

A FLUID TRANSACTION: BUYING AND SELLING WATER RIGHTS

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“We never know the worth of water till the well is dry.” – Thomas Fuller, 1732

As a young boy I raced handmade Styrofoam boats with my preschool classmates down City Creek in Pocatello. We experienced a fundamental lesson in physics: that water flows downhill. That lesson has often met defiance in the arid West, evident by the adage that “in the western United States water does not flow downhill, but towards money.”

As Idaho’s demand for a limited resource grows, issues involving water rights will increasingly confront members of the Idaho Bar, particularly when providing advice in relation to business and real estate transactions. Indeed, few farms and businesses can operate without a reliable supply of water. Fortunately, most water needs can be met with enough effort, ingenuity, and . . . money.

Real estate listings often state simply that the sale “includes water rights.” What the buyer may actually receive in terms of quantity of water, reliability of the water supply, and flexibility of water use is not so simple.

This article highlights issues that often must be addressed when a business or real estate transaction involves water rights. It does not discuss all of the issues that may arise or how they should be resolved. Rather, the goal of this article is to help members of the Bar spot water right issues that affect their clients and know when to seek the assistance of an experienced water attorney or other professional to complete the transaction.

One caveat: the issues discussed in this article pertain primarily to water needs that are not supplied by a municipality. Within city limits, water needs are usually met simply by hooking up to the municipal water system and paying the monthly usage fee. Outside of municipal water systems, businesses are on their own to secure a sufficient supply of water to meet their needs.

What is a Water Right?

Idaho’s waterways are owned by the State as a public trust resource.¹ A water right is the right to divert the public waters of the State and put them to beneficial use.² A water right is a “usufructuary right,” meaning a right to *use*, as opposed to a right to *possess*. The owner of a water right does not own the water itself, just the right to use it.

Every water right consists of certain “elements” that prescribe how, when, and where water may be used under the right. These include the source of water, beneficial use, diversion rate, place of use, and priority date. A water right cannot be used in ways that exceed the parameters of these elements. For example, a water right authorized for irrigation cannot be used for industrial purposes without first going through an administrative process to change the beneficial use and potentially other elements of the water right.

Because a water right is based on the use of water, it is a much more dynamic real property interest than a possessory interest in land. Whereas land is fixed in place and easily observed, water is fluid—it falls from the sky, evaporates, freezes, flows—and can be channeled from one place to another, used in different ways, intercepted by other water users, or forfeited by nonuse.³ These unique characteristics require buyers to perform additional and unique due diligence analyses to ensure the transaction meets their expectation.

Verify Water Right Ownership

The first step is to verify ownership of the right being sold. Title insurance policies typically exclude water rights from coverage. Therefore, buyers cannot rely upon a title report to verify that the seller owns the water rights the buyer desires to purchase. It is up to the buyer to independently confirm that the seller owns the right and that it meets the buyer’s needs.

Begin by obtaining a “Water Right Report” from the Idaho Department of Water Resources (IDWR). Water Right Reports identify the water right number, owner of record, and elements of the right. Buyers should compare the Water Right Report to the title report for the land to which it is appurtenant, to ensure the owner of the land is also the owner of the water right.

It is not uncommon for a Water Right Report to identify someone other than the seller as the owner of the water right. This could occur because IDWR records were not updated in conjunction with a prior transaction, or because the seller does not actually own the water right. If a discrepancy occurs, the buyer should require the seller to provide evidence to verify the seller is the true owner of the water right.

Identify the Basis of the Water Right

What is referred to generally as a water right may be based upon a permit, license, decree, claim, stock in an irrigation company, or statutorily authorized use. Some of these provide a more concrete entitlement to use water than others. Therefore, it is important that buyers know the basis of the water rights they buy.

The process of developing a new water right begins with submitting an application to the IDWR for a permit to appropriate water.⁴ An application is nothing more than a hope for a water right, and is of little or no value to a potential purchaser.

If the application is approved, the IDWR will issue a permit to appropriate water.⁵ A permit is not a water right, but rather the authorization to develop a water right by diverting water and putting it to beneficial use.⁶ A permit is considered an unperfected water right.⁷ Still, a permit holds value because, if developed properly, the IDWR must issue a license based on the extent of actual water use (which may be less than the permit authorized).⁸ A permit is personal property and can be assigned from a seller to a buyer.

A licensed water right has been validated by the IDWR and is a perfected water right.⁹ A decreed water right has been judicially validated and is akin to a license. Both are real property rights and are afforded the protections of due process.¹⁰

Buyers should look to purchase water rights that are based upon licenses and decrees. Permits may be suitable, but the assistance of an experienced water attorney is advisable to help determine whether the permit will be licensed to meet the buyer's needs.

A water right may also be based on a "statutory claim." Statutory claims exist because historically there was a second method of acquiring a water right (in addition to the permit method described above). A water right could in times past be obtained simply by diverting water and putting it to use, without filing anything with the IDWR.¹¹ This approach is commonly referred to as the "constitutional method" of appropriation.¹²

The Idaho legislature passed laws in 1963 (for groundwater) and 1971 (for surface water) requiring all new appropriations to follow the permit method. Because there were thousands of outstanding water rights that had been appropriated under the constitutional method, the legislature also passed Idaho Code 42-243 to require users of these water rights to file claims (commonly referred to as "statutory claims" or "243 claims") with the IDWR.¹³ A statutory claim is merely that—a *claim* to a water right. Statutory claims have not been verified by the IDWR or a court and may not provide a valid entitlement to use water. Thus, buyers should be cautious about buying a water right based upon a statutory claim.

Sometimes a seller does not own a permit, license, decree, or claim, but rather stock in an irrigation company. Irrigation company stock entitles the stockholder to a proportionate share of the water available under water rights owned by the company. This stock is as good as the company's water rights. However, the use of irrigation company water is often subject to additional restrictions set forth in the bylaws of the company. An individual's ability to change the way irrigation com-

pany water is used can be much more difficult than changing an independently-owned water right, since irrigation companies resist changes that may affect other shareholders. Therefore, buyers of irrigation company stock may need to consult the company and its bylaws to ensure the stock meets the buyer's needs.

Finally, the Idaho legislature has authorized the use of water for some purposes, such as household use, in-stream watering of livestock, and firefighting, without a license or decree.¹⁴ These water uses are available to anyone willing to comply with the statute authorizing the use. While the IDWR does not have record of many of these water uses, they are valid nonetheless.

Confirm that the “Paper Right” Meets the Buyer’s Needs

A Water Right Report shows what the water right consists of on paper, and, thus, is often referred to as the “paper right.” Reviewing the elements (quantity, place of use, etc.) shown on the Water Right Report will enable the buyer to confirm that the right should meet the buyer's needs. However, because the extent of a water right is ultimately based on the *use* of water, and may be forfeited for nonuse, what the seller actually owns may differ from what is shown on paper. Consequently, buyers should not stop at reviewing the paper right; they must also investigate the seller's actual use of water.

Investigate Actual Water Use

The buyer should investigate the seller's use of water to confirm it coincides with the parameters of the paper right. If the seller has been using water at a different location, for a different purpose, or otherwise in contravention of the elements of the paper right, or if the seller has not used all or part of the water right for more than five years, then additional investigation should be done to determine whether the water right is still valid and will meet the buyer's needs.

Investigating actual water use is also important to determine the reliability of the water supply that serves the water right. During times of water shortage, water is generally allocated between water users based on the rule that “first in time is first in right.”¹⁵ Each water right has a priority date that determines its place in line for receiving available water. Whereas a relatively early priority water right may always receive water, a relatively late priority right may receive water only for a few days or weeks during spring runoff. Thus, even though a seller has the right on paper to divert and use water, in practice there may be times when water is simply not available to fill the right.

Is a Change in Use Required?

While the dynamic nature of water creates additional work for buyers of water rights, it also presents opportunities. A water right can be moved from one piece of land to another, used in different ways, or captured, stored, and used at a later time.¹⁶ This flexibility rewards entrepreneurial effort and ingenuity.

The ability to change water rights to meet future needs is critical because Idaho's existing water supplies are, for the most part, tapped out. Opportunities for obtaining a new water right by applying for a permit are limited. Instead, meeting new water needs most often requires purchasing and changing an existing right.

Coming up with a way to meet a water need is one-half of the challenge; the other is obtaining IDWR approval. If a buyer desires to move the seller's water right to a new location, or to change the way it is used, the buyer must apply to the IDWR to change the elements of the right.¹⁷ This can be a lengthy process. It often requires technical assistance. Protests may be filed opposing the change, and there is no guarantee of success. So if a buyer desires to purchase a water right with the intent of changing it, he should evaluate beforehand the likelihood of the IDWR approving the change, and condition the closing of the purchase upon such approval.

Put It in the Deed

As a real property interest, water rights are conveyed by deed. As an appurtenance to land, a deed conveying land automatically conveys all water rights associated with the land, unless the deed expressly reserves all or part of the water rights from the conveyance.¹⁸ If a seller wants to sell land and keep all or a portion of the water rights used on that land, the deed must expressly reserve the water rights retained by the seller. More than one seller has assumed he retained ownership of water rights by not mentioning them in the deed conveying land, only to discover too late the opposite is true. For attorneys preparing transaction documents, the best practice is to specifically identify all water rights conveyed to the buyer and all water rights retained by the seller (if any).

Upon receipt of the executed deed, the buyer should send a copy to the IDWR with an ownership change form, which can be obtained from the IDWR website.¹⁹ The IDWR will then update its records to reflect the buyer as the owner of the right.

If the buyer purchases stock in an irrigation company, the stock should be transferred just like any other corporate stock. Typically the seller must sign the reverse side of the stock certificate and convey it to the buyer. The buyer then delivers it to the secretary of the company who will reissue the stock in the buyer's name.

Conclusion

The doctrine *caveat emptor* (let the buyer beware) is acutely relevant to transactions involving water rights. Attorneys can provide valuable service to their buyer clients by explaining and assisting with the added due diligence requirements discussed above. If discovered before closing, water right issues can often be resolved cooperatively between the parties. It becomes more difficult and costly after money changes hands.

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¹ *Walbridge v. Robinson*, 22 Idaho 236, 241-42 (1912).

² Idaho Code § 42-204; see also *Glavin v. Salmon River Canal Co.*, 44 Idaho 583, 588-89 (1927).

³ Idaho Code §§ 42-222(2) and 42-223.

⁴ Idaho Code § 42-202.

⁵ Idaho Code § 42-203A.

⁶ Idaho Code § 42-204.

⁷ *Hardy v. Higginson*, 123 Idaho 485, 490 (1993); Idaho Code § 42-204.

⁸ Idaho Code §§ 42-217 and 42-219.

⁹ Idaho Code § 42-220.

¹⁰ *Nettleton v. Higginson*, 98 Idaho 87, 90 (1977); Idaho Code § 55-101.

¹¹ *State v. United States (In re SRBA Case No. 39576)*, 134 Idaho 106, 111 (2000).

¹² *Olson v. Bedke*, 97 Idaho 825, 830 (1976).

¹³ Idaho Code § 42-243 et. seq.

¹⁴ Idaho Code §§ 42-113, 42-201(3), and 42-227.

¹⁵ Idaho Code § 42-106.

¹⁶ *First Sec. Bank v. Idaho*, 49 Idaho 740, 744 (1930).

¹⁷ Idaho Code § 42-222.

¹⁸ Idaho Code § 42-220; *Russell v. Irish*, 20 Idaho 194, 198-99 (1911).

¹⁹ www.idwr.idaho.gov