

Water Contracting Options: Finding the Right Structure for Your Needs*

By Nathan E. Vassar

In order to manage a water supply portfolio effectively in light of evolving demands and customer bases, the use of an appropriate contract structure is critical, along with other important tools. There are a variety of contract options and considerations to evaluate when pursuing amendments to existing supply agreements and new contracts as well. Our ongoing water supply planning series has focused to date on a number of technical, legal, and practical considerations, including accounting plan approaches, “low-hanging fruit” water rights amendment applications, and conservation, among others. This article now pivots to the contract vehicle that includes the obligations of water suppliers and their customers, and strategies that can help meet a supplier’s needs (and those of its customers) in the near term and over decades to come.

A starting point of any contract discussion is the identification of demonstrated need over a specific term. From a wholesale provider’s perspective, it is important to know whether a customer’s demands are expected to remain constant or if they will likely increase over time. If increased water quantities are not needed until many years in the future, a contract approach that includes a reservation or option quantity can afford flexibility while providing a revenue stream today for water that is set aside. For other customers, a “take or pay” contract may be more appropriate when demands are imprecise and when needs may fluctuate from year to year (or even month-to-month, depending upon the customer and its use). In this context, an annual take-or-pay quantity may be established that increases over periods of years to accommodate growth. Of

* This article is the eighth in an ongoing series of water supply planning and implementation articles to be published in the *Lone Star Current* that address simple, smart ideas for consideration and use by water suppliers in their comprehensive water supply planning efforts.

course, to the extent that quantities over and above a diversion amount or take-or-pay amount are needed, the contract should provide for a process for such overages. It is not uncommon to include an excess water rate, assuming that such excess water is even available for sale. Alternatively, diversions in excess of the stated quantity can be prohibited altogether and treated as a breach of the agreement. This approach, however, drives home the need to set an appropriate contract quantity that is in line with anticipated demands, including peaking during times of significant need.

Ultimately, addressing water quantity in a contract goes beyond just annual demands and planning horizons – it must also consider practical operating considerations and regulatory limitations. A water supplier must analyze the customer's needs in light of the supplier's broader customer base and available supplies. Such a discussion must also evaluate the reliability of the supply, and whether such supply is backed by storage or is dependent entirely upon streamflow. Drought planning considerations are also critical, and the contract should contemplate how curtailment will operate during times of drought, pointing to the supplier's water conservation and drought contingency plans as well.

Other questions and issues also merit analysis and discussion when entering into contract negotiations. Specifying how rates are set and the frequency of rate adjustment can help avoid disputes down the road. Transportation of water and identifying delivery points is important, and can either be addressed in a water supply contract or by a separate agreement. Do place/purpose of use restrictions require an amendment to an underlying water right or service area? How do current Regional and State Water Plans contemplate service to this customer, if at all? How is ownership of the water addressed, including reuse rights? These questions, among others, are important to address on the front end, and can be valuable in setting expectations before a contract is executed.

As we have recommended previously, a water supply audit can help inform a number of planning considerations, including how amended and/or new water supply contracts may be structured. In such a context, or independently, it can be helpful to develop a set of deal points that reflect priorities and limitations, and that may include areas where a supplier is unable to compromise, in light of its other obligations to existing customers, regulatory constraints, and anticipated future demands. Such deal points can be developed and then provided to a potential buyer in order to focus negotiations and determine whether the parties can reach a meeting of the minds on key issues.

As this series continues, our focus will next pivot to federal issues in water supply planning, including regulatory regimes with the Army Corps of Engineers and the U.S. Environmental Protection Agency. We will look at the interplay between water rights and Sections 402 and 404 of the Clean Water Act, addressing lessons learned and best practices when dealing with federal interests and agencies.

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