ADVANCED REAL ESTATE LAW:
WATER RIGHTS IN TEXAS

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

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

Mr. Ruttenberg has also handled the preparation of private offerings in connection with the formation of investment capital, the redevelopment and preservation of historic theaters, and general business matters.

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Education
L.L.M., Taxation, New York University School of Law, 1982
J.D., St. Mary's University School of Law, 1979
B.B.A., Finance, The University of Texas at Austin, 1976
Mr. Ruttenberg is listed among the *Best Lawyers in America* for real estate law. *Scene in San Antonio Monthly* named him among the Most Influential San Antonians of 2005, stating that he has been "widely regarded as the 'best of the best' in real estate and water law."

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

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

**Speeches**
- Drafting Issues: Limited Partnership Agreements for Landowners and Developers; Texas University School of Law - Mortgage Lending Institute (September 2006)
- Limited Liability Company Drafting Company Agreements Under the Code; State Bar of Texas; Texas Business Organizations' Choice of Entities and Formations (2006)
- Changing Face of Water Rights - Groundwater Conveyancing (Sale and Lease); State Bar of Texas (2005)
- Transferring Groundwater Rights; San Antonio Bar Association - Natural Resources Section (2004)
# TABLE OF CONTENTS

I. INTRODUCTION ............................................................................................................. 1

II. WHAT IS ACQUIRED ..................................................................................................... 2  
   A. Nature of Groundwater Rights ............................................................................. 2  
      B. Description of Groundwater Rights Conveyed ............................................. 4  
      C. Use of Appurtenant Surface Estate ................................................................. 4  
      D. Limitations on Use of Appurtenant Surface Estate ........................................ 4  

III. DUE DILIGENCE ............................................................................................................. 7  
   A. Title Matters ........................................................................................................... 7  
   B. Physical Inspections ............................................................................................... 8  
   C. Regulatory Due Diligence ...................................................................................... 8  
   D. Feasibility Period Issues ...................................................................................... 12  

IV. OPERATING COVENANTS .......................................................................................... 12  
   A. Restrictions on Use by Landowner and by Groundwater Developer .................. 12  

V. CONSIDERATION ......................................................................................................... 15  

VI OBLIGATIONS ON TERMINATION ........................................................................... 18  

VII. CONTRACTING WITH GOVERNMENTAL ENTITIES ............................................ 18  
   A. Apparent Authority .............................................................................................. 19  
   B. Talking to the Right Person ................................................................................. 19  
   C. Contracts With Obligations Extending Beyond One Year .................................. 19  
   D. Indemnity Provisions By Governmental Entities ................................................. 21  

VIII. RESERVATIONS OF GROUNDWATER RIGHTS ...................................................... 21  
   A. Reservation of Water Rights ................................................................................ 21  
   B. Reservation of Royalty ........................................................................................ 21  

IX. VALUE OF WATER RIGHTS ....................................................................................... 22  
   A. Location .............................................................................................................. 22  
   B. Quality ............................................................................................................... 22  
   C. Quantity ............................................................................................................. 22  
   D. Reliability .......................................................................................................... 23  
   E. Supply and Demand ............................................................................................ 23
WATER RIGHTS – HOT TOPICS

I. INTRODUCTION.

Businesses, municipalities and other water users situated in all parts of the country have begun to realize the importance of obtaining secure water sources for their needs. As a result, we have begun to see a dramatic increase in the number of transactions involving the transfer of all forms of water rights including both surface water and groundwater rights.

The purpose of this presentation is to focus on certain issues that may arise in connection with the negotiation of transactions of this nature from the buyer's perspective, in particular when the buyer is a governmental entity.

Many of the issues involved in purchasing or leasing groundwater are the same as those faced in the purchase of other real property interests. For this reason, the conveyance will generally take on a form that is similar to a real estate transaction. On occasion you may encounter a transaction of this nature that is cast in the form of a mineral lease. While this is not this author's preferred structure for transactions of this nature, it is my sense that the issues, regardless of the structure, will remain the same.

In addition to the typical issues that may arise from a buyer's perspective, when the groundwater transaction involves the acquisition of water rights by a governmental entity, issues that may arise in a typical real estate transaction may take on special significance or may require special consideration.

The following is intended to be a sampling of the issues that may arise from the perspective of a party seeking to acquire an interest in groundwater.

For the purpose of our discussions this outline will address these issues as part of the following categories:

Topics

1. Description of what is to be acquired
2. Due diligence for rights to be acquired
3. Operating covenants
4. Consideration
5. Obligations on termination
6. Government appropriations issues
7. Value of Water Rights

WARNING!!!

As a part of this outline I have inserted certain provisions from groundwater transfer agreements. As is the case with any commercial transaction, in particular water transfer agreements, the actual form of agreement used by the client should be tailored, as specifically as possible, to address the needs and desires of the parties involved. The language included with this outline is not recommended as a form or for any particular purpose, and is provided only for the purpose of allowing us to organize the discussion presented in this outline. As you review this outline, please keep in mind that these sample provisions are provided only for this purpose and should not be used without considering the specific nature of the transaction involved.

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1 As we review the form and substance of these agreements it is important to note that the issues which may be important to one form of governmental entity, may differ greatly from those which are of significance to another.
II. WHAT IS ACQUIRED

A. Nature of Groundwater Rights

As we undertake groundwater transfers the question that often arises is – what is it that we are transferring?

Under the Texas Supreme Court's decision in Houston & T.C.Ry. Co. vs. East, 98 Tex. 146, 81 S.W. 279, decided in 1904, it was determined that in the State of Texas groundwater is subject to the absolute ownership rule or Rule of Capture. Over the past 100 years this principle of Texas law has been tested and reconfirmed on a repeated basis, most recently in the Texas Supreme Court case Sipriano v. Great Springs, et. al.

Unfortunately, the line of cases addressing the Rule of Capture in Texas have dealt almost exclusively with a groundwater user’s liability to nearby landowners for a use of groundwater which adversely impacts the nearby landowners' use of groundwater. It has seldom been necessary for the court to address the nature and character of these property rights to determine the outcome in these claims. Accordingly, there is little guidance as to the character and nature of the rights we are seeking to transfer.

Due to the recent increase in activity in connection with the transfer of groundwater rights we have begun to focus on the more fundamental issues of: What is it we are trying to transfer? Is this groundwater right, real property interest, or an interest in personal property? Is the groundwater right vested in the landowner? If so, when does the right vest … upon acquisition of the land to which it relates or upon the actual capture of the groundwater itself? If it is not a vested right, who owns the groundwater beneath the surface of the ground until such time as it is vested?

In recent years some authors have argued that the groundwater right was not vested until the groundwater is actually withdrawn from the earth. The core principle being (i) if, due to the Rule of Capture, your neighbor can take the groundwater before it gets to your property and you cannot complain, and (ii) if you do not exercise your withdrawal right and it passes to your neighbor beyond your property, then (iii) what right do you really have? The basis of this argument seems to be:

1. The power to exclude someone from taking away a property interest is fundamental in determining it is a vested right in the owner. If the rule of capture prohibits a party from exercising this exclusive right and enforcing their exclusive rights, the right must not be vested. City of San Marcos vs. Texas Comm’n on Env. Quality, 128 S.W. 3rd 264, 271 (Tex Civ App. – Austin 2004), pet. denied.

2. These rights are analogues to the laws of ferae naturae which requires the landowner to control wild animals on their property before it becomes the property of the landowner.

3. The Supreme Court of Texas has twice been presented this direct question and has yet to rule on this issue, leaving it an open issue for discussion and debate.

Those who argue the right is fully vested point to the following:

1. A long line of cases have recited that groundwater belongs to the owner of the surface estate of the land and the owner of the land has the exclusive property rights to the groundwater to be used at their will, subject only to an obligation not to waste those resources. The rights to this groundwater

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2 Houston & Texas Central Railway Co. vs. East, 81 SW 279 (Tex. 1904); Tex Co. vs. Burkett, 296 SW 273 (1927); Corzelius vs. Harrell, 183 SW 2d 961 (1945); City of Corpus Christi vs. City of Pleasanton, 276 SW 2d 798 (1955); Sun Oil Co. vs. Whitaker, 483 SW 2d 808 (Tex. 1972); Friendswood Development Company vs. Smith-Southwest Industries, Inc. 576 SW 2d 21 (Tex 1978); Barshop vs. Medina County Underground Water Conservation District, 925 SW 2d 618 (Tex. 1996) and Sipirano vs. Great Springs Water of America, Inc. 1 SW 3d 75 (Tex. 1999).
include all rights incident thereto that one might have as to any other species of property. This groundwater is a part of the surface estate of the land, not the mineral estate.

2. The Texas Water Code expressly recognize the rights of the owner of the land in the underground.3

3. Over one hundred years ago the Texas Supreme Court stated, in connection with its landmark determination which established the rule of capture in our State: “an owner of the soil may divert percolating water, consume or cut it off, with impunity. It is the same as the land, and cannot be distinguished in law from the land. So the owner of the land is the absolute owner of the soil and of percolating water which is a part of, and not different from, the soil. This concept has been reiterated in several cases over the past 100 years.

4. By analogy, the Texas oil and gas law has confirmed that the rule of capture as to those property rights creates a property interest4; and

5. The fact that groundwater may not be available does not diminish the right to capture groundwater, but only speaks to the quality of the right; that is, the right to capture is absolute and exclusive… how much groundwater you can obtain may speak to the quality of that right.

6. The Property Code allows for the condemnation of water rights percolating below the surface, refers to the taking as a “fee interest in” such groundwater and requires compensation be paid when these property rights are taken, without a predicate of capture or prior use.5

7. The reliance upon analogy to ferae naturae is wholly inappropriate, for numerous reasons, including the lack of similarity of initial premise, and policy to be served by the application of the laws.

8. The Supreme Court of Texas has twice been presented this direct question and has found it unnecessary to rule on this issue.

Based upon these arguments, those of us who are left to deal with the practical reality are left with no real answers.

We would submit that the authors of this "vesting theory" might be confusing the physical act of capturing the molecules of groundwater with the groundwater right itself. While the quality of a groundwater right might be measurable by different factors from time to time (such as what the neighboring lands may be doing to affect pumping volume), it does nothing to diminish the right the landowner has to capture that groundwater which is an absolute right to capture as much as the landowner desires, subject, in this State, to only the Rule of Capture (and of course, all our new regulatory schemes). Any act to diminish that right should be reviewed for the purpose of determining if there has been a "taking".67

Where the production of groundwater is regulated by permit, this issue may be more academic than real, since the determination of the water rights will be "adjudicated" or established and embodied in the permit.

While the Texas courts have continued to confirm the existence of the Rule of Capture as the method for addressing a property owner's rights to groundwater, the regulatory scheme established by the Texas Legislature to govern groundwater, as recently enhanced, may have rendered the application of this case law obsolete in those areas of the state which are under the governance of a groundwater conservation district.

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3 Texas Water Code, Chapter 36.002 (Vernon Supp. 2002); Edwards Aquifer Authority Act 1.07.
4 Brown vs. Humble Oil Ref., 83 SW 2d 935 (1935)
6 City of Del Rio vs. Clayton Sam Colt Hamilton Trust, 4th Ct of Appeals, State of Texas 2008)
7 Barshop vs Medina County Underground Water Conservation District, 925 S.W.2d 618 (Tex. 1996)
B. Description of Groundwater Rights Conveyed  This can be complex when less than all of the groundwater rights are being conveyed. In these cases the agreement will need to be carefully drafted to address the priority between the two estates. Also, groundwater exists within certain geological formation situated under the real property. In the event the parties want to designate that groundwater will only be withdrawn from a specific geological formation, the conveyance will need to be accomplished by an appropriate geological description of the aquifer. It is important to remember that any groundwater rights not specifically described in the conveyance will remain with the owner of the surface estate, so the grant will need to include any authorizations, permits or other rights necessary for the withdrawal and beneficial use of the portion of the groundwater to be transferred.

The issues of exclusivity can impact several aspects of the agreement. Where exclusivity does not exist the parties will need to address the priority of rights between the interest holders as to the physical withdrawal rights. In addition, where there is a regulatory limitation on production, the parties will need to address the priority of rights between the interest holders as to the right to withdraw the groundwater under the applicable regulatory scheme.

A distinction may also be made between transactions that involve the purchase and sale of groundwater and transactions which are supply and delivery agreements, and which do not involve the transfer of any water rights but rather the promise of the provider to deliver water to the buyer for the buyer's use. Water Supply Agreements may need to be negotiated in an entirely different manner to protect the interest of the buyer since the buyer is not technically acquiring a property right. *SEE Attached maps of Major and Minor Aquifers*

C. Use of Appurtenant Surface Estate  A grant of groundwater may not automatically include a sufficient right of access for the withdrawal and collection of the groundwater. Various theories may exist which provide arguments for some forms of implied access. However, the access provided by these arguments may be insufficient to obtain the full enjoyment of the groundwater rights. The best practice is for a purchaser to acquire specific rights of access to the groundwater from the surface of the real property to which it relates. These rights will generally include:

1. The right to use the surface estate for the exploration and development of the groundwater estate on an exclusive or non-exclusive basis;
2. The right to place wells, pipelines, utilities and other related infrastructure upon the appurtenant surface estate (through a fee interest, lease or easement); and
3. The right for ingress and egress across the appurtenant surface estate for the purpose of constructing, operating and repairing the water collection system.

The acquiring party and the seller will also need to address what activities will need to be carried out upon the real property. This will certainly include the acts of withdrawal, collection and delivery to a point off-site. However the acquiring party may also need to conduct other operations upon the real property to make the groundwater useful for its purpose, including the storage and treatment of the groundwater as it is withdrawn.

D. Limitations on Use of Appurtenant Surface Estate  The seller and buyer may each have a need to impose certain limitations upon the use of the real property to better protect their interests. These restrictions may include operating restrictions. This will be discussed in greater detail below.

The following is an annotated version of a portion of a Groundwater Agreement which addresses what is conveyed.
Form Provisions

ARTICLE [?]
Conveyance of Well Sites and Groundwater

From and after the Effective Date of this Agreement, SELLER hereby grants to BUYER following rights and interests in the Real Property and Groundwater, in addition to any other rights granted hereunder:

A. Designation of Areas. On or before the end of the Project Assessment Period, BUYER will determine and designate the FOLLOWING areas on the Real Property which will be used by BUYER for the construction, operation, use and maintenance of the Facilities:

1. Well Sites.
2. __________ foot wide strips of land which are to run between and connect each of the Well Sites and connect the Point of Delivery to one or more such Well Sites.
3. The Point of Delivery.
4. The location of all roads to be used by the BUYER in connection with the operation of its Facilities or access to its Groundwater.
5. Up to ______ acres of additional land which may be located by BUYER along one of the _____ foot wide strips running to or from the Well Sites or the Point of Delivery.
6. Up to a ____ acre tract of land for water storage tank and related facilities.
7. Up to a ____ acre tract of land for water treatment facilities.

Note: In connection with the purchase of the groundwater the SELLER will also need to provide the BUYER with the right to construct and operate a collection and delivery system on the Real Property. (Note - this requirement may not be necessary in areas where the governing district allows the withdrawal point for the groundwater to be transferred to another location.) During the feasibility period the BUYER will conduct tests to determine the optimum location of these facilities. Often the location of these facilities can be some of the more difficult issues to deal with as the landowner reflects upon the level of intrusion these improvements may have upon their land.

Note: There are several different methods for addressing landowner concerns regarding the location of the improvements. These may include designation of certain areas of the Real Property that are off limits to the improvements, spacing requirements from certain then-existing improvements, construction standards, and building restrictions. In addition, procedures can be established to allow the landowner some input as to the exact location of these improvements; however, changes in the location of these improvements may have an effect upon the yield as well as the cost to obtain the ultimate yield from the collection and delivery system. A suitable method for accommodating the needs of each party will need to be established without adversely affecting the feasibility of the project.

Note: The owner of the groundwater rights will need certain rights to access and use the real property for the collection, storage treatment and delivery of the groundwater. The lease described below is intended to provide the rights to use portions of the real property for this purpose. If the groundwater has been purchased on a permanent basis this arrangement may need to be embodied in a more permanent relationship such as a permanent easement.

B. Easements. Beginning with the Effective Date of this Agreement, SELLER hereby grants to BUYER the following: (i) an easement upon the areas described in Article ?A2 through ?A7 for the purpose of constructing, maintaining, repairing, replacing and operating the Facilities upon those areas of the Real Property, (ii) an easement on or upon the Real Property for the purpose of providing reasonable ingress and egress access to the Leased Areas, Well Sites and the Facilities, and (iii) a Restrictive Covenant for Sanitary Control Easement for Public Water Well surrounding each Well or such greater area as may be required to allow the Well to be operated in compliance with the rules and regulations of the TCEQ or any successor agency, from time to time, which
easement will prohibit, among other things, the construction and/or operation of underground petrochemical storage tanks, stock pens, feed lots, dump grounds, privies, cesspools, septic tank drainfields, drilling of improperly constructed water wells of any depth, sanitary sewers, sewer appurtenances, septic tanks, storm sewers, and all other construction or operations that could create an unsanitary condition within, upon or across such portions of the Real Property as well as any activity upon that area of the easement that might impair the quality of the Groundwater (collectively, the "Easements"). The term of these Easements shall begin with the Effective Date of this Agreement and end at the end of the Term of this Agreement.

Note: In addition to the lease rights described above, this provision is intended to (i) augment the lease rights with easement rights for certain access to the collection and delivery system and (ii) provide certain easement protections that may be necessary by law to qualify the well site as a public drinking water supply.

C. Well Sites. As of the Effective Date, SELLER does hereby sell, transfer and convey to BUYER a fee simple determinable interest in and to all of the Well Sites, (being those portions of the Real Property located within a radius of 150 feet around each Well to be constructed upon the Real Property as designated by BUYER), together with all appurtenances pertaining to such Well Sites (the "Well Site(s)"), subject to only the Permitted Encumbrances. The term of the fee simple determinable interest in the Well Sites shall begin with the Effective Date of this Agreement and end on the earlier of (i) that date this Agreement is terminated due to BUYER election to terminate this Agreement in accordance with its rights under the terms of this Agreement or by SELLER due to a default by BUYER or pursuant to SELLER's rights under Article ?? H of this Agreement or (ii) that date which is the later of (A) twenty (20) years from the Actual Production Date, (B) twenty (20) years from the end of the Project Assessment Period, (C) the date BUYER discontinues producing Groundwater from the Real Property in accordance with the terms of this Agreement, or (D) the date BUYER discontinues making the Monthly Water Payments toward the purchase of Groundwater in accordance with this Agreement. Within ten (10) days following the date BUYER designates the Well Sites, SELLER agrees to execute and deliver to BUYER a deed in the form attached hereto as Exhibit "E" conveying the Well Sites to BUYER free and clear of all liens and encumbrances, excepting and excluding the Permitted Encumbrances.

The well sites often can or will be a part of the areas leased and/or upon which an easement has been granted. In this case the well sites have been transferred by the SELLER to BUYER in fee simple but with a divestiture clause which causes them to revert to the SELLER at the end of the Fee Simple Determinable period.

D. Additional Leased Areas. In the event BUYER reasonably determines, from time to time, that additional portions of the Real Property are necessary or useful to BUYER for the purpose of withdrawing, collecting, treating or transporting the Groundwater or delivering the Groundwater to the Point of Delivery, BUYER may designate these areas as additional Leased Areas (the "Additional Leased Areas") which shall thereafter be included as a part of the Leased Areas under the terms of this Agreement. The Additional Leased Areas shall only be added as Leased Areas to the extent BUYER's need for the use of such Additional Leased Areas are reasonably necessary or useful in connection with its rights to withdraw, collect, treat or transport Groundwater from the Real Property. BUYER agrees to consult with SELLER regarding the inclusion of such Additional Leased Areas so as to reduce the interference of BUYER's operations on the Real Property, to the extent reasonably practical; provided, however, it is understood that BUYER will not be prevented from exercising its rights to use and occupy the surface of the Real Property in order to accomplish the purposes of this Agreement.

Note: While the BUYER may make an initial determination as to where the collection and delivery system should be placed, over the term of the agreement it is certainly conceivable that some portion of the system will need to be relocated as a part of maintaining the optimum operation of the system. The SELLER and BUYER may need to develop certain terms and conditions which limit the nature of this expansion or relocation of the system.

F. Groundwater. As of the Effective Date of this Agreement SELLER does hereby sell, transfer and convey to BUYER a fee simple determinable interest in and to all of the Groundwater within the ____________ Aquifer which relates to the Real Property, together with (i) all real and personal property rights (along with those relating to the surface and subsurface of the Real Property within the ____________ Aquifer), appurtenances, Permits, authorities, licenses, consents and contracts, if any, pertaining to all such Groundwater (the "Groundwater"), and (ii) the right to develop, explore, produce, withdraw and/or beneficially use such Groundwater at any locations BUYER may determine appropriate from time to time, but expressly excluding from such Groundwater any portion thereof which is a part of the Reserved Groundwater Rights. The term of the fee simple determinable interest in the Groundwater shall begin with the Effective Date of this Agreement and end on the earlier of (i) that date this Agreement is terminated due to BUYER election to terminate this Agreement in accordance with its rights under the terms of this Agreement or by SELLER due to a default by BUYER or pursuant to SELLER's rights under Article ?? H of this Agreement or (ii) that date which is the later of (A) twenty (20) years...
from the Actual Production Date, (B) twenty (20) years from the end of the Project Assessment Period, (C) the date BUYER discontinues producing Groundwater from the Real Property in accordance with the terms of this Agreement, or (D) the date BUYER discontinues making the Monthly Water Payments toward the purchase of Groundwater in accordance with this Agreement. Contemporaneously with the Effective Date of this Agreement, SELLER agrees to execute and deliver to BUYER a deed in the form attached hereto as Exhibit "F" conveying the Groundwater to BUYER free and clear of all liens and encumbrances, excepting and excluding the Permitted Encumbrances.

Note: The groundwater often can or will be a part of what is leased or as a part of a groundwater agreement. In this case the well sites have been transferred by the SELLER to BUYER in fee simple but with a divestiture clause which causes them to revert to the SELLER at the end of the Fee Simple Determinable period.

G. Interim Real Property Rights. The above notwithstanding, from and after the Effective Date of this Agreement, and continuing until the areas described in Article ?A, above, have been designated by BUYER and BUYER has been granted its fee interests, lease rights and easement rights to the areas and property (as the case may be) in accordance with the terms of the Agreement (the "Final Designation Date"), BUYER rights under this Agreement as to the areas to be designated in Article ?A shall be deemed to be a lease, easement and conveyance of fee simple determinable interest in the entirety of the Real Property for the purpose of providing the property rights granted in Articles ? B, C and D, above. From and after the date BUYER is granted its fee simple determinable interests, lease rights and easement rights to the areas described in Article ? A (as the case may be) in accordance with the terms of the Agreement, BUYER rights will thereafter be reduced to (i) the lease, easement rights and fee simple determinable ownership of those specific areas of the Real Property as designated by BUYER under Article ?A for the purpose of identifying the areas described in Article ? B, C and D, above, and (ii) such other additional rights as BUYER may have in the Real Property under the terms of this Agreement.

Note: This provision is intended to provide a vested interest in the property for the areas to be designated until such time as they can be designated. This operates as a blanket encumbrance for the uses to be designated until such time as they are properly designated under the terms of the Agreement. This will keep any other right from intervening while the sites for wells and lines are designated.

III. DUE DILIGENCE

As a part of the acquisition process the acquiring party will need to know several important matters relating to the real property and the water rights to be acquired. The first is to assure it will obtain clear title or the unencumbered right to what it is acquiring; the second is to confirm that the groundwater rights will provide the groundwater yield anticipated from a physical standpoint; and the third is to confirm that the groundwater rights will provide the groundwater yield anticipated from a regulatory standpoint.

A. Title Matters. As a part of the title review the acquiring party will need to determine that no prior severance has occurred and the Seller has title to the water rights and ancillary real estate to be acquired. The acquiring party will also need to determine that no prior restrictions or land use limitations, liens or encumbrances exist that may affect the use of the groundwater. Determine that no prior outstanding mineral interests exist which may have a claim on the use of the surface estate and the water rights. Mineral estate owners may own implied surface easements and rights to use groundwater in exploration.

To assist in connection with this portion of the due diligence several title insurance companies (Stewart Title Company and Chicago Title Insurance Company) have begun to provide title insurance products for this purpose. As you review the application of title insurance to your transaction also remember to keep in mind that within areas where the withdrawal of groundwater is now regulated, the value of the groundwater right will include both the common law groundwater right as well as the permits which regulate the withdrawal. Since many of the permitting agencies have their own record keeping system for the title to the permits, you will need to clear title on both the common law groundwater rights as well as the permit. To my knowledge the current title insurance products only address the common law rights and expressly disclaim application to the permits. While there have been some discussions among title companies about the possibility of extending the nature of the coverage, it is my understanding that no such coverage exists at the moment.
In real estate transactions the general rule in Texas has been that the Seller provides this title insurance to the Buyer of the real estate interest at Seller's cost. The insurance is provided as a part of the Seller's duty to provide and warrant title to the acquiring party. While a general custom and practice has not yet fully developed in connection with the transfer of interest in water rights, the rationale should be the same. For this reason a similar custom and practice should evolve over time.

B. **Physical Inspections.** Proper review will need to be done by the acquiring party to determine not only the amount of the available groundwater yield from the real property but also what areas of the property will provide the best points to withdraw the groundwater for the purpose of obtaining the best yield of groundwater for the acquiring party. This will typically involve the development on the real property of several test wells. In addition, the acquiring party will need to study the best manner in which to construct its collection system on the real property as well as other facilities that may be necessary in connection with the withdrawal, collection, storage treatment and delivery of the groundwater as other geological studies. The acquiring party will need to have a right to conduct tests throughout the real property to determine the best locations for these activities. This is often where the parties first begin to address the need for behavioral controls upon the property. As the party acquiring the groundwater rights voices the quality and nature of the access to the real property and use of the real property, the acquiring party will need to determine the quality of the groundwater rights it is seeking to acquire, and the landowner will address any concerns it may have with the required level of access and use.

C. **Regulatory Due Diligence.** The acquiring party will also need to address the possible application of regulatory restrictions to the right to withdraw groundwater from the real property.

Under authority granted by the Texas Constitution, the State retains the authority to regulate the conservation of our groundwater resources. While there are some exceptions, the preferred method for doing so is a groundwater district formed under the authority of Section 36 of the Water Code. As a part of this regulatory scheme there are over 90 groundwater districts now in existence in the State of Texas and the number of groundwater districts in Texas has more than doubled in the last ten years. More than thirty new districts were ratified or created by the 77th Legislature (2001). Much of the impetus for the recent creation of these groundwater districts has been a concern about future or planned use of groundwater within defined geographic areas. It is not coincidental that these groundwater districts were authorized in the same legislative session where SB-2's provisions amending Chapter 36 of the Water Code were adopted. Senate Bill 2's sweeping revisions of Chapter 36 marked a new era in groundwater district power and authority. The following is a short history leading up to SB-2's provisions.

Senate Bill 1 contained the first major rewrite of general groundwater conservation district law, clarifying a district's right to require permits and develop and implement management plans. In addition to a general reorganization, SB-1 authorized districts to require a permit for transfer of groundwater outside the district. Senate Bill 1 added Section 36.122 to the Texas Water Code authorizing regulation of transfers of groundwater out of a "district." Subsection (a) provided:

(a) A district may promulgate rules requiring a person to obtain a permit from the district for the transfer of groundwater out of the district to:

1. Increase, on or after March 2, 1997, the amount of groundwater to be transferred under a continuing arrangement in effect before that date; or

2. Transfer groundwater out of the district on or after March 2, 1997 under a new arrangement.

Subsection (d) then established the criteria the district must use in determining whether to issue a permit. The district was to consider (i) the availability of water in the district and in the proposed receiving area during the period for which the water supply is requested; (ii) the availability of feasible and practicable alternatives to the applicant; (iii) the amount and purposes of use in the proposed receiving area for which water is needed; the projected effect of the proposed transfer on
aquifer conditions, depletion, subsidence, or effects on existing permit holders or other groundwater users within the district; and the approved regional water plan and certified district management plan. Subsection (e) authorized the district to limit a transfer permit if conditions described above warranted the limitation. Other provisions say: A district may not prohibit the export of groundwater if the purchase was in effect on or before June 1, 1997. This section applies only to a transfer of water that is initiated or increased after the effective date of this section.

It should be noted that transfers from the property where the water was produced were not deemed in need of regulation, only those where the use is "outside" the district. It is also important to consider how infrequently a district's boundaries and an aquifer's boundaries coincide.

The empowerment of groundwater districts accomplished in SB-1, together with the emphasis on long-range planning mandated by the 1997 legislation, led to a flurry of proposed groundwater districts being presented to the 76th Legislature. At least 22 separate groundwater districts, proposed in most cases with boundaries based on political geography, not groundwater boundaries, were authorized by legislation passed by the House and sent to the Senate. Senate Natural Resources Committee Chairman Buster Brown held the bills authorizing these districts in committee, expressing concern over the scattered creation of groundwater districts, the goals of district sponsors, and the potential disruptions of the SB-1 planning process.

At the end of the session, the Senate agreed to a compromise whereby the majority of the districts proposed were temporarily created subject to reconfirmation by the 77th Legislature. Most of these districts were proposed to protect "local" groundwater from the perceived threat of "transfers" of water to areas "outside" district boundaries, again, even though usage often crossed the district's political boundaries. The conflict between landowners' rights and a district's right to regulate appeared centered on "transfers."

These circumstances led to an intense examination of groundwater issues by the House and Senate Natural Resources Committee in anticipation of the 77th Legislative Session and set the stage for SB-2. Interim charges studied prior to the session included specific examination of the Rule of Capture and the role of groundwater districts.

Senate Bill 2 amends Tex. Water Code Section 36.113 by adding a new subsection which provides that the district may impose more restrictive permit conditions on new permit applications and increased use by historic users if the limitations:

1. apply to all subsequent new permit applications and increased use by historic users, regardless of type or location of use;

2. bear a reasonable relationship to the existing district management plan; and

3. are reasonably necessary to protect existing use.

This provision directly addresses the delicate interplay between protecting existing use by regulation and allowing the exercise of the ownership right by landowners proposing new or increased use. Groundwater districts may under this provision impose more restrictive conditions if they are willing to impose those conditions on all new users and existing users proposing to increase their historic use. By necessity, decisions concerning the fairness of such limitations will now need to be made considering the needs of all users and landowners within the district.

Senate Bill 2 amendments to Section 36.116 of the Tex. Water Code describe the district's power to regulate production of groundwater by delineating the methods that might be included in the district's rules. Section 36.116 now reads, with amendments from the 2003 session underlined, is as follows:
(a) In order to minimize as far as practicable the drawdown of the water table or the reduction of artesian pressure, to control subsidence, to prevent interference between wells, to prevent degradation of water quality, or to prevent waste, a district by rule may regulate:

(1) the spacing of water wells by requiring all wells to be spaced certain distance from property lines or adjoining wells; requiring wells with a certain production capacity, pump size, or other characteristic related to the construction or operation of and production from a well to be spaced a certain distance from property lines or adjoining wells; or imposing spacing requirements adopted by the board; and

(2) the production of groundwater by setting production limits on wells; limiting the amount of water produced based on acreage or tract size; limiting the amount of water that may be produced from a defined number of acres assigned to an authorized well site; limiting the maximum amount of water that may be produced on the basis of acre-feet-per-acre or gallons-per-minute per well site; or any combination of the methods listed above in Paragraphs (A) and (D).

(b) In promulgating any rules limiting groundwater production, the district may preserve historic use prior to the effective date of these rules to the maximum extent practicable consistent with the district's comprehensive management plan under Section 36.1071.

(c) In regulating the production of groundwater based on tract size or acreage, a district may consider the service needs or service area of a retail water utility. For the purposes of this subsection, "retail water utility" shall have the meaning provided at Section 13.002.

(d) For better management of the groundwater resources located in a district or if a district determines that conditions in or use of an aquifer differ substantially from one geographic area of the district to another, the district may adopt different rules for: each aquifer, subdivision of an aquifer, or geologic strata located in whole or in part within the boundaries of the district; or each geographic area overlying an aquifer or subdivision of an aquifer located in whole or in part within the boundaries of the district.

(e) In regulating the production of groundwater under Subsection (a)(2), a district shall select a method that is appropriate based on the hydrogeological conditions of the aquifer or aquifers in the district; and may limit the amount of water produced based on contiguous surface acreage.

The questions raised by what appears to be a simple outline of a groundwater district's powers are more numerous than the answers provided. Clearly groundwater districts are authorized to adopt spacing rules and to regulate the production of groundwater through a permit by limiting the amount of water produced based on acreage or tract size or some version or variation based on acre feet per acre or gallons per minute per well site. Section 316.116(a)(2)(A) authorizes setting production limits on wells. Nowhere does the legislature provide a frame of reference for this authority, other than the already referenced spacing and production limits based upon surface acreage.

Subsection (b) authorizing a district to "preserve historic use" likewise provides no guidance or criteria for determining to what extent and how the district may accomplish this preservation.

Subsection (c) authorizes the district to consider the service needs or service area of a retail water utility in regulating the production of groundwater based on tract size. How is this to be applied by the district?

Perhaps the most fundamental changes contained in SB-2 addressing groundwater are amendments to Section 36.122 of the Tex. Water Code, which addressed the authority of groundwater districts to regulate transfers of groundwater out of the district. In summary, these amendments prohibit a district from imposing more restrictive permit conditions on transporters than the district imposes on in-district users, and prevent a district from denying a permit based on the fact that the applicant seeks to transfer groundwater outside of the district, with the recognized exception in
Section 36.113(e) that may authorize the imposition of more restrictive permit conditions if the district imposes those more restrictive permit conditions on all new users in the future, and all existing users proposing to increase their historic use. These provisions, for the first time, establish the framework within which a groundwater district's role in proposed water transfers may be objectively analyzed.

While limiting the district's ability to deny or prevent transfers, Senate Bill 2, for the first time, clearly authorizes the district to impose a surcharge fee for the export of groundwater outside district boundaries. The fee can be calculated using one of the following statutory methods:

1. A fee negotiated between the district and the transporter;

2. A rate not to exceed the equivalent of the district's tax rate per hundred dollars of valuation for each thousand gallons of water transferred out of the district or 2.5 cents per thousand gallons of water, if the district assessing a tax rate of less than 2.5 cents per hundred dollars of valuation; or

3. For a fee-based district, a fifty-percent export surcharge, in addition to the district's production fee, for water transferred out of the district.

Under these provisions, districts are therefore authorized to obtain a disproportionate share of their fee revenue from producers of groundwater that transfer the groundwater outside the district. However, their willingness to impose such penalties is constrained by the fact that surcharges are directly related either to the district's tax rate or the district's user fee, requiring the district to either raise its tax rate or user fee to its in-district users to impose a higher surcharge.

New subsection (l) of Section 36.122 prohibits the district from using revenues obtained as surcharges to prohibit the transfer of groundwater outside the district. Most problematic for purchasers of groundwater are the provisions of Section 36.122 of the Texas Water Code which address the minimum period for which permits for the transfer of groundwater out of district are to be issued. Section 36.122 (i) provides that the permit provide a period for which the water may be transferred which will be (1) at least 3 years if construction of a conveyance system has not been initiated prior to the issuance of the permit, (2) at least 30 years if construction of a conveyance system has been initiated prior to the issuance of the permit. This disparity in term construction period appears to be remedied by 36.122 (j) which goes further and states that a three year term under (i)(1) will be extended to the 30 year term if the construction of a conveyance system is begun before the expiration of the three year term. However, 36.122 (k) states that the terms of (i) and (j) notwithstanding, a district may periodically review the amount of groundwater that may be transferred under the permit and may limit the amount after taking into consideration (x) the availability of water in the district and in the proposed receiving area during the period for which the water supply is requested, (y) the projected effect of the proposed transfer on aquifer conditions, depletion, subsidence or effects on existing permit holders or other groundwater users within the district and (z) the approved regional water plan and certified district management plan provided the application of these considerations do not impose more restrictive permit conditions on transporters out of the district than the district imposes on existing in-district users.

Groundwater districts in Texas now have substantial power to regulate groundwater usage within their geographical boundaries in very substantial ways. This process starts with amendments to Section 36.002, making it clear that Chapter 36 districts have new and substantial powers to regulate the rights of landowners to use groundwater. Section 36.002 now reads:

The ownership and rights of the owners of the land and their lessees and assigns in groundwater are hereby recognized, and nothing in this Code shall be construed as depriving or divesting the owners or their lessees and assigns of the ownership or rights, except as those rights may be limited or altered by rules promulgated by a district. (Emphasis added).
The recognition by the legislature that groundwater districts may, through the exercise of the new powers granted them, limit or alter the rights of landowners is significant.

Section 36.1071 of the Water Code is the beginning of the foundation for the compromise reflected in Senate Bill 2's amendments to Chapter 36 granting districts greater powers. In return for this power, the district must undertake certain obligations, including the development of a comprehensive management plan which addresses the district's management goals as specified by these new provisions of Section 36.1071.

Section 36.1072 provides a mechanism in Subsection (g) for resolution of disputes between groundwater conservation district management plans and regional or state water plans. Section 36.108 addresses joint planning in management areas, and requires some degree of coordination in uniformity.

D. Feasibility Period Issues. As a part of the due diligence requirements an acquiring party will need a feasibility period to carry out these investigations which allow for the right to do the following:

1. Investigate groundwater hydrology and geology issues;
2. Investigate water quality;
3. Determine the infrastructure needs and costs (wells, pipelines, etc.);
4. Determine the limitations on withdrawal and transfer of groundwater set by the groundwater district or other regulatory body, if any; and
5. Determine the environmental condition of the real property through an environmental site assessment.

IV. OPERATING COVENANTS

A. Restrictions on Use by Landowner and by Groundwater Developer. As the parties to a water agreement begin to reflect on the nature of their agreement they will quickly focus on the fact that, once the contractual relationship is created the real property will be divided into two estates (i) one consisting of the rights of the original landowner and (ii) a second held by the owner of the water rights. The two estates may in certain circumstances have needs which could be in conflict. To reduce the likelihood of conflict it is our sense that the parties should attempt to address as many of these issues as possible in advance. Often by doing so the level of potential conflict can be reduced, if not eliminated entirely. The nature and type of conflict that might arise between these two estates will depend upon the expectations and needs of each group, on a case-by-case basis. By way of example the landowner may be interested in preserving the use of its surface estate for real estate development, farming, mineral development or ranching. Conversely the owner of the groundwater rights may have an interest in the unfettered right to develop its groundwater rights. The areas of conflict may be as simple as what locations on the real property may be developed for each respective use to areas of access, maintenance requirements, or construction standards. It has been our experience that finding a balance, in advance, between these two goals will greatly increase the success of the relationship.

When negotiating these covenants, typically the Landowner wants:

1. Construction standards;
2. Restricted use of surface by groundwater owner;
3. Limits on location of facilities - low intrusion factor;
4. High maintenance responsibility;
5. Preservation of development rights for other use; and
6. A duty of mitigation.

In contrast to the needs and desires of the Landowner, the owner of the groundwater rights will typically want the following:

1. Flexibility as to placement of facilities;
2. Reasonable access;
3. Restricted surface use that will not interfere with withdrawal of groundwater;
4. Limitations on surface penetrations (oil and gas); and
5. Limits on environmentally harmful use--sanitary control easements.

The following is an example of a provision designed to address some of the issues that might be encountered in a transaction of this nature.

**Operations And Maintenance Of The Facilities**

**A. Right to Operate**

1. **Operation of Facilities.** From and after the Effective Date, BUYER shall have the full and exclusive right to operate the water development facilities (the "Facilities") at its sole cost and expense. BUYER shall be authorized to operate the Facilities and to withdraw all of the Groundwater from the Real Property as it may determine useful or necessary to BUYER, in its sole and absolute discretion, except for the Reserved Groundwater Rights. The above notwithstanding, BUYER shall always have the right to limit the amount of Groundwater withdrawn from the Wells and purchased hereunder for any reason, including but not limited to, its System demand, aquifer conditions, and meteorological conditions, however, the reduction in the amount of Groundwater BUYER elects to withdraw, from time to time will not reduce the amount of the Minimum Water Payment otherwise due hereunder.

2. **Exclusive Rights to Withdraw Water.** Provided this Agreement has not been rightfully terminated by either of the Parties hereto, SELLER hereby agrees that, except for the Reserved Groundwater Rights, it will not sell or withdraw or cause to be sold or withdrawn, for use, sale, transfer or lease to a person other than BUYER, any of the Groundwater or other surface water appurtenant to or relating to the Real Property. SELLER hereby agrees that any water produced as part of the Reserved Groundwater Rights is to be used only by SELLER in connection with their use of the Real Property or other parties who may be rightfully entitled to use the portions of the Real Property which are not exclusively granted to BUYER, however it shall not otherwise use, sell, or otherwise convey such water to any third party other than BUYER.

3. **Project Control System.** BUYER shall have the right to install within the areas described in this Agreement as the Leased Areas a project control system for the Wells and/or Withdrawal and Delivery System to be used in connection with the Facilities. SELLER shall cooperate fully with BUYER in relation to or in connection, with such installation.

**B. Maintenance of Facilities.** Following the Effective Date, BUYER agrees that it shall (i) maintain and operate any Facilities it may construct upon the Real Property in a manner which is consistent with its own internal custom and practice, reasonable wear, tear and casualty loss or condemnation loss excepted, (ii) maintain and operate any Facilities in accordance with all applicable laws and regulations which are of a material nature, and (iii) except as expressly set out herein, bear all the costs associated with the operation and maintenance of the Facilities. BUYER shall be entitled to carry out any alterations or modifications to the Facilities it may determine to be necessary or desirable in its sole discretion. The above notwithstanding, in connection with any repair, replacement, modification or alteration of all or any part of the Facilities, in the event SELLER has rights to any claims, insurance proceeds, third party indemnity or warranty relating to such repair, replacement, modification or alteration, SELLER shall
deliver all of such proceeds to BUYER for the purpose of defraying BUYER' costs and responsibilities in connection therewith.

C. Seller's Operating Agreements as to Real Property and Permits. Except as set out in this Agreement, SELLER will bear all costs associated with the Reserved Groundwater Rights and operation of the Real Property and shall be responsible for paying all fees and obtaining and maintaining as current all Permits and licenses required by federal, state or local laws, regulations or rules relating thereto. BUYER shall bear all costs associated with the Permits relating to the construction, development or operations of the Facilities, the Well Sites and the Groundwater (including any withdrawal permits from the Gonzales County Underground Water Conservation District which relate to the Groundwater).

D. Regulatory Requirements. This Agreement is subject to all applicable federal, state, and local laws and any applicable ordinances, rules, orders, and regulations of any of the Authorities having jurisdiction. However, nothing contained in this Agreement shall be construed as a waiver of any right to question or contest any law, ordinance, order, rule, or regulation in any forum having jurisdiction, and SELLER and BUYER each agree to make a good faith effort to support proposed laws and regulations which would be consistent with the performance of this Agreement in accordance with its terms.

In connection with the operation of the Facilities, BUYER agrees to conform to all regulatory requirements relating to the Facilities to report pumping volumes, Groundwater quality information and such other data and information as may now or in the future be required by any governmental or regulatory body having jurisdiction for continuation and establishment of pumping rights under any laws or regulations now existing or that in the future may exist. To the extent filings are in the future required to establish Groundwater production volumes for the purposes of issuing Permits, or for Groundwater conservation purposes, BUYER shall provide SELLER with records and data as may be reasonably necessary to establish or preserve SELLER's production rights. In any such permitting process, SELLER shall make a good faith effort to maximize the pumping volume to which the Wells are entitled, based upon the capacity and production history of the Wells and all other data available to BUYER and SELLER.

E. BUYER Sporting Limitations. BUYER shall not hunt, fish or engage in any other recreational activities on the Leased Areas or Well Sites. BUYER shall not bring onto the Real Property any guns or firearms.

F. Gates and Fences. BUYER agrees to use reasonable business efforts to keep all gates located on the Real Property and outside the Leased Areas and Well Sites closed and locked at all times during the term of this Agreement, except during periods of ingress and egress and as may be necessary in connection with construction of the Facilities by BUYER. During construction of the Facilities, BUYER shall cooperate with SELLER so that SELLER can cause cattle and livestock to be relocated to areas under fence. From and after the date SELLER shall provide BUYER with a key or combination to each locked gate or allow BUYER to place a separate combination or keyed lock on each locked gate on the Real Property to allow BUYER access to the Real Property and Leased Areas and Well Sites as contemplated by this Agreement.

G. Oil And Gas Well Plugging. SELLER hereby authorizes and agrees that BUYER shall in its sole and absolute discretion and at its sole cost and expense have the right to plug or cap and/or re-drill and re-plug any abandoned or inoperable oil and gas well located on the Real Property. SELLER does hereby confirm that the rights granted to BUYER hereunder will at all times exist as a right granted to BUYER and shall in no event be construed as an obligation of BUYER to do so, even as to wells it may have previously elected to plug or cap. SELLER does hereby grant to BUYER during the term of this Agreement (from and after the date that BUYER delivers to SELLER the Signing Bonus set forth in the Paragraph VI B below) full right to access all portions of the Real Property for purposes of testing, plugging, capping and/or re-drilling and re-plugging such wells including but not limited to (i) testing the status or integrity of any abandoned or inoperable oil and gas well casings, and (ii) carrying out any tests upon the Real Property it determines to be reasonably necessary, within or around any such wells, to determine if and how any such well may be contributing to any environmental contamination to the Groundwater due to degradation or contamination of any well.

H. Non-Interference with Groundwater Withdrawal. Seller will not conduct or allow others to conduct any operations upon the Real Property which will interfere with Buyer's operations of the Facilities or lessen the amount of the Leased Groundwater. In addition, Seller shall not take or allow others to take any actions (or omit to take any actions) which will harm or diminish Buyer's use of or
In this regard, Seller will not cause, or allow others to cause, any contamination to the Leased Groundwater from the quality or state in which it naturally exists in the ground. In addition, in no event will Seller, or its authorized agents or independent contractors (including suppliers) generate on, use on, treat or store on, transport to or from or arrange for transportation to or from, the Real Property, any Hazardous Materials or other items that may contaminate the Leased Groundwater, except as they are used or stored in compliance with applicable environmental laws. For purposes of this Lease, the term "Hazardous Materials" shall mean all of the following:

Any substance, material, or waste that is included within the definitions of "hazardous substances," "hazardous materials," "hazardous waste," "toxic substances," "toxic materials," "toxic waste," or words of similar import in any environmental law; Those substances listed as hazardous substances by the United States Department of Transportation (or any successor agency) (49 C.F.R. part 172.101 and amendments thereto) or by the Environmental Protection Agency (or any successor agency) (40 C.F.R. part 302 and amendments thereto); and Any substance, material, or waste that is petroleum, petroleum-related, or a petroleum by-product, asbestos or asbestos-containing material, polychlorinated biphenyls, flammable, explosive, radioactive, freon gas, radon, or a pesticide, herbicide, or any other agricultural chemical.

I. In the event BUYER' production of Leased Groundwater from the Real Property has the effect of lowering the water table relating to a well from which Reserved Groundwater is being withdrawn by SELLER as of the Effective Date of this Agreement (collectively, the "Existing Water Well(s)") to a level which causes SELLER to be unable to continue to withdraw that quantity of Reserved Groundwater which SELLER has historically produced from such well, BUYER agree to take steps to mitigate its impact on such Existing Water Well during the Term of this Agreement by causing additional Groundwater to be made available at the well site in the amount sufficient to make up such deficit (that is, the difference between what Reserved Groundwater can be produced from the Existing Water Well and what Reserved Groundwater has been historically used by SELLER) by, at PARTICIPANT’S election and expense, either (i) providing additional Groundwater to such Existing Water Well or supplementing Groundwater to SELLER at that well site, (ii) reworking, lowering of pumps or re-drilling the Existing Water Well, or (iii) such other means as BUYER may determine to be reasonable and appropriate. In connection with any such efforts to mitigate this reduction in available Reserved Groundwater from the Existing Water Wells, SELLER agrees to cooperate with BUYER to the fullest extent necessary to allow BUYER to address its mitigation efforts. BUYER shall not be responsible for any impact on the lowering of the water table caused by any other persons. The location and historical usage of each of the Existing Water Wells is set out on Exhibit "C" attached hereto.

To the extent BUYER provide any additional Groundwater to SELLER as a part of a mitigation effort as set out above, BUYER shall be entitled to withdraw Groundwater that is other than the Leased Groundwater for this purpose, and SELLER and BUYER shall not be required to pay SELLER for any such Groundwater or Leased Groundwater.

V. CONSIDERATION.

Each groundwater agreement will set out provisions for the payment of consideration for the water rights that are to be purchased. In some cases the consideration may be paid in one lump sum or as a fixed price to be paid over time in a set number of installments. In other cases the right to use the groundwater may be paid for as it is withdrawn. Regardless of the payment periods, several issues will arise in connection with the negotiation and drafting of each consideration provision. Some of the items to be considered in connection with the negotiation and drafting of the consideration provisions of the agreement include the following:

1. What is being purchased?
2. What is the payment for each item to be purchased?
3. How do you measure what is to be paid?
4. When is payment due?
5. If due over time how will they be adjusted during that time period?
6. What are adjustments to payments, if any?

The following are a few examples of provisions which address the payment of consideration.

Example 1

1. **Purchase Price.** The total purchase price ("Purchase Price") for the sale and purchase of the Groundwater Rights is $__________, cash. This payment is based upon the sum of $_____ per acre foot of Groundwater.

Example 2

2. **Lease Payments.** Buyer shall pay to Seller, in advance and at the address set out in Paragraph ____ below or at such place or places as Seller may from time to time direct, without offset, a monthly rental of $__________ ("Lease Payment") on the 1st day of each month during the Term of this Lease; provided, however, that the Lease Payment for the 1st month of the Term shall be paid upon the Effective Date of this Lease. The Lease Payment for any partial month shall be proportionately reduced.

**Lease Payment Adjustment.** The Lease Payment is based upon $_____ per acre-foot per month of Leased Groundwater. If the Leased Groundwater or Leased Groundwater Rights leased to Buyer are decreased during the Term of this Lease, then in addition to any other remedies Buyer may have at law or in equity, including termination, all subsequent Lease Payments during the Term shall be decreased on a proportionate basis.

Example 3

3. **Price and Terms**

A. **Signing Bonus.** Provided this Agreement has not been earlier terminated, BUYER shall pay to SELLER on or before the end of the Title Feasibility Period the sum of $100.00 multiplied by the number of Surface Acres as a signing bonus to further bind the Parties to this Agreement.

**Note:** As a carry over from the oil and gas transactions its seems that several sellers will request a signing bonus.

B. **Monthly Water Payment.** For each calendar month during the Term of this Agreement from and after the Actual Production Date a monthly payment shall be due from BUYER to SELLER in an amount equal to the then Applicable Water Rate multiplied by each acre-foot of Groundwater which is actually produced from the Wells by BUYER and delivered to the Delivery System during that month (the "Monthly Water Payment"). Following the Actual Production Date, for each month a Monthly Water Payment is due to SELLER under the terms of this Agreement, BUYER will deliver to SELLER within thirty (30) days following the end of that month, a reading of the Meters for each of the Wells indicating the amount of the Groundwater upon which the Monthly Water Payment is to be paid. SELLER will invoice BUYER for such payment. The Monthly Water Payment for each such calendar month's water usage shall be payable within thirty (30) days following BUYER' receipt of each such invoice. In the event this Agreement is terminated and a Monthly Water Payment for Groundwater withdrawn prior to the date of termination remains outstanding, BUYER's obligation to make such payment in accordance with this Agreement shall be a Surviving Obligation. For the purpose of this Agreement **Applicable Water Rate** will mean $______ for the first Year following the Effective Date, which rate will be adjusted on each anniversary date following the Effective Date thereafter during the Term of this Agreement to be that amount which is equal to $______, increased (but not decreased) by the average percentage increase between the (i) increase in the Producer Price Index – Finished Goods (1982=100) reported by the U.S. Department of Labor (or any successor or substitute index) from the Effective Date to the date which is one hundred twenty (120) days prior to the date of the applicable annual adjustment, and (ii) increase in the Consumer Price Index All Urban Consumers, All Items (1986=100) reported by the U.S. Department of Labor (or any successor or substitute index) from the Effective Date to the date which is one hundred twenty (120) days prior to the date of the applicable annual adjustment (such average of these two indexes hereinafter referred to as the "Growth Factor"). For example, if one hundred twenty (120) days prior to the second anniversary date of this Agreement the PPI has increased from 3.0% to 4.0% and the CPI has increased from 3.0%...
to 4.5%, the average percentage increase in the CPI and PPI would be 1.25% (calculated as follows 
\[\frac{4.0\%-3.0\%=1.0\%}{2} = \frac{4.5\%-3.0\%=1.5\%}{2} = 1.25\%\]) and Applicable Water Rate for the second Year 
following the Effective Date would be $63.28125 (calculated as follows $____________________). 

**Note:** This provision in intended to apply to circumstances where there is a monthly water payment 
for water actually used. It is indexed to address inflation. Questions often arise as to how to index 
water payments. This is based upon a CPI. Others have used the PPI and others still a blend of these 
two indices. An index for water values in difficult to provide for.

**C. Minimum Water Payments.** The above notwithstanding, for each calendar month during the 
Term of this Agreement for each Year of this Agreement following the first (1st) Year of the Project 
Assessment Period, to the extent the amount of Groundwater withdrawn for each such Year is not 
sufficient to provide Monthly Water Payments, in aggregate, in the amount for such Year as set out on 
Exhibit "G" (the "Minimum Water Payment"), BUYER shall pay to SELLER, within forty-five (45) days 
following the end of that Year, a sum equal to the amount by which the Minimum Water Payment 
relating to that Year exceeds the aggregate Monthly Water Payments otherwise made for that Year, if 
any (the "Excess Water Payment"), which payment shall be an additional Monthly Water Payment. 
The above notwithstanding, for any Year following that date which is eight (8) Years from the Effective 
Date, if the Actual Production Date has not yet occurred, the Minimum Water Payment for such Year 
as set out on Exhibit "G" shall be increased by 5%. The Parties recognize that no Minimum Water 
Payment is due for the 1st Year of the Project Assessment Period, as consideration for this period was 
fully addressed as part of BUYER' payment of the Initial Consideration and Signing Bonus described 
in Sections VI A and B, above.

**Note:** This provision sets a minimum water payment to compensate the Seller regardless of how little 
water is actually used. This is a negotiated percentage.

**D. Credit.** If, from and after the Effective Date, BUYER makes any Excess Water Payments, 
BUYER shall receive a credit (the "Monthly Production Credit") equal to the Excess Water Payments 
which shall be applied against any future Monthly Water Payments. The Monthly Production Credits 
shall accumulate on a month to month basis and, until the date used, shall be increased at the Growth 
Factor used in connection with the increase in the Applicable Water Rate. The Monthly Production 
Credits (as increased by the Growth Factor) shall be used and applied as a credit against future 
Monthly Water Payments, on a first-in, first-out basis, provided however, up to and through that date 
which is twenty (20) Years from the Effective Date of this Agreement, the Monthly Production Credits 
shall not reduce a Monthly Water Payment below the Minimum Water Payment as set out in Section D 
above. Following that date which is twenty (20) Years from the Effective Date of this Agreement, the 
Monthly Production Credits may be used as a credit for any purpose, including reduction of the 
Monthly Water Payment and the Minimum Water Payments. The use of a Monthly Production Credit 
under the terms of this Agreement shall be deemed payment, upon the Monthly Water Payment or 
Minimum Water Payment, as the case may be for the purpose of determining the Term of this 
Agreement. In addition, in the event any sums become due by BUYER to SELLER as payments toward 
the purchase of Transferred Rights or otherwise under the terms of this Agreement, any Monthly 
Production Credits then outstanding shall be credited against and reduce those sums otherwise due by 
BUYER to SELLER.

**Note:** Water is seldom used on a level basis. It is pumped on an irregular basis based upon usage, 
rainfall and other conditions. Where minimum payments are set on a level basis, provisions are often 
included in the agreement to allow the buyer to adjust its level water payment for its seasonal usage.

The price to be paid may also be subject to adjustment for certain failures of ability to withdraw 
groundwater. These failures may occur due to the acts of the Seller, the acts of the Buyer or may be 
systemic. The parties will need to discuss who is to take the risk related to these failures. In addition how 
this risk will be addressed in the pricing of the water. By way of example, if the Buyer pays to Seller a 
one time payment of $500 per acre foot of groundwater for 1000 acres of groundwater ($500,000.00) and 
for a systemic reason the Buyer is only able to withdraw 500 acre feet, who should be responsible for this 
risk of loss?
VI. OBLIGATIONS ON TERMINATION.

At the time of the termination of the water withdrawal arrangement the parties will need to address several issues in connection with the termination of the relationship including the following:

1. Ownership of facilities after termination
2. Removal of the facilitates after termination;
3. Condition of groundwater and facilities after termination;
4. Return of permits after termination; and
5. Plugging of wells upon termination.

Proposed forms of termination provision

A. All other provisions of this Agreement notwithstanding, upon termination of this Agreement for reasons other than a default of SELLER, BUYER will deliver to SELLER an instrument of release in recordable form evidencing the complete release of the real Property from the effects of this Agreement within sixty (60) days following any such termination. Within sixty (60) days after the delivery of such instrument of release, SELLER will give Notice to BUYER of its intention to retain the use of any one or more of the existing Wells or other portions of the Delivery System located upon the Real Property (the "Well Notification Notice").

B. All other provisions of this Agreement notwithstanding, upon termination of this Agreement for reasons other than a default of SELLER, the BUYER will within eighteen months after the date of termination, remove or cause to be removed all surface installations and equipment located above ground which is located on a Strip, Well Site or Flex Space. Removal of improvements other than Well casing (addressed below), which are located below the surface of the Real Property shall be removed to a level which is 24 inches below the surface of the Real Property and, where appropriate backfilled. The above notwithstanding, in the event the SELLER desire to retain part or all of the Wells or Delivery System situated within the Strip, Well Site or Flex Space, no such removal shall be required.

C. Except as otherwise set out below, within one (1) year of BUYER's receipt of the Well Notification Notice BUYER will plug the Well(s) in accordance with all applicable state and federal laws and governmental rules and regulations; provided, however, that BUYER will be released of such obligation with respect to those Wells which SELLER elected to retain in the Well Notification Notice. In addition, in plugging any Well BUYER will cut off the well casing at least thirty-six inches (36") below he surface of the ground. BUYER shall continue to have full access to the Real Property for such one (1) year period for the purpose of plugging such Wells.

D. In the event BUYER abandons the use of a portion of the Leased Areas by expressly giving Notice to SELLER of its desire to so abandon such portion of the Leased Areas, this Agreement shall be deemed to terminate as to that portion of the Leased Areas upon the stated effective date of such abandonment. In such event the BUYER shall address its responsibilities regarding removal as to that portion of the Leased Areas only, in the same manner as if this Agreement had terminated in its entirety.

VII. CONTRACTING WITH GOVERNMENTAL ENTITIES.

Drafting agreements with governmental entities requires us to give special consideration to certain provisions of our real property agreements that may otherwise be considered somewhat routine.
It is important to keep in mind that there are a number of different forms of governmental entities and quasi governmental entities, most of which will not only be subject to the general principals that may apply to entering into contracts with the government, but also certain special rules that are designed to apply to that special governmental or quasi governmental entity. This portion of the outline is not intended to address all of the various idiosyncrasies that may rise in connection with all of the different governmental bodies that one may encounter. However in the space allotted we will attempt to frame for you certain selected issues that seem to arise on a reoccurring basis with most of these contracts and provide some practical drafting tips for addressing these concerns.

A. **Apparent Authority.** Whenever you are dealing with a governmental entity one of the most important first steps is to make certain what authority the governmental entity may have to deal with you on transactions of this nature. From a drafting standpoint this becomes important for several important reasons, including, determining what procedures the governmental entity needs to go through to enter into or execute on the contract.

The real estate sale, purchase and/or lease of a fee interest, easement, or other interest involving governmental entities always requires formal approval either by the governing body or other official of the respective governmental entity. Therefore, reliance on the governmental entity's sales, purchasing and/or leasing agent's authority must be based on actual authority; not apparent authority. The party involved in a real estate transaction with a governmental entity should exercise due diligence and ascertain with complete certainty that the transaction has complied with all applicable legal requirement and been approved by all required governing bodies and/or officials. A city or county may contract only upon express authorization of its council or commissioners court by a vote of the body reflected in the minutes. Statements or acts of the mayor or other officers or governing body members are ineffectual. Persons contracting with governmental units are charged by law with notice of the limits of their authority and are bound at their peril to ascertain if the contemplated contract is properly authorized. *Hill Farm, Inc. v. Hill County, 425 S.W.2d 414 (Tex.1968); City of Bryan v. Page, 51 Tex. 532 (1879); Corpus Christi v. Bayfront Associates, 814 S.W.2d 98 (Tex.App.-Corpus Christi 1991, writ denied); Stirman v. City of Tyler, 443 S.W.2d 354 (Tex.Civ.App.-Tyler 1969, writ ref'd n.r.e.); First Nat'l Bank of Marlin v. Dupuy, 133 S.W.2d 238 (Tex.Civ.App.-Waco 1939, writ dism'd judgm't cor.); Canales v. Laughlin, 147 Tex.169, 214 S.W.2d 451 (1948); Alamo Carriage v. City of San Antonio, 768 S.W.2d 937 (Tex.App.-San Antonio 1989, no writ).*

B. **Talking to the Right Person** Often in dealing with governmental contract you will find yourself negotiating with staff members of the organization for the purpose of attempting to reach agreement as to the terms and conditions of the contract. Those who have had some experience in this area recognize that it is not uncommon for the staff to make clear either in the document itself that the terms negotiated are subject to the approval of the final authority such as the City Council or the County Commissioners or School Board. While the party you are dealing with does not have final authority to bind the terms of the contract, it is often important to know that the parties you are dealing with are at least the ones who will make the final recommendation to the final decision makers.

C. **Contracts With Obligations Extending Beyond One Year.** The provisions of Article XI, Sections 5 of the Texas Constitution provides that "no debt shall ever be created by a city, unless at that same time provision be made to assess and collect annually a sufficient sum to pay the interest thereon and creating a sinking fund of at least two percent thereon.

Article XI, Section 7 of the Texas Constitution further provides that … no debt for any purpose shall ever be incurred in a manner by any city or county unless provision is made, at the time of creating the same, for levying and collecting a sufficient tax to pay the interest thereon and provide at least two percent (2%) as a sinking fund.

These provisions of the Texas Constitution were adopted to limit a city's and county's ability to pledge future revenues for the current year's obligations.
It has been determined that a "debt" for the purpose of the above sections, means any pecuniary obligation imposed by contract. However a contract does not create a debt if the parties lawfully and reasonably contemplate that the obligation will be satisfied out of current revenues or out of some fund then within the immediate control of the governing body.

Several cases have found contracts which violate these provisions of the Texas Constitution to be void.

When analyzing the impact of these sections consider the following drafting tips:

1. Determine if you are contracting with a city or county directly. In many cases you may be contracting with an agency or subsidiary entity and are therefore only attempting to bind the full faith and credit of that agency. If this is the case it may be that the only proceeds of the city or county that are being placed in jeopardy are those obtained by the agency and therefore the obligation is to be paid only out of funds within the immediate control of the governing body.

2. If you are contracting with a city or county, include appropriate savings clauses in the agreement, which may include (i) a standard savings clause for a void contract, combined with (ii) an offset clause to adjust the economics of the transaction. Also include non appropriation language and provisions such as the provisions of Section 271.903 of the Local Government Code, which states the following:

   \[(a)\] If a contract for the acquisition, including lease, of real or personal property retains to the governing body of a local government the continuing right to terminate at the expiration of each budget period of the local government during the term of the contract, is conditioned on a best efforts attempt by the governing body to obtain and appropriate funds for payment of the contract, or contains both the continuing right to terminate and the best efforts conditions, the contract is a commitment of the local government’s current revenues only.

   \[(b)\] In this section, "local government" means a municipality, county, school district, special purpose district or authority, or other political subdivision of this state.

The concern has also been raised in the contract of contracts that extend beyond one year in length. While this may be an issue in other areas of contract law with governmental entities contracting for governmental functions, in the area of water supply agreements the State Legislature has provided some guidance in Local Government Code Section § 402.018 which states that under certain circumstances a municipality that owns and operates its water distribution system may contract, with an individual, firm, or corporation that operates without profit, for any duration to which the parties agree, to make available for delivery to and use by the municipality all or part of the raw or treated water to be used for the municipal water distribution system. One of the conditions to the application of this section is that the contract make clear the Contractual payments require dare to be made solely from municipal water system revenue and are an operating expense of that system. The agreement should also state that the municipality shall set its rates and charges to users of the municipal water distribution system at a level sufficient to pay the maintenance and operating expenses of that system as provided by Section 1502.057, Government Code, and to provide for payment of principal of and interest on any revenue bonds of the municipality payable from water revenue.

**Sample Provision**

**Operating Expense; Source of Payments.** The Parties agree and covenant that all moneys required to be paid by LESSEE under this Agreement shall constitute an operating expense of each LESSEE’ operating System as authorized by the laws of the State of Texas. All payments required to be made by LESSEE under this Agreement shall be payable from LESSEE’ revenue from their respective system. LESSOR shall never have the right to demand payment of any obligations assumed by LESSEE or imposed upon LESSEE under or by virtue of this Agreement from any funds raised or to be raised by taxation and in no event shall the obligations under this
Agreement be construed to be a general obligation debt of LESSEE of such kind as to require LESSEE under the Constitution or laws of the State of Texas to levy and collect an ad valorem tax to discharge such obligation. Each PARTICIPANT agrees to fix and maintain rates and collect charges for the facilities and services provided by their respective system as will be adequate to permit such LESSEE to make payment of all expenses of operating and maintaining their system, including payments under this Agreement, from the revenues of their system. LESSEE represents and covenants that all payments to be made by it under this Agreement shall constitute reasonable and necessary maintenance and operating expenses as set forth in Section 1502.056, Texas Government Code, as amended, and that all such payments will be made from the revenues of LESSEE.

D. Indemnity Provisions By Governmental Entities. Generally, governmental entities will not indemnify any party or parties to the agreement. At the agreement negotiating, reviewing and drafting stage, a governmental entity will argue that it will not indemnify the remaining party or parties to the agreement since such an indemnity is an uncertain liability that is difficult to quantify in its budget.

Generally, Counties and cities will argue that Article XI of the Texas Constitution prevents these governmental entities from indemnifying a party or parties since indebtedness beyond the current budget year would require a levy and collection of taxes necessary to pay the indebtedness beyond the current budget year and such an indemnity is impossible since the amount of the indebtedness is unknown and open-ended.

Alternatively, governmental entities will also argue that these entities cannot indemnify the remaining party or parties to the contract if such an indemnity is prohibited by the Section 127.001, et seq., of the Texas Civil Practice and Remedies Code.

If a governmental entity is unsuccessful in preventing the inclusion of an indemnity provision in an agreement where the governmental entity is the indemnitee, the governmental will likely only agree to indemnify the indemnitee to the extent allowed by law for the governmental entity's sole negligence and obtain a similar indemnity from the indemnitee.

VIII. Reservations of Groundwater Rights.

Often a land owner will want to sell their land and retain their water rights or some portion of their water rights should they ever be developed or sold by the buyer of the real property. This arrangement might be structured as an actual reservation of water rights or retention of some sort of "royalty" on future production.

A. Reservation of Water Rights. The actual retention of water rights will create some unique challenges. To make this a useful right the seller of the real property will need to retain some easement rights and other rights for a collection and delivery system to be placed upon the real property. Often the retention of such rights on the surface use of the real property is problematic. In addition. Even where those rights might be available to be reserved by a seller, knowing where you want those rights to be situated at the time of the sale is often a problem as well. If the arrangement is obtainable, the Seller and Buyer will also need to address the "operating relationship" as these surface rights are shared between the Seller and Buyer.

B. Reservation of Royalty. If the seller of real property believes that the buyer may ultimately develop some or all of the water rights on the real property, in place of a reservation of water rights which may create the complication set out above, an alternative may be for the seller to retain a royalty right in the possible future production. Issues that might arise in connection with the royalty are, whether this is net of cost of gross of cost of production, how that calculation is to be made, payment for use of the groundwater on the real property, and duty to develop. (see a draft of an addendum attached).
IX. Value of Water Rights

For more than 100 years, it has been understood that landowners in Texas own the groundwater relating to their land. As both demand for and limitations on the use of groundwater have increased, this right has taken on new importance. In fact, the sales of water is often referred to by others as the next "oil boom" in the commodities market.

Texas landowners are increasingly being approached to sell their groundwater to water developers. As they consider these offers, the marketplace provides little guidance on the value of these water rights, with current prices ranging from $25 to $6,000 per acre foot.

This large price disparity raises a not-so-simple question: What is my groundwater worth? The answer is largely dependent on five key factors: (i) proximate location, (ii) quality, (iii) quantity, (iv) reliability and (v) competing supplies.

A. Location. The first factor is proximate location; that is; the distance between the groundwater source and its destination. This factor will influence the cost of the infrastructure necessary to transport the groundwater to its place of use.

Generally, the further the groundwater from its ultimate place of use, the greater the cost to access the groundwater and the less a buyer is willing to pay for that groundwater.

To better illustrate, a barrel of oil in today's market has a value of approximately $90 per barrel and has associated with it transportation costs which is a fraction of that cost (maybe $3.00 a barrel or 3.33% of the cost of the oil). Assuming the transportation cost to move a similar quantity of groundwater the same distance, the transportation cost for groundwater is over 1700% of the cost of the groundwater. This simple example shows that transportation cost will necessarily have a large impact on the pricing of water. It is also the primary reason groundwater is not likely to become the next "oil boom" in the commodities market, as some might suggest.

B. Quality. The second factor is the quality of the groundwater. Almost every form of groundwater will require some sort of treatment to make it useable. It may also require some level of treatment to make it compatible with other water with which it will be combined in an integrated system. The extent of the treatment — and the cost of the necessary infrastructure will directly affect the comparative value of that groundwater.

C. Quantity. The third factor is the quantity of groundwater available at the source. Where large transportation costs are involved, there must be a large enough quantity of groundwater within an area to justify the capital cost for the collection, delivery, treatment and storage systems.

Typically, the party acquiring the groundwater rights will plan to remove only the yield that is sustainable over a long period of time. This helps ensure the continued replenishment of the resource, but also creates a physical limitation on the available groundwater.

The quantity of groundwater available for withdrawal is also affected by both physical and regulatory limitations. In areas where groundwater districts have been created, production-limiting regulations are usually in place, including such measures as well spacing requirements and withdrawal limitations.

These limitations will require buyers to block up enough surface acreage to assure a yield sufficient to justify the capital and operating costs of the collection and delivery system. They also increase the size and area of the system necessary to gather these water resources, all of which reduce the value of the groundwater.
D. **Reliability.** The fourth factor is the *reliability* of the groundwater source. While this may be seen as contributing to overall, available groundwater quantity, it is important that the groundwater source will provide a relatively predictable yield of that quantity of groundwater.

If the available quantity might be reduced due to physical aberrations (e.g., an aquifer that reacts precipitously to drought conditions) or frequent regulatory intervention (e.g., a groundwater district that regularly changes withdrawal limits or offers only short-term permits), this will increase the risk to the buyer and reduce the value of the groundwater.

E. **Supply and Demand.** The law of supply and demand is of no less importance to groundwater prices than it is to the price of any commodity. Once all of the factors noted above have been taken into consideration, the resource value will be further affected by the availability of competing sources.

A good example of this rule can be found in the regulated portions of the Edwards Aquifer. As regulation has limited the supply of groundwater available for withdrawal, its value has also increased steadily.

In today's rapidly heating water market it is critical that landowners know the true value of their groundwater resources. Given the many variables involved, such determinations will need to be made on a case-by-case basis. By focusing on these five factors, sellers and buyers should be in a better position to determine the relative value of groundwater.
FORM OF GROUNDWATER SALES AGREEMENT

This Groundwater Sales Agreement (the "Agreement") is made and entered into effective as of the _____ day of ____________________, 200____ (the "Effective Date"), by and between ____________________ ("SELLER") and _____________________________ ("BUYER").

RECITALS

A. SELLER owns the Real Property described on Exhibit "A" attached hereto as well as all groundwater water rights relating thereto,

B. BUYER desires to purchase, and SELLER desires to sell to BUYER, on an exclusive basis, the Groundwater producible from the Real Property, in accordance with the terms and conditions of this Agreement,

C. In connection with BUYER's acquisition and use of the Groundwater to be purchased under the terms of this Agreement, BUYER desires to develop, operate and maintain groundwater wells and a collection and delivery system upon the Real Property for the purpose of withdrawing the groundwater from the Real Property and delivering to BUYER, and

D. SELLER desires that BUYER develop, operate and maintain groundwater wells and a collection and delivery system upon the Real Property for the purpose of withdrawing the groundwater from the Real Property and delivering to BUYER in accordance with the terms and conditions of this Agreement.

Note!!! This form of Agreement is intended to address an arrangement between the SELLER and BUYER where the SELLER is to provide BUYER the exclusive rights to all groundwater relating to the Real Property and BUYER will construct a collection and delivery system on the Real Property to collect and make beneficial use of that groundwater.

AGREEMENT

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

I. Definitions

A. As used in this Agreement each of the following terms has the meaning given to it as set out below:

"Actual Production Date" means that date which is the earlier of the date that BUYER either (i) (A) drills and completes construction and development of the Wells, (B) constructs the Delivery System, (C) causes the first Well and the Delivery System to be connected at the Point of Delivery, and (D) begins the process of withdrawing Groundwater from the Real Property (excluding any pumping carried out for the purpose of testing the Groundwater or operations of the Facilities); or (ii) has carried out the actions described in (i)(A) through (D) upon other real property for the production of groundwater which is Pooled Groundwater under the terms of this Agreement.

It is often important to determine when the BUYER has begun to produce groundwater (i) for the purpose of determining when payments may be due under the terms of this Agreement, which are linked to the volume of groundwater produced and (ii) for the purpose of addressing any covenants which require production by a certain date under the terms of the Agreement. Note that, under this form of the Agreement, the mere production of groundwater for the purpose of testing groundwater or testing the collection and delivery system is NOT considered the beginning of production for these purposes.

"Agreement" means this Water Sales Agreement entered into by and between BUYER and SELLER, together with any and all amendments, renewals and extensions thereto.

"Applicable Water Rate" will mean $_____ for the first Year following the Effective Date, which rate will be adjusted on each third (3rd) anniversary date following the Effective Date thereafter during the Term of this
Agreement to be that amount which is equal to $30, increased (but not decreased) by the percentage increase in the Producer Price Index – Finished Goods (1982=100) reported by the U.S. Department of Labor (or any successor or substitute index) from the Effective Date to the date which is sixty (60) days prior to the date of the applicable annual adjustment, (hereinafter referred to as the "Growth Factor").

This paragraph begins to address the VALUE of groundwater. There are several methods for that might be used for the payment of groundwater, including a lump sum payment or, as is set out in this Agreement, a periodic payment as it is being used or being made available for use. Where payment is made on a periodic basis over the term of the Agreement, several issues can arise. The first is how to index the economics of this arrangement, to take into consideration the time value of money or the change in the value of the groundwater. The second is to determine if it is an installment payment in connection with the sale of groundwater or a rental payment for the periodic use of the groundwater. What is the value of groundwater?

"Authorities" means the various federal, state and local governmental and quasi-governmental bodies or agencies having jurisdiction over all or any portion of the Groundwater, Real Property, Facilities, as the case may be.

"BUYER" means _______________________________ and their successors or assigns.

"Delivery System" shall have the meaning set forth below.

"Easements" has the meaning set out in Article III C.

"Effective Date" shall mean the date first set out above.

"Environmental Laws" means any federal, state or local law, whether common law, statute, ordinance, rule, regulation, or judicial or administrative decision or policy or guideline, pertaining to Hazardous Materials, health, industrial hygiene, environmental conditions, or the regulation or protection of the environment, and all amendments thereto as of this date and thereafter and any successor statute or rule or regulation promulgated thereto.

"Facilities" means (i) all of the Wells, (ii) the Delivery System, (iii) all pipelines, pumping, treatment, storage and transportation equipment situated on the Real Property by or for BUYER or which relates to the Wells, Delivery System, storage or treatment of the Groundwater, and (iv) such other equipment or personal property located in, on, or under the Real Property as BUYER deems necessary or desirable in connection with the withdrawal of the Groundwater from the Real Property, treatment of the Groundwater, storage of the Groundwater and/or delivery of the Groundwater to and through the Delivery System to the Point of Delivery, and all operations reasonably relating thereto.

The purchaser of the Groundwater will need to not only acquire the rights to withdraw and utilize the groundwater but also the right to place on the landowner's property a collection and delivery system sufficient to capture this groundwater and deliver it off of the landowner's property to the point of its ultimate utilization. This definition is intended to describe the nature and character of these facilities. Note that the facilities include several functions, (i) withdrawal of groundwater, (ii) collection and delivery of groundwater, (iii) treatment of groundwater and (iv) storage of groundwater.

"Fee Owned Groundwater" means that Groundwater acquired by BUYER in fee simple determinable as described in Article III F.

"Groundwater" means all groundwater relating to the Real Property which is or can be withdrawn from, or otherwise relates to, the Real Property.

Note that this definition of groundwater includes all groundwater from all aquifers on the land. A parcel of land can be situated over several aquifers.

"Hazardous Materials" means all of the following:

1. Any substance, material, or waste that is included within the definitions of "hazardous substances," "hazardous materials," "hazardous waste," "toxic substances," "toxic materials," "toxic waste," or words of similar import in any Environmental Law;
2. Those substances listed as hazardous substances by the United States Department of Transportation (or any successor agency) (49 C.F.R. part 172.101 and amendments thereto) or by the Environmental Protection Agency (or any successor agency) (40 C.F.R. part 302 and amendments thereto); and

3. Any substance, material, or waste that is petroleum, petroleum-related, or a petroleum by-product, asbestos or asbestos-containing material, polychlorinated biphenyls, flammable, explosive, radioactive, freon gas, radon, or a pesticide, herbicide, or any other agricultural chemical.

"Historic Groundwater Benefits" means the historic Groundwater use under the terms of this Agreement as described in Article V. E. hereof.

"Leased Areas" shall mean that portion of the Real Property leased by SELLER to BUYER as described in Article III. B.

"Meter" means each totalizing flow meter which is a part of the Facilities.

"Minimum Water Payment" has the meaning set out in Article VI. D. below.

"Monthly Water Payment" shall have the meaning set forth in Article VI. C. below.

"Notice" shall have the meaning set forth in Article XXX below.

"Parties" means BUYER and SELLER, or their respective successors and assigns.

"Party" means either BUYER and SELLER, or their respective successors and assigns, as the case may be and as the context may require.

"Permit(s)" means any permit, authorization, license, consent, contract or certificate issued or provided by any of the Authorities relating to the Fee Owned Groundwater, Facilities, Real Property, or the operations relating thereto.

"Point of Delivery" means that point on the boundary of the Real Property, as determined by BUYER, where the Delivery System is connected to BUYER' water collection and transmission systems located off of the Real Property.

"Project Assessment Period" means that period beginning with the Effective Date of this Agreement and continuing until that date which is the earlier of the Actual Production Date, or two (2) Years from the Effective Date of this Agreement.

"Real Property" means the real property described on Exhibit "B" attached hereto and all appurtenances relating thereto.

"Real Property Interest Holders" means any lender or other person who has an interest in the Real Property, Groundwater or this Agreement (through SELLER or otherwise) or which has a lien or other security interest in all or any part of the Groundwater, Real Property or this Agreement except for the non participating royalty interest owners as set forth on Exhibit "C" attached hereto.

"Reserved Groundwater Rights" shall mean that Groundwater relating to the Real Property which consists of (i) the groundwater that may be withdrawn from year to year pursuant to the standard stated exemptions provided to landowners as set out in Section __________ of the Rules of the ________________ Water District or any similar exemption as to those rules which is available to landowners within the ________________ Water District; so long as the withdrawal by SELLER does not in any manner reduce BUYER's right to withdraw and utilize, as it may deem appropriate or useful, at least the Surface Acre Yield, plus (ii) up to _______acre feet of the Groundwater per calendar year as reserved by SELLER during each calendar year during the term of this Agreement in the manner set out in Article III. J. below.

Typically the BUYER will be looking for exclusive use of the groundwater relating to the Real Property or a particular aquifer which runs beneath the Real Property. This is particularly important when the groundwater is located in a groundwater district, which regulates or limits the amount of groundwater that can be withdrawn from the real property in that district. Providing exclusivity helps to avoid the dicey issues as to priority of use between
two different users. Often the SELLER is the landowner and may want some continued use of the groundwater. One alternative proposed from time to time is to allow the landowner to retain the "exempt" groundwater; that is, the groundwater that may be withdrawn without impacting the limitations imposed on the right to withdraw by the local groundwater district.

"SELLER" means ____________________________ and their successors or assigns.

"Surface Acres" means the total number of surface acres contained within the Real Property as described on Exhibit "B" attached hereto.

"Surface Acre Yield" means, for each Year (A) that _______ acre feet of Groundwater which is authorized to be withdrawn from the Real Property under the Rule adopted by the __________ Groundwater District and which is transferable by BUYER to be used by BUYER outside of the area which is governed by the __________ Groundwater District, multiplied by (B) the number of Surface Acres.

Certain Groundwater District Rules will limit the amount of water that can be withdrawn from a tract of real property, such as 1.5 acre feet of ground water per calendar year. It is important to understand these limitations so that a landowner can better understand the maximum yield from their property.

"Surviving Obligations" means the obligations set out in Article XXXI, below.

"System" means BUYER' existing water utility system, together with all extensions and improvements thereto.

"Term" shall have the meaning set forth in Article II below.

"TCEQ" shall mean the Texas Commission on Environmental Quality (formerly known as the Texas Natural Resource Conservation Commission) or any successor governmental agency.

"Transferred Rights" shall have the meaning set forth in Article XIX below.

"Weekend or Holiday" means Saturday, Sunday or any day on which national banking associations are authorized to be closed for business.

"Wells" shall have the meaning set forth in Article IVA below.

"Well Site(s)" means the site(s) for each of the Wells acquired or to be acquired by BUYER in fee simple determinable upon designation by BUYER, as described in Article III D.

"Year(s)" means each consecutive 12 month period of time beginning on the Effective Date of this Agreement.

B. Other Defined Terms. Other defined terms used in this Agreement are described below and shall have the meaning given to them as set out herein.

II. Term

This Agreement shall commence on the Effective Date and, unless earlier terminated in accordance with the terms of this Agreement, remain in force and effect until the later of (i) __________ years from the Actual Production Date, (ii) that date when BUYER is no longer producing Groundwater from the Real Property in accordance with this Agreement or (iii) that date when BUYER is no longer making the Monthly Water Payments toward the purchase of Groundwater from the Real Property in accordance with this Agreement (the "Term").

In circumstances where the groundwater is to be acquired for only a term of years, the agreement will typically address a minimum term, and may also provide for the term to extend for as long as production continues. Where a minimum payment is involved, the agreement may also provide a "shut in" type payment which will allow the term to be continued so long as minimum payments are being made.
III. Conveyance of Well Sites and Fee Owned Groundwater

From and after the Effective Date of this Agreement, SELLER hereby grants to BUYER following rights and interests in the Real Property and Groundwater, in addition to any other rights granted hereunder:

A. Designation of Areas. On or before the end of the Project Assessment Period, BUYER will determine and designate the following areas on the Real Property which will be used by BUYER for the construction, operation, use and maintenance of the Facilities:

1. Well Sites
2. ________ foot wide strips of land which are to run between and connect each of the Well Sites and connect the Point of Delivery to one or more such Well Sites;
3. The Point of Delivery;
4. The location of all roads to be used by the Buyer in connection with the operation of its Facilities or access to its Fee Owned Groundwater.
5. Up to ______ acres of additional land which may be located by BUYER along one of the _____ foot wide strips running to or from the Well Sites or the Point of Delivery.
6. Up to a ____ acre tract of land for water storage tank and related facilities.
7. Up to a ____ acre tract of land for water treatment facilities.

In connection with the purchase of the groundwater the SELLER will also need to provide the BUYER with the right to construct and operate a collection and delivery system on the Real Property. (Note - this requirement may not be necessary in areas where the governing district allows the withdrawal point for the groundwater to be transferred to another location.) During the feasibility period the BUYER will conduct tests to determine the optimum location of these facilities. Often the location of these facilities can be some of the more difficult issues to deal with as the landowner reflects upon the level of intrusion these improvements may have upon their land.

There are several different methods for addressing landowner concerns regarding the location of the improvements. These may include designation of certain areas of the Real Property that are off limits to the improvements, spacing requirements from certain then-existing improvements (see H below), construction standards, and building restrictions. In addition, procedures can be established to allow the landowner some input as to the exact location of these improvements; however, changes in the location of these improvements may have an effect upon the yield as well as the cost to obtain the ultimate yield from the collection and delivery system. A suitable method for accommodating the needs of each party will need to be established without adversely affecting the feasibility of the project.

B. Leased Areas. Beginning with the Effective Date of this Agreement SELLER hereby leases to BUYER and BUYER shall have the exclusive right to use the surface and subsurface of the Real Property in Article IIIA3 through IIIA7, above, respectively. SELLER hereby leases to BUYER and BUYER shall have the non exclusive right to use, along with SELLER, the surface and subsurface of those areas of the Real Property designated as the ____ foot wide strips of land which are to run between and connect each of the Well Sites and connect the Point of Delivery to one or more such Well Sites as described in Article IIIA2 above; provided however (i) SELLER's use of those areas shall not interfere with BUYER's use of those areas of the Real Property as authorized under the terms of this Agreement, (ii) SELLER shall not construct, nor allow any other person to construct, any improvements or structures on those areas of the Real Property except for fences, gates and cattle guards necessary to control livestock operations upon the Real Property, and (iii) to the extent SELLER disrupts any of BUYER's improvements within such areas, SELLER shall repair those improvements to a condition which is substantially similar to the condition in which they existed prior to such disturbance, reasonable wear and tear excepted. Once designated by BUYER, the above described areas of the Real Property together with (A) the personal property rights which underlie or relate to the operations of all or any portion of the Facilities or the Groundwater rights relating to the operation thereto, (B) any Additional Leased Areas set out in Article III E below; and (C) the Easements set out in Article III C below shall, collectively, be the "Leased Areas". Once designated by BUYER the Leased Areas shall be set out on Exhibit "D" attached hereto.
The owner of the groundwater rights will need certain rights to access and use the real property for the collection, delivery treatment and storage of the groundwater. The lease described above is intended to provide the rights to use portions of the real property for this purpose. If the groundwater has been purchased on a permanent basis this arrangement may need to be embodied in a more permanent relationship such as a permanent easement.

C. Easements. Beginning with the Effective Date of this Agreement, SELLER hereby grants to BUYER the following: (i) an easement upon the areas described in Article IIIA2 through IIIA7 for the purpose of constructing, maintaining, repairing, replacing and operating the Facilities upon those areas of the Real Property, (ii) an easement on or upon the Real Property for the purpose of providing reasonable ingress and egress access to the Leased Areas, Well Sites and the Facilities, and (iii) a Restrictive Covenant for Sanitary Control Easement for Public Water Well surrounding each Well or such greater area as may be required to allow the Well to be operated in compliance with the rules and regulations of the TCEQ or any successor agency, from time to time, which easement will prohibit, among other things, the construction and/or operation of underground petrochemical storage tanks, stock pens, feed lots, dump grounds, privies, cesspools, septic tank drainfields, drilling of improperly constructed water wells of any depth, sanitary sewers, sewer appurtenances, septic tanks, storm sewers, and all other construction or operations that could create an unsanitary condition within, upon or across such portions of the Real Property as well as any activity upon that area of the easement that might impair the quality of the Groundwater (collectively, the "Easements"). The term of these Easements shall begin with the Effective Date of this Agreement and continue until the earlier of (i) the date this Agreement is terminated due to BUYER election to terminate this Agreement in accordance with its rights under the terms of this Agreement or by SELLER due to a default by BUYER or pursuant to SELLER's rights under Article IV H of this Agreement, or (ii) that date which is the later of (A) twenty (20) years from the Actual Production Date, (B) twenty (20) years from the end of the Project Assessment Period, (C) the date BUYER discontinues producing Groundwater from the Real Property in accordance with the terms of this Agreement, or (D) the date BUYER discontinues making the Monthly Water Payments toward the purchase of Groundwater in accordance with this Agreement. SELLER agrees to execute and cause to be filed with the terms of this Agreement or by SELLER due to a default by BUYER or pursuant to SELLER's rights under Article IV H of this Agreement or (ii) that date which is the later of (A) twenty (20) years from the Actual Production Date, (B) twenty (20) years from the end of the Project Assessment Period, (C) the date BUYER discontinues producing Groundwater from the Real Property in accordance with the terms of this Agreement, or (D) the date BUYER discontinues making the Monthly Water Payments toward the purchase of Groundwater in accordance with this Agreement. SELLER agrees to execute and cause to be filed with the terms of this Agreement or by SELLER due to a default by BUYER or pursuant to SELLER's rights under Article IV H of this Agreement or (ii) that date which is the later of (A) twenty (20) years from the Actual Production Date, (B) twenty (20) years from the end of the Project Assessment Period, (C) the date BUYER discontinues producing Groundwater from the Real Property in accordance with the terms of this Agreement, or (D) the date BUYER discontinues making the Monthly Water Payments toward the purchase of Groundwater in accordance with this Agreement.

In addition to the lease rights described above, this provision is intended to (i) augment the lease rights with easement rights for certain access to the collection and delivery system and (ii) provide certain easement protections that may be necessary by law to qualify the well site as a public drinking water supply.

D. Well Sites. As of the Effective Date, SELLER does hereby sell, transfer and convey to BUYER a fee simple determinable interest in and to all of the Well Sites, (being those portions of the Real Property located within a radius of 150 feet around each Well to be constructed upon the Real Property as designated by BUYER), together with all appurtenances pertaining to such Well Sites (the "Well Site(s)"), subject to only the Permitted Encumbrances. The term of the fee simple determinable interest in the Well Site(s) shall begin with the Effective Date of this Agreement and end on the earlier of (i) that date this Agreement is terminated due to BUYER election to terminate this Agreement in accordance with its rights under the terms of this Agreement or by SELLER due to a default by BUYER or pursuant to SELLER's rights under Article IV H of this Agreement or (ii) that date which is the later of (A) twenty (20) years from the Actual Production Date, (B) twenty (20) years from the end of the Project Assessment Period, (C) the date BUYER discontinues producing Groundwater from the Real Property in accordance with the terms of this Agreement, or (D) the date BUYER discontinues making the Monthly Water Payments toward the purchase of Groundwater in accordance with this Agreement. Within ten (10) days following the date BUYER designates the Well Sites, SELLER agrees to execute and deliver to BUYER a deed in the form attached hereto as Exhibit "E" conveying the Well Sites to BUYER free and clear of all liens and encumbrances, excepting and excluding the Permitted Encumbrances.

The well sites often can or will be a part of the areas leased and/or upon which an easement has been granted. In this case the well sites have been transferred by the SELLER to BUYER in fee simple but with a divestiture clause which causes them to revert to the SELLER at the end of the Fee Simple Determinable period.

E. Additional Leased Areas. In the event BUYER reasonably determines, from time to time, that additional portions of the Real Property are necessary or useful to BUYER for the purpose of withdrawing, collecting, treating or transporting the Fee Owned Groundwater or delivering the Fee Owned Groundwater to the Point of Delivery, BUYER may designate these areas as additional Leased Areas (the "Additional Leased Areas") which shall thereafter be included as a part of the Leased Areas under the terms of this Agreement. The Additional
Leased Areas shall only be added as Leased Areas to the extent BUYER’ need for the use of such Additional Leased Areas are reasonably necessary or useful in connection with its rights to withdraw, collect, treat or transport Groundwater from the Real Property. BUYER agrees to consult with SELLER regarding the inclusion of such Additional Leased Areas so as to reduce the interference of BUYER’ operations on the Real Property, to the extent reasonably practical; provided, however, it is understood that BUYER will not be prevented from exercising its rights to use and occupy the surface of the Real Property in order to accomplish the purposes of this Agreement.

While the BUYER may make an initial determination as to where the collection and delivery system should be placed, over the term of the agreement it is certainly conceivable that some portion of the system will need to be relocated as a part of maintaining the optimum operation of the system. The SELLER and BUYER may need to develop certain terms and conditions which limit the nature of this expansion or relocation of the system.

F. Fee Owned Groundwater. As of the Effective Date of this Agreement SELLER does hereby sell, transfer and convey to BUYER a fee simple determinable interest in and to all of the Groundwater within the ___________ Aquifer which relates to the Real Property, together with (i) all real and personal property rights (along with those relating to the surface and subsurface of the Real Property within the _______ Aquifer), appurtenances, Permits, authorities, licenses, consents and contracts, if any, pertaining to all such Groundwater (the "Fee Owned Groundwater"), and (ii) the right to develop, explore, produce, withdraw and/or beneficially use such Groundwater at any locations BUYER may determine appropriate from time to time, but expressly excluding from such Fee Owned Groundwater any portion thereof which is a part of the Reserved Groundwater Rights. The term of the fee simple determinable interest in the Fee Owned Groundwater shall begin with the Effective Date of this Agreement and end on the earlier of (i) that date this Agreement is terminated due to BUYER election to terminate this Agreement in accordance with its rights under the terms of this Agreement or by SELLER due to a default by BUYER or pursuant to SELLER's rights under Article IV H of this Agreement or (ii) that date which is the later of (A) twenty (20) years from the Actual Production Date, (B) twenty (20) years from the end of the Project Assessment Period, (C) the date BUYER discontinues producing Groundwater from the Real Property in accordance with the terms of this Agreement, or (D) the date BUYER discontinues making the Monthly Water Payments toward the purchase of Groundwater in accordance with this Agreement. Contemporaneously with the Effective Date of this Agreement, SELLER agrees to execute and deliver to BUYER a deed in the form attached hereto as Exhibit "F" conveying the Fee Owned Groundwater to BUYER free and clear of all liens and encumbrances, excepting and excluding the Permitted Encumbrances.

The groundwater often can or will be a part of what is leased or as a part of a groundwater agreement. In this case the well sites have been transferred by the SELLER to BUYER in fee simple but with a divestiture clause which causes them to revert to the SELLER at the end of the Fee Simple Determinable period.

G. Interim Real Property Rights. The above notwithstanding, from and after the Effective Date of this Agreement, and continuing until the areas described in Article IIIA, above, have been designated by BUYER and BUYER has been granted its fee interests, lease rights and easement rights to the areas and property (as the case may be) in accordance with the terms of the Agreement (the "Final Designation Date"), BUYER rights under this Agreement as to the areas to be designated in Article IIIA shall be deemed to be a lease, easement and conveyance of fee simple determinable interest in the entirety of the Real Property for the purpose of providing the property rights granted in Articles III B,C and D, above. From and after the date BUYER is granted its fee simple determinable interests, lease rights and easement rights to the areas described in Article III A (as the case may be) in accordance with the terms of the Agreement, BUYER rights will thereafter be reduced to (i) the lease, easement rights and fee simple determinable ownership of those specific areas of the Real Property as designated by BUYER under Article IIIA for the purpose of identifying the areas described in Article III B, C and D, above, and (ii) such other additional rights as BUYER may have in the Real Property under the terms of this Agreement.

This provision provides a blanket access right to the Real Property until the final designation of the specific areas of the collection and delivery system have been established. This arrangement is only to be for a short period of time while the BUYER conducts its review of the Real Property to determine the best configuration for the collection and delivery system to achieve the best interests of the BUYER and SELLER.

H. Existing Improvements. BUYER does hereby agree that no portion of the improvements to be constructed on the Leased Areas or the Well Sites (including the Additional Leased Areas) shall be located within
I. Insurance and Claims. SELLER hereby agrees to transfer and assign to BUYER (i) all right, title and interest of SELLER under the terms of any insurance claims or other legal claims relating to the Wells, Delivery System, or other portions of the Facilities which may arise during the Term of this Agreement, and (ii) all Permits relating to the Facilities or Fee Owned Groundwater.

J. Reserved Groundwater. From and after the Effective Date of this Agreement, for each calendar year during the Term of this Agreement, SELLER shall have the right to the Reserved Groundwater Rights for each such calendar year. As to that portion of the Reserved Groundwater Rights which SELLER is to make an election to use for each calendar year, SELLER shall make such election to use this portion of the Reserved Groundwater Rights by providing BUYER with written notice of this election at least sixty (60) days prior to the beginning of each such calendar year. When any such election is made, the election shall remain in effect for each subsequent calendar year unless an election to decrease or further increase the amount of Reserved Groundwater Rights to be reserved for a calendar year is provided by SELLER to BUYER at least sixty (60) days prior to that calendar year.

K. Filings Upon End of Term. At the end of the term of BUYER fee simple determinable interest in the Fee Owned Groundwater and/or Well Sites, or Easements, as the case may be, BUYER will file of record in the County Real Property Records a statement confirming the end of that term.

IV. Construction and Delivery of Wells and Delivery System

A. General. In accordance with the terms of this Agreement, from and after the Effective Date of this Agreement, BUYER is hereby authorized to: (i) drill, develop and construct such water wells upon the Well Sites or Additional Leased Areas as it deems necessary or desirable in order to withdraw Fee Owned Groundwater from the Real Property (the "Wells"), and (ii) develop, construct and operate within the Leased Areas or Well Sites a related Groundwater delivery, treatment and transportation system which collects Groundwater from the Wells to (and including) the Point of Delivery and the delivery, treatment, storage and transportation of groundwater from wells and to and from facilities located on other real property as may be determined by BUYER. The delivery, treatment and transportation system shall include, but is not limited to, pipelines, pumping and transportation equipment, tanks, electric lines and roads, for the purpose of withdrawing, capturing, treating, storing and transporting groundwater (the "Delivery System").

B. Information Relating to Real Property and Groundwater. Within fifteen (15) days following the Effective Date of this Agreement, and continuing throughout the Term of this Agreement, SELLER shall make available to BUYER copies of all of its records and information relating to the Real Property and Groundwater. In
C. **Construction and Cooperation.** SELLER agrees to cooperate with BUYER to the fullest extent reasonably possible in connection with BUYER's development, construction and operation of the Facilities within the Leased Areas and Well Sites, which cooperation shall include but is not limited to, upon BUYER's request, obtaining such Permits or authorizations which SELLER may be required to obtain from time to time to allow BUYER to use the Fee Owned Groundwater and/or Real Property in the manner herein contemplated. In the event it is necessary or useful for SELLER to obtain any such Permits for BUYER relating solely to BUYER's production or withdrawal of the Fee Owned Groundwater, BUYER shall be responsible for all reasonable costs incurred by SELLER in connection with its obligation to obtain and maintain any such Permits or authorizations and shall reimburse SELLER for any such sums expensed by SELLER. The above notwithstanding, in connection with any such development or construction, BUYER will abide by the following construction standards (the "Construction Standards"):

1. BUYER agrees that, if it causes damage to the surface of the areas of the Real Property outside of the Leased Areas or Well Sites in connection with its construction of the Wells or Delivery System, BUYER shall, upon Notice from SELLER, restore such damage to the surface of the Real Property to a condition which is substantially the same as the condition in which it existed immediately prior to such damage caused by BUYER, reasonable wear, tear and casualty loss excepted. SELLER agrees that in no event shall the roads, power lines, wells, pipelines or other Facilities or modifications that BUYER is allowed to make to the Leased Areas or Well Sites in accordance with the terms of this Agreement, be considered damage to the Real Property.

4. 2. BUYER agrees that it shall cause all pipelines relating to the Facilities on the Real Property to be placed at least _____ inches below the surface of the Real Property, except in areas where the pipelines are required to

D. **Exclusive Rights.** Provided this Agreement has not been rightfully terminated by either of the Parties, except for the Reserved Groundwater Rights, BUYER shall have the exclusive right to develop, use and/or produce Groundwater from the Real Property (that is; both the Fee Owned Groundwater and all other Groundwater) and the exclusive use of the Facilities. In addition, SELLER shall not own any part of the Facilities. All such ownership and other rights to the Facilities shall belong to BUYER.

This provision of the Agreement makes clear the BUYER's exclusive rights to withdraw groundwater from the Real Property, with the exclusion of the Reserved Groundwater.

E. **Environmental Site Assessment.** Prior to the operation of the Wells, BUYER shall have prepared for the benefit of BUYER and SELLER, at BUYER's cost and expense, an Environmental Site Assessment to establish baseline environmental conditions of the Leased Areas and Well Sites.

Paragraphs A-E above set out a form of construction standard which the BUYER is required to follow in connection with the development of the collection and delivery system.

**Project Assessment Period.** From and after the Effective Date of this Agreement, BUYER shall have the right to conduct all such investigations and tests as BUYER shall determine to be necessary or useful relating to the legal, physical, regulatory or any other aspects of the Real Property or Groundwater for the purpose of making a determination as to the viability of the acquisition and utilization of the Groundwater by BUYER, including such matters as the quantity and quality of the Groundwater or the ability of BUYER to develop or operate the Facilities on any basis it deems relevant. In the event BUYER is not satisfied with any aspect of the Real Property or Groundwater, or the ability of BUYER to develop or operate the Facilities on any basis it deems relevant, including BUYER's determination of the feasibility of the overall groundwater project, based upon the availability of other groundwater in the area, BUYER shall have the ability to terminate this Agreement at any time prior to the expiration of the Project Assessment Period by providing Notice to SELLER. Following any such termination of this Agreement, BUYER shall, upon Notice from SELLER, undertake either or both of the following actions: (i) restore any damage BUYER caused to the Real Property to a condition which is substantially the same as the condition in which it existed immediately prior to such damage, reasonable wear, tear and casualty loss excepted; and (ii) plug
any Wells that may have been drilled by BUYER. Following such termination, no further payments shall be due by BUYER to SELLER under the terms of this Agreement and neither Party shall have any further obligation to the other hereunder, except for the "Surviving Obligations" described in Article XXXI hereof be brought to the surface in connection with their operations with Wells, cleanouts, vents or other apparatus as a part of the design of the Facilities.

3. BUYER agrees to use reasonable business efforts to remove construction debris from the Real Property following completion of the construction of the Facilities.

F. In cases where BUYER cuts an existing fence and elects to install a gate along one of the fences on the Real Property to construct its Facilities or carry out any of its other rights as set out under the terms of this Agreement, to the extent the area fenced is utilized by SELLER for cattle operations, BUYER shall, at the request of SELLER, install a cattle guard below the gate to assist in maintaining the cattle within the area fenced.

The provisions of Section F set out the time frame for the BUYER to conduct its investigation of the Real Property and Groundwater. During this period the BUYER will need to review the legal, physical and regulatory aspects of the groundwater project.

V. Operations And Maintenance Of The Facilities

A. Right to Operate. From and after the Effective Date, BUYER shall have the full and exclusive right to operate the Facilities at its sole cost and expense. BUYER shall be authorized to operate the Facilities and to withdraw all of the Fee Owned Groundwater from the Real Property as it may determine useful or necessary to BUYER, in its sole and absolute discretion, except for the Reserved Groundwater Rights. The above notwithstanding, BUYER shall always have the right to limit the amount of Fee Owned Groundwater withdrawn from the Wells and purchased hereunder for any reason, including but not limited to, its System demand, aquifer conditions, and meteorological conditions, however, the reduction in the amount of Fee Owned Groundwater BUYER elects to withdraw, from time to time will not reduce the amount of the Minimum Water Payment otherwise due hereunder.

B. Limitations of SELLER's use of Reserved Groundwater. Provided this Agreement has not been rightfully terminated by either of the Parties hereto, SELLER hereby agrees that, except for the Reserved Groundwater Rights, it will not sell or withdraw or cause to be sold or withdrawn, for use, sale, transfer or lease to a person other than BUYER, any of the Groundwater or other surface water appurtenant to or relating to the Real Property. SELLER hereby agrees that any water produced as part of the Reserved Groundwater Rights is to be used only by SELLER in connection with their use of the Real Property or other parties who may be rightfully entitled to use the portions of the Real Property which are not exclusively granted to BUYER, however it shall not otherwise use, sell, or otherwise convey such water to any third party other than BUYER.

C. Maintenance of Facilities. Following the Effective Date, BUYER agrees that it shall (i) maintain and operate any Facilities it may construct upon the Real Property in a manner which is consistent with its own internal custom and practice, reasonable wear, tear and casualty loss or condemnation loss excepted, (ii) maintain and operate any Facilities in accordance with all applicable laws and regulations which are of a material nature, and (iii) except as expressly set out herein, bear all the costs associated with the operation and maintenance of the Facilities. BUYER shall be entitled to carry out any alterations or modifications to the Facilities it may determine to be necessary or desirable in its sole discretion. The above notwithstanding, in connection with any repair, replacement, modification or alteration of all or any part of the Facilities, in the event SELLER has rights to any claims, insurance proceeds, third party indemnity or warranty relating to such repair, replacement, modification or alteration, SELLER shall deliver all of such proceeds to BUYER for the purpose of defraying BUYER' costs and responsibilities in connection therewith.

D. SELLER's Operating Agreements as to Real Property and Permits. Except as set out in this Agreement, SELLER will bear all costs associated with the Reserved Groundwater Rights and operation of the Real Property and shall be responsible for paying all fees and obtaining and maintaining as current all Permits and licenses required by federal, state or local laws, regulations or rules relating thereto. BUYER shall bear all costs associated with the Permits relating to the construction, development or operations of the Facilities, the Well Sites and the Fee Owned Groundwater (including any withdrawal permits from the Water Conservation District which relate to the Fee Owned Groundwater).
E. Regulatory Requirements. This Agreement is subject to all applicable federal, state, and local laws and any applicable ordinances, rules, orders, and regulations of any of the Authorities having jurisdiction. However, nothing contained in this Agreement shall be construed as a waiver of any right to question or contest any law, ordinance, order, rule, or regulation in any forum having jurisdiction, and SELLER and BUYER each agree to make a good faith effort to support proposed laws and regulations which would be consistent with the performance of this Agreement in accordance with its terms. In connection with the operation of the Facilities, BUYER agrees to conform to all regulatory requirements relating to the Facilities to report pumping volumes, Groundwater quality information and such other data and information as may now or in the future be required by any governmental or regulatory body having jurisdiction for continuation and establishment of pumping rights under any laws or regulations now existing or that in the future may exist. To the extent filings are in the future required to establish Groundwater production volumes for the purposes of issuing Permits, or for Groundwater conservation purposes, BUYER shall provide SELLER with records and data as may be reasonably necessary to establish or preserve SELLER's production rights. In any such permitting process, SELLER shall make a good faith effort to maximize the pumping volume to which the Wells are entitled, based upon the capacity and production history of the Wells and all other data available to BUYER and SELLER.

F. Historic Use. All historic Groundwater use or developed use under the terms of this Agreement shall be deemed to have been withdrawn for the benefit of BUYER and thereby inure to the benefit of BUYER (the "Historic Groundwater Benefits"), and all of SELLER's rights relating to the Historic Groundwater Benefits shall be a part of the Fee Owned Groundwater and shall be owned and retained by BUYER. At BUYER' request, SELLER agrees to take such actions as may in the future be legally required to confirm such Historic Groundwater Benefits to BUYER including executing, delivering and recording regulatory filings, assignments, transfer or other documents necessary or appropriate under any laws or regulations that may be enacted or promulgated by any authority having jurisdiction. Upon the end of the Term of this Agreement, to the extent all or any portion of the Historic Groundwater Benefits are no longer of benefit to BUYER and are transferable to SELLER, BUYER will, at SELLER's written request, take reasonable business efforts to convey that portion of the Historic Groundwater Benefits to SELLER; provided, however, SELLER shall be responsible for any and all third party costs and expenses incurred by BUYER in connection with such transfer.

Historic use or the rights to the developed use of the groundwater may become important to the Buyer since these are rights that it has developed through its development efforts on the Real Property. As the groundwater districts become increasingly more focused on the rights of prior users over those of current users, the importance of these historic or developed use rights may increase.

G. BUYER's Sporting Limitations. BUYER shall not hunt, fish or engage in any other recreational activities on the Leased Areas or Well Sites. BUYER shall not bring onto the Real Property any guns or firearms.

H. Gates and Fences. BUYER agrees to use reasonable business efforts to keep all gates located on the Real Property and outside the Leased Areas and Well Sites closed and locked at all times during the term of this Agreement, except during periods of ingress and egress and as may be necessary in connection with construction of the Facilities by BUYER. During construction of the Facilities, BUYER shall cooperate with SELLER so that SELLER can cause cattle and livestock to be relocated to areas under fence. SELLER shall provide BUYER with a key or combination to each locked gate or allow BUYER to place a separate combination or keyed lock on each locked gate on the Real Property to allow BUYER access to the Real Property and Leased Areas and Well Sites as contemplated by this Agreement.

I. Oil And Gas Well Plugging. SELLER hereby authorizes and agrees that BUYER shall in its sole and absolute discretion and at its sole cost and expense have the right to plug or cap and/or re-drill and re-plug any abandoned or inoperable oil and gas well located on the Real Property. SELLER does hereby confirm that the rights granted to BUYER hereunder will at all times exist as a right granted to BUYER and shall in no event be construed as an obligation of BUYER to do so, even as to wells it may have previously elected to plug or cap. SELLER does hereby grant to BUYER during the term of this Agreement full right to access all portions of the Real Property for purposes of testing, plugging, capping and/or re-drilling and re-plugging such wells including but not limited to (i) testing the status or integrity of any abandoned or inoperable oil and gas well casings, and (ii) carrying out any tests upon the Real Property it determines to be reasonably necessary, within or around any such wells, to determine if and how any such well may be contributing to any environmental contamination to the Groundwater due to degradation or contamination of any well.

J. Removal of Improvements. Upon the end of the term of the Lease and Easement, as described above, the BUYER may, but is not obligated to, remove any or all of its equipment or other tangible personal
property from the Real Property. In the event BUYER does not remove the equipment or other tangible personal property from the Real Property within 90 days following the end of the Lease and Easement, that equipment or other tangible personal property which is not removed shall become the property of the SELLER. BUYER is granted a limited right following the end of the term of the Lease and Easement to access the Real Property for the sole purpose of removing any of such equipment or other tangible personal property.

The following provisions set out certain operating standards the BUYER and SELLER will follow in connection with the operations of the Real Property. These standards may be more or less stringent depending upon the desires or needs of the Parties.

VI.
Price and Terms

B. Initial Consideration. BUYER shall pay to SELLER on the Effective Date the sum of $100.00 as the initial consideration to bind this Agreement.

These sums are provided as independent consideration for the feasibility period.

C. Monthly Water Payment. For each calendar month during the Term of this Agreement from and after the Actual Production Date a monthly payment shall be due from BUYER to SELLER in an amount equal to the then Applicable Water Rate multiplied by each acre-foot of Groundwater which is actually produced from the Wells by BUYER and delivered to the Delivery System during that month (the "Monthly Water Payment"). Following the Actual Production Date, for each month a Monthly Water Payment is due to SELLER under the terms of this Agreement, BUYER will deliver to SELLER within thirty (30) days following the end of that month, a reading of the Meters for each of the Wells indicating the amount of the Groundwater upon which the Monthly Water Payment is to be paid. SELLER will invoice BUYER for such payment. The Monthly Water Payment for each such calendar month's water usage shall be payable within thirty (30) days following BUYER' receipt of each such invoice. In the event this Agreement is terminated and a Monthly Water Payment for Groundwater withdrawn prior to the date of termination remains outstanding, BUYER' obligation to make such payment in accordance with this Agreement shall be a Surviving Obligation.

This paragraph sets out the payment arrangement for the monthly payments. The language might also be drafted as a lump sum payment in connection with the outright purchase of the groundwater.

D. Minimum Water Payments. The above notwithstanding, for each calendar month during the Term of this Agreement for each Year of this Agreement following the first (1st) Year of the Project Assessment Period, to the extent the amount of Groundwater withdrawn for each such Year is not sufficient to provide Monthly Water Payments, in aggregate, in the amount for such Year as set out on Exhibit "G" (the "Minimum Water Payment"), BUYER shall pay to SELLER, within forty-five (45) days following the end of that Year, a sum equal to the amount by which the Minimum Water Payment relating to that Year exceeds the aggregate Monthly Water Payments otherwise made for that Year, if any (the "Excess Water Payment"), which payment shall be an additional Monthly Water Payment.

In many cases the SELLER will require that, regardless of the amount of groundwater produced by the BUYER the Seller will receive a minimum payment for the groundwater has bee reserved for the Buyer. This issue might also be addressed by the Owner requiring that the BUYER produce a minimum amount of groundwater during each calendar year.

E. Credit. If, from and after the Effective Date, BUYER makes any Excess Water Payments, BUYER shall receive a credit (the "Monthly Production Credit") equal to the Excess Water Payments which shall be applied against any future Monthly Water Payments. The Monthly Production Credits shall accumulate on a month to month basis and, until the date used, shall be increased at the Growth Factor used in connection with the increase in the Applicable Water Rate. The Monthly Production Credits (as increased by the Growth Factor) shall be used and applied as a credit against future Monthly Water Payments, on a first-in, first-out basis, provided however, up to and through that date which is twenty (20) Years from the Effective Date of this Agreement, the Monthly Production Credits shall not reduce a Monthly Water Payment below the Minimum Water Payment as set out in Section D
above. Following that date which is twenty (20) Years from the Effective Date of this Agreement, the Monthly Production Credits may be used as a credit for any purpose, including reduction of the Monthly Water Payment and the Minimum Water Payments. The use of a Monthly Production Credit under the terms of this Agreement shall be deemed payment, upon the Monthly Water Payment or Minimum Water Payment, as the case may be for the purpose of determining the Term of this Agreement. In addition, in the event any sums become due by BUYER to SELLER as payments toward the purchase of Transferred Rights or otherwise under the terms of this Agreement, any Monthly Production Credits then outstanding shall be credited against and reduce those sums otherwise due by BUYER to SELLER.

VII.
POOLING

BUYER is hereby granted the right, at its option, to pool all or any part of its Groundwater withdrawal rights under this Agreement with all or portions of its other groundwater withdrawal rights from other real property which is either (i) immediately contiguous to the Real Property or real property which is contiguous to such other tracts of real property or any other tracts contiguous thereto, or (ii) real property which may be pooled with this Real Property by law or regulation (due to its contiguous nature or otherwise). The Fee Owned Groundwater, when combined with groundwater withdrawal rights from other real property as described above, shall be referred to as the "Pooled Groundwater". BUYER shall exercise its right to pool the Groundwater withdrawal rights under this Agreement with other groundwater by (a) providing SELLER Notice on or before that date which is the earlier of (X) three (3) Years from the Effective Date of this Agreement, or (Y) the Actual Production Date, and (b) as a part of that notice, identifying both (x) the portion of the Groundwater withdrawal rights under this Agreement which are to be pooled, and (y) the location and amount of the other groundwater withdrawal rights to be pooled as a portion of that Pooled Groundwater. During the period set out above, BUYER may increase or decrease the size of any Pooled Groundwater unit established hereunder without the prior written consent of SELLER, and thereafter BUYER shall have no right to additional pooled real property as set out above without the written consent of SELLER.

In the event all or a portion of the Groundwater withdrawal rights conferred under this Agreement are pooled as described above, the Pooled Groundwater withdrawn shall be deemed withdrawn from the Real Property in that proportion which is equal to the number of acre feet of Groundwater relating to the Real Property which has been included in the Pooled Groundwater under the terms of this Agreement divided by the total number of acre feet of Pooled Groundwater contained within that unit of Pooled Groundwater. The production of Groundwater so allocated shall be considered for all purposes hereunder to be the production of Groundwater from the Real Property in the same manner as though produced from the Real Property under the terms of this Agreement.

VIII.
MEASUREMENT

BUYER shall install at its sole cost and expense a Meter for each Well, which Meter(s) shall be a part of the Facilities. The Meters shall record the total production of Groundwater produced and made available to the Delivery System at the wellhead of each Well. BUYER shall read the Meters on a monthly basis. BUYER shall maintain the records of the measurements of Groundwater withdrawn from the Wells as indicated by the Meters. All such records shall be open for SELLER's inspection during BUYER's normal business hours after 48 hours prior Notice to BUYER of SELLER's desire to review such records. If requested in writing by SELLER (but in no event more than once in each calendar year), on a date as near the end of a calendar month as practical, BUYER shall provide SELLER, or a representative of SELLER, the opportunity to be present while BUYER causes the Meters to be calibrated. If SELLER makes such a written request to BUYER to calibrate the Meters, BUYER shall give SELLER Notice of the time when any such calibration is to be made and, if SELLER or a representative of SELLER is not present at the time set, BUYER may proceed with the calibration and adjustment in the absence of SELLER or any representative of SELLER. In the event a Meter is in disrepair, BUYER will install a new Meter or repair an existing Meter within a reasonable time not to exceed ninety (90) days.
The accuracy of any Meter shall be determined by application of an orifice plate port permanently installed on the discharge line from the Well, which orifice plate port has been calibrated by other testing procedures promulgated by ASTM or other technical oversight body applicable to the specific measuring device in question, under the supervision of a registered professional engineer reasonably acceptable to BUYER. If, upon any test of a Meter, the percentage of inaccuracy of such metering equipment is found to be in excess of one percent (1%), the calculation thereof shall be corrected for a period extending back to the time when such inaccuracy began, if such time is ascertainable. If such time is not ascertainable, then the calculation thereof shall be corrected for a period extending back one-half (½) of the time elapsed since the last date of calibration, but in no event further back than a period of six (6) months. If any Meters are out of service or out of repair so that the amount of water delivered cannot be ascertained or computed from the reading thereof, the water delivered through the period such Meter is out of service or out of repair shall be estimated and agreed upon by SELLER and BUYER upon the basis of the best data available. If SELLER and BUYER fail to agree on the amount of Groundwater delivered during such period, the amount of water delivered may be estimated by:

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

2. estimating the quantity of delivery by deliveries during the preceding periods under similar conditions when the Meter or Meters were registering accurately.

All books and records pertaining to the measurement of Groundwater withdrawals under this Agreement shall be open and available for copying, inspection, and audit by SELLER, their successors and assigns.

IX. Covenants

SELLER and BUYER each hereby covenant and agree that at all times during the Term of this Agreement, they will take all of the following actions as required of them by this Section:

A. Existence and Compliance. Each Party will maintain its existence, good standing and qualification to do business, where required, and comply with all laws, regulations and governmental requirements including, without limitation, Environmental Laws applicable to it or to any of its property, business operations and transactions.

B. Taxes and Other Obligations. Each Party will pay their respective taxes, assessments and other obligations as they become due on the property that they own relating to the Real Property, Groundwater or Facilities, including, but not limited to taxes, costs or other expenses arising out of this transaction as the same become due and payable, except to the extent the same are being contested in good faith by appropriate proceedings in a diligent manner. In this regard, BUYER will be responsible for any ad valorem taxes and assessments upon the Facilities, Well Sites and Fee Owned Groundwater and SELLER shall be responsible for any ad valorem taxes and assessments upon the Reserved Groundwater and all other portions of the Real Property. In the event SELLER fails to pay any such taxes and the failure to pay such taxes may have an adverse effect on BUYER’ rights to withdraw and use the Groundwater or to construct or operate the Facilities under this Agreement, BUYER shall have the right, but not the obligation, to pay such taxes and offset the sums paid against any sum due by BUYER to SELLER. All of the above notwithstanding, as for any taxes owed by either Party as described above, each Party shall have the right, at their own cost and expense, to initiate and prosecute any proceedings permitted by law for the purpose of obtaining an abatement of, or otherwise contesting the validity or amount of such taxes. If required by law, either party may take any such action in the name of the other Party hereto.

C. Environmental Matters. Each Party shall immediately advise the other Party in writing of (i) any and all enforcement, cleanup, remedial, removal, or other governmental or regulatory actions instituted, completed or threatened pursuant to any applicable federal, state, or local laws, ordinances or regulations relating to any Hazardous Materials affecting the Real Property in the Groundwater; and (ii) all claims made or threatened by any third party relating to damages, contribution, cost recovery, compensation, loss or injury resulting from any Hazardous Materials affecting the Real Property or Groundwater.

In connection with any such environmental matters, each Party shall immediately notify the other Party of any remedial action to be taken with respect to the Real Property or Groundwater. In this regard, each Party shall:

(i) Be liable for all costs and expenses incurred in addressing environmental matters for which they or their agents, invitees or lessees are directly responsible;
(ii) Take all steps to prohibit the generation, manufacture, storage or disposal of any Hazardous Materials upon the Real Property by itself or by others under their control upon the Real Property;

(iii) Take all steps to prohibit the use of any Hazardous Materials upon the Real Property or which might effect the Groundwater, except such materials as are incidental to the parties normal course of business on the Real Property and which are handled in compliance with all applicable Environmental Laws; and

(iv) Provide the other Party, its agents, contractors, employees and representatives with access to, and copies of, any and all data and documents in their possession or control relating to, or dealing with, any Hazardous Materials used, generated, manufactured, stored or disposed of upon the Real Property within five (5) days of the request therefore.

All other provisions of this Agreement notwithstanding: (i) SELLER shall not be liable to BUYER for any environmental contamination to the Groundwater which is caused by a degradation of any abandoned or inoperable oil and gas well wells or relating casings situated upon the Real Property as of the Effective Date of this Agreement except to the extent such degradation or contamination is caused by SELLER or its agents, contractors, employees or representatives, (ii) BUYER shall not be liable to SELLER for any environmental contamination to the Groundwater which is caused by a degradation of any abandoned or inoperable oil and gas well wells or relating casings situated upon the Real Property except to the extent such degradation or contamination is caused by BUYER or its agents, contractors, employees or representatives. Except as otherwise required by law, SELLER shall have no obligation to plug any existing abandoned or inoperable oil and gas well located on the Real Property.

The BUYER and SELLER will each be interested in causing the other to maintain the environmental integrity of the real property as well as the groundwater. This can raise interesting issues when there is oil and gas production on the Real Property. The BUYER is often interested in requiring the SELLER to be responsible for the bad acts of its tenant or the owner of the mineral estate, since it is the beneficiary of their operations.

D. Liens. Each Party will not grant, suffer or permit any contractual or non-contractual lien on or security interest in this Agreement or the Real Property or Groundwater, unless such lien or security interest is subject to this Agreement or is permitted under Article X E below. In addition, each Party agrees to promptly pay when due all lawful claims, whether for labor, materials or otherwise.

E. SELLER Liability Insurance. SELLER will maintain during the entire Term of this Agreement a comprehensive general liability insurance policy with respect to any of SELLER's activities upon the Real Property or relating to the improvements thereon or activities relating thereto. The policy shall name BUYER as an additional insured. The policy shall insure SELLER and BUYER against liability arising from any occurrences on or about the Real Property caused by SELLER, its employees, agents or invitees. The policy shall include contractual liability, severability of interest and cross liability endorsements. The type and nature of coverage shall initially be as set out on Exhibit "H" Schedule 1 attached hereto. BUYER may require that the coverage limits be reviewed after intervals of three (3) years to determine whether the limits are more or less than customary coverage limits for Real Property and improvements of similar size, uses and location. If the coverage limits are less than the customary limits, the coverage limits shall be adjusted to the customary limits.

F. BUYER Liability Insurance. BUYER will maintain during the entire Term of this Agreement a comprehensive general liability insurance policy with respect to any of BUYER's activities upon the Real Property or relating to the improvements thereon or activities relating thereto. The policy shall insure SELLER and BUYER against liability arising from any occurrences on or about the Real Property caused by BUYER, its employees, agents or invitees. The policy shall include contractual liability, severability of interest and cross liability endorsements. The type and nature of coverage shall initially be as set out on Exhibit "H" Schedule 2 attached hereto. BUYER may require that the coverage limits be reviewed after intervals of three (3) years to determine whether the limits are more or less than customary coverage limits for Real Property and improvements of similar size, uses and location. If the coverage limits are less than the customary limits, the coverage limits shall be adjusted to the customary limits.

Note – when dealing with governmental entities the issue of insurance may need to be adjusted to reflect the requirements and limitations on their ability to insure both their property and their requirements for insurance from the parties with whom they are contracting.
G. Books and Records. SELLER shall maintain separate books and records relating to the Real Property and Groundwater and shall cause all such books, records and other documentation related to the Groundwater and/or Real Property which SELLER may have in its possession or which is available to SELLER to be open and available for copying and inspection by BUYER at all reasonably times during the Term of this Agreement. On or before ninety (90) days following the end of each calendar year during the Term of the Agreement, BUYER shall furnish SELLER a report which reflects the measurements of Groundwater withdrawn from the Wells as indicated by the Meters for such calendar year. In addition, SELLER, at its own expense, may perform, or cause to be performed, audits of the measurements of Groundwater withdrawn from the Wells.

H. Mitigation as to Existing Wells. In the event BUYER's production of Fee Owned Groundwater from the Real Property has the effect of lowering the water table relating to a well from which groundwater is being withdrawn by SELLER as of the Effective Date of this Agreement (collectively, the "Existing Water Well(s)") to a level which causes SELLER to be unable to continue to withdraw that level of Groundwater which SELLER has historically produced from such well, BUYER agrees to take steps to mitigate its impact on such Existing Water Well during the Term of this Agreement by causing additional Groundwater to be made available at the well site in the amount sufficient to make up such deficit (that is, the difference between what can be produced from the Existing Water Well and what has been historically used by SELLER from that Existing Water Well, but only to the extent necessary by SELLER) by, at BUYER election and expense, either (i) providing additional Groundwater to such Existing Water Well or supplementing Groundwater to SELLER at that well site, (ii) reworking, lowering of pumps or re-drilling the Existing Water Well, or (iii) such other means as BUYER may determine to be reasonable and appropriate. In connection with any such efforts to mitigate this reduction in available groundwater from the Existing Water Wells, SELLER agrees to cooperate with BUYER to the fullest extent necessary to allow BUYER to address its mitigation efforts. BUYER shall not be responsible for any impact on the lowering of the water table caused by any other persons. The location and historical usage of each of the Existing Water Wells are set out on Exhibit "I" attached hereto. To the extent BUYER provides any additional Groundwater to SELLER as a part of a mitigation effort as set out above, BUYER shall be entitled to withdraw Groundwater that is other than Fee Owned Groundwater from the Wells.

A SELLER will be interested in requiring that the BUYER mitigate the impact that its collection and delivery system may have on SELLER's existing wells. This may include reworking the existing wells or artesian flows or providing replacement groundwater out of the BUYER's collection system. This has become a very important consideration in groundwater agreements.

I. Non-Interference with Groundwater Withdrawal. Subject to SELLER's Reserved Groundwater Rights, SELLER will not conduct or allow others to conduct any operations upon the Real Property which will interfere with BUYER' operations of the Facilities or lessen the amount of the Fee Owned Groundwater. In the event SELLER allows any oil or gas production or other operations to take place upon the Real Property, SELLER shall cause to be included in any documentation relating to that usage, an indemnity in favor of both SELLER and BUYER for any damage that such Party may cause to the Facilities or the Fee Owned Groundwater. In this regard, SELLER will not cause, or allow others to cause, any contamination to the Fee Owned Groundwater, except as they are used or stored in compliance with Environmental Laws.

The BUYER will want to make clear the priority rights to withdraw groundwater. This section makes it clear to the owner of other groundwater rights the priority for the use of this groundwater, including the reserved groundwater rights.

J. Compliance with Groundwater District Rules. SELLER shall at all times comply with the Conservation District rules and regulations, as they may be amended from time to time, in all material respects. Except as expressly set out below, in the event SELLER, or any other tenant, agent or invitee of SELLER should withdraw any Groundwater from the Real Property (as authorized by the terms of this Agreement) the wells utilized by such persons shall be located and operated in a manner which do not adversely affect BUYER's use of the Wells under the terms of this Agreement or its ability to withdraw the Fee Owned Groundwater from the Real Property. In the event SELLER is unable to withdraw any portion of its Reserved Groundwater Rights due to spacing limitations or other regulations imposed by the Conservation District or
other applicable laws, as set out above, SELLER shall have the right to collect that Groundwater which might otherwise be withdrawn from the well that was it was unable withdraw through a connection to BUYER Facilities, which connection will be carried out at SELLER's sole cost and expense and at locations and in the manner determined by BUYER.

The BUYER will need to obtain the SELLER's obligation to comply with the local groundwater district rules in a manner that does not disturb the BUYER's right to use the Groundwater it has purchased from the SELLER. This provision also sets out a method for mitigating the SELLER's loss of groundwater in certain circumstances where the SELLER is prohibited from withdrawing the Reserved Groundwater based upon these limitations.

K. Title Exceptions to Real Property. SELLER shall cooperate with BUYER to obtain a title commitment upon the Real Property and the Fee Owned Groundwater with Stewart Title Company or such other title company as BUYER may select from time to time for the purpose of insuring BUYER interests in the Real Property and Fee Owned Groundwater as set forth herein. Any such title insurance obtained by or for BUYER shall be at BUYER's cost and expense. Each of the exceptions to title to the Real Property and Fee Owned Groundwater set out on Schedule B to the title commitment shall be exceptions to the title to the Real Property and Fee Owned Groundwater and, if this Agreement is not terminated by BUYER on or before the date the Bonus Payment is due, shall thereafter be set out on Exhibit "J" attached hereto as the Permitted Encumbrances to this Agreement.

You now have title insurance to assist you in these areas from both Stewart Title and Chicago Title.

X. Representations and Warranties of SELLER

For the purposes of inducing BUYER to enter into this Agreement, SELLER hereby makes the following representations, warranties and covenants to BUYER, all of which shall be true as of the Effective Date of this Agreement and at all times thereafter during the Term of this Agreement:

A. Ownership. As of the Effective Date, SELLER is the owner of the Real Property and Groundwater and has the right to capture the Fee Owned Groundwater subject to the items set out on Exhibit "J". There has been no previous transfer of any groundwater rights relating to the Real Property or Groundwater except as set out in Exhibit "C" and all of the groundwater rights relating to the Real Property and Groundwater remain with the Real Property and Groundwater except as set out in Exhibit "C".

B. Authorization and Validity of Agreement. SELLER has obtained due approval and authorization for the execution and delivery of this Agreement, and no other proceedings are necessary to approve or authorize the execution, delivery and performance of this Agreement by SELLER. SELLER has the full right, power, legal capacity and authority to (a) execute, deliver and perform this Agreement and all other documents and instruments referred to herein or contemplated hereby, and (b) consummate the transactions contemplated hereby and thereby. Upon full execution, this Agreement constitutes the valid and legally binding obligation of SELLER, enforceable against it in accordance with its terms.

C. Consents and Approvals; No Violations. The execution, delivery and performance of this Agreement by SELLER and the consummation by SELLER of the transactions contemplated hereby will not, with or without the giving of notice or the lapse of time or both: (a) violate any statute, ordinance, rule, regulation, order, judgment or decree of any court or of any governmental or regulatory body, agency or authority applicable to SELLER or by which any of its properties or assets may be bound; (b) require any filing by SELLER with, or require SELLER to obtain any Permit from, or require SELLER to give any notice to, any governmental or regulatory body, agency or authority; or (c) result in a violation or breach by SELLER of, conflict with, constitute a default by SELLER (or give rise to any right of termination, cancellation, payment or acceleration) under or result in the creation of any encumbrance upon any of the assets or properties of SELLER under any of the terms, conditions, or provisions of any note, bond, mortgage, indenture, Permit, contract, lease or other instrument or obligation to which SELLER is a party, or by which SELLER or any of the assets or properties of SELLER may be bound.

D. Litigation and Warranty Claims. As of the Effective Date, there are no decrees, judgments, fines, forfeiture, awards, orders or injunctions to which SELLER, the Real Property, or the Fee Owned Groundwater is subject, or which otherwise relate thereto, and there is no proceeding pending or threatened against or relating to SELLER, the Real Property or the Fee Owned Groundwater, that, if determined adversely, would, individually or in
the aggregate, be expected to have a material adverse effect upon SELLER or the transactions contemplated by this Agreement. SELLER will notify BUYER immediately of any such actions which arise following the Effective Date.

E. Title to Assets; Encumbrances; Condition. As of the Effective Date, except as set forth on Exhibit "J" SELLER owns outright, and has full legal and beneficial title to the Real Property and Groundwater and, as captured upon the Real Property.

F. Real Property. Exhibit "B" identifies all of the Real Property out of which BUYER is leasing or acquiring its rights therein to be used in connection with the Facilities. SELLER owns fee simple title to the Real Property and the Fee Owned Groundwater subject to only those items set out on Exhibit "J" attached hereto as Permitted Encumbrances. The lease and conveyance, as the case may be, out of the Real Property and the Fee Owned Groundwater hereunder is legal, valid, binding, enforceable, and in full force and effect and no default or condition, which after notice or lapse of time or both would constitute a default, exists which will effect the rights hereunder. Except as set out herein, SELLER has not assigned, transferred, conveyed, mortgaged, deeded in trust, or encumbered any interest in the Real Property or the Fee Owned Groundwater.

G. Compliance with Laws. SELLER is in compliance with all applicable laws, regulations, orders, judgments and decrees.

H. Environmental Laws and Regulations. (i) Neither SELLER nor, to the best of their knowledge, their authorized agents or independent contractors (including suppliers) have generated, used, treated or stored, transported to or from, or arranged for transportation to or from, the Real Property or Groundwater or any property adjoining such Real Property or Groundwater, any Hazardous Materials except as used or stored in compliance with Environmental Laws; (ii) Hazardous Materials have not been released or disposed of by SELLER nor, to the best of SELLER's knowledge, its authorized agents or independent contractors (including suppliers) on the Real Property or Groundwater or any property adjoining such Real Property, except such releases which do not violate any Environmental Laws; (iii) SELLER is, and at all times has been, in compliance with all applicable Environmental Laws, possesses all Permits required thereunder, and is in compliance with all Permits issued thereunder with respect to such Real Property and Fee Owned Groundwater as well as all of SELLER's operations conducted upon the Real Property; (iv) there are no pending or threatened environmental claims against SELLER or, to the best of their knowledge, any other person relating to the Real Property or Fee Owned Groundwater; (v) SELLER has not received any written request for information, nor has been notified that it is a potentially responsible party, under any Environmental Law in connection with the Real Property or Groundwater; (vi) there are no facts, or present or past circumstances, conditions or occurrences on the Real Property or Groundwater that reasonably could be anticipated (A) to form the basis of an environmental claim against SELLER or any owner or operator of any such Real Property or Groundwater, or (B) to cause any such Real Property or Groundwater to be subject to any restrictions on the ownership, occupancy, use or transferability under any Environmental Law; (vii) there are not now, and there never have been, any underground storage tanks located on the Real Property; and (viii) SELLER has not transported, treated, disposed of, or stored, Hazardous Materials upon or adjacent to the Real Property which are not in compliance with Environmental Laws or other applicable laws.

I. Disclosure. No representation or warranty by SELLER contained in this Agreement, nor any statement or certificate furnished or to be furnished by SELLER to BUYER or its representatives in connection herewith or pursuant hereto, contains or will contain any untrue statement of a material fact, or omits or will omit to state any material fact required to make the statements herein or therein contained not misleading or necessary in order to provide BUYER with adequate information as to SELLER and the Real Property (and Groundwater) and their condition (financial and otherwise), properties, assets, liabilities, business and prospects, and SELLER has disclosed to BUYER in writing all material adverse facts known to SELLER relating to the same.

J. Adjacent Property. SELLER acknowledges that BUYER has acquired and may acquire from other persons other water rights to withdraw groundwater from the same aquifer(s) as the Groundwater to be withdrawn pursuant to the terms of this Agreement (the "Adjacent Water Rights"). Accordingly, in no event will BUYER be responsible for any claim, damage or loss relating to or arising from BUYER’ acquisition or use of the Adjacent Water Rights; provided however, in no event shall this language be construed as a release of BUYER for any obligations it may have to SELLER under the terms of this Agreement for contaminating the Groundwater due to its activities in connection with the Adjacent Water Rights.
The BUYER will need to disclose the potential development of adjacent property, in particular if it may affect the drawdown on this real property.

XI.

Representations and Warranties of BUYER

For the purposes of inducing SELLER to enter into this Agreement, BUYER hereby makes the following representations, warranties and covenants to SELLER, all of which shall be true as of the Effective Date and at all times thereafter during the Term of this Agreement:

A. Existence and Good Standing. BUYER is duly organized and validly existing under the laws of the State of Texas and has the power and authority to own, lease and operate its property and to carry on its business as now being conducted and to own or lease the assets owned or leased by it.

B. Authorization and Validity of Agreement. BUYER has obtained due approval and authorization for the execution and delivery of this Agreement, and no other proceedings are necessary to approve or authorize the execution, delivery and performance of this Agreement by BUYER. BUYER has full right, power, legal capacity and authority to (a) execute, deliver and perform this Agreement and all other documents and instruments referred to herein or contemplated hereby, and (b) consummate the transactions contemplated hereby and thereby. Upon full execution, this Agreement constitutes the valid and legally binding obligation of BUYER, enforceable against it in accordance with its terms.

C. Consents and Approvals; No Violations. The execution, delivery and performance of this Agreement by BUYER and the consummation by BUYER of the transactions contemplated hereby will not, with or without the giving of notice, or the lapse of time, or both: (a) violate, conflict with, or result in a breach or default under, any provision of the organizational documents relating to BUYER; (b) violate any statute, ordinance, rule, regulation, order, judgment or decree of any court or of any governmental or regulatory body, agency or authority applicable to BUYER or by which any of its properties or assets may be bound; (c) require any filing by BUYER with, or require BUYER to obtain any Permit from, or require BUYER to give any notice to, any governmental or regulatory body, agency or authority; or (d) result in a violation or breach by BUYER of, conflict with, or constitute a default by BUYER (or give rise to any right of termination, cancellation, payment or acceleration) under, any encumbrance upon any of the assets or properties of BUYER.

D. Disclosure. No representation or warranty by BUYER contained in this Agreement, nor any statement or certificate furnished or to be furnished by BUYER or its representatives in connection herewith or pursuant hereto, contains or will contain any untrue statement of a material fact, or omits or will omit to state any material fact required to make the statements herein or therein contained not misleading.

XII.

Damage and Destruction

A. Damage Repair Election. If all or any portion of the Facilities, Well Sites or Fee Owned Groundwater which are (or may be) used by BUYER under the terms of this Agreement are damaged by fire or other casualty, BUYER will give SELLER Notice of the casualty loss as soon as reasonably possible thereafter. Within 180 days after any such casualty loss, BUYER will determine, in its discretion, if the Facilities or Groundwater can be repaired to its satisfaction, and will notify SELLER of its determination. In the event BUYER determines the Facilities, Well Sites or Fee Owned Groundwater can be repaired or restored to a condition which is satisfactory to BUYER, this Agreement will continue in full force and effect, except that the Minimum Water Payments then applicable shall be reduced on a pro rata basis to reflect the loss or to damaged the Fee Owned Groundwater production caused by the casualty, which reduction shall continue until that date which is the earlier of the date the casualty loss has been repaired and becomes fully functional to the level determined satisfactory to BUYER, or that date which is 36 months from the date of the casualty (the "Repair Period"). If BUYER does not elect to cancel this Agreement, as set out in Article XII B., below, BUYER will diligently proceed to repair the Facilities or Groundwater, as the case may be, to the extent it requires, but shall only be required to do so to the extent of the insurance proceeds made available to BUYER for such casualty loss. SELLER shall make available to BUYER all of the casualty insurance proceeds payable relating to the damage to the Facility or Fee Owned Groundwater, as the case may be, if any, to assist BUYER in the payment for any such repairs, but shall only be required to do so to the extent of the casualty insurance proceeds made available to SELLER for such loss.
B. Termination Election. If all or a portion of the Facilities, Leased Areas, Easement, Fee Owned Groundwater or the Well Sites are damaged by fire or other casualty to an extent BUYER has determined cannot be repaired or replaced to its satisfaction, then BUYER may cancel this Agreement by written Notice given to SELLER on or before 365 days after any such casualty loss. SELLER shall make available to BUYER all of the casualty insurance proceeds payable to SELLER relating to the damage to the Leased Areas, Easements, Facilities, Well Sites or Fee Owned Groundwater, if any, to assist BUYER in defraying the loss of its investment in the Leased Areas, Easements, Facilities, Well Sites or Fee Owned Groundwater.

In circumstances where groundwater is being acquired to be included in the public water supply of a municipal operation, the idea of a quick termination of an agreement may not be prudent or possible. The result may be to cause our good citizens to be left without water. This provision requires a long notice period before the remedy of termination can be utilized.

XIII. Condemnation

A. Condemnation Repair Election. If all or any portion of the Leased Areas, Easements, Facilities, Well Sites or Fee Owned Groundwater are taken by an act of condemnation or transfer in lieu of condemnation (a "Taking"), SELLER will give BUYER written Notice of the Taking (the "Taking Notice") within thirty (30) days after SELLER is notified of such Taking. Within 180 days after any such Taking Notice, BUYER will determine, in its discretion, if the Facilities can, following the Taking, be operated, restructured or repaired to its satisfaction, and the Fee Owned Groundwater rights can be restored or BUYER can be properly compensated therefore (as determined by BUYER) and will notify SELLER of its determination. In the event BUYER determines that, following the Taking, the Facilities can be operated, restructured or repaired to its satisfaction, and the Fee Owned Groundwater rights restored or BUYER can be properly compensated therefore (as determined by BUYER) this Agreement will continue in full force and effect, except that the Minimum Water Payments then applicable, shall be reduced on a pro rata basis to reflect the loss of Fee Owned Groundwater production caused by the Taking, if any. This reduction in the Minimum Water Payments shall continue until the earlier of that date on which the condemnation loss has been fully restructured or repaired and (i) the Facilities become functional to the level determined satisfactory to BUYER and the Fee Owned Groundwater restored or BUYER is properly compensated (as determined by BUYER), or (ii) that date which is 36 months from the date of the Taking (the "Condemnation Period"). If BUYER does not elect to cancel this Agreement, as set out in Article XIII B. below, BUYER will diligently proceed to restructure or repair the Facilities, to the extent it requires, but shall only be required to do so to the extent of the condemnation proceeds made available to BUYER for such Taking. SELLER shall make available to BUYER all of the proceeds payable relating to the Taking of the Facility to assist BUYER in the payment for any such restructure or repairs to the Facilities.

B. Termination Election. If all or a portion of the Leased Areas, Easements, Facilities, Well Sites or Fee Owned Groundwater are subject to a Taking and BUYER determines that the Facilities cannot be operated, repaired or replaced to BUYER satisfaction, or the Fee Owned Groundwater is diminished and cannot be restored or BUYER cannot be properly compensated therefore, then BUYER may cancel this Agreement by Notice given to SELLER on or before 180 days after it receives the Taking Notice from SELLER. SELLER shall make available to BUYER all of the condemnation proceeds payable to SELLER for that portion of the Real Property relating to the Leased Areas, Easements, Facilities, Well Sites and Fee Owned Groundwater, if any, to assist BUYER in defraying the loss of its investment in the Facilities.

C. Award. If a Taking affecting the portions of the Real Property covered by the Leased Areas, Easements, Facilities, Well Sites or Fee Owned Groundwater which are (or may be) used by BUYER under the terms of this Agreement occurs, BUYER shall have the right to make a claim against the condemnor for removal expenses, business dislocation damages, and moving expenses relating to its interests in its rights to the Real Property included in the Leased Areas, Easements, Facilities, Well Sites and Fee Owned Groundwater and diminution in value to its interests in the Leased Areas, Easements, Facilities, Well Sites and Fee Owned Groundwater hereunder.

D. Temporary Taking. If the condemnor takes possession of all or any portion of the Real Property covered by the Leased Areas, Easements, Facilities, Well Sites or Fee Owned Groundwater for a fixed period of time, or for the duration of an emergency or other temporary condition, this Agreement will continue in full force and effect without any abatement of payments, and the amounts payable by the condemnor with respect to any period of time will be paid by the condemnor to BUYER. SELLER will cooperate with BUYER in collecting any sums due by the condemning authority for such Taking.
XIV. 

Defaults

Except as otherwise expressly set out in this Agreement, if for any reason SELLER or BUYER fails to comply with any of the provisions of this Agreement, and such failure continues for a period of thirty (30) days after receiving Notice of such failure from the other Party, then the non-defaulting Party may exercise all rights which may be available to it at law or in equity, including termination of the Agreement for a default in the payment of the sums due under Article VI. In no event shall BUYER or SELLER be responsible for consequential or exemplary damages for any breach of this Agreement. The above notwithstanding, in the case of a default that cannot reasonably be cured within such thirty (30) day period, no such default shall be deemed to exist if the Party responsible to address such default is using due diligence to cure such default and continues to do so until the matter is cured.

The above notwithstanding, in the event a bona fide dispute exists as to the computation of any amounts due under the terms of this Agreement, failure to pay the sums in dispute shall in no event be construed or considered a default, or an event of default, unless and until that date which is thirty (30) days following the date a final determination has been made by a court of competent jurisdiction as to the matters in dispute.

All amounts due and owing to SELLER by BUYER shall, if not paid within thirty (30) days after being invoiced shall, at SELLER's election, bear interest at the Texas post-judgment interest rate set out in Texas Finance Code Section 3.04, or any successor statute, from the date when due until paid, but shall not accrue interest during judicial proceedings, if any, provided that such rate shall never be usurious or exceed the maximum rate permitted by law as set forth in Chapter 1204, as amended Texas Government Code.

XV.

Remedies

Except as otherwise expressly set out in this Agreement, the Parties do not intend to specify (and this Agreement shall not be considered as specifying) an exclusive remedy for any default, but all such other remedies existing at law or in equity may be availed by any Party hereto and shall be cumulative. Recognizing, however, that failure in the performance of any Party's obligations hereunder could not be adequately compensated in money damages alone, each Party agrees in the event of any default (after any applicable cure period) on its part, the other Party shall have available to it the equitable remedy of specific performance, in addition to any other legal or equitable remedies which also may be available to such Party.

The above notwithstanding, in the event of a default by a Party under the terms of this Agreement, other than a default in the payment of the sums due under Article VI, before the non-defaulting Party pursues the remedy of terminating this Agreement, the Party asserting the violation or breach shall provide the defaulting Party Notice of the violation or breach. The defaulting Party shall have one hundred and eighty (180) days from the date it receives such Notice to cure the violation or breach, and if the breach is one that cannot reasonably be cured within such 180 day period, for so much longer thereafter as is reasonably necessary provided the Party is diligently pursuing such cure. If the violation or breach has been remedied prior to the end of such cure period, the Party asserting the violation or breach shall not be entitled to terminate this Agreement because of such violation or breach.

XVI.

Indemnity

A. Indemnity by BUYER. BUYER agrees, to the fullest extent permitted by law and the Texas Constitution, but solely from the net revenues of the System, on behalf of itself and its successors and assigns, to defend, indemnify and protect SELLER and SELLER's, agents, consultants, heirs and assigns from and against all claims, expenses, costs, demands, judgments, causes of action, suits, and liability in tort, contract or any other basis, and of every kind and character whatsoever (including but not limited to all costs of defense, such as fees and charges of attorneys, expert witnesses, and other professionals incurred by SELLER, and all court or arbitration or other dispute resolution costs) arising out of, or incident to, directly or indirectly, BUYER' breach or inaccuracy of any of its representations or warranties contained in this Agreement as well as any and all negligent actions, inactions or omissions in connection with its operations of the Facilities or its use of the Real Property in connection therewith, including but not limited to, any such claim for bodily injury, death, property damage and any claim that may arise in connection therewith.

B. Indemnity by SELLER. SELLER agrees, to the fullest extent permitted by law and the Texas Constitution, on behalf of itself and its heirs, executors, and assigns, to defend, indemnify and protect BUYER and BUYER' officers, directors, trustees, employees, agents, consultants, successors and assigns, from and against all
claims, expenses, costs, demands, judgments, causes of action, suits, and liability in tort, contract or any other basis and of every kind and character whatsoever (including but not limited to all costs of defense, such as fees and charges of attorneys, expert witnesses, and other professionals incurred by BUYER and all court or arbitration or other dispute resolution costs) arising out of, or incident to, directly or indirectly, SELLER's breach or inaccuracy of any of its representations or warranties contained in this Agreement as well as any and all negligent actions, inactions or omissions in connection with its use or operation of the Real Property or Groundwater, including but not limited to, any such claim for bodily injury, death, property damage and any claim that may arise in connection therewith.

C. Demands. Each indemnified Party hereunder agrees that promptly upon its discovery of facts giving rise to a claim for indemnity under the provisions of this Agreement, including receipt by it of notice of any demand, assertion, claim, action or proceeding, judicial or otherwise, by any third party (such third party actions being collectively referred to herein as the "Claim"), with respect to any matter as to which it claims to be entitled to indemnity under the provisions of this Agreement, it will give prompt Notice thereof to the indemnifying Party, together with a statement of such information respecting any of the foregoing as it shall have. Such Notice shall include a formal demand for indemnification under this Agreement. The indemnifying Party shall not be obligated to indemnify the indemnified Party with respect to any Claim if the indemnified Party failed to give property Notice to the indemnifying Party in accordance with the provisions of this Agreement in sufficient time to permit the indemnifying Party or its counsel to defend against such matter and to make a timely response thereto including, without limitation, any responsive motion or answer to a complaint, petition, notice or other legal, equitable or administrative process relating to the Claim, only insofar as such failure to notify the indemnifying Party has actually resulted in prejudice or damage to the indemnifying Party.

D. Right to Contest and Defend. The indemnifying Party shall be entitled, at its cost and expense, to contest and defend by all appropriate legal proceedings, any Claim with respect to which it is called upon to indemnify the indemnified Party under the provisions of this Agreement; provided, that Notice of the intention so to contest shall be delivered by the indemnifying Party to the indemnified Party in a timely manner. Any such contest may be conducted in the name, and on behalf of, the indemnifying Party or the indemnified Party as may be appropriate. The indemnified Party shall have the right, but not the obligation, to participate in such proceedings and to be represented by counsel of its own choosing, at its sole cost and expense. As to any portions of the Claim which the indemnifying Party will be financially responsible, the indemnifying Party shall have full authority to determine all action to be taken with respect thereto; provided, however, that the indemnifying Party will not have the authority to subject the indemnified Party to any obligation whatsoever, other than the performance of purely ministerial tasks or obligations not involving material expense. If the indemnifying Party does not elect to contest any such Claim, the indemnifying Party shall be bound by the result obtained with respect thereto by the indemnified Party.

E. Cooperation. If requested by the indemnifying Party, the indemnified Party agrees to cooperate with the indemnifying Party and its counsel in (i) contesting any Claim that the indemnifying Party elects to contest; (ii) in making any counterclaim against the person asserting the Claim, if appropriate; or (iii) making any cross-complaint against any person, and the indemnifying Party will reimburse the indemnified Party for any expenses incurred by it in so cooperating. At no cost or expense to the indemnified Party, the indemnifying Party shall cooperate with the indemnified Party and its counsel in contesting any Claim.

XVII. Assignability

SELLER may not assign its interest under this Agreement without the written approval of BUYER, which approval will not be unreasonably withheld. BUYER may not assign its interest under this Agreement without the written approval of SELLER, which approval will not be unreasonably withheld. Any assignment of rights or delegation of duties under this Agreement is void without the written consent described above. The above notwithstanding, BUYER may assign this Agreement to any entity with which it is affiliated, provided BUYER shall not be released from its obligations hereunder without the prior written approval of SELLER.

XVIII. Estoppel And Non Disturbance Provisions

A. SELLER's Estoppel Certificate. As a condition to BUYER's obligations hereunder, SELLER agrees to furnish BUYER, upon request from time to time, a certificate certifying the following:
1. This Agreement is in full force and effect;

2. Except as disclosed in such certificate, this Agreement is unmodified;

3. Except as disclosed in such certificate, (i) there is no existing default under this Agreement by reason of, or act or omission by BUYER, and (ii) no event has occurred or condition exists which, with the passage of time or the giving of notice, or both, would constitute a default by BUYER;

B. Non-Disturbance Agreements. As a condition to BUYER’s obligations hereunder, within thirty (30) days from the Effective Date of this Agreement, SELLER will cause the Real Property Interest Holders to deliver to BUYER an executed non-disturbance agreement in a form which is acceptable to BUYER, which agreements shall provide that (i) each of the Real Property Interest Holders will not disturb BUYER’s rights hereunder and will, upon acquiring its interest in the Real Property or Groundwater or this Agreement, assume SELLER’s obligations under this Agreement which arise from and after the date they obtain possession or control of such Real Property or Groundwater; (ii) so long as BUYER is not in default hereunder, they will not terminate this Agreement; (iii) prior to taking any action which will affect BUYER’s rights or obligations under the terms of this Agreement, they shall provide BUYER with at least 60 days prior written Notice of any proposed action and the right to cure or cause to be cured any default or activity which has brought about the proposed action. Any such written non-disturbance agreement shall also provide that BUYER shall have the right, but not the obligation, to undertake a cure of any defaults of SELLER or other Real Property Interest Holder which will give rise to any such proposed actions and BUYER shall have the right to offset any sums expended in connection therewith against any sums due to SELLER hereunder.

Obtaining a non disturbance agreement to protect the BUYER's interest may be very important to protect BUYER's continued rights under the terms of the Lease.

XIX.

Right of First Offer

In the event SELLER desires to sell, transfer or assign all or any portion of the Real Property, the Groundwater or its rights under this Agreement (collectively, the "Transferred Rights"), SELLER hereby grants to BUYER a right of first offer to acquire the Transferred Rights. For the purpose of this Agreement, a sale, transfer or exchange of all or a portion of the Real Property, the Groundwater or its rights under this Agreement to person(s), a trust(s), and/or an entity or entities described in Section XVII to whom SELLER has the right to assign this Agreement without the consent of BUYER, shall not be considered to be a sale, transfer or exchange for the purposes of this Section, provided however, each such transferee shall take their interest in the Real Property, the Groundwater or its rights under this Agreement subject to the terms of this Section as to any future sale, transfer or exchange and shall be bound by the terms of this Agreement. In addition, SELLER shall have the right to mortgage all or any portion of such Real Property, the Groundwater or its rights under this Agreement provided the mortgage is subordinate to the terms of this Agreement in all respects.

SELLER shall give written Notice to BUYER of its desire to convey the Transferred Rights and shall provide BUYER with Notice of the terms and conditions (including the purchase price) upon which it desires to convey such Transferred Rights (the "Proposal"). BUYER shall make its election to acquire the Transferred Rights within sixty (60) days following its receipt of such Proposal. In the event BUYER elects to acquire the Transferred Rights within the sixty (60) day period provided above, BUYER shall close on the acquisition of the Transferred Rights on the same terms and conditions as are set out in the Proposal. In the event BUYER does not elect to acquire the Transferred Rights pursuant to the terms of the Proposal as set out above, SELLER shall have the right for a period of 270 days, to convey the Transferred Rights to a third party free of any right of BUYER to acquire the Transferred Rights; provided the conveyance is made on the same terms and conditions set out in the Proposal. In the event BUYER does not elect to acquire the Transferred Rights as set out above and SELLER desires to convey the Transferred Rights to another person (i) for a price which is less than that set out in the Proposal, and/or (ii) on other terms and conditions which are more favorable to the transferee than those set out in the Proposal, SELLER shall give Notice to BUYER of the details of the proposed transfer (the "Modified Proposal") and BUYER shall have a period of forty five (45) days thereafter to elect to accept such Modified Proposal. If BUYER elects to accept the Modified Proposal, BUYER shall close on the acquisition of the Transferred Rights on the same terms and conditions as are set out in the Modified Proposal. In the event BUYER elects not to acquire the Transferred Rights upon the terms of the Modified Proposal, SELLER shall be entitled to convey the Transferred Rights to a third party upon the terms and conditions set forth in the Modified Proposal, pursuant to the terms contained herein, for any proposal which is not accepted by BUYER. In the event the Transferred Rights are less than the entirety of the Real
Property or Groundwater and all of the rights under this Agreement, this right of first offer shall remain in effect as to the remaining other portions of the Real Property, the Groundwater, and all other rights under this Agreement. Any party acquiring Transferred Rights shall acquire the rights subject to the terms of this Agreement, including the continuing application of this Article on any subsequent transfer.

XX.
Waiver and Amendment

The waiver of or the failure to enforce any provision of this Agreement or any breach or nonperformance by SELLER or BUYER shall not be deemed a waiver by BUYER or SELLER of the right in the future to demand strict compliance and performance of any provision of this Agreement. Regardless of any provision contained in this Agreement to the contrary, any right or remedy or any default under this Agreement, except the right of SELLER to receive the payment provided herein which shall never be determined to be waived, shall be deemed to be conclusively waived unless asserted by a proper proceeding at law or in equity within three (3) years plus one (1) day after the occurrence of the default.

No modifications to, or rescission of, this Agreement may be made except by a written document signed by both SELLER's and BUYER' authorized representatives.

XXI.
Force Majeure

A Party shall be held harmless and shall not be held to any penalty(ies) for its inability to perform under this Agreement due to events of Force Majeure. For the purpose of this Agreement an event of “Force Majeure” shall mean a Party's inability to perform under this Agreement or otherwise meet its obligations set out herein that may be caused by strike, insurrection, civil disobedience, war, governmental regulation, or any Act of God, including but not limited to alteration of the underground groundwater flow regime, change in underground water quality, corrosion, lightning, contamination from any source or sources, and changing groundwater level in the presence of underground karstic features, but only to the extent any such event is beyond the control of that Party. In the event an act of Force Majeure shall cause a partial inability of BUYER to withdraw Groundwater from the Wells and export that Groundwater to areas outside of ________________ County by BUYER (including but not limited to an act of the ________________ Water District or any other governmental body which causes a reduction in the Surface Acre Yield), the rights and obligations of SELLER and BUYER, including the payment of the Minimum Water Payments, as the case may be, shall be reduced on a pro rata basis to reflect any such reduction.

XXII.
Sole Agreement

This Agreement, and the documents to be delivered in connection herewith which shall be incorporated herein, constitutes the sole and only agreement of BUYER and SELLER as to the matters addressed hereby or set out herein and supersedes any prior understanding or oral or written agreements between SELLER and BUYER respecting the subject matter of this Agreement. The Parties agree that they have drafted this Agreement jointly and that construction of the terms of this Agreement shall not be read or interpreted to favor either Party on the basis of authorship.

XXIII.
Severability

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

XXIV.
Operating Expense; Source of Payments

The Parties agree and covenant that all moneys required to be paid by BUYER under this Agreement shall constitute an operating expense of BUYER’ System as authorized by the laws of the State of Texas. All payments required to be made by BUYER under this Agreement shall be payable from BUYER’ revenue from its System. SELLER shall never have the right to demand payment of any obligations assumed by BUYER or imposed upon
BUYER under or by virtue of this Agreement from any funds raised or to be raised by taxation and in no event shall the obligations under this Agreement be construed to be a general obligation debt of BUYER or the City of San Antonio, Texas of such kind as to require BUYER or the City of San Antonio, Texas under the Constitution or laws of the State of Texas to levy and collect an ad valorem tax to discharge such obligation. BUYER agrees to fix and maintain rates and collect charges for the facilities and services provided by its System as will be adequate to permit BUYER to make payment of all expenses of operating and maintaining its System, including payments under this Agreement, from the revenues of their system.

XXV.

Pledge of Revenue

BUYER represents and covenants that all payments to be made by it under this Agreement shall constitute reasonable and necessary maintenance and operating expense of its System as set forth in Section 1502.056, as amended Texas Government Code that all such payments will be made from the revenues of its System.

XXVI.

Place of Performance

This Agreement shall be deemed to be performed in Bexar County, Texas. All amounts due under this Agreement, including but not limited to payments due under this Agreement or damages for the breach of this Agreement, shall be paid and be due in Bexar County, Texas. Venue as to any cause of action relating to this Agreement will be in Bexar County, Texas, except to the extent the law requires otherwise in connection with issues relating to the title of the Real Property, which, as set out in the Texas Property Code, shall require venue in ______________ County, Texas.

XXVII.

Duplicate Originals

This Agreement may be executed in several counterparts, each of which shall be an original and shall, when taken together, constitute one document.

XXVIII.

Captions and Headings

The captions and headings used herein are for reference purposes only and shall not affect the meaning or interpretation of the terms and provisions of this Agreement.

XIX.

Weekends and Holidays

In the event the last date of a time period or the date for performance under this Agreement falls on a Weekend or Holiday, the last date for such time period or performance shall extend to the next day thereafter which is not a Weekend or Holiday.

XXX.

Notices

Any notice provided or permitted to be given under this Agreement must be in writing and may be served by (i) depositing same in the United States mail, addressed to the Party to be notified, postage prepaid and registered or certified with return receipt requested; (ii) depositing it with an overnight delivery service such as Federal Express; (iii) delivering the same in person to such Party; or (iv) confirmed facsimile transmission/telecopy to the telephone numbers set out below. Notice given in accordance herewith (the "Notice") shall be effective upon its deposit with the U.S. mails in the case of registered/certified mail; upon the next business day, in the case of overnight delivery service; upon receipt at the address of the addressee, in the case of personal delivery; and upon confirmation in the case of a facsimile transmission/telecopy. For purposes of Notice, the addresses of the Parties shall be as follows:

If to SELLER, to: ________________________

_______________________

_______________________
XXXI. Surviving Obligations

For the purpose of this Agreement any obligation, representation, warranty or covenant expressly stated in
this Agreement to survive the Agreement and/or termination of this Agreement, together with all of those
obligations set out in Articles III, IX, X, XI, XII, XIII, XIV, XV, XVI, XVII, XIX, XX, XXIV, XXV, XXI, XXX
and XXXI of the Agreement shall survive the termination of the Agreement (the "Surviving Obligations").

XXXII. Further Assurances

Each of the Parties shall take all further actions and shall execute and deliver to the other Party any other
document or instrument which is determined to be necessary or useful to fully carry out the transactions evidenced
by this Agreement.

XXXIII. Recordation of Memorandum of Agreement

Upon the request of BUYER or SELLER, each Party will execute and acknowledge a Memorandum of
Agreement, in recordable form, setting forth the basic terms of this Agreement (in form and substance reasonably
satisfactory to SELLER and BUYER) to be filed for the purpose of placing of public record, the existence of this
Agreement.

IN WITNESS WHEREOF, this instrument is executed as of the Effective Date.

SELLER:

By: __________________________________
Name: ______________________________
Title: ________________________________

BUYER:

By: __________________________________
Name: ______________________________
Title: ________________________________

STATE OF TEXAS )
) ______________________
COUNTY OF __________ )

This instrument was acknowledged before me on the _____ day of _______, 200___, by ___________.

____________________________________
Notary Public, State of Texas
This instrument was acknowledged before me on the _____ day of ______, 200___, by ____________.

________________________________
Notary Public, State of Texas
ADDENDUM

This ADDENDUM TO REAL PROPERTY CONTRACT entered into between ______________________, as Seller and ______________________, as Buyer (the "Addendum") is executed as an addendum modifying the terms of that one certain Farm and Ranch Contract (the "Contract") entered into by ______________________, as Seller and, ______________________, as Buyer contemporaneously herewith. All of the terms of this Addendum are incorporated into the terms of the Contract as if a part thereof. To the extent a term set out in this Addendum is inconsistent with a term set out in the Contract, the term in this Addendum shall control.

1. The following is inserted in Section 11 "Special Provisions":

Subject to the terms and conditions set out below, Seller hereby reserves a 50% net royalty interest ("Royalty") in the groundwater relating to the Property ("Groundwater") which is produced or withdrawn from the Property and actually sold by Buyer and/or its successors or assigns. The above notwithstanding, Buyer shall have the exclusive right to transfer, assign, sell and/or lease the Groundwater and any transferable and severable permits or authorizations related thereto without the joinder or consent of any other party. The Royalty shall be paid by Buyer to Seller within thirty (30) days after Buyer's actual receipt of sums giving rise to a net royalty interest under the terms of this paragraph. For purposes of this paragraph, "net royalty interest" shall mean (A) if Buyer assigns, transfers, sells or leases the rights to develop and produce the Groundwater, the amount, if any, of the fees or payments actually received by Buyer from the assignment, transfer, sale or lease of the rights to so develop and produce the Groundwater, or (B) if Buyer develops and produces the Groundwater, the amount by which (i) the amount of gross revenues actually received by Buyer from the production and sale of the Groundwater from the Property or any part thereof, computed as of a particular date, exceeds (ii) the sum of all expenses incurred or accrued by Buyer in the exploration, development, production of the Groundwater from the Property as of such date, including but not limited to all development and exploration expenses, permit fees, operating expenses, capital expenses for the installation, construction, operation and maintenance of any groundwater wells, and all other expenses incurred by Buyer in connection with the exploration, development, production, and operation of such wells. Seller hereby expressly agrees and confirms that Buyer has no duty or obligation to sell, assign, transfer or lease such Groundwater. The obligation to pay the Royalty is binding upon Seller's heirs, successors, assigns and personal representatives, and shall run with the real property as an obligation relating thereto.

Seller: ______________________

Buyer: ______________________