

Comments of Kathleen Callison, Law Office of Kathleen Callison, on Ecology's Report on Water Trust Banking, and Transfers in Washington State (October 2020, Publication 20-11-091)

November 15, 2020

Summary of Comments

These comments are my own and do not reflect the opinions or positions of any client or clients.

The Washington State Constitution and other foundational laws of the state reflect the drafters' concern about the effect of the monopoly power of railroads on the economic wellbeing of farmers and the overall economy of the state. It is not a stretch to think that the control of mitigation water might have similar potential impacts on our state's economy in the future, including the agricultural economy, if not adequately regulated. Ecology's report, and the process leading up to it, were well done, seeking and incorporating input from a large number of participants. Because of Ecology's limited mandate, however, additional analysis is needed to support a comprehensive framework for the trust and banking program.

To achieve a balanced approach that addresses community needs and provide sufficient incentive to water right holders, investors, and water managers to participate in successful design and implementation of the trust and banking programs, Ecology's findings and recommendations should be incorporated into a broader assessment of incentives and disincentives for participation and investment, and constraints that may be necessary to ensure that community needs are met. Such a study might consider ways local land use plans and utility plans, financial and tax implications of investments, and the roles of local governments, quasi-governmental entities, and special purpose districts, in consultation with tribal, state and federal representatives.

I recently led teams to draft a geothermal law and regulation for Ethiopia., and I am currently providing comments on a guidance document for Ethiopia's geothermal program. At each successive level of drafting, discussion of a range of necessary elements to provide a comprehensive regulatory framework. Integrating Ecology's findings and recommendations into a broader assessment of the role of water trusts and banking could help communities fulfill land use and utility plans, and utilize institutions already in place in affected counties, and reduce risk for both developers and regulators.

Specific comments on the text of the report

P. 8 "Water right change" is defined as "synonymous with a water right transfer." Comment: A subtle point, but worth mentioning: A water right change generally relates to the regulatory process in RCW 90.03.380. A water right transfer may refer to the same regulatory process, or it may refer to the conveyance of a property interest from one person or entity to another.

P.8 Water right sales are not reported to Ecology. Comment: Conveyances of real property interests in water rights are, in theory, subject to real estate excise tax (REET). Reports could be provided to Ecology by Department of Revenue. If not implemented now, a process could be developed for future implementation.

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### BACKGROUND

#### **Water right sales and transfers**

P. 10 identifies water conservancy boards as mechanisms for water right change and transfer. Comment: This mechanism could be the institutional link between the community and Ecology in a future trust and banking program. Establishing conservancy boards where needed, and either recommending or requiring that they review proposed transfers associated with trusts or banks could strengthen the input of local communities. A link between the proposed transfer and county plans under the Growth Management Act could provide criteria for decisions about allocations or reservations for future use of water. Such a link was identified as a potential goal in a recent Ruckelshaus Center report.

#### **The Trust Water Rights Program**

Comment: P. 11 para 1, the word “tenet” is misspelled.

### FINDINGS

#### **Out-of-basin water right transfers**

P. 13, Section (4). Ecology states, “Economic realities may make it difficult for communities in headwater basins to compete in an open marketplace for available water rights. In these basins, long-term goals to reduce downstream and out of basin transfers may require outside or state level investment in local water banking programs or partnerships to level the playing field.” Comment: This statement assumes benefits of an open market. The need for restraints on the market should be considered as part of an economic assessment of alternative approaches.

#### **Water Banking**

p. 15. Section 18, The report identifies “shared concerns” that banks that “provide water to meet basic residential needs” gaining monopoly power and while other participants argued that even if monopolistic behavior can be worrisome, increasing regulation is not warranted” and that the solution “would be to reduce barriers to entry and increase competition.” Comment: Multiple entry to bankers may not be possible, for several reasons. In those circumstances, the natural tendency will be towards monopoly and increasing prices. Even in areas with multiple banks, mitigation water will not be fungible (like money in a bank), due to location. Prices may increase beyond the reach of governments and nonprofits.

### POLICY ANALYSIS

#### **Rewrite the Trust Water statutes (Chap 90.42 RCW) to clarify key terminology and create a cohesive framework for trust water and water banking. Page 18**

Comment: The report states, “These changes could help to reduce potential speculation and impairment of water rights... . However, increasing clarity could reduce flexibility for water right holders when their plans are uncertain.” Comment: A broader analysis would consider combinations of restrictions and incentives, such as payment terms, including payments over time, and tax issues, including capital gains, asset depreciation schedules, etc. This approach would identify incentives to speculate and laws, regulations or policies to reduce the likelihood of speculation.

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**Promote the use of conservation easement on water rights to limit their use to the basin of origin.**

Comment: This approach requires that entities will anticipate the need for future mitigation water and are willing to put money into drafting and recording easements. As demand increases, investments in easements could be seen as another investment vehicle. Holders of easements may release then to facilitate downstream users, in exchange for consideration . This eventuality should be considered.

**Make information on water right change applications more accessible to the public through administrative improvements.**

Comment: “Water bank service areas” are mentioned in this Section. A service area assumes a monopoly as well as a duty to serve. In cases where a service provider is providing a necessary service to a designated population or area, that provider is regulated. Given the limited number of water rights that ultimately will be on deposit in any bank, and the need for water in specific areas, a utility model should be considered.

**Develop an application form for prospective bankers in which they outline their proposed banking and operations plans.**

Comment: What are the criteria for granting operating rights by bank? How are costs to customers justified? These questions can be answered if a broader assessment of the financial and service requirements of banks are identified.

**Publically post draft water banking agreements and consider comments before finalizing water bank agreements.**

Comment: “Publicly” is misspelled.

Also, Ecology states, “It could create a scenario whereby tribes or other stakeholders press Ecology to require conditions for banking agreements that are outside Ecology’s current authorities.” Comment: A regulatory framework that clarifies expectations and requirements could reduce the likelihood of conflicts. A template for agreements could be based on that framework.

**Align disclosure laws for water right sales with the laws for land sales. Require that water right sales (including processes) are reported to the state and made publicly available.**

This section states that Ecology does not “necessarily” receive notice when a water right is sold.

Comment: There are two pathways that might be bolstered: 1. REET which in theory should receive notice of sale of vested water rights. Look at the tax code as a place to put brackets around speculative profits. 2. Land use applications. Oregon’s model would work for near-term or intermediate-term land use proposals but would not address deposits in trust when there is no plan for future development.

**Establish that before a water right may be sold for transfer out of the basin of origin, state, local, and tribal governments, and nonprofit are provided a “right of first refusal.”**

Comment: In order to secure a right of first refusal, communities and nonprofits need a justification to do so. Tying decisions to local planning goals could serve as the basis for making expenditure commitments.

IDEAS CONSIDERED BUT NOT RECOMMENDED

**Out of basin transfers**

**Authorize Ecology to “close” a basin to out-of-basin transfers through rulemaking**

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Ecology believes that “incentive and market-based solutions provide a more effective mechanism to keep water in a basin.” Comment: In order to establish incentives and market-based solutions, the state needs to understand market incentives. How are participants incentivized and how do they make decisions?

**Restrict the number of water rights that may be transferred out-of-basin from any one WRIA.**

Ecology states, “because the end goal would be preserving social and economic goals in the basin-of-origin, the allowable number of water rights would be subjective and not science-based. Comment: We do have tools to implement social and economic goals. Local governments already use best available science to identify the water needed to meet future goals.

**Water right sales**

**Limit who can buy a Washington water right to Washington residents and entities**

Ecology acknowledges that investors and entities could avoid limitations through loopholes and argues that land is not subject to such limitations. Comments: Land is not held in trust for the people. A more appropriate comparison might be limitations on use of *state lands*, which are held in trust for the benefit of the people. It would be useful to examine ways regulations of state lands might serve as a model for regulation and use of the people’s water resources.

**Require the reporting of any water right change or transfer to county commissioners**

Comment: The lack of a link with local officials could be avoided if the process involved a Board already appointed by a county commission (e.g., water conservancy board). Growth management goals and benchmarks could be used as decision-making criteria for the conservancy board to “connect the dots” between water needs and demands, water availability and community interests.

**Use of the TWRP**

**Limit use of the TWRP such that individuals who buy a water right must plan to put the water to beneficial use themselves**

Ecology states that a plan for future use of a water right placed in the TWRP “inherently constitutes putting the water right to beneficial use.” Comment: The existence of a plan without more cannot be considered to be equivalent to actual beneficial use under Western Water Law. Protecting water from relinquishment must be based on social or economic goals, likely requiring statutory changes.

**Restrict how long a temporarily donated water right may remain in trust**

Ecology states that implementing limits on the timeframe which a water right may remain in trust would incentivize waste because water right holders would use water simply as a means of preserving that water right. Comment: Time limits might be tied to local or regional planning goals.

**Limit the number of trust water rights that can be removed from trust in any given year**

Comment: Such limitations would only make sense if tied to planning and economic goals.

**Water banking**

**Amend chapter 90.42 RCW to establish that water banks must define their service area and have a “duty to serve” within that area**

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Ecology acknowledges that this approach could help ensure mitigation to all customers in a defined area, could prevent price discrimination and ensure that no customer is denied service; however, Ecology suggests that this approach would reduce competition and increase costs to consumers. Comment: There will be a natural tendency – if not immediately, over time – for banks to trend towards monopoly, especially as water is more limited and investors/bank operators will be in a position to demand higher prices.

### **Amend chapter 90.42 RCW to establish that Ecology may prioritize working on water banks that serve the greatest public need**

Ecology acknowledges the pressures to support domestic water use as a preferred beneficial use, which is currently contrary to the water code. Comment: This has been done in other states. If the framework for decision-making includes a broader set of criteria, Ecology's approval would not be seen as "choosing winners and losers", i.e., not endorsing specific beneficial uses.

### **Clarify in statute that Ecology may deny a proposal to establish a new water bank**

Ecology states that it does not need authority to enter into a banking agreement, but that "Ecology has not yet exercised this discretion, nor have we articulated the criteria upon which we would do so."

Ecology doesn't want to be seen as "picking winners and losers." Comment: In addition to a more robust legal and regulatory framework that accounts for financial, planning, tax and economic issues beyond Ecology's authority, a process is needed for consultation between local, state, federal and tribal representatives.

### Summary of my comments

Ecology has done an excellent job carrying out a series of workshops and publishing findings and recommendations for trust and banking programs to support water management. Given the increasing demand for water in the future and climate change resulting in changed patterns of water availability, additional analysis of finance, tax, land use and other considerations will ensure that program design and implementation incentivizes participation while protecting the public's interest in water resources.