

**REPORT ON TERMINABILITY
OF WATER SUPPLY SERVICE IN TEXAS
AND
MODEL AGREEMENT FOR
FIXED-TERM WHOLESALE RAW WATER SUPPLY**

Prepared by

**BOOTH, AHRENS & WERKENTHIN, P.C.
and
TODD CHENOWETH, J.D.**

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1.

SCOPE OF ANALYSIS

Uncertainty exists among wholesale water suppliers about whether municipal service can be effectively terminated at the end of a purchaser's contract period without lengthy litigation, if at all. This uncertainty may have a chilling effect on the marketing of short- to medium-term water supplies. Uncertainty also may encourage the development of additional water supply projects in advance of total water supply needs, increasing overall cost to current ratepayers, hastening adverse effects on environmental values, and shortening the useful life of future supplies.

This analysis presents a framework for giving additional assurances to municipal water suppliers that their supplies will be secure to meet their own future needs, thereby making more water available for interim supply to others from existing sources. It is not the intent of this report or the attached model agreement to address long-term water supply arrangements. Section 2 is an executive summary of the report. The current legal framework for wholesale municipal water utility contracts in Texas is presented in Section 3. Materials in Section 4 discuss alternative solutions; evaluate the need for legislation; and present proposed statutory amendments to Texas Water Code §§ 11.036 and 11.041 and Texas Government Code § 791.026, and propose new legislation or rules related to enforcement of contractual provisions. Section 5 introduces a model agreement for interim water sales containing termination conditions and assurances that alternative or replacement supplies will be timely pursued. The model agreement itself is attached in its entirety as Appendix A.

A summary by Todd Chenoweth of legal issues from other states is presented in Appendix B. Appendix C presents the credentials of the authors.

Research has included review of Texas statutory and case law, and of extensive in-firm resources on water rights and service matters. Computer-assisted research was conducted in both in-state and out-of-state databases. Periodicals and other legal materials available through the Tarleton Law Library at the University of Texas and through the Texas State Law Library were researched as well. A list of references appears in Section 6 of this report.

Model contract provisions have been based both on the results of our research with regard to terminability, and with regard to general matters, on various water supply contracts in use around the state.

No diagrams or graphics, nor any computer models, have been utilized or developed as part of this study. Computer-assisted research was conducted through commercially available services.

2.

EXECUTIVE SUMMARY

Without certainty of contract as to termination, water suppliers who anticipate needing access to the full extent of their supplies in the future are justifiably hesitant to make short- to medium-term sales of water in the interim. At the same time, the purchasers of water under short- to medium-term contracts cannot become complacent in depending on terminable contractual rights.

The legal framework in which water supply relationships are forged contains elements of both statutory obligations and common law principles. Among the relevant statutory provisions are Texas Government Code Chapter 791, specifically regarding contracts for water supply and wastewater treatment facilities; Local Government Code Chapter 402 concerning outside-boundary service, etcetera; Texas Water Code § 11.036 regarding water service with and without a contract; and Texas Water Code § 11.041, providing a mechanism for forcing service from an unwilling seller. Cases construing the meaning of Texas Water Code §§ 11.036 and 11.041 are few and primarily point out the fact that confusion exists even as to statutory criteria controlling water service.

The difficulty in applying these statutes, together with general legal principles of contract, to wholesale municipal water supply agreements comes primarily from the tension between enforcing the letter of a contract and protecting the public interest in utility service. As a general matter, if a contract is deliberately made and is not contrary to public policy or illegal, it is to be enforceable by its terms. Vested water

rights are property interests which may be made the subject of contract if the owner so wishes. Nevertheless, the public interest has long been held to require regulation of the use of water in the provision of utility service. There are constitutional and common law principles that address a right to receive public utility service without discrimination. There also is considerable precedent in Texas law that a contract which abdicates governmental authority with regard to water or sewer service is illegal or contrary to public policy and, therefore, void.

Texas law, including precedent most recently established in the area of sewer service, should support a seller's right to discontinue service at the expiration of contract, if the expiration provisions are clear. Recitations and provisions also can be added to the contract to clarify a purchaser's and seller's agreements for period of service. For example, the purchaser could acknowledge that it has no rights to service beyond the expiration date and that the supplier does not have, nor does it represent to have, water available for sale beyond the expiration date of the contract. Any renewal provisions also should be clear and unambiguous. It should be clearly stated that no rights beyond the expiration date may be created except upon explicit, written extension of the contract.

Even these protections may be insufficient under the most dire situations, if no reasonable alternative or replacement supplies are available or if the purchaser has limited resources. Contracting provisions that place all burden on the purchaser to provide alternative or replacement supplies by a date certain may be appropriate in some circumstances. Providing for enforcement of interim compliance steps should at

3.

LEGAL FRAMEWORK FOR TERMINABLE WHOLESAL WATER CONTRACTS

3.1 INTRODUCTION OF SECTION

The existing statutory and regulatory provisions that impact wholesale water supply arrangements are addressed under Section 3.2. Research on the legal framework for terminating wholesale water supply contracts next turns to a survey of the general principles of contract law in Texas. Particular issues regarding wholesale water contracts also are examined, followed by legal case studies involving those issues.

3.2 EXISTING STATUTORY AND REGULATORY FRAMEWORK

Texas statutory provisions generally applicable to authority for water service contracting appear in the Revised Civil Statutes, Government Code, Local Government Code, Water Code, and in various statutes creating special law water districts and water authorities, among other laws. The survey that follows in Section 3.2.1 of this report is not intended to be exhaustive of such statutes. For example, numerous statutory and regulatory provisions govern financial commitments for water service and are not discussed. Selected provisions of the Texas Water Code are discussed together in Section 3.2.2.

3.2.1 General Statutory Provisions Related to Authority for Water Supply Service by Contract

A. Texas Government Code: Chapter 791. Interlocal Cooperation Act.

Chapter 791 of the Government Code is intended to “increase the efficiency and effectiveness of local governments by authorizing them to contract, to the greatest possible extent, with one another and with agencies of the state.” TEX. GOV’T CODE ANN. § 791.001 (Vernon 1994) (Interlocal Cooperation Act, purpose clause). Section 791.026 provides:

Contracts for Water Supply and Wastewater Treatment Facilities.

(a) A municipality, district, or river authority of this state may contract with another municipality, district, or river authority of this state to obtain or provide part or all of:

(1) water supply or wastewater treatment facilities; or

(2) a lease or operation of water supply facilities or wastewater treatment facilities.

(b) The contract may provide that the municipality, district, or river authority obtaining one of the services may not obtain those services from a source other than a contracting party, except as provided by the contract.

(c) If a contract includes a term described by Subsection (b), payments made under the contract are the paying party’s operating expenses for its water supply system, wastewater treatment facilities, or both.

(d) The contract may:

(1) contain terms and extend for any period on which the parties agree; and

(2) provide that it will continue in effect until bonds specified by the contract and any refunding bonds issued to pay those bonds are paid.

(e) Tax revenue may not be pledged to the payment of amounts agreed to be paid under the contract.

(f) The powers granted by this section prevail over a limitation contained in another law.

Id. § 791.026.

Subsection (d) is of particular interest, as it regards the term of a contract, because of preexisting case law discussing the impropriety of binding governmental functions by service agreements of perpetual or indefinite duration. This statute is relatively new. Pursuant to § 791.005, the act does not affect any act done or a right, duty or penalty existing prior to its enactment on May 31, 1991. The only reported case discussing the meaning of the statute's provisions for contracts for water supply and wastewater treatment facilities is *Texas Water Comm'n v. City of Fort Worth*, 875 S.W.2d 332 (Tex. Civ. App.—Austin 1994, writ denied). With respect to Chapter 791, the opinion said only that the Interlocal Cooperation Act merely allows municipalities to enter into contracts with each other, and the provision giving the law prevalence over limitations in other laws relates to other laws that might prohibit such contracts. It does not preclude later legislative action, and the law does not preclude the Texas Natural Resource Conservation Commission ("Commission") from altering a wholesale rate set by contract between two cities.

Other provisions of interest in the Government Code include § 791.011(c) (any local government may contract with another local government to provide a governmental function or service that each party to the contract is authorized to perform individually) and § 791.027 (under specified conditions, a local government

may provide emergency assistance to another local government whether or not the local governments have previously agreed to provide that kind of assistance). TEX. GOV'T CODE ANN. §§ 791.011, 791.027 (Vernon 1994).

B. Local Government Code.

A municipal utility's general powers include the powers to operate utility systems outside their municipal boundaries and to regulate such systems in a manner that protects the interests of the municipality. TEX. LOC. GOV'T CODE ANN. § 402.001(a) (Vernon 1988) (formerly TEX. REV. CIV. STAT. ANN. art. 1108). Subsection (c) continues that "[t]he municipality may contract with persons outside its boundaries to permit to connect with those utility systems on terms the municipality considers to be in its best interest." *Id.* § 402.001(c).

The Fort Worth court of appeals construed a municipality's "best interest" broadly in *Melton v. City of Wichita Falls*, 799 S.W.2d 778 (Tex. Civ. App.—Fort Worth 1990, no writ). Citing Local Government Code § 402.001, the court upheld a city ordinance prohibiting new connections outside its boundaries as an express exercise of legislatively granted powers. The court said, "The law presumes that city officials act within the limits of their authority in good faith, and in the best interest of the city they serve." *Id.* at 780 (citing *Kimbrough v. Walling*, 371 S.W.2d 691, 692 (Tex. 1963)).

Municipalities contracting with water districts have specific authorities under Local Government Code Chapter 402 for property acquisition and financing. Section 402.012(g) provides that:

The governing body of a municipality that acquires facilities or property under this section may impose reasonable charges for the use of the facilities or property. In the case of jointly operated facilities, the governing bodies of the municipalities involved may impose the charges by agreement.

TEX. LOC. GOV'T CODE ANN. § 402.012(g) (Vernon 1988). Section 402.012(h) provides that “[a] municipality or a combination of municipalities acting under this section may contract with another municipality to supply the other municipality with services from the facilities or improvements acquired or constructed under this section” *Id.* § 402.012(h). Section 402.012(i) provides that: “[a]n election is not required for approval of any contract relating to water treatment under this section.” *Id.* § 402.012(i). Section 402.014 makes special provision for municipalities to contract with water districts and non-profit corporations which would acquire water supply and/or treatment systems for the benefit of the municipality and then convey the system to the municipality. *Id.* § 402.014.

Local Government Code § 402.018 authorizes municipalities to contract with private, non-profit entities for raw or treated water to be used for the municipalities’ distribution systems. The service may include the holding of water in reserve, and the contract may be for any duration to which the parties agree, may provide for renewal or extension, and may restrict the municipality from obtaining water from another supplier. *Id.* § 402.018 Section 402.019 regards municipal contracts with water districts, with subsection (a) providing that:

A municipality may contract with a water improvement district or water control and improvement district created under Article XVI, Section 59, of the Texas Constitution for the supplying of water to the municipality. The governing body of the municipality and the board of directors of the

district may provide for any duration for the contract that does not exceed 30 years, except that they may provide for the contract to continue in effect until the repayment of all warrants, notes, or bonds issued by the district to acquire facilities necessary or convenient for the district to supply water to the municipality.

Id. § 402.019(a); *see also id.* § 402.021 (municipality with population more than 900,000 may have up to 40-year contract). The 30-year and 40-year limitations in these provisions, is overridden by the Interlocal Cooperation Act discussed above. A § 402.020 contract for water supply between a municipality and an Article XVI, § 59, district may be on any terms and for any duration to which the parties agree. *Id.* § 402.020. Similarly to provisions in Government Code § 791.026, more recent provisions in Chapter 402 related to contract duration may have been intended to mitigate the effect of case law finding some service arrangements to be contrary to public policy.

C. Specific Statutes.

Besides statutes having general applicability such as the statutes discussed above, some political subdivisions were created by special law and others have specific statutory provisions contained in the general laws that must be reviewed prior to contract execution. For example, Local Government Code § 402.023 discusses the requirements for contracts between a municipality and the Trinity River Authority. *Id.* § 402.023 (with regard to contracting for sewage disposal services). Another example is Texas Revised Civil Statute, Article 8280-107, the Lower Colorado River Authority's enabling statute. *See* TEX. REV. CIV. STAT. ANN. art. 8280-107 (Vernon 1954 and Supp. 1971). Section 2(a) of this Act limits the Authority's ability to sell water outside its boundaries.

3.2.2 Primary Texas Water Code Provisions and Related Commission Rules for Water Supply Service

No provision in the Texas Water Code directly addresses terminability of a wholesale municipal water contract, either by express contract language or by litigation. Two provisions in Texas Water Code Chapter 11, however, specify circumstances in which a potential purchaser is entitled to receive water from a surface water supply even without a contract. Chapter 12 includes rate-making authority. Chapter 13 makes limited provision for emergency service. Chapter 49 contains general provisions with regard to the authority of districts to contract. References are made in these sections to the authority of the Commission.

A. Chapter 11. Water Rights.

Texas Water Code § 11.036 contemplates service both with and without a contract. It states:

Conserved or Stored Water: Supply Contract.

(a) A person, association of persons, corporation, or water improvement or irrigation district having in possession and control any storm water, floodwater, or rainwater that is conserved or stored as authorized by this chapter may contract to supply the water to any person, association of persons, corporation, or water improvement or irrigation district having the right to acquire use of the water.

(b) The price and terms of the contract shall be just and reasonable and without discrimination, and the contract is subject to the same revision and control as provided in this code for other water rates and charges. If any person uses the stored or conserved water without first entering into a contract with the party that conserved or stored it, the user shall pay for the use at a rate determined by the commission to be just and reasonable, subject to court review as in other cases.

TEX. WATER CODE ANN. § 11.036 (Vernon 1988).

Texas Water Code § 11.041 for compelling service from an unwilling seller, states:

Denial of Water: Complaint.

(a) Any person entitled to receive or use water from any canal, ditch, flume, lateral, dam, reservoir, or lake or from any conserved or stored supply may present to the commission a written petition showing:

(1) that he is entitled to receive or use the water;

(2) that he is willing and able to pay a just and reasonable price for the water;

(3) that the party owning or controlling the water supply has water not contracted to others and available for the petitioner's use; and

(4) that the party owning or controlling the water supply fails or refuses to supply the available water to the petitioner, or that the price or rental demanded for the available water is not reasonable and just or is discriminatory.

(b) If the petition is accompanied by a deposit of \$25, the executive director shall have a preliminary investigation of the complaint made and determine whether or not there are probable grounds for complaint.

(c) If, after preliminary investigation, the executive director determines that probable grounds exist for the complaint, the commission shall enter an order setting a time and place for a hearing on the petition.

(d) The commission may require the complainant to make an additional deposit or execute a bond satisfactory to the commission in an amount fixed by the commission conditioned on the payment of all costs of the proceeding.

(e) At least 20 days before the date set for the hearing, the commission shall transmit by registered mail a certified copy of the petition and a certified copy of the hearing order to the person against whom the complaint is made.

(f) The commission shall hold a hearing on the complaint at the time and place stated in the order. It may hear evidence orally or by affidavit in support of or against the complaint, and it may hear arguments. On completion of the hearing, the commission shall render a written decision.

(g) If, after the preliminary investigation, the executive director determines that no probable grounds exist for the complaint, the executive director shall dismiss the complaint. The commission may either return the deposit or pay it into the State Treasury.

Id. § 11.041. See also 30 TEX. ADMIN. CODE § 291.44 (West 1995) (Tex. Natural Res. Cons. Comm'n) (Contents of Pleadings Seeking Review of Rates for Sales of Water under the Texas Water Code).

Several other Texas Water Code provisions are of note. Although these provisions arguably are intended to apply only to irrigation rights, they are not so limited by their terms and a similar claim to limit § 11.041 failed in the courts. See *Texas Water Rights Comm'n v. City of Dallas*, 591 S.W.2d 609 (Tex. Civ. App.—Austin 1979, writ ref'd n.r.e). Among the provisions of additional interest are § 11.037 (every person supplying water shall make reasonable rules relating to, e.g., the use and distribution of water and the procedure for applying for the water); and § 11.039 (in case of shortage, water to be distributed shall be divided among all customers pro rata, but not precluding supply to a person with a prior vested right to the water).

A.1 Seller's interest in water under Chapter 11.

Brushy Creek Mun. Utility Dist. v. Texas Water Comm'n, 887 S.W.2d 68 (Tex App.—Austin 1994), *rev'd*, 917 S.W.2d 19 (Tex. 1996), addressed the required nature of the supplier's interest in water under Texas Water Code §§ 11.036 and 11.041. At issue was the City of Round Rock's attempt as an interim wholesaler of water to get rate relief against its purchaser under Water Code § 11.036 (regarding supply contracts) and § 12.013 (regarding rate-fixing jurisdiction).

The City of Round Rock obtained its water supply from the Brazos River Authority and, in turn, sold it to Brushy Creek M.U.D. under contract. The Commission took jurisdiction and granted relief, substituting its fixed rate. The purchaser, Brushy Creek M.U.D., appealed. The Commission and the petitioning seller both argued that the Commission had independent bases for jurisdiction under Texas Water Code §§ 11.036 and 12.013. The intermediate court had examined the wording of § 11.036 in great detail, but found that because § 11.036 was restricted to water reduced to storage “as authorized by this chapter,” the Commission had jurisdiction under that section only when the seller is himself an *appropriator* of the stored water by virtue of a permit or certificate issued by the Commission. TEX. WATER CODE ANN. § 11.036(a) (Vernon 1988). The Supreme Court reversed the lower court on this point, focusing on Texas Water Code § 12.013. While the intermediate court also had discussed § 11.041, the Supreme Court stated that it would not consider the scope of the agency’s authority under any provision other than § 12.013. The effect of the Supreme Court’s opinion is that any wholesale supplier of conserved or stored surface water is subject to the Commission’s authority, regardless of whether or not it is an “appropriator” of water. Until the Court’s opinion is released for publication, it remains subject to change.

A.2 Purchaser’s interest in water under Chapter 11.

The *Brushy Creek* case dealt with the nature of the seller’s interest in water. A question still exists as to what qualifies a would-be purchaser to avail itself of § 11.041’s provisions. Sections 11.036 and 11.041 both apply to persons having a

right or entitlement to acquire water, but there is no statutory or regulatory guidance as to what is meant by “entitlement.” Neither section specifies that the right must come from the seller, as through a contract, only that it be a right to the supply. There are general constitutional and common law principles that address a right to receive public utility service without discrimination that may apply in this situation. For example, entitlement could spring from physical location within a dedicated service area or from the fact that the supplier has voluntarily undertaken service to others in the area. It could be fairly argued that “entitlement” should be read broadly under common law principles in the absence of any statutory or regulatory provisions that would limit its meaning.

In addition, there are at least two lines of Texas court cases that have upheld Commission determinations that a complainant was entitled to water within the meaning of these provisions. These court cases demonstrate two methods for establishing entitlement, although they do not purport to address all possible methods. One group of these cases discussing “entitlement” involved the Devers Canal system. It is clear from this line of cases that an existing contract is not necessary to establish an entitlement. Farmers in the Devers Canal case had received a rate ruling, an order compelling service, and a refund order from the Commission under authority of Texas Water Code §§ 11.036 and 12.013, but the order had not resulted in a written contract.

During the pendency of a separate appeal of the Commission order, the farmers sought injunctive relief and declaratory judgment regarding the sellers’ requirement

that they enter into a contract requiring them to pay a rate higher than that established in the Commission's order. The declaratory judgment court, writing in *Trinity Water Reserve, Inc. v. Evans*, 829 S.W.2d 851 (Tex. App.–Beaumont 1992, no writ), discussed the farmer's entitlement to water as based on a specific Texas Water Code provision not applicable here. That provision, § 11.038, states that a person who owns or holds a possessory right in any land adjoining or contiguous to a canal, ditch, flume, or other parts of a canal system, and who has secured a right in the past to use the water, is entitled to be supplied from the canal system. This is the method of "entitlement" discussed in *Borden v. Trespolacios Rice & Irrigation Co.*, 98 Tex. 494, 86 S.W. 11 (Tex. 1905), *aff'd*, 204 U.S. 667 (1907). The Court stated that "[w]ho the others 'entitled' are, and what they are entitled to, are questions not expressly answered by the statute; but when it is found that the sites and route of the canal and other works are to be evidenced by a public record, the answer to the first question is easily found" *Id.* at 14-15. The Court found that the persons "entitled" were all persons who own or hold a possessory right or title to land adjoining or contiguous to any canal. *Id.*

The court's ruling in *Trinity Water Reserve* was expressly limited to statutory and common law rights to irrigation water, not to the rates. The Commission's rate ultimately was upheld in a separate and unreported opinion, *Texas Water Comm'n v. Boyt Realty Co.*, No. 3-91-279-CV (Tex. App.–Austin June 23, 1993, n.w.h.) (not designated for publication), 1993 WL 219704, without discussion of the entitlement issue. It is of interest, however, that the Austin court of appeals, in its unreported

opinion, expressly stated that in a § 11.041 proceeding, the Commission is not restricted to the period of a proposed contract in dispute.

The case of *Texas Water Rights Comm'n v. City of Dallas* demonstrates entitlement under Texas Water Code § 11.041 based on representations made in securing water rights. In that case, City of Farmers Branch filed a petition with the Commission's predecessor agency alleging that the treated water supply contract tendered to it by City of Dallas and rates commanded under it were unreasonable, unjust and discriminatory. The Commission took jurisdiction under Water Code § 5.041 (now § 11.041) and § 6.056 (now § 12.013(a)) over the City of Dallas' objection. The Commission held by conclusion of law in the underlying administrative proceeding that "[b]y acceptance of permits for the use of the State's water, Dallas had subjected itself to the jurisdiction of the Commission" The Commission also stated by conclusion of law that:

Farmers Branch and Grand Prairie are persons entitled to receive water within the meaning of Section [11.041], Texas Water Code, and are entitled to receive water based upon representations made by Dallas to the Commission prior to the granting of certain permits to appropriate waters of the State. These representations are binding upon the water supplies held under permits previously granted to Dallas by this Commission.

Texas Water Rights Comm'n v. City of Dallas, 591 S.W.2d at 611.

These representations also obligated Dallas to provide treatment services under the Commission's order. Dallas argued in court that "entitlement" to water under § 11.041 applied only to open means of conserving and storing water and could not apply to Dallas' pipelines. The court viewed that as an argument that § 11.041 was

limited to irrigation use and did not affect domestic water. The court found the argument to be without merit. It was apparently persuasive that, as the court put it, “Dallas enjoys a substantial monopoly closely resembling that of canal and irrigation entities occupying a monopolistic position. Dallas, over a long period of time, has secured permits to appropriate state waters which are so extensive as to afford Dallas control of substantially all municipal water supplies in Dallas County.” *Id.* at 614. The court upheld the Commission’s decision to compel service.

A.3 Term and availability under Chapter 11.

A Commission order under Texas Water Code §§ 11.036 or 11.041 does not take the place of a contract, and as noted above with regard to the Devers Canal cases, a contract is not necessary to the compelled service relationship. Section 11.041 contemplates a petition to obtain water from an unwilling supplier. Its terms do not, however, preclude petition by a purchaser seeking to secure future service from a supplier with whom the purchaser does have a current, but terminable contract. The petitioner need demonstrate only that the supplier has water not contracted to others and available for the petitioner’s use. With regard to the availability of water in *Texas Water Rights Comm’n v. City of Dallas*, the Commission had considered Dallas’ year 2050 projected use. *Id.* (citing Texas Water Commission Conclusion of Law No. 5). It also seems logical that the offer of a contract is evidence that the supplier has water available for that period of time.

Texas Water Comm’n v. Boyt Realty Co., the unpublished Devers Canal case, directly addresses duration of compelled service. There, the Austin court of appeals

stated that “[s]o long as [the supplier] was not contractually committed to other third parties, the [purchasers] had a statutory right under the Water Code to use water after 1990, the period of [the supplier’s] proposed contract, and to pay reasonable rates for this water. *Boyt Realty Co.*, 1993 WL 219704 at 3 (emphasis added). It is uncertain whether the court intended to imply that the Commission can order service for the term offered in a rejected contract. It also is uncertain whether the supplier retains the right to contract the supply out to other customers during the pendency of a statutory order of service and thereby defeat the order. Later language in the same opinion implies that the supplier does retain the power to contract the water to others. *Id.* (the Commission recognized the right to use water in the future “as long as [the supplier] has not contracted all its water to other customers”).

In the 1905 case, *Borden v. Trespalacios Rice & Irrigation Co.*, however, the Supreme Court discussed the power to contract as related to the predecessor statutes of §§ 11.036 and 11.041. In reading the Court’s opinion, it should be kept in mind that a codification is not intended to substantively alter the meaning of a statute. The Court wrote:

The power to contract, here given, to the owner of the plant, cannot, if the business is to be regarded as affected with a public interest, be recognized as absolute and uncontrolled. Common carriers, and others engaged in public callings, have the power to contract, but it cannot be so employed as to absolve them from their duties to the public, or to deprive others of their rights. Rights are evidently secured by this statute to those so situated as to be able to avail themselves of the water provided for, and those rights it is the duty of the owners of the contemplated business to respect; and the power to contract, under the well-recognized principles applicable to those charged with such duties, must be exercised in subordination to such duties and rights. Reasonable contracts are what this statute means, and not contracts

employed as evasions of duty. . . . It is not entirely clear, when all of the provisions of the act of 1895 are considered, whether those who do not make contracts are wholly postponed to those who do or not. If they are, with the qualification that the contracts must be made in good faith and be reasonable, we cannot see in this anything to raise a constitutional question. The question as to the expediency of the regulations was for the Legislature. Furthermore, when the conclusion is reached that this is a business in which the use of the water is secured to the public in consideration of the franchises and privileges granted, there results a power in the Legislature to further regulate it in a reasonable way.

Borden, 98 Tex. 494, 86 S.W. at 15.

The Commission's Utility Division staff has confirmed that an order under § 11.041 does not have the characteristics of a contract, such as a specified term of years. Nor do we believe that the Commission has the authority to require service in perpetuity. See, e.g., *Boyt Realty Co.*, 1993 WL 219704 at 5; cf. *City of Arlington v. City of Fort Worth*, 873 S.W.2d 765 (Tex. App.—Fort Worth 1994, writ dismissed w.o.j.) (discussed *supra* at Section 3.4.3 of this report). Presumably, a supplier could cease supply under a § 11.041 order at any time it could defeat a new finding by the Commission that water still was available, unless some provision is made to the contrary.

It makes parallel sense that a commission which has no authority to overappropriate a basin may not compel service from an inadequate supply. Cf. TEX. WATER CODE ANN. § 11.134 (Vernon 1988) (Commission may grant application for water right *only* when unappropriated water is available in the source of supply); *id.* § 11.138 (Commission may issue temporary permits *when* they do not adversely affect prior rights and permit is limited to 10 acre-feet and to no more than one year in duration); *id.* § 11.1381) and 30 TEX. ADMIN. CODE § 297.19 (West 1995) (Tex. Natural

Res. Cons. Comm'n) (Commission may grant permit for a limited term of years *when* it determines that inadequate water is available in the source of supply on a perpetual basis to satisfy an application but that adequate water is available on a limited basis due to the under-utilization of existing water rights in the source of supply, *provided that* the supplier has not shown that to do so would prohibit the supplier from using his senior right during the term of the permit); *Lower Colorado River Auth. v. Texas Dept. of Water Resources*, 689 S.W.2d 873 (Tex. 1984) (overappropriation would return water rights to the state of chaos that the appropriation statutes are designed to avoid).

When the Commission can compel service, it also may set the rate for water under Texas Water Code §§ 11.036, 11.141, 12.013. Orders under any of these provisions still leave the parties free to contract with each other for different terms or rates. *See Boyt Realty Co.*, at 3-5.

B. Chapter 12. Provisions Generally Applicable to Water Rights.

Texas Water Code § 12.013 gives the Commission explicit authority to fix reasonable rates for the furnishing of wholesale raw or treated water for any purpose mentioned in Chapter 11 or 12. TEX. WATER CODE ANN. § 12.013 (Vernon 1988). This jurisdiction requires both that the supplier has set rates and that there is a real issue with regard to the reasonableness of the rate. *Cf. Trinity River Auth. of Tex. v. Texas Water Rights Comm'n*, 481 S.W.2d 192 (Tex. Civ. App.—Austin 1972, writ ref'd n.r.e.) (holding that only after the proprietor of an irrigation system has set water rates may the customer petition the Commission). It is not necessary, however, that the “customer” have a current contract. *See Texas Water Rights Comm'n v. City of Dallas*.

The Commission may, under Texas Water Code § 12.013 authority, compel continuing service during the pendency of the rate proceeding. There are no guidelines for the Commission's exercise of this discretion. It is unknown, but doubtful, whether the Commission could order interim commencement, as opposed to interim continuation, of service.

C. Chapter 13. Water Rates and Services.

The Commission also has rate and service jurisdiction under Texas Water Code Chapter 13. Interestingly, the only provision in the Water Code for *emergency service* appears in Chapter 13. By their terms, various provisions of Chapter 13 may apply to wholesale or retail service. See TEX. WATER CODE ANN. § 13.002(21) (Vernon Supp. 1996). See generally *id.* § 13.189 (a "water and sewer utility," as specifically defined in § 13.002, as to rates or services may not make any unreasonable preference or advantage; whereas a "utility" may not establish and maintain any unreasonable differences as to rates of service between localities); *id.* § 13.248 (contracts between retail public utilities designating areas to be served by those utilities, when approved by the Commission after public notice and hearing, are valid and enforceable and are incorporated into the appropriate areas of public convenience and necessity; *id.* § 13.250 (restrictions on discontinuance of service within a certificated area); *id.* § 13.253 (regarding order to retail public utility possessing a certificate of convenience and necessity for improvement in service); 30 TEX. ADMIN. CODE ch. 291 (West 1995) (Tex. Natural Res. Cons. Comm'n) (Water Rates). Chapter 13 does appear to be limited to provision of *potable* water service or sewer service.

Texas Water Code Chapter 13 powers to compel emergency service are limited. Subsections 13.041(d)-(f) provide that:

(d) The commission may issue emergency orders, with or without a hearing:

(1) to compel a water or sewer service provider that has obtained or is required to obtain a certificate of public convenience and necessity to provide continuous and adequate water service, sewer service, or both, if the discontinuance of the service is imminent or has occurred because of the service provider's actions or failure to act; and

(2) to compel a retail public utility to provide an emergency interconnection with a neighboring retail public utility for the provision of temporary water or sewer service, or both, for not more than 90 days if service discontinuance or serious impairment in service is imminent or has occurred.

(e) The commission may establish reasonable compensation for the temporary service required under Subsection (d)(2) of this section and may allow the retail public utility receiving the service to make a temporary adjustment to its rate structure to ensure proper payment.

(f) If an order is issued under Subsection (d) without a hearing, the order shall fix a time, as soon after the emergency order is issued as is practicable, and place for a hearing to be held before the commission.

TEX. WATER CODE ANN. § 13.041(d)-(f) (Vernon Supp. 1996). A “retail public utility” under chapter 13 refers to “any person, corporation, public utility, water supply or sewer service corporation, municipality, political subdivision or agency operating, maintaining, or controlling in this state facilities for providing potable water service or sewer service, or both, for compensation.” *Id.* § 13.002(19).

To read § 13.041(d)(2) most expansively, one could argue that, in addition to retail service, its emergency provisions do reach wholesale service of potable water, when the interconnection for wholesale service would be between two utilities that

both happen to have retail systems. It also is not known to what extent the Commission may issue serial 90-day emergency orders under Chapter 13. *Cf.* TEX. WATER CODE ANN. § 11.139 (Vernon 1988) *and* 30 TEX. ADMIN. CODE § 297.17 (West 1995) (Tex. Natural Res. Cons. Comm'n) (Commission may issue an emergency permit to authorize appropriation of state water for a period of not more than thirty days to alleviate conditions which threaten the public health, safety, and welfare, *provided that* no extension or additional emergency permit may be granted at the expiration of the original permit); *see also id.* § 291.14 (emergency orders).

Limited as the Chapter 13 emergency power is, there is *no* provision in the Texas Water Code that authorizes emergency wholesale service from a *raw* water supply. Texas' "area-of-origin statute" also makes no exception for emergency needs. TEX. WATER CODE ANN. § 11.085 (Vernon 1988) ("No person may take or divert any of the water of the . . . watershed . . . into any other . . . watershed to the prejudice of any person or property situated within the watershed from which the water is proposed to be taken or diverted.").

It should be noted that the Commission has no apparent authority to order provision of wholesale service from a groundwater supply other than retail service under Chapter 13. Section 11.036 does not apply to groundwater even if the water happens to be "conserved or stored." *Brushy Creek*, 887 S.W.2d at 71 (citing Hutchins, *The Texas Law of Water Rights*, 163-69, 396-99 (1961)). Common law utility theories have been applied by the courts in cases involving groundwater supplies, however. *See West v. Probst*, 50 Tex. 74, 6 S.W.2d 96 (Tex. Comm'n App. 1928,

holding approved) (owner of wells and associated waterworks had assumed duties and obligations of public utility).

D. Chapter 49. General Law Districts.

Chapter 49 applies to all general and special law districts to the extent its provisions do not conflict with any other chapter of the code or any act creating or affecting a special law district. TEX. WATER CODE ANN. § 49.002 (Vernon Supp. 1996).

With regard to the authority to issue contracts, it provides:

§ 49.213. Authority to Issue Contracts.

(a) A district may contract with a person or any public or private entity for the joint construction, financing, ownership, and operation of any works, improvements, facilities, plants, equipment, and appliances necessary to accomplish any purpose or function permitted by a district, or a district may purchase an interest in any project used for any purpose or function permitted by a district.

(b) A district may enter into contracts with any person or any public or private entity in the performance of any purpose or function permitted by a district.

(c) A district may enter into contracts, which may be of unlimited duration, with persons or any public or private entities on the terms and conditions the board may consider desirable, fair, and advantageous for:

(1) the purchase or sale of water;

(2) the collection, transportation, treatment, and disposal of its domestic, industrial, and communal wastes or the collection, transportation, treatment, and disposal of domestic, industrial, and communal wastes of other persons;

(3) the gathering, diverting, and control of local storm water, or other local harmful excesses of water;

(4) the continuing and orderly development of the land and property within the district through the purchase, construction, or installation of works, improvements, facilities, plants, equipment, and

appliances that the district may otherwise be empowered and authorized to do or perform so that, to the greatest extent reasonably possible, considering sound engineering and economic practices, all of the land and property may be placed in a position to ultimately receive the services of the works, improvements, plants, facilities, equipment, and appliances;

(5) the maintenance and operation of any works, improvements, facilities, plants, equipment, and appliances of the district or of another person or public or private entity;

(6) the collection, treatment, and disposal of municipal solid wastes; and

(7) the exercise of any other rights, powers, and duties granted to a district.

Id. § 49.213. Again, provisions in this statute and other statutes granting the authority to contract for an unlimited duration most probably are intended to counteract case law finding perpetual or undefined service arrangements to be violative of public policy. These cases are discussed below in Section 3.3 of this report.

Districts also are given explicit authority to provide water service outside their boundaries by Texas Water Code § 49.215, which states:

§ 49.215. Service to Areas Outside the District.

(a) A district may purchase, construct, acquire, own, operate, repair, improve, or extend all works, improvements, facilities, plants, equipment, and appliances necessary to provide any services or facilities authorized to be provided by the district to areas contiguous to or in the vicinity of the district provided the district does not duplicate a service or facility of another public entity. A district providing potable water and sewer utility services to household users shall not provide services or facilities to serve areas outside the district that are also within the corporate limits of a city without securing a resolution or ordinance of the city granting consent for the district to serve the area within the city.

* * * *

(d) A district shall not be required to hold a certificate of convenience and necessity as a precondition for providing retail water or sewer service to any customer or service area, notwithstanding the fact that such customer or service area may be located either within or outside the boundaries of the district or has previously received water or sewer service from an entity required by law to hold a certificate of convenience and necessity as a precondition for such service. This subsection does not authorize a district to provide services within an area for which a retail public utility holds a certificate of convenience and necessity or within the boundaries of another district without that district's consent, unless the district has a valid certificate of convenience and necessity to provide services to that area.

(e) A district is authorized to establish, maintain, revise, charge, and collect the rates, fees, rentals, tolls, or other charges for the use, services, and facilities that provide service to areas outside the district that are considered necessary and may be higher than those charged for comparable service to users within the district.

Id. § 49.215.

3.3 GENERAL PRINCIPLES OF TEXAS CONTRACT LAW

Texas law generally recognizes the right of parties to contract with regard to their property as they see fit. *Crutchfield v. Associates Inv. Co.*, 376 S.W.2d 957 (Tex. Civ. App.—Dallas 1964, writ ref'd). If a contract is deliberately made and is not contrary to public policy or illegal, it is to be enforceable by its terms. *Labbe v. Magnolia Petroleum Co.*, 350 S.W.2d 873 (Tex. Civ. App.—San Antonio 1961, writ ref'd n.r.e.). Courts will enforce a valid contract without regard to whether the parties contracted wisely or foolishly. *Ross v. Burlison*, 274 S.W.2d 105 (Tex. Civ. App.—San Antonio 1954, no writ); *see also Gillam v. City of Fort Worth*, 287 S.W.2d 494, 499 (Tex. Civ. App.—Fort Worth 1956, writ ref'd n.r.e.) (stating that councilmen who made contract are responsible, not to the courts, but to the citizenry who elected them, and courts are not to judge the necessity, wisdom, or expediency of their acts).

A valid contract requires consideration. Consideration may be an act; a forbearance; the creation, modification, or destruction of a legal relationship; or a return promise. RESTATEMENT (SECOND) OF CONTRACTS, § 75 (ALI 1981); see *Combs v. United Irrigation Co.*, 110 S.W.2d 1157 (Tex. Civ. App.—San Antonio 1937, writ dism'd) (an irrigation company's contract with landowner to furnish water to his lands was not wanting in consideration or mutuality of obligation because company was required by law to furnish water to such lands); *Berry v. American Rio Grande Land & Irrigation Co.*, 236 S.W. 550 (Tex. Civ. App.—San Antonio 1921, writ ref'd n.r.e.) (though plaintiff as riparian owner was entitled to free use of the water from which irrigation company drew its supply, as such owner, she was not entitled to the free use of company's facilities for distributing it, and therefore a sale of water supplied by company to plaintiff was not without consideration). Municipal water supply contracts of the type discussed here, involving the immediate or promised transfer of something of commercial value--water, would rarely raise questions concerning the sufficiency of consideration. See generally D. Tarlock, *Essentials of a Valid Natural Resources Agreement*, Natural Resources & Environment, vol. 3, no. 1 (1988).

A contract requires two or more legally competent parties who voluntarily and mutually assent to the agreement. *Garcia v. Villarreal*, 478 S.W.2d 830 (Tex. Civ. App.—Corpus Christi 1971, no writ). A contract takes form when there is an offer and an acceptance. It requires reasonable definition and certainty such that a court could determine what the parties intended and what legal obligations were created. *Bendalin v. Delgado*, 406 S.W.2d 897 (Tex. 1966). For example, a contract is sufficiently certain where acts which make up performance are expressed definitely

enough to permit the court to tell whether or not the promisor had fulfilled them. *Ford Motor Co. v. Davis Bros., Inc.*, 369 S.W.2d 664 (Tex. Civ. App.—Eastland 1963, no writ); *see also Mesa Agro v. R.C. Dove & Sons*, 584 S.W.2d 506 (Tex. Civ. App.—El Paso 1979, writ ref'd n.r.e.) (to be enforceable, a contract for sale must be definite as to quantity or amount of property involved).

The time and place of performance also should be fixed with reasonable certainty. Where time is of the essence in a contract, the intention of the parties that the contract be performed by the time stated should be clearly stated. *Ferguson v. Seggern*, 434 S.W.2d 380 (Tex. Civ. App.—Dallas 1968, writ ref'd n.r.e.). A contract that is indefinite as to time or performance may generally be terminated by either party. *Hughes v. Cole*, 585 S.W.2d 865 (Tex. Civ. App.—Tyler 1979, writ ref'd n.r.e.). However, a statement or implication that performance is to occur within a reasonable time or over a specified period of time may be deemed sufficiently certain. *Texas Farm Bureau Cotton Ass'n v. Stovall*, 113 Tex. 273, 253 S.W. 1101 (1923). *But cf. Clear Lake City Water Auth. v. Clear Lake Utilities Co.*, 549 S.W.2d 385, 390 (Tex. 1977) (stating, with regard to contracts affecting governmental functions such as water or sewer service, that such contracts which contemplate continuing performance or successive performances and which are indefinite in duration can be terminated at the will of either party). Uncertainty in a contract can be removed by the subsequent acts of the parties to the agreement.

Contracts may be express as where the agreement of the parties is stated, or be implied in law or fact. Both types of contract are binding except where the subject of

the contract requires it to be in writing. The statute of frauds requires contracts that transfer real property and contracts not to be performed within a year, to be in writing. TEX. BUS. & COM. CODE ANN. § 26.001 (Vernon 1995) (Statute of Frauds). The writing, however, may be as informal as a memorandum signed by the party against whom enforcement is sought. In the area of natural resource agreements, which seldom are informal, a statute of frauds problem is most likely to arise where there is an improper integration of several documents. Tarlock, *supra*, at 4.

A contract can be implied only where no express agreement exists. *Musick v. Pogue*, 330 S.W.2d 696 (Tex. Civ. App.—San Antonio 1959, writ ref'd n.r.e.); *Davis v. McQueen*, 842 S.W.2d 376 (Tex. App.—Beaumont 1992, writ denied) (where total amount of compensation was not fixed in express agreement). An implied-in-fact contract also arises from the mutual assent of the parties as evidenced by conduct of the parties demonstrating that the parties were willing to contract for the service. Implied-in-law contracts are imposed by the courts to avoid unjust enrichment. The latter are related to the concept of promissory estoppel, that “a promise which the promisor should reasonably expect to induce action or forbearance of a definite and substantial character on the part of the promisee and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise.” RESTATEMENT OF THE LAW, CONTRACTS, § 90.

An express contract may have *terms* implied as a matter of law when those terms are necessary to the agreement. See, e.g., *NHA, Inc. v. Jones*, 500 S.W.2d 940 (Tex. Civ. App.—Fort Worth 1973, writ ref'd n.r.e.). A contract term cannot be express

and implied as to the same point or matter. *Bennett v. Giles*, 12 S.W.2d. 843 (Tex. Civ. App.–Fort Worth 1928, no writ) (stating that in law and common sense, there cannot be express and implied contract for the same thing existing at same time). In Texas, the courts have been hesitant to imply contract terms in any situation. Therefore, the elements of implied contracts will not be discussed further.

Contracts will be enforced according to their express terms, viewed as of the time the agreement was made. *First Nat'l Bank in Dallas v. Kinabrew*, 589 S.W.2d 137 (Tex. Civ. App.–Tyler 1979, writ ref'd n.r.e.). The normal rules of contract construction apply to contracts between governmental entities, with a few exceptions. See generally *Canadian River Mun. Water Auth. v. City of Amarillo*, 517 S.W.2d 572 (Tex. Civ. App.–Amarillo 1974, writ ref'd n.r.e.). Where the express terms are ambiguous, a court will resort to various rules of contract construction to ascertain the true intent of the parties. For example, contracts will be construed so as to make them valid, if possible, *Spanish Village, Ltd. v. American Mortg. Co.*, 586 S.W.2d 195 (Tex. Civ. App.–Tyler 1979, writ ref'd n.r.e.); a contract will be construed more strictly against the party who drafted it, *Ervay, Inc. v. Wood*, 373 S.W.2d 380 (Tex. Civ. App.–Dallas 1963, writ ref'd n.r.e.); words are to be given their ordinary meaning, *Wahlenmaier v. American Quasar Petroleum Co.*, 517 S.W.2d 390 (Tex. Civ. App.–El Paso 1974, writ ref'd n.r.e.); technical terms are given the meaning placed on them by persons in the business to which the terms are related, *Lone Star Gas Co. v. McCarthy*, 605 S.W.2d 653 (Tex. Civ. App.–Houston [1st Dist.] 1980, writ ref'd n.r.e.). Interpretations of a board of directors of a municipal water authority of its own contracts and resolutions are entitled to great weight in construing those contracts and resolutions. *Canadian*

River Mun. Water Auth. v. City of Amarillo, 517 S.W.2d at 584. We believe it also is the case that where the words of a contract are ambiguous, agreements affecting the public interest will be construed in favor of the public. *Cf. Byke v. City of Corpus Christi*, 569 S.W.2d 927 (Tex. Civ. App.–Corpus Christi 1978, writ ref'd n.r.e.).

Generally, contracts can be set aside for fraud, duress, or coercion, for undue influence or for an unconscious mistake of fact not involving negligence. A threat to do what one has a legal right to do is not duress. Evidence that a water district refused, or threatened to refuse, to sign a commitment of bonds of a complaining district unless the complaining district executed a contract was not sufficient to set aside that contract because of duress in *Cameron County Water Improvement Dist. No. 1 v. Cameron County Water Improvement Dist. No. 15*, 134 S.W.2d 491 (Tex. Civ. App.–San Antonio 1939, no writ). Where the parties to a contract are mistaken about a fact that is material and essential to the formation of the agreement, and where the mistake creates an injury, a contract can be voided. *See Chas. F. Noble Oil & Gas Co. v. Gist*, 271 S.W. 300 (Tex. Civ. App.–Amarillo 1925, no writ) (where both parties to sale of water supply erroneously assumed, as basis for contract, existence of sufficient water in pond to satisfy defendant's demands, such assumption was mutual mistake of fact as to material matter, rendering contract unenforceable).

Subsequent events that substantially upset the parties' expectations may give rise to an impracticability excuse. If, after a contract has been formed but prior to full performance, some unforeseeable event occurs which makes performance impracticable, the promisor's duty to perform may be "discharged." This could happen,

for example because of a supervening illegality or by destruction of the subject matter of the contract not caused by the fault of the promisor. If, however, the promisor foresaw and assumed the risk of an event that makes performance impracticable, the obligation will not normally be discharged. See *Colorado Canal Co. v. McFarland & Southwell*, 50 Tex. 74, 109 S.W. 435 (1908) (irrigation company could only excuse its failure to furnish water according to contract by proof that its failure resulted from inevitable accident, or a cause that could not be obviated by ordinary care and foresight).

Natural resource agreements also are more susceptible to defenses of unfairness, because of the public interest involved. A contract which violates public policy is unenforceable. The core of this principle is the effect of the contract on those who are not themselves parties to the agreement. *St. Regis Candies v. Hovas*, 117 Tex. 313, 3 S.W.2d 429 (1928). Contracts which interfere with a public or quasi-public entity's duties to the public is illegal or void. L. Simpson, *Handbook of the Law of Contracts* § 215 (2d ed. 1965). *Accord McNutt v. Intratex Gas Co.*, 600 S.W.2d 947 (Tex. App.—Waco 1980, writ ref'd n.r.e.) (a public utility cannot bind itself by contract to do that which would disable it from performing those duties and obligations to the public with which it is charged, and any contract which does impair its ability to perform those services is against public policy and is void). The Restatement (Second) of Contracts provides the following guidelines for when a contract term is unenforceable on grounds of public policy:

- (1) A promise or other term of an agreement is unenforceable on grounds of public policy if legislation provides that it is unenforceable or

the interest in its enforcement is clearly outweighed in the circumstances by a public policy against the enforcement of such terms.

(2) In weighing the interest in the enforcement of a term, account is taken of

(a) the parties' justified expectations,

(b) any forfeiture that would result if enforcement were denied,
and

(c) any special public interest in the enforcement of the particular term.

(3) In weighing a public policy against enforcement of a term, account is taken of

(a) the strength of that policy as manifested by legislation or judicial decisions,

(b) the likelihood that a refusal to enforce the term will further that policy,

(c) the seriousness of any misconduct involved and the extent to which it was deliberate, and

(d) the directness of the connection between that misconduct and the term.

RESTATEMENT (SECOND) OF CONTRACTS, *supra*, § 178. Commentary in the Restatement continues that “[e]nforcement will be denied only if the factors that argue against enforcement clearly outweigh the law’s traditional interest in protecting the expectations of the parties, its abhorrence of any unjust enrichment, and any public interest in the enforcement of the particular term.” *Id. Accord Garwood Irrigation Co. v. Lower Colorado River Auth.*, 387 S.W.2d 746, 750 (Tex. Civ. App.–Austin 1965, writ ref’d n.r.e.) (citing *Registering Co. v. Sampson*, L.R. 19 Eq. 465, for proposition that you are not lightly to interfere with the freedom of contract and holding that when evaluating a claim that a contract is void as against public policy, courts are to keep in

mind that public policy also requires liberty of contracting, and that contracts entered into freely and voluntarily by competent parties are to be held “sacred”).

In *Guelker v. Hidalgo County Water Improvement Dist. No. 6*, 269 S.W.2d 551 (Tex. Civ. App.—San Antonio 1954, writ ref'd n.r.e.), the court found that a contract of the Donna Irrigation District granting to an out-of-District entity perpetual rights in its drainage water was not void as against public policy. The court explained that the Donna District, having the usufruct of the water in its drains, could sell that right unless such a sale would be against public policy. The Donna District was organized for the purpose of selling irrigation water within its territorial boundaries. No doubt, the court said, at the time the Donna District made the contract, no one thought that anyone owning land in the District would ever desire to pump water from its drainage ditches. Although the 1950s drought changed this perception and the water contracted away twenty-five years ago would now be used by District landowners, these circumstances did not make the contract void as being against public policy.

There is considerable precedent in Texas law that a contract which abdicates governmental authority with regard to water or sewer service is illegal, or contrary to public policy, and therefore void. In *Fidelity Land & Trust Co. of Tex. v. City of West University Place*, 496 S.W.2d 116 (Tex. Civ. App.—Houston [14th Dist.] 1973, writ ref'd n.r.e.), a landowner executed a 1942 deed granting the City a sewer line easement outside the corporate limits of the City. As part of the consideration, the landowner and his assigns were granted the right to make connections without charge to the City sewer system and to receive service under the same terms as inhabitants of the City.

When the landowner's successor was denied connection in 1968, it sued for breach of contract. The court denied relief, holding that the agreement operated to inhibit the municipality in its discretionary control over a governmental function (i.e., operation of a sewer system) and was, therefore, unenforceable. Similarly, in *Banker v. Jefferson County Water Control & Improvement Dist. No. 1*, 277 S.W.2d 130 (Tex. Civ. App.—Beaumont 1955, writ ref'd n.r.e.), the court denied relief to a plaintiff who paid to extend a water line outside the boundary of the District to an adjacent subdivision under a contract that provided the District would not extend service to others outside that subdivision without the plaintiff's authorization. The court, noting that the District was authorized by statute to sell surplus water to lands in the vicinity, held that the District could not bargain away its governmental power to determine whether or not it had surplus water for sale, the people most in need of the water it had available, and under what conditions it would sell its surplus water to them. *Id.* at 134.

City of Farmers Branch v. City of Addison, 694 S.W.2d 94 (Tex. App.—Dallas 1985, writ ref'd n.r.e.), involved a contractual dispute between two cities. The City of Farmers Branch and the City of Addison entered into a contract by which Farmers Branch agreed to provide sanitary sewer service to a designated portion of Addison. The contract obligated Farmers Branch to construct a trunk sanitary sewer line. Addison was granted the right to connect its sanitary sewer lines to the trunk sewer line at such times and at such locations as it deemed necessary. Based on the principle that a contract in derogation of a municipality's governmental functions is unenforceable, the court held that:

Connection to Farmers Branch's sewer system is a privilege Farmers Branch may grant in the exercise of its police power, but to grant Addison the right and the privilege of making, presently and in the future, as many connections at as many locations as Addison deems necessary and to grant Addison the right and the privilege of depositing an unlimited amount of sewage into the system is a surrender of a consequential part of control and regulation of the system. Consequently, the contract to do so is not enforceable.

Id. at 96.

The *Farmers Branch* court distinguished *City of Big Spring v. Board of Control*, 389 S.W.2d 523 (Tex. Civ. App.—Austin 1965), *aff'd*, 404 S.W.2d 810 (Tex. 1966), a case upholding the City's contract to provide water to a state hospital at a set rate so long as the State maintains the facility, on grounds that the sale of water, as opposed to provision of sewer service, was a proprietary, rather than governmental function. This is no longer the case under Texas law. See TEX. CIV. PRAC. & REM. CODE ANN. § 101.0215(a) (Vernon Supp. 1996) (declaring as governmental functions sanitary and storm sewers, subsection (9); water works, subsection (11); and water and sewer service, subsection (32)); see also *Banker v. Jefferson County Water Control & Improvement Dist. No. 1*, 277 S.W.2d at 133-134 (provision of water service by district is governmental). It also is the case, however, that the Supreme Court found the Big Spring contract to be for a stated duration (i.e., so long as the state-operated the hospital) and that the State had given good consideration for the low rate. In this regard, it should be noted as well-established that governmental entities do have the authority to enter into contracts binding beyond the term of office of the sitting officials. *Gillam v. City of Fort Worth*, 287 S.W.2d at 499 (declining to overrule judgment that ten-year contract could be sustained). With regard to cases questioning the

unconstitutional creation of debt by long-term contracts, *see, e.g., City of Tyler v. L.L. Jester & Co.*, 97 Tex. 344, 78 S.W. 1058 (1904) (the making of a contract for water for a number of years, to be delivered in the future did not create a debt against the city, but the liability of the city arose upon the use by it of the water during each year). These cases discussing duration of contract as being the issue that makes the contract void must now be viewed in light of subsequent statutes such as Texas Government Code § 791.026 and Texas Local Government Code § 402.020, which authorize contracts for any duration to which the parties agree. TEX. GOV'T CODE ANN. § 791.026 (Vernon 1994); TEX. LOC. GOV'T CODE ANN. § 402.020 (Vernon 1988).

Where a court has a choice to construe a contract to *not* be in derogation of governmental functions, it should do so. This was the case in *Clear Lake City Water Auth. v. Clear Lake Utilities Co.*, where the court refused to apply to a wholesale water and sewer service contract the general rule of contracts that where no duration of contract is specified, a “reasonable” duration will be implied. The court there held that the water authority could not, by contract or otherwise, bind itself in such a way as to restrict its free exercise of governmental powers, nor could it abdicate its governmental functions, even for a “reasonable time.” *Clear Lake City Water Auth. v. Clear Lake Utilities Co.*, 549 S.W.2d at 391. The court held instead that the contract was terminable at will by either party and that it had, in fact, been terminated. A subsequent Houston appellate court declined to apply this rule where the commitment of service is to an “end user” rather than to an “intermediary” in *Brubaker v. Brookshire Mun. Water Dist.*, 808 S.W.2d 129 (Tex. App.–Houston [14th Dist.] 1991, no writ). That

case enforced a district's oral commitment to provide water and sewer services to an apartment project.

It also is true that a contract may be void as to one term, but still valid as to others. See, e.g., RESTATEMENT (SECOND) OF CONTRACTS, *supra*, § 184. Where parties disagree as to the fundamental validity of a contract, however, an action lies for cancellation. A cancellation suit seeks to set aside the contract and restore the parties, as far as possible, to their original position. Reformation of contract is appropriate where the terms used in a contract have a clear and unambiguous meaning, but mistake is alleged such that the contract fails to express the actual intent of the parties. Reformation is a means of compelling performance of the real agreement that was made by adjusting the terms of the contract to the actual conditions of fact. Cancellation and reformation are forms of equitable relief, in the discretion of the court. See *Chenault v. County of Shelby*, 320 S.W.2d 431 (Tex. Civ. App.—Austin 1959, writ ref'd n.r.e.).

Traditionally, the recourse for *breach* of contract has been to the district court and the remedies have been an award of damages or specific relief. *Colorado Canal Co. v. McFarland & Southwell*, 50 Tex. 74, 109 S.W. at 438-39 (company having negligently or willfully failed to furnish water to a consumer, according to contract, was liable for any damages suffered in loss of or injury to the consumer's crops by reason of the breach of contract). Specific relief may entail requiring the breaching party to perform its side of the bargain. Such relief also is an equitable remedy, resting in the discretion of the court. Before a contracting party may have specific performance, for

example, he must comply with all of his obligations under the contract, even though the party against whom relief is sought is noncompliant. *Ferguson v. Seggern*, 434 S.W.2d at 384-85.

Numerous contract cases involve an action asking that the court declare the rights of the parties to the contract even before an actual breach occurs. The Texas Uniform Declaratory Judgments Act provides that the courts may declare rights, status, and other legal relations whether or not further relief is or could be claimed. TEX. CIV. PRAC. & REM. CODE ANN. § 37.003 (Vernon 1986). Specifically with regard to contracts, the statute provides:

(a) A person interested under a . . . written contract, or other writings constituting a contract or whose rights, status, or other legal relations are affected by a . . . contract or franchise may have determined any question of construction or validity arising under the instrument . . . contract, or franchise and obtain a declaration of rights, status or other legal relations thereunder.

(b) A contract may be construed either before or after there has been a breach.

Id. § 37.004. Of course, a justiciable controversy must actually exist between the parties and it also must be shown that the declaration would terminate the uncertainty or controversy giving rise to the proceeding. *Id.* § 37.008; *State v. Margolis*, 439 S.W.2d 695 (Tex. Civ. App.–Austin 1969, writ ref'd n.r.e.) (court has duty, in declaratory judgment action, to decide whether a justiciable controversy exists); *Harrell v. F.H. Vahlsing, Inc.*, 248 S.W.2d 762 (Tex. Civ. App.–San Antonio 1952, writ ref'd n.r.e.) (where plaintiff did not make application to District to use water at reasonable rates or

offer to contract, plaintiff's right to use water should be settled in proper suit in event controversy actually arises).

Often a request also is made that the court enjoin or temporarily restrain the actions of parties to the contract pending resolution of the contract dispute. Although Texas law does not favor the use of injunctions in contract matters, they are appropriate where an award of damages cannot adequately compensate for a breach and injunction would prevent the breach or maintain the status quo. See, e.g., *Alexander v. Edwards-Northcutt-Locke*, 329 S.W.2d 304 (Tex. Civ. App.—Dallas 1959, no writ) (injunction proper to avoid multiplicity of suits); *Trinity Water Reserve, Inc. v. Evans*, 829 S.W.2d at 865-66 (granting temporary injunction preserving status quo was not abuse of discretion in action by rice farmers challenging irrigation system operator's requirement that they enter into contract at rate higher than those set by Commission, although financial hardship to operator allegedly would result); *City of Arlington v. City of Fort Worth*, 873 S.W.2d at 768-69 (where last peaceable status quo was continuation of service and "damages" were compensable by monetary payment, issuance of a temporary injunction to cease discharge into sewer system was inappropriate). For injunction to lie, the contract must be legal. *Grand Prize Distrib. Co. of San Antonio v. Gulf Brewing Co.*, 267 S.W.2d 906 (Tex. Civ. App.—San Antonio 1954, writ ref'd). Increasingly, parties also provide in advance for alternative means of dispute resolution, including arbitration and mediation. For further discussion of general contract principles and remedies, see, among other sources, *Texas Jurisprudence*, 3rd edition (Contracts, Cancellation and Reformation of Instruments, Declaratory Relief, Duress and Undue Influence and Specific Performance);

Handbook of the Law of Contracts, supra; H. Hunter, *Modern Law of Contracts*, rev. ed. (Warren Gorham Lamont 1993).

3.4 SPECIAL ISSUES WITH REGARD TO WHOLESALE WATER SERVICE CONTRACTS

3.4.1 Nature of Interest in Water

“A water right granted in accordance with law is a ‘vested’ right which may not be affected or otherwise diminished except in accordance with law and after notice and opportunity for hearing is provided to the water right holder.” Tex. Natural Res. Cons. Comm’n, *A Regulatory Guidance Document for Applications to Divert, Store or Use State Water*, p. 7 (June 1995). See *Lower Colorado River Auth. v. Texas Dept. of Water Resources*, 689 S.W.2d at 881-82. No entity has an unqualified right to take or use a water right that belongs to another. It is a fundamental principle of law that neither the State, nor any person, can “take” an entity’s vested property interest in its water right without compensation. Consider, for example, that the Wagstaff Act makes non-municipal water rights effective after May 17, 1931, susceptible to a taking without necessity of compensation. TEX. WATER CODE ANN. § 11.028 (Vernon 1988). This statutory limitation burdens post-Wagstaff rights from the time they are granted, and, therefore, should be considered constitutional. The necessary implication from the statute is that otherwise, compensation would be required. Political subdivisions, generally, have the right to condemn water supplies for public purposes. *Id.* § 11.033. *But cf. id.* § 49.222 (Vernon Supp. 1996) (with regard to districts and water supply corporations, the power of eminent domain may not be used for the condemnation of

land for the purpose of acquiring rights to underground water or of water or water rights).

3.4.2 Principles of Common Law Utility Affecting Freedom of Contract

Vested water rights are property interests which may be made the subject of contract if the owner so wishes. Nevertheless, the public interest has long been held to require regulation of the use of water in the provision of utility service. A business providing a necessary and essential service to the public may be affected with a public interest creating a duty to serve on reasonable terms. *State v. Southwestern Bell Telephone Co.*, 526 S.W.2d 526 (Tex. 1975); *see also City Water Co. v. State*, 33 S.W. 259 (Tex. Civ. App. 1895, writ ref'd) (a water company's business is of such public character as to make it a quasi-public corporation such that its charter was forfeited for failure to discharge its duty to provide service). The public interest inherent in the provision of essential services creates special obligations on those entities engaged in providing the service. *City of Texarkana v. Wiggins*, 246 S.W.2d 622, 624-25 (Tex. 1952). These obligations, in turn, affect the entities' freedom of contract.

One such instance regards the responsibility to provide service to all of the public alike, without discrimination. *See, e.g., City of Houston v. Lockwood Inv. Co.*, 144 S.W. 685 (Tex. Civ. App.—El Paso 1912, writ dismiss'd) (ordinances invalid where they required applicant for water service to own property); *City of Galveston v. Kenner*, 240 S.W. 894 (Tex. 1922) (in suit to mandamus city to establish separate water service to distinct apartments in a building, it was discriminatory to refuse direct service to a tenant that was not in possession of an entire building); *Allen v. Park Place Water*,

Light & Power Co., 266 S.W. 219 (Tex. Civ. App.—Galveston 1924, writ ref'd) (corporation undertaking to supply water for domestic purposes must do so without discrimination, and treat all similarly situated within territory alike with reference to service and rates, but are not required to furnish water at unreasonable distances, which would cause loss); *Inverness Forest Improvement Dist. v. Hardy Street Investors*, 541 S.W.2d 454 (Tex. Civ. App.—Houston [1st Dist.] 1976, writ ref'd n.r.e.) (district was obliged to supply such services to all landowners within the district without discrimination).

A substantial number of the “anti-discrimination” cases, including *Allen*, deal with service to those within the suppliers’ own jurisdiction, most often on a retail basis. In *Allen*, a water company bought wells and other service facilities from the Park Place Company under an agreement to serve Park Place. The water company’s charter provided that it was to supply water to, and in the vicinity of, Park Place; but the water company had refused all service outside specific tracts, except in three instances where special contracts had been made in which service could be discontinued by the water company at any time that purchases from the Park Place Company might demand.

When challenged in court, the company argued that (1) it had not chosen to extend into the broader area, and (2) it was under obligation to serve Park Place and all future growth and that if all of the lots owned were improved and a supply of water demanded for same, the present capacity of appellee’s water plant would not be sufficient to supply more than that demand. The court did not accept either of these

theories. Instead, it emphasized that the water company's charter recital of its purpose to serve those "in the vicinity of Park Place" included *all* those in the prospective town, not just the original tracts. The *Allen* court made two specific statements regarding the water company's capacity. It stated that: (1) the water company had an ample supply of water to furnish the plaintiff's demands without lessening the supply of water to its *present* customers; and (2) the company should not be permitted to refuse to supply water to those who reside in the territory which it undertook to serve because it anticipates that at some future time a supply of water, beyond its present capacity, may be demanded. *Allen v. Park Place Water Light & Power Co.*, 266 S.W. at 224.

Absent a contract or a certificate of convenience and necessity, a city owning or operating a waterworks generally is under no duty to furnish water to persons residing beyond its corporate limits. *City of Livingston v. Wilson*, 310 S.W.2d 569 (Tex. Civ. App.—Beaumont 1958, writ ref'd n.r.e.). A city, of course, may contract to sell water outside its jurisdiction. Cities have statutory authority to extend the lines of their water service system outside their limits to sell water to any person or corporation outside those limits and to permit such person or corporation to connect under contract with the city, under terms and conditions as may appear to be for the city's best interest. TEX. LOC. GOV'T CODE ANN. § 402.001 (Vernon 1938). Having done so, however, it must not discriminate in providing that service. *City of Big Spring v. Board of Control*, 404 S.W.2d at 812; *City of El Paso v. State Line, Inc.*, 570 S.W.2d 409, 414 (Tex. Civ. App.—El Paso 1978, writ ref'd n.r.e.) (Texas city that undertook to serve some customers in New Mexico had a duty to serve all customers in the area and cannot "be permitted to pick or choose as to whom it will grant or refuse service," even though its

reason for refusing service [to conserve water for its own residents and prevent use of water where it had no control over development] was a worthwhile goal); *State v. City of Houston*, 270 S.W.2d 235 (Tex. Civ. App.–Galveston 1954, writ ref'd n.r.e.) (where City furnished water to residents previously outside the City, its obligation was to furnish water without discrimination to all others similarly situated).

In *City of Texarkana v. Wiggins*, the Texas Supreme Court ruled that a municipality which voluntarily undertook to provide water services outside its municipal boundaries could not discriminate by a rate 1.5 times higher against persons outside the City. The Court said:

The common-law rule that one engaged in rendering a service affected with a public interest or, more strictly, what has come to be known as a utility service, may not discriminate in charges or service as between persons similarly situated is of such long standing and is so well-recognized that it needs no citation of authority to support it. The economic nature of the enterprise which renders this type of service is such that the courts have imposed upon it the duty to treat all alike unless there is some reasonable basis for differentiation.

* * * *

The utility consumer is at the mercy of the monopoly and, for this reason, utilities, regardless of the character of their ownership, should be and have been, subjected to control under the common-law rule forbidding unreasonable discrimination.

City of Texarkana v. Wiggins, 246 S.W.2d at 624-25. *But cf. Gillam v. City of Fort Worth*, 287 S.W.2d at 499 (in case brought by supplier's own citizens declining to overturn judgment that sustained contract charging twice regular rates for residents with consumption in same bracket). The language quoted above from *Wiggins* is strong, but has two important caveats. A municipality may discriminate in charges and service as between those similarly situated where (1) the discrimination has a

reasonable basis or (2) a statute permits it. *See, e.g., Town of Terrell Hills v. City of San Antonio*, 318 S.W.2d 85 (Tex. Civ. App.–San Antonio 1958, writ ref'd n.r.e.).

The court, in *City of El Paso v. State Line, Inc.*, impliedly suggested another interesting solution, that service could be *terminated* to all those similarly situated. *City of El Paso v. State Line, Inc.*, 570 S.W.2d at 413 (stating, “the fact remains that when the new policy [against extending service] was established, service was not terminated to those commercial establishments . . . which did not meet the policy requirements.”); *see also Gillam v. City of Fort Worth*, 287 S.W.2d at 499 (where contract provided City had right, upon 30 days notice, to discontinue service to town in the event its water supply became inadequate, such service to be resumed when the supply became adequate for the needs of the City’s residents, court found terms were within discretion of the City’s governing body to make). The Commission of Appeals, writing in *West v. Probst*, also recognized a utility’s right to discontinue service upon reasonable notice to its customers. *See also City of Livingston v. Wilson*, 310 S.W.2d at 576 (a municipality has inherent authority to discontinue extraterritorial water service to outside customers). *Compare Munn v. Illinois*, 94 U.S. 113 (1876) (when a city voluntarily undertakes to provide an essential public service and its customers lack other reasonably economic alternatives for obtaining the service, then the courts must protect the public from abuses such as unjustified termination of service). However, when the petitioner in *Melton v. City of Wichita Falls* complained that if the city had a legitimate reason for refusing to extend service, where it would also have terminated service to those similarly situated, the Fort Worth court of appeals opined that such a

termination of service would have constituted a discrimination to those whose service was terminated. *Melton v. City of Wichita Falls*, 799 S.W.2d at 782.

The extent to which the principle of non-discrimination between potential customers would apply in the case of wholesale service was addressed in dicta in *City of San Antonio v. Texas Water Comm'n*, 407 S.W.2d 752 (Tex. 1966). In that case, San Antonio challenged the Commission's order granting to Guadalupe-Blanco River Authority ("GBRA") a permit for Canyon Reservoir over the City's competing application. The City argued that by granting GBRA "a permit for the entire unappropriated water of the Guadalupe watershed," the Commission had illegally made the rights of subsequent municipal users of the water subject to a decision of GBRA as to whether GBRA would elect to contract to supply water to such users. The Supreme Court disagreed and stated that "GBRA is under a duty to serve the public without discrimination." *Id.* at 768. For this proposition, the court cited *Allen v. Park Place Water, Light & Power Co.*, a case decided on common law utility principles. *Cf. Nueces County Water Improvement Dist. No. 1 v. Spring*, 162 S.W.2d 155 (Tex. Civ. App.—San Antonio 1942, no writ) (where District received wholesale service from a city by contract, District could not discriminate between retail customers based on requirements in wholesale contract that were unrelated to the service itself).

General legal principles aside, we have found no Texas case directly addressing what the courts would do if a wholesale municipal water supply consumer faced termination of its water supply contract without any available alternatives. It is, of course, fortunate that we have not found such a case. With regard to emergency

service, it is of note that we know of no case that has recognized a fundamental right to receive water services. *Cf. Bay Ridge Utility Dist. v. 4M Laundry*, 717 S.W.2d 92 (Tex. App.–Houston [1st Dist.] 1986, writ ref'd n.r.e.) (entertaining civil rights violation claim for denying continuing service, but holding that the duty to serve customers without discrimination does not create an absolute right to unlimited service and must be qualified by a District's greater duty to protect entire system and its users); *Lockary v. Kayfetz*, 917 F.2d 1150, 1155 (9th Cir. 1990) (no fundamental right to water predicated on right to develop real estate); *Bank of Am. Nat'l Trust & Sav. Ass'n v. Summerland County Water Dist.*, 767 F.2d 544, 548 (9th Cir. 1985).

The 1950's Texas drought did produce at least two cases in the Rio Grande Valley which imply that the courts would actively intervene in a water supply emergency, even if to do so goes beyond existing legal principles. When a voluntary rationing agreement among Valley water users disintegrated in 1952, a Cameron County district court issued a temporary injunction to enforce the same system by court order. On appeal of that injunction in *Hidalgo County Water Improvement Dist. No. 2 v. Cameron County Water Control & Improvement Dist. No. 5*, 253 S.W.2d 294 (Tex. Civ. App.–San Antonio 1952, writ ref'd n.r.e.), a dissenting judge recognized that, in effect, the lower court had seized all water of Texas flowing in the Rio Grande River below Rio Grande City to be administered by a Master in Chancery under the orders of the court. The majority opinion explains its reasoning for nevertheless maintaining the injunction as follows:

Water is life, and one accustomed to its uses who suddenly finds his supply is cut off, in our opinion, experiences a materially changed and

tragically different status. To divert attention from that important fact is to abandon the substance of this controversy in favor of a legal mirage. Had the court denied the relief appellees sought, they would have sustained irreparable injury, in which circumstances courts of equity may issue even mandatory writs before the case is heard on its merits.

Id. at 298. Any subsequent hearing on the merits of the dispute was not reported.

After construction of Falcon Dam, however, the State filed suit to adjudicate water rights in the American share of waters of the Rio Grande. *State v. Valmont Plantations*, 346 S.W.2d 853 (Tex. Civ. App.—San Antonio 1961), *aff'd*, 355 S.W.2d 502 (Tex. 1962), addressed the contest between appropriators and those asserting riparian claims to the water. The Corpus Christi court of appeals revisited the issue of insufficient Valley water rights in the severed case, *State v. Hidalgo County Water Control & Improvement Dist. No. 18*, 443 S.W.2d 728 (Tex. Civ. App.—Corpus Christi 1969, writ ref'd n.r.e.). The suit was filed on June 28, 1956, and as of October 17, 1956, the court had taken judicial custody of the American share of water. The court adopted for the Rio Grande River a system of “weighted priorities” with the following justification:

It has been suggested that when there is an abundant quantity of available water and few people, the riparian system works satisfactorily; when there is less water and more people, an appropriation system of sorts usually develops and for a while meets the exigencies of the situation, but when there is still less water and still more people, a demand for governmental conservation, control and allotment becomes imperative.

Id. at 739.

The court gave recognition to persons making “actual good faith uses” of Rio Grande River water even if those persons had no “legal right” to the water. “[W]hile

such persons may not be entitled to a right of the same grade or class as those who have complied with the appropriation statutes or whose rights have been recognized by the State in some way, they are nevertheless entitled to consideration by a court of equity,” the court said. *Id.* at 746. The court acknowledged that it had no precedent for the “unusual situation” with which it had to deal. It quoted a concurring opinion from an 1872 Colorado case as follows:

I am fully aware that courts should be slow to justify their decisions on the ground of necessity, but I am equally conscious of the fact that they will betray their trust if, in the administration of law or in the expounding of constitutional principles, they shut their eyes and refuse to recognize those conditions of society which call into force and operation principles whose existence and recognition cannot be disregarded without bringing ruin on all. As has been said by another, the law is not a system marked by folly, based on bald sentences without reason; it is a grand code, founded upon the necessities of man, erected by mature judgment, gradually expanding in beneficence and wisdom as time progresses, and resulting with care the interest of society and civilization.

Id. at 746-47 (citing J. Belford, concurring, *Yunker v. Nichols*, 1 Colo. 551, 569 (1872)).

The Corpus Christi court, in *State v. Hidalgo Co. Water Control & Improvement Dist. No. 18*, concluded that:

While there are imaginable circumstances under which strict priority would operate more beneficially than a “weighted priority” plan, we are in agreement with the court below, despite the recognized danger inherent in attempting to predict climatic, meteorological and weather conditions along the Rio Grande in future years. In times of severe drought, public policy calling for efficient and effective use of water as opposed to waste and enforceable under the police power of the state, is available to ameliorate extreme conditions.

Id. at 747-48.

Interestingly, the district court, whose judgment the appellate court affirmed as to creation of weighted priorities but modified with regard to classification of rights, had severed the claims of holders of surplus water contracts from various irrigation districts and left them to such recourse as was otherwise available. The district court's judgment said that it did not pass upon those claims except to hold that the owner of such a surplus water contract had failed to establish any legal right to water. *Id.* at 754, n. 36. Other contract holders had been decreed water rights, apparently on the theory that the land irrigated with contract water was within the contemplation of a certified filing, or had been irrigated prior to the 1945 treaty. The appellate court reversed on this point, finding no equitable difference between contractual rights and riparian rights. The court held that those who filed appeals, whose land was originally in a district, and who held contracts were entitled to Class B rights. The court refused on rehearing to change its decision with regard to the contract rights, offering as further explanation only that its reason for recognizing the claims of contract purchasers was based upon the unprecedented situation with which it was faced and that, in reaching its decision, it had considered the existence of the contract itself and the probable intended extent of the agreement as disclosed by all the surrounding circumstances, together with the general irrigation history of the area. No comment is made in the original opinion or on motion for rehearing as to what effect the allocation may have had on contractual obligations. The Texas Water Rights Adjudication Act was passed after rendition of the court's original opinion. On rehearing, the court stated specifically that the act superseded the administrative procedures set forth in its judgment. The

Texas Water Rights Commission was to assume control of the water rights adjudicated by the court upon sixty days following final entry of the court's judgment. *Id.* at 761.

Subsequent to the Adjudication Act, recognition of "equitable water rights" was rejected in *In re Adjudication of Water Rights of Brazos III Segment of Brazos River Basin*, 746 S.W.2d 207 (Tex. 1988). The Supreme Court characterized the earlier *Hidalgo* decision as creating rights that theretofore had not existed. The Supreme Court said:

The *Hidalgo* case did recognize [equitable] rights, but only on the unprecedented facts of that case. We hold that *Hidalgo* is limited to those facts, and cannot again be used as authority for the equitable creation of water rights. To hold otherwise would destroy the benefits of the Water Rights Adjudication Act.

Id. at 210. "*Hidalgo* cannot reoccur," the Court said. *Id.* at 211.

Whether or not *Hidalgo* can reoccur, it is certain that extreme drought or another "unprecedented" situation may occur. The lesson of the Valley water cases, and even of the Brazos River Segment III adjudication case by negative implication, is that the courts *may* take extraordinary measures in extreme circumstances. For this reason, among others, measures to ameliorate emergency situations before they occur are advisable. An interesting aside with regard to emergencies being in the eyes of the beholder is found in *City of San Antonio v. Texas Water Comm'n*, 407 S.W.2d at 761 (the Canyon Dam contest). The Court discussed a 1963 San Antonio City Water Board report as follows:

With regard to San Antonio's water supply, the report showed the following:

No emergency exists now, and no emergency is likely to come about in the next 15 or 20 years San Antonio can, if necessary, obtain all of its water supply from Edwards wells for at least another 15 or 20 years. Computations of future water levels at San Antonio during this period are not likely to be more than 20 feet below the 1956 level.

3.4.3 Case Studies in Common Law Utility

The recent Fort Worth/Arlington wholesale wastewater service contract dispute, where the arguments for compelling service existed outside the language of the contract, is instructive of how a court might view a claim to continuing service after expiration of an unambiguous wholesale municipal water supply contract. *See City of Arlington v. City of Fort Worth*, 844 S.W.2d 875 (Tex. App.–Fort Worth 1992, writ denied). After Arlington refused to sign a renewal contract with new rate terms, Arlington sued Fort Worth for a declaratory judgment that Fort Worth was obligated to provide sewage treatment services beyond February 14, 2001, the date upon which its existing contract expired. Fort Worth filed a counterclaim, seeking declaratory judgment that it was not obligated to continue treating Arlington's sewage beyond that date. Summary judgment was granted and upheld for Fort Worth, and it was declared that Fort Worth would have no obligations to Arlington following the contract termination date unless the parties renewed or extended the current contract. *Id.* at 876.

Arlington conceded that Fort Worth's contractual obligation would terminate according to the terms of the contract. Nonetheless, Arlington contended that Fort Worth had obligations to Arlington beyond the contract. Arlington argued six theories: express trust (from the receipt of federal funds and designation as a regional

management agency); third-party beneficiary (again, because Fort Worth received federal funds based partly on regional service); common law utility; constructive trust (based on a relationship of trust and confidence); estoppel (because Arlington abandoned its own treatment capability); and implied contract (based on representations to federal and state agencies regarding Fort Worth improving its system as evidencing an intent to extend service beyond the termination date). The district court held that the police powers doctrine overrode all of these theories and that service would expire with the contract.

While district court judgments are not considered to be of wide precedential value because they are not reported, the court's order granting summary judgment is nevertheless of interest, particularly because its decision was upheld. The district court found the implied contract argument to conflict with clear language in the contract specifying an expiration date. Citing *Exxon Corp. v. Atlantic Richfield Co.*, 678 S.W.2d 944 (Tex. 1984), and *Sun Oil Co. v. Madeley*, 626 S.W.2d 726 (Tex. 1981), for the principle that matters expressly covered in a contract will be enforced according to the intent of those specific terms, the court continued:

Even if the mayor of Fort Worth had said to the mayor of Arlington, "we'll take care of you forever," it would no more create an open-ended contract than an employer's statement, "There'll always be a place for you. You are indispensable," creates a contract of life-time employment with an otherwise at-will employee.

With regard to estoppel, the district court ruled that requiring Fort Worth to provide services beyond the ending date of its contract would impermissibly interfere with Fort Worth's governmental function. See *City of Hutchins v. Prasifka*, 450 S.W.2d

829 (Tex. 1970) (a governmental function is not subject to being estopped except on limited grounds). The Court said, "Justice does not require the application of estoppel as Fort Worth has given notice well in advance to allow Arlington time to plan for and seek alternative treatment service." *City of Arlington, Texas v. City of Fort Worth, Texas*, No. 348-118909-89 (348th Dist. Ct., Tarrant County, Tex., Feb. 10, 1992). In this case, Fort Worth notified Arlington of its decision not to extend service twelve years before the expiration date in the contract.

The district court's discussion of the common law utility theory also is interesting. The court said:

The thrust of this [common-law utility] argument is that the communities outside Fort Worth are so dependent upon its integrated sewage treatment system that it has become a "common law utility" requiring Fort Worth to keep the Village Creek plant operational indefinitely. However, as a matter of law, a municipality cannot be required to provide governmental functions outside its jurisdiction. *City of Livingston v. Wilson*, 310 S.W.2d 569, at 576-579 (Tex. Civ. App., 1958, n.r.e.) and *Town of Griffing Park v. City of Port Arthur*, 628 S.W.2d 101 (Tex. Civ. App., 1981, n.r.e.).

The situation here is that, for whatever reason, Arlington has chosen not to extend its contract with Fort Worth. Given that choice and Arlington's position that it is *not* obligated by the contract to continue as a customer except as it may will to do so, it seems incongruous to hold that Fort Worth may be compelled to provide service indefinitely for an unascertained price, yet Arlington cannot be compelled to remain a customer forever paying whatever price might be "fair" and that it may in truth disconnect at any time depriving Fort Worth of the revenue and market base. It seems better to leave the cities as they are bound by a contract, but bound only so long as the contract endures. Convenience and necessity should be allowed to influence the decisions of the cities to contract or not. If it is in the interest of their citizens to seek customers elsewhere or to find an alternative supplier, then the respective councils should have that flexibility. This is not unlike the case in *Gray v. City of East Ridge*, 641 S.W.2d 204 (Tenn. App. 1982), where a property owner declined to subscribe to a subscription fire service and then sued

because the service would not extinguish a fire on his property. The Tennessee court had little difficulty in understanding that a person choosing not to be bound by a contract is not entitled to benefits under it. So it should be here. Arlington has chosen not to continue its contractual relationship with Fort Worth and Fort Worth therefore cannot be required to keep providing service as though that relationship existed.

Arlington cannot establish that Fort Worth's service constitutes a common law utility and so that affirmative defense must likewise fail.

In the final analysis, what we have here is a clash over the use of police powers. Neither city has bargained away its police power. Arlington is merely exercising its police power through another, but the responsibility is still Arlington's. Fort Worth on the other hand cannot be required to abdicate to Arlington its responsibility to exercise its police power in a way which it determines will benefit those within its jurisdiction. Any arrangement which would require Fort Worth to exercise its police power for the benefit of Arlington for an indefinite period without regard to the benefit to Fort Worth or the needs of its citizens would cede that power to another and would be an unnatural and illegal abnegation of Fort Worth's police power. The cases cited by the defendant/counter-claimant demonstrate that this result cannot be countenanced. *City of Farmers Branch v. City of Addison*, 694 S.W.2d 94 (Tex. App., 1985, n.r.e.); *Banker v. Jefferson Co. W.C.I.D. No. 1*, 277 S.W.2d 130 (Tex. Civ. App., 1955, n.r.e.); and *Fidelity Land & Trust v. City of West University Place*, 496 S.W.2d 116 (Tex. Civ. App. 1973, n.r.e.). Even if there were an affirmative defense which could conceivably be proven, this line of authority would bar the result sought by Arlington and mandate the result sought by Fort Worth.

Id. (Mem. and Order Granting Mot. for Summ. J. at 7-9).

City of Arlington appealed the district court's decision. On the issue of binding a municipality to its oral commitments to provide service, Arlington cited, among other cases, *Winograd v. Clear Lake City Water Auth.*, 811 S.W.2d 147 (Tex. App.—Houston [1st Dist.] 1991, writ denied); *Brubaker v. Brookshire Mun. Water Dist.*, 808 S.W.2d at 131-32; and *Winograd v. Clear Lake City Water Auth.*, 654 S.W.2d 862 (Tex. App.—Houston [14th Dist.] 1983, writ ref'd n.r.e.). Arlington argued that in each of these cases, a court enforced a city's oral commitment to provide sewer service based on

theories of contract, implied contract, and promissory estoppel, in the absence of any proof that to do so would be an abdication of governmental responsibilities. Full discussion of this issue is not within the scope of this project because it assumes acts by the supplier other than a written contract, i.e., an oral commitment of service. However, we do agree that a governmental entity may be the subject of estoppel on the proper facts. *Cf. Southwest Water Services, Inc. v. Cope*, 531 S.W.2d 873 (Tex. Civ. App.—Fort Worth 1975, writ ref'd n.r.e.) (promissory estoppel recognized with regard to continuation of rate where written contract as to rate was silent as to time and duration of entitlement). Also, we would point out that in none of the three cases cited by Arlington did the supplier have an explicit contract that was overridden by the contrary representation.

The appellate court agreed with the district court, stating that “[u]nder Texas case law, a ruling, premised upon any theory, that Fort Worth has a duty to provide wastewater treatment services to Arlington indefinitely after February 14, 2001, would violate the police powers doctrine.” *City of Arlington v. City of Fort Worth*, 844 S.W.2d at 877. It was the court’s holding that the City could not even voluntarily agree to provide perpetual service outside its territorial limits because to do so would impermissibly abdicate its governmental responsibilities. The court reasoned that Arlington cannot rely on any other theory to establish a duty for Fort Worth that Fort Worth is powerless to undertake on its own. *Id.* at 878 (citing *Clear Lake City Water Auth. v. Clear Lake Utilities Co.*, 549 S.W.2d at 390-91; *Pittman v. City of Amarillo*, 598 S.W.2d 941, 945 (Tex. Civ. App.—Amarillo 1980, writ ref'd n.r.e.) (municipality cannot by contract grant another entity free connection to its sewer system, obligate itself to

meet all water and sewage treatment needs of another entity, or permit another entity to control the charging or collection of revenue from its sewer system); and *Fidelity Land & Trust Co. of Tex. v. City of West University Place*, 496 S.W.2d at 116-17).

It is uncertain how a court might apply the principles of *City of Arlington v. City of Fort Worth* to a water supply controversy. As discussed above, water supply is no less a governmental function than is provision of sewer service. Governmental functions are legal duties imposed by state law which cannot be exercised or ignored by a municipality at its discretion. As stated in *City of Uvalde v. Uvalde Electric & Ice Co.*, 250 S.W. 140, 141 (Tex. Comm'n App. 1923, opinion adopted):

This class of functions the city must perform. The city has no option. They are not to be exercised or ignored by the municipality at discretion. Such functions are legal duties imposed by the State upon its creature. These duties the municipality may not omit with impunity, but must perform at its peril.

At least one out-of-state case related to water service was decided on grounds similar to those relied on by the appellate court in *City of Arlington v. City of Fort Worth*. At issue in *Fairway Manor, Inc. v. Board of Comm'rs of Summit County*, 521 N.E.2d 818 (Ohio 1988), *cert. denied*, 488 U.S. 1005 (1988), were rates set forth in a contract between a city and county. A lower court struck down an existing contract, and then ordered service under the terms of a previous, expired contract. The Supreme Court disagreed. The Court stated:

[M]unicipally owned public utilities have no duty to sell their products, including water, to extraterritorial purchasers absent a contractual obligation. Even where there is a contract, but the contract provides no termination date, either party to the agreement may terminate it upon reasonable notice. Thus, it can be seen that a municipality does not

assume a duty to continue supplying water in perpetuity to extraterritorial customers merely by virtue of having once agreed to supply it.

* * * *

This court has previously refused to compel a municipality to continue to supply water to non-residents under the terms of an expired contract, on the basis that the council of the municipality has the sole authority to decide whether it would continue to furnish its surplus water to surrounding territories.

Ordering the parties to renegotiate is certainly not a realistic alternative. Again, the problem arises of compelling appellant to continue supplying water under terms other than those to which it had agreed. Other problems inevitably present themselves. What rate prevails while the contract is being negotiated? How can the parties be forced to come to a meeting of the minds? It can readily be seen from the foregoing that judicial interference in these kinds of contract disputes creates many more problems than it solves. The only sensible, practical and logical solution is simply to leave the parties with their bargain. It is neither harsh nor unfair to require appellee to abide by the terms of the agreement for which it bargained. Appellee cannot be relieved of its obligations under this contract merely because it now believes that the bargain it made was a bad one.

Moreover, we are mindful of the extreme ramifications which would follow from an order requiring appellant not only to continue to sell its surplus water to appellee, but at a price to which appellant has not agreed. Such an outcome would cast uncertainty on every similar contract throughout the state where the supplier charges a higher rate to extraterritorial purchasers, or differing rates to non-residents in different contracting districts. We are unwilling to take such a step.

Id. at 822-23 (citations omitted).

Despite this out-of-state concurrence, how can the Fort Worth/Arlington case be reconciled with Texas cases requiring water service be provided without discrimination when an entity undertakes to supply water outside its own jurisdiction? It is our understanding that in Fort Worth's case, it had made an offer of contract on terms similar, if not identical to, offers made and accepted by other regional customers. No discrimination among those entities similarly situated would be evident. Also

compare *Guelker v. Hidalgo County Water Improvement Dist. No. 6*, where the court said a perpetual sale of water did not violate the public interest. On the one hand, the difference may lie in the nature of the contractual agreement. The *Guelker* court may have viewed Donna Irrigation District's arrangement as a sale of a right rather than just a contract for service. Surely, the sale of an equity interest in a wastewater treatment plant would be upheld on the same facts. However, the *Guelker* court's opinion could be read to imply that had the contract *not* been perpetual, the outcome may have been different. Specifically, the court said that it was not willing to look *back* 25 years and hold the contract void. The Fort Worth/Arlington decision also may be a product of its factual circumstances. Arlington had twelve years notice to find an alternative, and the court indicated no reason to believe that some alternative could not be made available. It also is important to keep in mind that there is no statutory provision on wastewater service equivalent to Texas Water Code § 11.041.

3.4.4 State's Continuing Interest in Water

A different basis for finding a duty to serve municipal water comes from the State's continuing interest in that water which originates as state water. The Conservation Amendment to the Texas Constitution provides that the waters of this State are "public rights and duties." TEX. CONST. art. XVI, § 59(a) (1917, amended 1978). See also *City of Corpus Christi v. City of Pleasanton*, 276 S.W.2d 798, 807 (Tex. 1955) (the use of all property, including property rights in water, is subject to the general police power of a state and the state's power extends to legislation affecting the use of water). The authority of the Commission to compel service lies not in the

common law principles discussed above but in the specific statutory grants of authority in Texas Water Code §§ 11.036, 11.041 and, for service during the pendency of a rate appeal, § 12.013. Recall that the *Borden* court said, considering a business in which the use of water is secured to the public, “there results a power in the Legislature to further regulate it in a reasonable way.” *Borden*, 98 Tex. 494, 86 S.W. at 15. A state agency, however, has only such authority as is expressly granted it. Further, the legislature intends an administrative agency to have the necessary powers to perform its required functions, although powers beyond that will not be implied. *Sexton v. Mount Olivet Cemetery Ass’n*, 720 S.W.2d 129, 137 (Tex. App.—Austin 1986, writ ref’d n.r.e.).

Aside from the State Supreme Court’s implication in *City of San Antonio v. Texas Water Comm’n* that theories of common law utility apply to wholesale water service, which was discussed above, the Court in that case also discussed at some length the State’s continuing interest in the water rights being granted to the Guadalupe-Blanco River Authority. The court specifically rejected the argument that the Commission was delegating to GBRA exclusive authority to administer water rights in the Guadalupe watershed. The court discussed that in addition to retaining a veto power exercised by approving or disapproving subsequent contracts entered into between GBRA and municipal users, the Commission retained continuing rights of supervision over the water right under statute and by the terms of the permit granted. The right could be canceled if GBRA failed to put the water to beneficial use. The Commission also has the power, the court said, to compel service under the predecessor statute to Texas Water Code § 11.041. And, under the terms of the

permit, the Commission could refuse to approve a contract that attempted to furnish too much water to an entity, or for any other reason.

It should be noted that the Commission, if it ever actually did, no longer exercises the kind of veto authority over contracts that the Supreme Court discussed in *City of San Antonio v. Texas Water Comm'n*. Commission rules § 295.101 relates to Filing Requirements for Water Supply Contracts and Amendments, and § 297, Subchapter J, relates generally to Water Supply Contracts and Amendments. Under these Commission rules, a supplier of treated or untreated state water is to submit copies of its supply contracts to the Commission. If the contract meets the requirements of the Commission's rules and is consistent with the authorizations of the base water right, the Executive Director will simply file it with the Commission's records. 30 TEX. ADMIN. CODE § 297.101 (West 1995) (Tex. Natural Res. Cons. Comm'n). The requirements set forth in § 295.101 include that the contract terms specify a per unit cost of water; effective date and termination date; annual average quantity of water being furnished; location of purchaser's diversion point; and a statement of compliance with § 297, Subchapter J, of the Commission's rules. When the contract is filed under § 297.101, water use by the purchaser counts toward perfecting the supplier's water right. *Id.* § 297.106(a); *see also id.* § 295.11 (Requirements for Applications for Authorization to Convey Stored Water).

If the exercise of rights under a contract between the supplier and the purchaser would require significant amendment of the appropriative right on which the sale is based, the supplier must submit an application to amend the base right. Applying the

general permitting standards of Chapter 11 to an amendment, the Commission will have to make a finding that granting the application would not be detrimental to the public welfare. We are not aware of any instance when a would-be purchaser has protested a water rights amendment requested in furtherance of another's contract. It is a more common situation that two applicants would compete directly with each other for a limited supply, or an existing water rights holder would protest the amendment. If the contract requires only amendment to add a diversion point or to change the place of use of a water right then the supplier does not have to submit an application for an amendment. *Id.* § 297.102(b). Contrast *id.* § 297.103 (Special Requirements for Downstream Sales of Water from a Storage Reservoir with regard to diversion from streamflows other than those resulting from releases) and § 297.104 (Special Requirements for Upstream Sales of Water from Storage). Both §§ 297.103 and 297.104 contemplate the acquisition of a regular, term or temporary permit, or amendment of the supplier's water right. We believe that the Commission also will assert jurisdiction over placement of added upstream diversion points to consider environmental consequences. *A Regulatory Guidance Document for Applications to Divert, Store or Use State Water, supra*, at 38.

It was the Commission's past practice to issue a contractual permit, such that no additional amendment of the supplier's right would be needed. A contractual permit authorized the use of state water where the source of supply is water lawfully authorized for the use of another person and a written agreement had been entered into with that person. The permit was issued for a time limited by the contract itself, and no permanent right was acquired by the holder. The Commission's current rules

specify that although some contractual permits may still be in existence, they are no longer being issued by the Commission. 30 TEX. ADMIN. CODE § 297.14 (West 1996).

Because it was not the case that GBRA had, in fact, denied or threatened to deny, service to San Antonio or any other entity, the Court's discussion of the obligation of service in *City of San Antonio v. Texas Water Comm'n* is not considered definitive, particularly as to the finer distinctions in possible legal reasoning. The Court, for example, cited *Allen*, a common law utility case, and the Commission's statutory authority to compel service as though both co-existed as to wholesale service. A question exists as to what extent a court might decline to consider a petitioner's request to compel service beyond the expiration of a contract given that Texas Water Code § 11.041 provides administrative procedure for compelling service. This principle of finding primary jurisdiction in an administrative agency has been explained as follows:

[T]he courts will not determine a controversy (1) involving a question that is within the jurisdiction of an administrative tribunal prior to the decision by the administrative tribunal, (2) where the question demands the exercise of sound administrative discretion requiring the special knowledge, experience and services of the administrative tribunal to determine technical and intricate matters of fact, and (3) a uniformity of ruling is essential to comply with the purposes of the regulatory statute administered. The theory seems reasonably clear that the test for applying the principle of primary jurisdiction is not whether some parts of the case are within the exclusive jurisdiction of the courts but whether some parts of the case are within the exclusive jurisdiction of the agency.

Lake Country Estates, Inc. v. Toman, 624 S.W.2d 677, 681-82 (Tex. App.—Fort Worth 1981, writ ref'd n.r.e.) (citations omitted) (quoting Davis, *Administrative Law Text*, § 19.07 at 352 (Hornbook Series 1950)). For district court jurisdiction, see also TEX.

CONST. art. V, § 8 (1895, amended 1991); TEX. GOV'T CODE ANN. § 24.007 (Vernon 1988).

Although courts generally retain jurisdiction to resolve controversies that are inherently judicial in nature, and contract interpretation may be considered inherently judicial, the legislature may grant an administrative agency exclusive jurisdiction over specific controversies that involve contracts. In such a circumstance, a trial court may dismiss or stay litigation pending resolution of at least part of the action by an administrative agency. See *Harris County Mun. Utility Dist. No. 48 v. Mitchell*, 915 S.W.2d 859 (Tex. App.–Houston [1st Dist.] 1995, writ denied) (where issue was not inherently judicial such as determining contractual rights, but regarded determination of an interest rate, Commission had primary jurisdiction). It is arguable that the statutory provisions for compelling wholesale service from a surface water supply override the common law in certain circumstances, and that primary jurisdiction over a dispute has been placed in the Commission. It could be argued that, on facts which meet the standards of Texas Water Code § 11.041, a court should not compel service beyond the time stated in unambiguous termination and renewal provisions when the Texas Water Code creates an administrative cause of action to compel service.

A primary jurisdiction argument was urged in *Town of Griffing Park v. City of Port Arthur*, 628 S.W.2d 101,103 (Tex. Civ. App.–Beaumont 1981, writ ref'd n.r.e.). Griffing Park, the purchaser, was resisting leaving Port Arthur's water and sewer systems, so Port Arthur brought a declaratory judgment action to determine the expiration date of the contract. Griffing Park alleged among other things that the Commission's

predecessor agency had primary jurisdiction over the setting of rates for extraterritorial water supply service (in § 12.013) and for compelling service of extraterritorial water supply (in § 11.041). The court, however, found that because there was no rate dispute, § 12.013 did not apply; and, because Port Arthur purchased its water from Lower Neches Valley Authority rather than “appropriating” it, the Commission’s authority to compel service would not apply. There being no jurisdiction over the dispute in the Commission at all, primary jurisdiction principles could not apply, and this issue was left unresolved. Recalling the above discussion of *Brushy Creek*, the *Griffing Park* court’s discussion of “appropriators” of state water should be considered overruled. Compare *Colorado Canal Co. v. McFarland & Southwell*, 50 Tex. 74, 109 S.W. at 439 (quoting a secondary source that “[i]n voluntarily engaging in the business of carrying water as a public agency, in the absence of any legislation on the subject, an irrigation company must be held to have submitted itself to a reasonable judicial control in the matter of regulations and charges”) (emphasis added) with *Trinity Water Reserve, Inc. v. Evans*, 829 S.W.2d at 862 (discussing “statutory and common law rights to obtain irrigation water” but distinguishing between that cause which was taken to the Commission (water rates) and that cause which was taken to the district court (injunction against insistence on contract)) (emphasis added).

3.4.5 State’s Authority to Regulate Contracts

In addition to the State’s interest in the fact of utility service, the State also has some authority to regulate the conditions of service as affecting the public interest. The Commission’s rate jurisdiction is one example.

The 1905 State Supreme Court decision in *Borden v. Trespalacios Rice & Irrigation Co.*, upheld the State's authority to regulate contracts made under the 1895 Irrigation Act because the appropriative right under which the water was obtained and stored in the first instance, coupled with the power of eminent domain given canal corporation's to obtain the necessary land and right-of-way affected the public interest. *Borden*, 98 Tex. 494, 86 S.W. at 14 (cited in *Brushy Creek*, 887 S.W.2d at 73-4). In reviewing this principle, the court of appeals in *Brushy Creek* continued, "[t]hat the contracts affected the public interest was, of course, the talisman that enabled the State to exercise its police power to [constitutionally] regulate a privately owned business, including its prices" *Brushy Creek*, 887 S.W.2d at 74; see also *id.* at n. 5 (discussing development of other bases for holding regulation permissible--whether the regulation was found to be arbitrary, discriminatory or demonstrably irrelevant to a public policy, the legislature was free to adopt--and citing *Nebbia v. New York*, 291 U.S. 502 (1934)). In 1913, the legislature placed enforcement of the water laws in the system of state agency administration. The lower court's *Brushy Creek* opinion goes on from that point to give the history of predecessor statutes to Texas Water Code §§ 11.036, 11.041, and 12.013, each affecting the State's authority to compel service and fix rates.

The recent case of *Texas Water Comm'n v. City of Fort Worth*, 875 S.W.2d at 335, in part, turned on Texas' constitutional limits on the State's ability to pass laws that impair contractual obligations except in instances where the public safety and welfare must be protected. On this premise, the court ruled that the Commission was required to first find that Fort Worth's proposed sewer service rates adversely affected

the public interest before entertaining review of that rate. *Cf. Brushy Creek* (wherein the court ruled that Round Rock's impairment of contract argument was not properly before the court). Specifically, the court stated that "[t]he District Court correctly concluded that the appropriate scope of appellate review under Section 13.043(f) of the Water Code requires that the Commission first make a finding that rates affected by a 'decision of the provider' adversely affect the public interest by being unreasonably preferential, prejudicial, or discriminatory." 875 S.W.2d at 336. This holding affected the Commission's recent rulemaking efforts to implement a bifurcated rate review to determine the public interest. 30 TEX. ADMIN. CODE ch. 291, subchapter I (West 1995) (Tex. Natural Res. Cons. Comm'n) (Wholesale Water or Sewer Service).

The principles for determining whether the public interest would be adversely affected by various rate structures is not within the scope of our analysis and will not be discussed here, except to note that the authority to compel service does not unconstitutionally deprive the supplier of property so long as the rates established for that service are constitutionally adequate. However, it should be kept in mind that any contractual provisions that effect a surcharge instituted after failure to comply with requirements for developing alternative or replacement supplies or as a penalty would have to withstand public interest review. A provision that is backed by specific statutory and/or rulemaking authority should be presumed to be in the public interest, subject to a finding of some egregious harm.

4.

STRATEGIES FOR INCREASING CERTAINTY OF TERMINATION PROVISIONS

4.1 ALTERNATIVES ON TERMINATION OF CONTRACT

Uncertainty in termination of supply contracts appears to stem less from the strength or weakness of the termination provision, and more from common law or statutory methods for compelling service. This being the case, it appears to be necessary to address both the public interest in providing utility service and the conditions under which the Commission's statutory authority over water create an avenue for obtaining service beyond the expiration of a contract.

The public interest in providing utility service appears to be best served by protecting both suppliers and purchasers as to clarity of contract. Suppliers' interests may be served by including recitations and provisions in a contract whereby the purchaser acknowledges that it has no rights to service beyond the expiration date and that the supplier does not have nor represent to have water available for sale beyond the expiration date of the contract. See Model Agreement, Recitals 2-5, Sections 1, 2, 3. Recitals are not contractual obligations but are used to memorialize the circumstances and understandings of the parties at the time of contracting. *Gardner v. Smith*, 168 S.W.2d 278 (Tex. Civ. App.—Beaumont 1942, no writ).

Following such recitations, an unambiguous termination clause should be drafted in the contract. See Model Agreement, Section 2. It also should be clear that no rights beyond the expiration date may be created except by explicit, written

extension of the contract. If a renewal is contemplated, however, that clause should be as equally clear and unambiguous.

Termination contests arise also on other grounds, including common law utility. This was the case in Fort Worth and Arlington's contest over wastewater service. Despite explicit assurances of contract, it is unknown how a court would rule in a situation where a purchaser literally has no alternative to service from the supplier. Would a court find a duty in the *supplier* to develop more supply? This question has arisen in other jurisdictions with regard to retail service and development moratoria, and there have been mixed results. As further protection against this unknown, a supplier may want to consider contract provisions that explicitly place all burden on the purchaser to develop alternative supplies, or replacement supplies if the purchaser would be allowed to remain on the system, and to provide proof to the supplier that such supplies will be available prior to contract expiration. See Model Agreement, Appendix A, Section 2. Even these protections might be insufficient under the most dire situations, if no reasonable alternatives or replacement supplies are available or if the purchaser's resources are more limited than the supplier's resources.

Providing for enforcement of interim compliance steps should at least allow determination of the legal status of the parties *before* a critical juncture is reached at the end of the contract term. Of course, it is up to the parties, based on their particular circumstances, whether the development of alternative or replacement supplies is appropriate. Additionally, we believe that such provisions must be reinforced through legislation. See generally *Keller Industries, Inc. v. Reeves*, 656 S.W.2d 221 (Tex.

App.–Austin 1983, writ ref'd n.r.e.) (if there is no ambiguity, the statute itself is the public policy). RESTATEMENT (SECOND) OF CONTRACTS, *supra*, § 179 (discussing the role of legislatures in declaring public policy). Otherwise, it is possible that a court would find provisions in a contract read to restrict governmental discretion as to development of water supplies to be unenforceable as against public policy.

The authority of the Commission to compel service exists outside both a contract itself and outside theories of common law utility. Amendment of Texas Water Code § 11.041 could be both a “carrot” for the supplier and a “stick” against the purchaser in refining a supplier’s statutory liability to provide service. Specified protections from § 11.041 jurisdiction with regard to the availability of supply could enhance a supplier’s security even outside a contract.

Suggested language to amend Texas Water Code § 11.036, and/or Texas Government Code § 791.026, to reinforce consistency with public policy and to § 11.041 to limit or refine the Commission’s authority to compel service are presented below, along with other statutory concepts for discussion.

4.2 PROPOSAL FOR AMENDMENT OF TEXAS WATER CODE AND COMMISSION RULES

Several possible legislative or rulemaking changes are discussed below for consideration.

4.2.1 Modification of Texas Water Code § 11.036

Texas Water Code § 11.036 currently addresses water service both under a contract and without a contract. Possible modifications are set out and discussed below:

Conserved or Stored Water: Supply Contract.

(a) A person, association of persons, corporation, or water improvement or irrigation district having in possession and control any storm water, floodwater, or rainwater that is conserved or stored as authorized by this chapter may contract to supply the water to any person, association of persons, corporation, or water improvement or irrigation district having the right to acquire use of the water.

(b) The price and terms of the contract shall be just and reasonable and without discrimination, and the contract is subject to the same revision and control as provided in this code for other water rates and charges. If the contract sets forth explicit expiration provisions, no continuation of the service obligation will be implied.

(c) The terms of a contract may expressly provide that the person using the stored or conserved water is required to take actions that will result in alternative or replacement supplies being available prior to expiration of the contract, and may further provide for enforcement of such terms by court order.

(d) If any person uses the stored or conserved water for irrigation or domestic purposes without first entering into a contract with the party that conserved or stored it, the user shall pay for the use at a rate determined by the commission to be just and reasonable, subject to court review as in other cases.

[or alternatively]

(d) If any person uses the stored or conserved water, with the supplier's continuing consent but without first entering into a contract with the party that conserved or stored it, the user shall pay for the use at a rate determined by the commission to be just and reasonable, subject to court review as in other cases.

The first substantive revision requires no explanation, except to point out the possible negative effect that any desirable flexibility in judicial decision-making would be coincidentally limited.

The second substantive change in § 11.036 is intended to ensure that reasonable provisions in a contract that require a buyer to develop alternative or replacement supplies would not be per se unenforceable as against public policy. Presumably, if the requirement was unreasonable because of its specific provisions, i.e., development of replacement supplies at any cost when the supplier has additional water available, the term still could be voided. Various other remedies explored in the future can be expressed in this section of the Code as also being consistent with public policy.

The existing second sentence of § 11.036 is moved to (d) and, in the first alternative, is limited to irrigation and domestic purposes. The existing sentence implies an unlimited right to take water outside a contract and is either inconsistent with the remainder of § 11.036 and with § 11.041 or is, to some extent, redundant of § 11.041. What little case law exists under these provisions already demonstrates confusion about their interrelationship. *See, for example, Town of Griffing Park v. City of Port Arthur*, 628 S.W.2d at 103 (addressing compelled service and § 11.036 but ignoring provisions in § 11.041 regarding “control” of supplies). One alternative was to delete this concept from § 11.036 in its entirety; however, we are uncertain whether this provision has continuing utility in irrigation systems and are hesitant to

recommend any restriction of the Commission's already limited ability to regulate water use from existing permit holders.

The second alternative (d) limits the applicability of § 11.036 to service from willing suppliers. Service from unwilling sellers still could be compelled under § 11.041, which has specific standards and procedures. However, there is concern that this alternative also may unintentionally affect irrigation canal rights.

4.2.2 Modification of Texas Government Code § 791.026

For the same reasons discussed above, Texas Government Code § 791.026 could be modified as follows to reinforce termination provisions and provisions that require development of alternative or replacement supplies:

Contracts for Water Supply and Wastewater Treatment Facilities.

(a) A municipality, district, or river authority of this state may contract with another municipality, district, or river authority of this state to obtain or provide part or all of:

- (1) water supply or wastewater treatment facilities; or
- (2) a lease or operation of water supply facilities or wastewater treatment facilities.

(b) The contract may provide that the municipality, district, or river authority obtaining one of the services may not obtain those services from a source other than a contracting party, except as provided by the contract.

(c) If a contract includes a term described by Subsection (b), payments made under the contract are the paying party's operating expenses for its water supply system, wastewater treatment facilities, or both.

(d) The contract may:

(1) contain terms and extend for any period on which the parties agree;

(2) require the purchaser to take actions that will result in alternative or replacement supplies being available prior to the expiration date of the contract, and provide for enforcement of such terms by court order; and

(3) provide that it will continue in effect until bonds specified by the contract and any refunding bonds issued to pay those bonds are paid.

(e) Where a contract sets forth explicit expiration provisions, no continuation of the service obligation will be implied.

(f) Tax revenue may not be pledged to the payment of amounts agreed to be paid under the contract.

(g) The powers granted by this section prevail over a limitation contained in another law.

4.2.3 Modification of Texas Water Code § 11.041(a)

Texas Water Code § 11.041 addresses the Commission's authority to compel service from an unwilling supplier. Alternative suggestions are discussed below:

Denial of Water: Complaint.

(a) Any person entitled to receive or use water from any canal, ditch, flume, lateral, dam, reservoir, or lake or from any conserved or stored supply may present to the commission a written petition showing:

(1) that he is entitled to receive or use the water;

(2) that he has not breached provisions in a previous or existing contract for use of the water that require him to have alternative or replacement supplies available upon expiration of the contract;

[or, alternatively]

(2) that he has in good faith attempted to comply with all previous contractual agreements to secure alternative or replacement supplies but determined that no such supplies are reasonably available.

[or, alternatively]

(2) that he has not previously contracted for use of the water, to expire on a date certain [or if a previous contract exists, that there has been a material change of circumstances since the contract became effective that warrants continuation or reinstatement of service].

(3) that he is willing and able to pay a just and reasonable price for the water;

(4) that the party owning or controlling the water supply has water not contracted to others and available for the petitioner's use; and

(5) that the party owning or controlling the water supply fails or refuses to supply the available water to the petitioner, or that the price or rental demanded for the available water is not reasonable and just or is discriminatory.

These changes protect a water supplier from petition under § 11.041 by a purchaser whose contract term has expired or who has breached a contract with regard to replacement or alternative supplies. The first alternative intends that, if the former purchaser had breached an earlier agreement to develop alternative or replacement supplies, the Executive Director would not be able to find "good cause" for the petition, and it would not be sent to hearing. This protection from § 11.041 compelled service could be an *incentive* for suppliers.

The second alternative provides a more "pro-purchaser" stance that would allow the petition if the former purchaser could show that the reason for breaching the agreement with regard to alternative or replacement supplies was that no such supplies were reasonably available. The purchaser still would have to establish that the supplier had water available.

As a third alternative, the law could provide that any purchaser who voluntarily contracts to terminate service on a date certain is later barred from recourse to

§ 11.041. This stricter approach could be relaxed by allowing changed circumstances to override the agreed-to termination date. However, recognition of changed circumstances may negate any benefits gained in certainty of contract.

4.2.4 Availability of Water

Amendment of Texas Water Code § 11.041, or rulemaking, to specify criteria for determining when a supplier has water available for sale would add a measure of certainty for both purchasers and suppliers. Clarification of the suppliers' right to contract the supply to other users even during the pendency of a Commission order compelling service should be considered. A similar amendment could specify that a supplier has the right to petition the Commission to cancel an order compelling service whenever the supplier can show that its own needs and the needs of its existing contract purchasers reach a stated percentage (i.e., 80%) of the available supply. A finding that a supplier is using less than the stated percentage of its supplies should, however, not be conclusive proof that supplies are available within the meaning of § 11.041. Precedent for service capacity percentages is found in TEX. WATER CODE ANN. § 13.139(d) (Vernon 1988).

4.2.5 Entitlement to Water

Amendment of § 11.041, or rulemaking, to specify criteria for determining when a would-be customer is "entitled" to water could be considered.

4.2.6 Water Management Plan Protection

Texas Water Code § 11.173 allows an entity with an approved water management plan to protect its supplies from cancellation. This concept could be adopted to protect suppliers from application of § 11.041 beyond certain time frames or levels of supply expressed in such a plan.

4.2.7 Statutory Enforcement of Interim Compliance

A new statute, or additional amendment of Texas Water Code § 11.036 could create a specific statutory procedure for a supplier to enforce interim contractual steps for developing replacement or alternative supplies by filing action for specific relief in district court.

A model for this type of provision exists in parts of Texas Water Code § 11.091 (Interference with Delivery of Water Under Contract). That provision states the nature of a violation and then provides that, on the petition of any interested party, the district court of any county through which water delivered under contract shall pass, may enjoin any actual or threatened act prohibited by the section. TEX. WATER CODE ANN. § 11.091 (Vernon 1988) (also creating criminal penalties).

4.2.8 Contract Oversight

Another alternative is to increase the Commission's overall responsibilities for contract oversight. For example, the Commission could be required to specifically approve or disapprove contracts for municipal water supplies with terms of a specified number of years (i.e., ten years) or more. Alternatively, approval could be required of

all contracts of at least a specified duration that include a provision requiring proof of development of an alternative or replacement supply. It could be provided that when a dispute arises as to the termination of service or as to interim steps for development of alternative or replacement supplies, under a Commission-approved contract, the supplier has specific recourse to the Commission for enforcement of those provisions relating to the new supply.

4.2.9 Receivorship

If enforcement authority has been placed in the Commission's jurisdiction, receivership could, perhaps, be made one of the Commission's enforcement tools, with clear statutory standards. The receiver would be responsible for taking over development of new supplies. Texas Water Code § 13.412 is a model for receivership provisions. It provides that, at the request of the Commission, the attorney general shall bring suit for the appointment of a receiver to collect the assets and carry on the business of a water or sewer utility that violates a final order of the Commission. The court is to appoint a receiver if appointment is necessary to, among other things, guarantee continued service to the customers of the utility or to prevent continued or repeated violation of the final order. On a showing of good cause by the utility, the court may dissolve the receivership and order the assets and control of the business returned to the utility. TEX. WATER CODE ANN. § 13.412 (Vernon 1988 and Supp. 1996). The Texas Water Development Board, or its designee, could be an appropriate receiver.

4.2.10 Moratoria

A future new statute could place moratoria on growth in communities served by suppliers that are in breach of contractual obligations to provide proof of alternative or replacement supplies, or that have not secured water supplies for a defined planning horizon whether or not provided for in contract.

There are, of course, two solutions to a growing water shortage: developing additional supplies and limiting growth. Limiting growth may be the most draconian solution. Consider, for example, Arizona's A.R.S. § 45-576 requiring real estate developers in an active groundwater management area to establish an assured water supply, defined as "sufficient groundwater, surface water, or effluent of adequate quality that will be continuously available to satisfy the water needs of the proposed use for at least one hundred years." *See also Cherry v. Steiner*, 543 F. Supp. 1270 (D.C. Ariz. 1982), *aff'd*, 716 F.2d 687 (9th Cir. 1983), *cert denied*, 466 U.S. 931 (1984) (regarding constitutionality of Arizona Groundwater Code); *Gilbert v. State of California*, 218 Cal. App. 3d 234 (C. App. Cal. [1st Dist.] 1990) (although state agency could not require water district to obtain additional water supplies, it could condition a permit on that District maintaining the moratorium status quo until such time as it could demonstrate additional water sources or an adequate water supply and stating that without question, such a permit condition promotes the valid public health purpose of ensuring a continuous supply of potable water).

Some communities wishing to halt growth have used moratoria as "clubs" against developers. Potential implications include equal protection and due process

challenges, and takings claims under the state and federal constitutions. See D. Herman, *Sometimes There's Nothing Left to Give: The Justification for Denying Water Service to New Consumers to Control Growth*, 44 STAN. L. REV. 429 *et seq.* (1992) (discussing the examples of Bolinas, Goleta, and Hidden Valley, California). The City of Clear Lake Water Authority adopted a moratorium on multi-family construction in 1978. Where a developer sued to enforce a prior oral commitment to extend service that was breached after the moratorium, the court, in *Winograd v. Clear Lake City Water Authority*, upheld a finding that the developer had been denied due process and equal protection of the laws. The general merits of moratoria, however, are not discussed in the opinion. See also CAL. WATER CODE § 355 (providing that moratoria on new hookups remain in effect during the period of the emergency and *until* the supply of water has been replenished or augmented) (emphasis added) and § 358 (West 1971) (allowing review of findings and regulations regarding water moratoria on grounds that such actions are fraudulent, arbitrary, or capricious); *Swanson v. Marin Mun. Water Dist.*, 56 Cal. App. 3d 512, 524, 128 Cal. Rptr. 485, 493 (1976) (stating that water district has neither the power nor the authority to initiate or implement a no-growth policy within a community, and imposition of any restriction on the use of its water supply for that purpose would be invalid). *But cf. Wilson v. Hidden Valley Mun. Water Dist.*, 256 Cal. App. 2d 271, 63 Cal. Rptr. 889 (1967) (upholding decision to abandon search for new water supplies where decision was made by elected board members of water district formed for express purpose of controlling growth in a lightly populated rural area, and the board was clear in its intention).

In judging a takings claim under the common law, a court probably would consider whether the moratorium was legitimately based on a water shortage. The discussion of a moratorium in *Melton v. City of Wichita Falls*, however, depended heavily on interpreting a municipality's authority under Texas Local Government Code § 402.001. The court held that prohibiting new connections for water service beyond the City limits was a proper method to address the issue of "improper growth" at its periphery. *Melton v. City of Wichita Falls*, 799 S.W.2d at 782. The court would, of course, in the first instance apply any statutory criteria that test the validity of a moratorium.

Regardless of whether a city's actions are intended to limit growth, an issue exists as to whether there is any independent duty on public water suppliers to develop new supplies to accommodate new retail customers. One commentator suggests that, because of the expense and uncertainty involved in developing new water supplies, it would be impossible for the law to impose such a duty. *Id.* at 437. This is not to say that the supplier can refuse to provide water without a valid reason. In *Lukrawka v. Spring Valley Water Co.*, 169 Cal. 318, 146 P. 640 (1915), a case addressing whether a water company which has enough water can refuse to extend service based on the cost of needed infrastructure, the California Supreme Court recognized a limited public duty to provide residents with water. In dictum, having less precedential value because it is a statement not necessary to the decision, the court said that a water provider does have the duty to anticipate the future growth of a community and to make plans to augment water supplies accordingly. *See also Swanson v. Marin Mun. Water Dist.* (water provider must exert every reasonable effort

to augment supplies during a moratorium); *Building Industry Ass'n of N. California v. Marin Mun. Water Dist.*, 1 Cal. Rptr. 2d 625, 629-30 (1991) (water provider can choose which options to investigate first); *Robinson v. City of Boulder*, 547 P.2d 228 (Colo. 1976) (city could only refuse to extend its service to landowners for utility-related reasons; growth control and land-use planning considerations did not suffice). Where water districts are involved, the express language of their organic statutes also must be considered with regard to any duty they may have.

4.2.11 Rate Surcharge

A new rule or statute could expressly allow a utility to levy a surcharge on wholesale customers who fail to timely develop alternative or replacement supplies before expiration of a contract.

It may be appropriate to develop this concept in the provisions of the Commission's rate-making jurisdiction. The surcharge should be based on cost to supplier of developing the supply. However, a significant drawback to this approach would exist if it could be construed to create a duty on the supplier to develop additional supplies.

5.

INTRODUCTION TO MODEL AGREEMENT

To be enforceable, all agreements must first observe the minimum requirements of a valid contract. Basic contract principles govern even agreements as to use of natural resources. However, additional challenges facing the draftsman of a water supply contract include anticipating the characteristics of a relatively long-term relationship between the parties with potential disputes, and accounting for the special legal context in which the contract exists. As discussed above, that context includes the common law principles of utility, protection of governmental functions, and statutory overlays of authority which, for example, allow the Commission to compel service.

The intent of the model agreement presented as Appendix A to this report is to describe the agreement between the supplier and purchaser in a manner that does not lend support to a claim of entitlement to water by the purchaser after the expiration of the contract under the statutory and common law theories discussed above. In this regard, the contract states that the supplier does not have water available to provide to purchaser except for the duration of the contract. It also states that the purchaser does not acquire any equity or other interest in the supplier's water system. This is intended to defeat a claim of entitlement based on a theory that the purchaser's payments helped the supplier acquire the water source.

The agreement also requires the purchaser to investigate water supply alternatives and to identify a replacement supply during the term of the contract. This

should give the supplier an indication of whether there will be problems with curtailing service to the purchaser after the contract has expired.

The model agreement is annotated to explain the reason for the provisions in the contract. Annotations begin on page A-29 of the agreement. For the most part, sections dealing with curtailing service after the contract has expired are located near the beginning of the agreement. Although the agreement anticipates wholesale service of raw water from a storage project, provisions related to terminability should be equally applicable to treated water service.

THE MODEL AGREEMENT IS FOR THE PURPOSE OF AN EXAMPLE ONLY AND IS NOT INTENDED TO SUBSTITUTE FOR THE ADVICE OF AN ATTORNEY. Individual water agreement negotiations will have specific facts and circumstances that must be carefully considered before a final contract is executed.

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APPENDIX A

FIXED-TERM WHOLESALE RAW WATER SUPPLY AGREEMENT

THIS MODEL AGREEMENT IS FOR THE PURPOSE OF EXAMPLE ONLY. IT IS NOT INTENDED TO SUBSTITUTE FOR THE ADVICE OF AN ATTORNEY.

STATE OF TEXAS §
§ **FIXED-TERM WHOLESAL RAW**
§ **WATER SUPPLY AGREEMENT**
COUNTY OF _____ §

This Fixed-Term Wholesale Raw Water Supply Agreement (“Agreement”) is made and entered into by and between _____ (“Supplier”)^[Note1], and _____ (“Purchaser”).

RECITALS^[Note2]

1. Supplier owns and operates _____ Dam and Reservoir (“Project”) and may sell water from the Project subject to the provisions of _____^[Note3] and subject to the contract between Supplier and the _____^[Note4], dated _____ (“Long-term Contract”).^[Note5]
2. Service of raw water to Purchaser was not contemplated in the grant of _____ [Supplier’s water right].
3. The entire firm yield of the Project is dedicated to meet current and future raw water demands of _____.^[Note6] Supplier does not have water available from the yield of the Project that can be made available to Purchaser only for the term set out in this Agreement.
4. Purchaser needs a supply of raw water on a non-permanent basis. This supply will be replaced by _____.^[Note7]
5. Purchaser acknowledges, and Supplier has made no representations to the contrary, that Supplier does not have sufficient water to provide water to Purchaser

beyond the term of this Agreement and that there is no duty on Supplier to develop additional sources of water to provide water to Purchaser.

6. Except under the terms of this contract, Purchaser is not entitled to any water owned, stored or under the control of Supplier.

AGREEMENT

For and in consideration of the mutual promises, covenants, obligations, and benefits described in this Agreement, Supplier and Purchaser agree as follows:

Section 1. Limitation of Rights^[Note8]

Purchaser acknowledges that this Agreement is only a short-term commitment of the Project water by Supplier and that on a long-term basis the entire yield of the Project is committed to _____. In this regard, this Agreement is a non-renewable, term-certain agreement to provide water.

Section 2. Investigation of Other Sources^[Note9]

Purchaser agrees to investigate, and have available at the end of the term of this agreement, an additional supply of water to replace the short-term water committed in this agreement. In this regard, three (3) years^[Note10] from the execution date of this agreement, Purchaser will provide Supplier with a report identifying water supply alternatives. Five (5) years from the execution date of this agreement, Purchaser shall provide Supplier with a report identifying the source selected and an executed contract for the water if the source is owned or to be developed by an entity

other than Purchaser or _____[Note11] if the source is to be owned or developed by Purchaser.

Section 3. Term

This Agreement shall be effective on the date it is signed by Supplier's authorized representative, as shown on the signature page of this Agreement. This Agreement shall continue in effect for a period of ten (10) years from the effective date unless this Agreement is terminated sooner because Supplier and Purchaser both agree to terminate this Agreement, or this Agreement is terminated pursuant to its terms. Because the full water supply yield of the Project is committed on a long-term basis, Purchaser acknowledges that this Agreement is a short-term water contract that except for Section [31] and [any of the provisions that survive termination of the Agreement] _____[Note12] shall not continue in effect past ten (10) years from its effective date.

Section 4. Equity[Note13]

Purchaser acknowledges that it will accrue no equity or any other interest in the Project or any other assets of Supplier as a result of payment or other performance of Purchaser under this Agreement.

Section 5. Incorporations[Note14]

This Agreement is entered into pursuant to Section ____ of the _____ [Long-term Contract or other instrument evidencing long-term commitment of project] dated as of _____ and the rights and obligations of Supplier and Purchaser

under this Agreement shall be subject to, and be interpreted consistent with, the terms and conditions of _____ [Long-term Contract]. The _____ [Long-term Contract] is incorporated into this Agreement by reference as if quoted verbatim in this section. _____ shall, within the limits permitted by law, have absolute priority over Purchaser's right to purchase water from Supplier in accordance with this Agreement. Water furnished by Supplier to Purchaser under this Agreement shall be from the Project and from no other source.

Section 6. Construction Permit^[Note15]

Purchaser may have to obtain federal, state and local permits or easements to construct and maintain a raw water intake structure. It is Purchaser's responsibility to obtain and comply with any such permit or easement. Failure to obtain or comply with such permit or easement under this section may, at Supplier's sole discretion, be grounds for terminating this Agreement without liability to Purchaser. Purchaser also specifically recognizes that it will have to apply for and be granted a permit or easement to construct and maintain a raw water intake structure on any land and water owned and controlled by Supplier. When granted by Supplier, this permit will be incorporated into this Agreement by reference as if quoted verbatim in this section.

Section 7. Volume^[Note16]

Subject to the limitations and conditions described in this Agreement, Supplier agrees to sell Purchaser up to _____ acre feet of raw water per annum from the Project at the diversion point described in this Agreement. The volume of water actually purchased depends upon Purchaser's demand^[Note17], but the average volume

to be furnished during the first contract year is estimated to be _____ acre-feet. Purchaser shall not divert more than _____ acre-feet per year without prior Supplier approval. Based upon past usage and future projections, the average quantity of water to be furnished in succeeding years is estimated to be from _____ acre-feet to _____ acre-feet per year.

Section 8. Diversion Point^[Note18]

Purchaser shall divert the raw water from the Project by installing the diversion point as herein established. A narrative description of the location of the diversion point and a vicinity map which shows the location of the diversion point are attached as Exhibit 1 to this Agreement. The diversion shall be accomplished by facilities with a maximum combined diversion rate of _____. Purchaser shall provide, at Purchaser's expense, the facilities required to divert and transport raw water to Purchaser's place of treatment and/or use. If Purchaser adds or changes location of a diversion point(s), Purchaser shall deliver to Supplier a reproducible vicinity map with a narrative and graphic description of the location of the additional or relocated diversion point(s) which shall be attached to this Agreement, and subject to Supplier's approval, this Agreement will be modified by attaching the map to this Agreement as an exhibit. Upon filing this Agreement, as modified, with the Texas Natural Resource Conservation Commission ("Commission"), or its successor agency, the modification shall become effective upon regulatory approval of the location of the additional or relocated diversion point(s).

Section 9. Facilities for Diverting Water^[Note19]

All facilities required for the taking of water under this Agreement from a watercourse or Supplier's reservoir shall be appropriately marked and lighted if at any time so directed by Supplier in the interest of the safety of persons using the watercourse or reservoir surface or shore. The detailed plans and specifications for such facilities shall be submitted to Supplier and approved by Supplier in writing before such facilities are installed, and any changes thereafter made in the nature, type, or location of such facilities shall be made only after Supplier's prior written approval.

All facilities and property of Purchaser used by Purchaser or relating to the use or diversion of the water contemplated by this Agreement are subject to flood damage, by reason of their location near a watercourse or reservoir owned or used by Supplier or Supplier water transportation facility. Purchaser acknowledges the possibility of flood damage and assumes the risk of such an occurrence. Purchaser will hold Supplier harmless for any claims asserted by Purchaser or by others growing out of the operation by Purchaser of the facilities used and employed by it in connection with this Agreement.

Purchaser agrees that its use of the facilities to be constructed under this Agreement, if any, and its operations under this Agreement shall not cause or in any way result in the pollution of reservoirs and other water bodies within Supplier Watersheds. Supplier Watersheds are defined as areas that drain, either directly or indirectly, into a reservoir owned, controlled or used by the Supplier or watercourses

used by the Supplier in providing water to its customers. Purchaser agrees to correct any practice of Purchaser which Supplier deems likely to result in such pollution within thirty (30) days from the receipt by Purchaser of notice from Supplier to do so.

Section 10. Purpose and Place of Use^[Note20]

Purchaser shall use raw water purchased from Supplier under this Agreement for _____ purposes only and within the city limits of Purchaser, as described in Exhibit 2 to this Agreement.

Section 11. Losses

If Purchaser's diversion, now or in the future, requires a release of water from a Supplier reservoir or pipeline, Supplier agrees to bear the cost of transportation and evapotranspiration losses incident to the downstream sale of water from the reservoir or pipeline to Purchaser's point of diversion of water.

Section 12. Texas Natural Resource Conservation Commission Rules^[Note21]

The effectiveness of this Agreement is dependent upon Supplier and Purchaser complying with the rules of the Commission (or any successor agency), specifically including the rules codified as Texas Administrative Code, Title 30, §§ 295.101 and 297.101-.108 (West 199___), as of the effective date of this Agreement. Supplier will file a signed copy of this Agreement with the Executive Director of the Commission (or any successor agency) as required by the rules of the Commission (or any successor agency). Purchaser may continue diverting raw water from the Project unless Supplier notifies Purchaser that Supplier has received written notification from the Commission

(or successor agency) that a copy of this Agreement has been received by the Commission but not accepted for filing. Purchaser shall submit written reports annually to the Commission (or successor agency), with copy to Supplier, on forms provided by the Commission, indicating the total amount of water diverted under this Agreement each week and each month. Purchaser also shall submit to Supplier written reports each month, indicating the total amount of water diverted under this Agreement each week and each month.

Section 13. Regulatory Requirements

This Agreement is subject to applicable federal, state and local laws and any applicable ordinances, rules, orders, and regulations of any local, state or federal governmental authority having jurisdiction with the exception of a law or rule that purports to give Purchaser any entitlement to receive water from Supplier after the termination or expiration of this agreement. However, nothing contained in this Agreement shall be construed as a waiver of any right to question or contest any law, ordinance, order, rule or regulation in any forum having jurisdiction, and Supplier and Purchaser each agree to make a good faith effort to support proposed laws and regulations which would be consistent with the performance of this Agreement in accordance with its terms.

Sectopm 14. Water Conservation Plans^[Note22]

Purchaser shall cooperate with and assist Supplier in its efforts to develop and implement plans, programs and rules to develop water resources and to promote practices, techniques and technologies that will reduce the consumption of water,

reduce the loss or waste of water, or improve the efficiency in use of water or increase the recycling and reuse of water. Supplier's obligations under this Agreement shall be subject to Purchaser preparing and implementing a water conservation plan or water conservation measures, as well as any water conservation plans and drought contingency plans adopted by Supplier and required or approved by the Commission, the Texas Water Development Board, or any other federal, state or local regulatory authority with power to require or approve water conservation and drought contingency plans. Upon execution of this Agreement, Purchaser shall submit its water conservation plan or water conservation measures to the Supplier for its review and approval.

If Supplier authorizes Purchaser to resell Supplier water, Purchaser shall require through a contract condition that any successive user of Supplier water must implement water conservation measures that comply with the State's, Supplier's and Purchaser's water conservation plans, programs and rules.

Section 15. Water Quality^[Note23]

Purchaser shall cooperate with and assist Supplier in its efforts to develop and implement plans, programs, and rules to maintain and improve the quality of the water flowing into or impounded within reservoirs owned or used by the Supplier; to maintain the existing uses of the water impounded in reservoirs owned or used by the Supplier for public water supply, contact recreation, and high quality aquatic habitat; and to decrease the effects of eutrophication and siltation upon the storage capacity and uses of reservoirs owned or used by the Supplier. Such plans, programs, and

rules may include, but are not limited to, matters involving water conservation; water quality; construction, operation, and regulation of wastewater collection, treatment, and disposal facilities; siting and operation of solid waste transfer and disposal facilities; non-point source pollution control; generation, storage, transportation, and disposal of hazardous substances; sedimentation due to construction activities; improper farming practices; and highly erodible soil.

Purchaser agrees that in areas subject to its jurisdiction, it will require and enforce compliance with the Commission (or any successor agency) rules relating to Construction Standards for On-Site Sewerage Facilities currently found at Texas Administrative Code, Title 31, § 285 *et. seq.* (West 199___). Purchaser further agrees to require and enforce compliance with any stricter standards that may be imposed by state or federal governments in the future. Supplier agrees that, after review and approval by Supplier, Purchaser may impose stricter standards than the current Commission (or any successor agency) standards.

Section 16. Sewage Treatment

By signing this Agreement, Purchaser stipulates and agrees that Supplier is potentially aggrieved or affected by any actions taken by Purchaser relating to the collection, treatment and disposal of wastewater. If Purchaser proposes to renew, modify, or amend its permit(s), if any, or obtain additional or new permit(s) which authorize the construction of wastewater treatment facilities or the disposal of treated effluent, Purchaser shall inform Supplier of Purchaser's plans and provide Supplier a comprehensive assessment of the individual and cumulative effect of Purchaser's proposed activities on surface water and groundwater quality and such additional

information as Supplier may reasonably require. Purchaser shall provide notice of its proposed plans to Supplier at least sixty (60) days before Purchaser submits an application to the Commission or other regulatory authority.

Supplier may terminate this Agreement, without liability to Purchaser, if Purchaser seeks or obtains authorization from the Commission, its successors, or other regulatory authority, to discharge effluent which contains concentrations of biochemical oxygen demand (5-day), total suspended solids, ammonia-nitrogen, or other regulated constituents any of which is in excess of the concentrations allowed by Purchaser's most stringent permit as of the date this Agreement is signed or concentrations of dissolved oxygen or disinfectant in amounts less than the concentrations allowed by Purchaser's most stringent permit as of the date this Agreement is signed. Supplier also may terminate this Agreement, without liability to Purchaser, if a court, or federal or state regulatory authority with jurisdiction to regulate Purchaser's collection, treatment, and disposal of wastewater within a Supplier watershed, enters an order of any type which includes an express or implied finding that Purchaser violated applicable statutes, rules, orders, or permits for a period of four (4) months or for a shorter period if the noncompliance causes an actual or potential hazard to public health and safety or severe adverse impact on or to the uses of a receiving stream or of groundwater.

Section 17. Payments by Purchaser

As consideration for the water supply to be provided to Purchaser under this Agreement, Purchaser agrees to the following:

During the Annual Payment Period commencing _____, 199_, Purchaser shall pay its Annual Payment to Supplier in twelve (12) approximately equal monthly

installments, to the extent that equal installments are practical, on or before the tenth (10th) day of each month, beginning ____, 199__. Purchaser's Annual Payment shall be calculated as follows:

Determination of Annual Payment. The term "Annual Payment" means the amount of money to be paid to Supplier by Purchaser during each Annual Payment Period. On or before the first (1st) day of June, Purchaser shall give written notice to Supplier specifying the total amount of water, expressed in acre-feet, that Purchaser reasonably expects to divert and use from the Project during the upcoming Annual Payment Period (the period beginning on October 1 of each calendar year and ending on the last day of September of the next calendar year). If Purchaser does not timely provide an estimate, Supplier may estimate the amount expected to be diverted and used from the Project during the upcoming Annual Payment Period, which estimated amount shall not be less than the amount Supplier expects to be diverted and used by Purchaser during the Annual Payment Period for which the estimate is due.

On or before the fifteenth (15th) day of June of each year, except for the Annual Payment Period commencing _____, 199__, only, on or before _____, 199__, Supplier shall furnish Purchaser with an estimated schedule of the monthly payments to be made by Purchaser to Supplier for the following year, together with supporting budgetary or proposed budgetary data showing the basis for arriving at such schedule. Supplier will determine Purchaser's Annual Payment by multiplying the amount of water to be purchased pursuant to Section [1] from the Project,

expressed in thousands of gallons, times the rate established for Purchaser in Section [18] in effect on the first (1st) day of the applicable Annual Payment Period.

If Purchaser at any time disputes the amount to be paid by it to Supplier, Purchaser shall nevertheless promptly make the disputed payment or payments, but if it is subsequently determined by agreement or court decision that the disputed amount paid by Purchaser should have been less, or more, Supplier shall promptly revise and reallocate Purchaser's Annual Payment in a manner that Purchaser, or Supplier, will recover the amount due.

If a court, the Commission or any federal or state regulatory authority finds that Supplier's rates or policies for delivering water to Purchaser under this Agreement are unreasonable or otherwise unenforceable, Supplier has the option to terminate this Agreement without liability to Purchaser. By signing this Agreement, Purchaser stipulates and agrees that Supplier and its other customers will be prejudiced if Purchaser avoids the obligation to pay the rates for water specified in this Agreement while accepting the benefits of obtaining water from Supplier. Nothing in this Agreement shall be construed as constituting an undertaking by Supplier to furnish water to Purchaser except pursuant to the terms of this Agreement. If Purchaser initiates or participates in any proceeding regarding Supplier's rates and policies under this Agreement and advocates a position that is adverse to Supplier and Supplier prevails, Purchaser shall pay Supplier for its expenses including attorneys' fees in the proceeding within fifteen (15) days after Supplier's demand for payment.

Purchaser stipulates and agrees that the rates and policies specified in this Agreement are just, reasonable, and without discrimination.^[Note24]

Section 18. Rate^[Note25]

Purchaser specifically agrees to pay the rate per 1,000 gallons (U.S. Standard Liquid Measure) of water equal to Supplier's "Standard Rate," which for any given year shall be the rate charged by Supplier to _____ in effect on the first (1st) day of such year. As an example, for the Annual Payment Period beginning October 1, 199_, and ending September 30, 199_, the audited "Standard Rate," was _____.

Section 19. Measurement^[Note26]

Purchaser shall provide, operate, maintain, and read meters which shall record water taken by Purchaser from Supplier at Purchaser's diversion point(s). Water shall be measured through conventional types of approved meter(s). Purchaser shall keep accurate records of all measurements of water required under this Agreement, and the measuring device(s) and such records shall be open for Supplier inspection at all times. Supplier shall have access to Purchaser's metering equipment at all reasonable times. This access shall include authorization for Supplier to install, inspect, adjust, or test measuring and recording equipment. Upon written request of Supplier, Purchaser will give Supplier copies of such records or permit Supplier to have access to the same in Purchaser's office during reasonable business hours. If requested in writing by Supplier and not more than once in each calendar month, on a date as near the end of such calendar month as practical, Purchaser shall calibrate its raw water meter(s) in the presence of a Supplier representative, and Supplier and

Purchaser shall jointly observe any adjustments that shall be necessary. If Supplier shall in writing request Purchaser to calibrate its raw water meter(s), Purchaser shall give Supplier reasonable notice of the time when any such calibration is to be made and, if a representative of Supplier is not present at the time set, Purchaser may proceed with the calibration and adjustment in the absence of any representative of Supplier.

If upon any test of the raw water meter(s), the percentage of inaccuracy of such metering equipment is found to be in excess of two percent (2%), registration thereof shall be corrected for a period extending back to the time when such inaccuracy began, if such time is ascertainable. If such time is not ascertainable, then registration thereof shall be corrected for a period extending back one-half (1/2) of the time elapsed since the last date of calibration, but in no event further back than a period of six (6) months. If any meter(s) are out of service or out of repair so that the amount of water delivered cannot be ascertained or computed from the reading thereof, the water delivered through the period such meter(s) are out of service or out of repair shall be estimated and agreed upon by Supplier and Purchaser upon the basis of the best data available, and, upon written request by Supplier, Purchaser shall install new meter(s) or repair existing meter(s) within a reasonable time not to exceed one hundred eighty (180) days. Upon Purchaser's refusal to install new meter(s) or repair existing meter(s) or after one hundred eighty (180) days following Supplier's request to do so, Supplier, at its option, may install new meters or repair existing meters at Purchaser's cost. Supplier shall recover this cost, labor, and materials by billing Purchaser in twelve (12) equal monthly installments on or before the tenth (10th) day of each month.

If Supplier and Purchaser fail to agree on the amount of water delivered during such period, Supplier may estimate the amount of water delivered by:

(1) correcting the error if the percentage of the error is ascertainable by calibration tests or mathematical calculation; or

(2) estimating the quantity of delivery by deliveries during the preceding periods under similar conditions when the meter or meters were registering accurately.

All books and records pertaining to this agreement shall be open and available for copying, inspection and audit by the Supplier.

Section 19. Source and Adequacy of Supply^[Note27]

Water supplied by Supplier to Purchaser under this Agreement shall be water from Project and from no other source. Purchaser acknowledges that Supplier is under no obligation to remain in a position to furnish raw water sufficient for the reasonable demands of Purchaser after the period of time the Agreement is in effect. During the term of this agreement, Supplier agrees to use its best efforts to remain in position to provide Purchaser with the amount of water in Section [7]. Supplier's agreement to provide water to Purchaser shall not be deemed a guarantee on Supplier's part that any particular quantity of water will be available, and the quantity of water taken shall at all times be subject to the right of Supplier to reduce or terminate said quantity of water as Supplier in its sole judgment may deem necessary in order to meet the Supplier's commitments under _____ [_____],

comply with any order of any court or administrative body having appropriate jurisdiction, reduce flooding or prevent injury.

Supplier's rights to maintain and operate the reservoirs owned or used by Supplier and its water transportation facilities and at any and all times in the future to impound and release waters thereby in any lawful manner and to any lawful extent Supplier may see fit is recognized by Purchaser, and except as otherwise provided herein, there shall be no obligation hereunder upon Supplier to release or not to release impounded waters at any time or to maintain any waters at any specified level.

Section 21. Pledge of Revenue^[Note28]

Purchaser represents and covenants that all payments to be made by it under this Agreement shall constitute reasonable and necessary "operating expenses" of its system, as defined in Texas Revised Civil Statutes, Article 1113 (Vernon 1963), and that all such payments will be made from the revenues of its water system. Purchaser represents and has determined that the water supply to be obtained from the Project is absolutely necessary and essential to the present and future operation of its water system for the term of the contract, and, accordingly, all payments required by this Agreement to be made by Purchaser shall constitute reasonable and necessary operating expenses of Purchaser's system or systems as described above with the effect that the obligation to make such payments from revenues of such system or systems shall have priority over any obligation to make any payments from such revenues, whether of principal, interest, or otherwise, with respect to all bonds heretofore or hereafter issued by Purchaser.

Purchaser agrees throughout the term of this Agreement to continuously operate and maintain its water system and to fix and collect such rates and charges for water services to be supplied by its water system as will produce revenues in an amount equal to at least (i) all of its payments under this Agreement and (ii) all other amounts as required by the provisions of the ordinances or resolutions authorizing its revenue bonds or other obligations now or hereafter outstanding.

Unless otherwise specifically provided in writing by subsequent agreement between Supplier and Purchaser, Supplier shall never have the right to demand payment by Purchaser of any obligation assumed or imposed on it under this Agreement from funds raised or to be raised by taxation, it being expressly understood by Supplier and Purchaser that all payments due by Purchaser are to be made from the revenues and income received by Purchaser from the ownership and operation of its water system.

This pledge of revenues is only for the purpose of securing payments under this Agreement.

Section 22. Reporting Requirements^[Note29]

[optional]

Section 23. Raw Water Quality^[Note30]

THE WATER WHICH SUPPLIER OFFERS TO SELL TO PURCHASER IS NON-POTABLE, RAW AND UNTREATED. PURCHASER HAS SATISFIED ITSELF THAT SUCH WATER IS SUITABLE FOR ITS NEEDS. SUPPLIER EXPRESSLY DISCLAIMS

ANY WARRANTY AS TO THE QUALITY OF THE RAW WATER OR SUITABILITY OF THE RAW WATER FOR ITS INTENDED PURPOSE. SUPPLIER EXPRESSLY DISCLAIMS THE WARRANTIES OF MERCHANTABILITY AND FITNESS. PURCHASER AGREES THAT ANY VARIATION IN THE QUALITY OR CHARACTERISTICS OF THE RAW WATER OFFERED FOR SALE AS PROVIDED BY THIS AGREEMENT SHALL NOT ENTITLE PURCHASER TO AVOID OR LIMIT ITS OBLIGATION TO MAKE PAYMENTS PROVIDED FOR BY THIS AGREEMENT. THERE ARE NO WARRANTIES WHICH EXTEND BEYOND THE DESCRIPTION CONTAINED IN THIS AGREEMENT.

Section 24. Title

Title to all water supplied hereunder shall be in Supplier up to each Point of Delivery, at which point title shall pass to Purchaser. A narrative description and vicinity map of the Point(s) are attached as Exhibit 1 to this Agreement. Supplier and Purchaser hereby agree to save and hold each other harmless from all claims, demands and causes of action which may be asserted by anyone on account of the transportation and delivery of said water while title remains in the other party.

Section 25. Other Charges^[Note31]

In the event any sales or use taxes, assessments or charges of any similar nature are imposed on diverting, storing, delivering, gathering, impounding, taking, selling, using, or consuming the water received by Purchaser from the Project, the amount of the tax, assessment, or charge shall be borne by Purchaser, in addition to all other charges, and whenever Supplier shall be required to pay, collect, or remit any

tax, assessment, or charge on water received by Purchaser, then Purchaser shall promptly pay or reimburse Supplier for the tax, assessment or charge in the manner directed by Supplier.

Section 26. Return Flows^[Note32]

Purchaser acknowledges that some of the water supplied to it by the Supplier may be returned to watercourses in the _____ Basin. The Supplier and Purchaser believe that the most economical means for meeting some of the future demands of Supplier's customers may involve the use of return flow to extend or enhance the yield of Supplier's water sources. In this regard, Purchaser will, upon request, make return flows resulting from Purchaser's use of water under this contract ("Project Return Flows") available to the Supplier. To the extent that Purchaser resells Project water to others, Purchaser shall include language in any contract for resale of Project water assigning Project Return Flows to the Supplier and requiring cooperation with the Supplier in making Project Return Flows available to the Supplier. Similarly, to the extent that Purchaser finds it necessary to treat its water before it is discharged and in the event that Purchaser does not treat its wastewater, Purchaser shall include language in any wastewater treatment contract assigning Project Return Flows to Supplier and requiring cooperation with Supplier in making Project Return Flows available to Supplier. Neither Purchaser nor its customers will be entitled to consideration or credit of any type, either in exchange of water, money or other consideration for the Project Return Flow assigned back to the Supplier. The

right of Supplier to Project Return Flows was considered in the formulation of this agreement.

Section 27. Default in Payments^[Note33]

All amounts due and owing to Supplier by Purchaser shall, if not paid when due, bear interest at the Texas post-judgment interest rate as set out in Texas Revised Civil Statutes, Article 5069-1.05 (Vernon Supp. 1995) [NOTE: CHECK FOR CITATION THAT IS CURRENT AT TIME OF CONTRACTING], or any successor statute from the date when due until paid, provided that such rate shall never be usurious or exceed the maximum rate as permitted by law. If any amount due and owing by Purchaser to Supplier is placed with an attorney for collection, Purchaser shall pay to Supplier, in addition to all other payments provided for by this Agreement, including interest, Supplier's collection expenses, including court costs and attorneys' fees. Supplier shall, to the extent permitted by law, suspend delivery of water from the Project to Purchaser if Purchaser remains delinquent in any payments due hereunder for a period of sixty (60) days, and shall not resume delivery of water while Purchaser is so delinquent.

Section 28. Termination^[Note34]

If Supplier decides to terminate this Agreement as provided by this Agreement, Supplier shall deliver written notice of the decision to Purchaser. Purchaser shall discontinue taking water from Supplier or its facilities and physically seal Purchaser's diversion facilities within one hundred eighty (180) days after Supplier delivers written notice to Purchaser.

Section 29. Waiver and Amendment^[Note35]

Failure to enforce or the waiver of any provision of this Agreement or any breach or nonperformance by Supplier or Purchaser shall not be deemed a waiver by Purchaser or Supplier of the right in the future to demand strict compliance and performance of any provision of this Agreement. Regardless of any provision contained in this Agreement to the contrary, any right or remedy or any default under this Agreement, except the right of Supplier to receive the Annual Payment which shall never be determined to be waived, shall be deemed to be conclusively waived unless asserted by a proper proceeding at law or in equity within two (2) years plus one (1) day after the occurrence of the default.

No officer or agent of Supplier or Purchaser is authorized to waive or modify any provision of the Agreement. No modifications to or rescission of this Agreement may be made except by a written document signed by Supplier's and Purchaser's authorized representatives.

Section 30. Remedies

It is not intended hereby to specify (and this Agreement shall not be considered as specifying) an exclusive remedy for any default, but all such other remedies existing at law or in equity may be availed of by any party hereto and shall be cumulative.

Section 31. Indemnity^[Note36]

By signing this Agreement, Purchaser agrees on behalf of itself and its successors and assigns, that it relinquishes and discharges and will, to the fullest

extent permitted by law, defend, protect, indemnify and hold harmless the Supplier and the Supplier's officers, directors, employees, agents and consultants from and against all claims, losses, expenses, costs, damages, demands, judgments, causes of action, suits, and liability in tort, contract or any other basis and of every kind and character whatsoever (including, but not limited to, all costs of defense, such as fees and charges of attorneys, expert witnesses, and other professionals incurred by the Supplier and all court or arbitration or other dispute resolution costs) arising out of or incident to, directly or indirectly, this Agreement including, but not limited to, any such claim for bodily injury, death, property damage, consequential damage or economic loss and any claim that may arise in connection with the quality, quantity, use, misuse, impoundment, diversion, transportation and measurement of Project water and any claim that may arise as a result of installation, inspection, adjusting, or testing of measuring and recording equipment involving Purchaser's diversion of Supplier water, as well as any claim that may arise from any condition of Purchaser's facilities, separate operations being conducted on Purchaser's facilities, or the imperfection or defective condition, whether latent or patent, of any material or equipment sold, supplied or furnished by the Supplier. **THE INDEMNITY PROVISIONS OF THIS PARAGRAPH ARE APPLICABLE FOR THE PROTECTION OF THE SUPPLIER REGARDLESS OF WHETHER OR NOT THE CLAIMS, LOSSES, EXPENSES, DAMAGES, DEMANDS, JUDGMENTS, CAUSES OF ACTION, SUITS AND LIABILITY IN TORT, CONTRACT OR ANY OTHER BASIS ARE ALLEGED TO HAVE BEEN CAUSED IN WHOLE OR IN PART BY THE NEGLIGENCE OR OMISSION OF THE SUPPLIER OR ANY**

SUPPLIER OFFICER, AGENT, DIRECTOR, EMPLOYEE OR CONSULTANT, THE PARTIES INTENDING HEREBY TO SATISFY THE TEXAS EXPRESS NEGLIGENCE DOCTRINE. THIS INDEMNIFICATION AND RELEASE SHALL SURVIVE TERMINATION OR EXPIRATION OF THE AGREEMENT.

Section 32. Force Majeure^[Note37]

If for any reason of "force majeure," either Supplier or Purchaser shall be rendered unable, wholly or in part, to carry out its obligation under this Agreement, other than the obligation of Purchaser to make the payments required under the terms of this Agreement, then if the party shall give notice of the reasons in writing to the other party within a reasonable time after the occurrence of the event, or cause relied on, the obligation of the party giving the notice, so far as it is affected by the "force majeure," shall be suspended during the continuance of the inability then claimed, but for no longer period. The term "force majeure" as used in this Agreement shall mean acts of God, strikes, lockouts, or other industrial disturbances, acts of public enemy, orders or actions of any kind of government of the United States or of the State of Texas, or any civil or military authority, insurrections, riots, epidemics, land slides, lightning, earthquakes, fires, hurricanes, storms, floods, washouts, droughts, arrests, restraints of government and people, civil disturbances, explosions, breakage or accident to dams, machinery, pipelines, canals, or other structures, partial or entire failure of water supply including pollution (accidental or intentional), and any inability on the part of Supplier to deliver water, or of Purchaser to receive water, on account of any other cause not reasonably within the control of the party claiming the inability.

Section 33. Non-Assignability

Purchaser understands and agrees that any assignment of rights or delegation of duties under this Agreement is void without prior written consent of the Supplier.

Section 34. Sole Agreement^[Note38]

Except for the _____ [incorporated documents] this Agreement constitutes the sole and only agreement of Purchaser and Supplier and supersedes any prior understanding or oral or written agreements between Supplier and Purchaser respecting the subject matter of this Agreement including any oral or written agreement with the Supplier that Purchaser obtained by assignment.

Section 35. Severability^[Note39]

The provisions of this Agreement are severable and if, for any reason, any one or more of the provisions contained in the Agreement shall be held to be invalid, illegal or unenforceable in any respect, the invalidity, illegality or unenforceability shall not affect any other provision of this Agreement and this Agreement shall remain in effect and be construed as if the invalid, illegal or unenforceable provision had never been contained in the Agreement.

Section 36. Notices^[Note40]

All notices, payments and communications ("notices") required or allowed by this Agreement shall be in writing and be given by depositing the notice in the United States mail postpaid and registered or certified, with return receipt requested, and addressed to the party to be notified. Notice deposited in the mail in the previously

described manner shall be conclusively deemed to be effective from and after the expiration of three (3) days after the notice is deposited in the mail. For purposes of notice, the addresses of and the designated representative for receipt of notice for each of the parties shall be shown above the signatures of the individuals who signed this Agreement on behalf of Supplier and Purchaser. Either party may change its address by giving written notice of the change to the other party at least fifteen (15) days before the change becomes effective.

Section 37. Place of Performance^[Note41]

All amounts due under this Agreement, including, but not limited to, payments due under this Agreement or damages for the breach of this Agreement, shall be paid and be due in _____ County, Texas, said _____ County, Texas, being the place of performance agreed to by the parties to this Agreement. In the event that any legal proceeding is brought to enforce this Agreement or any provision hereof, the same shall be brought in _____ County, Texas.

Section 38. Duplicate Originals

Purchaser and Supplier, acting under authority of their respective governing bodies, shall authorize the execution of this Agreement in several counterparts, each of which shall be an original. Purchaser shall submit written evidence in the form of bylaws, charters, resolutions or other written documentation specifying the authority of Purchaser's representative to sign this Agreement which evidence shall be attached to this Agreement as Exhibit 3.

EFFECTIVE as of the date signed by the authorized representative of
Supplier.

Supplier Name
Supplier Address

BY: _____

NAME: _____

TITLE: _____

DATE: _____

APPROVED AS TO FORM AND LEGALITY:

By: _____
Attorney for Supplier

Purchaser Name
Purchaser Address

BY: _____

NAME: _____

TITLE: _____

DATE: _____

STATE OF TEXAS §
 §
COUNTY OF _____ §

BEFORE ME, the undersigned authority, on this day personally appeared _____ [Supplier], known to me to be the person whose name is subscribed to the foregoing instrument, and acknowledged to me that he/she executed same for the purposes and consideration therein expressed.

GIVEN UNDER MY HAND and seal of office this _____ day of _____, 199_.

Notary Public, State of Texas

STATE OF TEXAS §
 §
COUNTY OF _____ §

BEFORE ME, the undersigned authority, on this day personally appeared _____ [Purchaser], known to me to be the person whose name is subscribed to the foregoing instrument, and acknowledged to me that he/she executed same for the purposes and consideration therein expressed.

GIVEN UNDER MY HAND and seal of office this _____ day of _____, 199_.

Notary Public, State of Texas

ANNOTATIONS TO MODEL AGREEMENT

Page: 1

[Note1] Describe the entity (political subdivision and reclamation district; municipal corporation; etc.).

Page: 1

[Note2] Recitals are not contractual obligations but are used to memorialize the circumstances and understandings of the parties at the time of contracting.

Page: 1

[Note3] Include a legal description of surface water right.

Page: 1

[Note4] Insert long-term customers or say subject to the demands of long-term customers or of Supplier.

Page: 1

[Note5] This recital does several things: It identifies the source of the water, it states the legal basis for Supplier to sell the water, and subjects the short-term water sale to a long-term water contract. This recital is written for a Supplier other than a city. If Supplier is a city, there may not be any long-term contracts. In that case, the limiting factor is the needs of the city's retail customers.

Page: 1

[Note6] This blank should be filled with either Supplier or Supplier's long-term raw water customers as the case may be. This recital is intended to counter a claim that there is water available.

Page: 1

[Note7] If Purchaser knows what its ultimate water source will be, it should be specified here. If not, this recital should state that Purchaser is to identify an alternative source of water during the term of the Agreement.

Page: 2

[Note8] This section identifies this contract as being a fixed-term sale of water.

Page: 2

[Note9] This section is included to give Supplier an indication about whether to expect problems with terminating service at the end of the contract term and, if necessary, an ability to get an injunction to require Purchaser to find additional water.

Page: 2

[Note10] The time triggers in the model contract assume a contract term of 10 years. If a different contract term is used, the triggers should be adjusted.

Page: 3

[Note11] If Purchaser is to get water from another entity, a contract must be provided. If Purchaser is developing its own source of supply, Supplier could require that a copy of the application or permit be provided.

Page: 3

[Note12] Section 0 is the section relating to indemnity. The indemnity section is usually given perpetual effect to protect the indemnified party against claims filed after the expiration of the contract. If there are any other clauses that the drafter wishes to give perpetual effect, the section numbers should be listed here.

Page: 3

[Note13] This provision is to help avoid a claim of entitlement to water after the term of the contract. In this regard, the contract should not have any third-party beneficiary provision in favor of Supplier's bond holders that could be construed as an advancement of Purchaser's credit to acquire or extend the Project or Supplier's system.

Page: 3

[Note14] The purpose of this section is to incorporate the terms of another instrument that is necessary to the interpretation of the Agreement. For example, if there are long-term contracts which allow Supplier to sell water on a short-term basis, these contracts can be incorporated. Incorporation by reference is used to give a clear indication of the total circumstances without having to repeat the terms of the incorporated instrument. In drafting the incorporating language, the drafter should be clear as to whether amendments to the incorporated instruments are to be incorporated.

Page: 4

[Note15] This provision may not be needed if Purchaser is not going to take water from a watercourse. Also, some provision for what happens to the diversion works after the end of the contract should be added to this section.

Page: 4

[Note16] Most of this is required by TNRCC water supply contract rules.

Page: 4

[Note17] This clause will need to be modified if the contract is to be strictly take-or-pay.

Page: 5

[Note18] Information regarding the location of the diversion point is required by 30 TEX. ADMIN. CODE § 295.101 (West 1995). The model language is for a diversion from a reservoir. If the water is provided to Purchaser directly from Supplier's pipeline, a description of the location and the facilities used to provide the water to Purchaser should be substituted.

Page: 6

[Note19] This section may not be applicable. The purpose of the provision is to prevent diversion facilities from being safety hazards, to protect Supplier from liability for flooding the facilities, and to protect the source of supply from water pollution.

Page: 7

[Note20] This information is required by 30 TEX. ADMIN. CODE § 295.101 (West 1995). It also limits Purchaser from competing with Supplier.

Page: 7

[Note21] This section relates to TNRCC wholesale water contract rules cited in the text. Note that certain water sales could require a diversion permit from TNRCC.

Page: 8

[Note22] This section relates to TNRCC water conservation requirements found in 30 TEX. ADMIN. CODE § 288.5 (West 1995).

Page: 9

[Note23] This section, along with a portion of Section 0, and Section 0 are intended to help protect the quality of Supplier's water source.

Page: 14

[Note24] This sentence is designed to prevent unwarranted rate challenges but is not as one-sided as some that we have seen.

Page: 14

[Note25] The model agreement provides for a fixed rate based on the rate charged to Supplier's long-term customers. There are as many different rate provisions as there are water contracts. It should be cautioned that charging a short-term customer the same or a higher rate than is charged long-term customers could lend support to a claim of entitlement at the end of the contract term. Purchaser would argue that it was paying the same as long-term customers so it should have the same right to continued service as long-term customers, particularly in the case of a Supplier that bases its rates on a cost of service basis. If the rate to be charged under this contract is the same or higher than Supplier's long-term rate, some justification should be included. For example, the contract could state that Purchaser is not making a commitment of its credit to support the bonds used to finance the Project. Many Suppliers also include take-or-pay provisions in their rate provisions making a Purchaser pay for a minimum quantity of water whether it is used or not.

Page: 14

[Note26] This is standard language found in many contracts. It requires Purchaser to provide a meter and read it. Some providers take the opposite tack and supply and read the meter and charge the customer for the associated costs.

Page: 16

[Note27] This section limits Supplier to providing water to Purchaser from a

particular source. It also limits Supplier's obligation to remain in position to provide water to seller for the term of the contract.

Page: 17

[Note28] This section is a pledge of Purchaser's water system revenue. It is required by certain statutes such as TEX. GOVT. CODE § 791.026 (Interlocal Cooperation Contracts) and TEX. REV. CIV. STAT. art. 1113 (Vernon 1963). Making the contract payments part of Purchaser's operating expenses establishes a first lien on Purchaser's system that is effectively prior to all other liens. Article 1113 applies to contracts with municipalities. TEX. GOVT. CODE § 791.026 applies to contracts between municipalities, districts, and river authorities. Other statutes provide for similar liens when a contract is made with other types of entities.

Page: 18

[Note29] Some contracts require the customer to report such data as population of the customer, number of hookups, list of major users, number of commercial users, number of domestic users, and other water sources used by customer.

Page: 18

[Note30] This section disclaims any implied warranties as to quality of water.

Page: 19

[Note31] This section takes care of the rate question when additional fees or taxes are imposed on Supplier for water service. The parties can decide whether the Purchaser or Supplier is to bear the cost of the fees.

Page: 20

[Note32] This section may not be necessary for many Suppliers. It is intended to allow Supplier to reuse Purchaser's wastewater treatment plant effluent and to avoid a claim for credit or offset.

Page: 21

[Note33] Some suppliers set a specific interest rate for late payments.

Page: 21

[Note34] There are very few causes for termination under this contract.

Page: 22

[Note35] This provision is to prevent waiver for not enforcing minor breeches of the contract. It is also intended to keep the contract as the agreement rather than having a written agreement that has been modified by subsequent conduct. The intent is to make enforcement of the contract simpler by minimizing waiver, estoppel, etc., as defenses in litigation.

Page: 22

[Note36] This indemnity provision is very favorable for Supplier. The emphasized language is called an express negligence provision. It is an attempt to have

Purchaser hold Supplier harmless and indemnify for claims based on negligence of Supplier. Some contracts have a more balanced indemnity provision. These provisions are usually negotiated with the parties taking into account insurance policies and sovereign immunity.

Page: 24

[Note37] This is a typical force majeure clause for a water sales contract. Note that Purchaser still has to pay if a force majeure occurs in the example provision. This is typically the case in a contract that is used as security for bonds.

Page: 25

[Note38] This provision is an attempt to limit the terms of the agreement to written instruments. The reference to incorporated documents is included because there could be a contract between Supplier and its long-term customers.

Page: 25

[Note39] The purpose of this section is to prevent the invalidity of minor provisions of the contract being construed as invalidating the whole contract.

Page: 25

[Note40] This provision is necessary so the parties know who to notify in situations when notification to the other party is necessary.

Page: 26

[Note41] This provision establishes venue for possible enforcement of the agreement. Supplier will want to avoid venue in counties in which Purchaser has a greater presence than Supplier.

APPENDIX B

OTHER JURISDICTIONS

by Todd Chenoweth, J.D.

APPENDIX B
OTHER JURISDICTIONS

This section will review and analyze the availability, in western states with appropriated water rights, of interim water transfers. Interim water transfers are transfers of water use for a term of years. During the term of the transfer, the receiving entity must be developing alternative sources for use at the end of the term. At the end of the term the use of the water returns to the original transferor. The western states were selected as a focus for two reasons. First, because of the similarity with Texas of the water resource problem of allocation of sparse water. Second, because of the common use of an appropriated water rights legal system rather than a riparian system. An indepth look at the entire body of water law in these jurisdictions is beyond the scope of this work. Instead this paper will focus on the law of interim surface water transfers, with an emphasis on (1) statutes affecting interim transfers with a view to suggested language for a similar Texas statute and (2) any recent cases of interim water transfers.

This section will first consider three states that historically have not favored surface water transfers: Wyoming, Arizona, and Utah. Next the water transfer law of Washington sate will be briefly considered. Finally the section will examine the surface water transfer law of three states that historically have favored transfers and have some of the most comprehensive water transfer statutes on the books: New Mexico, Colorado, and California.

1. Wyoming

Wyoming adheres to the prior appropriation doctrine as the method of allocating water rights. Water rights are granted by state permit but must be put to beneficial use. WYO. STAT. § 41-3-101 (Michie Supp. 1994). Early Wyoming cases were favorable to permanent transfers of water rights. See *Frank v. Hicks*, 35 P. 475 (Wyo. 1894), (holding that water rights were severable from the land and by implication transferable separately); *Johnston v. Little Horse Creek Irr. Co.*, 79 P. 22 (Wyo. 1904), (holding water rights appropriator can sell water separate from land if water was being beneficially used, if it was not surplus water, and if others were not injured.) In response to the *Johnston* decision, in 1909 the Wyoming legislature passed a statute that prohibited water transfers. 1909 WYO. SESS. LAWS, ch. 68. It was not until 1973 that the Wyoming legislature passed a statute authorizing permanent transfers of water rights. Wyo. Stat. § 41-3-104 (Michie 19xx).

Temporary transfers of water rights are now authorized in Wyoming by statute. The legal mechanism of temporary transfer is a purchase, gift or lease of the right to use water. Temporary transfers must be for the purposes of either highway construction or repair, railroad roadbed construction or repair, drilling and producing operations, or "other temporary purposes." The transfer must not result in injury to another appropriator. The statute expressly provides that no loss, abandonment or impairment "shall occur or attach as a result of such change or use" All rights to the transferred water are automatically re-acquired by the transferor at the end of the term of temporary use. The temporary transfer must be approved by the state

engineer, but apparently no opportunity for a contested hearing by affected protestants exists. WYO. STAT. § 41-3-110 (Michie Supp. 1994).

The statute is clearly limited by three provisions. First the period of the temporary transfer may not exceed two years. Secondly only water that has historically been consumptively used is eligible for temporary transfer. Surplus or unused water cannot be temporally transferred. WYO. STAT. § 41-3-110 (Michie Supp. 1994). Finally, temporary water rights are subordinate to all permanent water rights, regardless of their priority. WYO. STAT. § 41-3-111 (Michie Supp. 1994). These limitations hinder use of this statute as a model for any proposed Texas legislation.

2. Arizona

Arizona regulates its surface water by the appropriation system. Surface water belongs to the public and is subject to private appropriation. Permanent water rights may be granted by the state to those who first appropriate surface water. A surface water right is maintained by the diversion and application of the water to a specific beneficial use. The right to surface water may be canceled if it goes unused for five years.

The point of diversion may be changed provided that other user's rights are not adversely affected. Transfer requires approval of the state with notice to adversely affected parties. Adversely affected parties have a right to a hearing to contest the application. Arizona has no statute or case law on interim transfers of water for a term of years.

Arizona has adopted comprehensive groundwater regulation. The Groundwater Management Act (1980) moved Arizona from unregulated pumping of groundwater to groundwater management. The act regulates withdrawal, use, and transportation of groundwater. Prior to the act, landowners that were harmed by their neighbor's pumping of groundwater could sue to stop the pumping. Under the act, when the withdrawal of groundwater damages an adjoining land owner, the damaged landowner can only sue for monetary damages.

Under the Arizona Groundwater Management Act, measures are taken to reduce groundwater overdraft. One of the regulatory tools under the act is the Assured Water Supply Program. Under the Assured Water Supply Program, land developers must demonstrate a 100-year assured water supply as a precondition to the sale of subdivided land. Without a secure water supply, the subdivision plat is not approved. ARIZ. REV. STAT. ANN. § 45-576 (West 1994).

This statute might have some application to a Texas contract for interim water sales. In a Texas contract for the use of transferor's excess water for a period of ten to fifteen years, provisions could be included for the transferee during the term of the contract, to take steps to develop new water supplies for the day the contract terminate. A provision could cover the situation where the transferee was not developing alternative supplies fast enough. In that case, the contract could provide that the transferee not approve new subdivision plats or connect new customers to the water system. Growth of the system could be reduced, thus reducing the demand for new water at the expiration of the contract term.

3. Utah

Utah adheres to the doctrine of prior appropriation of acquisition of water rights. Appropriated water rights holders receive a right to use the water, not ownership of the corpus of the water. Water rights holders must put the water to beneficial use. Water rights are transfers by deed, similar to real property transactions.

A Utah statute authorizes temporary changes of water use for fixed periods of time not to exceed one year. Temporary changes include changes in: (1) point of diversion, (2) place of use, or (3) purpose of use. As a practical matter, any contract for interim use of water would involve one or more of these three changes. Therefore, any interim transfer of water would be subject to the act.

The act requires that the state engineer approve temporary changes. If the state engineer finds that the temporary change will not impair any vested right of others, the state engineer can issue an order authorizing the change without any further notice or administrative proceeding. However, if the state engineer finds that the temporary change might impair vested water rights, he must give notice to potentially affected persons. Potentially affected persons may file a protest within 30 days of notice. An administrative hearing resolves the issue of affected vested rights. UTAH CODE ANN. § 73-3-3 (Michie 1989).

4. Washington

Washington case law considered water rights as real property and appurtenant to specific pieces of land that receive the water's beneficial use. A corollary to this

legal principle is that transfers of water rights separate from transfers of the underlying land are not allowed. The Washington legislature in 1917 changed this state of the law by a statute that allowed transfers of water rights. The current version of that statute allows transfers of water rights to another person, place of use, or point of diversion, if the transfer can be made without injury to existing water rights. After the transfer, the water right becomes appurtenant to another plot of land. The transfer must be approved by the state after notice and opportunity for a hearing by affected water rights holders. WASH. REV. CODE ANN. § 90.03.380 (West 19xx).

Seasonal or temporary changes are also currently allowed under Washington law. Seasonal or temporary changes in point of diversion or place of use are permitted when the temporary change can be made “without detriment to existing rights.” The change must be approved by the local water master or the state Department of Ecology. WASH. REV. CODE ANN. § 90.03.390 (West 19xx).

5. New Mexico

New Mexico has also adopted the prior appropriation doctrine for water rights. By statute all natural water are public property. The first appropriator in time has the superior right to take and use water. The right continues as long as the appropriator puts the water to beneficial use. Water rights in New Mexico are transferred by deed.

Permanent water transfers are allowed if the applicant can demonstrate non-impairment of uses of other water rights holders, conservation of water, and

consistency with the public welfare. A transferred water right retains the same priority after it is transferred. N.M. STAT. ANN. § 72-12-7A (Michie 19xx).

New Mexico statutes have authorized temporary transfers since 1953. The statute provides that a water right owner may lease all or part of his water right. The owner's water right is not affected by the lease. At the end of the lease, the water use reverts to the transferor's original use and location of use. The lease can't enlarge the water use nor can it injure other water users. The initial term and renewal term may not exceed 10 years. N.M. STAT. ANN. § 72-6-3 (Michie 19xx).

The water lease must be approved by the state engineer. The state engineer gives notice and an opportunity for a hearing to affected water rights holders. The state engineers decision may be appealed to state district court. N.M. STAT. ANN. § 72-6-6 to § 72-7-3 (Michie 19xx).

The water lease statute provides that "the lease shall not toll any forfeiture of water-rights for non-use, and the owner shall not, by reason of the lease, escape the forfeiture for nonuse prescribed by law" N.M. STAT. ANN. § 72-6-3 (Michie 19xx). Presumably if the leasee is beneficially using the water, it is not subject to forfeiture. However, this provision has never been authoritatively interpreted by a New Mexico appellate court. Perhaps the New Mexico legislature intended to prevent a water rights holder from preventing a forfeiture by leasing the water to a leasee who also did not beneficially use the lease. If a similar provision is contemplated for a Texas statute, the wording of the New Mexico statute could be modified to make its intent clearer.

6. Colorado

The Colorado Constitution established the prior appropriation doctrine in state water law. COLO. CONST. art. XVI, § 5. The appropriation system in Colorado is administered by the state engineer's office. COLO. REV. STAT. § 37-92-501 (1973). A water rights court determines the priority dates of appropriated water. COLO. REV. STAT. § 37-92-301 (1973 & Supp. 1968). Colorado water law recognizes a conditional water right based on intent to divert and use water for a beneficial use. The appropriator must show reasonable diligence in developing the beneficial use of the water every four years in a water court proceeding until actual beneficial use is shown. COLO. REV. STAT. § 37-92-301 (1973).

Colorado courts early on recognized the right of an appropriator to transfer water rights. *See Sieber v. Frink*, 2 P. 901 (Colo. 1884) (change in point of diversion does not affect the water right or priority); *Fuller v. Swan River Placer Mining Co.*, 19 P. 836 (Colo. 1888) (any change in point of diversion or place of use that does not injure others is legal); *Strickler v. City of Colorado Springs*, 26 P. 313 (Colo. 1891) (holding water right can be severed from land and transferred independent of land).

Colorado law recognizes that water may be supplied by contract for a specified term. This is distinct from a transfer of a water right. A person that takes water under a contract is a mere consumer, as opposed to a property owner, whose rights are determined by contract. *Green v. Chaffee Ditch Co.*, 371 P.2d 775 (1962).

The general principle for water transfers in Colorado is that water rights acquired by contract or deed are governed by the deed or contract. Courts will not step in after the fact and alter the terms of the contract. *Application for Water Rights of Merrick v. Fort Lyon Canal Company*, 621 P.2d 952 (Colo. 1981). However, Colorado courts have struck down some water sales contracts for provisions against public policy. See *Wheeler v. Northern Colorado Irr. Co.*, 17 P. 487 (Colo. 1887) (fee for water in addition to a transport charge struck down); *White v. Farmers' Highline Canal & Reservoir Co.*, 43 P. 1028 (Colo. 1896) (contract provision allowing users to determine the amount of water to take regardless of other users' rights struck down).

The Colorado legislature has passed three statutes to remove perceived barriers to term transfers of water. The first statute provides authority for water conservation districts which own or hold water rights to transfer those rights for a term of years. The transfer is expressly only for the period of time agreed by the parties. The mechanism for the transfer is an exchange or lease. The statute also provides authority for the financing of the lease of water rights.

The second Colorado water transfer statute allows an owner of a reservoir to deliver water into a ditch or stream and to take in exchange an equal amount, plus a reasonable amount for losses, from a public stream up river from the reservoir. COLO. REV. STAT. ANN. § 37-83-104 (West 1990).

The third Colorado water transfer statute allows owners of water rights to loan or exchange water for a limited time for purposes of saving crops or using water in a more economical manner. The owner must give written notice stating the length of

time of the loan or exchange. All water transfers are subject to regulation by the state engineer. COLO. REV. STAT. ANN. § 37-83-105 (West 1990).

7. California

California follows the doctrine of prior appropriation of water rights. First appropriators to use water for beneficial use have priority on use of water. Water rights may be transferred provided that the transfer does not injure or harm another. California also recognizes water transfer by contract. The transfer by contract is a sale of the use of water, the property right remains with the transferor through the term of the transfer agreement.

California statutes allow temporary transfers of water use, if the change would cause no injury to others, if the change would not involve a greater amount of water that would have otherwise been consumptively used, and if the change would not unreasonably affect fish, wildlife, or other instream beneficial uses. CAL. WATER CODE § 1725 (West 1971 & Supp. 1995). For purposes of this statute, a temporary transfer is for one year or less. CAL. WATER CODE § 1728 (West 1971 & Supp. 1995). At end of the term of the contract, water rights automatically revert to the original holder of the right without any action by the state authorities. CAL. WATER CODE § 1731 (West 1971 & Supp. 1995).

Another California statute expressly grants authority to political subdivisions to sell lease, exchange or other wise transfer surplus water. Transfers are as a practical matter unlimited in duration because the statute provides that the transfer is for a term

up to seven years, unless the parties mutually agree to a longer period. CAL. WATER CODE § 380–87 (West 1971 & Supp. 1995).

To add to the overlap of temporary water transfer statutes, California has a water leasing statute. A surface water rights holder under various provisions of California law may lease up to 25% of their water right for a term of up to five years. The lease is subject to the no injury rule, which includes protection for fish, wildlife, or other instream beneficial uses. The lease must be approved by the state regulatory agency, with provisions for notice and hearing for potentially adversely affected persons. CAL. WATER CODE § 1020 *et seq.* (West 1971 & Supp. 1995).

Temporary Urgency Changes for water supply emergencies are statutorily provided for in § 1435 of the Water Code. The proponent must establish to the satisfaction of the state regulators that there exists an urgent need for the temporary change, no injury to other legal users will occur, no unreasonable affects on fish, wildlife, or other in stream beneficial use will be caused by the change, and that the proposed change is in public interest. CAL. WATER CODE § 1435 *et seq.* (West 1971 & Supp. 1995).

8. Summary and Conclusions

Western states that wish to encourage water transfers have adopted a variety of statutes in attempts to provide clear authority for the transfers. The statutes have not been authoritatively construed by the state courts. Each state has tailored their particular statutes to the water transfer law of their jurisdiction. The water codes, even among appropriated water allocation systems, are unique enough so that no other state has a statutory scheme sufficiently similar enough to serve as a model for a Texas statute.

References

CASES

<i>Application for Water Rights of Merrick v. Fort Lyon Canal Company,</i> 621 P.2d 952 (Colo. 1981).....	9
<i>Frank v. Hicks,</i> 35 P. 475 (Wyo. 1894).....	2
<i>Fuller v. Swan River Placer Mining Co.,</i> 19 P. 836 (Colo. 1888).....	8
<i>Green v. Chaffee Ditch Co.,</i> 371 P.2d 775 (1962).....	8
<i>Johnston v. Little Horse Creek Irr. Co.,</i> 79 P. 22 (Wyo. 1904).....	2
<i>Sieber v. Frink,</i> 2 P. 901 (Colo. 1884).....	8
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APPENDIX C

PROFESSIONAL RÉSUMÉS OF AUTHORS

LAW OFFICES OF
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A PROFESSIONAL CORPORATION

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FIRM RÉSUMÉ

Booth, Ahrens & Werkenthin, P.C. is a small dynamic law firm that provides legal services enhanced by a specialized understanding of its clients' business and goals. In all instances, we strive to provide the fullest possible range and quality of services in a timely and effective manner and at a reasonable cost. To help ensure the high quality of our legal services, we concentrate our practice on the areas of Environmental and Water Utility Law. While we are best known for our work in the areas listed below, we also successfully practice in many other areas of civil law.

Our Environmental and Water Utility Law practice includes groundwater and surface water rights, water supply and other utility contracts, water quality, political subdivision creation, water and wastewater rates, solid and hazardous waste, eminent domain, environmental auditing, stormwater drainage, dredge and discharge, wetlands, endangered species matters, title opinions concerning ownership of water rights, underground storage tanks, utility and construction contracts, municipal regulation, OSHA compliance, and the drafting, servicing and monitoring of legislation.

The services that we offer our clients are broad, spanning from litigation in both state and federal court and administrative agencies to the negotiation and drafting of contracts and other agreements. We represent a diverse client base throughout the State, including public and quasi-public bodies, international corporations, land and water rights owners, agricultural and aquacultural interests, trade associations, and individuals. Our practice frequently involves novel legal issues and important questions of public policy.

- Members of the firm have assisted clients in a number of State water right matters involving the permitting or amending of permits for many Texas reservoirs, including the Paluxy Reservoir, Little Cypress Reservoir, Lake Benbrook, Richland-Chambers Reservoir, Cedar Creek Reservoir, Bridgeport Reservoir and Eagle Mountain Reservoir. Most recently, the firm obtained a permit authorizing the City of Victoria to divert up to 20,000 acre-feet per annum from the Guadalupe River. The permitting of the reservoirs also required members of the firm to master collateral legal issues, such as the impacts to fish and wildlife resources, mitigation techniques, instream flow releases, water quality impacts, and endangered species.

Firm Résumé of Booth, Ahrens & Werkenthin, P.C.

- Members of the firm have extensive experience in assisting clients in negotiation and development of short, medium and long-term water supply contracts for suppliers and purchasers all over the State of Texas. Such contracts have included rate provisions supporting over 200 million dollars worth of bonds for a regional water supply system, as well as provisions supporting reuse to enhance reservoir yields, protecting water quality and increasing water conservation. Additionally, members of the firm have developed and negotiated water rights subordination agreements and wastewater treatment contracts.
- Members of the firm, in conjunction with the Fort Worth District Corps of Engineers and other attorneys, successfully defended litigation brought against the Corps' granting to Tarrant County Water Control and Improvement District Number One a Section 404 permit for the Richland-Chambers Reservoir and pipeline. At the time, this was the largest reservoir project undertaken in the State during the last 15 years. Pipeline and reservoir costs were over \$300 million.
- Members of the firm represented an international chemical corporation in contesting water rates charged the corporation by a river authority. That rate appeal saved the corporation an estimated \$80 million over the next 50 years.
- Members of the firm provided legal representation to individuals, industry and political subdivisions relating to permitting and compliance with complex state and federal water and solid/hazardous waste laws and regulations.
- Members of the firm have assisted in the development of groundwater production permitting regulations for Panhandle Groundwater Conservation District Number Three and have participated in the development of legislation attempting to regulate production from the Edwards Aquifer.
- Firm attorneys were instrumental in obtaining numerous water use and wastewater disposal permits and amendments for agricultural, municipal and industrial concerns required for the continued growth and development of Texas. This included obtaining and defending state and federal permits for two regional wastewater treatment plants for the Trinity River Authority.

Our goal at Booth, Ahrens & Werkenthin, P.C. is to excel in serving our clients in a cost-efficient and timely manner; to be accessible to those clients; and to work together with the clients to meet their goals and responsibilities.

The firm's energy derives from the collective capabilities of our attorneys. We match the specific client tasks with the particular attorney who possesses the expertise and experience to perform the needed services with a constant view towards achieving the most cost-effective result. See the following biographies regarding each attorney.

Firm Résumé of Booth, Ahrens & Werkenthin, P.C.

***MICHAEL J. BOOTH**, born Austin, Texas, June 9, 1956; admitted to bar 1982, Texas; 1983, U.S. District Court, Northern District of Texas; 1987, U.S. District Court, Eastern District of Texas; 1988, U.S. District Court, Western District of Texas; 1992, U.S. District Court, Southern District; 1986, U.S. Court of Appeals, Fifth Circuit; 1992, U.S. Supreme Court.

Education:

University of Texas (B.B.A., 1978); St. Mary's University (J.D., 1982). Phi Delta Phi. Notes and Comments Editor, St. Mary's Law Journal, 1981-82. Briefing Attorney, Court of Appeals for the Third Supreme Judicial District, 1982-83.

Publications:

"The Status of Privileges Allowed Environmental Audits under State and Federal Evidentiary Law," 18 State Bar of Texas Environmental Law Journal 12 (1987).

Speeches:

"Overview of Texas Water Law," September 1996, State Bar of Texas Advanced Oil, Gas and Mineral Law Course. "The Clean Water Act," September 1995, January 1994, Executive Enterprises, Inc. Environmental Regulation Course. "Water Conservation Fact and Fiction," 1993 Texas Water Conservation Association Mid-Year Technical Conference. "Legal Aspects of Environmental Issues at the Corps of Engineers and the Texas Water Commission," Water Rights Seminar, Austin, Texas, December 1987. "Legal Rights and Duties Available During a RCRA Facility Assessment," Corrective Action Strategy Seminar, Houston, Texas, June 1987. "Use and Abuse of Expert Testimony," Administrative and Regulatory Law Section, Travis County Bar Association, June 1986. Groundwater Regulation in Central Texas: Overview and Current Issues and Developments, Environmental Issues for Central Texas Lawyers. Federal Government Pulls Plug on State Water Laws in the Name of Hydroelectric Development, 1991 TWCA Mid-Year Technical Conference.

Professional Affiliations:

American Bar Association (Member, Litigation Section; Public Utility Law Section; Tort and Insurance Section; Urban, State and Local Government Law Section); State Bar of Texas (Member, Environmental and Natural Resources Law Section; Public Utility Law Section); Travis County Bar Association (Member, Administrative Law Section); Chamber of Commerce, City Regulatory and Planning Committee (1988-89); Texas Water Conservation Association's Water Laws Committee, Chairman (1990-present). Member: Texas Water Commission's Clean Water Council: Water Supply and Use Sub-Committee; Health, Safety and Environment Committee, Austin Chamber of Commerce; Lower Colorado River Authority Travis County Water Council.

Firm Résumé of Booth, Ahrens & Werkenthin, P.C.

***CAROLYN AHRENS**, born Karnes City, Texas, January 13, 1959; admitted to bar 1985, Texas.

Education:

Southwest Texas State University (B.S. in Education with Highest Honors, 1979; Master of Education, 1981); University of Texas (J.D. with Honors, 1985). Recipient: Dean's Awards for Academic Achievement in Water Law Seminar, Land Use Planning, and Federal and Texas Public Mineral Land Law. Member, Delta Theta Phi (Tribune, 1984-85); Environmental and Natural Resources Law Society.

Publications:

"Looking Back—Looking Forward: The YLD Mission," BARRISTER Vol. 21, No. 2 (60th Anniversary Edition, Summer 1994); "Step Up to the Bar: Surviving Law School," Full Disclosure: Do You Really Want to Be a Lawyer? (1989; 2nd ed. 1992); "Fairness and the Administrative Process," 8 Austin Lawyers Journal (July and August 1987).

Speeches:

"Retaining and Working with Special Counsel," Water Environment Association of Texas Total Project Management Seminar, June 2, 1993; "The National Environmental Policy Act," Executive Enterprises, Inc., November 1994 (Austin), January 1994 (Dallas), November 1993 (Austin) and March 1993 (San Antonio); Moderator: Administrative Law Seminar, June 5, 1987, and June 3, 1988, Administrative Law Section, Travis County Bar Association.

Bar Associations:

Member: American Bar Association (Section of Administrative Law and Regulatory Practice: Young Lawyers Division Liaison 1995-97; Gavel Awards Screening Committee 1994-96; Young Lawyers Division: Cabinet 1991-95; Executive Council Coordinator 1994-95; Executive Council 1990-94; Chairman, Barrister Magazine Editorial Board 1991-94; District Representative for Texas 1991-93; Vice-Chair, National Conferences Team 1990-91); Texas Bar Foundation; State Bar of Texas (Member, Administrative and Public Law Section; Environmental and Natural Resources Law Section); Texas Young Lawyers Association (Director 1989-91; Co-Chair, Local Affiliates Committee 1990-92; Vice-Chair, Legislative Committee 1990); Travis County Bar Association (Board of Directors 1989-90; Administrative Law Section: Board of Directors 1987-93; President 1989-90; Programs Committee 1985-89); Austin Young Lawyers Association (Board of Directors 1987-93; Secretary 1988-89); Association Internationale des Jeunes Avocats (Liaison to ABA 1996-97).

Professional Affiliations:

Member: Water Environment Association of Texas (Secretary 1995-97; Chair, Long-Range Planning Committee 1996-97; Annual Meeting Program Committee 1993-96; Texas Water '96: WEAT and AWWA Texas Joint Annual Meeting Committee 1994-96; Central Texas Chapter: President 1994-95; President-Elect 1993-94; Vice-President and Programs Chair 1992-93); Firm memberships: Texas Water Conservation Association; Texas Rural Water Association; Texas Municipal League.

Firm Résumé of Booth, Ahrens & Werkenthin, P.C.

***FRED B. WERKENTHIN, JR.**, born Austin, Texas, May 25, 1951; admitted to bar 1989, Texas.

Education:

Southwest Texas State University (B.S., 1978; M.S., 1980); St. Mary's University (J.D., 1989). Phi Delta Phi.

Publications:

"The Relationship of Nutrients and Morphometry to Productivity in Canyon Reservoir, Texas," May 1980. Environmental Quality Specialist Hydraulist, Texas Department of Water Resources, 1981-86.

Speeches:

"Regulation of Aquaculture Effluents in Texas," World Aquaculture Association, February 1995 (San Diego); "Regulation of Effluents, An Industry Perspective," Texas Aquaculture Association, February 1995 (Austin).

Professional Affiliations:

Travis County Bar Association (Member, Administrative Law Section); State Bar of Texas (Member, Administrative and Public Law Section); Texas Young Lawyers Association; Austin Young Lawyers Association; Water Environment Association of Texas; Water Environment Federation; World Aquacultural Society; American Bar Association.

* Not certified by the Texas Board of Legal Specialization for a Certificate of Special Competence in Civil Trial Law or in Administrative Law. No designation has been made by the Texas Board of Legal Specialization for a Certificate of Special Competence in environmental law or in the other areas of practice described above.

TODD CHENOWETH, J.D., M.P.A.
Vice President
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Summary

Mr. Chenoweth holds advanced degrees in law and public administration. He has practical experience in water resource issues, having worked as the project director of the Texas Water Development Board's Economically Distressed Areas Program. In addition he has:

- Researched and written over fifteen appellate briefs;
- Drafted legislation to create water districts;
- Drafted legislation to amend the Water Code related to the Economically Distressed Areas Program;
- Principal author of three regional or EDAP related water and wastewater planning reports.

Education

Masters of Public Administration, John F. Kennedy School of Government, Harvard University, 1989. Course work emphasis on Economics, Quantitative Policy Analysis, and Program Evaluation.

Juris Doctorate, The University of Texas at Austin, Austin, Texas, 1976 with Honor grades in Torts, Remedies, Criminal Procedure, Jurisprudence, Fraud and Criminal Procedure.

Bachelor of Arts in Political Science, cum laude, Texas A&M University, College Station, Texas 1973. Course work included, engineering design, statistical analysis, and calculus.

Professional Experience

Vice President, Michael Sullivan and Associates, Inc. November 1992 - Present.

Program Director, Economically Distressed Areas Program, Texas Water Development Board; 1989 - 1992.

Assistant City Attorney, City of El Paso, Texas; 1986 - 1988.

Executive Assistant to the El Paso County Judge, El Paso, Texas; 1984 - 1986.

First Assistant County Attorney, El Paso County, Texas; 1982 - 1984.

Assistant County Attorney, El Paso County, Texas; 1977 - 1982

Professional Registration

Licensed to practice law in the State of Texas, U.S. District Court for the Western District, U.S. Court of Appeals for the 5th Circuit, and the United States Supreme Court

Detailed Experience Record

Michael Sullivan and Associates, Inc.

As Vice President for Michael Sullivan and Associates, Inc., Mr. Chenoweth is also responsible for legal, institutional, and planning aspects of regional water planning. Mr. Chenoweth co-authored, "*Southern Bexar County Medina Valley Surface Water Supply Study*," "*Cameron County Colonia Wastewater Treatment Planning Study - Baseline Report and Facility Plan for Combes, Primera and Arroyo Colorado Estates.*" Mr. Chenoweth is responsible for project management of a multi-disciplinary team of engineers, hydrologists, and planners responsible for water and wastewater regional plans. Additional responsibilities include:

- Determination of financial feasibility of water and wastewater projects,
- Statistical analysis of population and water usage,
- Design of user charge systems,
- Negotiations and drafting of interlocal agreements for project implementation,
- Interagency coordinator.

Texas Water Development Board

As Project Director for the Economically Distressed Areas Program (EDAP) of the Texas Water Development Board (TWDB), Mr. Chenoweth was responsible for the overall management and supervision of the TWDB's program to bring water and wastewater facilities to colonias and other economically distressed areas in Texas. Additional responsibilities included:

- Supervised development of EDAP engineering regulations
- Supervised development of EDAP financial regulations
- Served on the Texas Water Commission's Technical Advisory Committee for the *1992 Regional Assessment of Water Quality in the Rio Grande Basin*
- Coordinated efforts of the Texas Department of Health, Texas Water Commission and the Texas Water Development Board to draft model subdivision rules
- Served on the U.S. Environmental Protection Agency's Texas Colonia Subcommittee for the Integrated Environmental Plan for the Mexico-U.S. Border Area
- Served on the Governor's Border Working Group

City of El Paso

As an Assistant City Attorney for the City of El Paso, Texas, Mr. Chenoweth performed legal research, wrote appellate briefs, and represented the City in appellate court and district court in declaratory judgment actions involving constitutional issues related to the city's charitable solicitations ordinance and statutory interpretation issues related to the city's transit system. He also negotiated construction contract disputes. Mr. Chenoweth structured and drafted financing documents for a joint public/private sector project to provide low income housing. Additional duties included drafting numerous ordinances to regulate on-site wastewater disposal, to regulate smoking in public

places, to regulate subdivisions, to revise lay midwifery regulations, and to require dedication of land for city parks in subdivisions. Mr. Chenoweth negotiated and drafted numerous inter-local contracts between cities, the county, and other public entities including: contracts for County enforcement of septic tank regulation in the City's extra-territorial jurisdiction, jail booking, management of the Tourist and Convention Center, and organization of the City-County Health District.

El Paso County Judge

As the Executive Assistant to the County Judge of El Paso County, Mr. Chenoweth served on an ad hoc group of attorneys and investment bankers to negotiate water resource issues and draft legislation creating a water district for an area of colonias. He also coordinated a team of software analysts and court managers to produce the logical design for a computer mainframe court administration database.

El Paso County Attorney

As First Assistant County Attorney, Mr. Chenoweth supervised a staff of over ten attorneys and associated support staff. His duties included representing the County in state and federal court, in suits involving tort claims, trespass to try title actions, EEOC claims, tax suits, and civil rights claims. He is the author of over fifteen appellate briefs. Mr. Chenoweth also was responsible for drafting statutes on child support enforcement, juvenile prosecution, and creation of water districts by special legislation. Additional duties included negotiating construction contract disputes and drafting real estate deeds, leases and contracts. He also coordinated the County's industrial development and housing finance efforts which resulted in the issuance of fifteen and one half million dollars worth of Industrial Revenue Bonds.