 (citing C.R.S.A. § 37-92-305).

[15] H.B. 14-1026, *supra* note 1. As of the date of this article, the Colorado State Senate has yet to vote on the matter.

[16] Chris Woodka, *Flex Marketing Bill Advances*, THE PUEBLO CHIEFTAIN (Feb. 12, 2014), http://www.chieftain.com/special/water/2281153-120/bill-lower-pueblo-winner.

[17] Hannah Holm, *Water Lines: Drought, Flood & Controversy*, POST INDEPENDENT (Jan. 17, 2014), http://www.postindependent.com/opinion/9736973-113/bill-colorado-controversy-rights.

[18] H.B. 14-1026, *supra* note 1.

[19] Holm, *supra* note 17. The term "buy and dry" is addressed in further detail below.

[20] Catherine Tsai, *Water Lease Test Aims To End 'Buy And Dry' Trend*, CBS DENVER (Sept. 25, 2011), http://denver.cbslocal.com/2011/09/25/water-lease-test-aims-to-end-buy-and-dry-trend/.

[21] Woodka, *supra* note 16.

[22] Chris Woodka, *Flex Water Bill Advances*, THE PUEBLO CHIEFTAIN (Jan. 19, 2014), http://www.chieftain.com/special/water/2236361-120/bill-committee-state-chieftain.

[23] Woodka, *supra* note 16.

[24] Frank Hoag, *Flexing Muscles*, THE PUEBLO CHIEFTAIN (Feb. 12, 2014), http://www.chieftain.com/opinion/editorials/2277431-120/publisher-colorado-frank-hoag.

[25] *Mission and Purpose*, COLORADO WATER CONGRESS (Feb. 26, 2014), http://www.cowatercongress.org/about/Mission_and_Purpose.aspx.

[26] *Id.*

[27] Hoag, *supra* note 24.

[28] *Irrigation Water Use*, USGS.GOV (Feb. 24, 2014), http:// water.usgs.gov/edu/wuir.html.

[29] Bureau of Economic Analysis, Interactive Data, U.S. Dept. of Commerce (Feb. 25, 2014), http://www.bea.gov/iTable/itable.cfm?reqid =51&step=1 #reqid=51&step=51&isuri=1&5102=5.

[30] *Meeting Colorado's Future Water Supply Needs Opportunities and Challenges Associated with Potential Agricultural Water Conservation Measures*, COLORADO AGRICULTURAL WATER ALLIANCE (Feb. 11, 2008), http:// cwrri.colostate.edu/other_files/Ag%20water%C20conservation%C20paper%C20Feb%C2011% 20(2).pdf.

[31] Business Research Division, *49th Annual Colorado Business Economic Outlook 2014*, THE UNIVERSITY OF COLORADO BOULDER, LEEDS SCHOOL OF BUSINESS (2014), *available at* http://leeds.colorado.edu/asset/brd/2014_colo_bus_econ_ outlook.pdf.

[32] *Id.*

[33] SCOTT A. CLARK & ALIX L. JOSEPH, *Changes of Water Rights and the Anti-Speculation Doctrine: The continuing Importance of Actual Beneficial Use*, 9 U. DENV. WATER L. REV. 553 (2006).

[34] *See supra* notes 30-32.

[35] *See generally*, JAMES N. CORBRIDGE, JR., Historical Water Use and The Protection of Vested Rights: A Challenge for Colorado Water Law 69 U. Colo. L. Rev. 503 (1998).

[36] H.B. 14-1026, *supra* note 1.

[37] *See generally*, CORBRIDGE. *supra* note 34; *see also* Orr v. Arapahoe Water & Sanitation District 753 P.2d 1217 (Colo. 1988). The doctrine of implied limitations is sometimes referred to as the "Orr doctrine." In this case, "the court identified the following 'implied' limitations in every decree: 1. Diversions are limited to an amount sufficient for the purposes of the appropriation, even though less than the decreed rate; 2. An appropriator cannot, as against a junior, divert more water than can be used beneficially; 3. A senior may not, as against a junior, 'lend, rent, or sell any excess water after completing the irrigation of the land for which the water was appropriated;' 4. An appropriator, again as against a junior, cannot 'extend the time of diversion to irrigate lands other than those for which the appropriation was made;' 5. 'The right to change a point of diversion is limited in quantity by historical use at the original decreed point of diversion.'"

[38] CORBRIDGE, *supra* note 34.

[39] Id. at 529-530.

[40] *The Drying of the West*, THE ECONOMIST, Feb 22-28, 2014, at 22.