

TRANSFERS AND CONVEYANCES OF WATER RIGHTS: EVALUATION, DUE DILIGENCE, AND FORMS OF CONVEYANCES

**ANNE J. CASTLE, CHRISTOPHER L. THORNE & LEAH A. KUKOWSKI
HOLLAND & HART LLP
www.westernwaterlaw.com**

DECEMBER 18, 2002

1. INTRODUCTION

This outline first addresses the practical steps that should be taken by an attorney involved in the evaluation of water rights being acquired by a client. Next, this outline addresses forms of conveyancing of water rights, the benefits and effects of various forms of deeds, and related information concerning conveyances of water rights.

2. DUE DILIGENCE AND EVALUATION

a. Water Rights Evaluation

An attorney representing a buyer of land and associated water rights should discuss with the buyer the degree of assurance necessary with respect to the water rights to be acquired with the property. At a minimum, the current validity of claimed water rights to be conveyed should be confirmed through a review of pertinent court decrees, permits and other documents and records. In addition, for major transactions, it may be prudent to obtain a water rights title opinion from a water rights attorney. Finally, consultation with a water resources engineer often times may be needed to assist in determining likely physical yield of the water rights to be conveyed and whether the water rights are sufficient to meet the anticipated uses of the buyer.

i. Identify Water Rights To Be Purchased

(1) Obtain evidence of water rights associated with property to be conveyed, which may be in the form of water court decrees, deeds transferring water rights, well permits, certificates of stock in a mutual ditch company, or water allotment contracts. Water rights appurtenant to the property may include legal rights to withdraw ground water, which may be evidenced by a water court decree, a well permit from the State Engineer's Office, or both. *See Bayou Land Co. v. Talley*, 924 P.2d 136 (1997).

(2) Obtain water court decrees and well permits from the State Engineer's Office of the Division of Water Resources, located on the 8th floor of 1313 Sherman Street, Denver, Colorado, (303) 866-3581. The Office of the State Engineer's website contains useful information and is located at www.water.state.co.us.

A full review of the records related to water court decrees and well permits maintained at the State Engineer's Office should be conducted. In addition, the existence and status of any pending water court applications should be confirmed with the seller and the water court file reviewed.

(3) As discussed in more detail below, in many instances, a visual inspection of the property by a water resources engineer or consultant should be conducted. This may disclose evidence of other water rights adverse claims (e.g., diversions by adjacent property owner), and the like.

ii. *Determine Validity of Water Rights*

A determination should be made as to whether any decreed water rights remain valid, as a right to use water may be lost to non-use or abandonment, reduced based on the level of historic use, or subject to adverse possession.

(1) *Abandonment.* Colorado statutes define "abandonment of a water right" as "the termination of a water right in whole or in part as a result of the intent of the owner thereof to discontinue permanently the use of all or part of the water available thereunder." Colo. Rev. Stat. § 37-92-103(2). The Division Engineer of each of the seven water divisions is required to prepare an abandonment list, every ten years, that identifies all of the absolute water rights which he has determined have been partially or completely abandoned. Colo. Rev. Stat. § 37-92-401. Partial abandonment indicates that only a portion of the decreed amount of water has been abandoned. The Division Engineer is required to publish the abandonment list and to mail a copy of it to each owner of a water right that has been listed as partially or completely abandoned. *Id.* The most recent decennial abandonment list was published in 2001 and is available on the Division of Water Resources web site, and should be consulted if decreed water rights are proposed to be conveyed.

(2) *Diversion Records.* Diversion records, which are often compiled by local water commissioners, indicate how much water is reported to have been diverted under each water right located in a water district on an annual basis. Diversion records are maintained in the offices of the State and Division Engineer and, for some river basins, are on-line. If available, the diversion records for the water district where the water right is located should be reviewed to determine if the water right has been consistently diverted and used. This will be significant in any future water court proceeding to change the use of the water right. These records also indicate whether there was sufficient water available to meet the water right and may include comments regarding the condition of the diversion structures or other relevant information as to why a water right may not have been diverted in an amount equal to its full entitlement.

(3) *Water Commissioner.* The status of water rights should be discussed with the current (and in some cases, former) water commissioner, who administers water rights within the water district where the water right is located. Water commissioners can be a wealth of information on the type and place of use of

water rights adverse claims, whether such water rights are generally fulfilled or only available in very wet years, and whether adverse claims may exist.

(4) **Well Permits.** If a well permit is being conveyed, check to make sure a statement of beneficial use has been filed and well drilling and pump installation reports have been timely filed with the State Engineer's Office. Failure to file such documentation may have caused the well permit to lapse.

(5) **Conditional Water Rights.** If any of the water rights are decreed conditional water rights (meaning the associated water has not yet been placed to a beneficial use), check to make sure that the necessary reasonable diligence proceedings have been completed in water court (required every six years.) Colo. Rev. Stat. § 37-92-301(4)(a)(I) (2002). If diligence has not been timely demonstrated, the water right will be considered abandoned. *Id.* The State Engineer's Office should have copies of any findings of reasonable diligence that have been issued to maintain a conditional water right.

(6) **Easements & Rights-of-Way.** If any structure related to the water right is located on lands that are not a part of the property being purchased, the status of any rights-of-way or easements required to access the structure and deliver the water to the place of use should be confirmed.

(7) **Ditch Shares.** For shares in mutual ditch companies, confirm that any annual or other assessments have been paid, and that ditch company's records show no restrictions (*e.g.*, liens or pledges) on transfer of the shares. Also, confirm that the seller has the original stock certificate. The ditch company secretary should be able to verify ownership of the stock certificate. In addition, it is often useful to obtain an estimate from the ditch company of how much water is delivered on average per share. Diversion records for the ditch should be reviewed.

(8) **Allotment Contracts.** For water delivered pursuant to a water allotment contract with a water conservancy or conservation districts or similar entities, confirm that payments are current and there has been no default on the contract. In addition, many districts have specific contract transfer requirements that may impact the timing and other aspects of closing a transaction.

b. Using an Engineer

Engaging a water resources engineer or consultant to review the water rights proposed for acquisition may be necessary, particularly if the buyer intends to change the use of the property and/or the associated water rights (for example, purchasing agricultural property with irrigation water rights for conversion to residential development). When changing the use of a water right, Colorado law limits the amount of water that can be changed to the amount of historical beneficial use of the water right. *See Orr v. Arapahoe Water & Sanitation District*, 753 P.2d 1217 (Colo. 1988). An engineer is usually necessary to determine the historic yield of the water rights and determine the future water supply needs of the buyer.

i. *Determine the Historic Use of the Water Right*

Water rights on paper do not guarantee that such water will be available each year and is no guarantee of reliability. For instance, a water court decree may permit the diversion of 10 cfs of water, though the flow from the stream where the water is diverted may rarely exceed 5 cfs. A water resources engineer may be necessary to determine that the water rights being conveyed with the property sought to be purchased are sufficient to meet the intent of the buyer. In order to assess the historic use of the water right and whether it is sufficient to meet anticipated future needs, the following steps should be taken:

(1) Obtain from the seller any engineering reports, documents or other correspondence related to the water needs of the property, the water facilities located on the property, the water rights associated with the property, and the water supply system for the property. Maps, diagrams, and drawings of the water supply facilities should also be obtained and reviewed.

(2) Review diversion records and use records for the previous fifteen years.

(3) Obtain and review diversion records for the water right to ascertain the amount of water that is typically diverted under the water right.

(4) Have the engineer analyze the relative priority of the water right and local call records to determine how often the water right is in priority and how often it is subject to a call by a senior water right.

(5) Have the engineer obtain and review aerial photographs to determine the historic use of the water right (when the water rights are used for irrigation).

(6) Have the engineer calculate the historic consumptive use and historic return flows.

(7) Have the engineer analyze the physical supply reliability.

ii. *Determine Adequate Future Supply*

(1) An engineer may also assist in determining the future water demand for proposed development and assess whether current water rights are sufficient to meet those needs. This will involve identifying water demand, the duration and volume of need and the physical water supply.

(2) Obviously, the suitability of water rights to be acquired for meeting new water supply needs will require legal evaluation of the water court or other administrative proceedings that may be required for new uses of the water

right, and review and understanding of other approvals that may be necessary (e.g., water supply requirements of local subdivision regulations).

c. Title Opinions

A buyer will want to ensure that the seller of a water right has good and marketable title to the water rights to be conveyed before purchasing the property and water rights. Since water rights are a form of real property, performing a title determination on water rights has many similarities to examining title to real estate. Unfortunately, however, the convenience of obtaining title insurance, which has substituted for attorney's title opinions in virtually all real property transactions, is not an option for water rights title. Title insurance companies will not issue commitments or policies to insure title to water rights. It is now rare to find a title company that will even compile an abstract certified to contain all documents pertaining to particular water rights.

Although beyond the scope of this outline, the following steps should be considered if a water right title determination is necessary, but should be evaluated for feasibility and effectiveness given the particular circumstances:

- i. Review of existing abstracts on the real property to which the water right has historically been appurtenant.
- ii. Obtaining from a willing title company an abstract certified to contain all documents relating to water rights associated with particular real property or relating to particular named rights.
- iii. Stand up examination of the county real property records, searching the grantor records starting with the named claimant in the original decree.
- iv. Review of limitations contained in the original decree for the water right and any subsequent change or augmentation decrees.
- v. Discussion with the local water commissioner concerning his/her knowledge of the current ownership of the water right, of any adverse claims, and of any abandonment.
- vi. Review of the tabulation of decreed water rights compiled by the Colorado State Engineer's Office and the current abandonment lists. In the case of a water right associated with a well, review of the State Engineer's well permit files.
- vii. Site inspection to reveal any adverse use of the water right.

If all else fails, title to a water right can be quieted in the same manner as title to real property. *See Colo. R. Civ. P. 105.*

3. FORMS OF CONVEYANCING

a. Forms and Procedure

i. ***Water Right as a Property Right.*** A water right is a property right separate and apart from the land on which it is used. *Southeastern Colorado Water Conservancy District v. Twin Lakes Associates*, 770 P.2d 1231, 1239 (Colo. 1989); *Nielson v. Newmyer*, 123 Colo. 189, 192-93, 228 P.2d 456, 458 (1951). Water rights can be bought and sold similarly to real property, and can be conveyed separately from the land to which they are appurtenant. *Navajo Development Co. v. Sanderson*, 655 P.2d 1374, 1378 (Colo. 1982).

ii. ***Formalities.*** The same formalities must be observed in a conveyance of water rights as in the conveyance of real estate. Colo. Rev. Stat. § 38-30-102. Water rights “can be conveyed and the quality of title may be warranted much like with real property.” *Navajo Development*, at 1378. Because the nature of the prior appropriation system dictates that a water right cannot be characterized as a fixed, tangible amount of water, any warranties of title or other covenants attached to the conveyance of a water right must be construed in harmony with the underlying nature of the right. *Id.* at 1377-78.

iii. ***General Warranty Deeds.*** A conveyance of a water right by general warranty deed guarantees that the water right is “a vested priority of use not subject to defeat by persons seeking the same priority.” *Navajo Development*, at 1380. The general warranty is not breached if there is a diminution of the amount of water available under the right conveyed. As with real property, a general warranty in a water rights deed is an assurance of protection against any defects of title, whether they result from mistakes of law or mistakes of fact. General warranty deeds are not the common practice in conveyancing of water rights for numerous reasons. First, water rights are particularly susceptible to adverse possession and abandonment based on non-use of the right. Second, the amount of the water right is determined by the physical and legal availability which may be reduced over time if the use of the water right has diminished.

iv. ***Special Warranty Deeds.*** As with a similar deed for real property, a special warranty deed for water rights warrants the grantor’s title against all persons claiming under the grantor. This covenant protects the grantee against a claim to title which can be traced back to the grantor, but not against a claim of title superior to or adverse to the grantor. A special warranty deed does not render the grantor liable for defects such as abandonment based on events which occurred while the property was in the hand of a prior titleholder. *Colorado Land & Resources, Inc. v. Creditthrift of America, Inc.*, 778 P.2d 320, 323 (Colo. App. 1989).

v. ***Quit Claim Deeds.*** A quitclaim deed does not contain any language “warranting the title” to the property. Rather, it operates to convey whatever right, title, and interest the grantor has at the time of the execution of the deed and does

not convey after acquired title. Often times, sellers will only be willing to convey water rights with a quitclaim deed.

vi. ***Bargain and Sale Deeds.*** A bargain and sale deed contains the words “sell” or “convey” and has no language “warranting the title” to the property. Such a deed has the same effect as a quitclaim deed, but conveys, in addition, any after acquired title of the grantor. Bargain and sale deeds should be used whenever a quitclaim deed is offered. It imposes no additional obligations on the seller, but provides some additional security to the buyer.

b. Contract for Purchase and Sale Considerations

i. The inclusion of water rights in a real property transaction requires special consideration during the drafting of the Purchase and Sale Contract and deed.

ii. The purchase and sale contract should include an appropriate diligence period to investigate water rights, which should involve a full legal, engineering, and physical inspection of the property and the water right.

iii. If there is a purchase money deed of trust involved that will encumber the water rights being conveyed, there are several additional considerations: 1) the buyer cannot make any changes to the water right that cannot be undone, or without seller’s consent; 2) the buyer is prohibited from future sales or assignments without seller’s consent; and 3) the buyer covenants to fully utilize the water rights while the deed of trust is outstanding so as to minimize risk of abandonment.

iv. Additional considerations that may need to be addressed during contract discussions/negotiations include: 1) the type of deed that should be used for the conveyance; 2) the necessity for a “dry-up covenant” if water right is sold separately from the land (the form of covenant should be attached to the contract); and 3) obtaining the seller’s commitment to cooperate in any future water court proceedings.

c. Legal Descriptions of Water Rights

Water rights can be conveyed together with the land on which they are used without specific mention in the deed itself. Whether water rights are conveyed in a deed that does not expressly mention them is a question of fact, dependent upon the intention of the grantor and the circumstances surrounding the transfer. *Kinoshita v. North Denver Bank*, 181 Colo. 183, 188, 508 P.2d 1264, 1267 (1973); *Arnett v. Linhart*, 21 Colo. 188, 190, 40 P. 355 (1895).

A well-drafted water rights deed will specifically describe the water right being conveyed by reference to the name of the structure, the original decree adjudicating the right, its amount and priority (appropriation date). For example:

ABC Ditch, Priority No. 40, Water District No. 38,
appropriation date: June 15, 1889; adjudication date: April
4, 1902, for 3.5 c.f.s.

i. **Ground Water Rights.** When describing ground water rights, a well permit number should also be included. Note that express mention of several water rights in a list of rights to be conveyed may imply exclusion of any right not listed. *See Thomas v. Great Western Sugar Co.*, 773 P.2d 582 (Colo. App. 1988); *Denver Joint Stock Land Bank v. Markham*, 106 Colo. 5099, 107 P.2d 313 (1940).

ii. **Conveyance of Nontributary or Denver Basin Ground Water.** This is a unique type of ground water that merits particular attention. If the nontributary or Denver Basin ground water is adjudicated, reference to the relevant Water Court decree may be sufficient to fully describe the ground water being conveyed. If it is not adjudicated, then the ground water should be described by reference to the real property that overlies the ground water. Case law indicates that reference should be made to any “inchoate” rights to the nontributary or Denver Basin ground water if no well permit has been issued. Example: “all water and water rights . . . [including] all ditches and ditch rights, water wells and well rights, *all perfected and inchoate rights to the development, extraction, or use of nontributary or Denver Basin aquifer water . . .*”

d. Bill of Sale for Structures and Equipment.

When conveying water rights, a bill of sale should also be executed for the transfer of personal property associated with the water rights, such as wells, pumps, pipeline, headgates, flumes, and other fixtures necessary for the use of the water rights. If those fixtures are part of the security for the purchase price, the security interest is perfected by the filing of a UCC-1 form.

e. Water Rights Represented by Shares of Stock in Mutual Ditch Company

The conveyance of water rights represented by shares of stock in a mutual ditch company requires special procedures. The stock certificate itself is personal property which is transferred as other shares of stock are transferred, namely by stock assignment and physical transfer of the certificate. The secretary of the ditch company may prescribe particular transfer forms for use by conveying shareholders. In addition, however, a share of stock in a mutual ditch company is a representation of the shareholder’s proportionate ownership interest in the water rights held by the company. *Jacobucci v. District Court*, 189 Colo. 380, 541 P.2d 667, 672 (1975). Thus, it is also prudent to follow the procedures for the conveyance of real property, just as would be

done for other water rights. Accordingly, the transfer of mutual ditch company shares is accomplished by both transfer and assignment of the stock certificate and a deed of the water rights represented by the certificate. In addition, the purchase and sale contract should provide that the seller will properly endorse and deliver the stock certificates at closing.

A deed purporting to convey all water rights appurtenant to a particular parcel of property has been held not to convey the water rights represented to a stock certificate that was not identified in the deed, even though the certificate provided that those water rights should be used on that property. *See Denver Joint Stock Land Bank v. Markham*, 107 P.2d 313, 315 (Colo. 1940).

When the share of stock is part of the security for the purchase price, both real property and personal property forms of perfection of a security interest should be followed. The holder of the security interest should take possession of the stock certificate to perfect the interest in the shares of stock, and should obtain a deed of trust that specifically mentions the water rights represented by the shares.

f. Special Considerations When Water Is Severed From Land

If water rights are conveyed separately from the land, special care must be taken to ensure that the physical access and other rights necessary for use and development of the water are also conveyed. For example, if the land is sold and underground water rights are reserved to the seller, an easement to access and operate existing wells and the right to drill new wells should be reserved. If water rights are purchased separately from the land on which they have been used, the buyer should also obtain a “dry-up covenant” from the seller, authorizing the buyer to dry up the land historically irrigated by the purchased rights. Typical provisions contained in a dry-up covenant include:

- i. Seller covenants that the water and water rights described in Attachment 1 hereto (the “Water Rights”) were historically used on the real property currently owned by Seller (the “Dry-Up Property”). Seller further covenants that the Water Rights shall not be used from this date forward in connection with the Dry-Up Property.
- ii. Seller has good and marketable title to the Dry-Up Property, free and clear of all liens, encumbrances, leases, contracts, assessments, charges, interests, and adverse claims, or has obtained the consent or subordination of any lienholder.
- iii. Seller further covenants to take those actions reasonably necessary to eliminate any use of the Water Rights on the Dry-Up Property.
- iv. Seller hereby represents that all diversion ditches formerly used to irrigate the Dry-Up Property have been removed and filled in.
- v. Seller further covenants that diversion from [name of creek] into the ditches associated with the Water Rights will be reduced in the amount attributable to the Water Rights, less any portion of the Water Rights required to remain in the ditch in order to provide carriage water or ditch loss or for other required purposes.

vi. Seller represents that the entire Dry-Up Property has been removed from irrigation by the Water Rights.

vii. This Dry-Up Covenant shall bind Seller, its heirs, successors and assigns and shall run with and burden the Dry-Up Property and shall run with and benefit the Water Rights.

viii. This Dry-Up Covenant may be assigned by Seller, in whole or in part. Upon such assignment by Seller to any party, that party shall have the right to enforce the terms of this Dry-Up Covenant against Seller or, if the Dry-Up Property has been conveyed by SFR to others, against the then current owner of the Dry-Up Property.

ix. This Dry-Up Covenant shall be recorded in the office of the County Clerk and Recorder where the Dry-Up Property is located.

3019545_2.DOC