Options for California Law as it Affects Water Transfers.

Discussion Briefs
for the
Business-Sponsored Water Marketing and Finance Project
Discussion-Group Meetings

July 1995

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The Business Sponsored California Water Marketing and Finance Project is developing two water policy research papers: one which addresses methods to finance investments in small- and large-scale water supply infrastructure, and the other proposing ways to clarify transfer and trade sections of the California Water Code. As part of the project, local water supply agencies, government officials, and other interested parties and organizations have been invited to participate in focus groups to discuss policy proposals being considered by these papers.

This study will attempt to clarify and address those parts of the California Water Code that may be perceived as inhibiting a successful water market in California, including adequate protections for all affected parties. In addition to an overview of the goals of the project, there are eight specific sections of proposed statute revision: (1) Protection of water rights during and after transfer, (2) creation of expedited transfer procedures for transfers of conserved and "unutilized" water, (3) authorization of user-initiated transfers of water supplied by local water agencies, (4) Authorization of the acquisition of water by members and customers of local water agencies, (5) Protection of third-party interests through a variety of categorical limitations on transfers and compensation of third party injuries that may occur despite these protections, (6) Clarification of the law governing transfers of water rights, (7) Authorization of transfers to instream use, (8) Authorization of future state water banks and of regional and local water banks. The sections are divided into an overview of current law, the proposed transfer mechanism, the purpose of the mechanism, and general areas of strengths or weaknesses which might be associated with the change. We recognize that the areas of strengths and weaknesses are very general. It is our hope that the discussion groups will determine more specific criticisms and suggestions.

It is the business sponsors and advisory group's hope that these discussion briefs will serve as guidelines for further discussion and suggestions by focus group participants. We strongly encourage participants to develop and submit other transfer proposals that could be discussed at the meetings.

These discussion briefs do not necessarily reflect the views or positions of the business sponsoring groups. At the time of conclusion of the project (or earlier if necessary), project participants are free to disassociate themselves with part or all of the project conclusions.

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Goals for Changes in Water Transfer Law

1. Consolidation of all water transfer laws:

Current water transfer law contains conflicting statutes pertaining to water rights, and rights to use water --*viz.* riparian rights, pre-1914 appropriative rights, appropriative rights held under permit or license, correlative and appropriative groundwater rights, decreed surface and ground water rights, contract rights and rights to the use of water acquired through membership in (or service by) a local water agency. A comprehensive statute is needed to consolidate governing of all transfers of water and water rights.

2. Creation of a voluntary expedited transfer system:

Any new procedures should be exclusively voluntary. New procedures should apply only to transferors or transferees who choose to avail themselves of the new procedures. Although it is expected that new procedures would be attractive to many parties, transferors or transferees who choose not to use the expedited procedures would be governed by rules that are similar to existing laws.

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1. Protection of water rights during and after transfer.

Existing law provides protection of the rights of transferors and transferees during the term of the transfer agreement. It also seeks to assure transferors that, following the expiration of the transfer agreement, all rights to the future use of the water return to the transferor. Nevertheless, there are lingering doubts among some potential transferors that these laws do not adequately protect their rights.

Transfer Mechanism:

- Clarification and strengthening of the rights of transferors and transferees. To be achieved through a) declaring the conservation and transfer of water to be a reasonable and beneficial use by the transferor, b) requiring that assessment of waste and unreasonable use during the term of the transfer agreement be made by reference of the transferee's use, c) ensuring the full reversion of rights to the transferor at the conclusion of the term of the transfer agreement, d) the previous transfer of water will not be considered in determining waste and unreasonable use.

Purpose of Mechanism:

- To relieve a potential transferor's doubts regarding the protection of his/her rights.

Potential Strength:

- Creates the certainty necessary for any market to operate successfully.

Potential Weakness:

- Could limit state agencies ability to manage and control the state's water resources.

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2. Creation of the expedited transfer procedures for transfers of conserved and "unutilized" water.

The current transfer laws authorize the transfer of water, provided that the transfer does not injure other legal water users or cause unreasonable harm to fish, wildlife, and/or other instream beneficial uses. In some cases, transfer quantities are limited to the amount of water the transferor would have consumptively used or stored during the period of the transfer. In both situations, the State Water Resources Control Board (or a court on post hoc review) must make an ad hoc determination of the amount of water that lawfully may be transferred. This quantification system is designed to protect third-parties, both by requiring the Board (or the courts) to ensure the transfer does not cause them harm, and by excluding from the transfer that water which historically has been available to other users or instream uses as return flow following the transferor's use. However, this quantification system is problematic for three reasons:

a) The current law creates uncertainty for the parties to the transfer. This uncertainty can potentially deter otherwise salutary transfer proposals, and needlessly complicates contract negotiations.

b) The existing law creates uncertainty for potentially affected third-parties. Currently, the definition and determination of harm in individual cases is left to the discretion of the Board.

c) For short-term, drought-related transfers, there may not be adequate time to comply with the procedural requirements of the statute. In other cases, the expenditure of time and administrative costs may not be necessary to protect third-party interests.

"Unutilized water" is water that is legally and physically available to the transferor during the term of the transfer agreement, but which the transferor has not applied to any consumptive use for at least five years before the commencement of the proposed transfer. Because of the forfeiture statutes, if this water is held pursuant to an appropriative right, the transferor is in jeopardy of losing his or her rights to the water.

Transfer Mechanism:

- Authorize transfers of conserved, salvaged, and "unutilized" water on an expedited basis.
- The transferor would be required to provide public notice of the proposal and to submit its calculation of the amount of water available for transfer to the Board for its review. Upon approval the Board could provide full legal authorization for the transfer with a "Certificate of Transfer".

Purpose of Mechanism:

- To address the problems described above.

Potential Strengths:

- Increase the speed and efficiency of transfers.
- Allows public concerns to be raised and addressed.

Potential Weakness:

- Limits state agency flexibility to manage and control the state's water resources.

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3. Authorization of user-initiated transfers of water supplied by local water agencies.

Although individual water users within a local water agency hold transferable interests in their water supplies, current law states that the agency has the authority to veto transfers by their members or customers. The agency veto has two consequences that may be inconsistent with the goals of the state's transfer laws. First, it separates the user's financial incentive to transfer water, from the local agency's final decision-making authority to engage in the transfer. Second, the law allows the agency's interests to supersede the economic interests of the parties to the transfer, without considering whether the transfer would serve a broader public interest by promoting more efficient allocation of the water in question.

Local agencies have legitimate interests in proposals to transfer water out of their service area. These interests include protection of the fiscal integrity of the agency, retention of existing supplies for the use of other members of the agency, and use of "surplus" water for groundwater recharge. However, the prioritization of the agency's interests, before those of the parties to (and beneficiaries of) the transfer, may frustrate the use of water transfer laws to promote the voluntary reallocation of water. This is particularly true in California, because local agencies control a large percentage of the water resources, including most of the water supplied by the State Water Project (SWP) and the Central Valley Project (CVP).

Transfer Mechanism:

- Express authorization of the water agencies members and customers to transfer their individual entitlements to users located outside the agency, subject to conditions that the agency may impose to protect its own interests, as well as the interests of other members and customers who do not participate in the transfer.
- User initiated transfers could be classified in one of two ways:

a) If an individual transfer would *not* cause the aggregate quantity of water transferred outside the local water agency to exceed fifteen percent (or some agreed upon number) of the total water supplies available to the agency during the term of the transfer agreement, the agency would have limited authority to deny the proposed transfer (except as strictly defined per bullet above). The agency could charge a reasonable fee for the costs incurred in implementing the transfer. The agency would also be authorized to impose reasonable terms and conditions on the transfer.

b) If an individual transfer *would* cause the aggregate quantity of water transferred outside the local water agency to exceed fifteen percent of the total water supplies available to the agency during the term of the transfer agreement, the agency would have the authority to veto the proposed transfer or to place conditions on the transfer, if necessary, to protect a variety of interests.

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Purpose of Mechanism:

- To accommodate the legitimate interests of local water agencies and their members and customers.
- To give water users with the financial incentives to transfer water increased flexibility.

Potential Strengths:

- The existing authority of the local agency to transfer water that is in excess of the demands of its members and customers, as well as water that is made available for transfer by conservation measures undertaken or funded by the agency, would be preserved.
- Local agencies could serve as the brokers for the transfer of water by their members or customers.

Potential Weaknesses:

- Fifteen percent of the total water supplies available to the agency may not be the best choice.
- User-initiated transfer can cause conflicts between agencies and their users.

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4. Authorization of the acquisition of water by members and customers of local water agencies.

Existing law authorizes the parties to a water transfer, under statuatorily defined terms and conditions, to "wheel" water through a third-party's transportation or distribution facilities. However, the current statutes do not authorize a member or customer of a local agency to acquire transferred water without the permission of the agency, or to use the agency's facilities to accomplish the transfer.

Transfer Mechanism:

- Express authorization for members and customers to acquire transferred water, subject to terms and conditions that would protect the agency's concerns about the control and use of its facilities—a local water agency could acquire transferred water on behalf of its members or customers. Members and customers would be authorized to acquire transferred water from sources other than the agency, subject to certain terms and conditions.

Purpose of Mechanism:

- To address whether a member or customer of a local agency may acquire transferred water without the permission of the agency and use the agency's facilities to accomplish the transfer.

Potential Strength:

- Both the agency and its members have a legitimate interest in the latter's acquisition of transferred water.

Potential Weakness:

- May reduce flexibility, authority, and financial integrity of districts.

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5a, 5b. Protection of third-party interests through a variety of categorical limitations on transfers and compensation of third-party injuries that may occur despite these protections.

Existing statutory transfer law inadequately protects third-parties who are at risk of injury from water transfers because of the limited scope of current statutes, and because third-party water users are only protected through ad hoc *procedures and poorly defined substantive standards.*

a. Transfer Mechanism:

- Four categorical third-party transfer protections.

a. Throughout the term of all water transfer agreements, the parties to the agreement must comply with all requirements of federal law and state law, including but not limited to Article X, Section 2 of the California Constitution, other applicable provisions of the Water Code and the Fish and Game Code, all terms and conditions imposed on the transferor's water rights by the permit or license administered by the State Water Resources Control Board, and other judicial and administrative decisions respecting water rights and water quality.

b. No transfer of water within or through the Sacramento-San Joaquin Delta may cause a violation of the water quality standards applicable to the Delta as established under state and federal law. The Board would promulgate regulations to implement this requirement, which would include a table that states the additional amount of carriage water that must accompany each transfer within or through the Delta for various hydrologic conditions and types of water transfers.

c. Transfers of groundwater, and transfers of surface water for which groundwater is substituted, must be consistent with all other state and local laws that govern extraction, appropriation, and use of groundwater, including local groundwater management plans adopted to sections 10750 through 10755.4 of the Water Code and County groundwater ordinances.

d. As described above, transfers of conserved, salvaged, and "unutilized" water are limited in quantity in a manner that is designed to protect the interests of third-parties who have relied on return flows following the transferor's historical use.

Purpose of Mechanism:

- To protect third-party interests through categorical limitations.

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Potential Strengths:

- The categorical limitations widen the scope of the protections for third-parties.
- The determination of injury to the third-party is not left to *ad hoc* proceedings.

Potential Weakness:

- All third-parties may not be protected from harm by water transfers.

b. Transfer Mechanism:

- The establishment of a "Water Transfer Compensation and Restoration Fund," to be managed by the State Water Resources Control Board.

Purpose of Mechanism:

- The Fund would establish a source of revenue for the restoration and enhancement of the state's fisheries, wildlife, and other water resources; and create a source of funding for local economic assistance in areas of California from which water is transferred.

Financing of Mechanism:

- The Fund would be financed by a surcharge of $5 for every acre foot of transferred water used by the transferee for irrigation and $20 for every acre-foot of the transferee water used by the transferee for municipal and industrial or other purposes. Transferees would be responsible for payment of the surcharge to the Board.
- Once the balance of the Fund reaches $10 million, the excess funds could be distributed equally to the Department of Fish and Game and the Department of Economic Opportunity. The DFG would be required to give first priority to mitigation and restoration of harm to those resources caused by water transfers. DOE would use the funds in accordance with Government Code section 12087(b), which establishes criteria for local economic assistance programs, in the counties from which water is transferred.

Potential Strength:

- Categorical limitations may not completely protect all third parties from harm caused by water transfers.

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Potential Weakness:

- Local water transfers, that are currently taking place, might be discouraged. However, transfers between users located in the same local water agency and between users located in the same Planning Sub-Area could be exempted from the surcharge.

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6. Broadening of the law governing transfers of water rights.

Current law only requires that the State Water Resources Control Board review transfers of appropriative rights held under permit or license (and decreed riparian rights that have been quantified as part of a statutory adjudication) that involve a change in the point of diversion, place of use, or purpose of use from that specified in the permit or license (or decreed right). In addition, the transfer of riparian and groundwater rights are currently governed by common law.

Transfer Mechanism:

- Existing law regarding notification and application for transfer should not be substantially altered. However, existing public and SWRCB reporting requirements would be extended to include transfers of riparian and pre-1914 water rights water.
- Codify existing common law governing the transfer of riparian and groundwater rights. Transfers of groundwater rights would have to be consistent with all other state and local laws that govern the extraction, appropriation, and use of groundwater, including local groundwater management plans and county ordinances.
- Transferors of water rights could avail themselves of the expedited transfer procedures governing transfers of conserved, salvaged and "unutilized" water. These transfers would be required to comply with the standards applicable to transfer of conserved, salvaged and "unutilized" water, regardless of the type of water right involved.

Purpose of Mechanism:

- To streamline and clarify the transfer process. To codify existing common law as it pertains to the transfer of riparian and groundwater rights.

Potential Strength:

- Does not substantially alter existing governance of water rights. Would extend reporting requirements to include riparian and pre-1914 water rights to improve the flow of information to the public and governing agencies.

Potential Weakness:

- Codification of common law may adversely affect water rights.

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7. Authorization of transfers to instream uses.

Existing law provides for the limited recognition of instream water rights. Such provisions allow water right holders to petition the State Water Resources Control Board to change their water rights "for the purpose of reserving or enhancing wetlands habitat, fish and wildlife resources, or recreation in, or on, the water." Unlike all of the other changes in water right and transfer laws, this statute requires riparians, pre-1914 appropriators. and other users who are not subject to the Board's permit and license jurisdiction, to seek the Board's approval before they change their water rights.

Transfer Mechanism:

- The dedication or transfer of water to an instream use would be subject to the same rules that govern other water transfers. For example, the transfer of conserved, salvaged, or "unutilized" water to an instream user would qualify for the expedited transfer procedures described above. A permitee or licensee who chose not to use these procedures would be required to petition the Board for a change in the purpose and place of use. And, a riparian or pre-1914 appropriator could engage in the transfer simply by providing public notice of the change (and by submitting the transfer agreement to the Board), without having to seek the formal approval of the Board.

Purpose of Mechanism:

- Supports use of transfers for instream uses.

Potential Strength:

- Preserves the current law authorizing all water right holders and water users to dedicate their consumptive use rights to instream uses or to transfer the water to another user who would use the water for instream purposes.

Potential Weakness:

- Limits use of water transfers from helping achieve water quality requirements.

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8. Authorization of future state water banks and regional and local water banks.

During the last drought, the Governor created an Emergency State Water Bank within the Department of Water Resources. During the 1991 and 1992 water years, the Bank purchased water at fixed prices for resale to users in water-deprived areas of the state.

Transfer Mechanism:

- Permanent authorization for the Governor to create future state water banks whenever the Governor determines that there exists a water shortage emergency or other hydrologic condition that would be improved by direct state participation in water transfers.
- Authorize local water agencies, cities, counties, other local governmental agencies, and other interested parties to establish local and regional water banks on a temporary or permanent basis.
- As with the state water bank, local and regional water banks would not have exclusive jurisdiction over transfers within their area of authority.

Purpose of Mechanism:

- The state water bank would provide a listing of current offers to sell and to purchase water and water rights, to assist potential transferors and transferees in the negotiation and implementation of transfer agreements, to acquire water for subsequent transfer to willing buyers, and to carry out other responsibilities assigned to it by the Governor. The state bank would *not* have exclusive jurisdiction over water transfers.

Potential Strength: To be determined.

Potential Weakness: To be determined.

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