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THE SOUTHEASTERN WATER COMPACT, PANACEA OR PANDORA'S BOX? A LAW AND ECONOMICS ANALYSIS OF THE VIABILITY OF INTERSTATE WATER COMPACTS

DAVID N. COPAS JR.*

I. INTRODUCTION

The Chattahoochee River Basin is one of the most important water resources in the Southeastern portion of the United States. The "Hooch," as it is locally known,¹ cuts a more than four-hundred-mile path from Northern Georgia to its point of intersection with the Flint River on the border of Alabama, Florida, and Georgia. Along the way, the river supplies Lake Sidney Lanier, serves as a drinking water supply for Atlanta,² and forms a great portion of the border between Georgia and Alabama. Further, the "Hooch" combines with the Flint River to form the Apalachicola River, which flows through Northwest Florida before emptying into the Gulf of Mexico.

Increasing development of the Southeastern United States has taxed heavily the region's water resources. Consequently, the conflict over the Chattahoochee River has grown into a hotly contested battle.³ It has involved not only the states themselves, but also the Federal Government in the form of the U.S. Army Corps of Engineers, the agency in charge of the

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¹ See Carl Erhardt, *The Battle Over "The Hooch: The Federal-Interstate Water Compact and the Resolution of Rights in the Chattahoochee River*, 11 STAN. ENVTL. L.J. 200 n.1 (1992) (citing Brief for Plaintiff, Alabama v. United States Army Corps of Engineers (N.D. Ala. 1990) (No. CV-90-H-01331-E)).

² The Chattahoochee River supplies 70% of Atlanta's drinking water. See *id.* at 201 n.7 (citing *River Rivalry*, ECONOMIST, Mar. 30, 1991, at 26).

³ See *River Rivalry*, ECONOMIST, Mar. 30, 1991, at 26 (discussing feud between Alabama, Florida, and Georgia over rights to the Chattahoochee River).

maintenance of Lake Lanier.⁴ It is against this backdrop that this Note is developed.

The purpose of this Note is to take various solutions to interstate conflicts over water rights and analyze them in a law and economics framework. Though many authors have argued that one solution to such conflicts is superior to others, none have done so by applying law and economics theories to the problem. By looking for a solution to interstate water rights issues through the lens of law and economics analysis, it is possible to look beyond political and social concerns which, though important, should not override the requirement that laws reflect the most efficient means of resource allocation. Under this framework, federal-interstate water compacts emerge as the most logical choice for solving interstate water conflicts.

This Note begins with a discussion of the various water rights regimes employed by the states. A discussion of the law and economics theories employed by the author constitutes Part III. Part IV reviews the circumstances surrounding the current state of the conflict over the "Hooch," and discusses recent developments in the negotiating process between the states and the federal government. Part IV also reviews the three main solutions to questions of interstate water rights and examines how interstate water compacts have been used in a variety of settings. Part V examines four regional approaches to water rights. Finally, Part VI tests the federal interstate compact solution under the law and economics theories examined in Part III.

II. TRADITIONAL WATER RIGHTS REGIMES

Though the migratory nature of water makes defining property rights difficult, three types of water rights regimes have been developed within the

⁴ See Rivers and Harbors Act of 1945, 33 U.S.C. § 603a (1994); Flood Control Act of 1941, 33 U.S.C. § 701c (1994); Water Supply Act of 1958, 43 U.S.C. § 390b (1994); 33 C.F.R. § 222.7(a)-(d) (1994); 33 C.F.R. § 222.7(f)(9) (1994).

United States to deal with the problem.⁵ The regime used by a particular state has a great deal to do with the scarcity of water in that particular region.⁶ Furthermore, what is "owned" within these regimes is generally not the water itself, but the right to put that water to use.⁷ The East Coast, since colonial times, has been governed primarily under riparianism.⁸ The western states, on the other hand, employ some form of the prior appropriation system of water usage.⁹ Additionally, in recent years several states have moved away from pure riparianism, and have made use of some form of hybrid system.¹⁰

A. *Riparian Rights*

During the colonial period, and particularly during the early portions of the Industrial Revolution, the colonies (and later the eastern states) constructed water rights regimes based upon the traditional notions of European water rights.¹¹ Blessed with an abundance of water resources, the

⁵ The three types of water rights regimes include the riparian doctrine, appropriation doctrine, and hybrid systems.

⁶ See Deborah L. Freeman, *Introduction*, in WATER RIGHTS OF THE FIFTY STATES AND TERRITORIES 1-3 (Kenneth R. Wright ed., 1990) (comparing water rights doctrines utilized in the humid east versus the arid west).

⁷ See DAVID H. GETCHES, WATER LAW IN A NUTSHELL 28-29 (1984) (detailing nature of riparian rights).

⁸ States using some form of riparian rights for surface water include: Alabama, Arkansas, Connecticut, Delaware, Georgia, Illinois, Louisiana, Maine, Maryland, Massachusetts, Michigan, Missouri, New Hampshire, New Jersey, New York, North Carolina, Ohio, Pennsylvania, Rhode Island, South Carolina, Tennessee, Vermont, Virginia, West Virginia. See Patricia K. Flood, *Water Rights of the Fifty States and Territories*, in WATER RIGHTS OF THE FIFTY STATES AND TERRITORIES, *supra* note 6, at 31, 35-69.

⁹ States using some form of an appropriation system include: Alaska, Arizona, Colorado, Idaho, Kansas, Montana, Nebraska, Nevada, New Mexico, North Dakota, Oklahoma, Oregon, South Dakota, Texas, Utah, Washington, Wyoming. See *id.*

¹⁰ States that use a combination system or other type of system include: California, Florida, Hawaii, Iowa, Kentucky, Minnesota, Mississippi, Washington, and Wisconsin. See *id.*

¹¹ See Stuart L. Somach, *Water Rights*, in NATURAL RESOURCES LAW HANDBOOK 202, 203-04 (Government Institutes, Inc. 1991) (tracking evolution of riparian rights in the U.S.).

eastern seaboard did not have to develop a strict method of water allocation.¹² The result was the riparian system of water rights. Simply stated, riparian rights¹³ are those that an owner of land has in the water flowing through a watercourse¹⁴ adjacent to the owner's land.¹⁵

As development of the East Coast increased during the Industrial Revolution and as industrial powers sought to use rivers and streams to power their mills, new pressures on water resources developed.¹⁶ Against this backdrop two sub-doctrines of riparian rights developed. First is the "natural flow doctrine,"¹⁷ which is based on the idea that the owner of property adjacent to a watercourse is entitled to an undiminished portion of the water.¹⁸ The term "undiminished" refers to both quantity and quality of the water.¹⁹

The second, and more important, sub-set of riparianism is the "reasonable use" doctrine.²⁰ Under this regime, riparian owners can make any reasonable use of the water adjacent to their land, so long as it does not

¹² See *id.*

¹³ Riparian rights only attach to surface watercourses. Ground water (including subterranean streams) is not included in the riparian rights regime. See *id.* at 204-05.

¹⁴ A water course is defined as a "running stream of water; a natural stream fed from permanent or natural sources, including rivers, creeks, runs, and rivulets." BLACK'S LAW DICTIONARY 1592 (6th ed. 1990).

¹⁵ See Somach, *supra* note 11, at 205.

¹⁶ See James B. MacDonald, *Riparian Doctrine*, in WATER RIGHTS OF THE FIFTY STATES AND TERRITORIES, *supra* note 6, at 19, 20 (discussing the 1827 case of *Tyler v. Wilkinson*, 24 F. Cas. 472 (C.C.D.R.I. 1827) (No. 14,312)).

¹⁷ See JOHN NORTON POMEROY, A TREATISE ON THE LAW OF RIPARIAN RIGHTS AS THE SAME IS FORMULATED AND APPLIED IN THE PACIFIC STATES, INCLUDING THE DOCTRINE OF APPROPRIATION § 8 (Henry Campbell Black ed., 1887).

¹⁸ See *id.*

¹⁹ See *id.*

²⁰ See *id.* § 125.

affect adversely the rights of other proprietors along the watercourse.²¹ *Tyler v. Wilkinson*²² laid the foundation for the doctrine in 1827:

When I speak of this common right, I do not mean to be understood, as holding the doctrine, that there can be no diminution whatsoever . . . by a riparian proprietor, in the use of water as it flows for that would be to deny any valuable use of it The true test of the principle and extent of the use is, whether it is to the injury of the other proprietors or not.²³

In effect, the "reasonable use" doctrine serves as one of the earliest applications of law and economics theory. In *Wilkinson*, the court's concern about protecting valuable uses illustrated an early interest in ensuring that even a seemingly abundant resource be allocated to the most efficient uses. Efficient uses were protected so long as those uses did not impinge on the abilities of downstream users to make efficient use of the resource.

Apart from generalized recognition of the need for economic resource allocation inherent in the "reasonable use" doctrine, riparian regimes have one other advantage. Riparian systems require very little control from centralized government, as they are, by and large, self-governing.²⁴ Unfortunately, this advantage can serve as a disadvantage as well. The fact that riparian rights are so generalized creates several problems, one of which is uncertainty over rights.²⁵ This uncertainty, in turn, leads to problems in enforcement of such rights.²⁶ Such ambiguity forces parties in a dispute to turn to the most inefficient of all dispute resolution mechanisms—litigation.

²¹ *See id.*

²² 24 F. Cas. 472 (C.C.D.R.I. 1827) (No. 14,312).

²³ *Id.* at 474.

²⁴ *See MacDonald, supra* note 16, at 21 (stating that under riparianism there is no need for a government agency to develop and enforce regulations).

²⁵ *See id.*

²⁶ *See id.* Further exacerbating this situation is an imprecise definition of what exactly constitutes a "reasonable use;" *see also* WILLIAM GOLDFARB, *WATER LAW* 23 (2d ed. 1989).

Finally, and most importantly, pure riparianism is no longer in tune with the reality of water resources. Riparianism inherently was based on the notion that supply is generally large enough to accommodate, at least, all demands for reasonable uses.²⁷ Present reality simply does not permit such an inference.²⁸ Instead, increasing consumptive uses are pushing demand closer to supply levels, if not beyond in some cases.²⁹ Riparian states are addressing slowly this problem by utilizing hybrid systems.

B. *The Western Model: Prior Appropriation*

The scarcity of water, coupled with the demands of extensive mining concerns, forced the western portions of the United States to move away from the riparian system.³⁰ What developed in its place was the prior appropriation system, a regime based upon the economically beneficial use of water.³¹ The three general requirements of the doctrine are an intent to divert the water to a beneficial use,³² an actual diversion, and the application of the water for the use intended.³³ What exactly is considered to be an "economically beneficial use" is difficult to determine, as it varies from state to state.³⁴

²⁷ See GOLDFARB, *supra* note 26, at 24 (stating that riparianism presumes a surplus of water).

²⁸ See *id.* at 24-25.

²⁹ Atlanta, for example, planned to siphon off 529 million gallons of water per day from the "Hooch" by 2010, a 50% increase over 1990 levels. See *River Rivalry*, *supra* note 3, at 26. But see A. Dan Tarlock, *Introduction to Symposium on Eastern Water Rights*, 24 WM. & MARY L. REV. 535, 535-45 (1983) (asserting that riparianism still may be a workable model for the future).

³⁰ See GOLDFARB, *supra* note 26, at 32.

³¹ See *id.* at 33.

³² Traditionally, this meant domestic and economic uses, but has been extended to include recreation, scenic beauty, and ecological concerns. See *id.* at 35-36.

³³ See *id.* at 35; see also GETCHES, *supra* note 7, at 79.

³⁴ Generally, states employ a hierarchy of uses. Domestic, agricultural (irrigation, stockwatering) and industrial uses (power generation, mining, milling) are accorded top preference, followed by fish, wildlife and recreation uses. See GOLDFARB, *supra* note 26, at 37.

Even if an owner is granted the right to take water away from a stream, the state still can apply restrictions on the types of usage. It is not uncommon for western states to restrict transportation of water, return flow rates, and the like, in the interest of protecting downstream water users.³⁵ Moreover, state water administrations may require those seeking access to water to purchase licenses or permits for use.³⁶ In a manner of speaking, then, western states actually attempt to put a price on water usage.³⁷ By doing so, those who use the water can develop cost estimates that reflect the actual cost to society of doing business. In a law and economics sense, this is good law, though it is not without flaws.

One of the backbones of the prior appropriation doctrine is the idea that earlier appropriators have precedence over those who recently have acquired water rights.³⁸ In short, prior appropriation doctrine is based on the notion of "first in time, first in right."³⁹ Though the rights of prior appropriators can be forfeited through abandonment or adverse possession,⁴⁰ the system could favor older interests over the most efficient uses.⁴¹ The system also provides the possibility for interested parties to purchase rights from owners so that water resources can be traded like fuels and other natural resources.⁴² Thus, water is allocated to the most economically beneficial use.

³⁵ See Somach, *supra* note 11, at 210-12.

³⁶ See *id.*

³⁷ Although this price is different from the usual prices that consumers pay to the water company for water.

³⁸ See David Elliott Prange, Note, *Regional Water Scarcity and the Galloway Proposal*, 17 ENVTL. L. 81, 85 (1986) (calling this doctrine the "principal tenet of Western water law").

³⁹ The Supreme Court coined this phrase in *Arizona v. California*, 373 U.S. 546, 555 (1963).

⁴⁰ See William R. Fischer & Ward H. Fischer, *Appropriation Doctrine*, in WATER RIGHTS OF THE FIFTY STATES AND TERRITORIES, *supra* note 6, at 23, 28.

⁴¹ This is true particularly in times of shortage. See Kathleen Marion Carr & James D. Crammond, *Introduction*, in WATER LAW TRENDS, POLICIES AND PRACTICE xix, xx (Kathleen M. Carr & James D. Crammond eds., 1995).

⁴² See *id.*

This is what law and economics theorists intend when they assert that laws should direct society to the most efficient use of its resources.⁴³

C. *The New Eastern Philosophy: Hybrid Systems*

Due to the failure of the riparian system to adequately deal with increasing claims on decreasingly available stream flows, many eastern states have moved towards hybrid systems.⁴⁴ While recognizing the riparian rights of prior landowners, these systems institute permit schemes for new drains on watercourses.⁴⁵ In addition, these hybrid systems focus less on priority of rights than do western prior appropriation systems.⁴⁶ Permits are granted and administered by one central agency, with the exception of Florida, which employs a regional system.⁴⁷ The major drawback is that, though these systems do provide for application fees for permits, most states do not have a means to collect royalty payments for continued use.⁴⁸ However, hybrid systems are a step in the right direction and are the trend in the East, rather than an exception to the rule.⁴⁹

⁴³ See RICHARD A. POSNER, *ECONOMIC ANALYSIS OF THE LAW* 22 (4th ed. 1992).

⁴⁴ See *supra* note 10 and accompanying text.

⁴⁵ See GOLDFARB, *supra* note 26, at 26.

⁴⁶ See *id.*

⁴⁷ See *id.*

⁴⁸ See *id.* at 27.

⁴⁹ See George A. Gould, *Water Rights Systems*, in *WATER RIGHTS OF THE FIFTY STATES AND TERRITORIES*, *supra* note 6, at 6, 9 (citing the trend towards hybrid systems in the East); MacDonald, *supra* note 16, at 22.

III. ECONOMIC ANALYSIS OF THE LAW

Law and economics theory, as applied in a non-anti-trust setting, is a fairly recent development in jurisprudence.⁵⁰ The general idea underlying law and economics analysis is that “many of the doctrines and institutions of the legal system are best understood and explained as efforts to promote the efficient allocation of resources.”⁵¹ The scope of law and economics theory has both a normative and a positive aspect. Normative analysis consists of looking at how policy decisions would lead to differing results in terms of lost opportunity cost.⁵² Though the economist does not make value judgments per se, the economist can look at how different solutions would result in trade-offs between efficiency and other social values. The economist also can look at past policies and determine their efficiency.⁵³

Positive economic analysis, on the other hand, looks at the present situation and discusses how things became the way they are.⁵⁴ Together, these normative and positive elements direct economic analysis to the most efficient outcomes for society. Judge Posner refers to this as the efficiency theory of common law.⁵⁵ Though he believes that statutory or constitutional laws tend to focus less on efficiency, Posner notes the possibility of efficient allocation of resources by statutory means.⁵⁶ Interstate water compacts, for example, create just such an efficient solution to resource problems.

⁵⁰ The “new law and economics,” as it is called by Judge Richard Posner, grew out of the articles of Guido Calabresi and Ronald Coase in the early 1960s. See POSNER, *supra* note 43, at 16; Guido Calabresi, *Some Thoughts on Risk Distribution and the Law of Torts*, 70 YALE L.J. 499 (1961); Ronald H. Coase, *The Problem of Social Cost*, 3 J. LAW & ECON. 1 (1960); see also A.C. PIGOU, *THE ECONOMICS OF WELFARE* 98-105 (4th ed. 1932).

⁵¹ POSNER, *supra* note 43, at 22.

⁵² See *id.* at 23.

⁵³ See *id.*

⁵⁴ See *id.*

⁵⁵ See *id.*

⁵⁶ See *id.* (“Statutory or constitutional as distinct from common law fields are less likely to promote efficiency, yet even they . . . are permeated by economic concerns and illuminated by economic analysis.”)

It is now possible to take a positive law and economics analysis of how different water rights regimes have developed in the various regions of the U.S. The starting point for such an analysis is what is commonly referred to as "the tragedy of the commons."⁵⁷ This doctrine states that public goods are likely to be utilized inefficiently by society.⁵⁸ A fitting example is a lake full of fish. Fishermen with no economic stake in the lake itself are unlikely to care about maximizing long-term harvests. As a result, the fishermen are likely to overfish the lake, squandering its value.

Consider, however, a fisherman who seeks to assert ownership over the lake. Harold Demsetz proposed the theory that property rights will be developed if they will add to economic efficiency.⁵⁹ Demsetz applied this theory to the development of property rights in French Canada as a result of the fur trade.⁶⁰ The right to property included the right to harvest the pelts of animals on that land.⁶¹ Demsetz also argued that property interests made it prudent for landowners to protect their resources, both from other hunters and from their own over-hunting.⁶²

Returning to the lake example, an economically rational fisherman decides that the best way to ensure a high income level is to gain control of the lake. The fisherman buys the lake from the state and secures it from other fishermen. Two things immediately result. First, overfishing is stopped

⁵⁷ See Garrett Hardin, *The Tragedy of the Commons*, 162 SCI. 1243 (1968) (postulating that the population dilemma does not have a technical solution, but requires a moral solution).

⁵⁸ See *id.* at 1244.

⁵⁹ See Harold Demsetz, *Toward a Theory of Property Rights*, 57 AM. ECON. REV., PAPERS AND PROC. 348, 350 (1967) (Demsetz's thesis is that "property rights develop to internalize externalities when the gains of internalization become larger than the cost of internalization").

⁶⁰ See *id.* at 351-53. Demsetz relied on the studies of Eleanor Leacock and Frank Speck as the basis for his analysis of the rise of property rights with regard to the fur trade. See generally Eleanor Leacock, *The Montagnais "Hunting Territory" and the Fur Trade*, 57 AM. ANTHROPOLOGIST Memoir No. 78 (1954); Frank G. Speck, *The Basis of American Indian Ownership of Land*, 1915 OLD PENN WEEKLY REV. 490, 491-95 (1915).

⁶¹ See Demsetz, *supra* note 59, at 351-53.

⁶² See *id.*

because outsiders are excluded and the prudent fisherman seeks to maximize long-term income by stock management. Second, the price of the fish taken from the lake increases. At first, this would seem to be a negative externality on society; however, that is not the case. The higher price now more fully reflects the true cost to society of using fish from that lake. The price signals the relative scarcity of the resource and its value to society. Without such protection, the price may remain low, at least until the fish are depleted. At that point, the price of fish caught (surely not of the quality previously sold) will skyrocket, and ultimately no fish will remain for harvesting. Thus, in the absence of property rights, the tragedy of the commons will have generated a long-term, dead weight loss on society.

The prior appropriation doctrine of the Western United States is a fine example of Demsetz's principle. The scarcity of water led those seeking water rights to construct a regime to protect their interests.⁶³ By doing so, water-rights owners maximized their economic utility without fear of others impinging on those rights.⁶⁴ The system creates certainty, which, in turn, fosters greater development.⁶⁵ On the other hand, riparianism arguably illustrates a weak form of the tragedy of the commons. Though the reasonable use doctrine⁶⁶ does put some emphasis on economically efficient uses, the uncertainty of rights under the riparian regime has led to over-utilization of water resources by upstream users, often adversely affecting more efficient downstream uses.⁶⁷ It is precisely for this reason that the trend away from riparianism is such a positive step towards a more beneficial system for society on the whole.

Two models that deal with the question of what is, in fact, beneficial to society are the Pareto and Kaldor-Hicks ("K-H") models. Both the Pareto model and the K-H model do much to explain why certain developments in law lead to net gains for society. Each model, however, works from

⁶³ See *supra* text accompanying notes 30-31.

⁶⁴ See *supra* text accompanying notes 30-31.

⁶⁵ See *supra* text accompanying notes 30-31.

⁶⁶ See *supra* text accompanying notes 20-24.

⁶⁷ See *supra* text accompanying notes 27-29.

somewhat different premises.⁶⁸ The notion of Pareto superiority is simple; an economic outcome is superior so long as at least one member of society is positively affected, with no detrimental effects falling on any other member of society.⁶⁹ An example of such a policy would be a tax cut that encourages better investment by individual members of society rather than the government. With each member of society using the money to improve his or her economic standing, the net gain to society would be greater than the value of any loss of government services that may occur.

K-H superiority works somewhat differently. An outcome is K-H superior if one party could compensate the other and still maintain a net economic gain.⁷⁰ In effect, one party buys off another and puts the resources to better use. An example may be a cement factory buying out neighboring residential developments because the value of goods created by the factory is far greater than the aggregated value of the residential properties.⁷¹ This does not mean, necessarily, that the cement company may pay only the bare minimum to get the other parties back to where they would have been had no action taken place (though that is a possible outcome). Any "pay off" up to the surplus value created by the more efficient use is K-H superior.

While all Pareto superior outcomes are K-H superior, the reverse is not always the case.⁷² Still, the benefit to society under a K-H superior system can be excellent in the long run, as resources flow to more efficient uses. The problem with K-H analysis is that it can fail to deal with intangible

⁶⁸ In fact, the K-H Model is sometimes referred to as potential Pareto superiority. See POSNER, *supra* note 43, at 14-15.

⁶⁹ See *id.* at 13-14.

⁷⁰ See *id.* Charles K. Rowley described K-H efficiency in terms of the ability of gainers in policy changes to potentially overcompensate losers, without those losers being able to potentially overcompensate the gainers. See Charles K. Rowley, *Public Choice and the Economic Analysis of Law*, in LAW AND ECONOMICS 123, 130-31 (Nicholas Mercuro ed., 1989).

⁷¹ See *Boomer v. Atlantic Cement Co.*, 309 N.Y.S.2d 312 (1970), *aff'd*, 26 N.Y.2d 219 (1970), and *aff'd*, 73 Misc. 2d 834 (1970).

⁷² See POSNER, *supra* note 43, at 13-14.

values.⁷³ A home, for example, may have much more value to a family than the price of the property. As a result, those who promote K-H solutions constantly must be aware that other values may have to be weighed against efficiency.

Additionally, law and economics theorists face the problem posed by Scitovszky's paradox.⁷⁴ Scitovszky recognized the economic benefits of K-H models, but stated that they are inadequate to deal with original rights.⁷⁵ Turning to the example of the lake, though the fisherman, once in control of the lake, can enter into K-H transactions, how does one compensate another if no tangible property right exists to begin with? Likewise, the absence of tangible property rights in the context of watercourses poses a tremendous hurdle. It is difficult to determine who exactly "owns" the entitlement to water. The systems in place could not be scrapped easily without removing hundreds of years of development based upon previously erected original rights.⁷⁶ In fact, there is now systemic inertia in place that makes a full-scale revision of water rights difficult. This is one powerful reason why many states moving away from riparian systems have grandfathered in previous riparian rights.⁷⁷ By working within these original rights, however, it is possible to erect a system that enables water resources to flow to those who will put the resources to the best possible use.

The Coase theorem⁷⁸ serves as a powerful benchmark against which to measure the efficiency of any water rights policy. The theorem itself is part of a greater framework laid out by Ronald Coase in his article *The*

⁷³ See *id.*

⁷⁴ See Tibor Scitovszky, *A Note on Welfare Propositions in Economics*, 9 REV. ECON. STUD. 75, 77 (1941).

⁷⁵ See *id.*

⁷⁶ See *infra* note 77 and accompanying text.

⁷⁷ Even prior appropriation states locked into interstate compacts have sought to protect previously held rights. See, e.g., Colorado River Compact art. VIII, COLO. REV. STAT. ANN. § 37-61-101 (West 1990).

⁷⁸ See Coase, *supra* note 50, at 1.

Problem of Social Cost.⁷⁹ The article suggests a five “pillar” strategy for tackling economic analysis in the legal context.⁸⁰

The first pillar is the Coase theorem itself, which states that in the absence of transaction costs, parties will seek out the allocatively efficient result.⁸¹ The second pillar suggests that harm is often joint; each party in a dispute creates a negative externality upon the other.⁸² For example, a hotel owner could decide to build a fourteen-story addition to a hotel which borders a residential property. The addition will affect negatively the residential owner by blocking out sunlight. On the other hand, a challenge to the hotel owner's right to expand operations will limit the hotel's profitability.⁸³ Whoever wins in a dispute like this inflicts a negative externality upon the other. Furthermore, the level of harm created can be ascertained only after the court has decided who owns the entitlement to the affected property.⁸⁴

The third pillar could be termed “Positive Coase.” This pillar reiterates the idea introduced by the second pillar—that an externality is harmful only if an entitlement to the affected property is owned by the aggrieved party.⁸⁵ The third pillar points out that the best way that law determines an externality is vis-à-vis property rights.⁸⁶ Thus the fisherman, introduced earlier, only can claim an injury to his fish if it is determined that

⁷⁹ *Id.*

⁸⁰ The five pillars of Coase's theory can be distilled from the various subsections of his article. *See id.*

⁸¹ *See id.* at 3-8.

⁸² *See id.* at 2.

⁸³ *See Fountainebleau Hotel Corp. v. Forty-Five Twenty-Five, Inc.*, 114 So. 2d 357 (Fla. Dist. Ct. App. 1959). For other examples of joint harm see *Sturges v. Bridgman*, 11 Ch. D. 852 (1879) (involving the alleged nuisance to practice of doctor caused by the use of two mortars and pestles by a confectioner located next door); *Travis v. Moore* 377 So. 2d 609 (Miss. 1979) (efforts by residential property owners to enjoin a funeral parlor from locating in the area); *Prah v. Maretti*, 108 Wis. 223, 321 N.W.2d 182 (1982) (dealing with claim of owner of solar-heated home against proposed construction by neighbor that would have interfered with access to the sun).

⁸⁴ *See Coase, supra* note 50, at 19-28.

⁸⁵ *See supra* text accompanying notes 82-84.

⁸⁶ *See Coase, supra* note 50, at 3-8.

the fisherman has an entitlement to the lake. When examined from this standpoint, an externality in the context of the tragedy of the commons is a misnomer to some extent. Because no one specifically owns an entitlement to public property, it is impossible to have an externality in the Coasian sense. However, that does not suggest that public property is not owned by society as a whole. In fact, that is the only way to look at externalities in the public property sense. Everyone is affected by the externality, because everyone has an entitlement.

Coase also recognized the importance of transaction costs in real disputes. The fourth pillar suggests that transaction costs do matter in determining an efficient solution.⁸⁷ One of the most important costs facing economic analysis is strategic in nature. Strategic costs take two major forms: holdouts and free-riders.⁸⁸ The concept of the holdout and the free-rider are not altogether different; they are opposite sides of the same coin. Holdouts invariably drive up transaction costs by refusing to negotiate until a windfall can be achieved, whereas free-riders refuse to bear the costs of positive externalities.⁸⁹ In effect, a holdout is a free-rider on the coattails of the transaction. The law must take into account these realities, because elimination of the problem is improbable.

The final pillar posits that courts should try to achieve K-H superior results.⁹⁰ Because Pareto optimization is difficult to achieve, it is generally infeasible for the courts to apply the Pareto model. However, once a court has determined who owns an entitlement, it is much easier for a court to analyze the situation and determine the proper outcome.⁹¹

⁸⁷ See *id.* at 15-18 (major costs include communication and monitoring expenses, once a solution has been determined).

⁸⁸ See *id.*

⁸⁹ See *id.*

⁹⁰ See *id.* at 27-28. Though not mentioning K-H efficiency, Coase does state that "[w]hat has to be decided is whether the gain from preventing the harm is greater than the loss which would be suffered elsewhere as a result of stopping the action which produces the harm." *Id.*

⁹¹ For example, a court could determine the nature of the rights protected and whether compensation should be awarded.

The major problem behind a law and economics approach is that in some cases economics cannot answer the question of how a resource will be distributed. There are always cases where no amount of efficiency analysis can generate an outcome favorable to the parties, particularly if society sees other concerns as superior to economic efficiency.⁹² One additional problem involves information. To achieve a truly rational economic decision, a party must have access to all available information. A judge or administrative body must be knowledgeable about the issues and values related to entitlements. Making sure that this information is available should be the paramount concern in any attempt to institute a system following law and economics principles.

IV. THE SOUTHEASTERN WATER PACT

One of the major problems facing the states involved in the dispute over the Chattahoochee River is that the states employ two different regimes. Florida utilizes a system governed by statute,⁹³ while both Georgia and Alabama are governed by a riparian regime.⁹⁴

The Chattahoochee, as mentioned earlier, is the major source of drinking water for the metro-Atlanta area.⁹⁵ The United States Army Corps of Engineers was directed to create Lake Sidney Lanier for precisely that

⁹² An example may be found in the rise of the "Public Trust Doctrine" growing out of *National Audubon Soc'y v. Superior Court*, 658 P.2d 709 (Cal. 1983) (The Mono Lake Case). The Public Trust Doctrine is based on the notion that "environmental demands now could be made on existing uses of water rights, and that those uses might have to be adjusted in order to maintain or restore natural ecosystem values." Joseph L. Sax, *Bringing an Ecological Perspective to Natural Resources Law: Fulfilling the Promise of the Public Trust*, in *NATURAL RESOURCES POLICY AND LAW: TRENDS AND DIRECTIONS* 148, 149 (Lawrence J. MacDonnell & Sarah F. Bates eds., 1993). As Sax explains, Public Trust Doctrine has as its underlying precept "public entitlement to the benefit of natural systems." *Id.* at 150. Economically, this may not be the best use for land, yet society has deemed aesthetic, spiritual, and environmental concerns paramount.

⁹³ See Flood, *supra* note 8, at 43.

⁹⁴ See *id.* at 37, 43.

⁹⁵ See *supra* note 2 and accompanying text.

purpose.⁹⁶ A 1990 plan for Atlanta's growth included provisions to create reservoirs that would have held back an additional 529 million gallons of water a day from the river.⁹⁷ The reason for such a large increase in the amount retained in Lake Lanier was Atlanta's robust growth projections for upcoming years.⁹⁸

The reaction from Alabama was fairly swift. In 1991 Alabama, seeking to enjoin the Army Corps of Engineers from enacting the plan, filed suit in Federal Court.⁹⁹ This suit was later joined by Florida in an effort to secure water flows in the Apalachicola River.¹⁰⁰ The parties set aside the suit while the Army Corps of Engineers conducted a comprehensive study of water usage in the river basin.¹⁰¹ Uncertainty over the study results, coupled with Georgia's desire for an expedited resolution to the controversy, led the states and the Corps of Engineers to form a compromise agreement in 1992.¹⁰² Alabama was especially eager to enter into such an agreement because its claim to the Chattahoochee River is questionable.¹⁰³

The agreement stipulates that each state support a three million dollar study of water resources in the Chattahoochee River Basin.¹⁰⁴ Second,

⁹⁶ See *supra* note 4 and accompanying text.

⁹⁷ See *River Rivalry*, *supra* note 3, at 26.

⁹⁸ Georgia planned to increase withdrawals from the Chattahoochee by 50% by the year 2010. This would be done to keep pace with a projected 800,000 person increase in Atlanta's population over the next two decades. See Greg Jaffe, *Water Deal May Settle Old Dispute*, WALL ST. J., Sept. 11, 1996, at F1, available in 1996 WL-WSJ 11797854.

⁹⁹ See Brief for Plaintiff, Alabama v. United States (N.D. Ala. 1990) (No. CV-90-H-01331-E).

¹⁰⁰ See Jaffe, *supra* note 98, at F1.

¹⁰¹ See *id.*

¹⁰² See *id.* (Georgia's eagerness for an agreement is based on projections of a population boom in the Atlanta area).

¹⁰³ See Erhardt, *supra* note 1, at 207-11 (examining Alabama's tenuous claim to the Chattahoochee River); see also Alabama v. Georgia, 64 U.S. (23 How.) 505 (1859) (holding that the west bank of the Chattahoochee River constituted Alabama's eastern border).

¹⁰⁴ See Memorandum of Agreement by, between, and among the State of Alabama, the State of Florida, the State of Georgia, and the United States Department of the Army, Jan. 3, 1992, at 1, 5. The cost of the study has since grown to \$15 million.

Alabama agreed to halt its legal action, and in return, water use levels were frozen temporarily, with increases only taking place after notification to all parties.¹⁰⁵ Finally, the states agreed to negotiate and share information with each other.¹⁰⁶ This agreement has been renewed twice since its enactment,¹⁰⁷ with the ultimate goal of establishing a regional solution to the conflict over the "Hooch."¹⁰⁸

There are three typical solutions for water rights disputes such as the one now existing in the Southeast: congressional apportionment, judicial apportionment, and interstate compacts. While water rights occasionally are apportioned by Congress or the Supreme Court, the use of interstate compacts is, undoubtedly, the most common and desirable method. The reason for this conclusion is that congressional and judicial apportionment schemes often are based on incomplete information, and, in the case of legislative apportionment, often reflect non-economic concerns that dictate decisions.

A. Congressional Apportionment

The Supreme Court originally held in *Kansas v. Colorado*¹⁰⁹ that congressional apportionment of water rights was not valid under the Constitution.¹¹⁰ This ruling was overturned a half century later, when the Court held in *Arizona v. California*¹¹¹ that Congress's implied powers, especially under the Commerce Clause, allowed for legislative apportionment of water rights in the Colorado River.¹¹² However, Congress has seemed reluctant to apply this power to all water rights disputes. In fact, the only

¹⁰⁵ See *id.* at 2-3, 6.

¹⁰⁶ See *id.* at 2.

¹⁰⁷ See Supplemental Memorandum of Agreement, Jan. 18, 1994; Supplemental Memorandum of Agreement, Sept. 30, 1996.

¹⁰⁸ See Memorandum of Agreement, *supra* note 104, at 1.

¹⁰⁹ 206 U.S. 46 (1907).

¹¹⁰ See *id.* at 97.

¹¹¹ 373 U.S. 546 (1963).

¹¹² See *id.* at 564-67.

instance since *Arizona v. California* in which Congress has decided to apportion water rights was the conflict over the Truckee and Carson Rivers and Lake Tahoe.¹¹³

The success of the apportionment scheme in the "Truckee Dispute," at least in the short run, has prompted some commentators to promote more pervasive use of congressional apportionment of water rights.¹¹⁴ Though it is attractive to have Congress usurp control of all water disputes, this approach has two important flaws that make congressional apportionment, from a law and economics perspective, an inefficient choice. The first major shortcoming is that Congress is often not very well informed about the problems facing a particular region, and even if that information is available, a question of genuine interest also is raised.¹¹⁵ Congress, through the use of hearings and other investigative mechanisms, can inform itself to a certain point regarding a particular water dispute.¹¹⁶ On the other hand, it is highly unlikely that a typical member of Congress has the type of specialized knowledge necessary to deal with certain aspects of water disputes.¹¹⁷ Furthermore, it is unlikely that a senator from Maryland will be particularly interested in a dispute over the Canada River. What is likely to result in such a setting is a solution that is made with inadequate information—a clear violation of the five pillars of Coase.¹¹⁸ Thus, the allocation mechanism that Congress would enact is likely to be based on water values that do not have a strong basis in reality.

A second, and more cynical reason for opposing congressional apportionment is based on political reality. Congress is not an economic body, but is influenced by powerful interests.¹¹⁹ Thus, any decision made by

¹¹³ See Jerome C. Muys, *Approaches and Considerations for Allocation of Interstate Waters*, in *WATER LAW TRENDS, POLICIES AND PRACTICE*, *supra* note 41, at 311, 312.

¹¹⁴ See E. Leif Reid, Note, *Ripples from the Truckee: The Case for Congressional Apportionment of Disputed Interstate Water Rights*, 14 *STAN. ENVTL. L.J.* 145, 147-48 (1995).

¹¹⁵ See Muys, *supra* note 113, at 311-12.

¹¹⁶ See *id.*

¹¹⁷ See *id.*

¹¹⁸ See *supra* notes 78-91 and accompanying text.

¹¹⁹ Muys, *supra* note 113, at 312.

Congress is not necessarily based on notions of efficiency. Instead, individual members of Congress could give in to "special interests" and therefore vote against economically advantageous decisions.¹²⁰ For example, if a Southern Cotton Growers lobby could exert enough influence on members of Congress from the southeast region, Georgia could wind up with windfalls, while Alabama and Florida would be forced to deal with fewer water resources. It is because of special interest influence, more than the informational restraints, that congressional apportionment should be avoided at all costs.

B. *Judicial Apportionment*

A second means to allot water rights between states is the doctrine of judicial apportionment. The Supreme Court has constitutional authority over "[c]ontroversies between two or more States,"¹²¹ and additional legislative authority from Congress provides that the Court "shall have original and exclusive jurisdiction over all controversies between two or more States."¹²²

Using this authority, the Court developed its own system of allocation of water rights in disputes between states.¹²³ The doctrine of "Equitable Apportionment" was first introduced in *Kansas v. Colorado*.¹²⁴ The term states exactly the goal of the Court in applying the standard—equitably dividing the pie for all parties. To do so, the Court laid out a number of factors to consider, including: priority of appropriation, physical and

¹²⁰ See *id.*

¹²¹ U.S. CONST. art. III, § 2, cl. 1.

¹²² 28 U.S.C. § 1251(a)(1) (1993 & Supp. 1997). In its original jurisdiction, the court effectively serves as a trial court. See *Rhode Island v. Massachusetts*, 37 U.S. 657, 657 (1838).

¹²³ The Court's original jurisdiction "has been invoked in disputes on the Arkansas, Colorado, Connecticut, Delaware, Laramie, Mississippi, North Platte, Rio Grande, Vermeo, and Walla Walla Rivers." CHARLES J. MEYERS ET AL., *WATER RESOURCE MANAGEMENT* 950 (3d ed. 1988).

¹²⁴ 206 U.S. 46, 117 (1907); see also *Nebraska v. Wyoming*, 325 U.S. 589 (1945) (applying the equitable apportionment principle).

climactic conditions, consumptive uses of water in the different sections of the river, character and rate of return flows to the river, the extent of established uses, availability of storage water, practical effect of wasteful uses on downstream users, and damages to upstream users as compared to benefits downstream.¹²⁵ The Court asserted that this list was not exhaustive, thereby laying the groundwork for a nearly infinite number of considerations.¹²⁶

Although the Court in *Nebraska v. Wyoming*¹²⁷ asked the right questions, it freely admitted that it was not the best venue in which to decide the issue.¹²⁸ The Court restated this idea in *Texas v. New Mexico*.¹²⁹ The central criticism of judicial allocation of water resources under the Equitable Apportionment doctrine is that the court lacks the expertise that is necessary to make allocation decisions of such monumental importance.¹³⁰ In fact, unless the Justices of the Supreme Court were educated fully as to the issues involved in water apportionment decisions, it would be impossible for them to establish an economically optimal decision. To educate the Court to a point where it could make a somewhat informed decision requires far too many resources to be truly efficient. For example, *Arizona v. California*¹³¹ cost several million dollars to litigate, with thousands of pages of data, most

¹²⁵ *Nebraska v. Wyoming*, 325 U.S. at 618.

¹²⁶ *See id.*

¹²⁷ 325 U.S. 589 (1945).

¹²⁸ *See id.* at 616. In fact, the court, in cases of water rights disputes, employs a Special Master to hear the evidence, decide on motions, determine legal questions, and recommend the solution. Though the Court has the final decision, it pays greater deference to the Special Master's determination. *See* William D. Olcott, Comment, *Equitable Apportionment: A Judicial Bridge Over Troubled Waters*, 66 NEB. L. REV. 734, 736 (1987).

¹²⁹ 462 U.S. 554, 575-76 (1983).

¹³⁰ *See* Erhardt, *supra* note 1, at 213-14; *see also* GOLDFARB, *supra* note 26, at 53 (claiming the court lacks the technical resources to handle complicated questions involved in apportioning water rights).

¹³¹ 373 U.S. 546 (1963).

of which would appear to be nothing more than scientific nonsense to one without a technical background.¹³²

Second, even if the Supreme Court could develop a solution for a particular water rights dispute, the system created would amount to nothing more than a series of quick fixes.¹³³ This is true because the only mechanism available to states with a grievance under an equitable apportionment system is more litigation. The Court does not have the resources to monitor constantly the parties to a dispute, creating an incentive for states to "cheat" because further litigation is ungainly and incremental increases in consumption by upstream users may go unnoticed. Even if noticed, the chance that another state would mount a full-scale judicial attack on that action is slim. After all, it took a fairly drastic plan by Georgia and the Army Corps of Engineers to push Alabama to action in 1992.¹³⁴

Together, the lack of Court expertise, high cost of litigation, adjudicatory elements, and incentives to cheat, all create a system fraught with extremely high transaction costs that will, even in the short run, amount to inefficient allocation of water rights. It is precisely for this reason that the Court is so reluctant to play the role of referee in a water rights dispute.¹³⁵ It is also for this reason that the Court openly favors the use of interstate compacts.¹³⁶

¹³² See Erhardt, *supra* note 1, at 214 n.74 ("In addition, judicial apportionment is expensive . . . the Special Master in *Arizona v. California* received, as compensation (not including expenses), \$185,000. Prof. Corker, who represented California in the litigation, estimates total costs at \$50 million.") (quoting CHARLES MEYERS & A. DAN TARLOCK, *WATER RESOURCE MANAGEMENT* 402 (2d ed. 1980)); see also GOLDFARB, *supra* note 26, at 53 (discussing the high cost of litigation).

¹³³ See Erhardt, *supra* note 1, at 214 n.75 (discussing the lack of finality inherent with equitable apportionment).

¹³⁴ See *supra* text accompanying notes 99-108

¹³⁵ See *supra* notes 127-29 and accompanying text.

¹³⁶ See *supra* notes 127-29 and accompanying text.

C. Interstate Water Compacts

The final means to divide water rights between states is the use of an interstate compact.¹³⁷ The key issue underlying these compacts is prior appropriation for future use. While negotiating compacts, states attempt to anticipate future uses of water and apportion rights accordingly.¹³⁸ Therefore, the most important aspect of any compact is the enforcement mechanism, which could take one of two forms. The first model is a prescriptive mechanism that provides guidelines for state agencies to implement.¹³⁹ The purpose of such a scheme is "to delimit the scope of the arrangements, to control the use of the resource, to control the activities of the management agencies themselves, and to protect the arrangement."¹⁴⁰ In effect, the agreement becomes the enforcement mechanism for apportioning water rights between the states.

A second approach is the use of an interstate commission or agency.¹⁴¹ Such commissions consist of representatives of each state involved and

¹³⁷ Buck, Gleason, and Jofuku divide interstate compacts into three groups: binding without congressional consent, binding with congressional consent, and non-binding. The authors point out that though the non-binding compacts would appear unlikely to work well, they are in fact effective. See Susan J. Buck et al., *The Institutional Imperative: Resolving Transboundary Water Conflict in Arid Agricultural Regions of the United States and the Commonwealth of Independent States*, 33 NAT. RESOURCES J. 595, 619 (1993).

¹³⁸ See Muys, *supra* note 113, at 314 n.17 (citing the Colorado River Compact); see also Saunders, *Reflections of Sixty Years of Water Law Practice*, 1 COLO. L. REV., Resource Law Notes 7, 9-10 (1989); Richard A. Sims et al., *Interstate Compacts and Equitable Apportionment*, 34 ROCKY MTN. MIN. L. INST. § 23.01, § 23.03 (1988).

¹³⁹ See, e.g., Colorado River Compact art. III, COLO. REV. STAT. ANN. § 37-61-101 (West 1990).

¹⁴⁰ Buck et al., *supra* note 137, at 619 (quoting V. Tinsely & L. Nielsen, *Interstate Fisheries Arrangements: Application of a Pragmatic Classification Scheme for Interstate Arrangements*, 6 VA. J. NAT. RESOURCES L. 265, 272 (1987)).

¹⁴¹ See *id.* (the Upper Colorado River Compact, Rio Grande Compact and Delaware River Basin Compact are examples of this form of administration).

usually includes the federal government.¹⁴² It is within these commissions that the true worth of a water compact is revealed. Commissions, as permanently standing bodies, can accumulate information and can remain constantly in negotiation, thus adapting to changing circumstances. Additionally, the commission system lowers transaction costs, because all information collection and negotiation is centralized. For these reasons, the use of interstate water compacts results in both short-term and long-term efficiency.

One constraint on these negotiated solutions is that the compacts often are subject to congressional approval¹⁴³ under Article I of the Constitution.¹⁴⁴ There is some dispute over how the Compact Clause applies in practice. In particular, the issue is whether the nature of the compact dictates whether it must be approved by Congress or not.¹⁴⁵ One view, building upon the language of *Virginia v. Tennessee*,¹⁴⁶ asserts that a compact only needs to be approved when it threatens the political balance of power.¹⁴⁷ The general consensus, however, which finds support in *Dyer v. Sims*,¹⁴⁸ is that all compacts require congressional consent. In fact, in the water rights context this seems particularly true. Because nearly every river is to some degree tied to interstate trade, Congress's power under the Commerce Clause allows the national legislature to have a say in any state action that affects a

¹⁴² See, e.g., Upper Colorado River Compact art. VIII, COLO. REV. STAT. ANN. § 37-62-101 (West 1990); Rio Grande Compact art. XII, COLO. REV. STAT. ANN. § 37-66-101 (West 1990); Delaware River Basin Compact § 2.2, DEL. CODE ANN. tit. 7, § 6501 (1974).

¹⁴³ This is true notwithstanding the classification made by authors Buck et al. See *supra* note 137.

¹⁴⁴ See U.S. CONST. art I, § 10, cl. 3 ("No State shall, without the Consent of Congress . . . enter into any Agreement or Compact with another State, or with a foreign Power . . .").

¹⁴⁵ See Muys, *supra* note 113, at 314, 318 n.16.

¹⁴⁶ 148 U.S. 503 (1893) (boundary dispute case between Virginia and Tennessee).

¹⁴⁷ See 148 U.S. at 518-19.

¹⁴⁸ 341 U.S. 22 (1951) (holding compact to control water pollution is not invalid because it delegates police power to the federal government).

watercourse.¹⁴⁹ In the dispute over the Chattahoochee, congressional involvement is especially important, due to the strong presence of the U.S. Army Corps of Engineers.¹⁵⁰ Thus, any final action regarding the "Hooch" certainly requires Congressional approval. The need for such approval is not a particularly large hurdle to clear for states wishing to utilize water compacts. Since Congress first approved a water compact dealing with the Colorado River in 1922, it has approved at least thirty other compacts dealing with various interstate water rights issues.¹⁵¹ Furthermore, Congress rarely refuses to ratify a compact, once negotiated.¹⁵²

As mentioned before, one of the principal advantages of water compacts over other methods of apportionment is that water compacts centralize information and thus lower transaction costs.¹⁵³ Tied to this advantage is the idea of certainty. Because compacts create a baseline for apportionment of rights in the long run, as well as establishing an authorized body to deal with, compacts generate a level of certainty for those utilizing water resources. Certainty, the basis of contract theory, assists in planning for all economic actors, be they public or private.¹⁵⁴ The contract analogy goes further than that recognized by the Supreme Court in *Texas v. New Mexico*.¹⁵⁵ The Court pointed out that because compacts had such a

¹⁴⁹ See Muys, *supra* note 113, at 311; see also *Arizona v. California* 373 U.S. 546, 597-98 (1963).

¹⁵⁰ See *supra* text accompanying notes 95-108.

¹⁵¹ See Erhardt, *supra* note 1, at 216 n.86 (citing JEROME C. MUYS, INTERSTATE WATER COMPACTS: THE INTERSTATE COMPACT AND FEDERAL-INTERSTATE COMPACT 5 (National Water Commission 1971); GOLDFARB, *supra* note 26, at 54.

¹⁵² However, Congress did not approve the 1970 Compact between California and Nevada to solve the Tahoe Truckee dispute. See Reid, *supra* note 114, at 160 n. 95.

¹⁵³ See *supra* text accompanying notes 137-42.

¹⁵⁴ See Charles Seabrook, *State Releases Details of Plans on Waterways Formulas to be Worked out with Fla., Ala.*, ATL. J. & CONST., Dec. 12, 1996, at A21, available in 1996 WL 8245987 ("Under the compacts, Georgia will 'give up some sovereignty' over the rivers that originate within its boundaries, but it 'would gain certainty' in how much water it can depend on for growth . . .").

¹⁵⁵ 482 U.S. 124, 128 (1987) ("[A] Compact is, after all, a contract.") (quoting *Petty v. Tennessee-Missouri Bridge Comm'n*, 359 U.S. 275, 285 (1959) (Frankfurter, J., dissenting)).

contractual similarity, contract remedies such as rescission or reformation were possible.¹⁵⁶ Thus, compacts have a judicial safety valve built into them should the commission system fail to adequately deal with unforeseen circumstances. On the whole, the commission system allows for equitable and efficient allocation of resources, without many of the efficiency concerns haunting the judicial and congressional apportionment schemes.

This is not to say, however, that compacts are flawless. One of the biggest problems facing states using such compacts is that water supply estimates often are inaccurate.¹⁵⁷ This is troublesome because these estimates form the basis for long-term "fine-tuning" of allocations. If estimates are sufficiently inaccurate, the basis for the system is undermined. Consequently, commissions must be especially careful to keep such problems in mind when dealing with any estimates.

A second flaw in the system is the specter of federal interference with the compact mechanism.¹⁵⁸ One aspect of this problem is the need for congressional approval of water compacts.¹⁵⁹ By requiring such approval, the system limits the contractual rights of the states, and thus the Supreme Court's contract analogy falls short. Also, state water compacts, in several cases, do not adequately deal with federal water uses. A compact that does not account for federal drains on water resources is doomed to fail. All users must be accounted for and dealt with for a compact to be successful. An omission of the federal government's interests in water rights means that any decisions made will fail under Coase's five pillars.¹⁶⁰

¹⁵⁶ See *id.* (noting the ability of the Court to fashion remedies for failure to perform, along with mandating future performance).

¹⁵⁷ See Muys, *supra* note 113, at 314 n.17 (suggesting that 13.5 million acre-feet per annum is the actual use of the upper basin, instead of the 17.5 million allocated by the compact).

¹⁵⁸ In the case of the "Hooch," the federal government is represented by the large presence of the U.S. Army Corps of Engineers and its role in development of the Chattahoochee Lake Lanier. See Erhardt, *supra* note 1, at 217-24.

¹⁵⁹ See *supra* notes 143-52 and accompanying text.

¹⁶⁰ See *supra* text accompanying notes 78-91.

Another problem with the compact paradigm is that commissions are not given free rein over water policy. The representatives on commissions still must answer to their state legislatures.¹⁶¹ Furthermore, if the federal government is not a signatory to the compact, there is always the possibility of bullying by the federal government. Additionally, compacts can create an incentive for parties to break the agreement. The situation in a water compact is somewhat analogous to that of the famous "prisoner's dilemma."¹⁶² Even after an effective mechanism is in place, each state has much to gain by ignoring the agreement.¹⁶³

One final problem, on the public side of the equation, is the role of special interests within each state. The fact that rights are apportioned to each state does not necessarily mean that water will, by definition, flow to the most efficient users within each state. Instead, those who have the greatest political power can exact privileges within the state that may put resources to inefficient uses.¹⁶⁴

On a private level, water compacts can create short-term uncertainty for users. Though compacts are forward looking, there may be sacrifices in short- and long-term consumption that must be made. These sacrifices will, to some measure, fall on large private users to the point that such compact-induced scaling back could rise to the level of a constitutional "taking."¹⁶⁵ A compact, to truly reflect economic reality, must have some means by which

¹⁶¹ See, e.g., Colorado River Compact art. VI, COLO. REV. STAT. ANN. § 37-61-101 (West 1990); Upper Colorado River Compact art. VIII, COLO. REV. STAT. ANN. § 37-62-101 (West 1990); Rio Grande Compact art. XII, COLO. REV. STAT. ANN. § 37-66-101 (West 1990).

¹⁶² See KEN BINMORE, GAME THEORY AND THE SOCIAL CONTRACT VOL. 1: PLAYING FAIR 102-04 (1994) (describing the "dilemma" when two distinct parties must make a rational choice without the benefit of consultation).

¹⁶³ This is true because the generally accepted solution to the "prisoner's dilemma" is for each party to act selfishly. See *id.*

¹⁶⁴ See *supra* notes 119-20 and accompanying text.

¹⁶⁵ See Delaware River Basin Compact § 14.14, DEL. CODE ANN. tit. 7, § 6501 (1974) (outlining condemnation procedures).

to compensate the losers. This is the requirement of K-H efficiency,¹⁶⁶ and one of Coase's pillars.¹⁶⁷

V. THE REGIONAL APPROACH TO WATER RIGHTS

The water supply situation in the Southwestern United States is similar to the dilemma facing Alabama, Florida, and Georgia.¹⁶⁸ Like the Chattahoochee River, the combination of the Colorado and Rio Grande Rivers account for a huge portion of the Southwest's irrigation.¹⁶⁹ Also like the Chattahoochee/Apalachiola River Basin, the Colorado and Rio Grande pass through several states, each with conflicting claims to the waters.¹⁷⁰ These conflicting claims have led to the development of three main region-based regimes to deal with water apportionment.¹⁷¹ These regimes are based on the Colorado River Compact,¹⁷² Upper Colorado River Compact,¹⁷³ and Delaware River Basin Compact.¹⁷⁴ Additionally, the conflict over the Delaware River Basin has led to a substantially more advanced system of interstate water rights: the federal-interstate compact.¹⁷⁵

¹⁶⁶ See *supra* notes 70-77 and accompanying text.

¹⁶⁷ See *supra* notes 90-91 and accompanying text.

¹⁶⁸ See *supra* notes 93-98 and accompanying text.

¹⁶⁹ Combined, the rivers constitute 90% of the irrigation resources for the region. See Buck et al., *supra* note 137, at 610.

¹⁷⁰ The Colorado passes through Arizona, California, Colorado, New Mexico, Utah, Wyoming. The Rio Grande passes through Colorado and New Mexico, and then forms the Texas-Mexico border. See *id.*

¹⁷¹ See *id.* at 619.

¹⁷² Colorado River Compact, COLO. REV. STAT. ANN. § 37-61-101 (West 1990).

¹⁷³ Upper Colorado River Compact, COLO. REV. STAT. ANN. § 37-62-101 (West 1990).

¹⁷⁴ Delaware River Basin Compact, DEL. CODE ANN. tit. 7, § 6501 (1974).

¹⁷⁵ See Erhardt, *supra* note 1, at 224-27.

A. *The Colorado River Basin Regimes*

1. *The Colorado River Compact*

The Colorado River Compact of 1922¹⁷⁶ ("CRC") is based on the notion of "equitable division and apportionment of the use of the waters of the Colorado River system"¹⁷⁷ and beneficial consumptive use.¹⁷⁸ It provides 7,500,000 acre feet of water per year for economically beneficial use¹⁷⁹ to the states of both the upper¹⁸⁰ and lower basin.¹⁸¹ The CRC also preserves "present perfected rights" in the beneficial use of the Colorado River,¹⁸² thus building certainty for past users. The establishment of predictability for original uses is essential because only the certainty of basic entitlements allows the law to distribute those rights peripherally under a K-H setting.¹⁸³

What the CRC lacks, however, is a mechanism for an interstate committee. Instead, any disputes are handled on an ad hoc basis.¹⁸⁴ Herein lies one of the more troubling aspects of this type of regime. The benefits of having set water allocations are disrupted by the fact that there is limited flexibility inherent in the system.¹⁸⁵ The lack of a standing commission

¹⁷⁶ COLO. REV. STAT. ANN. § 37-61-101 (West 1990).

¹⁷⁷ *Id.* art. I.

¹⁷⁸ *See id.*

¹⁷⁹ *See id.* art. III(a).

¹⁸⁰ The compact defines the "Upper Basin" as "those parts of the States of Arizona, Colorado, New Mexico, Utah and Wyoming within and from which waters naturally drain into the Colorado River System above Lee Ferry." *Id.* art. II(f).

¹⁸¹ The "Lower Basin" is defined as "those parts of the States of Arizona, California, Nevada, New Mexico and Utah within and from which waters naturally drain into the Colorado River System below Lee Ferry." *Id.* art. II(g).

¹⁸² *See id.* art. VIII.

¹⁸³ *See supra* notes 70-77 and accompanying text.

¹⁸⁴ In the event of a dispute, the governors of the states in dispute are to name commissioners to negotiate an adjustment, ultimately subject to congressional approval. *See Colorado River Compact* art. VI.

¹⁸⁵ *See id.* art. III.

greatly increases transaction costs whenever a dispute arises. There are costs in naming commissioners, setting up negotiations, gathering information, and ultimately negotiating a new deal. All of these costs could be reduced dramatically by the institution of a permanent body to administer the river.

The CRC also suffers from the exclusion of the United States as a signatory. The Directors of the United States Reclamation Service and the United States Geological Survey are bound to cooperate, *ex officio*, but there is nothing else within the terms of the agreement that places any burden on the federal government to limit its potential uses.¹⁸⁶ It is very difficult to effectively allocate resources with one major user left out of the equation. Hence, the Colorado River Compact falls short of the economic ideal.

2. *Upper Colorado River Compact*

The Upper Colorado River Compact¹⁸⁷ ("UCRC") is a step in the right direction. Its purpose is to specifically allocate the 7,500,000 acre feet of water provided to the upper river basin in the CRC.¹⁸⁸ Rather than set exact numbers,¹⁸⁹ the states are granted percentages of the water flow¹⁹⁰ in order to follow the concepts of equitable apportionment and beneficial use. This apportionment works in conjunction Article III of the CRC to maintain exact proportions, depending on water supplies in the Colorado, during times of surplus and shortfall.¹⁹¹

The UCRC represents a significant step beyond the CRC by including, within its provisions, the formation of the "Upper Colorado river commission."¹⁹² The Commission has the power to adopt rules and

¹⁸⁶ See *id.* art. V.

¹⁸⁷ Upper Colorado River Compact, COLO. REV. STAT. ANN. § 37-62-101 (West 1990).

¹⁸⁸ See *id.* art I(a).

¹⁸⁹ Arizona is limited to 50,000 acre-feet per year. See *id.* art. III(a)(1).

¹⁹⁰ Under the Agreement, Colorado is entitled to 51.75%, New Mexico receives 11.25%, Utah receives 23%, and Wyoming has claim to 14% of the 7,500,000 minus Arizona's 50,000 acre-feet. See *id.* art. III(a)(2).

¹⁹¹ See *id.* art. IV.

¹⁹² *Id.* art. VIII.

regulations, engage in studies of the river and its tributaries, study stream flows and uses, and, most importantly, “determine the quantity of the consumptive use of water, which use is apportioned by article III hereof.”¹⁹³ Thus, the UCRC erects a mechanism for flexible application of the compact. The advantages of such a system are significant. With long-standing commissioners working together and information equally available to all parties, any negotiations regarding future use require lower transaction costs.

The federal specter remains, however. Like the CRC, the United States is not a signatory. Nevertheless, the UCRC does request the President to appoint a commissioner.¹⁹⁴ This measure is a good step, but ultimately, it falls short. Mere congressional approval of the UCRC and the appointment of a commissioner does not bind the federal government to any set level of usage. In fact, the UCRC provides that nothing within the statute can affect any “rights or powers of the United States of America, its agencies or instrumentalities, in or to the waters of the upper Colorado river system, or its capacity to acquire rights in and to the use of said water.”¹⁹⁵ Thus, the very purpose of such an agreement, the efficient allocation of water rights, is defeated because one of the major users of water is left out of the equation. One must look elsewhere for the economically optimal solution.

B. *The Rio Grande Compact*

The Rio Grande Compact¹⁹⁶ (“RGC”) is slightly more troublesome to decipher. Based on the notion of equitable apportionment,¹⁹⁷ the compact forces Colorado and New Mexico to allow certain levels of water to reach downstream users.¹⁹⁸ The RGC painstakingly lays out requirements for the

¹⁹³ *Id.* art. VI.

¹⁹⁴ *See id.* art. VIII(a).

¹⁹⁵ *Id.* art. XIX.

¹⁹⁶ Rio Grande Compact, COLO. REV. STAT. ANN. § 37-66-101 (West 1990).

¹⁹⁷ *See* Buck et al., *supra* note 137, at 622.

¹⁹⁸ *See id.*

parties, but allows for a certain level of flexibility within parameters set out in the document.¹⁹⁹

Like both of the Colorado River regimes, the RGC does not include the federal government as a signatory. Further, any representative sent by the United States government only would serve as a non-voting chair of the commission created by the Compact.²⁰⁰ For the reasons discussed above,²⁰¹ this may not be an optimal solution.

C. *The Delaware River Basin Compact*

The Delaware River Basin Compact²⁰² ("DRBC") represents a significant step towards efficiency in the use of water compacts. The DRBC arose out of the realization that potentially 40,000,000 people will live within the basin by the year 2010.²⁰³ Though water resources are plentiful, the resource must be managed properly for any potential population increase.²⁰⁴ The DRBC represents one of the first attempts to create a truly integrated water allocation mechanism.²⁰⁵ The DRBC accomplishes this by including the federal government as a signatory to the pact, thus replacing the overlapping authority of forty-three state agencies, fourteen interstate

¹⁹⁹ See Rio Grande Compact arts. I, IV-VIII.

²⁰⁰ See *id.* art. XII.

²⁰¹ See *supra* text accompanying notes 186, 195.

²⁰² Delaware River Basin Compact, DEL. CODE ANN. tit. 7, § 6501 (1974).

²⁰³ See *id.* § 1.

²⁰⁴ See *id.* § 1.3(d).

²⁰⁵ The text of the Compact points out that:

WHEREAS decisions of the United States Supreme Court relating to the waters of the basin have confirmed the interstate regional character of the water resources of the Delaware River Basin, and the United States Corps of Engineers has in a prior report on the Delaware River Basin (House Document 179, 73d Cong. 2nd Sess.) officially recognized the need for an interstate agency and the economies that can result from unified development and control of the water resources of the basin.

Id. § 1.

agencies, and nineteen federal agencies with one commission given broad powers for administration of the river basin.²⁰⁶

The ramifications of this choice of administration are significant. Under the DRBC, the federal government is no longer free to do as it wishes on the Delaware River.²⁰⁷ Instead, the federal government must comply with the water levels allocated to it by the compact, via the enforcing commission.²⁰⁸ The pact tracks the doctrine of equitable apportionment, most likely as an effort to avoid the rigidity of traditional compacts and to avoid interference from the Supreme Court.

The DRBC meets several of the criteria of Coasian analysis. Transaction costs are lowered because state and federal interests are weighed concurrently and because the information acquired from federal sources adds to the overall picture of water usage in a particular river basin. This type of complete information is essential for parties to determine the allocatively efficient level of water usage by each user of the watercourse.²⁰⁹ The ability of the states to operate with the federal government on an equal basis within the committee mechanism, centralizes negotiations further lowering costs.

Additional efficiency measures in the compact include the ability of the commission to condemn property, including riparian rights, for use in projects sponsored by the commission.²¹⁰ Condemnation proceedings set up a typical K-H system by which those who lose their entitlements are compensated for the loss, allowing the entitlement to be used for more efficient purposes. Also, the DRBC includes a section providing for penal sanctions in the event "[a]ny person, association or corporation"²¹¹ violates

²⁰⁶ *See id.*

²⁰⁷ Section 1 of the Delaware River Basin Compact states that the Interstate River Commission on the Delaware River Basin "concluded that regional development of the Delaware River Basin is feasible, advisable and urgently needed; and has recommended that an interstate compact with federal participation be consummated to this end." *Id.*

²⁰⁸ *See id.* arts. II, III.

²⁰⁹ *See supra* notes 68-91 and accompanying text.

²¹⁰ Delaware River Basin Compact § 14.14.

²¹¹ *Id.* § 14.17.

the terms of the compact or the rules of the commission.²¹² These efficiency measures are a tremendous leap beyond the Colorado and Rio Grande Compacts. Furthermore, the inclusion of the federal government as an active participant in all decisions means that any determinations reached by the commission have the air of greater authority. The imprimatur of authority, in turn, may have the effect of limiting, at least to some extent, the incentive for parties to engage in opportunistic activity.²¹³

It is on this point, however, that an important shortcoming of the DRBC reveals itself. Congress insisted on a "safety valve" clause within the compact, which allows the federal government to effectively "seize" the resources of the river in times of need.²¹⁴ This provision creates the possibility, albeit a remote one, that the federal government could circumvent completely the other terms of the compact. If such a use were so important to the nation, it is likely the committee and the respective states would agree to shift water usage accordingly. This would protect the integrity of the compact at a fairly low cost in terms of negotiation and collection of information. Yet, this important shortcoming is far outweighed by the large gains in efficiency that are produced by the DRBC. Because of the tremendous efficiency advantages, a federal-interstate compact represents the most economically intelligent idea for Alabama, Florida, and Georgia to pursue. The following section will look more closely to the efficiency concerns addressed and raised by such a compact.

²¹² See *id.*

²¹³ "[F]ederal codification 'limits the ability of a compacting state to withdraw from the compact on any terms other than those set forth in the compact itself.'" Reid, *supra* note 114, at 161 (quoting JOSEPH L. SAX ET AL., *LEGAL CONTROL OF WATER RESOURCES* 736 (2d ed. 1991)).

²¹⁴ See Delaware River Basin Compact § 1.4.

VI. LAW AND ECONOMICS ANALYSIS OF FEDERAL-INTERSTATE WATER COMPACTS

The use of an federal-interstate water compact is not a painless undertaking by any means. There are a number of problems that must be considered before attempting to implement such a system. Foremost is the problem of negotiating such a compact.²¹⁵ As the drawn out negotiations over the "Hooch" show, even the most urgently needed compact can take years to negotiate.²¹⁶ Upstream users are often in a very strong position in such negotiations, as they are the first in time and right. Under a riparian regime, such leverage is not particularly important due to the system's protection of downstream users. However, state regimes are just that—applicable to a particular state. As has been the case in the battle over the "Hooch," only the fear that the Supreme Court would create a wholly unacceptable solution brought the parties to the bargaining table.²¹⁷

The bargaining process also is ripe for the possibility of "free-riders" by allowing certain threatened states to do less of the work while enjoying all of the benefits. In the case of the Chattahoochee, the low number of states involved makes it easy to see if any one party attempts to free-ride in the negotiating process. However, if such negotiations took place between the signatories to the Colorado River Compact, for example, the opportunity for free-riding is always present. An analogous problem arises after the compact has been approved. Returning to the "prisoner's dilemma" problem, it is always profitable, in the short-term, for one party to a compact to break ranks and opportunistically "take from the cookie jar." Some authors note, on the other hand, that compacts actually eliminate the incentive to "shirk" or "free-ride," and that "[r]emoving discussion from the local level . . . moderated the interests of the states as separate parties in collective action deliberations."²¹⁸

²¹⁵ See Reid, *supra* note 114, at 175.

²¹⁶ The Southeastern Water Pact has been negotiated over constantly since 1992.

²¹⁷ See Charles Seabrook, '97 *Georgia Legislature Murphy Panel Support Tri-State Water Agreement*, ATL. J. & CONST., Jan. 24, 1997, at B3, available in 1997 WL 3951219 (citing state House Speaker Tom Murphy's fear of U.S. Supreme Court intervention).

²¹⁸ Buck et al., *supra* note 137, at 626.

What is important to note is that incentives for opportunism continue to exist even with the institution of a compact system, and that additional steps may be required to prevent such activities. The Delaware River Basin Compact represents a significant step in the right direction because of its inclusion of penal sanctions for those who violate the compact.

A second major problem with the concept of a federal-interstate compact is the ever-present specter of federal meddling.²¹⁹ In the case of the Southeastern Water Compact, the role of the Army Corps of Engineers makes the federal government an especially important player. As discussed earlier, the Corps has had a strong presence in the basin since the middle of the century by virtue of several congressional acts.²²⁰ In addition, a federal-interstate compact would raise Commerce Clause problems.²²¹ Congress always will hold a Commerce Clause trump card over any action by the commission, though making the United States a party to the compact limits that power considerably.

The DRBC solution, despite these shortfalls, serves as the most appropriate means to allocate water rights between states. The reason is that even with limited participation by the federal government, the commission still can create a more vivid picture of the uses of water within the region and prompt the parties to adjust accordingly. Further, a commission, with all parties accounted for, remains a very flexible mechanism for apportioning rights. A great deal of the formality of negotiating can be eliminated by using such a compact because the parties are authorized to negotiate only subject to certain restrictions. Any major change would require formal approval by the states and the federal government, but minor changes can be implemented and then "rubber stamped" by the respective governments with little fear that interests are being sacrificed.

Again, the five pillars of Coase are useful to analyze the economic efficiency of a compact, in particular, the DRBC model. The basic theorem

²¹⁹ See *supra* note 158-60 and accompanying text. This could take the form of "bullying" during the negotiation process for favorable terms (as could be the case with the escape valve clause in the DRBC).

²²⁰ See *supra* note 4 and accompanying text.

²²¹ See U.S. CONST. art I, § 8, cl. 3.

states that in a world absent transaction costs, parties will negotiate the most economically efficient outcome.²²² Thus the question is raised—would an interstate water compact, modeled after the DRBC, create the most efficient solution for Alabama, Florida, Georgia, and the United States government? The fact that transaction costs would be reduced greatly by such an arrangement already has been discussed.²²³ The DRBC model also recognizes the importance of property rights within the scheme.²²⁴ The ideal compact serves as the ingredients of a pie which can later be fixed in final form and equitably divided by the commission. The DRBC is set up in just such a way. In fact, such a system goes beyond K-H optimization, almost achieving Pareto superior allocations which increase the size of the pie for all. The DRBC system creates certainty as well, by generating parameters within which all parties can work, while also constructing a mechanism (the commission) by which adjustments can be made depending on circumstances.²²⁵

Finally, the use of condemnation provisions²²⁶ allows the commission to achieve pure K-H efficiency. Those users that must be supplanted by projects deemed essential by the commission can be compensated for their loss subject to federal and state condemnation laws. While these condemnation actions may be subject to takings criticism, economic efficiency requires that if a resource can be put to a better use, it should. Economic efficiency is especially vital when a scarce resource like water is involved.

CONCLUSION

The Southeastern Water Compact marks an important step in the development of the Chattahoochee/Apalachiola River basin. Growth comes

²²² See *supra* notes 78-91 and accompanying text.

²²³ See *supra* text accompanying note 209.

²²⁴ See *supra* text accompanying notes 210-12.

²²⁵ See Erhardt, *supra* note 1, at 225; see also Muys, *supra* note 113, at 316-18.

²²⁶ See *supra* text accompanying note 210.

at a price, however. In the case of Alabama, Florida, and Georgia that price is the potential scarcity of water resources in the basin. Water is a resource that has historically been vehemently fought over and this case is no different.

Southern states were faced with three potential choices for dealing with the dispute: congressional apportionment, judicial apportionment, or the use of an interstate compact. Though Alabama originally intended to resort to the Supreme Court for a remedy to the dispute over the "Hooch," it realized the dangers of such a solution and turned, along with all the parties, to the compact system. The choice now facing the parties is exactly which system to follow. There are three possible approaches: the Colorado River Compact, the Upper Colorado River Compact/Rio Grande Compact, or the Delaware River Basin Compact. Each has its merits, but the failure of the first two types of compacts to include the federal government as a party makes them less attractive in terms of true economic efficiency.

What remains is the solution proposed by the Delaware River Basin Compact. Such a compact would provide Alabama, Florida, Georgia, and the federal government with a means to properly deal with allocation of water rights in the Chattahoochee/Apalachiola river basin. Though not flawless, the DRBC Model comes closest to true economic efficiency by ensuring that resources are initially divided according to economic use, while allowing flexibility to long-term apportionment—all at relatively low transaction costs.

Normative economic analysis steers rational policy makers away from the Colorado/Rio Grande models, while positive economic analysis illuminates the advantages and possible trade-offs that must be made by choosing the DRBC. Wherever the parties in the dispute over the "Hooch" ultimately end up, it is safe to say that the states at least have taken a step towards achieving the law and economics goal of efficiency by choosing the compact route.