



## Underground water will be valuable commodity, some say

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CALDWELL — On a balmy October evening three years ago, Diane Johnson was kicking a soccer ball around the front yard with her two little girls when a stranger rumbled up the driveway in a pickup.

Her husband, Steve, who had been cooking supper on a grill, came around the corner to see who had arrived.

To the Johnsons' surprise, the stranger, W. Scott Carlson of Brenham, had a check for more than \$300 with their names on it. He wanted to lease some of the water beneath their 121/2 acres of Burleson County land.

All they had to do was sign a lease and endorse the check, Carlson said, and the bonus money of \$25 per acre would be theirs. They also would reap some of the profits when his company sold the water.

What the Johnsons didn't know was that Carlson, under the terms of his probation, is required to carry an "offender identification card" connected to a July 2002 felony theft charge in Houston. Fifteen months earlier, he had pleaded guilty in a Houston courtroom to stealing \$2.4 million from two oil companies he'd worked for as a land man.

Carlson, now 46, did not return repeated phone calls for this report. He remains on probation but has continued to approach landowners in Burleson and Milam counties about their water rights.

He was among the first people in the state to bet that water shortages would make groundwater a profitable business — maybe even the next big thing after oil. Responding to population growth along the Interstate 35 corridor, he has been working in some of the counties east of there, in picturesque rolling ranchland where artesian wells still flow.

When it comes to the future of water, this is how Texas has decided to grow — through the unseen hand of the marketplace, with private business people working the space between those who have water and those who don't.

Fundamental questions about where growth will occur, who will profit by it and how much water will be left

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when they are finished are being worked out in decisions made by rural landowners trying to sort through an offer from a stranger.

The pressure to find new sources of water is only likely to ratchet higher. The 2007 State Water Plan, released this month in draft form by the Texas Water Development Board, predicts that the state's population will double by 2060 and that available water resources will decline by 18 percent if no new water sources are found.

The volume of marketing in Texas is elusive because the state requires no record of groundwater rights transactions. Some say the fever has abated in the past couple of years, in part because no one has successfully closed a major deal to move water to the I-35 corridor.

Still, in the counties east of Austin, in Kinney County and a handful of other hot spots around the state, residents continue to hear overtures from businesses hoping to profit from their water.

There's nothing to suggest that the marketing activities of Carlson and the others violate any Texas law. But it still makes Bill Graham mad.

Graham, a Milam County rancher, finds himself on the other side of the fight over water. Vigilant, he attends the local groundwater meetings regularly.

Plainspoken, he describes one confrontation with a big-city water lawyer as "about like William Jennings Bryan debating Buckwheat."

Graham, who owns a 600-acre ranch in Milam County, is 58 and stands 5-foot-8. He has a staccato laugh, a gleam in his eye and a scattershot way of talking that gives the impression of a man struggling to keep pace with his thoughts.

Graham quotes everyone from Benjamin Franklin to Shakespeare — sometimes in the same conversation.

When he invokes Franklin, it's the line about never knowing the value of water until the well runs dry. When it's Shakespeare, the something rotten is not in Denmark but in Milam and Bureson Counties.

It's the efforts by Carlson and others to make a buck off

## **An increasingly precious resource**

The new State Water Plan, issued in draft form on the Internet last week, draws an ominous picture of the future of water in Texas. Among its findings:

- The state's total water supply, if no new sources of water are found, will drop from 17.9 million to 14.6 million acre-feet per year by 2060 because of sedimentation in reservoirs and depletion of the state's underground aquifers.
- By 2060, demand for water in Texas is projected to increase 27 percent, from almost 17 million acre-feet of water in 2000 to a projected demand of 21.6 million acre-feet.
- Of 238 cities that five years ago reported significant water needs by 2020, only 21 have put projects in place that were recommended in the 2002 State Water Plan to meet that demand. Another 12 have projects under construction, while 89 have taken no steps toward building the projects.
- Farming as a way of life is headed toward a dramatic transformation. That stress will be felt most severely in the Rio Grande Valley, where farmers stand last in line for water from the river between the U.S. and Mexico during a drought. The plan projects that the Valley's population will more than double by 2060, while water use in the region will rise only 13 percent.
- The Ogallala Aquifer, the sprawling underground reservoir that provides 40 percent of all the water used in Texas, continues to disappear, mostly because of irrigated agriculture. In Texas alone, more than 6 million acre-feet, or roughly four times the amount of water in Lake Travis and Canyon Lake combined, is withdrawn from the Ogallala each year.
- If no new water supply sources are found, available surface water will decrease 7 percent by 2060,

the area's water.

"I'm here to tell you, them people that got their \$25 up front, if they ever get more than \$3 a year per acre for the next 20 years, I will — think of something for me to do — wear a ballet dress up in the Capitol and dance around in little circles," he said.

while available groundwater will decline 32 percent. Most of that decline will occur in the Ogallala.

Graham, also a retired Ford dealer, bought his ranch in 1992, a year after one of his two sons suffered a sudden brain aneurysm and died at 12 while playing baseball. Graham bought more than 600 acres and later moved to the ranch from Elgin, in part because water flowed freely from artesian wells on the property.

His family had lived in this area since the early 1800s, and he remembered as a child seeing the water bubbling up from the ground.

"I didn't come here a blithering dumbass," he said. "I came here because I had water. And I intended on it being beneficial financially to myself or to my children or to my grandchildren. And when somebody comes in and starts scamming it away, it pisses me off."

Graham said he had never gotten involved in a public policy fight before.

"Never cared to," he said. "I don't want to be the righter of all wrongs."

When it comes to water, though, Graham offers story after story of neighbors being approached by Carlson with a check and a lease he wanted them to sign. Some signed; some didn't. The moral of each story is the same.

"I think the nutshell of it is that they have used some pretty — what's a better word than lowlife?"

Unsavory?

"I think that they have not told the truth."

### **Stayed too long**

In Burleson County alone, Carlson's Metropolitan Water Co. has leased water rights from some 3,000 property owners, records show. In neighboring Milam County, another 1,600 landowners have agreed to lease to the company, known informally as MetWater.

Altogether, the company has tied up water rights to some 70,000 acres of land. But the Johnsons' 121/2 acres are not among them.

The check was enticing enough, Diane Johnson said, but the surprise visit made them wary. They felt Carlson stayed too long.

"We thought, if this guy doesn't leave soon we're going to have to invite him for dinner," she said.

They asked for time to think about it. A few days later, Diane Johnson called Ron Kaiser, a professor of water law and policy at Texas A&M University, whose wife works with her in the university's accounting department.

Kaiser read the lease Carlson had left with the Johnsons and advised them against the deal. If they leased to Carlson, he said, they wouldn't be able to break the agreement if something better came along.

"He said if it was him, he wouldn't do it," Diane Johnson said.

The Johnsons never called Carlson back. But several weeks later, he returned to their home along Texas 21 west of Caldwell, and they told him they weren't interested.

"You could tell he was not very happy about it," Diane Johnson said. "And he didn't stay very long the second time."

Kaiser said he reviewed several of Carlson's leases for landowners in the area who asked about them. He said he thought the price Carlson offered was low and that the value of water in the area, situated between the I-35 corridor and the Bryan-College Station area — another pocket of growth — would rise.

In some of the leases Kaiser reviewed, the landowners were given a memorandum suggesting they had the option of pulling out of the deal. But the leases themselves contained no such option. Kaiser said that gave Carlson a legal trump card.

"He would give them a sheet of paper separate from the lease that said, 'You can pull out of it at any time,'" Kaiser said. "And so people would come to me and say, 'Well, this looks like a good deal.' I said, 'Read the lease. The lease said this: the lease incorporates all the terms. All this other stuff he's giving you is immaterial.'"

### **'Ten percent of what?'**

T.A. Peek, a 70-year-old Burleson County rancher, has read Carlson's lease and doesn't like it. Peek's ranch lies within the boundaries of an area Carlson designated as the Porters Branch Collective Water Development and Production Unit.

The area covers 411,609 acres of land, though less than a quarter of the property in it has been leased.

Peek used to work in the oil business and said he has read a lot of oil leases. He said Carlson's offered the landowner 10 percent of the profits on the water. But Peek said it would be easy for Carlson's company to sell the water to another company for a low price, give the landowner 10 percent of that and then sign a more lucrative contract with a buyer along the I-35 corridor.

"That's where the profit's going to be, is the handling of it down the way," Peek said. "And they're going to get 10 percent of something, but what? Not a contract one tells you where you're going to get 10 percent or what you're going to get 10 percent of."

It angers Peek that some of his neighbors have jumped at Carlson's offer.

"A lot of people aren't familiar with how open that contract leaves them," he said. "They think that little cash bonus deal is a bird in the hand and they're going to get it. Well, I agree it is a bird in the hand — but you don't know what that bird is until you look at it real close."

Carlson sold the leases to Layne Water Development of Texas, a subsidiary of a Kansas company, which later sold them to Ross Cummings, an Austin real estate investor who formed a company called

Blue Water Systems. Cummings, who in April 2004 paid \$500,000 in bond money to free Carlson from jail, said he believed the leases gave landowners a fair shake.

"They're structured just like oil and gas leases, and that's a time-tested structure that seems to work for both sides for a long time," he said. "I think there's a lot of people out there that think they're getting treated very fairly."

Cummings declined to discuss the specific concerns raised by Peek and Kaiser, the A&M professor, but said the landowners who signed on "stand to make a tremendous amount of money."

As for posting Carlson's bond money, Cummings said that was part of "a very detailed business transaction" in which he obtained the leases. He said Carlson no longer has any involvement with Blue Water.

"We've insulated Scott from the market and from this project," Cummings said.

Kaiser said that despite his misgivings about Carlson's leases, he thinks local groundwater districts won't not be able to stem the tide against water marketing. There simply are too many places in Texas that need water.

"The political reality has hit home for groundwater districts and a number of people that if urban areas need the water, the water laws of this state are going to change and groundwater districts will not be able to prevent urban areas from having access to that rural water."

That will happen "most severely and initially" along the I-35 corridor, Kaiser said.

### **Fictitious land men**

A 1978 graduate of Conroe High School who later dropped out of Texas Tech University, Scott Carlson had worked as a land man for a number of Houston oil companies between 1982 and 2000, according to a pre-sentencing report.

In 1998, he was caught billing two of them for \$2.4 million worth of work he did not do. He did it by billing for others who never worked for him, billing for 21 days worked in a 14-day period, billing for the services of fictitious land men and billing for land men who had been working on other projects.

In a written statement, Carlson said: "I never intended to steal a penny from any of my clients and certainly did not think that my actions were criminal."

His pastor and several friends wrote letters testifying to his character. They portrayed him as a dedicated church and family man.

But Bob Frederick, a Ballard Exploration Co. land man who discovered the improper billing, wrote a 10-page letter calling Carlson "a liar, thief and con man who carries out his deceitful and fraudulent acts without a hint of conscience or remorse."

Frederick asked the court to put Carlson in jail, but it didn't. Instead, he was given "deferred adjudication," which meant he could enter a guilty plea, pay restitution and walk away after 10 years of probation with no conviction. He entered the plea in July 2002.

Less than five months after Carlson approached the Johnsons, the Austin American-Statesman published an article that reported on his background. The article quoted Carlson as saying he had made "no admission of guilt." That violated the terms of his probation, and a judge threw him in jail.

Cummings declined to say whether any water deal had been reached with a customer along the I-35 corridor. But he said his company was building a pipeline to eastern Travis County, toward the proposed route of the new Trans-Texas Corridor, Interstate 130.

The company's purpose, Cummings said, was to bring water to Central Texas, which he said had nothing to do with Carlson's past.

"There are some people that have done some things in the past that have left a little bit of a stain, and we're trying to move past that," he said. "We weren't involved in that."

### **The regulator**

The Post Oak-Savannah groundwater district's office is in a small building at the foot of the U.S. 79 overpass in Milano, a town of 400 people in southern Milam County.

The manager of the district is Gary Westbrook, a soft-spoken, 48-year-old rancher who also serves as pastor of the Bedias and Shiloh United Methodist churches east of College Station. On his desk, a hymnal and a Bible sometimes lie atop groundwater district business as he plans Sunday worship services.

The district was created in 2001 after news of Carlson's efforts set off alarms among area residents. Graham, the Milam County rancher, supported it wholeheartedly in the beginning.

Westbrook said the district limits water exports through pumping limits, well spacing restrictions and well fees. He said only two applications for water export had been filed with the district since it was formed, both by Layne Water Development of Texas. Those permits now belong to Blue Water.

Blue Water hasn't pumped any water, but pays the district about \$67,000 a month to maintain its permits.

On Westbrook's recommendation, the groundwater district's board of directors in 2004 approved a Blue Water permit to pump 15,488 acre-feet per year. An acre-foot is the amount of water needed to cover an acre of land with a foot of water, or 325,851 gallons, enough to supply three average San Antonio families of four for a year.

In January 2005, the board imposed a six-month moratorium on all permit applications. It did so out of concern that approved and pending permits might exceed the natural recharge in the Carrizo-Wilcox Aquifer, the primary source of water beneath Milam and Burleson counties.

After studying the available groundwater further, the board approved total pumping of about 31,000 acre-feet per year, or slightly less than the aquifer's natural annual recharge, the amount replenished from rainfall and other sources.

Westbrook said he believes water is plentiful in the district and thinks good safeguards are in place. Still, after discussing the district's rules for more than an hour one day in his office, he smiled and said: "You haven't asked me if I leased my land yet."

He hadn't. In fact, when his cousins, brothers or sisters ask him about it, he advises caution. Talk to a lawyer, he tells them. Ask the neighbors why they did or didn't lease.

And why hasn't he leased his land?

"Concerns," Westbrook said. "Concerns."

He sat silently for a moment.

"Well, there's days I think I know and there's days I think I don't know," he said. "I don't even know what is the right thing to do there. And I wouldn't want to speculate on that for anybody else anyway, because it's not my place. Everybody's got their own land and they have a right to do with it whatever they want."

### **The mantra**

That, of course, is a mantra among water marketers. It's the case made by Harry Vowell, a business associate of Carlson's, when he was interviewed one day at the Milano Livestock Exchange.

Vowell, who lives in Milano but came to Milam County from Odessa, said he had been working with Carlson, leasing water rights and sometimes buying property and selling the land but retaining the water rights.

Wearing jeans, a salmon-color shirt and a cowboy hat with a sweat stain around the brim, Vowell said people who don't lease their water rights are going to miss the boat.

"If you lease, you get paid," he said. "If you don't lease, you don't get paid."

For the landowners, he said, "They have enough water here. The aquifer's full now. They've got enough water to supply the Austin area with all their water needs for the next thousand years if it doesn't rain in that thousand-year period."

Really?

"Um-hm," he said. "That's my understanding, but they've got all that documented. The hydrologist has got all that stuff."

Graham, the rancher, scoffed at that assessment. He said the matter of how much water lies beneath the land is debatable at best.

"They're good at what they're arguing," he added. "They have themselves believing."

That same day at the livestock exchange, Arnold Kornegay, an elderly man who owns 222 acres in Milam County, said he leased his water rights several years ago but couldn't remember to whom.

"I didn't know for sure what it was," Kornegay said. "The big story was they was protecting your water, you see."

Texas law offers landowners no protection from unscrupulous water marketers. The Texas Farm Bureau has a standard lease it recommends, but the advice is fairly simple: Hire a lawyer; read the lease.

Doug Caroom, an Austin water lawyer who helped draft the Farm Bureau lease, said water rights leases aren't as standardized as oil and gas leases.

"There are a lot of leases that are floating around, some of which are protective of the landowners and some of which don't protect them at all," he said.

Caroom said he didn't think there was much the Legislature could do about it

"I can't see that the government getting into regulating groundwater rights, particularly on the business side, is such a great idea," he said.

Groundwater rights are different from surface rights in that no record of them is required by the state. Legislation that would have asked the Texas Water Development Board to keep track of groundwater rights was offered but did not pass during the 2005 legislative session.

Caroom said knowing what other landowners had done might benefit the public, including the landowner. But, he added, "I don't think the Water Development Board is going to volunteer to do it for free."

State Sen. Kip Averitt, R-Waco, chairman of the Senate Natural Resources Committee, said water marketing was a growing phenomenon and that the regulation of it is evolving. He said he didn't know if there was a way to give landowners more protection but that he thought the idea was worth considering.

"The need will grow for more oversight," he said.

### **Sustainable resources**

Graham wonders why Carlson's company is one of only two looking for water leases in Milam and Burleson counties. The Texas Water Development Co., an Austin-based business better known as WaterTexas, showed interest early on but hasn't been heard from lately.

"For whatever reason, they're not as aggressive as they were," said Westbrook, the groundwater district manager.

Graham suggested a conspiracy among some of the state's biggest marketers.

"Usually, it's not by coincidence that one won't come on the other's territory," he said.

A document filed at the Milam County Courthouse in September 2002 lends support to Graham's theory. It outlined a "confidentiality and limited use agreement" between Carlson and WaterTexas.

In the document, Lynn Sherman and Derek Saunders, two of the founders of WaterTexas, agree not to share any proprietary information they learned from Carlson.

But it also said that for a five-year period expiring Sept. 14, 2006, "Sherman, et al are prohibited from leasing and/or buying any groundwater rights located within the boundaries of the Metropolitan Water Co., L.P. Porters Branch Collective Water Development and Production Unit covering approximately 411,609.13 acres of land, more or less, located in Burleson, Lee and Milam Counties, Texas."

Last week, Sherman acknowledged signing such a document, but he said it didn't preclude WaterTexas

from operating in the area. He said the company had leases in Lee and Milam, though he did not know whether they fell within the area described.

Sherman said the agreement came about because Carlson was having difficulty finding buyers. He said WaterTexas had been thinking about buying Carlson's leases.

The document, he said, was a standard agreement not to divulge proprietary information. The "non-compete provision" was something Carlson "induced" WaterTexas to sign on the promise of making the information available. He said Carlson slipped it into the document, then didn't make any information available.

"I don't think that thing is worth the paper it's written on, No. 1, and No. 2, it's going to expire soon anyway," Sherman said after reviewing a copy of the document.

Sherman said the conversations with Carlson were exploratory in nature. Once they learned more about how Carlson operates, he said, "it became apparent very quickly that he was not somebody we could do business with."

Now, he says, "I wouldn't share an apple pie with Scott Carlson."

Westbrook, the groundwater district manager, said the document was interesting but that he didn't know that it confirmed Graham's suspicions. Even if it did, he said, there probably wasn't much the district could do about it. His job is to treat every permit application the same under the district's rules.

"I've never doubted that there were conspiracies out there," Westbrook said. "I just doubted whether they were challengeable."

WaterTexas, as it happens, is trying to close a deal to sell water from Lee and Milam Counties to the Guadalupe-Blanco River Authority, Sherman said. The company would market the water through a new entity formed with several other interested parties, Sustainable Water Resources. It would serve communities along the I-35 corridor and the proposed 130 highway.

Steve Baker, a Lee County rancher who helped found WaterTexas, first came up with the idea of selling water out of the area in the 1990s. He said groundwater is plentiful there and that he thought the income might help him preserve his ranchland.

Baker, 48, took the idea to Saunders and Sherman, friends of his in Austin, and WaterTexas was born.

The company owns about 20,000 acres of water leases near the Lee-Milam County line. Baker said he approached his neighbors but did not pressure them to get involved. Most of them did.

The terms of the arrangement, which Baker said are confidential, make it more of a partnership than other leases he has heard about. Landowners have input and veto power over what happens on their property.

"It wasn't a sales pitch," he said. "It was, 'This is what I'm trying to do. If you want to be a part of this, you're welcome. If not, that's fine, too.'"

If the water showed signs it wasn't replenishing properly, Baker said, the company would back off.

Baker said the Gold Rush mentality that took hold several years ago on water may have been overblown.

"I think that's been unfortunate because it has led to people thinking they were going to get rich," he said.

### **'Trigger points'**

In Milam County, Westbrook said he thinks the district has come up with a good way to prevent too much water from leaving the area. If the amount of water being used hit certain "trigger points," he said, exports would be cut back.

Back in the spring, Graham at first balked at showing a visitor his property, which lies between Milano and the Bureson County line "dead center over the sweetest part of the aquifer in Milam County." Later he changed his mind, saying: "Maybe this will help explain my passion."

At the gate beside his house, Graham encouraged a black-and-white border collie named Danny to jump in the truck. The dog barked but didn't jump, then ran along in front of the pickup as Graham tumbled and rolled down a hill.

When he got to the bottom, water flowed freely out of a pipe sticking out of the ground. It created a pool that followed the natural contours of the land and turned into Cedar Creek, a stream that meanders across Graham's ranch. Danny stood in the water up to his shoulders, lapping at it in a way that made him seem like he was smiling.

Graham said he wants Westbrook's assurances to be true. He just can't convince himself the district can protect the water.

"Say that there were four or five developments that were dependent on this water somewhere along that 130 corridor, and we got to those trigger points and they started to cut them down, and those people, that meant they didn't have water," Graham said. "Now what do you think the state is going to do at that point when they've got developments out of water, and there's a bunch of huckabucks over here with artesian wells running out of the ground? What do you think they're going to do?"

Kaiser, the Texas A&M water law professor, said Graham's pessimism probably is justified.

"Our Legislature is by and large an urban and suburban Legislature, and those legislators are not going to let suburban areas go dry, particularly if there's water in rural areas," he said. "So it's sort of this political reality of the shift in urban influence and suburban influence on our Legislature. Our Legislature's going to protect the growth in those suburban areas."

Of people who hope to prevent water from being sold, he said: "Those poor folks are really caught between a rock and a hard place."

That's because property rights go both ways. If Graham has a right to hang on to his water, other landowners have a right to sell theirs. If that drains water from beneath his land, well, current Texas law says that's allowed.

Later in the afternoon, back at the top of the hill, Graham disappeared briefly into his ranch house and returned with a family Bible. He brought it outside and showed an old photograph of the same artesian

well. In the photograph, water bubbled out of the ground like a mushroom.

Graham tucked the photo back into the Bible. He keeps it there, next to a picture of the son he lost all those years ago.

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