DUE DILIGENCE IN DRAFTING GROUNDWATER TRANSFER AGREEMENTS

FRANK Z. RUTTENBERG, San Antonio
Bracewell & Giuliani

State Bar of Texas
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THE CHANGING FACE OF WATER RIGHTS IN TEXAS
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Bastrop

CHAPTER 3
Frank Z. Ruttenberg
Partner
San Antonio Office

(T) 210.299.3467  (F) 210.299.0123

E-mail: frank.ruttenberg@bracewellgiuliani.com

Profile
Frank Z. Ruttenberg has been practicing law as a commercial and real estate lawyer in San Antonio since 1979. Mr. Ruttenberg's real estate practice includes the negotiation and preparation of documents relating to the sale, purchase, and operation of income producing properties, day-to-day operations for apartment complexes, acquisition of multi-family housing, landlord/tenant relations, real estate financing, commercial leasing, real property development, easements, leases, and commercial transactions with governmental agencies, and the preservation of historic structures.

Mr. Ruttenberg's practice in general commercial law includes assisting business with day-to-day operating needs, negotiating and drafting business contracts, the formation of business entities including limited partnerships, limited liability companies, general partnerships, registered limited liability partnerships and corporations, as well as the preparation of intra owner documentation relating to such entities.

In recent years, Mr. Ruttenberg has been involved in assisting clients in connection with the purchase of groundwater rights and surface water rights throughout the state of Texas. His experience in dealing with water rights includes negotiating and drafting documents for the purchase and sale of groundwater rights, the lease of groundwater rights, the development of diversion facilities for the diversion of surface water rights, and other water development and water supply agreements.

Mr. Ruttenberg has also handled the preparation of private offerings in connection with the formation of investment capital, the redevelopment and preservation of historic theaters, and general business matters.
Mr. Ruttenberg is listed among the *Best Lawyers in America* for real estate law. *Scene in San Antonio Monthly* named him among the Most Influential San Antonians of 2005, stating that he has been "widely regarded as the 'best of the best' in real estate and water law."

Mr. Ruttenberg is a frequent lecturer at state-wide seminars which have included the annual University of Texas Course on Partnerships and Related Business Entities, and the annual State Bar of Texas Advanced Real Estate Course.

**Affiliations**

American Bar Association, Tax Section Committee on Partnerships  
Texas Real Estate Commission Broker/Lawyer Committee (oversees the promulgation of the TREC Real Estate forms for the State of Texas)  
State Bar of Texas, Real Estate Probate and Trusts Section  
State Bar of Texas, Business Law Section, Chair of the Partnership and Limited Liability Company Law Committee  
San Antonio Bar Association, Real Estate Discussion Group  
American Bar Association, Business Section  
Real Estate Council of San Antonio  
Board of Directors, San Antonio Zoo

**Speeches**

Drafting Issues: Limited Partnership Agreements for Landowners and Developers; Texas University School of Law - Mortgage Lending Institute (September 2006)

Limited Liability Company Drafting Company Agreements Under the Code; State Bar of Texas; Texas Business Organizations' Choice of Entities and Formations (2006)


Changing Face of Water Rights - Groundwater Conveyancing (Sale and Lease); State Bar of Texas (2005)

Transferring Groundwater Rights; San Antonio Bar Association - Natural Resources Section (2004)
Due Diligence in Drafting Groundwater Transfer Agreements

Frank Z. Ruttenberg
Bracewell & Giuliani LLP
106 S. St. Mary’s Suite 800
San Antonio, Texas 78205

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Drafting Groundwater Transfer Agreements

Overview

- History of Texas Water Law – Groundwater vs. Surface Water
  - Surface Water – Owned by State adjudicated and use by permit
  - Groundwater – Owned by Landowner
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Overview

- Early Legal/Regulatory Scheme – Groundwater
  Law developed when there was generally sufficient supply of groundwater
  Rule of Capture – law of biggest pump - A rule that addressed lack of liability for over pumping

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Recent Trends – Regulation of Groundwater

- Increasing demand = Increased pressure on legal system to sort out rights to this resource = Increased Legal involvement
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Recent Trends – Regulation of Groundwater

➤ Under authority granted by the Texas Constitution, the State retained the authority to *regulate* the conservation of our groundwater resources.

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**Groundwater Regulation**

➤ Major Water Bills over the last four legislative sessions

SB-1, SB-2 and SB-3

➤ As a part of this regulatory scheme there are approximately 90 groundwater districts and 16 groundwater Management Areas now in existence in the State of Texas.
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Result:

Cities, industry and property owners are scrambling to firm up water rights – including groundwater

Water Rights – which use to be a passing thought to property owners are now – in certain circumstances - a very valuable property right

People are searching for the right way to obtain value from these groundwater rights
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**Purpose of Outline – Due Diligence Items**

To Address

**First**  What are we trying to transfer?

**Next** - What issues typically arise between a buyer and seller or lessors and lessees of these rights that need to be considered?

**Last** - How Much is my Water Worth?

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**Transfers of Groundwater**

Beginning Questions - What is the nature and character of these Groundwater Rights we are attempting to transfer?

- Real Property?
- Personal Property?
- Does it matter?
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Transfers of Groundwater

Case Law:

✓ Groundwater is a *part of the surface estate* of the land (not the mineral estate);
✓ The owner of land *has the exclusive property rights* to the groundwater to be used at their will; and
✓ The rights to this groundwater *include all rights* that they might have *for any other species of property*.
✓ It is subject to the Rule of Capture (maybe just a limitation on remedies?)

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Transfers of Groundwater

May be real property but may also be personal property or have personal property that goes with it in the form of permits - unclear

Non Vested Property?

In *City of Del Rio vs. Clayton Sam Colt Hamilton Trust*– Del Rio argued that the Groundwater rights did not attach to the groundwater until captured…..
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WHAT TYPE OF TRANSFERS ARE WE CONSIDERING?

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Purchase and Sale of Groundwater

How do we purchase and sell groundwater?

Most Common Forms:

✔ Buy the land and get the groundwater as a part of the bundle of sticks (not covered in this outline)

✔ Purchase of groundwater in fee simple

✔ Transfer of groundwater for a period of time

❖ Fee simple determinable

❖ Lease

❖ License

❖ Water supply agreements
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**Purchase and Sale of Groundwater**

**Legal Description:**

- What groundwater is being conveyed? – if not all of it - geological description.
- If not exclusive right to develop and use groundwater in a geological formation - physical impact of others.
- If less than all is conveyed - determine the priority for use (withdrawal limitations) and access (spacing limitations).

Physical Limitations
Regulatory Limitations

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**Access to Groundwater from Surface Estate**

Now that you have the Groundwater? What else do you need and why???
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Purchase and Sale of Groundwater

- What does a water right give you – one stick?
- What does a water right NOT give you – rest of sticks!
- O&G Distinction
- Naked Water Right

- DON’T BUY A NAKED WATER RIGHT!!

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Access to Groundwater from Surface Estate

What else does the Purchaser of Groundwater need?

✓ The right to use the surface estate for the exploration and development of the groundwater estate on an exclusive or non-exclusive basis;

✓ The right to place infrastructure on the surface estate (through a fee interest, lease or easement); and

✓ The right of ingress and egress to construct, operate and repair a water collection system.
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Purchase and Sale of Groundwater

Legal Description:

- DON’T BUY A NAKED WATER RIGHT!!

- In *City of Del Rio vs. Clayton Sam Colt Hamilton Trust* – Del Rio argued that a severance without access was void due to the fact that it violated the Texas Constitution Art 1 Sec 26 – rule against perpetuities

- Implied easement of necessity?

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Access to Groundwater from Surface Estate

- Development Responsibility – determine who will develop and deliver the groundwater?
  - Withdrawal
  - Collection
  - Storage
  - Treatment
  - Delivery
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Access to Groundwater from Surface Estate

✓ Development Responsibility –
✓ Capital investment responsibility
  - Exploration
  - Infrastructure
  - Right of Way
  - Marketing
  - Political issues

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Access to Groundwater from Surface Estate

✓ Operating responsibility and Responsibility for costs
  - Maintenance
  - Repair
  - Liability
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Access to Groundwater from Surface Estate

- Development and Operating Responsibility
- Impact on Pricing
- Allocation of risk for failure to provide

Groundwater Owner wants:
- Flexibility as to placement of facilities at beginning and in future;
- Access for construction maintenance and operations;
- Restricted use by landowner that will not interfere with withdrawal of groundwater;
- Limitations on surface penetrations (Oil and Gas);
- Limits on environmentally harmful use - sanitary control easements;
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Access to Groundwater from Surface Estate

Operating covenants or behavioral covenants relating to the Groundwater owner’s use of the surface estate;

✔ Landowner wants –
  ❖ Restricted use by groundwater owner
  ❖ Construction standards
  ❖ Limits on location of facilities - low intrusion factor
  ❖ High maintenance responsibility
  ❖ Preservation of development rights for other uses, and
  ❖ Duty of mitigation.

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Purchase and Sale of Groundwater

Mitigation:

✔ Rework wells
✔ Deliver groundwater to site
✔ Provide access to delivery system
✔ $$$$ cost to mitigate
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Due Diligence Issues

STEPS TO BE TAKEN

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Due Diligence Issues - Water

✔ Review or investigative period;
✔ Investigate groundwater hydrology and geology;
✔ Investigate water quality;
✔ Investigate water quantity (of desired future condition);
✔ Determine infrastructure needs, location and costs (wells, pipelines)
✔ Determine width of easements necessary electric and roadway
✔ Review access for construction, maintenance and repair
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Due Diligence Issues – Water Regulations

✓ Determine the limitations on withdrawal of groundwater set by the groundwater district or other regulatory body, if any.
  ✓ Aquifer by Aquifer
  ✓ Nature of water (brackish or fresh)
✓ Determine the limitations on transfers of groundwater.
✓ Determine the limitations on spacing issues for wells
✓ Determine Pooling policy
✓ Determine Impact of critical period restrictions – if any

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Due Diligence Issues Real Property

✓ Determine that no prior severance has occurred;
✓ Review title for effect of prior liens and encumbrances. Remember, security instruments may encumber the groundwater estate; and
✓ Review mineral interests which may have a claim on the water rights. Mineral estate owners may own implied surface easements and rights to use groundwater in exploration.
✓ Title Insurance
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WHAT IS MY WATER WORTH?

Groundwater has value, just like any other property. The problem is that this value isn’t uniform.

There are four factors that have the greatest influence on the value of groundwater.

- Location
- Quality
- Quantity/Reliability
- Supply and Demand
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First Factor

location, location, location!!

That is, how far is the groundwater from where it is needed and what type of infrastructure is necessary to transport the groundwater to its place of use?

Generally, the closer the groundwater to the ultimate place of use, the more valuable the groundwater.

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First Factor

55 gallon barrel of oil $120.00 trans. cost $5

55 gallon barrel of water $.01 trans. cost $5

Transportation cost is approx the same but as to water is a much larger % of unit cost = big difference

55 gallon barrel of oil $120.00 % trans. cost 4.166%

55 gallon barrel of water $.01% so trans. cost is 50000% of the cost of the water, or said differently, water is .02% of the transportation cost!
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Second Factor:

Quality.

Groundwater that requires treatment is generally less valuable than groundwater that needs little treatment.

Groundwater can require several levels of treatment depending on the ultimate use.

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Third Factor:

Quantity/Reliability

Where large transportation costs are involved, there must be a large enough quantity of groundwater to justify the capital cost of the collection and delivery system.

Users of the groundwater will also consider the reliability of the groundwater source; if the quantity might be reduced due to physical or regulatory matters, the user will discount the value
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Third Factor:
Quantity/Reliability

Where there are physical limitations on the withdrawal of the groundwater, the value will be reduced due to the lack of predictability of the yield.

Where there are regulatory limitation or a lack of predictability of the impact of regulations on the possible groundwater yield, this too will impact the value of the groundwater.

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Fourth Factor:

General Principals of Supply and Demand.

If there is increasing demand and stagnant or diminishing supply, the value will undoubtedly increase.

A good example can be found in the groundwater in the regulated portions of the Edwards Aquifer. As regulation has limited the availability for withdrawal, the value has also steadily increased.
THERE IS NO EASY ANSWER

Much will depend on:

How far does it have to be moved
Cost of collection
What will it be used for and need for treatment
The reliability of the supply
Regulatory Framework; and
What alternative supply exist for the current demand

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