9th Annual CLE
Law of the Rio Grande
Collaborative Approaches to the River's Biggest Challenges

April 2 - 3, 2009
Santa Fe, New Mexico

Conversion of Irrigation Rights to Municipal and Industrial Rights

New Legislation, Court Cases and Transactions Affecting the Lower Rio Grande

By
Glenn Jarvis

Law Offices of Glenn Jarvis
Inter National Bank Bldg.
1801 South Second Street, Suite 550
McAllen, TX 78503
(956) 682-2660
www.GlennJarvis.com

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I. Introduction

Regions along the Rio Grande in Texas have experienced rapid population growth, a rise in retail, industrial, and services with a resultant need for additional water supplies. In the past two decades this growth has increased at a rapid rate. The developed land areas were once agricultural lands developed in the early 1900s for agricultural purposes. Water rights were obtained for these uses when there was less need for municipal and industrial water. As a result, most all of the Rio Grande water supply was appropriated (sometimes over appropriated) for agricultural use and those rights have now been adjudicated.

Population in the Middle and Lower Rio Grande region in Texas increased from approximately 400,000 in 1950 to over 1.2 million in 2000 with much of this increase occurring after 1970. During the period from 1970 through 1990, six of the 31 fastest growing counties in Texas were within this Rio Grande region, and now some are the fastest growing areas in the United States. There is also tremendous growth in the El Paso area in the Upper Rio Grande in Texas, and continued growth in the Middle Rio Grande reach principally in the cities of Laredo and Eagle Pass and in the Lower Rio Grande or the Rio Grande Valley area.

The population distribution in the Lower Rio Grande is concentrated in the Rio Grande Valley area (principally Cameron, Hidalgo, Willacy and Starr Counties and in the Middle Rio Grande area principally Webb and Maverick Counties (Laredo and Eagle Pass). In 2000, the

combined population of the Valley counties accounted for nearly 89% of the region's total population. It is projected that the population in Cameron and Hidalgo Counties only, by the year 2060 will be near 2,800,000 and Webb County (Laredo) over 725,000 and Maverick County (Eagle Pass) to over 76,000. *Rio Grande Regional Water Planning Group* (Texas Water Development Board), Rio Grande Regional Water Plan 2006 (Pgs. 1-21 through 1-24).

The Regional Water Plan identified shortages of supply in all use areas. In agricultural use no strategy would offset shortage, but could be reduced by conservation projects. As to municipal and industrial use waters recommended water management strategies to overcome these shortages include water conservation, desalinization, and the voluntary transfer and conversion of agricultural rights to municipal use water rights since much of the population growth involves the subdivision of lands which were previously under irrigation.

The continued growth and need for municipal and industrial waters, have brought about calls for the transfer of water from traditional agricultural use to meet the new demands for municipal and industrial purposes. This has raised challenges and conflicts between agricultural and municipal use interests in how these water rights will be converted from one use to the other.

This paper will discuss issues downstream of the El Paso region: (1) a case involving the transfer and marketing of a water right in the Upper Rio Grande reach to the Middle Rio Grande reach in Texas, which required an amendment to water rights proceeding in the Texas Commission on Environmental Quality (TCEQ) and which has been recently upheld by the Texas Supreme Court; (2) a statute passed in 2007 pertaining to the Lower Rio Grande reach which provides a mechanism dealing with the conversion of agricultural rights held by water districts to municipal use and transfer to municipal suppliers; and (3) the status of current marketing of water rights in the Lower and

Middle Rio Grande.

II. Background

It is necessary to generally define the water rights regime on the Rio Grande in Texas to understand the issues discussed in this paper. It is noted that the entire Rio Grande Basin has been divided by politics and needs of the time into two segments. When looking at the entire Rio Grande Basin as a whole, the term "Upper Reach" is the segment of the River from its head waters in the San Juan range of the Rocky Mountains in Southern Colorado through central New Mexico to Fort Quitman, Texas, about 90 miles downstream of El Paso, Texas. The "Lower Reach" is that portion of the River from Fort Quitman, Texas downstream to the Gulf of Mexico. The water in the Upper Reach is all from tributary sources in the United States whereas in the Lower Reach the majority of the flows derive from Mexico. Flows in the Lower Reach historically were mixed waters composed of United States flows from the Upper Reach, substantial inflows of water from several Mexican tributaries, and water from the Texas tributaries consisting mainly of the Pecos and Devils Rivers.

The Lower Reach in Texas has been further subdivided by custom, law, rules, and regulations into three separate segments referred to as the "Upper Rio Grande," being that portion of the River between Fort Quitman, Texas and Amistad Reservoir (near Del Rio, Texas); the "Middle Rio Grande," being that portion of the River between Amistad and Falcon Reservoirs; and the "Lower Rio Grande," being that portion of the Rio Grande downstream from Falcon Reservoir (downstream from Laredo, Texas) to the Gulf of Mexico, which includes an area called the Lower Rio Grande Valley at the southern tip of Texas where the River normally flows into the Gulf of Mexico. 30 TEX. ADMIN. CODE CH. 303, contain specific rules governing River operations in Lower and Middle Rio Grande.

The legal regime in each reach of the Rio Grande downstream of Fort Quitman, Texas is also

unique. The water rights in the Lower Rio Grande below Falcon Reservoir were adjudicated by a District Court in Hidalgo County, Texas, over a twenty year period between 1951 and 1971. The District Court in Hidalgo County initially took judicial custody of the waters in Falcon Reservoir, and established a Watermaster under the direction of the Court while the rights were being adjudicated by the Court. Following the final judgment, the Watermaster's office established by the Court was transferred to the Texas Water Rights Commission (now the TCEQ), and thus began water rights administration on the Lower Rio Grande. *State of Texas v. Hidalgo County Water Control and Improvement Dist. No. 18, et al.*, 443 S.W.2d 728 (writ ref'd. n.r.e.) commonly referred to as the "Valley Water Case."

In the 1970s and early '80s, the water rights in the Middle Rio Grande segment were adjudicated pursuant to the Texas 1967 Adjudication Act (Vernon's Ann. Texas Civil Stat., Texas Water Code, Subchapter G., §§11.376 *et seq*.) The Middle Rio Grande adjudication, although it involved some different legal issues than was involved in the Court adjudication, was blended with the adjudication by the Court in the Valley Water Case with respect to management of the reservoirs. This was done at that time because the Amistad Reservoir was then complete, and a decision was made by the Commission and the courts that the Amistad and Falcon reservoir systems would be better utilized through coordinated water management as a unit. The legal regime and water management system in the Middle Rio Grande and Lower Rio Grande were blended and managed as a single system.

The Upper Rio Grande segment in Texas was later adjudicated by the Commission, (now the TCEQ). Since there were no reservoirs in this reach of the River from Fort Quitman, Texas to Amistad Reservoir, the water rights were adjudicated as regular "run of the river" water rights.

Following the adjudication of these "run of the river rights" in the Upper Rio Grande segment, the Commission enlarged the jurisdiction of the Rio Grande Watermaster to include the Upper Rio Grande. (*See* 30 TEX. ADMIN. CODE, Chapter 303).

These events established the operations of the Rio Grande Watermaster in the three reaches of the Rio Grande from Fort Quitman, Texas to the Gulf of Mexico. The rules established in each reach reflect the marked differences between the water rights system in the Middle and Lower Rio Grande segments compared to the "run of the river" system above Amistad in the Upper Rio Grande segment. Water rights in the Middle and Lower Rio Grande are similar to bank accounts because all water is allocated based upon storage in the reservoirs. In contrast, under 30 TEX. ADMIN. CODE §303.23, the distribution of water in the Upper Rio Grande segment is based upon the "prior appropriation system" of first in time is first in right with respect to the exercise of each water rights.

As a result of the unique adjudication and management of the Middle and Lower Rio Grande as a single unit of stored water rights, not based upon the prior appropriation system, all of the adjudicated prior appropriation water rights above Amistad Reservoir, as a practical matter are senior and superior to the stored water rights in and downstream of Amistad Reservoir to the Gulf of Mexico. In other words, under Texas water law the storage water rights in the Middle and Lower Rio Grande have no priority or right to control use of Rio Grande water by water rights holders in the Upper Rio Grande. As such, the Middle and Lower Rio Grande rights are junior to rights in the Upper Rio Grande, and prior appropriation rights apply only between water rights holders in the Upper Rio Grande.

III. Court Cases on the Rio Grande in Texas - the Presidio Case

A recent case involves the transfer of a total of 8059 acre feet of water per annum with 3

different, but old priority dates, of water rights from the Upper Rio Grande to the Middle Rio Grande with diversion points at or near Presidio, Texas. It involved many complex water rights transfer issues in this context. This case[1] is referred to as the "Presidio Case" for discussion purposes and will be summarized as it proceeded through the TCEQ to the Texas Supreme Court.

In the administrative proceeding before the TCEQ, the complex mix of water right principles discussed above between the Upper Rio Grande and the regime of water law in the Lower and Middle Rio Grande, the Applicants anticipated the problems at hand and the need to demonstrate protection of water rights in the Lower and Middle Rio Grande. The Applicants before the TCEQ were the seller, Presidio Valley Farms, Inc., and the buyers of the water rights, Eagle Pass, Laredo and Maverick County, Texas.

The Applications filed with the TCEQ took into account the differences between the water administration in the Middle and Lower Rio Grande segments and the water rights involved in the Upper Rio Grande.

The water rights at Presidio are located near the confluence of the Rio Conchos from Mexico with the Rio Grande below Fort Quitman, Texas. The Rio Conchos and other tributaries in Mexico below the Rio Conchos in Mexico contribute the substantial flows to the Rio Grande below Fort Quitman. The Applicants did not request that these Upper Rio Grande segment water rights be combined or merged in some manner with the stored water rights regime downstream because of these divergent laws, rules, and regulations. This would have resulted in changing the legal

[1] *Brownsville Irrigation District, Bayview Irrigation District, Cameron County Irrigation District No. 6, Hidalgo and Cameron Counties Irrigation District No. 9, and Valley Acres Irrigation District v. Texas Commission on Environmental Quality; Presidio Valley Farms, Inc.; Maverick County; City of Laredo; and City of Eagle Pass Water Works System*, 264 S.W.3d 458 (Tex. App.- Austin, August 28, 2008) review denied. Sup. Ct. of Texas, January 9, 2009.

characteristics of the rights, not recognized by any law or regulations. The Applicants sought only to change the diversion points downstream to maintain the legal status of the water rights as "run of the river" rights. The accounting method presented with their Application to the TCEQ avoided unnecessary complications, which could occur if these rights were merged with the stored water rights of the Middle and Lower Rio Grande segments. Accordingly, the Applicants submitted an accounting procedure whereby the amount of water authorized to be diverted at the new downstream diversion points would be based upon the availability of water at designated gauging points downstream in Presidio County, taking into account transportation losses incurred between this upstream location and the new downstream points where water will be taken from the River.

(A) Controlling Law

The Applicants requested an amendment to PVF's water rights that did not increase the amount of water authorized to be diverted or the authorized rate of diversion. The authorized rate of diversion was actually decreased from a combined 173.8 cfs to a combined 75 cfs, a 57% reduction. This was significant because it reduced the rate (capacity of pumps) that water can be taken from the River, and extends the amount of time it takes within a year's time to actually take the amount of water authorized to be taken during the year.

The controlling law in considering the Application was and is Texas Water Code, §11.122(b), which states that a requested amendment to a Texas water rights (assuming no request for an additional amount of water or increased diversion rate):

> A. . . .shall be authorized if the requested change will not cause adverse impact on other water right holders or the environment on the stream of greater magnitude *than under circumstances in which the permit, certified filing, or certificate adjudication that is sought to be amended was fully exercised according to its terms and conditions as they existed before the requested amendment."* (Emphasis added)

The above emphasized portion of the statute is sometimes referred to as the "four corners doctrine," which means that the impact analysis of the requested amendment must assume that the water rights being amended were fully exercised according to the terms and conditions of the previously authorized water right being amended. For example, it is assumed that the full amount of authorized diversion is used which in this case was 8059 acre feet diverted (taken from the River) at any time during an annual period. The statute required the Commission to grant the amendment if the standards quoted above are met taking into account other issues identified by the Court in a recent case involving amendment to water rights in Texas.

The Texas Supreme Court recently considered §11.122(b) in relation to whether notice and hearing is required under this section. *City of Marshall v. City of Uncertain,* 206 S.W.3d 97, 49 Tex. Sup. Ct. J. 695. (2006). The *Marshall case* addresses whether notice and hearing is required because of the mandatory language "shall be authorized" within §11.122(b)[2]. In the Presidio case, the Applicants avoided these notice and hearing issues. Notice was sent to the 100s of downstream water rights holders in the Middle and Lower Rio Grande, and a contested case hearing was requested by several Protestants holding downstream water rights in the Lower Rio Grande and a hearing was conducted.

The *Marshall case* is different than this case because issues of notice and hearing were not before the TCEQ. Nevertheless, the *Marshall case* was instructive because it illustrates that the

[2]The City of Marshall filed an Application to change the purpose of use of its water rights from municipal use to municipal and industrial use because it had potential industrial use customer(s) who needed a raw water supply for industrial use as opposed to potable municipal use water. It was undisputed that the City had only used 50% of its water rights in the past. The Commission held that §11.122(b) required it to approve the amendment and that a contested case hearing was not necessary. The Supreme Court held a hearing could be necessary even under the "four corners doctrine," where facts and circumstances raised fact issues and that the "subject to other applicable" provisions in §11.122(b) made necessary consideration of other issues, such as public interest and welfare.

TCEQ's role in a case relating to an amendment to water rights (which is always involved in the sale of water rights) is limited because of the "shall" language in §11.122(b). The amendment "shall" be granted if the standards of §11.122(b) are satisfied. The statute was the controlling law. This statute establishes that if the statutory conditions are met, the Applicants have the right to have their Application granted subject to consideration of other issues, such as public interest and beneficial use of water will be made. The issues explored in the *Marshall case* demonstrate the strong public policy declared by the Legislature in Senate Bill 1 to promote the voluntary transfers of irrigation use rights for municipal use.

After notice was published and mailed in the Presidio case, there were seven Protestants who requested a contested case hearing. Four of those withdrew their protests based upon their review of the Draft Amendment by the TCEQ staff containing the water accounting plan and protection accorded to downstream water rights.

The Supreme Court in the *Marshall case* concluded that in amendment cases:

> While §11.122(b) significantly restricts the issues that may be reviewed in a contested-case proceeding, it does not all together preclude one. Depending upon the particular amendment application, the hearing may be necessary to allow the Commission to assess certain limited criteria other than the applications effect on other water right holders, and the on stream environment that the legislature considered necessary to protect the public interest, including assessment of water conservation plans, consistency with the State and any approved regional water plans, and groundwater effects.

Even though the TCEQ did not have the Supreme Court's opinion in the *Marshall case* when it issued its Order in the Presidio case, the Commission did what the Supreme Court required in the *Marshall case*. The TCEQ required a contested case hearing and it considered in its processing of the Application all of the issues the Supreme Court discussed in the *Marshall case*.

(B) Adverse Impact on Other Water Rights

The Applicants included with its Application, an Engineering Report of over 30 pages which included a complex water accounting plan which was deemed required so that the Rio Grande Watermaster could manage the diversions downstream based upon flows at Presidio, including a deduction for transportation losses. The water accounting plan was consistent with the divergent water rights systems in the Upper Rio Grande reach and the reach below Amistad and with the accounting of ownership of the water between the United States and Mexico under the 1944 Treaty. The Applicants asserted that the only substantive issues involved were: water accounting and transportation losses. On this basis, the Applicants provided to the TCEQ, with their Application the Engineering Report addressing these issues, which was later supplemented based upon requested revisions by the TCEQ's staff during the TCEQ administrative process.

The Amendments to the water rights issued by the TCEQ protected downstream water right holders by providing proper water accounting procedures based upon flows at the previous diversion points at Presidio, and containing provisions pertaining to unauthorized diversions and discontinuous flows in the reach between Presidio and Amistad Reservoir, and provisions dealing with any adverse impact that occurs with respect to the I.B.W.C.' s determination of the ownership of water between the United States and Mexico under the 1944 Treaty.

Within the water accounting system is a transportation loss factor. Expert testimony supported the determination of transportation losses. This testimony was accepted and supported by the TCEQ's hydrologist and testimony received from the I.B.W.C. The Protestants produced no controverting evidence, except to assert that the loss factor was different from the I.BW.C. losses applied in isolated incidents. All of the expert testimony distinguished the I.B.W.C. loss calculations

as being for a different purpose than was required in the Presidio case, and were inapplicable. The testimony of the I.B.W.C. recognized that there was a difference between the I.B.W.C.' s real-time calculations and the Watermaster's accounting of water rights loss. It was noted in the testimony that Applicants' calculation of losses took into consideration the low flow periods of the year, which is a conservative and correct approach with respect to the calculation of losses for a long term water management system because these are periods with the most water loss. The Amendments did not cause adverse impact on the environment. Moving the diversion points was favorable to the environment as it leaves water in the Rio Grande for longer reaches.

Ultimately, the Protestants in Court did not attack the determination of transportation losses or the water accounting plan, but contended that the TCEQ should have applied the conversion factor established in rules for the Lower and Middle Rio Grande instead of finding that the conveyance loss, water accounting plan and other conditions in the issued water rights amendment was "the applicable conversion factor" in the Presidio case.

As background, it is noted that the TCEQ in 1986 established a conversion factor in amendment cases in the Lower and Middle reaches of the Rio Grande. The rules relating to these reaches, 30 TEX. ADMIN. CODE §303.43, provides that all Class A and B priority rights[3] in the Lower and Middle Rio Grande which have been or will be acquired for domestic, municipal, or industrial use shall be amended to authorize the change in purpose of use and converted to receive a definite quantity of water in acre-feet per annum of one acre-foot of Class A irrigation water rights shall be

[3]See *State v. District 18*, 443 S.W.2d 728, for the distinctions between Class A and Class B, essentially Class A rights were based upon prior appropriation or legal paper water rights, and Class B were equitable water rights based on long use and generally were prior riparian irrigation common law rights found invalid in Texas in Spanish Land Grants and State Grants after 1895, see *State of Texas, et al. v. Valmont*, 163 Tex. 381, 355 S.W.2d 502 (Tex. 1962).

converted to 0.5 acre-feet of water per annum for either domestic, municipal, or industrial purposes; one acre-foot of Class B irrigation water right shall be converted to 0.4 acre-feet of water per annum for either domestic, municipal, or industrial purposes.[4]

Rules were established by the TCEQ to deal with stored water rights established by the Valley Water Suit and the Middle Rio Grande Adjudication, and is again unique to those water rights. Domestic, municipal, and industrial use rights in the Lower and Middle Rio Grande are unique in Texas in that they are entitled to a priority of allocation. The first water allocated from the available water supply in the reservoirs is set aside for their use.

The Applicants did not request that, in moving the diversion points downstream, that the amended rights downstream take any characteristic of a "stored water right." This would change the legal characteristics of the water rights involved and applicable law under the prior appropriation doctrine and law applicable to the Upper Rio Grande in determining the amount of water that they are entitled to divert at their diversion points downstream of Amistad Reservoir.

The TCEQ has a special rule relating to transferring points of diversion on the Upper Rio Grande contained in 30 TEX. ADMIN. CODE § 303.42(4) which states:

> Transfers of the point of diversion or place of use of water rights from the Upper Rio Grande into the Middle or Lower Rio Grande below International Amistad Reservoir will be prohibited unless:
>
> (B) an applicable conversion factor has been approved by the commission;
> (C) the commission finds that the transfer would not impair other water rights within the Middle and Lower Rio Grande; and

[4]This conversion factor was a recognition of the prior appropriation doctrine of priorities. Class A rights were appropriative rights with priority date and superiority, whereas after *Valmont* (which held that common law riparian rights did not exist for irrigation purposes on land derivative of Spanish Land Grants, was a recognition in equity of long use of water and from a judicial equity stand point were given a Class B status.

(D) the commission finds that the transfer would not reduce the amount of water available for allocation.

Applicants argued that the TCEQ should not apply the term "conversion factor" contained in 30 TEX. ADMIN. CODE §303.42(4)(A) as similar in meaning to the "conversion factor" used in the Middle and Lower Rio Grande contained in §303.43. To do so would convert the "run of the river" appropriation rights involved in the Presidio case into stored water rights. The Applicants did not request to merge the rights at Presidio with any rights in the Middle or Lower Rio Grande regime. The Applicants requested that the water that they would be entitled to divert is water available in the Rio Grande at Presidio, which would pass through Amistad Reservoir, and be diverted downstream in such quantities after deduction of the appropriate transportation losses as determined by the Rio Grande Watermaster pursuant to the Amendments. That is, a "conversion" factor corresponding to stored water rights in Amistad Reservoir is not applicable.

The TCEQ asserted that it had applied this rule in this case by *approving* the *applicable* conversion factor as being the special conditions contained in its Order of over 20 pages approving the Amendments to the water rights which contains many specifics to protect downstream rights

The District Court and Court of Appeals approved the TCEQ's Order and Amendments to the Presidio water rights and the Texas Supreme Court denied the petition for review. See Court of Appeals Opinion in 264 S.W.3d 458 (footnote 1 above).

IV. Conversion of Irrigation Water Rights to Municipal on Urban Lands

Another recent event in the Lower Rio Grande was a legislative one. This was the result of over 20 years of disputes between irrigation water districts and municipal suppliers in the Rio Grande Valley, which are cities or water supply corporation organized initially to serve rural

residents but which, because of the growth in previously rural areas, now serve a large population. These disputes centered around how irrigation rights previously used on farm land now urbanized would be changed to municipal use.

The Texas State Legislature in 2007, passed a statute on the conversion of agricultural rights to municipal use rights based upon a consensus compromise on the issue. It only applies to the Lower Rio Grande but impacts the Middle Rio Grande. The statute sets out a statutory method by which agricultural water rights are converted to municipal use and the terms of the conversion transaction. (Acts 2007, 80th Leg., Ch. 1430, Vernon's Texas Civil Statutes, Water Code, Subchapter O, Sections 49.501, *et seq.*)

This legislation only covers water districts and municipal water suppliers in counties that border the Gulf of Mexico and Mexico or is adjacent to such a county. This basically means the four-county area in the Lower Rio Grande Valley.

When subdivisions are platted and recorded, the municipal water supplier, who will serve the subdivision with potable water, has 2 years in which to petition the water district to convey the water rights associated with the previous farm land now in the subdivision or contract over a 40-year period for the delivery of the equivalent amount of water.

If the municipal supplier fails to file such a petition within this 2 year period, then after notice to other water suppliers in these counties, other water suppliers in the 4 county area may opt to purchase the rights at the same terms and conditions as a purchaser from outside the county areas. If no one opts to purchase the rights within 90 days, then the sale may be made to the purchaser located outside the 4 county area. The effect on the Middle Rio Grande and one county in the Lower Rio Grande is that municipal suppliers in the 4 county area have first right to purchase the water rights.

The amount of water rights which are associated with a subdivision is based upon the number of previous irrigated acres within the subdivision and its prorated share of the district's water rights.

The law provides that a district can provide for the water rights out of its existing municipal use water rights or convert the previous irrigation rights of the district to municipal use through an amendment to its water rights as provided by TCEQ rules.

The statute provides that if the water rights are conveyed to the municipal water supplier, that the amount paid to the water district is equivalent to 68% of the prevailing market value of water rights sold in the Lower and Middle Rio Grande determined by the Rio Grande Regional Water Authority based upon the price paid in the last 3 sales transactions of 100 acre feet or more the previous year. If the water is to be delivered on a contractual basis, the law provides for a formula to determine the delivery charge to be paid by the municipal supplier to the water district on an annual basis.

The water district agrees to designate at least 75% of the proceeds from the sale of water rights for capital improvements of the district.

So far no petitions have been filed under this statute, but the Authority has established the market value according to the statute as $2218 per acre foot of municipal use rights after conversion from irrigation rights for the year 2009. *Board Minutes*, Rio Grande Regional Water Authority, January 7, 2009.

V. Transactions in the Lower and Middle Rio Grande

This reach of river has experienced a most active market. Data compiled indicate a market value in the sale of water rights in the range $2000 per acre to $2250 per acre foot of municipal and/or industrial use rights with most recent sales at the high end of $2250 per acre foot. Contract

sales of water allocations in specific amounts to be used within a year range from $10 to $30 per acre feet and have been as high as $60 per acre foot for agricultural use in drought years. Municipal use water sales range from $45 to $52 per acre foot and mining use water (same allocation type as irrigation) has ranged up to $212 per acre foot.

VI. Conclusion

Policies, agency action, legislation, and court cases dealing with the change of agricultural/irrigation rights to municipal and industrial rights use rights and resulting transactions is alive and will continue in the future in Texas. This is also true in the other western states because of shifts in population in the United States to the west and south and resultant continued growth in population, commercial and industrial activities. The stress of need for more water supply will continue in arid and semi-arid western states, and it is now becoming more apparent in some of the eastern States where water supply has not been as critical as in the West. *See, "Gulp - Litigation Won't End the Battles Over Disputed Water Resources in Several Regions of the United States*." Kristin Choo, American Bar Association Journal, September 2008.