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PRODUCED WATER IN TEXAS – WASTE OR GROUNDWATER? WHO OWNS IT?

by Stephen Cooney
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As we welcome around 1,100 new Texans a day, water has become our most precious natural resource. According to the 2017 State Water Plan, Texas' population is expected to increase more than 70 percent between 2020 and 2070, from 29.5 million to 51 million. As the technology continues to improve, recycling and reusing water is one of the many planning strategies needed to ensure Texas can withstand this population boom.

Imagine you purchased ranch land in 2010 but acquire the surface only as the minerals were severed decades before. You take the land subject to an oil and gas lease and a surface use agreement. The surface use agreement has typical provisions for a specific location on the property where production activities are to occur, so you are comfortable that the remaining parts of your property will not be disturbed. There is even a provision that the operator may elect to dispose of produced water into an injection well on your property for a monthly fee, which for a few years now has amounted to some nice "mailbox money" for you. However, on September 1, 2019 (the date HB 3246 became effective), XYZ Water Company approaches the operator and wants to buy the produced water so it can take it offsite, recycle it and resell it to ABC municipality or other operators for fracking operations. You, the landowner, may not even know the transaction occurred and now that mailbox money is going to the operator. Landowners will have something to say about their water being sold without compensation, their consent or even knowledge and the battles will begin.

In 2013, the Texas Legislature passed HB 2767 to encourage the recycling of produced water. The bill added Section 122 to the Natural Resources Code, which provides that when a person takes possession of produced water (part of the definition in the statute of "fluid oil and gas waste") to treat it for a subsequent beneficial use, the produced water becomes that person's property. The statute was amended this last legislative session by HB 3246 to include operators that reuse produced water for beneficial use also take ownership of it.

The ownership of oil and gas waste has never been defined by the courts or the legislature, mainly because it has always been viewed as just that – waste to be disposed. It was for this reason the legislature first passed HB 2767 in order to clear up any ambiguity and provide recyclers comfort that once they take possession of the waste, they are the owners of it. Without this clarity, recyclers, and now with HB 3246 operators, would not make the investment for the needed technology to recycle and reuse produced water off lease. These bills, however, create a different problem with respect to surface owners and their groundwater rights – what happens when that waste, which includes produced water that is part of the groundwater estate, suddenly has independent economic value? Who benefits? Who truly owns it?

It is well established in Texas that groundwater is part of the surface estate, owned by the surface owner as a vested property right. The Texas Water Code defines groundwater as water percolating below the surface of the earth. Case law strongly suggests that produced water is part of the groundwater estate and thus the property of the surface owner. HB 2767 and 3246 then, in effect, transfers ownership of what is a real property right from one party (the surface owner) to another (the operator or recycler). This is an unconstitutional taking. Mineral owners or lessees have the implied right to use as much of the surface, including groundwater,

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as is reasonably necessary to extract and produce the minerals. As part of that implied right is the duty by operators to dispose of the waste, including the produced water, that is a byproduct of the oil and gas process. Most of the time the waste is hauled off or piped to an injection well. But if that waste becomes a commodity with economic value, you can bet surface owners will want to be compensated.

Both bills passed the legislature easily and relatively quietly. Proponents of the legislation view this as a waste management issue, not an ownership issue. The argument being that we need to encourage recycling of this waste water so as to not increase pressure on the state's freshwater supplies. Those who testified against the bills, while agreeing for the need for recycling, believe it is indeed an ownership issue and that surface owners are left out in the cold while others may economically benefit from what is the surface owner's real property interest. They argued the surface owner, at least, should have a seat at the table if another party is making money from something that the mineral owner or lessee has the implied right to *use*, but not *take*.

HB 3246 does provide that a surface use agreement, oil and gas lease, or other contract can override the statute, but this does not affect surface use agreements in place today that are silent on the issue. Further, surface owners many times, like the example above, acquire their property subject to a severed mineral estate that occurred decades ago and thus the surface owner virtually has no interaction with an operator or mineral owner. Some opponents of the legislation argued surface owners should have the opportunity to consent or have a right of first refusal before the waste is sold for economic gain as opposed to disposed.

Again, the proponents of this legislation view this is as a waste management issue that clears the path to recycle this waste for beneficial use and save our precious freshwater supplies. The opponents of the legislation point out that monetizing the waste for independent economic value without the consent of or compensation to the surface owners amounts to a taking of a private property right. This appears ripe for the courts to decide or the Legislature to revisit when it convenes again in January 2021. In any event, surface owners should pay close attention to how produced water is handled and address the issue going forward in surface use agreements.

ABOUT THE AUTHOR



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Stephen Cooney focuses on representing buyers and sellers in negotiating and documenting the sale, purchase, lease, development, finance and operation of commercial properties. He also advises clients and negotiates deals concerning a wide range of other commercial real estate matters, including land use issues, deed restrictions, access to water resources and the formation and operation of property owners associations. Stephen is Board Certified in Commercial Real Estate Law by the Texas Board of Legal Specialization.