TEMPLATES OF ISSUES IN BUYING AND SELLING SURFACE WATER RIGHTS

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I. INTRODUCTION:

Buying and selling surface water rights, and for that matter "leasing" those rights, are essentially real estate transactions. Accordingly, the fundamental principles of real property law generally apply to such transactions. There are nuances and peculiarities that distinguish transactions involving the sale of water rights, however, from other real property transactions that must be considered. Another characteristic of water transactions that distinguishes them from traditional real estate transactions is the lack of a well-developed water market, and the attendant lack of "structure" makes every

Water in Texas generally falls into one of two categories: (i) "surface water," and (ii) "groundwater." Both the ownership of, and regulatory scheme governing water in Texas is dependent upon its classification. The classification also affects the strategy and requirements for buying and selling, or leasing, the water. A basic understanding of the laws related to these two water sources is essential to engaging in a water related transaction. Groundwater is privately owned and subject to the "Rule of Capture" as modified by potential regulation by a groundwater conservation district.[1] Surface water is owned by the State, and held in trust for the benefit of all of the people of the State.[2] The focus of this paper is to assist in understanding the transactions involving surface water rights, and identify some of the regulatory and political considerations affecting these transactions.[3]

II. STATE SURFACE WATER OVERVIEW:

"State water" is defined very broadly by statute as follows:[4]

> Water of the ordinary flow, under flow and tides of every flowing river, natural stream, and lake, and of every bay or arm of the Gulf of Mexico, and the storm water, flood water, and rain water of every river, natural stream, canyon, ravine, depression and water shed in the state is State water.[5]

As evidenced by the breadth of the statutory language, all water flowing in a "watercourse" is presumptively owned by the State.

The Texas Commission on Environmental Quality ("TCEQ") is the state agency to whom the Texas Legislature has delegated authority and primary jurisdiction to be the steward of Texas "state water" and to regulate its use.[6] Originally created as the State Board of Water Engineers, over the years the TCEQ and its functions have been known by many names including the Texas Water Quality board, Texas Water Rights Commission, Texas Water Commission and Texas Natural Resources Commission.

To lawfully divert, store or use State water for any purpose, unless authorized as an "exempt use,"[7] you must first obtain a water right from the State.[8] It is illegal to "take, divert, or appropriate" surface water without prior authorization.[9] Civil penalties can be imposed in amounts up to $5,000/day for each day the unlawful use continues.[10] It is also unlawful to sell a water right unless the right has been perfected, or the TCEQ, by permit, has authorized such a sale.[11]

The "exemptions" from the water rights permitting requirement include the right of a landowner to construct a dam or reservoir on his property that will impound less than 200 acre-feet of water to be used for domestic, livestock, fish and wildlife, purposes.[12] These reservoirs and dams are

[1] *See* Drummond, Sherman & McCarthy, "The Rule of Capture in Texas – Still Misunderstood After All these Years," 37 TEX. TECH L. REV. 1 (2004); *see generally* TEXAS WATER CODE Ch. 36.

[2] *See generally* TEXAS WATER CODE § 11.021, 11.121.

[3] Transactions involving groundwater are addressed in a separate conference paper. *See* Cheney, *Groundwater Overview: What a Transaction Looks Like*, 17th Annual Changing Face of Water Rights (State Bar of Texas, San Antonio, Tx Feb. 24-26, 2016).

[4] *See* TEXAS WATER CODE § 11.021.

[5] *Id*.

[6] TEXAS WATER CODE §§ 5.012-5.013.

[7] *See id.* §§ 11.142, 11.1421, 11.1422, 11.303 *See generally* Acts of 2001, 77th Leg. R.S., Ch. 966, §2.09 2001 Tex. Gen. Laws 1880, 1886-1887 (SB 2 amending Section 11.142 to authorize the impoundment of up to 200 ac-ft of water for fish and wildlife use-similar to the existing domestic and livestock exemption); 30 TAC §§297.21-297.30.

[8] TEXAS WATER CODE § 11.121; *see Turner v. Big Lake Oil Co.*, 96 S.W.2d 221, 228 (Tex. 1936); *Motl v. Boyd*, 286 S.W. 458, 473 (Tex. 1926); *Domel v. Georgetown*, 6 S.W.3d 349, 353 (Tex. App.–Austin 1999, pet. denied); HUTCHINS, THE TEXAS LAW OF WATER RIGHTS, 518-519 (1961); Caroom & Sherman, 45 TEXAS PRACTICE, WATER DEVELOPMENT AND WATER RIGHTS, § 13.3(a), at 491-492 (1997).

[9] *See* TEXAS WATER CODE § 11.081; 11.082, 11.084, *cf., id.* § 11.121 (requiring a permit be obtained to use State Water).

[10] *See id.* § 11.082 (each day of continued unlawful use is a new violation subject to a separate penalty).

[11] *See id.* § 11.084 (the sale of the water right is to be distinguished from the sale of water diverted pursuant to the water right).

[12] *See* TEXAS WATER CODE §11.142. S*ee generally* RG-141, A REGULATORY GUIDANCE DOCUMENT FOR APPLICATIONS TO DIVERT, STORE OR USE STATE

generally "off-channel," as TCEQ regulations prohibit the construction of an exempt dam across a "navigable watercourse" without a permit.[13] An exempt structure can be constructed on a non-navigable watercourse if the landowner owns the property on both sides of the watercourse where the dam is located.

Other statutory exemptions include: i) the diversion of water from the Gulf of Mexico at a rate not to exceed one acre-foot of water during a 24 hour period for oil and gas development and production;[14] ii) the use of brackish or marine water for mariculture activities;[15] and iii) the diversion of up to 200 acre-feet of water a year from a river by a tax-exempt, non-profit corporation to irrigate the grounds of a 100 year old cemetery that borders the river.[16] Reservoirs also may be constructed without a permit under the Texas Surface Coal Mining & Reclamation Act, if their sole purpose is sediment control as part of a surface coal mining operation.[17]

Another historic means to use surface water without obtaining a water right was the exercise of a "riparian right." This right allows the owner of property adjacent to a stream to divert a "reasonable" amount of water for domestic and livestock purposes. Because that right is considered a "correlative right," the riparian landowner must allow sufficient water to flow past his property to satisfy the rights of other downstream riparian land owners both as to the quantity and quality of the water.[18] These riparian rights are still recognized today, but are commonly known as "domestic and livestock" or "D&L" uses.[19]

However, it is the general rule that one must hold a valid water right to store and divert or otherwise use surface water.[20] Forms of authorization to use, or to appropriate, State water include "permits," "certificates of adjudication," or "certified filings." Certificates of adjudication[21] and, in particular, "certified filings"[22] are historic evidences of the right to appropriate State water. The most common form of evidence of the ability to appropriate State water today is a water rights permit.[23]

While the right to divert and use surface water for beneficial purposes is considered a usufructury right or a "right of use,[24] in Texas a water right is treated as a property right. The holder of a water rights permit does not hold title to the corpus of the water. That title remains in the State;[25] however, as against all other persons, the permit holder possesses a superior property right, and the right can be bought and sold.[26]

An individual who wishes to obtain a water right may either acquire an existing right or file an application for a new permit with the TCEQ. As most Texas watersheds are already considered fully appropriated,[27] acquiring an existing water right may be the most productive means of securing a water right that will satisfy the needs of the individual.[28] Depending on (i) the type of water right or amendment sought, *e.g.*, whether for municipal, industrial, agriculture, or other use, (ii) the quantity and/or diversion rate, (iii) the location of the proposed diversion point and/or place of use and whether the water has or proposes to have "storage" (on-channel or off-channel) associated with it, (iv) the surrounding and downstream environment, and (v) the number of existing downstream water rights, limitations may be imposed on a water right that affects its value and/or usefulness to the permittee.[29]

Permits may be obtained for varying periods of time (*e.g.*, in perpetuity or for specific "term" of years)[30] or as a "temporary permit."[31] A permit

WATER, 10-11 (JUNE 1995) (hereinafter cited as "RG-141").

13 30 TAC § 297.21(c). Navigable streams include both those watercourses that are "navigable in fact" as well as "navigable as a matter of law." Section 21.001(3), Texas Natural Resources Code defines a "navigable stream" as "a stream which retains an average width of 30 feet from the mouth up" and includes a dry river bed. *See* TEX. NAT. RES. CODE § 21.001(3); *see generally* Sweeney, *Riverbeds and Banks: Title and Regulatory Issues*, Texas Land Trust Association Webinar (Oct. 25, 2012).

14 *See* TEXAS WATER CODE §11.142.

15 *See* TEXAS WATER CODE § 11.1421.

16 *See* Texas Water Code § 11.1422.

17 *See* TEX.NAT. RES. CODE CH. 134; TEXAS WATER CODE § 11.142(c).

18 *See generally Motl v. Boyd*, *supra, 286 S.W. at* 458; HUTCHINS, *supra*, at 356-369; SKILLERN, TEXAS WATER LAW, 26-30, 34-36, 66 (1988); Caroom & Sherman, *supra*, at 493-494.

19 *See* 30 TAC § 297.21(a).

20 *See* TEXAS WATER CODE §§ 11.081, 11.082, 11.084, 11.121.

21 *See id.* § 11.323.

22 *See id.* § 11.307.

23 During the water rights adjudication process water rights evidenced by certified filing and historically issued permits were adjudicated and upon the issuance of a district court final order validating the adjudication process, the Commissioner's predecessor agency, *i.e.*, the Texas Water Rights Commission issued Certificates of Adjudication. *See* TEXAS WATER CODE § 11.301 *et seq*. Today, the Commission issues "permits."

24 *See* Booth, *Ownership of Developed Water Rights in Texas: A Property Right Threatened*, 17 ST. MARY'S L.J. 1185, 1187-1188 (1986).

25 *See South Texas Water Co. v. Bieri*, 247 S.W.2d 268, 272 (Tex. Civ. App.--Galveston 1952, writ ref'd n.r.e.).

26 *Id.*

27 *See* RG-141, *supra*, at 26 (Table 8 – "Fully Appropriated Stream Segments").

28 *Cf.*, TEXAS WATER CODE § 11.084 (prohibiting the sale of an unperfected/unpermitted water right).

29 *See* 30 TAC §§ 297.41-297.59 ("Issuance and Conditions of Water Rights").

30 *See* TEXAS WATER CODE § 11.1381.

obtained in perpetuity becomes a permanent property right unless it is canceled.

Temporary permits are usually issued for a quantity not to exceed 10 acre-feet to be used over a period of time not to exceed three (3) years. These types of permits are frequently used for construction, particularly road construction projects. Temporary permits may be issued for longer terms or larger volumes, but only after the issuance of notice and holding a public hearing.[32]

A term permit is issued generally in watersheds which are already fully appropriated. These permits are issued for a finite period to allow subsequent evaluation of whether water either remains available, or water has become available that would allow conversion of the term permit to a perpetual permit. Use of term permits also provides the TCEQ with an "opportunity" to terminate a water right due to a lack of available water or demonstrated beneficial use, or adverse impacts to the watershed, without surprise to the permittee.[33] Term permits are usually issued for a period of ten to twenty years. They may be extended upon application by the permittee; however, renewal is not guaranteed. Term permits are sometimes issued when existing permits are amended in order to implement a "lease" or similar contractual agreement usually will contain a provision automatically terminating the amendment upon expiration of the lease or contractual relationship.

Water rights permits, and amendments thereto, may only be issued by the TCEQ after a determination that the purpose for which the water will be used is a "beneficial purpose."[34] By statute, multiple categories of use have been identified as beneficial uses by the Legislature.[35] These include domestic and municipal use, agricultural and industrial uses, mining, hydroelectric power generation, navigation, recreation, stock raising, public parks and game preserves. State water may also be used for any other "beneficial use."[36] Since 2007, a water right may also be amended for application to uses that benefit the environment.[37]

The limited scope of this paper precludes a full discussion of the water rights permit and amendment application process, and related water rights issues. In order to appreciate the complexity of a water transaction involving surface water rights, however, a summary of the major issues involved in the permitting/amendment process is set forth below:

A. Application Requirements:

To obtain a water right, or an amendment to an existing right, an individual must file an application with the TCEQ. The Application must be on a form developed by the TCEQ, and must comply with the TCEQ's rules and regulations.[38]

B. Section 11.122(b) Amendments - Notice & Opportunity for Hearing:

In *City of Marshall v. City of Uncertain*,[39] the Supreme Court addressed the issues of whether the TCEQ was required to approve, without notice or an opportunity for a contested case hearing, an amendment of the City of Marshall's water rights permit filed under Section 11.122(b), TEXAS WATER CODE. In 2001, the City filed a permit amendment application seeking authorizing it to change the purpose of use to include industrial purposes.

Although the TCEQ received multiple requests for a contested case hearing on the amendment, it concluded Section 11.122(b) required the requested change be granted without publication of any notice or granting an opportunity for a contested case hearing because the requested amendment was within the authorization of the existing of the permit if the same were fully utilized. As the Supreme Court noted,

> The full use assumption, also known as the four corners doctrine, requires the Commission to assess a requested amendment's impact on other water rights and on the on-stream environment based upon the full amount of water authorized by the existing permit irrespective of the amount that the permit holder has actually used.

On appeal, the Travis County District Court held that TCEQ erred in its determination that Section 11.122(b) required approval of the amendment without a contested case hearing and remanded the application to TCEQ. The Austin Court of Appeals affirmed, concluding that Section 11.122(b) allowed a hearing

[31] *See id.* § 11.138.

[32] TEXAS WATER CODE § 11.138 (a).

[33] *See generally* Caroom & Sherman, *supra*, at 505-506.

[34] *See* TEXAS WATER CODE § 11.134(b)(3)(A); *see generally* Caroom & Sherman, *supra*, at 501-502.

[35] *See* TEXAS WATER CODE § 11.023(a). *Cf.*, 30 TAC § 297.43(a) (identifying the beneficial uses contained in §11.023(a), and adding, *without legislative basis*, "in-stream uses, water quality, aquatic and wildlife habitat or freshwater inflows to bays and estuaries").

[36] *See* TEXAS WATER CODE § 11.023; 30 TAC § 297.43(b).

[37] *See Id.* § 11.0235(d), (d-1).

[38] *See* TEXAS WATER CODE Ch. 11; 30 TAC Chs. 281, 288, 295, 297; *see generally* RG-141, *supra*, at 13-15. A copy of the Commission's application forms for a new water right, as well as, an amendment to an existing right may be obtained by contacting the Commission or on-line at http://www.tceq.state.tx.us/permitting/water_rights/wr-permitting/wr_applications.html/#applications (TCEQ Form-10214, TCEQ Form-10201).

[39] 206 S.W.3d 97 (Tex. 2006).

where the amendment sought a change in the purpose of use.

The Supreme Court concluded that Section 11.122(b) requires an amendment application meet "all other applicable requirements of this chapter [11, TEXAS WATER CODE] for the approval of an application." All "other" requirements, the Court concluded, included assessment of matters outside of Section 11.122, including the potential adverse impact of the amendment on other water rights' holders and/or the environment.

> [W]e interpret Section 11.122(b) to require the Commission to assess specified criteria other than impacts on other water right holders and the on-stream environment when considering a proposed water right's amendment.

The Court did confirm that TCEQ must make the full use assumption in considering impacts on water rights or the on-stream environment, but that the potential, at least for a limited hearing on other issues addressed by Chapter 11 had to be held unless the record before the TCEQ was sufficient to allow a determination to be made without a hearing. In the Marshall case the Court noted that the protestants had raised substantive issues outside of full use assumption, including the proposed amendment's impact on public welfare, groundwater and the adequacy of Marshall's conservation plan, which were not addressed in the record before the TCEQ when the determination was made not to grant the hearing requests.

During the subsequent 80th Legislative Session the TCEQ may have looked to the Legislature for guidance on how to respond to the Court's 2006 ruling in *Marshall*, however, no specific legislation related to Section 11.122(b) was passed in 2007. On September 7, 2007, the TCEQ conducted a workshop on rules and policy issues related to the notice requirements of Section 11.122, TEXAS WATER CODE, in light of the Supreme Court's decision in the *Marshall* case. Further information related to the issues considered by the TCEQ, including the TCEQ staff's analysis of the issues is available on the TCEQ's website.[40]

Since that workshop, in response to Section 11.122(b) amendment applications, the Executive Director's Staff has submitted requests for information that include the option for the applicant to either agree to allow (and pay for) basin-wide notice to be published or, alternatively, respond to the following seven "Marshall Questions":

*Marshall* Questions:

1. Confirm whether this application meets the administrative requirements for an amendment to a water use permit pursuant to TWC Chapter 11 and Title 30 Texas Administrative Code (TAC) §§ 281, 295, and 297. An amendment application should include, but is not limited to, a sworn application, maps, completed conservation plan, fees, etc.
2. Discuss how the proposed amendment is a beneficial use of the water right as defined in TWC §11.002 and listed in TWC §11.023. Identify the specific proposed use of the water (*e.g.*, road construction, hydrostatic testing, etc.) for which the amendment is requested.
3. Explain how the proposed amendment is not detrimental to the public welfare. Consider any public welfare matters you think might be relevant to a decision on the application. Examples could include concerns related to the well-being of humans and the environment.
4. Discuss the effects, if any, of the proposed amendment on groundwater or groundwater recharge.
5. Describe how the proposed amendment addresses a water supply need in a manner that is consistent with the state water plan or the applicable approved regional water plan for any area in which the proposed appropriation is located or, in the alternative, describe conditions that warrant a waiver of this requirement. The state and regional water plans are available for download at this website: http://www.twdb.state.tx.us/RWPG/planning_page.asp.
6. Provide evidence that reasonable diligence will be used to avoid waste and achieve water conservation as defined in TWC §11.002. Examples of evidence could include, but are not limited to, a water conservation plan or, if required, a drought contingency plan, meeting the requirements of 30 TAC §288.
7. Explain how the proposed amendment will or will not impact water right holders or the environment beyond and irrespective of the fact that the water right can be used to its full authorized amount.

The information provided by the applicant in response to these questions, in addition to any analysis by TCEQ staff, forms the basis of a memorandum from the Executive Director to the Commissioners with a

[40] The Commission's September 7, 2007, Workshop Agenda and back-up materials are available on-line at: *http://www.tceq.state.tx.us/assets/public/comm_exec/agendas/worksess/current/2007/070907.pdf.*

recommendation for TCEQ action on whether or not to publish notice of the amendment. Upon filing of this memorandum, the TCEQ currently schedules the matter for consideration by the TCEQ during a regularly scheduled agenda conference.

C. Accounting Plans:

Another development in the TCEQ water rights permitting process is a heightened requirement for applicants to demonstrate the ability to prove that they are only diverting the water authorized by their water right(s). This is accomplished through the development during the permitting process of a TCEQ approved "accounting plan." A thorough discussion of the specifications for developing an "accounting plan" is beyond the scope of this paper; however, an excellent paper presented to the membership of the Texas Water Conservation Association at its annual meeting in Austin, Texas in February, 2009 entitled *Basics of Water Accounting in Texas and its Implications for Raw Water Supply Operations* was the collaborative effort of Kathy Alexander Martin, Andres A. Salazar and Thomas C. Gooch.

Any water project of any consequence that involves State water should expect the need to develop/negotiate an accounting plan with the TCEQ. If an accounting plan is required, the applicant should schedule a meeting with its hydrology consultants and TCEQ staff to review the requirements for an accounting plan and the possible nuances to be addressed based upon site specific circumstances of the application.

D. Water Conservation & Drought Contingency Plans:

Water conservation and drought management requirements for surface water rights holders have increased since 1997.[41] All applications for new and/or amended water rights are required to include a water conservation plan.[42] Additionally, water conservation plans are required to be submitted by water rights holders authorized to appropriate (i) 1,000 acre-feet or more per annum for municipal, industrial or other uses, or (ii) 10,000 acre-feet or more per annum for irrigation use.[43] Wholesale and retail water suppliers, and irrigation districts are required to develop drought contingency plans, and to coordinate the same with the regional water planning groups.[44] These plans are to be updated at least every five years.

E. Delivering Water Down Banks and Beds:[45]

Section 11.042 of the Texas Water Code entitled "Delivering Water Down Banks and Beds," contains the statutory authority for the TCEQ to issue what are commonly known as "bed-and-banks permits."46 Section 11.042 does not permit sate water.47 Instead, Section 11.042 is the statute by which the TCEQ has the power to "authorize" the use of a state watercourse to transport water (surface or groundwater and/or treated effluent or imported water) from a point of discharge to a point of diversion for beneficial use.[48] The term "permit" is actually a "misnomer."[49] Bed and banks authorizations allow the TCEQ to document, inventory, and regulate the use of State water courses to move water downstream. In particular, Section 11.042, allows the TCEQ to regulate the indirect reuse of treated wastewater effluent, including persons wishing to reuse water that originated as privately owned groundwater after the same is discharged into a State water course for conveyance downstream for diversion and reuse.[50]

Section 11.042 authorizes the TCEQ to subject the "reuse" bed-and-banks project to "special conditions"[51] which can reduce the volume of return flows available for reuse <u>if</u> the TCEQ determines the same are necessary to protect an existing water right that was granted based on the use or availability of the historic return flows of the privately owned groundwater which had not previously been part of a "reuse project."[52] These "special conditions" are in addition to accounting for the traditional "carriage losses"[53] associated with bed-and-banks permits, "Special conditions" can also be imposed upon Section 11.042 reuse bed-and-banks permits to protect the environment, *i.e.*, to maintain instream uses, including aquatic and riparian habitats, and recreational uses, and

[41] *See* TEXAS WATER CODE §§ 11.1271, 11.1272.

[42] *See id.* §§ 11.1271; *see generally* 30 TAC Ch. 288.

[43] *See* TEXAS WATER CODE § 11.1271; 30 TAC § 288.30(1)-(2).

[44] *See* TEXAS WATER CODE § 11.1272; *see generally* 30 TAC Chapter 288; *Handbook for Drought Contingency Planning for Retail Public Water Suppliers* (TNRCC 2000); *Handbook for Drought Contingency Planning for Wholesale Water Suppliers* (TNRCC 1999).

[45] *See generally* McCarthy, *Water Reuse Issues – Post-Senate Bill 1 – Water for the New Millennium* (Texas Water Law Institute, September 30 – October 1, 1999, Austin, Texas).

[46] *See* TEXAS WATER CODE §11.042; *see generally* RG-141, *supra*, at 6, 8.

[47] TEXAS WATER CODE § 11.042.

[48] *Id.*

[49] *Id.*

[50] *See* TEXAS WATER CODE § 11.042(b).

[51] *See id.* § 11.042

[52] *See id.* § 11.042(b)

[53] "Carriage Losses" include reductions in the volume of stream flow resulting from evaporation and bank seepage. A person wishing to use a watercourse to convey a volume of water downstream must account for, and <u>not</u> divert, "carriage losses."

freshwater inflows to bays and estuaries.[54] In the event the amount of the discharged effluent increases in the future, prior authorization must be obtained to reuse the increased discharges before the increase in the applicant's discharge occurs in order to avoid the desired reuse volumes being subjected to any "special conditions."[55]

F. Interbasin Transfers:

In the case of a permit application that contemplates the transfer of surface water from one river basin to another, the application for an "interbasin transfer" must include the following information:

1. The contract price of the water to be transferred;
2. A statement of the categories of proposed use of the water to be transferred and a detailed description of the proposed uses and users under each category;
3. The cost of diverting, conveying, distributing, and supplying the water to, and treating the water for the proposed users;
4. An analysis of the need for the water in the basin of origin and in the proposed receiving basin based upon the period for which the transfer is requested, but not to exceed 50 years;
5. Factors identified in the applicable approved regional water plans which address the following:

    a. The availability of feasible and practicable alternative supplies in the receiving basin for which the water is needed;
    b. The amount and purposes of use in the receiving basin for which the water is needed;
    c. The proposed methods and efforts by the receiving basin to avoid waste and implement water conservation and drought contingency measures;
    d. The proposed methods and efforts by the receiving basin to put the water proposed for transfer to beneficial use;
    e. The projected economic impact that is reasonably expected to occur in each basin as a result of the transfer; and
    f. The projected impacts of the proposed transfer that are reasonably expected to occur on existing water rights, instream uses, water quality, aquatic and riparian habitat, and bays and estuaries in each basin;

6. Proposed mitigation or compensation, if any, to the basin of origin by the applicant;
7. The continued need to use the water for the purposes authorized under the existing water right if an amendment to an existing water right is being sought; and
8. Any other related information the TCEQ may require.[56] In addition to the other statutorily mandated considerations,[57] the TCEQ must conduct at least two (2) public meetings (one in the basin of origin and one in the receiving basin), and consider the effects of the following factors:

    a. The need for the water in the basin of origin and in the proposed receiving basin over the period for which the transfer is requested, not to exceed 50 years;
    b. Any factors identified in an approved regional water plan regarding the following:
    c. The availability of a feasible or practicable alternative supply in the receiving basin;
    d. The amount and purposes of use in the receiving basin for which water is needed;
    e. The proposed methods and efforts by a receiving basin to avoid waste and implement water conservation and drought contingency measures;
    f. Proposed methods and efforts by the receiving basin to put water to a beneficial use;
    g. The projected economic impact that is reasonably expected to occur within each basin as a result of the transfer;
    h. Impacts of the proposed transfer reasonably expected to occur on existing water rights, in stream uses, water quality, aquatic and riparian habitat, and bays and estuaries in each basin.

[54] *See* TEXAS WATER CODE § 11.042.

[55] *See id.*

[56] 30 TAC § 295.13(b), *See also* TEXAS WATER CODE §11.085(b); 30 TAC § 297.18. *See generally* RG-141, *supra*, at 7; Caroom & Sherman, *supra*, at 505; Jordan, *Interbasin Transfers in Texas and the "Balkanization" of Water Politics* (Texas Water Law Institute, September 30 – October 1, 1999, Austin, Texas)(hereinafter cited as "Jordan, *Interbasin Transfers, supra*, at ___").

[57] TEXAS WATER CODE §11.085

i. Proposed mitigation or compensation, if any, to the basin of origin by the applicant;
j. The continued need to use the water for the purposes authorized under an existing permit, certified filing, or certificate of adjudication if an amendment to an existing water right is sought; and
k. Any other information required to be submitted by an applicant.[58]

The TCEQ may only grant an application for an interbasin transfer after consideration of these factors, either in whole or in part, to the extent that it determines the following:

1. The detriment of the transfer to the basin of origin is less than the benefits to the receiving basin;
2. The applicant for the interbasin transfer has prepared a drought contingency plan and developed and implemented a water conservation plan that will result in the highest practicable levels of water conservation and efficiency achievable within the jurisdiction of the applicant.[59]

Furthermore, an interbasin transfer application may only be granted if it includes "specific conditions" under which the transfer of water may occur. In the case of a transfer of water based on a contractual sale of water, the permit must contain a specific term of years for the life of the permit not to exceed the contract term.[60] Finally, permits, by statute, are "junior" in priority to water rights in the originating basin.[61]

The restrictive requirements of Section 11.085 do not apply to all interbasin transfers.[62] As one author described it, "Mercifully, exemptions from the special new requirements were made to certain transfers … ."[63] The "exempt" transfers include:

1. A total transfer of less than 3,000 acre-feet per year from a single permit,
2. An emergency transfer of water, or
3. A transfer to an adjoining coastal basin,
4. A transfer from a basin to a county within a municipality's retail service area that is partially within the basin; or
5. A transfer imported from a source located wholly outside the boundaries of Texas (except from Mexico) that is transported via the bed and banks of any flowing natural stream located within the state.[64]

G. Cancellation of Water Rights:

Although a perpetual water right becomes the property of the permit holder once perfected,**[65]** the right remains subject to "cancellation" for nonuse.**[66]** Specifically, if all, or part, of a water right has not been put to beneficial use during the ten (10) year period immediately preceding the initiation of a cancellation proceeding, the water right is subject to cancellation for non-use.**[67]**

The threat e cancellation does not apply in the following situations:

1. The permit holder is participating in the Conservation Preserve Program authorized by the Food Security Act or participated in a similar governmental program;[68]
2. A "significant" portion of the water authorized for use under the permit has been used in accordance with an approved regional water plan;[69]
3. The permit was obtained to meet demonstrated long-term public water supply or electric generation needs and is consistent with projections of future water needs contained in the state water plan;
4. The permit was obtained as the result of the construction of a reservoir funded, in whole or in part, by the permit holder as part of the holder's long-term water planning; or
5. The nonuse resulted from:

    a. The implementation of water conservation measures;
    b. A suspension, adjustment, or other restriction on the use of the water pursuant to an order issued by the TCEQ; or
    c. An inability to appropriate the water due to drought conditions.[70]

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[58] *See id.* § 11.085(k).
[59] *See id.* § 11.085(l).
[60] *See id.* § 11.085(m) – (n).
[61] *See id.* § 11.085(s) – (t).
[62] *See id.* § 11.085(v).
[63] *See* Jordan, *Interbasin Transfers*, *supra*, at 11.
[64] *See* TEXAS WATER CODE § 11.085(v).
[65] *See* Booth, *supra*, at 1185.
[66] *See* TEXAS WATER CODE § 11.173.
[67] *Id.*; *see* Acts of 2001, 77th Leg. R.S., Ch. 966, § 2.12, 2001 Tex. Gen. Laws 1880, 1887 (amending Section 11.173, TEXAS WATER CODE).
[68] *See* Public Law No. 99-198, § 1231-1236, 99 Stat. 1354, 1507-1514 (1985).
[69] *See* TEXAS WATER CODE §§ 11.173(2) (as amended by SB2, § 2.12); 16.053.
[70] *See* TEXAS WATER CODE § 11.173.

III. KEY ISSUES IN SURFACE WATER TRANSACTIONS:

A. Key Issues:

Whether buying or selling surface water rights, or simply leasing the right to use the surface water, the following "key issues" are common to all Parties to the transaction:

1. Does the Seller have marketable title to the water right, *i.e.*, a valid permit issued by TCEQ, or one of its predecessor agencies?
2. Has the permittee beneficially used the water during the last ten (10) years, or is the water right subject to cancellation?
3. Is the water right subject to the jurisdiction of a watermaster operation?
4. If the answer to Issue 3. is "yes":

    a. Read the applicable TCEQ watermaster rules.
    b. Is the water right holder current on payment of watermaster fees?

5. Is the use of the water right restricted through any of the following:

    a. Minimum stream flow restriction?
    b. Seasonal use?
    c. Diversion/ Production Rates?
    d. What uses are authorized?
    e. What location is authorized for the use?
    f. Is production tied to any other special conditions?
    g. Where is the location of the diversion point?
    h. By any other means?

6. If the answer to Issue 5. is "yes," how will those restrictions affect (limit or prohibit) the possible development and beneficial use of surface water?
7. Is the water right issued in perpetuity or for a term of years?
8. Is the water right issued on the basis of a contract with a third party who has leased, or subordinated their superior rights, in order for the permit to be issued?
9. If the answer to Issue 8. is "yes," (i) is that contract still in effect, and (ii) is it being conveyed/assigned along with the permit?
10. If required, does the water right holder have a current TCEQ approved water conservation plan and/or drought contingency plan?

The foregoing list of "issues" is *not* intended to be exhaustive, but is offered only as a "starting point" for due diligence in a transaction involving surface water rights. Like all real property transactions, "site-specific" facts unique to the transaction will dictate the issues to be negotiated and investigated, and require modification and/or expansion of the aforementioned listed issues.

B. Other Considerations for Surface Water Leasing Transactions:

The same basic principles applicable to the purchase of a surface water or groundwater right discussed above generally apply to the "leasing" of the water right. However, structuring a water right lease can involve additional considerations, including those discussed below.

1. <u>Valuation:</u>

Due to the lack of an established market for water rights, the true value of the right is unknown. The price per acre foot in the sale for the water right will be higher than the per acre foot "lease price," despite the fact that over the life of the lease, the total return or cost of the leased water right could be greater on a per acre foot than the price to sell the water right. At the end of the lease, however, the water right owner will still own the water right. Additionally, the market value of the water right will likely have appreciated during the term of the lease.

2. <u>Additional Considerations "Affecting" the Lease Price:</u>

Additional considerations in negotiating the "lease price" affecting the overall value of the transaction include the following:

a. Guaranteed annual payment, *i.e.*, leases should be structured to include a take-or-pay, minimum take, or guaranteed purchase term. Each of these concepts ensures that the lessor receives an annual payment.
b. Payment based on lessee's "beneficial use," rather than lease payments based on "actual use," *e.g.*, if the lessor wants to insure receipt of lease payments, irrespective of whether water is actually used by the lessee, a take-or-pay provision should be included if the lessor wants to be sure that they are paid for lessee's "benefit," even if lessee does not actually "use" the water.

   For example, a lessee might lease water for the purpose of "trading" its use, *or non-use*, to improve the reliability of, or otherwise enhance, water available from another water right or source under the control of the lessee. This issue is particularly important in surface water leases where (i) the pressures from environmental interests and/or (ii) demands by downstream water right holders might cause a lessee developing a water project to negotiate a lease that would tie up a water right that would not actually be diverted. The *non-use* of the leased water right under these circumstances could facilitate having higher stream flows in a stream segment, or to bays and estuaries, that do not trigger obligations to pay for the leased water. Moreover, a lessee's "non-use" of the water over an extended period of time could jeopardize the underlying water right by subjecting it to cancellation.

c. Inclusion of a "Price Escalation Clause" should be considered in any lease involving a substantial amount of water, particularly where the lease term is for twenty-plus years. The lessor will want to provide for periodic increases of the annual rent during the term to reflect the appreciation in the value of the water right over time. This can be addressed in a variety of ways, *e.g.*, rent increases can be (i) scheduled at a set interval, *i.e.*, annually or every five (5) years, (ii) specified as a percentage increase or track (1) an index like the consumer price index, or (2) be tied to another market price indicator such as a large water purveyor's rate or price.

3. Cancellation of Water Rights:

Water rights are subject to cancellation, in whole or in part, for non-beneficial use during a ten-year period.[71] While a take-or-pay clause should help to insure that the lessor will get paid, it may not insure that the water is beneficially used during the term of the lease. To avoid cancellation resulting from a lessee's non-use of the water right, a lessor may want to include clauses in the lease like the following:

a. A clause mandating that the lessee protect the water right from cancellation and beneficially use the water right by actually diverting the leased water at least once every ten year cycle.

b. A clause mandating that the lessee "defend" against any action brought by the TCEQ to cancel the water right and to give immediate notice to the lessor of receipt of any notice of cancellation proceedings being initiated by the TCEQ.

c. A clause allowing the lessor to beneficially use, or cause to be beneficially used, the water right in order to prevent cancellation. This clause should also provide that in the event it is exercised, (a) the lessee is still required to pay the rent on one hundred percent of the water (including the quantity used by the lessor), and (b) the lessor has no obligation to either replace the water used or to rebate or refund any portion of the rent (even if the lessor does a spot sale to a third Party).

Unlike surface water permits issued by TCEQ, groundwater permits are usually issued for a term of one (1) to five (5) years. The permits are renewable; however, timely renewal applications must be filed. Among the requirements for renewal include timely payment of all fees owed to the groundwater district, together with compliance with Chapter 36, Water Code, and the district's enabling legislation and rules, including its reporting requirements. The lease should address the Parties' respective obligations to insure the continued renewal of the permit during the lease term. This obligation will generally fall on the party in whose name the permit has been issued, however, it is of biggest concern to the lessor who will want the permit to continue beyond the lease term.

4. Watermaster Fees and Other Assessments:

If the water right is located in a river basin subject to the jurisdiction of a watermaster, the lease should address payment of watermaster fees, as well as other assessments. Even if the water right is not located in a watermaster area, any long term lease should address this issue because of the possibility of watermaster operations being expanded throughout the State. The lease should address which Party is responsible for the payment of all assessments on the water right and the use of the water. Based upon the rationale that the lessee is benefiting from the use of the water, the lessor should transfer the obligation to the lessee. Assessments would include any annual watermaster fees or water quality fees under the Clean Rivers Program, as well as any other type of assessment such as ad valorem taxes.

5. Annual Reports:

Any requirement to file reports regarding the use of the water right, or use of water under the water right, whether to the TCEQ or local groundwater district should be expressly made the obligation of the lessee. For the lessor's protection, however, the lease should require that the lessee provide the lessor with a copy of all filed reports. The copies should be required to be delivered to the lessor by a date sufficiently before the filing deadline so that the lessor can accomplish the filing in the event the lessee defaults.

6. Third Party Offers, Rights of First Refusal, and Condemnation:

Much can happen during the life of a lease, particularly where the term is twenty-plus years. For

[71] TEXAS WATER CODE § 11.173.

example, the lessor could receive an offer to purchase the underlying water right(s). The lease may be negotiated to allow such a sale and, if it does, should address the following related issues.

a. Whether the sale of the underlying water right during the term of the lease triggers a right in the lessor to terminate the lease early, if necessary to close the sale. If so, the circumstances of such termination should be addressed, including what notice is provided to the lessee and whether the lessee is entitled to a replacement water source or some compensation because of the termination.
b. Whether the lessee should be entitled to a right of first refusal to buy the water rights for the same deal offered to the lessor. If so, the terms of the right of first refusal and the lessee's closing obligations should be specified in the lease.

Both surface and groundwater rights[72] are an interest in real property and are subject to condemnation. Due to the limited availability of new water rights and the length of the lease term, the possibility that a water right could be the subject of condemnation proceedings should be addressed in the lease, including how the condemnation proceeds should be paid, *e.g.*, should the proceeds be paid entirely to the lessor, or allocated in part to the lessee to reimburse the loss of the water right. Condemnation might also be an event that triggers a lessee's right to terminate the lease.

7. <u>Early Termination:</u>

The lessor's right, and in some instances the lessee's right, to terminate the lease before the expiration of its term should be addressed. This includes termination for cause, *e.g.*, non-payment of rent, as well as termination under other circumstances, *e.g.*, a third Party offer to purchase or condemnation of the underlying water right.

8. <u>Advance Payment of Rent:</u>

The lessee should be required to pay rent in advance for several reasons. First, once the water is used, it cannot be recovered for non-payment. Not only will it most likely have been consumed, once it is diverted it counts against the water right and cannot be double counted or added back in during the calendar year. Additionally, because water rights are usable on an annual calendar year basis, once the calendar year has expired, the right to use it during that year has been lost. The unused portion of the water right (whether a surface water permit or a groundwater permit) cannot be banked or carried forward for use in a subsequent calendar year.

9. <u>Assignability:</u>

To protect the Parties' expectations under the lease, the lease should address the Parties' respective right, if any, to assign the lease. Provisions similar to the following should be considered with respect to the assignee:

a. The assignee must be an entity qualified/capable of performing/ complying with the lease terms;
b. The assignee must acknowledge in writing its obligation to fulfill all of the lease terms;
c. The assignee must be "reasonably approved" by the non-assigning Party; and
d. The assignor continues to be liable for the assignee's full and faithful performance of the lease terms.

10. <u>Notice to TCEQ:</u>

If the lease involves surface water considered to be a "wholesale water supply contract" within the meaning of section 13.144, TEXAS WATER CODE, the obligation to provide notice to the TCEQ should be set forth in the lease.

C. Templates for the Transaction:

Attached hereto as Appendices "A" and "B" are two templates that provide a starting point for negotiating the acquisition of an existing surface water right. Appendix "A" is referenced as an "Option," however, it can easily be retooled to be water purchase/sale contract or earnest money contract for the water right deal. The second document, Appendix "B" is a template for the conveyance of the water right. Again, it can easily be modified to be called a "deed." A fundamental feature of each template is the expectation that (i) terms negotiated by the parties will be changed in the amendment process at TCEQ, and (ii) that the amendment process will take longer than the parties expect.

IV. OTHER STATE AGENCIES & THE LEGISLATURE

The other state agencies that regularly become involved in surface water rights related matters are the Texas Parks and Wildlife Department ("TPWD"), and the Texas Water Development Board ("TWDB"). TPWD reviews surface water rights permit applications, particularly ones with a potential to impact freshwater inflows into Texas bays and estuaries. By statute, TPWD participates in the TCEQ's permitting process.

[72] In the case of condemnation of groundwater rights, the Parties will want to consider the provisions of Section 21.0421, TEXAS PROPERTY CODE.

TWDB is often referred to as the state's "water bank" because of its role in financing infrastructure related to the development of surface water rights. TWDB can finance projects as large as new surface water reservoirs, to pipelines, water treatment plans and related infrastructure, to agricultural infrastructure to facilitate irrigation.

A. Texas Commission on Environmental Quality.

The TCEQ is the primary state agency charged with regulating state surface water. Key chapters of the Texas Water Code governing TCEQ authority include Chapters 5, 7 and 11. In addition to permitting the use of state water through the issuance of water rights, and amendments thereto under Chapter 11, TCEQ is also the primary state agency responsible for protecting the quality of Texas Water. In this regard, TCEQ's authority goes beyond surface water and includes "waters of the state" which is more broadly defined to include groundwater.[73] TCEQ's regulatory authority related to groundwater is also evidenced by the provisions of Chapter 26 and 27 of the Texas Water Code. Chapter 26 focuses on water quality and the issuance of Texas pollution discharge permits or TPDES permits pursuant to which Texas has been delegated authority by the United States Environmental Protection Agency to regulate the discharge of wastewater into or near waters of the state. Chapter 27 of the Water Code involves Texas' underground injection control or "UIC" program regulating the discharge of nonnative substances and fluids into underground aquifers and formations and ensuring that native water quality and its beneficial uses are protected. The TCEQ has also adopted a wide ranging set of regulations implementing its regulatory authority over both surface water and groundwater, as well as groundwater quality which are codified as Title 30 of the Texas Administrative Code. These regulations can be found on the TCEQ website at www.tceq.state.tx.us.

B. Texas Parks & Wildlife Department/Texas Parks & Wildlife Commission.

The Texas Parks & Wildlife Commission is an agency comprised of gubernatorially appointed Commissioners that establish policy and oversee the operations of the Texas Parks & Wildlife Department. The TPWD is responsible for the day to day implementation of the policy and the rules and regulations adopted by the Commission to carry out its mission. TPWD's statutory authority is found in the Parks & Wildlife Code primarily. Additionally, the Department exercises oversight of programs implemented and regulated by agencies such as the TCEQ with respect to issues associated with the protection of the state's wildlife resources including its marine wildlife.[74] The Texas Parks & Wildlife Department rules are codified in Title 31, TAC Chapters 51-69.

C. Texas Water Well Drillers Board.

The Texas Water Well Drillers Board is somewhat of an "orphan" in the water world. The agency is under the umbrella of the Texas Department of Licensing and Regulation ("TDLR") whose jurisdiction includes not only water well drillers but such entities as elevators, boilers, auctioneers, electricians, and water modification programs. With respect to water well drillers, the agency's rules are codified in Title 16, Texas Administrative Code, Chapter 76. Substantive laws related to water well drillers and pump installers are codified in Chapters 1901 and 1902 of the Texas Occupations Code.

D. Texas Public Utility Commission.

The Texas Public Utility Commission ("PUC") until recently focused its regulatory jurisdiction on electricity and telephone communications. Historically, the PUC had been responsible for regulation of water utilities and water utility rates. After a hiatus of several decades, following the passage of House Bill 1600 in 2013, effective September 1, 2014, the PUC once again obtained jurisdiction over water and wastewater utilities and matters related to the their service areas or CCNs (Certificates of Convenience and Necessity) as well as rate making appeals, customer service and protection and quality of service. In addition to its procedural rules (16 TAC, Chapter 22) and its administrative rules (16 TAC, Chapter 27) the PUC has adopted rules related to water and wastewater services providers (16 TAC, Chapter 24) the primary source of statutory authority for its newly reacquired authority is found in Chapter 13, TEXAS WATER CODE.

E. Texas Legislature.

As an executive agency, the source of the TCEQ's powers are the statutes enacted by the Legislature. Appearing before any members of the Executive or Legislative Branches may trigger a requirement for the

[73] *See* TEXAS WATER CODE § 26.001(5) defining "water in the state" to mean "groundwater, percolating or otherwise, lakes, bays, ponds, impounding reservoirs, springs, rivers, streams, creeks, estuaries, wetlands, marshes, inlets, canals, the Gulf of Mexico, inside the territorial limits of the state, and all other bodies of surface water, natural or artificial, inland or coastal, fresh or salt, navigable or nonnavigable, and including the beds and banks of all watercourses and bodies of surface water, that are wholly or partially inside or bordering the state or inside the jurisdiction of the state." *Id*.

[74] *See* Texas Parks & Wildlife Code § 12.0011; TEXAS WATER CODE §§ 11.0236, 11.02361, 11.1491, 11.0841, 11.147-11.1491.

Practitioner to register and/or report as a "Lobbyist."[75] Texas law requires that any person that communicates directly with a member of these Branches for the purpose of influencing legislation or an administrative action register if they meet certain "triggers."[76] Those trigger levels for expenditures start as low as $200 per calendar quarter, exclusive of the person's own travel, food, or lodging, membership dues or other activities described in Section 305.006(b), TEX. GOV'T CODE.[77] Even without expending any funds, if the communication was made for compensation under contract to a third party in an amount of not less than $200 per calendar quarter, registration as a lobbyist can be triggered.[78] Sections 305.003 (b-1), 305.004, and 305.0041 provide a variety of "exceptions" to the registration requirement.

Additional detailed information regarding lobby registration and reporting requirements, including registration and reporting forms as well as the adopted rules can be found on the Texas Ethics Commission website - www.ethics.state.tx.us.

The Commission's website also provides information on Ethics Opinions issued by the Commission and publication and Guides on Lobbying. One helpful publication included on the site is entitled "Lobbying in Texas."[79]

Special purpose districts are a permanent fixture of Texas' water landscape. In particular, groundwater districts have become the primary regulators of the permitting of wells and production of groundwater. For better or worse, "local control" is the catch phrase these groundwater authorities have seized upon. According to both the Texas Legislature and the appellate courts, at least for now, groundwater districts remain the State's "preferred" means to manage groundwater resources.[80] Getting to know your local special purpose district(s) is important. Set forth below are some "pointers" regarding practicing before, and dealing with, these districts.

V. ETHICAL CONSIDERATIONS

A. Conflicts and Dual Representation:

There are several ethical considerations dealing with water related matters worthy of note. The first, and probably the one most frequently confronted by practitioners is the obligation for lawyers to avoid conflicts of interest. Specifically, Rule 1.06 of the Texas Disciplinary Rules of Professional Conduct (the "DRs") prohibits a lawyer from handling a matter for a client whose interests are (i) adverse to another client, or (ii) substantially related to another client such that the representation is, or could be materially and directly adverse to the interests of another client. Comment 1. to Rule 1.06 is clear in its message:

> Loyalty is an essential element in the lawyer's relationship to a client.

The prospect of securing an adequate consent to and waiver of the conflict aside,[81] the Rule should be a guide to lawyers to *not* become counsel for both the landowner whose water is the objective of negotiations and the interested buyer or lessee. This is true irrespective of whether the water involved is surface water or groundwater.

For the sake of expediency and/or to keep costs down, the temptation exists to have the same lawyer represent both parties in (i) negotiating the contract for the water, and/or (ii) preparing and filing the application(s) for the permit whether at the Texas Commission on Environmental Quality (TCEQ) or the local groundwater district. Either act, or any similar requests to provide dual representation, however, should be avoided.

While the parties' interests may initially appear to be "generally aligned in interest,"[82] the red tape and time delays associated with the permitting process before either regulatory entity, *e.g.*, TCEQ for surface water, and the local groundwater district for groundwater, can become tedious and try the best of relationships. This is particularly true where the landowner may be waiting on permits to receive his money, or the buyer/lessee the right to use the water. The lawyer who takes on both sides as his client is almost guaranteed to find himself in the middle of some dispute as the permitting process drags on and either (or neither) party is accomplishing their respective primary objective.

In addition to the express prohibition against a lawyer representing opposing parties in litigation,[83] in the event an attorney's clients to a multi-party representation scenario "properly accepted"[84] the dual representation can become "improper" due to an unanticipated dispute among the clients. In such an event, Rule 1.06(e) mandates that the attorney "promptly withdraw" from representation of either one or all of the clients as necessary to be compliant with the Rules of Professional Conduct.[85]

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[75] *See* TEXAS GOV'T CODE, Ch. 305

[76] *Id*. § 305.003.

[77] *Id*. § 305.003(a)(1); *see id.* § 305.005.

[78] *Id*. § 305.003(a)(2), (b).

[79] *See* http://www.ethics.etate.tx.us./guides/LOBBY_guide.htm.

[80] TEXAS WATER CODE § 36.0015; *Sipriano*, 1 S.W.3d, *supra*, at 79.

[81] *See* DR 1.06(c)(2).

[82] *See* Comment 13 to DR 1.06.

[83] *See* DR 1.06(a).

[84] *See* DR 1.06(c).

[85] *Id*.; *see* DR 1.05 & 1.09.

A corollary issue for consideration involving water rights related representation is whether Rule 1.06 prohibits representation by a lawyer, or lawyers within the same law firm, in scenarios involving "issues conflicts."[86] Specifically, can you represent clients who either own or seek to secure permits to develop water, particularly groundwater, and also undertake representation of (i) any groundwater district, or (ii) the groundwater district with jurisdiction over the groundwater interests of your client who is or may desire to seek permits.

Rule 1.06(b) proscribes representation of clients in any matter which "involves a substantially related matter [*e.g.*, permitting] in which the person's interests are materially and directly adverse to the interests of another client of the lawyer or the lawyer's firm;…"[87] Notwithstanding the potential ability to secure a waiver of potential conflict from all affected clients prior to the existence of an actual conflict pursuant to DR 1.06(c), the inherent adversarial relationship between landowners/permit applicants and the groundwater district/regulatory authority seems to make dual representation impossible under any scenario because of the conflicts of issues/objectives involved. This is especially true in the context of a permit application. This conclusion is reinforced by Comment 2. to Rule 1.06, which provides that (i) not only must the representation in the substantially related matter be based upon the "informed consent" of both parties, but (ii) the lawyer must "reasonably believe" that his representation will be protective of the clients' interests.[88] Representing both the regulated and the regulatory entity on the issue of granting a permit makes it hard to conceive that you can "reasonably believe" the interests of both clients can be fully protected. With careful planning and coordination, it may be possible for lawyers in the same law firm to represent the regulated client and regulatory client; however, the groundwater client should never be one that a firm lawyer appears before on behalf of a permit applicant.

The permitting process is fraught with conflict between the desires of the landowner to secure the right to develop and produce his groundwater rights and the groundwater district's rules, management plan and/or enabling legislation. If the permit application does not get granted as requested, it will often require the landowner/permit applicant to file suit against the district to challenge the adverse ruling in a permit proceeding.

Assuming no conflict arises during the permit proceedings, however, the challenge of dual representation is not over. The relationship between the district as "regulator" and the landowner/permittee as the "regulated entity" will continue to be an adversarial one post-permit issuance. As a result, it would seem to be an inevitable recipe for creation of a conflict in the attorney's representation of both clients and maintain the ability to adhere to the strict duty of "loyalty" to both clients in the continuing representation. While not impossible, the "red flag" is hoisted signaling the message *not* to represent both the regulator and regulated entity.

B. *Ex parte* Communications:

The other pitfall for counsel to be wary of involves "*ex parte* communications." Historically, attorneys practicing before administrative agencies thought they could rely upon Section 2001.061 of the Administrative Procedures Act,[89] as the bright line for avoiding inappropriate contacts. Section 2001.061 clearly prohibits the involvement of an agency "decision maker" in a contested case proceeding from participating in any discussion on a matter in the absence of proper notice and opportunity for participation by all affected parties.[90] Accordingly, discussions with both non-decision makers and/or decision makers, in the absence of the existence of a pending "contested case,"[91] was considered permissible until 2009.[92] The fact that Section 2001.061 does not apply to groundwater district proceedings,[93] coupled with the 2009 interpretation of Rule 3.05 by the State Bar's Professional Ethics committee, has created a lingering black cloud over attorney communications with permitting agencies.

In May 2009 the Ethics Committee issued Opinion No. 587.[94] The opinion concluded that pursuant to Rule 3.05, an attorney may not contact or communicate with the decision maker of an administrative agency (*e.g.*, TCEQ or a groundwater district) in connection with any matter in which it is "reasonably foreseeable" that the matter could become subject to an adjudicatory proceeding or "contested case hearing."[95]

As noted, in light of Section 2001.061,[96] and the historic appellate court decisions in *Vandygriff v. First*

[86] DR 1.06(b).

[87] DR 1.06(b)(1); *see id*. 1.06(f).

[88] *See* Comment 2 to DR 1.06.

[89] TEX. GOV'T CODE § 2001.061.

[90] *See* TEX. GOV'T CODE § 2001.061.

[91] *See* TEX. GOV'T CODE § 2001.003(1) (defining "contested case").

[92] *See* Opinion 587. A copy is attached hereto as Appendix "B."

[93] TEXAS WATER CODE § 36.052(a); *cf.*, *id.* § 36.253 (making § 2001.174 of the Administrative Procedures Act (TEX. GOV'T CODE Ch. 2001) applicable to groundwater district decisions).

[94] Opinion No. 587 can be viewed online at http://www.legalethicstexas.com.

[95] *See* Opinion No. 587.

[96] TEX. GOV'T CODE § 2001.061.

Sav. & Loan Ass'n.,[97] and *Lewis v. Guaranty Fed. Sav. & Loan Ass'n.*,[98] attorneys confidently communicated with agency representatives, including decision makers, about matters "pre-application." Once an application was filed, the rules became tighter and communications with agency heads more limited, but interaction with agency staff continued.

The issue presented to the Ethics Committee in Opinion No. 587 was:

> Before filing a matter with an administrative agency having decision-making authority over a matter, may a lawyer communicate with the administrative agency concerning the matter?[99]

The Opinion concludes:

> In the absence of applicable law that permits *ex parte* communications in a particular matter, Rule 3.05 … imposes strict limits on *ex parte* communications with an agency's decision maker prior to the filing of a matter with an agency that is expected to act concerning the matter in a dispute resolution, licensing, or adjudicatory capacity, if a purpose of the *ex parte* communication is to influence the agency's decision in the matter.[100]

The Opinion purports to "qualify" its applicability by stating that Rule 3.05 does *not* apply to communications with non-decision makers of the agency.[101] That qualification is limited, however, by the caveat "unless such communications are intended to be indirect *ex parte* communications with the decision maker for the purpose of influencing the outcome of the matter.[102]

As one might imagine, the purpose of communications with an agency staff member is likely going to include persuading them to support the application and, thereafter, communicate that support to the decision-maker. Given the "broad brush" of the Opinion's conclusion, any such communication would seem to be susceptible to attack as an "indirect" *ex parte* communication.[103]

Opinion No. 587 was received with much angst by the administrative lawyers in Texas. In response, the Ethics committee published Opinion No. 604 in January 2011.[104]

The new opinion addressed three questions related to Opinion No. 587 and its interpretation of DR Rule 3.05:

1) may a lawyer communicate with the agency members about a rule or regulation under consideration if it would require his client to obtain a permit if adopted;
2) may the lawyer communicate about the client's planned permit in the context of the consideration of the regulation; and
3) may the client communicate with the members if the lawyer cannot?[105]

The Opinion concludes that the lawyer is not prohibited from communicating about a regulation which represents a legislative activity of the agency.[106]

A lawyer is, however, prohibited by Rule 3.05 from communicating about the regulation after it has been adopted for purposes of attempting to influence a decision on an application the lawyer and his client "plan to file."[107] While a non-attorney client who is not subject to Rule 3.05 would not be prohibited by the DR from communicating with the agency decision-maker, Rule 3.05 and Rule 8.04(a)(1) clearly prohibit the lawyer from encouraging or "instructing" his client to undertake any such *ex parte* communications.[108]

Both Opinion Nos. 587 and 604 arguably contain some gray areas of the law with respect to "as applied" factual determinations about who is, and who is not a decision maker, and what is "reasonably foreseeable." However, there are no gray areas with respect to the ultimate conclusion reached in both Opinions that they err on the side of concluding any such communication is likely governed by Rule 3.05 and, therefore, prohibited. *See* Opinion Nos. 587 and 604. While there is no bright line rule due to the gray areas, there are "flashing lights" cautioning counsel to be wary.

The uncertainty surrounding potential inappropriate *ex parte* communications can be compounded in the context of dealing with groundwater districts. As most district board members are non-lawyers, and prefer to act informally unless compelled to adopt and follow formal guidelines, dealing with the districts on behalf of the client can be a minefield. Specifically, avoiding inadvertent, or even knowing violations of Rule 3.05 can be viewed as a

[97] 617 S.W.2d 669 (Tex. 1981).
[98] 483 S.W.2d 837 (Tex. Civ. App. – Austin 1972, writ ref'd n.r.e.).
[99] Opinion No. 587, at 1.
[100] *Id.* at 5.
[101] *Id.*
[102] *Id.*
[103] *Id.*

[104] Opinion No. 604 can be viewed online at http://www.legalethicstexas.com. A copy is attached hereto as Appendix "C."
[105] Opinion No. 604 at 1.
[106] *Id.* at 5.
[107] *Id.*
[108] *Id.*

direct affront to district decision makers jeopardizing your client's permit application. Under the circumstances, counsel must learn to balance on a tightrope.

VI. CONCLUSION:

Today, Texas has a supply of approximately 17 million acre-feet[109] of developed surface water and groundwater resources. By 2060 the projected water demand in Texas will be 22 million plus acre-feet.[110] Former Supreme Court Chief Justice Jack Pope described Texas' water law as "the story of its droughts."[111] The TWDB, the state agency charged with the development of the State Water Plan, has predicted that unless new water supply sources are developed by the year 2060, the state will have an approximate 9 million acre-feet *shortfall* in the amount of water required to meet then-current demands in a reoccurrence of the drought of record.[112]

Dealing with water issues and, more importantly, the people and entities that control and regulate the water is something most every attorney in Texas will face at some point in their career.

Due to the importance of developing adequate reliable water supplies to meet the State's projected long-term demands, the need for long-term water deals is great. Because they are long-term, however, the parties need to consider carefully the terms of the deal, including those that are subject to third party influences.

Similar to a large real estate development project, in addition to the negotiations between the primary parties, *e.g.*, the buyer and seller, or lessor and lessee, third party governmental entities are involved, *e.g.*, TCEQ. Unlike the traditional real estate development project, however, there is a dearth of experience and no real established path to aid in your negotiations or decision making. Accordingly, marketing one's water rights or developing a water project, and structuring the form of the transaction take time. Patience is a key element.

Water transactions, both in the negotiation of the deal and any associated permitting, require attorneys to carefully balance their ethical duties to faithfully, effectively and earnestly represent their client's interests, while avoiding the pitfalls of unauthorized *ex parte* contacts with regulatory decision makers and/or crossing the line of multi-party representation. A periodic re-read of Opinion Nos. 587 and 604, and the DRs, particularly Rules 1.06 and 3.05, will provide a beneficial "reality check" for approaching water issues.

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[109] *See Quick Facts*, Executive Summary, 2012 State Water Plan (TWDB 2012). An "acre-foot" of water is the equivalent of 325,851 gallons of water, or the volume of water needed to cover an area one acre in size one foot deep in water. *See EAA v. Day*, 369 S.W.3d 814, 820 (Tex. 2012).

[110] *See Quick Facts*, Executive Summary, 2012 State Water Plan (TWDB 2012).

[111] *In re Adjudication of the Water Rights of the Upper Guadalupe Segment of the Guadalupe River Basin*, 642 S.W.2d 438, 441 (Tex. 1982).

[112] *See* TEXAS WATER CODE ANN § 16.051; 2012 WATER PLAN, at 17-18.

APPENDICES

Appendix “A” – Template Form "Option"

Appendix "B" – Template Form "Conveyance"

Appendix “C” - Opinion No. 587

Appendix “D” - Opinion No. 604

APPENDIX "A" – TEMPLATE FORM OPTION

State of Texas §
§
County of _______ §

Option to Acquire a Portion of
Permit No. _______, as amended

Authorized Diversion – _______ ac-ft/year **Authorized Uses –** ______________

Ownership Interests (the "Owner" or "Seller"): _______ _______, a Texas _____

Buyer: _______, a Texas _____

Option: _______, a Texas _____ ("Buyer"), acting by and through its ___________, desires to obtain an option to purchase _______ ac-ft of the _______ ac-ft of water rights authorized by Permit No. _______ which the Owner holds all right, title and interest in together with a proportionate share of the rights, privileges and benefits associated therewith in Permit No. _______, as the same may have been amended from time-to-time (the "Permit"). A copy of Seller's Permit No. _______ is attached hereto as Exhibit "A."

Purchase Price: The purchase price of the water rights is $___00.00 per ac-ft of water rights (the "Purchase Price") conveyed to Buyer. The "Total Purchase Price" to be paid at Closing will be calculated by multiplying the total number of the ________ (_______) acre-feet of water authorized by Texas Commission on Environmental Quality ("TCEQ") to be transferred from Seller to Buyer, and authorized for diversion at the diversion point described in COA No. _______A, times the Purchase Price of $______00.00/ac-ft.

Option Price: Contemporaneous with the execution and delivery of this Option to Acquire _______ ac-ft of the water rights authorized by Permit No. _______, Owner acknowledges that Buyer has paid to Owner Option Money in the amount of $_,000.00 cash (the "Option Money"). In consideration of the payment of the Option Money and other promises and benefits accruing to the Parties, Seller grants Buyer this Option. The Option Money will be applied to the Total Purchase Price at Closing if Option is exercised.

Option Period: The initial term of this Option is for a period of __________ (__) months commencing on the Effective Date (the "Option Period"). The Option Period may be renewed for an additional _________ (__) months (the "Extended Option Period") upon payment of an additional $5,000.00 ("Additional Option Money"). The Additional Option Money, if any, together with the Option Money, will be applied to the Purchase Price at Closing.

Option During the Option Period the Parties will, at Buyer's cost, pursue amendments to

Purpose:	the Permit and the Chanas Amendment thereto at TCEQ deemed necessary by Buyer to determine both the reliability and availability of the _______ ac-ft of water rights authorized by the Permit at Buyer's Diversion Point. Owner shall cooperate, but at no cost to Owner; provided, however, that the Owner shall be solely responsible for the payment of any professional fees incurred by Owner for any professional consultants, *e.g.*, attorneys, engineers, hydrologists, etc., engaged by Owner at Owner's discretion.
Limited Agency:	In granting this Option, Owner expressly authorizes Buyer to act as Owner's agent for the limited purposes of preparing, filing and prosecuting the processing of applications at the TCEQ to obtain amendments to Owner's Permit No. _______ contemplated by this Option; provided that Buyer provides copies of all such applications filed with TCEQ to Owner.
Exercise of Option & Closing:	Buyer shall exercise the Option, if at all, by giving written notice of its intent to exercise the Option to Owner prior to the termination of the Option Period or Extended Option Period, as applicable. Upon exercise of the Option, the Parties shall agree upon a date for Closing no later than ten (10) business days following the exercise of the Option.
Notices:	Any notice contemplated by this Option can be given by sending the same in writing via postage prepaid United States Mail to the following:

Owner: _______ _______, a Texas _____
Attn: __________________
____
________, _______ County, Texas ________

Buyer: _______ _______, a Texas _____
Attn: __________________
____
________, _______ County, Texas ________

All notices shall be deemed received on the date of the official U.S. Postal Service post-mark <u>if</u> the notice is mailed certified mail, return receipt requested. Either Party can change their address for receiving notices by providing the new address in writing to the other Party. No change of address shall become effective, however, until actually received by the other party and any notice sent to an existing address prior to the actual receipt of the change of address shall remain valid and effective as if the address had not been changed.

Purchase Terms:

a. Assuming that Buyer exercises the Option to Purchase the _______ ac-ft of water rights, the Total Purchase Price to be paid at Closing is _______________ and 00/100th Dollars U.S. ($__,000.00). The Total Purchase Price shall be payable in full (less the Option Money and any Additional Option Money) at Closing.

b. Owner's Warranties:

- Owner (i) has good and marketable title to _______ ac-ft of the water rights authorized by and, specifically, to Permit No. _______, the _________ (_______) acre-feet of water rights contemplated by this Option together with the rights and privileges authorized by Permit No. _______, and (ii) will convey the same to Buyer at Closing by general warranty deed, free and clear of all liens and/or other encumbrances using the "Conveyance of Water Rights" form attached hereto as Exhibit "B;"

- Owner has not received any notice of intent to cancel, reduce, or otherwise impair the Permit No. _______, as amended, and/or the water rights or other rights and privileges authorized by Permit No. _______, including the _______ acre-feet covered by this Option;

- Owner has paid current all taxes, fees and/or other assessments due and payable attributable to Permit No. _______; and

- All warranties made in this Option shall remain in full force and effect through the date Buyer exercises the Option and thereafter shall survive the Closing of the purchase of the __________ (_______) acre-feet of water rights authorized by Permit No. __________, as amended, together with all attendant rights and privileges, contemplated by this Option.

c. At Closing Owner shall convey the water rights together with a proportionate share of Owner's rights and privileges under the Permit associated with the _______ ac-ft to Buyer by general warranty pursuant to the "Conveyance of Water Rights" form attached hereto as Exhibit "B."

Cancellation of the Option: In the event TCEQ, through the amendment process contemplated by this Option, proposes to reduce by more than _______ percent (___%) the number of acre-feet available for diversion and beneficial use by the Buyer at Buyer's Diversion Point below the fifty-three (_______) acre-feet per annum contemplated by this Option, or otherwise imposes special conditions and/or restrictions upon the (i) amended Permit more onerous than those contained in the current Permit, which conditions or restrictions result in a reduction of the net acre-feet available for diversion at Buyer's Diversion Point by more than ____ percent (___%) below the _______ acre-feet contemplated by this Option, then in such event, the Parties agree that the Buyer may cancel the Option and recover from the Seller all Option Money and any Additional Option Money paid. Buyer must cancel the option in writing.

Amendments: This Option Agreement represents all of the agreements between the Parties related to the _______ acre-feet of water rights. This Option may be amended by the Parties, but only if done by written amendment executed by both Parties.

SIGNATURES FOLLOW ON NEXT PAGE

Agreed and accepted this ________ day of _________, 201__ (the "Effective Date").

Owner:

_______ _______, a Texas _____

____

Agreed and accepted this ________ day of ___________, 201__.

Buyer:

_______, a Texas _____

____

Exhibits

A. Permit No. ________

B. Conveyance of Water Rights form

Exhibit "A"

Permit No. _______

Exhibit “B”

Conveyance of Water Rights form

APPENDIX "B" – TEMPLATE FORM CONVEYANCE

STATE OF TEXAS §
§ **KNOW ALL MEN BY THESE PRESENT:**
COUNTY OF _______ §

CONVEYANCE OF WATER RIGHTS
(Permit No. _______)

Date: _______________________, 201__

Grantor: _______ _______, a Texas _____, c/o_____________, _____________, _________, _______ County, Texas ______ (hereinafter referred to herein as "Grantor").

Grantee: _______, a Texas _____, _______ _______, a Texas _____, c/o_____________, _____________, _________, _______ County, Texas ______ (hereinafter "Grantee").

Consideration: $_00.00 per acre-foot multiplied by fifty-three (_______) acre-feet for a total purchase price of _____________________ and 00/100th Dollars ($___________.00), and other good and valuable consideration, cash in hand, paid in full to Grantor, and for which no vendor's lien nor purchase money lien is given or retained.

Property: All of Grantor's right, title and interest in and to fifty-three (_______) acre-feet out of the _______ (_______) acre-feet of water authorized by Permit No. _______, together with a proportionate share of the rights, title and privileges associated with and appurtenant to said Permit No. _______ authorizing the appropriation of water rights from the _______ River, a tributary of the ___________ River, ___________ River Basin, in _______ County, Texas, for the uses and purposes described by, and represented and authorized in said Permit No. _______, including any and all amendments thereto granted by the Texas Commission on Environmental Quality, and its predecessor agencies (the "Permit"). A copy of Grantor's Permit No. _______ is attached hereto as Exhibit "A" and incorporated herein by reference for all purposes.

Conveyance: Grantor is the owner of one hundred percent (100%) of all right and title said to said fifty-three (_______) acre-feet. Grantor does hereby grant, sell and convey to Grantee the Property consisting of fifty-three (_______) acre-feet of water rights authorized by Permit No. _______, together with a proportionate share of the rights, privileges and authority authorized by the Permit, including title to the water and water rights contemplated by the Permit, in any wise belonging to Grantor, to have and to hold it to Grantee, Grantee's successors or assigns forever.

Grantor's Representations:

A) Grantor has good and marketable title to one hundred percent (100%) of the fifty-three (_______) acre-feet of Water Rights evidenced by Permit No. _______ being conveyed herein and the associated water rights, together with the proportionate share of the rights, privileges and authority authorized by the Permit, and hereby conveys the same by general warranty to Grantee, free and clear of all liens and encumbrances.

B) Grantor has not received a notice of intent to cancel or reduce the water rights authorized by Permit No. _______.

C) Grantor has not received a notice of violation or enforcement action related to Grantor's use, operation or ownership of the Property and water rights, nor for any violation of the terms and conditions set forth in Permit No. _______

D) Grantor has paid current all applicable all local, state and federal taxes and/or other assessments, including any applicable watermaster fees, due and payable, attributable to, or in any way affecting or appertaining to Permit No. _______ and the water rights being conveyed.

General Warranty: Grantor binds Grantor and Grantor's heirs, executors, administrators and successors to warrant and forever defend all and singular the Property to Grantee and Grantee's successors and assigns against every person(s) whomever lawfully claiming or to claim the same or any part thereof.

When the context requires, singular nouns and pronouns include the plural.

Executed this the ____ day of ___________________, 201__.

GRANTOR:

_______ _______, a Texas _____

____

STATE OF TEXAS §
§
COUNTY OF _______ §

This instrument was acknowledged before me on the ______ day of ____________________, 201__ by ___________________, acting in his capacity as ___________________ of _______ _______, a Texas _____, on behalf of said ___________________ for the purposes and consideration herein stated, known personally to me to be the person whose name is subscribed to this instrument.

____
Notary Public, State of Texas

Notary Seal _____________

Printed Name:______________________

Notary ID No._____________

My Commission Expires:____________

AFTER RECORDING, RETURN TO:
____
____
____

EXHIBIT "A"

Copy of Permit No. ________

Appendix "C" - Opinion No. 587

Opinion 587

May 2009

QUESTION PRESENTED

Before filing a matter with an administrative agency having decision-making authority over the matter, may a lawyer communicate with the administrative agency concerning the matter?

STATEMENT OF FACTS

A lawyer plans to file a matter with a state administrative agency that has decision- making authority over the matter. Before filing the matter, the lawyer proposes to communicate concerning the matter with persons in the agency for the purpose of ultimately obtaining a favorable decision from the agency. In such communications concerning the matter, the lawyer does not propose to provide copies of written communications or notice of oral communications to other potential parties in the matter.

DISCUSSION

Rule 3.05 of the Texas Disciplinary Rules of Professional Conduct provides as follows:

"Maintaining Impartiality of Tribunal - A lawyer shall not:

(a) seek to influence a tribunal concerning a pending matter by means prohibited by law or applicable rules of practice or procedure;

(b) except as otherwise permitted by law and not prohibited by applicable rules of practice or procedure, communicate or cause another to communicate ex parte with a tribunal for the purpose of influencing that entity or person concerning a pending matter other than:

(1) in the course of official proceedings in the cause;

(2) in writing if he promptly delivers a copy of the writing to opposing counselor the adverse party if he is not represented by a lawyer;

(3) orally upon adequate notice to opposing counselor to the adverse party if he is not represented by a lawyer. .

(c) For purposes of this rule:

(1) 'Matter' has the meanings ascribed by it in Rule 1.1O(i) of these Rules;

(2) A matter is 'pending' before a particular tribunal either when that entity has been selected to determine the matter or when it is reasonably foreseeable that that entity will be so selected."

Rule 3.05 provides that a lawyer shall not seek to influence a tribunal concerning a pending matter by means prohibited by law or applicable rules and that, except as permitted by law and not prohibited by applicable rules, a lawyer may not communicate *ex parte* with a tribunal for the purpose of influencing the tribunal concerning a pending matter except in one of three limited ways specified in Rule 3.05(b) - in official proceedings, in writing with copies to all parties, or orally with adequate notice to all parties.

Rule 3.05(c)(I) defines the term "matter" by reference to Rule 1.10(f). Rule 1.10(f) provides that the term "matter" does not include regulation-making or rule-making proceedings or assignments but that the term includes the following:

> (1) Any adjudicatory proceeding, application, request for a ruling or other determination, contract, claim, controversy, investigation, charge accusation, arrest or other similar, particular transaction involving a specific party or parties; and
>
> (2) any other action or transaction covered by the conflict of interest rules of the appropriate government agency.

Rule 3.05(c)(2) specifies that a matter is pending before a tribunal when the tribunal has been selected to determine the matter or it is reasonably foreseeable that the tribunal will be so selected. In the circumstances here considered, the matter is clearly "pending" for purposes of Rule 3.05 because the agency with which the communication occurs is expected to make a decision on the matter. As discussed in more detail below, the agency decision maker in these circumstances is a "tribunal" as that term is defined for purposes of the Texas Disciplinary Rules of Professional Conduct. Therefore, unless there is some applicable law that permits the lawyer to do so, under Rule 3.05 the lawyer may not communicate ex parte with the agency decision maker (or cause another to do so) for the purpose of influencing the outcome of the matter except in the limited ways specified in Rule 3.05(b). For purposes of applying Rule 3.05(b), there is no generally applicable law in Texas that permits the lawyer in these circumstances to communicate with the agency's decision maker, before a matter is filed, for the purpose of influencing the outcome of the matter. The Texas Supreme Court in *Vandygriff v. First Savings and Loan Association of Borger*, 617 S.W.2d 669 (Tex. 1981) held that the prohibition of what is now the Texas Administrative Procedure Act against *ex parte* communications in a pending matter does not apply to communications before a matter has been filed with an agency. However, that decision did not hold that such communications are affirmatively permitted by applicable Texas law. Accordingly, since under Rule 3.05(c)(2) of the Texas Disciplinary Rules of Professional Conduct a matter is "pending" before an administrative agency when future adjudicatory proceedings in the agency are reasonably foreseeable, ex parte communications with the agency decision maker prior to filing for the purpose of influencing the matter (except using a means specifically permitted by Rule 3.05(b)) would constitute a violation of Rule 3.05. This result applies even though the same communication would not be a violation of the Texas Administrative Procedure Act as interpreted by the Texas Supreme Court in the *Vandygriff* decision.

The question remains as to who is included within the term "tribunal" for purposes of applying the requirements of Rule 3.05. The Terminology section of the Texas Disciplinary Rules of Professional Conduct provides that

> "'Tribunal' denotes any governmental body or official or any other person engaged in a process of resolving a particular dispute or controversy. 'Tribunal' includes such institutions as courts and administrative agencies when engaging in adjudicatory or licensing activities as defined by applicable law or rules of practice or procedure, as well as judges, magistrates, special masters, referees, arbitrators, mediators, hearing officers and comparable persons empowered to resolve or to recommend a resolution of a particular matter; but it does not include jurors, prospective jurors, legislative bodies or their committees, members or staffs, nor does it include other governmental bodies when acting in a legislative or rule-making capacity."

In the application of this definition to administrative agencies, it is important to recognize that these agencies are legal hybrids that may have judicial, legislative, executive and ministerial functions. Rule 3.05 applies only to administrative agencies when they are, or will be, functioning as "tribunals," that is in a dispute-resolution, licensing or adjudicatory capacity and not when such agencies are functioning in a legislative, executive or ministerial capacity.

Whether applied to a court or an administrative agency, the restrictions of Rule 3.05 on communications with a tribunal could be read either to apply to communications with all personnel associated with a court or administrative agency or to apply only to communications with the judge or agency decision maker or decision-making body. The Committee is of the opinion that the term "tribunal" as defined in the Terminology section of the Texas Disciplinary Rules and as used in Rule 3.05 refers only to the judge or agency decision maker or decision-making body and not to all personnel associated with a court or administrative agency. In the case of an administrative agency, the decision maker could be an administrative law judge, a hearing officer, the executive in charge of the agency, or a board or other governing body of the agency. The decision maker, however, is not the agency itself or all of its members, representatives or employees. Lawyers routinely contact court and agency personnel other than decision makers to obtain answers to administrative questions, to obtain settings, to check on the status of pending matters and for a variety of other reasons where there could normally be no effect on the court's or agency's decision in the matter.

In the case of communications with non- decision-making personnel of an agency, Rule 3.05 would apply only if such a communication was intended by the lawyer as an indirect communication, through non-decision-making personnel, with the decision maker for the purpose of influencing the outcome of the agency's decision in the matter.

This interpretation of Rule 3.05 as applicable only to communications with decision makers is consistent with the requirements of section 2001.061 of the Texas Government Code, the provision of the Texas Administrative Procedure Act specifically addressing *ex parte* communications. Section2001.061(a) of the Texas Government Code provides in part:

> ". . . a member or employee of a state agency assigned to render a decision or to make findings of fact and conclusions of law in a contested case may not directly or indirectly communicate in connection with an issue of fact or law with a state agency, person, party, or a representative of those entities, except on notice and opportunity for each party to participate."

This provision generally prohibits certain *ex parte* communications in connection with an issue of fact or law in a contested case. The prohibition however, is only upon "a member or employee of a state agency assigned to render a decision or to make findings of fact and conclusions of law," in other words, the decision maker. See *County of Galveston v. Texas Department of Health*, 724 S.W.2d 115 (Tex. App. - Austin 1987, writ ref'd n.r.e.); *Coalition Advocating A Safe Environment v. Texas Water Commission*, 798 S.W.2d 639 (Tex. App. - Austin 1990), *vacated as moot*, 819 S.W.2d 799 (Tex. 1991).

This interpretation of Rule 3.05 appropriately treats the situation in which an administrative agency that has authority to make the decision on a contested matter also is a party that takes an advocacy position in the matter through other agency personnel. The parties to the contested case, including the representatives of the agency taking an advocacy position, are not permitted to have *ex parte* communications with the agency decision maker for the purpose of influencing the outcome of the matter unless as required by Rule 3.05(b) all parties participate or are given an opportunity to participate. However, representatives of another party in the matter may communicate directly with the advocacy representatives of the agency in the matter without including in the communication all other parties in the matter, as would be required i f the communication were subject to Rule 3.05(b).

Special laws or rules may apply to specific situations and govern communications in those specific situations. Comment 4 to Rule 3.05 notes the following:

> "There are certain types of adjudicatory proceedings, however, which have permitted pending issues to be discussed *ex parte* with a tribunal. Certain classes of zoning questions, for example, are frequently handled in that way. As long as such contacts are not prohibited by law or applicable rules of practice and procedure, and so long as

> paragraph (a) of this Rule is adhered to, such *ex parte* contacts will not serve as a basis for discipline."

See also Texas Attorney General Opinion No. DM-144 (July 24, 1992) (special provisions applicable to the Texas Water Commission impose additional limitations, beyond the limitations of general administrative law, on *ex parte* communications of hearings examiners with other employees of the agency).

In the factual situation here considered, if there are no other applicable laws or rules of practice or procedure that prohibit or specifically permit *ex parte* communications with respect to the matter coming before the agency, Rule 3.05 imposes strict limits on a lawyer's *ex parte* communications with the decision maker of the agency for the purpose of influencing the decision maker concerning the matter. These limitations apply only to communications directly or indirectly with the decision maker within the agency as established by applicable law (such as an administrative law judge, a hearing officer, the executive in charge of the agency, or a board or other governing body of the agency, including any individual member of that board or body). These limitations apply before the filing of the matter if it is reasonably foreseeable that the decision on the matter will be made by the agency. However, the limitations do not apply to communications with the members, employees or representatives of the agency who are not the decision maker or a member of the decision making body with respect to the matter provided that the communications with such persons are not intended to be indirect *ex parte* communications with the decision maker for the purpose of influencing the decision in the matter.

CONCLUSION

There are multiple players in the world of water whose direct and/or indirect interests may aid or affect your work for clients on water-related projects. A general working knowledge of each of them, including periodic checks of their respective web pages will be a useful practice.

Remember to double check before making contact to confirm whether or not you need to be registered either as a lobbyist at the state or local level. If registration is required, be sure both to have your registration be current, and insure that you timely file any required "reports" regarding your activities and, in particular, any expenditures made.

In the absence of applicable law that permits *ex parte* communications in a particular situation, Rule 3.05 of the Texas Disciplinary Rules of Professional Conduct imposes strict limits on ex parte communications with an agency's decision maker prior to the filing of a matter with an agency that is expected to act concerning the matter in a dispute resolution, licensing or adjudicatory capacity, if a purpose of the ex parte communication is to influence the agency's decision in the matter. However, in these circumstances, Rule 3.05 does not limit *ex parte* communications, either before or after the filing of the matter, with members, representatives or employees of the agency who are not the applicable decision maker or a member of the applicable decision making body unless such communications are intended to be indirect *ex parte* communications with the decision maker for the purpose of influencing the outcome of the matter.

Appendix "D" - Opinion No. 604

Opinion 604

January 2011

QUESTION PRESENTED

Under the Texas Disciplinary Rules of Professional Conduct, may a lawyer communicate privately with the members of a board of a state agency about their consideration of a regulation that would require the lawyer's client to apply for and obtain a permit? If the regulation is adopted, may the lawyer communicate privately with members of the board about the client's planned permit application? May the lawyer's client communicate privately with members of the board when the lawyer is prohibited by the Texas Disciplinary Rules of Professional Conduct from doing so?

STATEMENT OF FACTS

A state agency is considering a regulation that would institute a permitting process for what was previously an unregulated activity. A lawyer represents a client that is currently engaged in the activity but may have difficulty qualifying for a permit under the proposed regulation. The agency's board will decide whether and in what form to adopt the regulation. If the regulation is adopted, the board would also be the body that would decide whether to grant applications for permits. Any application for such a permit would be acted on as part of a contested case in which the permit applicant, the agency, and possibly others would be parties. The parties would normally be represented by counsel, and ultimately the permit application would be heard and decided by the board.

DISCUSSION

Professional Ethics Committee Opinion 587 (May 2009) addressed the application of Rule 3.05 of the Texas Disciplinary Rules of Professional Conduct to administrative law matters. The present opinion further considers certain issues involved in applying Rule 3.05 to administrative proceedings. This Opinion constitutes a clarification and amplification of the conclusions set forth in Opinion 587.

1. Rule 3.05 of the Texas Disciplinary Rules of Professional Conduct provides as follows:

   "Maintaining Impartiality of Tribunal A lawyer shall not:

   (a) seek to influence a tribunal concerning a pending matter by means prohibited by law or applicable rules of practice or procedure;

   (b) except as otherwise permitted by law and not prohibited by applicable rules of practice or procedure, communicate or cause another to communicate ex parte with a tribunal for the purpose of influencing that entity or person concerning a pending matter other than:

   (1) in the course of official proceedings in the cause;

   (2) in writing if he promptly delivers a copy of the writing to opposing counsel or the adverse party if he is not represented by a lawyer;

   (3) orally upon adequate notice to opposing counsel or to the adverse party if he is not represented by a lawyer.

   (c) For purposes of this rule:

> (1) 'Matter' has the meanings ascribed by it in Rule 1.10(f) of these Rules;
>
> (2) A matter is 'pending' before a particular tribunal either when that entity has been selected to determine the matter or when it is reasonably foreseeable that that entity will be so selected."

Rule 3.05 provides that a lawyer shall not seek to influence a tribunal concerning a pending matter by means prohibited by law or applicable rules and that, except as permitted by law and not prohibited by applicable rules, a lawyer may not communicate *ex parte* with a tribunal for the purpose of influencing the tribunal concerning a pending matter except in one of three limited ways specified in Rule 3.05(b) – in official proceedings, in writing with copies to all parties, or orally with adequate notice to all parties.

Rule 3.05(c)(1) defines the term "matter" by reference to Rule 1.10(f). Rule 1.10(f) provides that the term "matter" does *not* include "regulation-making or rule-making proceedings or assignments," but that the term includes the following:

> (1) Any adjudicatory proceeding, application, request for a ruling or other determination, contract, claim, controversy, investigation, charge accusation, arrest or other similar, particular transaction involving a specific party or parties; and
>
> (2) any other action or transaction covered by the conflict of interest rules of the appropriate government agency.

See Rule 1.10(f). Rule 3.05(c)(2) specifies that a matter is pending before a tribunal when the tribunal has been selected to determine the matter or it is reasonably foreseeable that the tribunal will be so selected. As discussed in more detail in Opinion 587, the agency decision maker (here, the members of the state agency's board) is the "tribunal" as that term is defined in the Texas Disciplinary Rules of Professional Conduct. For purposes of applying Rule 3.05(b), there is no generally applicable law in Texas that permits a lawyer to communicate with an agency's decision maker for the purpose of influencing the outcome of a matter when the matter is pending before the agency. In *Vandygriff v. First Savings and Loan Association of Borger*, 617 S.W.2d 669 (Tex. 1981), the Texas Supreme Court considered a case in which non-lawyers had *ex parte* communications with an agency's decision maker before the filing of a matter. In that case, the court held that the *ex parte* communications were not prohibited by what is now the Texas Administrative Procedure Act. 617 S.W.2d at 672. That decision, however, did not hold that such *ex parte* communications are affirmatively permitted by applicable Texas law (*compare* Rule 680 of the Texas Rules of Civil Procedure, which in certain circumstances affirmatively permits *ex parte* applications for temporary restraining orders).

At the stage at which the state agency is considering the adoption of a regulation that will institute a permitting process, the activity of the agency, and of its decision-making board in particular, is a regulation or rule-making activity, and hence the state agency and its board are acting in a legislative capacity. Thus, Rule 3.05 does not apply to these activities and does not prohibit a lawyer from having *ex parte* communications on behalf of the client with the board or its individual members regarding the proposed regulation under consideration by the state agency. This opinion does not address whether such activity in a particular situation would be permissible under other legal or regulatory requirements that may apply to the lawyer, the client, the agency, or other persons involved in the matter.

After the agency has adopted the regulation and the lawyer knows the client plans to seek a permit under the regulation, Rule 3.05 generally prohibits the lawyer from having private communications with the state agency's board or the board's individual members for the purpose of influencing the board on its decision regarding the client's planned permit application. As discussed in Opinion 587, Rule 3.05 prohibits such private communications because the board is the entity that will be acting as a "tribunal," *i.e.*, acting in a judicial capacity in deciding the permit application. At this stage, after the client has decided to apply for a permit, the matter is "pending" within the meaning of Rule 3.05(c)(2). Therefore, the lawyer is not permitted to communicate privately with members of the board about the client's anticipated permit application even though the permit application has not yet been filed. Such conduct is prohibited for essentially the same reasons that a lawyer is not permitted to communicate privately with members of the Texas Supreme Court about a planned petition to the Court before the petition is actually filed with the Court. It should be noted that Rule 3.05(b) allows a lawyer to communicate *ex parte* with the agency's board in three specific situations:

1. in the course of official proceedings in the cause;
2. in writing if he promptly delivers a copy of the writing to opposing counsel or the adverse party if he is not represented by a lawyer;
3. orally upon adequate notice to opposing counsel or to the adverse party if he is not represented by a lawyer."

The Committee is of the opinion that the filing of an application for a permit is a "matter" for purposes of Rule 3.05 in all cases where the application potentially requires discretionary action by the agency board acting as a "tribunal." As set forth in the Terminology section of the Texas Disciplinary Rules of Professional Conduct, the term "tribunal" "denotes any governmental body or official or any other person engaged in a process of resolving a particular dispute or controversy." Thus, in cases where the permit sought involves discretionary action by the agency board, there will almost always exist the realistic possibility of a dispute or controversy as to whether or on what terms the permit should be granted. When there is a realistic possibility of a dispute or controversy, either with the agency staff or with one or more third parties, the permit application will constitute a "matter" and communications by lawyers both before and after the actual filing of the application will be subject to Rule 3.05. Rule 3.05 and the foregoing analysis will not however apply if the permit-granting process involves purely ministerial, as contrasted with discretionary, action by the agency. In cases of purely ministerial action, the granting of the permit sought is mandated by applicable law or regulation when certain clearly defined requirements are met. There is in these cases no realistic possibility of a "dispute or controversy" that would require a discretionary decision by the agency board. In such cases the permit application will not involve a determination by a "tribunal" as defined in the Texas Disciplinary Rules and hence Rule 3.05 concerning communications with a "tribunal" on a "matter" will not apply.

In most cases where discretionary action by an agency board may be involved, the question of at what point a "matter" first becomes "pending" under Rule 3.05(c) will be a question of fact that will have to be determined in each case. In the circumstances here considered, that determination does not turn on when the "tribunal" is selected or when it becomes reasonably foreseeable that the tribunal will be selected because the tribunal (the board of the state agency) is selected either by the issuance of the regulation or by the prior passage of other governing legislation or regulation. In these circumstances, when the matter becomes pending turns on when the client and the lawyer decide to pursue a permit application. Before that time, the matter would not be pending. For example, if the client merely asked the lawyer about the requirements for obtaining a permit, there would not at that time be a pending matter. However, once it appears reasonably clear that the client will seek to file a permit application, the matter is pending. Before the matter is pending, a lawyer would have no reason to have an *ex parte* communication with the board or one of its members to try to influence the board's decision on the matter. At that stage, a lawyer might make a general inquiry about how decisions are made and what factors are relevant but any such inquiry would be solely for the purpose of gathering information. If, however, a lawyer's private communication attempted to persuade a member of the board regarding how a decision should be made or what factors should be relevant and the lawyer had a client whose interests were aligned with the lawyer's comments, such a conversation would evidence the fact that there was a pending matter and that the lawyer was attempting, *ex parte*, to influence the board's decision, in violation of Rule 3.05.

By contrast, as noted in Opinion 587, the lawyer may contact employees of and attorneys for the agency, other than members of the board, before and after the permit application is filed for a variety of reasons relating to the permit application. Those contacts may be used to discuss the requirements of the application, its processing, means for complying with regulatory requirements, determining the agency's position with respect to the requested permit, obtaining information or evidence from the agency, and dealing with any third parties that may join in the matter. As in any contested matter, it is permissible to communicate with another party in a matter (as contrasted with the decision maker) to attempt to influence the party's position on issues in dispute. So long as such communications are not in fact indirect communications that seek to influence the decision-making board and that would hence be violations of Rule 3.05 if the communications were directly with the board, Rule 3.05 does not prohibit the communications. For example, there would be no violation of Rule 3.05 if, in an attempt to come to an agreement on an application, the lawyer discussed with staff and lawyers of the agency, either before or after the application was filed, permit restrictions that could be jointly proposed to the agency's board by the applicant and the agency's staff. On the other hand, there would be a violation of Rule 3.05 if the applicant's lawyer met with a staff member or lawyer of the agency, before or after the permit application was filed, and asked the staff member or lawyer to convey privately to a member of the agency's board that the granting of the requested permit was very important to the lawyer and the lawyer's client.

The requirements of Rule 3.05 as discussed in this opinion and in Opinion 587 would apply to lawyers representing any party that ultimately participates in the permit-application case, including lawyers representing the agency itself. Again, it is important to note that this opinion considers only the requirements of Rule 3.05 and does not consider the impact of any other law or regulation that in the particular circumstances may apply to a lawyer, the lawyer's client, an agency lawyer, or any other person involved in a matter.

The last issue to address is whether the lawyer's client may have *ex parte* communications with members of the board before filing the permit application when the lawyer is not allowed to do so. Rule 3.05 governs only the conduct of lawyers and does not apply to a non-lawyer client. Rule 3.05 thus places no restrictions on the actions of such a client. Concerns have been expressed about the fact that Rule 3.05 as so interpreted gives rise to different standards for the conduct of lawyers and for the conduct of lawyers' clients. In fact, that is exactly what the Rules normally do. The Texas Disciplinary Rules of Professional Conduct regulate the conduct of lawyers but not their clients. Lawyers are prohibited by the Rules from doing many things that are permissible in the case of non-lawyers.

Of course, lawyers may not use the fact that the Texas Disciplinary Rules do not apply to non-lawyers as a basis for claiming that lawyers are permitted to cause their clients to accomplish indirectly what lawyers are prohibited from doing directly. Rule 3.05's prohibition against *ex parte* communications with a decision maker for the purpose of trying to influence the decision maker regarding a matter also prohibits the lawyer from causing another to communicate privately with a decision maker in order to influence that decision maker. Rule 3.05(b) and Rule 8.04(a)(1).

CONCLUSION

Rule 3.05 of the Texas Disciplinary Rules of Professional Conduct does not apply to *ex parte* communications between a lawyer and members of a state agency's board (the agency's decision maker) when the board is considering whether to act in a legislative capacity to adopt a regulation. After a regulation has been adopted, Rule 3.05 prohibits, with limited specified exceptions, a lawyer from communicating privately with members of the board of the state agency for the purpose of influencing the board's decision on a permit application that the lawyer and the client are planning to file. Rule 3.05 and Rule 8.04(a)(1) also prohibit the lawyer from causing another, including the client, to communicate privately with members of the board of the state agency for the purpose of influencing the board in its decision regarding a planned permit application. The Texas Disciplinary Rules of Professional Conduct apply only to Texas lawyers and, therefore, do not govern the conduct of non-lawyer clients acting independently of their lawyers. This opinion clarifies and amplifies the conclusions of Professional Ethics Committee Opinion 587 (May 2009).