Water Law Review

Volume 3 | Issue 1 Article 12

9-1-1999

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COMMENTARY

THE COLORADO SUPREME COURT ADDRESSES REASONABLE DILIGENCE IN THE CONTINUATION OF A CONDITIONAL WATER RIGHT

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I. INTRODUCTION

In its recent decision of *Municipal Subdistrict, Northern Colorado Water Conservancy District v. Chevron Shale Oil Co.*, the Colorado Supreme Court addressed the law with respect to reasonable diligence in the continuation of a conditional water right.[1]

The Subdistrict appealed the water court's finding of reasonable diligence in Chevron's development of its conditional water rights. Chevron's rights related to its shale oil project in Western Colorado. The conditional water rights originated in the early 1950s, which Chevron had appropriated to three structures for use in proposed pumping plants and pipelines.

The Subdistrict claimed that Chevron did not demonstrate reasonable diligence in the development of its rights. It further claimed that Chevron's intent to hold the rights for over 100 years without development amounted to unlawful speculation in conditional water rights.

II. BACKGROUND

Under Colorado's Prior Appropriation Doctrine, one may receive a decree for a conditional water right before actually applying water to

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1. Municipal Subdistrict, N. Colo. Water Conservancy Dist. v. Chevron Shale Oil Co., 986 P.2d 918, 920 (Colo. 1999) (hereinafter Municipal District).

beneficial use. A conditional water right is "a right to perfect a water right with a certain priority upon the completion with reasonable diligence of the appropriation upon which such water right is . . . based."[2] The primary value of a conditional right is that "a prospective water user may reserve its place in line in the priority system by seeking a conditional decree, provided that the user demonstrates to the water court that the water can and will be put to beneficial use within a reasonable time."[3]

The public policy surrounding a conditional right is to "encourage the pursuit of projects designed to place waters of the state to beneficial uses by reserving an antedated priority, in light of the necessity to obtain and complete financing, engineering, and the construction of works that will capture, possess, or otherwise control the water."[4] By design, a conditional right fulfills the "fundamental policy underlying Colorado's water law favoring the most beneficial use of the state's limited water supply."[5] However, to allow, an applicant to "maintain its conditional appropriation indefinitely and without progress would frustrate that fundamental policy."[6] Therefore, public policy limits a conditional right against the speculative hoarding of a water right.

"Accumulation of conditional water rights is subject to Colorado's anti-speculation doctrine."[7] To avoid speculation, the water court may not recognize an appropriation if the "purported appropriator of record does not have a specific plan and intent to divert, store, or otherwise capture, possess, and control a specific quantity of water for specific beneficial uses."[8]

Colorado River Water Conservation District v. Vidler Tunnel Water Co.[9] is the seminal case defining Colorado's anti-speculation doctrine.[10] The *Vidler* court noted that Colorado law gives:

> no one the right to preempt the development potential of water for the anticipated future use of others not in privity of contract, or in any agency relationship, with the developer regarding that use. To recognize conditional decrees grounded on no interest beyond a desire to obtain water for sale would as a practical matter discourage those who have need and use for the water from developing it.[11]

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2. COLO. REV. STAT. § 37-92-103(6) (1999).
3. Dallas Creek Water Co. v. Huey, 933 P.2d 27, 35 (Colo. 1997).
4. *Id.*
5. Trans-County Water Inc. v. Central Colo. Water Conservancy Dist., 727 P.2d 60, 65 (Colo. 1986).
6. *Id.*
7. *Dallas Creek*, 933 P.2d at 36.
8. COLO. REV. STAT. § 37-92-103(3)(a)(II) (1999); Act of July 6, 1979, § 5, ch. 346, 1979 Colo. Sess. Laws 1366, 1368.
9. Colorado River Water Conservation Dist. v. Vidler Tunnel Water Co., 594 P.2d 566 (Colo. 1979).
10. City of Thornton v. Bijou Irrigation Co., 926 P.2d 1, 37 (Colo. 1996).
11. *Vidler*, 594 P.2d at 568.

The Colorado legislature codified the anti-speculative holding of *Vidler* in the statutory definition of an "appropriation." An appropriation does not "occur when the proposed appropriation is based upon the speculative sale or transfer of the appropriative rights to persons not parties to the proposed appropriation."[12] Speculative sale or transfer may be shown when the:

> purported appropriator . . . does not have either a legally vested interest or a reasonable expectation of procuring such interest in the lands or facilities to be served by such appropriation, unless such appropriator is a governmental agency or an agent in fact for the persons proposed to be benefited by such appropriation [or if the appropriator] does not have a specific plan and intent to . . . [put] a specific quantity of water [to] specific beneficial use[].[13]

Successful challenges grounded on the anti-speculation doctrine have succeeded where the non-governmental applicant did not show that it intended to put the water to beneficial use for its own purposes.[14] Challenges have also succeeded where the private appropriator did not require the water for use on its own lands that it owned or leased and where they had no contractual commitment with any governmental entity to use the water.[15]

The anti-speculation doctrine does not on its face seem to deny the right to hold a conditional water right for specific use in a specific quantity by the appropriator so long as an intent exists to place the water to use within an indeterminate time. Instead, conditional rights are made "subject to continued scrutiny to prevent the hoarding of priorities 'to the detriment of those seeking to apply the state's water beneficially.' "[16]

To fulfill and balance the twin goals of encouraging large water projects while also preventing hoarding, Colorado law requires that in:

> every sixth calendar year after the calendar year in which a water right is conditionally decreed, . . . the owner or user thereof, if such owner or user desires to maintain the same, shall file an application for a finding of reasonable diligence, or said conditional water right shall be considered abandoned.[17]

"[A] reasonable diligence proceeding tests whether the decreed conditional appropriation is being effectively pursued in a manner

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12. COLO. REV. STAT. § 37-92-103(3)(a) (1999).

13. *Id.* § 37-92-103(3)(a)(I)-(II).

14. *See* Rocky Mtn. Power Co. v. Colorado River Water Conservation Dist., 646 P.2d 383, 388 (Colo. 1982).

15. Lionelle v. Southeastern Colo. Water Conservancy Dist., 676 P.2d 1162, 1169 (Colo. 1984).

16. Dallas Creek Water Co. v. Huey, 933 P.2d 27, 35 (Colo. 1997) (quoting Trans-County Water, Inc. v. Central Colo. Water Conservancy Dist., 727 P.2d 60, 65 (Colo. 1986)).

17. COLO. REV. STAT. § 37-92-301(4)(a)(I) (1999).

calculated to complete that appropriation."[18] Colorado courts have further justified and heightened the required scrutiny of a conditional water right by finding that " '[t]he doctrine of relation back is a legal fiction in derogation of the Constitution for the benefit of claimants under larger and more difficult projects and should be strictly construed.' "[19]

The burden of proof of diligence rests with the holder of the conditional right, and thus, "[t]he applicant has the burden of proving reasonable diligence by a preponderance of the evidence."[20] The water court's findings as to meeting the burden of proving diligence is "binding on appeal where . . . there is competent evidence to support those findings."[21]

The statutory standard by which the water court must measure reasonable diligence is:

> the *steady* application of effort to complete the appropriation in a *reasonably* expedient and efficient manner under all the facts and circumstances. When a project or integrated system is comprised of several features, work on one feature of the project or system shall be considered in finding that reasonable diligence has been shown in the development of water rights for all features of the entire project or system. . . . [C]urrent economic conditions beyond the control of the applicant which adversely affect the feasibility of perfecting a conditional water right . . . shall [not] be considered sufficient to deny a diligence application, so long as other facts and circumstances which show diligence are present.[22]

The Colorado legislature amended this standard in 1990. Prior to 1990, the statute required an applicant to show "*continuous* project specific effort . . . in the *most* expedient and efficient manner."[23] The amended section has arguably relaxed the standard for a finding of reasonable diligence.

The Colorado Supreme Court has approved and applied various narrative standards to aid in the determination of reasonable diligence. "[T]he applicant must prove that it has the intent to use the water and has performed concrete actions demonstrating diligent efforts to finalize its appropriation."[24] To show diligent efforts the applicant must "prove continuous, project–specific effort directed toward the development of the conditional right commensurate with

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18. *Dallas Creek*, 933 P.2d at 36.

19. *Id.* at 35 (quoting City & County of Denver v. Northern Colo. Water Conservancy Dist., 276 P.2d 992, 1001 (Colo. 1954)).

20. Talco, Ltd. v. Danielson, 769 P.2d 468, 472 (Colo. 1989).

21. Vail Valley Consolidated Water Dist. v. City of Aurora, 731 P.2d 665, 670 (Colo. 1987).

22. COLO. REV. STAT. § 37-92-301(4)(b), (c) (1999) (emphasis added).

23. Act of Apr. 13, 1990, § 1, ch. 269, 1990 Colo. Sess. Laws 1625, 1625-26 (emphasis added). *See also* Upper Gunnison River Water Conservancy Dist. v. Board of County Comm'rs, 841 P.2d 1061, 1064 n.7 (Colo. 1992).

24. Dallas Creek Water Co. v. Huey, 933 P.2d 27, 36 (Colo. 1997).

his capabilities."[25] The water court should consider the "totality of the circumstances"[26] in making its determination. Thus, the "determination of diligence can only be made on a case–by–case basis after considering all of the facts and circumstances relating to the development of each particular project."[27]

The considerations may include, but are not limited to:

> (1) economic feasibility; (2) the status of requisite permit applications and other required approvals; (3) expenditures made to develop the appropriation; (4) the ongoing conduct of engineering and environmental studies; (5) the design and construction of facilities; and (6) the nature and extent of land holdings and contracts demonstrating the water demand and beneficial uses which the conditional right is to serve when perfected.[28]

Other factors which the Colorado Supreme Court has found persuasive include: "the size and complexity of [the] project; the extent of the construction season; the availability of materials, labor, and equipment; the economic ability of the claimant; and the intervention of outside delaying factors such as wars, strikes, and litigation."[29] If "a project is comprised of several features, work on one feature can be considered in determining whether reasonable diligence has been shown in the development of water rights for all features."[30] "Actual good faith work on the overall facilities necessary to consummate the ultimate goal is a part of the diligence required to continue the conditional decree."[31]

III. CURRENT CASE

In *Municipal Subdistrict,* the Subdistrict claimed that the water court erred on three issues in its finding that Chevron demonstrated reasonable diligence. First, the court erred by not imposing a more stringent standard of reasonable diligence as a conditional water right ages.[32] Second, the Subdistrict argued that Chevron's past efforts had not resulted in any actual progress towards the perfection of its conditional water rights.[33] Third, the Subdistrict claimed that Chevron's participation in a joint venture with two other oil companies retarded Chevron's progress towards the perfection of its own

25. *Id.*

26. *Id.*

27. Colorado River Water Conservation Dist. v. City & County of Denver, 640 P.2d 1139, 1141 (Colo. 1982).

28. *Dallas Creek,* 933 P.2d at 36.

29. *City & County of Denver,* 640 P.2d at 1142 (citing Colorado River Water Conservation Dist. v. Twin Lakes Reservoir & Canal Co., 468 P.2d 853, 856 (Colo. 1970)).

30. Dallas Creek Water Co. v. Huey, 933 P.2d 27, 36 (Colo. 1997).

31. City of Lafayette v. New Anderson Ditch Co., 962 P.2d 955, 961 (Colo. 1998).

32. Municipal Subdistrict, N. Colo. Water Conservancy Dist. v. Chevron Shale Oil Co., 986 P.2d 918, 921 (Colo. 1999).

33. *Id.* at 922.

conditional water rights.[34]

The Colorado Supreme Court held that, contrary to the Subdistrict's claims, competent evidence supported the water court's findings of reasonable diligence.[35]

The water court found that Chevron had pursued activities in seven categories satisfying the reasonable diligence requirement. These included: (1) planning a diversion facility; (2) planning a dam; (3) planning pipeline facilities; (4) preparing environmental baseline studies; (5) preparing a detailed master plan; (6) participating in activities related to the conditional rights such as litigation, research, and studies; and (7) continuing basic research into oil shale production technology.[36] The Subdistrict challenged only the accuracy of the seventh category.

The Subdistrict based its primary challenge of the diligence finding on the grounds that Chevron had not demonstrated the "steady application of effort to complete the appropriation in a reasonably expedient and efficient manner."[37] The Subdistrict claimed that Chevron's efforts had not been continuous, and alleged that Chevron had decided to defer its oil shale project until 2085.

The supreme court agreed with the water court that although "the production of oil shale is currently not feasible, Chevron's efforts, although minimal, were sufficient to demonstrate a steady application of effort to complete the appropriation in a reasonably expedient and efficient manner."[38] By so finding, the court held that it was not improper for the water court to consider the current economic conditions of the shale industry in a determination of reasonable diligence.[39]

Because the issues were not properly raised before the water court, the supreme court declined to address the question of whether the anti-speculation doctrine applies in a diligence proceeding or whether postponement of perfecting the rights until 2085 violated anti-speculation.[40]

IV. IMPLICATIONS OF THE CASE

The economic feasibility of the oil shale industry always seems to lie just around the corner of the next oil shortage. Even with oil prices near $40/bbl. during the early 1980s, the industry only made economic sense based on a continued increase in oil prices. Since the current economic unfeasibility of the oil shale industry is not sufficient to deny a diligence application, it would seem this must be coupled

34. *Id.*
35. *Id.* at 924.
36. *Id.* at 921.
37. *Id.* (citing COLO. REV. STAT. § 37-92-301(4)(b) (1999)).
38. Municipal Subdistrict, N. Colo. Water Conservancy Dist. v. Chevron Shale Oil Co., 986 P.2d 918, 923 (Colo. 1999).
39. *Id.* at 923-24.
40. *Id.* at 923.

with a requirement of stricter proof that as the conditional right ages the appropriator will place the water to beneficial use within a reasonable time. To not require this eliminates one of the primary purposes of sextennial reasonable diligence findings: prevention of hoarding of junior priority dates to the detriment of those who can and will place waters of the state to more immediate beneficial use. In essence, the people of Colorado are allowing senior priority rights to the waters of the state to be held and invested by the oil shale industry without the promise of any future return.

Municipal Subdistrict also raises questions as to whether the codification of *Vidler* went far enough in preventing long term hoarding of conditional water rights. *Vidler* was limited by its facts to speculation based on the sale of water rights to other parties. It did not address the issue of whether hoarding of a right by an entity for its own use far in the future falls within the anti–speculation doctrine. By codifying the holding of *Vidler*, the state legislature essentially exempted such hoarding from the doctrine. To allow a non–governmental entity to hold such a right would seem to frustrate the fundamental policy of Colorado water law, which favors the development of the current beneficial use of the state's scarce water resources.

Under the *Municipal Subdistrict* holding, a junior absolute right may, if the senior conditional right is eventually perfected, find itself unable to divert more than a century after it has placed water to beneficial use. As *Vidler* stated, this will, as a practical matter, discourage those who have current uses of water from developing rights junior to the senior conditional right.

Because of the arguably loosened standards applied in today's diligence proceedings, the water courts seem much less likely to find a lack of diligence in the development of a conditional right. Today's diligence proceedings will not serve their proper function of balancing between the potential hoarding of water priorities and reasonable development. This seems contrary to the finding that the doctrine of relation back is a legal fiction in derogation of the state Constitution that should be strictly construed.

The supreme court reasonably interpreted the statutory provisions relating to reasonable diligence. Had the Subdistrict properly presented the speculation issues before the court, the supreme court probably also would have found that Chevron had not violated the anti–speculation doctrine as codified. Instead, the legislature must address these issues. For the legislature to fail to clarify the proper balance between the anti–speculation doctrine and reasonable diligence proceedings will lead to the inefficient allocation of the waters of the state.