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FACILITATING VOLUNTARY WATER TRANSFERS IN CALIFORNIA

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I. INTRODUCTION

A. During the past decade, interest in California in voluntary transfers of water as a means of supplying increasing water demand has intensified. Voluntary transfers are viewed by many as an alternative to environmentally and financially costly new water development projects. The increased interest has found expression in several California legislative enactments intended to encourage voluntary transfers. However, neither the increased interest nor the recent statutes have triggered anything like a free market in water or water rights. Additional proposals are pending in the current legislative session to remove what are perceived as impediments to a higher level of transfer activity. While the question of third party effects has been given some consideration, these effects have not been addressed as comprehensively and analytically as they should be.

B. Reference Sources.

1. C. T. Lee, "The Transfer of Water Rights in California: Background and Issues", Governor's Commission to Review California Water Rights Law (Staff Paper, No. 5), Sacramento, 1977.

2. Final Report, Governor's Commission to Review California Water Rights Law, Sacramento, 1978.
3. "A Marketing Approach to Water Allocation", California Legislature, Assembly Office of Research, Sacramento, 1982.
4. Conference Proceedings, "Buying and Selling Water in California", University Extension Public Policy Program, University of California, Los Angeles, February 27-28, 1986 (in preparation).
5. "Water Marketing: A New Option?", Western Water, Water Education Foundation, Sacramento, 1986.

II. WATER RIGHTS LEGAL SETTING

- A. California is a so-called "dual system" state. The duality is a reference to the coexistence of a modified English common law riparian doctrine with the traditional Western prior appropriation doctrine.

1. For groundwater rights -- that is, rights which are subject to the law of percolating groundwater -- substitute the term "overlying" for "riparian".
2. Other doctrinal bases of right to water use exist in California, making it actually a plural system rather than a dual system.
 - a. California courts have recognized prescriptive rights, by applying the real property law of adverse possession to water use. However, claims to prescriptive rights as to appropriation-type uses initiated after 1914 were foreclosed by the California Supreme Court in 1980. (People v. Shirokow, 26 Cal.3d 301, 605 P.2d 859, 162 Cal.Rptr. 30.)
 - b. Certain California cities have been held by the courts to have a kind of municipal water right -- called a "pueblo right" -- to serve the needs of their inhabitants. (See, e.g., Feliz v. Los Angeles, 58 Cal. 73 (1881).)

3. In California, rights acquired by priority of appropriation are further subdivided into "old" appropriative rights and "modern" appropriative rights. The watershed date is December 19, 1914, the effective date of the Water Commission Act (Calif. Stats. 1913, ch. 596).
 - a. Old appropriative rights are those initiated by a substantial act taken to appropriate water before December 19, 1914. The doctrine of relation applies to these rights, so that the appropriator enjoys the early priority as to the full amount initially contemplated and diligently placed to beneficial use by the project. (See Water Code Section 1202(b).)
 - b. Modern appropriative rights are those initiated on or after December 19, 1914, in compliance with the statutory application/permit/license process which went into effect on that date. Appropriative uses initiated without compliance with those statutes are trespasses against the state and may be, and are, enjoined. (Water Code

Section 1052; People v. Shirokow,
supra.) The exercise of these rights
is subject to a degree of state
administrative oversight not appli-
cable to exercise of other kinds of
rights.

- c. Of particular relevance to voluntary
transfers is the water right law
relating to changes in point of diver-
sion or place or purpose of use.
Changes in modern appropriative rights
require pre-approval by the State
Water Resources Control Board. The
statute requires that the Board find
that the change will not operate to
injure "other lawful users of water."
(Water Code Section 1702.) The same
standard applies to old appropriative
rights (Water Code Section 1706);
however, pre-approval is not
required. A lawful user of water
alleging injury must seek judicial
relief.

B. In discussing water transfers the focus may be narrowed to uses enjoyed under appropriative rights or, perhaps, all rights which have been recognized and prioritized by a judicial decree arising from a general statutory adjudication. (See Water Code Section 2500 et seq.)

1. Riparian rights are part and parcel of the land to which they are appurtenant and may not be enjoyed elsewhere. A conveyance purporting to transfer riparian use apart from the land to some other place of use merely operates to estop the transferor from complaining against his transferee. Strangers to the conveyance, in the form of other water users from the source, are not estopped from complaining of unauthorized riparian use. (Gould v. Eaton, 117 Cal. 539, 49 Pac. 577 (1897).) This obviously is an unattractive prospect for a potential buyer.
2. Whatever the doctrinal consequences of transferring pueblo rights, the reality is that such rights are enjoyed by municipalities (Los Angeles, San Diego) which are in water demand, not water surplus, areas.

3. Modern appropriative rights have the advantage of title documentation (permit or license). Rights which have been recognized by a judicial decree in a statutory general adjudication have both the advantage of title documentation (the decree) and the further advantage of the certainty of right afforded by the comprehensive system-wide prioritization of rights represented by the decree.

III. WATER TRANSFER LEGISLATION IN CALIFORNIA

A. A market approach to water transfer first received high statewide visibility with publication of the Final Report of the Governor's Commission to Review California Water Rights Law in December 1978 (supra, Reference 2). The Commission concluded that one of the areas of water law needing modernization was improvement in the efficiency of water use. In considering means to achieve this end, the Commission contrasted the "market approach" with the "regulatory approach" and made certain legislative proposals intended to encourage the former. Several of these proposals were enacted in 1979 and 1980.

1. An anti-forfeiture statute was enacted covering cessation or reduction in use of water under both old and modern appropriative rights, due to water conservation efforts. Such cessation or reduction is deemed equivalent to a reasonable beneficial use and no forfeiture of the right occurs upon the lapse of the 5-year forfeiture period. (Water Code Section 1011.)

2. A declaration of state policy was enacted which included the statement that it is "the established policy of this state to facilitate the voluntary transfer of water and water rights where consistent with the public welfare of the place of export and the place of import." (Water Code Section 109.)

3. Statutes were enacted which provide an expedited procedure for obtaining state approval of temporary changes in point of diversion or place or purpose of use under modern appropriative rights, when the change is needed to effect a transfer or exchange of water or water rights. (Water Code Section 1725.)

4. Statutes were enacted which provide a means of moving ahead with a "trial transfer" of water in cases where the effect on other legal users of water, or on instream beneficial uses (recreation, fish and wildlife), cannot positively be determined but is unlikely to be harmful. (Water Code Section 1735.)

B. The 1979 and 1980 legislative activity did not trigger an avalanche of market transfers of water. Thus in 1982, Assemblyman Katz successfully authored legislation which further encouraged voluntary water transfers. The principle features of this legislation follow.

1. Every local or regional public agency which is authorized by law to serve water to inhabitants of the agency may sell, lease, exchange, or otherwise transfer water "that is surplus to the needs of the agency's water users for use outside of the agency." (Water Code Section 382.)

2. A key concept in the authority granted public agencies by Section 382 is that of surplus water. Surplus water is defined in three alternative ways:
 - a. Water to which the right is held by the agency, to the extent it is in excess of the needs of water users within the agency for the duration of the transfer. (Water Code Section 383(a).)
 - b. Water to which the right is held by the agency, to the extent any water user within the agency agrees to forego use for the duration of the transfer. (Water Code Section 383(b).)
 - c. Water to which a modern appropriative right is held by a water user within the agency, where the water user agrees to forego use for a period of time and appoints the public agency as agent to effect a transfer. (Water Code Section 383(c).)
3. The latter two definitions of "surplus" water in effect place the public agency in a

broker position between users within the agency and potential buyers of water.

4. Additionally, the Katz legislation amended earlier statutes (discussed above) which suspend the operation of the five-year forfeiture statute to the extent of cessation or reduction of water use due to water conservation efforts or to substituted use of reclaimed water. The amendments specifically provide that water so conserved may be sold, leased, exchanged, or otherwise transferred pursuant to any provision of law relating to the transfer of water or water right. (Water Code Sections 1010(b) and 1011(b).)

IV. PENDING LEGISLATIVE PROPOSALS

- A. As was the case with enactment of the 1979-1980 legislation proposed by the Governor's Commission, the 1982 Katz legislation did not stimulate an appreciable water market in California. (The Imperial Valley program, which was the subject of an earlier separate presentation, has the potential for useful transfer of very substantial amounts of water. However, the

legal/institutional setting involved in Colorado River water uses, together with the factual circumstances surrounding Imperial Irrigation District's water use, make this program a somewhat special case.)

B. Perceiving that the continued absence of water marketing in California might be due to (1) unavailability of conveyance facilities to wheel transferred water to the buyer or (2) that it might be due to the absence of a statewide broker who would work to bring together willing sellers and willing buyers, legislators have introduced measures to remedy these perceived problems.

1. AB 2746 (1986, Katz) addresses the plumbing problem. If this measure were enacted, public agencies which own water conveyance facilities with unused capacity would be required to make such capacity available to bona fide transferors -- subject to certain conditions designed to protect the aqueduct owner's interests and those of its regular water users.

2. AB 3551 (1988, Isenberg) addresses the brokerage problem. This measure would create an "Office of Water Marketing" in state government charged with encouraging, promoting, and facilitating the transfer and exchange of water.
3. Copies of these measures in their most current form as of this writing are attached.

V. SOME PROBLEMS

- A. The most obvious problem is the question why, despite enabling legislation, statewide conferences, and considerable writing on the subject, water marketing activity is not increasing.
 1. Except for the special Imperial Valley circumstances, and some useful but short-term transfer arrangements during the 1976-77 drought, water marketing is not yet booming in California. (See "A Marketing Approach to Water Allocation", Reference 3, supra.)

2. The measures currently pending in the California Legislature, discussed above, reflect two ideas as to changes in the law needed to facilitate voluntary transfers.
3. There may be a more fundamental explanation. The ultimate objective of water marketing in California may be viewed as moving water from economically lower (agricultural) uses to economically higher (urban) uses. However, agricultural water users do not appear ready to permanently divest themselves of water rights or to execute longer-term leases of water, despite the present state of the agricultural economy. (See, e.g., proposed legislative findings and declarations (a) through (c) in Section 1 of AB 2746, attached.) Urban users, on the other hand, require long-term certainty of water supply. Under these circumstances, mutually advantageous water transfer arrangements seem to be difficult to achieve.

B. Protection of "third party interests" may also present (legitimate) problems in arriving at a comprehensive water market in California. One

may think of three classes of third party interests affected by market transfers of water. Ranging from the specific to the general, third party interests are these:

1. The most specific class -- and the class which enjoys the oldest water rights law claim to protection -- is what California's Water Code calls "other lawful users of water". As noted above, changes in point of diversion or place or purpose of use of water under both old and modern appropriative rights may be made only if such changes do not injure other lawful users of water. (Water Code Sections 1702, 1706.)
 - a. If the quantity of water that may be transferred by a water right holder is limited to that fraction of the transferor's total diversion right that is actually lost to the system -- i.e., depletion -- then the rights of this class of third party interests would presumably be protected.
 - b. This apparently is the import of the limitation in Water Code Section 1725

(1980 legislation authorizing temporary changes in water rights due to transfer of water) that the transfer "only involve the amount of water consumptively used by the permittee or licensee...."

c. Determining depletion, however, may be technically very difficult.

2. Another class of third party interests consists of persons within the economic community from which water is transferred. Local enterprises, such as feed and implement stores and banks, may be indirectly but drastically affected by movement of water from local agricultural use to remote urban use.

a. Unlike the protection provided "other lawful users of water" by water rights law, the interests of this class of third parties have not been regarded as protectable property rights. Nevertheless, the Owens Valley experience is a very vivid part of the cultural memory of rural California.

- b. Two of the recent legislative enactments designed to encourage water marketing recognize these interests: Water Code Section 109 (policy statement facilitating transfer of water "where consistent with the public welfare of the place of export and the place of import"); and Water Code Section 386 (requiring a State Water Board finding that a change associated with a transfer "does not unreasonably affect the overall economy of the area from which the water is being transferred"). Neither of these statutes has been construed by the State Water Board or the judiciary. Certainly there is a great deal of room for legislative clarification.
3. Finally, a third class of third party interests may be viewed as the statewide interest of the people in the public uses associated with California's watercourses -- "public trust" values. Again, several recent statutes require a finding, as a condition to approval of a change associated with a

transfer, that the proposed change would not
"unreasonably affect fish, wildlife, or
other instream beneficial uses." (Water
Code Sections 386, 1725, 1738.)

AMENDED IN ASSEMBLY APRIL 22, 1986

AMENDED IN ASSEMBLY APRIL 8, 1986

CALIFORNIA LEGISLATURE—1985-86 REGULAR SESSION

ASSEMBLY BILL

No. 3351

**Introduced by Assembly Member Isenberg, Bates,
Campbell, Hauser, Johnston, and Katz**

February 19, 1986

An act to add Chapter 7 (commencing with Section 470) to Division 1 of the Water Code, relating to water.

LEGISLATIVE COUNSEL'S DIGEST

AB 3351, as amended, Isenberg. Office of Water Marketing.

Under existing law, it is the policy of the state to facilitate the voluntary transfer of water and water rights where consistent with the public welfare of the place of export and the place of import.

This bill would create in the Department of Water Resources the Office of Water Marketing with specified powers and duties relating to encouraging, promoting, and facilitating water transfers and exchanges. The bill would authorize the department to purchase water, subject to specified conditions.

The bill would make legislative findings and declarations in this connection.

The bill would become operative on July 1, 1987.

Vote: majority. Appropriation: no. Fiscal committee: yes. State-mandated local program: no.

The people of the State of California do enact as follows:

1 SECTION 1. Chapter 7 (commencing with Section
2 470) is added to Division 1 of the Water Code, to read:

3

4 CHAPTER 7. OFFICE OF WATER MARKETING

5

6

Article 1. Policy

7

8 470. This chapter shall be known and may be cited as
9 the California Water Marketing Act of 1986.

10 471. The Legislature hereby finds and declares all of
11 the following:

12 (a) State law encourages water users to transfer water
13 without loss of their appropriative water rights.

14 (b) State law requires the department and the board
15 to encourage voluntary transfers of water and to provide
16 assistance to water users who are interested in so doing.

17 (c) Voluntary water transfers between water users
18 can result in a more efficient use of water, benefiting both
19 the buyer and the seller.

20 (d) Water transfers using state, federal, and privately
21 developed water have proven to be successful.

22 (e) Water transfers can help alleviate water shortages,
23 save project construction costs, and conserve water and
24 energy.

25 472. The Legislature further finds and declares that it
26 is the policy of the state as follows:

27 (a) The various state agencies that deal with water
28 issues shall coordinate their activities to encourage and
29 promote water transfers.

30 (b) There shall be established in the department an
31 Office of Water Marketing, whose task it is to implement
32 state laws that pertain to water transfers and water
33 markets.

34

35 Article 2. The Office of Water Marketing

36

37 480. There is hereby created the Office of Water
38 Marketing in the Department of Water Resources. As

1 used in this chapter, "office" means the Office of Water
2 Marketing. The office has such powers as may be
3 necessary or convenient for the exercise of its duties
4 under this chapter.

5 The Director of Water Resources may employ legal
6 counsel and other personnel and assistance that may be
7 necessary to carry out those duties.

8 481. The office shall coordinate its activities with
9 other state agencies, particularly the State Water
10 Resources Control Board. The office shall obtain
11 necessary information from the board to facilitate the
12 work of the office.

13 482. The office shall encourage, promote, and
14 facilitate the transfer and exchange of water. The office
15 shall seek to promote these transactions only if the water
16 to be transferred is already developed and being diverted
17 from a stream for beneficial use or has been conserved.
18 ~~The office shall not encourage, promote, or facilitate the~~
19 ~~transfer of water that presently is being used for fish,~~
20 ~~wildlife, recreational, or other instream purposes.~~

21 483. The office shall prepare a water marketing
22 guide. The guide shall include, but not be limited to, the
23 following information:

24 (a) A review of existing and appropriate state and
25 federal laws that pertain to water transfers, water
26 markets, or water rights.

27 (b) Step-by-step instructions on how to proceed with
28 water transfers.

29 (c) A list of key contact agencies or persons
30 throughout the state who deal with water transfers and
31 who could be helpful to those seeking assistance to
32 transfer water.

33 (d) A description of the services available to water
34 users from the office.

35 484. The office shall create and maintain a list of users
36 of water in the state who are most likely to engage in
37 water transfers and shall distribute the water marketing
38 guide to those users.

39 485. The office shall evaluate, with the assistance of
40 other appropriate state agencies, the local economic

1 impact of a proposed water transfer when requested,
2 subject to available office funding and resources.

3 486. The office shall review, with the assistance of
4 other appropriate state agencies, the environmental
5 impact of proposed transfers when requested, subject to
6 available office funding and resources.

7

8

Article 3. Other Provisions

9

10 490. The department may expend available funds to
11 purchase water, subject to the following conditions:

12 (a) The transaction is approved by the board,
13 according to law.

14 (b) The transaction is approved by the Department of
15 Fish and Game, if appropriate.

16 490. *The department may expend available funds to
17 purchase water if the transaction is approved by the
18 board, according to law. If, according to law, the
19 transaction does not have to be approved by the board,
20 it shall be approved by the Department of Fish and
21 Game, if appropriate.*

22 491. Any water transfers undertaken by the
23 department pursuant to this chapter shall be subject to
24 the California Environmental Quality Act (Division 13
25 (commencing with Section 21000) of the Public
26 Resources Code).

27 492. The office shall work with local, state, and federal
28 agencies, as well as private nonprofit organizations, as
29 appropriate to the performance of its duties.

30 493. Nothing in this chapter prohibits, restricts, or
31 regulates the private or public transfer of water if
32 otherwise permitted by law.

33 *SEC. 2. This act shall become operative on July 1,*
34 *1987.*

AMENDED IN ASSEMBLY APRIL 2, 1986

CALIFORNIA LEGISLATURE—1985-86 REGULAR SESSION

ASSEMBLY BILL

No. 2746

Introduced by Assembly Member Katz
(Principal Assembly coauthors: Assembly Members
Isenberg, Johnston, and Stirling)
(Principal Senate coauthor: Senator Presley)

January 23, 1986

An act to add Article 4 (commencing with Section 1810) to Chapter 11 of Part 2 of Division 2 of the Water Code, relating to water.

LEGISLATIVE COUNSEL'S DIGEST

AB 2746, as amended, Katz. Water transfer: ~~aqueduct~~ conveyance facility use.

(1) Existing law declares it to be the policy of the state to facilitate the voluntary transfer of water and water rights where consistent with the public welfare of the place of export and the place of import, and directs the Department of Water Resources, the State Water Resources Control Board, and all other appropriate state agencies to encourage voluntary transfers of water and water rights.

This bill would prohibit ~~any~~ the state and any regional or local public agency from denying a bona fide transferor of water, as defined, the use of a water conveyance facility which has unused capacity, as defined, for the period of time for which that capacity is available, if ~~that~~ fair market value, as specified, is paid for that use, subject to specified conditions, thereby imposing a state-mandated local program. The bill would direct the department, upon application of the transferor if a fair market value cannot be mutually agreed upon, to investigate and file a report with the board

recommending the fair market value, and would require the board, after notice and hearing, to determine the fair market value for that use, subject to judicial review, as prescribed.

(2) The California Constitution requires the state to reimburse local agencies and school districts for certain costs mandated by the state. Statutory provisions establish procedures for making that reimbursement.

This bill would provide that no reimbursement is required by this act for a specified reason.

Vote: majority. Appropriation: no. Fiscal committee: yes. State-mandated local program: yes.

The people of the State of California do enact as follows:

1 SECTION 1. The Legislature hereby finds and
2 declares as follows:

3 (a) There has been a severe downturn in the state's
4 agricultural economy which has made it difficult for
5 many farmers to meet their financial obligations to the
6 state *or regional or local public agencies* for water
7 facilities already in place ~~and authorized by the~~
8 ~~Legislature.~~

9 (b) In addition, many agricultural operations *and*
10 *public agencies experiencing financial difficulties or*
11 facing default may desire to sell, lease, or exchange water
12 as a means of obtaining financial relief or augmenting
13 their income.

14 (c) Since the sale, lease, or exchange of conserved
15 water does not result in the forfeiture of an appropriative
16 right to water, the marketing of water may provide
17 *financial relief or supplemental income* during periods of
18 economic hardship.

19 (d) It is the policy of the state to encourage the
20 voluntary sale, lease, or exchange of water or water rights
21 in order to promote efficient use.

22 SEC. 2. Article 4 (commencing with Section 1810) is
23 added to Chapter 11 of Part 2 of Division 2 of the Water
24 Code, to read:

1 Article 4. Joint Use of ~~Aqueduct~~ Capacity in Water
2 Conveyance Facilities
3

4 1810. Notwithstanding any other provision of law, ~~no~~
5 *neither the state, nor any regional or local public agency*
6 *shall deny a bona fide transferor of water the use of a*
7 *water conveyance facility which has unused capacity, for*
8 *the period of time for which that capacity is available, if*
9 *fair market value is paid for that use, subject to the*
10 *following:*

11 (a) *Any person who has a long-term water service*
12 *contract with the owner of the conveyance facility shall*
13 *be afforded the opportunity to exercise their rights to any*
14 *unused capacity prior to any bona fide transferor.*

15 (b) *The commingling of transferred water does not*
16 *result in a diminution of the beneficial uses of the water*
17 *in the facility, except that the transferor may, at the*
18 *transferor's own expense, provide for treatment to*
19 *prevent the diminution.*

20 (c) *Any person who has a water service contract with*
21 *the owner of the conveyance facility who has an*
22 *emergency need may utilize the unused capacity that*
23 *was made available pursuant to this section for the*
24 *duration of the emergency.*

25 1811. ~~For purposes of this article, "fair market value"~~
26 ~~includes, but is not limited to, the reasonable operation~~
27 ~~and maintenance costs and depreciation costs associated~~
28 ~~with the conveyance facility use, offset by enhanced~~
29 ~~revenues, if any, realized by the public agency.~~

30 1811. *As used in this article, the following terms shall*
31 *have the following meanings:*

32 (a) *"Bona fide transferor" means a transferor with a*
33 *contract for sale of water which may be conditioned upon*
34 *the acquisition of conveyance facility capacity to convey*
35 *the water that is the subject of the contract.*

36 (b) *"Emergency" means a time of extraordinary stress*
37 *and disaster resulting from storms, floods, fire, or other*
38 *calamitous events.*

39 (c) *"Fair market value" means the marginal cost to*
40 *the owner of a conveyance facility operator to provide*

1 *the service and a markup of 6 percent to compensate the*
2 *owner for the cost of doing business.*

3 (d) *“Unused capacity” means space that is physically*
4 *available for all or any part of a calendar year, for which*
5 *the owner has no use during the period of the proposed*
6 *transfer, in a water conveyance facility to convey the*
7 *quantity of water proposed to be transferred.*

8 1812. *If a fair market value cannot be mutually agreed*
9 *upon by a bona fide transferor and the state or any*
10 *regional or local public agency owning the conveyance*
11 *facility, upon application of the transferor, the*
12 *department shall investigate and file a report with the*
13 *board recommending the fair market value for the use.*
14 *The owner of the facility shall cooperate with the*
15 *department in supplying information in a timely fashion*
16 *and in allowing access to its facilities.*

17 1813. *The board shall, after notice and opportunity for*
18 *hearing, determine the fair market value for use of the*
19 *water conveyance facility. The determination of the*
20 *board shall be binding, subject to judicial review pursuant*
21 *to Section 1814.*

22 1814. *Any transferor or conveyance facility owner*
23 *may, within 30 days after final action by the board, file a*
24 *petition for a writ of mandate in the Superior Court in*
25 *and for the County of Sacramento to inquire into the*
26 *determination of the board. The court shall affirm the*
27 *determination of the board if the determination is found*
28 *to be supported by substantial evidence in the record*
29 *before the board.*

30 SEC. 3. *No reimbursement is required by this act*
31 *pursuant to Section 6 of Article XIII B of the California*
32 *Constitution because the local agency or school district*
33 *has the authority to levy service charges, fees, or*
34 *assessments sufficient to pay for the program or level of*
35 *service mandated by this act.*