

## WATER DUE DILIGENCE:

### What real estate attorneys should understand about water rights due diligence when their clients are purchasing property with water rights

- I. A brief history of salient Colorado water laws:
  - A. In Colorado, we rejected the riparian doctrine of water rights early on. That doctrine holds that if you own land adjacent to a stream, you can make a reasonable use of the water flowing through your land.
    - a. This did not make sense in Colorado because one must often transport water far from a stream to make land productive, because we do not have sufficient rainfall.
  - B. 1861 the Territorial Legislature provided that water could be taken from the streams to lands not adjacent to streams.
  - C. In 1872, the Colorado Territorial Supreme Court recognized rights of way (easements), citing custom and necessity, through the lands of others for ditches carrying irrigation water to its place of use. Yunker v. Nichols, 1 Colo. 551, 570 (1872)
  - D. In 1876 the Colorado Constitution declared:
    - a. "The 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." Const. of Colo., Art. XVI, Sec. 5.
    - b. "The 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 as between those using the water...." Const. of Colo., Art. XVI, Sec. 6
    - c. All persons and corporations shall have the right-of-way across public, private and corporate lands for the construction of ditches, canals and flumes for the purpose of conveying water for domestic purposes, for the irrigation of agricultural lands, and for mining and manufacturing purposes, and for drainage, upon payment of just compensation." -Const. of Colo., Art. XVI, Sec. 7.

- E. The Adjudication Acts of 1879 and 1881 provided for adjudication of irrigation water rights by amount and priority, and for the administration of the court's water decrees by state water officials.
- F. Groundwater Management Act of 1965 provided essentially for the permitting of wells.
- G. The current most salient code on water laws is 37-92-101 et seq., "The Colorado Water Determination and Administration Act". This law sought to streamline the system of water laws in Colorado, and to integrate groundwater diversions into Colorado's prior appropriation laws. Presumption that all groundwater is hydraulically connected to a stream unless proven otherwise.

## II. The Basics

### A. Types of Water Rights:

- 1. Absolute: subject to abandonment for non-use
- 2. Conditional: subject to cancellation for failure to file diligence

### B. Descriptions of Water Rights:

- 1. Direct Flow: Well, Ditch, Pipeline, etc. (measured by flow rate)
  - a. "c.f.s.": 1 cubic foot of water per second = 449 gallons of water per minute
- 2. Storage: Reservoir, Pond, etc. (measured in volume)
  - a. "acre-foot": 1.0 a.f. = 325,900 g (one foot deep covering one acre)

### C. Wells:

- 1. Exempt Wells:
  - a. Tract of 35 acres or larger: Entitled to well exempt from water administration for up to 3 single-family residences, livestock, fire protection and one acre of lawns and gardens. *Cautions: Definition of single-family dwellings by SEO, no ponds filled, paperwork requirements to perfect well permit, sharing the well restrictions and importance of what constitutes the "exemption parcel". Onsite non-evaporative wastewater treatment required. C.R.S. § 37-92-602 (2013)*

- b. Household use only wells: inside use only, in a subdivision created prior to 1972 or a parcel less than 35 acres that is exempt from the subdivision laws
  - c. Pre-existing Wells (before 05/22/1971) exempt permits for up to 50 gpm used for up to 3 single-family residences, livestock, fire protection and one acre of lawns and gardens. *Cautions: Limited by continuous historic uses. Onsite non-evaporative wastewater treatment required.*
  - d. Commercial exempt wells: wells used for drinking and sanitary facilities in individual commercial businesses. *Cautions: No outside use, not dependent on date or tract size, must employ onsite non-evapotranspirative wastewater systems.*
2. "Fee Wells"
- a. Cannot obtain absent an approved Substitute Supply Plan or Judicially Approved Plan for Augmentation;
  - b. Must consider delayed impact of well pumping
  - c. Can be interconnected, used for any beneficial use or amount but limited to 200' rule.
3. Wells in Designated Groundwater Basins:
- a. Designated groundwater basins are established by the Colorado Ground Water Commission. Located in the Front Range and in Eastern Colorado (map). Commission has sole jurisdiction over designated groundwater.
    - i. Within the designated basins there are separate groundwater management districts, which provide recommendations to the Commission on applications, and establish rules.
  - b. Groundwater in designated basins called "designated groundwater" (groundwater that is essentially not available to surface water rights b/c not tributary)
4. Denver Basin Wells:
- a. Denver Basin stretches from Greeley to Colorado Springs, and from the foothills to Limon.
  - b. It's series of aquifers that are isolated from each other geologically, and how deep you drill will determine which aquifer you are pumping from.
  - c. Landowner is limited to pumping one percent per year of the amount of water that is determined to be beneath their land in these aquifers.
  - d. Can and often are augmentation requirements

### III. Water Due Diligence

A. The need for due diligence

- a. Title policies exclude water rights- no central clearinghouse for who owns water rights
- b. Water rights are not necessarily appurtenant to the land- what you see may not be the Seller's
- c. Priority system of water rights and the stream regime can affect availability and hence value of the water rights
- d. Potential for unrecorded agreements that impact use
- e. Historic use is the scope and limit of every water right, especially so when dealing with the potential to change water rights for different uses
  - i. What the decree states is often greater than the historic use measure of the water right
- f. Other potential limitations a Buyer should be aware of:
  - i. Season of use
  - ii. Type of use
  - iii. Place of use
  - iv. Amount
  - v. Extent and place of return flow
- g. Filing requirements to maintain conditional water rights
- h. Can almost always secure more water, but at a cost = client business decision

B. Due diligence steps and factors:

- a. Identify water resources, structures, and features
- b. Determine validity, attributes, and any defects with water rights
- c. Determine transferability of water to meet client goals
- d. Assess suitability of water resources for the intended use, and whether additional water rights or changes of water rights will be necessary
- e. Note conditional water right filing deadlines

C. When to consider engaging water counsel? (see contract example)

- a. Ideally, when the contract is being negotiated that would include water rights
  - i. If representing a buyer, you may negotiate a special warranty deed
  - ii. If representing a seller, you should negotiate a quit claim or bargain and sale deed

- iii. Consider a potential water right and water resource contingency clause:

- 1. Contingency language for water issues:

This Agreement is contingent on Buyer's review of the adequacy of the water rights and water resources, any jurisdictional wetlands, any easements held by third parties for water structures, and the adequacy of wastewater disposal (the "Water Issues"). If during this contingency period Buyer finds any Water Issue unacceptable, for any reason in Buyer's sole discretion, Buyer may terminate this agreement. Seller will timely deliver to Buyer all documents and information available to Seller related to the Water Issues. If Buyer does not provide Seller with written notice that Buyer terminates this Agreement under this contingency within the [30-90] period, then Buyer waives this contingency. If Buyer delivers written notice of termination under this contingency during the contingency period, Seller may not claim that Buyer acted arbitrarily or unreasonably in terminating the Agreement.

During the contingency period, Buyer and Buyer's consultants, including attorneys, may access the Property to inspect and test the availability, yield, and quality of the water resources; delineate wetlands; and inspect water disposal. Buyer and Buyer's consultants may inspect any structure used to convey, pump, or dispose of water. Buyer must provide notice to Seller under paragraph \_\_\_ of this Agreement prior to accessing the Property, and will obtain Seller's permission before disturbing any land or fixtures. Buyer may not cause any harm to the Property, and will bear all expenses of these inspections.

This Agreement is contingent on Buyer's satisfaction about the Water Issues. This contingency is for Buyer's benefit and Buyer may waive it in his or her discretion. Seller will cooperate with Buyer in Buyer's review under this contingency.

- b. Almost always, water counsel is engaged after the property is under contract.
  - i. Consider allowing for a sufficient diligence period considering water rights review
  - ii. Engage water counsel before or early on in the diligence period
    - 1. Give time so that they can clear potential conflicts
    - 2. Will there be water title work? More time necessary

D. Title Commitment (see example)

- a. Title policies do not insure water
  - i. May wish to have a water title opinion, or at least sufficient title work to reach a reasonable comfort level that Seller owns what they purport to
  - ii. Water title opinion is about the only way to conclusively establish title
- b. Title exceptions often have agreements, easements, and other documents that affect water use

E. Survey (see example)

- a. Generally looking for the location of ditches, wells, water features, ponds, pipelines, etc., and any easements for them
- b. If it is an important transaction, consider a site visit (surveys can miss items)
- c. Ditch easements
  - i. Ditch easements exist where ditches or pipelines carry water across a property
    - 1. Can arise by prescription, express grant, acquiescence, etc.
  - ii. Very important aspect of water right due diligence because:
    - 1. If your client intends development through or near a ditch easement, they will need consent from the ditch owner
      - a. For as little as a driveway crossing, piping a ditch, or moving a ditch
  - iii. Roaring Fork Club rule:
    - 1. "Accommodation doctrine": competing uses between two interested owners should be accommodated if possible
    - 2. Allows a servient estate to alter a ditch easement IF:
      - a. He or she gets prior written consent from the ditch owner; or, if the ditch owner will not consent
      - b. Servient estate can seek a declaratory judgment that the proposed alteration will not:
        - i. Significantly lessen the easement's utility



terms of quality, quantity, and dependability will be available to ensure an adequate supply of water for the type of subdivision proposed.”

- b. If seeking annexation, determine the terms. Typically will require water right dedication, cash in lieu, or both. Consult the code.
  - c. If depending on an existing service provider, may want to determine the terms and costs
    - i. Determine if a will serve letter or an assured water supply commitment from the provider is available
    - ii. Due diligence on whether the provider has the water that the client needs. Can the client affordably connect (infrastructure)?
- I. Other issues:
- a. Wetlands
    - i. If your client intends to develop a property that may have jurisdictional wetlands under the CWA, the only way to establish where those are is to do a wetland delineation
    - ii. Development within jurisdictional wetlands generally needs a “404 Permit”
      - 1. Consider: nationwide permits, regional permits, exemptions
  - b. ESA
  - c. FLPMA and other authorizations if water facilities on federal land
  - d. Energy development – fracking
    - i. *Vance v. Wolfe*, 205 P.3d 1165 (Colo. 2009): Pumping produced water uses water to achieve the benefit of mineral production. Thus produced water is a beneficial water use that the SEO must permit.
    - ii. Demand for frack water in hotbed areas such as northeast Colorado has made the water very expensive
    - iii. Determine availability, pricing, and development strategy during the due diligence phase
  - e. Representing a bank foreclosing? Due diligence in “take-back” phase:
    - i. Assess liens that may impact water rights
    - ii. Did the lien encumber water?
    - iii. Assess agreements, water decrees, and water right historic use

## J. Closing

- a. Water rights are real property, convey by deed specified in the contract
  - i. If contract does not specify, negotiate per above
- b. Ditch company stock and well permits are personal property, which should be assigned
  - i. Can combine a deed of water rights with an assignment of well permits and ditch company stock
  - ii. Note for ditch company stock:
    - 1. Will need to work with the applicable ditch company to have a new share certificate issued
    - 2. Lenders may want actual possession of a share certificate to perfect their lien