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Legal Corner: A Guide to Valuing Water Rights in Colorado

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With population growth, increased environmental concerns, and a greater demand for water for residential, commercial and industrial projects, understanding water rights ownership and regulation is important for anyone evaluating water rights. While water laws vary from state to state, it is important to understand the complexities of water right ownership and regulation. This article focuses on Colorado water ownership and regulation given Colorado's unique water rights system.

In Colorado, water rights are a freely transferrable real property right that can be bought and sold separately from land. Both the legal and physical availability of a water right determine the value of that right. Having a strategy to address common issues related to buying and selling water rights results in maximizing the value of the water right.

Defining a Colorado Water Right

In Colorado, a water right is a real property right that can be severed from land ownership. Separating water from land allows more flexible use of water and for water use in areas where it is not otherwise available. Colorado's Constitution and statutes codify the idea of achieving the maximum beneficial use of water by transferring it to new locations.

Water rights are governed by a strict application of the prior appropriation doctrine. Prior appropriation means that more senior water rights are satisfied first. Junior water rights can only divert after all senior rights are satisfied. In dry years, junior water rights frequently cannot divert water.

Colorado uses a water court adjudication system to quantify, set priority dates for, and decree water rights. A water court adjudication is required to make any changes to a water right. The State and Division Engineer's Offices administer the priority and physical operation of water rights.

There are several different types of Colorado water rights. A vested or absolute water right requires diversion and actual beneficial use of the water. A conditional water right needs to be perfected through actual use during a specific period and can also be transferred or sold in the same way as an absolute right. A contract right is created and governed by contracts with the government or private water suppliers. Groundwater rights are more complex depending on the location of the water source and

generally require a water court adjudication for a plan for augmentation to allow diversion without injuring other water rights.

How to Value a Water Right

A critical piece in valuing a water right is understanding if the right has senior or junior priority date. A water right is created when available water is diverted and placed to beneficial use. However, a decree from the water court is necessary to create an enforceable priority date. A senior priority date results in a more reliable and secure water supply during times of water shortages. A water user may need a supplemental source of water if the right involved is junior. Because all rights in a stream system are relative to one another, it is also important to understand the priority dates and historical operation of other water rights in the same system.

The lawful uses of a water right are another important consideration. The court decree adjudicates the uses of a water right and associated limitations, such as location of use, season of use, and amount of use. Depending on future plans for the water right, it may be necessary to file a court case to change the type, location and/or season of use. As part of change case, the water court quantifies the historical use of water right. The quantification is based on a representative period and results in a consumptive use amount that can be transferred to new uses. A water court proceeding can be lengthy and costly.

However, the benefit of obtaining a water court decree for the new uses results in a legally secure right.

Because land ownership does not necessarily mean any water rights are associated with that land, it is always important to look at the physical and legal water supply. If the water rights were severed from the land, it may be necessary to purchase another water supply, which may present technical challenges in delivering the water.

Limitations and Issues Related to Valuing a Water Right

Legal Constraints

When evaluating the legal constraints, it is typical to start with title to the water rights. A critical determination is whether there is clear title to the water right. In Colorado, title companies will not write insurance on water rights; water attorneys typically prepare detailed title opinions and abstracts. At a minimum, a review of the recorded conveyance documents from the county clerk and recorder's office, the records kept by the State Engineer's Office, and any related water court decrees and documents is necessary to determine if there is clear title. If shares in a ditch or reservoir company are involved, the shareholder records, bylaws, and transfer policies of that company should also be reviewed.

The second consideration is whether the diversion and use of right occurred consistently and in accordance with the terms of any prior decrees. This involves a historical use analysis that compares actual use to the decreed use. It is also important to reveal whether there have been

prolonged periods of non-use and whether the water right has been used consistent with the terms of any existing decree, such as volumetric limitations, location, types of use, and season of use.

Physical Constraints

Physical constraints require an evaluation of the hydrologic, geographic, geologic, and climate of the area. This can also involve water quality issues, seasonal variations in water levels, frequency of drought conditions, over-appropriation of a river or aquifer, and the availability of storage facilities in the area. Unadjudicated and/or unquantified water rights are another area of concern. This could include federal reserved rights, tribal rights, or unperfected water rights and may impact the physical and legal availability of a water right.

How to Protect the Value of a Water Right

Once there is a clear understanding of the legal and physical availability of a water right and its value, it is necessary to take certain steps to protect the value of the right. Because the value of a water right is measured by its historical use over a representative period, the value of water right can diminish if there are not clear records regarding water use. Accordingly, accurate and reliable measurement of the amount diverted and applied to beneficial use helps preserve the value of a water right. Further, using a water right at an undecreed location or for an undecreed use will also result in diminishing the transferrable yield of a water right. Understanding any decree limitations ensures the water is lawfully used and whether a water court application is necessary to achieve different uses and/or use at a different location.

Conditional water right decrees required a water user to demonstrate the diligent development of the right. Failure to show diligence in developing a water right can result in the water court reducing the amount of water claimed and/or the claimed uses. Partial or full nonuse of a water right may also result in the State Engineer abandoning the entire or a portion of the water right, subject to certain statutory exceptions. Keeping clear records of the tasks associated with developing the water right, including associated costs, is important to preserve value.

As a water law attorney at Holland & Hart, Susan Ryan provides practical guidance on water rights, water law, and related land-use matters to energy companies, municipalities, water providers, ranchers, private landowners, corporations, and real estate developers to provide pragmatic solutions to complex water issues.

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