CONFIDENTIAL MEMORANDUM

To: Yellow Jacket Water Conservancy Board of Directors

From: Scott Grosscup

Date: February 3, 2020

Re: Water Rights - Legal Standards

Directors:

In the upcoming and future diligence applications, the District will be required to demonstrate that it has exercised reasonable diligence in the development of the conditional water rights, that it can and will complete the appropriation, and that the water rights have not become speculative over time. In the change of water right proceeding, the District will be required to demonstrate that the change in place of diversion or storage would not increase the contemplated draft of the water right, thereby increasing the amount of water that would be diverted, used, or stored at the new place of diversion and storage. These two legal standards are described in turn followed by several issues that would need to be overcome in the court proceedings.

**Diligence Applications**

***Reasonable diligence*.** The holder of a conditional water right must file an application for finding of reasonable diligence six years after entry of a decree finding diligence, or the right is considered abandoned. § 37-92-301(4)(a)(I), C.R.S. Apart from this periodic showing, “the legislature has not enacted a maximum time frame during which the conditional water right must mature.” *Muni. Subdistrict, Northern Colorado Water Conservancy Dist. v. Getty Oil Co.*, 997 P.2d 557, 561 (Colo. 2000) (“*Getty Oil*”); *Muni. Subdistrict, Northern Colorado Water Conservancy Dist. v. Oxy USA, Inc.*, 990 P.2d 701 706 (Colo. 1999) (“*OXY*”).

 To satisfy the statutory requirement of diligence, the applicant must show the “steady application of effort to complete the appropriation an a reasonably expedient and efficient manner under all the facts and circumstances.” § 37-92-301(4)(b). In each instance, the court is to make an ad hoc factual inquiry into many factors when it determines whether an applicant has been reasonably diligent. *OXY*, 990 P.2d at 706. These factors include, but are not limited to: economic feasibility; status of permit applications and governmental approvals; expenditures to develop an appropriation; ongoing engineering and environmental studies; design and construction of facilities; nature and extent of land holdings; and contracts demonstrating water demands and beneficial uses when conditional water rights are perfected. *Mun. Subdistrict, Northern Colorado Water Conservancy Dist. v. Chevron Shale Oil Co*., 986 P.2d 918, 921 (Colo. 1999) (“*Chevron*”). An applicant is not required to establish each and every factor. *Public Serv. Co. v. Blue River Irr. Co*., 782 P.2d 792, 794 (Colo. 1989) (Applicant not required to prove economic feasibility of development, rather it is one relevant factor). Whether an applicant has been reasonably diligent is a factually driven inquiry that is resolved on a case-by-case basis. *Getty Oil*, 997 P.2d at 561.

The court has also required an applicant to “prove continuous, project-specific effort directed toward the development of the conditional right commensurate with his capabilities.” *Getty Oil*, 997 P.2d at 563. But when a project is comprised of several features, “work on one feature of the project or system shall be considered in finding that reasonable diligence has been shown in the development of water rights for all features of the entire project or system.” § 37-92-301(4)(b), C.R.S.; *Getty Oil*, 997 P.2d at 565; see *also Colorado River Water Conservation Dist. v. Twin Lakes Res. & Canal Co.*, 181 Colo. 53, 56, 506 P.2d 1226, 1227 (1973) (“As long as a water system as a whole is being completed with due diligence, the fact that a small part of it is slow to progress is inconsequential”). Thus, work performed on separate facilities may be considered in determining whether an applicant has been reasonably diligent. *Getty Oil*, 997 P.2d at 564. However, the court has not decided what constitutes a “project or integrated system.” *Id*. at 565-66. Nor has the court addressed the issue of when does a change in plans constitute work on a separate water right. *Colorado River Water Conservation Dist. v. Twin Lakes, supra*.

Where other facts and circumstances are present to demonstrate diligence, “neither current economic conditions beyond the control of the applicant which adversely affect the feasibility of perfecting a conditional water right or the proposed use of water from a conditional water right nor the fact that one or more governmental permits or approvals have not been obtained shall be considered sufficient to deny a diligence application.” § 37-92-301(4)(c); *Chevron*, 986 P.2d at 921 (applying economic conditions). However, current economic conditions are not an absolute defense for not otherwise taking any actions to develop a conditional right. Rather a court may consider economic conditions that “slow progress towards the perfection of a conditional water right.” *Chevron*, 986 P.2d at 924.

The court may consider evidence of activities undertaken in pursuit of the conditional water rights during the period of time from the date of the entry of decree awarding the conditional water right or last diligence decree and the filing of the diligence application. *See Muni. Subdistrict, Northern Colo. Water Conservancy Dist. v. Rifle Ski Corp.*, 726 P.2d 635, 637 (Colo. 1986) (activities outside of diligence period not considered).

 ***Can and Will******.*** Along with demonstrating reasonable diligence, an applicant must show by a preponderance of the evidence that, based upon the totality of the circumstances, there is a substantial probability that it “can and will” complete the appropriation, with diligence, and within a reasonable time. § 37-92-305(9)(b), C.R.S.; *Bd of County Commissioners v. United States*, 891 P.2d 952, 961, n. 9 (Colo. 1995) (citing cases); *City of Black Hawk v. City of Central*, 97 P.3d at 957. In general terms, the test asks: is there a substantial probability that the project is economically and technically feasible or likely to become feasible – “can”; and is the Applicant resolved to develop the project if it can – “will”.

The court may look to a number of factors to determine whether the “can and will” statute is satisfied by the applicant’s proof. *Public Service Co. v. Pueblo Bd. of Water Works*, 831 P.2d 470, 478-79 (Colo. 1992); *see also Pagosa Area Water & San. Dist. v. Trout Unlimited*, 170 P.3d 307, 316 (Colo. 2007) (*Pagosa I*). These “non-exclusive” factors are effectively identical to those that are applied in whether an applicant has been reasonably diligent. *C.f. Pagosa I*, 170 P.3d at 316 (articulating factors for “can and will”) and *Chevron*, 986 P.2d at 921 (articulating factors for reasonable diligence). While identified as “factors”, these “factors” are in fact treated more like elements of proof in a diligence application – the failure of which may result in denial of an application.

For example, in *Arapahoe County v. Crystal Creek Homeowners’ Association*, the court affirmed denial of a conditional water right where the Applicant had failed to prove the feasibility of acquiring a permit to pump water from Taylor Park Reservoir to the proposed Union Park Reservoir. 14 P.3d 325, at 344 (Colo. 2000) (“*Arapahoe II*”). There, the Applicant offered “little evidence” that a permit would be issued by the United States which would result in “significant” changes to Bureau of Reclamation facilities – in other words, failing on the status of obtaining any required governmental approvals. *Id*.; *see also City of Aurora v. ACJ P’shp*, 209 P.3d 1076, 10884-85 (Colo. 2009) (final denial of access to governmental lands for construction of reservoir necessitate finding that applicant failed “can and will” test).

Similarly, an applicant for a new conditional water right must demonstrate that “water is available based upon river conditions existing at the time of the application, in priority, in sufficient quantities and on sufficiently frequent occasions, to enable the applicant to complete the appropriation with diligence and within a reasonable time.” *Aspen Wilderness Workshop, Inc. v. Hines Highlands Ltd. P’ship.*, 929 P.2d 718, 723 (Colo. 1996) (quoting *Arapahoe County Bd. of County Commissioners v. United States*, 891 P.2d 952, 962 (Colo. 1995) (emphasis added). If water is no longer available at the time a diligence application is filed due to development of other senior conditional water rights, the applicant would fail this factor. *Arapahoe II*, 14 P.3d at 334 (affirming water court finding that only 15,7000 acre feet available for claimed 325,000 acre foot reservoir).

#### Like the analysis for whether an applicant has been reasonably diligent, the court may consider current economic conditions necessary to develop the appropriation that are beyond the applicant’s control as part of the can and will test. *Getty Oil*, 997 P.2d at 566. Economic feasibility and “can and will” must be considered together in a diligence analysis. *Id*. at 564.

 In *Getty Oil*, the court applied the can and will test to Getty Oil’s oil shale project. There Getty Oil presented evidence concerning the technical feasibility of oil shale production based upon the technology of the time. The water court found that this evidence was sufficient to demonstrate that Getty “can” complete the project. It also found that Getty “will” proceed with the project when it becomes economically feasible. Thus, the Colorado Supreme Court held that the water court applied the proper standard based upon the facts of the case. *Id*. at 565.

 *Getty Oil* provides an additional evidentiary component to satisfy the can and will requirement. Not only must the water rights be feasible, but so too must be the intended uses – in that case oil shale production. And in addition to establishing that the water right will be constructed when economically feasible, Getty Oil also appears to create an obligation to establish that oil shale development will go forward when it becomes economically feasible. *Id*. at 565: *OXY*, 990 P.2d at 708.

#### However, the court has also said that the “can and will” requirement is not applied rigidly where the applicant has established an otherwise non-speculative intent. *City of Black Hawk*, 97 P.3d at 957. This is because any proof of a substantial probability “necessarily involves imperfect predictions of future events and conditions.” *Id*. (affirming court’s finding of can and will notwithstanding applicant’s present lack of access to reservoir site) (internal quotations omitted). And technical obstacles to satisfaction of the “can and will” requirement may be excused when the policy of maximum beneficial use is otherwise preeminent. *City of Aurora v. ACJ Partnership*, 209 P.3d at 1089 (lack of access to reservoir site is not technical obstacle that may be overlooked).

 ***Anti-Speculation Doctrine***. An applicant must satisfy the requirements of the anti-speculation doctrine, which is closely related to the requirement for showing “can and will.” *Pagosa I*, 170 P.3d at 316. Section 37-92-103(3)(a), C.R.S., prohibits an appropriation “based upon the speculative sale or transfer of the appropriative rights to persons not parties to the proposed appropriation” where the appropriator “does not have either a legally vested interest or a reasonable expectation of procuring such interest in the lands or facilities to be served by such appropriation” or “does not have a specific plan and intent to divert, store or otherwise capture, possess, and control a specific quantity of water for specific beneficial uses.”

An applicant for finding of reasonable diligence must show that the conditional water right has not become speculative over time. *OXY*, 990 P.2d at 708-9. In other words, the applicant must demonstrate that it continues to have a “vested interest or a specific plan to possess and control water for a specific beneficial use.” *Id*. In *OXY*, while stating that the anti-speculation doctrine applies to conditional water rights, the court was not required to determine whether any of the water rights had become speculative. Rather, it concluded that OXY intended to conclude the project at some point in the future, consistent with the water court’s findings. The court noted no party challenged whether OXY’s entire portfolio of water was in fact necessary for its oil shale program, and thus acknowledged that it was not asked to decide if OXY in fact *needed* all of its conditional water rights. In doing so, the court opened up the door that if presented with the proper question, it may consider cancelling conditional water rights that are no longer necessary if the applicant cannot establish a need for that water.

 Case law applying the anti-speculation doctrine has been focused on applicants claiming water rights without an identified demand. Recently in *Vermillion Ranch Limited Partnership v. Raftopoulos Brothers*, 307 P.3d 1056 (Colo. 2013), the court applied the anti-speculation doctrine to a private landowner that was seeking to develop a water supply to meet demands associated with developing its mineral resource. The applicant presented evidence of a plan by a third-party to develop 4,000 gas wells over a 20-year period, estimates of four to seven acre feet of demand per well, and contracts to deliver water for industrial purposes. *Id*. at 1063. Notwithstanding the trial court’s finding that the applicant had demonstrated a non-speculative need for water, the court reversed and held that this evidence was insufficient to support the amount claimed. In other words, without an “actual plan” to put the water to beneficial use and estimate of demand, the applicant could not demonstrate a non-speculative intent to put the water to beneficial use. *Id*. at 1065.

The court has also addressed this question of whether there is an “actual need” for the conditional water rights claimed by a governmental water supplier. Historically, in the context of governmental water suppliers such as a municipality, the court had applied a more lenient standard for determining whether the governmental supplier’s claims were speculative. This was known as the “Great and Growing Cities” doctrine and deferred questions about future needs and demands to the governmental water supplier. *Four Counties Water Users Association v. Colorado River Water Conservation Board*, 159 Colo. 499, 512, 414 P.2d 469, 476 (1966); *City and County of Denver v. Northern Colo. Water Conservancy Dist.*, 276 P.2d 992, 997 (Colo. 1954); *City and County of Denver. v. Sheriff*, 105 Colo. 193, 96 P.2d 836 (1939).

 The court has parted ways with such deference and has narrowly interpreted the governmental agency exception. The recent trend is to apply a more exacting standard on governmental suppliers to establish whether the conditional water right claimed is “reasonably necessary to serve the reasonably anticipated needs of the governmental agency.” *Pagosa I*, 170 P.3d at 313.[[1]](#footnote-1) The agency must: 1) identify a reasonable planning period; 2) provide substantiated growth projections; and 3) identify the amount of water “reasonably necessary” to serve that growth “above its current water supply.” *Id*.

The first and second elements require “close scrutiny” of the planning periods and be substantiated with expert testimony as to its reasonableness. *Id*. at 318-319. It cannot be “based on a conjectural population projection that becomes a self-fulfilling prophecy of growth.” *Id*. at 315. To determine whether the third requirement is met, the court articulated four “non-exclusive” considerations: 1) use of conservation measures; 2) expected land use mixes; 3) per capacity usage projections; and 4) amount of consumptive use necessary to serve the increased population. *Pagosa Area Water & San. Dist. v. Trout Unlimited*, 219 P.3d 774, 780 (Colo. 2009) (“*Pagosa II*”*)*. This requires the agency to demonstrate an actual need for a specific amount of water over and above what it is presently using, considering where the water will be used and what it is doing to limit future water use.

Like the “non-exclusive factors” applied in the can and will arena, which can be dispositive as to whether that test is met, these non-exclusive considerations of whether the water right is needed have the appearance of elements of proof necessary to establish a non-speculative intent. After *Pagosa I*, the applicant returned to water court and, without presenting any additional evidence, tendered a revised decree, the majority of which was accepted by the water court. Trout Unlimited appealed on the grounds that there was insufficient evidence to support the decree. *Pagosa II*, 219 P.3d at 778. The *Pagosa II* court seemingly took great offense that additional evidence was not presented and remanded the case to provide the applicant the ability to prove the anticipated need considering “all other evidence of population projections and water supply needs.” 219 P.3d at 788.

With respect to planning, in *Pagosa I*, the court affirmed a 50 year planning period as being reasonable for a municipal water supplier. 170 P.3d at 317. It is unclear what the court will do for water rights that have not been developed within the initial 50 year planning horizon or whether that horizon begins when the water rights were first claimed or if it renews every diligence period.

**Changes of Conditional Water Rights**

***Contemplated Draft.*** The doctrine of contemplated draft is applied in applications for changes of conditional water rights. It asks whether the change in type of use, place of use or point of diversion for a conditional water right would result in an increase of the use of water under the conditional right as changed. *Twin Lakes Reservoir & Canal Co. v. City of Aspen*, 568 P.2d 45, 50 (Colo. 1977). If the change would result in an increased use from the original decree then the change must be limited to the amount contemplated by the original decree. *See City of Thornton v. Clear Creek Water Users Alliance*, 859 P.2d 1348, 1356-57 (Colo. 1993).

The contemplated draft doctrine is similar to the historical use analysis that accompanies a change of an absolute water right. *See generally*, *Santa Fe Trail Ranches Prop. Owners Ass’n v. Simpson*, 990 P.2d 46, 54 (Colo. 1999) (holder of water right may only change “that amount of water actually used beneficially pursuant to the decree at the appropriator’s place of use”); *Farmers Highline Canal & Reservoir Co. v. Golden*, 272 P.2d 629, 634 (Colo. 1954) (“The extent of needed use in the original location is the criterion in considering change of point of diversion.”)

 There is no legislative or judicial test concerning the sufficiency of the evidence required to prove the contemplated draft of a conditional water right. The reported case law addressing the contemplated draft doctrine did not evaluate how to calculate the contemplated draft of a water right because that issue was either stipulated to or consented to during the course of the proceedings. *Twin Lakes*, 568 P.2d at 50 (stipulation that original engineering for transmountain project contemplated diversions between 40,000 to 80,000 acre feet); *Clear Creek Water Users*, 859 P.2d at 1356-57 (opposer prevented from claiming contemplated draft limited to physical capacity of original reservoir location after conceding right to store entire amount at original location).

 However, these cases do provide some guidance of factors that may be considered in a contemplated draft analysis. First, it is the amount of water that will be used for the initial decreed uses. In *Twin Lakes*, this was the amount of supplemental water necessary to irrigate certain lands in the water short Arkansas Basin. Second, it could be the amount of water stated in the decree notwithstanding the actual physical limitations of the decreed diversion structure or storage site. Finally, only the quantity of water legally and physically available at the original point of diversion may be used at the new place of use or point of diversion.

 ***Burlington Case.*** Fundamental to the contemplated draft doctrine is the concern that an appropriator will enlarge the use of the water right once changed to the detriment of junior water right holders. In a case examining a change of absolute water rights, the court looked at the circumstances surrounding the formation of the original decree to determine that uses occurring after entry of the decree constituted an expansion of the water right and could not be used to calculate the historical use of the water right. *Burlington Ditch Reservoir & Land Co. v. Metro Wastewater Reclamation Dist*., 256 P.2d 645, 665 (Colo. 2011) (“*Burlington*”).

 The facts of the *Burlington* case are instructive as to how the Colorado Supreme Court may view a future change of water rights application. There, a ditch and reservoir company claimed to change its water rights from irrigation to other uses. The water rights in question had been used to irrigate 12,000 acres at a rate of 200 cfs from date of decree to 1909. Then, diversions increased as new lands came under irrigation to 350 cfs, the decreed flow rate. The court held that this post-decree enlargement of diversions and irrigated lands constituted an unlawful enlargement of the water rights and limited the water rights as changed to the 200 cfs, not the 350 cfs decreed to the water right. *Id*. at 665.

 Thus, *Burlington* stands for the principle that when evaluating the historical use of a water right, the court must determine the intended uses at the time a decree enters. Expansion of use beyond that which was intended when the decree enters may not be considered in a change of water rights proceeding. By analogy, a change of conditional water rights is also limited to the amount of water that would have been put to beneficial use for those uses and amounts pursuant to the plan contemplated at the time the original decree entered.

 *Burlington* also means that additional use that occurs after a decree enters and was not contemplated by the original decree is not credited to the historical use of a water right. This point could be particularly relevant to Chevron’s future planning for its oil shale development. For example, a future court could determine that Chevron’s use of its water rights on lands acquired after the rights were decreed constitutes an enlargement of the water right and therefore enter a cease and desist order until the water rights are changed. See e.g., *V Bar Ranch LLC v. Cotten*, 233 P.3d 1200 (Colo. 2010) (expansion of use to irrigate fields acquired after entry of decree).

**Issues to Overcome**

 Should the District’s water court applications be challenged, following are several areas where it could be challenged.

Reasonable diligence –

* Water rights are 67 and 43 years old, respectively, without any on the ground activity to develop. What point is too much?
* Did District do enough in past six years to satisfy this requirement? The decision is an ad hoc determination subject to the court’s discretion.
* Has not applied for any permits.

Can and Will –

* District has limited financing and not enough to build reservoirs at this time with no guarantee of any additional financing.
* Questions can be raised about project feasibility. District has done initial study on Sawmill expansion but is this enough?
* Project feasibility of other water rights, no present alternate place of storage or use.

Anti Speculation –

* Does the Court agree that the water rights are reasonably necessary to serve anticipated demand when there has not been a call on the White River
* Are future anticipated demands reasonable?
* How far into the future will District be able to plan?
1. While the *Pagosa* cases were decided in the context of a claim for a new conditional water right, it would appear that the court would also apply the same anti-speculation requirements in future diligence applications. See *OXY, supra*. [↑](#footnote-ref-1)