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WATER RIGHTS TITLE INSURANCE: CURE FOR DUSTY BOOKS AND RICKETY LADDERS?

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Abstract: Water rights title insurance is becoming a hot topic in Colorado water rights transactions. However, the jury is still out as to whether it will gain traction as a useful tool in conveying water rights. This article provides an update to an article previously published in the University of Denver Water Law Review. See Amy W. Beatie & Arthur R. Kleven, The Devil in the Details: Water Rights and Title Insurance, 7 U. Denv. Water L. Rev. 381 (2004).

I. INTRODUCTION

Establishing a chain of title for water rights is a significant part of a water rights due diligence analysis.[1] The process typically involves reviewing recorded documents in the Clerk and Recorder's Office of the county in which the water rights are located. Every time I have had to conduct a water rights title analysis, however, I think to myself that there has to be a more civilized way to establish and review the chain. This feeling was particularly acute after spending two days in the Jackson County Clerk and Recorder's Office in Walden, Colorado, on an ancient, rickety, wooden step-ladder, poring over volume after volume of dusty old Grantor/Grantee indices that made me sneeze. I mean really sneeze.

Around the time I was wading through the title documents in Walden, rumors had been circulating that the title insurance industry was considering providing water rights title insurance. I dismissed the idea

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1. *See* Amy W. Beatie & Arthur R. Kleven, *The Devil in the Details: Water Rights and Title Insurance*, 7 U. DENV. WATER L. REV. 381, 383 (2004) (providing information about what is involved in a water rights due diligence analysis).

out of hand, assuming there were too many problems with the process, only some of which were:

- The tremendous initial effort to compile information into a water rights title plant or a similar document bank could not be easily balanced by appropriate premiums that people would be willing to pay;

- Title insurance for land depends largely on repeat business (e.g., providing title insurance for well-churned subdivisions), and the conveyance of a water right is never so formulaic or frequent. Water rights are seldom sold, and they are almost never immediately resold. Thus, it would be difficult to create a market for the product;

- A water right chain of title is rarely if ever clean because, among other reasons, it is extremely difficult to determine the original appropriator from which the chain commences as there is generally no recorded document similar to the patent for land title. A water right is created by appropriation, the conjunction of intent and action by one or more individuals. This is usually an unrecorded and undocumented act. As a result, the industry would always be insuring over clouded titles; and

- Water rights title insurance could only cover "naked legal title," which is of little value in the context of water rights, especially in the change context. After all, a water right is a usufruct, and its value is related solely to its reliability as such. Thus, in addition to obtaining insurance for just the legal title, a water right purchaser would still need a lawyer and engineer to review the historical use of the water right and other associated issues (including, perhaps, reviewing the title documents themselves, which procurement of title insurance alone would not provide).

Given those problems and others, I didn't believe the insurance would provide much value. But, still curious, I began researching. Could water rights title insurance obviate at least the rickety ladders, the hours poring over blinding microfiche, the sneezing, and the cold, dark vaults in the basements of county buildings? Would the industry be able to create reasonable exceptions to a water right title insurance policy without rendering the insurance meaningless with those exceptions?

While researching, I contacted a company that was marketing the insurance to see if it would provide a sample policy to review; I was unable to obtain one. Without that benefit, I could only guess what the industry might include as exceptions, how it would conduct the chain

of title research, and what the cost of the insurance would be. The result of the research was this: in addition to confirming the problems identified above, the research indicated that the industry would have to confront other factors before water right title insurance would become as commonplace (and useful) as real estate title insurance.[2]

II. THE POLICY

Then it happened. I was involved in a real estate transaction for the seller of property in Pitkin County with water rights for sale as part of the transaction. Lo and behold, the buyer requested title insurance for the water rights. At last, my opportunity to see a policy! Once the title commitment arrived, I went straight to the exceptions and there it was, the anticipated exception,[3] eleven subsections long:

> Loss or damages arising from (a) a future action to adjudicate water rights as provided for in Colorado Revised Statutes §§ 37-92-101, et seq., as amended; (b) use of waters (including historical use, actual use, type of use, location of use or diversion, or partial or total forfeiture due to non-use since the Division [] Engineer Abandonment list dated _____); (c) terms and conditions of the decree; (d) adverse or prescriptive use or claims against the waters; (e) any reservations of rights by the United States of America, and rights created by federal claims, and any prior rights held by another state, territory, sovereign tribe, nation or country obtained by appropriation, treaty, compact, legislation or otherwise; (f) local, state or federal laws or regulations; (g) future administrative action by the State Engineer/Division of Water [Resources]; (h) lack of right of access to or transport from the point of diversion and/or well bores and drilling of wells; (i) any consequence of the insured not having right, title, or interest in the historic place of use or the place of use as set out on the decree; (j) lack of priority of the water right and/or that the water right will be in priority to be diverted at all times; and (k) lack of physical availability or existence of water.

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2. *See id.* at 402-06 (detailing the conclusions from the research).

3. This article focuses only on the standard water-related exceptions; obviously, each transaction will have its own specific exceptions which may or may not be objectionable. Although unrelated to this article, it is important to note that the commitment contained a perplexing exception. It read: "Terms, conditions, provisions, and obligations contained in the conveyance document dated _____ and recorded on _____ at Reception No. _____ in _____County." The title company explained this to mean that it was excepting from coverage the very document that would convey the water right to the buyer. A mighty mission, albeit successful, ensued to have that exception removed.

III. THE EXCEPTIONS

At first, I thought the eleven sub-exceptions collectively were big enough to drive a truck through, and so broad they did indeed swallow the effectiveness of the insurance. However, upon more extensive consideration, they began to seem reasonable. The lettered sub-exceptions fell into one of three categories: (1) excepting water use issues, not title-related issues; (2) excepting water rights administration issues, not title issues; or (3) excepting title issues common to all title insurance.

Exception (a), excepting from coverage "a future action to adjudicate water rights," simply recognizes there is no feasible way an insurer of water rights could cover the effect of future water litigation. The exception does not except from coverage a quiet title action, a cause of action that would not be governed by Colorado water statutes, and the jurisdiction of which would be in the district court, not water court. A quiet title proceeding would be the exact kind of proceeding for which the title insurance would prove invaluable. As a result, sub-exception (a) is reasonable.

Exception (b), excepting from coverage "use of waters" is also reasonable. The parenthetical explanation of "use of waters" contained in Exception (b) relates to information to be obtained, not in a title analysis, but by the purchaser's engineers. A title company should not and could not entertain those technical analyses. This exception relates to how the right is used, not who owns it.

Exception (c) excepts "terms and conditions of the decree." Again, this exception relates to use, not ownership. It is analogous to a title company's exclusion of zoning and covenants from a land policy. The exception serves as a reminder that an attorney conducting a potential purchaser's water rights due diligence analysis must carefully review terms and conditions in decrees relating to the water right at issue in the transaction and clearly communicate their effects to the potential purchaser.

Exception (d), which excludes from coverage "adverse or prescriptive use or claims against the waters," simply provides that the insurer cannot insure against actions that cannot be discovered by recorded documents, or even a physical inspection, at the time of the conveyance. This exception is common to land policies, and is perfectly reasonable as applied to water rights. Recognizing that adverse possession of land is a tricky area of conveyancing, I believe it is even trickier in the water rights context.

Exception (e) excepts from coverage claims whose effects would manifest within the priority system. As a result, it is unrelated to title. By excluding the kinds of claims excluded in Exception (e), it is again clear that the policy covers title alone. Because title insurance only

insures "naked legal title" and not yield, excepting from coverage the Exception (e) types of claims is reasonable.

Exception (f), the exclusion from coverage of "local, state or federal laws or regulations," is vague, but is likely intended to except from coverage the effect of laws or regulations that are analogous to zoning, and any other laws or regulations that affect the use of the water right, not its title. In doing so, it also appears reasonable.

By excluding from coverage "future administrative action," Exception (g), similar to Exceptions (b) and (c), addresses use, not title. Injury from future administrative action would be speculative to insure at best, unless it relates to the policy holder's title to the water right. Again, the exception is reasonable.

Exception (h) excludes from coverage injury from "lack of right of access to or transport from the point of diversion and/or well bores and drilling of wells." Access is not a title issue. However, it is likely the insurer could include access as part of the policy, if so desired. I am sure it would add to the premium.

Exception (i), which excludes "any consequence of the insured not having right, title, or interest in the historic place of use or the place of use as set out on the decree," is also related to water use, specifically the place of use. Whether the water has been used at its decreed place of use, and whether the purchaser of the water right has title to or an interest in that property is a matter for the attorney and the engineer to determine, not the title company.

Exceptions (j) and (k), "lack of priority of the water right and/or that the water right will be in priority to be diverted at all times" and "lack of physical availability or existence of water" are administrative and use issues. Again, they are unrelated to title and as such are reasonable exclusions.

Really, then, each sub-exception is reasonable. Notwithstanding, I could not help but be disappointed. The disappointment stemmed from the realization that the insurance indeed only insured "naked legal title." Remembering that researching chain of title is only one aspect of a water right due diligence analysis, it is clear that the insurer was careful to limit its coverage to that aspect. I remain unsure of what else I expected the insurance to accomplish, but believe the disappointment stemmed from a desire—perhaps unreasonable—that water rights title insurance would contribute something more to the due diligence process.

And, in addition to my disappointment, unreasonable or not, I had many lingering questions. Would the industry insure over irregularities, nearly universal in a water rights chain of title? What about circumstances in the chain of title in which the water rights passed as an appurtenance to property? Would the industry be able to divine the intent of the grantor under those circumstances? How would the in-

dustry conduct its research? Given the unique nature of water rights, what would trigger the insurer's duty to defend?

The most important lingering question to me, however, is this: if the exceptions except all aspects of use from coverage, what does the insurance insure in practical effect? After all, a Colorado water right is defined as "a right to use in accordance with its priority a certain portion of the waters of the state by reason of the appropriation of the same."[4] Take, for example, the following scenario. Seller conveys to Buyer 1 cubic foot per second ("cfs") in a particular ditch, and the Buyer obtains a title policy for the 1 cfs. The conveyance is recorded. Three days later, the Seller conveys the historic consumptive use (e.g. irrigated acreage) associated with the same 1 cfs just sold to the Buyer to someone else. Because the title policy does not cover issues associated with use, only naked legal title, would the policy protect the Buyer?

IV. THINKING OUTSIDE THE BOX

With the lingering, unanswered questions, I remained uncertain about whether water rights title insurance provided value to the due diligence process. Would I suggest it to a client, or agree to use it if a client requested it? I needed answers; the need got me thinking. The exceptions seem to be clearly derived from lessons the insurance industry has learned in dealing with land. However, as explained in the example above, the principles that apply to water and land transactions are not fungible. What if the industry approached water rights from "outside the box"? In other words, what if it created a product that was as different from land title insurance as a water right conveyance is from land conveyance? What if that product were not title insurance at all? What if the role the industry served was document collection, similar to creation of an abstract of title, allowing instead for the attorneys to draw the conclusions about the viability of the chain of title. The attorney would no longer have to conduct the from-scratch research that water rights title assessment requires—the travel to county recording offices, the up and down the step ladders, the pouring over the dusty Grantor/Grantee indices, the endless hours of whizzing microfiche—but would still be able to obtain all the necessary documentation.

V. CANVASSING

Uncertain about the abstract of title idea, and about my conclusions about the usefulness of water rights title insurance, I engaged in a "process," a decision-making-by-committee if you will. The process

4. COLO. REV. STAT. § 37-92-103(12) (2006) (emphasis added).

involved canvassing water attorneys well-seasoned in conducting water transactions to obtain their opinions on water rights title insurance. When asked about the insurance, each attorney agreed that the insurance was useful only to insure naked legal title, and conceded that determining marketability of title is only one aspect of the water rights due diligence process. Each also agreed that the circumstances would be unusual in which the due diligence analysis did not necessitate consulting title documents for purposes unrelated to title and that by obtaining a title insurance policy, the attorney would not have immediate access to those documents. Each of the attorneys also agreed that obtaining a collection of documents similar to an abstract of title would be valuable, if obtaining the product would not cost any more than having someone in-house conduct the document collection, and if they could trust someone outside their own offices to obtain all of the relevant documents.

Notwithstanding these concessions, several of the attorneys I consulted had used title insurance in water transactions. Themes emerged from their decisions to do so. In each case, cost was the primary motivator. The title company had offered a policy ranging from somewhat to significantly less expensive than their estimate for the cost of a stand up Grantor/Grantee search. Convenience was another motivator. And still another was the nature of entities involved in the transaction; an east coast lender, for example, may be so accustomed to land title insurance policies that the purchase of real property, no matter what kind, without title insurance, might seem ludicrous. Indeed, that was the case with one of the transactions discussed. To be sure, there are still questions; time will answer them. Even so, water attorneys are beginning to give the title insurance a try. The result of the canvassing: the jury is still out.

VI. CONCLUSION

I still find the stand up Grantor/Grantee searches for piecing together a water right chain of title a bit uncivilized and I learned in my research that others do, too. An attorney friend of mine spent two days in an unheated vault in the basement of a county building during the winter wearing a hat, coat, and gloves while viewing microfiche under a single bare light bulb. My experiences, although less medieval, are always unique. And while I hope the rickety step-ladders and dusty Grantor/Grantee indices are things of my past, my research and canvassing indicate that water rights title insurance may not be the panacea I had originally hoped it would be. So as of now it looks as though, under most circumstances, I am heading back to the ladders and the sneezing.