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BY EMAIL ONLY

August 21, 2013

Tina Cannon Leahy
Principal Consultant
California State Assembly
Committee on Water, Parks and Wildlife
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**RE: Water Bond Working Group
Voluntary Water Transfers with Environmental and Instream Benefits**

Dear Tina,

I am writing to ask the Water Bond Working Group to create a placeholder and consider setting aside \$150 million for voluntary water transactions in the draft 2013 Water Bond Framework under Section VI, which addresses "Protecting Rivers, Lakes, Streams and Watersheds (\$1B)."

Voluntary Water Transactions Rationale: Voluntary transactions - water right acquisition, temporary lease agreements, and donations - are a strategic alternative and complement to regulatory action.

These voluntary instream water transactions seek to increase instream flows to create new levels of ecological resilience primarily in small streams and tributaries that have volume, temperature, and other stressors to fish and wildlife. These transactions take on more importance in anticipation of potentially greater future systemic volatility - such as flood and drought - associated with climate change. Indeed, in a "critically dry" year, California's fish and rivers need more water, *however* it gets instream.

California Opportunity: In 1991, California passed Water Code Section 1707, which allows water right holders to voluntarily transfer all or part of their water right to instream use for the benefit of fish or wildlife. These "1707 transfers" are a significant departure from the past, when California water law required water rights to be diverted and applied to *consumptive use* to be considered valid property rights, e.g. "Use it or lose it." A water right can now be used instream and not lost or forfeited.

Although "1707" is potentially transformative in that it provides a non-regulatory approach to help solve water issues in California, it has only been applied a few dozen times in the past twenty years. Reasons for such limited application of Section 1707 include: **lack of consistent funding mechanism to support water transfers**, lack of water transfer guidance documentation, lengthy and costly transfer processes, and uncertainty and inconsistency in regulatory permitting.

In 1998, Resource Renewal Institute (RRI) acquired – and still holds – a water right to 5.0 cubic feet per second permanently transferred instream for a reasonable and beneficial fish and wildlife

use to California's Butte Creek, a Sacramento River tributary supporting salmon. Today, public interest organizations and private parties are increasingly looking to Section 1707 to tackle instream flow challenges across the state.

Federal Tax Deductions: In recent years, I have represented a number of public interest clients to advance the issue of instream flows through voluntary water transfers, prominently including advocacy to affirm the federal tax deductibility of water right donations. Such a tax incentive would be analogous to land donations made through conservation easements - a tool that has led to millions of acres saved in its four decades of use.

An affirmative Revenue Ruling by the Internal Revenue Service will effectively expand federal funding and improve the tools available for conservation. The most likely implementation of this tax deduction will be in bargain sale transactions that have both cash and donative components, e.g. 75%-25%. Formal clarity from the IRS regarding federal tax deductions for water right donations will reduce donor uncertainty and will provide a new opportunity for land and water trusts in California and throughout the west to enhance and protect instream flows in rivers.

My related analysis of California voluntary instream water transactions (acquisition, lease, and donation) concluded: (1) the future impact of water right donations in California was fundamentally linked to the categorical success of all instream water transfers, and (2) California was considerably lagging behind regional states' administration of instream transfers.

Due Diligence and Coordination: Since 2010, a growing number of California land trusts and specialized instream water transfer organizations ("California Instream Transfer Organizations") have coordinated to protect and enhance instream flows through voluntary water transfers and transactions. While "Water Trusts" already exist in Oregon, Washington, Montana, and Colorado, California is too big for one statewide entity to be effective locally. California Instream Transfer Organizations are geographically positioned in local communities with the most significant potential to convert *reduced consumptive water use* to instream flow.

Through August 2013, these California Instream Transfer Organizations have collaborated to address inconsistent state and federal instream water transfer policies. Important policy focus and momentum has been established through an initial scoping meeting (March 2011) and three subsequent "Instream Water Transfer Briefings" (January and September 2012, and April 2013) all held in Sacramento. These well-attended briefings have directly engaged all relevant state and federal agencies, as well as varied California water interests.

To date, these California Instream Transfer Organizations have informally engaged these state and federal agencies:

- *State Water Resource Control Board*
- *Department of Fish & Wildlife*
- *Department of Water Resources, Water Transfers Program*
- *Department of Conservation*
- *U.S. Fish & Wildlife Service*

- *U.S. Bureau of Reclamation*
- Others

While not yet formalized, the contours of a *California Instream Water Transfers Working Group* comprised of California Instream Transfer Organizations, state and federal agencies, and other water interests is moving forward. These public agencies increasingly recognize the need for an ongoing and dedicated policy collaboration related to instream water transfers.

Importantly, there is a current proposal circulating for a Department of Interior-funded *Central Valley Water Transactions Program*. This could directly help fund California voluntary water right transactions and instream transfers much like the *Columbia Basin Water Transactions Program* in the Pacific Northwest. The potential emergence of a dedicated DOI, Department of Commerce, or ***other state or municipal sources of funding*** will be the single most important development to advance California instream water transactions.

The Public Policy Institute of California's recent *California's Water Market, By the Numbers: Update 2012* and *Managing California's Water: From Conflict to Reconciliation* both reinforce the timeliness and premise of environmental water transactions. **See Addenda below.**

Use of Bond Funds: California Instream Transfer Organizations with applicable expertise will provide direct and cost-effective water transaction and instream transfer support services and technical assistance (legal, policy, engineering, hydrological modeling, scientific) to land trusts, Resource Conservation Districts, and other organizations or individuals who are planning or in the process of implementing 1707 transfers or other instream transfers such as temporary forbearance agreements within California. Specific assistance will include water rights evaluation, flow monitoring program guidance, field monitoring training, and petition and permitting assistance.

Similar instream water right transactions in the Pacific Northwest, Nevada, and Northern California, combine fee interest and water right transactions that can range from a few hundred thousand dollars, e.g. temporary 1-year lease, to \$8-\$15 million dollars for permanent transactions involving the most senior and reliable water rights needed most in critically dry year conditions.

California Conclusion: In the past few years, there has been a growing convergence of independent and coordinated efforts related to California water right transactions and instream water transfers. These and many other pieces are cumulatively poised for a breakthrough along the lines of a "California Trust Waters Program" (modeled on Washington State's Trust Waters Program), which will significantly advance the statewide impact of voluntary instream transactions and transfers. Dedicated state and federal funding is the single most important component needed to advance the promise of this emerging conservation strategy.

California Instream Transfer Organizations are already engaged in compensated reallocations of water from agriculture to environmental flows through projects on coastal streams, Klamath

tributaries, and Upper Sacramento River and Sierra tributaries. These projects involve smaller rates and volumes of water and have already proven that water markets can make an appreciable instream flow difference, especially in late summer months with reduced flows and increased water temperatures.

While regulatory enforcement to achieve instream objectives has been and will remain an important strategy to achieve increased instream flows, voluntary transfers are an emerging alternative approach to achieve the same environmental outcome.

Indeed, in April 2013 at the Anne Schneider Memorial Lecture in Sacramento, Prof. Joseph Sax pronounced in his keynote address that Public Trust Doctrine outcomes can be achieved through voluntary "acquisition" and "buying" of water rights, not just through involuntary reallocation without compensation.

California is a transformative window of opportunity to make these instream transactions work. In many respects, "Environmentalism 2.0" is being gradually reconsidered through environmental transactions and ecosystem services, which define "Environmentalism 3.0."

The use of California bond dollars is an appropriate and timely mechanism to ensure that instream public interest values can be protected in perpetuity.

Please call me directly at 415.309.2098 if you have any questions or I can be of any further assistance.

Sincerely,

A handwritten signature in blue ink that reads "Thomas Hicks". The signature is fluid and cursive, with the first name "Thomas" and the last name "Hicks" clearly legible.

Thomas Hicks

Addenda: California's Water Market, By the Numbers: Update 2012, November 2012

This recent Public Policy Institute of California report by Ellen Hanak and Elizabeth Stryjewski reinforces the timeliness and premise of this new California network focused on environmental water transactions. The CWTN is already leveraging its experience and network to become the leading California water policy voice advancing voluntary instream water transfers.

p.2-3: "The report offers a number of recommendations for strengthening these tools and fostering their responsible development, including the following: California should continue to pursue—and find the funds to support—environmental water purchases, which can help reduce the conflicts associated with reallocating water to the environment while improving the efficiency of environmental water management."

p.33: "As EWA and WAP purchases have declined, two new types of environmental water purchases have emerged: acquisitions of water to mitigate the impacts of Colorado River water transfers from the Imperial Irrigation District to San Diego, and a variety of smaller transfers to instream flows under § 1707 of the Water Code."

p.34: "The other new thrust in environmental acquisitions was prompted by § 1707 of the Water Code, enacted in 1991. This statute authorizes the dedication or transfer of water to instream flows by protecting it legally from inconsistent upstream uses by junior water-rights-holders. Many of the environmental water transfer programs noted above operate with § 1707 permits. The additional transfers labeled explicitly as § 1707 flows in Figure 11 are a collection of local watershed support measures in the Far North (Scott and Trinity Rivers), the San Francisco Bay Area (Tomales Bay, San Pablo Bay), and the Sacramento Valley (Butte Creek). Most involve relatively small volumes of water, are essentially permanent in duration, and are associated with non-profit organizations participating in watershed management (e.g., the Scott River Trust). In contrast to all of the other environmental water trades shown in the figure, the § 1707 acquisitions are generally made as donations rather than for monetary compensation (though some policy discussions are under way about making these donations eligible for tax deductions to create financial incentives to increase instream flows)."

p.43: Environmental water purchases offer the prospect of reducing the conflicts associated with reallocating water to the environment.

p.43: High-level leadership is needed to routinize water marketing and groundwater banking transactions...One option might be to assemble a high-level coordinating committee from relevant agencies, with the ability to break through barriers.

Managing California's Water: From Conflict to Reconciliation, PPIC

p.406: "Interest groups also can engage in direct reforms without changes in legislation or administrative rules. Non-profits, for example, can directly protect the environment through market mechanisms or business pressure. In recent years, "water trusts" such as the Oregon-based Freshwater Trust, have adopted a lesson from land trusts and helped protect environmental flows by acquiring water from willing farmers for environmental purposes."