Hastings Environmental Law Journal

Volume 14
Number 1 *Winter 2008*

Article 1

1-1-2008

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In a recent report, the National Research Council observed that water markets cannot be expected to resemble more conventional markets for a variety of reasons, including the long-held tradition that water resources support a wide variety of public uses.[1] Transfers can impose significant third-party effects, which must be accounted for in any reallocation. If transfers are to achieve their potential, the report said, the decision-making process should bring all relevant third parties into the deliberations. This broad participation is necessary because water is a unique resource, different from other commodities. Markets alone cannot accurately reflect all the relevant values of water. I share these conclusions.

In testifying before the study commission that wrote the report, I noted the common inclination to think of transfers as a contract, with two parties only—a buyer and a seller. I believe that a more appropriate model would be a diplomatic negotiation with a number of parties, each with important and legitimate interests that need to be accommodated, but without clearly defined rights. The future of water transfers will be jeopardized unless something like that broader and more inclusive model is embraced.

The question of who has, and who ought to have, what rights in water raises an issue that has received very little recognition in our legal system: the rights of communities. A companion issue is the limit on privatization of water as a commodity. Unlike almost every other form of property, which we allow to be entirely privatized, water has always been viewed as something in which the community has a stake and which no one can fully own. The complexity of this point is usually embraced in the phrase, "third-party effects" when talking about water transfers.

Although third-party effects exist wherever significant resources are allocated or reallocated, they are usually ignored. Years ago, when O'Hare

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1. COMMITTEE ON WESTERN MANAGEMENT, NATIONAL RESEARCH COUNCIL, WATER TRANSFERS IN THE WEST; EFFICIENCY, EQUITY AND THE ENVIRONMENT (1992).

Airport in Chicago was opened, Midway Airport—at the time the busiest airport in the world—was entirely closed down. Many of the businesses located around the airport, and dependent on it, went broke. When a theater next to a restaurant is sold and turned into a warehouse, the restaurant may go out of business. When General Motors closes a factory in Michigan and opens one in another state of another country, workers may be left in a lurch. These are all third-party effect problems. With rare exceptions, they have no standing in our legal system. But water is and always has been different—certainly in theory, and to some extent in practice.

Reallocations of resources, such as a factory relocation, usually generate a variety of costs to the export community, such as increased welfare payments, more unemployment compensation and fewer public services as tax revenues decline. At worst, reallocations result in the creation of a permanently depressed Appalachian-type community. However, positive effects also occur. A new community may prosper, products may be produced more efficiently, and obsolete industries phased out.

Legal History of the Issue

Concerns about the de-watering of the Owens Valley by Los Angeles gave rise to the area of origin law in California legislation stating that people in the area where water arises have first claim to it.[2] This is not solely a California phenomenon; the same issue has arisen elsewhere in the West. It has been played out between the western slope of the Rockies in Colorado and the more populous and urbanized eastern slope; the western slope people have had their rights recognized as water was removed from the area of origin.[3] The same is true in the Great Lakes area, where states and Canadian provinces bordering the lakes have fought and won, through Federal law, the right to keep other states from drawing on the water there.[4] The intense sense of loss was not diminished by the fact that in the Great Lakes region, water is measured not in acre-feet but in cubic miles.

Sometimes, the state itself asserts a right in water. Many years ago, a New Jersey company diverted water from the Passaic River in order to transport it to New York and sell it there. The State of New Jersey prohibited the exports, and the U.S. Supreme Court sustained the state by rejecting the property claims of the putative exporter.[5] The Supreme Court described water as something that could not be fully privatized, something in which there was a residual and inalienable interest in the community of origin. In effect, the Court stated that water was a heritage resource, which the

2. E.*g*. CAL. WATER CODE Sec. 11460 (West 1992).
3. E.*g*. COLO. REV. STAT. Sec. 3745-118(b)(IV) (West 1990).
4. 42 U.S.C. Sec. 1962d-20 (1988).
5. Hudson County Water Co. v. McCartier, 209 U.S. 349 (1908).

community could control and keep for itself. This may be the earliest example of court action holding that ordinary contract principles were not sufficient to govern water marketing. The Supreme Court more recently recognized a similar public right in groundwater. In that case, the State of Nebraska wanted to prevent water from being pumped there and exported to Colorado. The court recognized that—at least where there was a demonstrable need for the water in the area of origin—the state could override property claims, or claims that water was simply a commodity.[6]

The situation involving water is very unusual, and it applies to virtually nothing else. For purposes of interstate commerce, for example, all other state resources may be privatized fully, and freely shipped away from the area of origin as ordinary commodities—even though states have often tried to keep such resources within their own boundaries to benefit their own residents. Such efforts have routinely and repeatedly been held unconstitutional by the courts.[7] The only other common example where things are treated like water—that is, as community resources and not as ordinary salable commodities—arises with cultural properties, antiquities for example, where the nation of origin often asserts a national claim on the property in order to prevent exports.[8]

Community claims on water do not arise solely in the context of interstate commerce. They are also found in state law. The area of origin protection that California and other states employ in a variety of forms already has been mentioned. California has a law that limits rights to transfer if there are unreasonable impacts on the local economy or on natural resources.[9] Some states have an even broader test of compatibility, with the public welfare as a condition of transfer, or requiring consideration of economic loss to the community, although the content of these so-called "public interest statutes" has been given very little interpretation.

As is well known, California has applied the public trust doctrine in the Mono Lake case to limit the removal of water from its natural setting.[10] Of course, the traditional theory of riparian law was that water must be kept for use on land riparian to its native stream and within its watershed. At least in theory, this is still the law in California.

In addition, there is a tradition, both in some Western states and also under the original federal reclamation program, to keep water appurtenant to the land on which it was first used—that is, to keep it within the community as a community resource.[11] Appurtenance is a very strong

6. Sporhase v. Nebraska *ex. re.* Douglas, 458 U.S. 941 (1982).
7. LAURENCE H. TRIBE, AMERICAN CONSTITUTIONAL LAW 409-10 (2d ed., 1988).
8. *See, e.g.*, JEANETTE GREENFIELD, THE RETURN OF CULTURAL TREASURES (1989).
9. *e.g.*, N.M. STAT. ANN. Sec. 72-5-23 (1990); WYO. STAT. Sec. 41-3-104(A).
10. National Audubon Society v. Superior Court, 658 P.2d 709 (1983).
11. 43 U.S.C. Sec. 372 (1988).

tradition in other cultures, such as Hispanic water law, where community is valued far more than efficiency.[12]

Lack of Legal Doctrine

Thus, to treat water purely as a commodity, and transfers as two-party transactions only, is to depart from a very deeply rooted tradition in the water field and from consistent intuitions about water as a community resource. But community right is such an unusual idea in our law that, despite its history and despite its strong intuitive power, we have little experience in giving it content. For example, we may say that in general an owner may not sell more water than his or her consumptive use; but we have no theory about whether even that should be salable. We have virtually no legal doctrine to describe the relation between an owner who wants to sell water and the community from which that water will be exported.

Nor is there any clear concept of a "community" entitled to protection against the effects of export transfers. There are all kinds of different communities whose claims could lead, depending on how the community is described, to very different sorts of limitations on water transfers.

If the state is the relevant community, then a review of transfers by a state agency might be seen as fulfilling the community claim. But if the community is the local economy, then the state may not—and to some extent almost certainly will not—fully reflect that community's interests. Another relevant community may be the water institution, the water district, for example, which certainly has interests of its own. If the district is the relevant community, it may not fully overlap the local economy that may be affected by a sale of water. There also are the so-called "natural communities" or "in-stream value communities."

Because of strong desires to facilitate transfers, efforts have been primarily directed toward empowering individual sellers as against community claims in order to promote transfers. Almost all recent legislation dealing with transfers looks in this direction. This is understandable. If enough interests are involved and each has something like a veto power, transfers will be so weighted down that the whole enterprise is likely to collapse under its own bureaucratic weight and increased transactional costs.

Redistribution of Wealth

My observations are based on two premises; (1) that the claim for a community state in water is legitimate and is reflected in a wide range of responses to water problems over a very long time; and (2) that

12. ARTHUR MAAS & RAYMOND L. ANDERSON, AND THE DESERT SHALL REJOICE: CONFLICT, GROWTH AND JUSTICE IN ARID ENVIRONMENTS, 41 (1978).

legitimate community claims have been neglected in the effort to facilitate water transfers.

First, water in place is a type of wealth. That wealth accrues not only to the owner of a water right, but to many other people in the place where the water is located—in the form of employment, direct and indirect; in lower prices for water because of its relative abundance; and in natural values, such as recreation and fisheries, that arise as a result of water's presence.

Second, when water is sold as a mere commodity, only the formal owner of a water right is compensated. For that individual, there is a transformation of wealth from one form to another—from water to cash. Indeed the seller is likely to be significantly enriched, particularly in agricultural-to-urban transfers, since water has usually been under-priced. Payments for water frequently exceed the profits that sellers could have obtained from using the water for irrigation.

Third, while such sales are, for the owner-sellers, transformational—wealth is transformed from water to cash—for everyone else who has been benefiting from the presence of that water, the sales are redistributional. That is, others in the community who have up to that point benefited from wealth in the form of water in place will be made worse off, since the water is gone and they receive nothing in return. Moreover, it is likely that the redistribution will be essentially adverse to (1) people who have salaried jobs that depend on the presence of the water and are likely to be the first to lose work if economic activity is reduced, and (2) poorer people in the communities, since they are often the least mobile residents; they are unlikely to move and find equivalent work and amenities elsewhere.

It may be true that aggregate losses resulting from agricultural-to-urban water transfers are relatively small because agricultural employment is a small percentage of total state employment, and because the economic contribution of the low value crops that are the most likely to decline is small. Nonetheless, to those in the community who are the losers, the losses are likely to be very significant.

All this suggests to me the existence of a first order of conflict between user-sellers—that is owner of water rights who have been in a position to reap the benefits of a sale—and other interests, natural, economic and social, who have hitherto been enriched by the presence of water and will obtain no benefit from its sale. The relevant community is composed of those who would be made poorer by the sale of a particular amount of water.

To avoid wealth redistribution in transfers, the following precepts would apply: first, transfers should not be redistributive to the disadvantage of those in the selling area, both in human and natural terms. Second, the price of the water to those acquiring it should take into account all the benefits the water has produced, not just those that have flowed to the holders of formal water rights.

Approaches to Mitigation

There are several practical ways to promote such goals. One is to favor sales that minimize disadvantages to the community. The most obvious are those that free up water by applying water-saving techniques, so that the same amount of economic activity continues in the selling community.

Another device is the provision of community compensation through a transfer tax. Where sales generate a general decline in the wealth of the community, the concern ought to be for those who remain—those who are least able to leave, rather than for those who can shift and leave the community. A tax on water sales, depending on the nature of the sale and its redistributive impact, would be the easiest means to mitigate the redistributive tendency of export sales. A similar approach could be taken to mitigate natural losses—losses to waterfowl habitat for example.

It is true that much of the water likely to be sold does not come from the original place of origin, but rather from a place to which water has been imported. That fact should not affect the conclusion as long as a community has been established—whether it is a human settlement or a natural habitat, such as a wildlife refuge. Once such uses are established, the removal of water constitutes a disruption in that community, even if the community is only a few decades old, and thus also constitutes wealth redistribution.

The more one enlarges the interests that need to be accounted for, and the more complex or extensive the arrangements to evaluate transfers become, the more transfers will be discouraged. This is a serious problem, but there are ways around it. The best way to deal with this issue is to adopt generally applicable formulae that are meant to approximate the losses to the community caused by various types and sizes of transfers. Formulae for taxes on transfers, compensation to in-stream uses, and prioritization of favored and disfavored types of transfers can be employed to assure mitigation without making transactional costs unduly burdensome. Large and pervasive impacts can be treated differently from small and ephemeral ones; and different standards can be imposed for in-basin and out-of-basin transfers.

Reducing all these concerns to some kind of workable formulae can promote transfers by reducing transaction costs while taking account of the most important third-party effects: reductions in existing wealth. Of course, a formulaic approach is a second-best solution, and will not produce the appropriate result in every individual case. But the alternative—extensive participation and elaborate public interest hearings—while theoretically appropriate, threatens to make all but the largest water transfers uneconomic and untimely. Certainly some review process is necessary, but the goal should be to make it largely a fall-back device for especially hard cases. For the most part, some sort of formulaic approach will have to be adopted, or the whole system is likely to sink from its own weight.

Most discussion of water transfers has been focused on what are seen as obstacles—legal, institutional and psychological. In my view, we need to encourage some transfers, but not by commodity theories that lead to reverse wealth redistribution. The solution to inadequate water transfers in California is not to ignore community interests in water, but to institutionalize them as part of the price of water, rather than letting all the benefits flow to the formal owners of water rights and to the buyers of water.

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