

Texas Real Estate Forms Manual
Third Edition

Volume 3



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Third Edition

Volume 3

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Chapter 16

Water Rights Conveyancing Documents

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I. Overview of Water Law

§ 16.1 Introduction

Texas real estate transactions increasingly involve issues of groundwater or surface water resources and supply. These issues affect the use and valuation of the land. In addition, transactions involving the purchase or lease of existing water rights (surface and groundwater), severed from the surface estate, are becoming increasingly common as a result of the limited availability of unappropriated surface water and of groundwater shortages in many parts of the state. This chapter provides an overview of Texas water law, including major statutory changes that have revised Texas's systems for water resource planning, management, and development; it includes some basic forms for the sale, conveyance, and mortgage of surface water and groundwater rights.

Surface water and groundwater, while both interests in real property, are treated differently under Texas law. Surface water is generally the property of the state. *See, e.g. Texas Water Rights Commission v. Wright*, 464 S.W.2d 642 (Tex. 1971); *South Texas Water Co. v. Bieri*, 247 S.W.2d 268 (Tex. Civ. App.—Galveston 1952, writ ref'd n.r.e.) (state owns the corpus of the water, appropriator owns a usufructory right). Groundwater in place under the land is the property of the owner of the surface estate. Tex. Water Code § 36.002(a); *see Edwards Aquifer Authority v. Day*, 369 S.W.3d 814, 817, 831 (Tex. 2012); *Edwards Aquifer Authority v.*

Bragg, 421 S.W.3d 118, 137–38 (Tex. App.—San Antonio 2013, pet. denied); *City of Del Rio v. Clayton Sam Colt Hamilton Trust*, 269 S.W.3d 613 (Tex. App.—San Antonio 2008, pet. denied). Surface water is regulated through a statewide program administered by the Texas Commission on Environmental Quality (TCEQ). Tex. Water Code ch. 11, 30 Tex. Admin. Code chs. 295, 297. Groundwater is regulated by local groundwater conservation districts generally operating pursuant to chapter 36 of the Texas Water Code, and their respective enabling legislation, to provide some regulation of the withdrawal and use of groundwater within their jurisdictions. As of January 1, 2017, there were one hundred confirmed groundwater districts operating across Texas. Thus, parties to real estate transactions must carefully consider whether they are dealing with issues of surface water rights, groundwater rights, or both, and they must also consider which regulatory entities have jurisdiction over those rights.

The TCEQ and the Texas Water Development Board (TWDB) are the two state agencies principally involved in the implementation of Texas's surface water laws and policies. The TWDB serves as the state's financier for major water projects. The regulation of water and sewer utilities, including the responsibility for rate and other economic regulation, and the jurisdiction over certain water supply and sewer service corporations, is under the Public Utility Commission of Texas. The TCEQ's jurisdiction

includes water rights, water pollution and water quality, water rates, some groundwater district formation and supervision, dam safety, and the regulation of public sewer and drinking water systems. The TCEQ is the adjudicatory body for all contested surface water rights cases and has substantive and procedural rulemaking authority. The TWDB is the state agency with authority for the planning of and financial assistance for water development projects. The TWDB is responsible for the development of the state water plan and coordination with the regional planning groups. The TWDB makes loan and grant programs available to qualifying local governments and utilities for water supply development projects and for water quality purposes.

§ 16.2 Groundwater

§ 16.2:1 Definition

Groundwater is water occurring under the surface of land. Groundwater may consist of percolating water or artesian water, but the underflow of a surface water river or stream or the underground flow of water in confined channels is not groundwater. Groundwater is presumed to be percolating unless it is proven to be otherwise. *Pecos County WCID No. 1 v. Williams*, 271 S.W.2d 503, 506 (Tex. Civ. App.—El Paso 1954, writ ref'd n.r.e.). The Texas Water Code defines “groundwater” as water percolating below the surface of the earth. *See* Tex. Water Code § 36.001(5).

Artesian water is groundwater confined under pressure by an impermeable geological layer, capable of flowing “above the first impervious stratum below the surface of the ground” when properly cased in a well. *See* Tex. Water Code § 11.201. The only significant difference between the legal treatment of percolating water and artesian water is that there are statutory provisions prohibiting the waste of artesian water and relating to artesian water produced from

wells in the Edwards Aquifer. *See* Tex. Water Code § 11.202(d)–(e).

Underflow is that portion of a surface watercourse that flows through sand and gravel deposits beneath the surface of the bed of a stream. Underflow is surface water and is the property of the state. Tex. Water Code § 11.021(a). The laws governing the allocation and use of surface water apply to underflow. *Texas Co. v. Burkett*, 296 S.W. 273, 277 (Tex. 1927); *see* Tex. Water Code § 11.021.

Water “confined to underground streams with definite channels” means a subsurface watercourse that has all the characteristics of a surface watercourse, including a bed, banks that form a channel, and a current of water. *Denis v. Kickapoo Land Co.*, 771 S.W.2d 235, 237 (Tex. App.—Austin 1989, writ denied). Ownership rights for this type of subsurface watercourse are the same as for surface water. Tex. Water Code § 11.021(a); *see Edwards Aquifer Authority v. Day*, 369 S.W.3d 814, 822 & n.28 (Tex. 2012). Whether subsurface water is the underground flow of water in a defined subterranean channel or percolating groundwater is a determination that must be made on a case-by-case basis. *Denis*, 771 S.W.2d at 237.

§ 16.2:2 Ownership: “Rule of Capture,” Theory of Absolute Ownership of Groundwater in Place, and Common-Law and Regulatory Use Restrictions

In 1904, the Texas Supreme Court applied the English common-law rule of capture to groundwater and held that the owner of land could pump unlimited quantities of water from under his land, regardless of whether his action drained water from under his neighbor’s land. *Houston & T.C. Railway Co. v. East*, 81 S.W. 279 (Tex. 1904). Under common law, a landowner could use groundwater at a location other

than his land and sell groundwater that he captured below the surface of his land for off-site use by a third party. *Texas Co. v. Burkett*, 296 S.W. 273 (Tex. 1927). Texas courts subsequently upheld the right of a landowner to capture and use groundwater even when doing so affects surface water supplies. *Pecos County WCID No. 1 v. Williams*, 271 S.W.2d 503 (Tex. Civ. App.—El Paso 1954, writ ref'd n.r.e.). The supreme court has declined to overrule the holding of *East*, finding that the common-law rule of capture does not preclude ownership in place. See *Edwards Aquifer Authority v. Day*, 369 S.W.3d 814 (Tex. 2012), in which the State of Texas and the Edwards Aquifer Authority challenged this well-established rule.

There are only two significant limitations at common law on the landowner's right to capture and use groundwater: (1) the landowner cannot capture and use groundwater maliciously for the purpose of injuring a neighbor or in a manner that constitutes wanton and willful waste (*City of Corpus Christi v. City of Pleasanton*, 276 S.W.2d 798 (Tex. 1955)); and (2) the landowner may be liable for damages if he negligently pumps groundwater in a manner that causes subsidence of neighboring land (*Friendswood Development Co. v. Smith-Southwest Industries, Inc.*, 576 S.W.2d 21 (Tex. 1978)). These limitations are recognized in section 36.002 of the Texas Water Code. Tex. Water Code § 36.002.

In recent years, Texas courts and the Texas legislature have had to address issues regarding the nature and extent of a landowner's ownership interest in groundwater under his land. Specifically, the question has arisen whether a landowner owns groundwater in place under his land or whether the landowner's property interest in the groundwater actually vests only when the landowner has captured the groundwater by producing it and putting it to a beneficial use. A related question that has arisen is whether the landowner's interest in the groundwater is a vested right that would enable the landowner to

challenge groundwater regulation by a governmental authority as an unconstitutional taking of the landowner's ownership of groundwater.

In *City of Del Rio v. Clayton Sam Colt Hamilton Trust*, 269 S.W.3d 613 (Tex. App.—San Antonio 2008, pet. denied), the trust, which was the owner of a large ranch, sold a fifteen-acre portion of the ranch to the city of Del Rio but reserved the rights to all groundwater under the land. The trust had never produced groundwater from the fifteen-acre tract. After the sale, the city drilled a well on the land for the production of groundwater for its municipal water supply. The trust sued the city on the grounds that the trust was the owner of the groundwater due to its reservation. The city, using an interpretation of the "rule of capture" as a theory of ownership, rather than a defense to liability for the pumping and use of groundwater in place, argued that the landowner's interest in the groundwater under his land is not a vested right but vests only when the landowner has "captured" the groundwater by pumping it and using it. Under this argument, because the trust had never produced groundwater from the fifteen-acre tract, the trust did not have an ownership interest in the groundwater that could be reserved in the deed, and therefore the city owned the groundwater under the fifteen acres. The court rejected the city's argument, holding instead that "under the absolute ownership theory, the Trust was entitled to sever the groundwater from the surface estate by reservation." *City of Del Rio*, 269 S.W.3d at 617. The Texas Supreme Court denied the city's petition for review.

In *Edwards Aquifer Authority v. Day*, the landowners sued the Edwards Aquifer Authority (EAA) on the grounds that the EAA's denial of the landowners' permit applications constituted a regulatory taking of the landowners' vested rights in the groundwater. The Texas Supreme Court affirmed many aspects of the EAA's final order regarding the permit applications at issue but remanded the case to the trial court for fur-

ther proceedings on the taking claim. The supreme court affirmed the court of appeals' key holding, stating that "land ownership includes an interest in groundwater in place that cannot be taken for public use without adequate compensation. *Day*, 369 S.W.3d at 817. The court ruled that prior decisions neither recognized nor precluded ownership in place. The court noted that it had held oil and gas in place to be owned by the landowner long ago, and concluded 'we find no reason to treat groundwater differently.' *Day*, 369 S.W.3d at 823. In a subsequent case, *Edwards Aquifer Authority v. Bragg*, 421 S.W.3d 118, 137–38 (Tex. App.—San Antonio 2013, pet. denied), the court relied on the supreme court's ruling in *Day* that groundwater rights in place are vested rights, constitutionally protected from a government taking, including a regulatory taking resulting from the permitting decisions of groundwater conservation districts (GCDs), without just compensation.

The Texas legislature in 2011 amended section 36.002 of the Water Code to address the issue of ownership of groundwater in place and the authority of GCDs to regulate the pumping and use of groundwater. To some extent this section, as amended, codifies the existing case law. Section 36.002(a) states that the 'legislature recognizes that a landowner owns the groundwater below the surface of the landowner's land as real property.' Section 36.002(b) provides that this ownership interest entitles the landowner to drill for and produce the groundwater 'subject to' the authority of GCDs to limit or prohibit drilling and to regulate production as described in section 36.002(d). While the term *vested right* is never used in this statute, section 36.002(c) expressly states that nothing in the Water Code "shall be construed as granting the authority to deprive or divest a landowner of the groundwater ownership and rights described by this section. Section 36.002(b) was further amended in 2015 to extend the scope of rights to include "any other right recognized under common law." Section 36.002(b–1)(1) states, how-

ever, that the "groundwater ownership and rights described by this section [does not] entitle a landowner to the right to capture a specific amount of groundwater below the surface of the landowner's land.

The common-law rule of capture in Texas, as adopted by the court in the *East* case referenced above, is being eroded. GCDs, where they exist, have the authority to adopt regulations that require permits for drilling wells and pumping groundwater and that impose limitations on a landowner's ability to produce groundwater and to export it outside the district. Tex. Water Code §§ 36.001(1), 36.101, 36.116. Restrictive covenants that prohibit a landowner's drilling of water wells have been held to be enforceable against the right of a landowner to access its groundwater. See *Dyegard Land Partnership v. Hoover*, 39 S.W.3d 300 (Tex. App.—Fort Worth 2001, no pet.). Municipal ordinances prohibiting or limiting the drilling of wells may be found to be enforceable.

§ 16.2:3 Groundwater Conservation Districts and Groundwater Management

The state has the power to impose reasonable regulations on real property, including groundwater, to protect the public health and welfare, as part of its police powers. In addition, the Conservation Amendment (article XVI, section 59, of the Texas Constitution) declares the right and duty of the state to conserve and develop its natural resources and gives the legislature authority and duty to pass all laws appropriate to these conservation goals. See Tex. Const. art. XVI, § 59; *City of Corpus Christi v. City of Pleasanton*, 276 S.W.2d 798, 803 (Tex. 1955). The legislature has emphasized that groundwater conservation districts (GCDs) are the state's preferred method of groundwater management. Tex. Water Code § 36.0015; see *Sipriano v. Great Spring Waters of America, Inc.*, 1 S.W.3d 75, 79 & n.33 (Tex. 1999).

GCDs may be created by special legislation or by the TCEQ on petition of landowners within the proposed district. *See* Tex. Water Code §§ 36.013–.021. Chapter 36 of the Texas Water Code sets out the main regulatory powers of general-law GCDs. However, most GCDs have been legislatively created and thus may have powers and authority that differ from those of general-law districts. To the extent of any conflict between an individual GCD’s enabling legislation and the provisions of chapter 36, the provisions of the individual GCD’s special legislation controls. Tex. Water Code § 36.052(a). Although the legislation creating most districts follows closely the provisions of chapter 36, the enabling legislation of a legislatively created district must be reviewed to determine the scope of its jurisdiction and authority. A notable example of such a special-law groundwater district is the Edwards Aquifer Authority in central Texas. Similarly, the Harris-Galveston Subsidence District and the Fort Bend Subsidence District, which were originally established as special-law GCDs, were created to address the specific issue of subsidence. In 2003, the legislature clarified that these two districts had the particularized purpose of regulating groundwater to prevent subsidence. Tex. Spec. Dist. Code §§ 8801.003, 8834.003. These districts were created for very specific purposes that go beyond regulating a water supply. The regulatory requirements for transferring groundwater rights within the EAA and these subsidence districts are unique, making it important for attorneys to understand the substantive and procedural rules of each district. Generally, most GCDs have the authority to incur debt, levy taxes, charge for services, obtain easements, and condemn property. *See* Tex. Water Code §§ 36.101–.124. Districts may impose fees to cover administrative acts of the district and production fees on pumping authorized in the district. Tex. Water Code § 36.205. A GCD may impose additional fees for exporting water out of the district but may not impose more restrictive permit conditions on transporters than the GCD imposes on existing in-district

users. *See* Tex. Water Code § 36.122. A seller of residential real property must disclose whether the seller is aware (actual knowledge, without any duty of investigation) of any portion of the property being located within a GCD or subsidence district. *See* Tex. Prop. Code § 5.008(b)(6).

Each GCD has the power to implement its statutory authority through rulemaking and permitting. *See* Tex. Water Code §§ 36.101, 36.113, 36.1131, 36.117. District rules may include well spacing and regulation of groundwater production by well production limits, limits based on acreage or tract size, rate of production limits, or ‘managed depletion’ (an approach that aims to control the amount and rate of depletion districtwide over the long term). *See* Tex. Water Code § 36.116. Within certain constraints, a GCD may also regulate groundwater production in a manner designed to preserve ‘historic or existing use.’ Tex. Water Code § 36.116(b). All wells are required to be permitted unless they are exempted by statute or the GCD’s rules. Tex. Water Code §§ 36.113, 36.117. Small wells used solely for domestic and livestock purposes, wells used for oil and gas production or surface mining activities, and wells existing at the time of the creation of the district are generally exempt from the permitting process but still may be required to be registered with the district. *See* Tex. Water Code § 36.117. Consequently, if land is within a GCD or a subsidence district, it is important to review the regulations of the district to determine any requirements and limitations on the landowner’s ability to access and produce groundwater.

Information and maps of groundwater conservation districts are available on the TWDB website at www.twdb.texas.gov. Copies of district rules and district management plans generally must be obtained from the individual conservation district. Contact information for GCDs may be available on the Texas Alliance of Groundwater Districts website at www.texasgroundwater.org.

Landowners also should be aware of the tools for groundwater management implemented by the Texas legislature, as these processes and their results can affect the regulation of groundwater in a specific area of the state. Each GCD is required to develop a comprehensive management plan that addresses various management goals, includes specific performance standards, details actions and procedures to carry out the plan, and includes estimates of various aspects of the groundwater resources within the district. *See* Tex. Water Code § 36.1071(e). However, GCDs do not follow aquifer boundaries, and more than one district may have jurisdiction over a single aquifer. The TWDB must designate ‘groundwater management areas’ for aquifers across the state to promote coordination among GCDs. *See* Tex. Water Code § 35.004. GCDs within a groundwater management area sharing jurisdiction over the same aquifer are required to engage in a joint planning process to determine “desired future conditions” (as adopted by the district under Water Code section 36.108) for the aquifer. Tex. Water Code § 36.1071(a)(8).

The TCEQ has statutory authority to designate a “priority groundwater management area” if the area is currently experiencing, or is anticipated to experience within the next twenty-five years, critical groundwater problems, such as shortages, contamination of groundwater supplies, or land subsidence through the withdrawal of groundwater. Tex. Water Code § 35.007(a). Once an area is designated a priority groundwater management area, the landowners within the area may either (1) create one or more general-law GCDs, (2) have the area annexed to an adjoining GCD, or (3) create one or more GCDs through the legislative process. Tex. Water Code § 35.012(a).

§ 16.3 Practical Considerations for Conveying Groundwater Rights

§ 16.3:1 Severability and Marketing of Groundwater Rights

In *Edwards Aquifer Authority v. Day*, 369 S.W.3d 814 (Tex. 2012), the Texas Supreme Court determined that groundwater rights may be severed from the surface estate and leased or sold to a party other than the owner of the surface estate. The supreme court held in *Coyote Lake Ranch, LLC v. City of Lubbock*, 498 S.W.3d 53, 64 (Tex. 2016), that general groundwater rights were the “dominant estate” to be treated similarly to severed mineral rights. Groundwater currently is the favored source of water for water marketers, but the purchase or lease of groundwater rights presents its own challenges, not the least of which is navigating the various regulatory regimes used by different groundwater conservation districts (GCDs). If the real estate or groundwater rights being considered are located within a designated priority groundwater management area, due consideration should be given to the potential for creation of a groundwater conservation district in the future.

§ 16.3:2 GCD Permitting

When evaluating a prospective lease or purchase of groundwater rights from property within a groundwater conservation district (GCD), the permitting implications of the transaction, which are determined by the district’s rules and management plan, must be carefully considered. For example:

Does the transaction involve the purchase or lease of the groundwater rights in place, of only production rights of the groundwater, or of existing permitted rights also?

What permits, or permit amendments, will the buyer need for his intended use of the groundwater, if any, and what are the district's applicable permitting requirements?

Are there any existing permits, such as production or drilling permits, that can be transferred to the purchaser? If so, do the terms or other limitations of those permits need to be amended to meet the purchaser's needs?

How and when in the closing process should the transfer of any existing permits or the rights being sold be completed?

Do the district's permitting requirements allow for adequate production, including export of groundwater if desired by the purchaser, for a sufficient term?

Are the district's fees (for example, for water use or export) prohibitive?

Are there any aspects of the district's rules that affect the relative advantage of well-field design or amount of contiguous acreage included in the permit?

It has become increasingly important, in conducting due diligence on groundwater rights, to determine whether there is likely to be opposition to the buyer's intended use of the groundwater by landowners sharing the same aquifer, other permit holders, or interested organizations, and whether past permitting decisions of the GCD indicate that there may be difficulty in obtaining the required permits. This is particularly important in areas in which there has been an increase—either in scope or frequency—of the acquisition of groundwater rights for development, transportation for use outside of the GCD, or water marketing, where such opposition may lead to contested hearings or litigation. In one recent case, a GCD refused to grant in full the requested operating and transport permits, even though the application was uncontested and the GCD staff recommended approval. *See Forestar (USA) Real Estate*

Group, Inc. v. Lost Pines Groundwater Conservation District, No. 15369, 335th Dist. Ct., Lee County, Tex., filed March 14, 2014; *but see* Tex. Water Code § 36.4051(d) allowing an applicant to seek a contested case hearing following such a decision). In another instance, a water marketer's plan to produce and transport groundwater from land not subject to a GCD, and thus not subject to production limits, was opposed by neighboring landowners, who feared that the magnitude of the production would cause their wells to fail. As a result, the Texas legislature in 2015 took action to give an existing GCD jurisdiction over the aquifer from which the groundwater would be produced by adding Tex. Spec. Dist. Code § 8802.0035 and amending Tex. Spec. Dist. Code § 8802.1045.

§ 16.3:3 Other Due Diligence

Among the other issues that the purchaser or lessee of groundwater rights should consider are the following:

- What types of legal or technical (for example, hydrological or well-field design) advice are necessary before closing on the transaction, and how should the closing be conditioned on the results of such analysis?

What method of pricing the groundwater rights is most appropriate for the transaction? For example, should pricing be based on amount of production, a flat price per acre, the volume of permitted production, or hydrological analysis estimating the saturated thickness of groundwater under the surface?

To what extent, if any, will groundwater rights, or the right to use some portion of the conveyed groundwater, be reserved to the owner of the surface estate?

What types of easement rights will be required to make use of the groundwater rights?

What existing uses are being made of the surface (for example, agricultural or oil and gas production) that might affect the purchaser's development of the groundwater rights?

Can the water be transported to its place of use or need?

What is the native quality of the groundwater?

- What is the condition of any infrastructure or groundwater production, treatment, or storage facilities to be conveyed?

What are the terms and conditions in any existing permits authorizing production or export of groundwater?

§ 16.4 Surface Water

Although in most cases surface water in Texas is owned by the state, transactions for the purchase of rights to use surface water are quite common. Individuals and entities enter into water supply contracts to meet their needs for municipal, industrial, agricultural, or other water uses. Because most stream segments in Texas are already fully appropriated or even overappropriated, the market relating to existing water rights is necessarily dynamic. This section of the chapter addresses the nature of surface water rights under Texas law, the requirements for obtaining a new or amended surface water right from the TCEQ, and some practical considerations in surface water rights transactions, including requirements related to changes in ownership of appropriated surface water rights.

Generally, surface water is owned by the state and is available for use pursuant to the statutory appropriation process. Section 11.021(a) of the Texas Water Code reads as follows:

The water of the ordinary flow, underflow, and tides of every flowing river, natural stream, and lake, and of

every bay or arm of the Gulf of Mexico, and the storm water, floodwater, and rainwater of every river, natural stream, canyon, ravine, depression, and watershed in the state is the property of the state.

Tex. Water Code § 11.021(a).

Navigable streams, defined as streams retaining an average width of thirty feet from the mouth, measured from cut bank to cut bank, generally are considered watercourses and thus are subject to appropriation. Tex. Nat. Res. Code § 21.001(3). The state holds the waters of navigable streams in trust for the public, and therefore such streams are subject to appropriation. *In re Adjudication of the Water Rights of Upper Guadalupe Segment of Guadalupe River Basin*, 642 S.W.2d 438, 444 (Tex. 1982). The state also owns the riverbed—the lands underlying navigable streams. *See State v. Bradford*, 50 S.W.2d 1065, 1069 (Tex. 1932).

Under some circumstances, the landowner may have more or different rights to surface water.

Domestic and Livestock Exemption: The use of water for domestic and livestock purposes is generally exempt from state water rights administration. Without obtaining a permit, a person may construct a dam or reservoir up to two hundred acre-feet in capacity for domestic and livestock purposes on his own property. Tex. Water Code § 11.142.

Diffused Surface Water: Diffused surface water is water on the surface of the land, such as rainfall runoff, that has not yet entered a watercourse. A watercourse is a channel, with a well-defined bed and banks, in which water flows as a stream and has a permanent source of supply. *Hoefs v. Short*, 273 S.W. 785 (Tex. 1925). Diffused surface water is the property of the owner of the soil until it enters a watercourse, at which point diffused surface water is transformed legally to public property (state water or riparian

water). *Turner v. Big Lake Oil Co.* 96 S.W.2d 221 (Tex. 1936); *Mott v. Boyd*, 286 S.W. 458 (Tex. 1926).

Developed Water: “Developed water” refers to water augmenting the natural streamflow that has been made available through artificial means, such as an imported surface water supply or groundwater pumped to the surface. Generally water that is legally reduced to possession and still under the physical control of the owner of an artificial conveyance system is subject to sale or further use by the owner of the system, as long as the water does not escape his control and rejoin a watercourse. *See Guelker v. Hidalgo County WCID No. 6*, 269 S.W.2d 551 (Tex. Civ. App.—San Antonio 1954, writ ref’d n.r.e.).

§ 16.5 General Types of Surface Water Rights

§ 16.5:1 Appropriative Water Rights

In Texas, the appropriation doctrine has developed over more than a century of legislation. The water right, documented in the form of a permit, certificate of adjudication, or certified filing, is a right of use and is precisely defined, with the state authorizing the use of water in a specific amount, by diversion from a watercourse at a definite location, for a particular purpose, and for use on a particular tract of land. It is unlawful to willfully take, divert, or appropriate any state water for any purpose without first complying with all applicable requirements of chapter 11 of the Water Code. Tex. Water Code § 11.081. Violators are also subject to civil and administrative penalties. *See* Tex. Water Code §§ 11.082, 11.0842–.0843.

Under the doctrine of seniority, or “first in time, first in right,” each water right is assigned a specific priority date. During times of shortage, this system determines the allocation of water among appropriators by use of relative priority dates. Tex. Water Code § 11.027. Senior rights

holders are entitled to fully exercise their rights before those holding junior rights receive any water. Two exceptions should be noted, however. First, the TCEQ in 2012 promulgated rules that allow it to deviate from the prior appropriation system by exempting junior water rights from suspension or adjustment “based on public health, safety, and welfare concerns.” *See* 30 Tex. Admin. Code § 36.5(c). These rules are currently under judicial review. Second, the seniority system does not apply to water in the Rio Grande below Lake Amistad. *See* Tex. Water Code § 11.3271. There, the type of water right (for example, municipal, industrial, Class A irrigation, Class B irrigation) governs who is entitled to water during times of shortage. Beneficial use is another principle concept in the appropriation doctrine. A permit authorizing use of state water under the appropriative system is a license. To the extent the appropriator actually puts the water to beneficial use, the appropriation is perfected and becomes a vested property right. *See* Tex. Water Code §§ 11.025–.026.

Even within the framework of appropriative rights, there are various limitations on a landowner’s rights to use surface water, including the following.

Damage to Other Property: No person may divert or impound the natural flow of surface water in the state in a manner that damages the property of another because of the overflow of the diverted or impounded water. Tex. Water Code § 11.086(a). If property is injured by such a diversion or impoundment, the owner of the injured property may recover damages from the liable party. Tex. Water Code § 11.086(b).

Eminent Domain for Municipal Use:

Section 11.033 of the Texas Water Code provides that municipalities and other governmental agencies can exercise the power of eminent domain to acquire water or property devoted to uses other than municipal and domestic purposes. Although this eminent domain provision

has not been repealed or amended, the Texas Property Code imposes various additional requirements on condemnation of water rights by municipalities and provides for separate valuation of groundwater rights in excess of the market value of the fee simple estate. *See* Tex. Prop. Code §§ 21.0121, 21.0421.

Cancellation of Water Rights: Although a perfected water right is considered a vested property right, with notice and hearing the TCEQ may cancel a water right in whole or in part based on ten years of nonuse immediately before the cancellation proceeding. *See* Tex. Water Code §§ 11.172, 11.173(a); *Texas Water Rights Commission v. Wright*, 464 S.W.2d 642 (Tex. 1971). There are now certain statutory exemptions from cancellation, including exemptions for water rights dedicated to certain conservation programs, and the TCEQ may find ‘justified nonuse’ in cases in which the water right is being made available for private marketing or reserved for environmental use. *See* Tex. Water Code §§ 11.173(b), 11.177(b).

§ 16.5:2 Riparian Rights

A riparian water right is a right recognized at common law that entitles the owner of property adjacent to a watercourse to make ‘reasonable’ use of the normal flow of the stream. This right is not quantified. A riparian property owner may impound and use any amount of water that is reasonably necessary for any reasonable purpose; however, the owner may not unreasonably interfere with the use of water by others. A riparian landowner may sell the water for use off-site of the riparian property, provided that the off-site use does not prejudice other riparian water users. Riparian rights holders may separate, by express conveyance, their riparian water rights from the riparian land. *See Watkins Land Co. v. Clements*, 86 S.W. 733 (Tex. 1905). On rivers for which the state has completed the water rights adjudication process, the distinction between riparian rights and appropriative rights

has been removed, and riparian rights have been converted into appropriative rights for all practical purposes.

§ 16.5:3 Civil-Law Water Rights

Before the Republic of Texas adopted the common law, land grants from the sovereign were governed by civil law—either of Mexico or of Spain. These laws therefore determine the water rights relating to property originally granted under civil law. If a civil-law grant expressly includes a grant of water with the land, there is a legally recognizable water right. If the water right was not expressly granted, it is presumed that the sovereign retained the water rights when it made the land grant, and thus those water rights ultimately pass to the state of Texas. *See State v. Valmont Plantations*, 346 S.W.2d 853 (Tex. Civ. App.—San Antonio 1961), *opinion adopted*, 355 S.W.2d 502 (Tex. 1962). Like riparian rights, civil-law water rights are subject to the water rights adjudication process and thus have been quantified and merged with appropriative rights through that process.

§ 16.6 Water Rights Adjudication and Administration

The Texas Water Rights Adjudication Act provides the mechanism for the state to quantify and compile the various sorts of water rights, such as civil-law water rights, riparian water rights, certified filings, and permits. *See* Tex. Water Code §§ 11.301–.341. The final decree in each water rights adjudication is final and conclusive as to all existing and prior rights and claims to the water rights in the adjudicated stream or segment and is binding on all claimants to water rights outside that stream or segment. Tex. Water Code § 11.322(d). This statute is the exclusive means by which water rights may be recognized in Texas, and thus courts cannot recognize equitable water rights based on good-faith prior use. *In re Adjudication of Water Rights of Brazos III Segment of Brazos River*

Basin, 746 S.W.2d 207 (Tex. 1988). Nearly all of the general stream adjudications for Texas have been completed.

For river basins in which a watermaster program has been established, the TCEQ administers adjudicated water rights through a watermaster and a watermaster advisory committee appointed for each water division. *See* Tex. Water Code §§ 11.326, 11.3261. Watermaster programs are intended to ensure compliance with water rights by monitoring stream flows, reservoir levels, and water use. The watermaster divides the water of the streams (or other sources of supply) in the division based on the adjudicated water rights. Tex. Water Code § 11.327(a). The watermaster also regulates controlling works and diversion works in times of shortage to protect existing water rights, prevent waste, and prevent practices in excess of adjudicated rights. Tex. Water Code § 11.327(b). Currently, there are watermaster programs only for South Texas, the Rio Grande, the Concho River, and the Brazos River. More information on watermaster programs, including a map of the locations, can be found on the TCEQ website at <https://www.tceq.texas.gov>.

An attorney representing a purchaser or lender acquiring an interest in water rights that are subject to a watermaster program should become familiar with the applicable statutory and program provisions at Tex. Water Code §§ 11.325–.3291, 30 Tex. Admin. Code §§ 304.1–.63 (Watermaster Operations), and the TCEQ website. Water rights in the Rio Grande below Lake Amistad are allocated on an account basis based on the use of the water, such as municipal and irrigation, instead of on a seniority basis, with priority being given to municipal use. If, in any given month, surplus water is identified over the water needed for municipal use, the water is allocated to the other accounts, such as irrigation. In purchasing water rights, the buyer should determine whether an allocation has been made to the seller, and if so the purchase con-

tract should address how the water allocation will be divided between the parties at closing. The cost of administration of water rights by watermasters is allocated among the adjudicated water rights holders, and assessments are made by the TCEQ. In general, no water may be diverted, taken, or stored by or delivered to a person while he is delinquent in the payment of his assessed costs. *See* Tex. Water Code §§ 11.329, 11.455. Purchasers should determine the amount of assessments that have been made against a seller and the payment status as part of their due diligence. The purchase contract should address the manner in which these assessments will be allocated at closing, if appropriate.

Attorneys dealing with water rights within the Rio Grande should be aware of recording requirements applicable to the Rio Grande watermaster. There are two subsections (j) to section 11.3271 of the Texas Water Code adopted by the legislature in 2003 that have never been reconciled. *See* Tex. Water Code § 11.3271. Under one subsection (j), the watermaster with jurisdiction over the Rio Grande is made the official recorder for all instruments, including deeds, deeds of trust, financing statements, security agreements, and liens that the TCEQ authorizes or requires to be filed in connection with a water right relating to water in the lower, middle, or upper basin of the Rio Grande and that are subject to a permit, certified filing, or certificate of adjudication, and the filing will have the same legal effect as filing under other law for the same type of instrument. Under the other subsection (j), the watermaster is required to maintain a central repository that includes certified copies of all instruments, including deeds, deeds of trust, and liens that the TCEQ requires to be filed in connection with the same type of water rights as are described in the first-referenced subsection (j), and it is expressly stated that on and after September 1, 2003, a lien against a water right shall not be effective against third parties unless a certified copy of

the instrument is filed with the watermaster and all requirements under other law are met. It would be prudent when conveying rights or interests in water rights in the Rio Grande to record a duplicate set of original documents with the Texas watermaster, as well as in the real property records of the county or counties in which the documents are otherwise authorized to be recorded, and to also file a certified copy of the documents recorded in the county real property records (at least with regard to liens) with the watermaster.

§ 16.7 Obtaining Surface Water Rights

A person desiring to appropriate surface water must obtain a permit from the TCEQ. *See* Tex. Water Code §§ 11.022, 11.121. The permit or amendment may be granted only if—after the proper application is filed, the required fees are paid, and notice and hearing are held—the applicant shows that (1) unappropriated water is available in the source of supply; (2) the proposed appropriation is intended for a beneficial use, does not impair existing water rights or vested riparian rights, is not detrimental to the public welfare, considers various environmental and water quality assessments required by statute, and addresses a water supply need in a manner consistent with the state water plan and the relevant approved regional plan or plans; and (3) reasonable diligence will be used to avoid waste and achieve water conservation. Tex. Water Code § 11.134(b). Each of these requirements is discussed briefly below. (The TCEQ also issues several types of more restrictive permits, such as seasonal permits, temporary permits, and emergency permits, authorized by other provisions of the Texas Water Code.)

§ 16.7:1 Availability of Unappropriated Water

‘Unappropriated water’ must be available in the source of supply, which the Texas Supreme

Court has held to mean the amount of water remaining after taking into account complete satisfaction of all existing uncanceled permits and filings valued at their recorded levels. *Lower Colorado River Authority v. Texas Department of Water Resources*, 689 S.W.2d 873 (Tex. 1984). The TCEQ’s water availability models, sometimes referred to as “WAMs,” for each river basin in the state and the TCEQ’s regulatory criteria determine how frequently water must be available to support a finding that unappropriated water is available for appropriation.

§ 16.7:2 Beneficial Use

The Texas Water Code recognizes various purposes for which state water may be appropriated, stored, or diverted and ranks those uses by preference for permit issuance: domestic and municipal, agricultural and industrial, mining, hydroelectric power, navigation, recreation, public parks, game preserves, and “any other beneficial use.” Tex. Water Code §§ 11.023(a), (b), 11.024. The TCEQ may grant a water right application only if the proposed appropriation “is intended for a beneficial use.” Tex. Water Code § 11.134(b)(3)(A).

§ 16.7:3 Nonimpairment of Existing Water Rights

The TCEQ may grant a water right (or amendment) application only if the proposed appropriation does not impair existing water rights or vested riparian rights. Tex. Water Code § 11.134(b)(3)(B). To the extent the proposed appropriation would impair water availability for existing downstream rights, the commission may include restrictions, such as minimum streamflow restrictions, on the diversion and use of water in the new permit.

§ 16.7:4 Public Welfare

The TCEQ may grant a water right only if it finds that it would not be ‘detrimental to the

public welfare. Tex. Water Code § 11.134(b)(3)(C). Under the commission's rules, this very broad requirement includes consideration of environmental, social, and economic impacts of the proposed appropriation. *See* 30 Tex. Admin. Code ch. 297.

§ 16.7:5 Conservation and Drought Contingency Requirements

The TCEQ may grant a water right application only if the applicant has provided evidence that reasonable diligence will be used to avoid waste and achieve "water conservation, as that term is defined by Tex. Water Code § 11.002(8)(B). Tex. Water Code § 11.134(b)(4). With few types of exceptions, such as applications for emergency use, temporary use, or to impound water solely for in-place use, an applicant for new or amended water rights must submit a water conservation plan and adopt reasonable conservation measures, with varying criteria for such plans depending on the water use. *See* Tex. Water Code § 11.1271. In addition to developing conservation plans, wholesale and retail public water suppliers and irrigation districts must develop and submit drought contingency plans, relating to their water rights, to be implemented during periods of water shortages and drought. Tex. Water Code § 11.1272(a).

§ 16.7:6 Other Requirements

The TCEQ may grant an application for a water right or amendment only if the proposed appropriation addresses a water supply need in a manner consistent with the state water plan and any relevant approved regional water plan, unless the commission waives this consistency requirement. Tex. Water Code §§ 11.134(b)(3)(E), 11.1501. Information regarding each of the sixteen regional water plans can be found on the 'Planning' page of the TWDB's website, www.twdb.texas.gov.

Various other statutory provisions require the TCEQ to consider the environmental and conservation impact of water rights applications, including the effects, if any, of the issuance of the permit on groundwater or groundwater recharge (Tex. Water Code § 11.151); the effects, if any, on the bays and estuaries of Texas (Tex. Water Code § 11.147(b)); and permit conditions necessary to maintain existing instream uses, the water quality of the river or stream to which the permit would apply (Tex. Water Code §§ 11.147(d), 11.150), and fish and wildlife habitats (Tex. Water Code §§ 11.147(e), 11.152).

The Texas Parks and Wildlife Department also has significant authority relating to certain environmental aspects of water rights applications. The TCEQ must send a copy of every water rights permit application to the department, which is entitled to participate in hearings on such applications. Information and evidence presented by the department must be considered by the TCEQ in making a final decision on a water rights application. Tex. Water Code § 11.147(f).

A prospective buyer or seller of water rights as part of a real estate transaction must take special note if the water is intended to be taken or diverted from one watershed or river basin to another, because special TCEQ authorization must be obtained before any such 'interbasin transfers. *See* Tex. Water Code § 11.085. There are criminal penalties for taking or diverting water in violation of this statute. *See* Tex. Water Code § 11.085(q), (r). The legislature has sought to balance the interests of the basin of origin and the receiving basin. *See* Tex. Water Code § 11.085(k)-(l); *San Antonio v. Texas Water Commission*, 407 S.W.2d 752 (Tex. 1966). Because newly authorized interbasin transfers have junior priority to all other water rights granted before the filing of a transfer application, the feasibility of an interbasin transfer from existing water rights can be severely limited. *See* Tex. Water Code § 11.085(s).

§ 16.8 Practical Considerations for Conveying Surface Water Rights

§ 16.8:1 Severability and Marketing of Surface Water Rights

Water rights may or may not be appurtenant to a specific tract of land. State-owned surface water rights, arising from either permit or certificate of adjudication, may be transferred as an easement that passes with title to the land or may be transferred separately from the land. Tex. Water Code § 11.040(a); *Strayhorn v. Jones*, 300 S.W.2d 623, 634 (Tex. 1957). In general, title to private water rights will pass automatically with title to the land unless the water rights have been previously sold or conveyed to some third party or are specifically reserved by the grantor. See *Graham v. Kuzmich*, 876 S.W.2d 446 (Tex. App.—Corpus Christi 1994, no writ); *Fleming Foundation v. Texaco, Inc.*, 337 S.W.2d 846, 850 (Tex. Civ. App.—Amarillo 1960, writ ref'd n.r.e.). See the discussion at sections 16.5:1 and 16.5:2 above distinguishing private water rights from state water.

For marketing of surface water rights in Texas, there are significant restrictions on interbasin transfers, as discussed at section 16.7:6 above. Within a river basin, water transfers and marketing by regional suppliers such as river authorities are relatively straightforward. Difficulties may arise, however, when these transactions require amendment of an existing water rights permit, particularly if there are potential issues of impairment of existing senior water rights or environmental impacts. Nonetheless, there is an active market for surface water rights in some parts of Texas, particularly in the Rio Grande Valley. It should be noted that the transfer of water rights in the Rio Grande Valley is governed by TCEQ rules that are unique to the Rio Grande basin. Practitioners should fully understand those rules before beginning negotiations

for the sale or purchase of surface water rights in that area.

§ 16.8:2 TCEQ Permitting

In cases in which an applicant is seeking a new or amended water right, the requirements outlined generally at sections 16.7 through 16.7:6 above will govern the substantive and procedural aspects of the TCEQ's consideration of the application. Even in cases of transactions to sell or lease existing water rights, however, there may be commission requirements that must be satisfied, which could include the following:

- Do the TCEQ rules require actual amendments of the water right as a result of the transaction (for example, diversion point, place, or purpose of use)?
 - If so, will notice and hearing be required? If so, is there any potential for opposition from other interests within the basin?
 - Must the contract or the deed for the transaction be submitted to the TCEQ for its records?
 - Do any special rules or procedures apply (for example, for transactions within the jurisdiction of a watermaster program)?

§ 16.8:3 Other Due Diligence

Among the other issues that the purchaser or lessee of surface water rights should consider are the following:

- What types of legal or technical advice are necessary before closing on the transaction, and how should the closing be conditioned on the results of such analysis?
- How much water is needed for the proposed project, in terms of firm yield requirements over the relevant time period?
- Are the existing rights valid and properly perfected?

Can the relative priority of the water right be determined through examination of county deed records and the TCEQ's records?

What do the TCEQ's records of existing water rights in the stream segment or basin reveal that might impact the desirability of the transaction?

What types of easement rights will be required to make use of the surface water rights?

Can the water be transported to its place of use or need?

§ 16.8:4 **Transfer and Recording of Permits**

Transfers of ownership of surface water rights must be reported to the TCEQ. *See* Tex. Water

Code § 11.122. The change of ownership form, TCEQ Form 10204, may be downloaded from the commission's website, <https://www.tceq.texas.gov>. This form initiates the transfer process at the TCEQ, which is not complete until an approval letter, amended certificate of adjudication, or amended permit is issued to the new owner.

The permit or amended permit must be recorded with the county clerk of the county or counties in which the appropriation will be made. Tex. Water Code § 11.136. This would include at least the county or counties in which the point of diversion is located. In most cases, a certificate of adjudication or amendment must be similarly recorded in each applicable county. *See* Tex. Water Code § 11.324. For more discussion on recordation, see part IV. in this chapter.

[Sections 16.9 and 16.10 are reserved for expansion.]

II. Groundwater Transaction Guide for Sale of Groundwater Rights for On-Site Production

§ 16.11 **Sale of Groundwater Rights in Place for On-Site Production**

The rights to explore for, drill for, produce, and transport groundwater can be sold under a contract of sale and conveyed by deed and easement agreement. These rights can also be leased under a groundwater lease. (But see section 16.1 above for a discussion of ownership of groundwater rights.) This part of this chapter applies to the sale and conveyance of groundwater rights for on-site production, that is, to a transaction in which the groundwater is intended to be produced from wells located on the seller's land. It does not cover the sale or conveyance of permitted groundwater for off-site production, which is addressed in part III. in this chapter, nor does it

apply to the sale of surface water rights, which are addressed in part IV. Financing documents for use in transactions in which the groundwater rights, easement rights, and permit, if any, constitute the collateral, are discussed in part V.

The forms discussed in this part of the chapter are for general use. Users should be aware that modifications may be required for specific transactions. For all groundwater sales, it is imperative that the attorneys involved in the transaction identify the regulatory agencies with jurisdiction over the groundwater rights (referred to collectively in this transaction guide as the 'groundwater authority') and obtain copies of all rules and regulations pertaining to groundwater as early in the transaction as possible. The rules may contain requirements that

have an important bearing on the transaction, such as minimum acreage requirements for production, limitations on production, and requirements for the issuance and transfer of permits. It may be necessary for the practitioner to make modifications to the forms based on the rules of the groundwater authority. Forms 16-1, 16-2, and 16-3 in this chapter, as described in this part of the chapter, are not generally used in the sale of groundwater rights subject to the rules of the Edwards Aquifer Authority.

§ 16.12 **Groundwater Rights Sales Contract, Deed, Easement, and Related Forms; Place for Recordation**

If the seller is the owner of both the surface and groundwater estates in the land and is selling the groundwater and the right to use the surface estate for drilling, production, and transportation of groundwater on-site, the groundwater sales contract, form 16-1 in this chapter, should be used in the transaction. If the seller owns only groundwater rights that have already been severed from the land, together with easement rights to use the surface of the land for drilling, production, and transportation, the groundwater sales contract may be used if appropriately modified. At closing, the deed would describe both the groundwater rights and the easement rights. If the seller acquired the easement rights through a separate easement agreement, the deed would reference the recorded easement agreement. Alternatively, a separate assignment of easement rights could be used.

If the groundwater is subject to regulation by a groundwater authority, the attorney should determine whether the seller has obtained a groundwater permit. If so, the information regarding the permit should be set out in the contract, and the seller should request a transfer of the permit from the groundwater authority as part of the sale transaction. See section 16.17:5 below regarding permits.

All recordable documents should be recorded in the county or counties in which the land from which the groundwater and easement rights are obtained is located. If the real property identified in forms 16-2 and 16-3 is located in Brazos County, Texas, for example, the deed and easement would be recorded in that county. In many groundwater districts, the permits issued in connection with groundwater rights for on-site production are not recorded in the real property records. If a groundwater permit is issued to the buyer in a form that may be recorded, the permit should be recorded in the real property records in the same county or counties as the deed is recorded. It has generally not been the practice to record production permits in the real property records except for those issued by the Edwards Aquifer Authority. See part III. in this chapter.

The contract anticipates that a memorandum of contract will be recorded in the real property records when the contract is signed. The memorandum will put the public on notice of the buyer's contract rights in the event there is a significant period of time between signing the contract and closing. See form 16-16.

The basic sales documents include the following:

1. Groundwater Rights Sales Contract (form 16-1).
2. Groundwater Rights Warranty Deed (form 16-2).
3. Blanket Easement Agreement for Groundwater Rights (form 16-3).
4. Permit Transfer Request (form 16-12) or a transfer form promulgated or approved by the groundwater authority if a permit has been issued to the seller or another form promulgated by the groundwater authority, if it has a particular form for transfer.
5. Partial Release of Lien (On-Site) (form 16-8) if the seller has an exist-

- ing lien on the land and only the groundwater rights are being released from the lien at closing.
6. Release of Lien (form 10-2 in this manual) if the seller's entire lien will be released at closing.
 7. Lienholder Consent and Subordination to Easement Agreement (form 16-7) if the seller has an existing lien on both the surface estate and groundwater, which will not be released as to the surface estate at closing.
 8. Bill of Sale (form 5-16 in this manual) if personal property will be conveyed at closing and a more detailed description is required than the description in the deed.
 9. Form UCC3 (form 9-14 in this manual), a form promulgated by the Texas secretary of state, if there is a security interest that covers or that could be construed to cover the groundwater rights, the permit, or personal property to be conveyed at closing.
 10. Assignment and Assumption of Lease (form 16-14) if there is an existing lease of the groundwater.
 11. Lessee Estoppel Certificate (form 16-15) used to assure the buyer that the groundwater lease is valid and is not in default and that the lessee understands the lease is being assigned.
 12. Affidavit of Debts and Liens [and Indemnity] (form 16-13) (if this form is not being provided by a title company) used to provide additional protection to the buyer, especially in instances in which no title insurance will be obtained or title insurance is not available.
 13. Loan documents required by the lender.

The groundwater deed, easement, and other recordable documents should be recorded in the real property records of the county or counties in which the land is located. If the buyer has applied for a new or amended production permit from a groundwater conservation district, the permit, when issued, may not be in recordable form. It has generally not been the practice to record these types of production permits in the real property records.

§ 16.13 General Considerations

The groundwater rights sales contract for on-site production, form 16-1 in this chapter, is drafted as a neutral form of contract, intending to favor neither the buyer nor the seller. For each contract, the basic elements of the transaction are, in general, stated in the sections to be completed at the beginning of the form. Some provisions, however, are required to be completed throughout the contract. The general terms that follow in the form may be used for many transactions. However, the sale of groundwater rights is an emerging area of law, and there are no well-established terms of sale. Contracts for the purchase and sale of groundwater rights are diverse, and additional drafting may be necessary to tailor the forms to the transaction.

§ 16.14 Special Surface Use Considerations

In the sale of groundwater rights in which the groundwater will be produced using the surface estate, it is possible for the deed to convey not only an interest in the groundwater but also easement rights in the surface of the land for exploration, drilling, production, and transportation of groundwater. However, it is advisable to use a separate easement agreement to describe in detail the easement rights that the owner of the groundwater estate will have in the surface estate. The parties may also want to provide for payment terms and use restrictions that are too detailed to include in the deed. Although form

16-1 in this chapter and the groundwater warranty deed, form 16-2, provide for the sale and conveyance of groundwater rights, which include surface use rights, these provisions are intended as safeguards to ensure that surface use rights are included in the sale and conveyance. It is recommended that the optional provision for the execution of a separate easement agreement at closing be used.

§ 16.15 Groundwater Rights Sales Contract

The following sections describe the provisions and terms of form 16-1 in this chapter and include considerations for the attorney in drafting or reviewing a contract, assisting the client during investigation of the groundwater rights, and closing the transaction. This commentary is organized in the same order as the sections of the contract.

§ 16.16 Introductory Paragraph: Offer and Acceptance

The introductory paragraph of the contract states what the parties must do to form the contract of purchase and sale. If the buyer's earnest money cannot be collected, the buyer will be in default.

§ 16.17 Defined Terms

§ 16.17:1 Seller and Buyer

There are sections for the names of and other information concerning the seller, the buyer, and their respective attorneys. Proper identification of the parties is important, and the seller and the buyer should be identified as fully as possible. Capacity and authority should be considered, especially if a party is not an individual acting on his or her own behalf. See chapter 3 in this manual for a discussion of party designations.

§ 16.17:2 Title Company/Escrow Agent

Title insurance to insure title to severed groundwater rights in Texas is not generally offered by title insurance underwriters in Texas, although currently there is at least one insurer that offers title insurance for water rights. The contract designates a title company or escrow agent to act as the escrow and closing agent to address the situation in which the property will close through a title insurance company and the situation when it will not. The title company or escrow agent will be responsible for closing the transaction and receiving and disbursing funds under the terms of the contract.

It is advisable to have a written escrow agreement between the title company or escrow agent, the buyer, and the seller that defines the rights and duties of the title company or escrow agent. Form 4-2 in this manual is an escrow agent receipt and escrow agreement. It can be modified for use with an escrow agent other than a title company. The escrow agent should be responsible for getting signed at closing the affidavit of debts and liens (form 16-13), the settlement statement, and similar documents typically provided by a title company.

§ 16.17:3 Surveyor

This section of the contract should be completed if a surveyor has been designated for the transaction. See section 16.21:3 below regarding survey requirements.

§ 16.17:4 Groundwater Authority

If the real property is located within a groundwater conservation district or other groundwater authority, the authority should be identified. It is imperative that the buyer's attorney consult the rules of the groundwater authority to determine all restrictions on the use and production of groundwater, requirements for sale of groundwater, and rules regarding the issuance or trans-

fer of a permit. Generally, copies of the rules can be obtained only from the groundwater authority. The buyer's attorney should also obtain, and personally review, copies of all documents maintained by the groundwater authority pertaining to the groundwater being sold. The attorney should note all relevant information from the file, such as yearly allocations, if applicable, and should determine the feasibility of meeting all conditions of the groundwater authority's approval of the sale within the buyer's required time frame.

§ 16.17:5 Seller's Permit

It is important for the buyer to determine whether the seller has a production or other permit issued by a groundwater authority in connection with the groundwater, whether the permit will allow the use of the groundwater contemplated by the buyer, and what requirements the groundwater authority imposes for the transfer, amendment, or issuance of a permit. If the seller has been issued a permit, the permit information should be set out in the contract and a copy of the permit and all amendments provided to the buyer as part of the seller's records. If there is an existing permit, the buyer generally will want to obtain a transfer of the seller's permit, and the seller should be required to submit a request for transfer of the permit in connection with the sale transaction. If the buyer needs a modification to the permit, such as a change in the type of groundwater use permitted, the buyer can file the appropriate documentation for a request with the groundwater authority, with any transfer of the permit and change in permit terms taking effect after closing. Because the rules and procedures for groundwater authorities vary, the attorney should contact the groundwater authority to obtain information on the forms and procedures required by the specific groundwater authority.

Paragraph G.5. of form 16-1 addresses the buyer's right to evaluate the seller's permit

during the inspection period and contains an optional paragraph if the purchase of the groundwater is contingent on the buyer's ability to obtain required permits.

§ 16.17:6 Earnest Money

The amount of earnest money is negotiable and depends on several factors, including the purchase price, the type of financing, and the relative financial strengths of the parties.

§ 16.17:7 Independent Consideration

If the buyer terminates the contract before the end of the inspection period, and the buyer is otherwise entitled to have the earnest money returned, the contract provides that a stated amount should not be returned to the buyer but should be paid to the seller, because that amount is the independent consideration to the seller for the buyer's right to terminate the contract.

§ 16.17:8 Real Property

The real property is the land from which the groundwater is to be sold and is described in exhibit A. Any fixtures and personal property to be conveyed with the groundwater rights at closing also should be described in exhibit A. The contract should describe the real and personal property with legal specificity. If the property is not described sufficiently, the contract may be unenforceable because of vagueness. See chapter 3 in this manual for a discussion of property descriptions. Attention should also be given to the conveyance of appurtenant rights, such as permits, licenses, access easements, access to utilities, and similar rights. Because it is not clear whether some types of property, such as the components of a well, are personal property or fixtures, if wells or similar items are being conveyed at closing, it is advisable to treat them as both real and personal property in the conveyance documents.

§ 16.17:9 Groundwater Defined

The definition of groundwater is derived in part from *Pecos County WCID No. 1 v. Williams*, 271 S.W.2d 503, 505–06 (Tex. Civ. App.—El Paso 1954, writ ref'd n.r.e.).

§ 16.17:10 Groundwater Rights

The contract defines groundwater rights to include the right to use the surface of the land for exploration, drilling, and production and any governmental licenses or permits to so use the groundwater.

§ 16.17:11 Reserved Groundwater

If the seller intends to reserve ownership of or the right to use groundwater, the reserved rights should be described with specificity, including any limitation on use of the groundwater or the quantity of groundwater that may be pumped. In general, it is customary for the seller to retain a right of usage to accommodate the seller's needs, without retention of an undivided ownership interest in the groundwater. Form 16-1 reserves the seller's right to use groundwater. The form should be amended if the parties intend for the seller to reserve an undivided interest in the groundwater and should specify the percentage interest reserved. The reservation should be carefully drafted to protect the buyer's rights in the groundwater without unnecessarily curtailing the surface owner's right to use its property. If the buyer is acquiring the groundwater for commercial use, the buyer will want to prohibit the seller from using the reserved groundwater for commercial uses or production. The restriction on the seller's use may include restrictions on using groundwater for oil and gas exploration or production. The seller's water production may be limited in various ways, as by specifying the amount of groundwater that can be produced from the real property on a per-year or other basis or by limiting the number of seller's wells that may be maintained in opera-

tion on the real property at any one time. The parties may wish to specify whose right to the groundwater is paramount in the event of an extreme drought or production limitations. The following is a sample reservation provision for a deed:

Grantor reserves for itself and Grantor's successors and assigns the right to utilize Groundwater, at no cost, solely for domestic and livestock use on the Real Property. The term *domestic and livestock use* means use of the Groundwater on the Real Property solely for household uses by Grantor, Grantor's employees, and their respective families for the watering of domestic and grazing animals and for Grantor's limited oil and gas use permitted by this deed. The right to utilize Reserved Groundwater includes the right to drill, use, and operate domestic-type wells or windmills but does not include the right to drill, use, or operate any industrial-type or irrigation-type wells on the Real Property or to use Groundwater for the creation or maintenance of ponds. No Reserved Groundwater may be used for the operation of crop irrigation, feedyard purposes, dairy operations, confined animal feeding operations, mining operations, or other industrial or commercial purposes, except that Grantor will have the right to use one existing well, or to drill and use one well, for each oil and gas well drilled as reasonably necessary during the drilling, completion, recompletion, reworking, remediation, and revegetation process (but not for water flooding and secondary recovery operations). After these processes have been completed, Grantor will have the right to use these wells for

domestic and livestock purposes subject to the limitations set forth in this deed. The aggregate number of wells for the production of Reserved Groundwater existing at any time on the Real Property may not exceed, on the average, one well per [number] acres. If at any time Grantor fails to pump all the Reserved Groundwater to which Grantor is entitled, Grantee will have the right to pump all Groundwater not pumped by the Grantor without additional consideration or compensation.

The parties may wish to provide that the seller's right to use groundwater will terminate if water sufficient to meet the seller's needs becomes available to the property from some other source, such as a public water supply system, or from other land owned by the seller.

§ 16.17:12 Hydrogeological Testing

Paragraph G.3. of form 16-1 authorizes the buyer to perform hydrogeological testing during the inspection period to determine the quality of the groundwater, to estimate the quantity of the groundwater, to establish well locations, and to form the basis for establishing the purchase price of the groundwater as described in section 16.17:13 below.

§ 16.17:13 Purchase Price

There is no standard method of determining the purchase price for groundwater rights. The purchase price may be based on a dollar amount per acre of land from which the groundwater rights will be obtained or on the appraised value of the groundwater rights as determined by an appraiser. The field of groundwater rights appraisal is still evolving. In areas where there are numerous groundwater sales or leases, it is possible to obtain an appraisal of groundwater rights based on comparable sales. In areas where

there are few sales or lease transactions or where the water quantity or quality is highly variable, it may be difficult to obtain a reliable appraisal of groundwater rights without obtaining hydrogeological information on the groundwater. Where groundwater is obtained over a large area that may exhibit variability in water quality, volume, or sustainability, the calculation of the purchase price in the contract may be based on an estimate of these variables as determined by a hydrogeological study, so that the purchase price for groundwater in lands with a higher quality or greater volume of groundwater will be higher than the purchase price for groundwater in lands with lower quality or less sustainable groundwater.

Exhibit I may be used if the parties agree to seller financing of the purchase. If obtaining third-party financing is a condition to the buyer's obligations, that fact and the terms of the complying financing should be addressed in the contract. See chapters 6 and 8 in this manual for further discussion of financing.

§ 16.17:14 Buyer's and Seller's Liquidated Damages

These sections of the contract are provided so that the parties can agree on additional liquidated damages to be paid by the defaulting party to the nondefaulting party on default.

§ 16.17:15 Title Commitment and Title Information

Title insurance to insure title to severed groundwater rights is no longer generally offered by title insurance underwriters in Texas, although it may still be available from a small number of insurers. If the seller is not required to provide a title commitment, or if a title commitment is not available for the groundwater rights, the contract requires the seller to provide the buyer with an abstract of title. The contract provides that the buyer may have the abstract of title reviewed by

an attorney of the buyer's choice, at the expense of the seller or buyer as specified in the contract. If the buyer obtains an abstract of title, the buyer should have it reviewed by an attorney who is experienced in land titles and knowledgeable about groundwater rights.

§ 16.17:16 Title Documents

The contract defines title documents to include the seller's permit and instruments affecting title to the groundwater and the real property referenced in the title commitment or title information, survey, or UCC search or to be provided as part of the seller's records. Title documents may include probate records, marital records, and birth and death certificates. Under paragraph F.7. of the contract, title objections can be made on the basis of the title documents. This provides the buyer with the ability to make objections to title based on the seller's permit or unrecorded documents provided as part of the seller's records.

§ 16.18 Deadlines

Section A of the contract groups most of the deadlines for ease of reference and provides two alternate ways to determine most of the deadlines: either a stated date or a specified number of days after the effective date of the contract or another specific date. The contract provides that time is of the essence. The contract provides that closing will occur a certain number of days after the expiration of the inspection period, but closing may also be specified to occur a certain number of days following a different event or on a certain date. The closing date may also be specified as "on or before" a certain date or event.

§ 16.19 Closing Documents

Section B of the contract lists the documents to be signed and delivered to close the transaction

and serves as a checklist to prepare for closing. Section C contains a number of exhibits. The attorney should choose the specific exhibits appropriate for the sale.

§ 16.19:1 Exhibit B—Representations; Environmental Matters

Exhibit B contains the parties' representations. These items are always negotiated by the parties and will vary from transaction to transaction.

§ 16.19:2 Exhibit C—Seller's Records

Exhibit C is a list of the seller's records of the property that will be delivered or made available to the buyer for review during the inspection period and also delivered to the buyer at closing.

§ 16.19:3 Exhibit D—Notices, Statements, and Certificates

Exhibit D lists notices, statements, and certificates required by federal and state law and regulations to be delivered when common real estate contracts are executed. The items applicable to a specific transaction should be selected. See chapter 2 in this manual for brief discussions of each law and regulation and for references to other laws and regulations that require notices, statements, and certificates for less common transactions. Some of the statutory provisions would appear to include the sale of groundwater, simply because they apply to a sale or conveyance of real property, and no exemption is made for the sale of groundwater.

§ 16.19:4 Exhibit E—Permits

Copies of the seller's permits should be attached to the contract as an exhibit. If copies cannot be attached for some reason, they should be described with specificity, including any permit numbers.

§ 16.19:5 Exhibit F—Leases and Contracts to Be Terminated

This exhibit lists the seller’s leases and contracts affecting the real property or groundwater that will be terminated at or before closing.

§ 16.19:6 Exhibit G—Leases and Contracts Not to Be Terminated

This exhibit lists the seller’s leases and contracts affecting the real property or groundwater that will be assumed by the buyer or taken subject to.

§ 16.19:7 Exhibit I—Seller Financing

Exhibit I contains seller-financing terms.

§ 16.19:8 Exhibit J—Easement Agreement

The deed conveying the groundwater should grant basic surface use rights for access to, and development of, the groundwater. Forms 16-1 and 16-2 accomplish this by defining ‘Groundwater Rights’ to include these basic surface use rights. It is advisable, however, that the parties agree on more extensive surface use rights and surface use restrictions for both the surface owner and the groundwater rights owner and set out these rights and restrictions in a separate easement agreement. The owner of the groundwater estate has easement rights implied by law to use as much of the surface estate as is reasonably necessary to produce groundwater. *Coyote Lake Ranch, LLC v. City of Lubbock*, 498 S.W.3d 53 (Tex. 2016). However, many issues can arise when the surface owner and the groundwater rights owner both use the surface estate for their respective purposes, and it is important for the parties to consider and agree on specific terms that will establish their respective rights, priorities, and limitations with regard to the use of the surface estate. It is advisable for these terms to be set out in a separate easement

agreement, rather than in the deed, so that they can be described in detail, along with indemnifications and other terms that are not customary in deeds.

The easement documents included in this chapter consist of a blanket easement agreement for surface use (form 16-3), with three optional addenda that impose surface use restrictions (form 16-6, surface use restrictions addendum), require payments for use of the surface estate (form 16-5, surface damage payment addendum), and require the groundwater rights owner to limit its use of the surface estate to specific locations over time (form 16-4, easement location addendum). In light of the Texas Supreme Court’s decision in *Coyote Lake Ranch*, attorneys using the easement forms should modify them as necessary to clearly identify the respective surface use rights of the parties. Consideration should be given to incorporating into the easement documents the concept that the owners of the surface and groundwater estates will each make reasonable accommodations to the other in the use of the surface estate. Any obligation to make accommodations should be expressly stated, and the action required to fulfill this obligation should be clearly set out. The court’s analysis of when the accommodation doctrine applies, discussed below, can be used as a template in drafting this language.

In *Coyote Lake Ranch*, the court held that the owner of the groundwater estate has implied easements for access and use over the surface estate as reasonably necessary to develop the groundwater and that these easements are dominant to the surface use rights of the surface owner. Despite the broad surface use rights granted to the city, the court found that the language in the deed did not address all of the surface use issues raised by the ranch owner. The court held that when the documents creating the surface use rights do not fully address questions on surface use, the accommodation doctrine can

be applied to limit the surface use by the owner of the groundwater estate.

Under the *Coyote Lake Ranch* holding, to successfully assert a claim that the accommodation doctrine applies, the surface owner must prove that—

1. the groundwater rights owner's use completely precludes or substantially impairs the existing use; and
2. there is no reasonable alternative method available to the surface owner by which the existing use can be continued; and
3. there are alternative reasonable, customary, and industry-accepted methods available to the groundwater rights owner that will allow recovery of the groundwater and also allow the surface owner to continue the existing use.

Coyote Lake Ranch, 498 S.W.3d at 64. The court's decision in this case underscores the importance of drafting surface use rights in a manner that is clear and unambiguous about the nature and extent of the authorized use.

Form 16-3 includes the grant of a 150-foot-wide sanitary control easement around each groundwater well as required by the TCEQ for wells that are part of a municipal water supply system. See 30 Tex. Admin. Code §§ 290.38(73), 290.41(c). The purpose of the easement is to create an area around each well in which uses that could adversely affect the quality of the groundwater are prohibited. The requirement for a sanitary control easement is included in the form because a grantee acquiring groundwater for domestic and livestock use may want this protection for its well. The blanket easement agreement also contains a provision requiring the grantor to execute a separate sanitary control easement in the form promulgated by the TCEQ at the grantee's request. The TCEQ easement

form requires the specific location of the well and easement to be identified. The grantee may not know the location of future wells at the time it acquires the easement, but the grantee can have the separate sanitary control easement executed when the location of each well is established.

§ 16.19:9 Exhibit K—Memorandum of Contract

If it is anticipated that there may be a significant amount of time between the date the contract is signed and the date of closing, it is advisable to have the memorandum of contract signed and recorded in the real property records to provide notice of the buyer's contract rights. See form 16-16 in this chapter.

§ 16.19:10 Exhibit L—Notice of Termination of Contract

If the memorandum of contract is used, the parties should execute the notice of termination of contract form at the same time and deliver it to the title company or escrow agent for recordation in the event the contract is terminated before closing. See form 16-17 in this chapter.

§ 16.20 Investment of Earnest Money

The contract provides that the buyer may direct the title company or escrow agent to invest the earnest money in an interest-bearing account in a federally insured financial institution. If the earnest money is to be invested, the title company will require the buyer's tax identification or Social Security number so that accrued interest may be reported to the Internal Revenue Service.

§ 16.21 Title and Survey

The contract incorporates the statutory notice that the Texas Real Estate License Act requires

real estate brokers and real estate salespersons to give to a buyer, advising that the buyer should either have title examined by an attorney or obtain a title insurance policy, if available. *See* Tex. Occ. Code § 1101.652(b)(29). If a broker or salesperson is not involved, the paragraph may be deleted.

The contract requires that the seller provide to the buyer by the deadlines stated in the contract the title commitment or title information, the survey (if required), the UCC search, and legible copies of each document referred to in these instruments.

The contract follows a typical procedure under which the buyer reviews the title commitment or title information, the survey, the seller's permit, the documents provided by the seller, and the UCC search and notifies the seller of any objections. After notice, the seller may elect to cure the buyer's objections but is not required to do so. If the seller does not agree to cure, the buyer may either proceed to close the transaction and accept the groundwater rights subject to the uncured matters or terminate the contract. However, the seller is obligated to resolve all items listed on Schedule C of the title commitment at or before closing and to cure title matters that arise by, through, or under the seller after the contract is signed.

Attorneys reviewing title should look for contracts or for provisions in existing oil and gas leases that allow injection or disposal into or onto the land of saltwater or other substances that can adversely affect the quality of the groundwater. Owners of the mineral estate, including oil and gas lessees, can use as much of the groundwater as is reasonably necessary to produce minerals, including using groundwater for hydraulic fracturing ("fracking"). *See Sun Oil Co. v. Whitaker*, 483 S.W.2d 808 (Tex. 1972); *Fleming Foundation v. Texaco, Inc.* 337 S.W.2d 846 (Tex. Civ. App.—Amarillo 1960, writ ref'd n.r.e.).

It is unlikely that the seller will be able to modify or terminate existing oil and gas leases, so it is important to evaluate their effect on the groundwater estate. If the surface owner is also the owner of the mineral estate, the buyer can negotiate restrictions on the mineral estate limiting the use of groundwater for fracking and prohibiting the injection or disposal of saltwater and other substances in or on the land so that these practices will not be allowed in future leases and contracts.

§ 16.21:1 Review of Title Commitment

The contract provides that the condition of title will be established by either a title commitment or an abstract of title, as agreed to by the buyer and the seller. If an abstract of title is furnished, the buyer may have the abstract of title reviewed by an attorney and obtain the attorney's written opinion of the abstract of title. The benefit of obtaining title insurance, if available, over an attorney's opinion of title is that title insurers are required to maintain reserves to cover claims that are greater than the malpractice coverage maintained by most law firms. Consequently, there is an increased likelihood of recovery if an error is made by the title company in its determination of title.

An essential reference on title insurance is the *Basic Manual of Rules, Rates and Forms for the Writing of Title Insurance in the State of Texas*, available from the Texas Department of Insurance at <https://www.tdi.texas.gov/title/titleman.html>. The manual contains Texas rate and procedural rules; the text of title 11 of the Texas Insurance Code, relating to title insurance; and various bulletins of the Texas State Board of Insurance dealing with title insurance practices.

The attorney should review the signature and effective date of the commitment. The attorney should confirm that the commitment is signed and that the issuance date is not more than

ninety days before the closing. Otherwise, a new or revised commitment should be ordered.

Schedule A: The attorney should confirm that the proposed insured parties are correctly named, the amounts of insurance are correctly stated, and the correct estate is insured. The commitment should list two estates to be insured, the fee ownership of the groundwater estate, and the buyer's easement estate. Record title should be vested in the seller. The attorney should confirm that the property description is correct and conforms to the description in the contract and in the survey (if applicable).

Schedule B: The attorney should review the following matters:

Item 1, relating to covenants and restrictions, should be noted as either "Covenants, conditions, and restrictions (other than any restrictions indicating preference, limitation, or discrimination based on race, color, religion, sex, handicap, familial status, or national origin) as set forth in [recording data] of the real property records of [county] County, Texas" or "Item 1 of Schedule B is hereby deleted in its entirety."

Item 2, relating to the standard survey exception, may be amended and partially deleted to read 'any shortages in area' if a current survey approved by the title company is obtained. An additional 5 percent premium is charged to amend the owner policy for a residential transaction; an additional 15 percent premium is charged to amend the owner policy for a commercial transaction. No additional premium is required to amend the mortgagee policy. The responsibility for paying the extra premium for the survey modification in the owner policy of title insurance is often negotiated between the parties, although the pertinent provision in the contract form provides for the extra premium to be paid by the buyer.

Item 3, relating to homestead or community property or survivorship rights, and item 4, relating to tidelines, lands comprising the shores and beds of waterways, lands beyond the line of the harbor or bulkhead lines, filled-in lands, artificial islands, statutory water rights, and areas extending from the line of mean low tide to the line of vegetation, apply only to the owner policy and cannot be deleted or amended.

Item 5, relating to property taxes, should be reviewed for the status of tax payments and the existence of rollback taxes.

Item 6, relating to the terms and conditions of the documents creating the insured's interest in the land, cannot be revised. The referenced documents should, however, be reviewed.

Item 7, relating to materialman's and mechanic's liens, applies only to the mortgagee policies on interim construction loans and may be deleted if satisfactory evidence that the paragraph does not apply is furnished to the title company.

Item 8, relating to subordinate liens and leases, applies only to the mortgagee policy.

Item 9, relating to existing liens, should show only liens permitted by the contract. Copies of all lien documents should be reviewed with regard to due-on-sale provisions; dragnet clauses relating to other debt; condemnation provisions; notice, cure, and default provisions; and subordinate financing. A superior lienholder's estoppel agreement should be obtained from any lienholder whose note and lien are being either assumed or taken "subject to."

All other special exceptions, such as easements, mineral interests, leases, or matters shown on a current survey, should be carefully reviewed to determine if they affect the buyer's groundwater rights. The commitment should indicate whether these exceptions apply to the groundwater

estate, the easement estate, or both. If the real property consists of more than one tract of land, the commitment should specify which items apply to which tract or tracts.

Schedule C: The attorney should ensure that the seller has complied with the contract by curing and effectively removing all matters appearing on Schedule C at or before closing. Schedule C matters may require obtaining releases of liens, settling specific claims or lawsuits affecting title to the property, furnishing evidence of good standing and authority (corporate resolution or partnership agreement), and obtaining proof of property settlement and divorce, proof of heirship or probate of a particular estate, or evidence relating to a bankruptcy. From the buyer's perspective, curative matters appearing on Schedule C should be attended to by either the seller or the title company. The contract requires that the seller resolve all Schedule C items before closing, but if that provision is not used, the buyer should object to all Schedule C items in the commitment to ensure that they are not added to Schedule B of the title policy.

The *Basic Manual of Rules, Rates and Forms for the Writing of Title Insurance in the State of Texas* should be consulted for information on the various types of policies and endorsements that are available and their respective costs.

§ 16.21:2 Review of Abstract of Title

If the seller is obligated to provide an abstract of title, the contract provides that the buyer may have the abstract of title reviewed by an attorney at either the buyer's or seller's expense, as specified in the contract. If the condition of title is to be determined based on an abstract of title, the buyer should have the abstract of title reviewed by an attorney experienced in land title examination and knowledgeable about groundwater rights, and should obtain a written opinion of title in time to make title objections within the deadline specified in section A of the contract.

The abstract of title required by the contract covers the period from the first conveyance from the sovereignty to the present. It is possible to obtain an abstractor's certificate from a title or abstract company that covers a shorter period and may contain a conclusion by the abstractor as to the identity of the current record owner of property, the existence of any outstanding liens, and other title encumbrances affecting the real property. While this information is useful, it is not a satisfactory substitute for an abstract of title as specified in the contract and an attorney's opinion of title. Often, the title or abstract company preparing the abstractor's certificate or abstract of title will limit liability for error to the amount charged for the certificate or abstract.

§ 16.21:3 Review of Survey

The seller is required to provide copies of any existing surveys under exhibit C (seller's records). The contract allows the buyer to require the seller to provide a new survey of the real property, at the seller's expense, as specified in the contract. The required survey category should be set out in the contract in the indicated place under the block for information on the surveyor. Different types of surveys and survey certifications are available, depending on the nature of the property and the requirements of the parties. An excellent resource on surveys is the *Manual of Practice for Land Surveying in the State of Texas*, published by the Texas Society of Professional Surveyors, which may be contacted at www.tsps.org. It describes the various categories and conditions for surveys in Texas, the level of accuracy required for each category of survey, matters to be depicted on the survey, and the nature of certificates.

The attorney should keep the following points in mind when reviewing a boundary survey:

The survey should bear a recent date and should conform to the required category and

condition for the type of survey specified in the contract and location of the property.

The certificate should be sealed and signed and should conform to any certificate specified in the contract.

There should be a north compass bearing on the survey.

The attorney should observe the system of reference used for the survey, locate the beginning point, and determine that it is monumented and locatable.

The survey, particularly all course and distance notations, should be compared to the legal description either appearing on or attached to the survey. This description then should be compared to the one appearing in the contract and the title commitment or title opinion.

If a more extensive survey, such as a land title survey, is obtained, the attorney should also keep the following points in mind:

All recorded easements appearing in the title commitment or title opinion should be located and noted on the survey with the appropriate recording data, and blanket easements should be noted in the surveyor's notes. The surveyor should also note any items shown in Schedule B that the surveyor determines do not affect the real property. Conversely, the attorney should examine the survey for any matters (such as easements) not appearing in the title commitment or title opinion.

The survey should be examined for the location of improvements. The attorney should determine if the improvements protrude onto adjoining property or easement areas, if there are encroachments of improvements from adjoining property onto the property, and if there are building setback line violations.

The survey should be examined for the depiction of overhead lines, roadways, or other uses of the property that are not within an easement area covered by a recorded easement, as these may indicate the existence of prescriptive easement rights. Any written notations on the survey, such as those relating to rights of parties in possession, should be reviewed to determine their effects on the property and its anticipated use.

The property should have legal and adequate access to public streets or roads.

The survey should show the existence and location of utilities.

The surveyor's certificate should indicate the location of the floodplain, if applicable.

§ 16.21:4 Review of UCC Search

The contract includes provisions for the conveyance of personal property and fixtures and requires that the seller furnish UCC searches of the UCC records of the Texas secretary of state and the UCC records of any other appropriate state. It should be remembered that groundwater permits, wells, and other property may fall within broad collateral descriptions such as "equipment" and "general intangibles" in security agreements and financing statements.

§ 16.22 Inspection Period

The inspection period is intended to give the buyer the opportunity to investigate the groundwater and real property and decide whether to close the transaction. The contract provides that the buyer may terminate the contract at any time before the end of the inspection period for any reason and have the earnest money returned, except for the independent consideration provided in the contract.

The contract provides for reasonable rules of entry and that the buyer will indemnify the seller

for claims resulting from the buyer's inspection of the property. Except for the environmental indemnity stated in exhibit B (if used), the indemnity provisions of the contract are not intended to shift risk from the indemnified party to the indemnitor for the indemnified party's own negligence. One consequence of this allocation of risk is that the indemnified party may not be able to recover the costs of defense from the indemnitor if the indemnified party is sued for the consequences of its alleged negligence. See *Fisk Electric Co. v. Constructors & Associates*, 888 S.W.2d 813 (Tex. 1994). The environmental indemnity, if used, shifts risk for the seller's own negligence from the seller to the buyer. It is unlikely, however, that the environmental indemnity will be effective to shift risk in the event of misrepresentation or fraud.

It is prudent for the purchaser of groundwater rights to be produced on site, whether or not previously severed, to obtain an environmental site assessment on the land overlying the groundwater that meets the requirements of the 'all appropriate inquiries' rule under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), 42 U.S.C. §§ 9601–9675, in order to secure protection as an "innocent landowner" from strict liability for groundwater contamination. While there is no case law in which the owner of a groundwater right has been held strictly liable for groundwater contamination as a result of his ownership of the groundwater right, the owner of a mineral estate has been held to be an 'owner' under CERCLA because it is the owner of a fee simple estate separate from the surface estate. See *City of Grass Valley v. Newmont Mining Corp.*, No. 2:04-cv-00149-GEB-DAD, 2007 WL 4287603 (E.D. Cal. Dec. 4, 2007) (also cited in *Halliburton Energy Services, Inc. v. NL Industries*, 648 F. Supp. 2d 840, 896–97 (S.D. Tex. 2009)). An owner of a groundwater rights estate would, under the court's reasoning in *Edwards Aquifer Authority v. Day*, 369 S.W.3d 814 (Tex. 2012), be the owner of a fee simple estate separate from

the surface estate and could, therefore, be held to have strict liability for groundwater contamination. See William D. Dugat, *All Appropriate Inquiries in Connection with Groundwater Purchases*, in *The Changing Face of Water Rights in Texas*, State Bar of Texas (2015).

The contract provides that the earnest money will be deposited in one lump sum. The parties alternatively may agree that the buyer is obligated to deposit additional earnest money after agreed conditions have been satisfied—for example, if the buyer decides not to terminate the contract at the end of the inspection period and to proceed to closing.

§ 16.23 Representations and Warranties

Representations and warranties are negotiated by the parties with specific reference to the transaction. They may include such matters as ownership of the real property and groundwater rights; organization of the parties; authority to execute the contract and close the transaction; condition of title; parties in possession; pending litigation and claims that may ripen into litigation; pending or threatened condemnation or other taking; use restrictions, such as zoning and restrictive covenants; condition of the property or disclaimer of representations (for example, 'as is' language); presence of landfills or hazardous and toxic wastes; floodplain location; utility availability and capacity; compliance with all laws; effectiveness of required licenses and permits; status of leases; operation and maintenance of property before closing; accuracy of books and records; agricultural or other special-use tax assessment; payment of ad valorem taxes; and status of debt to be assumed or taken 'subject to.'

In negotiating representations, the parties should specify whether representations are to be absolute or based on the seller's knowledge and belief; whether the representations will be based

on the knowledge of the entity that is the seller or on the knowledge of specified individuals; whether the seller must perform further investigation to make the representations or may rely on its current knowledge, without further investigation; and whether and to what extent the representations will survive closing.

The approach used in this contract limits the seller's representations and warranties, but it is not intended to insulate the seller from liability for fraud or misrepresentation.

The seller represents only facts, not opinions. For example, the seller does not represent whether, in the seller's opinion, the property is in compliance with applicable laws and regulations. Instead, the seller represents that it has not received notice of violation of any law, ordinance, regulation, or requirement affecting the property or use of the property, except as stated in the contract.

The seller makes no representations or warranties that are not stated in the contract, including exhibit D (notices, statements, and certificates required by law and regulation), or in the closing documents.

The following optional clauses are also provided:

The buyer agrees to accept the property in its "as is, where is" condition, investigate the property on the buyer's own behalf, and not rely on information or representations attributable to the seller, except to the extent stated in the contract.

The buyer waives its rights under the Texas Deceptive Trade Practices–Consumer Protection Act.

The buyer assumes responsibility after closing for all environmental matters relating to the property.

If the parties negotiate different representations, exhibit B must be revised accordingly.

The contract provides that the parties' representations are true and correct when made and must be true and correct at closing, or the buyer may terminate the contract.

It is common practice to include representations regarding the organization and authority of the parties in contracts but to defer the obligation to deliver documentary evidence confirming those representations until the closing of the transaction. That evidence customarily consists of certificates of existence and good standing from public officials; certified copies of organizational documents; certified corporate resolutions or partnership consents, and certificates of incumbency. The attorney may consider requiring such documentary evidence at the execution of the contract to avoid encountering a claim, after substantial obligations have been paid or incurred, that the other party is not authorized to consummate the transaction. While the seller's organizational documents should be available at the time of execution of the contract, the buyer's organizational documents are often not prepared until shortly before closing.

§ 16.24 Condition of Property until Closing; Cooperation; No Recording

The parties' signing of the contract obligates them concerning maintenance and operation of the property, casualty damage, condemnation, claims, governmental proceedings, permits, licenses, and inspections. The contract also sets out the parties' agreement not to record the contract. Oil and gas leases may be of concern to the buyer of groundwater, because the lessee has the right to use groundwater in connection with its operations whether that right is stated in the lease or not. In addition, oil and gas leases may expressly allow the lessee to use significant amounts of groundwater for flooding or secondary recovery operations or may permit activities that could contaminate the groundwater, such as the injection or disposal of saltwater onto the

real property. Paragraph I.2. of the contract contains provisions that restrict the ability of the seller to enter into oil and gas leases before and after closing.

§ 16.25 Termination

The contract provides for disposition of the earnest money after termination and for posttermination obligations in certain events. If the memorandum of contract is used, the title company or escrow agent should record the notice of termination of contract if the contract is terminated before closing. See form 16-17 in this chapter.

§ 16.26 Closing

The contract provides that, unless the parties agree otherwise before closing, certain closing documents will use the forms contained in the current edition of the *Texas Real Estate Forms Manual*. This approach defers the time and expense of negotiating the closing documents until after the contract is signed, while providing certainty if the parties do not otherwise negotiate closing documents. Alternately, the closing documents can be negotiated before the contract is signed and, if so, should be attached as exhibits to the contract.

The contract allocates closing obligations and transaction costs between the parties.

The contract provides that the buyer acquires possession of the property at closing. The parties may agree, however, on earlier or later possession by the buyer. If the buyer takes possession before closing, a groundwater lease may be appropriate.

Although it is not common, a seller or buyer may be represented by a real estate broker in a groundwater transaction. Real estate brokers and real estate salespersons must have a written

commission agreement to enforce payment of a real estate commission. The commission may be payable on contract execution, when the contract closes, or as otherwise agreed by the parties. The contract provides that the commission agreement is a separate document between the broker and the party responsible for paying the commission. For applicable forms, see forms 26-29 through 26-31 in this manual. Alternately, the contract may include the commission agreement or restate its key terms. The parties indemnify each other against claims by brokers and finders arising by, through, or under the indemnifying party. The contract may state that there are no brokers, but there is no requirement to do so.

If either the buyer or the seller is licensed as a real estate salesperson or real estate broker and is acting as a broker in the transaction, a disclosure to that effect is required under the Real Estate License Act. See Tex. Occ. Code § 1101.652(b)(16).

§ 16.27 Default and Remedies

The contract provides that the buyer may elect one of the following remedies for the seller's default: termination (with disposition of the earnest money and payment of additional liquidated damages to the nondefaulting party) or specific performance. In addition, the buyer may terminate if the seller's representations are not true and correct or if a warranty set forth in the contract is breached. The parties may be entitled to payment of actual damages and perhaps of consequential damages if the untruth or breach is first discovered after closing. The contract is drafted to limit the parties' remedies, but remedies are often negotiated.

The contract provides that the party prevailing in litigation is entitled to recover attorney's fees and court and other costs.

§ 16.28 Assignment

The contract contains alternate clauses concerning assignment. The buyer either may not assign the contract or may assign the contract only to an entity controlled by the buyer.

If the contract provides that the buyer has the right to assign, the assignment provision should state whether the buyer is relieved from obligations under the contract after assignment.

§ 16.29 Closing Functions

The party handling the closing (the title company or escrow agent) commonly attends to the matters discussed in the following sections.

§ 16.29:1 Payoff Information and Other Closing Expenses

Written request should be made to each lienholder for the lienholder's written payoff statement. The lienholder should be requested through an authorized representative to state the remaining principal balance due on the note, the accrued interest as of a certain date, a per diem amount of interest, and whether the lienholder will credit the amount held in the escrow account, if one exists, to the total due or, alternatively, refund the amount directly to the borrower. Closing must occur and payment be made to the lienholder before the release of lien will be signed.

Additionally, information concerning other matters requiring payment at closing should be obtained, such as payoff amounts for mechanic's lien claims, federal or state tax liens, property taxes, paving assessments, and abstracted judgments that affect the property.

The closing agent must also determine the amounts of closing costs, such as surveying expenses, attorney's fees, brokers' commissions, and loan fees.

§ 16.29:2 Ad Valorem Taxes and Groundwater Authority Fees

Currently groundwater is not assessed and taxed independently from the surface estate for ad valorem tax purposes. Consequently, the contract does not provide for a proration of ad valorem property taxes at closing, but it does require that the taxes be paid in full at closing by the seller, if they are due and payable at the time of closing. Under current law, the sale of the groundwater rights, at least when the buyer retains sufficient reserved groundwater to enable it to continue its existing use of the real property, would not appear to trigger the assessment of rollback taxes. Consequently, the contract provides that if the real property has been, or at any time after closing is, the subject of special valuation and reduced tax assessments pursuant to the provisions of chapter 23, subchapter D, of the Texas Tax Code, the seller will be responsible for the payment of any such taxes, penalties, and interest, including rollback taxes. If the seller is not reserving sufficient groundwater to continue the seller's existing use of the real property, the parties should consider modifying this provision.

After closing, the seller will continue to pay all ad valorem taxes and assessments due in connection with the real property before delinquency, except that if ad valorem taxes are ever assessed separately against the buyer's groundwater rights after closing, the buyer will be responsible for paying such taxes and assessments if the buyer is obligated to pay such taxes under applicable law. After closing, the buyer will be responsible for paying all fees, assessments, taxes, and charges of any kind imposed by the groundwater authority or any successor authority in connection with the buyer's use of the groundwater, and the seller will be obligated to pay such taxes and assessments with regard to the reserved groundwater, if any. The provisions regarding taxes should be set out in the deed and

ement agreement signed by the parties at closing.

§ 16.29:3 Preparation of Closing Documents

The closing agent may be expected to prepare several documents.

Closing Statements: Closing statements may be on either the federally prescribed settlement statement, the State Board of Insurance settlement statement, or a separate seller's, buyer's, or borrower's statement, depending on the nature of the transaction. The purpose of a closing statement is to assemble in one document all the pertinent financial features of the contract, including purchase price, loan amounts, costs and expenses of closing the transaction, and pro-rations. Execution of the statement evidences the parties' agreement with the numbers and computations appearing on the statement.

Affidavits: Affidavits concerning debts and liens, parties in possession, identity of the parties, leases, and the parties' marital status will likely be required at closing by the title company, escrow agent, or a party's attorney.

Financing documents are typically prepared by the lender's attorney. Conveyancing and other closing documents may be prepared by the parties to the transaction, their attorneys, or an attorney for the closing agent.

§ 16.29:4 Funding

The closing agent typically disburses funds in connection with closing. Disbursements are made according to the closing statement, usually from funds paid by the buyer and its lenders.

Except in the case of certain nontaxable sales of principal residences, the person responsible for closing a real estate transaction is required to file with the Internal Revenue Service an infor-

mation return relating to the transaction and is subject to penalties for failing to report. See 26 U.S.C. § 6045. This reporting requirement is often satisfied by the responsible person by delivering the seller's closing statement, together with an attachment of additional required information, to the IRS.

If funds will be disbursed at closing, payments must be made to the closing agent with 'good funds' as defined by the regulations of the Texas State Board of Insurance or immediately available funds. See Procedural Rule P-27, *Basic Manual of Rules, Rates and Forms for the Writing of Title Insurance in the State of Texas*.

If it is not necessary to disburse funds at closing, the parties need not comply with the "good funds" rule, and payment may be made in other ways.

In a lending transaction, the attorney for the lender should consider obtaining an insured closing service letter from the title insurance underwriter, if title insurance is available, whose policies are to be issued. This letter indemnifies the lender for any fraudulent acts of the closing title insurance company relating to the handling of closing funds. See forms T-50 and T-51 of the *Basic Manual of Rules, Rates and Forms for the Writing of Title Insurance in the State of Texas*. See <https://www.tdi.texas.gov/title/titlemm5.html>.

§ 16.29:5 Recording Documents

The title company or escrow agent is responsible for recording documents intended to be recorded. This responsibility extends to the recording of releases or transfers of liens for notes paid at closing. Each document should be checked before recording to ensure that exhibits referred to in the document are attached and the name and address of the person to whom the document is to be returned after recording is included.

§ 16.29:6 Closing Instructions

Attorneys for the buyer, the seller, and the lender may each prepare closing instructions for the closing agent. For applicable forms, see forms 26-15 through 26-18 in this manual. These instructions relate to the conditions precedent to closing, including the status of the title after closing, the title insurance policies to be issued, disposition of funds, and distribution of documents received by the closing agent.

§ 16.30 Additional Considerations**§ 16.30:1 Transactions Involving Foreign Persons**

Buyer: If the buyer is a foreign person, certain disclosures and reports may be required under the Foreign Investment in Real Property Tax Act of 1980. *See* 26 U.S.C. § 6039C.

Seller: With certain exceptions, anyone purchasing real property located in the United States from a foreign person must withhold 15 percent of the price and remit the funds to the Internal Revenue Service within twenty days of the date of transfer. *See* 26 U.S.C. § 1445(a), (b). The transferee should assume that the seller is a foreign person until the contrary is established, because transferees act at their own peril until they obtain a nonforeign affidavit. *See* 26 U.S.C.

§ 1445(b)(2). The nonforeign affidavits (forms 26-19 and 26-20 in this manual) are suggested for use in all transactions.

§ 16.30:2 Closing Checklist

The attorney should prepare a closing checklist, itemizing the documents that will be required to close the transaction, including curative documents. The checklist should also refer to all other preclosing considerations relating to the transaction.

§ 16.30:3 Postclosing Considerations

After closing, recorded documents and relevant title insurance policies issued after closing should be reviewed for accuracy and compliance with the title commitment. The owner policy should be dated on or after the recording date of the deed conveying title to the buyer, and the mortgagee policy should be dated on or after the recording date of the deed of trust of the insured lien.

An original or title company's certified copy of each executed document relating to the closing should be provided to the seller and the buyer or the borrower by their attorneys. Generally, the party benefiting from a document receives the original, and the other parties receive copies.

[Sections 16.31 through 16.40 are reserved for expansion.]

III. Groundwater Transaction Guide for Sale of Permitted Groundwater Rights for Off-Site Production

§ 16.41 Sale of Permitted Groundwater Rights for Production Off-Site

The rights to produce and transport groundwater can be sold under a contract of sale and con-

veyed by deed and easement agreement. These rights can also be leased under a groundwater lease. (But see section 16.1 above for a discussion of ownership of groundwater rights.) This part of this chapter applies to the sale and conveyance of permitted groundwater rights for off-

site production. The sale or conveyance of groundwater for on-site production is addressed in part II. of this chapter. The sale and conveyance of surface water rights is addressed in part IV. Financing documents for use in transactions in which the groundwater rights and permit constitute the collateral are discussed in part V.

The forms discussed in this part of this chapter are for general use. Users should be aware that modifications may be required for specific transactions. For all groundwater sales, it is imperative that attorneys involved in the transaction identify the regulatory agencies with jurisdiction over the groundwater rights (referred to collectively in this transaction guide as the "groundwater authority") and obtain copies of all rules and regulations pertaining to groundwater as early in the transaction as possible. The rules may contain requirements that have an important bearing on the transaction, such as minimum acreage requirements for production, limitations on production, and requirements for the issuance and transfer of permits. It may be necessary for the practitioner to make modifications to the forms based on the rules of the groundwater authority. The forms require significant modifications for use in the sale of groundwater subject to the rules of the Edwards Aquifer Authority.

§ 16.42 Groundwater Rights Sales Contract, Deed, and Related Forms; Place for Recordation

Whether the seller is the owner of both the surface and groundwater estates in the land or is the owner only of groundwater pursuant to ownership of all or part of a permit for production of groundwater, if the seller is selling the permitted groundwater for production at a location other than the land from which the original permit was derived, only the groundwater sales contract, form 16-9 in this chapter, should be used in the transaction. Specifically, in some groundwater authorities, notably the Edwards Aquifer

Authority (EAA), a purchaser may buy all or a portion of the unrestricted right to produce groundwater pursuant to the terms of a permit issued by the EAA and then elect to withdraw the water from a location different from the original permit location as long as the new location is within the jurisdiction of the EAA. Form 16-9 specifically contemplates a transaction in which a groundwater authority has issued a permit for the production of groundwater, and the groundwater, through the mechanism of the permit, is what is being sold. The production of the groundwater will occur at a well location other than the land set forth in the permit. The new location for production will be designated by the buyer at some point in the transfer mechanism with the groundwater authority. With these types of transactions, it is never contemplated that the buyer will actually produce groundwater on the land owned by the seller, and, in fact, the contract and the subsequent deed prohibit the buyer from having access to the land owned by the seller.

All recordable documents, including the new permit when issued, should be recorded in the county or counties in which the land from which the groundwater and permit rights were originally obtained is located. In addition, if a new withdrawal location is selected in a different county, all of the same documents, including the new permit, should also be recorded in that county. For example, if the original permit was derived from land in Medina County, but the new withdrawal location is to be in Bexar County, all documentation should be recorded in both Medina and Bexar counties. Although not required, deeds, deeds of trust, and other recordable documents may, in addition, be filed in any county in which land from which the permit is derived is located. This may include land that was at one time owned or leased by the permit holder or the holder's predecessor in title. This serves as a means of giving actual notice of the groundwater rights and liens to persons looking in the real property records of these counties.

The basic sales documents include the following:

1. Groundwater Rights Sales Contract (Off-Site) (form 16-9).
2. Groundwater Rights Warranty Deed (Off-Site) (form 16-10).
3. Permit Transfer Request (form 16-12) or a transfer form promulgated or approved by the groundwater authority or another form promulgated by the groundwater authority, if it has a particular form for transfer.
4. Partial Release of Lien (form 16-11) if the seller has an existing lien on the land and only the groundwater rights are being released from the lien at closing.
5. Release of Lien (form 10-2 in this manual) if the seller's entire lien will be released at closing.
6. Form UCC3 (form 9-14 in this manual), a form promulgated by the Texas secretary of state, if there is a security interest that covers or that could be construed to cover the groundwater or the permit to be conveyed at closing.
7. Assignment and Assumption of Lease (form 16-14) if there is an existing lease of the groundwater.
8. Lessee Estoppel Certificate (form 16-15) used to assure the buyer that the groundwater lease is valid and not in default and that the lessee understands the lease is being assigned.
9. Affidavit of Debts and Liens [and Indemnity] (form 16-13) (if this form is not being provided by a title company) used to provide additional protection to the buyer, especially in instances in which no title insurance will be obtained or title insurance is not available.

10. Loan documents required by the lender.

§ 16.43 General Considerations

The groundwater rights sales contract, form 16-9 in this chapter, is drafted as a neutral form of contract, intending to favor neither the buyer nor the seller. For each contract, the basic elements of the transaction are, in general, stated in the sections to be completed at the beginning of the form. Some provisions, however, are required to be completed throughout the contract. The general terms that follow in the form may be used for many transactions. However, the sale of groundwater is an emerging area of law, and there are no well-established terms of sale. Contracts for the purchase and sale of groundwater are diverse, and additional drafting may be necessary. The following commentary is organized in the same order as the sections of the contract.

§ 16.44 Introductory Paragraph: Offer and Acceptance

The introductory paragraph of the contract states what the parties must do to form the contract of purchase and sale. If the buyer's earnest money cannot be collected, the buyer will be in default.

§ 16.45 Defined Terms

§ 16.45:1 Seller and Buyer

There are sections for the names of and other information concerning the seller, the buyer, and their attorneys. Proper identification of the parties is important, and the seller and buyer should be identified as fully as possible. Capacity and authority should be considered, especially if a party is not an individual acting on his own behalf. See chapter 3 in this manual for a discussion of party designations. It should be noted that if the owner of the real property and the

owner of the permit are not the same party, the attorney for the buyer must make certain that both parties sign all closing documents. Most groundwater authorities will not mediate ownership of groundwater rights.

§ 16.45:2 Title Company or Escrow Agent

Title insurance to insure title to groundwater rights in Texas is not generally offered by title insurance underwriters in Texas, although currently there is at least one insurer that offers title insurance for water rights. To the extent it is available, the title insurance product is a variation of a title policy on the real property. In many ways, it may not provide the parties with the complete coverage and closing details they are used to receiving in a land closing and title policy. For that reason, many sales of groundwater, in particular permitted groundwater transactions, are completed through the use of a title opinion based on information prepared by a title company. Nonetheless, the contract designates a title company or escrow agent to act as the escrow and closing agent in order to address either option. The title company or escrow agent is responsible for closing the transaction and receiving and disbursing funds under the terms of the contract. If a title opinion is provided as evidence of title to the groundwater rights, it should be reviewed by an attorney who is knowledgeable about land titles and groundwater rights.

It is advisable to have a written escrow agreement between the title company or escrow agent, the buyer, and the seller that defines the rights and duties of the title company or escrow agent. Form 4-2 in this manual is an escrow agent receipt and escrow agreement. It can be modified for use with an escrow agent other than a title company.

§ 16.45:3 Surveyor

A survey is rarely used in the sale of permitted groundwater, as the underlying issue is not the location of the real property but rather the chain of title related to the real property and the permit. If there is a need for a survey, a section could be drafted for the contract.

§ 16.45:4 Groundwater Authority

Generally, for a groundwater transaction involving a permit, the real property is located within a groundwater conservation district or other groundwater authority, and the authority should be identified. It is imperative that the buyer's attorney consult the rules of the groundwater authority to determine all restrictions on the use and production of groundwater, requirements for sale of groundwater, and rules regarding the issuance or transfer of a permit. Generally, copies of the rules can be obtained only from the groundwater authority. The buyer's attorney should also obtain, and personally review, copies of all documents maintained by the groundwater authority pertaining to the groundwater and permit being sold. The attorney should note all relevant information from the file, such as yearly allocations, if applicable, and should determine the feasibility of meeting all conditions of the groundwater authority's approval of the sale within the buyer's required time frame.

§ 16.45:5 Seller's Permit

It is important for the buyer to determine the status of the seller's permit issued by the groundwater authority in connection with the groundwater and what the groundwater authority requires for the transfer of the permit. Cooperation by the seller in the transfer of the permit should be set out in the contract and is paramount to the buyer's efforts to obtain approval of the transfer. All permit information should be set out in the contract.

§ 16.45:6 Earnest Money

The amount of earnest money is negotiable and depends on several factors, including the purchase price, the type of financing, and the relative financial strengths of the parties.

§ 16.45:7 Independent Consideration

If the buyer terminates the contract before the end of the inspection period and the buyer is otherwise entitled to have the earnest money returned, the contract provides that a stated amount should not be returned to the buyer but should be paid to the seller, because that amount is the independent consideration to the seller for the buyer's right to terminate the contract.

§ 16.45:8 Real Property

The real property is the land from which the groundwater or permit is to be sold and is described in exhibit A of the contract. The contract should describe the real and personal property with legal specificity. If the property is not described sufficiently, the contract may be unenforceable because of vagueness. See chapter 3 in this manual for a discussion of property descriptions. Attention also should be given to the conveyance of appurtenant rights, such as permits, licenses, and similar rights.

§ 16.45:9 Groundwater Defined

The definition of groundwater is derived in part from *Pecos County WCID No. 1 v. Williams*, 271 S.W.2d 503, 505–06 (Tex. Civ. App.—El Paso 1954, writ ref'd n.r.e.).

§ 16.45:10 Groundwater Rights

The contract defines groundwater rights to include the right to withdraw a stated quantity of groundwater from a specific aquifer as described in the permit (the “groundwater”) and

all rights and interests relating to the groundwater, including—

all of the real and personal property rights, appurtenances, authorities, licenses, consents, and contracts, if any, relating to or pertaining to the Groundwater, which will also include all common-law property rights in and to the Groundwater as well as those rights or interests that now or in the future may be useful or necessary to withdraw or otherwise beneficially use the Groundwater Rights

§ 16.45:11 Reserved Groundwater

Generally, the seller will retain ownership of some permitted rights; however, a specific reservation is not usually required, as the description of the groundwater will describe specifically what number of acre-feet of water will be sold out of the permit. In addition, if the permit being transferred is that of an irrigation groundwater right, in some groundwater districts, there is a certain required acre-feet of groundwater that cannot be severed or sold from the real property. In the case of the Edwards Aquifer Authority, one acre-foot of irrigation groundwater is known as the base water and, with a few specific exceptions, cannot be sold from the real property from which it derived.

§ 16.45:12 Purchase Price

There is no standard method of determining the purchase price for groundwater rights; however, in the case of permitted groundwater, the sales have been based most often on a price per acre-foot of water. The field of groundwater rights appraisal is still evolving. In areas in which there are numerous groundwater sales, such as the Edwards Aquifer, it is possible to obtain an appraisal of groundwater rights based on comparable sales. The contract provides for the purchase price based on a stated price per acre of

groundwater being purchased. The buyer will be paying for the groundwater under each acre of land, based on a stated price per acre, regardless of how much or how little water is actually under the land. Exhibit E of the contract may be used if the parties agree to seller financing of the purchase. If obtaining third-party financing is a condition to the buyer's obligations, that fact and the terms of the complying financing should be addressed in the contract. See chapters 6 and 8 in this manual for further discussion of financing.

§ 16.45:13 Buyer's and Seller's Liquidated Damages

The liquidated damages sections of the contract are provided so that the parties can agree on additional liquidated damages to be paid by the defaulting party to the nondefaulting party on default.

§ 16.45:14 Title Commitment and Title Information

Title insurance may not be available to insure title to groundwater rights, but even if available, the parties may agree not to procure title insurance. If the seller is not required to provide a title commitment, the contract requires the seller to provide the buyer with title information. The contract provides that the buyer may have the title information reviewed by an attorney of the buyer's choice, at the expense of the seller or buyer as specified in the contract. If the buyer obtains title information, the buyer should have it reviewed by an attorney who is experienced in land titles and knowledgeable about groundwater rights.

§ 16.45:15 Title Documents

The contract defines title documents to include the seller's 'Permit and instruments affecting

title to the Groundwater and the Real Property" referenced in the title commitment or title information and UCC search. These documents are to be provided as part of the seller's records. Under paragraph F.6. of the contract, title objections can be made on the basis of the title documents. This provides the buyer with the ability to make objections to title based on the seller's permit or unrecorded documents provided as part of the seller's records.

§ 16.46 Deadlines

Section A of the contract contains most of the deadlines, grouped for ease of reference, and provides two alternate ways to determine most of the deadlines: either a stated date or a specified number of days after the effective date of the contract or another specific date. The contract provides that time is of the essence and that closing will occur a certain number of days after the expiration of the inspection period, but closing may also be specified to occur a certain number of days following a different event or on a certain date. The closing date may also be specified as "on or before" a certain date or event.

§ 16.47 Closing Documents

Section B of the contract lists the documents to be signed and delivered to close the transaction and serves as a checklist to prepare for closing. Section C contains a number of exhibits. The attorney should choose the specific exhibits appropriate for the sale.

§ 16.47:1 Exhibit B—Representations; Environmental Matters

Exhibit B contains the parties' representations. These items are always negotiated by the parties and will vary from transaction to transaction.

§ 16.47:2 Exhibit C—Seller's Records

Exhibit C is a list of the seller's records of the property that will be delivered or made available to the buyer for review during the inspection period and also delivered to the buyer at closing.

§ 16.47:3 Exhibit D—Notices, Statements, and Certificates

Exhibit D lists notices, statements, and certificates required by federal and state law and regulations to be delivered when common real estate contracts are executed. The items applicable to a specific transaction should be selected. See chapter 2 in this manual for brief discussions of laws and regulations that require notices, statements, and certificates. Some of the statutory provisions would appear to include the sale of groundwater, simply because they apply to a sale or conveyance of real property, and no exemption is made for the sale of groundwater.

§ 16.47:4 Exhibit E—Seller Financing

Exhibit E contains seller-financing terms.

§ 16.47:5 Exhibit F—Memorandum of Contract

If it is anticipated that there may be a significant amount of time between the date the contract is signed and the date of closing, it is advisable to have the memorandum of contract signed and recorded in the real property records to provide notice of the buyer's contract rights. See form 16-16 in this chapter.

§ 16.47:6 Exhibit G—Notice of Termination of Contract

If the memorandum of contract is used, the parties should execute the notice of termination of contract form at the same time and deliver it to the title company or escrow agent for recorda-

tion in the event the contract is terminated before closing. See form 16-17 in this chapter.

§ 16.48 Investment of Earnest Money

The contract provides that the buyer may direct the title company or escrow agent to invest the earnest money in an interest-bearing account in a federally insured financial institution. If the earnest money is to be invested, the title company will require the buyer's tax identification or Social Security number so that accrued interest may be reported to the Internal Revenue Service.

§ 16.49 Title

The contract incorporates the statutory notice that the Texas Real Estate License Act requires real estate brokers and real estate salespersons to give to a buyer, advising that the buyer should either have the title examined by an attorney or obtain a title insurance policy, if available. Tex. Occ. Code § 1101.652(b)(29). If a broker or salesperson is not involved, the paragraph may be deleted.

The contract requires that the seller provide to the buyer the title commitment or title information, the UCC search, and legible copies of each document referred to in these instruments by the deadlines stated in the contract. The contract follows a typical procedure under which the buyer reviews the title commitment or title information, the seller's permit, the documents provided by the seller, and the UCC search and notifies the seller of any objections. After notice, the seller may elect to cure the buyer's objections but is not required to do so. If the seller does not agree to cure, the buyer may either proceed to close the transaction and accept the groundwater subject to the uncured matters or terminate the contract. However, the seller is obligated to resolve all items listed on Schedule C of the title commitment at or before closing and to cure title

matters that arise by, through, or under the seller after the contract is signed.

§ 16.49:1 Review of Title Commitment

The contract provides that the condition of title will be established by either a title commitment or title information, as agreed to by the buyer and the seller. If title information is furnished, the buyer may have the title information reviewed by an attorney and obtain the attorney's written opinion of the title information. The benefit of obtaining title insurance, if such insurance is available, over an attorney's opinion of title is that title insurers are required to maintain reserves to cover claims that are greater than the malpractice coverage maintained by most law firms. Consequently, there is an increased likelihood of recovery if an error is made by the title company in its determination of title. See also section 16.21:1 above.

An essential reference on title insurance is the *Basic Manual of Rules, Rates and Forms for the Writing of Title Insurance in the State of Texas*, available from the Texas Department of Insurance at <https://www.tdi.texas.gov/title/titleman.html>. The manual contains Texas rate and procedural rules; the text of title 11 of the Texas Insurance Code, relating to title insurance; and various bulletins of the Texas State Board of Insurance dealing with title insurance practices.

The attorney should review the signature and effective date of the commitment. The attorney should confirm that the commitment is signed, and the issuance date is not more than ninety days before the closing. Otherwise, a new or revised commitment should be ordered.

Schedule A: The attorney should confirm that the proposed insured parties are correctly named, the amounts of insurance are correctly stated, and the correct estate is insured, including the correct number of acre-feet of ground-

water and the correct reference to the permit. Record title should be vested in the seller. The attorney should confirm that the property description is correct and conforms to the description in the contract.

Schedule B: The attorney should review the following matters:

Item 1, relating to covenants and restrictions, should be noted as either "Covenants, conditions, and restrictions (other than any restrictions indicating preference, limitation, or discrimination based on race, color, religion, sex, handicap, familial status, or national origin) as set forth in [recording data] of the real property records of [county] County, Texas" or "Item 1 of Schedule B is hereby deleted in its entirety."

Item 3, relating to homestead or community property or survivorship rights, should be reviewed to verify ownership right.

Item 5, relating to property taxes, should be reviewed for the status of tax payments and the existence of rollback taxes.

Item 6, relating to the terms and conditions of the documents creating the insured's interest in the land, cannot be revised. The referenced documents should, however, be reviewed.

Item 7, relating to materialman's and mechanic's liens, applies only to the mortgagee policies on interim construction loans and may be deleted if satisfactory evidence that the paragraph does not apply is furnished to the title company.

Item 8, relating to subordinate liens and leases, applies only to a mortgagee policy and may not be applicable for every water transaction.

Item 9, relating to existing liens, should show only liens permitted by the contract. Copies of all lien documents should be reviewed with regard to due-on-sale provi-

sions; dragnet clauses relating to other debt; condemnation provisions; notice, cure, and default provisions; and subordinate financing. A superior lienholder's estoppel agreement should be obtained from any lienholder whose note and lien are being either assumed or taken 'subject to.

All other special exceptions should be carefully reviewed to determine if they affect the buyer's groundwater rights. If there is more than one set of groundwater rights being insured, the commitment should specify which exceptions apply to which set of groundwater rights.

Schedule C: The attorney should ensure that the seller has complied with the contract by curing and effectively removing all matters appearing on Schedule C at or before closing. Schedule C matters may require obtaining releases of liens, settling specific claims or lawsuits affecting title to the property, furnishing evidence of good standing and authority (corporate resolution or partnership agreement), and obtaining proof of property settlement and divorce, proof of heirship or probate of a particular estate, or evidence relating to a bankruptcy. From the buyer's perspective, curative matters appearing on Schedule C should be attended to by either the seller or the title company. The contract requires that the seller resolve all Schedule C items before closing, but if that provision is not used, the buyer should object to all Schedule C items in the commitment to ensure that they are not added to Schedule B of the title policy.

The *Basic Manual of Rules, Rates and Forms for the Writing of Title Insurance in the State of Texas* should be consulted for information on the various types of policies and endorsements that are available and their respective costs.

§ 16.49:2 Review of Abstract of Title or Title Information

If the seller is obligated to provide an abstract of title or title information, the contract provides

that the buyer may have the abstract of title or title information reviewed by an attorney at either the buyer's or seller's expense, as specified in the contract. If the condition of title is to be determined based on an abstract of title or title information, the buyer should have it reviewed by an attorney experienced in land title examination and knowledgeable about groundwater rights, and should obtain a written opinion of title in time to make title objections within the deadline specified in section A of the contract.

The abstract of title required by the contract covers the period from the first conveyance from the sovereignty to the present. It is possible to obtain an abstractor's certificate from a title or abstract company that covers a shorter period and may contain a conclusion by the abstractor as to the identity of the current record owner of property, the existence of any outstanding liens, and other title encumbrances affecting the real property. While this information is useful, it is not a satisfactory substitute for an abstract of title or title information as specified in the contract and an attorney's opinion of title. Often, the title or abstract company preparing the abstractor's certificate or abstract of title will limit liability for error to the amount charged for the certificate or abstract.

§ 16.49:3 Review of Survey

A survey is not required for a transaction involving off-site production.

§ 16.49:4 Review of UCC Search

The contract includes provisions that require the seller to furnish searches of the UCC records of the Texas secretary of state and the UCC records of any other appropriate state. Groundwater permits, wells, and other property may fall within broad collateral descriptions such as 'equipment' and 'general intangibles' in security agreements and financing statements.

§ 16.50 Inspection Period

The inspection period is intended to give the buyer the opportunity to investigate the groundwater and real property and decide whether to close the transaction. The contract provides that the buyer may terminate the contract at any time before the end of the inspection period for any reason and have the earnest money returned, except for the independent consideration provided in the contract.

The contract provides for reasonable rules of entry and that the buyer will indemnify the seller for claims resulting from the buyer's inspection of the property, although in the case of the purchase of permitted groundwater to be produced from another location, the need to visually inspect the real property is rare. Generally, inspection periods in these types of contracts are used more as a feasibility period, allowing the buyer time to evaluate the overall purchase of the groundwater rather than inspect the actual property.

Except for the environmental indemnity stated in exhibit B (if used), the indemnity provisions of the contract are not intended to shift risk from the indemnified party to the indemnitor for the indemnified party's own negligence. One consequence of this allocation of risk is that the indemnified party may not be able to recover the costs of defense from the indemnitor if the indemnified party is sued for the consequences of its alleged negligence. *See Fisk Electric Co. v. Constructors & Associates*, 888 S.W.2d 813 (Tex. 1994). The environmental indemnity, if used, shifts risk for the seller's own negligence from the seller to the buyer. It is unlikely, however, that the environmental indemnity will be effective to shift risk in the event of misrepresentation or fraud.

The contract provides that the earnest money will be deposited in one lump sum. The parties alternatively may agree that the buyer is obligated to deposit additional earnest money after

agreed conditions have been satisfied—for example, if the buyer decides not to terminate the contract at the end of the inspection period and to proceed to closing.

§ 16.51 Representations and Warranties

Representations and warranties are negotiated by the parties with specific reference to the transaction. They may include such matters as ownership of the real property and groundwater, organization of the parties, authority to execute the contract and close the transaction, condition of title, pending litigation and claims that may ripen into litigation, pending or threatened condemnation or other taking, disclaimer of representations (for example, 'as is' language), compliance with all laws, status of leases, payment of ad valorem taxes, and status of debt to be assumed or taken 'subject to.

In negotiating representations, the parties should specify whether representations are to be absolute or based on the seller's knowledge and belief; whether the representations will be based on the knowledge of the entity that is the seller or on the knowledge of specified individuals; whether the seller must perform further investigation to make the representations or may rely on its current knowledge, without further investigation; and whether and to what extent the representations will survive closing.

The approach used in this contract limits the seller's representations and warranties, but it is not intended to insulate the seller from liability for fraud or misrepresentation.

- The seller represents only facts, not opinions. For example, the seller does not represent whether, in the seller's opinion, the property is in compliance with applicable laws and regulations. Instead, the seller represents that it has not received notice of violation of any law, ordinance, regulation, or

requirement affecting the property or use of the property, except as stated in the contract.

- The seller makes no representations or warranties that are not stated in the contract, including exhibit D (notices, statements, and certificates required by law and regulation), or in the closing documents.

The following optional clauses are also provided:

The buyer agrees to accept the property in its “as is, where is” condition, investigate the property on the buyer’s own behalf, and not rely on information or representations attributable to the seller, except to the extent stated in the contract.

The buyer waives its rights under the Texas Deceptive Trade Practices–Consumer Protection Act.

If the parties negotiate different representations, exhibit B must be revised accordingly.

The contract provides that the parties’ representations are true and correct when made and must be true and correct at closing, or the buyer may terminate the contract. Termination of the contract may not be a satisfactory remedy for the buyer, in which case other remedies could be negotiated, such as a reduction in the sales price.

It is common practice to include representations regarding the organization and authority of the parties in contracts but to defer the obligation to deliver documentary evidence confirming those representations until the closing of the transaction. That evidence customarily consists of certificates of existence and good standing from public officials, certified copies of organizational documents, certified corporate resolutions or partnership consents, and certificates of incumbency. The attorney may consider requiring such documentary evidence at the execution of the contract to avoid encountering a claim, after substantial obligations have been paid or incurred, that the other party is not authorized to

consummate the transaction. While the seller’s organizational documents should be available at the time of execution of the contract, the buyer’s organizational documents are often not prepared until shortly before closing.

§ 16.52 Condition of Property until Closing; Cooperation; No Recording

The parties’ signing of the contract obligates them concerning the groundwater, condemnation, claims, governmental proceedings, permits, licenses, and inspections. The contract also sets out the parties’ agreement not to record the contract.

§ 16.53 Termination

The contract provides for disposition of the earnest money after termination and for posttermination obligations in certain events. If the memorandum of contract is used, the title company or escrow agent should record the notice of termination of contract if the contract is terminated before closing. See form 16-17 in this chapter.

§ 16.54 Closing

The contract provides that, unless the parties agree otherwise before closing, certain closing documents will use the forms contained in the current edition of the *Texas Real Estate Forms Manual*. This approach defers the time and expense of negotiating the closing documents until after the contract is signed, while providing certainty if the parties do not otherwise negotiate closing documents. Alternately, the closing documents can be negotiated before the contract is signed and, if so, should be attached as exhibits to the contract.

The contract allocates closing obligations and transaction costs between the parties.

The contract provides that the buyer acquires possession of the groundwater at closing; however, the groundwater authority may not actually approve the transfer of the permit until weeks after closing. For this reason, the continued cooperation of the seller, if necessary, is required should there be any impediment at the office of the groundwater authority.

If closing is performed by an escrow agent, the escrow agent should be responsible for getting the affidavit of debts and liens (form 16-13 in this chapter), the settlement statement, and similar documents typically provided by a title company, signed at closing.

Although it is not common, a seller or buyer may be represented by a real estate broker in a groundwater transaction. Real estate brokers and real estate salespersons must have a written commission agreement to enforce payment of a real estate commission. The commission may be payable on contract execution, when the contract closes, or as otherwise agreed by the parties. The contract provides that the commission agreement is a separate document between the broker and the party responsible for paying the commission. For applicable forms, see forms 26-29 through 26-31 in this manual. Alternately, the contract may include the commission agreement or restate its key terms. The parties indemnify each other against claims by brokers and finders arising by, through, or under the indemnifying party. The contract may state that there are no brokers, but there is no requirement to do so.

If either the buyer or the seller is licensed as a real estate salesperson or real estate broker and is acting as a broker in the transaction, a disclosure to that effect is required under the Real Estate License Act. Tex. Occ. Code § 1101.652(b)(16).

§ 16.55 Default and Remedies

The contract provides that each party may elect one of the following remedies for the other's default: termination (with disposition of the earnest money and payment of additional liquidated damages to the nondefaulting party) or specific performance. In addition, the buyer may terminate if the seller's representations are not true and correct or if a warranty set forth in the contract is breached, and as noted earlier, if termination is not a satisfactory remedy for the buyer, other remedies such as a reduction in the purchase price can be negotiated and included in the contract. The parties may be entitled to payment of actual damages and perhaps of consequential damages if the untruth or breach is first discovered after closing. The contract is drafted to limit the parties' remedies, but remedies are often negotiated.

The contract provides that the party prevailing in litigation is entitled to recover attorney's fees and court and other costs.

§ 16.56 Assignment

The contract contains alternate clauses concerning assignment. The buyer may either not assign the contract or assign the contract only to an entity controlled by the buyer.

If the contract provides that the buyer has the right to assign, the assignment provision should state whether the buyer is relieved from obligations under the contract after assignment.

§ 16.57 Closing Functions

The party handling the closing (the title company or escrow agent) commonly attends to the matters discussed in the following sections.

§ 16.57:1 Payoff Information and Other Closing Expenses

Written request should be made to each lienholder for the lienholder's written payoff statement. The lienholder should be requested, through an authorized representative, to state the remaining principal balance due on the note, the accrued interest as of a certain date, a per diem amount of interest, and whether the lienholder will credit the amount held in the escrow account, if one exists, to the total due or, alternatively, refund the amount directly to the borrower. Closing must occur and payment be made to the lienholder before the release of lien will be signed. In many cases, when only permitted groundwater is being sold, the lender will provide only a partial release and the amount of the payoff will be determined by a lender formula related to the value of the permitted water compared with the remaining value of the mortgaged asset.

Additionally, information concerning other matters requiring payment at closing should be obtained, such as payoff amounts for mechanic's lien claims, federal or state tax liens, property taxes, estate taxes, and abstracted judgments that affect the real property or groundwater.

The closing agent must also determine the amounts of closing costs, attorney's fees, brokers' commissions, and loan fees.

§ 16.57:2 Ad Valorem Taxes and Groundwater Authority Fees

Currently groundwater is not assessed and taxed independently from the surface estate for ad valorem tax purposes. Consequently, the contract does not provide for a proration of ad valorem property taxes at closing, but it does require that the taxes be paid in full at closing by the seller, if they are due and payable at the time of closing. The sale of the groundwater, at least when the buyer retains sufficient reserved

groundwater to enable it to continue its existing use of the real property, would not appear to trigger the assessment of rollback taxes. Consequently, the contract provides that if the real property has been, or at any time after closing is, the subject of special valuation and reduced tax assessments pursuant to the provisions of chapter 23, subchapter D, of the Texas Tax Code, the seller will be responsible for the payment of any such taxes, penalties, and interest, including rollback taxes. If the seller is not reserving sufficient groundwater to continue the seller's existing use of the real property, the parties should consider modifying this provision.

After closing, the seller will continue to pay all ad valorem taxes and assessments due in connection with the real property before delinquency. However, if ad valorem taxes are assessed separately against the buyer's groundwater rights after closing, the buyer will be responsible for paying such taxes and assessments if the buyer is obligated to pay such taxes under applicable law. After closing, the buyer will be responsible for paying all fees, assessments, taxes, and charges of any kind imposed by the groundwater authority or any successor authority in connection with the buyer's use of the groundwater; the seller will be obligated to pay such taxes and assessments with regard to the reserved groundwater, if any. The provisions regarding taxes should be set out in the groundwater deed signed by the parties at closing.

§ 16.57:3 Preparation of Closing Documents

The closing agent may be expected to prepare several documents.

Closing Statements: Closing statements may be on either the federally prescribed HUD-1 settlement statement, the State Board of Insurance settlement statement, or a separate seller's, buyer's, or borrower's statement, depending on the nature of the transaction. The purpose of a

closing statement is to assemble in one document all the pertinent financial features of the contract, including purchase price, loan amounts, costs and expenses of closing the transaction, and prorations. Execution of the statement evidences the parties' agreement with the numbers and computations appearing on the statement.

Affidavits: Affidavits concerning debts and liens, parties in possession, identity of the parties, leases, and the parties' marital status will likely be required at closing by the title company, escrow agent, or a party's attorney.

Financing documents are typically prepared by the lender's attorney. Conveyancing and other closing documents may be prepared by the parties to the transaction, their attorneys, or an attorney for the closing agent.

§ 16.57:4 Funding

The closing agent typically disburses funds in connection with closing. Disbursements are made according to the closing statement, usually from funds paid by the buyer and its lenders.

Except in the case of certain nontaxable sales of principal residences, the person responsible for closing a real estate transaction is required to file an information return with the Internal Revenue Service relating to the transaction and is subject to penalties for failing to report. *See* 26 U.S.C. § 6045. This reporting requirement is often satisfied by the responsible person by delivering the seller's closing statement, together with an attachment of additional required information, to the IRS.

If funds will be disbursed at closing, payments must be made to the closing agent with 'good funds' as defined by the regulations of the Texas State Board of Insurance. *See* Procedural Rule P-27, *Basic Manual of Rules, Rates and Forms*

for the Writing of Title Insurance in the State of Texas.

If it is not necessary to disburse funds at closing, the parties need not comply with the "good funds" rule, and payment may be made in other ways.

In a lending transaction, the attorney for the lender should consider obtaining an insured closing service letter from the title insurance underwriter, if title insurance is available, whose policies are to be issued. This letter indemnifies the lender for any fraudulent acts of the closing title insurance company relating to the handling of closing funds. *See* forms T-50 and T-51 of the *Basic Manual of Rules, Rates and Forms for the Writing of Title Insurance in the State of Texas*. *See* <https://www.tdi.texas.gov/title/titlemm5.html>.

§ 16.57:5 Recording Documents

The title company or escrow agent is responsible for recording documents intended to be recorded. This responsibility extends to the recording of releases or transfers of liens for notes paid at closing. Each document should be checked before recording to ensure that exhibits referred to in the document are attached and the name and address of the person to whom the document is to be returned after recording is included. The deed and other recordable documents should be recorded in the county or counties in which the groundwater is permitted to be withdrawn.

§ 16.57:6 Closing Instructions

Attorneys for the buyer, the seller, and the lender may each prepare closing instructions for the closing agent. For applicable forms, *see* forms 26-15 through 26-18 in this manual. These instructions relate to the conditions precedent to closing, including the status of the title after closing, the title insurance policies to be issued,

if applicable, disposition of funds, and distribution of documents received by the closing agent.

§ 16.58 Additional Considerations

§ 16.58:1 Transactions Involving Foreign Persons

Buyer: If the buyer is a foreign person, certain disclosures and reports may be required under the Foreign Investment in Real Property Tax Act of 1980. 26 U.S.C. § 6039C.

Seller: With certain exceptions, anyone purchasing real property located in the United States from a foreign person must withhold 15 percent of the price and remit the funds to the Internal Revenue Service within twenty days of the date of transfer. *See* 26 U.S.C. § 1445(a), (b). The transferee should assume that the seller is a foreign person until the contrary is established, because transferees act at their own peril until they obtain a nonforeign affidavit. 26 U.S.C. § 1445(b)(2). The nonforeign affidavits (forms 26-19 and 26-20 in this manual) are suggested for use in all transactions.

[Sections 16.59 and 16.60 are reserved for expansion.]

IV. Surface Water Rights Transaction Guide

§ 16.61 Sale of Surface Water Rights

This part of the chapter applies to the sale and conveyance of surface water evidenced by a permit or certificate of adjudication. It does not cover the sale or conveyance of groundwater rights, which is covered in parts II. and III. of this chapter.

Surface water in Texas is generally owned by the state. One may obtain a right to use the

§ 16.58:2 Closing Checklist

The attorney should prepare a closing checklist, itemizing the documents that will be required to close the transaction, including curative documents. The checklist should also refer to all other preclosing considerations relating to the transaction.

§ 16.58:3 Postclosing Considerations

After closing, if a title policy has been obtained, recorded documents and relevant title insurance policies issued after closing should be reviewed for accuracy and compliance with the title commitment. The owner policy should be dated on or after the recording date of the deed conveying title to the buyer, and the mortgagee policy should be dated on or after the recording date of the deed of trust of the insured lien.

An original or title company's certified copy of each executed document relating to the closing should be provided to the seller and the buyer or the borrower by their attorneys. Generally, the party benefiting from a document receives the original, and the other parties receive copies. If no title company is involved in the transaction, the closing agent should perform this task.

state's surface water under the state's statutory appropriation process. Under this process, the state may grant precisely defined surface water rights, evidenced by a permit or certificate of adjudication. The surface water rights consist of the right to use water in a specific amount, from a specified body of water, by diversion at a definite location or locations ("point of diversion") for a specified use.

If the surface water is authorized for use in connection with an identified tract of land (as in the case of water permitted for irrigating a specific tract of land), the water right is considered “appurtenant” to that land unless the water right is held by a water corporation or governmental entity authorized to supply water to others. 30 Tex. Admin. Code § 297.81. If land subject to an appurtenant surface water right is conveyed, the water right passes with the conveyance of title to the land, unless the water right has been expressly reserved or excepted or the water right has been granted for the irrigation of land not owned by the applicant. 30 Tex. Admin. Code § 297.81. Once a surface water right has been put to beneficial use according to its terms, the right is ‘perfected’ and becomes a vested property interest. Tex. Water Code §§ 11.025–.026.

The forms contained in this chapter are for general use. The forms conveying surface water rights assume that the water rights to be conveyed have already been appropriated, as is the case with most surface water rights in Texas. Surface water rights that are the subject of a proposed transfer will therefore be represented by either a permit or a certificate of adjudication. The term *permit* refers to the document the Texas Commission on Environmental Quality (TCEQ) or its predecessor water authority issued when the surface water right was first appropriated. If the applicable river basin or stream segment has not been adjudicated, or if a new water right is recognized following the conclusion of adjudication proceedings, the document evidencing the water right will usually be a TCEQ permit. The surface water rights, whether evidenced by a permit or a certificate of adjudication, are real property. See sections 16.5:1 through 16.5:3 above.

Adjudication occurs when existing water rights (whether represented by permit, certified filing, or riparian rights) for a particular river basin or stream segment are subjected to administrative and judicial proceedings that recognize owner-

ship of water rights and determine the quantities, priority dates, and other terms and conditions of each of the water rights from that river basin or stream segment. *See generally* Tex. Water Code §§ 11.301–.324. At the conclusion of the adjudication process, the recognized holders of then-existing water rights are issued certificates of adjudication to show what rights have been adjudicated to them in that proceeding. Thereafter, that certificate of adjudication is the document evidencing the owner’s surface water rights and is required to be recorded with the county clerk of each county in which the appropriation is made. Tex. Water Code § 11.324. Most stream adjudications in Texas were concluded in the 1970s and 1980s. The Upper Rio Grande adjudication was completed in 2007.

Thus, new (or any postadjudication) surface water rights issued by the TCEQ are in the form of a water rights permit. As with certificates of adjudication, the law requires the permit to be recorded with the county clerk of the county in which the appropriation is to be made. Tex. Water Code § 11.136. An existing certificate of adjudication is amended, when necessary, through the same TCEQ process as for water rights permits. The processes for obtaining a permit for previously unappropriated surface water rights and for adjudicating water rights in Texas are beyond the scope of this chapter.

As early in the surface water transaction as possible, it is imperative that the attorneys involved (1) examine the permit or certificate of adjudication evidencing the water rights, including all amendments to it; (2) identify the regulatory agencies with jurisdiction over the surface water rights (referred to collectively in this part of the chapter as the ‘water authority’); (3) obtain copies of all rules and regulations pertaining to the surface water rights; and (4) obtain a title report or title commitment on any appurtenant land to determine whether the surface water rights have been previously severed or whether there are liens on the land that may affect the water rights.

The rules and regulations for surface water rights transactions may vary depending on the river basin involved in the transaction. *See* 30 Tex. Admin. Code chs. 281, 288, 295, 297–299, 303, 304. If the transaction involves an interbasin transfer, there are other statutory and regulatory implications affecting the water rights, which are beyond the scope of this chapter. *See* Tex. Water Code § 11.085; 30 Tex. Admin. Code §§ 295.13, 295.155, 295.177, 297.1, 297.18.

The TCEQ is the water authority that has jurisdiction over all surface water rights transactions in Texas, including the issuance, amendment, cancellation, and transfer of water rights permits. *See* Tex. Water Code §§ 5.011–.013; Tex. Water Code ch. 11. For river basins in which a watermaster has been appointed, the TCEQ administers adjudicated water rights through a watermaster and a watermaster advisory committee appointed for each water division. *See* Tex. Water Code §§ 11.326, 11.3261. *See generally* 30 Tex. Admin. Code chs. 303, 304. The watermaster divides the water of the streams (or other sources of supply) in the division based on the adjudicated water rights. Tex. Water Code § 11.327(a). The watermaster also regulates controlling works and diversion works in times of shortage to protect existing water rights, prevent waste, and prevent practices in excess of adjudicated rights. Tex. Water Code § 11.327(b). Currently, there are watermaster programs for South Texas, the Rio Grande, the Concho River, and the Brazos River.

More information regarding the watermaster programs can be found on the TCEQ’s website at <https://www.tceq.texas.gov>.

An attorney representing a purchaser or lender acquiring an interest in water rights that are subject to a watermaster program should become familiar with the applicable statutory and program provisions at Tex. Water Code §§ 11.325–.3291, 30 Tex. Admin. Code chs. 303, 304

(Watermaster Operations), and the TCEQ website. Water rights in the Rio Grande below Lake Amistad are allocated on an account basis based on the use of the water, such as municipal and irrigation, instead of on a seniority basis, with priority being given to municipal use. If, in any given month, surplus water is identified over the water needed for municipal use, the water is allocated to the other accounts, such as irrigation. In purchasing water rights, the buyer should determine whether an allocation has been made to the seller, and if so, the purchase contract should address how the water allocation will be divided between the parties at closing. The cost of administration of water rights by watermasters is allocated among the adjudicated water rights holders, and assessments are made by the TCEQ. In general, no water may be diverted, taken, or stored by or delivered to a person while he is delinquent in the payment of his assessed costs. *See* Tex. Water Code §§ 11.329, 11.455. Purchasers should determine the amount of assessments that have been made against a seller and the payment status as part of their due diligence. The purchase contract should address the manner in which these assessments will be allocated at closing, if appropriate.

§ 16.62 **Surface Water Rights Sales Contract and Related Forms; Place for Recordation**

The surface water rights sales contract, form 16-18 in this chapter, represents an approach to the sale of surface water rights under which a conditional closing of the transaction first occurs, pending the required water authority’s prior approval of the transaction. Once the water authority (that is, the TCEQ) has approved the change in ownership and any amendments to the permit or certificate of adjudication sought by the buyer or required by the TCEQ, there is a final closing of the transaction. Alternatives to this “conditional closing followed by a final closing” approach include granting the buyer an

option to purchase the water rights, or leasing the water rights to the buyer, pending TCEQ approval; however, the water right must be used in accordance with the terms of the permit or certificate of adjudication until such time as the TCEQ has granted any necessary amendments to the permit/certificate of adjudication.

The basic sales documents include the following:

1. Surface Water Rights Sales Contract (form 16-18).
2. TCEQ Change of Ownership Form (Form TCEQ-10204), plus any additional applications, forms, and supplemental materials necessary to obtain the amendments to the permit or certificate of adjudication to accommodate the buyer's intended use of the water rights.
3. Surface Water Rights Conveyance—Conditional (form 16-19). Frequently, this is the only conveyance document used by the parties, as they deem the conditional conveyance final once the stated condition—TCEQ approval of necessary amendments—has occurred.
4. TCEQ Amendment to Permit or Certificate of Adjudication, or letter amendment (Form TCEQ-10201).
5. Surface Water Rights Conveyance—Unconditional (form 16-20).

In addition, the release of lien (form 10-2) or partial release of lien (form 10-3) in this manual, bill of sale (form 5-16), assignment and assumption of lease (form 5-21), and other forms may need to be adapted for use in connection with the transaction.

Although many attorneys rely on the files maintained by the TCEQ to determine ownership of surface water rights, rather than the real property

records, recordation of surface water rights documents in the county real property records is still a legal requirement. *See* Tex. Water Code § 11.136. The attorney for the buyer of a surface water right should be aware that the buyer is responsible for making sure that the certificate of adjudication, permit, or any amendments, the surface water conveyance document, and other recordable real property documents are recorded with the county clerk of the appropriate county or counties. *See* Tex. Water Code § 11.136. In some instances, there can be uncertainty as to which of two or more locations is the correct place for recordation. If there is uncertainty, it is advisable to record the document in all the locations.

The Texas Water Code states that the TCEQ is required to transfer the certificate of adjudication or permit for recordation to the county clerk of the county in which appropriation is made. Tex. Water Code §§ 11.136, 11.324. In practice, however, the TCEQ does not do this. Instead the TCEQ sends the certificate of adjudication, permit, or amendment to the applicant for recordation along with a card. The applicant must send the document and card to the county clerk of the proper county or counties for recordation. In general, the certificate, permit, or amendment should be recorded in each county in which the points of diversion are located. If the water right is appurtenant to land, the certificate, permit, or amendment should also be recorded in the county or counties in which the water is used (that is, where the land is located). If a TCEQ amendment issued in connection with the transfer changed the land to which the water right is appurtenant to a different county, the conveyance document should be recorded in both counties. The county clerk is required to index the document by the name of the applicant and the stream or source of the water supply. Tex. Water Code §§ 11.136, 11.324. The county clerk should fill out the card with the recording information and send it to the TCEQ. It is incumbent on the attorney to make sure the county clerk

records the documents and provides the information to the TCEQ. The attorney should also obtain the recording information for the attorney's own records. The attorney should ensure that proper postage is added to the card provided by the TCEQ for completion and return mailing by the county clerk(s). This will increase the likelihood of the card's being returned to the TCEQ.

It is important to identify the county or counties in which the documents affecting the surface water rights should be recorded to ensure that the public is put on constructive notice. Section 297.83 of the TCEQ regulations states that the "written instrument evidencing a water right ownership transfer shall be recorded in the office of the county clerk," but does not specify in which county clerk's office the instrument should be recorded. *See* 30 Tex. Admin. Code § 297.83. *See generally* Tex. Water Code § 11.136. As a rule, a surface water right conveyance document should be recorded in the real property records of each county in which the points of diversion and places of use are located. In addition, if the surface water rights are appurtenant to land (and there is no proposed amendment to change the land to which the surface water rights are appurtenant), the conveyance documents should also be recorded in the real property records of each county in which the land is located. If, however, the sale transaction contemplates an amendment that changes the land to which the surface water rights are appurtenant, only the final surface water rights conveyance—unconditional form should be recorded in each county in which the land is located. Recordation of the initial surface water rights conveyance—conditional document, before the TCEQ approved the amendment changing the land to which the surface water rights are appurtenant, could cloud the records and titles if the TCEQ did not approve the requested amendment.

As an added precaution, it is advisable to record the final documents in the real property records

of each county in which the water is used, if different from the county or counties in which the points of diversion are located. It is helpful to have duplicate originals of the conveyance document executed for this purpose. Deeds of trust, leases, and other real estate documents pertaining to the surface water rights should be recorded in the same counties as the conveyance document.

The law requires an owner of a surface water right to promptly inform the executive director of the TCEQ of any transfer of water right or change of the owner's address. *See* Tex. Water Code § 11.122; 30 Tex. Admin. Code § 297.82. Persons seeking to transfer surface water rights must file with the TCEQ executive director certified copies or photocopies of the recorded instruments establishing the complete chain of title between the owners of record and the new owner, along with the change of ownership form and the required fee. 30 Tex. Admin. Code § 297.83.

If the surface water rights are subject to the jurisdiction of a watermaster, the TCEQ Watermaster Operations Rules require the new owner to promptly inform the TCEQ executive director of the change of ownership and provide the appropriate ownership documents. 30 Tex. Admin. Code §§ 303.44, 304.43. If the new ownership record is not complete, the executive director will inform the alleged owner by letter of the required submission. For a sixty-day period following the date of that letter, the watermaster will honor "declarations of intent" by the alleged owner in accordance with the water right; after that, however, no such declaration will be honored until the executive director informs the watermaster of the approved change in ownership. 30 Tex. Admin. Code § 304.43.

Because the place for recordation of surface water rights documents is somewhat unusual, there may be some benefit in recording duplicate originals of the conveyance document in

additional county records, in order to provide actual notice of the buyer's surface water rights to any person who may consult these records. As examples, additional locations may include Travis County (where the TCEQ main administrative office is located) and, if the water rights are subject to regulation by a watermaster, the county in which the administrative office of the watermaster is located.

Attorneys dealing with water rights where a watermaster is located should be aware of recording requirements. *See generally* 30 Tex. Admin. Code chs. 303, 304. This is particularly true for water rights subject to the jurisdiction of the Rio Grande watermaster. There are two subsections (j) to section 11.3271 of the Texas Water Code adopted by the legislature in 2003 that have never been reconciled. *See* Tex. Water Code § 11.3271. Under one subsection (j), the watermaster with jurisdiction over the Rio Grande is made the official recorder for all instruments, including deeds, deeds of trust, financing statements, security agreements, and liens that the TCEQ authorizes or requires to be filed in connection with a water right relating to water in the lower, middle, or upper basin of the Rio Grande and that are subject to a permit, certified filing, or certificate of adjudication, and the filing will have the same legal effect as filing under other law for the same type of instrument. Under the other subsection (j), the watermaster is required to maintain a central repository that includes certified copies of all instruments, including deeds, deeds of trust, and liens that the TCEQ requires to be filed in connection with the same type of water rights as are described in the first-referenced subsection (j), and it is expressly stated that on and after September 1, 2003, a lien against a water right shall not be effective against third parties unless a certified copy of the instrument is filed with the watermaster and all requirements under other law are met. It would be prudent when conveying rights or interests in water rights in the Rio Grande to record a duplicate set of original documents

with the Texas watermaster, as well as in the real property records of the county or counties in which the documents are otherwise authorized to be recorded, and to also file a certified copy of the documents recorded in the county real property records (at least with regard to liens) with the watermaster.

§ 16.63 General Considerations

The surface water rights sales contract, form 16-18 in this chapter, is drafted as a neutral form of contract, intending to favor neither the buyer nor the seller. For each contract, the basic elements of the transaction are, in general, stated in the sections to be completed at the beginning of the form. Some provisions, however, are required to be completed throughout the contract. The general terms that follow in the form may be used for many transactions. However, the sale of surface water rights is an emerging area of law, and there are no well-established terms of sale. The terms in contracts for the purchase and sale of surface water rights are diverse and heavily negotiated. Additional drafting may be necessary to tailor the forms to the transaction.

§ 16.64 Surface Water Rights Sales Contract

The following sections describe the provisions and terms of form 16-18 in this chapter and include considerations for the attorney in drafting or reviewing a contract, assisting the client during investigation of the surface water rights, and closing the transaction. This commentary is organized in the same order as the sections of the contract.

§ 16.65 Introductory Paragraph: Offer and Acceptance

The introductory paragraph of the contract states what the parties must do to form the contract of

purchase and sale. If the buyer's earnest money cannot be collected, the buyer will be in default.

§ 16.66 Defined Terms

§ 16.66:1 Seller and Buyer

There are sections for the names of and other information concerning the seller, the buyer, and their attorneys. Proper identification of the parties is important, and the seller and buyer should be identified as fully as possible. Capacity and authority should be considered, especially if a party is not an individual acting on his own behalf. See chapter 3 in this manual for a discussion of party designations.

§ 16.66:2 Title Company or Escrow Agent

Title insurance to insure title to surface water rights in Texas is no longer generally offered by Texas title insurance underwriters, and it is uncertain whether it will be available in the future. Even if available, parties may choose not to obtain title insurance or to close the transaction through a title company. The contract designates a title company or escrow agent to act as the escrow and closing agent in order to address either option. The title company or escrow agent will be responsible for closing the transaction and receiving and disbursing funds under the terms of the contract.

It is advisable to have a written escrow agreement between the title company or escrow agent, the buyer, and the seller that defines the rights and duties of the title company or escrow agent. Form 4-2 in this manual is an escrow agent receipt and escrow agreement. It can be modified for use with an escrow agent other than a title company.

In surface water transactions in which no appurtenant land is being transferred, the parties generally do not provide for a survey. The form

provides optional language, however, if there is appurtenant land to be surveyed.

§ 16.66:3 Water Authority

The water rights authorities with jurisdiction over the subject surface water rights will include, at a minimum, the TCEQ. There may also be a watermaster appointed for the river basin and division in which the water rights are located. See section 16.6 above.

§ 16.66:4 Permit or Certificate of Adjudication

Permits and certificates of adjudication have a TCEQ number designation and establish the priority date of the water rights. In addition, the permit or certificate of adjudication, as it may have been previously amended, will describe the water rights authorized in the particular river basin and stream, including any rights of diversion, use, or storage. Diversion and use rights will include, at a minimum, the following details: (1) quantity, expressed in terms of a right to divert a certain number of acre-feet of water, often also limited to a certain rate of diversion (expressed in gallons per minute or cubic feet per second), from a particular watercourse; (2) the current ownership; (3) the place of use; (4) the purpose of use (for example, municipal, irrigation, industrial, recreational); and (5) the precise location of the point or points of diversion. Depending on the river basin from which the water rights are derived, there may be further descriptions. For example, Rio Grande Valley water rights are further described by class (for example, "Class B Water Rights"), a designation relating to the priority and use of the water rights. The permit or certificate of adjudication will also identify any other special terms or conditions defining the water rights or affecting the owner's exercise of those rights (for example, streamflow restriction requirements or other environmental or conservation requirements).

§ 16.66:5 Buyer's Intended Use of Water Rights

The description of the buyer's intended use (purpose and place of use) of the water rights is important for purposes of determining what amendments to the permit or certificate of adjudication must be obtained from the TCEQ and any other applicable water authority, such as a watermaster, before the transfer of the water rights. The approval process can be both costly and lengthy, particularly if the buyer's intended use requires amendments to the permit or certificate beyond ownership of the water rights, and especially if these amendments are contested by the TCEQ staff, by other water rights holders in the basin, or by other affected parties.

The statement of the buyer's intended use also affects the parties' rights in the event of condemnation before conveyance of the water rights.

§ 16.66:6 Water Rights

The description of the water rights to be conveyed will be based on the permit or certificate of adjudication, amended as needed to accommodate the buyer's intended use, including the rights of diversion, use, or storage set out in the permit or certificate of adjudication, as described in section 16.61 above. Surface water rights may be conveyed in whole or in part, like land. The contract should clearly indicate if only portions of the water rights are being conveyed. The parties can contract for the sale and purchase of all or a portion of (1) the number of acre-feet authorized to be diverted, (2) the diversion rate, (3) storage capacity, or (4) storage reservoirs authorized by the water right. Accordingly, the parties should be specific regarding components of the water right to be sold.

§ 16.66:7 Appurtenant Land

The surface water rights to be sold may be appurtenant to specific land. The description of any appurtenant land is important, regardless of whether the appurtenant land is also to be purchased by the buyer. There may be liens on the appurtenant land that, absent language in the lien documents to the contrary, attach to the water rights. A description of the appurtenant land is therefore important to the buyer's due diligence inquiries, the title investigation, and the determination of the need for lien releases, subordination agreements, or other documents required at closing.

If the water rights permit authorizes the irrigation of specific land, it generally will be appurtenant to the land, unless the water right is owned by a water supply corporation, water district, river authority, or governmental entity authorized to supply water to others. 30 Tex. Admin. Code § 297.81(b). If the buyer intends to use the water on land other than as specified in the permit or certificate of adjudication, an amendment to the permit or certificate of adjudication must be obtained before use. The land to which the water rights are appurtenant may not be the land from which the water is diverted. The permit or certificate of adjudication, or other water authority records, will identify the land authorized to be irrigated ("place of use") to which the permit or certificate of adjudication is appurtenant. Under current TCEQ rules, conveyance of the land to which water rights are appurtenant conveys the water rights, unless the conveyance specifically reserves or excepts the water rights, or the water right has been granted for the irrigation of land not owned by the applicant. 30 Tex. Admin. Code § 297.81(a).

If the water rights are appurtenant to land and the land is not also being conveyed to the buyer, the attorney should verify that the water rights can be severed from the land under applicable statutory, regulatory, and case law. *See Herr-*

mann v. Lindsey, 136 S.W.3d 286 (Tex. App.—San Antonio 2004, no pet.). If the appurtenant land is also being purchased by the buyer, the drafter can adapt the additional provisions in the forms in chapter 4 in this manual. If the buyer will purchase a portion of the land and a portion of the water rights with which to irrigate the land, the parties should expressly describe in the contract the specific allocation of the water rights to the specific tract of land.

In addition, any fixtures and personal property to be conveyed with the land or the surface water rights should be described in the applicable contract forms. Contract provisions discussed in section 16.21:4 above, providing for UCC searches, should be inserted into the contract form if fixtures or personal property are included in the transaction.

§ 16.66:8 Reserved Surface Water Rights

The seller of surface water rights may retain ownership of some permitted rights; however, a specific reservation is not usually required, as the description of the surface water will specify the number of acre-feet of water that will be sold out of the certificate of adjudication.

In instances in which surface water rights are appurtenant to land, however, if the seller is selling the land and some portion of the water rights, the conveyance of the land and unsevered surface water rights will be by deed, and the seller should expressly state in the contract and the deed the acre-feet of surface water rights that will be severed from the land and retained by the seller. After closing, the seller will generally need to file an application with the TCEQ either to change the designated land on which the severed agricultural or irrigation water rights may be used and the point of diversion or to change the use of the severed water rights from agricultural or irrigation to some other permitted use

and to obtain approval of a new point of diversion.

If the water right is being purchased independently of the appurtenant land, and the parties agree that the buyer will have certain use rights on the appurtenant land, such as the right to use the same diversion point(s) or to use storage facilities located at the land, the parties will need to address these property rights in the contract by providing for the seller to grant or convey an easement, a license, a lease, or another property interest at closing.

§ 16.66:9 Earnest Money

The amount of earnest money is negotiable and depends on several factors, including the purchase price, the type of financing, and the relative financial strengths of the parties. Additional factors unique to surface water rights transactions include the required prior approval from the TCEQ and any other applicable water authority, and a generally longer due diligence period.

The parties therefore often provide for more than one earnest money deposit, either over a period of time or based on certain events. In the description of the initial and each additional earnest money deposit inserted into the form, the drafter needs to specify the time when each earnest money deposit is to be made and whether each earnest money deposit is refundable or nonrefundable, in relation to the occurrence of events as the parties proceed towards conditional and final closing of the transaction.

§ 16.66:10 Independent Consideration

If the buyer terminates the contract before the end of the inspection period and the buyer is otherwise entitled to have the earnest money returned, the contract provides that a stated amount should not be returned to the buyer but should be paid to the seller, because that amount

is the independent consideration to the seller for the buyer's right to terminate the contract.

§ 16.66:11 Purchase Price

There is no standard method of determining the purchase price for surface water rights. For further discussion on this topic, the attorney may want to consult Martyn C. Glen, *Valuation of Water Rights, in The Changing Face of Water Rights in Texas*, State Bar of Texas (2004). Exhibit F may be used if the parties agree to seller financing of the purchase. If obtaining third-party financing is a condition to the buyer's obligations, that fact and the terms of the complying financing should be addressed in the contract. See part V. in this chapter and chapters 6 and 8 in this manual for further discussions of financing.

§ 16.66:12 Buyer's and Seller's Liquidated Damages

These sections of the contract are provided so that the parties can agree on additional liquidated damages to be paid by the defaulting party to the nondefaulting party on default.

§ 16.66:13 Title Commitment/Title Information

Title insurance to insure title to surface water rights in Texas is no longer generally offered by Texas title insurance underwriters, and it is uncertain whether it will be available in the future. If title insurance is not available, or if the parties agree not to procure title insurance, the contract may instead call for an opinion of counsel to be provided as evidence of title. In that event, certain title information, on which the buyer's title inspection is to be based, is to be delivered to the buyer.

§ 16.66:14 Title Documents

The contract defines title documents to include the permit or certificate of adjudication and instruments affecting title to the surface water rights and the real property referenced in the title commitment or title information. Under paragraph G.2. of the contract, the buyer can terminate the contract on the basis of the title commitment and title documents or the seller's failure to cure the buyer's objections to matters disclosed therein. This provides the buyer with the ability to make objections to title based on the permit or certificate of adjudication or unrecorded documents provided as part of the seller's records.

In addition to checking these documents, the buyer should also review (1) the annual water use reports the seller has filed with the TCEQ, (2) the priority of the seller's water rights relative to other water rights in the same source of supply, and (3) the TCEQ's current records and any applicable TCEQ or watermaster rules reflecting any loss of water rights or priority as a result of the seller's nonuse.

An attorney representing a purchaser or lender acquiring an interest in water rights that are subject to a watermaster program should become familiar with the applicable statutory and program provisions at Tex. Water Code §§ 11.325–.3291, 30 Tex. Admin. Code chs. 303, 304 (Watermaster Operations), and the TCEQ website. Water rights in the Rio Grande below Lake Amistad are allocated on an account basis based on the use of the water, such as municipal and irrigation, instead of on a seniority basis, with priority being given to municipal use. If, in any given month, surplus water is identified over the water needed for municipal use, the water is allocated to the other accounts, such as irrigation. In purchasing water rights, the buyer should determine whether an allocation has been made to the seller, and if so, the purchase contract should address how the water allocation

will be divided between the parties at closing. The cost of administration of water rights by watermasters is allocated among the adjudicated water rights holders, and assessments are made by the TCEQ. In general, no water may be diverted, taken, or stored by or delivered to a person while he is delinquent in the payment of his assessed costs. *See* Tex. Water Code §§ 11.329, 11.455. Purchasers should determine the amount of assessments that have been made against a seller and the payment status as part of their due diligence. The purchase contract should address the manner in which these assessments will be allocated at closing, if appropriate.

§ 16.67 Deadlines

Section A of the contract groups most of the deadlines for ease of reference. Most of the deadlines are stated in terms of a specified number of days after the effective date of the contract or another specific date. The contract provides that time is of the essence; however, final closing cannot occur until such time as the TCEQ and any other applicable water authority has approved the change in ownership and any other amendments to the permit or certificate of adjudication representing the water rights.

§ 16.68 Closing Documents

Section B of the contract lists the documents to be signed and delivered to close the transaction. Paragraph B.1. lists the documents for the conditional closing (before the TCEQ or other water authority approval of the transaction). The parties might consider adding to the list of documents for the conditional closing a power of attorney appointing the buyer as agent of the seller to pursue the necessary proceedings with the TCEQ for approval of the sale and any amendments to the certificate of adjudication or permit. Paragraph B.2. lists the documents for the final closing. Form 16-20 in this chapter is for conveyance of the surface water rights once

the TCEQ has approved the change of ownership and any other amendments to the permit or certificate of adjudication. The parties sometimes do not provide for or sign a final unconditional conveyance document, instead relying on the TCEQ's issuance of an amendment to the certificate or permit as satisfying the condition stated in the earlier conditional conveyance document. Both paragraphs B.1. and B.2. in the contract serve as checklists to prepare for closing.

Section C contains a number of exhibits. The attorney should choose the specific exhibits appropriate for the sale.

§ 16.68:1 Exhibit C—Representations; Environmental Matters

Exhibit C contains the parties' representations. These items are always negotiated by the parties and will vary from transaction to transaction. Exhibit C is offered as a checklist; however, not all items will necessarily apply to a sale of surface water rights, and the buyer may want to seek additional representations or warranties with respect to water quality, environmental matters, and the like.

§ 16.68:2 Exhibit D—Seller's Records

Exhibit D is a list of the seller's records of the property that will be delivered or made available to the buyer for review during the inspection period and also delivered to the buyer at closing.

§ 16.68:3 Exhibit E—Notices, Statements, and Certificates

Exhibit E lists notices, statements, and certificates required by federal and state law and regulations to be delivered when common real estate contracts are executed. The items applicable to a specific transaction should be selected. See chapter 2 in this manual for brief discussions of laws and regulations that require notices, state-

ments, and certificates. Some of the statutory provisions would appear to include the sale of surface water rights, simply because they apply to a sale or conveyance of real property, and no exemption is made for the sale of surface water rights.

§ 16.68:4 Exhibit F—Seller Financing

Exhibit F contains seller-financing terms.

§ 16.69 Investment of Earnest Money

The contract provides that the buyer may direct the title company or escrow agent to invest the earnest money in an interest-bearing account in a federally insured financial institution. If the earnest money is to be invested, the title company will require the buyer's tax identification or Social Security number so that accrued interest may be reported to the Internal Revenue Service.

§ 16.70 Title

The contract requires that the seller provide to the buyer by the deadlines stated in the contract the title commitment or title information and legible copies of each document referred to in these instruments.

The contract follows a typical procedure in which the buyer reviews the title commitment or title information, with the permit or certificate of adjudication and the documents provided by the seller. The buyer's review is done during the inspection period. The buyer then has a right to terminate the contract based on the buyer's review or can notify the seller of any objections. After notice, the seller may elect to cure the buyer's objections but is not required to do so. If the seller does not agree to cure, the buyer may either proceed to close the transaction and accept the surface water rights subject to the uncured matters or terminate the contract. However, the seller is obligated to resolve all items

listed on Schedule C of the title commitment at or before closing and to cure title matters that arise by, through, or under the seller after the contract is signed.

The contract provides that the condition of title will be established by either a title commitment or an abstract of title, as agreed to by the buyer and the seller. If an abstract of title is furnished, the buyer may have the abstract of title reviewed by an attorney and obtain the attorney's written opinion of the abstract of title. The benefit of obtaining title insurance over an attorney's opinion of title is that title insurers are required to maintain reserves to cover claims that are greater than the malpractice coverage maintained by most law firms. Consequently, there is an increased likelihood of recovery if an error is made by the title company in its determination of title.

An essential reference on title insurance is the *Basic Manual of Rules, Rates and Forms for the Writing of Title Insurance in the State of Texas*, available from the Texas Department of Insurance at <https://www.tdi.texas.gov/title/titleman.html>. The manual contains Texas rate and procedural rules; the text of title 11 of the Texas Insurance Code, relating to title insurance; and various bulletins of the Texas State Board of Insurance dealing with title insurance practices.

The attorney should review the signature and effective date of the commitment. The attorney should confirm that the commitment is signed and the issuance date is not more than ninety days before the closing. Otherwise, a new or revised commitment should be ordered.

Schedule A: The attorney should confirm that the proposed insured parties are correctly named, the amounts of insurance are correctly stated, and the correct estate is insured. Record title should be vested in the seller. The attorney also should confirm that the property description

is correct and conforms to the description in the contract.

Schedule B: The attorney should review the following matters:

- Item 1, relating to covenants and restrictions, should be noted as either “Covenants, conditions, and restrictions (other than any restrictions indicating preference, limitation, or discrimination based on race, color, religion, sex, handicap, familial status, or national origin) as set forth in [recording data] of the real property records of [county] County, Texas” or “Item 1 of Schedule B is hereby deleted in its entirety.”

Item 2 is the standard, preprinted survey exception. It generally would not apply to a transaction involving only surface water rights. If the surface water rights are being conveyed along with land, this exception may be amended and partially deleted to read “any shortages in area” if a current survey approved by the title company is obtained. An additional 5 percent premium is charged to amend the owner policy for a residential transaction; an additional 15 percent premium is charged to amend the owner policy for a commercial transaction. No additional premium is required to amend the mortgagee policy. The responsibility for paying the extra premium for the survey modification in the owner policy of title insurance is often negotiated between the parties, although the pertinent provision in the contract form provides for the extra premium to be paid by the buyer.

Standard preprinted exceptions item 3 (relating to homestead or community property or survivorship rights) and item 4 (relating to tidelines, lands comprising the shores and beds of waterways, lands beyond the line of the harbor or bulkhead lines, filled-in lands, artificial islands, statutory water rights, and areas extending from the

line of mean low tide to the line of vegetation) apply only to the owner policy and cannot be deleted or amended.

Item 5, relating to property taxes, can be reviewed for the status of tax payments and the existence of rollback taxes; however, taxes generally are not involved in a transaction involving only surface water rights.

Item 6, relating to the terms and conditions of the documents creating the insured’s interest in the land, cannot be revised. The referenced documents should, however, be reviewed.

Item 7, relating to materialman’s and mechanic’s liens, applies only to the mortgagee policies on interim construction loans and may be deleted if satisfactory evidence that the paragraph does not apply is furnished to the title company. This exception would not generally apply to a transaction involving only surface water rights.

Item 8, relating to subordinate liens and leases, applies only to the mortgagee policy.

Item 9, relating to existing liens, should show only liens permitted by the contract. Copies of all lien documents should be reviewed with regard to due-on-sale provisions; dragnet clauses relating to other debt; condemnation provisions; notice, cure, and default provisions; and subordinate financing. A superior lienholder’s estoppel agreement should be obtained from any lienholder whose note and lien are being either assumed or taken “subject to.

All other special exceptions should be carefully reviewed to determine if and how they affect the buyer’s surface water rights.

Schedule C: The attorney should ensure that the seller has complied with the contract by curing and effectively removing all matters appearing on Schedule C at or before closing. Schedule C matters may require obtaining releases of liens, settling specific claims or lawsuits affect-

ing title to the water rights, furnishing evidence of good standing and authority (corporate resolution or partnership agreement), and obtaining proof of property settlement and divorce, proof of heirship or probate of a particular estate, or evidence relating to a bankruptcy. From the buyer's perspective, curative matters appearing on Schedule C should be attended to by either the seller or the title company. The contract requires that the seller resolve all Schedule C items before closing, but if that provision is not used, the buyer should object to all Schedule C items in the commitment to ensure that they are not added to Schedule B of the title policy.

The *Basic Manual of Rules, Rates and Forms for the Writing of Title Insurance in the State of Texas* should be consulted for information on the various types of policies and endorsements that are available and their respective costs.

§ 16.71 Inspection Period

The inspection period is intended to give the buyer the opportunity to investigate the surface water rights and real property and decide whether to close the transaction. The contract provides that the buyer may terminate the contract at any time before the end of the inspection period for any reason and have the earnest money returned. The inspection is based on the seller's records and information in either the title commitment and documents referenced therein, if the parties have provided for title insurance, or the title information as defined.

§ 16.72 Representations and Warranties

Representations and warranties are negotiated by the parties with specific reference to the transaction. They may include such matters as ownership of the real property and surface water rights; organization of the parties; authority to execute the contract and close the transaction; condition of title; parties in possession; pending

litigation and claims that may ripen into litigation; pending or threatened condemnation or other taking; use restrictions, such as zoning and restrictive covenants; condition of the property or disclaimer of representations (for example, "as is" language); presence of landfills or hazardous and toxic wastes; floodplain location; utility availability and capacity; compliance with all laws; effectiveness of required licenses and permits; status of leases; operation and maintenance of property before closing; accuracy of books and records; agricultural or other special-use tax assessment; payment of ad valorem taxes; and status of debt to be assumed or taken "subject to."

In negotiating representations, the parties should specify whether representations are to be absolute or based on the seller's knowledge and belief; whether the representations will be based on the knowledge of the entity that is the seller or on the knowledge of specified individuals; whether the seller must perform further investigation to make the representations or may rely on its current knowledge, without further investigation; and whether and to what extent the representations will survive closing.

The approach used in this contract limits the seller's representations and warranties, but it is not intended to insulate the seller from liability for fraud or misrepresentation.

The seller represents only facts, not opinions. For example, the seller does not represent whether, in the seller's opinion, the property is in compliance with applicable laws and regulations. Instead, the seller represents that it has not received notice of violation of any law, ordinance, regulation, or requirement affecting the property or use of the property, except as stated in the contract.

The seller makes no representations or warranties that are not stated in the contract, including exhibit E (notices, statements, and

certificates required by law and regulation), or in the closing documents.

The following optional clauses are also provided:

- The buyer agrees to accept the property in its ‘as is, where is’ condition, investigate the property on the buyer’s own behalf, and not rely on information or representations attributable to the seller, except to the extent stated in the contract.
- The buyer waives its rights under the Texas Deceptive Trade Practices–Consumer Protection Act.
- The buyer assumes responsibility after closing for all environmental matters relating to the property.

If the parties negotiate different representations, exhibit C must be revised accordingly.

The contract provides that the parties’ representations are true and correct when made and must be true and correct at closing, or the buyer may terminate the contract.

It is common practice to include representations regarding the organization and authority of the parties in contracts but to defer the obligation to deliver documentary evidence confirming those representations until the closing of the transaction. That evidence customarily consists of certificates of existence and good standing from public officials, certified copies of organizational documents, certified corporate resolutions or partnership consents, and certificates of incumbency. The attorney may consider requiring such documentary evidence at the execution of the contract to avoid encountering a claim, after substantial obligations have been paid or incurred, that the other party is not authorized to consummate the transaction. While the seller’s organizational documents should be available at the time of execution of the contract, the buyer’s

organizational documents are often not prepared until shortly before closing.

§ 16.73 **Conveyance of Water Rights—Conditional; Application for Approval; Cooperation; Condition of Water Rights until Final Closing; Memorandum/No Recording of Contract**

The parties’ signing of the contract and the expiration of the inspection period without the buyer’s termination of the contract obligates the seller to conditionally convey the water rights to the buyer, pending the TCEQ’s and any other required water authority’s approval of the change in ownership and any amendments necessary to accommodate the buyer’s intended use. It also obligates the parties to pursue and cooperate in the water authority approval process, to maintain and operate the water rights in a certain manner pending the approval process, and to proceed in a certain fashion in the event of condemnation or claims affecting the water rights. The contract also sets out the parties’ agreement not to record the contract; however, given the sometimes lengthy duration involved in obtaining water authority approval, the buyer may want to record a memorandum of the contract in the public records. See form 16-16 in this chapter.

Form 16-19 is a proposed form of conditional conveyance to be signed by the parties at the initial, conditional closing on the contract. The surface water rights are not deemed transferred, however, until the TCEQ (and any other applicable water authority) has approved the change in ownership and any amendments to the certificate or permit. The parties often do not execute a second unconditional conveyance document (form 16-20); rather, once the condition (TCEQ approval) has been satisfied through issuance of the amended certificate or permit, the conveyance is treated as final.

§ 16.74 Conditions of Contract and Termination

The contract provides for disposition of the earnest money if the TCEQ does not approve the transfer of ownership and any other amendments sought by the buyer by a specific date and after any other termination of the contract. It also provides for posttermination obligations. It is possible that the TCEQ's approval of a transfer may be overturned on judicial review, and the parties may want to provide how the sale is affected if judicial review is sought by a protestant.

§ 16.75 Final Closing

Once the TCEQ has approved the transaction and issued any necessary amendments to the permit or certificate of adjudication, the parties proceed to the final closing. The contract allocates closing obligations and transaction costs between the parties. In the case of irrigation surface water rights, the water rights will become appurtenant to the land approved for the "place of use" in the amended certificate or permit. To facilitate title examinations, the parties may want to describe this appurtenant property in an unconditional conveyance document signed at the final closing (form 16-20 in this chapter). The parties do not want to describe this property as appurtenant in the initial, conditional conveyance document (form 16-19), because of the risk that the TCEQ or other applicable water authority may not approve the transaction. There may be a cloud on the title to the water rights if the water rights were described as appurtenant to property in the initial conditional conveyance but not later approved as appurtenant to property by the applicable water authority.

§ 16.76 Default and Remedies

The contract provides that the buyer may elect one of the following remedies for the seller's default: termination (with disposition of the ear-

nest money and payment of additional liquidated damages to the nondefaulting party) or specific performance. In addition, the buyer may terminate if the seller's representations are not true and correct or if a warranty set forth in the contract is breached. The parties may be entitled to payment of actual damages and perhaps of consequential damages if the untruth or breach is first discovered after closing. The contract is drafted to limit the parties' remedies, but remedies are often negotiated.

The contract provides that the party prevailing in litigation is entitled to recover attorney's fees and court and other costs.

§ 16.77 Assignment

The contract contains alternate clauses concerning assignment. The buyer either may not assign the contract or may assign the contract only to an entity controlled by the buyer.

If the contract provides that the buyer has the right to assign, the assignment provision should state whether the buyer is relieved from obligations under the contract after assignment.

§ 16.78 Closing Functions

The party handling the closing (the title company or escrow agent) commonly attends to the matters discussed in the following sections.

§ 16.78:1 Payoff Information and Other Closing Expenses

Written request should be made to each lienholder for the lienholder's written payoff statement. The lienholder should be requested through an authorized representative to state the remaining principal balance due on the note, the accrued interest as of a certain date, a per diem amount of interest, and whether the lienholder will credit the amount held in the escrow account, if one exists, to the total due or, alterna-

tively, refund the amount directly to the borrower. Closing must occur and payment be made to the lienholder before the release of lien will be signed.

Additionally, information concerning other matters requiring payment at closing should be obtained, such as payoff amounts for mechanic's lien claims, federal or state tax liens, property taxes, paving assessments, and abstracted judgments that affect the property.

The closing agent must also determine the amounts of closing costs, such as surveying expenses, attorney's fees, brokers' commissions, and loan fees.

§ 16.78:2 Ad Valorem Taxes

Currently surface water rights are not assessed and taxed independently from the surface estate for ad valorem tax purposes. Consequently, the contract does not provide for a proration of ad valorem property taxes at closing, but it does require that the taxes be paid in full at closing by the seller if they are due and payable at the time of closing.

§ 16.78:3 Closing Documents

The closing agent may be expected to prepare or provide several documents.

Closing Statements: Closing statements may be on either the federally prescribed HUD-1 settlement statement, the State Board of Insurance settlement statement, or a separate seller's, buyer's, or borrower's statement, depending on the nature of the transaction. The purpose of a closing statement is to assemble in one document all the pertinent financial features of the contract, including purchase price, loan amounts, costs and expenses of closing the transaction, and prorations. Execution of the statement evidences the parties' agreement with

the numbers and computations appearing on the statement.

Affidavits: Affidavits concerning debts and liens, parties in possession, identity of the parties, leases, and the parties' marital status will likely be required at closing by the title company, escrow agent, or a party's attorney.

Financing documents are typically prepared by the lender's attorney. Conveyancing and other closing documents may be prepared by the parties to the transaction, their attorneys, or an attorney for the closing agent.

§ 16.78:4 Funding

The closing agent typically disburses funds in connection with closing. Disbursements are made according to the closing statement, usually from funds paid by the buyer and its lenders.

Except in the case of certain nontaxable sales of principal residences, the person responsible for closing a real estate transaction is required to file an information return with the Internal Revenue Service relating to the transaction and is subject to penalties for failing to report. *See* 26 U.S.C. § 6045. This reporting requirement is often satisfied by the responsible person by delivering the seller's closing statement, together with an attachment of additional required information, to the IRS.

If funds will be disbursed at closing, payments must be made to the closing agent with 'good funds' as defined by the regulations of the Texas State Board of Insurance. See Procedural Rule P-27, *Basic Manual of Rules, Rates and Forms for the Writing of Title Insurance in the State of Texas*.

If it is not necessary to disburse funds at closing, the parties need not comply with the 'good funds' rule, and payment may be made in other ways.

If title insurance is obtained through a title agent or fee attorney, the attorney for the lender and buyer should consider obtaining an insured closing service letter from the title insurance underwriter whose policies are to be issued. This letter indemnifies the lender or buyer for certain wrongful acts of the title agent or fee attorney relating to the handling of closing funds. See forms T-50 and T-51 of the *Basic Manual of Rules, Rates and Forms for the Writing of Title Insurance in the State of Texas*. See <https://www.tdi.texas.gov/title/titlemm5.html>.

§ 16.78:5 Recording Documents

The title company or escrow agent is responsible for recording documents intended to be recorded. This responsibility extends to the recording of releases or transfers of liens for notes paid at closing. Each document should be checked before recording to ensure that exhibits referred to in the document are attached and the name and address of the person to whom the document is to be returned after recording is included.

Section 297.83 of the Texas Commission on Environmental Quality regulations currently provides only that the “written instrument evidencing a water right ownership transfer shall be recorded in the office of the county clerk.” 30 Tex. Admin. Code § 297.83. It does not specify in which county clerk’s office the instrument should be recorded. To assure notice to all persons in affected counties, the parties may want to prepare several duplicate originals to be filed in Travis County (where the TCEQ is located) and in each of the counties (1) from which the water is appropriated (that is, diverted), (2) in which the water is used, (3) in which any of the appurtenant land is located, and (4) in which the watermaster is located.

Attorneys dealing with water rights within a watermaster operation should be aware of the notice and recording requirements applicable to

watermaster operations. *See generally* 30 Tex. Admin. Code chs. 303, 304. This is particularly true for the Rio Grande watermaster. There are two subsections (j) to section 11.3271 of the Texas Water Code adopted by the legislature in 2003 that have never been reconciled. *See* Tex. Water Code § 11.3271. Under one subsection (j), the watermaster with jurisdiction over the Rio Grande is made the official recorder for all instruments, including deeds, deeds of trust, financing statements, security agreements, and liens that the TCEQ authorizes or requires to be filed in connection with a water right relating to water in the lower, middle, or upper basin of the Rio Grande and that are subject to a permit, certified filing, or certificate of adjudication, and the filing will have the same legal effect as filing under other law for the same type of instrument. Under the other subsection (j), the watermaster is required to maintain a central repository that includes certified copies of all instruments, including deeds, deeds of trust, and liens that the TCEQ requires to be filed in connection with the same type of water rights as are described in the first-referenced subsection (j), and it is expressly stated that on and after September 1, 2003, a lien against a water right shall not be effective against third parties unless a certified copy of the instrument is filed with the watermaster and all requirements under other law are met. It would be prudent when conveying rights or interests in water rights in the Rio Grande to record a duplicate set of original documents with the Texas watermaster, as well as in the real property records of the county or counties in which the documents are otherwise authorized to be recorded, and to also file a certified copy of the documents recorded in the county real property records (at least with regard to liens) with the watermaster.

§ 16.78:6 Closing Instructions

Attorneys for the buyer, the seller, and the lender may each prepare closing instructions for the closing agent. For applicable forms, see forms

26-15 through 26-18 in this manual. These instructions relate to the conditions precedent to closing, including the status of the title after closing, the title insurance policies to be issued, disposition of funds, and distribution of documents received by the closing agent.

§ 16.79 Additional Considerations

§ 16.79:1 Transactions Involving Foreign Persons

Buyer: If the buyer is a foreign person, certain disclosures and reports may be required under the Foreign Investment in Real Property Tax Act of 1980. *See* 26 U.S.C. § 6039C.

Seller: With certain exceptions, anyone purchasing real property located in the United States from a foreign person must withhold 15 percent of the price and remit the funds to the Internal Revenue Service within twenty days of the date of transfer. *See* 26 U.S.C. § 1445(a), (b). The transferee should assume that the seller is a foreign person until the contrary is established, because transferees act at their own peril until they obtain a nonforeign affidavit. *See* 26 U.S.C. § 1445(b)(2). The nonforeign affidavits (forms 26-19 and 26-20 in this manual) are suggested for use in all transactions.

[Section 16.80 is reserved for expansion.]

V. Water Rights Lien Documents

§ 16.81 General Considerations

The lien forms contained in this chapter may be used, with appropriate modification, for either

§ 16.79:2 Closing Checklist

The attorney should prepare a closing checklist, itemizing the documents that will be required to close the transaction, including curative documents. The checklist should also refer to all other preclosing considerations relating to the transaction.

§ 16.79:3 Postclosing Considerations

After closing, recorded documents and relevant title insurance policies issued after closing should be reviewed for accuracy and compliance with the title commitment. The owner policy should be dated on or after the recording date of the deed conveying title to the buyer, and the mortgagee policy should be dated on or after the recording date of the deed of trust of the insured lien.

An original or title company's certified copy of each executed document relating to the closing should be provided to the seller and the buyer or the borrower by their attorneys. Generally, the party benefiting from a document receives the original, and the other parties receive copies.

If the transaction fails to close, but the TCEQ and any other water authority have approved the transfer or any amendments to the permit or certificate of adjudication, the parties can ask the TCEQ and any other water authority to delete the amendment to the permit or certificate of adjudication.

groundwater rights or surface water rights transactions.

To address both the real and the personal property characteristics of water rights, it is advis-

able to incorporate both deed-of-trust provisions and security agreement provisions in loan documents. This can be done in one or more documents, depending on the transaction. The water rights deed of trust (form 16-21 in this chapter) is an adaptation to water rights of the basic deed of trust (form 8-1 in this manual). The water rights security agreement (form 16-22) is an adaptation of form 9-2, the basic form for security agreement found in chapter 9. Depending on the nature and use of the water rights being pledged, and the other collateral associated with those water rights, the additional clauses and forms from chapters 8 and 9 should be added to the basic forms appearing in this chapter. These additional clauses from chapters 8 and 9 are thus referenced in this chapter and should be inserted into the form 16-21 and form 16-22, as appropriate.

In any transaction, the pledged water rights may have both real and personal property characteristics. For example, surface water rights are real property, requiring use of a deed of trust. Once the water is transported for use, however, the water may become personal property. In addition, the permit or certificate of adjudication evidencing the surface water rights may constitute a separate property right. It is not clear under existing case law whether the permit or certificate of adjudication would constitute an interest in real property, similar to a license or land development permit, or whether it would be considered personal property in the nature of a general intangible. Consequently it is advisable to use both a deed of trust and a security agreement with financing statements in loans secured by groundwater or surface water rights, to ensure that the lender has a lien on all real and personal property. The separate security agreement (form 16-22, adapted from the basic form for security interests in personalty) may be used if there is other purely personal property that secures the loan. Form 16-21 (which includes the additional security agreement language of clause 8-9-10) may be used to create both the

real property lien and a personal property security interest in a single deed of trust document when there is no other personal property.

In other types of transactions, for example, groundwater rights completely severed from real property and represented by only permits (as described in part III. of this chapter) or groundwater rights for on-site production and for which a groundwater permit may have been issued (as described in part II.), the groundwater rights are real property, the produced water may be personal property, and the permit itself may be either an interest in real property or a general intangible under the Texas Uniform Commercial Code.

If a facility such as a well or pipeline is included in the collateral, this property may constitute either a fixture or equipment. Consequently, it is advisable to describe this type of facility in the deed of trust and security agreement and to file financing statements as both a fixture filing and a personal property filing.

In loan transactions in which water rights, permits, or facilities are used as collateral, the attorney drafting the loan documents will want to consider the importance of including in the loan documents a UCC article 9 security agreement, UCC financing statements, and a deed of trust to address both the real and the personal property aspects of water rights. The places for recording the deed of trust and financing statements are discussed in section 16.81:4 below.

In addition to using a deed of trust and security agreement, the attorney should consider using other documents to more fully protect the lender's lien rights, particularly in instances in which the water rights are subject to the jurisdiction of a water authority (for example, the TCEQ, a watermaster, or a groundwater district authority). Persons dealing with water rights, including the water authority itself, may not check the real property records or the UCC lien records (particularly those in another state)

before taking action in connection with the water rights. They instead may look solely at the information filed in the water authority's records. There is currently no mechanism for recording liens in the records of any water authority. Furthermore, there is no statutory or case law that clearly requires a water authority to consult real property records or UCC lien records, or to acknowledge the rights of a lender, before authorizing a modification, termination, or transfer of a permit.

Consequently, the owner of the water rights pledged as collateral may adversely affect the value of those water rights to the lender by obtaining a change in the permitted use of the water rights or transferring the permit in whole or in part to another person without the lender's knowledge. The lender may then have a difficult time re-establishing its rights in the collateral. In order to put the water authority, and persons checking the water authority's records, on actual notice of the lender's lien on the water rights, the attorney may want to file a form for notice of lender's rights in the records of the water authority. The attorney may also want to have the owner of the water rights give written instructions to the water authority directing it not to take any action with regard to the permit or certificate of adjudication without the written authorization of the lender. Because there is no formal mechanism for filing such notice or instructions with a water authority, it is possible that the water authority may reject such a filing or refuse to comply with the instructions. Nevertheless, the lender will be in a better position to assert its rights against the water authority or a person who obtained a transfer of the permit or certificate, if such notice or instructions were delivered to the water authority, to be placed in the records pertaining to the permit or certificate for the pledged water rights. One or more of the following forms may be used: memorandum of groundwater loan (form 16-23), notice of the lender's interest in water rights (form 16-24),

and the permittee's instruction letter to water authority (form 16-25).

§ 16.81:1 Groundwater vs. Surface Water

Form 16-21 and form 16-22 in this chapter are designed for establishing a lien on or security interest in either groundwater or surface water rights. The forms contain suggested alternative clauses to describe the type of water rights being encumbered as security and categories of additional property associated with the water rights that might also serve as collateral for the loan.

§ 16.81:2 Deed of Trust

A deed of trust is a mortgage on real property with a power of sale. Although a deed of trust by its literal terms conveys the real property in trust to the trustee, its actual effect under Texas law is to create a lien against the property to secure a debt of the grantor of the lien to the beneficiary of the lien. This chapter provides one basic water rights deed of trust form (form 16-21), which is an adaptation to water rights of form 8-1 in this manual. If the borrower is assuming obligations under the seller's existing loan for which the water rights serve as collateral, similar adaptations can be made to the deed of trust to secure assumption (form 8-2). If a leasehold interest in the water rights is collateral for the loan, the leasehold deed of trust (form 8-10) can be revised. As discussed in this chapter and chapter 8, the forms may be adapted to a variety of situations.

A description of collateral in the deed of trust should be inserted for each category of property intended as collateral. In the water rights category, the description will include such identifying information from the permit or certificate of adjudication as the TCEQ or other water authority number designation, priority date, amendments, water rights authorized (including any rights of diversion, use, or storage), quantity,

particular watercourse or aquifer from which the water rights come, ownership, place of use, purpose of use (for example, municipal, irrigation, industrial, recreational), and point of diversion. Also, if adapting form 8-10 for a leasehold deed of trust on the water rights, note that the description of the property in the leasehold deed of trust should be of the leasehold interest of the lessee granting the deed-of-trust lien.

In the case of irrigation surface water rights, the water rights will be appurtenant to the land designated as the "place of use" in the certificate or permit. If the land to which the water rights are appurtenant is also intended as collateral for the loan, the description of that land should be inserted in the definition of "appurtenant land." If the land from which the water is diverted or on which it is to be used is not intended as collateral for the loan, the land should be described here as the "surface estate.

The deed of trust for water rights contains security agreement and financing statement language. This security agreement language, in addition to addressing the personal property aspects of water rights, can also be used to create a security agreement in any fixtures associated with the real estate and water rights. For drafting instructions and guidance in using a deed of trust with a security agreement, see sections 8.11 and 9.8.

There are a number of other considerations in using a deed-of-trust form, depending on the nature of the loan transaction and related collateral. The attorney can consult chapter 8 to determine whether and to what extent these additional considerations apply, and find additional guidance for completing and modifying the provisions of form 16-21 to reflect the dynamics in the loan transaction.

§ 16.81:3 Security Agreement

Chapter 9 of the Texas Business and Commerce Code, titled "Secured Transactions," governs consensual, contractual security interests in personal property and fixtures that secure payment or performance of an obligation. Tex. Bus. & Com. Code § 9.109(a)(1). Almost all water rights in Texas are evidenced by a permit or a certificate of adjudication. Because a permit or certificate of adjudication resembles a general intangible, form 16-22 in this chapter, for creating a security interest in water rights, is an adaptation of form 9-2, the security agreement found in chapter 9 in this manual.

If water rights are considered real property, an argument can be made that the secured transactions provisions of chapter 9 of the Business and Commerce Code do not apply to liens or security interests in water rights. Chapter 9 contains a real property interest exclusion. With an exception for fixtures, the creation or transfer of an interest in or a lien on real property, including a lease or rents, as defined by section 64.001 of the Property Code, is not governed by chapter 9. Tex. Bus. & Com. Code § 9.109(d)(11). By comparison, however, the definition of "account" under chapter 9 explicitly includes rights to payment for property (real or personal) sold. Tex. Bus. & Com. Code § 9.102(a)(2). In addition, security interests in farm products are governed by chapter 9, and specifically include supplies produced or used in farming operations, including aquatic farming operations. *See* Tex. Bus. & Com. Code § 9.102(a)(34), (35).

To eliminate the risks associated with water rights collateral being classified as either exclusively real or exclusively personal property to which different rules may apply, a lender may ask the debtor to provide both a deed of trust and a security agreement. Although the deed of trust (form 16-21) contains security agreement language that may be sufficient to create a lien on the personal property aspect of water rights, the

additional provisions in the security agreement (form 16-22) may provide greater clarity and guidance regarding the parties' rights and obligations, particularly if related collateral for the loan has strictly personal property characteristics.

The rules for creating and perfecting a security interest are complex. Accordingly, in the context of any particular transaction, the attorney should consult chapter 9, giving due consideration to all of the types of collateral involved in the loan transaction. The rules relating to classification and definitions of collateral, creation, attachment, perfection, priority, choice of law, and other issues will vary, depending on the transaction. Chapter 9 contains instructions that will provide guidance in completing and modifying form 16-22 and additional clauses that should be considered. Because of the complexity of the rules for creating and perfecting a security interest, the attorney should also consult the statutory text, the official comments, secondary sources, and any relevant case law.

§ 16.81:4 Attachment, Perfection, and Recording

There are currently no express rules governing attachment and perfection of a security interest in water rights. For other types of collateral, there are four basic methods of perfecting an attached security interest, although as few as one of those methods may be effective, depending on the specific category of collateral. Those methods include (1) a properly completed financing statement (*see* Tex. Bus. & Com. Code § 9.102(a)(39)) filed in the appropriate UCC filing offices, (2) possession of the collateral in the secured party, (3) the secured party's control of the collateral, and (4) in a few cases, automatic perfection on attachment of a security interest. If there are alternative methods of perfection, one secured party may obtain priority over another secured party, depending on the method used to perfect. For guidance on the var-

ious methods of attachment and perfection, consult sections 9.4 and 9.5 in this manual.

The lender should record the deed of trust in the place for recordation of the deed or conveyance documents described in section 16.12 above (groundwater rights for production on-site), in section 16.42 (permitted groundwater rights for production off-site), and in section 16.62 (surface water rights), as applicable. Given the ambiguities surrounding attachment and perfection of a security interest in water rights, and the different locations from which surface water rights or permitted groundwater rights may originate or be used, a lender may want to use as many means as it can to make sure persons are put on actual and constructive notice of the lender's lien rights and security interests. Consequently, note should be taken of the additional alternative places for recording documents described in sections 16.42, 16.62, and 16.78:5.

Attorneys dealing with water rights within a watermaster operation should be aware of the notice and recording requirements applicable to watermaster operations. *See generally* 30 Tex. Admin. Code chs. 303, 304. This is particularly true for the Rip Grande watermaster. There are two subsections (j) to section 11.3271 of the Texas Water Code adopted by the legislature in 2003 that have never been reconciled. *See* Tex. Water Code § 11.3271. Under one subsection (j), the watermaster with jurisdiction over the Rio Grande is made the official recorder for all instruments, including deeds, deeds of trust, financing statements, security agreements, and liens that the TCEQ authorizes or requires to be filed in connection with a water right relating to water in the lower, middle, or upper basin of the Rio Grande and that are subject to a permit, certified filing, or certificate of adjudication, and the filing will have the same legal effect as filing under other law for the same type of instrument. Under the other subsection (j), the watermaster is required to maintain a central repository that includes certified copies of all instruments,

including deeds, deeds of trust, and liens that the TCEQ requires to be filed in connection with the same type of water rights as are described in the first-referenced subsection (j), and it is expressly stated that on and after September 1, 2003, a lien against a water right shall not be effective against third parties unless a certified copy of the instrument is filed with the watermaster and all requirements under other law are met. It would be prudent when conveying rights or interests in water rights in the Rio Grande to record a duplicate set of original documents with the Texas watermaster, as well as in the real property records of the county or counties in which the documents are otherwise authorized to be recorded, and to also file a certified copy of the documents recorded in the county real property records (at least with regard to liens) with the watermaster.

Because water rights, permits, and facilities have both real and personal property characteristics, financing statements used in the loan transaction should be treated as applying to both fixtures and personal property and should be recorded in the appropriate locations as provided by the Uniform Commercial Code (title 1 of the Texas Business and Commerce Code). If applicable law requires the financing statement to be filed with the secretary of state of a state other than Texas (for example, in the state of the debtor's location), the lender may still want to file an additional financing statement with the Texas secretary of state, to provide actual notice of the security interest to persons who check for filings in Texas. The UCC forms are available in a fill-in-the-blank format over the Internet from the Texas secretary of state at www.sos.state.tx.us/ucc/uccforms.shtml. For guidance in filling out the UCC forms, consult sections 9.13 through 9.17 in this manual.

Additional Resources

- Bradbury, James D. "Surface Water Markets Including Valuation." In *Changing Face of Water Rights in Texas, 2017*. Austin: State Bar of Texas, 2017.
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- Cheney, Denise. "Water Documents: Real Estate Forms Manual." In *Changing Face of Water Rights in Texas, 2017*. Austin: State Bar of Texas, 2017.
- Cheney, Denise, and Ramona Kantack Alcantara. "Basic Water Transaction Forms." In *Changing Face of Water Rights in Texas, 2009*. Austin: State Bar of Texas, 2009.
- Dugat, William D. "All Appropriate Inquiries in Connection with Groundwater Purchases." In *Changing Face of Water Rights in Texas, 2015*. Austin: State Bar of Texas, 2015.
- Glen, Martyn C. "Valuation of Water Rights." In *Changing Face of Water Rights in Texas, 2004*. Austin: State Bar of Texas, 2004.
- Jolley, Grady B. "Forms and Transactional Issues in Private Sales of Groundwater and Water Rights." In *Changing Face of Water Rights in Texas, 2007*. Austin: State Bar of Texas, 2007.
- . "Water Reuse as a Tool in Real Estate Development Opportunities and Challenges." In *Changing Face of Water Rights Advanced Course, 2010*. Austin: State Bar of Texas, 2010.
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- Jolley, Rhonda G. "Water Rights: Methods of Conveyancing and Documentation." In *Real Estate Law Boot Camp, 2008*. Austin: State Bar of Texas, 2008.
- . "Who Owns the Groundwater? State? Landowner? No One?" In *Advanced Real Estate Law Course, 2009*. Austin: State Bar of Texas, 2009.
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- Ruttenberg, Frank Z. "Basics of Groundwater Transfer Agreements." In *Advanced Real Estate Law Course, 2010*. Austin: State Bar of Texas, 2010.
- . "Due Diligence." In *Changing Face of Water Rights in Texas, 2008*. Austin: State Bar of Texas, 2008.
- . "Water Law Transfer Agreements." In *Changing Face of Water Rights Advanced Course, 2010*. Austin: State Bar of Texas, 2010.
- . "Water Rights in Texas." In *Advanced Real Estate Law Course, 2008*. Austin: State Bar of Texas, 2008.

Sahs, Mary K., ed. *Essentials of Texas Water Resources*. 4th ed. Austin: State Bar of Texas, 2016.

Sherman, Lynn, and Edmond R. McCarthy, Jr. 'Marketing' Your Water—Tips for Selling or Leasing Groundwater & Surface Water Rights. In *Changing Face of Water Rights In Texas, 2015*. Austin: State Bar of Texas, 2015.

[Reserved]

Form 16-1

Groundwater Rights Sales Contract

[For Sale of Groundwater Rights in Place for On-Site Production
If Seller Owns Groundwater and Surface Estate]

This contract to buy and sell groundwater rights [**include if applicable:** and fixtures and personal property] is between Seller and Buyer as identified below and is effective on the date (“Effective Date”) of the last of the signatures by Seller and Buyer as parties to this contract and by [Title Company/Escrow Agent] to acknowledge receipt of the Earnest Money. Buyer must deliver the Earnest Money to [Title Company/Escrow Agent] and obtain a signature acknowledging receipt of the Earnest Money before the Earnest Money Deadline provided in paragraph A.1. for this contract to be effective. If the Earnest Money is paid by check and payment on presentation is refused, Buyer is in default.

Seller: [**include the names of all persons owning the groundwater; also include all owners of the surface of the property, if different from the owners of the groundwater**]

Address:

Phone:

E-mail:

Type of entity:

Seller’s Attorney:

Law firm:

Address:

Phone:

E-mail:

Seller's Broker:

Brokerage firm:

Address:

Phone:

E-mail:

Buyer:

Address:

Phone:

E-mail:

Type of entity:

Buyer's Attorney:

Law firm:

Address:

Phone:

E-mail:

Buyer's Broker:

Brokerage firm:

Address:

Phone:

E-mail:

[Title Company/Escrow Agent]: **[identify title company or, if title insurance will not be obtained, identify person who will act as escrow agent]**

Address:

Phone:

E-mail:

[Underwriter:]

Include the following if applicable.

Surveyor:

Address:

Phone:

E-mail:

Survey Category:

Continue with the following.

If there is no groundwater authority with jurisdiction over the real property, modify the contract as appropriate.

Groundwater Authority: **[list any groundwater conservation districts or other groundwater authority with jurisdiction over the real property]**

Seller's Permit: [describe and provide all of seller's permits, e.g., [permit title] Permit No. [number], issued and approved by [name of groundwater authority] on [date].]

Earnest Money: \$[amount]

Real Property: The Real Property described in Exhibit A [include if applicable: together with the fixtures and personal property described in Exhibit A]. [Include if a survey is required under the contract: The metes-and-bounds description of the Real Property, as reflected by the Survey, will automatically be incorporated into this contract in Exhibit A and will supersede any prior Exhibit A when the Survey is approved by Seller and Buyer, and the acreage will be automatically adjusted to the acreage amount reflected by the Survey.]

Groundwater: All of the underground water, percolating water, artesian water, and any other water from any and all depths and reservoirs, formations, depths and horizons beneath the surface of the Real Property, excluding underflow or flow in a defined subterranean channel.

Groundwater Rights: (1) The legal title to the Groundwater [include if applicable: subject to the Reserved Groundwater] and the right to test, explore for, drill for, develop, withdraw, capture, or otherwise beneficially use the Groundwater; (2) the right to use the surface of the Real Property for access to and to explore for, develop, treat, produce, and transport the Groundwater; and (3) all permits, licenses, or other governmental authorizations relating to any of the foregoing. If a separate Easement Agreement is required by this contract, the Groundwater Rights include the easement rights.

If the seller does not reserve any groundwater for use in connection with the surface estate, modify the contract as appropriate.

Reserved Groundwater: Seller reserves the right to use the Groundwater in connection with its surface estate in the Real Property for the following purposes only: [state purposes for

which the reserved groundwater may be used and any limit on the quantity of reserved groundwater that seller may use including any limit on the number of wells that seller may drill or maintain].

Excepted Groundwater: Seller excepts from the sale the rights to use the Groundwater in connection with prior grants or conveyances or grants to use the Groundwater affecting the conveyance.

Buyer's Intended Use of Groundwater: [specify]

Purchase Price:

Select one of the following.

[\$amount], which is determined on the basis of [describe basis for determining purchase price, e.g., \$[amount] per acre of Real Property from which the Groundwater Rights are obtained] [include if applicable: and \$[amount] for the personal property and fixtures].

Or

To be determined after obtaining the hydrogeological information described in paragraph G.3. during the Inspection Period. [State the basis on which price is to be calculated, including any applicable provisions in paragraph G.3. below] [include if applicable: and \$[amount] for the personal property and fixtures].

Continue with the following.

Cash portion:

Seller-financed portion (principal amount of note):

Interest rate:

Maturity date:

Payment schedule:

See exhibit I for additional terms and conditions.

Third-party-financed portion:

Buyer's Liquidated Damages: \$[**amount**]

Seller's Additional Liquidated Damages: \$[**amount**]

Title Information: If Seller is not required to provide a Title Commitment and Title Policy, Seller will have the obligation to provide to Buyer, at Seller's expense, the Title Information as defined in paragraph F.3. Buyer may have the Title Information reviewed and obtain a written opinion of title by an attorney selected by Buyer, at [Seller/Buyer]'s expense.

Title Documents: The Seller's Permit and instruments affecting title to the Groundwater and the Real Property referenced in the [Title Commitment/Title Information] [, Survey,] and UCC Search are to be provided as part of Seller's Records.

A. Deadlines and Other Dates

All deadlines in this contract expire at 5:00 P.M. local time where the Real Property is located. If a deadline falls on a Saturday, Sunday, or national holiday, the deadline will be extended to the next day that is not a Saturday, Sunday, or national holiday. A national holiday is a holiday designated by the federal government. Time is of the essence.

A.1. Earnest Money Deadline: [**date**]

Select one of the following.

A.2. Delivery of Title Commitment: [[**date**]/[**number**] days after the Effective Date]

Or

A.2. Delivery of Title Information: [[date]/[number] days after the Effective Date]

Select one of the following.

A.3. Delivery of Survey: No Survey is required.

Or

A.3. Delivery of Survey: [[date]/[number] days after the Effective Date]

Continue with the following.

A.4. Delivery of UCC Search: [[date]/[number] days after the Effective Date]

A.5. Delivery of legible copies of the Title Documents: [[date]/[number] days after the Effective Date]

A.6. Delivery of Title Objections: [[date]/[number] days after delivery of the last of the [Title Commitment/Title Information], [Survey,] UCC Search, and legible copies of the Title Documents]

A.7. Delivery of Seller's Records as specified in Exhibit C: [[date]/[number] days after the Effective Date]

A.8. End of Inspection Period: [[date]/[number] days after the Effective Date, or at the date specified if the Inspection Period is extended]

A.9. Closing Date: [[date]/[number] days after the End of the Inspection Period]

A.10. Closing Time: [time]

B. Closing Documents

B.1. At Closing, Seller will deliver the following items:

Include all applicable items.

Groundwater Rights [General/Special] Warranty Deed [**include if applicable:**
with Vendor's Lien] ("Groundwater Rights Warranty Deed")

Easement Agreement for Groundwater Rights as shown in Exhibit J

Release of Lien

Partial Release of Lien as to Groundwater Rights

Lienholder Consent and Subordination to Easement Agreement

Assignment of Seller's Permit or transfer form promulgated or approved by relevant groundwater authority

Bill of Sale

IRS Nonforeign Person Affidavit

Evidence of Seller's authority to close this transaction

Notices, statements, and certificates as specified in Exhibit D

Affidavit of Debts and Liens

Assignment and Assumption of Leases

Assignment and Assumption of Contracts

Tenant Estoppel Certificate

Releases of any leases or contracts affecting the Groundwater Rights that will
be terminated at Closing

B.2. At Closing, Buyer will deliver the following items:

Include all applicable items.

Balance of Purchase Price

Easement Agreement for Groundwater Rights

Evidence of Buyer's authority to close this transaction

Deceptive Trade Practices Act waiver

Assignment and Assumption of Leases

Seller-financing documents

Promissory Note

Deed of Trust

Security Agreement

Financing Statement

Loan Documents required by third-party lender

Releases of any leases, contracts, or other legal interests affecting the Groundwater agreed to be terminated before or at Closing

Continue with the following.

The documents listed in this section B. are collectively known as the "Closing Documents." The Closing Documents for which forms exist in the current edition of the *Texas Real Estate Forms Manual* (State Bar of Texas) will be prepared using those forms.

C. Exhibits

The following are attached to and are a part of this contract:

Exhibit A—Description of the Real Property [**include if applicable:** and Fixtures and Personal Property]

Exhibit B—Seller's Representations and Warranties

Exhibit C—Seller's Records

Exhibit D—Notices, Statements, and Certificates

Exhibit E—Copies of Seller's Permits issued by the Groundwater Authority

Exhibit F—List of Seller's leases or other contracts affecting the Groundwater Rights or Real Property to be terminated before Closing

Exhibit G—List of Seller's leases or other contracts affecting the Groundwater Rights or Real Property that will survive Closing

Exhibit H—Groundwater Rights Warranty Deed

[**Include if applicable:** Exhibit I—Seller Financing Addendum]

[**Include if applicable:** Exhibit J—Easement Agreement]

[**Include if applicable:** Exhibit K—Memorandum of Contract]

[**Include if applicable:** Exhibit L—Notice of Termination of Contract]

D. Purchase and Sale of Groundwater Rights

Seller agrees to sell and convey the Groundwater Rights to Buyer, and Buyer agrees to buy and pay Seller for the Groundwater Rights. The promises by Buyer and Seller stated in this contract are the consideration for the formation of this contract.

E. Interest on Earnest Money

Buyer may direct [Title Company/Escrow Agent] to invest the Earnest Money in an interest-bearing account in a federally insured financial institution by giving notice to [Title Company/Escrow Agent] and satisfying [Title Company/Escrow Agent]'s requirements for investing the Earnest Money in an interest-bearing account. Any interest earned on the Earnest Money will become part of the Earnest Money.

F. Title [and Survey]

F.1. Review of Title. The following statutory notice is provided to Buyer on behalf of the real estate licensees, if any, involved in this transaction: Buyer is advised that it should either have the abstract covering the Real Property examined by an attorney of Buyer's own selection or be furnished with or obtain a policy of title insurance.

Include the following if applicable.

F.2. Title Commitment; Title Policy. "Title Commitment" means a Commitment for Issuance of an Owner Policy of Title Insurance by Title Company, as agent for Underwriter, or directly by Underwriter, stating the condition of title to the Groundwater and the Real Property. The effective date stated in the Title Commitment must be after the Effective Date of this contract. "Title Policy" means an Owner Policy of Title Insurance issued by Title Company, as agent for Underwriter, or directly by Underwriter, in conformity with the last Title Commitment delivered to and approved by Buyer.

Continue with the following.

F.3. Title Information. “Title Information” means an abstract of title prepared by a title insurance company or an abstract company licensed by the Texas State Board of Insurance, covering the period from the first conveyance of title to the Real Property out of the sovereignty to the Effective Date, and containing complete and legible copies of all the deeds, easements, liens, and other documents affecting title to the Real Property and the Groundwater.

Include the following if applicable.

F.4. Survey. “Survey” means an on-the-ground, staked plat of survey and metes-and-bounds description of the Real Property, prepared by Surveyor or another surveyor satisfactory to [Title Company/Escrow Agent], dated after the Effective Date, and certified to Seller, Buyer, [Title Company/Escrow Agent], and any other person specified by Buyer, to comply with the current standards and specifications as published by the Texas Society of Professional Surveyors for the Survey Category.

Continue with the following.

F.5. UCC Search. “UCC Search” means written reports stating the instruments that are on file in the Texas secretary of state’s UCC records, the UCC records of any other appropriate state, and the UCC records in the jurisdiction in which the Seller is organized, showing as debtor Seller and all other owners of the Real Property and Groundwater [**include if applicable:** and fixtures and personal property] during the five years before the Effective Date of this contract.

F.6. Delivery of [Title Commitment/Title Information], [Survey,] UCC Search, and Title Documents. Seller must deliver the [Title Commitment/Title Information] to Buyer and Buyer’s attorney by the deadline stated in paragraph A.2. above; the Survey, if required, by the deadline stated in paragraph A.3., the UCC Search by the deadline stated in paragraph

A.4., and legible copies of the Title Documents by the deadline stated in paragraph A.5.

F.7. Title Objections. Buyer has until the deadline stated in paragraph A.6. above (“Title Objection Deadline”) to review the Survey, [Title Commitment/Title Information], UCC Search, and legible copies of the Title Documents, notify Seller of Buyer’s objections to any of them, and request any additional information needed to evidence Seller’s title to the Real Property and the Groundwater (“Title Objections”). Buyer will be deemed to have approved all matters reflected by the Survey, [Title Commitment/Title Information], Title Documents, and UCC Search to which Buyer has made no Title Objection by the Title Objection Deadline. The matters that Buyer either approves or is deemed to have approved are “Permitted Exceptions.” If Buyer notifies Seller of any Title Objections, Seller has five days from receipt of Buyer’s notice to notify Buyer whether Seller agrees to cure the Title Objections before Closing (“Cure Notice”). If Seller does not timely give its Cure Notice or timely gives its Cure Notice but does not agree to cure all the Title Objections before Closing, Buyer may, within five days after the deadline for the giving of Seller’s Cure Notice, notify Seller that either this contract is terminated or Buyer will proceed to close, subject to Seller’s obligations to resolve the items [listed in Schedule C of the Title Commitment/listed in the Title Information], remove all liquidated liens, remove all exceptions that arise by, through, or under Seller after the Effective Date, and cure only the Title Objections that Seller has agreed to cure in the Cure Notice. At or before Closing, Seller must resolve the items that are [listed in Schedule C of the Title Commitment/listed in the Title Information], remove all liquidated liens, remove all exceptions that arise by, through, or under Seller after the Effective Date of this contract, and cure the Title Objections that Seller has agreed to cure.

G. Inspection Period

G.1. Review of Seller’s Records. Seller, at Seller’s expense, will deliver to Buyer copies of Seller’s Records specified in Exhibit C, or otherwise make those records available for Buyer’s review, by the deadline stated in paragraph A.7. above.

G.2. Entry onto Real Property. Buyer may enter the Real Property before Closing to perform all investigations Buyer deems appropriate, at Buyer's cost, including exploration for, drilling for, and testing of Groundwater, subject to the following conditions.

G.2.a. Buyer must deliver evidence to Seller that Buyer has liability insurance for its proposed inspection activities, with coverages and in amounts that are substantially the same as those maintained by Seller or with such lesser coverages and in such lesser amounts as are reasonably satisfactory to Seller.

G.2.b. Buyer may not interfere in any material manner with existing operations or occupants of the Real Property.

G.2.c. Buyer must notify Seller in advance of Buyer's plans to conduct tests so that Seller may be present during the tests.

G.2.d. If the Real Property is physically altered because of Buyer's inspections, Buyer must return the Real Property to its preinspection condition promptly after the alteration occurs.

G.2.e. Buyer must deliver to Seller copies of all inspection reports that Buyer prepares or receives from third-party consultants or contractors within three days after their preparation or receipt.

G.2.f. Buyer must abide by any other reasonable entry rules imposed by Seller.

G.3. Hydrogeological Testing. Buyer has the right to perform investigations to estimate the quality, quantity, and sustainability of the Groundwater.

Include the following if the purchase price will be determined based on hydrogeological testing.
--

The parties agree that the Purchase Price is to be determined based on [specify basis for pricing the groundwater rights, such as average saturated foot of groundwater or some other calculation related to the estimated quality, quantity, or sustainability of the groundwater available for production]. Buyer will perform investigations during the Inspection Period, at [Buyer's/Seller's/both parties'] expense, to estimate the quality, quantity, and sustainability of the Groundwater. Buyer and Seller will select a mutually acceptable independent hydrogeologist ("Hydrogeologist") to perform the evaluation of the Groundwater. If Seller and Buyer are not able to choose a hydrogeologist within twenty days after the Effective Date, each will select a hydrogeologist, and the two hydrogeologists selected will choose a third hydrogeologist to perform the evaluation. The investigations will include such test drilling, logging, and data analysis on the Real Property [include if applicable: and on property within the region of the Real Property] as Hydrogeologist deems appropriate. If [Seller/Buyer] desires more test wells than Hydrogeologist determines is necessary, [Seller/Buyer] may cause additional test wells to be drilled and logged at [Seller/Buyer]'s expense. The data from Buyer's investigations, Seller's logs, if applicable, and Seller's Records will be submitted to Hydrogeologist. The parties agree to be bound by the determination of Hydrogeologist.

G.4. Appraisal of Groundwater. Buyer has the right to have an appraisal performed of the Groundwater Rights, Seller's Permits (if any), and the Real Property. The cost of the appraisal [will be paid at Closing by [Buyer/Seller]/will be shared at Closing by Buyer and Seller].

G.5. Adequacy of Seller's Permit. If a Seller's Permit has been issued, Buyer will have the right to determine whether Seller's Permit, on transfer to Buyer, will be adequate for Buyer's intended use of the Groundwater, whether an alternative permit or permit amendment will be required, and the requirements of the Groundwater Authority for the transfer of Seller's Permit. Seller will cooperate with Buyer at all times in obtaining any information and forms required from the Groundwater Authority. On Buyer's request, Seller, at [Seller's/

Buyer's] expense, will execute and transmit to the Groundwater Authority all necessary applications, forms, and documentation required for the transfer of Seller's Permit to Buyer, provided that the transfer will not be effective until Closing. Seller will not take any action before or after Closing to oppose the transfer of Seller's Permit to Buyer, the issuance of an amendment to Seller's Permit, or other permitting sought by Buyer to enable Buyer to use the Groundwater for Buyer's Intended Use of the Groundwater.

Include the following if buyer's obligation to purchase is contingent on permitting.

Buyer's obligation to purchase the Groundwater Rights is contingent on the Groundwater Authority approving, before the expiration of the Inspection Period, the Required Permitting (as defined below) contingent on Closing or, in the sole discretion of Buyer, providing sufficient assurance that the Groundwater Authority will issue the Required Permitting after Closing. Required Permitting means [issuance of a production permit authorizing **[specify]**/transfer of Seller's Permit/transfer of Seller's Permit and amendment of the Permit to authorize **[specify]**]. Buyer will initiate action to obtain the Required Permitting promptly after the Effective Date and diligently pursue obtaining the Required Permitting during the Inspection Period. **[Include if applicable:** If Buyer has been unable to obtain approval of the Required Permitting, or assurance satisfactory to Buyer of obtaining the Required Permitting after Closing, despite Buyer's diligence, Buyer will have the right to extend the Inspection Period solely for the purpose of obtaining the Required Permitting for a period not to exceed **[number]** days, by giving Seller written notice of the extension before the termination of the Inspection Period. Buyer's right to terminate this contract before the end of the extension period is limited to the failure to obtain, or to obtain satisfactory assurance of, the Required Permitting.]

G.6. Environmental Assessment. Buyer has the right to conduct environmental assessments of the Real Property and Groundwater. Seller will provide, or will designate a person with knowledge of the use and condition of the Real Property and Groundwater to pro-

vide, information requested by Buyer or Buyer's agent or representative regarding the use and condition of the Real Property and Groundwater during the period of Seller's ownership of the Property. Seller will cooperate with Buyer in obtaining and providing to Buyer, its agent, or representative information regarding the Real Property and Groundwater.

G.7. Buyer's Right to Terminate. Buyer may terminate this contract for any reason by notifying Seller before the end of the Inspection Period.

G.8. Buyer's Indemnity and Release of Seller

G.8.a. Indemnity. Buyer will indemnify, defend, and hold Seller harmless from any loss, attorney's fees, expenses, or claims arising out of Buyer's investigation, except those arising out of the acts or omissions of Seller and those for repair or remediation of existing conditions discovered by Buyer's inspection. The obligations of Buyer under this provision will survive termination of this contract and Closing.

G.8.b. Release. Buyer releases Seller and those persons acting on Seller's behalf from all claims and causes of action (including claims for attorney's fees and court and other costs) resulting from Buyer's investigation of the Groundwater and Real Property.

H. Representations and Warranties

The parties' representations stated in Exhibit B are true and correct as of the Effective Date and must be true and correct on the Closing Date. Seller will promptly notify Buyer if Seller becomes aware that any of the representations are not true and correct.

I. Condition of the Property until Closing; Cooperation; No Recording of Contract

I.1. Maintenance and Operation. Until Closing, Seller will (a) maintain the Real Property [**include if applicable:** , the personal property and fixtures,] and the Groundwater Rights as they existed on the Effective Date [**include if applicable:** , except for reasonable wear

and tear and casualty damage]; (b) use the Real Property and the Groundwater Rights in the same manner as they were used on the Effective Date; [and] (c) comply with all permits, contracts, laws, and regulations affecting the Real Property and the Groundwater Rights [**include if applicable:** , and (d) not transfer or dispose of any of the personal property and fixtures, except to sell inventory, replace equipment, and use supplies in the normal course of operating the personal property and fixtures]. [**Include if applicable:** Until the end of the Inspection Period, Seller will not enter into, amend, or terminate any contract that affects the personal property and fixtures other than in the ordinary course of operating such property and will promptly give notice to Buyer of each new, amended, or terminated contract, including a copy of the contract, in sufficient time so that Buyer may consider the new information before the end of the Inspection Period. If Seller's notice is given within three days before the end of the Inspection Period, the Inspection Period will be extended for three days.] Until the end of the Inspection Period, Seller will not (a) grant or convey any easement, lease, license, option, or other right affecting the Real Property or the Groundwater Rights, including the right to use the Groundwater; (b) enter into any lease or agreement that allows the surface of the Real Property to be mined or excavated; or (c) enter into any oil and gas lease [**include if applicable:** or surface use agreement or subsurface use agreement that does not comply with paragraph I.2. below]. After the end of the Inspection Period, Seller may not enter into, amend, or terminate any contract that affects the Groundwater, the Groundwater Rights, or the Real Property without first obtaining Buyer's written consent.

I.2. Oil and Gas Leases. Before and after Closing, Seller will not enter into any oil and gas lease [affecting the Real Property/or surface use agreement that allows (a) flooding of the Real Property, (b) injection into or disposal of saltwater or other substance onto the Real Property, or (c) use of Groundwater for any purpose other than drilling, completion, recompletion, reworking, remediation, and revegetation]. This provision will survive Closing and will be set forth in one or more of the Closing Documents.

1.3. Condemnation. Seller will notify Buyer promptly after Seller receives notice that any part of the Real Property or Groundwater Rights has been or is threatened to be condemned or otherwise taken by a governmental or quasi-governmental authority. Buyer may terminate this contract if the condemnation would materially affect Buyer's intended use of the Groundwater Rights by giving notice to Seller within fifteen days after receipt of Seller's notice to Buyer (or before Closing if Seller's notice is received less than fifteen days before Closing). The condemnation will be deemed to materially affect Buyer's intended use of the Groundwater Rights if [**specify reason, e.g.**, the condemnation would result in Buyer's not being able to produce more than [**number**] acre-feet of Groundwater]. If Buyer does not terminate this contract, (a) Buyer and Seller will each have the right to appear and defend their respective interests in the Groundwater Rights in the condemnation proceedings; (b) any award in condemnation will be assigned to Buyer to the extent necessary to compensate Buyer for the loss of or reduction in the Groundwater Rights; and (c) if the taking occurs before Closing, the description of the Real Property or Groundwater Rights will be revised to delete the portion taken.

1.4. Claims; Hearings. Seller will notify Buyer promptly after Seller receives notice of any claim or administrative hearing that is threatened, filed, or initiated before Closing that affects the Groundwater Rights.

1.5. Cooperation. Seller will cooperate with Buyer (a) before and after Closing to transfer the applications, permits, and licenses held by Seller and used in the production of the Groundwater and to obtain any consents necessary for Buyer to withdraw or produce the Groundwater; (b) before closing, with any reasonable evaluation, inspection, or study of the Real Property or the Groundwater; and (c) in all other matters related to, or arising out of or in connection with, this contract. These provisions will survive Closing.

1.6. Casualty or Other Loss or Damage. Until Closing has been completed and funded, Seller will bear the risk of any damage, casualty, or other loss to the Real Property or

Groundwater Rights [**include if applicable:** and the personal property and fixtures]. If any damage, casualty, or other loss results in a material adverse change in the quality, quantity, or usability of the Groundwater, Buyer will have the right to terminate this contract. [**Include if applicable:** If personal property or fixtures are damaged by casualty, the portion of the purchase price attributable to the personal property and fixtures will be equitably reduced.]

I.7. Memorandum of Contract; Termination of Contract; No Recording of Contract. At the request of Buyer, Seller will execute a memorandum of this contract, in a mutually acceptable form, to be recorded in the real property records of [county] County, Texas. At the time the memorandum is signed, Buyer and Seller will also sign a termination of contract in recordable form and deposit it into escrow with [Title Company/Escrow Agent]. The parties authorize [Title Company/Escrow Agent] to record the termination of contract as provided in section J. below. Neither Buyer nor Seller may file this contract in the real property records of any county. If either party records this contract, the other party may terminate this contract and record a notice of termination.

J. Termination

J.1. Disposition of Earnest Money after Termination

J.1.a. To Buyer. If Buyer terminates this contract in accordance with any of Buyer's rights to terminate, then unless Seller delivers notice of Seller's objection to [Title Company/Escrow Agent]'s release of the Earnest Money to Buyer within five days after Buyer delivers Buyer's termination notice to Seller and [Title Company/Escrow Agent], [Title Company/Escrow Agent] is authorized, without any further authorization from Seller, to deliver the Earnest Money to Buyer, less \$100, which will be paid to Seller as consideration for the right granted by Seller to Buyer to terminate this contract. [Title Company/Escrow Agent] will record the termination of contract and return the Earnest Money to Buyer on receipt of Seller's authorization.

J.1.b. To Seller. If Seller terminates this contract in accordance with any of Seller's rights to terminate, then unless Buyer delivers notice of Buyer's objection to [Title Company/Escrow Agent]'s release of the Earnest Money to Seller within five days after Seller delivers Seller's termination notice to Buyer and [Title Company/Escrow Agent], [Title Company/Escrow Agent] is authorized, without any further authorization from Buyer, to pay and deliver the Earnest Money to Seller and to record the termination of contract. [Title Company/Escrow Agent] will record the termination of contract and pay the Earnest Money to Seller on receipt of Buyer's authorization.

J.2. Duties after Termination. If this contract is terminated, Buyer will promptly return to Seller all of Seller's Records in Buyer's possession or control. After return of the documents and copies, neither party will have further duties or obligations to the other under this contract, except for those obligations that cannot be or were not performed before termination of this contract or that expressly survive termination of this contract.

K. Closing

K.1. Closing. This transaction will close at [Title Company/Escrow Agent]'s offices at the Closing Date and Closing Time. At Closing, the following will occur:

K.1.a. Closing Documents. The parties will execute and deliver the Closing Documents.

K.1.b. Payment of Purchase Price. Buyer will deliver the Purchase Price and other amounts that Buyer is obligated to pay under this contract to [Title Company/Escrow Agent] in funds acceptable to [Title Company/Escrow Agent]. The Earnest Money will be applied to the Purchase Price.

K.1.c. Disbursement of Funds; Recording; Copies. [Title Company/Escrow Agent] will be instructed to disburse the Purchase Price and other funds in accordance with this con-

tract, record the deed and the other Closing Documents directed to be recorded, and distribute documents and copies in accordance with the parties' written instructions.

K.1.d. Delivery of Originals. Seller will deliver to Buyer the originals of Seller's Records.

K.1.e. Possession. Seller will deliver possession of the Groundwater Rights to Buyer, subject to the Permitted Exceptions existing at Closing and any liens and security interests created at Closing to secure financing for the Purchase Price.

K.2. Transaction Costs

K.2.a. Seller's Costs. Seller will pay [the basic charge for the Title Policy/the cost of providing the Title Information as specified in this contract, if not previously paid by Seller]; one-half of the escrow fee charged by [Title Company/Escrow Agent]; the costs to prepare the Groundwater Rights Warranty Deed and the Easement Agreement and addenda, if required by this contract; the costs to obtain, deliver, and record any releases of liens, lender's consent, and subordination to Buyer's easement rights required in connection with the sale; the costs to cure and record the documents to cure Title Objections agreed or required to be cured by Seller and to resolve matters shown in Schedule C of the Title Commitment; **[include if applicable: Title Company's inspection fee to delete from the Title Policy the customary exception for rights of parties in possession;]** the costs to obtain the [Survey,] UCC Search[,] and certificates or reports of ad valorem taxes; the costs to deliver copies of the instruments described in paragraph A.5. above and Seller's Records; any other costs expressly required to be paid by Seller in this contract; and Seller's attorney's fees and expenses.

K.2.b. Buyer's Costs. Buyer will pay one-half of the escrow fee charged by [Title Company/Escrow Agent]; the costs to obtain, deliver, and record all documents other than those to be obtained or recorded at Seller's expense; **[include if applicable: the additional premium for the "survey/area and boundary deletion" in the Title Policy, if the deletion is**

requested by Buyer, as well as the cost of any other endorsements or modifications of the Title Policy requested by Buyer;] [include if applicable: the costs of work required by Buyer to have the Survey reflect matters other than those required under this contract except changes required for curative purposes;] the costs to obtain financing of the Purchase Price, including the incremental premium costs of the loan title policy and endorsements and deletions required by Buyer's lender; any other costs expressly required to be paid by Buyer in this contract; and Buyer's attorney's fees and expenses.

K.2.c. Taxes, Fees, and Assessments. At Closing, Seller will pay any ad valorem taxes and assessments, including penalties and interest (collectively, "Taxes"), in connection with the Real Property and the Groundwater that are owing for prior calendar years. Seller will pay all Taxes in connection with the Real Property and Groundwater for the current calendar year, if payable at the time of Closing. After Closing, Seller will continue to pay all Taxes due in connection with the Real Property (including the Reserved Groundwater) before delinquency, except that if ad valorem taxes are assessed separately against Buyer's Groundwater Rights after Closing, Buyer will be responsible for paying such taxes and assessments if Buyer is obligated to pay such taxes under applicable law. After Closing, each party will have the right to protest taxes that the party is responsible for paying, provided that the protesting party does not allow the taxes to become delinquent. If the Real Property has been, or is at any time after Closing, the subject of special valuation and reduced tax assessments pursuant to the provisions of chapter 23, subchapter D, of the Texas Tax Code or under any other provision of law, and additional taxes, penalties, or interest are assessed pursuant to Code section 23.55 or under such other provision of law, Seller will be responsible for the payment of any such taxes, penalties, and interest, including rollback taxes. If Seller fails to pay Taxes for which Seller is responsible when due, Seller authorizes Buyer to pay Taxes and on such payment to (i) be subrogated to all liens held by the taxing authority against the Real Property as security for the Taxes paid, (ii) have the right to set off amounts paid against amounts owed to Seller, if any, under the terms of the Closing Documents, and (iii) seek reimbursement of

amounts paid in accordance with applicable law. Buyer will have the right, but not the obligation, to pay the Taxes. If Buyer pays the Taxes, at Buyer's request Seller will promptly take the action required by section 32.06 of the Texas Tax Code to authorize a transfer of the tax lien to Buyer.

After Closing, Buyer will be responsible for paying all fees, assessments, taxes, and charges of any kind imposed by the Groundwater Authority, or any successor authority, in connection with Buyer's use, development, pumping, or transportation of the Groundwater. Buyer will timely pay any taxes assessed by any taxing authority against any equipment or personal property of Buyer located on the Real Property and any fees or costs charged by any Groundwater Conservation District or other regulatory body for Buyer's development, pumping, transportation, or use of the Groundwater.

These provisions will survive Closing and will be set out in one or more of the Closing Documents.

K.2.d. Proration of Expenses and Income. Except as provided in paragraph K.2.c. above, all items of expense or income arising in connection with the use or operation of the Groundwater will be prorated as of the Closing Date. Seller will pay all bills and expenses that could give rise to a lien against the Real Property or Groundwater at or before Closing.

K.2.e. Brokers' Commissions. Buyer and Seller each indemnify and agree to defend and hold the other party harmless from any loss, attorney's fees, and court and other costs arising out of a claim by any person or entity claiming by, through, or under the indemnitor for a broker's or finder's fee or commission because of this transaction or this contract, whether the claimant is disclosed to the indemnitee or not. At Closing, each party will provide the other party with a release of broker's or appraiser's liens from all brokers or appraisers for which each party was responsible.

K.3. Issuance of Title Policy. Seller will cause [Title Company/Escrow Agent] to issue the Title Policy, if required, to Buyer as soon as practicable after Closing.

L. Default and Remedies

L.1. Seller's Default; Remedies before Closing. If Seller fails to perform any of its obligations under this contract, or if any of Seller's representations are not true and correct as of the Effective Date or on the Closing Date or any of its warranties have been breached ("Seller's Default"), Buyer may elect either of the following as its sole and exclusive remedy before Closing:

L.1.a. Termination; Liquidated Damages. Buyer may terminate this contract by giving notice to Seller on or before the Closing Date and Closing Time and have the Earnest Money, less the \$100 as described above, returned to Buyer. If Seller's Default occurs after Buyer has incurred costs to investigate the Real Property or Groundwater after the Effective Date and Buyer terminates this contract in accordance with the previous sentence, Seller will also pay to Buyer as liquidated damages the lesser of Buyer's actual out-of-pocket expenses incurred to investigate the Real Property and Groundwater after the Effective Date ("Buyer's Expenses") or the amount of Buyer's Liquidated Damages, within ten days after Seller's receipt of an invoice from Buyer stating the amount of Buyer's Expenses accompanied by reasonable evidence of Buyer's Expenses.

L.1.b. Specific Performance. Unless Seller's Default relates to the untruth or incorrectness of Seller's representations for reasons not reasonably within Seller's control, Buyer may enforce specific performance of Seller's obligations under this contract, but any such action must be initiated, if at all, within ninety days after the breach or alleged breach of this contract. If title to the Groundwater Rights is awarded to Buyer, the conveyance will be subject to the matters stated in the [Title Commitment/Title Information].

L.2. Seller's Default; Remedies after Closing. If Seller's representations are not true and correct at Closing for reasons reasonably within Seller's control and Buyer does not become aware of the untruth or incorrectness until after Closing, Buyer will have all the rights and remedies available at law or in equity. If Seller fails to perform any of its obligations under this contract that survive Closing, Buyer will have all rights and remedies available at law or in equity unless otherwise provided by the Closing Documents.

L.3. Buyer's Default; Remedies before Closing. If Buyer fails to perform any of its obligations under this contract ("Buyer's Default"), Seller may terminate this contract by giving notice to Buyer on or before Closing and have the Earnest Money paid to Seller. If Buyer's Default occurs after Seller has incurred costs to perform its obligations under this contract and Seller terminates this contract in accordance with the previous sentence, Buyer will also reimburse Seller for the lesser of Seller's actual out-of-pocket expenses incurred after the Effective Date to perform its obligations under this contract ("Seller's Expenses") or the amount of Seller's Additional Liquidated Damages, within ten days after Buyer's receipt of an invoice from Seller stating the amount of Seller's Expenses accompanied by reasonable evidence of Seller's Expenses. The foregoing constitute Seller's sole and exclusive remedies for a default by Buyer before Closing.

L.4. Buyer's Default; Remedies after Closing. If Buyer fails to perform any of its obligations under this contract that survive Closing, Seller will have all rights and remedies available at law or in equity unless otherwise provided by the Closing Documents.

L.5. Liquidated Damages. The parties agree that just compensation for the harm that would be caused by a default by either party cannot be accurately estimated or would be very difficult to accurately estimate and that the Earnest Money and the amounts provided above are reasonable forecasts of just compensation to the nondefaulting party for the harm that would be caused by a default.

L.6. Attorney's Fees. If either party retains an attorney to enforce this contract, the party prevailing in litigation is entitled to recover reasonable attorney's fees and court and other costs.

M. Miscellaneous Provisions

M.1. Notices. Any notice required by or permitted under this contract must be in writing. Any notice required by this contract will be deemed to be given (whether received or not) the earlier of receipt or three business days after being deposited with the United States Postal Service, postage prepaid, certified mail, return receipt requested, and addressed to the intended recipient at the address shown in this contract. Notice may also be given by regular mail, personal delivery, courier delivery, or e-mail and will be effective when received, provided that (a) any notice received on a Saturday, Sunday, or national holiday will be deemed to have been received on the next day that is not a Saturday, Sunday, or national holiday; and (b) any notice received after 5:00 P.M. local time at the place of delivery on a day that is not a Saturday, Sunday, or national holiday will be deemed to have been received on the next day that is not a Saturday, Sunday, or national holiday. Any address for notice may be changed by not less than ten days' prior written notice given as provided herein. Copies of each notice must be given by one of these methods to the attorney of the party to whom notice is given.

M.2. Entire Agreement. This contract, its exhibits, and any Closing Documents delivered at Closing are the entire agreement of the parties concerning the sale and use of the Groundwater Rights and the use of the Reserved Groundwater and Real Property. There are no representations, warranties, agreements, or promises between the parties pertaining to the Groundwater Rights, Reserved Groundwater, Real Property, sale and use of the Groundwater Rights, or use of the Reserved Groundwater and Real Property, and neither party is relying on any statements or representations of any agent of the other party, that are not in those documents.

M.3. Amendment. This contract may be amended only by an instrument in writing signed by the parties.

Select one of the following.

M.4. Prohibition of Assignment. Buyer may not assign this contract or any of Buyer's rights under it without Seller's prior written consent, and any attempted assignment is void.

Or

M.4. Assignment. Buyer may assign this contract and Buyer's rights under it only to an entity in which Buyer possesses, directly or indirectly, the power to direct or cause the direction of its management and policies, whether through the ownership of voting securities or otherwise, and any other assignment is void.

Continue with the following.

M.5. Survival. The provisions of this contract that expressly survive termination or Closing and other obligations of this contract that cannot be performed before termination of this contract or before Closing survive termination of this contract or Closing, and the legal doctrine of merger does not apply to these matters. If there is any conflict between the Closing Documents and this contract, the Closing Documents control.

M.6. Choice of Law; Venue. This contract is to be construed under the laws of the state of Texas, without regard to choice-of-law rules of any jurisdiction. Venue is in the county in which all, or the majority, of the Real Property is located.

M.7. Waiver of Default. It is not a waiver of default if the nondefaulting party fails to declare a default immediately or delays taking any action with respect to the default.

M.8. No Third-Party Beneficiaries. There are no third-party beneficiaries of this contract.

M.9. Severability. If a provision of this contract is unenforceable for any reason, to the extent the unenforceability does not destroy the basis of the bargain among the parties, the unenforceability does not affect any other provision of this contract, and this contract is to be construed as if the unenforceable provision is not a part of the contract.

M.10. Ambiguities Not to Be Construed against Party Who Drafted Contract. The rule of construction that ambiguities in a document will be construed against the party who drafted it will not be applied in interpreting this contract.

M.11. No Special Relationship. The parties' relationship is an ordinary commercial relationship, and the parties do not intend to create the relationship of principal and agent, partners, joint venturers, or any other special relationship.

M.12. Counterparts. If this contract is executed in multiple counterparts, all counterparts taken together constitute this contract. Copies of signatures to this contract are effective as original signatures.

M.13. Confidentiality. The parties will keep confidential this contract, this transaction, and all information learned in the course of this transaction, except to the extent disclosure is required by law or court order, to enable third parties to advise or assist Buyer to investigate the Groundwater Rights and the Real Property, or by either party to close this transaction. Remedies for violations of this provision are limited to injunctions, and no damages or rescission may be sought or recovered as a result of any such violations.

M.14. Binding Effect. This contract binds, benefits, and may be enforced by the parties and their respective heirs, successors, and permitted assigns.

Include the following only if the buyer has agreed to waive its rights under the DTPA.

M.15. *Waiver of Consumer Rights.* BUYER WAIVES ITS RIGHTS UNDER THE TEXAS DECEPTIVE TRADE PRACTICES–CONSUMER PROTECTION ACT, SECTION 17.41 *ET SEQ.* OF THE TEXAS BUSINESS AND COMMERCE CODE, A LAW THAT GIVES CONSUMERS SPECIAL RIGHTS AND PROTECTIONS. AFTER CONSULTATION WITH AN ATTORNEY OF ITS OWN SELECTION, BUYER VOLUNTARILY CONSENTS TO THIS WAIVER.

Continue with the following.

[Name and title of seller]

Date:

[Name and title of buyer]

Date:

[Title Company/Escrow Agent] acknowledges receipt of Earnest Money in the amount of \$_____ and a copy of this contract executed by both Buyer and Seller.

[Name of title company/escrow agent]

By _____

Name:

Title:

Date:

Exhibit A

Description of the Real Property [and Fixtures and Personal Property]

Include legal description of the land.

Include the following if applicable.

The following described fixtures and personal property: [**describe fixtures and property**].

Exhibit B**Seller's Representations and Warranties****A. Seller's Representations to Buyer**

Seller represents and warrants to Buyer that the following are true and correct as of the Effective Date and will be true and correct as of the Closing Date:

If the seller is an individual or is acting in a representative capacity, some of the items should be modified.

A.1. Authority. Seller is a **[specify type of organization]** duly organized, validly existing, and in good standing under the laws of the state of [Texas/**[state]**] with authority to perform its obligations under this contract. This contract is binding on Seller. This contract is, and all documents required by this contract to be executed and delivered to Buyer at Closing will be, duly authorized, executed, and delivered by Seller.

A.2. Litigation. Seller has not received written notice and has no actual knowledge of any litigation pending or threatened against Seller that might affect the Groundwater Rights, the Real Property, **[include if applicable: the fixtures and personal property,]** or Seller's ability to perform its obligations under this contract **[include if applicable: , except [specify]]**.

A.3. Violation of Laws. Seller has not received written notice of violation of any law, ordinance, regulation, or requirements affecting the Real Property, the Groundwater, **[include if applicable: the fixtures and personal property,]** or Seller's use of the Real Property **[/or]** Groundwater **[include if applicable: , or fixtures and personal property]** **[include if applicable: , except [specify]]**.

A.4. Licenses, Permits, and Approvals. Seller has not received written notice that any license, permit, or approval necessary to use the Real Property **[/or]** the Groundwater

[**include if applicable:** , or the fixtures and personal property] in the manner in which it is currently used has expired or will not be renewed on expiration or that any material condition will be imposed in order to use such permit or license or obtain its renewal [**include if applicable:** , except [**specify**]].

A.5. Condemnation; Zoning; Land Use; Hazardous Materials. Seller has not received written notice of any condemnation, zoning, or land-use proceedings affecting the Real Property [./or] the Groundwater [**include if applicable:** , or the fixtures and personal property] or any written inquiries or notices by any governmental authority or third party with respect to condemnation or the presence of hazardous materials affecting the Real Property [./or] the Groundwater [**include if applicable:** , or the fixtures and personal property] [**include if applicable:** , except [**specify**]].

A.6. No Other Obligation to Sell or Restriction against Sale. Seller has not obligated itself to sell all or any portion of the Real Property [./or] the Groundwater [**include if applicable:** , or the fixtures and personal property] to any person other than Buyer. Seller's performance of this contract will not cause a breach of any other agreement or obligation to which Seller is a party or to which it is bound [**include if applicable:** , except [**specify**]].

A.7. No Liens. On the Closing Date, the Groundwater Rights [**include if applicable:** and the fixtures and personal property] to be conveyed under the contract will be free and clear of all liens and encumbrances of any nature not arising by, through, or under Buyer except the Permitted Exceptions or liens to which Buyer has given its consent in writing. If an Easement Agreement is executed at Closing, any lien on the surface estate permitted by Buyer will be subordinated to Buyer's easement rights.

A.8. No Rights of Possession or Use. There are no persons presently in possession of the Real Property [./or] the Groundwater [**include if applicable:** , or the fixtures and personal property] or having any rights to possession of the Real Property [./or] the Groundwater

[include if applicable: , or the fixtures and personal property] or rights, either present or future, to explore for, use, produce, or withdraw the Groundwater other than Seller [include if applicable: , except [specify]].

A.9. *Good Title.* Seller has good and indefeasible fee simple title to the Real Property and the Groundwater [include if applicable: , and to the fixtures and personal property,] free and clear of all mortgages, liens, licenses, encumbrances, leases, tenancies, security interests, covenants, conditions, restrictions, rights-of-way, easements, judgments, and other matters affecting title [include if applicable: , except [specify]].

A.10. *No Bills or Claims.* There will be no unpaid bills or claims in connection with any repair or work performed or material furnished to the Real Property [include if applicable: and the fixtures and personal property] or otherwise relating to the Groundwater for the benefit of Seller as of the Closing Date, and all bills attributable to or affecting the Groundwater or the Real Property [include if applicable: and the fixtures and personal property] will be paid by Seller in full before Closing.

A.11. *No Adverse Matters.* To the best of Seller's knowledge, there is no (a) change contemplated in any applicable laws, ordinances, or restrictions, including the rules of the Groundwater Authority; (b) judicial or administrative action threatened or pending against the Real Property, the Groundwater, [include if applicable: the fixtures and personal property,] or Seller; (c) action by adjacent landowners pending or threatened against the Real Property, the Groundwater, [include if applicable: the fixtures and personal property,] or Seller; or (d) natural or artificial condition on the Real Property [./or] the Groundwater [include if applicable: , or relating to the fixtures and personal property] that would have a material adverse effect on the Real Property [./or] the Groundwater [include if applicable: , or the fixtures and personal property].

A.12. Compliance with Laws. Seller has at all times complied with and operated in compliance with all applicable federal, state, and local laws, regulations, and ordinances regarding the Real Property [,/and] the Groundwater [**include if applicable:** , and the fixtures and personal property,] including rules of the Groundwater Authority. Seller will promptly notify Buyer of any noncompliance notice received by Seller.

A.13. No Environmental Contamination. Seller has not caused any environmental contamination of the Real Property or the Groundwater and has no knowledge of the existence of any environmental contamination of the Real Property or the Groundwater.

A.14. No Hazardous Substances. No Hazardous Substances are located on the Real Property or in the Groundwater or have been released into the environment or deposited, discharged, placed, or disposed of at, on, under, or near the Real Property or the Groundwater or transported to or from the Real Property [**include if applicable:** , except for aboveground fuel storage tanks and other substances used by Seller in its routine operation of the Real Property, all of which are used and stored on the Real Property in compliance with all applicable laws, rules, and regulations]. To Seller's knowledge, no portion of the Real Property is being used or has been used at any previous time for the generation, storage, handling, or disposal of any Hazardous Substances at, on, under, or in the Real Property or Groundwater, or any portion thereof, nor is there any actual or threatened investigation, inquiry, proceeding, litigation, or claim of any kind by any person or governmental authority relating to such matters. "Hazardous Substances" means, but is not limited to, any substance that is or contains (a) any "hazardous substance" as now defined in section 101(14) of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA), as amended (42 U.S.C. § 9601 *et seq.*), or regulations promulgated under CERCLA; (b) any "hazardous waste" as now defined in the Resource Conservation and Recovery Act (RCRA) (42 U.S.C. § 6901 *et seq.*) or regulations promulgated under RCRA; (c) any substance regulated by the Toxic Substances Control Act (15 U.S.C. § 2601 *et seq.*); (d) gasoline, diesel fuel, or other petroleum

hydrocarbons; (e) asbestos and asbestos-containing materials in any form, whether friable or nonfriable; (f) polychlorinated biphenyls; (g) radon gas; and (h) any additional substances or materials (whether solid, liquid, or gas) that are classified, defined, or listed as pollutants, hazardous wastes, hazardous substances, hazardous materials, extremely hazardous wastes, regulated substances, toxic substances, or words of similar meaning or regulatory effect under the foregoing statutes or any other present federal, state, or local laws, statutes, ordinances, rules, regulations, and the like or the common law or any other applicable laws relating to the Real Property. "Hazardous Substances" includes, without limitation, any substance the presence of which on the Real Property (a) requires reporting, investigation, or remediation under the statutes cited above or (b) causes or threatens to cause a nuisance on any portion of the Real Property or adjacent property or poses or threatens to pose a hazard to the environment or the health or safety of persons on any portion of the Real Property or adjacent property.

A.15. No Underground Storage Tanks. To the best of Seller's knowledge and belief, no underground storage tanks are located on the Real Property or were previously located on the Real Property and subsequently removed and filled [**include if applicable:** , except [**specify**]].

A.16. Oil, Gas, and Minerals. To the best of Seller's knowledge, Seller owns all the oil, gas, and other mineral rights beneath the surface of the Real Property [**include if applicable:** , except [**specify**]].

Include the following if applicable.

A.17. No Other Representations or Warranties. Except as stated above [**include if applicable:** or in the notices, statements, and certificates set forth in Exhibit D] or in the Closing Documents, Seller makes no representations or warranties with respect to the Real Property [,or] the Groundwater Rights [**include if applicable:** , or the fixtures and personal property].

Include the following if the conveyance is on an "as is" basis.

B. "As Is, Where Is"

THIS CONTRACT IS AN ARM'S-LENGTH AGREEMENT BETWEEN THE PARTIES. THE PURCHASE PRICE WAS BARGAINED ON THE BASIS OF AN "AS IS, WHERE IS" TRANSACTION AND REFLECTS THE AGREEMENT OF THE PARTIES THAT THERE ARE NO REPRESENTATIONS OR EXPRESS OR IMPLIED WARRANTIES, EXCEPT THOSE IN THIS CONTRACT AND THE CLOSING DOCUMENTS.

SELLER DISCLAIMS ALL WARRANTIES AND REPRESENTATIONS REGARDING THE QUANTITY, QUALITY, OR SUSTAINABILITY OF GROUNDWATER THAT CAN BE PRODUCED FROM THE REAL PROPERTY, OR THE AVAILABILITY NOW OR IN THE FUTURE OF PERMITTING NECESSARY FOR BUYER TO USE THE GROUNDWATER FOR ANY PURPOSE. SELLER FURTHER DISCLAIMS ALL WARRANTIES AND REPRESENTATIONS WITH RESPECT TO THE FITNESS OF THE GROUNDWATER RIGHTS AND GROUNDWATER FOR ANY PARTICULAR USE OR PURPOSE.

[**Include if applicable:** BUYER ACKNOWLEDGES THAT THE LOCAL GROUNDWATER DISTRICT'S RULES AND REGULATIONS OR PERMITTING DECISIONS MAY LIMIT THE VOLUME OF GROUNDWATER PRODUCED FROM THE REAL PROPERTY AND THE PURPOSE OR PLACE OF ITS USE, AS WELL AS THE LOCATION OF ANY WELL, ITS DEPTH, OR RATE OF PRODUCTION.]

BUYER IS NOT RELYING ON ANY REPRESENTATIONS, DISCLOSURES, OR EXPRESS OR IMPLIED WARRANTIES OTHER THAN THOSE EXPRESSLY CONTAINED IN THIS CONTRACT AND THE CLOSING DOCUMENTS. BUYER IS NOT RELYING ON ANY INFORMATION REGARDING THE GROUNDWATER OR THE REAL PROPERTY PROVIDED BY ANY PERSON, OTHER THAN BUYER'S OWN INSPECTION AND THE REPRESENTATIONS AND WARRANTIES CONTAINED IN THIS CONTRACT AND THE CLOSING DOCUMENTS.

The provisions of this section B. regarding the Real Property [,/and] the Groundwater Rights [**include if applicable:** , and the fixtures and personal property] [will/will not] be included in the deed [**include if applicable:** and bill of sale] with appropriate modification of terms as the context requires.

Include the following if the seller retains no liability for environmental matters after closing. Because of the joint use of the real property and groundwater after closing, the buyer's attorney may want to limit the release to environmental problems existing before closing.

C. Environmental Matters

AFTER CLOSING, BUYER RELEASES SELLER FROM LIABILITY FOR ENVIRONMENTAL PROBLEMS AFFECTING THE PROPERTY, INCLUDING LIABILITY (1) UNDER THE COMPREHENSIVE ENVIRONMENTAL RESPONSE, COMPENSATION, AND LIABILITY ACT (CERCLA), THE RESOURCE CONSERVATION AND RECOVERY ACT (RCRA), THE TEXAS SOLID WASTE DISPOSAL ACT, OR THE TEXAS WATER CODE; OR (2) ARISING AS THE RESULT OF THEORIES OF PRODUCTS LIABILITY AND STRICT LIABILITY, OR UNDER NEW LAWS OR CHANGES TO EXISTING LAWS ENACTED AFTER THE EFFECTIVE DATE THAT WOULD OTHERWISE IMPOSE ON SELLERS IN THIS TYPE OF TRANSACTION NEW LIABILITIES FOR ENVIRONMENTAL PROBLEMS AFFECTING THE PROPERTY [**include if applicable: THIS RELEASE APPLIES EVEN WHEN THE ENVIRONMENTAL PROBLEMS AFFECTING THE PROPERTY RESULT FROM SELLER'S OWN NEGLIGENCE OR THE NEGLIGENCE OF SELLER'S REPRESENTATIVE.**]

The provisions of this section C. regarding the Real Property and Groundwater will be included in the Groundwater Rights Warranty Deed [**include if applicable:** and bill of sale] with appropriate modification of terms as the context requires.

D. Buyer's Representations to Seller

Buyer represents to Seller that the following are true and correct as of the Effective Date and will be true and correct on the Closing Date:

If the buyer is an individual or is acting in a representative capacity, some of the items should be modified.

D.1. Authority. Buyer is a [**specify type of organization**] duly organized, validly existing, and in good standing under the laws of the state of [Texas/[**state**]] with authority to perform its obligations under this contract. This contract is binding on Buyer. This contract is, and all documents required by this contract to be executed and delivered to Seller at Closing will be, duly authorized, executed, and delivered by Buyer.

Include other representations from the buyer to the seller as needed.

Exhibit C**Seller's Records**

To the extent that Seller has possession or control of the following items pertaining to the Real Property or Groundwater [include if applicable: and the fixtures and personal property], Seller will deliver or make the items or complete, legible, and accurate copies of them available to Buyer by the deadline stated in paragraph A.7.

Select items as agreed by the parties.
--

Records and Reports

governmental licenses, certificates, permits, and approvals, specifically including

Seller's Permit

all environmental reports and other information regarding the environmental condition of the Real Property or Groundwater

current tax certificate showing taxes assessed and owed against the Real Property and any tax exemption, special use, or other valuation or exemption applicable to the Real Property

records of regulatory proceedings or violations regarding the Real Property or Groundwater

any survey of all or any portion of the Real Property

abstracts of title relating to the Real Property or Groundwater

other: [specify]

Groundwater

all documents related to the use or condition of Groundwater, including:

water well logs

drilling logs

hydrogeological information and reports

information on the location of existing water wells

information on plugged wells

soil reports

production records

other: [specify]

Leases, Licenses, Agreements, and Encumbrances

all leases, licenses, agreements, and encumbrances (including all amendments and exhibits) affecting title to or use of the Real Property [./or] Groundwater [**include if applicable:** , or the fixtures and personal property] that have not been recorded in the real property records of the county or counties in which the Real Property is located

Exhibit D

Notices, Statements, and Certificates

Certain notices must be contained in the contract and others must be provided as separate notices. Please refer to the statutory requirements for each notice.

The notices, statements, and certificates (arranged by their application to particular transactions) that are listed below are [include as applicable: included in the sales contract [and]/attached for delivery to Buyer], and Buyer acknowledges receipt of the notices, statements, and certificates by executing this contract:

Include one or more of the following paragraphs as applicable and modify section headers and paragraph numbers as appropriate.

A. Consumer Notices

Notice of Cancellation. Notice concerning the purchaser’s three-day right of rescission under a contract to purchase real property if (1) the seller or the seller’s agent solicits the sale at a place other than the seller’s place of business, (2) the purchaser submits the purchase contract to the seller or the seller’s agent at a place other than the seller’s place of business, and (3) the consideration payable under the purchase contract exceeds \$100; unless either (1) the purchaser is represented by a licensed attorney, (2) the transaction is negotiated by a licensed real estate broker, or (3) the transaction is negotiated at a place other than the purchaser’s residence by the person who owns the property, as described in chapter 601 of the Texas Business and Commerce Code.

If applicable, attach form 4-4 in this manual to the end of this exhibit D.

And/Or

B. Residential Transaction Notices

B.1. Seller's Disclosure of Property Condition. Seller's disclosure of the condition of residential property, described in section 5.008 of the Texas Property Code.

If applicable, attach the full text of Tex. Prop. Code § 5.008, with all relevant information filled in, to the end of this exhibit D.

And/Or

B.2. Notice of Membership in Property Owners Association. Notice concerning the sale of single-family residential property that is subject to membership in a property owners association, described in section 5.012 of the Texas Property Code.

If applicable, attach form 23-8 to the end of this exhibit D.

And/Or

B.3. Seller's Disclosure of Location of Conditions under Surface of Unimproved Real Property. Seller's disclosure of the location of pipelines under the surface of unimproved property to be used for residential purposes, described in section 5.013 of the Texas Property Code. A seller of unimproved property to be used for residential purposes shall provide the purchaser written notice disclosing the location of any transportation pipeline to the best of the seller's belief and knowledge as of the date the notice is completed and signed by the seller. If the information required to be disclosed is not known by the seller, the seller shall indicate that fact in the notice. A seller is not required to give this notice if (a) the seller is obligated under the terms of the contract to furnish a title insurance commitment to the buyer before closing and (b) the buyer is entitled to terminate the contract if the buyer's objections to title as permitted by the contract are not cured by the seller before closing.

No form is provided, because the sales contract portion of this form 16-1 satisfies the provisions for exemption from disclosure.

And/Or

B.4. Notice of Obligation to Pay Public Improvement District Assessment. Seller's disclosure that a single-family residential property is located within a public improvement district, described in section 5.014 of the Texas Property Code.

If applicable, attach form 4-5 to the end of this exhibit D.

And/Or

B.5. Residential Contracts for Deed. Notice regarding the sale of property used or to be used as the purchaser's residence if the contract does not provide for delivery of a deed from the seller to the purchaser within 180 days after the final execution of the contract.

See Tex. Prop. Code §§ 5.069–.074.

And/Or

B.6. Notice Regarding Insulation to Buyer of New Home. Notice concerning insulation to be installed in a new home, described in section 460.16 of title 16 of the Code of Federal Regulations.

If applicable, attach form 4-6 to the end of this exhibit D.

And/Or

B.7. Disclosure of Information on Lead-Based Paint and/or Lead-Based Paint Hazards. Lead-based paint warning statement, described in section 745.100 *et seq.* of title 40 of the Code of Federal Regulations.

If applicable, attach form 4-7 to the end of this exhibit D.

And/Or

B.8. Asbestos Disclosure Notice. Notice concerning asbestos, described in sections 1910.1001 and 1926.1101 of title 29 of the Code of Federal Regulations.

If applicable, attach form 4-8 to the end of this exhibit D.

And/Or

B.9. Notice Regarding Sale Subject to a Recorded Lien. Notice to the purchaser and each lienholder required under Texas Property Code section 5.016 that property being sold will be conveyed subject to a lien.

If applicable, attach form 4-9 to the end of this exhibit D.

And/Or

C. Condominium Transaction Notices

C.1. Acknowledgment of Receipt of Condominium Documents. Condominium declaration, bylaws, and association rules, described in section 82.156 of the Texas Property Code.

If applicable, attach form 24-8 to the end of this exhibit D.

And/Or

C.2. Condominium Resale Certificate. Resale certificate from the condominium owners association or waiver of resale certificate, described in section 82.157 of the Texas Property Code.

If applicable, attach condominium resale certificate promulgated by the Texas Real Estate Commission, available at <https://www.trec.texas.gov/pdf/contracts/32-4.pdf>, or form 24-7 (waiver of condominium resale certificate) to the end of this exhibit D.

And/Or

D. All Real Property Transaction Notices

D.1. Storage Tanks Disclosure Provider. Notice concerning underground storage tanks, described in section 334.9 of title 30 of the Texas Administrative Code.

If applicable, attach form 4-10 to the end of this exhibit D.

And/Or

D.2. Notice to Purchaser Regarding Restrictive Covenants. Notice of deed restrictions, described in section 212.155 of the Texas Local Government Code.

If applicable, attach form 4-11 to the end of this exhibit D.

And/Or

D.3. Notice to Purchaser Regarding Coastal Area Property. Notice regarding real property located adjacent to tidally influenced, submerged lands of Texas, described in section 33.135 of the Texas Natural Resources Code.

If applicable, attach form 4-12 to the end of this exhibit D.

And/Or

D.4. Notice to Purchaser of Property Seaward of Gulf Intracoastal Waterway. Notice concerning public easements to the public beach, described in section 61.025 of the Texas Natural Resources Code.

If applicable, attach form 4-13 to the end of this exhibit D.

And/Or

D.5. Notice Regarding Possible Liability for Additional Taxes. Notice of additional tax liability for vacant land that has been subject to a special tax appraisal method, described in section 5.010 of the Texas Property Code.

If applicable, attach form 4-14 to the end of this exhibit D.

And/Or

D.6. Notice Regarding Possible Annexation. Notice concerning the sale of property located outside the limits of a municipality that may now or later be included in the extra-territorial jurisdiction of a municipality and may now or later be subject to annexation by the municipality, described in section 5.011 of the Texas Property Code.

If applicable, attach form 4-15 to the end of this exhibit D.

And/Or

D.7. Notice for Unimproved Property in a Certificated Service Area of a Utility Service Provider. Notice for property in a certificated service area of a utility service provider, described in section 13.257 of the Texas Water Code.

If applicable, attach form 4-16 to the end of this exhibit D.

And/Or

D.8. Utility District Notice. Notice concerning the bonded indebtedness of, or rates to be charged by, a utility or other special district, described in section 49.452 of the Texas Water Code, with the form of notice to be used being dependent on whether the property (a) is located in whole or in part within the extraterritorial jurisdiction of one or more home-rule municipalities but is not located within the corporate boundaries of a municipality, (b) is located in whole or in part within the corporate boundaries of a municipality, or (c) is not located in whole or in part within the corporate boundaries of a municipality or the extraterritorial jurisdiction of one or more home-rule municipalities.

If applicable, attach form 4-17 to the end of this exhibit D.

And/Or

D.9. Notice to Purchaser of Property Located in Certain Annexed Water Districts. Notice required by section 54.016(h)(4)(A) of the Texas Water Code when property being sold is in a water or sanitary sewer district that entered a contract with a city with a population

of 1.18 million or less under which the city is permitted to set rates in the district after annexation that are different from rates charged other residents of the city.

If applicable, attach form 4-18 to the end of this exhibit D.

And/Or

D.10. Notice to Purchaser that Property Is Located within the Area of the Alignment of a Transportation Project. Notice required under Texas Local Government Code section 232.0033 that all or part of the subdivision in which the property being sold is located is within the area of the alignment of a transportation project as shown in the final environmental decision document that is applicable to a future transportation corridor identified in a contract between the Texas Department of Transportation and a county under Texas Transportation Code section 201.619.

If applicable, attach form 4-19 to the end of this exhibit D.

And/Or

D.11. Certificates of Mold Remediation. Notice pursuant to section 1958.154 of the Texas Occupations Code, titled "Certificate of Mold Remediation; Duty of Property Owner," requiring a property owner who sells property that has been issued a certificate of mold remediation pursuant to this section to deliver copies to the purchaser of each certificate of mold remediation issued for the property within the preceding five years.

And/Or

D.12. Notice of Water Level Fluctuations. Notice to purchasers of residential or commercial property adjoining an impoundment of water, including a reservoir or lake, constructed and maintained under Texas Water Code chapter 11, that has storage capacity of at

least 5,000 acre-feet at the impoundment's normal level, provided pursuant to Texas Property Code section 5.019.

If applicable, attach form 4-20 to the end of this exhibit D.

Exhibit E

Seller's Permits

Attach seller's permits issued by the groundwater authority.

Exhibit F

Seller's Leases and Contracts to Be Terminated

List seller's leases or other contracts affecting the groundwater rights or real property to be terminated before closing.

Exhibit G

Seller's Leases and Contracts to Survive Closing

List seller's leases or other contracts affecting the groundwater rights or real property that will survive closing.

Exhibit H

Groundwater Rights Warranty Deed

Attach groundwater rights warranty deed. See form 16-2 in this chapter.

Exhibit I

Seller Financing Addendum

A. Promissory Note. The promissory note (“Note”) will be payable by Buyer (“Maker”) to the order of Seller (“Payee”) at the place designated by Payee. The Note may be prepaid in whole or in part at any time without penalty, premium, or restriction of any kind. Any prepayments are to be applied to the payment of the installments of principal last maturing, and interest will immediately cease on the prepaid principal. The lien securing payment of the Note will be inferior to any lien securing any superior note described in the contract. The Note will be payable as follows:

Select one of the following.

In one payment due [number] days after the date of the Note with interest payable [at maturity/monthly/quarterly/annually].

Or

In [number] installments of \$[amount] each [including interest/plus interest] beginning [number] days after the date of the Note and continuing at [monthly/quarterly/annual] intervals thereafter until [date], when the entire balance of the Note will be due and payable.

Or

Interest only in [number] installments for the first [number] year[s] and thereafter in [number] installments of \$[amount] each [including interest/plus interest] beginning [number] days after the date of the Note and continuing at [monthly/quarterly/annual] intervals thereafter until [date], when the entire balance of the Note will be due and payable.

Or

Other: [specify].

Continue with the following.

B. Deed of Trust and Security Agreement. The deed of trust and security agreement (“Deed of Trust”) securing the Note will provide for the following:

Select one of the following.

B.1. Assumption without Consent. The Property may be sold, transferred, or conveyed without the consent of Payee, provided any subsequent buyer or transferee assumes in writing for the benefit of Payee the obligation to pay the Note and to perform the covenants and agreements in the Deed of Trust in accordance with the terms of those instruments. No such assumption will release Maker from any liabilities or obligations arising under the Note or Deed of Trust. Neither the creation of a subordinate lien nor a sale thereunder will be construed as a sale or conveyance of the Property.

Or

B.1. Assumption with Consent. The Property may be sold, transferred, or conveyed provided that (a) any subsequent buyer assumes in writing for the benefit of Payee the obligation to pay the Note and to perform the covenants and agreements in the Deed of Trust in accordance with the terms of those instruments and (b) Maker or the subsequent buyer obtains prior written consent to such a sale from Payee. Consent will be based on the subsequent buyer’s credit history, with no change in interest rate or terms, and may not be unreasonably withheld, conditioned, or delayed. No such assumption will release Maker from any liabilities or obligations arising under the Note or Deed of Trust. If all or any part of the Property is sold, conveyed, leased for a period longer than three years, leased with an option to purchase, otherwise sold (including by contract for deed), or otherwise transferred or conveyed without prior written consent of Payee, Payee may, at Payee’s sole option, declare the outstanding principal balance of the Note plus accrued interest immediately due and payable. Any deed under threat or order of condemnation, any conveyance solely between makers, and the passage of title by

reason of death of a maker or by operation of law will not be construed as a sale or conveyance of the Property. [Neither the creation of a subordinate lien nor a sale thereunder will be construed as a sale or conveyance of the Property./The creation of a subordinate lien without the consent of Payee will be construed as a sale or conveyance of the Property, but any subsequent sale under a subordinate lien to which Payee has consented will not be construed as a sale or conveyance of the Property.]

Or

B.1. Prohibition against Assumption. If all or any part of the Property is sold, transferred, or conveyed without the prior written consent of Payee, Payee may, at Payee's sole option, declare the outstanding principal balance of the Note plus accrued interest immediately due and payable. Payee has no obligation to consent to any such sale or conveyance of the Property, and Payee is entitled to condition any consent on a change in the interest rate that will thereafter apply to the Note and any other change in the terms of the Note or Deed of Trust that Payee in Payee's sole discretion deems appropriate. A lease for a period longer than three years, a lease with an option to purchase, or a contract for deed will be deemed to be a sale, transfer, or conveyance of the Property for purposes of this provision. Any deed under threat or order of condemnation, any conveyance solely between makers, and the passage of title by reason of death of a maker or by operation of law will not be construed as a sale or conveyance of the Property. The creation of a subordinate lien without the consent of Payee will be construed as a sale or conveyance of the Property, but any subsequent sale under a subordinate lien to which Payee has consented will not be construed as a sale or conveyance of the Property.

Select one of the following.

B.2. Without Escrow. Maker will furnish to Payee annually, before the taxes become delinquent, copies of tax receipts showing that all taxes on the Property have been

paid. Maker will furnish to Payee annually evidence of current paid-up insurance naming Payee as an insured.

Or

B.2. With Escrow. Maker will, in addition to the principal and interest installments, deposit with Payee a pro rata part of the estimated annual ad valorem taxes on the Property and a pro rata part of the estimated annual insurance premiums for the improvements on the Property. These tax and insurance deposits are only estimates and may be insufficient to pay total taxes and insurance premiums. Maker must pay any deficiency within thirty days after notice from Payee. Maker's failure to pay the deficiency will constitute a default under the Deed of Trust. If any superior lienholder on the Property is collecting escrow payments for taxes and insurance, this paragraph will be inoperative as long as payments are being made to the superior lienholder.

Continue with the following.

B.3. Cross-Default. Any act or occurrence that would constitute a default under the terms of any lien superior to the lien securing the Note will constitute a default under the Deed of Trust securing the Note.

C. Recourse Provisions. The Note and Deed of Trust are subject to the following provisions:

Select one of the following.

Full Recourse. Maker will have full recourse liability for repayment of the principal and interest of the Note and the performance of all covenants and agreements of Maker in the Deed of Trust.

Or

No Recourse. Maker will not have any recourse liability for repayment of the principal and interest of the Note or the performance of any covenants and agreements of Maker in the Deed of Trust. The sole remedy of Payee or other holder of the Note in the event of a default by Maker under the Note or Deed of Trust will be to foreclose the liens and security interests granted in the Deed of Trust, and Payee or other holder of the Note will not be entitled to any personal judgment against Maker.

Or

Partial Recourse. Except as set forth below, Maker will not have any recourse liability for repayment of the principal and interest of the Note or the performance of any covenants and agreements of Maker in the Deed of Trust. Except as set forth below, the sole remedy of Payee or other holder of the Note in the event of a default by Maker under the Note or Deed of Trust will be to foreclose the liens and security interests granted in the Deed of Trust, and Payee or other holder of the Note will not be entitled to any personal judgment against Maker. Maker will have full recourse liability for any loss or damage actually suffered or incurred by Payee or other holder of the Note by reason of—

1. taxes, assessments, and charges for labor, materials, or other amounts that if unpaid may create an encumbrance against the Property that accrue before foreclosure;
2. unpaid premiums for insurance required hereunder that accrue before foreclosure;
3. damage to the Property to the extent such damage would be otherwise covered by insurance required hereunder that was not maintained;
4. all rents, issues, profits, and income derived from the Property after a default occurs and not expended for debt service or operating expenses of the Property before foreclosure;

5. tenant security deposits for leases of the Property not forfeited by or refunded to the tenants;

6. any condemnation or insurance proceeds not paid or applied as required in the Deed of Trust;

7. damage to and depreciation of the Property beyond normal wear and tear caused by the negligence of Maker or the failure of Maker to keep the Property in good repair and condition;

8. the return of or reimbursement for personal property taken from the Property by or on behalf of Maker and not replaced with personal property of equal utility and value;

9. damages resulting from fraud or misrepresentation by Maker;

10. damages resulting from breach of any warranty of title by Maker;

11. interest on the Note from the date of default through foreclosure, payment, or settlement of the debt;

12. all interest on the Note during any bankruptcy proceeding of Maker and all reasonable attorney's fees and expenses incurred as a result of Maker's bankruptcy; and

13. all attorney's fees and expenses incurred by Payee to collect any of the foregoing amounts.

Continue with the following.

Buyer/Maker

Seller/Payee

Exhibit J

Easement Agreement

Attach any easement agreement for the surface use of the real property. See form 16-3 in this chapter for a blanket easement agreement for groundwater rights.

Exhibit K

Memorandum of Contract

Attach a memorandum of contract if applicable. See form 16-16 in this chapter.

Exhibit L

Notice of Termination of Contract

Attach a notice of termination of contract if applicable. See form 16-17 in this chapter.

Form 16-2

Groundwater Rights Warranty Deed

[For Use If Grantor Owns Both Groundwater and Surface Estate]

Notice of confidentiality rights: If you are a natural person, you may remove or strike any or all of the following information from any instrument that transfers an interest in real property before it is filed for record in the public records: your Social Security number or your driver’s license number.

Date:

Grantor:

Grantor’s Mailing Address:

Grantee:

Grantee’s Mailing Address:

Consideration:

See form 5-6 in this manual for consideration clauses.

Real Property: [describe real property from which the groundwater will be obtained]

Include the following if applicable.

Personal Property: All personal property rights relating to the Groundwater, together with the following items of personal property and fixtures: [list items] [include if applicable: and all of Grantor’s right, title, and interest in the [permit title] Permit No. [number], issued and approved by [name of groundwater authority] on [date]].

Continue with the following.

Groundwater: All of the underground water, percolating water, artesian water, and any other water from any and all depths and reservoirs, formations, depths and horizons beneath

the surface of the Real Property, excluding underflow or flow in a defined subterranean channel.

Groundwater Rights: (1) The Groundwater [**include if applicable:** save and except the Reserved Groundwater] and the right to test, explore for, drill for, develop, withdraw, capture, or otherwise beneficially use the Groundwater; (2) the right to use the surface of the Real Property for access to and to explore for, develop, treat, produce, and transport the Groundwater; and (3) all permits, licenses, or other governmental authorizations relating to any of the foregoing.

If the conveyance includes personal property, include the defined term from clause 5-9-12.

Reservations from Conveyance:

Select as appropriate.

None

Or

Grantor reserves the right to use the Groundwater in connection with its surface estate in the Real Property for the following purposes only: [**state purposes for which the reserved groundwater may be used and any limit on the quantity of the reserved groundwater that the grantor may use including any limit on the number of wells that the grantor may drill or maintain**].

To create additional reservations of title, include the appropriate clauses from form 5-7

Exceptions to Conveyance and Warranty:

State "None" or, to create exceptions to conveyance and warranty, include the appropriate clauses from form 5-8.

Grantor, for the Consideration and subject to the Reservations from Conveyance and the Exceptions to Conveyance and Warranty, grants, sells, and conveys to Grantee the

Groundwater Rights, together with all and singular the rights and appurtenances thereto in any way belonging, to have and to hold it to Grantee and Grantee's heirs, successors, and assigns forever. Grantor binds Grantor and Grantor's heirs and successors to warrant and forever defend all and singular the Groundwater Rights to Grantee and Grantee's heirs, successors, and assigns against every person whomsoever lawfully claiming or to claim the same or any part thereof [**include if applicable:** , except as to the Reservations from Conveyance and the Exceptions to Conveyance and Warranty].

If the conveyance includes personal property, include clause 5-9-13. If appropriate, include additional clauses like those suggested in form 5-9.

When the context requires, singular nouns and pronouns include the plural.

[Name of grantor]

If the deed imposes contractual obligations on the grantee, include the following signature line.

[Name of grantee]

Include acknowledgments.

[Reserved]

Form 16-3

Blanket Easement Agreement for Groundwater Rights

[For Use with Groundwater Rights Warranty Deed (On Site)]

Notice of confidentiality rights: If you are a natural person, you may remove or strike any or all of the following information from any instrument that transfers an interest in real property before it is filed for record in the public records: your Social Security number or your driver's license number.

Date:

Grantor:

Grantor's Mailing Address:

Grantee:

Grantee's Mailing Address:

[Grantor's Lienholder:]

[Grantor's Lienholder's Mailing Address:]

Easement Property: [describe the property subject to the easement, which may be all or part of
the real property]

Real Property: [describe the property in which the grantee has groundwater rights or attach
field notes as exhibit A]

“Deed” means the Groundwater Rights Deed in which Grantor conveyed the Groundwater Rights to Grantee, recorded in the real property records of the county or counties in which the Real Property is located.

“Facilities” means aboveground, underground, surface or subsurface pipelines, electric transmission and communication lines and conduits, communication towers, pumps, monitor wells, water wells and well sites (whether production wells or test or exploratory wells), water storage tanks, water treatment facilities, pump station facilities, pumping plant facilities, buildings, machinery, equipment, meters, tangible personal property, roads, gates, bridges, culverts, erosion control structures, fences, cattle guards, and all other necessary, desirable, or convenient installations, appurtenances, facilities, and structures related thereto.

“Force Majeure” means act of war, civil disobedience, insurrection, act of terrorism, act of God, strike, prolonged drought, or prolonged or extreme weather conditions, or other event beyond the reasonable control of a party giving rise to a delay in performance that was not foreseeable and that could not have been avoided through the exercise of reasonable care.

“Groundwater” means all of the underground water, percolating water, artesian water, and any other water from any and all depths and reservoirs, formations, depths and horizons beneath the surface of the Real Property, excluding underflow or flow in a defined subterranean channel.

“Groundwater Rights” means the title to the Groundwater and other rights conveyed to Grantee in the Deed.

“Sanitary Control Easement” means an easement around the circumference of a well to prohibit uses that could cause contamination of the groundwater in accordance with the requirement for municipal water supply wells prescribed by the Texas Commission on Environmental Quality (TCEQ) under sections 290.38(73) and 290.41(c) of title 30 of the Texas Administrative Code and as provided in TCEQ Form 20698.

“Surface Water” means any water, flowing or stationary, naturally presenting itself above the top layer of soil, be that top layer of soil a lake or stream bed, whether the source of the water is from runoff, overflow, springs, or seeps.

“Water” means Groundwater or Surface Water.

Easement Purpose: The installation, construction, operation, use, maintenance, repair, modification, removal, replacement, and upgrade of Grantee’s Facilities on, from, and across the Easement Property as may be necessary or desirable in connection with the exploration, monitoring, testing, drilling, extracting, capturing, collection, development, pumping, treatment, withdrawal, production, transmission, transportation, storage, supply, and beneficial use of the Groundwater and other utilization of the Groundwater Rights [include if applicable: , including the transportation of groundwater obtained from other real property].

Consideration: This agreement is executed in connection with the Deed. Consideration paid under the Deed constitutes full consideration for the rights granted under this agreement [include if applicable: , except for payments required by the Surface Damage Payment Addendum].

Reservations and Exceptions from Conveyance: [describe any reservations and exceptions from the conveyance in this instrument]

Exceptions to Warranty: [describe any exceptions to the warranties in this instrument]

Grant of Easement: Grantor, for the Consideration and subject to the Reservations from Conveyance and Exceptions to Warranty, grants, sells, and conveys to Grantee and Grantee’s heirs, successors, and assigns an easement over, on, under, and across the Easement Property for the Easement Purpose, together with (1) a sanitary control easement around each well site sufficient to meet the requirements of law; (2) the right to use roads, driveways, and access ways, and the right of ingress and egress at all times across the [Real Property/Easement Property] for reasonable access to and use of the Easement Property and Grantee’s Facilities for the Easement Purpose; and (3) all and singular the rights and appurtenances thereto in any way belonging (collectively, the “Easement”), to have and

to hold the Easement to Grantee and Grantee's heirs, successors, and assigns forever. Grantor binds Grantor and Grantor's heirs, successors, and assigns to warrant and forever defend the title to the Easement in Grantee and Grantee's heirs, successors, and assigns against every person whomsoever lawfully claiming or to claim the Easement or any part thereof, except as to the Reservations from Conveyance and Exceptions to Warranty [include if applicable: , to the extent that such claim arises by, through, or under Grantor, but not otherwise].

Terms and Conditions: The following terms and conditions apply to the Easement granted by this agreement:

1. *Character of Easement.* The Easement is a nonexclusive blanket easement and is irrevocable, subject to the terms of this agreement. The Easement is for the benefit of Grantee and Grantee's heirs, successors, and assigns who at any time own all or any portion of the Groundwater Rights conveyed to Grantee in the Deed.
2. *Duration of Easement.* The duration of the Easement is perpetual.
3. *Reservation of Rights.* Grantor reserves for Grantor and Grantor's heirs, successors, and assigns the right to continue to use and enjoy the Easement Property for all purposes that do not interfere with or interrupt the use or enjoyment of the Easement by Grantee for the Easement Purpose, except as limited by the terms of this agreement.
4. *Improvement and Maintenance of Easement Property.* Improvement and maintenance of the Easement Property for the Easement Purpose will be at the sole expense of Grantee, except as otherwise provided by this agreement. Grantee has the right to eliminate any encroachments into the Easement Property. On written request by Grantee, Grantor will execute or join in the execution of easements for drainage, electricity, or utility facilities serving the Easement Property.

5. *Use of Water.* Grantee will have the Groundwater Rights provided in the Deed. The compensation paid by Grantee under the Deed [**include if applicable:** and the Surface Damage Payment Addendum] is the only compensation to which Grantor is entitled if Grantee's exercise of its rights causes a decline in the Surface Water or Groundwater available to Grantor.

6. *Taxes.* Grantor will be responsible for paying all ad valorem property taxes or assessments assessed against the Easement Property ("Taxes") before delinquency. If Grantor fails to do so, Grantor authorizes Grantee to pay the Taxes, and on such payment, (a) to be subrogated to all liens held by the taxing authority against the Easement Property as security for the Taxes paid, (b) to have the right to set off amounts paid against amounts owed to Grantor under this agreement, and (c) to seek reimbursement of amounts paid in accordance with applicable law. Grantee will have the right, but not the obligation, to pay the Taxes. If Grantee pays the Taxes, at Grantee's request Grantor will promptly take the action required by section 32.06 of the Texas Tax Code to authorize a transfer of the tax lien to Grantee. Grantee will timely pay any taxes assessed by any taxing authority against Grantee's Facilities or easement estate in the Easement Property as well as any fees or costs charged by any Groundwater Conservation District or other regulatory body for Grantee's development, pumping, transportation, or use of the Groundwater.

7. *Addenda.* The following [is/are] attached to and [is/are] a part of this agreement:

Select as applicable.

Easement Location Addendum

Surface Damage Payment Addendum

Surface Use Restrictions Addendum

8. *Abandonment of Facilities.* The occurrence of abandonment is to be determined solely by Grantee or by a court of competent jurisdiction. On abandonment of any easement or portion of an easement granted on the Easement Property for the production or transportation of water, Grantee will have one year in which to remove the Facilities, at Grantee's option or in accordance with any written agreement regarding removal between Grantor and Grantee, and to restore the site to its approximate original condition to the extent reasonably practicable. If Grantee does not remove the Facilities, Grantor will become the owner of the Facilities, and Grantee will execute and deliver to Grantor all documents reasonably necessary to indicate that the Facilities have been abandoned and that title to the abandoned Facilities and easements and, to the extent owned by Grantee, all communications lines, electric power lines, poles, and appurtenances serving the abandoned Facilities have reverted to Grantor.

9. *Cooperation.* Grantor will cooperate with Grantee as reasonably necessary to enable Grantee to obtain any consents or permits necessary for Grantee to withdraw or produce the Groundwater, provided that Grantor will not be obligated to incur any costs thereby. Grantor and Grantee will cooperate with one another in the use of the Real Property, the Easement Property, and the Groundwater in order to effectuate the terms of this agreement.

10. *Modifications.* This Easement Agreement may be modified or terminated by the written agreement of Grantor and Grantee, provided, however, that if the Easement Property is divided into two or more tracts, this agreement may be modified or terminated as to any tract by Grantee and the owner of that portion of the Easement Property at the time the modification or termination is requested, without the requirement for the consent of any owner of any other portion of the Easement Property. Such modification or termination will be binding on and affect only the rights of Grantee and the owner of the portion of the Easement Property who enters into the modification or termination of this agreement with regard to that owner's tract and will not affect the terms and provisions of this agreement as they apply to any other portion of the Easement Property.

11. *Equitable Rights of Enforcement.* This Easement may be enforced by restraining orders and injunctions (temporary or permanent) prohibiting interference and commanding compliance. Restraining orders and injunctions will be obtainable on proof of the existence of interference or threatened interference, without the necessity of proof of inadequacy of legal remedies or irreparable harm, and will be obtainable only by the parties to or those benefited by this agreement, provided, however, that the act of obtaining an injunction or restraining order will not be deemed to be an election of remedies or a waiver of any other rights or remedies provided by this agreement or available at law or in equity. All rights and remedies provided by this agreement or available at law or in equity are cumulative, not exclusive, and may be exercised successively or concurrently.

12. *Attorney's Fees.* If any party retains an attorney to enforce this agreement, the party prevailing in litigation is entitled to recover reasonable attorney's fees and court and other costs.

13. *Force Majeure.* Any provision in this agreement to the contrary notwithstanding, if a party is delayed in the performance of an obligation under this agreement due to an event of Force Majeure, that party will be given an extension of one day for each day in which the party was unable to perform its obligation due to the event of Force Majeure.

14. *Binding Effect.* This agreement binds and inures to the benefit of the parties and their respective heirs, successors, and assigns. The covenants and conditions stated in this agreement run with the land.

15. *Choice of Law.* This agreement will be construed under the laws of the state of Texas, without regard to choice-of-law rules of any jurisdiction. Venue is in the county or counties in which the Easement Property is located.

16. *Counterparts.* This agreement may be executed in any number of counterparts with the same effect as if all signatory parties had signed the same document. All counterparts will be construed together and will constitute one and the same instrument.

17. *Waiver of Default.* It is not a waiver of or consent to default if the nondefaulting party fails to declare immediately a default or delays in taking any action. Pursuit of any remedies set forth in this agreement does not preclude pursuit of other remedies in this agreement or provided by law.

18. *Further Assurances.* Each signatory party agrees to execute and deliver any additional documents and instruments and to perform any additional acts necessary or appropriate to perform the terms, provisions, and conditions of this agreement and all transactions contemplated by this agreement. At the request of Grantee, Grantor will execute a separate Sanitary Control Easement for each of Grantee's wells in the form attached as Exhibit B or on another form supplied by Grantee meeting TCEQ requirements.

19. *Indemnity.* Each party agrees to indemnify, defend, and hold harmless the other party from any loss, attorney's fees, expenses, or claims attributable to (a) breach or default of any provision of this agreement by the indemnifying party or (b) the negligent acts or omissions of the indemnifying party, its employees, agents, representatives, or persons with whom it contracts for the performance of activities on the Easement Property.

20. *Entire Agreement.* This agreement, all attached exhibits and addenda, and the Deed constitute the entire agreement of the parties concerning the grant of the Easement by Grantor to Grantee. There are no representations, warranties, agreements, or promises pertaining to the grant of the Easement that are not in those documents. All addenda and exhibits to this agreement are incorporated herein.

21. *Legal Construction.* If any provision in this agreement is for any reason unenforceable, to the extent the unenforceability does not destroy the basis of the bargain among

the parties, the unenforceability will not affect any other provision hereof, and this agreement will be construed as if the unenforceable provision had never been a part of the agreement. Whenever context requires, the singular will include the plural and neuter include the masculine or feminine gender, and vice versa. Article and section headings in this agreement are for reference only and are not intended to restrict or define the text of any section. This agreement will not be construed more or less favorably between the parties by reason of authorship or origin of language.

22. *Notices.* Any notice required or permitted under this agreement must be in writing. Any notice required by this agreement will be deemed to be given (whether received or not) the earlier of receipt or three business days after being deposited with the United States Postal Service, postage prepaid, certified mail, return receipt requested, and addressed to the intended recipient at the address shown in this agreement. Notice may also be given by regular mail, personal delivery, courier delivery, or e-mail and will be effective when received. Any address for notice may be changed by written notice given as provided herein. If the Easement Property is divided into two or more tracts, Grantee will be deemed to have complied with any notice requirement under this agreement if Grantee provides written notice only to the owners of the tracts directly affected by the matter for which notice is being given.

23. *Recitals.* Any recitals in this agreement are represented by the parties to be accurate and constitute a part of the substantive agreement.

24. *Dispute Resolution.* If a dispute arises between the parties with regard to the rights or obligations of the parties as set forth in this agreement, the aggrieved party will provide written notice of its complaint or claim to the other party with sufficient specificity to enable the recipient to determine the cause and nature of the complaint. On receipt of the notice, the receiving party will have a reasonable period of time, not to exceed thirty days, in which to respond in writing to the other party. If the parties are not able to resolve the issues to their mutual satisfaction through negotiation within thirty days after the commencement of

negotiations, or within such longer period as the parties may agree on, the parties agree to mediate the matter in good faith before instituting a suit for damages or exercising any right to terminate expressly provided by this agreement.

25. *Time.* Time is of the essence. Unless otherwise specified, all references to “days” mean calendar days. Business days exclude Saturdays, Sundays, and legal public holidays. If the date for performance of any obligation falls on a Saturday, Sunday, or legal public holiday, the date for performance will be the next following regular business day.

Include the following if applicable.

26. *Partial Releases.* Grantor and Grantee acknowledge that Grantor may need portions of the Easement Property released from this Blanket Easement from time to time in order to use, sell, or finance portions of the Easement Property. If, before the installation of Facilities by Grantee, Grantor makes a written request for a partial release of any portion of this Blanket Easement to Grantee, Grantee will, within forty-five days after receipt of the request, provide Grantor with written consent to the partial release or with proposed plans showing Grantee’s intended use of the area. If the request is granted, Grantor, at Grantor’s expense, will provide the partial release, in a mutually acceptable form, and the field-note description of the area to be released. Grantee may condition the partial release on Grantor’s conveyance of easement rights to replace those being released. If Grantee fails to respond to Grantor in writing within the required time, Grantee will be deemed to have consented to the partial release and will execute the partial release of the area when presented by Grantor. If Grantee fails to do so in a timely manner, Grantor will have the right to execute the partial release on behalf of Grantee and to record it in the real property records as evidence of the release.

Include the following if applicable.

27. *Relocation of Facilities.* After the installation of Facilities by Grantee, Grantor will have the right to require Grantee to execute a partial release of the easement rights granted under this Easement Agreement and to relocate Facilities installed in an easement area if all the following conditions are met: (a) Grantor pays for all surveying and document preparation costs for the area to be released and easements required to be provided by Grantor; (b) Grantor provides a comparable replacement easement to Grantee, at Grantor's expense, for the easement to be released and all additional easements on Grantor's or neighboring properties necessary for the operation of Grantee's relocated Facilities, in form and content reasonably acceptable to Grantee; (c) the proposed relocation will not materially increase the cost of operating Grantee's Facilities or result in a material adverse change in the efficiency or productivity of Grantee's Facilities; (d) Grantor pays for the reasonable costs arising from the relocation of Grantee's Facilities, including, to the extent applicable, site preparation work, making additions or alterations to the Facilities in order to connect them to Grantee's remaining Facilities, hydrological investigations in connection with determining water quality and quantity, drilling replacement wells, the construction of new roads if necessary to provide reasonable access to the new easement or Facilities, plugging wells in accordance with applicable legal requirements, and the removal of debris; and (e) reimbursement to Grantee for any loss of profits or increase in operating costs during the period in which the relocation of the Facilities occurs and that result from the relocation activities. To initiate the process, Grantor must make written request to Grantee for the relocation, identifying with reasonable particularity the easement or easement areas to be released. Grantee will have a reasonable period of time, not to exceed ninety days, in which to make an initial evaluation and response to Grantor regarding the cost and feasibility of relocating Grantee's Facilities. If Grantee believes that the proposed relocation will not meet the conditions of (c) above, or that Grantor will not be able to provide suitable replacement easements or is not financially able to pay the costs of relocation, Grantee will notify Grantor of the basis for its determination. If Grantor does not agree with Grantee, Grantor will have the right to pursue dispute resolution

as provided in paragraph 24. above. If the parties are able to reach an agreement on the terms for the relocation, they will commit those terms to writing. Grantee may require Grantor to escrow funds, furnish a letter of credit, or provide other reasonable guarantee of Grantor's financial ability to perform its obligations as a condition to entering into the relocation agreement.

Continue with the following.

[Name of grantor]

[Name of grantee]

If applicable, include the following consent and subordination or the separate lienholder consent and subordination at form 16-7 in this chapter.

Consent and Subordination by Lienholder

Lienholder, as the holder of [a] lien[s] on the Real Property, consents to the above grant of an Easement, including the terms and conditions of the grant, and Lienholder subordinates its lien[s] to the rights and interests of Grantee, so that a foreclosure of the lien[s] will not extinguish the rights and interests of Grantee.

[Name of lienholder]

Include acknowledgment.

Exhibit A

Real Property

Describe the property in which the grantee has groundwater rights or attach field notes.

Exhibit B

Sanitary Control Easement

[TCEQ Form 20698]

Texas Commission on Environmental Quality

SANITARY CONTROL EASEMENT

DATE:

GRANTOR(S):

GRANTOR'S ADDRESS:

GRANTEE:

GRANTEE'S ADDRESS:

SANITARY CONTROL EASEMENT: Purpose, Restrictions, and Uses of Easement:

1. The purpose of this easement is to protect the water supply of the well described and located below by means of sanitary control.

2. The construction, existence, and/or operation of the following within a 150-foot radius of the well described and located below are prohibited: septic tank or sewage treatment perforated drainfields; areas irrigated by low dosage, low angle spray on-site sewage facilities; absorption beds; evapotranspiration beds; abandoned, inoperative or improperly constructed water wells of any depth; underground petroleum and chemical storage tanks or liquid transmission pipelines; sewage treatment plants; sewage wet wells; sewage pumping stations; drainage ditches which contain industrial waste discharges or wastes from sewage treatment systems; animal feed lots; solid waste disposal sites, landfill and dump sites; lands on which sewage plant or septic tank sludge is applied; lands irrigated by sewage plant efflu-

ent; military facilities; industrial facilities; wood-treatment facilities; liquid petroleum and petrochemical production, storage, and transmission facilities; Class 1, 2, 3, and 4 injection wells; pesticide storage and mixing facilities; and all other constructions or operations that could pollute the groundwater sources of the well that is the subject of this easement. For the purpose of this easement, improperly constructed water wells are those wells which do not meet the surface and subsurface construction standards for a public water supply well.

3. The construction, existence and/or operation of tile or concrete sanitary sewers, sewer appurtenances, septic tanks, storm sewers, cemeteries, and/or the existence of livestock in pastures is specifically prohibited within a 50-foot radius of the water well described and located below.

4. This easement permits the construction of homes or buildings upon the Grantor's property, and farming and ranching operations, as long as all items in Restrictions Nos. 2 and 3 are recognized and followed.

The Grantor's property subject to this Easement is described in the documents recorded at: Volume [number], Pages [number] of the real property records of [county] County, Texas.

PROPERTY SUBJECT TO EASEMENT:

All of that area within a 150 foot radius of the water well located [number] feet at a radial of degrees from the [specify] corner of Lot [number], of a Subdivision of Record in Book [number], Page [number] of the County Plat Records, [county] County, Texas.

TERM:

This easement shall run with the land and shall be binding on all parties and persons claiming under the Grantor(s) for a period of two years from the date that this easement is

recorded; after which time, this easement shall be automatically extended until the use of the subject water well as a source of water for public water systems ceases.

ENFORCEMENT:

Enforcement of this easement shall be proceedings at law or in equity against any person or persons violating or attempting to violate the restrictions in this easement, either to restrain the violation or to recover damages.

INVALIDATION:

Invalidation of any one of these restrictions or uses (covenants) by a judgment or court order shall not affect any of the other provisions of this easement, which shall remain in full force and effect.

FOR GOOD AND VALUABLE CONSIDERATION, the receipt and sufficiency of which are hereby acknowledged, the Grantor does hereby grant and convey to Grantee and to its successors and assigns the sanitary control easement described in this easement.

[Name of grantor]

Include acknowledgment.

Form 16-4

Easement Location Addendum

Date:

Grantor:

Grantee:

Easement Agreement:

Easement Property:

Real Property:

Easement Location Period:

This Easement Location Addendum modifies the Easement Agreement. Terms defined in the Easement Agreement have the same meaning in this Addendum. The terms of the Easement Agreement that are not modified by this Addendum remain in effect.

Although the Easement Agreement initially grants a blanket Easement over the Easement Property, it is the intention of the parties that the easement location be restricted to (1) the areas to be occupied by Grantee's Facilities, including roads to be constructed by Grantee, and (2) roads, driveways, and access ways to the Easement Property and Grantee's Facilities.

At least [**number**] days before the expiration of the Easement Location Period, Grantee will provide Grantor with a map or sketch showing the areas to be occupied by Grantee's Facilities, which may include areas to be used immediately and those reserved for future expansion. Grantor may request changes in location of any of the Facilities within [**number**]

days after Grantor's receipt of Grantee's proposal. Grantee will accommodate any requested change that does not materially increase Grantee's construction or operation costs or adversely affect the use or efficiency of Grantee's Facilities. Grantee, at its expense, will provide a field-note description of the area to be occupied by its Facilities at least [number] days before the expiration of the Easement Location Period, and the parties will execute and record an amendment to the Easement Agreement that identifies the Easement Property as (1) the area or areas described by field notes to be occupied by Grantee's Facilities, together with any additional area needed as a sanitary control site around each well in order to meet the requirements of law for the protection of water produced from the well, and (2) roads, driveways, and access ways over the [Real Property/Easement Property] to access the Easement Property and Grantee's Facilities. The amendment may restrict the types of uses allowed in each identified easement location. **[Include if applicable:** The amendment will also provide Grantee with the right to use reasonable portions of the Real Property adjacent to or in the vicinity of the Easement Property as needed for construction staging areas, parking, and storing vehicles and equipment during construction or maintenance activities.]

Grantee's easement rights in the areas to be occupied by its Facilities are exclusive. Grantee's easement rights in roads, driveways, and access ways are nonexclusive. **[Include if applicable:** After Grantee has [identified the areas to be occupied by its Facilities/provided field notes for the areas to be occupied by its Facilities], paragraph 26. of the Easement Agreement will no longer apply.]

If Grantee fails to identify the location of its Facilities and to provide a field-note description of the area or areas to be occupied by its Facilities as provided in this Addendum, and the failure is not cured through the dispute resolution procedure set out in the Easement Agreement, Grantor may terminate the Easement Agreement as to any Easement Property on which Grantee has not installed Facilities or provided a field-note description by giving

Grantee written notice of termination. Grantee authorizes Grantor to execute and record a release evidencing that termination.

[Name of grantor]

[Name of grantee]

Include acknowledgment.

[Reserved]

Form 16-5

Surface Damage Payment Addendum

Date:

Grantor:

Grantee:

Easement Property:

Real Property:

Easement Agreement:

This Surface Damage Payment Addendum modifies the Easement Agreement. Terms defined in the Easement Agreement have the same meaning in this Addendum. The terms of the Easement Agreement that are not modified by this Addendum remain in effect.

1. *Damage Payments.* Grantee agrees to pay Grantor, in addition to any other consideration paid for the Easement, the following amounts as damages for use of the Easement Property:

The following are examples of possible damage provisions.

Item for Which Payment Is Due	Amount of Payment Due	Time Payment Due
Water well location other than test well or monitoring wells (on area not larger than 1 acre), compensation will be \$[amount] for each additional acre occupied	\$[amount] per location	Before drilling or construction

Sanitary Control Easement	[\$amount] per location	Before drilling or construction
Pumping plant sites, including tank battery and related Facilities (on area not larger than [number] acres), compensation will be [\$amount] for each additional acre occupied; if water wells and pumping plant sites are installed at the same location, Grantee will pay separate damages for each	[\$amount] per location	Before construction
Aboveground pipeline appurtenances, including tank batteries if not on well site or pumping plant site (except for signs required by law) (on area not larger than [number] acres), compensation will be [\$amount] for each additional acre occupied	[\$amount] per location except [\$amount] per air valves	Before construction
Use of existing roads on Real Property	[\$amount] per [rod/linear foot]	Before construction of Facilities
Pipelines (underground)	[\$amount] per [rod/linear foot]	Before beginning of ditching for pipelines
New roads constructed by or on behalf of Grantee	[\$amount] per [rod/linear foot]	Before beginning construction of road
Electric or communications lines placed on Real Property	[\$amount] per [rod/linear foot]	Before construction of Facilities
Fences—removal	[\$amount] per [rod/linear foot]	Before beginning construction
Fences—new	[\$amount] per [rod/linear foot]	Before beginning construction

2. *Injury to Grantor's Property.* Grantee will be liable and will promptly provide reasonable compensation to Grantor for any damage to Grantor's improvements, livestock, or real or personal property caused by the negligence of Grantee, its employees, agents, invitees, representatives, or contractors while performing services or acts on the Real Property. The amount of damages will be determined in accordance with the provisions of paragraph 24. of the Easement Agreement.

3. *Injury to Grantee's Property.* Grantor will be liable and will compensate Grantee for any damage to Grantee's Facilities or real or personal property caused by the negligence of Grantor, its employees, agents, invitees, representatives, or contractors. The amount of damages will be determined in accordance with the provisions of paragraph 24. of the Easement Agreement.

4. *Interest.* Amounts owing under this agreement that are not paid when due will accrue interest at the highest interest rate allowed by applicable law.

[Name of grantor]

[Name of grantee]

Include acknowledgment.

[Reserved]

Form 16-6

Surface Use Restrictions Addendum

Date:

Grantor:

Grantee:

Real Property:

Easement Property:

Facilities Construction Period:

Easement Agreement:

“Residence Unit” means a residential structure, together with barns, sheds, and associated outbuildings.

“Hazardous Substances” means, but is not limited to, any substance that is or contains (1) any “hazardous substance” as defined in section 101(14) of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA), as amended (42 U.S.C. § 9601 *et seq.*), or regulations promulgated under CERCLA; (2) any “hazardous waste” as now defined in the Resource Conservation and Recovery Act (RCRA) (42 U.S.C. § 6901 *et seq.*) or regulations promulgated under RCRA; (3) any substance regulated by the Toxic Substances Control Act (15 U.S.C. § 2601 *et seq.*); (4) gasoline, diesel fuel, or other petroleum hydrocarbons; (5) asbestos and asbestos-containing materials in any form, whether friable or nonfriable; (6) polychlorinated biphenyls; (7) radon gas; and (8) any additional substances or materials (whether solid, liquid, or gas) that are classified, defined, or listed as pollutants, hazardous wastes, hazardous substances, hazardous materials, extremely hazardous

wastes, regulated substances, toxic substances, or words of similar meaning or regulatory effect under the foregoing statutes or any other present federal, state, or local laws, statutes, ordinances, rules, regulations, and the like or the common law or any other applicable laws relating to the Real Property. "Hazardous Substances" includes, without limitation, any substance the presence of which on the Real Property (1) requires reporting, investigation, or remediation under the statutes cited above or (2) causes or threatens to cause a nuisance on any portion of the Real Property or adjacent property or poses or threatens to pose a hazard to the environment or the health or safety of persons on any portion of the Real Property or adjacent property.

This Surface Use Restrictions Addendum modifies the Easement Agreement. Terms defined in the Easement Agreement have the same meaning in this Addendum. The terms of the Easement Agreement that are not modified by this Addendum remain in effect.

The following are samples of possible surface use restrictions.

1. Grantee agrees that it will—
 - a. provide Grantor with a set of its plans for the Facilities at least sixty days before the commencement of initial construction of the Facilities;
 - b. provide Grantor with at least thirty days' notice before the commencement of the initial construction of its Facilities;
 - c. complete initial construction of its Facilities before the expiration of the Facilities Construction Period;
 - d. construct, maintain, and operate all Facilities in a good and workmanlike manner, in good working order, and in accordance with all applicable laws and the terms of the Easement Agreement;

- e. remove from the Easement Property and properly dispose of all trash and debris caused by Grantee, including any fencing, brush, and trees taken down by Grantee and unused materials, parts, tools, and equipment after construction or maintenance;
- f. use existing roads on the Easement Property when feasible for ingress and egress;
- g. provide Grantor, on request, with reasonable access to or copies of Grantee's records relating to Grantee's Facilities on the Easement Property, including permits, well logs, test results, and the location of underground Facilities;
- h. restore and revegetate any area disturbed by Grantee in connection with its activities on the Easement Property to approximately the condition existing immediately before the commencement of the activity;
- i. promptly repair, remove, or replace any damaged or destroyed Facility;
- j. require its employees, agents, representatives, and contractors to comply with the provisions of this Addendum;
- k. pay its proportionate share for upkeep and maintenance of roads used by Grantor and Grantee;
- l. promptly repair any damage to roads caused by Grantee, its employees, agents, representatives, or contractors;
- m. comply with any reasonable rules established by Grantor for the use of the Easement Property during Grantee's activities;
- n. conduct its operations on the Easement Property in accordance with all applicable laws;

- o. comply with the Construction Provisions set out below; and
 - p. comply with all rules and regulations of any governmental entity, including a local groundwater conservation district, with jurisdiction over the Real Property.
2. Grantee will not—
- a. own or use in any manner any Surface Water located on the Easement Property not pumped from Grantee's Facilities;
 - b. construct a well within [number] feet of any Residence Unit existing on the Easement Property on the date of the Easement Agreement, or within [number] feet of any Residence Unit constructed on the Easement Property after the date of the Easement Agreement, or within [number] feet of an existing groundwater well, without the written consent of Grantor;
 - c. hunt or fish [**include if applicable:** or carry or allow possession of any firearms, explosives, or incendiary devices] on the Real Property;
 - d. extract or mine any caliche or gravel from the Real Property for building or road construction without a written agreement with Grantor;
 - e. store vehicles on the Easement Property, except in permitted staging areas when construction activities are in progress;
 - f. store any equipment or materials on the Easement Property that Grantee does not intend to use within the next six months for construction or maintenance on the Easement Property;

- g. obstruct Grantor's access to its buildings, equipment, crops, or livestock or unreasonably interfere with Grantor's use of or operations on the Easement Property;
 - h. cause or permit contamination of the Easement Property or the Groundwater by Hazardous Substances;
 - i. cut or damage trees on the Easement Property, unless reasonably necessary for Grantee's use of the Easement; or
 - j. construct a well or produce groundwater without first securing all necessary authorizations, including permits from any local groundwater conservation district with jurisdiction.
3. Grantor agrees that it will—
- a. include in any mineral lease or any grant or reservation of mineral rights or interests, and any amendment to an existing mineral lease or reservation, a provision prohibiting the grantee from using Groundwater from the Real Property for any purpose other than drilling, completion, recompletion, reworking, remediation, and revegetation and from injecting or disposing of saltwater on the Real Property;
 - b. require its employees, invitees, agents, representatives, grantees, assigns, and contractors to comply with the provisions of this Addendum;
 - c. conduct its activities and operations on the Easement Property in accordance with applicable laws;
 - d. promptly repair any damage caused by Grantor to roads used by Grantee, its employees, invitees, agents, representatives, or contractors; and

- e. pay its proportionate share for upkeep and maintenance of roads used by Grantor and Grantee.
4. Grantor will not—
- a. create Groundwater-fed or -maintained lakes or ponds on the Easement Property, other than reasonable livestock drinking tanks or ponds;
 - b. cause or permit contamination of the Easement Property or the Groundwater by Hazardous Substances;
 - c. construct or permit construction by a third party of any improvements or utilities within [number] feet of the Easement Property without Grantee's prior written consent; or
 - d. contract for or allow the use of Groundwater by any third party without Grantee's prior written consent.
5. *Construction Provisions.* Unless otherwise agreed to by the parties in writing:
- a. Any new roads built by Grantee will not be wider, on average, than [number] feet.
 - b. Grantee will construct new roads to its Facilities with a top course of crushed caliche covering the entire length and width. Roads constructed by Grantee for access to monitoring wells or for temporary use may be constructed to lesser standards agreed on by the parties.
 - c. Pipeline easements that are not blanket easements will be no greater than [number] feet in width on each side of the center line of the pipeline.

- d. If the Easement Property is not a blanket easement, Grantee will have the right to use reasonable portions of the Real Property adjacent to or in the vicinity of the Easement Property as needed for construction staging areas, parking, and storing vehicles and equipment during construction or maintenance activities.

- e. All pipelines and underground Facilities will be buried to a depth of at least [number] inches below the surface of the ground.

- f. Grantee will use reasonable efforts to construct and maintain its Facilities in a manner that does not cause or contribute to erosion of the Easement Property or damage to Grantor's livestock.

- g. Grantee will restore any fencing that it temporarily removes for the purpose of constructing improvements and will take reasonable measures to contain livestock while the fencing is down or being restored.

[Name of grantor]

[Name of grantee]

Include acknowledgment.

[Reserved]

Form 16-7

Lienholder Consent and Subordination to Easement Agreement

Date:

Holder of Note and Lien:

Holder's Mailing Address:

Note

Date:

Original principal amount:

Borrower:

Lender:

Note and Lien Are Described in the Following Documents: **[include recording information]**

Easement Holder:

Easement Holder's Mailing Address:

Easement Agreement: The Easement Agreement dated **[date]**, executed by Borrower to the Easement Holder recorded in **[recording data]** of the real property records of **[county]** County, Texas.

Real Property:

For value received, Holder of Note and Lien hereby consents to the Easement Agreement. Holder of Note and Lien subordinates the lien referenced above and all liens held by it

regardless of how created or evidenced to the rights and interests of the Easement Holder and its successors and assigns. Foreclosure of the lien or liens will not extinguish the Easement.

[Name of lienholder]

By:

[Name of representative]

[Title]

Include acknowledgment.

Form 16-8

Partial Release of Lien
[Water Rights On-Site Production]

Date:

Holder of Note and Lien:

Holder's Mailing Address:

Owner of Groundwater Rights:

Owner's Mailing Address:

Note

Date:

Original principal amount:

Borrower:

Lender:

Note and Lien Are Described in the Following Documents: **[include recording information]**

“Groundwater” means all of the underground water, percolating water, artesian water, and any other water from any and all depths and reservoirs, formations, depths and horizons beneath the surface of the Real Property, excluding underflow or flow in a defined subterranean channel.

“Reserved Groundwater” means the right of the Borrower to use Groundwater in, on, and under the Real Property as more fully set out and described in the Groundwater Rights

Warranty Deed from Borrower to Owner of Groundwater Rights of even date, recorded in the county or counties where the Real Property is located.

“Real Property” means the following: [describe real property].

“Property to Be Released from Lien” means all the Groundwater now or in the future located in, on, or under the Real Property, excepting and excluding the Reserved Groundwater, together with all associated rights related to the Groundwater, including but not limited to the right to capture, explore for, drill for, develop, withdraw, produce, transport, or otherwise beneficially use the Groundwater; the nonexclusive right to use as much of the surface of the Real Property as is reasonably necessary for the exercise of the associated rights, including the right of ingress and egress; and all permits, licenses, or other governmental authorizations relating to any of the foregoing, including rights under any permit issued by the applicable governmental authority.

For value received, Holder of Note and Lien releases only the Property to Be Released from Lien and from all liens held by Holder of Note and Lien, without regard to how they were created or evidenced.

When the context requires, singular nouns and pronouns include the plural.

[Name of lienholder]

By:

[Name of representative]

[Title]

Include acknowledgment.

Form 16-9

Groundwater Rights Sales Contract

[For Sale of Permitted Groundwater Rights for Off-Site Production]

This contract to buy and sell groundwater rights is between Seller and Buyer as identified below and is effective on the date (“Effective Date”) of the last of the signatures by Seller and Buyer as parties to this contract and by [Title Company/Escrow Agent] to acknowledge receipt of the Earnest Money. Buyer must deliver the Earnest Money to [Title Company/Escrow Agent] and obtain a signature acknowledging receipt of the Earnest Money before the Earnest Money Deadline provided in paragraph A.1. below for this contract to be effective. If the Earnest Money is paid by check and payment on presentation is refused, Buyer is in default.

Seller: [include the names of all persons owning the groundwater]

Address:

Phone:

E-mail:

Type of entity:

Seller's Attorney: _____

Law firm:

Address:

Phone:

E-mail:

Seller's Broker:

Brokerage firm:

Address:

Phone:

E-mail:

Buyer:

Address:

Phone:

E-mail:

Type of entity:

Buyer's Attorney:

Law firm:

Address:

Phone:

E-mail:

Buyer's Broker:

Brokerage firm:

Address:

Phone:

E-mail:

[Title Company/Escrow Agent]: [Identify title company, or if title insurance will not be obtained, identify person who will act as escrow agent]

Address:

Phone:

E-mail:

[Underwriter:]

Groundwater Authority: [list any groundwater conservation districts or other groundwater authority with jurisdiction over the real property]

Seller's Permit: [describe and provide all of seller's permits, e.g., [permit title] Permit No. [number], issued and approved by [name of groundwater authority] on [date].]

Earnest Money: \$[amount]

Real Property: The Real Property described in Exhibit A.

Groundwater Rights: Seller's legal title and perpetual right to withdraw up to [number] acre-feet per year of Groundwater from the [name] Aquifer permitted [irrigation/industrial/[and/or] municipal] groundwater (the "Groundwater") relating to the Real Property. The Groundwater Rights include all of the real and personal property rights, appurtenances, hereditaments, licenses, and contracts, if any, related to or pertaining to the Groundwater, including Permit[s] No[s]. [number[s]] [include if recorded: , recorded in Volume [number], Page [number], of the Official Public Records of [county] County,

Texas] (the “Permit”), as amended or modified, as applicable, insofar as it pertains to the Groundwater Rights, including, but not limited to—

1. all of the real and personal property rights, appurtenances, authorities, licenses, consents, and contracts, if any, relating to or pertaining to the Groundwater, which will also include all common-law property rights in and to the Groundwater as well as those rights or interests that now or in the future may be useful or necessary to withdraw or otherwise beneficially use the Groundwater Rights (the “Appurtenant Rights”);

2. all permit rights (including the right in and to the Permit that relates to the Groundwater Rights) allowing for possession, withdrawal, or use of the Groundwater Rights (the “Permit Rights”); and

3. all other rights to withdraw and beneficially use the Groundwater, Appurtenant Rights, Permit, or Permit Rights, together with all modifications, amendments, renewals, extensions, or successor or substitute permits relating to any of the above-described items.

Purchase Price:

Include the following if applicable.

[\$amount], which is determined on the basis of [\$amount] per acre-foot of Groundwater.

Continue with the following.

Cash portion:

Seller-financed portion (principal amount of note):

- Interest rate:

Maturity date:

Payment schedule:

See exhibit E for additional terms and conditions.

Buyer's Liquidated Damages: \$[amount]

Seller's Additional Liquidated Damages: \$[amount]

Title Information: If Seller is not required to provide a Title Commitment and Title Policy, Seller will have the obligation to provide to Buyer, at Seller's expense, the Title Information as defined in paragraph F.3. below. Buyer may have the Title Information reviewed and obtain a written opinion of title by an attorney selected by Buyer, at [Seller/Buyer]'s expense.

Title Documents: The Permit and instruments affecting title to the Groundwater and the Real Property referenced in the [Title Commitment/Title Information] and UCC Search are to be provided as part of Seller's Records.

A. Deadlines and Other Dates

All deadlines in this contract expire at 5:00 P.M. local time where the Real Property is located. If a deadline falls on a Saturday, Sunday, or national holiday, the deadline will be extended to the next day that is not a Saturday, Sunday, or national holiday. A national holiday is a holiday designated by the federal government. Time is of the essence.

A.1. Earnest Money Deadline: [date]

Select one of the following.

A.2. Delivery of Title Commitment: [[date]/[number] days after the Effective Date]

Or

A.2. Delivery of Title Information: [[date]/[number] days after the Effective Date]

Continue with the following.

- A.3. Delivery of UCC Search: [[date]/[number] days after the Effective Date]
- A.4. Delivery of legible copies of the Title Documents: [[date]/[number] days after the Effective Date]
- A.5. Delivery of Title Objections: [[date]/[number] days after delivery of the last of the [Title Commitment/Title Information], UCC Search, and legible copies of the Title Documents]
- A.6. Delivery of Seller's records as specified in Exhibit C: [[date]/[number] days after the Effective Date]
- A.7. End of Inspection Period: [[date]/[number] days after the Effective Date]
- A.8. Closing Date: [[date]/[number] days after the End of the Inspection Period]
- A.9. Closing Time: [time]

B. Closing Documents

- B.1. At Closing, Seller will deliver the following items:

Include all applicable items.

Select one of the following.

Groundwater General Warranty Deed [include if applicable: with Vendor's Lien]

Or

Groundwater Special Warranty Deed [include if applicable: with Vendor's Lien]

Continue with the following.

Release of Lien

Partial Release of Lien as to Groundwater Rights

Assignment of Seller's Permit or transfer form promulgated or approved by relevant groundwater authority

IRS Nonforeign Person Affidavit

Evidence of Seller's authority to close this transaction

Notices, statements, and certificates as specified in Exhibit D

Assignment of Leases

Tenant Estoppel Certificate

Affidavit of Debts and Liens [**include if applicable:** and Indemnity]

B.2. At Closing, Buyer will deliver the following items:

Include all applicable items.

Balance of Purchase Price

Evidence of Buyer's authority to close this transaction

Deceptive Trade Practices Act waiver

Seller-financing documents

Promissory Note

Deed of Trust

Security Agreement

Financing Statement

Loan Documents required by third-party lender

Releases of any leases, contracts, or other legal interests affecting the
Groundwater agreed to be terminated before or at Closing

Continue with the following.

The documents listed in this section B. are collectively known as the “Closing Documents.” The Closing Documents for which forms exist in the current edition of the *Texas Real Estate Forms Manual* (State Bar of Texas) will be prepared using those forms.

C. Exhibits

The following are attached to and are a part of this contract:

Exhibit A—Description of the Real Property

Exhibit B—Seller’s Representations and Warranties

Exhibit C—Seller’s Records

Exhibit D—Notices, Statements, and Certificates

[Include if applicable: Exhibit E—Seller Financing Addendum]

[Include if applicable: Exhibit F—Memorandum of Contract]

[Include if applicable: Exhibit G—Notice of Termination of Contract]

D. Purchase and Sale of Groundwater Rights

Seller agrees to sell and convey the Groundwater Rights to Buyer, and Buyer agrees to buy and pay Seller for the Groundwater Rights. The promises by Buyer and Seller stated in this contract are the consideration for the formation of this contract.

E. Interest on Earnest Money

Buyer may direct [Title Company/Escrow Agent] to invest the Earnest Money in an interest-bearing account in a federally insured financial institution by giving notice to [Title Company/Escrow Agent] and satisfying [Title Company/Escrow Agent]'s requirements for investing the Earnest Money in an interest-bearing account. Any interest earned on the Earnest Money will become part of the Earnest Money.

F. Title

F.1. Review of Title. The following statutory notice is provided to Buyer on behalf of the real estate licensees, if any, involved in this transaction: Buyer is advised that it should either have the abstract covering the Real Property examined by an attorney of Buyer's own selection or be furnished with or obtain a policy of title insurance.

Include the following if applicable.

F.2. Title Commitment; Title Policy. "Title Commitment" means a Commitment for Issuance of an Owner Policy of Title Insurance by Title Company, as agent for Underwriter, or directly by Underwriter, stating the condition of title to the Groundwater Rights and the Real Property. The effective date stated in the Title Commitment must be after the Effective Date of this contract. "Title Policy" means an Owner Policy of Title Insurance issued by Title Company, as agent for Underwriter, or directly by Underwriter, in conformity with the last Title Commitment delivered to and approved by Buyer.

Include the following if applicable.

F.3. Title Information. “Title Information” means an abstract of title prepared by a title insurance company or an abstract company licensed by the Texas State Board of Insurance, covering the period from the first conveyance of title to the Real Property out of the sovereignty to the Effective Date, and containing complete and legible copies of all the deeds, easements, liens, and other documents affecting title to the Real Property and the Groundwater Rights.

Continue with the following.

F.4. UCC Search. “UCC Search” means written reports stating the instruments that are on file in the Texas secretary of state’s UCC records, the UCC records of any other appropriate state, and the UCC records in the jurisdiction in which the Seller is organized, showing as debtor Seller and all other owners of the Real Property and Groundwater Rights [include if applicable: and fixtures and personal property] during the five years before the Effective Date of this contract.

F.5. Delivery of [Title Commitment/Title Information], UCC Search, and Title Documents. Seller must deliver the [Title Commitment/Title Information] to Buyer and Buyer’s attorney by the deadline stated in paragraph A.2. above; the UCC Search by the deadline stated in paragraph A.3., and legible copies of the Title Documents by the deadline stated in paragraph A.4.

F.6. Title Objections. Buyer has until the deadline stated in paragraph A.5. above (“Title Objection Deadline”) to review the [Title Commitment/Title Information], UCC Search, and legible copies of the Title Documents, notify Seller of Buyer’s objections to any of them, and request any additional information needed to evidence Seller’s title to the Real Property and the Groundwater Rights (“Title Objections”). Buyer will be deemed to have approved all matters reflected by the [Title Commitment/Title Information], Title Documents,

and UCC Search to which Buyer has made no Title Objection by the Title Objection Deadline. The matters that Buyer either approves or is deemed to have approved are "Permitted Exceptions." If Buyer notifies Seller of any Title Objections, Seller has five days from receipt of Buyer's notice to notify Buyer whether Seller agrees to cure the Title Objections before Closing ("Cure Notice"). If Seller does not timely give its Cure Notice or timely gives its Cure Notice but does not agree to cure all the Title Objections before Closing, Buyer may, within five days after the deadline for the giving of Seller's Cure Notice, notify Seller that either this contract is terminated or Buyer will proceed to close, subject to Seller's obligations to resolve the items [listed in Schedule C of the Title Commitment/listed in the Title Information], remove all liquidated liens, remove all exceptions that arise by, through, or under Seller after the Effective Date, and cure only the Title Objections that Seller has agreed to cure in the Cure Notice. At or before Closing, Seller must resolve the items that are [listed in Schedule C of the Title Commitment/listed in the Title Information], remove all liquidated liens, remove all exceptions that arise by, through, or under Seller after the Effective Date of this contract, and cure the Title Objections that Seller has agreed to cure.

G. Inspection Period

G.1. Review of Seller's Records. Seller, at Seller's expense, will deliver to Buyer copies of Seller's Records specified in Exhibit C, or otherwise make those records available for Buyer's review, by the deadline stated in paragraph A.6. above.

G.2. Adequacy of Seller's Permit. Buyer will have the right to determine whether the Permit, on transfer to Buyer, will be adequate for Buyer's intended use of the Groundwater Rights, whether an alternative permit will be required, and the requirements of the Groundwater Authority for the transfer of Permit. Seller will cooperate with Buyer at all times in obtaining any information and forms required from the Groundwater Authority. On Buyer's request, Seller, at Seller's expense, will execute and transmit to the Groundwater Authority all necessary applications, forms, and documentation required for the transfer of Seller's Permit

to Buyer, provided that the transfer will not be effective until Closing. Seller will not take any action before or after Closing to oppose the transfer of Seller's Permit to Buyer, the issuance of an amendment to Seller's Permit, or other permitting sought by Buyer to enable Buyer to use the Groundwater for Buyer's Intended Use of the Groundwater.

G.3. Buyer's Right to Terminate. Buyer may terminate this contract for any reason by notifying Seller before the end of the Inspection Period.

G.4. Buyer's Indemnity and Release of Seller

G.4.a. Indemnity. Buyer will indemnify, defend, and hold Seller harmless from any loss, attorney's fees, expenses, or claims arising out of Buyer's investigation of the Groundwater Rights and Real Property. The obligations of Buyer under this provision will survive termination of this contract and Closing.

G.4.b. Release. Buyer releases Seller and those persons acting on Seller's behalf from all claims and causes of action (including claims for attorney's fees and court and other costs) resulting from Buyer's investigation of the Groundwater and Real Property.

G.5. Appraisal of Groundwater. Buyer has the right to have an appraisal performed of the Groundwater Rights, the Real Property, and Seller's Permits. The cost of the appraisal [will be paid at Closing by [Buyer/Seller]/will be shared at Closing by Buyer and Seller].

H. Representations and Warranties

The parties' representations stated in Exhibit B are true and correct as of the Effective Date and must be true and correct on the Closing Date. Seller will promptly notify Buyer if Seller becomes aware that any of the representations are not true and correct.

I. Condition of the Property until Closing; Cooperation; No Recording of Contract

I.1. Maintenance and Operation. Until Closing, Seller will (a) maintain the Real Property [**include if applicable:** , the personal property and fixtures,] and the Groundwater Rights as they existed on the Effective Date, except for reasonable wear and tear and casualty damage; (b) use the Real Property and the Groundwater Rights in the same manner as they were used on the Effective Date; and (c) comply with all contracts, laws, and governmental regulations affecting the Real Property and the Groundwater Rights. Until the end of the Inspection Period, Seller will not grant or convey any easement, lease, license, or other right affecting the Real Property or the Groundwater Rights. After the end of the Inspection Period, Seller may not enter into, amend, or terminate any contract that affects the Groundwater Rights or the Real Property without first obtaining Buyer's written consent.

I.2. Condemnation. Seller will notify Buyer promptly after Seller receives notice that any part of the Real Property or Groundwater Rights has been or is threatened to be condemned or otherwise taken by a governmental or quasi-governmental authority. Buyer may terminate this contract if the condemnation would materially affect Buyer's intended use of the Groundwater Rights by giving notice to Seller within fifteen days after receipt of Seller's notice to Buyer (or before Closing if Seller's notice is received less than fifteen days before Closing). The condemnation will be deemed to materially affect Buyer's intended use of the Groundwater Rights if [**specify reason, e.g.,** the condemnation would result in Buyer's not being able to produce more than [**number**] acre-feet of Groundwater]. If Buyer does not terminate this contract, (a) Buyer and Seller will each have the right to appear and defend their respective interests in the Groundwater Rights in the condemnation proceedings; (b) any award in condemnation will be assigned to Buyer to the extent necessary to compensate Buyer for the loss of or reduction in the Groundwater Rights; (c) if the taking occurs before Closing, the description of the Real Property or Groundwater Rights will be revised to delete the portion taken; and (d) no change in the Purchase Price will be made.

I.3. Claims; Hearings. Seller will notify Buyer promptly after Seller receives notice of any claim or administrative hearing that is threatened, filed, or initiated before Closing that involves or directly affects the Groundwater Rights.

I.4. Cooperation. Seller will cooperate with Buyer (a) before and after Closing to transfer the applications, permits, and licenses held by Seller and used in the production of the Groundwater and to obtain any consents necessary for Buyer to withdraw or produce the Groundwater; (b) before Closing, with any reasonable evaluation, inspection, or study of the Real Property or the Groundwater; and (c) in all other matters related to, or arising out of or in connection with, this contract.

I.5. Casualty or Other Loss or Damage. Until Closing has been completed and funded, Seller will bear the risk of any damage, casualty, or other loss to the Real Property or Groundwater [include if applicable: and the personal property and fixtures]. If any damage, casualty, or other loss results in a material adverse change in the quality, quantity, or usability of the Groundwater, Buyer will have the right to terminate this contract.

I.6. Memorandum of Contract; Termination of Contract; No Recording of Contract. At the request of Buyer, Seller will execute a memorandum of this contract, in a mutually acceptable form, to be recorded in the real property records of [county] County, Texas. At the time the memorandum is signed, Buyer and Seller will also sign a termination of contract in recordable form and deposit it into escrow with [Title Company/Escrow Agent]. The parties authorize [Title Company/Escrow Agent] to record the termination of contract as provided in section J. below. Neither Buyer nor Seller may file this contract in the real property records of any county. If either party records this contract, the other party may terminate this contract and record a notice of termination.

J. Termination

J.1. Disposition of Earnest Money after Termination

J.1.a. To Buyer. If Buyer terminates this contract in accordance with any of Buyer's rights to terminate, then unless Seller delivers notice of Seller's objection to [Title Company/Escrow Agent]'s release of the Earnest Money to Buyer within five days after Buyer delivers Buyer's termination notice to Seller and [Title Company/Escrow Agent], [Title Company/Escrow Agent] is authorized without any further authorization from Seller, to deliver the Earnest Money to Buyer, less \$100, which will be paid to Seller as consideration for the right granted by Seller to Buyer to terminate this contract. [Title Company/Escrow Agent] will record the termination of contract and return the Earnest Money to Buyer on receipt of Seller's authorization.

J.1.b. To Seller. If Seller terminates this contract in accordance with any of Seller's rights to terminate, then unless Buyer delivers notice of Buyer's objection to [Title Company/Escrow Agent]'s release of the Earnest Money to Seller within five days after Seller delivers Seller's termination notice to Buyer and [Title Company/Escrow Agent], [Title Company/Escrow Agent] is authorized, without any further authorization from Buyer, to pay and deliver the Earnest Money to Seller and to record the termination of contract. [Title Company/Escrow Agent] will record the termination of contract and pay the Earnest Money to Seller on receipt of Buyer's authorization.

J.2. Duties after Termination. If this contract is terminated, Buyer will promptly return to Seller all of Seller's Records in Buyer's possession or control. After return of the documents and copies, neither party will have further duties or obligations to the other under this contract, except for those obligations that cannot be or were not performed before termination of this contract or that expressly survive termination of this contract.

K. Closing

K.1. Closing. This transaction will close at [Title Company/Escrow Agent]'s offices at the Closing Date and Closing Time. At Closing, the following will occur:

K.1.a. Closing Documents. The parties will execute and deliver the Closing Documents.

K.1.b. Payment of Purchase Price. Buyer will deliver the Purchase Price and other amounts that Buyer is obligated to pay under this contract to [Title Company/Escrow Agent] in funds acceptable to [Title Company/Escrow Agent]. The Earnest Money will be applied to the Purchase Price.

K.1.c. Disbursement of Funds; Recording; Copies. [Title Company/Escrow Agent] will be instructed to disburse the Purchase Price and other funds in accordance with this contract, record the Groundwater Deed and the other Closing Documents directed to be recorded, and distribute documents and copies in accordance with the parties' written instructions.

K.1.d. Delivery of Originals. Seller will deliver to Buyer the originals of Seller's Records.

K.1.e. Possession. Seller will deliver possession of the Groundwater Rights to Buyer, subject to the Permitted Exceptions existing at Closing and any liens and security interests created at Closing to secure financing for the Purchase Price.

K.2. Transaction Costs

K.2.a. Seller's Costs. Seller will pay [the basic charge for the Title Policy/the cost of providing the Title Information as specified in this contract, if not previously paid by Seller]; one-half of the escrow fee charged by [Title Company/Escrow Agent]; the costs to prepare the Groundwater Rights Deed; the costs to obtain, deliver, and record any releases of liens or lender's consent; the costs to cure and record the documents to cure Title Objections agreed or required to be cured by Seller and to resolve matters [shown in Schedule C of the Title Commitment/raised in the Title Information]; the costs to obtain the UCC Search and certificates or reports of ad valorem taxes; the costs to deliver copies of the instruments described in para-

graph A.4. above; any other costs expressly required to be paid by Seller in this contract; and Seller's attorney's fees and expenses.

K.2.b. Buyer's Costs. Buyer will pay one-half of the escrow fee charged by [Title Company/Escrow Agent]; the costs to obtain, deliver, and record all documents other than those to be obtained or recorded at Seller's expense; the costs to obtain financing of the Purchase Price, including the incremental premium costs of the loan title policy and endorsements and deletions required by Buyer's lender, if applicable; any other costs expressly required to be paid by Buyer in this contract; and Buyer's attorney's fees and expenses.

K.2.c. Taxes, Fees, and Assessments. At Closing, Seller will pay any ad valorem taxes and assessments, including penalties and interest (collectively, "Taxes"), in connection with the Real Property and the Groundwater Rights that are owing for prior calendar years. Seller will pay all Taxes in connection with the Real Property and Groundwater Rights for the current calendar year, if payable at the time of Closing. After Closing, Seller will continue to pay all Taxes due in connection with the Real Property before delinquency, except that if ad valorem taxes, if any, are assessed separately against Buyer's Groundwater Rights after Closing, Buyer will be responsible for paying such taxes and assessments if Buyer is obligated to pay such taxes under applicable law. After Closing, each party will have the right to protest taxes that the party is responsible for paying, provided that the protesting party does not allow the taxes to become delinquent.

After Closing, Buyer will be responsible for paying all fees, assessments, taxes, and charges of any kind imposed by the Groundwater Rights Authority, or any successor authority, in connection with the Groundwater Rights.

These provisions will survive Closing and will be set out in one or more of the Closing Documents.

K.2.d. Income and Expenses. Except as provided in paragraph K.2.c. above, all items of expense, including fees paid to any Groundwater Authority, or income arising in connection with the use or operation of the Groundwater Rights will be prorated as of the Closing Date. Seller will pay all bills and expenses that could give rise to a lien against the Real Property or Groundwater Rights at or before Closing.

K.2.e. Postclosing Adjustments. If errors in the prorations made at Closing are identified within ninety days after Closing, Seller and Buyer will make postclosing adjustments to correct the errors within fifteen days of receipt of notice of errors.

K.2.f. Brokers Commissions. Buyer and Seller each indemnify and agree to defend and hold the other party harmless from any loss, attorney's fees, and court and other costs arising out of a claim by any person or entity claiming by, through, or under the indemnitor for a broker's or finder's fee or commission because of this transaction or this contract, whether the claimant is disclosed to the indemnitee or not. At Closing, each party will provide the other party with a release of broker's or appraiser's liens from all brokers or appraisers for which each party was responsible.

K.3. Issuance of Title Policy. Seller will cause [Title Company/Escrow Agent] to issue the Title Policy, if required, to Buyer as soon as practicable after Closing.

L. Default and Remedies

L.1. Seller's Default; Remedies before Closing. If Seller fails to perform any of its obligations under this contract, or if any of Seller's representations are not true and correct as of the Effective Date or on the Closing Date or any of Seller's warranties have been breached ("Seller's Default"), Buyer may elect either of the following as its sole and exclusive remedy before Closing:

L.1.a. Termination; Liquidated Damages. Buyer may terminate this contract by giving notice to Seller on or before the Closing Date and Closing Time and have the Earnest Money, less the \$100 as described above, returned to Buyer. If Seller's Default occurs after Buyer has incurred costs to investigate the Real Property and Groundwater Rights after the Effective Date and Buyer terminates this contract in accordance with the previous sentence, Seller will also pay to Buyer as liquidated damages the lesser of Buyer's actual out-of-pocket expenses incurred to investigate the Real Property and Groundwater Rights after the Effective Date ("Buyer's Expenses") or the amount of Buyer's Liquidated Damages, within ten days after Seller's receipt of an invoice from Buyer stating the amount of Buyer's Expenses accompanied by reasonable evidence of Buyer's Expenses.

L.1.b. Specific Performance. Unless Seller's Default relates to the untruth or incorrectness of Seller's representations for reasons not reasonably within Seller's control, Buyer may enforce specific performance of Seller's obligations under this contract, but any such action must be initiated, if at all, within ninety days after the breach or alleged breach of this contract. If title to the Groundwater Rights is awarded to Buyer, the conveyance will be subject to the matters stated in the [Title Commitment/Title Information].

L.2. Seller's Default; Remedies after Closing. If Seller's representations are not true and correct at Closing for reasons reasonably within Seller's control and Buyer does not become aware of the untruth or incorrectness until after Closing, Buyer will have all the rights and remedies available at law or in equity. If Seller fails to perform any of its obligations under this contract that survive Closing, Buyer will have all rights and remedies available at law or in equity unless otherwise provided by the Closing Documents.

L.3. Buyer's Default; Remedies before Closing. If Buyer fails to perform any of its obligations under this contract ("Buyer's Default"), Seller may elect either of the following as its sole and exclusive remedy before Closing:

L.3.a. Termination; Liquidated Damages. Seller may terminate this contract by giving notice to Buyer on or before Closing and have the Earnest Money paid to Seller. If Buyer's Default occurs after Seller has incurred costs to perform its obligations under this contract and Seller terminates this contract in accordance with the previous sentence, Buyer will also reimburse Seller for the lesser of Seller's actual out-of-pocket expenses incurred after the Effective Date to perform its obligations under this contract ("Seller's Expenses") or the amount of Seller's Additional Liquidated Damages, within ten days after Buyer's receipt of an invoice from Seller stating the amount of Seller's Expenses accompanied by reasonable evidence of Seller's Expenses.

L.3.b. Specific Performance. Seller may enforce specific performance of Buyer's obligations under this contract. If title to the Groundwater Rights is awarded to Buyer, the conveyance will be subject to the matters stated in the [Title Commitment/Title Information].

L.4. Buyer's Default; Remedies after Closing. If Buyer fails to perform any of its obligations under this contract that survive Closing, Seller will have all rights and remedies available at law or in equity unless otherwise provided by the Closing Documents.

L.5. Liquidated Damages. The parties agree that just compensation for the harm that would be caused by a default by either party cannot be accurately estimated or would be very difficult to accurately estimate and that the Earnest Money and the amounts provided above are reasonable forecasts of just compensation to the nondefaulting party for the harm that would be caused by a default.

L.6. Attorney's Fees. If either party retains an attorney to enforce this contract, the party prevailing in litigation is entitled to recover reasonable attorney's fees and court and other costs.

M. Miscellaneous Provisions

M.1. Notices. Any notice required by or permitted under this contract must be in writing. Any notice required by this contract will be deemed to be given (whether received or not) the earlier of receipt or three business days after being deposited with the United States Postal Service, postage prepaid, certified mail, return receipt requested, and addressed to the intended recipient at the address shown in this contract. Notice may also be given by regular mail, personal delivery, courier delivery, or e-mail and will be effective when received, provided that (a) any notice received on a Saturday, Sunday, or national holiday will be deemed to have been received on the next day that is not a Saturday, Sunday, or national holiday; and (b) any notice received after 5:00 P.M. local time at the place of delivery on a day that is not a Saturday, Sunday, or national holiday will be deemed to have been received on the next day that is not a Saturday, Sunday, or national holiday. Any address for notice may be changed by not less than ten days' prior written notice given as provided herein. Copies of each notice must be given by one of these methods to the attorney of the party to whom notice is given.

M.2. Entire Agreement. This contract, its exhibits, and any Closing Documents delivered at Closing are the entire agreement of the parties concerning the sale and use of the Groundwater Rights and the use of the Real Property. There are no representations, warranties, agreements, or promises between the parties pertaining to the Groundwater Rights and Real Property, sale and use of the Groundwater Rights, or use of the Real Property, and neither party is relying on any statements or representations of any agent of the other party, that are not in those documents.

M.3. Amendment. This contract may be amended only by an instrument in writing signed by the parties.

Select one of the following.

M.4. Prohibition of Assignment. Buyer may not assign this contract or any of Buyer's rights under it without Seller's prior written consent, and any attempted assignment is void.

Or

M.4. Assignment. Buyer may assign this contract and Buyer's rights under it only to an entity in which Buyer possesses, directly or indirectly, the power to direct or cause the direction of its management and policies, whether through the ownership of voting securities or otherwise, and any other assignment is void.

Continue with the following.

M.5. Survival. The provisions of this contract that expressly survive termination or Closing and other obligations of this contract that cannot be performed before termination of this contract or before Closing survive termination of this contract or Closing, and the legal doctrine of merger does not apply to these matters. If there is any conflict between the Closing Documents and this contract, the Closing Documents control.

M.6. Choice of Law; Venue. This contract is to be construed under the laws of the state of Texas, without regard to choice-of-law rules of any jurisdiction. Venue is in the county in which the Real Property out of which the Permit is derived is located.

M.7. Waiver of Default. It is not a waiver of default if the nondefaulting party fails to declare a default immediately or delays taking any action with respect to the default.

M.8. No Third-Party Beneficiaries. There are no third-party beneficiaries of this contract.

M.9. Severability. If a provision of this contract is unenforceable for any reason, to the extent the unenforceability does not destroy the basis of the bargain among the parties, the

unenforceability does not affect any other provision of this contract, and this contract is to be construed as if the unenforceable provision is not a part of the contract.

M.10. Ambiguities Not to Be Construed against Party Who Drafted Contract. The rule of construction that ambiguities in a document will be construed against the party who drafted it will not be applied in interpreting this contract.

M.11. No Special Relationship. The parties' relationship is an ordinary commercial relationship, and the parties do not intend to create the relationship of principal and agent, partners, joint venturers, or any other special relationship.

M.12. Counterparts. If this contract is executed in multiple counterparts, all counterparts taken together constitute this contract. Copies of signatures to this contract are effective as original signatures.

M.13. Confidentiality. The parties will keep confidential this contract, this transaction, and all information learned in the course of this transaction, except to the extent disclosure is required by law or court order, to enable third parties to advise or assist Buyer to investigate the Groundwater Rights and the Real Property, or by either party to close this transaction. Remedies for violations of this provision are limited to injunctions and no damages or rescission may be sought or recovered as a result of any such violations.

M.14. Binding Effect. This contract binds, benefits, and may be enforced by the parties and their respective heirs, successors, and permitted assigns.

Include the following only if the buyer has agreed to waive its rights under the DTPA.

M.15. Waiver of Consumer Rights. BUYER WAIVES ITS RIGHTS UNDER THE TEXAS DECEPTIVE TRADE PRACTICES-CONSUMER PROTECTION ACT, SECTION 17.41 *ET SEQ.* OF THE TEXAS BUSINESS AND COMMERCE CODE, A LAW THAT GIVES CONSUMERS SPECIAL RIGHTS

AND PROTECTIONS. AFTER CONSULTATION WITH AN ATTORNEY OF ITS OWN SELECTION,
BUYER VOLUNTARILY CONSENTS TO THIS WAIVER.

Continue with the following.

[Name and title of seller]

Date:

[Name and title of buyer]

Date:

[Title Company/Escrow Agent] acknowledges receipt of Earnest Money in the amount
of \$ _____ and a copy of this contract executed by both Buyer and Seller.

[Name of title company/escrow agent]

By _____

Name:

Title:

Date:

Exhibit A

Description of the Real Property

Include legal description of the land.

Exhibit B**Seller's Representations and Warranties****A. Seller's Representations to Buyer**

Seller represents and warrants to Buyer that the following are true and correct as of the Effective Date and will be true and correct as of the Closing Date:

If the seller is an individual or is acting in a representative capacity, some of the items should be modified.

A.1. Authority. Seller is a [**specify type of organization**] duly organized, validly existing, and in good standing under the laws of the state of [Texas/[**state**]] with authority to perform its obligations under this contract.

A.2. Litigation. Seller has not received written notice and has no actual knowledge of any litigation pending or threatened against Seller that might affect the Groundwater Rights, the Real Property, or Seller's ability to perform its obligations under this contract [**include if applicable: , except [specify]**].

A.3. Violation of Laws. Seller has not received written notice of violation of any law, ordinance, regulation, or requirements affecting the Real Property, the Groundwater Rights, or Seller's use of the Real Property or Groundwater Rights [**include if applicable: , except [specify]**].

A.4. Licenses, Permits, and Approvals. Seller has not received written notice that any license, permit, or approval necessary to use the Groundwater Rights in the manner in which they are currently used has expired or will not be renewed on expiration or that any material condition will be imposed in order to use such permit or license or obtain its renewal [**include if applicable: , except [specify]**].

A.5. *Condemnation; Zoning; Land Use; Hazardous Materials.* Seller has not received written notice of any condemnation, zoning, or land-use proceedings affecting the Real Property or the Groundwater Rights or any written inquiries or notices by any governmental authority or third party with respect to condemnation or the presence of hazardous materials affecting the Real Property or the Groundwater Rights [**include if applicable:** , except [**specify**]].

A.6. *No Other Obligation to Sell or Restriction against Sale.* Seller has not obligated itself to sell all or any portion of the Real Property or the Groundwater Rights to any person other than Buyer. Seller's performance of this contract will not cause a breach of any other agreement or obligation to which Seller is a party or to which it is bound [**include if applicable:** , except [**specify**]].

A.7. *No Liens.* On the Closing Date, the Groundwater Rights to be conveyed under the contract will be free and clear of all liens and encumbrances of any nature not arising by, through, or under Buyer except the Permitted Exceptions or liens to which Buyer has given its consent in writing.

A.8. *No Rights of Possession or Use.* There are no persons presently in possession of the Real Property or the Groundwater or having any rights to possession of the Real Property or the Groundwater or rights, either present or future, to explore for, use, produce, or withdraw the Groundwater other than Seller [**include if applicable:** , except [**specify**]].

A.9. *Good Title.* Seller has good and indefeasible fee simple title to the Real Property and the Groundwater Rights, free and clear of all mortgages, liens, licenses, encumbrances, leases, tenancies, security interests, covenants, conditions, restrictions, rights-of-way, easements, judgments, and other matters affecting title [**include if applicable:** , except [**specify**]].

A.10. No Bills or Claims. There will be no unpaid bills or claims in connection with any repair or work performed or material furnished to the Real Property or otherwise relating to the Groundwater Rights for the benefit of Seller as of the Closing Date, and all bills attributable to or affecting the Groundwater Rights and the Real Property will be paid by Seller in full before Closing.

A.11. No Adverse Matters. To the best of Seller's knowledge, there is no (a) change contemplated in any applicable laws, ordinances, or restrictions, including the rules of the Groundwater Authority; (b) judicial or administrative action threatened or pending against the Real Property, the Groundwater Rights, or Seller; or (c) action by adjacent landowners pending or threatened against the Real Property, the Groundwater Rights, or Seller.

A.12. Compliance with Laws. Seller has at all times complied with and operated in compliance with all applicable federal, state, and local laws, regulations, and ordinances regarding the Real Property and the Groundwater Rights, including rules of the Groundwater Authority. Seller will promptly notify Buyer of any noncompliance notice received by Seller.

B. "As Is, Where Is"

THIS CONTRACT IS AN ARM'S-LENGTH AGREEMENT BETWEEN THE PARTIES. THE PURCHASE PRICE WAS BARGAINED ON THE BASIS OF AN "AS IS, WHERE IS" TRANSACTION AND REFLECTS THE AGREEMENT OF THE PARTIES THAT THERE ARE NO REPRESENTATIONS OR EXPRESS OR IMPLIED WARRANTIES, EXCEPT THOSE IN THIS CONTRACT AND THE CLOSING DOCUMENTS.

SELLER DISCLAIMS ALL WARRANTIES AND REPRESENTATIONS REGARDING THE QUANTITY, QUALITY, OR RELIABILITY OF THE GROUNDWATER OR THE AVAILABILITY NOW OR IN THE FUTURE OF AMENDMENTS TO THE PERMIT NECESSARY FOR BUYER TO USE THE GROUNDWATER FOR ANY PURPOSE. SELLER FURTHER DISCLAIMS ALL WARRANTIES AND REPRESENTATIONS WITH RESPECT TO THE FITNESS OF THE GROUNDWATER FOR ANY PARTICULAR USE.

[Include if applicable: BUYER ACKNOWLEDGES THAT THE LOCAL GROUNDWATER DISTRICT'S RULES AND REGULATIONS OR PERMITTING DECISIONS MAY LIMIT THE VOLUME OF GROUNDWATER PRODUCED FROM THE REAL PROPERTY AND THE PURPOSE OR PLACE OF ITS USE, AS WELL AS THE LOCATION OF ANY WELL, ITS DEPTH, OR RATE OF PRODUCTION.]

BUYER IS NOT RELYING ON ANY REPRESENTATIONS, DISCLOSURES, OR EXPRESS OR IMPLIED WARRANTIES OTHER THAN THOSE EXPRESSLY CONTAINED IN THIS CONTRACT AND THE CLOSING DOCUMENTS. BUYER IS NOT RELYING ON ANY INFORMATION REGARDING THE GROUNDWATER OR THE REAL PROPERTY PROVIDED BY ANY PERSON, OTHER THAN BUYER'S OWN INSPECTION AND THE REPRESENTATIONS AND WARRANTIES CONTAINED IN THIS CONTRACT AND THE CLOSING DOCUMENTS.

The provisions of this section B. regarding the Groundwater Rights [will/will not] be included in the Groundwater Rights Warranty Deed with appropriate modification of terms as the context requires.

C. Buyer's Representations to Seller

Buyer represents to Seller that the following are true and correct as of the Effective Date and will be true and correct on the Closing Date:

If the buyer is an individual or is acting in a representative capacity, some of the items should be modified.

C.1. Authority. Buyer is a [specify type of organization] duly organized, validly existing, and in good standing under the laws of the state of [Texas/[state]] with authority to perform its obligations under this contract. This contract is binding on Buyer. This contract is, and all documents required by this contract to be executed and delivered to Seller at Closing will be, duly authorized, executed, and delivered by Buyer.

Include other representations from the buyer to the seller as needed.

Exhibit C**Seller's Records**

To the extent that Seller has possession or control of the following items pertaining to the Real Property or Groundwater Rights, Seller will deliver or make the items or complete, legible, and accurate copies of them available to Buyer by the deadline stated in paragraph A.6.

Select items as agreed by the parties.

Records and Reports

governmental licenses, certificates, permits, and approvals, specifically including

Seller's Permit and any other information related to the Permit, including but not limited to a copy of Seller's application for the Permit

current tax certificate showing taxes assessed and owed against the Real Property and any tax exemption, special use, or other valuation or exemption applicable to the Real Property

records of regulatory proceedings or violations regarding the Real Property or Groundwater Rights

any survey of all or any portion of the Real Property

abstracts of title or prior title policies relating to the Real Property or Groundwater Rights

groundwater production records

other: [specify]

Leases, Licenses, Agreements, and Encumbrances

all leases, licenses, agreements, and encumbrances (including all amendments and exhibits) affecting title to or use of the Real Property or Groundwater Rights that have not been recorded in the real property records of the county or counties in which the Real Property is located

Exhibit D**Notices, Statements, and Certificates**

Certain notices must be contained in the contract and others must be provided as separate notices. Please refer to the statutory requirements for each notice.

The notices, statements, and certificates (arranged by their application to particular transactions) that are listed below are [**include as applicable:** included in the sales contract/ [and] attached for delivery to Buyer], and Buyer acknowledges receipt of the notices, statements, and certificates by executing this contract:

Include one or more of the following paragraphs as applicable and modify section headers and paragraph numbers as appropriate.

A. Consumer Notices

Notice of Cancellation. Notice concerning the purchaser's three-day right of rescission under a contract to purchase real property if (1) the seller or the seller's agent solicits the sale at a place other than the seller's place of business; (2) the purchaser submits the purchase contract to the seller or the seller's agent at a place other than the seller's place of business; and (3) the consideration payable under the purchase contract exceeds \$100; unless either (1) the purchaser is represented by a licensed attorney; (2) the transaction is negotiated by a licensed real estate broker; or (3) the transaction is negotiated at a place other than the purchaser's residence by the person who owns the property, as described in chapter 601 of the Texas Business and Commerce Code.

If applicable, attach form 4-4 in this manual to the end of this exhibit D.

And/Or

B. Residential Transaction Notices

B.1. Seller's Disclosure of Property Condition. Seller's disclosure of the condition of residential property, described in section 5.008 of the Texas Property Code.

If applicable, attach the full text of Tex. Prop. Code § 5.008, with all relevant information filled in, to the end of this exhibit D.

And/Or

B.2. Notice of Membership in Property Owners Association. Notice concerning the sale of single-family residential property that is subject to membership in a property owners association, described in section 5.012 of the Texas Property Code.

If applicable, attach form 23-8 to the end of this exhibit D.

And/Or

B.3. Seller's Disclosure of Location of Conditions under Surface of Unimproved Real Property. Seller's disclosure of the location of pipelines under the surface of unimproved property to be used for residential purposes, described in section 5.013 of the Texas Property Code. A seller of unimproved property to be used for residential purposes shall provide the purchaser written notice disclosing the location of any transportation pipeline to the best of the seller's belief and knowledge as of the date the notice is completed and signed by the seller. If the information required to be disclosed is not known by the seller, the seller shall indicate that fact in the notice. A seller is not required to give this notice if (a) the seller is obligated under the terms of the contract to furnish a title insurance commitment to the buyer before closing and (b) the buyer is entitled to terminate the contract if the buyer's objections to title as permitted by the contract are not cured by the seller before closing.

No form is provided, because the sales contract portion of this form 16-9 satisfies the provisions for exemption from disclosure.

And/Or

B.4. Notice of Obligation to Pay Public Improvement District Assessment. Seller's disclosure that a single-family residential property is located within a public improvement district, described in section 5.014 of the Texas Property Code.

If applicable, attach form 4-5 to the end of this exhibit D.

And/Or

B.5. Residential Contracts for Deed. Notice regarding the sale of property used or to be used as the purchaser's residence if the contract does not provide for delivery of a deed from the seller to the purchaser within 180 days after the final execution of the contract.

See Tex. Prop. Code §§ 5.069-.074.

And/Or

B.6. Notice Regarding Insulation to Buyer of New Home. Notice concerning insulation to be installed in a new home, described in section 460.16 of title 16 of the Code of Federal Regulations.

If applicable, attach form 4-6 to the end of this exhibit D.

And/Or

B.7. Disclosure of Information on Lead-Based Paint and/or Lead-Based Paint Hazards. Lead-based paint warning statement, described in section 745.100 *et seq.* of title 40 of the Code of Federal Regulations.

If applicable, attach form 4-7 to the end of this exhibit D.

And/Or

B.8. Asbestos Disclosure Notice. Notice concerning asbestos, described in sections 1910.1001 and 1926.1101 of title 29 of the Code of Federal Regulations.

If applicable, attach form 4-8 to the end of this exhibit D.

And/Or

B.9. Notice Regarding Sale Subject to a Recorded Lien. Notice to the purchaser and each lienholder required under Texas Property Code section 5.016 that property being sold will be conveyed subject to a lien.

If applicable, attach form 4-9 to the end of this exhibit D.

And/Or

C. Condominium Transaction Notices

C.1. Acknowledgment of Receipt of Condominium Documents. Condominium declaration, bylaws, and association rules, described in section 82.156 of the Texas Property Code.

If applicable, attach form 24-8 to the end of this exhibit D.

And/Or

C.2. Condominium Resale Certificate. Resale certificate from the condominium owners association or waiver of resale certificate, described in section 82.157 of the Texas Property Code.

If applicable, attach condominium resale certificate promulgated by the Texas Real Estate Commission, available at <https://www.trec.texas.gov/pdf/contracts/32-4.pdf>, or form 24-7 (waiver of condominium resale certificate) to the end of this exhibit D.

And/Or

D. All Real Property Transaction Notices

D.1. Storage Tanks Disclosure Provider. Notice concerning underground storage tanks, described in section 334.9 of title 30 of the Texas Administrative Code.

If applicable, attach form 4-10 to the end of this exhibit D.

And/Or

D.2. Notice to Purchaser Regarding Restrictive Covenants. Notice of deed restrictions, described in section 212.155 of the Texas Local Government Code.

If applicable, attach form 4-11 to the end of this exhibit D.

And/Or

D.3. Notice to Purchaser Regarding Coastal Area Property. Notice regarding real property located adjacent to tidally influenced, submerged lands of Texas, described in section 33.135 of the Texas Natural Resources Code.

If applicable, attach form 4-12 to the end of this exhibit D.

And/Or

D.4. Notice to Purchaser of Property Seaward of Gulf Intracoastal Waterway. Notice concerning public easements to the public beach, described in section 61.025 of the Texas Natural Resources Code.

If applicable, attach form 4-13 to the end of this exhibit D.

And/Or

D.5. Notice Regarding Possible Liability for Additional Taxes. Notice of additional tax liability for vacant land that has been subject to a special tax appraisal method, described in section 5.010 of the Texas Property Code.

If applicable, attach form 4-14 to the end of this exhibit D.

And/Or

D.6. Notice Regarding Possible Annexation. Notice concerning the sale of property located outside the limits of a municipality that may now or later be included in the extra-territorial jurisdiction of a municipality and may now or later be subject to annexation by the municipality, described in section 5.011 of the Texas Property Code.

If applicable, attach form 4-15 to the end of this exhibit D.

And/Or

D.7. Notice for Unimproved Property in a Certificated Service Area of a Utility Service Provider. Notice for property in a certificated service area of a utility service provider, described in section 13.257 of the Texas Water Code.

If applicable, attach form 4-16 to the end of this exhibit D.

And/Or

D.8. Utility District Notice. Notice concerning the bonded indebtedness of, or rates to be charged by, a utility or other special district, described in section 49.452 of the Texas Water Code, with the form of notice to be used being dependent on whether the property (a) is located in whole or in part within the extraterritorial jurisdiction of one or more home-rule municipalities but is not located within the corporate boundaries of a municipality, (b) is located in whole or in part within the corporate boundaries of a municipality, or (c) is not located in whole or in part within the corporate boundaries of a municipality or the extraterritorial jurisdiction of one or more home-rule municipalities.

If applicable, attach form 4-17 to the end of this exhibit D.

And/Or

D.9. Notice to Purchaser of Property Located in Certain Annexed Water Districts. Notice required by section 54.016(h)(4)(A) of the Texas Water Code when property being sold is in a water or sanitary sewer district that entered a contract with a city with a

population of 1.18 million or less under which the city is permitted to set rates in the district after annexation that are different from rates charged other residents of the city.

If applicable, attach form 4-18 to the end of this exhibit D.

And/Or

D.10. Notice to Purchaser that Property Is Located within the Area of the Alignment of a Transportation Project. Notice required under Texas Local Government Code section 232.0033 that all or part of the subdivision in which the property being sold is located is within the area of the alignment of a transportation project as shown in the final environmental decision document that is applicable to a future transportation corridor identified in a contract between the Texas Department of Transportation and a county under Texas Transportation Code section 201.619.

If applicable, attach form 4-19 to the end of this exhibit D.

And/Or

D.11. Certificates of Mold Remediation. Notice pursuant to section 1958.154 of the Texas Occupations Code, titled "Certificate of Mold Remediation; Duty of Property Owner," requiring a property owner who sells property that has been issued a certificate of mold remediation pursuant to this section to deliver copies to the purchaser of each certificate of mold remediation issued for the property within the preceding five years.

And/Or

D.12. Notice of Water Level Fluctuations. Notice to purchasers of residential or commercial property adjoining an impoundment of water, including a reservoir or lake, constructed and maintained under Texas Water Code chapter 11, that has storage capacity of at least 5,000 acre-feet at the impoundment's normal level, provided pursuant to Texas Property Code section 5.019.

If applicable, attach form 4-20 to the end of this exhibit D.

Exhibit E

Seller Financing Addendum

A. Promissory Note. The promissory note (“Note”) will be payable by Buyer (“Maker”) to the order of Seller (“Payee”) at the place designated by Payee. The Note may be prepaid in whole or in part at any time without penalty, premium, or restriction of any kind. Any prepayments are to be applied to the payment of the installments of principal last maturing, and interest will immediately cease on the prepaid principal. The lien securing payment of the Note will be inferior to any lien securing any superior note described in the contract. The Note will be payable as follows:

Select one of the following.

In one payment due [number] days after the date of the Note with interest payable [at maturity/monthly/quarterly/annually].

Or

In [number] installments of \$[amount] each [including interest/plus interest] beginning [number] days after the date of the Note and continuing at [monthly/quarterly/annual] intervals thereafter until [date], when the entire balance of the Note will be due and payable.

Or

Interest only in [number] installments for the first [number] year[s] and thereafter in [number] installments of \$[amount] each [including interest/plus interest] beginning [number] days after the date of the Note and continuing at [monthly/quarterly/annual] intervals thereafter until [date], when the entire balance of the Note will be due and payable.

Or

Other: [specify].

Continue with the following.

B. Deed of Trust and Security Agreement. The deed of trust and security agreement (“Deed of Trust”) securing the Note will provide for the following:

Select one of the following.

B.1. Assumption without Consent. The Property may be sold, transferred, or conveyed without the consent of Payee, provided any subsequent buyer or transferee assumes in writing for the benefit of Payee the obligation to pay the Note and to perform the covenants and agreements in the Deed of Trust in accordance with the terms of those instruments. No such assumption will release Maker from any liabilities or obligations arising under the Note or Deed of Trust. Neither the creation of a subordinate lien nor a sale thereunder will be construed as a sale or conveyance of the Property.

Or

B.1. Assumption with Consent. The Property may be sold, transferred, or conveyed provided that (a) any subsequent buyer assumes in writing for the benefit of Payee the obligation to pay the Note and to perform the covenants and agreements in the Deed of Trust in accordance with the terms of those instruments and (b) Maker or the subsequent buyer obtains prior written consent to such a sale from Payee. Consent will be based on the subsequent buyer’s credit history, with no change in interest rate or terms, and may not be unreasonably withheld, conditioned, or delayed. No such assumption will release Maker from any liabilities or obligations arising under the Note or Deed of Trust. If all or any part of the Property is sold, conveyed, leased for a period longer than three years, leased with an option to purchase, otherwise sold (including by contract for deed), or otherwise transferred or conveyed without prior written consent of Payee, Payee may, at Payee’s sole option, declare the outstanding principal balance of the Note plus accrued interest immediately due and payable. Any deed under threat or order of condemnation, any conveyance solely between makers, and the passage of title by

reason of death of a maker or by operation of law will not be construed as a sale or conveyance of the Property. [Neither the creation of a subordinate lien nor a sale thereunder will be construed as a sale or conveyance of the Property./The creation of a subordinate lien without the consent of Payee will be construed as a sale or conveyance of the Property, but any subsequent sale under a subordinate lien to which Payee has consented will not be construed as a sale or conveyance of the Property.]

Or

B.1. Prohibition against Assumption. If all or any part of the Property is sold, transferred, or conveyed without the prior written consent of Payee, Payee may, at Payee's sole option, declare the outstanding principal balance of the Note plus accrued interest immediately due and payable. Payee has no obligation to consent to any such sale or conveyance of the Property, and Payee is entitled to condition any consent on a change in the interest rate that will thereafter apply to the Note and any other change in the terms of the Note or Deed of Trust that Payee in Payee's sole discretion deems appropriate. A lease for a period longer than three years, a lease with an option to purchase, or a contract for deed will be deemed to be a sale, transfer, or conveyance of the Property for purposes of this provision. Any deed under threat or order of condemnation, any conveyance solely between makers, and the passage of title by reason of death of a maker or by operation of law will not be construed as a sale or conveyance of the Property. The creation of a subordinate lien without the consent of Payee will be construed as a sale or conveyance of the Property, but any subsequent sale under a subordinate lien to which Payee has consented will not be construed as a sale or conveyance of the Property.

Continue with the following.

B.2. Cross-Default. Any act or occurrence that would constitute a default under the terms of any lien superior to the lien securing the Note will constitute a default under the Deed of Trust securing the Note.

C. **Recourse Provisions.** The Note and Deed of Trust are subject to the following provisions:

Select one of the following.

Full Recourse. Maker will have full recourse liability for repayment of the principal and interest of the Note and the performance of all covenants and agreements of Maker in the Deed of Trust.

Or

No Recourse. Maker will not have any recourse liability for repayment of the principal and interest of the Note or the performance of any covenants and agreements of Maker in the Deed of Trust. The sole remedy of Payee or other holder of the Note in the event of a default by Maker under the Note or Deed of Trust will be to foreclose the liens and security interests granted in the Deed of Trust, and Payee or other holder of the Note will not be entitled to any personal judgment against Maker.

Continue with the following.

Buyer/Maker

Seller/Payee

Exhibit F

Memorandum of Contract

Attach a memorandum of contract if applicable. See form 16-16 in this chapter.

Exhibit G

Notice of Termination of Contract

Attach a notice of termination of contract if applicable. See form 16-17 in this chapter.

[Reserved]

Form 16-10

Groundwater Rights Warranty Deed

[For Sale of Permitted Groundwater Rights for Off-Site Production]

Notice of confidentiality rights: If you are a natural person, you may remove or strike any or all of the following information from any instrument that transfers an interest in real property before it is filed for record in the public records: your Social Security number or your driver's license number.

Date:

Grantor:

Grantor's Mailing Address:

Grantee:

Grantee's Mailing Address:

Groundwater Authority: [list any groundwater conservation districts or other groundwater authority with jurisdiction over the real property]

Consideration:

See form 5-6 in this manual for consideration clauses.

Real Property: [describe real property from which groundwater rights will be obtained]

Groundwater Rights: Seller's perpetual right to withdraw up to [number] acre-feet per year of [name] Aquifer permitted [irrigation/industrial/[and/or] municipal] groundwater (the "Groundwater") relating to the Real Property. The Groundwater Rights include all of the real and personal property rights, appurtenances, hereditaments, licenses, and contracts, if any, related to or pertaining to the Groundwater, including Permit[s] No[s]. [number[s]] [include if recorded: , recorded in Volume [number], Page [number], of the Offi-

cial Public Records of [county] County, Texas] (the “Permit”), as amended or modified, as applicable, insofar as it pertains to the Groundwater Rights, including, but not limited to—

1. all of the real and personal property rights, appurtenances, authorities, licenses, consents, and contracts, if any, relating to or pertaining to the Groundwater, which will also include all common-law property rights in and to the Groundwater as well as those rights or interests that now or in the future may be useful or necessary to withdraw or otherwise beneficially use the Groundwater Rights (the “Appurtenant Rights”);
2. all permit rights (including the right in and to the Permit that relates to the Groundwater Rights) allowing for possession, withdrawal, or use of the Groundwater Rights (the “Permit Rights”); and
3. all other rights to withdraw and beneficially use the Groundwater, Appurtenant Rights, Permit, or Permit Rights, together with all modifications, amendments, renewals, extensions, or successor or substitute permits relating to any of the above-described items.

Reservations from Conveyance:

1. Notwithstanding anything herein contained to the contrary, it is understood and agreed that Grantee or its successors or assigns will not enter upon or use the surface of the Real Property for conducting any surface or drilling operations related to the Groundwater Rights.
2. Any beneficial use of the Groundwater Rights from the Real Property will be by way of transfer of the permitted withdrawal rights to a withdrawal point on other lands.

To create additional reservations of title, include the appropriate clauses from form 5-7

Exceptions to Conveyance and Warranty:

1. Any existing limitations, restrictions, applicable rules, or other conditions now in effect or that may be adopted or imposed by the Groundwater Authority, including but not limited to the limitations and conditions to the rights to withdraw and beneficially use Groundwater Rights as recited in the Permit.

2. Any physical aspect of the water including but not limited to: availability, existence, utility, recoverability, source, quality, condition, potability, chemistry, or other characteristics of water, if any, lying on, under, or over the land or lands or that may be produced or used from the land or lands.

3. Lack of a right of access.

4. All groundwater rights from any formations or aquifers under the Real Property other than the [indicate aquifer or groundwater rights formation] formation. This conveyance is limited to Groundwater Rights from the [indicate aquifer or groundwater rights formation] formation.

5. Any subsequent decrease in the amount of water available for withdrawal under the Permit or the portion conveyed to Grantee that is the result of any pro rata reduction applied to all holders of Permits for withdrawal of Groundwater Rights by the Groundwater Authority or any governmental entity with authority to restrict Groundwater Rights withdrawals.

Grantor, for the Consideration and subject to the Reservations from Conveyance and the Exceptions to Conveyance and Warranty, grants, sells, and conveys to Grantee the Groundwater Rights, together with all and singular the rights and appurtenances thereto in any way belonging, to have and to hold it to Grantee and Grantee's heirs, successors, and assigns forever. Grantor binds Grantor and Grantor's heirs and successors to warrant and forever defend all and singular the Groundwater Rights to Grantee and Grantee's heirs, successors, and assigns against every person whomsoever lawfully claiming or to claim the same or any

part thereof, except as to the Reservations from Conveyance and the Exceptions to Conveyance and Warranty.

Groundwater Authority fees on the use of the Groundwater Rights, if any, before the date of this Deed will be paid by Grantor; subsequent Groundwater Authority fees for the Groundwater Rights or Permit are the responsibility of Grantee.

When the context requires, singular nouns and pronouns include the plural.

[Name of grantor]

If the deed imposes contractual obligations on the grantee, include the following signature line.

[Name of grantee]

Include acknowledgments.

Form 16-11

Partial Release of Lien
[Water Rights Off-Site Production]

Date:

Holder of Note and Lien:

Holder's Mailing Address:

Owner of Groundwater Rights:

Owner's Mailing Address:

Note

Date:

Original principal amount:

Borrower:

Lender:

Note and Lien Are Described in the Following Documents: **[include recording information]**

Real Property: **[describe real property from which groundwater rights will be obtained]**

Groundwater Rights: Seller's perpetual right to withdraw up to **[number]** acre-feet per year of **[name]** Aquifer permitted [irrigation/industrial/[and/or] municipal] groundwater (the "Groundwater") relating to the Real Property. The Groundwater Rights include all of the real and personal property rights, appurtenances, hereditaments, licenses, and contracts, if any, related to or pertaining to the Groundwater, including Permit[s] No[s]. **[num-**

ber[s]] [include if recorded: , recorded in Volume [number], Page [number], of the Official Public Records of [county] County, Texas] (the “Permit”), as amended or modified, as applicable, insofar as it pertains to the Groundwater Rights, including, but not limited to—

1. all of the real and personal property rights, appurtenances, authorities, licenses, consents, and contracts, if any, relating to or pertaining to the Groundwater, which will also include all common-law property rights in and to the Groundwater as well as those rights or interests that now or in the future may be useful or necessary to withdraw or otherwise beneficially use the Groundwater Rights (the “Appurtenant Rights”);
2. all permit rights (including the right in and to the Permit that relates to the Groundwater Rights) allowing for possession, withdrawal, or use of the Groundwater (the “Permit Rights”); and
3. all other rights to withdraw and beneficially use the Groundwater, Appurtenant Rights, Permit, or Permit Rights, together with all modifications, amendments, renewals, extensions, or successor or substitute permits relating to any of the above-described items.

Property to Be Released from Lien: the Groundwater Rights.

For value received, Holder of Note and Lien releases only the Groundwater Rights from Lien and from all liens held by Holder of Note and Lien, without regard to how they were created or evidenced.

When the context requires, singular nouns and pronouns include the plural.

[Name of lienholder]

By:

[Name of representative]

[Title]

Include acknowledgment.

[Reserved]

Form 16-12

Permit Transfer Request

[Date]

[Name and address of groundwater authority]

Re: Application for Transfer of Ownership of [permit title] Permit No. [number] (the "Permit")

[Salutation]

I am the current owner of the groundwater rights in the land located within the [name of groundwater authority] (the "Groundwater Authority") and the owner of the Permit. I have entered into a contract with [name of buyer] ("Buyer") to sell Buyer my entire ownership interest in the water rights that are the subject of the Permit. By this letter, I am requesting that the Groundwater Authority transfer the Permit to reflect Buyer's purchase of my ownership interest, with the express condition that the transfer be "effective on the date of closing of Buyer's purchase of the ownership interest in the water rights that are the subject of the permit referenced above." I understand that following closing Buyer will provide to the Groundwater Authority appropriate documentation of the purchase.

Because Buyer is requiring issuance of a satisfactory permit from the Groundwater Authority in connection with closing, I request your prompt attention to this matter. If you have questions or require additional information regarding this application, please [describe contact information, e.g., call my office at [telephone number]].

[Name of grantor], Permittee

[Reserved]

Form 16-13

Affidavit of Debts and Liens [and Indemnity]

Date:

Contract of Sale

Date:

Seller:

Buyer:

Property:

Permit No. [include specific reference to all surface water permits and groundwater permits associated with the property]

Affiant:

Lender:

Title Insurance Provider

Agent:

Underwriter:

Include the following if applicable.

Commitment for Title Insurance

GF#:

Issuance Date [and Time]:

Continue with the following.

Closer:

Affiant on oath swears that the following statements are true and are within the personal knowledge of Affiant:

1. Affiant is [Seller/[the president/an authorized partner/a general partner/[**describe other representative capacity**] of Seller]] and authorized to make this affidavit [on behalf of Seller].
2. Seller is the owner of [an undivided interest in] the Property [**include if applicable:** together with the other persons identified above as Seller] and Permit No. [number].
3. Seller has performed its obligations under the Contract by [**include as applicable:** providing Buyer with copies of or access to all records required to be furnished to Buyer/ terminating all lease, service, or maintenance agreements required to be terminated/obtaining the release of all liens, security instruments, and encumbrances required to be released/ [**describe other obligations**]].
4. Seller has not granted any rights or interests in the Property during the pendency of the Contract, and there are no leases, contracts to sell the Property, or parties in possession of the Property [**include if applicable:** , except [**specify**]].
5. Seller has made no improvements to the Property that have not been fully paid for or that could give rise to any mechanic's and materialman's liens or adverse claims [**include if applicable:** , except [**specify**]].
6. Seller has not received notice of any adverse claim, violation of applicable law, notice of default, notice of intent to condemn, or threatened lawsuit or proceeding that could

adversely affect the Property or Buyer's rights in the Property or Permit No. [number]

[include if applicable: , except [specify]].

7. There are no unpaid debts, judgments, liens, or obligations affecting the Property [include if applicable: , except [specify]].

8. Seller has paid all fees and filed all reports required by the [Texas Commission on Environmental Quality/[name of applicable groundwater authority]], and there are no outstanding deficiencies or violations related to Permit No. [number].

9. Affiant acknowledges that this affidavit is made to induce Buyer to purchase the Property [include as applicable: [and/,] Lender to make a loan to Buyer secured by the Property/[and/,] Title Insurance Provider to insure title to the Property subject only to the exceptions shown in Schedule B of the Commitment for Title Insurance/[and] Closer to close this transaction].

Include the following if applicable.

10. The representations and warranties set out in the Contract are still true and correct [include if applicable: , except [specify]].

Include the following if applicable.

11. The indemnification obligations set out in the Contract are hereby acknowledged and confirmed.

Continue with the following.

[Name of affiant]

SUBSCRIBED AND SWORN TO before me on _____ by [name of affiant].

Notary Public, State of Texas

Include the following if applicable.

Indemnity

For valuable consideration, [Affiant/Seller] indemnifies and agrees to defend and hold Buyer [and [Lender/Title Insurance Provider/Closer]] harmless from all losses, damages, judgments, and expenses, including attorney's fees and court and other costs, that Buyer [and [Lender/Title Insurance Provider/Closer]] suffer[s], incur[s] or pay[s] because any part of this Affidavit is not true or completely correct.

[Name of affiant or seller]

Form 16-14

Assignment and Assumption of Lease
[Water Rights]

Date:

Assignor:

Assignor's Mailing Address:

Assignee:

Assignee's Mailing Address:

[Real Property:]

Water Rights:

Lease

Date:

Lessor:

Lessor's Address:

Lessee:

Lessee's Address:

Amendments:

Consideration:

Assignor is conveying the Water Rights to Assignee by warranty deed dated this date.

Assignor, for the Consideration and subject to the Reservations from Conveyance and the Exceptions to Conveyance and Warranty in the warranty deed, to the extent they affect the Lease, assigns to Assignee all of Assignor's right, title, and interest in and to the Lease. Assignor binds Assignor and Assignor's heirs and successors to warrant and forever defend all and singular Lessor's interest in the Lease to Assignee and Assignee's heirs, successors, and assigns against every person whomsoever lawfully claiming or to claim the same or any part thereof [**include if applicable:** when the claim is by, through, or under Assignor but not otherwise], except as to the Reservations from Conveyance and the Exceptions to Conveyance and Warranty in the warranty deed, to the extent they affect the Lease.

Assignee assumes and agrees to perform Lessor's obligations under the Lease arising after this date. The obligation to repay security and prepaid rental deposits to Lessee under the Lease is limited to the amount of cash delivered or credited by Assignor to Assignee with respect to security and prepaid rental deposits. Assignee will indemnify, defend, and hold Assignor harmless from any loss, attorney's fees, expenses, or claims arising out of or related to Assignee's failure to perform any of the obligations of Lessor under the Lease after this date.

Assignor will indemnify, defend, and hold Assignee harmless from any loss, attorney's fees, expenses, or claims arising out of or related to Assignor's failure to perform any of the obligations of Lessor under the Lease before this date.

When the context requires, singular nouns and pronouns include the plural.

[Name of assignor]

[Name of assignee]

Include acknowledgments. Attach exhibits.

[Reserved]

Form 16-15

Lessee Estoppel Certificate
[Water Rights]

Date:

Lease

Date:

Lessor:

Lessee:

Water Rights:

Amendments:

Addressee:

Lessee certifies to Addressee that—

1. Lessee has accepted and is in possession of the Water Rights.
2. All requirements under the Lease required to be performed through the date of this certificate have been completed to the satisfaction of Lessee.
3. Neither Lessor nor Lessee is in default in the performance of the Lease.
4. The current rent is [amount] dollars (\$[amount]) per [term] payable [describe due date, e.g., on the first of the month], and has been paid through [date]. The next payment is due on [date]. No rent under the Lease has been paid more than thirty days in advance of its due date.

5. The Lease term ends on [date], and Lessee has no right or option to purchase all or any part of the Water Rights.

6. Lessee has not paid a security or other deposit with respect to the Lease except as follows: [describe].

7. Lessee has not given Lessor written notice of any dispute between Lessor and Lessee, and Lessee has no knowledge of any event that, with the giving of notice, the passage of time, or both, would constitute a default by Lessor under the Lease.

8. Lessee has not assigned the Lease in whole or in part.

9. The Lease is valid, enforceable, and unmodified except for the Amendments.

10. Lessee understands that Addressee is relying on the representations in this certificate.

Include the following if applicable.

11. Lessee will give Addressee written notice of any default by Lessor under the Lease that would entitle Lessee to terminate the Lease and sixty days in which to cure the default before taking action to terminate the Lease.

Include the following if applicable.

12. Lessee has notice that Lessor's interest in the Lease, the rents, and all other sums due in connection with the Lease have been or will be assigned to Addressee as security for a loan. The loan documents authorize Addressee to obtain rents directly from Lessee if Lessor defaults on the loan, and Lessee agrees that it will pay the rent directly to Addressee on receipt of a written request by Addressee.

Include the following if applicable.

13. In the event that Addressee succeeds to the interest of Lessor or any successor to Lessor, then Lessee hereby agrees to attorn to and accept Addressee and to recognize Addressee as its Lessor under the Lease for the remaining term and at Lessor's request will sign and deliver an attornment agreement to Lessor.

Continue with the following.

[Name of lessee]

By _____

[Reserved]

Form 16-16

Memorandum of Contract

Date:

Contract: [Groundwater Rights Sale Contract/Surface Water Rights Sale Contract]

Date:

Seller:

Buyer:

Description of Water Rights:

This Memorandum of Contract is given to evidence Buyer's right to acquire the Water Rights pursuant to the terms of the Contract. Buyer and Seller will execute a notice of termination of the Contract if the Contract is terminated before completion of the sale.

Buyer:

[Name of buyer]

STATE OF TEXAS

COUNTY OF [county]

This instrument was acknowledged before me on [date] by [name].

Notary Public, State of Texas

Seller:

[Name of seller]

STATE OF TEXAS

COUNTY OF [county]

This instrument was acknowledged before me on [date] by [name].

Notary Public, State of Texas

After recording, return to:
[name and address]

Form 16-17

Notice of Termination of Contract
[Water Rights]

Date:

Contract: [Groundwater Rights Sale Contract/Surface Water Rights Sale Contract]

Date:

Seller:

Buyer:

Description of Water Rights:

This Notice of Termination of Contract is given to evidence the termination of the Contract, which is more fully described in that Memorandum of Contract recorded under Document No. [number] in the Official Public Records of [county] County, Texas.

Seller and Buyer hereby agree that the Contract was terminated before completion of the sale, and Seller is the owner of the Water Rights free from any claims by Buyer.

Buyer:

[Name of buyer]

STATE OF TEXAS

COUNTY OF [county]

This instrument was acknowledged before me on [date] by [name].

Notary Public, State of Texas

Seller:

[Name of seller]

STATE OF TEXAS

COUNTY OF [county]

This instrument was acknowledged before me on [date] by [name].

Notary Public, State of Texas

After recording, return to:
[name and address]

Form 16-18

This form is for the sale of surface water rights when water rights have already been severed from the land or when water rights are to be severed from the land to which they are appurtenant. The form should be modified as appropriate.

Surface Water Rights Sales Contract
Permit/Certificate of Adjudication No[s].

Notice of confidentiality rights: If you are a natural person, you may remove or strike any or all of the following information from any instrument that transfers an interest in real property before it is filed for record in the public records: your Social Security number or your driver's license number.

This contract to buy and sell surface water rights is between Seller and Buyer as identified below and is effective on the date ("Effective Date") of the last of the signatures by Seller and Buyer as parties to this contract and by [Title Company/Escrow Agent] to acknowledge receipt of the [Initial] Earnest Money. Buyer must deliver the [Initial] Earnest Money and obtain a signature acknowledging receipt of the [Initial] Earnest Money before the [Initial] Earnest Money Deadline provided in paragraph A.1. below for this contract to be effective. If the Earnest Money is paid by check and payment on presentation is refused, Buyer is in default.

Seller:

Address:

Phone:

E-mail:

Type of entity:

Seller's Attorney:

Law firm:

Address:

Phone:

E-mail:

Buyer:

Address:

Phone:

E-mail:

Type of entity:

Buyer's Attorney:

Law firm:

Address:

Phone:

E-mail:

Include the following if applicable.

Surveyor:

Survey Category:

Continue with the following.

[Title Company/Escrow Agent]: **[identify title company, or if title insurance will not be obtained, identify person who will act as escrow agent]**

Address:

Phone:

E-mail:

[Underwriter:]

Water [Authority/Authorities]: The Texas Commission on Environmental Quality (TCEQ) and **[list any other applicable agencies or governmental bodies or authorities having jurisdiction over the administration of the water rights, e.g., a watermaster or other river or basin water authority]**

Seller's Permit/Certificate of Adjudication No[s]. **[list all permits and certificates of adjudication, including numbers, that are the subject of the sale and attach copies of each together with all amendments thereto as exhibit A]**

Appurtenant Land: **[provide legal description of any land to which the water rights are appurtenant or attach field notes as exhibit B]**

Buyer's Intended Use of Water Rights:

Water Rights: Seller's Permit/Certificate of Adjudication No[s]. **[number[s]]**

Select one of the following.

All right, title, and interest in and to Permit/Certificate No. **[number]** as amended, dated **[date]**, issued by the TCEQ to **[name of seller]**, concerning the right to appropriate surface waters of the state of Texas in the **[identify water body]** for **[purpose, e.g., irrigation, municipal, industrial, recreational purposes]** (the "Permit/Certificate").

Or

The following portion of the Water Rights: [**specify portion being sold, such as number of acre-feet authorized to be diverted**]

[**Include if applicable:** These Water Rights are currently appurtenant to the Appurtenant Land, but will be amended to change the [**include as applicable:** place of use/place of appropriation/purpose of use/point of diversion/[**other provision for which amendment of the current certificate is sought**]] from [**describe place of use, place of appropriation, purpose of use, point of diversion, or other provision in the current certificate for which amendment is sought, as applicable**] to [**describe place of use, place of appropriation, purpose of use, point of diversion, or other amendment to the water right sought by buyer**] [**include if applicable:** and to sever the Water Rights from the Appurtenant Land in the Permit/Certificate to make the water rights appurtenant to the land described on Exhibit [**exhibit number/letter**] attached to this contract]].

Include the following if the water rights are within the Rio Grande and are allocated on an account basis, and attach the TCEQ Rio Grande Water Division Monthly Report statements for the applicable period as an exhibit at the end of this contract.

Seller's Current Year Water Allocation: The amount of water allocated to Seller by the Rio Grande Watermaster for the year beginning January 1, [**year**], and ending December 31, [**year**], as more fully described in Exhibit [**exhibit number/letter**]. The Seller's Water Rights being sold and conveyed to Buyer will include [all/[**describe portion**]] of the Seller's Current Year Water Allocation.

Include the following if the water rights are subject to a watermaster program.

Water Rights Assessments: The amount assessed by the TCEQ for the watermaster program for the period beginning January 1, [**year**], and ending December 31 of the year in which the sale closes. Seller shall pay all Water Rights Assessments when due for the period

during which Seller owns the Water Rights and shall provide proof of payment at or prior to closing. Seller shall escrow any amounts necessary to pay for assessments that will be billed or become payable after closing, attributable to Seller's ownership of the Water Rights prior to closing. This provision shall survive closing.

Continue with the following.

Earnest Money: \$[amount]

[Initial Earnest Money:]

[Additional Earnest Money:]

Depending on the anticipated time for obtaining TCEQ approval, the parties may want to provide for more than one additional earnest money deposit. If there is more than one additional earnest money deposit, the parties should specify whether and the extent to which (1) each is refundable or non-refundable, coordinating with section J. of this contract, and (2) to be applied to the purchase price under paragraph K.2.b.

Independent Consideration: \$[amount] of the Earnest Money constitutes Independent Consideration given for Buyer's right to terminate during the Inspection Period under paragraph G.2. The Independent Consideration will be applied to the Purchase Price at closing, but [will/will not] be returned to Buyer if Buyer terminates this contract during the Inspection Period.

Purchase Price

Cash portion:

Seller-financed portion (principal amount of note):

Interest rate:

Maturity date:

Payment schedule:

See exhibit F for additional terms and conditions.

Third-party-financed portion:

Total purchase price:

Buyer's Liquidated Damages: \$[amount]

Seller's Additional Liquidated Damages: \$[amount]

[Title Commitment/Title Information]: If no Title Commitment is required, Seller will have the obligation to provide to Buyer, at [Buyer/Seller]'s expense, the Title Information as defined in paragraph F.2. below.

Title Documents: Seller's [Certificate of Adjudication/[specify other water authority document]] and instruments affecting title to the Water Rights and the Real Property referenced in the [Title Commitment/Title Information] [and as otherwise provided as part of Seller's Records].

County for Performance:

A. Deadlines and Other Dates

All deadlines in this contract expire at 5:00 P.M. local time where the point of diversion of the Water Rights is located. If a deadline falls on a Saturday, Sunday, or national holiday, the deadline will be extended to the next day that is not a Saturday, Sunday, or national holiday. A national holiday is a holiday designated by the federal government. Time is of the essence.

A.1. [Initial] Earnest Money Deadline: [date]

A.2. Delivery of Seller's records as specified in Exhibit D: **[[date]/[number]** days after the Effective Date]

Select one of the following.

A.3. Delivery of Title Commitment to [Water Rights [and/or Appurtenant Land]]: **[[date]/[number]** days after the Effective Date]

Or

A.3. Delivery of Title Information: **[[date]/[number]** days after the Effective Date]

Include the following if applicable.

A.4. Delivery of Survey: **[[date]/[number]** days after the Effective Date]

Select one of the following.

A.5. Delivery of written documents from lienholder(s) consenting to transfer of **[include if applicable: and modifications to]** Water Rights and agreement to release lien on Water Rights or land to which Water Rights are appurtenant, or from other adverse claims to Seller's title to Water Rights: **[[date]/[number]** days after the Effective Date]

Or

A.5. Delivery of Seller's Affidavit of No Liens or Adverse Claims to Water Rights or to Appurtenant Land: **[[date]/[number]** days after the Effective Date]

Continue with the following.

A.6. End of Inspection Period: **[[date]/[number]** days after receipt of the [Title Commitment/Title Information]] **[include if applicable: and Survey]**

A.7. Delivery of Water Rights Conveyance (Conditional) **[include if applicable: with Vendor's Lien]** and other documents necessary to accomplish application for transfer of Water Rights: **[[date]/[number]** days after the Effective Date]

A.8. Filing of TCEQ Application: [number] days after Delivery of Title Conveyance of Water Rights (Conditional)

A.9. Delivery of Additional [Refundable/Nonrefundable] Earnest Money: [At the Conditional Closing in paragraph A.7./[[date]/[number] days after the Effective Date]]

If there is more than one additional earnest money deposit, the parties should specify whether and the extent to which (1) each is refundable or nonrefundable, coordinating with section J. of this contract, and (2) to be applied to the purchase price under paragraph K.2.b.

A.10. Delivery of [Title Policy/Opinion of Counsel]: At Final Closing

A.11. Final Closing: [number] days after issuance of TCEQ Approval [Letter/Order] [and other water authority approvals] and receipt thereof by [Title Company/Escrow Agent]

B. Closing Documents

B.1. Conditional Closing Documents

B.1.a. At the Conditional Closing on the deadline stated in paragraph A.7., Seller will deliver the following items:

Water Rights Conveyance (Conditional) [include if applicable: with Vendor's Lien], to be delivered through [Title Company/Escrow Agent]

Documents necessary to accomplish application for transfer of Water Rights from Seller to Buyer, including documents necessary to request from applicable Water [Authority/Authorities] approval of any modifications to Permit/Certificate of Adjudication

IRS Nonforeign Person Affidavit

Select one of the following.

Written documents from lienholder(s) consenting to transfer of Water Rights and modifications to Permit/Certificate sought by Buyer from any Water [Authority/Authorities] and agreeing to release lien(s) on Water Rights and/or the land to which Water Rights are appurtenant, or from any other adverse claims to Seller's title to Water Rights on Final Closing

Or

Seller's Affidavit of No Liens or Adverse Claims to Water Rights or to Appurtenant Land

Continue with the following.

[Title Policy/Opinion of Counsel]

Evidence of Seller's authority to close this transaction

B.1.b. At the Conditional Closing on the deadline stated in paragraph A.7., Buyer will deliver the following items:

Additional [Refundable/Nonrefundable] Earnest Money deposit

Evidence of Buyer's authority to close this transaction

B.2. Final Closing Documents

B.2.a. At Final Closing, Seller will deliver the following items:

Conveyance of Water Rights (Unconditional) [**include if applicable:** with Vendor's Lien], to be delivered through [Title Company/Escrow Agent]

Include the following if applicable.

Transfer of Existing Water Allocations, if any, pertaining to Water Rights

Include the following if applicable.

[Release of Lien on Water Rights from lienholder(s) holding a lien on Water Rights or the Appurtenant Land or from other adverse claims to Seller's title to Water Rights/Seller's Affidavit of No Liens or Adverse Claims, dated as of the date of Closing]

Continue with the following.

B.2.b. At Final Closing, Buyer will deliver the following items:

Balance of Purchase Price

Evidence of Buyer's authority to close this transaction

Seller-financing documents

Promissory Note

Deed of Trust

The documents listed in section B.1. are collectively known as the "Conditional Closing Documents." The documents listed in section B.2. are collectively known as the "Final Closing Documents." Unless otherwise agreed by the parties before Closing, the Water Rights Conveyance [**include if applicable:** , note, and water rights deed of trust (with security agreement, financing statement, and assignment of leases and rents)] will be prepared using the printed forms contained in the current edition of the *Texas Real Estate Forms Manual* (State Bar of Texas).

C. Exhibits

The following are attached to and are a part of this contract:

Exhibit A—Copy of Permit/Certificate of Adjudication and any amendments

Exhibit B—Description of the Appurtenant Land

Exhibit C—Representations; Environmental Matters [; Severance of Water Rights]

Exhibit D—Seller's Records [**attach copies of annual water reports and water-master assessment payments if applicable**]

Exhibit E—Notices, Statements, and Certificates

[**Include if applicable:** Exhibit F—Seller Financing Addendum]

[**Include if applicable:** Exhibit G—Memorandum of Contract]

[**Include if applicable:** Exhibit H—Notice of Termination of Contract]

D. Purchase and Sale of Water Rights

The parties acknowledge that the essence of this transaction is that the TCEQ [and [name of water [authority/authorities]]] approve the change of ownership, [**include as applicable:** place of use/purpose of use/point of diversion] of the Water Rights. The parties therefore agree that subject to necessary proceedings before and approval of the TCEQ [and [name of water [authority/authorities]]], Seller agrees to sell and convey the Water Rights to Buyer and Buyer agrees to buy and pay Seller for the Water Rights. The promises by Buyer and Seller stated in this contract are the consideration for the formation of this contract.

Include the following if applicable.

The parties further acknowledge that Buyer is purchasing the Water Rights of Seller as a right separate and apart from the Appurtenant Land and that no interest in such land is intended to be sold, transferred, or conveyed to Buyer.

Continue with the following.

E. Interest on Earnest Money

Buyer may direct [Title Company/Escrow Agent] to invest the Earnest Money in an interest-bearing account in a federally insured financial institution by giving notice to [Title Company/Escrow Agent] and satisfying [Title Company/Escrow Agent]'s requirements for investing the Earnest Money in an interest-bearing account. Any interest earned on the Earnest Money will become part of the Earnest Money.

F. Title [and Survey]

F.1. Opinion of Counsel. "Opinion of Counsel" means a written opinion of an attorney designated by [Buyer/Seller] that Seller has marketable title to the Water Rights.

Select one of the following.

F.2. Title Commitment; Title Policy. "Title Commitment" means a Commitment for Issuance of an Owner Policy of Title Insurance by Title Company, as agent for Underwriter, stating the condition of title to the Water Rights and any Appurtenant Land. The "effective date" stated in the Title Commitment must be after the Effective Date of this contract. "Title Policy" means an Owner Policy of Title Insurance issued by Title Company, as agent for Underwriter, in conformity with the last Title Commitment delivered to and approved by Buyer.

Or

F.2. Title Information. "Title Information" means an abstract of title prepared by a title insurance company or an abstract company licensed by the Texas State Board of Insurance, covering the period from the first conveyance of title to the Water Rights and any Appurtenant Land out of the sovereignty to the Effective Date, and containing complete and legible copies of all of the deeds, easements, liens, and other documents affecting title to the Water Rights and any Appurtenant Land.

Continue with the following.

F.3. Delivery of Seller's Records; [Title Commitment/Title Information]; Consent to Transfer and Agreement to Release; Water Rights Conveyance (Conditional). Seller must deliver Seller's Records to Buyer by the deadline stated in paragraph A.2., any [Title Commitment/Title Information] to Buyer by the deadline stated in paragraph A.3., the [written documents from lienholder(s)/Seller's Affidavit of No Liens] described in paragraph A.5. by the deadline stated in paragraph A.5., the Water Rights Conveyance (Conditional) by the deadline stated in paragraph A.7., and the [Opinion of Counsel/Title Policy] by the deadline stated in paragraph A.10.

Include the following if applicable.

F.4. Survey. "Survey" means an on-the-ground, staked plat of survey and metes-and-bounds description of the Land, prepared by Surveyor or another surveyor satisfactory to Title Company, dated after the Effective Date, and certified to comply with the current standards and specifications as published by the Texas Society of Professional Surveyors for the Survey Category.

F.5. Delivery of Survey. [Seller must deliver to Buyer/Buyer must order for delivery] the Survey by the deadline stated in paragraph A.4.

Continue with the following.

G. Inspection Period

G.1. Title Search. "Title Search" means a search of appropriate records or reports stating the condition of the title to the Water Rights and to any Appurtenant Land.

G.2. Buyer's Right to Terminate. Buyer may conduct a Title Search during the Inspection Period at [Buyer/Seller]'s cost. Buyer may terminate this contract for any reason by notifying Seller before the end of the Inspection Period.

G.3. Title Objections. Buyer has until the End of Inspection Period in paragraph A.6. above to review the [Title Commitment/Title Information] [**include if applicable:** , Survey,] and legible copies of the Title Documents, notify Seller of Buyer's objections to any of them, and request any additional information needed to evidence Seller's title to the Water Rights [**include if applicable:** and Appurtenant Land] ("Title Objections"). Buyer will be deemed to have approved all matters reflected by the [Title Commitment/Title Information] [**include if applicable:** , Survey,] and Title Documents to which Buyer has made no Title Objection by the end of the Inspection Period. The matters that Buyer either approves or is deemed to have approved are "Permitted Exceptions." If Buyer notifies Seller of any Title Objections, Seller has five days from receipt of Buyer's notice to notify Buyer whether Seller agrees to cure the Title Objections before Closing ("Cure Notice"). If Seller does not timely give its Cure Notice or timely gives its Cure Notice but does not agree to cure all the Title Objections before Closing, Buyer may, within five days after the deadline for the giving of Seller's Cure Notice, notify Seller that either this contract is terminated or Buyer will proceed to close, subject to Seller's obligations to resolve the items listed in Schedule C of the [Title Commitment/Title Information], remove the liquidated liens, remove all exceptions that arise by, through, or under Seller after the Effective Date, and cure only the Title Objections that Seller has agreed to cure in the Cure Notice. At or before Closing, Seller must resolve the items that are listed in Schedule C of the [Title Commitment/Title Information], remove all liquidated liens, remove all exceptions that arise by, through, or under Seller after the Effective Date of this contract, and cure the Title Objections that Seller has agreed to cure.

H. Representations and Warranties

The parties' representations stated in Exhibit C are true and correct as of the Effective Date and must be true and correct on the Closing Date. Seller will promptly notify Buyer if Seller becomes aware that any of the representations are not true or correct.

I. Water Rights Conveyance (Conditional); Application for Approval; Cooperation; Condition of Water Rights until Final Closing; Memorandum/No Recording of Contract

I.1. Conditional Conveyance. By the deadline stated in paragraph A.7., Seller will execute and deliver to Buyer (a) a Water Rights Conveyance (in form and substance acceptable to Buyer and the TCEQ and containing warranty of title) and (b) such other applications or documents as may be required to transfer the Water Rights, including all documents required to pursue governmental approval proceedings; provided, however, that Seller's conveyance of the Water Rights shall be deemed conditional until the Final Closing Date (i.e., such time as the TCEQ has issued an Amendment to Certificate of Adjudication No. [number] or other appropriate order or orders approving the transfer of water rights [include if applicable: and the approval of any other Water [Authority/Authorities]], and Buyer has paid the balance of the Purchase Price).

I.2. Application for TCEQ Approval; Additional Earnest Money. Seller hereby authorizes Buyer to file an application with the TCEQ and all other required governmental and Water Authorities for approval of the transfer of ownership [include if applicable: and [include as applicable: change of place/purpose of use/point of diversion], as designated by Buyer] for the Water Rights (the "Governmental Proceedings"). Buyer must file the application(s) for such Governmental Proceedings by the deadline stated in paragraph A.8. [Buyer/Seller] will bear the expenses of the Application(s), including the expenses of any public hearings or proceedings before the TCEQ and all other required Water Authorities, and any required filing and recording fees; provided, however, that Buyer will bear any expenses incurred by Buyer to place Buyer in a position to accept the transfer of the Water Rights. Buyer will initiate and pursue the Governmental Proceedings, and Seller will cooperate with Buyer to procure approval of the transfer of Water Rights by the deadline stated in paragraph A.9., provided, however, that failure to procure governmental approval or delay in Govern-

mental Proceedings beyond the deadline stated in paragraph A.9. not attributable to the conduct of either of the parties to this contract will not be grounds for termination of this contract.

1.3. Maintenance and Use. Until closing, Seller will (a) maintain the Water Rights as they exist on the Effective Date, except to the extent otherwise required by the TCEQ or any governmental or water rights authority or order of a court of competent jurisdiction; (b) use the Water Rights in the same manner as they were used on the Effective Date; and (c) comply with all permit conditions and applicable contracts and governmental regulations affecting the Water Rights. Until the end of the Inspection Period, Seller will not enter into, amend, or terminate any contract that affects the Water Rights other than in the ordinary course of using the Water Rights and will promptly give notice to Buyer of each new, amended, or terminated contract, including a copy of the contract, in sufficient time so that Buyer may consider the new information before the end of the Inspection Period. If Seller's notice is given within three days before the end of the Inspection Period, the Inspection Period will be extended for three days. After the end of the Inspection Period, Buyer may terminate this contract if Seller enters into, amends, or terminates any contract that affects the Water Rights without first obtaining Buyer's written consent.

1.4. Condemnation. Seller will notify Buyer promptly after Seller receives notice that any part of the Water Rights has been or is threatened to be condemned or otherwise taken by a governmental or quasi-governmental authority. Buyer may terminate this contract if the condemnation would materially affect Buyer's Intended Use of Water Rights by giving notice to Seller within fifteen days after receipt of Seller's notice to Buyer (or before Final Closing if Seller's notice is received less than fifteen days before Final Closing). The condemnation will be deemed to materially affect Buyer's Intended Use of Water Rights if [**specify reason, e.g.**, the condemnation would result in Buyer's not being able to divert more than [**number**] acre-feet of water; would have an adverse effect on quality or availability of water]. If Buyer does not terminate this contract, (a) Buyer and Seller will each have the right to

appear and defend their respective interests in the Water Rights in the condemnation proceedings, (b) any award in condemnation will be assigned to Buyer to the extent necessary to compensate Buyer for the loss of or reduction in the Water Rights, and (c) if the taking occurs before Closing, the description of the Water Rights will be revised to delete the portion taken.

1.5. Claims; Hearings. Seller will notify Buyer promptly after Seller receives notice of any claim or administrative hearing that is threatened, filed, or initiated before Closing that affects the Water Rights.

1.6. Memorandum of Contract; Termination of Contract; No Recording of Contract. At the request of Buyer, Seller will execute a memorandum of this contract, in a mutually acceptable form, to be recorded in the real property records of [county] County, Texas. At the time the memorandum is signed, Buyer and Seller will also sign a termination of contract in recordable form ("Termination of Contract") and deposit it into escrow with [Title Company/Escrow Agent]. The parties authorize [Title Company/Escrow Agent] to record the Termination of Contract as provided in section J. below. Neither Buyer nor Seller may file this contract in the real property records of any county. If either party records this contract, the other party may terminate this contract and record a notice of termination.

J. Conditions of Contract Termination

If there is more than one additional earnest money deposit, the parties should specify which deposits are refundable and which are nonrefundable.

J.1. Termination on Failure to Obtain TCEQ Order of Approval. If, through no fault of Seller or Buyer, the TCEQ does not issue (a) an amendment to the Certificate of Adjudication or other permit for the Water Rights or (b) its other final approval [letter/order] of the transfer of Water Rights to Buyer as provided herein, then [Title Company/Escrow Agent] will return (a) to Seller the Title Conveyance of Water Rights and (b) to Buyer the [Earnest Money/Additional Earnest Money], and the parties will cancel all portions of the transaction

set forth in this contract by appropriate legal means. In such event, neither party will have any further obligation to the other, and the parties agree to sign such instruments and take such actions as are required to place the parties in the position each was in with respect to the Water Rights before entering into this contract. [Title Company/Escrow Agent] will record the Termination of Contract on receipt of Seller's authorization to return the Earnest Money.

J.2. Disposition of Earnest Money after Other Termination

J.2.a. To Buyer. If Buyer terminates this contract in accordance with any of Buyer's rights to terminate, then unless Seller delivers notice of Seller's objection to [Title Company/Escrow Agent]'s release of the Earnest Money to Buyer within five days after Buyer delivers Buyer's termination notice to Seller and [Title Company/Escrow Agent], [Title Company/Escrow Agent] is authorized, without any further authorization from Seller, to deliver the Earnest Money to Buyer. [Title Company/Escrow Agent] will record the Termination of Contract on receipt of Seller's authorization to return the Earnest Money.

J.2.b. To Seller. If Seller terminates this contract in accordance with any of Seller's rights to terminate, then unless Buyer delivers notice of Buyer's objection to [Title Company/Escrow Agent]'s release of the Earnest Money to Seller within five days after Seller delivers Seller's termination notice to Buyer and [Title Company/Escrow Agent], [Title Company/Escrow Agent] is authorized, without any further authorization from Buyer, to pay and deliver the Earnest Money to Seller. [Title Company/Escrow Agent] will record the Termination of Contract on receipt of Buyer's authorization to pay the Earnest Money.

J.3. Duties after Termination. If this contract is terminated, Buyer will promptly return to Seller all documents relating to the Water Rights that Seller has delivered to Buyer and all copies that Buyer has made of the documents. After return of the documents and copies, neither party will have further duties or obligations to the other under this contract, except for those obligations that cannot be or were not performed before termination of this contract.

K. Final Closing

K.1. Date of Final Closing. Within the number of days stated in paragraph A.11. following (a) issuance of TCEQ and/or other final Water Authority approval order(s) and (b) notice thereof to Buyer, Buyer will deliver to [Title Company/Escrow Agent] the balance of the Purchase Price and any additional expenses attributable to Buyer under this section of this contract.

K.2. Final Closing. This transaction will close at [Title Company/Escrow Agent]'s offices at the Final Closing. At Closing, the following will occur:

K.2.a. Final Closing Documents. The parties will execute and deliver the Final Closing Documents.

K.2.b. Payment of Purchase Price. Buyer will deliver the Purchase Price and other amounts that Buyer is obligated to pay under this contract to [Title Company/Escrow Agent] in funds acceptable to [Title Company/Escrow Agent]. The [Earnest Money/Additional Earnest Money] will be applied to the Purchase Price.

K.2.c. Disbursement of Funds; Recording; Copies. [Title Company/Escrow Agent] will be instructed to disburse the Purchase Price and other funds in accordance with this contract, record the deed and the other Final Closing Documents directed to be recorded, and distribute documents and copies in accordance with the parties' written instructions.

K.2.d. Delivery of Originals. Seller will deliver to Buyer the originals of Seller's Records.

K.3. Transaction Costs

K.3.a. Seller's Costs. Seller will pay (i) one-half of the escrow fee charged by [Title Company/Escrow Agent]; (ii) the costs to prepare the Title Conveyance to Water Rights; (iii)

the costs to obtain, deliver, and record releases of all liens to be released at Closing and of [obtaining documents from lienholders consenting to the transfer or modification of Water Rights or other adverse claims to Seller's title to Water Rights/Seller's Affidavit of No Liens or Adverse Claims to Water Rights or to Appurtenant Land]; (iv) the costs to deliver copies of the instruments described in paragraph A.2., [and] (v) Seller's attorney's fees and expenses [**include as applicable:** , (vi) the basic charge for the Title Policy/Title Information; (vii) the charge for the Opinion of Counsel; (viii) the charge for proceedings before the TCEQ and/or other Water Authority, including the expenses of any public hearings or proceedings before the TCEQ, and required filing and recording fees; (ix) the charge for the Survey [[: and] **include any additional charges**]].

K.3.b. Buyer's Costs. Buyer will pay (i) one-half of the escrow fee charged by [Title Company/Escrow Agent]; (ii) the costs to obtain, deliver, and record all documents other than those to be recorded at Seller's expense; (iii) the costs to obtain financing of the Purchase Price, including the incremental premium costs of the mortgagee's title policies and endorsements and deletions required by Buyer's lender; (iv) the costs incurred for Buyer to place itself in a position to accept the transfer of the Water Rights; [and] (v) Buyer's attorney's fees and expenses [**include as applicable:** , (vi) the basic charge for the Title Policy; (vii) the charge for the Opinion of Counsel; (viii) the charge for proceedings before the TCEQ and/or other Water Authority, including the expenses of any public hearings or proceedings before the TCEQ, and required filing and recording fees; (ix) the charge for the Survey [[: and] **include any additional charges**]].

K.3.c. Postclosing Adjustments. If errors in the prorations made at closing are identified within ninety days after Closing, Seller and Buyer will make postclosing adjustments to correct the errors within fifteen days of receipt of notice of the errors.

K.3.d. Brokers Commissions. Buyer and Seller each indemnify and agree to defend and hold the other party harmless from any loss, attorney's fees, and court and other costs

arising out of a claim by any person or entity claiming by, through, or under the indemnitor for a broker's or finder's fee or commission because of this transaction or this contract, whether the claimant is disclosed to the indemnitee or not. At Closing, each party will provide the other party with a release of broker's or appraiser's liens from all brokers or appraisers for which each party was responsible.

Include the following if applicable.

K.4. Issuance of Title Policy. Seller will cause Title Company to issue the Title Policy to Buyer at Final Closing.

Continue with the following.

L. Default and Remedies

L.1. Seller's Default. If Seller fails to perform any of its obligations under this contract, or if any of Seller's representations is not true and correct as of the Effective Date or on the Final Closing ("Seller's Default"), Buyer may elect either of the following as its sole and exclusive remedy:

L.1.a. Termination; Liquidated Damages. Buyer may terminate this contract by giving notice to Seller on or before the Final Closing and have the Earnest Money, less the Independent Consideration as described above, returned to Buyer. Unless Seller's Default relates to the untruth or incorrectness of Seller's representations for reasons not reasonably within Seller's control, if Seller's Default occurs after Buyer has incurred costs to investigate the Water Rights after the Effective Date and Buyer terminates this contract in accordance with the previous sentence, Seller will also pay to Buyer as liquidated damages the lesser of Buyer's actual out-of-pocket expenses incurred to investigate the Water Rights after the Effective Date ("Buyer's Expenses") or the amount of Buyer's Liquidated Damages, within ten days after Seller's receipt of an invoice from Buyer stating the amount of Buyer's Expenses accompanied by reasonable evidence of Buyer's Expenses.

L.1.b. Specific Performance. Unless Seller's Default relates to (i) the untruth or incorrectness of Seller's representations for reasons not reasonably within Seller's control, (ii) a defect in Seller's title to the Water Rights, or (iii) the failure of the TCEQ or other water rights authority to approve the transfer of the Water Rights (unless such failure is due to the acts of Seller), Buyer may enforce specific performance of Seller's obligations under this contract, but any such action must be initiated, if at all, within ninety days after the breach or alleged breach of this contract. If title to the Water Rights is awarded to Buyer, the conveyance will be subject to the matters stated in any Title Commitment.

L.2. Buyer's Default. If Buyer fails to perform any of its obligations under this contract ("Buyer's Default"), Seller may terminate this contract by giving notice to Buyer on or before the Final Closing and have the Earnest Money paid to Seller. If Buyer's Default occurs after Seller has incurred costs to perform its obligations under this contract and Seller terminates this contract in accordance with the previous sentence, Buyer will also reimburse Seller for the lesser of Seller's actual out-of-pocket expenses incurred to perform its obligations under this contract ("Seller's Expenses") or the amount of Seller's Additional Liquidated Damages, within ten days after Buyer's receipt of an invoice from Seller stating the amount of Seller's Expenses accompanied by reasonable evidence of Seller's Expenses. The foregoing constitute Seller's sole and exclusive remedies for a default by Buyer before closing.

L.3. Liquidated Damages. The parties agree that just compensation for the harm that would be caused by a default by either party cannot be accurately estimated or would be very difficult to accurately estimate and that the Earnest Money and the amounts provided above are reasonable forecasts of just compensation to the nondefaulting party for the harm that would be caused by a default.

L.4. Attorney's Fees. If either party retains an attorney to enforce this contract, the party prevailing in litigation is entitled to recover reasonable attorney's fees and court and other costs.

M. Miscellaneous Provisions

M.1. Notices. Any notice required by or permitted under this contract must be in writing. Any notice required by this contract will be deemed to be given (whether received or not) the earlier of receipt or three business days after being deposited with the United States Postal Service, postage prepaid, certified mail, return receipt requested, and addressed to the intended recipient at the address shown in this contract. Notice may also be given by regular mail, personal delivery, courier delivery, or e-mail and will be effective when received, provided that (a) any notice received on a Saturday, Sunday, or national holiday will be deemed to have been received on the next day that is not a Saturday, Sunday, or national holiday; and (b) any notice received after 5:00 P.M. local time at the place of delivery on a day that is not a Saturday, Sunday, or national holiday will be deemed to have been received on the next day that is not a Saturday, Sunday, or national holiday. Any address for notice may be changed by not less than ten days' prior written notice given as provided herein. Copies of each notice must be given by one of these methods to the attorney of the party to whom notice is given.

M.2. Entire Agreement. This contract, its exhibits, and any documents delivered at Closing are the entire agreement of the parties concerning the sale of the Water Rights. There are no representations, warranties, agreements, or promises between the parties pertaining to the Water Rights or the sale of the Water Rights, and neither party is relying on any statements or representations of any agent of the other party, that are not in those documents.

M.3. Amendment. This contract may be amended only by an instrument in writing signed by the parties.

Select one of the following.

M.4. Prohibition of Assignment. Buyer may not assign this contract or any of Buyer's rights under it without Seller's prior written consent, and any attempted assignment is void.

Or

M.4. Assignment. Buyer may assign this contract and Buyer's rights under it only to an entity in which Buyer possesses, directly or indirectly, the power to direct or cause the direction of its management and policies, whether through the ownership of voting securities or otherwise, and any other assignment is void. No such assignment will relieve Buyer of its obligations under this contract, and Buyer and the assignee will be jointly and severally liable for the performance of such obligations after any such assignment.

Continue with the following.

M.5. Survival. The obligations of this contract that cannot be performed before termination of this contract or before Closing survive termination of this contract or Closing, and the legal doctrine of merger does not apply to these matters. If there is any conflict between the Final Closing Documents and this contract, the Final Closing Documents control.

M.6. Choice of Law; Venue. This contract is to be construed under the laws of the state of Texas, without regard to choice-of-law rules of any jurisdiction. Venue is in the County for Performance.

M.7. Waiver of Default. It is not a waiver of default if the nondefaulting party fails to declare a default immediately or delays taking any action with respect to the default.

M.8. No Third-Party Beneficiaries. There are no third-party beneficiaries of this contract.

M.9. Severability. If a provision of this contract is unenforceable for any reason, to the extent the unenforceability does not destroy the basis of the bargain among the parties, the unenforceability does not affect any other provision of this contract, and this contract is to be construed as if the unenforceable provision is not a part of the contract.

M.10. Ambiguities Not to Be Construed against Party Who Drafted Contract. The rule of construction that ambiguities in a document will be construed against the party who drafted it will not be applied in interpreting this contract.

M.11. No Special Relationship. The parties' relationship is an ordinary commercial relationship, and they do not intend to create the relationship of principal and agent, partnership, joint venture, or any other special relationship.

M.12. Counterparts. If this contract is executed in multiple counterparts, all counterparts taken together constitute this contract. Copies of signatures to this contract are effective as original signatures.

M.13. Confidentiality. The parties will keep confidential this contract, this transaction, and all information learned in the course of this transaction, except to the extent disclosure is required by law or court order or to enable third parties to advise or assist Buyer to investigate the Water Rights or either party to close this transaction. Remedies for violations of this provision are limited to injunctions, and no damages or rescission may be sought or recovered as a result of any such violations.

M.14. Binding Effect. This contract binds, benefits, and may be enforced by the parties and their respective heirs, successors, and permitted assigns.

Include the following only if the buyer has agreed to waive its rights under the DTPA.

M.15. Waiver of Consumer Rights. BUYER WAIVES ITS RIGHTS UNDER THE TEXAS DECEPTIVE TRADE PRACTICES–CONSUMER PROTECTION ACT, SECTION 17.41 *ET SEQ.* OF THE TEXAS BUSINESS AND COMMERCE CODE, A LAW THAT GIVES CONSUMERS SPECIAL RIGHTS AND PROTECTIONS. AFTER CONSULTATION WITH AN ATTORNEY OF ITS OWN SELECTION, BUYER VOLUNTARILY CONSENTS TO THIS WAIVER.

Continue with the following.

[Name and title of seller]
 Date:

[Name and title of buyer]
 Date:

[Title Company/Escrow Agent] acknowledges receipt of Earnest Money in the amount of \$ _____ and a copy of this contract executed by both Buyer and Seller.

[Name of title company/escrow agent]
 By _____
 Name:
 Title:
 Date:

Exhibit A

Copies of Permit/Certificate of Adjudication No.

Attach all permits and certificates of adjudication including numbers and all amendments that are the subject of this sale.

Exhibit B

Description of the Appurtenant Land

Include legal description of the land to which water rights are appurtenant or attach field notes.

Exhibit C**Representations; Environmental Matters [; Severance of Water Rights]****A. Seller's Representations to Buyer**

Seller represents to Buyer that the following are true and correct as of the Effective Date and will be true and correct on the Final Closing:

If the seller is an individual or is acting in a representative capacity, some of the items should be modified.

A.1. Authority. Seller is a [**specify type of organization**] duly organized, validly existing, and in good standing under the laws of the state of [Texas/[**state**]] with authority to convey the Water Rights to Buyer. This contract is, and all documents required by this contract to be executed and delivered to Buyer at Closing will be, duly authorized, executed, and delivered by Seller.

A.2. Litigation. Seller has not received written notice and has no actual knowledge of any litigation pending or threatened against Seller that might affect the Water Rights or Seller's ability to perform its obligations under this contract [**include if applicable:** , except: [**specify**]].

A.3. Violation of Laws. Seller has not received written notice of violation of any law, ordinance, regulation, or requirements affecting the Water Rights or Seller's use of the Water Rights [**include if applicable:** , except: [**specify**]].

A.4. Licenses, Permits, and Approvals. Seller has not received written notice that any license, permit, or approval necessary to use the Water Rights in the manner in which they are currently used has expired or will not be renewed on expiration or that any material condition will be imposed in order to obtain their renewal [**include if applicable:** , except: [**specify**]].

A.5. *Condemnation; Zoning; Land Use; Hazardous Materials.* Seller has not received written notice of any condemnation, zoning, or land-use proceedings affecting the Water Rights or any written inquiries or notices by any governmental authority or third party with respect to the presence of hazardous materials affecting the Water Rights [**include if applicable:** , except: [**specify**]].

A.6. *No Other Obligation to Sell Water Rights or Restriction against Selling Water Rights.* Except for granting a security interest in the Water Rights, Seller has not obligated itself to sell the Water Rights to any party other than Buyer. Seller's performance of this contract will not cause a breach of any other agreement or obligation to which Seller is a party or to which it is bound.

A.7. *No Liens.* On the Final Closing, the Water Rights will be free and clear of all liens and encumbrances of any nature not arising by, through, or under Buyer except the Permitted Exceptions or liens to which Buyer has given its consent.

A.8. *Good Title.* Seller has good and indefeasible fee simple title to the Water Rights, free and clear of all mortgages, liens, licenses, encumbrances, leases, tenancies, security interests, covenants, conditions, restrictions, rights-of-way, easements, judgments, and other matters affecting title [**include if applicable:** , except: [**specify**]].

A.9. *No Bills or Claims.* There will be no unpaid bills or claims in connection with any repair or work performed or material furnished or otherwise relating to the Water Rights for the benefit of Seller as of the date of Closing, and all bills attributable to or affecting the Water Rights will be paid by Seller in full before Closing.

A.10. *No Adverse Matters.* To Seller's knowledge, there is no (a) change contemplated in any applicable laws, ordinances, or restrictions, including the rules of the Water Authority; (b) judicial or administrative action threatened or pending against the Water Rights or Seller; (c) action [**include if applicable:** by landowners adjacent to the Appurtenant Land]

pending or threatened against the Water Rights or Seller; or (d) natural or artificial conditions relating to the Water Rights [**include if applicable:** or relating to the Appurtenant Land] that would have a material adverse effect on the Water Rights [**include if applicable:** and Appurtenant Land].

A.11. Compliance with Laws. To Seller's knowledge, Seller has at all times complied with and operated in compliance with all applicable federal, state, and local laws, regulations, and ordinances regarding the Water Rights [**include if applicable:** and the Appurtenant Land], including rules of any applicable Water Authority. Seller will promptly notify Buyer of any noncompliance notice received by Seller.

A.12. No Other Representation. Except as stated above or in the notices, statements, and certificates set forth in Exhibit E, Seller makes no representation with respect to the Water Rights.

Include the following if applicable.

A.13. No Warranty. Seller has made no warranty other than the warranty of title in connection with this contract.

Include the following if applicable.

A.14. Severance of Water Rights. The Water Rights that Seller agrees to convey herein are appurtenant to land in [**county**] County, Texas, and those Water Rights have not heretofore been severed from the land.

Continue with the following.

B. "As Is, Where Is"

THIS CONTRACT IS AN ARM'S-LENGTH AGREEMENT BETWEEN THE PARTIES. THE PURCHASE PRICE WAS BARGAINED ON THE BASIS OF AN "AS IS, WHERE IS" TRANSACTION AND REFLECTS THE AGREEMENT OF THE PARTIES THAT THERE ARE NO REPRESENTATIONS OR

EXPRESS OR IMPLIED WARRANTIES, EXCEPT THOSE IN THIS CONTRACT AND THE CLOSING DOCUMENTS.

SELLER DISCLAIMS ALL WARRANTIES AND REPRESENTATIONS REGARDING THE QUANTITY OR QUALITY OF THE WATER AVAILABLE PURSUANT TO THE WATER RIGHTS OR ITS RELIABILITY FOR ANY PARTICULAR USE OR PURPOSE.

BUYER IS NOT RELYING ON ANY REPRESENTATIONS, DISCLOSURES, OR EXPRESS OR IMPLIED WARRANTIES OTHER THAN THOSE EXPRESSLY CONTAINED IN THIS CONTRACT AND THE CLOSING DOCUMENTS. BUYER IS NOT RELYING ON ANY INFORMATION REGARDING THE WATER RIGHTS OR PERMIT/CERTIFICATE PROVIDED BY ANY PERSON OTHER THAN BUYER'S OWN INSPECTION AND THE REPRESENTATIONS AND WARRANTIES CONTAINED IN THIS CONTRACT AND THE CLOSING DOCUMENTS.

C. Environmental Matters

AFTER CLOSING, BUYER RELEASES SELLER FROM LIABILITY FOR ENVIRONMENTAL PROBLEMS AFFECTING THE PROPERTY, INCLUDING LIABILITY (1) UNDER THE COMPREHENSIVE ENVIRONMENTAL RESPONSE, COMPENSATION, AND LIABILITY ACT (CERCLA), THE RESOURCE CONSERVATION AND RECOVERY ACT (RCRA), THE TEXAS SOLID WASTE DISPOSAL ACT, OR THE TEXAS WATER CODE; OR (2) ARISING AS THE RESULT OF THEORIES OF PRODUCTS LIABILITY AND STRICT LIABILITY, OR UNDER NEW LAWS OR CHANGES TO EXISTING LAWS ENACTED AFTER THE EFFECTIVE DATE THAT WOULD OTHERWISE IMPOSE ON SELLERS IN THIS TYPE OF TRANSACTION NEW LIABILITIES FOR ENVIRONMENTAL PROBLEMS AFFECTING THE PROPERTY [**Include if applicable: THIS RELEASE APPLIES EVEN WHEN THE ENVIRONMENTAL PROBLEMS AFFECTING THE PROPERTY RESULT FROM SELLER'S OWN NEGLIGENCE OR THE NEGLIGENCE OF SELLER'S REPRESENTATIVE.**]

The provisions of this section C. regarding the Water Rights will be included in the Title Conveyance of Water Rights with appropriate modification of terms as the context requires.

D. Buyer's Representations to Seller

Buyer represents to Seller that the following are true and correct as of the Effective Date and will be true and correct on the Closing Date:

If the buyer is an individual or is acting in a representative capacity, some of the items should be modified.

D.1. Authority. Buyer is a [**specify type of organization**] duly organized, validly existing, and in good standing under the laws of the state of [Texas/[**state**]] with authority to perform its obligations under this contract. This contract is binding on Buyer. This contract is, and all documents required by this contract to be executed and delivered to Seller at Closing will be, duly authorized, executed, and delivered by Buyer.

Include other representations from the buyer to the seller as needed.

Exhibit D**Seller's Records**

To the extent that Seller has possession of the following items pertaining to the Water Rights, Seller will deliver or make the items or copies of them available to Buyer by the deadline stated in paragraph A.8.

Governmental

governmental licenses, certificates, permits, and approvals, specifically including

Seller's Permit or Certificate of Adjudication to the Water Rights

environmental reports

records of regulatory proceedings or violations

annual water use reports filed with TCEQ, and its predecessor agencies related to the
Water Rights

Watermaster reports, if any, related to the Water Rights

other: **[specify]**

Financial

books and records for the Water Rights

other: **[specify]**

Leases

Leases

renewal options

security deposit

current tenant or landlord defaults

estoppel letters and/or subordination agreements

other: [specify]

Exhibit E**Notices, Statements, and Certificates**

Certain notices must be contained in the contract and others must be provided as separate notices. Please refer to the statutory requirements for each notice.

The notices, statements, and certificates (arranged by their application to particular transactions) that are listed below are [**include as applicable:** included in the sales contract/ [and] attached for delivery to Buyer], and Buyer acknowledges receipt of the notices, statements, and certificates by executing this contract:

Include one or more of the following paragraphs as applicable and modify section headers and paragraph numbers as appropriate.

A. Consumer Notices

Notice of Cancellation. Notice concerning the purchaser's three-day right of rescission under a contract to purchase real property if (1) the seller or the seller's agent solicits the sale at a place other than the seller's place of business; (2) the purchaser submits the purchase contract to the seller or the seller's agent at a place other than the seller's place of business; and (3) the consideration payable under the purchase contract exceeds \$100; unless either (1) the purchaser is represented by a licensed attorney; (2) the transaction is negotiated by a licensed real estate broker; or (3) the transaction is negotiated at a place other than the purchaser's residence by the person who owns the property, as described in chapter 601 of the Texas Business and Commerce Code.

If applicable, attach form 4-4 in this manual to the end of this exhibit E.

And/Or

B. Residential Transaction Notices

B.1. Seller's Disclosure of Property Condition. Seller's disclosure of the condition of residential property, described in section 5.008 of the Texas Property Code.

If applicable, attach the full text of Tex. Prop. Code § 5.008, with all relevant information filled in, to the end of this exhibit E.

And/Or

B.2. Notice of Membership in Property Owners Association. Notice concerning the sale of single-family residential property that is subject to membership in a property owners association, described in section 5.012 of the Texas Property Code.

If applicable, attach form 23-8 to the end of this exhibit E.

And/Or

B.3. Seller's Disclosure of Location of Conditions under Surface of Unimproved Real Property. Seller's disclosure of the location of pipelines under the surface of unimproved property to be used for residential purposes, described in section 5.013 of the Texas Property Code. A seller of unimproved property to be used for residential purposes shall provide the purchaser written notice disclosing the location of any transportation pipeline to the best of the seller's belief and knowledge as of the date the notice is completed and signed by the seller. If the information required to be disclosed is not known by the seller, the seller shall indicate that fact in the notice. A seller is not required to give this notice if (a) the seller is obligated under the terms of the contract to furnish a title insurance commitment to the buyer before closing and (b) the buyer is entitled to terminate the contract if the buyer's objections to title as permitted by the contract are not cured by the seller before closing.

No form is provided, because the sales contract portion of this form 16-18 satisfies the provisions for exemption from disclosure.

And/Or

B.4. Notice of Obligation to Pay Public Improvement District Assessment. Seller's disclosure that a single-family residential property is located within a public improvement district, described in section 5.014 of the Texas Property Code.

If applicable, attach form 4-5 to the end of this exhibit E.

And/Or

B.5. Residential Contracts for Deed. Notice regarding the sale of property used or to be used as the purchaser's residence if the contract does not provide for delivery of a deed from the seller to the purchaser within 180 days after the final execution of the contract.

See Tex. Prop. Code §§ 5.069–.074.

And/Or

B.6. Notice Regarding Insulation to Buyer of New Home. Notice concerning insulation to be installed in a new home, described in section 460.16 of title 16 of the Code of Federal Regulations.

If applicable, attach form 4-6 to the end of this exhibit E.

And/Or

B.7. Disclosure of Information on Lead-Based Paint and/or Lead-Based Paint Hazards. Lead-based paint warning statement, described in section 745.100 *et seq.* of title 40 of the Code of Federal Regulations.

If applicable, attach form 4-7 to the end of this exhibit E.

And/Or

B.8. Asbestos Disclosure Notice. Notice concerning asbestos, described in sections 1910.1001 and 1926.1101 of title 29 of the Code of Federal Regulations.

If applicable, attach form 4-8 to the end of this exhibit E.

And/Or

B.9. Notice Regarding Sale Subject to a Recorded Lien. Notice to the purchaser and each lienholder required under Texas Property Code section 5.016 that property being sold will be conveyed subject to a lien.

If applicable, attach form 4-9 to the end of this exhibit E.

And/Or

C. Condominium Transaction Notices

C.1. Acknowledgment of Receipt of Condominium Documents. Condominium declaration, bylaws, and association rules, described in section 82.156 of the Texas Property Code.

If applicable, attach form 24-8 to the end of this exhibit E.

And/Or

C.2. Condominium Resale Certificate. Resale certificate from the condominium owners association or waiver of resale certificate, described in section 82.157 of the Texas Property Code.

If applicable, attach condominium resale certificate promulgated by the Texas Real Estate Commission, available at <https://www.trec.texas.gov/pdf/contracts/32-4.pdf>, or form 24-7 (waiver of condominium resale certificate) to the end of this exhibit E.

And/Or

D. All Real Property Transaction Notices

D.1. Storage Tanks Disclosure Provider. Notice concerning underground storage tanks, described in section 334.9 of title 30 of the Texas Administrative Code.

If applicable, attach form 4-10 to the end of this exhibit E.

And/Or

D.2. *Notice to Purchaser Regarding Restrictive Covenants.* Notice of deed restrictions, described in section 212.155 of the Texas Local Government Code.

If applicable, attach form 4-11 to the end of this exhibit E.

And/Or

D.3. *Notice to Purchaser Regarding Coastal Area Property.* Notice regarding real property located adjacent to tidally influenced, submerged lands of Texas, described in section 33.135 of the Texas Natural Resources Code.

If applicable, attach form 4-12 to the end of this exhibit E.

And/Or

D.4. *Notice to Purchaser of Property Seaward of Gulf Intracoastal Waterway.* Notice concerning public easements to the public beach, described in section 61.025 of the Texas Natural Resources Code.

If applicable, attach form 4-13 to the end of this exhibit E.

And/Or

D.5. *Notice Regarding Possible Liability for Additional Taxes.* Notice of additional tax liability for vacant land that has been subject to a special tax appraisal method, described in section 5.010 of the Texas Property Code.

If applicable, attach form 4-14 to the end of this exhibit E.

And/Or

D.6. Notice Regarding Possible Annexation. Notice concerning the sale of property located outside the limits of a municipality that may now or later be included in the extra-territorial jurisdiction of a municipality and may now or later be subject to annexation by the municipality, described in section 5.011 of the Texas Property Code.

If applicable, attach form 4-15 to the end of this exhibit E.

And/Or

D.7. Notice for Unimproved Property in a Certificated Service Area of a Utility Service Provider. Notice for property in a certificated service area of a utility service provider, described in section 13.257 of the Texas Water Code.

If applicable, attach form 4-16 to the end of this exhibit E.

And/Or

D.8. Utility District Notice. Notice concerning the bonded indebtedness of, or rates to be charged by, a utility or other special district, described in section 49.452 of the Texas Water Code, with the form of notice to be used being dependent on whether the property (a) is located in whole or in part within the extraterritorial jurisdiction of one or more home-rule municipalities but is not located within the corporate boundaries of a municipality, (b) is located in whole or in part within the corporate boundaries of a municipality, or (c) is not located in whole or in part within the corporate boundaries of a municipality or the extraterritorial jurisdiction of one or more home-rule municipalities.

If applicable, attach form 4-17 to the end of this exhibit E.

And/Or

D.9. Notice to Purchaser of Property Located in Certain Annexed Water Districts. Notice required by section 54.016(h)(4)(A) of the Texas Water Code when property being sold is in a water or sanitary sewer district that entered a contract with a city with a population

of 1.18 million or less under which the city is permitted to set rates in the district after annexation that are different from rates charged other residents of the city.

If applicable, attach form 4-18 to the end of this exhibit E.

And/Or

D.10. Notice to Purchaser that Property Is Located within the Area of the Alignment of a Transportation Project. Notice required under Texas Local Government Code section 232.0033 that all or part of the subdivision in which the property being sold is located is within the area of the alignment of a transportation project as shown in the final environmental decision document that is applicable to a future transportation corridor identified in a contract between the Texas Department of Transportation and a county under Texas Transportation Code section 201.619.

If applicable, attach form 4-19 to the end of this exhibit E.

And/Or

D.11. Certificates of Mold Remediation. Notice pursuant to section 1958.154 of the Texas Occupations Code, titled "Certificate of Mold Remediation; Duty of Property Owner," requiring a property owner who sells property that has been issued a certificate of mold remediation pursuant to this section to deliver copies to the purchaser of each certificate of mold remediation issued for the property within the preceding five years.

And/Or

D.12. Notice of Water Level Fluctuations. Notice to purchasers of residential or commercial property adjoining an impoundment of water, including a reservoir or lake, constructed and maintained under Texas Water Code chapter 11, that has storage capacity of at least 5,000 acre-feet at the impoundment's normal level, provided pursuant to Texas Property Code section 5.019.

If applicable, attach form 4-20 to the end of this exhibit E.

Exhibit F**Seller Financing Addendum**

A. Promissory Note. The promissory note (“Note”) will be payable by Buyer (“Maker”) to the order of Seller (“Payee”) at the place designated by Payee. The Note may be prepaid in whole or in part at any time without penalty, premium, or restriction of any kind. Any prepayments are to be applied to the payment of the installments of principal last maturing, and interest will immediately cease on the prepaid principal. The lien securing payment of the Note will be inferior to any lien securing any superior note described in the contract. The Note will be payable as follows:

Select one of the following.

In one payment due [number] days after the date of the Note with interest payable [at maturity/monthly/quarterly/annually].

Or

In [number] installments of \$[amount] each [including interest/plus interest] beginning [number] days after the date of the Note and continuing at [monthly/quarterly/annual] intervals thereafter until [date], when the entire balance of the Note will be due and payable.

Or

Interest only in [number] installments for the first [number] year[s] and thereafter in [number] installments of \$[amount] each [including interest/plus interest] beginning [number] days after the date of the Note and continuing at [monthly/quarterly/annual] intervals thereafter until [date], when the entire balance of the Note will be due and payable.

Or

Other: [specify].

Continue with the following.

B. Deed of Trust. The deed of trust ("Deed of Trust") securing the Note will provide for the following:

Select one of the following.

B.1. Assumption without Consent. The Water Rights may be sold, transferred, or conveyed without the consent of Payee, provided any subsequent buyer or transferee assumes in writing for the benefit of Payee the obligation to pay the Note and to perform the covenants and agreements in the Deed of Trust in accordance with the terms of those instruments. No such assumption will release Maker from any liabilities or obligations arising under the Note or Deed of Trust. Neither the creation of a subordinate lien nor a sale thereunder will be construed as a sale or conveyance of the Water Rights.

Or

B.1. Assumption with Consent. The Water Rights may be sold, transferred, or conveyed provided that (a) any subsequent buyer assumes in writing for the benefit of Payee the obligation to pay the Note and to perform the covenants and agreements in the Deed of Trust in accordance with the terms of those instruments and (b) Maker or the subsequent buyer obtains prior written consent to such a sale from Payee. Consent will be based on the subsequent buyer's credit history, with no change in interest rate or terms, and may not be unreasonably withheld, conditioned, or delayed. No such assumption will release Maker from any liabilities or obligations arising under the Note or Deed of Trust. If all or any part of the Water Rights is sold, conveyed, leased for a period longer than three years, leased with an option to purchase, otherwise sold (including by contract for deed), or otherwise transferred or conveyed without prior written consent of Payee, Payee may, at Payee's sole option, declare the outstanding principal balance of the Note plus accrued interest immediately due and payable. Any deed under threat or order of condemnation, any conveyance solely between makers, and

the passage of title by reason of death of a maker or by operation of law will not be construed as a sale or conveyance of the Water Rights. [Neither the creation of a subordinate lien nor a sale thereunder will be construed as a sale or conveyance of the Water Rights./The creation of a subordinate lien without the consent of Payee will be construed as a sale or conveyance of the Water Rights, but any subsequent sale under a subordinate lien to which Payee has consented will not be construed as a sale or conveyance of the Water Rights.]

Or

B.1. Prohibition against Assumption. If all or any part of the Water Rights is sold, transferred, or conveyed without the prior written consent of Payee, Payee may, at Payee's sole option, declare the outstanding principal balance of the Note plus accrued interest immediately due and payable. Payee has no obligation to consent to any such sale or conveyance of the Water Rights, and Payee is entitled to condition any consent on a change in the interest rate that will thereafter apply to the Note and any other change in the terms of the Note or Deed of Trust that Payee in Payee's sole discretion deems appropriate. A lease for a period longer than three years, a lease with an option to purchase, or a contract for deed will be deemed to be a sale, transfer, or conveyance of the Water Rights for purposes of this provision. Any deed under threat or order of condemnation, any conveyance solely between makers, and the passage of title by reason of death of a maker or by operation of law will not be construed as a sale or conveyance of the Water Rights. The creation of a subordinate lien without the consent of Payee will be construed as a sale or conveyance of the Water Rights, but any subsequent sale under a subordinate lien to which Payee has consented will not be construed as a sale or conveyance of the Water Rights.

Continue with the following.

B.2. Cross-Default. Any act or occurrence that would constitute a default under the terms of any lien superior to the lien securing the Note will constitute a default under the Deed of Trust securing the Note.

C. **Recourse Provisions.** The Note and Deed of Trust are subject to the following provisions:

Select one of the following.

Full Recourse. Maker will have full recourse liability for repayment of the principal and interest of the Note and the performance of all covenants and agreements of Maker in the Deed of Trust.

Or

No Recourse. Maker will not have any recourse liability for repayment of the principal and interest of the Note or the performance of any covenants and agreements of Maker in the Deed of Trust. The sole remedy of Payee or other holder of the Note in the event of a default by Maker under the Note or Deed of Trust will be to foreclose the liens and security interests granted in the Deed of Trust, and Payee or other holder of the Note will not be entitled to any personal judgment against Maker.

Or

Partial Recourse. Except as set forth below, Maker will not have any recourse liability for repayment of the principal and interest of the Note or the performance of any covenants and agreements of Maker in the Deed of Trust. Except as set forth below, the sole remedy of Payee or other holder of the Note in the event of a default by Maker under the Note or Deed of Trust will be to foreclose the liens and security interests granted in the Deed of Trust, and Payee or other holder of the Note will not be entitled to any personal judgment against Maker. Maker will have full recourse liability for any loss or damage actually suffered or incurred by Payee or other holder of the Note by reason of—

1. taxes, assessments, and charges for labor, materials, or other amounts that if unpaid may create an encumbrance against the Water Rights that accrue before foreclosure;

2. all rents, issues, profits, and income derived from the Water Rights after a default occurs and not expended for debt service or operating expenses of the Water Rights before foreclosure;
3. tenant security deposits for leases of the Water Rights not forfeited by or refunded to the tenants;
4. any condemnation or insurance proceeds not paid or applied as required in the Deed of Trust;
5. damages resulting from fraud or misrepresentation by Maker;
6. damages resulting from breach of any warranty of title by Maker;
7. interest on the Note from the date of default through foreclosure, payment, or settlement of the debt;
8. all interest on the Note during any bankruptcy proceeding of Maker and all reasonable attorney's fees and expenses incurred as a result of Maker's bankruptcy; and
9. all attorney's fees and expenses incurred by Payee to collect any of the foregoing amounts.

Continue with the following.

Buyer/Maker

Seller/Payee

Exhibit G

Memorandum of Contract

Attach a memorandum of contract if applicable. See form 16-16 in this chapter.

Exhibit H

Notice of Termination of Contract

Attach a notice of termination of contract if applicable. See form 16-17 in this chapter.

Form 16-19

Surface Water Rights Conveyance—Conditional
Permit/Certificate of Adjudication No[s].

Notice of confidentiality rights: If you are a natural person, you may remove or strike any or all of the following information from any instrument that transfers an interest in real property before it is filed for record in the public records: your Social Security number or your driver's license number.

Date:

Grantor:

Grantor's Mailing Address:

Grantee:

Grantee's Mailing Address:

Consideration:

See form 5-6 in this manual for consideration clauses.

Water Rights: [include appropriate description[s], which may be found in the subject permit[s], and certificate[s] of adjudication. It is advisable to attach a copy or copies of the applicable permit[s] or certificate[s] of adjudication as an exhibit.]

Include the following if the water rights are within the Rio Grande and are allocated on an account basis.

Grantor's Current Year Water Allocation: The amount of water allocated to Grantor by the Rio Grande Watermaster for the year beginning January 1, [year], and ending December 31, [year], as more fully described in the TCEQ Rio Grande Water Division Monthly Report statements for the applicable period. The Grantor's Water Rights being conveyed

to Grantee include [all/[**describe portion**]] of the Grantor's Current Year Water Allocation.

Continue with the following.

Severed Appurtenant Property (property from which surface water rights are severed in this conveyance upon satisfaction of Condition): [**include legal description or state "None" as applicable**]

A description of the land to which the water rights are appurtenant and from which they are being severed in the conveyance assists title examination of the land and any appurtenant water rights. With respect to irrigation rights involving a change in the place of use, the water rights will become appurtenant to other land; however, that other land is not to be described in this conditional conveyance to avoid confusion and is unnecessary if the TCEQ does not approve the transaction or the change in place of use.

Reservations from Conveyance: [**state "None" or describe any reservations from conveyance in this instrument; see form 5-7 for examples**]

Exceptions to Conveyance and Warranty: [**state "None" or describe any exceptions to conveyance and warranty in this instrument; see form 5-8 for examples**]

Condition: Approval by the Texas Commission on Environmental Quality (TCEQ) [**include if applicable: and [other water [authority/authorities]] of the change of [include as applicable: [ownership/place of use/purpose of use/point of diversion] of the Water Rights**]].

Include the following if water rights are irrigation rights appurtenant to land and the land is not also being conveyed by the grantor.

Grantor does hereby expressly sever the Water Rights here conveyed from the Severed Appurtenant Property on satisfaction of the Condition.

Continue with the following.

Subject to the Condition, Grantor, for the Consideration and subject to the Reservations from Conveyance and the Exceptions to Conveyance and Warranty, grants, sells, and conveys to Grantee the Water Rights, together with all and singular the rights and appurtenances thereto in any way belonging, to have and to hold it to Grantee and Grantee's heirs, successors, and assigns forever. Grantor binds Grantor and Grantor's heirs and successors to warrant and forever defend all and singular the Water Rights to Grantee and Grantee's heirs, successors, and assigns against every person whomsoever lawfully claiming or to claim the same or any part thereof, except as to the Reservations from and Exceptions to Conveyance and Warranty.

If the conveyance includes personal property, include clause 5-9-13. If appropriate, include additional clauses like those suggested in form 5-9.

Include the following if applicable.

The parties agree that once the TCEQ [**include if applicable:** and [**other water [authority/ authorities]]**] approve[s] the transfer, and Grantee pays any remaining consideration for the transfer, in accordance with the terms of the contract between Grantor and Grantee, this conveyance will become absolute. Grantor hereby authorizes the Texas Commission on Environmental Quality, or its successor, and any such other governmental body or authority that has jurisdiction over the Water Rights ("Water Authority") to make such changes in the records as are necessary to accomplish the conveyance and transfer of the Water Rights. Grantor agrees to execute such other instruments as shall be necessary and required by the TCEQ and other Water Authority.

Continue with the following.

When the context requires, singular nouns and pronouns include the plural.

[Name of grantor]

If the deed imposes contractual obligations on the grantee, include the following signature line.

[Name of grantee]

Include acknowledgments.

Form 16-20

Surface Water Rights Conveyance—Unconditional

Permit/Certificate of Adjudication No[s].

Notice of confidentiality rights: If you are a natural person, you may remove or strike any or all of the following information from any instrument that transfers an interest in real property before it is filed for record in the public records: your Social Security number or your driver's license number.

Date:

Grantor:

Grantor's Mailing Address:

Grantee:

Grantee's Mailing Address:

Consideration:

See form 5-6 in this manual for consideration clauses.

Water Rights: [include appropriate description[s], which may be found in the subject permit[s], and certificate[s] of adjudication. It is advisable to attach a copy or copies of the applicable permit[s] or certificate[s] of adjudication as an exhibit.]

Include the following if the water rights are within the Rio Grande and are allocated on an account basis.

Grantor's Current Year Water Allocation: The amount of water allocated to Grantor by the Rio Grande Watermaster for the year beginning January 1, [year], and ending December 31, [year], as more fully described in the TCEQ Rio Grande Water Division Monthly Report statements for the applicable period. The Grantor's Water Rights being sold and

conveyed to Grantee include [all/[**describe portion**]] of the Grantor's Current Year Water Allocation.

Continue with the following.

Severed Property (property from which surface water rights are severed in this conveyance):

[**include legal description or state "None" as applicable**]

A description of the land to which the water rights are appurtenant and from which they are being severed in the conveyance assists title examination of the land and any appurtenant water rights.

Include the following if the TCEQ has approved the transfer and an amendment changing the place of use with respect to irrigation water rights.

Appurtenant Property (property to which Water Rights attach in this conveyance): [**include legal description**]

Continue with the following.

Reservations from Conveyance: [**state "None" or describe any reservations from conveyance in this instrument; see form 5-7 for examples**]

Exceptions to Conveyance and Warranty: [**state "None" or describe any exceptions to conveyance and warranty in this instrument; see form 5-8 for examples**]

Include the following if water rights are irrigation rights appurtenant to land and the land to which the water rights are appurtenant prior to the conveyance is not also being conveyed to the grantee.

Grantor does hereby expressly sever the Water Rights here conveyed from the Severed Appurtenant Property.

Continue with the following.

Grantor, for the Consideration and subject to the Reservations from Conveyance and the Exceptions to Conveyance and Warranty, grants, sells, and conveys to Grantee the Water Rights, together with all and singular the rights and appurtenances thereto in any way belonging, to have and to hold it to Grantee and Grantee's heirs, successors, and assigns forever. Grantor binds Grantor and Grantor's heirs and successors to warrant and forever defend all and singular the Water Rights to Grantee and Grantee's heirs, successors, and assigns against every person whomsoever lawfully claiming or to claim the same or any part thereof, except as to the Reservations from and Exceptions to Conveyance and Warranty.

If the conveyance includes personal property, include clause 5-9-13. If appropriate, include additional clauses like those suggested in form 5-9.

When the context requires, singular nouns and pronouns include the plural.

[Name of grantor]

If the deed imposes contractual obligations on the grantee, include the following signature line.

[Name of grantee]

Include acknowledgments.

[Reserved]

Form 16-21

Deed of Trust and Security Agreement
[Water Rights]

Notice of confidentiality rights: If you are a natural person, you may remove or strike any or all of the following information from any instrument that transfers an interest in real property before it is filed for record in the public records: your Social Security number or your driver's license number.

Terms

Date:

Grantor:

If the deed of trust is to be filed as a financing statement and if the grantor is an organization, the deed of trust should also indicate the type of organization, the jurisdiction of the organization, and an organizational identification number.

Grantor's Mailing Address:

Trustee[s]:

Trustee's Mailing Address[es]:

Lender:

Lender's Mailing Address:

Obligation

Note

Date:

Original principal amount:

Borrower:

Lender:

Maturity date:

If there is more than one note, repeat above information for each additional note and change the word *Note* to *Notes* in all applicable instances.

Other Debt: [include optional clauses from form 8-6 in this manual or describe other debt]

Property: [include description[s] of each applicable category of property]

For construction loans, include clause 8-9-12 immediately following the real property description.

1. Water Rights: [include appropriate description[s] (same as in the security agreement, form 16-22), which may be found in the subject permit[s], certificate[s] of adjudication, deed[s], easement[s], or other document[s] of conveyance].
2. Permits and Certificates of Adjudication (“Permits/Certificates” whether one or more): [describe, e.g., All Permits and Certificates of Adjudication pertaining to the Water Rights, now existing or hereafter acquired, including those identified below, and all amendments, replacements, and modifications thereto].
3. The following equipment, fixtures, and personal property used in connection with the Water Rights: [describe].
4. All easements and other rights appurtenant to, or used in connection with, the Water Rights, whether now existing or hereafter acquired [include if applicable: , including that Easement Agreement for Groundwater Rights dated [date], executed by [name] as grantor and Grantor as Grantee, recorded under Document No. [number] in the Official Public Records of [county] County, Texas].

5. All agreements for the sale of water derived from the Water Rights, whether now existing or hereafter executed, and the proceeds thereof.

6. All agreements for the lease of any portion of the Water Rights, whether now existing or hereafter executed, and all rents and proceeds thereof.

7 [Describe other property as applicable.]

Include the following if applicable.

Appurtenant Land Conveyed to Trustee:

Or

Surface Estate/Place of Appropriation/Diversion:

And/Or

Surface Estate/Place of Use:

Continue with the following.

Grantor's Intended [Purpose of Use] [and] [Point of Diversion] of Water Rights:

Water Authority: [include as applicable: The Texas Commission on Environmental Quality (TCEQ) [and/or [any groundwater authority, watermaster, or conservation district, or other agency or governmental bodies or authorities having jurisdiction over the administration of the water rights covered]]].

Prior Lien: [include recording information]

If there is more than one prior lien, repeat above information for each additional prior lien and change the words *Prior Lien* to *Prior Liens* in all applicable instances.

Other Exceptions to Conveyance and Warranty:

A. Granting Clause

For value received and to secure payment of the Obligation, Grantor conveys the Property to Trustee, in trust [**include if applicable:** , provided, however, that the conveyance of the Water Rights is separate and apart from the Surface Estate, and no right in the Surface Estate is granted, except as expressly provided above and described as Appurtenant Land]. Grantor warrants and agrees to defend the title to the Property, subject to the [**include if applicable:** Prior Lien and] Other Exceptions to Conveyance and Warranty. On payment of the Obligation and all other amounts secured by this deed of trust, this deed of trust will have no further effect, and Lender will release it at Grantor's expense. In addition to creating a deed-of-trust lien on all the real and other property described above, Grantor also grants to Lender a security interest in all of the above-described property pursuant to and to the extent permitted by the Texas Uniform Commercial Code.

B. Grantor's Obligations

Grantor agrees to—

B.1. keep the Property in good repair and condition, and in accordance with all applicable laws, rules and regulations, and the terms of this agreement;

B.2. pay all taxes, fees, and assessments on the Property before delinquency, not authorize a taxing entity to transfer its tax lien on the Property to anyone other than Lender, and not request a deferral of the collection of taxes pursuant to section 33.06 of the Texas Tax Code;

B.3. defend title to the Property subject to the [**include if applicable:** Prior Liens and] Other Exceptions to Conveyance and Warranty, preserve the lien's priority as it is established in this deed of trust, and take all action necessary to protect or preserve Grantor's and Lender's rights and interests in the Water Rights and under the Permits/Certificates;

B.4. maintain all insurance coverages with respect to the Property, revenues generated by the Property, and operations on the Property that Lender reasonably requires (“Required Insurance Coverages”), issued by insurers and written on policy forms acceptable to Lender, and deliver evidence of the Required Insurance Coverages in a form acceptable to Lender at least ten days before the expiration of the Required Insurance Coverages;

B.5. obey all laws, ordinances, and restrictive covenants applicable to the Property;

B.6. keep any buildings occupied as required by the Required Insurance Coverages;

B.7. if the lien of this deed of trust is not a first lien, pay or cause to be paid all prior lien notes and abide by or cause to be abided by all prior lien instruments;

B.8. notify Lender of any change of address or if Grantor has obtained any new easement rights for use in connection with the Water Rights;

B.9. timely pay all permit fees, use fees, assessments, taxes, or other charges levied or assessed by any Water Authority, and maintain all Permits/Certificates or other rights covered by this deed of trust in accordance with the terms of this deed of trust and in good standing with the issuing Water Authority;

B.10. comply with all rules and regulations of any applicable Water Authority, and immediately notify Lender of any threatened or actual enforcement action against Grantor or the Property by any applicable Water Authority;

B.11. obtain Lender’s written consent before seeking to modify or convert any agreement, including any Permits/Certificates issued by any applicable Water Authority, relating to the Property;

B.12. immediately notify Lender of any change in any permit or certificate issued by any Water Authority for the Property and of any proposed amendment, conversion, or other

change to the permit or certificate [**include if applicable:** and immediately record the permit or certificate, as amended, in the real property records of the applicable county or counties]; and

B.13. provide and maintain with the Water Authority written instructions, in form approved by Lender, notifying the Water Authority of Lender's rights and interests in the Water Rights and the Permits/Certificates, and prohibiting the Water Authority, without the prior written authorization of Lender, from (a) approving or documenting a conveyance of all or any portion of the Water Rights or (b) approving a request or application by Grantor or any other person to transfer, amend, or terminate the Permits/Certificates as it or they pertain to the Water Rights.

C. Lender's Rights

C.1. Lender or Lender's mortgage servicer may appoint in writing one or more substitute trustees, succeeding to all rights and responsibilities of Trustee.

C.2. If the proceeds of the Obligation are used to pay any debt secured by prior liens, Lender is subrogated to all the rights and liens of the holders of any debt so paid.

C.3. Lender may apply any proceeds received under the insurance policies covering the Property either to reduce the Obligation or to repair or replace damaged or destroyed improvements covered by the policy.

C.4. Notwithstanding the terms of the Note to the contrary, and unless applicable law prohibits, all payments received by Lender from Grantor with respect to the Obligation or this deed of trust may, at Lender's discretion, be applied first to amounts payable under this deed of trust and then to amounts due and payable to Lender with respect to the Obligation, to be applied to late charges, principal, or interest in the order Lender in its discretion determines.

C.5. If Grantor fails to perform any of Grantor's obligations, Lender may perform those obligations and be reimbursed by Grantor on demand for any amounts so paid, including

attorney's fees, plus interest on those amounts from the dates of payment at the rate stated in the Note for matured, unpaid amounts. The amount to be reimbursed will be secured by this deed of trust.

C.6. COLLATERAL PROTECTION INSURANCE NOTICE

In accordance with the provisions of section 307.052(a) of the Texas Finance Code, the Beneficiary hereby notifies the Grantor as follows:

(A) the Grantor is required to:

- (i) keep the collateral insured against damage in the amount the Lender specifies;**
- (ii) purchase the insurance from an insurer that is authorized to do business in the state of Texas or an eligible surplus lines insurer; and**
- (iii) name the Lender as the person to be paid under the policy in the event of a loss;**

(B) the Grantor must, if required by the Lender, deliver to the Lender a copy of the policy and proof of the payment of premiums; and

(C) if the Grantor fails to meet any requirement listed in Paragraph (A) or (B), the Lender may obtain collateral protection insurance on behalf of the Grantor at the Grantor's expense.

C.7. If there is a default on the Obligation or if Grantor fails to perform any of Grantor's obligations and the default continues after any required notice of the default and the time allowed to cure, Lender may—

- a. declare the unpaid principal balance and earned interest on the Obligation immediately due;
- b. direct Trustee to foreclose this lien, in which case Lender or Lender's agent will cause notice of the foreclosure sale to be given as provided by the Texas Property Code as then in effect; and
- c. purchase the Property at any foreclosure sale by offering the highest bid and then have the bid credited on the Obligation.

C.8. Lender may remedy any default without waiving it and may waive any default without waiving any prior or subsequent default.

C.9. Grantor authorizes Lender to file financing statements under the Uniform Commercial Code describing the Property. This deed of trust constitutes a fixture filing as to the Property.

D. Trustee's Rights and Duties

If directed by Lender to foreclose this lien, Trustee will—

- D.1. either personally or by agent give notice of the foreclosure sale as required by the Texas Property Code as then in effect;
- D.2. sell and convey all or part of the Property "AS IS" to the highest bidder for cash with a general warranty binding Grantor, subject to the Prior Lien and to the Other Exceptions to Conveyance and Warranty and without representation or warranty, express or implied, by Trustee;
- D.3. from the proceeds of the sale, pay, in this order—
 - a. expenses of foreclosure, including a reasonable commission to Trustee;

- b. to Lender, the full amount of principal, interest, attorney's fees, and other charges due and unpaid, including all attorney's fees and expenses attendant to (i) any proceedings before any applicable Water Authority to seek the approval of that Water Authority for the necessary changes in ownership, diversion point, place of use, and/or purpose of use of the Water Rights and (ii) the conveyance of the Water Rights;
- c. any amounts required by law to be paid before payment to Grantor; and
- d. to Grantor, any balance; and

D.4. be indemnified, held harmless, and defended by Lender against all costs, expenses, and liabilities incurred by Trustee for acting in the execution or enforcement of the trust created by this deed of trust, which includes all court and other costs, including attorney's fees, incurred by Trustee in defense of any action or proceeding taken against Trustee in that capacity.

E. Grantor's Authorization

Grantor agrees that Lender is authorized, but is not obligated, to perform one or more of the following:

E.1. To sever the Property, including the Water Rights, into separate groups or parcels [**include if applicable:** , to sever the Water Rights from the [Appurtenant Land/Surface Estate/easements]], and to foreclose or convey the Property in lieu of foreclosure in one or more separate or combined transactions.

E.2. To seek the approval of the Water Authority for a change in ownership, diversion point, place of use, or purpose of use of the Water Rights, and to transfer any existing unused water allotments that apply or pertain to the Water Rights in connection with a foreclosure or conveyance in lieu of foreclosure.

Include the following if applicable.

E.3. To file any application, institute any proceedings, and to perform such other acts or actions on behalf of Grantor, and in Grantor's name, as Lender may determine to be necessary to protect or preserve the Property, including the value of the Water Rights and the rights provided by the Permits/Certificates and Grantor's or Lender's interest therein. Grantor hereby appoints Lender as Grantor's attorney-in-fact, to perform the acts set forth above. This appointment as attorney-in-fact is coupled with an interest, is irrevocable, and shall survive Grantor's disability, foreclosure of this deed of trust, and conveyance of the Property in lieu of foreclosure.

Continue with the following.

F. General Provisions

F.1. If any of the Property is sold under this deed of trust, Grantor must immediately surrender possession to the purchaser. If Grantor does not, Grantor will be a tenant at sufferance of the purchaser, subject to an action for forcible detainer.

F.2. Recitals in any trustee's deed conveying the Property will be presumed to be true.

F.3. Proceeding under this deed of trust, filing suit for foreclosure, or pursuing any other remedy will not constitute an election of remedies.

F.4. This lien will remain superior to liens later created even if the time of payment of all or part of the Obligation is extended or part of the Property is released.

F.5. If any portion of the Obligation cannot be lawfully secured by this deed of trust, payments will be applied first to discharge that portion.

F.6. Grantor assigns to Lender all amounts payable to or received by Grantor from condemnation of all or part of the Property, from private sale in lieu of condemnation, and from damages caused by public works or construction on or near the Property. After deducting any expenses incurred, including attorney's fees and court and other costs, Lender will either release any remaining amounts to Grantor or apply such amounts to reduce the Obligation. Lender will not be liable for failure to collect or to exercise diligence in collecting any such amounts. Grantor will immediately give Lender notice of any actual or threatened proceedings for condemnation of all or part of the Property.

F.7. Interest on the debt secured by this deed of trust will not exceed the maximum amount of nonusurious interest that may be contracted for, taken, reserved, charged, or received under law. Any interest in excess of that maximum amount will be credited on the principal of the debt or, if that has been paid, refunded. On any acceleration or required or permitted prepayment, any such excess will be canceled automatically as of the acceleration or prepayment or, if already paid, credited on the principal of the debt or, if the principal of the debt has been paid, refunded. This provision overrides any conflicting provisions in this and all other instruments concerning the debt.

F.8. In no event may this deed of trust secure payment of any debt that may not lawfully be secured by a lien on real estate or create a lien otherwise prohibited by law.

If a due-on-sale clause is desired, select one of the following.

F.9. If Grantor transfers any part of the Property without Lender's prior written consent, Lender may declare the Obligation immediately payable and invoke any remedies provided in this deed of trust for default.

Or

F.9. Grantor may not sell, transfer, or otherwise dispose of any Property, whether voluntarily or by operation of law, without the prior written consent of Lender. If granted,

consent may be conditioned on (a) the grantee's integrity, reputation, character, creditworthiness, and management ability being satisfactory to Lender; and (b) the grantee's executing, before such sale, transfer, or other disposition, a written assumption agreement containing any terms Lender may require, such as a principal pay down on the Obligation, an increase in the rate of interest payable with respect to the Obligation, a transfer fee, or any other modification of the Note, this deed of trust, or any other instruments evidencing or securing the Obligation.

Grantor may not cause or permit any Property to be encumbered by any liens, security interests, or encumbrances other than the liens securing the Obligation and the liens securing ad valorem taxes not yet due and payable without the prior written consent of Lender. If granted, consent may be conditioned upon Grantor's executing, before granting such lien, a written modification agreement containing any terms Lender may require, such as a principal pay down on the Obligation, an increase in the rate of interest payable with respect to the Obligation, an approval fee, or any other modification of the Note, this deed of trust, or any other instruments evidencing or securing the Obligation.

Grantor may not grant any lien, security interest, or other encumbrance (a "Subordinate Instrument") covering the Property that is subordinate to the liens created by this deed of trust without the prior written consent of Lender. If granted, consent may be conditioned upon the Subordinate Instrument's containing express covenants to the effect that—

- a. the Subordinate Instrument is unconditionally subordinate to this deed of trust;
- b. if any action is instituted to foreclose or otherwise enforce the Subordinate Instrument, no action may be taken that would terminate any occupancy or tenancy without the prior written consent of Lender, and that consent, if granted, may be conditioned in any manner Lender determines;

- c. rents, if collected by or for the holder of the Subordinate Instrument, will be applied first to the payment of the Obligation then due and to expenses incurred in the ownership, operation, and maintenance of the Property in any order Lender may determine, before being applied to any indebtedness secured by the Subordinate Instrument;
- d. written notice of default under the Subordinate Instrument and written notice of the commencement of any action to foreclose or otherwise enforce the Subordinate Instrument must be given to Lender concurrently with or immediately after the occurrence of any such default or commencement; and
- e. in the event of the bankruptcy of Grantor, all amounts due on or with respect to the Obligation and this deed of trust will be payable in full before any payments on the indebtedness secured by the Subordinate Instrument.

Grantor may not cause or permit any of the following events to occur without the prior written consent of Lender: if Grantor is (a) a corporation, the termination of the corporation or the sale, pledge, encumbrance, or assignment of any shares of its stock; (b) a limited liability company, the termination of the company or the sale, pledge, encumbrance, or assignment of any of its membership interests; (c) a general partnership or joint venture, the termination of the partnership or venture or the sale, pledge, encumbrance, or assignment of any of its partnership or joint venture interests, or the withdrawal from or admission into it of any general partner or joint venturer; or (d) a limited partnership, (i) the termination of the partnership, (ii) the sale, pledge, encumbrance, or assignment of any of its general partnership interests, or the withdrawal from or admission into it of any general partner, (iii) the sale, pledge, encumbrance, or assignment of a controlling portion of its limited partnership interests, or (iv) the withdrawal from or admission into it of any controlling limited partner or partners. If granted, consent may be conditioned on (a) the integrity, reputation, character, creditworthiness, and management ability of the person succeeding to the ownership interest in Grantor (or security

interest in such ownership) being satisfactory to Lender; and (b) the execution, before such event, by the person succeeding to the interest of Grantor in the Property or ownership interest in Grantor (or security interest in such ownership) of a written modification or assumption agreement containing such terms as Lender may require, such as a principal pay down on the Obligation, an increase in the rate of interest payable with respect to the Obligation, a transfer fee, or any other modification of the Note, this deed of trust, or any other instruments evidencing or securing the Obligation.

Continue with the following.

F.10. When the context requires, singular nouns and pronouns include the plural.

F.11. The term *Note* includes all extensions, modifications, and renewals of the Note and all amounts secured by this deed of trust.

F.12. This deed of trust binds, benefits, and may be enforced by the successors in interest of all parties.

F.13. If Grantor and Borrower are not the same person, the term *Grantor* includes Borrower.

F.14. Grantor and each surety, endorser, and guarantor of the Obligation waive all demand for payment, presentation for payment, notice of intention to accelerate maturity, notice of acceleration of maturity, protest, and notice of protest, to the extent permitted by law.

F.15. Grantor agrees to pay reasonable attorney's fees, trustee's fees, and court and other costs of enforcing Lender's rights under this deed of trust if an attorney is retained for its enforcement.

F.16. If any provision of this deed of trust is determined to be invalid or unenforceable, the validity or enforceability of any other provision will not be affected.

F.17. The term *Lender* includes any mortgage servicer for Lender.

F.18. Grantor represents that this deed of trust and the Note are given for the following purposes: **[list specific purposes]**.

Include the following if applicable.

F.19. The Note is secured by this deed of trust **[[,/and] a Security Agreement/[and/, and] [include form 8-3 vendor's lien language, if applicable]]**. This deed of trust does not waive the provisions of the Security Agreement **[include if applicable: and the vendor's lien]**, and the liens and the rights created are cumulative. Lender may elect to foreclose under one or more liens without waiving any of the other lien(s).

Continue with the following.

[Name of grantor]

Include acknowledgment.

[Reserved]

Form 16-22

Security Agreement
[Water Rights]

Date:

Debtor:

Debtor's Mailing Address:

Secured Party:

Secured Party's Mailing Address:

Classification of Collateral: [**include as applicable:** [Inventory/Equipment/Goods/Fixtures/
General Intangibles]]

Collateral: All of Debtor's interest in the following property and all supporting obligations
and proceeds of such property:

1. Water Rights: [**include appropriate description[s] (same as in the deed of trust,
form 16-21), which may be found in the subject permit[s], certificate[s] of adjudication, deed[s],
easement[s], or other document[s] of conveyance].**

2. Permits and Certificates of Adjudication ("Permits/Certificates" whether one or
more): [**describe, e.g., All Permits and Certificates of Adjudication pertaining to the Water
Rights, now existing or hereafter acquired, including those identified below, and all amend-
ments, replacements, and modifications thereto].**

3. [**Include as applicable:** [Goods/Equipment/Fixtures/Inventory]]

4. All agreements for the sale of water derived from the Water Rights, whether now existing or hereafter executed, and the proceeds thereof.

5. All agreements for the lease of any portion of the Water Rights, whether now existing or hereafter executed, and all rents and proceeds thereof.

Water Authority: [**include as applicable:** The Texas Commission on Environmental Quality (TCEQ) [and [any groundwater authority, watermaster, or conservation district, or other agency or governmental bodies or authorities having jurisdiction over the administration of the water rights covered]]].

Obligation

Note

Date:

Original principal amount:

Borrower (Obligor):

Include either or both of the following if applicable.

Other Debt/Future Advances: The security interest also secures all other present and future debts and liabilities of Debtor and/or Obligor to Secured Party, including future advances.

Other Obligation[s]:

Continue with the following.

A. Debtor's Representations Concerning Debtor and Locations:

A.1. [Include if applicable: Description of Land to Which Water Rights Are [or Are to Become] Appurtenant ("Appurtenant Land"): [include legal description of land].]

A.2. [Include if applicable: Debtor's Intended [Place of Use/Purpose of Use/Point of Diversion] of Water Rights: [specify].]

A.3. [Include if applicable: [Debtor's place of business/Debtor's chief executive office] is located at [address, city, state].]

A.4. [Include if the debtor is an individual: Debtor's residence is located at [address, city, state].]

A.4. [Include if the debtor is a corporation, limited partnership, or limited liability company: Debtor's state of organization is [Texas/[state]], and Debtor's name, as shown in its public organic record, as amended, is exactly as set forth above.]

A.5. Debtor's records concerning the Collateral are located at [address, city, state].

A.6. Debtor has [caused the original of the Permits or Certificates to be delivered to Secured Party/recorded the Permits or Certificates in the real property records of all applicable counties].

B. Granting Clause

Debtor grants to Secured Party a security interest in the Collateral and all its proceeds to secure the Obligation and all renewals, modifications, and extensions of the Obligation. Debtor authorizes Secured Party to file financing statements describing the Collateral.

C. Debtor Represents the Following:

C.1. No financing statement covering the Collateral is filed in any public office [include if the secured party has prefiled a financing statement or otherwise has a financing statement on file: except any financing statement in favor of Secured Party].

C.2. Debtor owns the Collateral and has the authority to grant this security interest, free from any setoff, claim, restriction, lien, security interest, or encumbrance except liens for taxes not yet due.

C.3. All information about Debtor's financial condition is or will be accurate when provided to Secured Party.

C.4. All fees, taxes, and other charges levied or assessed against the Collateral have been properly paid, and none are delinquent or due and owing.

C.5. The Collateral is not the subject of any enforcement action by any Water Authority or other governmental entity.

Include the following if applicable if the debtor is an individual.

C.6. The Obligation was not incurred primarily for personal, family, or household purposes.

And/Or

C.7. The Collateral was not acquired and will not be held primarily for personal, family, or household purposes.

Continue with the following.

D. Debtor Agrees to—

D.1. Defend the Collateral against all claims adverse to Secured Party's interest; pay all fees, taxes, and other charges imposed on the Collateral, and provide Secured Party with proper evidence thereof; keep the Collateral free from liens, except for liens in favor of Secured Party or for taxes not yet due; keep the Collateral in Debtor's possession and ownership except as otherwise provided in this agreement; and protect the Collateral against waste, normal usage and normal wear and tear excepted.

D.2. Pay all of Secured Party's expenses, including reasonable attorney's fees [include for a loan transaction subject to Texas Finance Code section 342.502: assessed by a court], incurred to (a) obtain, preserve, perfect, defend, and enforce this agreement; (b) retake, hold, prepare for disposition, dispose, collect, or enforce the Collateral; and (c) collect or enforce the Obligation. These expenses will bear interest from the date of advance at the rate stated in the Note for matured, unpaid amounts and are payable on demand at the place where the Obligation is payable. These expenses and interest are part of the Obligation and are secured by this agreement.

D.3. Sign and deliver to Secured Party any documents or instruments that Secured Party considers necessary to obtain, maintain, and perfect this security interest in the Collateral.

D.4. Notify Secured Party immediately of any event of default and of any material change (a) in the Collateral; (b) in Debtor's Mailing Address; (c) in the location of any Collateral; (d) in any other representation or warranty in this agreement; (e) in the permit or certificate issued by any Water Authority for the Collateral, or any proposed adjustment, modification, amendment, or other change to the permit or certificate; (f) that may affect this security interest; and (g) of any change in Debtor's name and any location set forth above.

D.5. Use the Collateral primarily according to the stated classification.

D.6. Maintain accurate records of the Collateral at the address set forth above, furnish Secured Party any requested information related to the Collateral, and permit Secured Party to inspect and copy all records relating to the Collateral.

D.7. File with any applicable Water Authority all required reports and provide Secured Party with a true and correct copy of all such reports.

D.8. On Secured Party's demand, hold payments, including instruments, items, and money received as proceeds of the Collateral, separate and in an express trust for Secured Party and deposit all such payments received as proceeds of the Collateral in a special bank account designated by Secured Party, who alone will have power of withdrawal.

D.9. Inform Secured Party immediately of any claim made in regard to any Collateral.

E. Debtor Agrees Not to—

E.1. Sell, transfer, or encumber any of the Collateral except in the ordinary course of Debtor's business.

E.2. Allow the Collateral to become the subject of any enforcement action by any Water Authority or any other governmental authority.

Select one of the following.

Include the following if the debtor is a corporation, limited partnership, or limited liability company.

E.3. Change its name or jurisdiction of organization, merge or consolidate with any person, or convert to a different entity without notifying Secured Party in advance and taking action to continue the perfected status of the security interest in the Collateral.

Or

Include the following if the debtor is an entity other than a corporation, limited partnership, or limited liability company.

E.3. Change the state in which Debtor's place of business (or chief executive office if Debtor has more than one place of business) is located, change its name, or convert to a different entity without notifying Secured Party in advance and taking action to continue the perfected status of the security interest in the Collateral.

Or

Include the following if the debtor is an individual.

E.3. Change Debtor's name or state of residence without notifying Secured Party in advance and taking action to continue the perfected status of the security interest in the Collateral.

Continue with the following.

E.4. Amend or convert any agreement, permit, or certificate related to the Collateral without the prior written consent of Secured Party.

F. Insurance and Risk of Loss

F.1. Debtor will insure the Collateral in accordance with Secured Party's reasonable requirements regarding choice of carrier, risks insured against, and amount of coverage. Policies must be written in favor of Debtor, be endorsed to name Secured Party as an additional insured or as otherwise directed in writing by Secured Party, and provide that Secured Party will receive at least ten days' notice before cancellation. Debtor must provide copies of the policies or evidence of insurance to Secured Party.

***F.2.* COLLATERAL PROTECTION INSURANCE NOTICE**

In accordance with the provisions of section 307.052(a) of the Texas Finance Code, the Secured Party hereby notifies the Debtor as follows:

(A) the Debtor is required to:

- (i) keep the collateral insured against damage in the amount the Secured Party specifies;**
- (ii) purchase the insurance from an insurer that is authorized to do business in the state of Texas or an eligible surplus lines insurer; and**
- (iii) name the Secured Party as the person to be paid under the policy in the event of a loss;**

(B) the Debtor must, if required by the Secured Party, deliver to the Secured Party a copy of the policy and proof of the payment of premiums; and

(C) if the Debtor fails to meet any requirement listed in Paragraph (A) or (B), the Secured Party may obtain collateral protection insurance on behalf of the Debtor at the Debtor's expense.

F.3. Debtor assumes all risk of loss to the Collateral.

F.4. Debtor appoints Secured Party as attorney-in-fact to collect any returned unearned premiums and proceeds of any insurance on the Collateral and to endorse and deliver to Secured Party any payment from such insurance made payable to Debtor. Debtor's appointment of Secured Party as Debtor's agent is coupled with an interest and if Debtor is an individual will survive any disability of Debtor.

G. Default and Remedies

G.1. A default exists if—

- a. Debtor, Obligor, or any secondary obligor fails to timely pay or perform any obligation or covenant in any written agreement between Secured Party and any of Debtor, Obligor, or secondary obligor;
- b. any warranty, covenant, or representation in this agreement or in any other written agreement between Secured Party and any of Debtor, Obligor, or secondary obligor is materially false when made;
- c. a receiver is appointed for Debtor, Obligor, any secondary obligor, or any Collateral;
- d. any Collateral is assigned for the benefit of creditors;
- e. a bankruptcy or insolvency proceeding is commenced by Debtor, a partnership in which Debtor is a general partner, Obligor, or any secondary obligor;
- f. a bankruptcy or insolvency proceeding is commenced against Debtor, a partnership in which Debtor is a general partner, Obligor, or any secondary obligor, and the proceeding continues without dismissal for sixty days, the party against whom the proceeding is commenced admits the material allegations of the petition against it, or an order for relief is entered;
- g. any of the following parties is terminated, begins to wind up its affairs, is authorized to terminate or wind up its affairs by its governing body or persons, or any event occurs or condition exists that permits the termination or winding up of the affairs of any of the following parties: Debtor; a partnership of which Debtor is a general partner; Obligor; or any secondary obligor;

- h. any Collateral is impaired by loss, theft, damage, levy and execution, issuance of an official writ or order of seizure, or destruction, unless it is promptly replaced with collateral of like kind and quality or restored to its former condition; or
- i. Debtor receives notice from any applicable Water Authority of the potential of an enforcement action by that Water Authority related to the Collateral, Debtor's use of the Collateral, or a violation of any rule or regulation of the Water Authority and that matter is not cured within thirty days after the notice.

G.2. If a default exists, Secured Party may—

- a. demand, collect, convert, redeem, settle, compromise, receipt for, realize on, sue for, and adjust the Collateral either in Secured Party's or Debtor's name, as Secured Party desires, or take control of any proceeds of the Collateral and apply the proceeds against the Obligation;
- b. take possession of any Collateral not already in Secured Party's possession, without demand or legal process, and for that purpose Debtor grants Secured Party the right to enter any premises where the Collateral may be located;
- c. without taking possession, sell, lease, or otherwise dispose of the Collateral at any public or private sale in accordance with law;
- d. exercise any rights and remedies granted by law or this agreement; and
- e. cause the Collateral to be transferred to Secured Party's name with any appropriate Water Authority. Debtor appoints Secured Party as Debtor's attorney-in-fact to file any application, institute any proceedings, and per-

form such other acts or actions on behalf of Debtor, and in Debtor's name, as Secured Party may determine to be necessary to protect or preserve the Collateral and Lender's interest therein, and to seek the approval of that Water Authority for the necessary changes in ownership, diversion point, place of use, and/or purpose of use of the Collateral. This appointment is coupled with an interest, is irrevocable, and survives Debtor's disability or foreclosure under this security agreement.

G.3. Foreclosure of this security interest by suit does not limit Secured Party's remedies, including the right to sell the Collateral under the terms of this agreement. Secured Party may exercise all remedies at the same or different times, and no remedy is a defense to any other. Secured Party's rights and remedies include all those granted by law and those specified in this agreement. The debt is secured by a deed of trust [**include if applicable:** and [**include form 8-3 vendor's lien language**]]. This security agreement does not waive the provisions of the deed of trust [**include if applicable:** and the vendor's lien], and the liens and the rights created are cumulative. Secured Party may elect to foreclose under one or more liens without waiving any of the other lien(s).

G.4. Secured Party's delay in exercising, partial exercise of, or failure to exercise any of its remedies or rights does not waive Secured Party's rights to subsequently exercise those remedies or rights. Secured Party's waiver of any default does not waive any other default by Debtor. Secured Party's waiver of any right in this agreement or of any default is binding only if it is in writing. Secured Party may remedy any default without waiving it.

G.5. Secured Party has no obligation to clean or otherwise prepare the Collateral for sale.

G.6. Secured Party has no obligation to satisfy the Obligation by attempting to collect the Obligation from any other person liable for it. Secured Party may release, modify, or

waive any collateral provided by any other person to secure any of the Obligation. If Secured Party attempts to collect the Obligation from any other person liable for it or releases, modifies, or waives any collateral provided by any other person, that will not affect Secured Party's rights against Debtor. Debtor waives any right Debtor may have to require Secured Party to pursue any third person for any of the Obligation.

G.7. If Secured Party must comply with any applicable state or federal law requirements in connection with a disposition of the Collateral, such compliance will not be considered to adversely affect the commercial reasonableness of a sale of the Collateral.

G.8. Secured Party may sell the Collateral without giving any warranties as to the Collateral. Secured Party may specifically disclaim any warranties of title or the like. This procedure will not be considered to adversely affect the commercial reasonableness of a sale of the Collateral.

G.9. If Secured Party sells any of the Collateral on credit, Debtor will be credited only with payments actually made by the purchaser and received by Secured Party for application to the indebtedness of the purchaser. If the purchaser fails to pay for the Collateral, Secured Party may resell the Collateral and Debtor will be credited with the proceeds of the sale.

G.10. If Secured Party purchases any of the Collateral being sold, Secured Party may pay for the Collateral by crediting the purchase price against the Obligation.

G.11. Secured Party has no obligation to marshal any assets in favor of Debtor or against or in payment of the Note, any of the Other Obligation[s], or any other obligation owed to Secured Party by Debtor or any other person.

G.12. If the Collateral is sold after default, recitals in the bill of sale or transfer will be prima facie evidence of their truth and all prerequisites to the sale specified by this agreement and by law will be presumed satisfied.

H. General

H.1. Secured Party may at any time—

- a. take control of proceeds of insurance on the Collateral and reduce any part of the Obligation accordingly or permit Debtor to use the funds to repair or replace the Collateral and
- b. purchase single-interest insurance coverage that will protect only Secured Party if Debtor fails to maintain insurance, and premiums for the insurance will become part of the Obligation.

H.2. Notice is reasonable if it is mailed, postage prepaid, to Debtor at Debtor's Mailing Address at least ten days before any public sale or ten days before the time when the Collateral may be otherwise disposed of without further notice to Debtor.

H.3. This security interest will attach to an after-acquired commercial tort claim only to the extent permitted by law.

H.4. This security interest will neither affect nor be affected by any other security for any of the Obligation. Neither extensions of any of the Obligation nor releases of any of the Collateral will affect the priority or validity of this security interest.

H.5. This agreement binds, benefits, and may be enforced by the successors in interest of Secured Party and will bind all persons who become bound as debtors to this agreement. Assignment of any part of the Obligation and Secured Party's delivery of any part of the Collateral will fully discharge Secured Party from responsibility for that part of the Collateral. If

such an assignment is made, Debtor will render performance under this agreement to the assignee. Debtor waives and will not assert against any assignee any claims, defenses, or setoffs that Debtor could assert against Secured Party except defenses that cannot be waived. All representations, warranties, and obligations are joint and several as to each Debtor.

H.6. This agreement may be amended only by an instrument in writing signed by Secured Party and Debtor.

H.7. The unenforceability of any provision of this agreement will not affect the enforceability or validity of any other provision.

H.8. This agreement will be construed according to Texas law, without regard to choice-of-law rules of any jurisdiction. This agreement is to be performed in [**include if applicable in a consumer transaction:** , and has been signed by Debtor in,] the county of Secured Party's Mailing Address.

H.9. Interest on the Obligation secured by this agreement will not exceed the maximum amount of nonusurious interest that may be contracted for, taken, reserved, charged, or received under law. Any interest in excess of that maximum amount will be credited on the principal of the Obligation or, if that has been paid, refunded. On any acceleration or required or permitted prepayment, any such excess will be canceled automatically as of the acceleration or prepayment or, if already paid, credited on the principal of the Obligation or, if the principal of the Obligation has been paid, refunded. This provision overrides any conflicting provisions in this and all other instruments concerning the Obligation.

H.10. In no event may this agreement secure payment of any debt that may not lawfully be secured by a lien on real estate or create a lien otherwise prohibited by law.

H.11. When the context requires, singular nouns and pronouns include the plural.

H.12. Any term defined in sections 1.101 to 9.709 of the Texas Business and Commerce Code and not defined in this agreement has the meaning given to the term in the Code.

[Name of debtor]

[Reserved]

Form 16-23

Memorandum of Groundwater Loan
[For Use with Edwards Aquifer Authority]

Date:

Maker:

Maker's Mailing Address:

Payee:

Payee's Mailing Address:

Date of Loan:

Loan Term:

Real Property:

Groundwater Rights: Legal title to the Groundwater beneath the following Real Property
[include description from deed]

Groundwater Permit: [include copies of permit[s] issued by the groundwater authority]

Groundwater District: [include the name and mailing address of the local groundwater dis-
trict[s] with jurisdiction over the groundwater rights]

Maker:

By _____
Printed Name:

Payee:

By _____
Printed Name:
Title:

Include acknowledgments.

Form 16-24

Notice of Lender's Interest in Water Rights and Permit

Date:

Borrower:

Borrower's Mailing Address:

Lender:

Lender's Mailing Address and Contact Information:

Loan officer:

Phone:

E-mail:

Date of Loan:

Loan No.

[Real Property:]

Water Rights, including any Permit[s] now existing or hereafter issued:

All persons dealing with the Water Rights or the Permit[s] issued in connection with the Water Rights are hereby notified of Lender's interest in the Water Rights and Permit[s].

Lender has made a loan to Borrower secured by a lien and a security interest in Borrower's Water Rights and Permit[s]. Under the terms of the loan documents—

1. If Borrower defaults on the loan, Lender has the right to foreclose on its security interest in the Water Rights and to sell or acquire the Water Rights.
2. Lender's prior written consent is required for a sale or conveyance of any interest in the Water Rights and assignment of all or any portion of the Permit[s].
3. Lender's prior written consent is required for the issuance of [a] Permit[s] for the Water Rights and Lender must sign the application for issuance of [a] Permit[s].
4. Lender's prior written consent is required for a modification of the Water Rights or the Permit[s] and Lender must sign the application for modification of the Water Rights or the Permit[s].

If a Release of Lender's security interest in the Water Rights and Permit[s] does not appear in these records, then any person dealing with the Water Rights or the Permit[s] should assume that Lender still has a lien and security interest in the Water Rights and the Permit[s], even if Borrower has conveyed its interest in the Water Rights or assigned or modified the Permit[s]. You may contact Lender to determine whether the security interest has been released.

Borrower:

By _____
 Printed Name:

Lender:

By _____
 Printed Name:
 Title:

Include acknowledgments.

Form 16-25

Permittee's Instruction Letter to Water Authority

[Date]

[Name and address of water authority]

Re: Lender's Consent Required for a Transfer, Termination, or Modification of Permit No.
[number]

[Salutation]

I am the owner of the water rights described in Permit No. [number] (the "Permit") and the holder of the Permit. I have obtained a loan from [name] ("Lender") in the original principal amount of \$[amount], which is secured by a [first-lien] deed of trust and security interest in the water rights and Permit. Under these loan documents, as long as the loan is outstanding, Lender's consent is required for a transfer, termination, or modification of the water rights and Permit.

You are hereby directed not to authorize or approve a transfer, termination, or modification of the Permit unless the [name of water authority] has received the written consent of Lender to the transfer or modification or a copy of a written release of the lien and security interest. The consent may be evidenced by the signature of Lender on the application for transfer, termination, or modification submitted to you or by separate written authorization signed by Lender. Alternatively, no consent will be required if you receive a copy of a release or partial release of the lien and security interest in the water rights and Permit signed by Lender.

Questions regarding this matter should be directed to Lender at the following address:

[Name of lender]

[Contact person]

[Address]

Re: [loan number]

Phone:

E-mail:

Please include a copy of this letter with your file and records on the water rights and Permit.

Thank you for your cooperation.

Sincerely,

[Name of permittee]

Chapter 17

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Chapter 17

Risk Allocation: Indemnity, Waiver, and Insurance

Note: The State Bar of Texas Real Estate Forms Committee is grateful to Charles Comiskey, senior vice president of Brady Chapman Holland & Associates, Inc., an insurance brokerage firm with offices in Houston, Texas, and president of RiskTech, Inc., a risk management consulting firm in Houston, Texas; Aaron Johnston of the Johnston Law Firm in Dallas, Texas; and William W. Pugh of the Liskow & Lewis law firm in Houston, Texas, for their suggestions with respect to the content of this chapter.

§ 17.1 Risk Allocation Methods and Definitions

Indemnity: An indemnity is a promise to safeguard and hold another party harmless against a liability. An indemnity creates a potential cause of action for the indemnitee against the indemnitor. *Dresser Industries, Inc. v. Page Petroleum, Inc.*, 853 S.W.2d 505, 508 (Tex. 1993).

Waiver: A waiver is an agreement not to hold another party responsible for a liability. A waiver operates to bar any right of action on the released matter. *Hart v. Traders & General Insurance Co.*, 189 S.W.2d 493, 494 (Tex. 1945). Waivers are sometimes referred to as “releases.

Insurance: Insurance is a contract under which a company in the business of insuring against losses undertakes for a specified period of time to defend a party against, and compensate the party for, loss arising from a specified risk in consideration for the payment of a premium by the insured party.

Transfers of Risk: One strategy employed by a party in a transaction to minimize exposure to losses is to transfer identified risks to one or more of the following parties:

1. the party on the other side of the transaction through the use of contractual indemnities and waivers (and if the

damages or injuries are of the type covered by the indemnitor’s commercial general liability insurance policy and the indemnity is an insured contract, as the term is defined in the indemnitor’s commercial general liability insurance policy, the risks may also be transferred to the general liability carrier of the indemnitor to the extent of coverage);

2. a third party through a guaranty of payment or performance;
3. an insurance company or corporate surety by purchasing insurance or bonds (provided the risks are insurable or bondable); or
4. an insurance company or corporate surety by becoming a loss payee, additional insured, or beneficiary, as applicable, under an insurance policy or a bond purchased by another party (provided the risks are insurable or bondable).

§ 17.2 Indemnities and Waivers

§ 17.2:1 Types of Indemnities and Waivers

Insurance professionals sometimes describe indemnities as being “limited,” “intermediate,” or “broad.

1. A limited indemnity clause imposes liability on the indemnitor only to the extent of the indemnitor's fault or negligence and is the most favorable type of indemnity clause for an indemnitor.
2. Under an intermediate indemnity clause, the indemnitor assumes all liability except for the sole negligence of the indemnitee.
3. A broad-form indemnity clause imposes the entire risk of loss on the indemnitor, including the sole negligence of the indemnitee, and is the most favorable type of indemnity clause for an indemnitee.

§ 17.2:2 Drafting Considerations for Indemnities and Waivers

1. Does the party giving the indemnity or waiver have the authority or capacity to enter into the indemnity or waiver? (See section 17.2:3 below.)
2. What is the creditworthiness of the indemnitor? Is a guaranty, a surety bond, or insurance necessary?
3. Should persons other than the contracting parties (for example, shareholders, directors, officers, employees, contractors, or subcontractors) benefit from the indemnity or waiver?
4. Will liabilities arising out of the acts or omissions of persons other than the party giving the indemnity or waiver (for example, employees, agents, and contractors) be subject to the indemnity or waiver?
5. Is the recovery against the party giving the indemnity or waiver limited as to amount, ability to seek a deficiency judgment, or source of funds to pay damages?
6. What risks are covered by the indemnity or waiver?
7. Is the indemnity or waiver consistent with insurance coverages carried by the parties, both as to amounts and risks insured?
8. Is the obligation to defend and the entire cost of defense included in the indemnity? If so, will the beneficiary of the indemnity be entitled to separate counsel of its choosing?
9. Are there any types of damages (for example, punitive or consequential) that are excluded?
10. Are there any limitations as to the time period the indemnity or waiver will be in effect or the time period for making a claim under the indemnity or waiver?
11. Do any anti-indemnity statutes apply? (See section 17.2:4 below.)
12. Is compliance with the fair notice doctrine necessary? (See section 17.2:5 below.)

§ 17.2:3 Indemnities by Cities and Counties Prohibited

The Texas Constitution states that no debt for any purpose may be incurred by any city or county unless provision is made at the time of creating the debt for levying and collecting a sufficient tax to repay the debt. *See* Tex. Const. art. XI, §§ 5, 7. Because an indemnity is by its nature uncertain as to the timing and amount of the liability that could be incurred, an indemnity by a city or county is invalid. *See T. & N.O.R.R. Co. v. Galveston County*, 169 S.W.2d 713 (Tex. 1943).

§ 17.2:4 Anti-Indemnity Laws

With some exceptions, Texas Insurance Code chapter 151 prohibits broad-form and intermediate indemnities in construction contracts and requirements in a construction contract for insurance policies or endorsements that cover broad-form or intermediate indemnities. Under Tex. Ins. Code § 151.102, an indemnity in a construction contract, or in an agreement collateral to or affecting a construction contract, is void and unenforceable to the extent that it requires an indemnitor to indemnify a party, including a third party, against a claim caused by the negligence or fault, violation of a law, or breach of contract of the indemnitee, its agent or employee, or any third party under the control or supervision of the indemnitee, other than the indemnitor or its agent, employee, or subcontractor of any tier. Under Tex. Ins. Code § 151.104, a provision in a construction contract that requires the purchase of additional insured coverage or any coverage endorsement or provision within an insurance policy providing additional insured coverage is void and unenforceable to the extent that it requires coverage that is prohibited under Tex. Ins. Code § 151.102.

The definition of a “construction contract” contained in Tex. Ins. Code § 151.001(5) is extremely broad, including any “contract, sub-contract, or agreement made by an owner for the design, construction, alteration, renovation, remodeling, repair, or maintenance of a building, structure, appurtenance, or other improvement to or on real property.” Whether the definition covers a lease that contemplates leasehold improvements or contains provisions regarding repairs, maintenance, or alterations is, at best, unclear.

Among the exceptions under Insurance Code chapter 151 are the following:

1. There is a broad exception for any provision in a construction contract

that requires a party to indemnify, hold harmless, or defend another party to the construction contract or a third party against a claim for the bodily injury or death of an employee of the indemnitor, its agent, or its subcontractor of any tier (that is, so-called third-party-over actions). Tex. Ins. Code § 151.103.

2. Indemnity provisions contained in loan and financing documents other than construction contracts to which the contractor and owner’s lender are parties. Tex. Ins. Code § 151.105(3).
3. An indemnity provision in a construction contract, or in an agreement collateral to or affecting a construction contract, pertaining to a single family house, townhouse, duplex, or directly related land development, or to a public works project of a municipality. Tex. Ins. Code § 151.105(10).

Texas law also prohibits certain indemnities by a contractor with respect to an architect’s negligence and certain indemnities by an architect with respect to an owner’s negligence. *See* Tex. Civ. Prac. & Rem. Code § 130.002.

§ 17.2:5 Fair Notice Doctrine

Even if no anti-indemnity statute applies, when an indemnity, release, or waiver provision seeks to shift the risk of one party’s future negligence or other fault to the other party, Texas imposes a fair notice requirement before enforcing that agreement. *Dresser Industries, Inc. v. Page Petroleum, Inc.* 853 S.W.2d 505, 508 (Tex. 1993). The fair notice requirements are set out as the express negligence doctrine and the conspicuousness requirement. *Storage & Processors, Inc. v. Reyes*, 134 S.W.3d 190, 192 (Tex. 2004). The fair notice requirement is a rule of contract interpretation and is therefore determinable as a matter of law. *Fisk Electric Co. v. Con-*

structors & Associates, 888 S.W.2d 813, 814 (Tex. 1994).

Express Negligence Rule: If the parties to a contract want to indemnify one of the parties against its own negligence, the parties must express their intent in specific terms within the four corners of the contract. *Ethyl Corp. v. Daniel Construction Co.*, 725 S.W.2d 705, 707–08 (Tex. 1987). This same rule applies to releases. *Dresser Industries, Inc.*, 853 S.W.2d 505. There is no specific required language to use to comply with the express negligence doctrine in Texas, other than use of the terms *negligence* or *fault*, but a good example to follow states: “TENANT WILL RELEASE, DEFEND, AND INDEMNIFY LANDLORD [AND ANY OTHER INDEMNITEES] FROM ANY CLAIM OR LOSS EVEN THOUGH CAUSED IN WHOLE OR IN PART BY THE NEGLIGENCE (WHETHER SOLE, JOINT, OR CONCURRENT), STRICT LIABILITY, OR OTHER LEGAL FAULT OF LANDLORD [OR ANY OTHER INDEMNITEES].” Whether a release or indemnity for gross negligence is enforceable is unclear, but any release or indemnity intended to apply to gross negligence may need to specifically mention gross negligence to meet the express negligence test. *Van Voris v. Team Chop Shop, LLC*, 402 S.W.3d 915 (Tex. App.—Dallas 2013, no pet.).

Conspicuousness Rule: The indemnity, release, or waiver provision indemnifying or releasing a party from its own negligence must be conspicuous (for example, a separate indemnity and waiver provision in contrasting, capitalized, or colored type with a clear and informative heading). *Dresser Industries, Inc.*, 853 S.W.2d at 510–11.

Extensions of Fair Notice Doctrine: The fair notice doctrine has also been held to apply to indemnities or waivers—for strict liability (*Houston Lighting & Power Co. v. Atchison, Topeka & Santa Fe Railway Co.*, 890 S.W.2d 455, 459 (Tex. 1994)) and of a third party by a subscribing employer notwithstanding the

exclusive recovery (or one action) rule under the Workers’ Compensation Act (*Enserch Corp. v. Parker*, 794 S.W.2d 2, 9 (Tex. 1990)).

§ 17.3 Overview of Insurance Policies

§ 17.3:1 Categories of Insurance

Property Policies: Property insurance is ‘first party’ insurance that compensates the named insured for property that has been lost, damaged, or destroyed. Examples of property insurance policies are commercial property, builder’s risk, and business income and insurance. (See section 17.4 below.)

Liability Policies: Liability insurance is “third party” insurance that compensates a third party injured by the actions or omissions of an insured. Examples of liability insurance are commercial general, business auto, and workers’ compensation insurance. (See section 17.5 below.)

Package Coverage Policies: Package coverage policies cover both property risks and liability risks. An example of a package coverage insurance policy is homeowner’s insurance. (See section 17.4:4 below.)

§ 17.3:2 Lines of Insurance

Personal lines of insurance are for individuals and families—for example, homeowner’s insurance and renter’s insurance. Commercial lines of insurance cover businesses—for example, commercial property insurance, commercial general liability insurance, and business owner’s policies.

§ 17.3:3 Policy Forms

Insurance Services Office, Inc., commonly known in the insurance industry as ISO, drafts insurance forms that are used either verbatim or

with modifications in all fifty states. (The National Board of Fire Underwriters, the organization to which many real estate documents still refer, merged with the American Insurance Association in 1966 and ceased to exist as a separate entity. In 1971 the American Insurance Association merged with twenty-nine other ratings agencies to create ISO.) Although ISO forms are dominant, other forms in the marketplace may be (1) ‘manuscripted,’ that is, drafted by an insurance company (and which may be similar to or less broad than the ISO equivalent); (2) promulgated by the Texas Department of Insurance (for example, the Homeowner’s A, B, and C coverages); or (3) drafted by a competitor of ISO (for example, the American Association of Insurance Services).

Another set of property insurance forms, known as inland marine forms or floaters, evolved to insure property being transported by canal barges and later railroads and trucks. Today, inland marine is used primarily for ‘property which is mobile by nature and for which there is no fixed situs; and instruments of communication or transportation such as bridges, tunnels, piers or television antennas’ (State of New York Insurance Department, Circular Letter No. 22 (2000), August 11, 2000). In addition, inland marine forms are used in the construction area and for specialized coverages such as jewelry and computer data. Inland marine forms are generally manuscripted.

§ 17.4 Property Insurance

§ 17.4:1 Terminology and Structure

Commercial property insurance is the property insurance form used in most commercial settings. The phrase *fire and extended coverage insurance* was the name of a named-peril property insurance policy that is no longer available, and the phrase *casualty insurance* is incorrect if used to describe property insurance.

An ISO commercial property insurance policy is not a single form. Rather, an ISO commercial property insurance policy is made up of six different forms:

1. Common policy conditions (ISO Form IL 00 17)—describes the conditions applicable to all insurance policies.
2. Commercial property conditions (ISO Form CP 10 90)—describes the conditions applicable only to commercial property policies.
3. ISO Form CP 00 10, entitled “Building and Personal Property Coverage Form”—describes the property being covered.
4. Declarations and schedules provide specifics such as the name of the insured, location of property, and coverage amounts.
5. A causes of loss form (ISO Forms CP 10 10, CP 10 20, or CP 10 30)—determines whether the policy will be a named peril policy or an all risks policy (see section 17.4:2 below).
6. Any necessary coverage forms or endorsements describing additional property covered, additional limits, and optional coverages.

As a general rule, commercial property insurance is used to cover completed buildings, and builder’s risk insurance is used to cover buildings under construction or, in some cases, under extensive renovation. No bright line exists as to when builder’s risk insurance should be used rather than commercial property insurance. Builder’s risk policies have several important advantages over commercial property policies with respect to coverage for buildings under construction, such as coverage for property stored offsite and property in transit.

§ 17.4:2 Standard Forms of Commercial Property Policies

Historically, property insurance was written on either a named-peril basis, which insured against property damage arising from causes of loss expressly enumerated in the policy, or an all-risks basis, which insured against property damage arising from all causes of loss except those that were expressly excluded by the policy. The insurance industry has now abandoned use of the words *risk* and *peril* and instead uses the term *cause of loss*.

Basic and Broad (Named-Peril) Forms:

Two named-peril commercial property insurance policies are currently available: causes of loss—basic form and causes of loss—broad form. The basic form (ISO Form CP 10 10) covers twelve causes of loss: (1) fire, (2) lightning, (3) explosion, (4) windstorm or hail, (5) smoke, (6) aircraft, (7) vehicle collision, (8) riot or civil commotion, (9) vandalism, (10) sprinkler leakage, (11) sinkhole collapse, and (12) volcanic action. The broad form (ISO Form CP 10 20) covers all the causes of loss covered by the basic form plus (1) breakage of glass; (2) falling objects; (3) weight of snow, ice, or sleet; (4) water damage from leaking appliances; and (5) collapse from specified causes.

Special (All-Risks) Form: The correct terminology for commercial property insurance currently written on an all-risks basis is causes of loss—special form (ISO Form CP 10 30).

§ 17.4:3 Specialized Coverages

Separate property policies or endorsements are available to fill the gaps created under standard forms of commercial property insurance policies.

Equipment Breakdown: Equipment breakdown (formerly boiler and machinery) coverage

(for example, ISO Endorsement Form BM 00 20) insures against property losses caused by the explosion of pressure vessels and sudden and accidental, mechanical, or electrical breakdown of covered machinery and the resulting loss of business income.

Builder's Risk: Because of the higher likelihood of property loss during construction, a specialized form of property insurance called builder's risk is used during the construction of a building in lieu of commercial property insurance.

Although ISO has promulgated a builder's risk form (ISO Form CP 00 20), most builder's risk policies are written on manuscripted inland marine forms. ISO builder's risk insurance forms are available on a basic, broad, or special causes of loss basis, but the inland marine forms that are more commonly used may, depending on the insurer, have broader or narrower coverage than their ISO counterparts. Among the causes of loss that may not be covered by a builder's risk policy without endorsement are collapse resulting from design error and damage resulting from freezing, flood, and earthquake.

Builder's risk property insurance is available in nonreporting (commonly known as "completed value") or reporting forms. Under a completed value form, coverage is automatically increased as construction occurs. A reporting form will not cover the increased value until the increase is reported to the insurance carrier.

A builder's risk policy usually covers most of the property used in or incidental to the construction even if the property is stored off-site or in transit, but may not cover the following unless the policy is specifically endorsed: landscaping, temporary structures such as scaffolding, construction trailers, site work, underground structures such as footings, equipment used to construct the building, and business income.

Many extensions of coverage are available under builder's risk insurance policies. Because builder's risk policies forms are generally manuscripted, these extensions may be included within the basic coverage of some policies but must be added by endorsement to other policies. Most extensions or endorsements have a "sub-limit," which is less than the full policy limit but the maximum amount recoverable with respect to the extension or endorsement. The following are some of the extensions of coverage or endorsements that are available for builder's risk policies:

1. Contract penalties—covers contractual penalties to the insured's customers incurred as a result of a delay of completion date.
2. Collapse—covers damage or loss from collapse of the structure caused by certain causes of loss, generally including defective materials and faulty design, plans, or workmanship (but not the cost of correcting the defective workmanship or faultily designed work).
3. Debris removal—covers the cost of removing debris resulting from a covered cause of loss in excess of the limit of proceeds for debris removal contained in basic coverage.
4. Expediting expense—covers additional expenses necessarily incurred to complete construction on schedule after the occurrence of a covered cause of loss.
5. Pollutant cleanup—covers the cost of removing pollutants released by a covered cause of loss.
6. Preservation of property—covers the cost of removing covered property from the premises to preserve the property from loss after a covered cause of loss has occurred.
7. Soft costs (sometimes called "extra expenses")—covers necessary expenses incurred as a result of a delay of completion date, such as interest on the construction loan, real estate taxes, architectural and engineering supervisory costs, costs to renegotiate leases, brokerage commissions, and legal and accounting costs (*caveat*: coverage varies from policy to policy).
8. Testing—covers damage or loss from testing of boilers or other pressure vessels, air-conditioning systems, and mechanical or electrical machines or devices.
9. Loss of rents—covers the loss of rents caused by the delay of completion.

Because builder's risk property policies typically suspend coverage if any portion of the structure is occupied for purposes other than testing, a phased project may require an endorsement to permit a certain level of occupancy.

Business Income: Business income coverage (ISO Endorsement Form CP 00 32) insures against loss of earnings resulting from the insured's inability to operate a business after the occurrence of a covered cause of loss. This type of coverage was formerly known as 'business interruption' insurance. Business income and extra expense coverage (ISO Endorsement Form CP 00 30) also insure against extraordinary additional expenses resulting from the insured's inability to operate a business after the occurrence of a covered cause of loss.

Rental value coverage insures against loss of rents (including abatement of rentals under leases) resulting from the insured's inability to operate a building after the occurrence of a covered cause of loss. Rental value coverage is available under both business income endorsement forms (ISO Forms CP 00 30 and CP 00 32)

but is not included unless specified in the declaration to the policy.

All of the ISO commercial property causes of loss forms (ISO Forms CP 10 10, CP 10 20, and CP 10 30) exclude coverage for business income loss caused by “the failure of power or other utility services if the failure occurs outside of a covered building. ISO Form CP 15 45, entitled ‘Off-Premises Services—Time Element, is an endorsement to a business income coverage form (with or without extra expense coverage) that provides coverage for the loss of income arising from off-premises utility service disruption.

ISO Form CP 15 08, entitled “Business Income from Dependent Properties—Broad Form, is an endorsement to a business income coverage form (with or without extra expense coverage) that provides coverage for loss of income (and extra expenses incurred, if applicable) because of damage to another company’s facility. For example, a San Antonio-based automobile manufacturer depends on parts from an automobile parts facility located in Beaumont. If the Beaumont plant were damaged and rendered inoperable by a hurricane, the San Antonio manufacturer would incur losses even though the automobile manufacturer’s plant is unharmed.

Crime (or Fidelity): This coverage protects the insured against loss of property (generally money, securities, and inventory) resulting from the types of crime enumerated in the policy. Among the crimes for which crime insurance is available are computer fraud, social engineering fraud, employee dishonesty, embezzlement, extortion, forgery, premises theft, premises burglary, safe burglary, wire transfer fraud, counterfeiting, and off-premises robbery.

Earthquake: Earth movement or earthquake coverage insures against property losses caused by earth movement, including earthquake shocks, mudslides, and volcanic eruptions.

Flood: Flood coverage insures against property losses caused by rising waters, backup of storm sewers, and storm surges. Flood coverage is necessary because all three of the ISO commercial property insurance causes of loss forms (ISO Forms CP 10 10, CP 10 20, and CP 10 30) expressly exclude coverage for floods and many other types of water damage.

The National Flood Insurance Act of 1968 (42 U.S.C. §§ 4001–4131) (NFIP) created a program to make available flood insurance for property owners in flood-prone areas. Regulations implementing the NFIP are found at 44 C.F.R. pts. 59–78. *See also* Tex. Loc. Gov’t Code § 240.901 (participation in federal flood insurance program); Tex. Water Code §§ 16.311–.324 (Flood Control and Insurance Act). The Flood Disaster Protection Act of 1973 mandated that federally regulated lending institutions could not “make, increase, extend, or renew any loan secured by improved real estate or a mobile home located or to be located in an area that has been identified as an area having special flood hazards and in which flood insurance has been made available’ under the NFIP without flood insurance in an amount equal to the lesser of the loan amount or the available coverage. 42 U.S.C. § 4012a(b)(1).

NFIP insurance has several drawbacks:

1. The maximum coverage limits are \$500,000 for a building and \$500,000 for contents.
2. The policy pays only direct physical loss by or from flood and does not pay indirect damages such as loss of income.
3. In most cases, NFIP insurance pays only actual cash value, not replacement cost.

See section 17.4:5 below.

Private flood insurance coverage is also available. Coverage under a commercial property policy can be expanded with ISO Endorsement Form CP 10 65. Form CP 10 65 also has several drawbacks:

1. The endorsement does not cover underground water flows or seepage.
2. The endorsement excludes coverage for flooding within a wait period of seventy-two hours after the inception date of the endorsement, damage to land (including excavations, grading, filling, or backfilling), removal of mud and earth deposited by flooding, and loss or damage caused by sewer backup or overflow unless the backup or overflow occurs within seventy-two hours after the flood recedes.
3. A commercial property policy endorsed for flood coverage usually contains a very high deductible with respect to properties located in a special flood hazard area shown on flood insurance rate maps produced by the Federal Emergency Management Agency.
4. A commercial property insurance policy endorsed for flood coverage for flooding usually contains a sublimit with respect to the amount of coverage available for flood damage (a sublimit limits the amount of coverage available to cover a specific type of loss to an amount smaller than the policy limit).

Glass: Before 2000, coverage was excluded or limited in commercial property insurance policies for damage to plate glass. Glass coverage was obtained through so-called "plate glass insurance," issued as a separate coverage form. The exclusions and limitations were removed from ISO forms CP 10 10, CP 10 20, and CP 10 30 in 2000.

Loss Payee and Mortgage Clauses: A loss payee is a party named in a loss payee endorsement. A loss payee clause is referred to as an open clause if the loss payee under the loss payable clause has no independent right to enforce the policy but is simply a recipient of payments when the insured becomes entitled to collect under the policy. The drawback of an open clause is that the action or inaction of the insured can defeat the right of a loss payee to collect (for example, the insured may make a misrepresentation, fail to pay premiums, or fail to report a loss timely). On the other hand, a closed clause creates a separate contract between the insurer and the loss payee or mortgagee and contains language to the effect that the act or neglect of the insured will not invalidate the policy. A closed loss payee clause is also referred to as a mortgagee clause. It provides special protections to the mortgage holder that generally include payment for covered loss that will be made to the mortgage holder, not to the insured or to the insured and the mortgagee; coverage applies for the benefit of the mortgagee even if the insured's claim is denied because of the insured's acts, subject to a couple of basic requirements. The mortgagee will receive written notice of policy cancellation by the insurer.

Standard mortgage holder protection for buildings or structures only (but not the business personal property) is built into the current ISO Building and Personal Property Coverage Form (ISO Form CP 00 10).

The current edition of ISO Endorsement Form CP 12 18, entitled "Loss Payable Provisions," uses four different descriptions to describe the loss payee: "Loss Payable," "Lender Loss Payable," "Contract of Sale," and "Building Owner Loss Payable." It is critical for a mortgagee to pick the right category. If "Loss Payable" is chosen in the schedule to the endorsement, the provision becomes an open clause, and the interest of the loss payee is protected only if the named

insured chooses to enforce the protection. However, if 'Lender Loss Payable' is chosen in the schedule, the provision becomes a closed clause and protects a lender loss payee the same way as a mortgage holder is protected by the standard mortgagee clause in the building and personal property coverage form, with an important difference: under ISO Endorsement Form CP 12 18, the mortgagee protection applies to both the building and the business personal property associated with the building.

Form CP 12 18 may also be used by a landlord to create a 'Building Owner Loss Payable' and establish privity between the landlord and the tenant's property carrier with respect to insurance proceeds payable because of the loss of the landlord's property.

Signs: This coverage (ISO Form CM 00 28) insures against damage to signs resulting from windstorm, vandalism, or vehicle damage.

Terrorism: Terrorism insurance protects the insured against losses arising from terrorist activities that are excluded from commercial property policies.

Until 2002, damage or loss from terrorism was not expressly excluded by ISO's commercial property insurance policy forms. Following the attacks of September 11, 2001, ISO introduced several exclusions for losses caused by terrorism. In November 2002, the federal government enacted the Terrorism Risk Insurance Act of 2002 (TRIA) requiring all U.S. commercial property insurers to offer coverage for losses caused by international terrorism and creating a reinsurance program for this coverage with a total annual limit of \$100 billion. TRIA was extended in 2005 and reauthorized in 2015, in a modified form, through December 31, 2020. As originally enacted, TRIA applied to violent acts causing damage in excess of \$5 million in the United States (or aircraft or U.S.-flagged vessels), committed by a party acting on behalf of a

foreign person or interest, and certified as terrorism by the secretary of the U.S. Treasury. The 2007 reauthorization deleted the requirement that an act of terrorism be committed by someone acting on behalf of a foreign person or interest to be certified as an act of terrorism. However, the insurer is not required under TRIA to provide terrorism coverage if the insured rejects the coverage in writing or if the insured does not pay the premium for the terrorism coverage. TRIA does not set the premiums for terrorism coverage. *See* 15 U.S.C. § 6701 note (Terrorism Risk Insurance Act of 2002, Pub. L. No. 107-297, 116 Stat. 2322, as amended by Terrorism Risk Insurance Extension Act of 2005, Pub. L. No. 109-144, 119 Stat. 2660, the Terrorism Risk Insurance Program Reauthorization Act of 2007, Pub. L. No. 110-160, 121 Stat. 1839, and the Terrorism Risk Insurance Program Reauthorization Act of 2015, Pub. L. No. 114-1, 129 Stat. 3). *See also* 31 C.F.R. pt. 50.

§ 17.4:4 Residential or Farm Property Insurance

Homeowner's Insurance: Homeowner's insurance is available to the owner of an owner-occupied dwelling. Homeowner's insurance is a package coverage insurance policy covering both property claims, such as loss of or injury to the dwelling and to the insured's personal property, and liability claims, such as bodily injury to third parties caused by the insured. A homeowner's insurance policy also covers some living expenses incurred as a result of temporary displacement because of damage to a dwelling.

Most homeowner's policies may be written on forms generated by the Texas Department of Insurance (TDI) (HO-A, HO-B, and HO-C) or forms generated by ISO (HO 00 02, HO 00 03, and HO 00 05).

The property coverage under homeowner's insurance policies varies as follows:

1. TDI Form HO-A and ISO Form HO 00 02—named-peril basis (see section 17.4:2 above) for both the dwelling and its contents;
2. TDI Form HO-B and ISO Form HO 00 03—all-risks basis (see section 17.4:2 above) for the dwelling and a named-peril basis for its contents; and
3. TDI Form HO-C and ISO Form HO 00 05—all-risks basis for both the dwelling and its contents.

The amount collected for loss of or injury varies as follows under the various forms:

1. TDI Form HO-A—actual cash value (see section 17.4:5 below) for both the dwelling and its contents;
2. ISO Form HO 00 05—replacement cost (see section 17.4:5 below) for both the dwelling and its contents; and
3. TDI Forms HO-B and HO-C and ISO Forms HO 00 02 and HO 00 03—replacement cost for the dwelling and actual cash value for its contents. (All four forms can be endorsed to cover replacement cost for the contents.)

Condominium Insurance: A condominium has two sets of insurance, one covering the condominium association and another covering the individual unit owners.

The condominium association's insurance requirements are set forth in Tex. Prop. Code § 82.111. Tex. Prop. Code § 82.111(a) requires that the condominium association maintain separate commercial property and commercial general liability policies. A commonly used condominium association property coverage form, ISO Form CP 00 17, entitled 'Condominium Association Coverage Form, is nearly identical to its commercial property insurance coverage counterpart, ISO Form CP 00 10, except that the definition of business personal

property is limited to the personal property owned by the association or indivisibly by all unit owners and other property for which the association is responsible under the declaration. Tex. Prop. Code § 82.111(d) also requires that the unit owners be named as insureds under the association's policies, that the association's insurers waive subrogation as to the unit owners, and that the association's policies are primary to a unit owner's policies if there is duplicate coverage.

Individual unit owners purchase the equivalent of homeowners coverage for their individual units known as "condominium unit owners" policies. Like homeowners insurance, unit owners insurance is a package coverage insurance policy covering both property claims with respect to the dwelling and the insured's personal property, and liability claims. Unit owners policies may be written on TDI forms HO-B-CON and HO-C-CON and ISO Form HO 00 06.

The property coverage under unit owners insurance policies varies as follows:

1. TDI Form HO-B-CON and ISO Form HO 00 06—named-peril basis (see section 17.4:2 above) for both the dwelling and its contents (all risks coverage is available for both dwelling and contents under ISO Form HO 00 06 by endorsement); and
2. TDI Form HO-C-CON—all-risks basis for both the dwelling and its contents.

The amount collected for loss of or injury varies as follows under the various forms:

1. TDI Form HO-C-CON—replacement cost (see section 17.4:5 below) for both the dwelling and its contents; and
2. TDI Form HO-B-CON and ISO Form HO 00 06—replacement cost for the dwelling and actual cash value for its

contents. (Both forms can be endorsed to cover replacement cost for the contents.)

Tenant's Insurance: Tenant homeowner's insurance (commonly known as tenant's or renter's insurance) is available to tenants of residential property. Tenant's insurance is a package coverage insurance policy that covers the property insurance causes of loss of injury to or loss of the tenant's personal property and the liability insurance cause of loss of bodily injury to third parties. The property portion of tenant's insurance is available in either a named-peril version called broad form or, for a higher premium, an all-risks version called comprehensive form (see section 17.4:2 above). The amount collected for property loss under tenant's insurance is limited to actual cash value, unless the insured has purchased an endorsement increasing coverage to replacement cost (see section 17.4:5 below). The risks of injury to or loss of the dwelling are generally covered by the landlord's commercial property insurance policy on the dwelling, but tenant's insurance may cover some damage to the dwelling caused by the tenant if the tenant is liable for the damage under the lease. Tenant's insurance also covers some living expenses incurred as a result of temporary displacement from the dwelling because of damage.

Farm and Ranch Insurance: Farm owner's (sometimes called farmowner's) insurance is available to individuals who own and occupy property meeting the definition of a farm or ranch and who do not elect to be insured by a farm mutual insurance company (in Texas, farm mutual insurance companies cannot write liability insurance). Farm owner's insurance is a package coverage insurance policy that covers the property insurance causes of loss of injury to or loss of farm dwellings, outbuildings, and personal property and the liability insurance causes of loss of bodily injury to third parties.

If a farmer or rancher is not an individual or is purchasing his property insurance from a farm

mutual company, the farmer or rancher must purchase separate property and liability insurance policies. In a farm or ranch context, the equivalent of a commercial property insurance policy is typically called a farm and ranch insurance policy, and the equivalent of a general liability insurance policy is typically called a farm liability policy. In some situations liability insurance is provided through a commercial general liability policy properly endorsed to cover farm or ranch operations.

Farm or ranch operations can be covered by personal lines or commercial lines of insurance depending on the magnitude of the farming operation. Typically, an insurance company will set a threshold of gross income from farm or ranch activities or number of acres farmed or number of cattle grazed to differentiate between a personal line farm policy and a commercial line farm policy.

Caveat: The activities of a farm tenant may impact the size of the operation for insurance purposes. Assume, for example, a gentleman farmer (typically, a person with a country home and a few horses or other farm animals) whose level of farming or ranching activity does not rise to a commercial level insures the property in question under a homeowner's insurance policy, a personal lines coverage. The gentleman farmer then leases out surplus acreage to a farmer whose level of activity on the leased property is attributed to the gentleman farmer for insurance purposes. When a claim is made against both the owner and tenant because of an injury arising out of the operation of the tenant, the owner may discover that he is not covered because personal lines policies exclude from coverage losses arising out of operations covered under commercial lines policies.

§ 17.4:5 Amount of Proceeds

The discussion in this section covers terminology used in commercial property and business

owner's policies. These concepts may vary under homeowner's or farm and ranch policies.

Actual Cash Value: Actual cash value means an amount equal to the difference between the cost of replacing property with property of like kind and quality at the time of loss and the amount of physical (not book) depreciation of the property. Unless a commercial property policy is properly endorsed, the insured is entitled only to actual cash value. Actual cash value will be paid whether or not the property is replaced or restored.

Replacement Cost: Replacement cost is the cost of repairing or replacing insured property at the time of the occurrence of the loss, without reduction for loss of value through depreciation. Replacement cost will not be paid until the property is replaced or restored with property of like kind.

Agreed Value: Agreed value is an agreed valuation method that can be used with either actual cash value or replacement cost. The named insured and insurance company agree to the amount of the actual cash value or replacement cost for the insured property (less the applicable deductible) before the policy is written. Agreed value is desirable because it eliminates coinsurance. An agreed value endorsement usually requires annual agreement between the insurer and named insured.

Coinsurance: Coinsurance is a method by which an insurance company penalizes its insured for underinsuring below a minimum percentage of the replacement cost of a property at the time of loss (usually 80 percent if the policy is written for a single property and 90 percent if the policy covers more than one property). If coinsurance applies, the insurer will pay only an amount (subject to the policy limit and less any applicable deductible or self-insured retention) equal to the product obtained by multiplying the amount of the loss by a fraction having as its numerator the amount of cov-

erage the insured actually carried and as its denominator the minimum amount of coverage the insured should have carried.

Ordinance or Law Coverage: The valuation methods discussed above focus on the cost of replacing the existing structure without consideration to changes in laws or codes. Additional coverage under the Standard Building and Personal Coverage Form (ISO Form CP 00 10) is available up to the lesser of \$10,000 or 5 percent of the value of the damaged building as of the time of the loss. Larger amounts can be covered by an ordinance or law coverage endorsement (ISO Endorsement Form CP 04 05).

Debris Removal: The commercial property insurance policy limit includes debris removal costs resulting from a covered loss, but the recovery is limited to 25 percent of the sum of the paid loss plus the deductible. An additional limit of \$10,000 is made available by the current edition of the ISO commercial property policy for debris removal if (1) the amount payable under the policy to reconstruct or repair plus the amount payable under the policy for debris removal exceeds the entire policy limit or (2) the cost of debris removal exceeds 25 percent of the sum of the paid loss plus deductible. Higher limits for debris removal can be purchased by adding ISO Endorsement Form CP 04 15 entitled "Debris Removal Additional Limit of Insurance."

§ 17.5 Liability Insurance

§ 17.5:1 Claims-Made vs. Occurrence-Basis Liability Policies

Claims-Made: In theory, a claims-made liability policy covers any claim actually made during the policy term, regardless of when the injury or damage that gave rise to the claim occurred, but in reality the claims-made policy probably excludes claims arising from injuries

or damages that occurred before the inception of the policy term (known as prior acts). For an additional premium, a claims-made policy can sometimes be modified to cover prior acts.

Unless renewed on a similar form with retroactive coverage or with a coverage extension known as extended reporting period or tail coverage, all coverage ends when the claims-made policy expires. Defense is frequently included within the policy limits of claims-made policies and reduces the amount available to compensate an injured party for a loss. Claims-made policies are usually manuscripted.

Occurrence-Basis: An occurrence-basis liability policy covers claims for injuries or damages caused by an occurrence, but only if the injury or damage actually occurs during the policy period, regardless of when the claim is made (subject, of course, to statutes of limitation applicable to the claim). ISO Form CG 00 01 defines an occurrence as ‘an accident, including continuous or repeated exposure to substantially the same general harmful conditions. Defense is provided as an additional benefit under ISO occurrence-basis commercial general liability forms and does not reduce the limits available to pay for a loss, except for the defense of indemnitees if certain conditions are not met.

§ 17.5:2 Standard Form of General Liability Policies

Comprehensive General Liability: Comprehensive general liability insurance is, in fact, much less comprehensive in coverage than the commercial general liability insurance, has not been widely used since 1986, and should not be specified in real estate or other transaction documents.

Commercial General Liability: Commercial general liability insurance is the prevalent form of liability insurance in a commercial real estate context and has three coverages:

1. Coverage A—bodily injury (including death, disease, and illness) and property damage (including loss of use).
2. Coverage B—personal and advertising injury (including false arrest, detention or imprisonment, malicious prosecution, wrongful eviction or entry, slander, or libel, publication violating a person’s right of privacy, using another’s advertising idea, and copyright infringement).
3. Coverage C—medical payments.

Limits: The standard ISO commercial general liability policy form contains six policy limits: (1) each occurrence limit, (2) general aggregate limit, (3) products-completed operations aggregate limit, (4) personal and advertising injury limit, (5) damage to premises rented limit (formerly “fire damage limit”), and (6) medical expense limit.

A general aggregate limit is the maximum amount that a commercial liability insurance company will pay for all losses incurred during any one policy period except for bodily injury and property damage covered by the products-completed operations aggregate. ISO Form CG 25 04, entitled ‘Designated Location(s) General Aggregate Limit, an endorsement to a commercial general liability policy covering multiple properties, applies the general aggregate limit separately to each location but only with respect to bodily injury, property damage, and medical expenses. ISO Form CG 25 03, entitled ‘Designated Construction Project(s) General Aggregate Limit, an endorsement to a contractor’s commercial general liability policy covering multiple projects, applies the general aggregate limit separately to each project but only with respect to bodily injury, property damage, and medical expenses.

Contractual Liability: Several exclusions apply to Coverage A and Coverage B under a

commercial general liability insurance policy: willful misconduct, liquor liability, workers' compensation, employer's liability, pollution, aircraft, auto or watercraft, mobile equipment, war, damage to property, damage to product, damage to impaired property not physically injured, recall of products, and work or property, subject to the exception for damage to premises rented. However, the exclusion most often referenced in a real estate transaction is contractual liability.

The term *contractual liability* in the insurance context generally refers to claims that arise out of liability for the actions of others, rather than out of the actions of an insured, that has been contractually assumed by the insured. Coverage A excludes liability assumed under contracts but has an exception to this exclusion for liability assumed in a contract or agreement that is an insured contract. The definition of "insured contract" includes most indemnities that cover the tort liability of another party; however, a contractual assumption of another person's contractual liability is not covered under the typical definition of "insured contract." If, for example, a contractor agrees to indemnify the owner for its potential tort liability to an injured employee, the contractor would have insurance coverage for its indemnity obligation; if, however, the contractor agreed to indemnify the owner for the owner's contractual indemnity to the owner's representative, the contractor's indemnity might be enforceable but would not be covered under the contractor's standard commercial general liability policy. In addition, the insured contract exception cannot expand the scope of the commercial general liability policy beyond the coverage provided or the limits of liability that have been purchased. If, for example, the policy excludes coverage for property damage and bodily injury caused by pollutants, an indemnity for property damage and bodily injury caused by pollutants will not be covered by the policy even if the indemnity is contained in an insured contract. Coverage B of the ISO form of commer-

cial general liability policy also contains an exclusion for liability assumed in contracts but does not contain the insured contract exception. Coverage is typically available by the addition of ISO Form CG 22 74, entitled 'Limited Contractual Liability Coverage for Personal or Advertising Injury,' or, in some cases, by the deletion of the contractual liability exclusion.

§ 17.5:3 Business Auto

Business auto insurance (ISO Form CA 00 01) is a form of insurance covering liability arising out of the operation of automobiles by the insured and the ownership, maintenance, or use of mobile equipment subject to compulsory insurance or financial responsibility laws or other motor vehicle insurance laws. Landlords and mortgagees may require business auto insurance to cover potential liability arising from vehicular accidents occurring in project parking lots (commercial general liability policies expressly exclude coverage for injuries and damages arising from the operation of autos) and from the loading or unloading of goods from vehicles not being performed by certain types of mobile equipment such as forklifts.

§ 17.5:4 Workers' Compensation Insurance

Workers' compensation insurance is a statutory program that imposes strict liability on employers for injuries to employees occurring while the employees are acting in the scope of employment but limits the exposure of employers to a schedule of maximum recoveries. Tex. Lab. Code ch. 406. Landlords and lenders may wish to require tenants and borrowers to carry workers' compensation insurance to reduce the possibility that the tenant or borrower suffers an economically disastrous judgment because of an employee injury. If an employee of a tenant receives an award from a workers' compensation policy in a situation in which the landlord is

also negligent, the employee is less likely to sue the landlord.

§ 17.5:5 Employer's Liability Insurance

Employer's liability insurance supplements workers' compensation insurance by covering an employee for bodily injury occurring while in the scope of his or her employment if the injury is not covered by workers' compensation insurance. Unlike workers' compensation, the injured party must prove that the employer owed a duty to the injured party, that the employer breached the duty, and that the breach was the proximate cause of the injury. Employer's liability policies have defined each occurrence and aggregate limits, and these limits may be expanded by an umbrella or excess liability policy.

§ 17.5:6 Liquor Liability Insurance

Liquor liability insurance covers liability for bodily injury or property damage arising from (1) causing or contributing to the intoxication of any person, (2) furnishing alcoholic beverages to a person under the legal drinking age or under the influence of alcohol, or (3) violating any law relating to the sale, gift, distribution, or use of alcoholic beverages. Coverage applies only if the insured is involved in (1) manufacturing, selling, or distributing alcoholic beverages; (2) serving or furnishing alcoholic beverages for a charge; or (3) serving or furnishing alcoholic beverages for no charge, if a license is required for such activity. Insurance is available on an occurrence basis (ISO Form CG 00 33), on a claims-made basis (ISO Form CG 00 34), and on an aggregate per location basis (ISO Form CG 25 14).

§ 17.5:7 Innkeeper's Liability

Innkeeper's liability insurance protects motel and hotel operators from liability arising from the safekeeping of the property of guests.

§ 17.5:8 Garage Liability

Garage liability insurance (ISO Form CA 00 05) protects garage and parking lot operators from liability arising from garage operations, automobile physical damage, and uninsured or underinsured motorists. Ten different levels of coverage are generally available, ranging from the broad category of "any auto" to the narrow category of "specifically described autos." Garagekeeper's liability insurance protects garage operators against only direct damage or legal liability for damage to vehicles in the care, custody, or control of the garage operator (for example, if the named insured provides valet service). Although garagekeeper's liability insurance is available as separate coverage, garage liability insurance is broader coverage and includes garagekeeper's coverage.

§ 17.5:9 Umbrella or Excess Liability

Both umbrella and excess liability policies provide additional protection against catastrophic liability claims by increasing the policy limits of primary coverages.

Excess Liability: An excess liability policy relies on the primary policy for the insuring agreement and exclusions and provides coverage only in excess of the scheduled primary liability policies. The coverage is usually not broader than the primary policies.

Umbrella: An umbrella liability policy has its own insuring agreement and exclusions and usually serves three functions: (1) providing additional limits of liability over limits provided by the primary liability policies, (2) providing "drop down" coverage (that is, the umbrella coverage becomes primary) if the limits of the primary policy are exhausted, and (3) affording coverage for claims not covered by primary policies (to the extent not excluded by the umbrella liability policy). Because both an umbrella policy and the primary policy have their own insur-

ing sections, differences may arise between coverages, especially if the two policies have been issued by different companies. To ensure that no gap in coverage is created, the umbrella liability policy should contain an affirmative statement that the umbrella policy follows the form of the primary policy or at least provides coverage that is no less broad than the underlying policy.

Primary Liability: Both umbrella and excess liability policies contain a schedule of the primary liability policies over which umbrella or excess liability coverage is to be provided. This schedule may require that the primary coverage limits be unimpaired on inception of the umbrella or excess liability coverage, in which case the umbrella or excess liability coverage policies and their primary policies may need to have the same inception date.

§ 17.5:10 Hunting Lease Liability

An individual may be able to purchase an endorsement under the individual's homeowner's insurance policy extending personal liability coverage to a hunting lease. The availability and cost of this type of endorsement may vary with different insurance carriers. Although most forms of homeowner's insurance currently do not exclude bodily injuries caused by firearms, an individual should confirm that his homeowner's insurance policy does not contain an exclusion for hunting accidents before seeking to extend coverage to the premises under a hunting lease. An individual should also consider whether the personal liability limits under his homeowner's insurance policy are adequate to cover a hunting accident.

Hunting lease insurance, which covers hunting accidents, is also available from specialized insurance carriers, often through organizations such as hunting clubs and the National Rifle Association.

If the tenant under a hunting lease is a business entity, the tenant will probably be unable to extend its commercial liability policy to cover hunting accidents at the hunting lease and will need to purchase a hunting lease insurance policy.

§ 17.6 Additional Insured Status and Forms

§ 17.6:1 Usage

An additional insured is a party that is provided coverage as an insured under a policy by an additional insured endorsement. (Note that the correct terminology is "additional insured," not "additional named insured.") Except as discussed in sections 17.6:4 through 17.6:7 below, the status of additional insured is always used with reference to liability policies. An additional insured party is not responsible for payment of the policy premium, but a small administrative charge may be required to issue the endorsement. The policy premium is not adjusted for an additional insured's loss history.

With some exceptions, most notably coverage for bodily injury or death of an employee, Texas law prohibits a requirement in a construction contract for an additional insured endorsement covering a broad-form or intermediate indemnity. See section 17.2:4 above.

§ 17.6:2 Coverage

Many real estate attorneys believe that if a person or entity is an additional insured under the liability insurance of another person, the additional insured is afforded all the benefits of the other person's insurance policy; but in reality, protection is provided to the additional insured party only to the extent stipulated in the additional insured endorsement. Numerous additional insured endorsement forms exist for different situations with varying degrees of coverage. Many additional insured endorsements

explicitly or by implication exclude coverage for the sole or contributory negligence of the additional insured and limit or deny coverage to specific types of operations or locations.

§ 17.6:3 Additional Insured Endorsement Forms

Additional insured endorsement forms contain a granting clause stating that the party listed or described in the endorsement is to be included as an insured under the policy followed by restrictions introduced by the phrase *but only with respect to*. Granting clauses in additional insured endorsements do not typically cover partners, employees, agents, and other parties related to the party named as additional insured unless language to that effect is added or a contractual requirement to that effect is picked up by the wording of the endorsement. Although ISO publishes more than thirty different additional insured endorsement forms, individual insurance companies are increasingly using manuscripted forms that differ greatly in coverages and clarity. Hence, the type of additional insured endorsement required must be stipulated by ISO designation (including title, form number, and edition date) or, at a minimum, described in terms of the desired coverage.

The additional insured endorsements discussed below are standard forms promulgated by ISO. Note that the words *you* and *your* used in the forms quoted below refer to the named insured, not the additional insured.

In 2004, the ISO 20 10 additional insured form was amended to exclude coverage for the additional insured's sole negligence by adding a requirement that the claim be caused 'in whole or in part' by the acts or omissions of the named insured. Then, in April 2013, both of the additional insured endorsements described below (as well as several others) were amended to add three significant additional limitations. First, coverage is restricted to the extent permitted by

law. While the apparent intent was to incorporate statutes such as Tex. Ins. Code § 151.104, voiding a contractual provision requiring an additional insured endorsement to the extent that the provision requires coverage for an indemnity prohibited under Tex. Ins. Code § 151.102, the prohibition, if applicable, would presumably apply without this language. Second, coverage cannot be broader than the coverage required by the provision contained in the underlying contract, which is often limited to the indemnity obligations assumed by the named insured.

Here, the intent is to prevent coverage from exceeding what is required by the contract, so it is important for the contract to properly describe the scope of coverage required. Third, the dollar amount of coverage under the additional insured endorsement is limited to the lesser of the policy limit or the dollar limit of coverage required by the underlying contract. For this reason, insurance provisions in contracts often state that the policy limits set forth in the contract are minimum coverages and are not intended to limit the total amount the party should carry. However, some manuscript endorsements may include endorsements that limit coverage to the lesser of the policy limit or the "minimum" limits of coverage required by the underlying contract. The party seeking additional insured coverage should specify in the contract that the limits of insurance are just minimums and should specifically require that additional insured status be provided to the full limits of any liability policies. In any event, named insureds may wish to avoid restrictive additional insured endorsements, because the named insured's contractual obligation to provide additional insured coverage may be broader than the scope of the coverage of the available additional insured endorsement. On the other hand, the named insured may not want to provide additional insured coverage for risks that are assumed by or are the obligation of the additional insured. If so, both the contract and the policy should limit the additional insured coverage to the risks contractually assumed by the named insured.

The following provisions from ISO endorsement CG 20 10 04 13 illustrate the three limitations discussed in the preceding paragraph:

However:

1. The insurance afforded to such additional insured only applies to the extent permitted by law; and
2. If coverage provided to the additional insured is required by a contract or agreement, the insurance afforded to such additional insured will not be broader than that which you are required by the contract or agreement to provide for such additional insured.
3. With respect to the insurance afforded to these additional insureds, the following is added to Section III – Limits of Insurance:

If coverage provided to the additional insured is required by a contract or agreement, the most we will pay on behalf of the additional insured is the amount of insurance:

1. Required by the contract or agreement; or
2. Available under the applicable Limits of Insurance shown in the Declarations;

whichever is less.

This endorsement shall not increase the applicable Limits of Insurance shown in the Declarations.

ISO Form CG 20 10 04 13.

Owners, Lessees, or Contractors: The additional insured endorsement form entitled 'Additional Insured—Owners, Lessees or

Contractors—Scheduled Person or Organization' (ISO Form CG 20 10 04 13, quoted in part below) is commonly used in construction situations. The endorsement has three drawbacks: (1) it covers only the named insured's ongoing operations—that is, the additional insured is not covered for bodily injury or property damage occurring after completion or abandonment of the work; (2) it excludes from coverage injuries or damage caused by the sole negligence (but not the contributory negligence) of the additional insured, since the endorsement requires that the injury or damage be partially or totally caused by the named insured; and (3) it substitutes the word *caused* for the phrase *arising out of* used in editions before 2004 in order to eliminate coverage for losses or injuries occurring because of contractors' operations but not necessarily because of contractors' actions.

A. Section II—Who Is An Insured is amended to include as an additional insured the person(s) or organization(s) shown in the Schedule, but only with respect to liability for "bodily injury", "property damage" or "personal and advertising injury" caused in whole or in part by:

1. Your acts or omissions; or
2. The acts or omissions of those acting on your behalf;

in the performance of your ongoing operations for the additional insured(s) at the location(s) designated above.

ISO Form CG 20 10 04 13.

Coverage for completed operations can be obtained by using ISO Form CG 20 10 in tandem with ISO Form CG 20 37.

Managers or Lessors of Premises: The additional insured endorsement form entitled 'Additional Insured—Managers or Lessors of Premises' (ISO Form CG 20 11 04 13, quoted

in part below) is commonly used in lease situations and does not exclude the sole or contributory negligence of the additional insured. Coverage is tied to the lease's definition of "premises. Thus, if a lease defines "premises" in a way that excludes adjacent driveways or corridors, the landlord may not be an additional insured with respect to bodily injuries and property damage occurring in loading areas serving the premises.

A. Section II – Who Is An Insured is amended to include as an insured the person(s) or organization(s) shown in the Schedule but only with respect to liability arising out of the ownership, maintenance or use of that part of the premises leased to you and shown in the Schedule and subject to the following additional exclusions:

This insurance does not apply to:

1. Any "occurrence" which takes place after you cease to be a tenant in that premises.
2. Structural alterations, new construction or demolition operations performed by or on behalf of the person or organization shown in the Schedule.

ISO Form CG 20 11 04 13.

§ 17.6:4 Additional Insured as Its Interest May Appear

The beneficiary of a property insurance policy must have an "insurable interest" in the insured property, that is, a lawful, substantial, and enforceable interest in the safety or preservation of the subject matter of the insurance. Examples of parties having insurable interests in a building are the owner and the mortgagee. The owner is the named insured under a property policy, and a lender's interest would be protected with a

lender loss payable or other mortgagee clause endorsement. In the context of builder's risk policies the terminology 'additional insureds as their interests may appear' has often been used to attempt to protect parties other than the named insured and mortgagee. If the owner of a building under construction procured a builder's risk policy, the owner would be the named insured and the contractor and subcontractors would be named as additional insureds as their interests may appear. In theory, if the building were destroyed before completion, the contractor and subcontractors would be entitled to the portion of the insurance proceeds attributable to the portion of the completed construction for which the contractor and subcontractors had not been paid at the time the destruction occurred, and the insurance company would not be able to sue its 'insureds' to recover its loss. However, the phrase has led to confusion in litigation and to unintended consequences. Risk managers now advise against the use of "additional insureds as their interests may appear" in builder's risk policies and suggest instead that (1) all parties be named as insureds under the builder's risk policy, without reference to the phrase "additional insureds as their interests may appear"; (2) mutual waivers of subrogation be included in the construction contracts and subcontracts; and (3) the parties confirm that the policy permits the waivers of subrogation. If there are coverages that are not intended to benefit all parties (such as a third-party liability extension that is not intended to benefit the contractor), that issue may need to be addressed in the policy and the applicable contracts.

§ 17.6:5 Additional Insured Status for Landlords in Property Proceeds

ISO Form CP 12 19, entitled 'Additional Insured—Building Owner,' provides that the building owner identified in the endorsement is a "Named Insured" with respect to the coverage provided under the tenant's property policy 'for

physical loss or damage to the building(s) described in the Schedule' to the endorsement.

§ 17.6:6 Additional Insured Status for Landlords in Rental Value

ISO Form CP 15 03, entitled 'Business Income—Landlord as Additional Insured (Rental Value), names the landlord as an additional insured with respect to that portion of proceeds payable under a business income endorsement representing the amount of rent payable under the lease. The remainder of the business income proceeds are payable to the tenant, that is, the named insured. In addition, the insurer commits to provide advance notice in writing of cancellation to the additional insured. This endorsement is especially useful in an absolutely net lease transaction.

§ 17.6:7 Requirement that Coverage Be Primary and Noncontributory

If a party that is named as additional insured expects such coverage to be primary and noncontributory to the additional insured's existing insurance coverage, the policy providing additional insured coverage must be endorsed to that effect. All policies have 'other insurance' clauses that govern how overlapping insurance policies are required to share coverage. Some such clauses say a particular policy will be excess to any other policy, while some 'other insurance' clauses provide for sharing duplicate coverage pro rata. When the issue arises because the named insured has two policies that provide overlapping coverage, these 'other insurance' clauses make sense—the named insured is covered in any event, and the loss is shared by the overlapping insurers in accordance with the policy provisions. However, if a party has its own insurance but also requires that it be an additional insured on another party's policy, it could

be argued that the "other insurance" clauses should not apply and that the coverage obtained from the counterparty's policy should be primary. In the absence of an endorsement, however, this may not be the result; the courts may split coverage between a party's own insurance and its coverage as an additional insured. In addition, if the 'other insurance' clause is a strong excess clause, the additional insured coverage might be rendered completely inapplicable depending on the amount of the claim and the limits of the respective policies. This result can be avoided by contractually requiring that coverage provided to the additional insured shall be primary and noncontributory to any other policy providing coverage to any additional insured, at least to the extent of the risks and liabilities assumed by the counterparty. ISO Form CG 20 01 04 13 is an example of such an endorsement, stating:

This insurance is primary to and will not seek contribution from any other insurance available to an additional insured under your policy provided that:

- (1) The additional insured is a Named Insured under such other insurance; and
- (2) You have agreed in writing in a contract or agreement that this insurance would be primary and would not seek contribution from any other insurance available to the additional insured.

ISO Form CG 20 01 04 13.

However, the above endorsement applies only to policies in which the additional insured is a named insured, and the additional insured and the counterparty will both want to determine the existence of any such restrictions and whether any such restrictions are acceptable to them.

§ 17.7 Waivers of Subrogation

§ 17.7:1 Application

An insurance company is subrogated to the rights of its insured against third parties to the extent of a loss paid by the insurance company. However, the parties to a business transaction may prefer not to endanger their business relationship with potentially expensive, stressful, and time-consuming litigation conducted by an insurance company in the name of one party against the other party. Hence, each insured may require its insurance company to waive its right of subrogation to the insured's rights against the other party. If the named insured does not want to waive subrogation for risks that it did not intend, the contract can limit the scope of the waiver to the risks assumed by the named insured.

§ 17.7:2 Components of Waiver of Subrogation

A waiver of subrogation provision should have two components: a covenant by the insured to obtain the waiver of subrogation from its insurer and a release by the insured with respect to the liability that is covered by the insurance policy for which the waiver is sought. The purpose of the release is to protect the beneficiary of the waiver if the party agreeing to obtain the waiver fails to purchase insurance or if the loss exceeds the scope or limit of the insurance policy.

A waiver of subrogation should also state affirmatively which party is to be responsible for any deductible or self-insured retention under the policy in question.

§ 17.7:3 Availability

The current ISO edition of "Commercial Property Conditions" form (ISO Form CP 00 90) used in conjunction with an ISO commercial

property insurance policy contains the following waiver of subrogation:

If any person or organization to or for whom we make payment under this Coverage Part has rights to recover damages from another, those rights are transferred to us to the extent of our payment. That person or organization must do everything necessary to secure our rights and must do nothing *after loss* to impair them. *But you may waive your rights against another party in writing:*

1. *Prior to a loss* to your Covered Property or Covered Income.
2. *After a loss* to your Covered Property or Covered Income only if, at time of loss, that party is one of the following:
 - a. Someone insured by this insurance;
 - b. A business firm:
 - (1) Owned or controlled by you; or
 - (2) That owns or controls you; or
 - c. Your tenant.

This will not restrict your insurance.

ISO Form CP 00 90 07 88 (emphasis added).

The ISO form of commercial general liability policy (ISO Form CG 00 01) states "The insured must do nothing after loss to impair" the insurance company's right of recovery. Most insurance professionals believe that the implication of the language is that a waiver of subrogation given by the named insured before the occurrence is permissible.

Waivers of subrogation are also available for workers' compensation, employer's liability,

and builder's risk policies but are not provided absent a request.

§ 17.7:4 Fair Notice Doctrine Compliance

A provision that requires one party to release the liability of the other party even if the other party is negligent must comply with the fair notice doctrine under Texas law. See section 17.2:5 above. However, a provision requiring the insurer to waive subrogation has never been held to be subject to the fair notice doctrine.

§ 17.8 Deductible vs. Self-Insured Retention

Both a deductible and a self-insured retention (SIR) require the insured to pay the first dollars of a loss. However, the potential that a third-party claimant will not be compensated under a liability policy with an SIR is substantially greater than that under a policy with a deductible. When a deductible exists under a liability policy, the insurance company keeps control of the adjustment process, defends the insured, typically pays the claim to the third party, and thereafter charges the insured for the deductible. If an SIR exists, the insured controls the adjustment process to the extent of its SIR (unless the insured has contracted with a third party to administer the process) and the liability insurer has no duty to defend the insured or pay the claim to the third party until the SIR is exhausted.

§ 17.9 Quality of Insurance

A.M. Best's analysis of property and casualty insurance companies is generally the standard cited in real estate transaction documents. Best assigns a 'Financial Strength Rating' to insurance carriers. If a company is below Best's minimum asset threshold or if sufficient information is not available or is not submitted or if the

insurer so requests, Best may elect not to assign a Financial Strength Rating to an insurance company. Reports are available from the A.M. Best web site (www.ambest.com) at no cost.

The components of a Best's financial strength rating are the following:

1. *Rating*—A company is assigned one of sixteen "Best's Ratings." Each rating is composed of a letter (A to D) with or without plus or minus signs. A++ is the highest rating and D is the lowest.
2. *Financial Size Category*—A rated company is also assigned one of fifteen Financial Size Categories on the basis of its capital, surplus, and conditional reserve funds from which losses are paid. The Financial Size categories are referred to as 'Classes' and described with capital roman numerals. Class I (up to \$1 million) is the smallest and Class XV (\$2 billion or more) is the largest.
3. *Outlook*—An Outlook indicates the potential future direction of the company's rating over a designated period of twelve to thirty-six months. Outlooks can be 'positive, "negative, or 'stable.

Property and casualty insurance companies that are not rated are designated 'NR-1' through 'NR-5' based on the reason for which Best did not rate the company.

The desired quality of insurance companies should be specified with a combination of both Best's Rating and Financial Size Category. Most mortgagees require a minimum Best's financial strength rating of 'A' (Excellent) and a financial size category of 'Class X' (\$500 million to \$750 million).

§ 17.10 Evidencing the Existence of Coverage

The most common method for evidencing the existence of insurance coverage is to obtain a certificate of liability insurance or evidence of personal or commercial property insurance issued by an insurance broker. The standard forms of certificates of liability insurance and evidence of property insurance are published by the Association for Cooperative Operations Research and Development (ACORD), an insurance industry trade association.

§ 17.10:1 ACORD 25 “Certificate of Liability Insurance”

The 2016 edition of the ACORD 25 certificate (form 17-1 in this chapter) combines all disclaimers contained in previous editions into two disclaimers located at the top of the certificate:

THIS CERTIFICATE IS ISSUED AS A MATTER OF INFORMATION ONLY AND CONFERS NO RIGHTS UPON THE CERTIFICATE HOLDER. THIS CERTIFICATE DOES NOT AFFIRMATIVELY OR NEGATIVELY AMEND, EXTEND OR ALTER THE COVERAGE AFFORDED BY THE POLICIES BELOW THIS CERTIFICATE OF INSURANCE DOES NOT CONSTITUTE A CONTRACT BETWEEN THE ISSUING INSURER(S), AUTHORIZED REPRESENTATIVE OR PRODUCER, AND THE CERTIFICATE HOLDER.

IMPORTANT: If the certificate holder is an ADDITIONAL INSURED, the policy(ies) must have ADDITIONAL INSURED provisions or be endorsed. If SUBROGATION IS WAIVED, subject to the terms and conditions of the policy,

certain policies may require an endorsement. A statement on this certificate does not confer rights to the certificate holder in lieu of such endorsement(s).

The disclaimers address several matters:

1. The certificate is issued as a matter of information only.
2. The certificate confers no rights on the certificate holder.
3. The certificate does not create a contract between the certificate holder and the insurer or the insurance broker.
4. The certificate does not amend, extend, or alter the coverage afforded by the enumerated policies.
5. If the certificate contains a statement that an insurance policy has been endorsed to include an additional insured or to include a waiver of subrogation, but the endorsements were not, in fact, issued, the holder of the certificate has no rights against the insurer or broker.

An ACORD 25 certificate is expressly made subject to “all the terms, exclusions and conditions” of the policies listed therein, notwithstanding any requirement in any contract pursuant to which the certificate was issued. The certificate holder is also made aware that the policy limits shown in the certificate may have been reduced by paid claims.

An ACORD 25 certificate requires the issuing company to deliver notice only in the event of cancellation of the policies before the expiration date ‘in accordance with the policy provisions.

The ACORD 25 certificate is designed to be used with liability policies. To use the form for property policies, information must be inserted into the “DESCRIPTION OF OPERATIONS / LOCATIONS / VEHICLES” space, which

appears below the workers' compensation blank.

§ 17.10:2 ACORD 28 "Evidence of Commercial Property Insurance"

The 2016 edition of the ACORD 28 certificate (form 17-2 in this chapter) summarizes and states coverage under a commercial lines property policy (for example, a commercial property policy) to a mortgagee, additional insured, or loss payee and is designed to comply with the requirements of current lending practices. ACORD 25 and 28 have similar disclaimers. (See section 17.10:1 above for a discussion of the disclaimers.) ACORD 28 requires the issuing company to deliver notice only in the event of cancellation of the policies before the expiration date "in accordance with the policy provisions.

§ 17.10:3 Practical Considerations

According to risk managers, the vast majority of certificates of insurance are incorrectly completed. Hence, the forms should be reviewed for accuracy.

Insurance certificates are subject to fraud. A red flag is a certificate that is provided directly from the party that is supposedly insured rather than a third-party insurance agent. The recipient of a certificate may wish to consider (1) contacting the issuing insurance agency to confirm its existence, (2) contacting the insurance carrier to confirm the existence of the coverage, and (3) requiring copies of all endorsements dealing with additional insureds, loss payees, mortgagees, and waivers of subrogation.

§ 17.10:4 Alteration, Modification, Disclaimers, and Notice

Texas has joined a large number of states that have enacted laws to prevent modification of the

provisions of ACORD forms. Tex. Ins. Code § 1811.052(b) provides that "[a] person may not execute, issue, or require the issuance of a certificate of insurance for risks located in this state, unless the certificate of insurance form has been filed with and approved by the [Texas Department of Insurance]." Under Tex. Ins. Code § 1811.103, a standard certificate of insurance form promulgated by ACORD or ISO is deemed approved when filed with the Texas Department of Insurance, unless the standard form violates certain parameters contained in Tex. Ins. Code § 1811.102. The effect of approval of a certificate form by the Department is that a certificate confirms only that the referenced policy has been issued. Any certificate in violation of Texas Insurance Code chapter 1811 "is void and has no effect." Tex. Ins. Code § 1811.156.

Tex. Ins. Code § 1811.053 prohibits any alteration or modification of a certificate of insurance form approved the Texas Department of Insurance unless the alteration or modification is approved by the Department. In addition, Tex. Ins. Code § 1811.051 forbids an agent from issuing a certificate of insurance that alters, amends, or extends the coverage or terms and conditions provided by the referenced insurance policy. "A certificate of insurance may not contain a reference to a legal or insurance requirement contained in a contract other than the underlying contract of insurance, including a contract for construction or services. Tex. Ins. Code § 1811.154.

In the parameters for an acceptable form, Tex. Ins. Code § 1811.101 adopts many of the disclaimers contained in ACORD forms: 'for information purposes only', the certificate 'does not confer any rights or obligations other than the rights and obligations conveyed by the policy', the certificate does not convey a contractual right to a certificate holder; and 'the terms of the policy control over the terms of the certificate.

Tex. Ins. Code § 1811.155(b) prohibits any alteration in a certificate of the notice provisions of a referenced insurance policy. Under Tex. Ins. Code § 1811.155(a), a certificate can require

notice to a person only if the person is named in the policy or endorsement and the policy or endorsement (or law) requires notice to be provided.

Additional Resources

- Comiskey, Charles E. ‘Insurance Gaps: In the Eye of the Beholder.’ In *Advanced Real Estate Law Course, 2014*. Austin: State Bar of Texas, 2014.
- Johnston, Aaron, Jr. ‘Insurance and Indemnity in Real Estate Transactions (Drafting Insurance Requirements for Leases/Developments/Whatever).’ In *Advanced Real Estate Drafting Course, 2016*. Austin: State Bar of Texas, 2016.
- . ‘Property and Liability Insurance and Indemnities in Real Estate Transactions. In *Handling Your First (or Next) Commercial Real Estate Lease, 2015*. Austin: State Bar of Texas, 2015.
- Johnston, Aaron, Jr. and Charles E. Comiskey. ‘Property and Liability Insurance and Indemnity in Real Estate Transactions.’ Chap. 11 in *Commercial Real Estate Transactions Handbook, 4th ed.*, edited by Mark A. Senn. New York: Aspen Publishers, 2013.
- Locke, William H., Jr., and Charles E. Comiskey. ‘11 Things You Wish You Had Known About Commercial Project Insurance.’ In *Advanced Real Estate Law Course, 2013*. Austin: State Bar of Texas, 2013.
- Locke, William H., Jr., Charles Comiskey, and Elizabeth A. Lowe. ‘Insurance for Real Estate Lawyers.’ In *Advanced Real Estate Law Course, 2015*. Austin: State Bar of Texas, 2015.
- Malecki, Donald S., and Jack P. Gibson. *The Additional Insured Book*. 7th ed. Dallas: International Risk Management Institute, Inc., 2013. Online edition.
- Nettles, Larry W. ‘Environmental Indemnity and Liability Allocation Agreements—Evaluating and Negotiating About the Risks.’ In *Advanced Real Estate Drafting Course, 2010*. Austin: State Bar of Texas, 2010.
- Robinson, Linda G., and Jack P. Gibson. *Commercial Property Insurance*. Dallas: International Risk Management Institute, Inc., 2009. Online edition.
- Woodward, W. Jeffrey, Richard J. Scislowski, Maureen C. McLendon, and Jack P. Gibson. *Commercial Liability Insurance*. Dallas: International Risk Management Institute, Inc., 2010. Online edition.

[Reserved]

Form 17-1

ACORD 25
Certificate of Liability Insurance



CERTIFICATE OF LIABILITY INSURANCE

DATE (MM/DD/YYYY)

THIS CERTIFICATE IS ISSUED AS A MATTER OF INFORMATION ONLY AND CONFERS NO RIGHTS UPON THE CERTIFICATE HOLDER. THIS CERTIFICATE DOES NOT AFFIRMATIVELY OR NEGATIVELY AMEND, EXTEND OR ALTER THE COVERAGE AFFORDED BY THE POLICIES BELOW. THIS CERTIFICATE OF INSURANCE DOES NOT CONSTITUTE A CONTRACT BETWEEN THE ISSUING INSURER(S), AUTHORIZED REPRESENTATIVE OR PRODUCER, AND THE CERTIFICATE HOLDER.

IMPORTANT: If the certificate holder is an ADDITIONAL INSURED, the policy(ies) must have ADDITIONAL INSURED provisions or be endorsed. If SUBROGATION IS WAIVED, subject to the terms and conditions of the policy, certain policies may require an endorsement. A statement on this certificate does not confer rights to the certificate holder in lieu of such endorsement(s).

PRODUCER	CONTACT NAME:	
	PHONE (A/C, No, Ext):	FAX (A/C, No):
INSURED	E-MAIL ADDRESS:	
	INSURER(S) AFFORDING COVERAGE	
	NAIC #	
	INSURER A:	
	INSURER B:	
	INSURER C:	
INSURER D:		
INSURER E:		
INSURER F:		

COVERAGES **CERTIFICATE NUMBER:** **REVISION NUMBER:**

THIS IS TO CERTIFY THAT THE POLICIES OF INSURANCE LISTED BELOW HAVE BEEN ISSUED TO THE INSURED NAMED ABOVE FOR THE POLICY PERIOD INDICATED. NOTWITHSTANDING ANY REQUIREMENT, TERM OR CONDITION OF ANY CONTRACT OR OTHER DOCUMENT WITH RESPECT TO WHICH THIS CERTIFICATE MAY BE ISSUED OR MAY PERTAIN, THE INSURANCE AFFORDED BY THE POLICIES DESCRIBED HEREIN IS SUBJECT TO ALL THE TERMS, EXCLUSIONS AND CONDITIONS OF SUCH POLICIES. LIMITS SHOWN MAY HAVE BEEN REDUCED BY PAID CLAIMS.

INSR LTR	TYPE OF INSURANCE	ADD'L SUBR INSD / WVD	POLICY NUMBER	POLICY EFF (MM/DD/YYYY)	POLICY EXP (MM/DD/YYYY)	LIMITS
	COMMERCIAL GENERAL LIABILITY <input type="checkbox"/> CLAIMS-MADE <input type="checkbox"/> OCCUR GEN'L AGGREGATE LIMIT APPLIES PER: <input type="checkbox"/> POLICY <input type="checkbox"/> PRO-JECT <input type="checkbox"/> LOC OTHER:					EACH OCCURRENCE \$ DAMAGE TO RENTED PREMISES (Ea occurrence) \$ MED EXP (Any Genl perison) \$ PERSONAL & ADV INJURY \$ GENERAL AGGREGATE \$ PRODUCTS - COMP/OP AGG \$ \$
	AUTOMOBILE LIABILITY <input type="checkbox"/> ANY AUTO <input type="checkbox"/> OWNED AUTOS ONLY <input type="checkbox"/> SCHEDULED AUTOS <input type="checkbox"/> HIRED AUTOS ONLY <input type="checkbox"/> NON-OWNED AUTOS ONLY					COMBINED SINGLE LIMIT (Ea accident) \$ BODILY INJURY (Per per...n) \$ BODILY INJURY (Per ...cident) \$ PROPERTY DAMAGE (Per accident) \$ \$
	UMBRELLA LIAB <input type="checkbox"/> OCCUR EXCESS LIAB <input type="checkbox"/> CLAIMS-MADE DED RETENTION \$					EACH OCCURRENCE \$ AGGREGATE \$ \$
	WORKERS COMPENSATION AND EMPLOYERS' LIABILITY ANY PROPRIETOR/PARTNER/EXECUTIVE OFFICER/MEMBER EXCLUDED? (Mandatory in NH) If yes, describe under DESCRIPTION OF OPERATIONS below	Y/N				<input type="checkbox"/> PER STATUTE <input type="checkbox"/> OTH-ER E.L. EACH ACCIDENT \$ E.L. DISEASE - EA EMPLOYEE \$ E.L. DISEASE - POLICY LIMIT \$

DESCRIPTION OF OPERATIONS / LOCATIONS / VEHICLES (ACORD 101, Additional Remarks Schedule, may be attached if more space required)

CERTIFICATE HOLDER	CANCELLATION
	SHOULD ANY OF THE ABOVE DESCRIBED POLICIES BE CANCELLED BEFORE THE EXPIRATION DATE THEREOF, NOTICE WILL BE DELIVERED IN ACCORDANCE WITH THE POLICY PROVISIONS. AUTHORIZED REPRESENTATIVE

[Reserved]

Form 17-2

ACORD 28 Evidence of Commercial Property Insurance

ACORD **EVIDENCE OF COMMERCIAL PROPERTY INSURANCE** DATE (MM/DD/YYYY)

THIS EVIDENCE OF COMMERCIAL PROPERTY INSURANCE IS ISSUED AS A MATTER OF INFORMATION ONLY AND CONFERS NO RIGHTS UPON THE ADDITIONAL INTEREST NAMED BELOW. THIS EVIDENCE DOES NOT AFFIRMATIVELY OR NEGATIVELY AMEND, EXTEND OR ALTER THE COVERAGE AFFORDED BY THE POLICIES BELOW. THIS EVIDENCE OF INSURANCE DOES NOT CONSTITUTE A CONTRACT BETWEEN THE ISSUING INSURER(S), AUTHORIZED REPRESENTATIVE OR PRODUCER, AND THE ADDITIONAL INTEREST.

PRODUCER NAME, CONTACT PERSON AND ADDRESS	PHONE (A/C, No, Ext):	COMPANY NAME AND ADDRESS	NAIC NO:
FAX (A/C, No):		E-MAIL ADDRESS:	
CODE:		SUB CODE:	
AGENCY CUSTOMER ID #:		POLICY TYPE	
NAMED INSURED AND ADDRESS		LOAN NUMBER	POLICY NUMBER
ADDITIONAL NAMED INSURED(S)		EFFECTIVE DATE	EXPIRATION DATE
		CONTINUED UNTIL TERMINATED IF CHECKED <input type="checkbox"/>	
		THIS REPLACES PRIOR EVIDENCE DATED:	

PROPERTY INFORMATION (ACORD 101 may be attached if more space is required) BUILDING OR BUSINESS PERSONAL PROPERTY

LOCATION / DESCRIPTION

THE POLICIES OF INSURANCE LISTED BELOW HAVE BEEN ISSUED TO THE INSURED NAMED ABOVE FOR THE POLICY PERIOD INDICATED. NOTWITHSTANDING ANY REQUIREMENT, TERM OR CONDITION OF ANY CONTRACT OR OTHER DOCUMENT WITH RESPECT TO WHICH THIS EVIDENCE OF PROPERTY INSURANCE MAY BE ISSUED OR MAY PERTAIN, THE INSURANCE AFFORDED BY THE POLICIES DESCRIBED HEREIN IS SUBJECT TO ALL THE TERMS, EXCLUSIONS AND CONDITIONS OF SUCH POLICIES. LIMITS SHOWN MAY HAVE BEEN REDUCED BY PAID CLAIMS.

COVERAGE INFORMATION

PERILS INSURED	BASIC	BROAD	SPECIAL	DED:
COMMERCIAL PROPERTY COVERAGE AMOUNT OF INSURANCE: \$	YES	NO	NA	DED:
<input type="checkbox"/> BUSINESS INCOME <input type="checkbox"/> RENTAL VALUE				Actual Loss Sustained; # of months:
BLANKET COVERAGE				If YES, indicate value(s) reported on property identified above: \$
TERRORISM COVERAGE				Attach Disclosure / Notice / DEC
IS THERE A TERRORISM-SPECIFIC EXCLUSION?				
IS DOMESTIC TERRORISM EXCLUDED?				
LIMITED FUNGUS COVERAGE				If YES, LIMIT: DED:
FUNGUS EXCLUSION (If "YES", specify organization's form used)				
REPLACEMENT COST				
AGREED VALUE				
COINSURANCE				If YES, %
EQUIPMENT BREAKDOWN (If Applicable)				If YES, LIMIT: DED:
ORDINANCE OR LAW - Coverage for loss to undamaged portion of bldg				If YES, LIMIT: DED:
- Demolition Costs				If YES, LIMIT: DED:
- In... Cost of Co. structic...				If YES, LIMIT: DED:
EARTH MOVEMENT (If Applicable)				If YES, LIMIT: DED:
FLOOD (If Applicable)				If YES, LIMIT: DED:
WIND / HAIL INCL <input type="checkbox"/> YES <input type="checkbox"/> NO Subject to Different Provisions:				If YES, LIMIT: DED:
NAMED STORM INCL <input type="checkbox"/> YES <input type="checkbox"/> NO Subject to Different Provisions:				If YES, LIMIT: DED:
PERMISSION TO WAIVE SUBROGATION IN FAVOR OF MORTGAGE HOLDER PRIOR TO LOSS				

CANCELLATION

SHOULD ANY OF THE ABOVE DESCRIBED POLICIES BE CANCELLED BEFORE THE EXPIRATION DATE THEREOF, NOTICE WILL BE DELIVERED IN ACCORDANCE WITH THE POLICY PROVISIONS.

ADDITIONAL INTEREST


CONTRACT OF SALE	LENDER'S LOSS PAYABLE <input type="checkbox"/>	LOSS PAYEE	LENDER SERVICING AGENT NAME AND ADDRESS
MORTGAGEE			
NAME AND ADDRESS			AUTHORIZED REPRESENTATIVE

[Reserved]

Form 17-3

ACORD 45
Additional Interest Schedule

AGENCY CUSTOMER ID: _____

		ADDITIONAL INTEREST SCHEDULE		DATE (MM/DD/YYYY)
AGENCY		CARRIER		NAIC CODE
POLICY NUMBER	EFFECTIVE DATE	NAMED INSURED(S)		

ADDITIONAL INTEREST (Not all fields apply to all scenarios - provide only the necessary data)

INTEREST <input type="checkbox"/> ADDITIONAL INSURED <input type="checkbox"/> BREACH OF WARRANTY <input type="checkbox"/> CO-OWNER <input type="checkbox"/> EMPLOYEE AS LESSOR <input type="checkbox"/> LEASEBACK OWNER <input type="checkbox"/> LENDER'S LOSS PAYABLE <input type="checkbox"/> LIENHOLDER	<input type="checkbox"/> LOSS PAYEE <input type="checkbox"/> MORTGAGEE <input type="checkbox"/> OWNER <input type="checkbox"/> REGISTRANT <input type="checkbox"/> TRUSTEE	NAME AND ADDRESS RANK: _____	EVIDENCE: _____	CERTIFICATE _____	POLICY _____	SEND BILL _____	INTEREST IN ITEM NUMBER		
		REFERENCE / LOAN #:		INTEREST END DATE:		LOCATION: _____ BUILDING: _____		VEHICLE: _____ BOAT: _____	
REASON FOR INTEREST:		LIEN AMOUNT:		PHONE (A/C, No, Ext):		AIRPORT: _____ AIRCRAFT: _____		SCHED #: _____ ITEM: _____	
		E-MAIL ADDRESS:		ITEM CLASS:		ITEM DESCRIPTION			

[Reserved]

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Chapter 18

Residential Construction Contract Documents

§ 18.1 General Considerations

The principal functions of a residential construction contract are to establish the terms of the construction agreement, such as price, description of the project, commencement and completion dates, warranties, and allocation of responsibilities, and to create a system for building, approving, and paying for the construction.

The Texas Constitution provides several consumer protection provisions relating to construction on homestead property. For a lien for the construction of improvements to be created against homestead property there must be a written contract. For remodeling or renovations the constitution requires a written application for extension of credit be submitted by the homeowners at least five days before executing the contract, unless the work is acknowledged to be necessary for the immediate repair of conditions that materially affect the health or safety of the residents of the homestead. In addition to this five-day application period, the owner has a three-day right of rescission following execution of the contract. For renovation or repair projects, the contract must also be executed at the office of the third-party lender extending credit for the work and material, the office of an attorney at law, or a title company office. Tex. Const. art. XVI, § 50(a)(5). See chapter 20 in this manual for a detailed discussion of these requirements. Forms 20-6 and 20-7 are closing certificates used to confirm compliance with these requirements.

This chapter contains a residential construction contract (form 18-4). Designed as a basic form, the contract specifies construction costs, a description of the property on which the new

improvements are to be situated, a description of the plans and specifications for the project, and a completion date for the work.

Each transaction should be examined to determine if additional provisions are necessary. If form 18-4 is used to document a transaction in which the construction costs are financed, a comprehensive review of chapter 20 in this manual is needed. The attorney may also wish to consider including additional provisions, which are beyond the scope of this chapter, relating to such matters as work delays, responsibility for soil condition and design, loan commitment requirements, late charges, and delay damages.

§ 18.2 Cautions

§ 18.2:1 Construction Trust Fund Statute

The Texas Construction Trust Fund Act (Texas Property Code sections 162.001–.033) states that contractors agreeing to do more than \$5,000 worth of work must put the owner's funds for each such job in a "construction account" at a financial institution. Tex. Prop. Code § 162.006. The general contractor becomes a trustee for the funds received from the owner for the benefit of the subcontractors and suppliers on the project. Tex. Prop. Code § 162.003. The builder's profit on a cost-plus contract is not considered a trust fund. Tex. Prop. Code § 162.001(c). Misuse of trust funds of \$500 or more with intent to defraud is a third-degree felony. Failure to establish or maintain a construction account in violation of sections 162.006 or 162.007 is a class A misdemeanor. Making a false affidavit that the contractor has paid the project bills is a class A

misdemeanor with a possible penalty of up to one year in jail, a \$4,000 fine, or both, and personal liability for loss or damage resulting from a false statement. Tex. Prop. Code §§ 53.085(d), (e), 162.032.

The attorney should also be familiar with the law of involuntary mechanic's liens. See chapter 21 in this manual.

§ 18.2:2 Texas Residential Construction Liability Act

The Texas Residential Construction Liability Act (RCLA), Texas Property Code chapter 27, controls key aspects of residential construction regarding defect claims. Analysis of the provisions of the RCLA is beyond the scope of this manual, although an overview of the RCLA is included below because of its applicability to certain requirements in residential construction contract documents.

RCLA Applicability and Notice: The RCLA applies to construction defect disputes involving a residence, which the RCLA defines as “the real property and improvements for a single-family house, duplex, triplex, or quadruplex or a unit and the common elements in a multiunit residential structure in which title to the individual units is transferred to the owners under a condominium or cooperative system. Tex. Prop. Code § 27.001(7).

Notices Required in Contract: Contracts for home or residential construction must contain the statutory notices prescribed by the RCLA. The notice is included in form 18-4 in this chapter.

Dispute Resolution Requirements: Residential construction defect disputes are addressed by the RCLA. The RCLA requires owner claimants to complete several conditions precedent before filing suit or arbitration based

on most residential construction defect claims. Certain limited types of claims are exempt from the RCLA dispute resolution process, including claims solely for personal injury, wrongful death, or property damage; cases of builder wrongful abandonment of the project; real estate fraud claims under chapter 27 of the Texas Business and Commerce Code; and violations of the Trust Fund Act (Property Code chapter 162). Tex. Prop. Code § 27.002.

The dispute process includes several steps, including advance notice to builders, opportunity for builder inspection of the claimed defects, disclosure to the builder of expert reports, and builder offers to repair. Tex. Prop. Code § 27.004.

§ 18.2:3 Construction Anti-Indemnity Statute

Chapter 151 of the Texas Insurance Code prohibits an indemnity in a construction contract, or in an agreement collateral to or affecting a construction contract, to the extent that it requires an indemnitor to indemnify a party, including a third party, against a claim caused by the negligence or fault, violation of a law, or breach of contract of the indemnitee, its agent or employee, or any third party under the control or supervision of the indemnitee, other than the indemnitor or its agent, employee, or subcontractor of any tier. A provision in a construction contract that requires the purchase of additional insured coverage is void to the extent that it requires coverage that is prohibited under subchapter C of chapter 151. This subchapter does not apply to an indemnity provision in a construction contract, or an agreement collateral to or affecting a construction contract, pertaining to a single-family house, townhouse, duplex, or directly related land development, or to a public works project of a municipality. Tex. Ins. Code § 151.105(10).

§ 18.3 Precommencement

§ 18.3:1 Homestead and Mechanic's Liens

Texas homesteads are exempt from forced sale except for the enforcement of purchase-money liens, property tax liens, an owelty of partition, the refinancing of a federal tax lien, mechanic's and materialman's liens, 'home equity' or second-lien financing, a reverse mortgage, and the conversion and refinance of a personal property lien secured by a manufactured home to a lien on real property. A contract for new improvements or improvements to an existing home that create a mechanic's and materialman's lien against the homestead must be in writing, made before material is furnished or labor performed, signed by both husband and wife if the homestead is a family one, and compliant with other conditions provided in the Texas Constitution. Tex. Const. art. XVI, § 50; Tex. Prop. Code § 53.254. The contract must also contain the notice required by Tex. Prop. Code § 41.007. The residential construction contract, used alone, does not create a mechanic's lien. For a more complete discussion of lien and financing issues, see chapter 20 in this manual.

§ 18.3:2 Contract Price

Three basic price structures are used in construction contracts.

Lump sum or *stipulated sum* is the simplest type of contract price. The contractor reviews the plans and specifications for the project and contractually agrees on a fixed price for the work. Unless the parties agree to change this stipulated amount, this will be the amount paid by the owner.

A *unit price* contract establishes a price for a given unit of work (for example, \$13 per square yard of asphalt paving).

A *cost-plus* arrangement establishes the price to the owner based on the actual cost of the work plus a certain percentage of profit for the contractor. In cost-plus, guaranteed-maximum construction contracts the contractor guarantees that the cost to the owner will not exceed a maximum price.

§ 18.3:3 Cautions

Commencement of construction before the contract is executed invalidates a mechanic's lien on a homestead. Tex. Prop. Code § 53.254(b).

Changes to the scope of a project should be documented through the use of a change order, form 18-6 in this chapter. Whether a contractual mechanic's lien extends to such changes depends on the agreement of the parties as expressed in the original construction contract.

Without an agreement to the contrary, there is no contractual lien for partial performance on a homestead. The contract must be substantially performed. *Fidelity Savings & Loan Ass'n v. Baldwin*, 416 S.W.2d 482, 483 (Tex. Civ. App.—Beaumont 1967. writ ref'd n.r.e.).

Sales taxes are the responsibility of the owner unless the contract provides for a lump-sum price, in which case the cost is the responsibility of the contractor as the consumer. Tex. Tax Code § 151.056. If the contractor manufactures or produces and also places ready-mix concrete into the property, the concrete must be separately billed, with tax on the materials paid by the owner. Tex. Tax Code § 151.056(g).

Workers' compensation laws apply to employer-employee relationships but not to independent contractors. Tex. Lab. Code §§ 406.121–123.

Texas Consumer Protection Laws for Home Solicitations: The Texas Home Solicitations Transaction Act may apply if the consumer's obligation is entered into at a location other than the contractor's place of business. If the Act

applies, additional notices are required. Tex. Bus. & Com. Code §§ 601.002, 601.051–.053. The statutory notice of cancellation is included in the residential construction contract (form 18-4 in this chapter).

§ 18.3:4 **Owner Liability to Mechanic’s Lien Claimants and Owner Retainage**

The perfection of involuntary mechanic’s liens is covered in chapter 21 in this manual. Before contracting for residential construction, owners should become familiar with their potential liability for mechanic’s liens. Owner liability for properly noticed and filed subcontractor and supplier mechanic’s liens is the sum of two amounts described in Tex. Prop. Code § 53.084. First, an owner is liable for the 10 percent statutory retainage owners are required to withhold from payments to the original contractor on every construction project. Tex. Prop. Code §§ 53.101–.103; *Page v. Structural Wood Components*, 102 S.W.3d 720 (Tex. 2003). In addition, an owner is liable for “fund trapping,” which means “trapping” or withholding remaining contract funds otherwise owed to the original contractor. This is required when the owner receives a mechanic’s lien notice letter containing language telling the owner to withhold payment from the contractor for the claim amount. Tex. Prop. Code § 53.056(b), (d). If an owner receives a lien notice letter containing the required fund-trap warning and fails to withhold payment from the contractor, the owner is personally liable and the owner’s property is subject to a lien for amounts paid after receipt of the notice. This fund-trapping liability is in addition to the owner’s liability for the 10 percent statutory retainage. Consequently, to protect the owner in case involuntary mechanic’s liens are asserted, the owner must do two things: (1) retain 10 percent of the adjusted original contract price throughout the duration of the project and for the time after completion provided for lien claimants to file mechanic’s liens and (2)

withhold the proper amount of undisbursed funds (“trapped funds”) from the contractor if lien notices are received from subcontractors or suppliers. Tex. Prop. Code §§ 53.081, 53.084, 53.101. If an owner fails to withhold the statutory retainage, the owner is nevertheless liable for the amount that should have been withheld. Tex. Prop. Code § 53.103(a).

Time for Withholding Statutory 10 Percent Retainage:

Owners, to protect themselves from mechanic’s lien claimant liability, should withhold payment of statutory retainage for at least the time allowed for claimants to file lien affidavits. Tex. Prop. Code § 53.057. This period of time is discussed in chapter 21 in this manual. However, an outline of the applicable time limits is provided below.

The retainage provisions affecting first- and second-tier claimants were amended by the 2011 Texas legislature. Owners must withhold retainage until the earliest of the following:

1. The lien filing date provided by Tex. Prop. Code § 53.052, which is the fifteenth day of the third month following the last month of work or delivery by the claimant. (See the chart at section 21.9:2 in this manual.)
2. The fortieth day after the date stated in the affidavit of completion for the original contract, but only if the owner sent the claimant notice of the affidavit. This affidavit of completion is provided for in Tex. Prop. Code § 53.106, which allows, but does not require, the owner to file such an affidavit stating the date of final completion for the project. See form 18-7. Notice of filing and a copy of the affidavit must be sent to claimants making a written request for one or to claimants who have sent out owner lien notices. However, regardless of whether a claimant makes a request

for such affidavit or sends a lien notice, if the affidavit is not sent to a claimant, then the forty-day deadline described in this section does not apply to that claimant. The affidavit is prima facie evidence of the actual final completion date for the project if it is sent to claimants as required.

3. The thirtieth day after the day the owner sends written notice to the claimant demanding that the claimant file its mechanic's lien affidavit. The notice must contain a legal description of the project property and the owner's name and address, and it must specify that the lien affidavit must be filed within thirty days of the date the notice was sent. The "demand to file a lien" section of the Texas Property Code, Tex. Prop. Code § 53.057(g), provides that this notice is effective only for the amount of contractual retainage earned by the claimant as of the day notice was sent.

Owner Failure to Withhold 10 Percent

Retainage: If the owner fails to withhold statutory retainage, then the claimants are entitled to perfect their claims by notice and affidavit within the longer deadlines described above (i.e., the fifteenth day of the third month following the last month of work or delivery). No thirty-day or forty-day deadlines, under Tex. Prop. Code § 53.057(f), are applicable if the owner fails to withhold the statutory retainage.

Summary of Owner Retainage Withholding Period on Residential Projects: In summary, for residential projects, owners are liable to hold retainage for the longer lien-filing period provided by Tex. Prop. Code § 53.052, meaning the fifteenth day of the third month following the last month of work or delivery completing the project. See the chart at section 21.9:2 in this manual. If an owner wants to shorten this time, he must send one of the applicable notices

described above: either filing and sending an affidavit of completion (form 18-7) or sending notice to claimants demanding that they file their lien affidavits. Because the effect of the thirty-day notice to file lien is limited to the accrued amount of the claimant's retainage, this notice is of limited use. Therefore, residential owners should consider the affidavit of completion process if they want to shorten the retainage withholding period. Owners are cautioned that only those suppliers and subcontractors who are sent the affidavit of completion are subject to the forty-day deadline. A second-tier supplier-claimant, delivering material at the end of the project and not known to the owner, will not receive an affidavit of completion, and therefore that claimant's lien will not be cut off by the forty-day deadline.

§ 18.3:5 Other Considerations

Both property and liability insurance should be obtained by the contractor to insure the project, and the cost should be factored into the contract price.

Water and electricity should be provided to the lot line by the owner. If not, the contract should allocate the additional cost of obtaining service.

A survey should be performed before the commencement of construction, at the owner's cost.

The Federal Trade Commission requires insulation installers and new home sellers to supply information on the efficacy of the home insulation products they sell. See 16 C.F.R. pt. 460. The residential construction contract, form 18-4 in this chapter, includes a section for providing the required insulation disclosure data.

Independent contractor status of the contractor reduces the risk of owner liability. *Exxon Corp. v. Quinn*, 726 S.W.2d 17, 19-20 (Tex. 1987). To help preserve the contractor's independent con-

tractor status, the owner’s control over the performance of the work should be limited.

Responsibility for the foundation is one of the most important risk allocation issues in a construction contract. Usually, the party who has the most control over the design of the foundation bears the responsibility for its performance.

§ 18.4 Commencement

Commencement of construction is required under the residential construction contract, form 18-4 in this chapter, to begin within thirty days from the contract date. The inception date of a statutory mechanic’s lien is the date that construction begins or materials are first delivered. Tex. Prop. Code § 53.124. This date may be established by filing an affidavit of commencement, form 18-5.

§ 18.5 Postcommencement

In the residential construction contract, form 18-4 in this chapter, delays caused by unforeseen circumstances extend the completion date. Delays caused by either party can be made the subject of monetary penalties. The price of the project may be adjusted for concealed conditions.

The contractor agrees to clean up the property following completion. The owner walk-through is intended to produce a “punch list” of items the owner wants completed or corrected by the contractor. Acceptance of work occurs only after inspection and approval by the owner. Evidence of completion must be provided by the contractor to the owner. Substantial completion occurs when a certificate of occupancy is issued.

Change orders occur only on agreement by the owner and the contractor. This agreement may be documented by form 18-6.

§ 18.6 Warranties

Alternative express warranty provisions are included in form 18-4 in this chapter, in paragraph E.1.e. Texas law implies a warranty of “good and workmanlike” construction, which can be disclaimed. Also, a warranty of “habitability” is implied, which cannot be disclaimed. See *Centex Homes v. Buecher*, 95 S.W.3d 266 (Tex. 2002); *Melody Home Manufacturing v. Barnes*, 741 S.W.2d 349 (Tex. 1987); *Gupta v. Ritter Homes, Inc.*, 646 S.W.2d 168 (Tex. 1983); *March v. Thiery*, 729 S.W.2d 889 (Tex. App.—Corpus Christi 1987, no writ). In *Centex Homes*, the Texas Supreme Court held that—

the implied warranty of good workmanship may be disclaimed by the parties when their agreement provides for the manner, performance, or quality of the desired construction. We further hold that the warranty of habitability may not be disclaimed generally. This latter implied warranty, however, only extends to defects that render the property so defective that it is unsuitable for its intended use as a home.

Centex Homes, 95 S.W.3d at 274–75.

One of the alternative express warranties provided in form 18-4 refers to the Texas Residential Construction Commission (TRCC) warranties. These TRCC warranties provide detailed quality standards for residential construction. Although the TRCC was abolished effective September 1, 2009, the warranty standards previously developed by the TRCC may still be incorporated by reference. The TRCC warranties are available online at www.texasinspector.com/files/TRCC-Standards-of-Performance.pdf.

§ 18.7 Instructions for Completing Forms**§ 18.7:1 Contractor's Disclosure Statement for Residential Construction Contracts**

Form 18-1 in this chapter is mandated by the Texas Property Code. This statement must be delivered to the owner before the execution of the construction contract. Tex. Prop. Code § 53.255.

§ 18.7:2 Contractor's List of Subcontractors and Suppliers

Before beginning work on a project the original contractor must furnish to the owner a written list with the name, address, and telephone number of each subcontractor and supplier that the general contractor intends to use. See form 18-2 in this chapter. This list must be updated within fifteen days of the addition or deletion of a subcontractor or supplier unless the owner signs a written waiver of the right to an updated list. Tex. Prop. Code § 53.256(a). Specific language for the written waiver is given in Tex. Prop. Code § 53.256(d). To use the first alternative for payment of project retainage, described in form 18-4, paragraph 3.f. of exhibit A, the contractor must list all subcontractors and suppliers of any tier involved with the project, timely update this list, and furnish a final updated list on or before the date of final completion. See also the optional paragraph C.1.c in form 18-4. The owner should recognize that if this alternative is selected and an affidavit of completion is not sent to a claimant for any reason, including that the owner was not made aware of the claimant, then the owner will be liable to that claimant for the claimant's share of statutory retainage even though the owner may have already paid the retainage.

§ 18.7:3 Contractor's Disbursement Disclosure for Residential Construction

As a prerequisite to obtaining an advance of funds in a residential construction project, the general contractor is required to provide the owner with a signed statement listing the bills paid and to be paid. See form 18-3 in this chapter. If the lender is funding an advance directly to the contractor and not through the owner, that lender must provide the owner a lender's disbursement statement and the contractor's disbursement statement used to apply for the advance. Tex. Prop. Code § 53.258.

§ 18.7:4 Residential Construction Contract

Form 18-4 in this chapter is a contract for the construction of a residence without an architect. The contract assumes a project in which the ultimate homeowner holds title to the land before the commencement of construction. Under the contract, the construction process and the duties and obligations of the parties are divided into distinct preconstruction, construction, and post-construction stages. The principal functions of the contract are to establish the terms of the construction agreement, such as price, description of the project, commencement and completion dates, allocation of responsibilities, and so forth, and to create a system for building, approving, and paying for the construction.

§ 18.7:5 Affidavit of Commencement

The owner and the original contractor may jointly execute and file an affidavit of commencement with the county clerk of the county in which the land is located. Tex. Prop. Code § 53.124(c). See form 18-5 in this chapter. An affidavit of commencement is prima facie evidence of the date of the commencement of construction and fixes the date of inception of the

involuntary mechanic's liens filed relating to the construction. Tex. Prop. Code § 53.124(d).

The affidavit should be executed and recorded within thirty days after the date of actual commencement of construction or delivery of materials. Tex. Prop. Code § 53.124(c). The owner and the original contractor should not execute this affidavit at the closing of the construction loan lest a delay in recording cause the affidavit to reflect a commencement date before the recording date. The owner and the contractor should execute and record the affidavit promptly after the construction loan documents have been filed and construction has actually commenced.

§ 18.7:6 Change Order

Form 18-6 in this chapter documents amendments to the residential construction contract that may change the plans and specifications, adjust the contract amount, or alter the completion date.

§ 18.7:7 Affidavit of Completion

The owner may file an affidavit of completion with the county clerk of the county in which the property is located. See form 18-7 in this chapter. Completion is defined not as "substantial completion" as used in the contract but as "the actual completion of the work, including any extras or change orders reasonably required or contemplated under the original contract, other than warranty work or replacement or repair of the work performed under the contract." Tex. Prop. Code § 53.001(15). An affidavit of completion meeting the requirements of section 53.106 constitutes prima facie evidence of the date of completion. Tex. Prop. Code § 53.106(d).

The affidavit should be filed on or before the tenth day after the completion of the work. If the affidavit is filed following the tenth day after the date of completion, the date of completion is

presumed to be the date of actual filing. Tex. Prop. Code § 53.106(d).

The owner must send a copy, by certified mail, return receipt requested, or registered mail, to the original contractor not later than the date the affidavit is filed and to each claimant who has sent the owner a notice of lien liability not later than the date the affidavit is filed or the tenth day after the date the owner receives notice. Tex. Prop. Code § 53.106(b). The owner must also furnish a copy of the affidavit to any person who furnished materials or labor for the construction and requests a copy. The affidavit must be furnished not later than the tenth day after the date the request is received or ten days after the date the affidavit is filed, whichever is later. Tex. Prop. Code § 53.106(c).

§ 18.7:8 Lien Waiver

Forms 18-8 through 18-11 in this chapter are statutory forms required for lien and bond claim waivers to document final or interim acknowledgment of payments. The forms must be used verbatim, in lieu of any other form of lien release associated with construction payments. However, if a mechanic's lien affidavit has already been filed in the real estate records, the form of release does not have to conform to forms 18-8 through 18-11. Tex. Prop. Code §§ 53.281–.287. Blanket advance releases of all mechanic's lien rights of the contractor should be enforceable, if expressly stated in the residential construction contract and if the contract is executed before commencement of any work. Tex. Prop. Code § 53.282(a)(3).

§ 18.7:9 Bills-Paid Affidavit

The contractor, on request by the owner and as a condition of payment to the contractor, must provide the owner an affidavit stating that all of the contractor's subcontractors, laborers, and materialmen have been paid or identifying those not paid. See form 18-12 in this chapter. The

affidavit may include representations regarding bills to be paid with the funds received and indemnity provisions. Tex. Prop. Code § 53.085.

A bills-paid affidavit must be signed by the general contractor as a condition for final payment. Tex. Prop. Code § 53.259.

There are significant penalties, both civil and criminal, for the making of false affidavits. The penalties may include a \$4,000 fine, confinement in jail for a period not to exceed one year, or both, and personal liability of the person signing the affidavit for any loss or damage resulting from the false statement. Tex. Prop. Code §§ 53.085(d), (e), 53.259(c), (d).

Additional Resources

Beyer, Gerry W. *Real Property*. 2nd ed. West's Texas Forms 13–15. St. Paul, MN: West, 2001. Supplement 2016.

Bush, Robert L. Russell, James W. Rudnicki, and Kathryn L. Koons. "Drafting Issues in Residential Construction Contracts." In *Residential Real Estate Construction Law Course, 2008*. Austin: State Bar of Texas, 2008.

McQuality, Mark S. "Texas Residential Construction Claims: It Was Time for Change." In *Advanced Consumer and Commercial Law Course, 2009*. Austin: State Bar of Texas, 2009.

St. Claire, Frank A., and William V. Dorsaneo III. *Texas Real Estate Guide*. New York: Matthew Bender & Co., 2001.

Texas Residential Construction Commission. "Limited Statutory Warranty and Building and Performance Standards," effective June 1, 2005.

Walthall, Thomas J., Jr., and R. Wes Johnson. "Construction Contract Clauses & Retainage and Contingent Payment." In *Advanced Real Estate Drafting Course, 2009*. Austin: State Bar of Texas, 2009.

Form 18-1

The language of this disclosure is based on Tex. Prop. Code § 53.255(b). The disclosure must be substantially similar to the statutory language.

Contractor's Disclosure Statement for Residential Construction

Basic Information

Date:

Owner:

Contractor:

Property:

[Lender:]

Know Your Rights and Responsibilities under the Law. You are about to enter into a transaction to build a new home or remodel existing residential property. Texas law requires your contractor to provide you with this brief overview of some of your rights, responsibilities, and risks in this transaction.

Conveyance to Contractor Not Required. Your contractor may not require you to convey your real property to your contractor as a condition to the agreement for the construction of improvements on your property.

Know Your Contractor. Before you enter into your agreement for the construction of improvements to your property, make sure that you have investigated your contractor. Obtain and verify references from other people who have used the contractor for the type and size of construction project on your property.

Get It in Writing. Make sure that you have a written agreement with your contractor that includes (1) a description of the work the contractor is to perform; (2) the required or estimated time for completion of the work; (3) the cost of the work or how the cost will be determined; and (4) the procedure and method of payment, including provisions for statutory retainage and conditions for final payment. If your contractor made a promise, warranty, or representation to you concerning the work the contractor is to perform, make sure that promise, warranty, or representation is specified in the written agreement. An oral promise that is not included in the written agreement may not be enforceable under Texas law.

Read Before You Sign. Do not sign any document before you have read and understood it. NEVER SIGN A DOCUMENT THAT INCLUDES AN UNTRUE STATEMENT. Take your time in reviewing documents. If you borrow money from a lender to pay for the improvements, you are entitled to have the loan closing documents furnished to you for review at least one business day before the closing. Do not waive this requirement unless a bona fide emergency or another good cause exists, and make sure you understand the documents before you sign them. If you fail to comply with the terms of the documents, you could lose your property. You are entitled to have your own attorney review any documents. If you have any question about the meaning of a document, consult an attorney.

Get a List of Subcontractors and Suppliers. Before construction commences, your contractor is required to provide you with a list of the subcontractors and suppliers the contractor intends to use on your project. Your contractor is required to supply updated information on any subcontractors and suppliers added after the list is provided. Your contractor is not required to supply this information if you sign a written waiver of your rights to receive this information.

Monitor the Work. Lenders and governmental authorities may inspect the work in progress from time to time for their own purposes. These inspections are not intended as quality control inspections. Quality control is a matter for you and your contractor. To ensure that

your home is being constructed in accordance with your wishes and specifications, you should inspect the work yourself or have your own independent inspector review the work in progress.

Monitor Payments. If you use a lender, your lender is required to provide you with a periodic statement showing the money disbursed by the lender from the proceeds of your loan. Each time your contractor requests payment from you or your lender for work performed, your contractor is also required to furnish you with a disbursement statement that lists the name and address of each subcontractor or supplier that the contractor intends to pay from the requested funds. Review these statements and make sure that the money is being properly disbursed.

Claims by Subcontractors and Suppliers. Under Texas law, if a subcontractor or supplier who furnishes labor or materials for the construction of improvements on your property is not paid, you may become liable and your property may be subject to a lien for the unpaid amount, even if you have not contracted directly with the subcontractor or supplier. To avoid liability, you should take the following actions:

1. If you receive a written notice from a subcontractor or supplier, you should withhold payment from your contractor for the amount of the claim stated in the notice until the dispute between your contractor and the subcontractor or supplier is resolved. If your lender is disbursing money directly to your contractor, you should immediately provide a copy of the notice to your lender and instruct the lender to withhold payment in the amount of the claim stated in the notice. If you continue to pay the contractor after receiving the written notice without withholding the amount of the claim, you may be liable and your property may be subject to a lien for the amount you failed to withhold.

2. During construction and for thirty days after final completion, termination, or abandonment of the contract by the contractor, you should withhold or cause your lender to

withhold 10 percent of the amount of payments made for the work performed by your contractor. This is sometimes referred to as "statutory retainage." If you choose not to withhold the 10 percent for at least thirty days after final completion, termination, or abandonment of the contract by the contractor and if a valid claim is timely made by a claimant and your contractor fails to pay the claim, you may be personally liable and your property may be subject to a lien up to the amount that you failed to withhold.

If a claim is not paid within a certain time period, the claimant is required to file a mechanic's lien affidavit in the real property records in the county in which the property is located. A mechanic's lien affidavit is not a lien on your property, but the filing of the affidavit could result in a court imposing a lien on your property if the claimant is successful in litigation to enforce the lien claim.

Some Claims May Not Be Valid. When you receive a written notice of a claim or when a mechanic's lien affidavit is filed on your property, you should know your legal rights and responsibilities regarding the claim. Not all claims are valid. A notice of a claim by a subcontractor or supplier is required to be sent, and the mechanic's lien affidavit is required to be filed, within strict time periods. The notice and the affidavit must contain certain information. All claimants may not fully comply with the legal requirements to collect on a claim. If you have paid the contractor in full before receiving a notice of a claim and have fully complied with the law regarding statutory retainage, you may not be liable for that claim. Accordingly, you should consult your attorney when you receive a written notice of a claim to determine the true extent of your liability or potential liability for that claim.

Obtain a Lien Release and a Bills-Paid Affidavit. When you receive a notice of claim, do not release withheld funds without obtaining a signed and notarized release of lien and claim from the claimant. You can also reduce the risk of having a claim filed by a subcontractor or supplier by requiring as a condition of each payment made by you or your lender that your contractor furnish you with an affidavit stating that all bills have been paid. Under

Texas law, on final completion of the work and before final payment, the contractor is required to furnish you with an affidavit stating that all bills have been paid. If the contractor discloses any unpaid bill in the affidavit, you should withhold payment in the amount of the unpaid bill until you receive a waiver of lien or release from that subcontractor or supplier.

Obtain Title Insurance Protection. You may be able to obtain a title insurance policy to insure that the title to your property and the existing improvements on your property are free from liens claimed by subcontractors and suppliers. If your policy is issued before the improvements are completed and covers the value of the improvements to be completed, you should obtain, on the completion of the improvements and as a condition of your final payment, a "completion of improvements" policy endorsement. This endorsement will protect your property from liens claimed by subcontractors and suppliers that may arise from the date the original title policy is issued to the date of the endorsement.

I have received a copy of this contractor's disclosure statement for residential construction.

I have also received a copy of the attached contractor's list of subcontractors and suppliers.

[Name of owner]

Attach list of subcontractors and suppliers. See form 18-2 in this chapter.

[Reserved]

Form 18-2

The prescribed language in the 'Notice' paragraph of this form must appear in a minimum of ten-point bold-faced type. The list may be given either with form 18-1 in this chapter or before the commencement of construction. This list must be updated and provided to the owner not later than the fifteenth day after a subcontractor or supplier is added or deleted unless the owner has signed a written waiver of the right to receive updates. Tex. Prop. Code § 53.256.

Contractor's List of Subcontractors and Suppliers

Basic Information

Date:

Owner:

Contractor:

Property:

[Lender:]

NOTICE: THIS LIST OF SUBCONTRACTORS AND SUPPLIERS MAY NOT BE A FINAL LISTING. UNLESS YOU SIGN A WAIVER OF YOUR RIGHT TO RECEIVE UPDATED INFORMATION, THE CONTRACTOR IS REQUIRED BY LAW TO SUPPLY UPDATED INFORMATION, AS THE INFORMATION BECOMES AVAILABLE, FOR EACH SUBCONTRACTOR OR SUPPLIER USED IN THE WORK PERFORMED ON YOUR RESIDENCE.

Name of subcontractor or supplier:

Address:

Telephone number:

Repeat above information as needed.

If this list was not delivered with form 18-1, include the following.

I have received a copy of this list of subcontractors and suppliers.

[Name of owner]

Form 18-3

**Contractor's Disbursement Disclosure for Residential Construction
(Consumer-Owned)**

Basic Information

Date:

Owner:

Property:

Project: [include description]

Contractor:

[Lender:]

The following information is required to be provided under section 53.258 of the Texas Property Code in connection with this payment request for construction on the Property. This statement will be furnished by depositing the statement in the United States mail, first class, postage paid, and properly addressed to Owner or by hand delivering the statement to Owner before Contractor receives the requested funds.

A. Bills Paid. The following is a list of bills or expenses for labor or materials used on the Project that have been paid and for which Contractor is requesting payment:

Name and address of subcontractor or supplier:

Description of bill or expense paid:

Amount paid:

Repeat above information as needed.

B. Bills to Be Paid. The following is a list of bills or expenses relating to labor or materials used on the Project that will be paid from the funds requested. This list contains the name and address of each person who subcontracted directly with Contractor and whom Contractor intends to pay from the requested funds.

Name and address of payee:

Description of bill or expense to be paid:

Amount to be paid:

Repeat above information as needed.

[Name of contractor]

Form 18-4

Residential Construction Contract

Basic Information

Date:

Owner:

Owner's Mailing Address:

Contractor:

Contractor's Mailing Address:

Property

Address:

Legal description:

Project Description:

A. Construction Terms

A.1. Allowance Items:

Flooring:	\$[amount]	[retailer]
Light fixtures:	\$[amount]	[retailer]
Wall coverings:	\$[amount]	[retailer]

Appliances: \$[amount] [retailer]

Plumbing fixtures: \$[amount] [retailer]

Other: \$[amount] [retailer]

A.2. Contract Sum:

A residential construction contract may include more than one method of calculating the contract sum. Select one or more of the following as applicable. Attach exhibit A (payment schedule) if applicable.

Stipulated sum: [dollars] DOLLARS (\$[amount])

And/Or

Unit price: [dollars] DOLLARS (\$[amount]) per [unit of work, e.g., square yard of asphalt paving]

And/Or

Cost-plus basis: costs plus [percent] percent ([percent]%) of "costs" as defined in Exhibit [exhibit letter/number] [include if applicable: but not to exceed a guaranteed maximum of [dollars] DOLLARS (\$[amount])].

Continue with the following.

A.3. F.T.C. Insulation Disclosure Data: The following data reflect characteristics of insulation according to data from the manufacturer:

Ceilings: Type: Thickness: R-Value:

Exterior walls: Type: Thickness: R-Value:

Other: Type: Thickness: R-Value:

B. Definitions

B.1. “Commencement Date” means the date on which the building permit is issued for Contractor to construct the Improvements.

B.2. “Completion Date” means the date of Substantial Completion and notice to Owner, but not later than [date], unless extended by the terms of the Contract Documents, force majeure delays, or other delays not within Contractor’s control.

B.3. “Concealed Conditions” means preexisting physical conditions situated below the surface of the ground, or concealed or unknown conditions in an existing structure, at variance with the conditions indicated in the Contract Documents or differing materially from those ordinarily encountered and generally recognized as inherent in Work of the character provided for in the Contract Documents.

B.4. “Contract Documents” means this residential construction contract, the Plans, warranty documents, and any other documents governing the Work (collectively, the “Contract”).

B.5. “Improvements” means the improvements to be constructed on the Property according to the Plans, including [describe, e.g., a single-family residence].

B.6. “Payment Deadline” means 2:00 P.M. on the third business day after Contractor’s request for payment is received by [Owner/Owner’s lender/[specify]].

B.7. “Plans” means all design plans and specifications for the Improvements (dated and initialed by Owner and Contractor).

B.8. “Scope of Work” means the Work covered by the Contract Documents.

B.9. “Substantial Completion” or “Substantially Complete” means the stage of construction when a new home is sufficiently complete that the home can be occupied or used for

its intended purpose; or, if required, a certificate of occupancy has been issued in which the parties stipulate the Improvements have been completed in accordance with the Plans and are fit for their intended use except for minor “punch list” items, which are typically completed or cured following the taking of possession by Owner. However, if Owner moves into the home or Improvements, the home or Improvements shall be deemed to be Substantially Complete.

B.10. The “Work” means the physical activities, materials, and equipment relating to the construction of the Improvements.

C. Precommencement Matters

C.1. Contractor agrees to—

- a. Provide Owner a copy of the Builder’s Risk Insurance Policy for the Property with a coverage amount equal to or greater than the Contract Sum.
- b. Obtain Contractor’s risk insurance coverage for casualty loss and public liability in reasonable amounts, to protect Contractor and Owner.

Include the following if applicable. The list of subcontractors and suppliers is required for early release of retainage, as described in the first alternative within paragraph 3.f. of exhibit A.

- c. Provide Owner with a written list of all subcontractors and suppliers of any tier furnishing labor, material, equipment, or other improvements for the project. The list will include each subcontractor’s or supplier’s name, address, and telephone number and will be updated within fifteen days of any addition or deletion of a subcontractor or supplier. A final list will be provided to Owner on or before final completion of the project.
- d. If Contractor provides the Plans, Contractor will deliver to Owner two copies of the Plans. Contractor hereby assigns to Owner the right to use the

Plans for the purpose of completing the Improvements if Contractor fails to do so in accordance with the terms of the Contract Documents.

C.2. Owner agrees to—

- a. Furnish to Contractor reasonable proof acceptable to Contractor that Owner has the ability to pay to Contractor the full Contract Sum.
- b. Provide water and electricity to the property line.

C.3. The following are stipulated:

- a. *Change Orders.* Contractor is under no duty to make any changes in the Plans requested by Owner until a mutually agreeable change order is signed by Contractor and Owner.
- b. *Plans.* If Owner furnishes the Plans, Owner warrants the sufficiency of the Plans. If Contractor furnishes the Plans, Contractor warrants the Plans are in substantial compliance with all applicable laws, including applicable building codes and the International Residential Code, 2009 Edition, available at <http://codes.iccsafe.org/app/book/toc/2009/I-Codes/2009%20IRC%HTML/index.html>.
- c. *Consumer Products.* “Consumer Products,” as defined by the Federal Trade Commission, are excluded from Contractor’s warranty only to the extent individual manufacturers’ warranties are passed through Contractor and assigned to Owner, with a copy received by Owner. Contractor assigns and passes through to Owner the manufacturers’ warranties on all appliances and equipment. In the case of passed-through and received manufacturers’ warranties on Consumer Products, Owner’s recourse is directly to the manufacturer, and Contractor will have no responsibility for them,

except for problems relating to Contractor's installation and hookup of the items.

- d. *Consult Your Attorney.* This is intended to be a legally binding contract. READ IT CAREFULLY If you do not understand the effect of any part of the Contract Documents, consult your attorney BEFORE signing.
- e. *F.T.C. Insulation Disclosure.* The F.T.C. Insulation Disclosure Data are provided in accordance with the Federal Trade Commission regulation at 16 C.F.R. pt. 460.

D. After Completion of Precommencement Matters

D.1. Contractor agrees to—

- a. Obtain a building permit and commence the Work within thirty days after Owner has completed all of Owner's obligations under the Precommencement Matters and file an affidavit of commencement in the real property records of the county in which the Property is located.
- b. Diligently prosecute the Work to completion and substantially complete the Work according to the Plans by the Completion Date.
- c. Pay all valid bills and charges to Contractor for material or labor relating to the Improvements.
- d. Keep the Property free from claims of liens for labor or material arising directly through Contractor, except that Contractor may reasonably dispute any claim.
- e. Include in the Improvements insulation with the characteristics set forth above in the F.T.C. Insulation Disclosure Data.

D.2. Contractor agrees not to delay the work.

D.3. Owner agrees to—

- a. Pay to Contractor the Contract Sum, disbursed according to the [Contract terms/payment schedule], no later than the Payment Deadline.
- b. Promptly pay to the seller of the Allowance Items all charges in excess of the allowances.
- c. Make selection of Allowance Items within ten days after receipt of notice from Contractor; otherwise, Contractor may make the selections or extend the time for Owner to make the selections, in which case Owner will pay any charges related to the delay and Contractor is entitled to extend the Completion Date.
- d. Deliver to Contractor, within three business days of Contractor's draw request, written notice of Work not accepted, with specific reasons and reasonable requirements stated for causing the Work to be accepted.

D.4. Owner agrees not to—

- a. Communicate directly with laborers about the Work.
- b. Delay or interfere with the progress of the Work.

D.5. Contractor and Owner agree that—

- a. If Owner, at any time before or during the progress of the Work, wants any modifications made to the Plans ("Changed Work"), Owner will request in writing that Contractor undertake the Changed Work. If Contractor agrees to do the Changed Work, Contractor may submit to Owner an estimate of

the cost of the Changed Work and an extension of the Completion Date to reflect the additional time required for completing it. If a preapproved written change order is not obtained, Contractor may submit to Owner the notice of change order and extension of time in writing, and the failure of Owner to make written objection within ten days of the notice is conclusively deemed approval by Owner. The Contract Sum and the Completion Date will automatically adjust to incorporate any change orders.

- b. Should Contractor encounter Concealed Conditions, the Contract Sum will be equitably adjusted by change order on claim by either party made within twenty days after notice by Contractor to Owner of the Concealed Conditions.
- c. Contractor occupies the status of an independent contractor, as that term is defined in the construction industry.
- d. Unless otherwise specifically provided, reference to any equipment, material, article, or patented process by trade name, make, or catalog number is regarded as establishing a standard of quality and is not construed as limiting competition. Contractor may, at Contractor's option, use any equipment, material, article, or patented process that is substantially equal to that named.
- e. Contractor has the right to subcontract any part or all of the Work.

E. After Substantial Completion

E.1. Contractor agrees to—

- a. Remove debris and surplus materials occasioned by the Work.

- b. Notify Owner on Substantial Completion of the Work and file an affidavit of completion in the real property records of the county in which the Property is located.
- c. Deliver possession of the Improvements to Owner on the day following the later of Substantial Completion or final payment to Contractor of the Contract Sum.
- d. Release the Work and Property from all claims, including claims of subcontractors and materialmen, on receipt of final payment.

Select one of the following. Use the second paragraph to reference the Texas Residential Construction Commission warranty standards.

- e. Contractor warrants its labor and materials against construction defects and warrants that its construction services have been performed in a good and workmanlike manner and that the materials are adequate for their intended purposes. These warranties extend for a period of one year after substantial completion. Owner must give notice of the defect within this one-year warranty period, and contractor has up to six months to correct the defect. The giving of this express warranty is not intended to, and does not, negate implied warranties.

Or

- e. Contractor warrants that its performance of work on the project meets the residential construction warranties adopted by the Texas Residential Construction Commission. The warranties will extend for the following periods after substantial completion:
 - i. one year for workmanship and materials;

- ii. two years for plumbing, electrical, heating, and air-conditioning delivery systems; and
- iii. ten years for major structural components of the home.

THESE EXPRESS WARRANTIES ARE GIVEN IN LIEU OF THE IMPLIED WARRANTY OF GOOD AND WORKMANLIKE CONSTRUCTION, WHICH IS DISCLAIMED.

Continue with the following.

E.2. Owner agrees to—

- a. Pay to Contractor the final payment of the Contract Sum, including all amounts due under the Contract Documents, according to Exhibit A.
- b. Sign and file for record within five days after Substantial Completion a notice of substantial completion and acceptance.

E.3. Owner and Contractor agree that Owner's acceptance of possession will be conclusively presumed to constitute Owner's acceptance of the Improvements as Substantially Complete and inhabitable.

F. Default and Termination

F.1. Building Permit. If a building permit has not been issued within ten business days of completion of all Precommencement Matters, Owner may terminate this Contract by written notice within ten business days and recover out-of-pocket costs from Contractor; otherwise, Owner must give Contractor ten days' written notice and opportunity to cure before terminating this Contract.

F.2. Precommencement Matters. If the Precommencement Matters have not been completed within thirty days from the Contract Date, Owner or Contractor may unilaterally

terminate this Contract by written notice within forty days from the Contract Date, in which case this Contract will terminate, and the performing party is entitled to recover reasonable out-of-pocket costs from the nonperforming party.

F.3. Owner's Default. Each of the following constitutes a material breach of this Contract by Owner: (a) failing to fully and timely perform any covenant of Owner under this Contract; (b) making any representation to Contractor found to be materially false, misleading, or erroneous; and (c) substantially breaching any of Owner's obligations under this Contract.

F.4. Contractor's Default. Each of the following constitutes a material breach of this Contract by Contractor: (a) delaying the Work such that the progress of the Substantial Completion of the Improvements falls more than thirty days behind the time shown for completion of the Work; (b) failing to fully and timely perform any covenant of Contractor under this Contract; (c) making any representation to Owner found to be materially false, misleading, or erroneous; and (d) substantially breaching any of Contractor's obligations under this Contract or required by applicable law.

F.5. Remedies. If one party defaults, and the default is not cured within ten days of written notice specifically describing the default, this Contract may be terminated by written notice from the nondefaulting party to the defaulting party.

Include the following if desired, modifying if needed to reflect the appropriate price structure.

In the event of such termination, the following formula is agreed on as a reasonable and fair way to assess the actual damages, without the expense and delay associated with other forms of dispute resolution:

- a. *Damages to Contractor.* If termination resulted from an act of default of Owner, Owner will pay to Contractor, within thirty days of written notice

from Contractor, an amount equal to all amounts due and owing at the time of the termination, including payment for Changed Work, plus [percent] percent of the remaining Contract Sum to compensate Contractor for the lost profit and for the difficulty and burden of locating other work for the Contractor's subcontractors to prevent hardship on them and the loss of loyalty resulting from such hardship.

- b. *Damages to Owner.* If termination resulted from an act of default of Contractor, damages recoverable by Owner from Contractor will be in accordance with Texas Property Code chapter 27 (the Residential Construction Liability Act), if applicable. If the Residential Construction Liability Act does not apply, Contractor will pay to Owner, in addition to actual damages, consequential damages, which are liquidated in an amount equal to two months' interest on Owner's interim construction loan (based on the assumption, whether true or not, that there exists such a loan and that it is fully disbursed and in an amount equal to the Contract Sum) to compensate Owner for the time and expense associated with obtaining another contractor to complete the Work. It is agreed by the parties that this liquidated amount is a reasonable estimate of the consequential damages actually incurred by Owner. Payment by Contractor will be delivered to Owner on the earlier of (i) payment of all amounts due to Contractor, with a right of offset to Owner for unpaid damages under this section; (ii) completion of construction of the Improvements; or (iii) the expiration of thirty days from written notice from Owner.

Continue with the following.

G. Miscellaneous Provisions

G.1. Agreement of Parties. The Contract Documents, including any of their exhibits and attachments, are the entire agreement of the parties. There are no representations, agreements, or promises between the parties, and neither party is relying on any statements or representations of any agent of the other party, that are not in those documents.

G.2. Amendment of Contract. This Contract may be amended only by an instrument in writing signed by the parties.

G.3. Attorney's Fees. If either party retains an attorney to enforce this Contract, the party prevailing in litigation is entitled to recover reasonable attorney's fees, court and other costs, and related expenses.

G.4. Binding Effect. This Contract binds, benefits, and may be enforced by the parties and their respective representatives, successors in interest, and, if permitted, their assigns.

G.5. Counterparts. If this Contract is executed in multiple counterparts, all counterparts taken together will constitute this Contract.

G.6. Venue. Venue is in the county or counties in which the Property is located.

G.7. Notices. Any notice required or permitted under this Contract must be in writing. Any notice required by this Contract will be deemed to be given (whether received or not) the earlier of receipt or three business days after being deposited with the United States Postal Service, postage prepaid, certified mail, return receipt requested, and addressed to the intended recipient at the address shown in this Contract. Notice may also be given by regular mail, personal delivery, courier delivery, or e-mail and will be effective when received. Any address for notice may be changed by written notice given as provided herein.

G.8. Time. Time is of the essence. Unless otherwise specified, all references to days mean calendar days. Business days exclude all Saturdays, Sundays, and national holi-

days. If the date for performance of any obligation falls on a Saturday, Sunday, or national holiday, that obligation is performable on the next business day.

G.9. When the context requires, singular nouns and pronouns include the plural.

Include the following if the contract calls for renovation or repair of existing homestead improvements and a lien for financing the improvements is contemplated. See section 20.1:1 in this manual.

G.10. *Repair or Renovation Construction.* If the Scope of Work includes repair or renovation of existing improvements, the following provisions apply. Contractor and Owner certify and represent that they are aware of and have complied with the following legal rights and obligations:

- a. *Rescission.* Owner may rescind this contract (and any other proposals, contracts, or agreements with Contractor regarding the repair or renovation of existing improvements) without penalty or charge within three days after the execution of the contract by all parties. See the “Notice of Cancellation” form below.
- b. *Place of Signing Contract.* Owner acknowledges that this contract was signed at one of the following offices and not elsewhere: (i) the office of a third-party lender making an extension of credit for the Work and material to be furnished; (ii) the office of an attorney at law; or (iii) the office of a title company.
- c. *Five-Day Waiting Period.* This contract and any other contract signed in connection with the repair and renovation Work mentioned in this contract have not been executed by Owner or Owner’s spouse before the fifth day after Owner made written application for an extension of credit for the Work and material contemplated.

Include the following if applicable.

G.11. *Special Provisions.* [specify]

G.12. *Notices.*

The following notice is required by Tex. Prop. Code § 41.007
This notice must appear in a minimum of ten-point bold-faced
type or equivalent "next to" the owner's signature line. Tex.
Prop. Code § 41.007(a).

IMPORTANT NOTICE: You and your contractor are responsible for meeting the terms and conditions of this contract. If you sign this contract and you fail to meet the terms and conditions of this contract, you may lose your legal ownership rights in your home. KNOW YOUR RIGHTS AND DUTIES UNDER THE LAW.

The following notice is required by Tex. Prop. Code § 27.007

RESIDENTIAL CONSTRUCTION LIABILITY ACT (RCLA) NOTICE

This contract is subject to Chapter 27 of the Texas Property Code. The provisions of that chapter may affect your right to recover damages arising from a construction defect. If you have a complaint concerning a construction defect and that defect has not been corrected as may be required by law or by contract, you must provide the notice required by Chapter 27 of the Texas Property Code to the contractor by certified mail, return receipt requested, not later than the 60th day before the date you file suit to recover damages in a court of law or initiate arbitration. The notice must refer to Chapter 27 of the Texas Property Code and must describe the construction defect. If requested by the contractor, you must provide the contractor an opportunity to inspect and cure the defect as provided by Section 27.004 of the Texas Property Code.

Continue with the following.

[Name of owner]

If the owner is married, both spouses must sign the contract.

Include the following if applicable.

YOU, THE OWNER, MAY CANCEL THIS TRANSACTION AT ANY TIME BEFORE MID-NIGHT OF THE THIRD BUSINESS DAY AFTER THE DATE OF THIS TRANSACTION. SEE THE ATTACHED NOTICE OF CANCELLATION FORM FOR AN EXPLANATION OF THIS RIGHT.

Continue with the following.

[Name of contractor]

If the notice of the owner's right to cancel is included, attach completed duplicate copies of the following notice of cancellation.

The notice of right to cancel, if required, must appear "in immediate proximity to" the owner's signature in a minimum of ten-point bold-faced type. Tex. Bus. & Com. Code § 601.052; 16 C.F.R. § 429.1(a).

A notice concerning the purchaser's three-day right of rescission under a contract to purchase real property must be given if (1) the seller or the seller's agent solicits the sale at a place other than the seller's place of business; (2) the purchaser submits the purchase contract to the seller or the seller's agent at a place other than the seller's place of business; and (3) the consideration payable under the purchase contract exceeds \$100; unless either (1) the purchaser is represented by a licensed attorney; (2) the transaction is negotiated by a licensed real estate broker; or (3) the transaction is negotiated at a place other than the purchaser's residence by the person who owns the property, as described in Tex. Bus. & Com. Code ch. 601.

The notice of cancellation form must be easily detachable from the contract to which it is attached, must be in the same language as the contract, and must contain the following information and statements. Tex. Bus. & Com. Code § 601.053.

Notice of Cancellation

[Date]

YOU MAY CANCEL THIS TRANSACTION, WITHOUT ANY PENALTY OR OBLIGATION, WITHIN THREE BUSINESS DAYS FROM THE ABOVE DATE.

IF YOU CANCEL, ANY PROPERTY TRADED IN, ANY PAYMENTS MADE BY YOU UNDER THE CONTRACT OR SALE, AND ANY NEGOTIABLE INSTRUMENT EXECUTED BY YOU WILL BE RETURNED WITHIN TEN BUSINESS DAYS FOLLOWING RECEIPT BY THE MERCHANT OF YOUR CANCELLATION NOTICE, AND ANY SECURITY INTEREST ARISING OUT OF THE TRANSACTION WILL BE CANCELED.

IF YOU CANCEL YOU MUST MAKE AVAILABLE TO THE MERCHANT AT YOUR RESIDENCE, IN SUBSTANTIALLY AS GOOD CONDITION AS WHEN RECEIVED, ANY GOODS DELIVERED TO YOU UNDER THIS CONTRACT OR SALE; OR YOU MAY IF YOU WISH, COMPLY WITH THE INSTRUCTIONS OF THE MERCHANT REGARDING THE RETURN SHIPMENT OF THE GOODS AT THE MERCHANT'S EXPENSE AND RISK.

IF YOU DO NOT AGREE TO RETURN THE GOODS TO THE MERCHANT OR IF THE MERCHANT DOES NOT PICK THEM UP WITHIN TWENTY DAYS OF THE DATE OF YOUR NOTICE OF CANCELLATION, YOU MAY RETAIN OR DISPOSE OF THE GOODS WITHOUT ANY FURTHER OBLIGATION.

TO CANCEL THIS TRANSACTION, MAIL OR DELIVER A SIGNED AND DATED COPY OF THIS CANCELLATION NOTICE OR ANY OTHER WRITTEN NOTICE, OR SEND A TELEGRAM, TO [name of merchant], AT [address of merchant's place of business] NOT LATER THAN MIDNIGHT OF [date].

I HEREBY CANCEL THIS TRANSACTION.

Dated: _____.

[Name of purchaser]

Include any attachments.

Exhibit A**Payment Schedule**

The Contract Sum will be paid by Owner to Contractor as follows:

1. *Retainage.* Ten percent of all draws, including 10 percent of all change orders or other modifications to the contract price, will be withheld by Owner to be paid at the time of the Retainage Draw described below.

2. *Precommencement.* Owner has deposited with Contractor the sum of \$[amount], which will be credited to Owner on the [initial/final/[describe other]] draw.

Select one of the following.

3. *Interim Draws.* Owner will pay to Contractor the following portions of the Contract Sum according to the following schedule:

- a. Draw No. 1 for \$[amount]: After foundation poured
- b. Draw No. 2 for \$[amount]: Roof work begins
- c. Draw No. 3 for \$[amount]: Interior trim work begins
- d. Draw No. 4 for \$[amount]: Interior painting begins
- e. Draw No. 5 for \$[amount]: Substantial Completion
- f. Retainage Draw for remaining unpaid 10 percent withheld from each draw, change order, or other modification to the contract price: **[select one of the following:** If Contractor has complied with paragraph C.1.c. under "Precommencement Matters" by timely providing Owner with the updated written list of subcontractors and suppliers of any tier and Contractor has verified the list

as accurate as of final completion, Owner will prepare, file, and send an affidavit of completion within ten days of the date of project final completion. Retainage will then be released to Contractor the fiftieth day after the date of final completion as stated in the affidavit, provided no unreleased mechanic's liens have been filed by that time./Retainage will be paid to Contractor on the last business day of the third month following the month of final completion of the project, provided no unreleased mechanic's liens have been filed by that time.]

- g. Other Draws: In addition to the draws provided for above, Contractor will also make the following draws on the Contract Sum:

[\$amount] for [specify]

[\$amount] for [specify]

[\$amount] for [specify]

Or

3. *Interim Draws.* Owner will pay to Contractor the following portions of the Contract Sum according to the following schedule: [describe schedule for interim draws, including retainage draw].

Form 18-5

Affidavit of Commencement

Basic Information

Date:

Owner:

Owner's Mailing Address:

Contractor:

Contractor's Mailing Address:

Property: [include legal description]

Improvements:

Affiants, [name of owner] and [name of contractor], on oath swear that the following statements are true and within the personal knowledge of Affiants:

1. Commencement of Construction. Construction of the Improvements commenced on [date].

Include the following if applicable.

2. Delivery of Materials. Materials to be used in constructing the Improvements were first delivered to the Property on [date].

3. Representations. Affiant, [name of contractor], makes these representations individually and on behalf of Contractor.

Continue with the following.

[Name of owner]

SUBSCRIBED AND SWORN TO before me on _____ by [name of affiant].

Notary Public, State of Texas

[Name of contractor]

SUBSCRIBED AND SWORN TO before me on _____ by [name of affiant].

Notary Public, State of Texas

Form 18-6

Change Order

Basic Information

Date:

Change Order Number:

Owner:

Owner's Mailing Address:

Contractor:

Contractor's Mailing Address:

Property and Improvements: The Improvements described in the Residential Construction Contract ("Contract") (incorporated by reference) between Owner and Contractor for **[specify]**.

Changes to Contract:

1. *Change to Plans and Specifications*

In accordance with the Contract terms, the following changes ("Changed Work") are approved: **[specify]**.

2. *Contract Sum Adjustment*

Original contract sum: **[specify]**

[Include if applicable: Prior change orders number 1 through number [number]:
[specify]]

This change order: [specify]

Revised contract sum: [specify]

3. *Completion Date Adjustment*

Original completion date: [date]

[Include if applicable: Previous time changes number 1 through number [number]:
[days]]

This time change: [days]

Revised completion date: [date]

4. *Contract Amendment.* For the same consideration that supports the Contract, Owner and Contractor agree to amend the Contract as described in the Changes to Contract. The Contract as amended remains in full force and effect.

5. When the context requires, singular nouns and pronouns include the plural.

[Name of owner]

[Name of contractor]

If the owner is married, both spouses must sign any written agreement regarding estimates for changed work.

Form 18-7

Owner Affidavit of Completion

Basic Information

Date:

Owner:

Owner's Mailing Address:

Original Contractor:

Original Contractor's Mailing Address:

Property: [include legal description]

Improvements:

Completion Date: [date]

Affiant, [name of affiant], on oath swears that the following statements are true and within the personal knowledge of Affiant:

1. *Date of Completion.* The Improvements to the Property were completed on the Completion Date. For purposes of this affidavit, "completion" means the actual completion of the work, including any extras or change orders reasonably required or contemplated under the original contract, other than warranty or repair work.

2. *Claims against Retained Funds.* NO SUBCONTRACTOR OR OTHER LIEN CLAIMANT MAY HAVE A LIEN ON RETAINED FUNDS UNLESS THE CLAIMANT FILES AN AFFIDAVIT

CLAIMING A LIEN NO LATER THAN THE FORTIETH DAY AFTER THE WORK UNDER THE ORIGINAL CONTRACT IS COMPLETED.

3. *Statement as to Other Notices.* Owner states that Owner has received a written request to receive a copy of an affidavit of completion from the following persons who have furnished labor or materials for the Property and from no other persons:

Persons requesting copy of affidavit of completion: **[list]**.

[Name of owner]

SUBSCRIBED AND SWORN TO before me on _____ by **[name of affiant]**.

Notary Public, State of Texas

Form 18-8

This form is based on the form found in Tex. Prop. Code § 53.284(b). If a contractor (or other potential lien claimant) is required to execute a waiver and release in exchange for or to induce payment of a progress payment and is not paid in exchange for the waiver and release, or if a single payee check or joint payee check is given in exchange for the waiver and release, the waiver and release must read as follows.

Conditional Partial Release During Construction

Project:

Job No.

On receipt by the signer of this document of a check from [**name of maker of check**] in the sum of \$[**amount**] payable to [**name[s] of payee[s] of check**], and when the check has been properly endorsed and has been paid by the bank on which it is drawn, this document becomes effective to release any mechanic's lien right, any right arising from a payment bond that complies with a state or federal statute, any common-law payment bond right, any claim for payment, and any rights under any similar ordinance, rule, or statute related to claim or payment rights for persons in the signer's position that the signer has on the property of [**name of owner**] located at [**specify location**] to the following extent: [**specify job description**].

This release covers a progress payment for all labor, services, equipment, or materials furnished to the property or to [**name of person with whom signer contracted**] as indicated in the attached statement[s] or progress payment request[s], except for unpaid retention, pending modifications and changes, or other items furnished.

Before any recipient of this document relies on this document, the recipient should verify evidence of payment to the signer.

The signer warrants that the signer has already paid or will use the funds received from this progress payment to promptly pay in full all of the signer's laborers, subcontractors, materialmen, and suppliers for all work, materials, equipment, or services provided for or to the above-referenced project in regard to the attached statement[s] or progress payment request[s].

Date

[Company name]

By _____

[Name and title]

Form 18-9

This form is based on the form found in Tex. Prop. Code § 53.284(c). If a contractor (or other potential lien claimant) is required to execute an unconditional waiver and release to prove the receipt of good and sufficient funds for a progress payment and the claimant or potential claimant asserts in the waiver and release that the claimant or potential claimant has been paid the progress payment, the waiver and release must read as follows. The form must include the notice at the top of the document.

Unconditional Partial Release During Construction

NOTICE: This document waives rights unconditionally and states that you have been paid for giving up those rights. It is prohibited for a person to require you to sign this document if you have not been paid the payment amount set forth below. If you have not been paid, use a conditional release form.

Project:

Job No.

The signer of this document has been paid and has received a progress payment in the sum of \$[amount] for all labor, services, equipment, or materials furnished to the property or to [name of person with whom signer contracted] on the property of [name of owner] located at [specify location] to the following extent: [specify job description]. The signer therefore waives and releases any mechanic's lien right, any right arising from a payment bond that complies with a state or federal statute, any common-law payment bond right, any claim for payment, and any rights under any similar ordinance, rule, or statute related to claim or payment rights for persons in the signer's position that the signer has on the above-referenced project to the following extent:

This release covers a progress payment for all labor, services, equipment, or materials furnished to the property or to [name of person with whom signer contracted] as indicated in

the attached statement[s] or progress payment request[s], except for unpaid retention, pending modifications and changes, or other items furnished.

The signer warrants that the signer has already paid or will use the funds received from this progress payment to promptly pay in full all of the signer's laborers, subcontractors, materialmen, and suppliers for all work, materials, equipment, or services provided for or to the above-referenced project in regard to the attached statement[s] or progress payment request[s].

Date

[Company name]

By _____

[Name and title]

Form 18-10

This form is based on the form found in Tex. Prop. Code § 53.284(d). If a contractor (or other potential lien claimant) is required to execute a waiver and release in exchange for or to induce the payment of a final payment and is not paid in good and sufficient funds in exchange for the waiver and release, or if a single payee check or joint payee check is given in exchange for the waiver and release, the waiver and release must read as follows.

Conditional Final Release

Project:

Job No.

On receipt by the signer of this document of a check from **[name of maker of check]** in the sum of \$**[amount]** payable to **[name[s] of payee[s] of check]**, and when the check has been properly endorsed and has been paid by the bank on which it is drawn, this document becomes effective to release any mechanic's lien right, any right arising from a payment bond that complies with a state or federal statute, any common-law payment bond right, any claim for payment, and any rights under any similar ordinance, rule, or statute related to claim or payment rights for persons in the signer's position that the signer has on the property of **[name of owner]** located at **[specify location]** to the following extent: **[specify job description]**.

This release covers the final payment to the signer for all labor, services, equipment, or materials furnished to the property or to **[name of person with whom signer contracted]**.

Before any recipient of this document relies on this document, the recipient should verify evidence of payment to the signer.

The signer warrants that the signer has already paid or will use the funds received from this final payment to promptly pay in full all of the signer's laborers, subcontractors, material-

men, and suppliers for all work, materials, equipment, or services provided for or to the above-referenced project up to the date of this waiver and release.

Date

[Company name]

By _____

[Name and title]

Form 18-11

This form is based on the form found in Tex. Prop. Code § 53.284(e). If a contractor (or other potential lien claimant) is required to execute an unconditional waiver and release to prove the receipt of good and sufficient funds for a final payment and the claimant or potential claimant asserts in the waiver and release that the claimant or potential claimant has been paid the final payment, the waiver and release must read as follows. The form must include the notice at the top of the document.

Unconditional Release on Final Payment

NOTICE: This document waives rights unconditionally and states that you have been paid for giving up those rights. It is prohibited for a person to require you to sign this document if you have not been paid the payment amount set forth below. If you have not been paid, use a conditional release form.

Project:

Job No.

The signer of this document has been paid in full for all labor, services, equipment, or materials furnished to the property or to **[name of person with whom signer contracted]** on the property of **[name of owner]** located at **[specify location]** to the following extent: **[specify job description]**. The signer therefore waives and releases any mechanic's lien right, any right arising from a payment bond that complies with a state or federal statute, any common-law payment bond right, any claim for payment, and any rights under any similar ordinance, rule, or statute related to claim or payment rights for persons in the signer's position.

The signer warrants that the signer has already paid or will use the funds received from this final payment to promptly pay in full all of the signer's laborers, subcontractors, materialmen, and suppliers for all work, materials, equipment, or services provided for or to the above-referenced project up to the date of this waiver and release.

Date

[Company name]

By _____

[Name and title]

Form 18-12

This form may be used as written by an original contractor to fulfill the requirements of Tex. Prop. Code §§ 53.085, 53.258, 53.259; the wording may be modified if the affidavit is made for a subcontractor or supplier under Tex. Prop. Code § 53.085.

[Final] Bills-Paid Affidavit

Basic Information

Date:

Owner:

Owner's Mailing Address:

Contractor:

Contractor's Mailing Address:

Affiant: **[include relationship to contractor]**

Affiant's Mailing Address:

Property: **[include legal description]**

Improvements:

Affiant swears individually and on behalf of Contractor that the following statements are true and within the personal knowledge of Affiant:

1. Affiant has personal knowledge of the facts stated in this affidavit. Affiant has full authority to make the agreements in this affidavit on behalf of Contractor.

2. Affiant understands that Owner has required this affidavit as a condition of payment for labor or materials used in construction of the Improvements.

3. Contractor has paid each of Contractor's subcontractors, laborers, and materialmen in full for all labor and materials provided to Owner or Contractor for construction of the Improvements, excepting only the amounts owed to the persons identified below:

List all subcontractors, laborers, and materialmen and amounts owed to each. If there are no unpaid subcontractors, laborers, or materialmen, state "None."

Name:

Address:

Telephone number:

Amount owed:

Repeat above information as needed.

Include the following if applicable.

Contractor warrants and represents that the following specified bills or classes of bills will be paid by Contractor from the funds paid to Contractor by Owner in reliance on this affidavit:

Name of payee or description of class:

Amount:

Repeat above information as needed.

Include the following if applicable.

Contractor agrees to indemnify and hold Owner harmless from any loss or expense resulting from false or incorrect information in this affidavit.

Continue with the following.

[Name of affiant]

SUBSCRIBED AND SWORN TO before me on _____ by [name of affiant].

Notary Public, State of Texas

[Reserved]

Chapter 19
Commercial Construction Contract Documents

§ 19.1	Nature of Contract.	19-1
§ 19.2	Architect and Engineering Services	19-1
§ 19.3	Role of Architect/Engineer	19-1
§ 19.4	Contract Price	19-2
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Forms

Form 19-1	Commercial Construction Contract	19-1-1 to 19-1-74
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[Reserved]

Chapter 19

Commercial Construction Contract Documents

Note: The State Bar of Texas Real Estate Forms Committee is grateful to Bill Locke, shareholder with Graves, Dougherty, Hearon & Moody, in Austin, Texas, and Charles Comiskey, senior vice president of Brady Chapman Holland & Associates, Inc. an insurance brokerage firm with offices in Houston, Texas, and president of RiskTech, Inc., a risk management consulting firm in Houston, Texas, for their assistance in preparing exhibit D of form 19-1 in this chapter.

§ 19.1 Nature of Contract

Form 19-1 in this chapter is intended to be used for commercial construction projects that are designed by an architect with participation by the architect's engineering consultant(s). The term *Architect/Engineer* as used in the contract designates the design professional for the project.

§ 19.2 Architect and Engineering Services

The statutes applicable to architects and engineers govern the types of design and professional services that may be provided by each. Some professional services may be performed by either an architect or an engineer, including the preparation of site plans and the depiction of building systems. *See, e.g.,* Tex. Occ. Code §§ 1001.0031(d), (e), 1051.0016(b), (c). Certain plans and specifications may be prepared only by a licensed architect or a licensed engineer. *See* Tex. Occ. Code §§ 1001.0031(c), 1051.703. Some projects may be designed by persons who are not licensed architects or engineers. *See, e.g.,* Tex. Occ. Code §§ 1051.606, 1001.056-.057.

§ 19.3 Role of Architect/Engineer

The commercial construction contract (form 19-1 in this chapter) designates the Architect/Engineer (A/E) as the owner's representative and

anticipates that the A/E will provide design services prior to construction and contract administration services during the construction phase. As part of the contract administration services, the A/E will, among other duties, carry out the following: give the notice to proceed, approve payment applications from the contractor, respond to submittals and requests for clarification, review the contractor's construction schedule, determine whether delay is excused, approve or make reasonable objection to proposed subcontractors, review the contractor's draw requests for payment, determine whether the project is substantially complete, prepare the list of correction items required (punch list) for final completion, determine whether to recommend the owner's final payment, and receive information and documents on behalf of the owner, such as lien releases and affidavits of bills paid. The A/E is designated in the contract as the initial decision maker for claims made by the owner or the contractor.

The contract administration services specified in the contract are typical of those in industry-standard forms, such as American Institute of Architects construction contracts. However, the A/E is not a party to the construction contract. Therefore, the terms of the architect's contract should be made consistent with the A/E provisions in form 19-1. Alternatively, the architect's contract can be drafted to incorporate the provisions of form 19-1 by reference in describing the A/E's obligations.

§ 19.4 Contract Price

The cost of construction is calculated on the basis of the actual cost of the work, plus the contractor's fee, not to exceed a stated guaranteed maximum price.

Section F. of the contract specifies the types of construction costs that are reimbursable as the cost of the work.

Paragraph F.5. requires the contractor to provide a schedule of values for the owner's approval. The approved schedule of values will be used to determine progress payments, as provided in section J.

The contract price, allowances, contractor's contingency, owner's contingency, and the amount of liquidated damages, if required by the owner, are to be set out in exhibit C of the contract.

§ 19.5 Retainage

The contract provides for 10 percent retainage to be withheld in accordance with the provisions of chapter 53 of the Texas Property Code.

§ 19.6 Payment and Performance Bonds

The owner may require the contractor to provide payment and performance bonds by designating the requirement on exhibit D of the contract.

§ 19.7 Insurance

The insurance requirements for the contractor and, if applicable, the subcontractors are to be set out in exhibit D, which contains sample insurance requirements.

§ 19.8 Default and Remedies

Sections M. and N. contain the default and remedies provisions. Paragraph N.7. also includes a

waiver of consequential damages. Before selecting the liquidated damages option or determining the liquidated damages amount, the practitioner should consider the enforceability of such clauses. *See Phillips v. Phillips*, 820 S.W.2d 785, 789 (Tex. 1991); *Garden Ridge, L.P. v. Advance International, Inc.*, 403 S.W.3d 432, 440 (Tex. App.—Houston [14th Dist.] 2013, pet. denied). In *Garden Ridge, L.P.*, the court described the test set out in *Phillips* as follows:

'The test for determining whether a provision is valid and enforceable as liquidated damages is (1) if the damages for the prospective breach of the contract are difficult to measure; and (2) the stipulated damages are a reasonable estimate of actual damages. *Chan v. Montebello Dev. Co.*, No. 14-06-00936-CV, 2008 WL 2986379, at *3 (Tex. App.—Houston [14th Dist.] July 31, 2008, pet. denied) (citing *Phillips*, 820 S.W.2d at 788). Further, we stated:

In order to meet this burden, the party asserting the defense is required to prove the amount of the other parties' actual damages, if any, to show that the liquidated damages are not an approximation of the stipulated sum. If the liquidated damages are shown to be disproportionate to the actual damages, then the liquidated damages must be declared a penalty.

Id. at *3–4 (citations omitted).

Garden Ridge, L.P., 403 S.W.3d at 440.

Also, liquidated damages must be in lieu of and not coupled with or in addition to actual damages. A contract provision that 'fixes liquidated damages without excluding additional liability for actual damages is not a reasonable forecast

of just compensation and therefore a penalty.”
Phillips, 820 S.W.2d at 789.

Paragraph J.10. authorizes the owner to withhold payment based on conditions that could result in loss or damages to the owner as long as the conditions remain uncured. The practitioner should consult the provisions of chapter 28 of the Texas Property Code, requiring prompt payment to contractors and subcontractors.

§ 19.9 Warranties

The contractor’s warranties are set out in section P. In addition to the customary one-year warranty against defects in labor and materials, section P expressly provides a ten-year warranty on structural components, including the foundation.

[Reserved]

Form 19-1

Commercial Construction Contract
[Short Form—Guaranteed Maximum Price]

Basic Information

Effective Date:

Owner:

Address:

Phone:

E-mail:

Architect/Engineer (“Owner Rep”):

Address:

Phone:

E-mail:

Contractor:

Contractor’s Representative for Project:

Address:

Phone:

E-mail:

Lender:

Address:

Phone:

E-mail:

Project: [include general description of improvements to be constructed]

Project Site: [state physical address of site and attach legal description as identified in exhibit A]

Contract Price: [the sum of the costs of construction, contractor's contingency, owner's contingency, and contractor's fee as identified in exhibit C]

Guaranteed Maximum Price:

Substantial Completion Date:

Insurance and Bond Requirements: [see exhibit D]

Plans: [specifications and drawings as identified in exhibit B]

Owner and Contractor agree to the following terms and conditions.

A. Definitions

A.1. "Allowance" means a dollar amount specified to be used for portions of the Work that have not been fully defined in the Plans or where a range of options is available for Owner's selection.

A.2. "Applicable Law" means all federal, state, and local laws, rules, and regulations applicable to the Project, the Work, or the Contractor, as indicated by the context.

A.3. "Bid" means a response to a request for bids. The term includes proposals submitted in response to a request for proposals.

A.4. "Business Day" means a day other than a Saturday, Sunday, or national holiday. As used in this Contract, the term "days" means calendar days. All time periods are measured in calendar days unless business days are specified.

A.5. "Change Order" means a description of changes in the Work, and any increase or decrease in the Guaranteed Maximum Price and extension or reduction of Contract Time resulting from such changes, that has been signed by Owner and Contractor.

A.6. "Claim" means a demand or assertion by one of the parties seeking, as a matter of right, payment of money or other relief with respect to the terms of the Construction Documents, and also includes other disputes and matters in question between Owner and Contractor arising out of or relating to the Construction Documents.

A.7. "Commencement Date" means the date on which a written notice to proceed is delivered by Owner Rep to Contractor.

A.8. "Concealed Conditions" means physical conditions in existence on the Effective Date located beneath the surface of the ground, or concealed or unknown conditions in an existing structure, that are at variance with the conditions indicated in the Construction Documents or are substantially different from those conditions shown in the Construction Documents and that Contractor could not have discovered by the exercise of reasonable diligence.

A.9. "Conditions to Final Payment" means the conditions required by this Contract that must be satisfied by Contractor or waived by Owner in writing for Owner to be obligated to make the Final Payment to Contractor.

A.10. "Construction Documents" mean the documents identified in paragraph B.1.

A.11. “Contractor’s Contingency” means the amount identified in Exhibit C that is for Contractor’s exclusive use in connection with unanticipated increases to the Costs of Construction. The Contractor’s Contingency is not intended to be used to cover increases to the Costs of Construction due to changes in the Scope of Work resulting from errors in the Owner Information or changes to the Scope of Work.

A.12. “Contract Time” means the time period provided in this Contract for reaching Substantial Completion, and, if specified, the time period for achieving Final Completion.

A.13. “Cost Savings” means the amount equal to the Guaranteed Maximum Price less the total amount paid by Owner to Contractor under this Contract. It does not include savings that result from Owner’s failure to use all of the Owner’s Contingency or to fully utilize an Allowance or trade discounts, or from Owner’s decisions during construction to use less costly materials than called for in the Plans and Specifications, or to reduce the Scope of Work.

A.14. “Drawings” means the graphic and pictorial portions of the Construction Documents showing the design, location, and dimensions of the Work.

A.15. “Excused Delay” means a delay in Contractor’s performance under the terms of this Contract due to acts of God, strikes, lockouts, labor shortages, labor restrictions by any governmental authority, civil riot, floods, abnormal adverse weather conditions that exceed [number] days, unavoidable casualties, or any cause beyond the control of Contractor, a Subcontractor, or Supplier of any tier, that could not have been avoided using reasonable diligence. “Excused Delay” does not include delay resulting from negligence, default, or any condition not constituting an Excused Delay.

A.16. “Final Completion” means all the Work required by the Plans has been completed, all punch list items from the Substantial Completion review have been completed, and all Conditions to Final Payment have been satisfied.

A.17. "Governmental Approvals" means all approvals required by governmental entities with jurisdiction over the Property or Improvements for the Project to be used for its intended purpose, including, if applicable, a Certificate of Occupancy.

A.18. "Improvements" means the buildings, structures, landscaping, and other improvements to be constructed on the Property by Contractor according to the Construction Documents.

A.19. "Liquidated Damages" means an estimate of the amount of damages, as shown on Exhibit C, that Owner is likely to incur as a result of the failure of the Project to be Substantially Complete by the Substantial Completion Date due to Contractor's Unexcused Delay.

A.20. "Major Subcontractor" or "Major Sub-subcontractor" or "Major Supplier" means a Subcontractor, Sub-subcontractor, or Supplier whose contract price exceeds 10 percent of the Costs of Construction, or other amount agreed on by Owner and Contractor.

A.21. "Owner Information" means the survey of the Property or Project Site, reports from Owner's consultants, Property restrictions, and other information provided by Owner with its request for Bids for the use of bidders in preparing their Bids. The term does not include Plans and Specifications.

A.22. "Owner's Contingency" means the amount identified in Exhibit C that is for Owner's exclusive use in connection with the Project. The Owner's Contingency may be used by Owner to cover increases in the Costs of Construction resulting from errors in the Owner Information and changes in the Scope of Work.

A.23. "Plans" means the Drawings and Specifications approved by Owner and Contractor identified in Exhibit B and any amendments made after the Effective Date.

A.24. "Project Site" means the area(s) within the Property where the Improvements will be constructed.

A.25. "Property" means the real property described in Exhibit A.

A.26. "Retainage" means Owner's statutory 10 percent retainage required under Chapter 53 of the Texas Property Code.

A.27. "Scope of Work" means the Work covered by the Construction Documents.

A.28. "Specifications" means a detailed description of the building components and materials and installation requirements prepared by the Architect/Engineer for the Project.

A.29. "Subcontractor" means a person who contracts directly with Contractor to perform a portion of the Work for the Project.

A.30. "Substantial Completion" or "Substantially Complete" means that the Improvements have reached the stage at which they are usable for the purposes intended, all Governmental Approvals have been obtained, and only minor or cosmetic Work remains to be completed.

A.31. "Sub-subcontractor" means a person who contracts directly with a Subcontractor or Sub-subcontractor to perform a portion of the Work for the Project.

A.32. "Supplier" means a person who contracts with Owner, Contractor, a Subcontractor, or a Sub-subcontractor to furnish materials or equipment for the Project.

A.33. "Warranty Documents" means the written warranties on equipment, materials, labor, or the Work provided by Contractor, a Subcontractor, or a Supplier of any tier or a manufacturer.

A.34. "Work" means the labor, coordination, management, materials, equipment, and other materials and services required to construct the Project.

Terms not defined in this Contract or in the other Construction Documents have the meanings ascribed to them by common usage.

B. Construction Documents

B.1. This Commercial Construction Contract between Owner and Contractor consists of the following Construction Documents:

Drawings

Specifications

Addenda to this Contract

Change Orders

Warranty Documents

Approved Construction Schedule

This Contract and its Exhibits

Include the following if applicable.

Owner's Request for Bids/Proposals

Contractor's Bid/Proposal and Bid Qualifications and Exclusions

Continue with the following.

B.2. If there is an ambiguity or conflict, the Construction Documents are to control in the following order:

Change Orders

Addenda

This Contract

Drawings

Specifications

Schedule

Warranty Documents

Include the following if applicable.

Owner's Request for Bids/Proposals

Contractor's Bid/Proposal and Bid Qualifications and Exclusions

C. The Work

C.1. Contractor will furnish all Work necessary to construct the Project as stated in, or reasonably inferable from, the Construction Documents.

C.2. Owner Rep will reasonably interpret the Construction Documents in accordance with the intention of the parties as expressed in the Construction Documents. Owner Rep will take into consideration industry and trade custom and usage only in the case of ambiguity in or conflict between the Construction Documents. Contractor will follow Owner Rep's interpretation. Contractor may make a Claim if Contractor disputes the interpretation.

C.3. Contractor represents to Owner that it has made an inspection of the Property, the conditions existing at and in the vicinity of the Project Site, has determined normal weather conditions for the Project Site, has reviewed the Construction Documents and the

Owner Information, and agrees to construct the Project for the Contract Price and within the Contract Time. Time is of the essence of this Contract.

C.4. Before proceeding with the Work, Contractor will field check and verify all dimensions, grades, lines, levels, or other conditions or limitations at the Property to avoid construction or drainage errors.

C.5. Contractor has reported to Owner Rep all errors or omissions detected in the Plans and Owner Information before the Effective Date and will promptly report to Owner Rep any errors or omissions detected in the Owner Information after the Effective Date. Adjustments in the Contract Time and Contract Price may be made by Change Order resulting from errors or omissions that were detected and timely reported to Owner Rep.

C.6. Contractor will promptly notify Owner Rep if Contractor encounters Concealed Conditions. Contractor will provide Owner with an estimate of any additional costs and impact to the Construction Schedule resulting from the Concealed Conditions. Contractor and Owner will execute a Change Order for any agreed-on changes to the Work.

D. Contractor Obligations. Contractor agrees to perform its obligations under the Construction Documents, including the following:

D.1. Perform the Work in a good and workmanlike manner, free from defects in labor and materials, and in accordance with the Construction Documents and Applicable Law.

D.2. Provide Owner Rep with the following within ten days after the Effective Date and before the commencement of the Work:

- a. Construction Schedule as described in paragraph G.1.,
- b. Schedule of Values as described in paragraph F.5., and
- c. performance and payment bonds and insurance required under Exhibit D.

D.3. Cooperate with any contractor or supplier engaged by Owner to perform Work at the Project Site to minimize delay and disruption to the Project.

D.4. Comply with the terms of its subcontracts.

D.5. Pay Subcontractors and Suppliers within seven days after receipt from Owner of payment for their Work.

D.6. Provide and periodically update a list of Subcontractors as described in paragraph H.5.

D.7. Promptly report errors or omissions in the Plans and Owner Information to Owner Rep.

D.8. Maintain as-built drawings at the Project Site as described in paragraph J.6.c.xii.

E. Owner Obligations. Owner agrees to perform its obligations under the Construction Documents, including the following:

E.1. Provide Contractor with timely access to the Project Site.

E.2. Provide utility connections necessary for the Work to the Property line, unless utility extension is part of the Work.

E.3. Require Owner Rep to respond to submissions, including shop drawings, Draw Requests, and requests for clarification, in a timely manner so as not to cause undue delay to the Project.

E.4. Make decisions on Allowances, changes, selections, and other decisions in a timely manner so as not to cause undue delay.

E.5. Make timely payments of amounts owed to Contractor in accordance with section J.

E.6. Require third-party contractors and vendors performing Work at the Project Site to cooperate with Contractor and to be liable for damages caused to Contractor's Work.

F. Contract Price

F.1. The Contract Price is the sum of the (a) Costs of Construction, (b) Contractor's Contingency, (c) Owner's Contingency, and (d) Contractor's Fee, provided that the Contract Price shall not exceed the Guaranteed Maximum Price. The Contract Price includes the Allowances shown on Exhibit C. The Guaranteed Maximum Price may be changed only by Change Order.

F.2. The Costs of Construction include the following actual costs:

- a. Subcontracts—the price of approved subcontracts;
- b. Contractor's Labor—the cost of Contractor's direct labor for performance of the Work, whether on-site or at fabrication shops off-site assembling or manufacturing materials to be installed on the Project. The wages paid must not be materially higher than the standard paid for similar work by other contractors in the location of the Project;
- c. Contractor's Supervision—Contractor's superintendent, Project management, and administrative staff on-site devoting full time and attention to managing the Project. Off-site Project managers' costs will be paid upon written agreement with Owner based on their time devoted to the Project;
- d. Fringe Benefits—the cost of standard labor fringe benefits for Contractor's Labor and Contractor's Supervision for on-site personnel; Fringe Benefits" means costs for Contractor's Labor and Contractor's Supervision for on-site personnel in addition to wages for the employer's required contributions for employment taxes, insurance, and other employer labor cost required by

applicable labor agreement or by law. Fringe Benefits also includes employer contributions for qualified retirement plans, health insurance, and paid leave, provided such costs are standard in the industry and are based on wages or salaries included in the Costs of Construction. However, the Costs of Construction will not include employee profit sharing or bonuses (except qualified retirement plans);

- e. **Materials/Equipment**—materials and equipment installed as a part of the Project as specified in the Construction Documents, including freight for delivery to the Project, a reasonable standard allowance for waste, and sales or use taxes paid by Contractor unless Owner has furnished Contractor with a certificate of exemption from the payment of such taxes. Unreturned excess materials are owned by Owner;
- f. **Construction Equipment Costs**—cost for machinery, equipment, tools, and temporary structures and outbuildings on the Project. These costs will be at standard rental rates for the location of the Project, whether owned by or rented by Contractor;
- g. **Demolition and Site Clearing**—the cost of clearing the site and demolition and removal of existing structures and vegetation required for performance of the Work;
- h. **Site Office**—office supplies, copy charges, delivery charges, and other reasonable direct costs of maintaining a job site office;
- i. **Bonds and Insurance Premiums**—the percentage of Contractor's insurance premiums allocated to this Project for the insurance required in this Contracts and the cost of providing any required payment and performance bonds;

- j. Building Permit—fees for the building permit, licenses, and inspections by governmental authorities required for the Work;
- k. Royalties/Licenses—costs of use of designs, products, or processes required by the Construction Documents as part of the Work; and
- l. General Conditions—reasonable job site costs incurred in performing the Work, including costs such as utilities not paid by Owner, a job site trailer if needed due to the scope of construction, temporary restrooms used at the site, costs of on-site security, construction fencing, and site cleanup costs.

F.3. The following costs are excluded from the Costs of Construction:

- a. Contractor management and other employees or personnel not located full-time on the Project site, unless Owner's advance written approval is obtained;
- b. Contractor's principal office overhead;
- c. Contractor's general overhead including costs of borrowing;
- d. Costs not included in paragraph F.2.,
- e. Costs excluded under paragraph F.3.,
- f. Costs and expenses of any kind that, when added to the rest of the Costs of Construction and Contractor's Fee would be in excess of the Guaranteed Maximum Price, as adjusted by Change Order; and
- g. Costs to correct Work to bring it into conformance with the Construction Documents.

F.4. Discounts. Owner will be notified if material or equipment discounts in price are available for advance cash payments. If so notified, and if Owner advances the funds for such purchases, then Owner is entitled to the associated discount.

F.5. Schedule of Values. Contractor will prepare a Schedule of Values. The Schedule of Values must be approved in writing by Owner Rep before commencement. The Schedule of Values will apportion the Guaranteed Maximum Price between each constituent element of the Work.

F.6. Entitlement to Savings. Upon Final Payment by Owner to Contractor and provided Contractor is not in default of this Contract, Owner shall pay Contractor the percentage of Cost Savings, if any, shown on Exhibit C, provided that Owner retains the right to withhold payment for any outstanding Claims related to the Project in an amount reasonably determined by Owner to protect Owner from liability.

F.7. Allowances. Contractor shall include in the Contract Price the Allowances shown in Exhibit C. Items covered by Allowances shall be supplied for such amounts and by such persons or entities as Owner may direct, but Contractor is not required to employ persons or entities to whom Contractor has reasonable objection. Unless otherwise provided in the Construction Documents—

- a. allowances shall cover the cost to Contractor of materials and equipment delivered at the site and all required taxes, less applicable trade discounts;
- b. Contractor's costs for unloading and handling at the site, labor, installation costs, overhead, profit, and other expenses contemplated for stated Allowances amounts shall be included in the Costs of Construction but not in the Allowances;

- c. whenever costs are more than or less than Allowances, the Guaranteed Maximum Price shall be modified by Change Order. The amount of the Change Order shall reflect the difference between actual costs and the Allowances; and
- d. Owner shall select materials and equipment under an Allowance with reasonable promptness.

G. Contract Time

G.1. Contractor will promptly prepare and submit to Owner Rep for approval a Construction Schedule, using the critical path method, detailing how Substantial Completion will be achieved by the Substantial Completion Date. Contractor will periodically revise and resubmit the Construction Schedule to Owner Rep upon change orders, Excused Delays, or other events that cause the critical path or the Substantial Completion Date to change.

G.2. If the Work is damaged or destroyed before its final completion, Contractor will bear the risk of loss and will diligently proceed with restoration or replacement and completion of the Work.

G.3. If there is a delay in the Work that is not an Excused Delay, and in the determination of Owner Rep the Work will not reach Substantial Completion by the Substantial Completion Date, Owner Rep may direct Contractor to accelerate the Work at no cost to Owner by means of overtime, additional crews, additional shifts, or resequencing of the Work so as to achieve Substantial Completion by the Substantial Completion Date.

G.4. Owner may, with or without cause, by written directive, require Contractor to suspend or delay commencement of the Work in whole or in part for a length of time as desired by Owner. The Guaranteed Maximum Price and Contract Time are to be equitably adjusted for increases in the Costs of Construction and for the time caused by such delay or

suspension under this paragraph. However, no such equitable adjustment shall be made if Owner has the right to order delay or suspension of the Work under another provision of the Construction Documents or if an Unexcused Delay by Contractor would have caused such suspension or delay.

H. Subcontracts

H.1. Contractor may subcontract all or any part of the Work.

H.2. Subcontracts with Subcontractors and Suppliers must—

- a. be in writing;
- b. require the Subcontractor to assume toward Contractor all of the obligations and responsibilities that Contractor owes to Owner under the Construction Documents;
- c. be consistent with the terms of this Contract;
- d. require compliance with the terms of this Contract applicable to Subcontractors, including requirements for insurance and lien waivers;
- e. require that the Subcontractor provide a copy of the subcontract to Owner if Contractor's right to perform under this Contract has been terminated;
- f. be assignable to Owner or to Contractor's surety for the Project on the same terms; and
- g. prohibit assignment of the Subcontractor's obligations.

H.3. Contractor will provide each Subcontractor with a copy of the Construction Documents, or a copy of the portions to which Subcontractor will be bound, before entering into subcontracts.

H.4. Owner may require Contractor to provide Bids from Major Subcontractors, Major Sub-subcontractors, and Major Suppliers. Owner, Owner Rep, and Contractor will review the Bids and agree on selection. Contractor will not use a subcontractor or supplier to whom Owner has a reasonable objection. Contractor will not be required to enter into a subcontract or other agreement if Contractor reasonably objects to use of such subcontractor or supplier. If Owner requires Contractor to use a specific subcontractor or supplier instead of the subcontractor or supplier recommended by Contractor who has submitted a lower Bid, then the Guaranteed Maximum Price will be increased by the additional amount of the Bid from Owner's required subcontractor or supplier.

H.5. Contractor will provide Owner Rep with a written list of all its Subcontractors and Suppliers, and the Major Sub-subcontractors and Major Suppliers of any tier, with the address and telephone number of each. An updated list will be provided to Owner Rep within fifteen days after any change. A final list will be provided to Owner Rep on or before the date of Final Completion of the Project.

H.6. Contractor will not use any Subcontractor to whom Owner or Owner Rep has a reasonable objection. If the replacement of the Subcontractor due to Owner's objection results in an increase in cost over the Contractor's anticipated total Costs of Construction, then reasonable adjustment to the Guaranteed Maximum Price will be made by Change Order.

H.7. Owner has the right to contact any Subcontractor or Sub-subcontractor to obtain information on payments made by Contractor under the subcontract and to obtain lien waivers and bills-paid affidavits.

I. Contingent Assignment of Subcontracts

I.1. Each subcontract agreement is assigned by Contractor to Owner and the surety under a performance bond provided by Contractor, contingent on the occurrence of all of the following:

- a. Contractor is in default under the Construction Documents;
- b. Owner has terminated Contractor under this Contract pursuant to paragraph N.3. or Section O., and
- c. Owner has notified Contractor and the Subcontractor in writing that it assumes the subcontract or that it has made demand on the surety and the surety has so notified the Subcontractor.

I.2. Owner and the surety have the right to contact any Subcontractor or Supplier to obtain a copy of the subcontract, to determine if Contractor is in default under the Subcontract, and to confirm or negotiate the terms for assumption.

I.3. Upon assumption by Owner—

- a. if the Work has been suspended for more than thirty days, the Subcontract price will be equitably adjusted for increases in cost caused by the suspension. Contractor will be liable for the additional Costs of Construction;
- b. Owner may assign a subcontract that it has assumed to a replacement contractor but will remain liable for the obligations under the subcontract; and
- c. Contractor will remain liable to Owner and the Subcontractor or Supplier for any unpaid amounts due to the Subcontractor or Supplier, and for any increases in the Costs of Construction described in paragraph F.2., even if the increase does not result in the total Contract Price exceeding the Guaranteed Maximum Price.

J. Payment

J.1. The Contract Price is payable through Progress Draws and Final Payment as described in this section. Owner will have the right to withhold Retainage from each Progress Draw. Retainage due to Contractor will be included in the Final Payment.

J.2. Progress Payments. On or before the twenty-fifth day of each month after the commencement of Construction (the "Draw Date"), Contractor will assemble and present to Owner Rep a Draw Request for payment for conforming Work performed since the previous Draw Date. The amount of each Draw will be computed as follows, in the following order of operations:

- a. for each item in the Schedule of Values ("Scheduled Value Item") the Contractor will assign a percentage for the conforming Work accomplished through the Draw Date;
- b. multiply each item on the Schedule of Values by its assigned percentage of completion ("Draw Individual Scheduled Value Amount");
- c. determine the Costs of Construction for the Draw period and separate such Costs of Construction by Scheduled Value Item and calculate the subtotal of the Costs of Construction for each Scheduled Value Item;
- d. compare each Draw Individual Scheduled Value Amount with the assembled Costs of Construction for each item in the Schedule of Values and include the lesser of the two figures in the amount of the Draw Request;
- e. the total Draw will be the sum of the lesser of the two figures for each Scheduled Value;

- f. calculate Contractor's Fee earned through the Draw Date by multiplying the Contractor's Fee percentage by the total calculated in subparagraph e., above;
- g. deduct Retainage from the sum of subparagraphs e. and f., above;
- h. deduct payments previously made to Contractor;
- i. deduct amounts paid by Owner to Contractor's suppliers or subcontractors;
and
- j. deduct amounts that Owner Rep has determined to withhold as provided in paragraph J.10.

J.3. Each Progress Draw Request must include the following supporting documents:

- a. The receipts, invoices, delivery tickets, subcontractor draws, and other documentation reasonably required by Owner Rep substantiating the Costs of Construction for the Draw Period for which payment is sought.
- b. Bills Paid Affidavit by Contractor in the form attached as Exhibit E.
- c. Bills Paid Affidavit by each Subcontractor in the form attached as Exhibit F.
- d. Contractor's Conditional Partial Release in the form attached as Exhibit G.
- e. Contractor's Unconditional Partial Release in the form attached as Exhibit H.
- f. Subcontractor's Conditional Partial Release from each Subcontractor to be paid from the Draw in the form attached as Exhibit G;
- g. Subcontractor's Unconditional Partial Release from each Subcontractor for which Contractor received payment as a part of the prior month's Progress Draw in the form attached as Exhibit H.

J.4. Owner Rep will review the Draw Request and advise Owner whether to pay it in full or in part. Contractor will promptly provide any additional documentation reasonably requested and answer any questions on the Draw Request. Owner Rep will promptly notify Contractor of any disputed items in the Draw Request. Owner will have thirty days after the later of (a) the Draw Date or (b) the date that Owner Rep received the Draw Request and required documentation, to pay undisputed items. Undisputed items not paid when due will bear interest until paid at the rate specified in the Texas Prompt Payment Act, Texas Property Code Chapter 28.

J.5. Either party may make a Claim in connection with a payment dispute.

J.6. Final payment will be made according to the following job inspection and closeout process, and is subject to the conditions precedent to final payment, as follows:

- a. When Contractor determines that the Work has progressed to the point of reaching Substantial Completion, Contractor will give written notice to Owner Rep, and Owner Rep will promptly inspect the Work. If Owner Rep determines that the Work is Substantially Complete, Owner Rep will issue a certificate of substantial completion and prepare a punch list for Work that needs to be completed along with an agreed-on time for completion. If Owner Rep determines that the Work is not acceptable or is not Substantially Complete, Owner Rep will prepare a written list of Work that needs to be remedied or completed in order to achieve Substantial Completion. Contractor shall perform the Work to achieve Final Completion of the Work, including completion of all punch list items, within thirty days after receipt of Owner Rep's list or within an agreed-on time period for completion. Owner Rep will determine the dates for Substantial and Final Completion.

- b. Upon Owner Rep's written acknowledgement that the punch list has been completed, Contractor will submit a Final Draw Request. The amount of the final draw ("Final Payment") will be the balance of the Contract Price, after deducting amounts paid by Owner to Suppliers, Subcontractors, and Sub-subcontractors, amounts for unreleased mechanic's liens, amounts withheld by Owner pursuant to paragraph J.10., and previous payments to Contractor.
- c. The following are Conditions Precedent to Final Payment:
- i. receipt and approval by Owner, upon recommendation of Owner Rep, of a Final Draw Request;
 - ii. receipt by Owner Rep of Contractor's final and accurate list of Subcontractors and Suppliers in compliance with paragraph H.5.,
 - iii. executed and acknowledged Conditional Final Releases from Contractor and all Subcontractors, in the form attached as Exhibit I. The amounts contained in these Releases must match amounts stated as owed in the Final Bills Paid Affidavits;
 - iv. executed and acknowledged Final Bills Paid Affidavits from Contractor, Subcontractors, and Suppliers, in the forms attached as Exhibits J and K;
 - v. Unconditional Partial Releases (Exhibit H) and Unconditional Final Releases (Exhibit L) from Subcontractors who have been previously paid;
 - vi. Unconditional Partial Releases (Exhibit H) and Unconditional Final Releases (Exhibit L) from Suppliers and Sub-subcontractors of all tiers who have been previously paid;

- vii. Conditional Final Releases from all Subcontractors, Sub-subcontractors, and Suppliers of all tiers who have not been previously paid, in the form attached as Exhibit I;
- viii. receipt by Owner Rep of executed, acknowledged releases of all filed mechanic's liens against the Project, or Contractor will provide satisfactory evidence that Contractor has bonded around such lien claims pursuant to Chapter 53 of the Texas Property Code;
- ix. if a Subcontractor or Supplier of any tier refuses to provide a Conditional or Unconditional Release for the applicable amount stated in the Bills Paid Affidavits, or if there is otherwise a dispute about payment, satisfactory evidence that Contractor has bonded around such lien claims pursuant to Chapter 53 of the Texas Property Code or has provided other arrangements accepted by Owner in writing as sufficient to secure indemnity from such lien or claim;
- x. Conditional Final Releases from each Subcontractor, Sub-subcontractor, or Supplier from whom Owner has received a notification of nonpayment or the right to assert a claim, unless Contractor has provided Owner with satisfactory evidence that Contractor has bonded around such a lien claim pursuant to Chapter 53 of the Texas Property Code or has provided other arrangements accepted by Owner in writing as sufficient to secure indemnity from such lien or claim;
- xi. Contractor has assigned and delivered to Owner all required warranty documents required that have been assigned to Owner;
- xii. as-built drawings have been delivered to Owner Rep; and

- xiii. all Owner Manuals and keys have been delivered to Owner Rep, and Project control/security and other systems checkout and training contemplated by the Construction Documents has been performed.

J.7. The Final Payment, including release of all Retainage payable to Contractor, is due within fifty days after the Conditions Precedent to Final Payment have been satisfied or waived by Owner in writing.

J.8. Owner will file in the real property records of each county in which the Project is located and provide notice to Contractor of its Affidavit of Final Completion within three Business Days after both of the following have occurred: (a) the Conditions Precedent to Final Payment have been met, and (b) Owner Rep has received Contractor's Final Draw Request.

J.9. Any notice of lien claims or lien affidavits filed after notice and recordation of the Owner Affidavit will be resolved by Contractor and Owner Rep in accordance with one of the methods described in paragraph J.6.c.viii., ix., or x. above, at Owner's sole discretion.

J.10. Withholding Payment. Owner has the right to withhold from payments otherwise due to Contractor amounts deemed reasonably necessary, on advice from Owner Rep, to protect Owner from damage or liability due to—

- a. uncorrected defective work;
- b. reasonable evidence that the Contract Price will exceed the Guaranteed Maximum Price prior to Final Completion;
- c. claims of injury or property damage to Owner, a third party, or another contractor;
- d. reasonable evidence that Substantial Completion will not be reached according to the Construction Schedule, as revised;

- e. repeated failure by Contractor to perform the Work according to the Construction Documents; or
- f. mechanic's liens filed or noticed on the Project not removed by Contractor's furnishing a bond acceptable to Owner pursuant to Chapter 53 of the Texas Property Code or Contractor has provided other arrangements accepted by Owner in writing as sufficient to secure indemnity from such lien or claim.

When the basis for withholding has been resolved, Owner will promptly pay to Contractor any amounts not needed to protect Owner from damage or liability.

J.11. Owner Payment to Subcontractors. Owner will promptly notify Contractor if Owner receives a notice of nonpayment from a Subcontractor or Supplier of any tier. If Contractor does not provide Owner Rep with an Unconditional Release for the amount owed, or satisfactory evidence that Contractor has bonded around the claim within fifteen days after notification, then Owner may make payment by joint check to Contractor and the claimant, unless a payment bond has been provided for the Project.

J.12. Final Payment will be deemed accepted by Contractor when the check has been deposited or wire transfer received. Acceptance of Final Payment by Contractor constitutes a waiver of all claims by Contractor not previously received in writing by Owner Rep.

K. Change Orders and Required Changes

K.1. Owner, without invalidating the Contract, may order changes in the Work. All changes will be made by written Change Order, signed by Owner and Contractor, that states the adjustment in the Guaranteed Maximum Price and the Contract Time.

K.2. If Owner and Contractor cannot agree on the adjustment to the Guaranteed Maximum Price, then Owner may require Contractor to proceed with the Work by written

Required Change signed by Owner. The Guaranteed Maximum Price will be adjusted on a time and materials basis.

L. Claims

L.1. Contractor's Claims for extensions of time or changes to the Guaranteed Maximum Price must be submitted to Owner Rep in writing within seven days after the date when the events giving rise to the Claim occurred. Within fourteen days after the submission of such Claim, Contractor will furnish Owner Rep with Contractor's calculations of additional time needed to complete the Work, and, if applicable, the anticipated increase to the Costs of Construction and documentation supporting Contractor's Claim. Contractor will furnish additional information in support of such Claim(s) as reasonably required by Owner or Owner Rep. Contractor will proceed with the Work during the pendency of any such Claims.

L.2. Notwithstanding anything to the contrary in the Construction Documents, Contractor agrees that it will not attempt in any way to recover or pursue a Claim for delay if Contractor or a Subcontractor, Sub-subcontractor, or Supplier to Contractor has, before the claimed Delay, materially breached any contractual duty or obligation in the Construction Documents, or any duty or obligation at common law or created by statute, to the extent such breach causes, affects, or otherwise contributes to such delay, and such breach remains uncured at the time a Claim accrues.

L.3. Owner agrees to notify Contractor of any Claim, including Claims for Unexcused Delay and defects in the Work, within five Business Days after Owner becomes aware of the basis for the Claim.

L.4. Initial Decision Maker Process. All Claims arising under this Contract will be first submitted to Owner Rep as the Initial Decision Maker. Owner Rep's decision is a condition precedent to proceeding with mediation, as provided for in paragraph L.5. Owner Rep will issue a decision within thirty days after receiving the Claim and supporting documenta-

tion. Owner Rep may extend the initial decision deadline for up to an additional thirty days in order to receive supporting documentation and data and replies from the opposing party. If Owner Rep is unable to render a decision within the allotted time period, or if either party is dissatisfied with the decision, then either party may request mediation.

L.5. Mediation. If the dispute is not resolved by the decision of the Initial Decision Maker, then either party may request mediation of the dispute using a neutral mediator to be agreed on by the parties. Contractor will continue to perform the Work during the pendency of mediation.

L.6. Litigation. If a resolution is not reached through mediation, either party may pursue litigation.

M. Material Breach

M.1. Owner's Default. Each of the following constitutes a material breach of this Contract by Owner:

- a. failure to timely render or otherwise furnish responses, decisions, or selections according to the Construction Documents;
- b. failure to comply with Owner's payment obligations under the Construction Documents; or
- c. substantial breach of any of Owner's obligations under this Contract.

M.2. Contractor's Default. Each of the following constitutes a material breach of this Contract by Contractor:

- a. failure by Contractor to commence the Work in accordance with the provisions of this Contract;

- b. failure by Contractor to prosecute the Work to completion in a diligent, efficient, timely, workmanlike, skillful, and careful manner and in strict accordance with the provisions of the Contract;
- c. failure by Contractor to use an adequate number of qualified personnel or adequate amount of equipment to complete the Work without causing Unexcused Delay;
- d. Contractor's persistent failure to perform any of its material obligations under the Contract;
- e. Contractor's persistent failure to make prompt payments when due to its Subcontractors and Suppliers, unless Contractor has a bona fide dispute with any such Subcontractor or Supplier;
- f. Contractor creates any situation or state of facts that would authorize or permit an involuntary petition in bankruptcy to be filed against Contractor; or
- g. Contractor has not met, or in Owner Rep's and Owner's reasonable opinion, based on the schedules required by the Construction Documents, will not meet the dates of Substantial Completion set forth in the Construction Documents.

N. Remedies

N.1. Owner Remedies.

- a. *Owner's Right to Suspend Work.* If Contractor fails, after notice to correct Work that is defective or not in conformance with the requirements of the Construction Documents, or repeatedly fails to perform the Work in accordance with the Construction Documents, Owner or Owner Rep may issue a

written notice to Contractor to suspend the Work, in whole or part, until Contractor cures the reasons for issuance of the suspension notice. Owner's right in this section does not create a duty by Owner to suspend work for the benefit of Contractor or Subcontractors of any tier.

- b. *Owner Cure.* If Contractor is in default and does not within ten Business Days after receipt of Owner's or Owner Rep's written notice to commence and continue diligent, continuous effort to correct the default, then Owner may cure such default and withhold payment from Contractor for the reasonable cost and expenses incurred for Owner's cure. If insufficient amounts remain to be paid to Contractor, Contractor must pay Owner the reasonable costs and expenses to cure in excess of the remaining funds to be paid to Contractor.

N.2. Contractor Remedies. Contractor will give written notice to Owner or Owner Rep if Owner is in material breach of Owner obligations under the Construction Documents. The notice will state the specific items of Owner default and notify Owner that Owner must cure the items within ten Business Days of receipt of the notice or Contractor may suspend Work until Owner's material breach is cured or corrected. Contractor may terminate the Contract in accordance with paragraph N.3. if suspension of the Work by Contractor under this section continues without Owner cure for thirty or more days.

N.3. Termination. If one party defaults and the default is not cured by exercise of the remedies specified in paragraphs N.1. or N.2., then upon an additional ten Business Days' prior written notice specifically describing the default, and provided the defaulting party has not commenced diligent, good-faith, continuous, and effective action to cure the default within the ten-day period, then this Contract may be terminated by an additional written notice from the nondefaulting party to the defaulting party. If there is such a termination, the follow-

ing formula is agreed on as a reasonable and fair way to assess the actual damages, without the expense and delay associated with other forms of dispute resolution:

- a. *Damages to Contractor.* If termination resulted from an act of default of Owner, Owner will pay to Contractor, within thirty days after written notice from Contractor, an amount equal to all amounts due and owing for the Work performed in accordance with the Construction Documents at the time of the termination, plus 10 percent of the remaining Guaranteed Maximum Price to compensate Contractor for the lost profit.
- b. *Damages to Owner.* If termination resulted from an act of default of Contractor, Owner may—
 - i. use all materials, equipment, tools, and construction equipment owned by Contractor and occupy the Project site;
 - ii. accept assignment of Subcontracts and assume, in Owner's sole discretion, any agreements with Suppliers and Sub-subcontractors;
 - iii. finish the Work as expeditiously as reasonably possible provided the costs for completion and correction of the Work are reasonable and necessary. If requested, Owner will furnish Contractor a statement of costs in correcting and completing the Work, along with reasonable documentation of such costs. If Owner terminates according to this paragraph, no further payments will be due Contractor until final completion is reached. If, at that time, Owner's costs to complete and correct the Work exceed the unpaid balance of the Guaranteed Maximum Price, Contractor will pay the difference to Owner upon written demand; and

iv. assess liquidated damages if Substantial Completion has not been achieved as provided in Exhibit C.

c. *Recourse to Performance Bond.* Upon the occurrence of a Contractor default, Owner may make demand on the surety to perform its obligations under a Performance Bond provided for the Project.

N.4. Damages for Contractor's Unexcused Delay. If the Work is not Substantially Complete by the Substantial Completion Date due to Contractor's Unexcused Delay, Owner may assess liquidated damages as provided in Exhibit C.

N.5. Excused Delay. If it is determined that Contractor has been delayed by an Excused Delay, then the time to complete the Work will be extended by one day for each day of an Excused Delay. This extension of the Contract Time will be Contractor's sole remedy for an Excused Delay and no monetary damage or other compensation is due Contractor for such delay.

N.6. Damages for Owner's Delay. If it is determined that Contractor has been delayed by an Excused Delay, then the time to complete the Work will be extended by one day for each day of an Excused Delay. This extension of the Contract Time will be Contractor's sole remedy for an Excused Delay, unless the delay is due to acts of Owner constituting unreasonable interference with Contractor's ability to perform the Work that continues after notice of the interference is given by Contractor. The exercise by Owner of any right provided by this Contract, including suspension of Work, does not constitute unreasonable interference with Contractor's ability to perform the Work. Contractor will be entitled to the General Conditions and other direct Costs of Construction described in paragraph F.2. for each day of delay due to Owner's interference.

N.7. Waiver of Consequential Damages. Except as provided in this section N., Owner and Contractor each waive the right to recover consequential damages in a suit or

action brought against the other arising out of a default under the Construction Documents, regardless of whether the claim for recovery is based in contract or tort.

O. Owner's Right to Terminate for Convenience. Owner has the right to terminate this Contract for Owner's convenience by giving Contractor thirty days' prior written notice of termination. Upon such termination, Contractor will be entitled to payment as described in paragraph N.3.a.

P. Warranties. Contractor warrants to Owner that labor, materials, and equipment furnished under the Contract will be new and of high quality and will be free from defects, good and workmanlike, and that the Work will conform to the Construction Documents for a period of one year after the date of Substantial Completion. Work will be considered defective if it does not conform to the Construction Documents. Contractor additionally expressly warrants all structural components of the Project, including the foundation, for ten years following Substantial Completion. Contractor will repair or replace any defective Work at no charge if Owner provides written notice to Contractor of a warranty claim during the one-year warranty period. Contractor hereby assigns all equipment, roofing, and other vendor warranties to Owner and will deliver all manuals, books, and instructions and warranty policy documentation to Owner as part of the Conditions to Final Payment. The warranties set forth in this are cumulative of, and in addition to, any and all other warranties or remedies available at law or by this Contract, and can be assigned by Owner.

Q. Safety

Q.1. Owner will not have control over or charge of and will not be responsible for construction means, methods, techniques, sequences, or procedures used or for safety precautions and programs in connection with the Work, since these are solely Contractor's responsibility.

Q.2. Contractor shall give notices and comply with applicable laws, ordinances, rules, regulations, and lawful orders of public authorities bearing on safety of persons and property and their protection from damage, injury, or loss. Contractor shall promptly remedy damage and loss to property at the site, or off-site, if caused in whole or in part by Contractor, a Subcontractor, or anyone directly or indirectly employed by any of them or by anyone for whose acts they may be liable and for which Contractor is responsible.

Q.3. *Reasonable Precautions and Reasonable Protection.* As between Contractor and Owner, Contractor shall be responsible for all safety at the Project Site, including safety of personnel, material, and the Work. Contractor shall be responsible for providing any security necessary to prevent damage or loss to materials, equipment, the Improvements, and other property in the vicinity of the Project until Final Completion.

R. Indemnity

R.1. TO THE FULLEST EXTENT PERMITTED BY APPLICABLE LAW, CONTRACTOR SHALL INDEMNIFY, DEFEND, AND HOLD HARMLESS LENDER, OWNER, OWNER'S MEMBERS, MANAGERS, PARTNERS, AFFILIATED COMPANIES OF OWNER, AND ANY PARTNER, AND THEIR RESPECTIVE OFFICERS, DIRECTORS, SHAREHOLDERS, EMPLOYEES, AND AGENTS (COLLECTIVELY, THE "INDEMNITEES") FROM ALL CLAIMS, SUITS, ACTIONS, PROCEEDINGS, DAMAGES, LOSSES, AND EXPENSES WHATSOEVER, INCLUDING ATTORNEY'S FEES, CONNECTED WITH PERFORMANCE OF THIS CONTRACT OR THE CONSTRUCTION CONTEMPLATED BY THIS CONTRACT TO THE EXTENT CAUSED BY THE BREACH OF CONTRACT, NEGLIGENCE, OR OTHER ACT OR OMISSION OF CONTRACTOR, ITS SUBCONTRACTORS, SUB-SUBCONTRACTORS OF ANY TIER, OR ANYONE DIRECTLY OR INDIRECTLY EMPLOYED BY THEM OR ANYONE FOR WHOSE ACTS THEY MAY BE LIABLE.

Include the following employee claim indemnity paragraph if applicable.

R.2. IN ADDITION, REGARDING CLAIMS FOR THE BODILY INJURY OR DEATH OF AN EMPLOYEE OF CONTRACTOR, ITS AGENT(S), OR ITS SUBCONTRACTORS OF ANY TIER (HEREINAFTER REFERRED TO AS "EMPLOYEE CLAIM" OR "EMPLOYEE CLAIMS"), CONTRACTOR WILL INDEMNIFY, DEFEND, AND HOLD HARMLESS INDEMNITEES FROM ALL SUCH EMPLOYEE CLAIMS, SUITS, ACTIONS, PROCEEDINGS, DAMAGES, LOSSES, AND EXPENSES WHATSOEVER CONNECTED WITH PERFORMANCE OF THIS CONTRACT, INCLUDING SUCH EMPLOYEE CLAIMS, DAMAGES, LOSSES, OR EXPENSES ACTUALLY OR ALLEGEDLY ARISING IN WHOLE OR IN PART FROM THE NEGLIGENCE OF INDEMNITEES. IT IS THE EXPRESSED INTENT OF CONTRACTOR AND OWNER THAT IN THE CASE OF AN EMPLOYEE CLAIM, THE INDEMNITY PROVIDED FOR IN THIS SECTION IS AN INDEMNITY EXTENDED BY CONTRACTOR TO INDEMNIFY AND PROTECT INDEMNITEES FROM THE CONSEQUENCES OF INDEMNITEES' OWN NEGLIGENCE WHETHER OR NOT THAT NEGLIGENCE IS THE SOLE OR CONTRIBUTING CAUSE OF THE RESULTANT EMPLOYEE CLAIMS. CONTRACTOR FURTHER AGREES IN THIS CONNECTION TO DEFEND AT ITS OWN EXPENSE INDEMNITEES FROM ANY CLAIMS OR LITIGATION IN CONNECTION WITH ANY SUCH EMPLOYEE CLAIMS.

Continue with the following.

[R.2./R.3.] In claims against any person or entity indemnified under this section by an employee of Contractor, a Subcontractor, or anyone directly or indirectly employed by them or anyone for whose acts they may be liable, the indemnification obligation under this agreement shall not be limited by a limitation on amount or type of damages, compensation, or benefits payable by or for Contractor or a Subcontractor under worker's compensation acts, disability benefit acts, or other employee benefit acts.

S. Miscellaneous

S.1. Effect of Invalid Provision. Should any clause in this Contract be found invalid by a court of law, the remainder of the Contract shall not be affected thereby, and all other provisions of this Contract shall remain valid and enforceable.

S.2. Entire Agreement; Modification. The Construction Documents contain the entire agreement between the parties for the construction of the Project and cannot be modified except by written Change Order or modification.

S.3. Nonassignment. This Contract shall not be assigned by Contractor without the written consent of Owner. This limitation shall not apply to Contractor's right to retain Subcontractors for the prosecution of portions of the Work in the normal course of its construction business.

S.4. Execution of Other Documents; Further Action. Each party shall, on demand, execute or obtain such other documents or instruments and corrective filings or instruments and use all commercially reasonable efforts to do or cause such other things as may be reasonably necessary or desirable to effect the provisions and purposes of this Contract.

S.5. Fees and Expenses of Actions. If any litigation (an "Action") is commenced, including an Action for declaratory relief, to enforce or interpret the terms of this Contract, or any document or instrument executed in connection with or pursuant to this Contract, or involving any controversy or Claim between or among the parties to this Contract, whether sounding in contract, tort, or statute, whether through arbitration, probate, bankruptcy, receivership, or other judicial or administrative proceeding, the prevailing party in such Action (the "Prevailing Party") shall be entitled to recover reasonable attorney's fees, paralegal costs, expert witness and consulting expert fees and costs, and other expenses, costs, and necessary disbursements incurred by the Prevailing Party in the investigation, preparation, pursuit, or defense of any claim asserted by any party in such Action in addition to any other relief to

which the Prevailing Party may be otherwise entitled, at law or hereunder, in the amount determined by the fact finder(s) or the court.

S.6. Gender and Number. Unless otherwise required by context, the genders shall include each other and the singular shall include the plural and the plural the singular.

S.7. Headings. Headings, tables of contents, captions, titles, and marginal notations are for convenience only and shall not limit or restrict the interpretation or construction of the passage(s) to which such headings, tables of contents, captions, titles, and notations may relate.

S.8. Notices. Any notice to be given or to be served on any party hereto, in connection with this instrument, must be in writing and may be given in person or by courier, overnight delivery service, e-mail, or certified or registered mail. Such notice shall be deemed to have been given and received when actually received, in the case of hand delivery, overnight delivery service, or Express Mail; when a certified or registered letter containing such notice, properly addressed, with postage prepaid, is deposited in the United States mail; and, if given by e-mail, it shall be deemed to have been given when received by the party to whom it is addressed. Notice shall be given to Owner, Owner Rep, and Contractor at the addresses set forth at the beginning of this Agreement. Any party hereto may at any time by giving five days' written notice to the other party hereto designate any other address, phone number, or e-mail address in substitution of the following address, phone number, and e-mail address to which such notice shall be given. Owner Rep must be copied on any notice given to Owner.

S.9. Schedules, Addenda, Exhibits, and Attachments. All schedules, addenda, exhibits, and attachments and other documents or items identified as being attached hereto (the "Exhibits") shall be a part of this Contract for all purposes. Exhibits may be changed from time to time as the parties may agree. When Exhibits are changed, they shall be redrafted in accordance with agreed changes, dated as of the effective date of such changes, and signed by

the parties. Copies of changed Exhibits shall be furnished to each party, and such changed Exhibits shall become a part of this Contract for all purposes. An Exhibit that has been changed shall cease to be a part of this Contract, and the most recently dated Exhibit, signed by all parties, shall govern.

S.10. Third-Party Beneficiaries; None Created. Nothing express or implied in this Contract is intended to confer, nor shall anything herein confer, on any person other than the parties hereto and the respective successors or assigns of the parties hereto, any rights, remedies, obligations, or liabilities whatsoever.

S.11. Waiver. No waiver of any term of this Contract shall be valid unless it is in writing and signed by both parties. The failure of any party at any time or times to require performance of any provision hereof shall in no manner affect the right to enforce the provision. No waiver by any party of any condition contained in this Contract, or of the breach of any term, provision, representation, warranty, or covenant contained in this Contract, in any one or more instances, shall be deemed to be or construed as a further or continuing waiver of any such condition or breach or as a waiver of any other condition or of the breach of any other term, provision, representation, warranty, or covenant.

S.12. Lender Cooperation. Contractor agrees to cooperate, and cause its Subcontractors to cooperate, with the reasonable requirements of any Lender that Owner may elect to obtain financing from, including the requirement that Contractor subordinate, and cause its Subcontractors to subordinate, any lien they may have by statute against the Property to the lien of the Lender.

S.13. Independent Contractor. Contractor occupies the status of an independent contractor, as that term is defined in the construction industry.

[Name of owner]

[Name of contractor]

Exhibit A

Project Site Legal Description

Attach project site legal description.

Exhibit B

Plans and Specifications

1. Specifications:

List the specifications or refer to an exhibit attached to this contract.

Section	Title	Date	Pages
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2. Drawings:

List the drawings or refer to an exhibit attached to this contract.

Number	Title	Date
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3. Addenda including Supplemental Conditions, if any:

Number	Date	Pages
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Addenda relating to bidding/proposal requirements are not part of the Contract Documents unless the bidding/proposal documents are also listed as Construction Documents in paragraph B.1. of this Contract.

Exhibit C

**Contract Price; Guaranteed Maximum Price;
Allocation of Savings; Liquidated Damages**

The Contract Price for the Project is the sum of the following amounts:

Costs of Construction, including—

Allowance for [specify]	\$[amount]
Allowance for [specify]	\$[amount]
Contractor's Contingency:	\$[amount]
Owner's Contingency:	\$[amount]
Contractor's Fee:	\$[amount]
Total Contract Price:	\$[amount]

Total Contract Price not to exceed \$[amount], the Guaranteed Maximum Price

Cost Savings (as defined in section A) shall be allocated between Owner and Contractor as follows:

Owner: [percent]%

Contractor: [percent]%

Check if applicable:

Liquidated Damages

Owner has the right to assess Liquidated Damages in the amount of \$[amount] per day for each day after the Substantial Completion Date that Substantial Completion has not been achieved due to Contractor's Unexcused Delay. Owner has the right to withhold Liquidated Damages from the amounts due to Contractor. Owner and Contractor stipulate that the damages for the prospective breach of the Contract are difficult to measure and the Liquidated Damages amount is a reasonable estimate of actual damages.

Exhibit D

Insurance and Bond Requirements

Exhibit - Bond and Insurance Requirements

This Exhibit (the "Insurance Specifications") is attached as an Exhibit as part of the Agreement. In the event of conflict between any of the following Insurance Specifications with any provision in the Agreement, these Insurance Specifications control, amend and supplement the conflicting provision.

A. Specifications, Coverages, Limits & Other Requirements

No.	Specifications	Coverages, Limits and Other Requirements
A. LIABILITY INSURANCE		
§ 1.	Commercial General Liability.	To the extent permitted by law, Contractor is to maintain commercial general liability ("CGL") insurance and, if necessary, commercial umbrella/excess insurance (see Spec. 4 below), issued on an occurrence basis meeting at least the following specifications.
§ 1.1	Minimum Limits	The limits of coverage shall not be less than the following amounts:
		a. \$ __,000,000 Per Occurrence
		b. \$ __,000,000 General Aggregate
		c. \$ __,000,000 Products and Completed Operations Aggregate
		d. \$ __,000,000 Personal and Advertising Injury
§ 1.2	General Aggregate	The General Aggregate shall apply separately to this Project.
§ 1.3	Post-Completion Coverage	Contractor agrees to maintain Products-Completed Operations coverage with respect to the Work performed under the Agreement in identical coverage, form and amount, including required endorsements, for the full term of the Statute of Repose following Date of Substantial Completion of the Work. Contractor shall provide written representation to Owner stating Work completion date.
§ 1.4	Form	This insurance is to be issued on an ISO CG 00 01 and shall coverage liability arising from premises, ongoing and completed operations, hire of Subcontractors (independent contractors coverage), and incidental design liability arising from the contractor's construction means and methods.
§ 1.5	Insured Contracts	Coverage shall include but not be limited to liability assumed by Contractor under the Agreement to which this Exhibit is attached, including the tort liability of another assumed in a business contract, and shall include unmodified Separation of Insureds coverage.
§ 1.6	Additional Insureds	Additional insured status shall be provided in favor of Owner Parties and such other personas as are designed by Owner to Contractor to be additional insureds on a combination of ISO forms CG 20 10 10 01 and CG 20 37 10 01.
§ 1.7	Primary and Noncontributory	This insurance shall be endorsed to provide primary and noncontributing liability coverage by ISO CG 20 01 04 13. It is the specific intent of the parties to the Agreement that all insurance required herein shall be primary to and shall seek no contribution from all insurance held by Owner Parties, with Owner Parties' insurance being excess, secondary and noncontributing.
§ 1.8	Waiver of Subrogation	This insurance is to be endorsed with an ISO CG 24 04 05 09 Waiver of Transfer of Rights of Recovery Against Others Endorsement, or equivalent, to include a waiver of subrogation by insurer as to the Owner Parties and such other persons as are designated by Owner to Contractor as additional insureds.
§ 1.9	Electronic Data	This insurance is to include an Electronic Data Liability Endorsement ISO CG 04 37 with coverage to the full limits of the policy.
§ 1.10	Notice	This insurance is to contain a provision for 30 days' prior written notice by insurance carrier to Owner required for cancellation or material change.

§ 1.11	Personal Injury Contractual Liability	The personal injury contractual liability exclusion shall be deleted.
§ 1.13	Certificate of Insurance	A copy of the required Endorsements along with the Schedule of Forms and Endorsements page of the policy listing the required Endorsements as issued modifications to the policy shall be attached to the Certificate of Insurance provided by Contractor to Owner as Certificate Holder at the following address: _____.
§ 1.12	Prohibitions	The following exclusions/limitations or their equivalents are not permitted:
		a. Contractual Liability Limitation ISO CG 21 39.
		b. Amendment of Insured Contract Definition ISO CG 24 26.
		c. Limitation of Coverage to Designated Premises or Project ISO CG 21 44.
		d. Exclusion-Damage to Work Performed by Subcontractors On Your Behalf ISO CG 22 94 or CG 22 95.
		e. Exclusion-Explosion, Collapse and Underground Property Damage Hazard ISO CG 21 42 or CG 21 43.
		f. Any classification limitation.
		g. Any construction defect completed operations exclusion.
		h. Any endorsement modifying the employer's liability exclusion or deleting the exception to it.
		i. Any endorsement modifying or deleting explosion, collapse or underground coverage.
		j. Any habitational or residential exclusion.
		k. Any insured vs. insured exclusion except named insured vs. named insured.
		l. Any punitive, exemplary or multiplied damages exclusion.
		m. Any subsidence exclusion.
§ 2.	Business Auto Liability.	Contractor is to maintain business auto insurance meeting at least the following specifications.
§ 2.1	Minimum Limits	The limits of liability shall be no less than \$ __,000,000 per accident.
§ 2.2	Form	This insurance is to be issued on the current edition of the ISO CA 00 01
§ 2.3	Scope	This insurance is to coverage damages because of bodily injury or property damages caused by an accident and resulting from the ownership, maintenance or use of any auto, including owned, hired and non-owned autos.
§ 2.4	Additional Insureds	Additional insured status shall be provided in favor of Owner Parties and such other persons as are designated by Owner to Contractor as additional insureds, on ISO CA 20 48 10 13.
§ 2.5	Waiver of Subrogation	This insurance is to include a waiver of subrogation by insurer as to the Owner Parties and such other persons as are designated by Owner to Contractor on ISO CA 04 44 10 13.

§ 3.	Workers' Compensation and Employer's Liability. Contractor is to maintain workers' compensation and employer's liability insurance meeting at least the following specifications.	
§ 3.1	Workers' Compensation Limits	The minimum limits of this insurance shall be no less than the statutory limits.
§ 3.2	Employer's Liability Limits	The minimum limits of this insurance shall be no less than \$ __,000,000 each accident and disease.
§ 3.3	Territory	The state in which the Work is to be performed must be listed under Item 3.A. on the Information Page of the policy.
§ 3.4	Scope	This insurance is to cover liability arising out the Contractor's employment of workers and anyone for whom the contractor may be liability for workers' compensation claims. Worker's compensation insurance is required and no "alternative" form of insurance is permitted.
§ 3.5	Prohibitions	Employees leased through a Professional Employment Organization ("PEO") are not permitted.
§ 3.6	Stop Gap	Stop Gap coverage must be provided if Work is to be performed in a monopolistic state, listing the state in which Work is to be performed.
§ 3.7	USL&H	United States Longshoremen and Harborworkers ("USL&H") coverage must be provided where such exposure exists listing the state in which Work is to be performed.
§ 3.8	Waiver of Subrogation	This insurance is to include a waiver of subrogation by insurer as to the Owner Parties and such other persons as are designated by Owner to Contractor, on form WC 42 03 04.
§ 4.	Excess Liability. To the extent permitted by law, if any of the required coverages are to be maintained by and through excess liability insurance, Contractor is to maintain excess liability insurance meeting at least the following specifications.	
§ 4.1	Scope	This insurance shall be excess over and be no less broad than all coverages and conditions described above. The policy limits required herein may be provided by a combination of primary and excess policies, but in no event shall the total limits of liability available for any one occurrence or accident by less than the amount required herein.
§ 4.2	Concurrency	Such coverage shall have the same inception date as the commercial general liability and employer's liability coverages.
§ 4.3	Primary	This insurance shall be primary and non-contributing liability coverage. It is the specific intent of the parties to the Agreement that all insurance held by the Owner Parties shall be excess, secondary and non-contributory.
§ 4.4	Drop Down Coverage	Drop-down coverage shall be provided for reduction and/or exhaustion of underlying aggregate limits.
§ 4.5	Defense Costs	This insurance is to include a duty to defend any insured.
§ 4.6	Waiver of Subrogation	This insurance is to include a waiver of subrogation by insurer as to the Owner Parties and such other persons as are designated by Owner to Contractor.
§ 4.7	Notice	This insurance shall be endorsed to provide a 30 days' notice of cancellation to Owner.
§ 5.	Professional Liability. Contractor is to maintain Professional Liability insurance meeting at least the following specifications.	
§ 5.1	Minimum Limits	Limits of coverage shall be no less than:
	a.	\$ __,000,000 Each Loss
	b.	\$ __,000,000 Annual Aggregate
	If a combined Contractor's Pollution Liability and Professional Liability policy is utilized, the limits shall be \$ __,000,000 Each Loss and Annual Aggregate.	

§ 5.2	Scope	Such insurance shall cover all services rendered by the Contractor and its Subcontractors under the Agreement, including but not limited to design or design/build services.	
§ 5.3	Retroactive Date	Any retroactive date must be effective prior to beginning of services for the Owner.	
§ 5.4	Prohibitions	This insurance is not permitted to include any type of exclusion or limitation of coverage applicable to claims arising from:	
		a.	Bodily injury or property damage where coverage is provided in behalf of design professionals or design/build contractors;
		b.	Habitational or residential operations;
		c.	Mold or microbial matter and fungus or biological substance; or
		d.	Punitive, exemplary or multiplied damages.
		A professional liability endorsement to a general liability policy is not acceptable.	
§ 5.5	Term	Policies written on a claims-made basis shall be maintained for at least __ years beyond termination of the Agreement. The purchase of an extended discovery period or an extended reporting period on a claims-made policy will not be sufficient to meet the terms of this provision.	
§ 5.6	Waiver of Subrogation	Contractor shall cause this insurance to be endorsed to waive all rights of subrogation in favor of Owner Parties.	
§ 5.7	Notice	This insurance shall be endorsed to provide a 30 days' notice of cancellation to Owner.	
§ 6.	Pollution Liability. Contractor is to maintain Contractor's Pollution Liability insurance meeting at least the following specifications.		
§ 6.1	Minimum Limits	Limits of coverage shall be no less than:	
		a.	\$,000,000 Each Loss
		b.	\$,000,000 Annual Aggregate
		If a combined Contractor's Pollution Liability and Professional Liability policy is utilized, the limits shall be \$ __,000,000 Each Loss and Annual Aggregate.	
§ 6.2	Scope	The policy must provide coverage for:	
		a.	The full scope of the named insured's operations (on-going and completed) as described within the scope of work for the Agreement.
		b.	Loss arising from pollutants including but not limited to fungus, bacteria, biological substances, mold, microbial matter, asbestos, lead, silica and contaminated drywall.
		c.	Third party liability for bodily injury, property damage, clean up expenses, and defense arising from the operations.
		d.	Diminution of value and natural resources damages;
		e.	Contractual liability.
		f.	Claims arising from owned and non-owned disposal sites utilized in the performance of the Agreement.

		Coverage extensions to the General Liability insurance policy without a separate insurance agreement for Contractors Pollution Liability insurance will not fulfill this requirement																
§ 6.3	Additional Insured and Primary and Noncontributory	The policy must insure contractual liability, name Owner Parties as additional insureds and such other personas as are designed by Owner to Contractor to be additional insureds, and be primary and noncontributory to all coverage available to the additional insureds.																
§ 6.4	Retroactive Date	If coverage is provided on a claims made basis, coverage will at least be retroactive to the earlier of the date of the Agreement or the commencement of contractor services relation to the Work.																
§ 6.5	Prohibitions	This insurance is not permitted to include any type of exclusion or limitation of coverage applicable to claims arising from:																
		<table border="1"> <tr> <td>a.</td> <td>Insured vs. insured actions. However, exclusion for claims made between insured within the same economic family are acceptable.</td> </tr> <tr> <td>b.</td> <td>Impaired property that has not been physically injured.</td> </tr> <tr> <td>c.</td> <td>Materials supplied or handled by the named insured. However, exclusions for the sale and manufacture of products are allowed. Exclusionary language pertaining to materials supplied by the insured shall be reviewed by the certificate holder for approval.</td> </tr> <tr> <td>d.</td> <td>Property damage to the work performed by the contractor.</td> </tr> <tr> <td>e.</td> <td>Faulty workmanship as it relates to clean up costs.</td> </tr> <tr> <td>f.</td> <td>Punitive, exemplary or multiplied damages.</td> </tr> <tr> <td>g.</td> <td>Work performed by Subcontractors.</td> </tr> <tr> <td>h.</td> <td>Contractual liability incurred as a result of an injury to an employee of the insured.</td> </tr> </table>	a.	Insured vs. insured actions. However, exclusion for claims made between insured within the same economic family are acceptable.	b.	Impaired property that has not been physically injured.	c.	Materials supplied or handled by the named insured. However, exclusions for the sale and manufacture of products are allowed. Exclusionary language pertaining to materials supplied by the insured shall be reviewed by the certificate holder for approval.	d.	Property damage to the work performed by the contractor.	e.	Faulty workmanship as it relates to clean up costs.	f.	Punitive, exemplary or multiplied damages.	g.	Work performed by Subcontractors.	h.	Contractual liability incurred as a result of an injury to an employee of the insured.
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f.	Punitive, exemplary or multiplied damages.																	
g.	Work performed by Subcontractors.																	
h.	Contractual liability incurred as a result of an injury to an employee of the insured.																	
§ 6.6	Term	Completed operations coverage shall be maintained for a minimum of __ years after the completion of Work. (The extended reporting period on a claims-made based policy does not fulfill this requirement). Contractor's pollution liability insurance policies insuring a specific job shall have completed operations coverage for at least the duration of the Work plus __ years.																
§ 7.	<u>Subcontractor's Insurance.</u>																	
§ 7.1	Coverage	Contractor shall cause each first tier subcontractor employed by Contractor to purchase and maintain insurance of the types listed above; provided, however, Employers Liability Limits on such subcontractors are not to be less than \$500,000 each Accident or Disease, and such subcontractors' excess policy limit shall be no less than \$1,000,000.																
§ 7.2	Additional Insureds	This insurance is to be endorsed with an ISO CG 20 10 07 04, or equivalent form, Additional Insured Endorsement listing the Owner Parties and such other persons as are designated by Owner to Contractor, as additional insureds.																
§ 7.3	Waiver of Subrogation	This insurance is to be endorsed with an ISO CG 29 88 10 93 Waiver of Transfer of Rights of Recovery Against Others Endorsement, or equivalent, to include a waiver of subrogation by insurer as to the Owner Parties, and such other persons as are designated by Owner to Contractor, as additional insureds.																
§ 7.4	Evidence of Insurance	Contractor shall provide Owner certificates of insurance as to each subcontractor performing Work prior to the subcontractor's entry on the Property certified to Owner as Certificate Holder at the following address: _____.																
B. PROPERTY INSURANCE																		
§ 1.	<u>Builder's Risk.</u> Contractor is to maintain builder's risk insurance meeting at least the following specifications; but at Owner's option, Owner may in lieu of Contractor maintaining builder's risk insurance, Owner may obtain and maintain the builder's risk insurance. If																	

	Owner obtains the builder's risk insurance, the Contract Price is to be reduced by the amount of the premium and any Contractor markup cost that otherwise was included within the Contract Price.		
§ 1.1	Amount	Limits of coverage are to be the initial Contract Price as increased by amount of subsequent modification of the Contract Price. Coverage shall be provided in amount equal at all times to the full replacement value and cost of debris removal for any single occurrence.	
§ 1.2	Covered Property	Such insurance shall cover:	
		a.	All structures under construction, including retaining walls, paved surfaces and roadways, bridges, glass, foundations, footings, underground pipes and wiring, excavations, grading, backfilling or filling.
		b.	All temporary structures (e.g., fencing, scaffolding, cribbing, false work, forms, site lighting, temporary utilities and buildings) located at the site.
		c.	All property including materials and supplies on site for installation.
		d.	All property including materials and supplies at other locations but intended for use at the site.
		e.	All property including materials and supplies in transit to the site for installation by all means of transportation other than ocean transit.
		f.	Other property for which an insured is liable regarding the project.
§ 1.3	Insureds	Insureds shall include:	
		a.	Owner, Contractor, and all Loss Payees and Mortgagees as Named Insureds; and
		b.	Subcontractors of all tiers.
§ 1.4	Deductibles	Deductibles shall not exceed:	
		a.	All risks of direct damage, per Occurrence, except \$10,000
		b.	Delayed opening waiting period 5 days
		c.	Earthquake and earthquake sprinkler leakage, per Occurrence \$50,000
		d.	Flood, per Occurrence or excess of maximum available through National Flood Insurance Program \$50,000
§ 1.5	Form	Coverage shall be at least as broad as an unmodified ISO Special Causes of Loss form and shall include coverage for theft, collapse, flood and earthquake. All exclusions must be pre-approved by Owner. This insurance is to be written on a Completed Value, non-reporting form basis and shall be primary to any other insurance coverage available to the named insureds, with that other insurance being excess, secondary and noncontributing.	
§ 1.6	Prohibition	No protective safeguard warranty is permitted.	
§ 1.7	Coverage and Minimum Sublimits	Coverage	Minimum Sublimit

		a.	Additional expenses due to delay in completion of project (where applicable)	\$ _____
		b.	Agreed Value	Included without sublimit
		c.	Damage arising from error, omission or deficiency in construction methods, design, specifications, workmanship or materials, including collapse and ensuing loss	Included without sublimit
		d.	Debris removal additional limit	Included without sublimit
		e.	Earthquake and earthquake sprinkler leakage	\$1,000,000
		f.	Flood, per Occurrence, excess of maximum available through National Flood Insurance Program	\$1,000,000
		g.	Freezing	Included without sublimit
		h.	Mechanical breakdown including hot and cold testing (where applicable)	Included without sublimit
		i.	Occupancy pre-completion	Included
		j.	Ordinance or law	Included without sublimit
		k.	Pollutant clean-up and removal	\$1,000,000
		l.	Preservation of property	Included without sublimit
		m.	Replacement cost	Included without sublimit
		n.	Theft	Included without sublimit
§ 1.8	Occupancy	The termination of coverage provision shall be endorsed to permit occupancy of the coverage property being constructed.		
§ 1.9	Term and Termination	This insurance shall be maintained in effect, unless otherwise provided for in the Agreement, until the earliest of the following dates:		
		a.	The date on which all persons and organizations who are insureds under the policy agree that it shall be terminated;	
		b.	The date of final payment, as provided for in the Agreement; or	
		c.	The date on which the insurable interests in the Covered Property of all insureds other than Contractor have ceased.	

§ 1.10	Waiver of Subrogation	This insurance shall include a waiver of subrogation by insurer as to the insureds.
§ 1.11	Notice	This insurance shall be endorsed to provide 30 days' notice of cancellation to Owner.
§ 2.	<u>Contractor's Equipment.</u>	
§ 2.1	Amount	Contractor shall obtain and maintain property insurance on Contractor's equipment and personal property insured to 100% of its replacement cost. This insurance will have an equipment floater.
§ 2.2	Waiver of Subrogation	This insurance will be endorsed to waive subrogation in favor of Owner Parties.
C. BONDS		
§ 1.	General	Contractor is required to arrange and furnish separate performance and payment bonds, each for the full amount of the Guaranteed Maximum Price plus Contractor's Fee guaranteeing the faithful performance of all of the provision of the Agreement as well as payment to all persons for labor and material used in the performance of the Agreement. The bonds shall be executed by a surety company acceptable to Owner, on a form acceptable to Owner, and shall become a part of the Agreement. Owner may withhold payments on account until such time as said bonds have been furnished and accepted. No change, alteration or modification in the terms and conditions of the Agreement, or in the terms or manner of payment shall in any way exonerate or release, in whole or in part, any surety on any bond furnished on behalf of Contractor. The cost of the bonds is included in the Contract Price.
§ 2.	Payment Bond	The Payment Bond is to conform to the following requirements.
§ 2.1	Form	The Payment Bond is to be in statutory form. The AIA form is not acceptable.
§ 2.2	Coverage	The Payment Bond is to include coverage for consequential and delay damages due to Contractor's default.
§ 2.3	Rating	The issuer must be at least a Best's Key Rating Guide A/VII company and listed on the United States Department of the Treasury's List of Acceptable Sureties and Reinsurers (the "T" list) and duly licensed and authorized to issue surety bonds in Texas.
§ 2.4	Term	The Payment Bond is to be in effect for the period required by the Texas Property Code.
§ 2.5	Multiple Obligees	The Payment Bond is to name as additional obligees such persons as designated by the Owner, including its lender.
§ 2.6	Recorded	The Payment Bond and all required attachments (issuer's agent's power of attorney and memorandum of the Agreement) is to be recorded in the County's Official Public Records.
§ 3.	Performance Bond	The Performance Bond is to conform to the following requirements.
§ 3.1	Form	The Performance Bond is to be on the AIA form or equivalent. The Performance Bond is to cover Contractor's express warranty and obligations to correct defective Work arising under the Agreement.
§ 3.2	Rating	The issuer must be at least a Best's Key Rating Guide A/VII company and listed on the United States Department of the Treasury's List of Acceptable Sureties and Reinsurers (the "T" list) and duly licensed and authorized to issue surety bonds in Texas.
§ 3.3	Extended Coverages	The Performance Bond is to cover risk of contract penalties and delay damages.
§ 3.4	Term	The Performance Bond is to be in effect for a period of not less than one year following Final Completion.
§ 3.5	Multiple Obligees	The Performance Bond is to name as additional obligees such persons as designated by Owner including its lender.

B. GENERAL INSURANCE REQUIREMENTS**1. Definitions.** For purposes of this Exhibit:

a. Agreement. "Agreement" means the Commercial Construction Contract – Guaranteed Maximum Price executed by Owner and Contractor.

b. Owner Parties. "Owner Parties" means (a) _____ ("Owner"), (b) the project manager, (c) any lender whose loan is secured by a lien against the Property, (d) their respective shareholders, members, partners, joint venturers, affiliates, subsidiaries, successors and assigns, (e) any directors, officers, employees, or agents of such persons or entities, and (f) others as required by the Agreement.

c. Contractor. "Contractor" means _____ and Subcontractors of any tier.

d. ISO. "ISO" means Insurance Services Office.

2. Policies.

a. Insurer Qualifications. All insurance required to be maintained by Contractor must be issued by carriers having a Best's Rating of A or better, and a Best's Financial Size Category of VIII, or better, and/or Standard & Poor Insurance Solvency Review A- or better, and authorized to engage in the business of insurance in the State in which the Improvements are located.

b. No Waiver. Failure of Owner to demand such certificates or other evidence of full compliance with these insurance requirements or failure of Owner to identify a deficiency from evidence that is provided shall not be construed as a waiver of Contractor's obligation to maintain such insurance. Commencement of Work without provision of the required certificate of insurance, evidence of insurance and/or required endorsements, or without compliance with any other provision of this Contract, shall not constitute a waiver by any Owner Party of any rights. The Owner shall have the right, but not the obligation, of prohibiting the Contractor or any Subcontractor from performing any Work until such certificate of insurance, evidence of insurance and/or required endorsements are received and approved by the Owner.

c. Delivery Deadlines. Contractor shall provide Owner within 10 days of Owner's request with certified copies of all insurance policies. Renewal policies, if necessary, shall be delivered to the Owner prior to the expiration of the previous policy.

d. Waiver of Subrogation. All policies maintained by Contractor, whether required herein or not, shall contain a waiver of subrogation in favor of the Owner Parties.

e. Notice. All policies maintained by Contractor shall provide for 30 days' prior written notice of cancellation to Owner.

f. Compliance With Laws. If any insurance requirements are deemed to violate any law, statute or ordinance, the insurance requirements shall be reformed to provide the maximum amount of protection to Owner as allowed under the law.

3. Limits, Deductibles and Retentions.

a. Coverage Limits. The limits of liability may be provided by a single policy of insurance or by a combination of primary and excess policies, but in no event shall the total limits of liability available for any one Occurrence or accident be less than the amount required herein.

b. Deductible and Retention Limits. No deductible or self-insured retention shall exceed \$ _____ without the prior written approval of the Owner, except as otherwise specified herein. All deductibles and retentions shall be paid by, assumed by, for the account of, and at the Contractor's sole risk. The Contractor shall not be reimbursed for same.

c. Policy Limits. "Limits" set out in these specifications are the minimum dollar amount of insured coverage for the risk or peril specified. If Contractor or its contractors maintain greater limits, then these specifications shall not limit the amount of recovery available to Owner and Owner the limits specified below as the minimum limits are increased to the greater limits.

d. Post Completion Coverage. With respect to the insurance to be maintained after final payment to Contractor, an additional certificate evidencing such coverage shall be provided to Owner with final application for payment if the prior certificate has expired, and thereafter upon renewal or replacement of such insurance until the expiration of the time period for which such insurance must be maintained.

e. Use of the Owner's Equipment. The Contractor, its agents, employees, Subcontractors or suppliers shall use the Owner's equipment only with express written permission of the Owner's designated representative and in accordance with the Owner's terms and condition for such use. If the Contractor or any of its agents, employees, Subcontractors or suppliers utilize any of the Owner's equipment for any purpose, including machinery, tools, scaffolding, hoists, lifts or similar items owned, leased or under the control of the Owner, the Contractor shall defend, indemnify and be liable to the Owner Parties for any and all loss or damage which may arise from such use.

4. Forms.

a. Approved Revisions and Substitutions. If the forms of policies, endorsements, certificates, or evidence of insurance required by these specifications are superseded or discontinued, Owner will have the right to require other equivalent forms.

b. Approved Forms. Any policy or endorsement forms other than a form specified in this Exhibit must be approved in advance by Owner.

c. Compliance with Laws. If any additional insured requirements are deemed to violate any law, statute or ordinance, the additional insured requirements, including any additional insured policy provision or endorsements procured pursuant to the Agreement, shall be reformed to provide the maximum amount of protection to the Owner Parties as allowed under the law.

5. Evidence of Insurance. Insurance must be evidenced as follows:

a. Form. Liability insurance: ACORD™ Form 25 Certificates of Liability Insurance for liability coverages. Property Insurance: ACORD™ Form 28 Evidence of Commercial Property Insurance for property coverages.

b. Delivery Deadlines. Evidence to be delivered to Owner prior to entry on the Property and thereafter at least 30 days prior to the expiration of current policies or on replacement of each certified coverage and within 10 days of Owner's request for an updated certificate.

c. Certificate Requirements. Certificates must:

(1) **Insured.** State the insured's name and address.

(2) **Insurer.** State the name of each insurance company affording each coverage, policy number of each coverage, policy dates of each coverage, all coverage limits and sublimits, if any, by type of coverage, and show the signature of the authorized representative signing the certificate on behalf of the insurer.

(3) **Additional Insured Status and Subrogation Waiver.** Specify the additional insured status and waivers of subrogation as required by these specifications.

(4) **Primary Status.** State the primary and non-contributing status required herein.

(5) **Deductibles and Self-Insured Retentions Stated.** State the amounts of all deductibles and self-insured retentions.

(6) **Copy of Endorsements and Policy Declaration Page.** Be accompanied by certified copies of all required endorsements and policy declaration page reflecting issuance of the endorsements.

(7) **Notices.** Be accompanied by insurer certified copy of notice of cancellation endorsement providing that 30 days' notice of cancellation and material change will be sent to the certificate holder.

(8) **Certificate Holder.** Be addressed to the Owner as the certificate holder and show Owner's correct address. A separate certificate is to be addressed and delivered to Owner's lender.

(9) **Producer.** State the producer of the certificate with correct address and phone number listed.

(10) **Authorized Representative.** Be executed by a duly authorized representative of the insurers.

d. Suspension. Owner shall have the right, but not the obligation, of suspending Contractor's services, without an increase in the sum payable by Owner to Contractor due to such suspension, until such certificates or other evidence that the required insurance has been placed in compliance with these requirements is received and approved by Owner.

6. Contractor Insurance Representations to Owner Parties.

a. Minimum Requirements. The insurance coverages required herein (1) represent Owner Parties' minimum requirements and are not to be construed to void or limit the Contractor's indemnity obligations as contained in the Agreement nor represent in any manner a determination of the insurance coverages the Contractor should or should not maintain for its own protection; and (2) are being, or have been, obtained by the Contractor in support of the Contractor's liability and indemnity obligations under this Contract. Irrespective of the requirements as to insurance to be carried as provided for herein, the insolvency, bankruptcy or failure of any insurance company carrying insurance of the Contractor, or the failure of any insurance company to pay claims accruing, shall not be held to affect, negate or waive any of the provisions of the Agreement.

b. Defaults. Failure to obtain and maintain the required insurance shall constitute a material breach of, and default under, the Agreement. If the Contractor shall fail to remedy such breach within five business days after notice by the Owner, the Contractor will be liable for any and all costs, liabilities, damages and penalties resulting to the Owner Parties from such breach, unless a written waiver of the specific insurance requirement is provided to the Contractor by the Owner. In the event of any failure by the Contractor to comply with the provisions of this Contract, the Owner may, without in any way compromising or waiving any right or remedy at law or in equity, on notice to the Contractor, purchase such insurance, at the Contractor's expense, provided that the Owner shall have no obligation to do so and if the Owner shall do so, the Contractor shall not be relieved of or excused from the obligation to obtain and maintain such insurance amounts and coverages.

c. Survival. This Exhibit is an independent contract provision and shall survive the termination or expiration of the Agreement.

9. RELEASE AND WAIVER. TO THE EXTENT PERMITTED BY LAW, EACH OF CONTRACTOR AND OWNER (THE "RELEASING PARTY") RELEASES AND WAIVES ANY CLAIMS IT MAY HAVE AGAINST THE OTHER PARTY OR ITS PARTNERS, OFFICERS, DIRECTORS, EMPLOYEES OR AGENTS (THE "RELEASED PERSONS") FOR BUSINESS INTERRUPTION OR DAMAGE TO PROPERTY SUSTAINED BY THE RELEASING PARTY AS THE RESULT OF ANY ACT OR OMISSION OF THE RELEASED PERSON IN ANY WAY CONNECTED WITH ANY LOSS COVERED BY INSURANCE, WHETHER REQUIRED HEREIN OR NOT, OR WHICH SHOULD HAVE BEEN COVERED BY INSURANCE REQUIRED HEREIN, INCLUDING THE DEDUCTIBLE AND UNINSURED

PORTION THEREOF, MAINTAINED OR REQUIRED TO BE MAINTAINED BY THE RELEASING PARTY PURSUANT TO THE AGREEMENT. THE WAIVER OF CLAIMS CONTAINED IN THIS SECTION (A) WILL SURVIVE THE COMPLETION OF THE WORK OR THE TERMINATION OF THE AGREEMENT AND (B) WILL APPLY EVEN IF THE LOSS IS CAUSED IN WHOLE OR IN PART BY THE ORDINARY NEGLIGENCE OR STRICT LIABILITY OF THE RELEASED PERSONS BUT WILL NOT APPLY TO THE EXTENT A LOSS OF DAMAGE IS CAUSED BY THE GROSS NEGLIGENCE OR WILLFUL MISCONDUCT OF THE RELEASED PERSONS.

10. Insurance Requirements of Contractor's Subcontractors.

a. **Coverage.** Insurance similar to that required of the Contractor shall be provided by all Subcontractors (or provided by the Contractor on behalf of Subcontractors) to cover operations performed under any subcontract agreement. The Contractor shall be held responsible for any modification in these insurance requirements as they apply to Subcontractors. The Contractor shall maintain certificates of insurance from all Subcontractors containing provisions similar to those listed herein (modified to recognize that the certificate is from Subcontractor) enumerating, among other things, the waivers of subrogation, additional Insured status, and primary liability as required herein, and make them available to the Owner upon request.

b. **ALLOCATION OF RISK.** THE CONTRACTOR IS FULLY RESPONSIBLE FOR LOSS AND DAMAGE TO ITS PROPERTY ON THE SITE, INCLUDING TOOLS AND EQUIPMENT, AND SHALL TAKE NECESSARY PRECAUTIONS TO PREVENT DAMAGE TO OR VANDALISM, THEFT, BURGLARY, PILFERAGE AND UNEXPLAINED DISAPPEARANCE OF PROPERTY. ANY INSURANCE COVERING THE CONTRACTOR'S OR ITS SUBCONTRACTOR'S PROPERTY SHALL BE THE CONTRACTOR'S AND ITS SUBCONTRACTOR'S SOLE AND COMPLETE MEANS OR RECOVERY FOR ANY SUCH LOSS. TO THE EXTENT ANY LOSS IS NOT COVERED BY SAID INSURANCE OR SUBJECT TO ANY DEDUCTIBLE OR CO-INSURANCE, THE CONTRACTOR SHALL NOT BE REIMBURSED FOR SAME. SHOULD THE CONTRACTOR OR ITS SUBCONTRACTORS CHOOSE TO SELF-INSURE THIS RISK, IT IS EXPRESSLY AGREED THAT THE CONTRACTOR HEREBY WAIVES, AND SHALL CAUSE ITS SUBCONTRACTORS TO WAIVE, ANY CLAIM FOR DAMAGE OR LOSS TO SAID PROPERTY IN FAVOR OF THE OWNER PARTIES.

Exhibit E

Contractor's Bills Paid Affidavit

Basic Information

Date:

Owner:

Owner's Mailing Address:

Contractor:

Contractor's Mailing Address:

Affiant: **[include relationship to contractor]**

Affiant's Mailing Address:

Property: **[include legal description]**

Improvements:

Affiant swears individually and on behalf of Contractor that the following statements are true and within the personal knowledge of Affiant:

1. Affiant has personal knowledge of the facts stated in this affidavit. Affiant has full authority to make the agreements in this affidavit on behalf of Contractor.
2. Affiant understands that Owner has required this affidavit as a condition of payment for labor or materials used in construction of the Improvements.

3. Contractor has paid each of Contractor's subcontractors, laborers, and materialmen in full for all labor and materials provided to Owner or Contractor for construction of the Improvements, excepting only the amounts owed to the persons identified below:

List all subcontractors, laborers, and materialmen and amounts owed to each. If there are no unpaid subcontractors, laborers, or materialmen, state "None."

Name:

Address:

Telephone number:

Amount owed:

Repeat above information as needed.

Include the following if applicable.

Contractor warrants and represents that the following specified bills or classes of bills will be paid by Contractor from the funds paid to Contractor by Owner in reliance on this affidavit:

Name of payee or description of class:

Amount:

Repeat above information as needed.

Include the following if applicable.

Contractor agrees to indemnify and hold Owner harmless from any loss or expense resulting from false or incorrect information in this affidavit.

Continue with the following.

[Name of affiant]

SUBSCRIBED AND SWORN TO before me on _____ by [name of affiant].

Notary Public, State of Texas

Exhibit F

Subcontractor's Bills Paid Affidavit

Basic Information

Date:

Owner:

Owner's Mailing Address:

Contractor:

Contractor's Mailing Address:

Subcontractor:

Subcontractor's Mailing Address:

Affiant: **[include relationship to subcontractor]**

Affiant's Mailing Address:

Property: **[include legal description]**

Improvements:

Affiant swears individually and on behalf of Subcontractor that the following statements are true and within the personal knowledge of Affiant:

1. Affiant has personal knowledge of the facts stated in this affidavit. Affiant has full authority to make the agreements in this affidavit on behalf of Subcontractor.

2. Affiant understands that Owner and Contractor have required this affidavit as a condition of payment for labor or materials used in construction of the Improvements.

3. Subcontractor has paid each of Subcontractor's subcontractors, laborers, and materialmen in full for all labor and materials provided to Owner or Contractor or to Subcontractor for construction of the Improvements, excepting only the amounts owed to the persons identified below:

List all subcontractors, laborers, and materialmen and amounts owed to each. If there are no unpaid subcontractors, laborers, or materialmen, state "None."

Name:

Address:

Telephone number:

Amount owed:

Repeat above information as needed.

Include the following if applicable.

Subcontractor warrants and represents that the following specified bills or classes of bills will be paid by Subcontractor from the funds paid to Contractor by Owner in reliance on this affidavit:

Name of payee or description of class:

Amount:

Repeat above information as needed.

Include the following if applicable.

Subcontractor agrees to indemnify and hold Owner and Contractor harmless from any loss or expense resulting from false or incorrect information in this affidavit.

Continue with the following.

[Name of affiant]

SUBSCRIBED AND SWORN TO before me on _____ by [name of affiant].

Notary Public, State of Texas

Exhibit G

This waiver and release is based on the form found in Tex. Prop. Code § 53.284(b). If a contractor (or other potential lien claimant) is required to execute a waiver and release in exchange for or to induce payment of a progress payment and is not paid in exchange for the waiver and release, or if a single payee check or joint payee check is given in exchange for the waiver and release, the waiver and release must read as follows.

Conditional Partial Release During Construction

Project:

Job No:

On receipt by the signer of this document of a check from [**name of maker of check**] in the sum of \$[**amount**] payable to [**name[s] of payee[s] of check**], and when the check has been properly endorsed and has been paid by the bank on which it is drawn, this document becomes effective to release any mechanic's lien right, any right arising from a payment bond that complies with a state or federal statute, any common-law payment bond right, any claim for payment, and any rights under any similar ordinance, rule, or statute related to claim or payment rights for persons in the signer's position that the signer has on the property of [**name of owner**] located at [**specify location**] to the following extent: [**specify job description**].

This release covers a progress payment for all labor, services, equipment, or materials furnished to the property or to [**name of person with whom signer contracted**] as indicated in the attached statement[s] or progress payment request[s], except for unpaid retention, pending modifications and changes, or other items furnished.

Before any recipient of this document relies on this document, the recipient should verify evidence of payment to the signer.

The signer warrants that the signer has already paid or will use the funds received from this progress payment to promptly pay in full all of the signer's laborers, subcontractors, materialmen, and suppliers for all work, materials, equipment, or services provided for or to the above-referenced project in regard to the attached statement[s] or progress payment request[s].

Date

[Company name]

By _____

[Name and title]

Exhibit H

This waiver and release is based on the form found in Tex. Prop. Code § 53.284(c). If a contractor (or other potential lien claimant) is required to execute an unconditional waiver and release to prove the receipt of good and sufficient funds for a progress payment and the claimant or potential claimant asserts in the waiver and release that the claimant or potential claimant has been paid the progress payment, the waiver and release must read as follows. The waiver and release must include the notice at the top of the document.

Unconditional Partial Release During Construction

NOTICE: This document waives rights unconditionally and states that you have been paid for giving up those rights. It is prohibited for a person to require you to sign this document if you have not been paid the payment amount set forth below. If you have not been paid, use a conditional release form.

Project:

Job No.

The signer of this document has been paid and has received a progress payment in the sum of \$[**amount**] for all labor, services, equipment, or materials furnished to the property or to [**name of person with whom signer contracted**] on the property of [**name of owner**] located at [**specify location**] to the following extent: [**specify job description**]. The signer therefore waives and releases any mechanic's lien right, any right arising from a payment bond that complies with a state or federal statute, any common-law payment bond right, any claim for payment, and any rights under any similar ordinance, rule, or statute related to claim or payment rights for persons in the signer's position that the signer has on the above-referenced project to the following extent:

This release covers a progress payment for all labor, services, equipment, or materials furnished to the property or to [**name of person with whom signer contracted**] as indicated in

the attached statement[s] or progress payment request[s], except for unpaid retention, pending modifications and changes, or other items furnished.

The signer warrants that the signer has already paid or will use the funds received from this progress payment to promptly pay in full all of the signer's laborers, subcontractors, materialmen, and suppliers for all work, materials, equipment, or services provided for or to the above-referenced project in regard to the attached statement[s] or progress payment request[s].

Date

[Company name]

By _____
[Name and title]

Exhibit I

This waiver and release is based on the form found in Tex. Prop. Code § 53.284(d). If a contractor (or other potential lien claimant) is required to execute a waiver and release in exchange for or to induce payment of a final payment and is not paid in good and sufficient funds in exchange for the waiver and release, or if a single payee check or joint payee check is given in exchange for the waiver and release, the waiver and release must read as follows.

Conditional Final Release

Project:

Job No.

On receipt by the signer of this document of a check from [**name of maker of check**] in the sum of \$[**amount**] payable to [**name[s] of payee[s] of check**], and when the check has been properly endorsed and has been paid by the bank on which it is drawn, this document becomes effective to release any mechanic's lien right, any right arising from a payment bond that complies with a state or federal statute, any common-law payment bond right, any claim for payment, and any rights under any similar ordinance, rule, or statute related to claim or payment rights for persons in the signer's position that the signer has on the property of [**name of owner**] located at [**specify location**] to the following extent: [**specify job description**].

This release covers the final payment to the signer for all labor, services, equipment, or materials furnished to the property or to [**name of person with whom signer contracted**].

Before any recipient of this document relies on this document, the recipient should verify evidence of payment to the signer.

The signer warrants that the signer has already paid or will use the funds received from this final payment to promptly pay in full all of the signer's laborers, subcontractors, material-

men, and suppliers for all work, materials, equipment, or services provided for or to the above-referenced project up to the date of this waiver and release.

Date

[Company name]

By _____

[Name and title]

Exhibit J

This form may be used as written by an original contractor to fulfill the requirements of Tex. Prop. Code §§ 53.085, 53.258, 53.259.

Contractor [Final] Bills Paid Affidavit

Date:

Owner:

Owner's Mailing Address: **[include county]**

Contractor:

Contractor's Mailing Address: **[include county]**

Affiant: **[include relationship to contractor]**

Affiant's Mailing Address: **[include county]**

Property: **[include legal description]**

Improvements:

Affiant swears individually and on behalf of Contractor that the following statements are true and within the personal knowledge of Affiant:

1. Affiant has personal knowledge of the facts stated in this affidavit. Affiant has full authority to make the agreements in this affidavit on behalf of Contractor.
2. Affiant understands that Owner has required this affidavit as a condition of payment for labor or materials used in construction of the Improvements.

3. Contractor has paid each of Contractor's subcontractors, laborers, and materialmen in full for all labor and materials provided to Owner or Contractor for construction of the Improvements, excepting only the amounts owed to the persons identified below:

List all subcontractors, laborers, and materialmen and amounts owed to each. If there are no unpaid subcontractors, laborers, or materialmen, state "None."

Name:

Address:

Telephone number:

Amount owed:

Repeat above information as needed.

Include the following if applicable.

Contractor warrants and represents that the following specified bills or classes of bills will be paid by Contractor from the funds paid to Contractor by Owner in reliance on this affidavit:

Name of payee or description of class:

Amount:

Repeat above information as needed.

Include the following if applicable.

Contractor agrees to indemnify and hold Owner harmless from any loss or expense resulting from false or incorrect information in this affidavit.

Continue with the following.

[Name of affiant]

SUBSCRIBED AND SWORN TO before me on _____ by [name of affiant].

Notary Public, State of Texas

Exhibit K

This form may be used as written by a subcontractor or supplier under Tex. Prop. Code § 53.085.

Subcontractor [Final] Bills-Paid Affidavit

Date:

Owner:

Owner's Mailing Address: **[include county]**

Subcontractor:

Subcontractor's Mailing Address: **[include county]**

Contractor:

Contractor's Mailing Address: **[include county]**

Affiant: **[include relationship to subcontractor]**

Affiant's Mailing Address: **[include county]**

Property: **[include legal description]**

Improvements:

Affiant swears individually and on behalf of Subcontractor that the following statements are true and within the personal knowledge of Affiant:

1. Affiant has personal knowledge of the facts stated in this affidavit. Affiant has full authority to make the agreements in this affidavit on behalf of Subcontractor.

2. Affiant understands that Owner and Contractor have required this affidavit as a condition of payment for labor or materials used in construction of the Improvements.

3. Subcontractor has paid each of Subcontractor's suppliers and sub-subcontractors, laborers, and materialmen in full for all labor and materials provided to Owner or Contractor for construction of the Improvements, excepting only the amounts owed to the persons identified below:

List all sub-subcontractors, suppliers, laborers, and materialmen and amounts owed to each. If there are no unpaid sub-contractors, suppliers, laborers, or materialmen, state "None."

Name:

Address:

Telephone number:

Amount owed:

Repeat above information as needed.

Include the following if applicable.

Subcontractor warrants and represents that the following specified bills or classes of bills will be paid by Subcontractor from the funds paid to Subcontractor by Contractor or Owner in reliance on this affidavit:

Name of payee or description of class:

Amount:

Repeat above information as needed.

Include the following if applicable.

Subcontractor agrees to indemnify and hold Owner harmless from any loss or expense resulting from false or incorrect information in this affidavit.

Continue with the following.

[Name of affiant]

SUBSCRIBED AND SWORN TO before me on _____ by [name of affiant].

Notary Public, State of Texas

Exhibit L

This waiver and release is based on the form found in Tex. Prop. Code § 53.284(e). If a contractor (or other potential lien claimant) is required to execute an unconditional waiver and release to prove the receipt of good and sufficient funds for a final payment and the claimant or potential claimant asserts in the waiver and release that the claimant or potential claimant has been paid the final payment, the waiver and release must read as follows. The waiver and release must include the notice at the top of the document.

Unconditional Release on Final Payment

NOTICE: This document waives rights unconditionally and states that you have been paid for giving up those rights. It is prohibited for a person to require you to sign this document if you have not been paid the payment amount set forth below. If you have not been paid, use a conditional release form.

Project:

Job No.

The signer of this document has been paid in full for all labor, services, equipment, or materials furnished to the property or to [name of person with whom signer contracted] on the property of [name of owner] located at [specify location] to the following extent: [specify job description]. The signer therefore waives and releases any mechanic's lien right, any right arising from a payment bond that complies with a state or federal statute, any common-law payment bond right, any claim for payment, and any rights under any similar ordinance, rule, or statute related to claim or payment rights for persons in the signer's position.

The signer warrants that the signer has already paid or will use the funds received from this final payment to promptly pay in full all of the signer's laborers, subcontractors, materialmen, and suppliers for all work, materials, equipment, or services provided for or to the above-referenced project up to the date of this waiver and release.

Date

[Company name]

By _____

[Name and title]

[Reserved]

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Contractual Mechanic's Lien Documents

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Form 20-7	Home Improvement Closing Certificate	20-7-1 to 20-7-2
Form 20-8	Election Regarding Right of Rescission	20-8-1 to 20-8-2

Chapter 20

Contractual Mechanic's Lien Documents

§ 20.1 General Considerations

§ 20.1:1 Use of Forms

This chapter outlines common transactions for the creation and documentation of mechanic's liens on homesteads.

The Texas Constitution distinguishes between "work and material used in constructing new improvements" and "work and material used to repair or renovate existing improvements" on homestead property. Several requirements are added if the contractor or lender is obtaining a lien for repair or renovation of a homestead. *See* Tex. Const. art. XVI, § 50(a)(5)(A)-(D). This chapter contains forms suggested for use in new construction projects and for repair or renovation construction. The forms include a mechanic's lien contract (form 20-1), a mechanic's lien note (form 20-2), and closing certificates (forms 20-6 and 20-7), which confirm owner compliance with the homestead requirements for transactions involving new construction or renovation or repair of existing homesteads.

Section 20.6 below suggests other forms that may be necessary in various transactions, and chapter 12 in this manual discusses truth-in-lending notices and disclosure statements, which are required in several kinds of transactions. Chapter 18 contains a residential construction contract form. The forms and procedures contained in chapter 18 must be reviewed to ensure compliance with the terms of the residential construction contract, the loan disclosure requirements, and the closing procedure requirements of sections 53.255 through 53.260 of the

Texas Property Code, although failure to follow these requirements for residential contracts might not invalidate the lien securing the residential construction loan. *See* Tex. Prop. Code §§ 53.255(c), 53.256(c), 53.257(c), 53.258(e). The residential construction contract (form 18-4) should be referenced in the mechanic's lien contract (form 20-1). The residential construction contract addresses many construction contract terms not addressed by the mechanic's lien contract.

The forms in this chapter are designed to function interdependently to create and document liens arising from the credit financing of building a home located on homestead property. The choice of which forms to use and which optional provisions to include in the forms for a given transaction depends on several factors, such as which party is extending credit, who owns the property, whether the project is for construction of a new residence or is for renovation or repair of an existing homestead, and whether the lien is primary or subordinate. The mechanic's lien note, form 20-2, should not be used without the supporting documents suggested in this chapter.

If the construction loan does not affect homestead property, attorneys usually use the deed of trust (see chapter 8) and note (see chapter 6) instead of the mechanic's lien documents.

If the mechanic's lien contract is used for new improvements to a homestead, the property owner may not be able to refinance any payments made to the contractor or any amount owed to the contractor (other than with a home equity loan) if construction begins before appropriate documentation is executed, acknowledged, and filed. If the owner intends to finance

or refinance any part of the consideration, the appropriate documents and procedures prescribed in this chapter must be implemented before construction begins. Tex. Const. art. XVI, § 50(a)(5); Tex. Prop. Code § 53.254.

Caution: Only fixed-rate, simple interest may be charged in transactions using these forms. Mechanic's lien transactions face the cumulative and complex restrictions imposed by federal and state consumer protection laws, Texas homestead laws, and the Texas Finance Code. See sections 20.1:2 and 20.1:3 below. For this reason, transactions documented by the forms in this chapter must not use add-on interest or variable interest rates, either of which would require significant revision of the documents.

§ 20.1:2 Homestead Considerations

The Texas homestead exemption generally does not preclude a contractual lien for improvements from attaching to the homestead. However, contractors, laborers, and materialmen must create such a lien in strict compliance with constitutional, statutory, and regulatory formalities. *Kendall Builders, Inc. v. Chesson*, 149 S.W.3d 796, 807 (Tex. App.—Austin 2004, pet. denied).

Source of Requirements for Contractual

Liens for Improvements: The basic requirements for all contractual liens for improvements to the homestead are found at Tex. Const. art. XVI, § 50(a)(5). These constitutional requirements are in certain cases supplemented by additional requirements found at Tex. Prop. Code §§ 41.001, 53.254. Additionally, the Texas Finance Commission has issued regulations interpreting these constitutional and statutory formalities found at 7 Tex. Admin. Code ch. 152.

The formalities necessary for a valid contractual lien for improvements against the homestead are different depending on whether the contract is for new improvements or for repairs or renova-

tions to existing improvements. Tex. Const. art. XVI, § 50(a)(5). Additionally, statutory requirements differ depending on whether the property improved is a business or residential homestead. See Tex. Prop. Code § 53.251(a). Practitioners must be attentive to these variables when drafting a contractual lien for improvements made to the homestead.

Contract in Writing: All contractual liens for improvements to the homestead must be created by a contract in writing between the general contractor and the homestead owner. Tex. Const. art. XVI, § 50(a)(5). The contract must create direct privity between the contractor and the homestead owner. Tex. Att'y Gen. Op. No. JC-0386 (2001). The contract must be bona fide. A sham contract under which the putative contractor receives no consideration or performs no services will not create a valid lien against the homestead. See *In re Jeter*, 48 B.R. 404, 408 (Bankr. N.D. Tex. 1985).

Contract Must Set Forth Terms of

Agreement: A contractual lien for improvements to a residential homestead must set forth the terms of the agreement between the owner and the contractor. This requirement is not applicable to improvements made to a business homestead. Tex. Prop. Code §§ 41.001(b)(3), 53.254(a). The written contract between the owner and the contractor must at a minimum recite (1) the principal amount of the loan, (2) the interest rate, (3) the date that the final payment is due, (4) a description of the property, (5) a general description of the materials to be supplied or labor performed, and (6) that a lien is granted to secure payment. *In re Burnett*, 120 B.R. 839, 841–42 (Bankr. N.D. Tex. 1990). The contract need only provide the general nature of the improvements. It is not necessary that the contract contain a detailed itemized statement of the work performed or materials furnished. *Gomez v. Riddle*, 334 S.W.2d 197, 200 (Tex. Civ. App.—San Antonio 1960, no writ).

Contract Must Be Executed before Commencement of Work: A contractual lien for improvements to a homestead must be executed before the contractor furnishes any materials or performs any labor. Tex. Prop. Code §§ 41.001(b)(3), 53.254(b).

Contract Must Be Executed by Both Spouses: Generally, in the case of a family homestead, a contractual lien for improvements must be executed by both spouses in the manner required for the sale or conveyance of the homestead. Tex. Const. art. XVI, § 50(a)(5)(A); Tex. Prop. Code §§ 41.001(b)(3), 53.254(c). This joinder requirement apparently does not apply to new improvements made to a business homestead. See *Spradlin v. Jim Walter Homes*, 34 S.W.3d 578, 580–81 (Tex. 2000). See also Tex. Prop. Code §§ 41.001(b)(3), 53.251(a), 53.254(c).

Required Five-Day Waiting Period: If the extension of credit is to secure the repair or renovation of existing improvements to the homestead, whether with a contractor or third-party lender, the owner must complete a credit application for the extension of credit, and a five-day waiting period must expire between the date that the homeowner makes application for the extension of credit and the date that the contractual lien is executed. Any lien instrument executed before the expiration of the five-day waiting period is invalid. Tex. Const. art. XVI, § 50(a)(5)(B). To count the five days, the day after the application for the extension of credit is made is day one. If the fifth calendar day falls on a Sunday or a federal legal public holiday, the contractual lien may not be executed until the next calendar day that is not a Sunday or a federal legal public holiday. 7 Tex. Admin. Code § 152.9.

The five-day waiting period is not required if the work or materials are necessary to complete immediate repairs to conditions on the homestead property that materially affect the health

and safety of the owner or person residing in the homestead and the owner acknowledges this exigency in writing. Tex. Const. art. XVI, § 50(a)(5)(B). This written acknowledgment must at a minimum (1) describe the conditions of the homestead property, (2) describe how the conditions of the homestead property affect the health and safety of the owner or person residing in the homestead, and (3) state that the owner is waiving the five-day waiting period required by Tex. Const. art. XVI, § 50(a)(5)(B). Printed forms for this purpose are prohibited. 7 Tex. Admin. Code § 152.13.

Required Preclosing Disclosures: When the owner obtains third-party financing for the construction of improvements to a residential homestead, the lender must deliver to the owner all documentation relating to the closing of the loan not later than one business day before the date of the closing. If a bona fide emergency or other good cause exists and the lender obtains the written consent of the owner, the lender may provide the documentation or modify previously provided documentation on the date of closing. Tex. Prop. Code § 53.257(a).

In addition, the lender must deliver to the owner before the date of closing the extensive statutory disclosure specified at Tex. Prop. Code § 53.255. If a bona fide emergency or other good cause exists and the lender obtains the written consent of the owner, the lender may provide the required statutory disclosure at closing. The lender must retain a signed and dated copy of this disclosure with the closing documents for the loan. Tex. Prop. Code § 53.257(b).

A failure by the lender or contractor to provide these disclosures does not invalidate the lien. Tex. Prop. Code §§ 53.255(c), 53.257(c).

Right of Rescission: A contract for work or materials for repairs or renovations to existing homestead improvements must provide that the contract may be rescinded by the owner or the owner's spouse without penalty within three cal-

endar days after execution of the contract by the parties. Tex. Const. art. XVI, § 50(a)(5)(C). To count the three days, the day after the contract is executed is day one. If the third calendar day falls on a Sunday or a federal legal public holiday, the right of rescission is extended to the next calendar day that is not a Sunday or a federal legal public holiday. 7 Tex. Admin. Code § 152.11.

The three-day right of rescission is not required if the work or materials are necessary to complete immediate repairs to conditions on the homestead property that materially affect the health and safety of the owner or person residing in the homestead and the owner of the homestead acknowledges this exigency in writing. Tex. Const. art. XVI, § 50(a)(5)(C). This written acknowledgment and waiver must at a minimum (1) describe the conditions of the homestead property, (2) describe how the condition of the homestead property affects the health and safety of the owner or person residing in the homestead, and (3) state that the owner is waiving the three-day right of rescission. Printed forms for this purpose are prohibited. 7 Tex. Admin. Code § 152.13.

Restriction on Place of Closing: A contractual lien for improvements to repair or renovate existing improvements on the homestead must be executed in the offices of a third-party lender making the extension of credit, an attorney at law, or a title company. Tex. Const. art. XVI, § 50(a)(5)(D). There is no exception to this requirement for exigent circumstances as with the five-day waiting period or right of rescission.

Required Disclosures: A contract for improving an existing residential homestead must contain the following conspicuous disclosure next to the owner's signature line:

IMPORTANT NOTICE: You and your contractor are responsible for meeting the terms and conditions of

this contract. If you sign this contract and you fail to meet the terms and conditions of this contract, you may lose your legal ownership rights in your home. KNOW YOUR RIGHTS AND DUTIES UNDER THE LAW.

Failure to include the notice constitutes an actionable violation of the Texas Deceptive Trade Practices Act. Tex. Prop. Code § 41.007.

§ 20.1:3 Usury Laws and Regulations

The usury statutes and regulations that apply to a loan vary with the type of loan and lender. Regardless of the structure of the transaction, the creditor must comply with the Truth in Lending Act, 15 U.S.C. §§ 1601–1667f.

Third-Party Lenders and First Liens: State usury law has been preempted by federal statute for first liens on residential real property. This preemption eliminates the rate ceiling for this type of loan for most creditors, including all federally insured financial institutions and other creditors that make or invest in residential real property loans aggregating more than \$1 million per year. 12 U.S.C. §§ 1735f–7, 1735f–7a; *Seiter v. Veytia*, 756 S.W.2d 303 (Tex. 1988). *See also* Tex. Fin. Code § 302.103 (late charges are interest for purpose of federal preemption). Other third-party lenders may rely on Code section 302.001 as the usury law.

Texas usury law is located primarily in title 4 of the Texas Finance Code. The maximum legal interest rate, except as otherwise fixed by law, is set at 10 percent. Tex. Fin. Code § 302.001. Floating interest rate ceilings for written contracts are established by chapter 303 of the Code. Tex. Fin. Code ch. 303.

Contractor–Creditors and First Liens: A contractor–creditor may be limited to Code section 302.001 as the applicable usury law for a complete structure.

§ 20.1:4 Other Consumer Protection Laws

Federal Disclosure Laws and Regulations:

Federal consumer credit laws require disclosures designed to allow informed decision making. The most important of these are the Truth in Lending Act, 15 U.S.C. §§ 1601–1667f, and Federal Reserve Board Regulation Z, 12 C.F.R. pt. 226, both of which require certain creditors to disclose loan terms and rights of rescission to potential borrowers. See chapter 12 in this manual for forms and further discussion.

Other federal consumer protection laws that might affect mechanic's lien transactions include—

1. The Real Estate Settlement Procedures Act, 12 U.S.C. §§ 2601–2617, and Housing and Urban Development Regulation X, 24 C.F.R. pt. 3500, both of which apply primarily to closings for purchases of residential property designed for occupancy by one to four families involving federally related mortgage loans.
2. The Federal Trade Commission anti-holder-in-due-course rule, 16 C.F.R. pt. 433. A prescribed notice must be included in the instrument evidencing the debt if the contractor either (a) receives the proceeds of a loan made to the owner by a third-party creditor for the acquisition of goods or services by sale or lease and either refers customers to the third-party creditor or is affiliated with the third-party creditor by common control, contract, or business arrangement; or (b) extends credit to the owner in connection with a 'credit sale' under the Truth in Lending Act or Regulation Z. 16 C.F.R. §§ 433.1(d), (e), (i), 433.2.

The contractor and the third-party creditor have a referral relationship if

the contractor cooperates with the third-party creditor to channel customers to the third-party creditor on a continuing basis. A referral relationship may arise from a pattern of cooperative activity directly related to the arranging of financing. To fall within the rule, the contractor and the third-party creditor must be engaged in cooperative or concerted activity conducted to channel consumers to the third-party creditor, and this conduct must occur on a continuing basis. Once a referral relationship is established, the instruments evidencing debts owed to the third-party creditor arising out of referrals from the contractor must include the prescribed notice. However, a referral relationship does not include situations in which the contractor merely suggests credit sources to its customers or sends its customers to a third-party creditor without the express or implied agreement of the creditor or without any concerted or cooperative activity between the contractor and the creditor.

The contractor and the third-party creditor may be affiliated by common control. For example, common control exists if two companies are owned by a holding company or by substantially the same individuals or if one is a subsidiary of the other. The contractor and the third-party creditor may also be affiliated by a contract or business arrangement, which includes any agreement (oral or written), understanding, procedure, course of dealing, or arrangement between the contractor and the creditor to engage in cooperative or concerted activity in connection with the contractor's sale to customers or the financing thereof. However, the creditor can issue checks

payable jointly to the contractor and the owner, and the creditor can cooperate with the contractor to perfect the mechanic's lien without creating an affiliation by contract or other arrangement under the FTC rule.

If the contractor and the third-party creditor are not affiliated by common control or by a contract or business arrangement and if the contractor does not refer customers to the third-party creditor, FTC notices are not required and may be deleted from the forms. Federal Trade Commission Statement of Enforcement Policy, 41 Fed. Reg. 34,594 (1976).

3. **Right of Rescission.** The contractor may need to comply with the Federal Trade Commission rule on cooling-off periods for door-to-door sales. Exceptions exist if the agreement is entered into at the contractor's place of business or under prior negotiations during a visit by the owner to the contractor's fixed, permanent business establishment, at which the contractor's services are offered for sale on a continual basis. 16 C.F.R. pt. 429.
4. The Federal Trade Commission rule on credit practices, 16 C.F.R. pt. 444.

Texas Consumer Protection Law: The Texas Constitution provides several consumer protection provisions related to construction on homestead property. These requirements are described in this chapter specifically in section 20.1:2 above. Forms 20-6 and 20-7 in this chapter are certificates of closing used to confirm compliance with these requirements.

Texas Consumer Protection Laws for Home Solicitations: The Texas Home Solicitations Transaction Act may apply if the consumer's obligation is entered into at a location other than the contractor's place of business. If the Act

applies, additional notices are required. Tex. Bus. & Com. Code ch. 601. See the notice of cancellation attached to the mechanic's lien contract (form 20-1).

Texas Finance Code Chapter 343—Home Loan Requirements: In addition to the foregoing, the transactions described in this chapter may be subject to the disclosure and other requirements of chapter 343 of the Texas Finance Code. See sections 10.14 through 10.14:3 in this manual.

Confidentiality Notice: Instruments, meaning deeds and deeds of trust, transferring an interest in real property to or from an individual may be required to include the confidentiality notice required by Tex. Prop. Code § 11.008. See section 3.16 in this manual.

Texas Mechanic's Lien Claims: The perfection of involuntary mechanic's liens is covered in chapter 21 in this manual. Before contracting for residential construction, owners should become familiar with their potential liability for mechanic's liens. Mechanic's lien liability and related procedures are outlined for owners in section 18.3:4.

§ 20.2 Procedures for Various Fact Situations

This section describes typical construction projects on homesteads. Procedures are given for new construction and for repair or renovation construction projects.

§ 20.2:1 First Lien to Third-Party Lender to Secure Interim and Permanent Financing

The owner has title to the real property on which the contractor is building a home or repairing or renovating an existing home, and the third-party lender obtains a first lien to secure both interim and permanent construction financing. See sec-

tion 20.2:2 below for the procedure to be followed if the third-party lender is not providing interim construction financing.

Along with the forms suggested below, other forms used to document the construction process and establish the parties' rights may be found in chapter 18 in this manual. Chapter 18 also offers suggestions for completing those forms.

Following are the steps to create and document the mechanic's lien.

1. For repair or renovation construction projects, all the owners (both spouses) must sign a written application for extension of credit at least five days before signing the mechanic's lien contract. Tex. Const. art. XVI, § 50(a)(5)(B).
2. The contractor delivers the required disclosure statement (form 18-1) and the list of subcontractors and suppliers (form 18-2) to the owners. *See* Tex. Prop. Code §§ 53.255, 53.256. Also, a third-party lender is required to give the disclosure in form 18-1 under section 53.257(a) of the Texas Property Code and must deliver all documentation related to the loan not later than one business day before the date of the closing. Tex. Prop. Code § 53.257.
3. The contractor, the owner, and the owner's spouse sign the mechanic's lien contract. For repair or renovation construction, this contract must be signed only at the offices of the third-party lender, a lawyer, or a title company. Tex. Const. art. XVI, § 50(a)(5)(D).
4. A certificate of closing is signed. Form 20-6 in this chapter is for new construction projects, and form 20-7 is for repair or renovation projects.
5. The owner executes the mechanic's lien note payable to the contractor; the note should bear no interest and be payable in a single payment on completion of construction. The contractor thus is not a creditor under the federal Truth in Lending Act because no finance charge is involved and the obligation is payable in four or fewer installments. 15 U.S.C. § 1602(f).

Because the mechanic's lien note payable to the contractor bears no interest and is payable in a single installment, there is no retail installment transaction under Texas Finance Code chapter 345, and that chapter does not apply. Tex. Fin. Code § 345.001(7).

The contractor must comply with the FTC anti-holder-in-due-course rule if the contractor has a referral relationship or affiliation with the third-party lender. 16 C.F.R. pt. 433. (See section 20.1:4 above for additional discussion.) The FTC anti-holder-in-due-course notice should be included in the mechanic's lien note payable to the third-party creditor and may also be included in the mechanic's lien contract and the mechanic's lien note payable to the contractor. If no referral relationship or affiliation exists, the notice may be deleted from these documents.
6. The contractor gives the required notices under the FTC rule on cooling-off periods for door-to-door sales (unless an exception exists). In addition, for renovation or repair construction, a three-day right to rescind following execution of the mechanic's lien contract by all parties is required unless the project is for immediate repairs to conditions on the homestead property that materially affect the health or safety of the owner and the

owner of the homestead acknowledges such in writing. Tex. Const. art. XVI, § 50(a)(5)(C). The contractor then waits to be sure the foregoing rights of cancellation or rescission are not exercised. The owner executes the election regarding right of rescission (form 20-8) and checks the box indicating the owner's election *not* to rescind the contract.

7. The contractor endorses the mechanic's lien note to the third-party lender and assigns the lien with a transfer of lien, which is filed with the county clerk of the county in which the property is located. See section 10.1 and form 10-1.
8. The third-party lender renews and extends the mechanic's lien note by having the owner execute a note payable to the third-party lender; it bears interest and is payable as agreed between the owner and the third-party lender.

Only fixed-rate, simple interest may be charged in transactions using the forms in this chapter. If fixed interest rates are used, the adjustable-rate mortgage regulations do not apply. These forms are not designed for use with loans subject to the adjustable-rate mortgage regulations and must be significantly revised if used for that purpose.
9. The third-party lender extends the lien with the deed of trust executed by the owner, naming the trustee chosen by the third-party lender. The deed of trust is filed with the county clerk of the county in which the property is located. See chapter 8.
10. The third-party lender is a truth-in-lending creditor and must give the owner a truth-in-lending (loan) disclo-

sure form and a right-of-rescission form. See 12 C.F.R. § 226.23. See chapter 12 for forms and further discussion.

11. Construction begins. The affidavit of commencement is executed (see form 18-5). Normally, the third-party lender then advances funds in stages as the construction is completed, according to terms of the mechanic's lien contract and any incorporated residential construction contract. In some cases the lender will require its own construction loan agreement providing interim payments or draws. The owner pays interest to the third-party lender only on amounts advanced during construction and normally begins making payments on the principal of the renewal note only after completion of the construction.

A disbursement disclosure may be found at form 18-3. See section 18.7:3 for discussion of the balance of the construction process, including descriptions of change orders, affidavits of completion, and the all-bills-paid affidavits.

12. On final completion, the contractor executes the affidavit of completion and indemnity (form 20-3), and the owner executes the affidavit of acceptance (form 20-4). The owner has the option of executing and filing the affidavit of completion (form 18-7) (see sections 18.3:4 and 18.7:7).

§ 20.2:2 **First Lien to Contractor; No Interim Financing; Permanent Financing by Third-Party Lender**

The owner has title to the real property on which the contractor is building a home or repairing or renovating an existing home, and the third-party

lender obtains a first lien to secure permanent financing. The third-party lender is not providing interim construction financing. See section 20.2:1 above for the procedure to be followed if the third-party lender also provides interim construction financing.

Along with the forms suggested below, other forms used to document the construction process and establish the parties' rights may be found in chapter 18 in this manual. Chapter 18 also offers suggestions for completing those forms.

Following are the steps to create and document the mechanic's lien.

1. For repair or renovation construction projects, all the owners (both spouses) must sign a written application for extension of credit at least five days before signing the mechanic's lien contract. Tex. Const. art. XVI, § 50(a)(5)(B).
2. The contractor delivers the required disclosure statement (form 18-1) and the list of subcontractors and suppliers (form 18-2) to the owners. *See* Tex. Prop. Code §§ 53.255, 53.256.
3. The contractor, the owner, and the owner's spouse sign the mechanic's lien contract. For repair or renovation construction, this contract must be signed only at the offices of the third-party lender, a lawyer, or a title company. Tex. Const. art. XVI, § 50(a)(5)(D).
4. A certificate of closing is signed. Form 20-6 is for new construction projects, and form 20-7 is for repair or renovation projects.
5. The owner executes the mechanic's lien note payable to the contractor; the note should bear no interest and be payable in a single payment on com-

pletion of construction. The contractor thus is not a creditor under the federal Truth in Lending Act because no finance charge is involved and the obligation is payable in four or fewer installments. 15 U.S.C. § 1602(f).

Because the mechanic's lien note payable to the contractor bears no interest and is payable in a single installment, there is no retail installment transaction under Texas Finance Code chapter 345, and that chapter does not apply. Tex. Fin. Code § 345.001(7).

The contractor must comply with the FTC anti-holder-in-due-course rule if the contractor has a referral relationship or affiliation with the third-party lender. 16 C.F.R. pt. 433. The FTC anti-holder-in-due-course notice should be retained in the mechanic's lien note if the contractor has a referral relationship or affiliation with the third-party lender. 16 C.F.R. pt. 433. (See section 20.1:4 above for additional discussion.) Otherwise the notice may be deleted.

6. The contractor gives the required notices under the FTC rule on cooling-off periods for door-to-door sales (unless an exception exists). In addition, for renovation or repair construction, a three-day right to rescind following execution of the mechanic's lien contract by all parties is required unless the project is for immediate repairs to conditions on the homestead property that materially affect the health or safety of the owner and the owner of the homestead acknowledges such in writing. Tex. Const. art. XVI, § 50(a)(5)(C). The contractor then waits to be sure the foregoing rights of cancellation or rescission are not exercised. The owner executes the election regarding right of rescission (form

20-8) and checks the box indicating the owner's election *not* to rescind the contract.

7. Construction begins and the affidavit of commencement (form 18-5) is executed. Construction must then be completed before the next step in this procedure.
8. The contractor executes the affidavit of completion and indemnity (form 20-3), and the owner executes the affidavit of acceptance (form 20-4). The owner has the option of executing and filing the affidavit of completion (form 18-7) (see sections 18.3:4 and 18.7:7).
9. The contractor endorses the mechanic's lien note to the third-party lender and assigns the lien with a transfer of lien, which is filed with the county clerk of the county in which the property is located. See section 10.1 and form 10-1.
10. The third-party lender renews and extends the mechanic's lien note by having the owner execute another note payable to the third-party lender; it bears interest and is payable as agreed between the owner and the third-party lender.

§ 20.2:3 Second Lien to Third-Party Lender to Secure Interim and Permanent Financing

The owner has title to the real property on which the contractor is building a home or repairing or renovating an existing home, and the third-party lender obtains a second lien to secure both interim and permanent construction financing.

Along with the forms suggested below, other forms used to document the construction process and establish the parties' rights may be

found in chapter 18 in this manual. Chapter 18 also offers suggestions for completing those forms.

Following are the steps to create and document the mechanic's lien.

1. For repair or renovation construction projects, all the owners (both spouses) must sign a written application for extension of credit at least five days before signing the mechanic's lien contract. Tex. Const. art. XVI, § 50(a)(5)(B).
2. The contractor delivers the required disclosure statement (form 18-1) and the list of subcontractors and suppliers (form 18-2) to the owners. See Tex. Prop. Code §§ 53.255, 53.256. Also, a third-party lender is required to give the disclosure in form 18-1 under section 53.257(a) of the Texas Property Code and must deliver all documentation related to the loan not later than one business day before the date of the closing. Tex. Prop. Code § 53.257.
3. The contractor, the owner, and the owner's spouse sign the mechanic's lien contract. See form 20-1 in this chapter. Additional clauses 20-5-9, 20-5-10, and 20-5-11 are added to the mechanic's lien contract as part of the general provisions, section F. If a residential construction contract is to be executed, see form 18-4. If the project is for repair or renovation of an existing homestead, the contract must be signed only at the offices of the third-party lender, a lawyer, or a title company. Tex. Const. art. XVI, § 50(a)(5)(D).
4. A certificate of closing is signed. Form 20-6 is for new construction projects, and form 20-7 is for repair or renovation projects.

5. The owner executes the mechanic's lien note payable to the contractor; the note should bear no interest and be payable in a single payment on completion of construction. The contractor thus is not a creditor under the federal Truth in Lending Act because no finance charge is involved and the obligation is payable in four or fewer installments. 15 U.S.C. § 1602(f).

Under Texas homestead laws, when the contractor and the owner sign the mechanic's lien contract and the owner executes the mechanic's lien note payable to the contractor, an obligation is established in favor of the contractor and is secured by a mechanic's lien. Tex. Prop. Code § 53.254.

Because the mechanic's lien note payable to the contractor bears no interest and is payable in a single installment, there is no retail installment transaction under Texas Finance Code chapter 345, and that chapter does not apply. Tex. Fin. Code § 345.001(7).

The contractor must comply with the FTC anti-holder-in-due-course rule if the contractor has a referral relationship or affiliation with the third-party lender. 16 C.F.R. pt. 433. (See section 20.1:4 above for additional discussion.) The FTC anti-holder-in-due-course notice should be included in the mechanic's lien note payable to the third-party creditor and may also be included in the mechanic's lien contract and the mechanic's lien note payable to the contractor. If no referral relationship or affiliation exists, the notice may be deleted from these documents.

6. The contractor gives the required notices under the FTC rule on cooling-

off periods for door-to-door sales (unless an exception exists). For renovation or repair construction projects, a three-day right to rescind following execution of the mechanic's lien contract by all parties is required unless the project is for immediate repair to conditions on the homestead property that materially affect the health or safety of the owner and the owner of the homestead acknowledges such in writing. Tex. Const. art. XVI, § 50(a)(5)(C). The contractor then waits to be sure the right of cancellation is not exercised and otherwise complies with the rule, unless an exception exists and the FTC rule does not apply. See section 20.1:4. The owner executes the election regarding right of rescission (form 20-8) and checks the box indicating the owner's election *not* to rescind the contract.

7. The contractor endorses the mechanic's lien note to the third-party lender and assigns the lien with a transfer of lien, which is filed with the county clerk of the county in which the property is located. See section 10.1 and form 10-1.
8. The third-party lender renews and extends the mechanic's lien note by having the owner execute a note payable to the third-party lender; it bears interest and is payable as agreed between the owner and the third-party lender. Only fixed-rate, simple interest may be charged in transactions using the forms in this chapter. If fixed interest rates are used, the adjustable-rate mortgage regulations do not apply. These forms are not designed for use with loans subject to the adjustable-rate mortgage regulations and must be significantly revised if used for that purpose.

9. The third-party lender extends the lien with the deed of trust executed by the owner, naming the trustee chosen by the third-party lender. The deed of trust is filed with the county clerk of the county in which the property is located. See chapter 8.
10. The third-party lender may be a truth-in-lending creditor and may be required to give the owner the truth-in-lending (loan) disclosure form. See 12 C.F.R. § 226.23. See chapter 12 for forms and further discussion.
11. Construction begins. The affidavit of commencement is executed (see form 18-5). Ordinarily, the third-party lender then advances funds in stages as the construction is completed, according to terms of the mechanic's lien contract and any incorporated residential construction contract. In some cases the lender will require its own construction loan agreement providing interim payments or draws. The owner pays interest to the third-party lender only on amounts advanced during construction and usually begins making payments on the principal of the renewal note only after completion of the construction.

During construction additional forms are used. A disbursement disclosure may be found at form 18-3. See section 18.7:3 for discussion. Other forms used during construction are change-order forms, affidavits of completion, and all-bills-paid affidavits. These forms are included in chapter 18.
12. On final completion, the contractor executes the affidavit of completion and indemnity (form 20-3), and the owner executes the affidavit of acceptance (form 20-4). The owner has the option of executing and filing the affi-

davit of completion (form 18-7) (see sections 18.3:4 and 18.7:7).

Precautions for Subordinate Mechanic's Lien

Contracts: Subordinate lien financing involves a number of considerations for all the parties involved: the borrower, the prior lender, and the subordinate lender. The borrower should ascertain that the creation of a subordinate lien will not be a default under the prior deed of trust, as subordinate encumbrances are expressly prohibited in many deeds of trust. The prior lender may have concerns about the ability of the borrower to service both the superior and subordinate lien debts. If the borrower should default on the subordinate lien debt and the subordinate lender should foreclose, the borrower, although still liable on the debt, will no longer be the owner of the property, and the incentive to repay the senior loan will obviously be diminished.

The party at greatest risk in subordinate lien financing transactions is the subordinate lender. Foreclosure of a superior lien extinguishes all subordinate liens. See *Exchange Savings & Loan Ass'n v. Monocrete Proprietary, Ltd.*, 629 S.W.2d 34 (Tex. 1982). In Texas, unlike many other jurisdictions, a subordinate lienholder is not entitled by law to notice of default on the prior lien debt or notice of foreclosure proceedings. The subordinate lienholder is likewise not entitled to share in the foreclosure proceeds, unless there is an excess after payment of costs and expenses in connection with the foreclosure and satisfaction of the prior lien debt. The subordinate lienholder may therefore want to obtain the prior lienholder's agreement to provide notice of any default by the borrower under the first-lien note and deed of trust and the opportunity to cure such default or require the borrower to provide continuing proof that payments on the prior lien debt have been made.

A subordinate lien transaction may be subject to chapter 342 of the Texas Finance Code if the property is a dwelling designed for occupancy

by four or fewer families and the interest rate exceeds 10 percent per year. Tex. Fin. Code §§ 342.001(4), 342.005. Chapter 342 applies to a secondary mortgage loan made by a person in the business of making, arranging, or negotiating those types of loans. Tex. Fin. Code § 342.005. The chapter does not apply to a secondary mortgage loan made by a seller of property to secure all or part of the unpaid purchase price. Tex. Fin. Code § 342.006. If a lender is in the business of making, arranging, or negotiating secondary mortgage loans, the lender must obtain a license from the Office of Consumer Credit Commissioner (OCCC) unless the lender is a bank, savings bank, savings and loan association, credit union, or a residential mortgage loan originator licensed under chapter 156. Tex. Fin. Code §§ 124.005, 339.004, 341.103–.104, 342.051. Unless exempt under section 180.003, an individual who acts as a residential mortgage loan originator in the making, transacting, or negotiating of a secondary mortgage loan subject to chapter 342 must be individually licensed under chapter 342, be enrolled with the Nationwide Mortgage Licensing System and Registry as required by section 180.052, and comply with other applicable requirements of the Texas Secure and Fair Enforcement of Mortgage Licensing Act of 2009. Tex. Fin. Code ch. 180. Chapter 342 loans are highly specialized and regulated, and thus if a subordinate lien transaction is subject to chapter 342, the attorney must carefully review the chapter to make sure all requirements have been met. Texas Finance Code section 341.502 provides that “[a] contract for a loan under Chapter 342, a retail installment transaction under Chapter 348, or a home equity loan regulated by the Office of Consumer Credit Commissioner must be written in plain language designed to be easily understood by the average consumer. Tex. Fin. Code § 341.502(a). The Finance Commission of Texas is authorized to adopt model contracts for loans subject to that section. A lender may not use a contract other than a model contract unless the lender has submitted the contract to the

OCCC for its approval. If the OCCC issues an order disapproving a submitted contract, the lender may not use the contract after the order takes effect. Tex. Fin. Code § 341.502. Plain-language model contracts and related rules for chapter 342, subchapter G, second-lien home improvement contracts are codified at 7 Tex. Admin. Code §§ 90.601–.604.

The attorney general of Texas has determined that section 341.502(a) is applicable only to those loan transactions for which the consumer credit commissioner is the appointed regulating official and has no application to loan transactions subject to the regulatory authority of the banking commissioner, the savings and mortgage lending commissioner, the credit union commissioner, and federal regulatory officials. Tex. Att’y Gen. Op. No. JC-0513 (2002).

Banks, savings and loan associations, and credit unions accordingly are not required to comply with the section 341.502 “plain language” contract requirements or to obtain a license to engage in the business of making subordinate lien loans subject to chapter 342. Tex. Fin. Code § 342.051(c)(1). These institutional lenders nevertheless are thought to be subject to other substantive law provisions of chapter 342, including, for example, the limitations of that chapter on the collection of authorized fees and charges, as enforced by the policies of their respective regulatory agencies. *See* Tex. Fin. Code §§ 342.308, 342.502.

Before using the forms in this chapter for a loan subject to chapter 342 of the Texas Finance Code, the attorney should determine whether the lender is subject to the plain-language model contract provisions of Code section 341.502. The forms in this chapter have not been submitted to or approved by the OCCC.

If the attorney decides that the forms contained in this chapter may nevertheless be used for a loan regulated by chapter 342, the forms still must be modified to comply with the require-

ments of that chapter. For example, the secondary mortgage loan documents for a loan made by a licensed lender must contain the name, mailing address, and telephone number of the OCCC. Tex. Fin. Code § 14.104. See clause 8-9-24. Neither the mechanic's lien contract forms nor the note forms in this manual contain that information. The attorney should include that information in both the mechanic's lien contract form and the note form when documenting a secondary mortgage loan if the lender has a license from the OCCC. Additionally, if a subordinate lien transaction is subject to chapter 342, the printed language in the mechanic's lien contract must be modified slightly. In paragraph B.6., the phrase 'in a form acceptable to Contractor or its transferees' must be struck so that the obligation reads 'maintain at Owner's sole cost and expense insurance policies containing the following coverages'. This change is necessary because Finance Code sections 342.404 through 342.405 and 342.413 prohibit a lender from approving the selection of insurance. See Tex. Fin. Code §§ 342.404, 342.405, 342.413. Also, Finance Code section 342.404 provides that when insurance is required in connection with a loan made under that chapter, the lender must furnish the borrower a statement like the one in clause 20-5-9, which may be added to the mechanic's lien contract as a numbered paragraph under "General Provisions." Tex. Fin. Code § 342.404.

The same chapter imposes other requirements if the lender sells or procures insurance related to the loan at a rate not fixed or approved by the State Board of Insurance. See Tex. Fin. Code § 342.405.

Finance Code section 342.307 limits the enforcement fees that may be included in secondary mortgage loan documents. To comply with this section, the attorney's fee provisions in the note, form 6-1, and the mechanic's lien con-

tract should be modified if used in transactions subject to chapter 342 of the Finance Code. See Tex. Fin. Code § 342.307. In the note, the third paragraph, concerning attorney's fees, should be replaced with clause 6-6-15. See section 6.2:7.

An institutional third-party lender may be required to provide the borrower a truth-in-lending disclosure (loan) form. An example of this form is included in chapter 12.

It is essential that a subordinate deed of trust contain terms and provisions identifying the prior lien and obligating the borrower to keep the prior note and deed of trust current and not in default. Clauses 20-5-10 and 20-5-11 may be used for this purpose. The parties may wish to attempt to obtain an estoppel letter or intercreditor agreement from the prior lienholder. An example of such an instrument may be found at form 10-10.

§ 20.3 Cautions

§ 20.3:1 No Variable Interest Rate Loans

The forms in this chapter are designed for use with loans charging simple interest rates only; they must be carefully revised for use with adjustable-rate mortgages. Variable rates, balloon payments, and variable payment schedules require truth-in-lending disclosures and additional disclosures under the Texas Credit Title and Texas Finance Code.

The mechanic's lien note, form 20-2 in this chapter, makes no provision for credit life insurance.

See section 20.7 below for suggestions if one spouse will not become liable on the debt secured by the mechanic's lien contract.

§ 20.3:2 No Out-of-State Venue or Choice of Law

If a contract that provides for the construction of new improvements to real property located in Texas contains a provision making the contract or any conflict arising under the contract subject to the laws of another state, to litigation in the courts of another state, or to arbitration in another state, that provision is voidable by the party obligated to perform the construction. Tex. Bus. & Com. Code §§ 272.001–.002.

§ 20.3:3 Prompt Payment Act

Texas Property Code chapter 28 provides that an owner has thirty-five days from the date the owner receives a written request for payment from a contractor to pay the invoiced amount (less the retainage required by law) if the work covered was properly performed or materials delivered are suitably stored. Tex. Prop. Code § 28.002. Unpaid bills earn interest at the rate of 1.5 percent per month. Tex. Prop. Code § 28.004. Exceptions to this requirement are—

1. if there is a good-faith dispute about the amount owed (including a good-faith dispute about whether the work was done properly), no more than 110 percent of the amount in dispute may be withheld, Tex. Prop. Code § 28.003; or
2. if the lender does not fund the owner for a reason that is not the fault of the owner. *See* Tex. Prop. Code § 28.008.

§ 20.3:4 Construction Trust Fund Statute

Texas Property Code section 162.001 is generally referred to as the 'Construction Trust Fund Statute. This statute, among other provisions, states that loan receipts are trust funds if they are

borrowed by an owner for the purpose of improving specific real property in Texas and are secured in whole or in part by a lien on the property. Tex. Prop. Code § 162.001(b). The owner is designated as a trustee of loan funds the owner receives. Tex. Prop. Code § 162.002. As trustee, the owner is obligated to the 'beneficiaries' of the construction trust funds, including the contractor, subcontractors, mechanics, and laborers on the project. Tex. Prop. Code § 162.003(a). The owner is also a beneficiary. Tex. Prop. Code § 162.003(b). A trustee who intentionally, knowingly, or with intent to defraud directly or indirectly diverts construction trust funds without first paying the current and past-due obligations on the project has misapplied the trust funds. Tex. Prop. Code § 162.031. Criminal penalties apply to such diversion. *See* Tex. Prop. Code § 162.032. Also, diversion constitutes the basis for a civil action against the trustee. *See Tacon Mechanical Contractors v. Grant Sheet Metal, Inc.*, 889 S.W.2d 666 (Tex. App.—Houston [14th Dist.] 1994, writ denied).

§ 20.3:5 Texas Finance Code Chapter 343

A residential construction loan may be subject to the home loan disclosure and other requirements of chapter 343 of the Texas Finance Code. *See* sections 10.14 through 10.14:3 in this manual.

§ 20.4 Instructions for Completing Forms

§ 20.4:1 Generally

Chapter 3 of this manual offers useful information about designations of parties, property descriptions, and other matters generally related to completing the forms.

§ 20.4:2 Mechanic's Lien Contract

The mechanic's lien contract, form 20-1 in this chapter, closely resembles the deed of trust; reference to chapter 8 in this manual may be useful for completing the contract. For remarks about prior liens, see section 8.2:4. For discussion about other exceptions to conveyance and warranty, see section 5.2:7.

The mechanic's lien contract must be executed before the construction begins and must be filed with the county clerk of the county in which the property is located. Tex. Prop. Code § 53.254. In case of repair or renovation construction the contract must contain, and the parties must comply with, optional section G. See Tex. Const. art. XVI, § 50(a)(5)(A)–(D), and the explanation at section 20.1:1 above. Also in this case, the owners must be provided the election regarding right of rescission (see form 20-8).

The residential construction contract provides details about description of the work, schedules for completion, changes, termination of the contractor, and other matters. See form 18-4 for applicable clauses.

A force majeure and "time is of the essence" clause may be included in the additional provisions following paragraph F.13. of the mechanic's lien contract form. An example of such a clause appears as clause 20-5-2.

The contract contains the anti-holder-in-default notice required by the Federal Trade Commission for consumer credit contracts made in connection with the sale or lease of goods or services to consumers for personal, family, or household use. See 16 C.F.R. pt. 433. For transactions not covered by this FTC regulation, the notice may be deleted.

The contract contains the right-of-cancellation notice required by Tex. Bus. & Com. Code ch. 601 and 16 C.F.R. § 429.1. For transactions not covered by those provisions, the notice may be

deleted. Section G. of the contract contains the right of rescission required by Tex. Const. art. XVI, § 50(a)(5)(C), applicable to repair or renovation construction. These notices and cancellation forms may be deleted if an exception exists or if the sections are not applicable.

RCLA Notice Required: The notice statement required by the Texas Residential Construction Liability Act (RCLA, Tex. Prop. Code ch. 27) is included at the end of the contract, above the owner signatures. See Tex. Prop. Code § 27.007.

The RCLA notice is required in addition to the Tex. Prop. Code § 41.007 notice.

§ 20.4:3 Mechanic's Lien Note

The mechanic's lien note, form 20-2 in this chapter, is similar to the note discussed in chapter 6, which suggests payment clauses and other clauses that may also be appropriate for this note.

The mechanic's lien note should not be used alone. Interdependent uses of the forms are suggested in section 20.2 above.

Payment clauses should be drafted in accordance with the provision for statutory retainage contained in the mechanic's lien contract in paragraph D.4.

Notwithstanding anything to the contrary in this contract, during progress of the Construction, Owner may retain the amounts required by sections 53.101 and 53.081 of the Texas Property Code. Retainage will be withheld until the last business day of the third month after the month of final completion of the project, unless otherwise provided in the residential construction contract between the parties.

The mechanic's lien note contains the anti-holder-in-due-course notice required by the Federal Trade Commission for consumer credit contracts made in connection with the sale or lease of goods or services to consumers for personal, family, or household use. *See* 16 C.F.R. pt. 433. For transactions not covered by this FTC regulation, the notice may be deleted. The notice appears on the last page of the mechanic's lien note immediately preceding the signature line.

Often the note is drafted to become due on completion of construction. Alternatively, the parties may prefer to specify that partial payments are due on completion of distinct phases of construction. Installment payments may cause the Truth in Lending Act to apply. *See* chapter 12. Examples of both types of payment clauses appear in form 20-5.

§ 20.5 Additional Clauses

The mechanic's lien contract, form 20-1 in this chapter, may include additional clauses concerning contract price. *See* form 20-5 for examples of these clauses.

If payment is based on costs, the attorney should include a carefully drafted definition of costs in the contract.

For transactions subject to chapter 345 of the Texas Finance Code, the 'cost-plus' clauses (20-5-6 and 20-5-7) are not appropriate. *See* section 20.1:3 above.

If payment will be based on the cost of labor and material plus a fixed fee, not to exceed a certain amount, use clause 20-5-6. If payment will be based on the cost of labor and material plus a percentage of the cost, not to exceed a certain amount, use clause 20-5-7.

If the contractor's profit is calculated by fixed fee or percentage and the parties do not wish to limit the total cost, the examples suggested in clauses 20-5-6 and 20-5-7 could be modified by

omitting the sentence limiting total contract price. However, this practice is discouraged because a contract that does not limit total costs to a certain amount arguably may not create a valid lien against a homestead, because it might not satisfy the constitutional requirement for a complete precommencement contract that includes the price.

§ 20.6 Additional Documents

Chapter 12 in this manual contains documents that may be required for mechanic's lien transactions in accordance with the Truth in Lending Act and its accompanying regulations. Chapter 12 also offers suggestions for completing those forms.

In mechanic's lien transactions the owner and the contractor should either execute a detailed construction contract like form 18-4 in this manual, describing plans and specifications for the construction, or include those details in the mechanic's lien contract. The American Institute of Architects' standard form is also commonly used for this purpose if a separate contract is desired. Any separate contract used for this purpose should be incorporated by reference in the mechanic's lien contract.

Other forms used to document the construction process and establish the parties' rights may be found in chapter 18. Chapter 18 also offers suggestions for completing those forms.

If the mechanic's lien is subordinate to a prior lien, the lender ordinarily requires as a condition of the loan that the holder of the prior lien sign a third-party estoppel agreement. An example of this agreement appears as form 10-10.

If a cosigner, guarantor, or the like is not the spouse of the loan applicant and will not benefit from the credit transaction, federal regulations require creditors to provide a specified notice for consumer credit transactions other than the

purchase of real property. The notice, which must be given as a separate statement to each cosigner, guarantor, or the like, may be found at form 6-7.

The transaction described in section 20.2:2 above suggests the use of an affidavit of completion of construction and indemnity as part of the procedure. A model for this purpose is provided as form 20-3 in this chapter and is accompanied with a form for the owner's affidavit of acceptance of the construction, form 20-4.

§ 20.7 Required Signatures

If the spouse of the owner of record of the homestead subject to the mechanic's lien will not become liable on the underlying debt, the transaction must be structured accordingly. To avoid becoming liable on the debt, the spouse may execute only the lien instrument (mechanic's lien contract or deed of trust), not the mechanic's lien note.

If a homestead is the separate property of one spouse, both spouses must sign and acknowledge the mechanic's lien contract to create a valid mechanic's lien, but only the spouse liable on the debt need sign the note. In this case, a clause like clause 20-5-8 in this chapter should be added to the general provisions section of the mechanic's lien contract.

Although creditors often prefer that both spouses sign the note, regulations accompanying the Equal Credit Opportunity Act generally prohibit creditors from requiring an applicant's spouse to cosign or guarantee a note if the applicant is creditworthy. 12 C.F.R. § 202.7(d). Even if not liable on the debt secured by the lien on the property, a spouse may sign the instrument creating the lien if state law requires the signatures of both spouses; this compliance with state law does not violate the Equal Credit Opportunity Act.

A creditor may request a cosigner, guarantor, or the like on an extension of credit if the applicant does not meet the creditor's creditworthiness standard for individual credit. However, the creditor may not specify that the applicant's spouse be the cosigner or guarantor. Under some conditions creditors must provide cosigners a notice warning them of their liabilities. See section 6.5:2 and form 6-7.

§ 20.8 Foreclosure

Foreclosure of the voluntary contract lien granted in a mechanic's lien contract is similar to foreclosure under a deed of trust. See chapter 14 in this manual for foreclosure instruments that may be adapted for use in foreclosing a mechanic's lien.

Additional Resources

Beyer, Gerry W. *Real Property*. 2nd ed. West's Texas Forms 13-15. St. Paul, MN: West, 2001. Supplement 2016.

Melamed, Richard. "Mechanic's Liens on Homesteads." In *Advanced Real Estate Drafting Course, 2005*. Austin: State Bar of Texas, 2005.

Myers, Thomas W. "Mechanic's Liens: What's in Your Tool Box?" In *Advanced Real Estate Law Course, 2007*. Austin: State Bar of Texas, 2007.

St. Claire, Frank A., and William V. Dorsaneo III. *Texas Real Estate Guide*. New York: Matthew Bender & Co., 2001.

Walthall, Thomas J., Jr. "Annotated Mechanic's Liens." In *Real Estate Law Boot Camp, 2008*. Austin: State Bar of Texas, 2008.

———. "Texas Mechanic's Liens and Construction Payment Issues." In *Advanced Real Estate Law Course, 2008*. Austin: State Bar of Texas, 2008.

[Reserved]

Form 20-1

Mechanic's Lien Contract

Notice of confidentiality rights: If you are a natural person, you may remove or strike any or all of the following information from any instrument that transfers an interest in real property before it is filed for record in the public records: your Social Security number or your driver's license number.

Basic Information

Date:

Owner:

Owner's Mailing Address:

Contractor:

Contractor's Mailing Address:

Trustee:

Trustee's Mailing Address:

Property

Address:

Legal description:

Exceptions to Conveyance and Warranty:

Construction: [see clause 20-5-1 in this chapter]

Completion Date:

Consideration

Cash:

Note

Date:

Amount:

Maker:

Payee:

Maturity date:

[Terms of payment:]

For the Consideration, Contractor agrees to furnish the materials and labor and to complete the Construction on the Property on or before the Completion Date in a good and workmanlike manner according to the [residential construction contract between/plans and specifications agreed on by] Owner and Contractor, incorporated herein by reference.

To secure payment of the Note, Owner grants to Contractor a mechanic's, artisan's, and materialman's lien on the Property and on all improvements and fixtures on the Property at any time.

To enforce the lien and to further secure payment of the Note, Owner conveys the Property to Trustee in trust. Owner warrants and agrees to defend the title to the Property subject to the Other Exceptions to Conveyance and Warranty. If Owner performs all the covenants and pays the Note according to its terms, this conveyance will have no further effect, and at Owner's expense Contractor will execute a release of the liens created by this contract.

A. Owner's Representations and Rights

Owner makes the following representations and has the following rights:

A.1. Owner owns the Property in fee simple, subject only to the Exceptions to Conveyance and Warranty.

A.2. If Owner and Contractor agree in writing to alter plans for the Construction, on completion of the Construction Owner will pay for all extra work done and material furnished as a result of the alterations, and that amount will be a part of the Consideration and the debt secured by this contract.

A.3. If Owner receives notice of or may become liable for a lien or claim for labor or materials furnished to Contractor and primarily chargeable to Contractor, Owner may retain from payments on the Note an amount sufficient to completely indemnify Owner against the lien or claim.

A.4. Notwithstanding anything to the contrary in this contract, during progress of the Construction, Owner may retain the amounts required by sections 53.101 and 53.081 of the Texas Property Code. Retainage will be withheld until the last business day of the third month after the month of final completion of the project, unless otherwise provided in the residential construction contract between the parties.

A.5. If a loss occurs before the Construction is completed and delivered to Owner, Owner may use any insurance proceeds to restore the destroyed or damaged property without affecting the lien created in this contract.

A.6. OWNER MAY FURNISH THE INSURANCE REQUIRED OF OWNER BY THIS CONTRACT EITHER THROUGH EXISTING POLICIES OWNED OR CONTROLLED BY OWNER OR THROUGH EQUIVALENT COVERAGE FROM ANY INSURANCE COMPANY AUTHORIZED TO TRANSACT BUSINESS IN TEXAS.

B. Owner's Obligations

[Include if applicable: In addition to the obligations of Owner in the residential construction contract,] Owner agrees to—

B.1. pay all taxes and assessments on the Property when due, not authorize a taxing entity to transfer its tax lien on the Property to anyone other than Contractor, and not request a deferral of the collection of taxes pursuant to section 33.06 of the Texas Tax Code;

B.2. preserve the lien's priority as it is established in this contract;

B.3. if this is not a first lien, pay all prior lien notes that Owner is liable to pay and abide by all prior lien instruments;

B.4. if this contract is for improvements to the Property, keep the Property other than those improvements in good repair and condition during the Construction and keep all of the Property in good repair and condition after the Construction is completed;

B.5. if this contract is for new construction, keep the Property in good repair and condition after the Construction is completed;

B.6. except to the extent that Contractor is required to insure the Construction during its progress, maintain at Owner's sole cost and expense, and in a form acceptable to Contractor or its transferees, insurance policies containing the following coverages issued by an insurance company or companies authorized to engage in the insurance business in Texas with a financial rating acceptable to Contractor or its transferees:

- a. property insurance covering all improvements located on the Property in an amount equal to their full replacement cost or such lesser amount as Lender may agree, containing a standard mortgagee clause, provided that

the amounts of coverage comply with all coinsurance requirements of the policy;

- b. flood insurance, if the Property is located in a flood hazard area; and
- c. any other insurance coverages that may be reasonably required by Contractor or its transferees;

B.7. comply at all times with the requirements of the 80 percent coinsurance clause;

B.8. deliver the insurance policy to Contractor within ten days of the date of the contract and deliver renewals to Contractor at least fifteen days before expiration;

B.9. obey all laws, ordinances, and restrictive covenants applicable to the Property; and

B.10. keep any buildings occupied as required by the insurance policy.

C. Contractor's Obligations

Include the following if applicable.

In addition to Contractor's obligations in the residential construction contract, Contractor agrees that—

Continue with the following.

C.1. Until the Construction is completed and delivered to Owner, Contractor will insure the Construction and all related materials against loss or damage from all perils included in "causes of loss—special" forms in an amount equal to the Consideration. The policy will be payable to the parties to this contract according to their respective interests. If Contractor does not provide this insurance, Contractor will bear any loss to the Construction and materials.

C.2. Contractor will neither make nor charge for any alterations in the Construction described in the plans and specifications unless Contractor and Owner agree otherwise in writing. Any alterations made without a written agreement will be considered performed under the original contract at no additional charge.

C.3. Contractor will pay all costs of the Construction, including labor, materials, and subcontractors, and will furnish Owner receipts for and releases from these costs.

C.4. If any other lien claims are filed, Contractor will pay for their removal or else provide a statutory bond.

D. Contractor's Rights

Include the following if applicable.

In addition to Contractor's rights in the residential construction contract, Contractor has the following rights:

Continue with the following.

D.1. Contractor may appoint in writing a substitute trustee, succeeding to all rights and responsibilities of Trustee.

D.2. After completion of the Construction, Contractor may apply any proceeds received under the insurance policy either to reduce the Note or to repair or replace damaged or destroyed improvements covered by the policy.

D.3. If Owner fails to perform any of Owner's obligations other than providing insurance, Contractor may perform those obligations and be reimbursed by Owner on demand for any amounts so paid, including attorney's fees, plus interest on those amounts from the dates of payment at the rate stated in the Note for matured, unpaid amounts. Any amounts to be reimbursed will be secured by this contract.

D.4. If Owner is required to furnish insurance and fails to do so, Contractor may procure it and add the premium advanced by Contractor to the amount due under the Note and may charge interest on the amount added from the time of its addition until it is paid, at a rate not exceeding the rate that the Note would produce over its full term if each scheduled payment were paid on the date due.

D.5. If Owner defaults in any payment on the Note or if this lien is foreclosed, Owner will reimburse Contractor for reasonable fees paid to an attorney who is not an employee of Contractor and court and other costs for collection of payments or foreclosure of the lien. The amount to be reimbursed will be secured by this contract.

D.6. If a default exists or Owner fails to perform any of Owner's obligations and the default continues after Contractor gives Owner written notice of the default and a twenty-day period in which to cure the default (or longer if required by law or by written agreement), Contractor may—

- a. declare the unpaid principal balance and earned interest on the Note immediately due;
- b. request Trustee to foreclose this lien, in which case Contractor or Contractor's agent will give notice of the foreclosure sale as provided by the Texas Property Code as then in effect; and
- c. purchase the Property at any foreclosure sale by offering the highest bid and then have the bid credited on the Note.

Notice of default is deemed given when deposited with the United States Postal Service (certified mail, return receipt requested), addressed to Owner at Owner's Mailing Address or to Owner's last address as shown in the records of the holder of the debt.

E. Trustee's Duties

If requested by Contractor to foreclose this lien, Trustee will—

E.1. either personally or by agent give notice of the foreclosure sale as required by the Texas Property Code as then in effect;

E.2. sell and convey all or part of the Property "AS IS" to the highest bidder for cash with a general warranty binding Owner, subject to the Prior Lien and to the Other Exceptions to Conveyance and Warranty and without representation or warranty, express or implied, by Trustee;

E.3. from proceeds of the sale, pay, in this order:

- a. expenses of foreclosure, including a reasonable commission to Trustee;
- b. to Contractor, the full amount of principal, interest, attorney's fees, and other charges due and unpaid;
- c. any amounts required by law to be paid before payment to Owner; and
- d. to Owner, any balance; and

E.4. be indemnified by Contractor against all costs, expenses, and liabilities incurred by Trustee for acting in the execution or enforcement of the trust created by this contract, which includes all court and other costs, including attorney's fees, incurred by Trustee in defense of any action or proceeding taken against Trustee in that capacity.

F. General Provisions

F.1. [If Contractor is terminated according to the residential construction contract due to Contractor's default/If the Construction is not completed as agreed between Owner and Contractor], the amount of the Consideration subject to Contractor's lien will be reduced by

the amount reasonably necessary to complete the Construction as agreed. If Contractor is not the holder of the Note, the holder may complete the Construction, and the lien created in this contract will inure to the benefit of the holder.

F.2. This contract is executed, acknowledged, and delivered before any labor has been performed or any material has been delivered to the Property for the Construction. This contract is entered into by all Owners with the consent of each Owner's spouse, as evidenced by the signatures below.

F.3. If any of the Property is sold under this contract, Owner will immediately surrender possession to the purchaser. If Owner does not, Owner will be a tenant at sufferance of the purchaser, subject to an action for forcible detainer.

F.4. Recitals in any trustee's deed conveying the Property will be presumed to be true.

F.5. The lien created in this contract will remain superior to liens later created even if the time of payment of all or part of the Note is extended or part of the Property is released.

F.6. If any portion of the Note cannot be lawfully secured by this contract, payments will be applied first to discharge that portion.

F.7. Owner assigns to Contractor all amounts payable to or received by Owner from condemnation of all or part of the Property, from private sale in lieu of condemnation, and from damages caused by public works or construction on or near the Property. After deducting any expenses incurred, including attorney's fees and court and other costs, Contractor will either release any remaining amounts to Owner or apply them to reduce the Note. Owner will immediately give Contractor notice of any actual or threatened proceedings for condemnation of all or part of the Property.

F.8. Proceeding under this contract, filing suit for foreclosure, or pursuing any other remedy will not constitute an election of remedies.

F.9. Interest on the debt secured by this contract will not exceed the maximum rate or amount of nonusurious interest that may be contracted for, taken, reserved, charged, or received under law. Any interest in excess of that maximum amount will be automatically credited on the principal of the debt or, if that has been paid, refunded. On any acceleration or required or permitted prepayment, any such excess will be canceled automatically as of the acceleration or prepayment or, if already paid, credited on the principal of the debt or, if the principal of the debt has been paid, refunded. This provision overrides any conflicting provisions in this and all other instruments concerning the debt.

F.10. When the context requires, singular nouns and pronouns include the plural.

F.11. The term *Note* includes all amounts secured by this contract.

F.12. Contractor includes Contractor's assignees or transferees. This contract binds, benefits, and may be enforced by the successors in interest of all parties.

F.13. If Owner and Maker are not the same person, the term *Owner* includes Maker.

If additional clauses like those suggested in form 20-5 are used, they should appear here as numbered paragraphs following paragraph F.13.

Include the following if the contract calls for renovation or repair of existing homestead improvements. See section 20.1:1 in this chapter.

G. Repair or Renovation Construction

If the work of this contract includes repair or renovation of existing improvements, the following provisions apply. Contractor and Owner certify and represent that they are aware of and have complied with the following legal rights and obligations:

G.1. Rescission. Owner may rescind this contract (and any other proposals, contracts, or agreements with Contractor regarding the repair or renovation of existing improvements) without penalty or charge within three days after the execution of the contract by all parties. See the "Notice of Cancellation" below.

G.2. Place of Signing Contract. Owner acknowledges that this contract was signed at one of the following offices and not elsewhere: (a) the office of a third-party lender making an extension of credit for the work and material to be furnished; (b) the office of an attorney at law; or (c) the office of a title company.

G.3. Five-Day Waiting Period. This mechanic's lien contract and any other contract signed in connection with the repair and renovation work mentioned in this contract have not been executed by Owner or Owner's spouse before the fifth day after Owner made written application for an extension of credit for the work and material contemplated.

Include the following if applicable. This notice, if required, must appear in a minimum of ten-point bold-faced type. 16 C.F.R. § 433.2.

NOTICE

ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

Continue with the following.

The following notice is required by Tex. Prop. Code § 41.007
This notice must appear in a minimum of ten-point bold-faced type or equivalent "next to" the owner's signature line. Tex. Prop. Code § 41.007(a).

IMPORTANT NOTICE: YOU AND YOUR CONTRACTOR ARE RESPONSIBLE FOR MEETING THE TERMS AND CONDITIONS OF THIS CONTRACT. IF YOU SIGN THIS CONTRACT AND YOU FAIL TO MEET THE TERMS AND CONDITIONS OF THIS CONTRACT, YOU MAY LOSE YOUR LEGAL OWNERSHIP RIGHTS IN YOUR HOME. KNOW YOUR RIGHTS AND DUTIES UNDER THE LAW.

The following notice is required by Tex. Prop. Code § 27.007

RESIDENTIAL CONSTRUCTION LIABILITY ACT (RCLA) NOTICE

This contract is subject to Chapter 27 of the Texas Property Code. The provisions of that chapter may affect your right to recover damages arising from the performance of this contract. If you have a complaint concerning a construction defect arising from the performance of this contract and that defect has not been corrected through normal warranty service, you must provide the notice required by Chapter 27 of the Texas Property Code to the contractor by certified mail, return receipt requested, not later than the 60th day before the date you file suit to recover damages in a court of law or initiate arbitration. The notice must refer to Chapter 27 of the Texas Property Code and must describe the construction defect. If requested by the contractor, you must provide the contractor an opportunity to inspect and cure the defect as provided by Section 27.004 of the Texas Property Code.

[Name of owner]

Include the following if applicable.

YOU, THE OWNER, MAY CANCEL THIS TRANSACTION AT ANY TIME BEFORE MIDNIGHT OF THE THIRD BUSINESS DAY AFTER THE DATE OF THIS TRANSACTION. SEE THE ATTACHED NOTICE OF CANCELLATION FORM FOR AN EXPLANATION OF THIS RIGHT.

Continue with the following.

[Name of contractor]

Include acknowledgments for the owner and the contractor.

If the notice of the owner's right to cancel is included, attach completed duplicate copies of the following notice of cancellation.

The notice of right to cancel, if required, must appear "in immediate proximity to" the owner's signature in a minimum of ten-point bold-faced type. Tex. Bus. & Com. Code § 601.052; 16 C.F.R. § 429.1(a).

A notice concerning the purchaser's three-day right of rescission under a contract to purchase real property must be given if (1) the seller or the seller's agent solicits the sale at a place other than the seller's place of business; (2) the purchaser submits the purchase contract to the seller or the seller's agent at a place other than the seller's place of business; and (3) the consideration payable under the purchase contract exceeds \$100; unless either (1) the purchaser is represented by a licensed attorney; (2) the transaction is negotiated by a licensed real estate broker; or (3) the transaction is negotiated at a place other than the purchaser's residence by the person who owns the property, as described in Tex. Bus. & Com. Code ch. 601.

The notice of cancellation form must be easily detachable from the contract to which it is attached, must be in the same language as the contract, and must contain the following information and statements. Tex. Bus. & Com. Code § 601.053.

Notice of Cancellation

[Date]

YOU MAY CANCEL THIS TRANSACTION, WITHOUT ANY PENALTY OR OBLIGATION, WITHIN THREE BUSINESS DAYS FROM THE ABOVE DATE.

IF YOU CANCEL, ANY PROPERTY TRADED IN, ANY PAYMENTS MADE BY YOU UNDER THE CONTRACT OR SALE, AND ANY NEGOTIABLE INSTRUMENT EXECUTED BY YOU WILL BE RETURNED WITHIN TEN BUSINESS DAYS FOLLOWING RECEIPT BY THE MERCHANT OF YOUR

CANCELLATION NOTICE, AND ANY SECURITY INTEREST ARISING OUT OF THE TRANSACTION WILL BE CANCELED.

IF YOU CANCEL YOU MUST MAKE AVAILABLE TO THE MERCHANT AT YOUR RESIDENCE, IN SUBSTANTIALLY AS GOOD CONDITION AS WHEN RECEIVED, ANY GOODS DELIVERED TO YOU UNDER THIS CONTRACT OR SALE; OR YOU MAY IF YOU WISH, COMPLY WITH THE INSTRUCTIONS OF THE MERCHANT REGARDING THE RETURN SHIPMENT OF THE GOODS AT THE MERCHANT'S EXPENSE AND RISK.

IF YOU DO NOT AGREE TO RETURN THE GOODS TO THE MERCHANT OR IF THE MERCHANT DOES NOT PICK THEM UP WITHIN TWENTY DAYS OF THE DATE OF YOUR NOTICE OF CANCELLATION, YOU MAY RETAIN OR DISPOSE OF THE GOODS WITHOUT ANY FURTHER OBLIGATION.

TO CANCEL THIS TRANSACTION, MAIL OR DELIVER A SIGNED AND DATED COPY OF THIS CANCELLATION NOTICE OR ANY OTHER WRITTEN NOTICE, OR SEND A TELEGRAM, TO [name of merchant], AT [address of merchant's place of business] NOT LATER THAN MIDNIGHT OF [date].

I HEREBY CANCEL THIS TRANSACTION.

Dated: _____

[Name of purchaser]

Include any attachments.

Form 20-2

Mechanic's Lien Note

Basic Information

Date:

Maker:

Maker's Mailing Address:

Payee:

Payee's Mailing Address:

Place for Payment:

Principal Amount:

Annual Interest Rate on Unpaid Principal from Date of Funding:

Annual Interest Rate on Matured, Unpaid Amounts:

Terms of Payment (principal and interest): **[insert applicable clause from form 20-5 in this chapter]**

Security for Payment

Liens created in mechanic's lien contract between Maker and Payee

Date:

Trustee:

Contractor:

Property: [include legal description]

Include the following if applicable.

Deed of trust renewing liens

Date:

Grantor:

Beneficiary:

Trustee:

Continue with the following.

This note incorporates and is subject to the mechanic's lien contract.

Promise to Pay

Maker promises to pay to the order of Payee the Principal Amount plus interest at the Annual Interest Rate. This note is payable at the Place for Payment and according to the Terms of Payment. All unpaid amounts are due by the final scheduled payment date. If any amount is not paid either when due under the Terms of Payment or on acceleration of maturity, Maker promises to pay the unpaid amount plus interest from the date the payment was due to the date of payment at the Annual Interest Rate on Matured, Unpaid Amounts.

Default and Remedies

If Maker defaults in the payment of this note or in the performance of any obligation in any instrument securing or collateral to this note, Payee may declare the unpaid principal balance and earned interest on the note immediately due. Maker and each surety, endorser, and guarantor waive all demand for payment, presentation for payment, notice of intention to

accelerate maturity, notice of acceleration of maturity, protest, and notice of protest, to the extent permitted by law.

Prepayment

Maker may at any time make full or partial prepayments on the principal without paying any penalty, in addition to making regularly scheduled payments. Unless Payee agrees otherwise in writing, the making of partial prepayments will not alter the dates or amounts of regularly scheduled payments. Payee may require that any partial prepayments be in the same amount as regularly scheduled payments.

Attorney's Fees

If any party retains an attorney to enforce this note, the party prevailing in litigation is entitled to recover reasonable attorney's fees and court and other costs.

Usury Savings

Interest on the debt evidenced by this note will not exceed the maximum amount of nonusurious interest that may be contracted for, taken, reserved, charged, or received under law. Any interest in excess of that maximum amount will be credited on the principal of the debt or, if that has been paid, refunded. On any acceleration or required or permitted prepayment, any excess will be canceled automatically as of the acceleration or prepayment or, if already paid, credited to the principal of the debt or, if the principal of the debt has been paid, refunded. This provision overrides any conflicting provisions in this and all other instruments concerning the debt.

Other Clauses

Each Maker is responsible for all obligations represented by this note.

When the context requires, singular nouns and pronouns include the plural.

If additional clauses like those suggested in form 20-5 are used, they should appear here or on additional sheets attached to the form.

Include the following if applicable. This notice, if required, must appear in a minimum of ten-point bold-faced type. 16 C.F.R. § 433.2.

NOTICE

ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

Continue with the following.

[Name of maker]

Form 20-3

Affidavit of Completion and Indemnity

Basic Information

Date:

Mechanic's Lien Contract

Date:

Owner:

Contractor:

Trustee:

Property (including improvements): [include legal description]

Completion Date: [date]

Affiant:

Third-Party Lender:

Title Insurance Providers:

Affidavit of Completion

Affiant on oath swears that the following statements are true and are within the personal knowledge of Affiant:

1. Contractor is a [Texas corporation/Texas general partnership/Texas limited partnership/sole proprietorship/[specify other entity]].

2. Affiant is [the president/an authorized partner/a general partner/the sole proprietor/[describe other representative capacity]] of Contractor and is authorized to make this affidavit on behalf of Contractor.

3. The construction required by the Mechanic's Lien Contract has been completed in accordance with the requirements of the Mechanic's Lien Contract [include if applicable: and the residential construction contract between Owner and Contractor referred to in the Mechanic's Lien Contract].

4. Contractor has paid each of Contractor's subcontractors, laborers, and materialmen in full for all labor and materials provided to Contractor for the construction of improvements on the Property, excepting only the amounts owed to the persons identified below:

List all subcontractors, laborers, and materialmen and amounts owed to each. If there are no unpaid subcontractors, laborers, or materialmen, state "None."

Name:

Address:

Telephone number:

Amount owed:

Repeat above information as needed.

Continue with the following.

5. This affidavit is made to induce Owner to accept the construction as completed, to induce Third-Party Lender to fund a loan to Owner to pay Contractor all or part of the consideration in the Mechanic's Lien Contract, and to induce Title Insurance Providers to issue mortgagee [include if applicable: and owner] title insurance [policy/policies] without mechanic's lien exceptions.

[Name of affiant]

SUBSCRIBED AND SWORN TO before me on _____ by [name of affiant].

Notary Public, State of Texas

Indemnity

For valuable consideration, including Owner's acceptance of the construction as completed, Third-Party Lender's funding of Owner's loan to pay Contractor all or part of the consideration in the Mechanic's Lien Contract, and Title Insurance Providers's issuing of title insurance [policy/policies], Contractor warrants to those parties the truth of this affidavit of completion and agrees to indemnify, defend, and hold Owner, Third-Party Lender, and Title Insurance Providers harmless from all losses, damages, judgments, and expenses, including attorney's fees and court and other costs, that any or all of them suffer, incur, or pay because any part of this affidavit of completion is not true or completely correct.

[Name of contractor]

[Reserved]

Form 20-4

Affidavit of Acceptance

Basic Information

Date:

Mechanic's Lien Contract

Date:

Owner:

Contractor:

Trustee:

Property (including improvements): **[include legal description]**

Third-Party Lender:

Owner on oath swears that the following statements are true and are within the personal knowledge of Owner:

1. Relying on facts now known to Owner and on Contractor's affidavit of completion and indemnity, Owner has accepted the construction required by the Mechanic's Lien Contract as complete.

2. This affidavit is made to induce Third-Party Lender to fund a loan to Owner to pay Contractor all or part of the consideration in the Mechanic's Lien Contract.

3. This affidavit is solely for the benefit of Third-Party Lender, and it does not waive or release any of Owner's rights or remedies against Contractor.

[Name of owner]

SUBSCRIBED AND SWORN TO before me on _____ by [name of affiant].

Notary Public, State of Texas

Form 20-5

Additional Clauses for Contractual Mechanic's Liens*Construction Clause for Mechanic's Lien Contract***Clause 20-5-1**

Project as described in [residential construction contract between/plans and specifications agreed on by] Owner and Contractor.

*Force Majeure***Clause 20-5-2**

Use this clause under "General Provisions."

Time is of the essence in the completion and delivery of the Construction. If the Construction is delayed by matters that are beyond the reasonable control of Contractor and that Contractor is unable to prevent or overcome by the exercise of reasonable diligence, the Completion Date will be extended one day for each day the Construction is so delayed, up to a maximum of thirty additional days, provided Contractor notifies Owner of the delay in writing within seven days after its occurrence.

*Alternative Payment Terms for Mechanic's Lien Note***Clause 20-5-3**

This note, less the retainage required by statute, is payable on completion of the construction as provided in the mechanic's lien contract of even date. Completion of construction is determined by [specify]. The retainage, plus interest, is payable as follows: [Contractor must first provide Owner with

a written list of all subcontractors and suppliers of any tier who have furnished labor, material, equipment, or other improvements for the Project, including each subcontractor and supplier's name, address, and telephone number, updated and verified by Contractor as accurate as of the date of final completion of the Project, as a condition precedent to Owner action under this section. On receipt of the list, Owner will prepare, file, and send an affidavit of completion within ten days of the date of final completion of the Project. Retainage will then be released to Contractor the fiftieth day after the date of final completion as stated in the affidavit, provided no unreleased mechanic's liens have been filed by that time/On the last business day of the third month after the month of final completion and acceptance of the construction].

Or

Clause 20-5-4

This note is payable in the following installments during progress of the construction as provided in the mechanic's lien contract [**include if applicable:** and residential construction contract] of even date:

1. \$[amount], less retainage required by statute, on completion of foundation, slab, and preliminary rough plumbing;
2. \$[amount], less retainage required by statute, on completion of rough framing;
3. \$[amount], less retainage required by statute, on completion of roof and remainder of rough plumbing;
4. \$[amount], less retainage required by statute, on completion and acceptance of all construction; and

5. retainage required by statute, which will be paid as follows: [Contractor must first provide Owner with a written list of all subcontractors and suppliers of any tier who have furnished labor, material, equipment, or other improvements for the Project, including each subcontractor and supplier's name, address, and telephone number, updated and verified by Contractor as accurate as of the date of final completion of the Project, as a condition precedent to Owner action under this section. On receipt of the list, Owner will prepare, file, and send an affidavit of completion within ten days of the date of final completion of the Project. Retainage will then be released to Contractor the fiftieth day after the date of final completion as stated in the affidavit, provided no unreleased mechanic's liens have been filed by that time/On the last business day of the third month after the month of final completion and acceptance of the construction].

Or

Clause 20-5-5

This note is payable in the following installments during progress of the construction as provided in the mechanic's lien contract [**include if applicable:** and residential construction contract] of even date:

1. \$[amount] on [date];
2. \$[amount] on [date];
3. at the end of each two-week period after [date], an amount equal to 50 percent of the cost of all labor provided and material in place on the Property at that time, as estimated by [Contractor/the architect], and not already paid for by Owner, until the total amount paid is \$[amount];

4. the balance, plus interest, less retainage required by statute, on or before [date], or on completion of the construction, whichever is later; and

5. retainage required by statute, which will be paid as follows: [Contractor must first provide Owner with a written list of all subcontractors and suppliers of any tier who have furnished labor, material, equipment, or other improvements for the Project, including each subcontractor and supplier's name, address, and telephone number, updated and verified by Contractor as accurate as of the date of final completion of the Project, as a condition precedent to Owner action under this section. On receipt of the list, Owner will prepare, file, and send an affidavit of completion within ten days of the date of final completion of the Project. Retainage will then be released to Contractor the fiftieth day after the date of final completion as stated in the affidavit, provided no unreleased mechanic's liens have been filed by that time/On the last business day of the third month after the month of final completion and acceptance of the construction].

Cost Plus Fixed Fee, Not to Exceed a Certain Amount

Clause 20-5-6

This clause may be placed under "Terms of Payment" or at the end of the mechanic's lien contract before the notices.

Owner will pay Contractor the actual cost of all labor and materials furnished by Contractor and used in the Construction, plus a fixed fee of \$[amount]. The total contract price, however, will not exceed \$[amount not to exceed that of the mechanic's lien note]. Contractor will keep an accurate record of the labor and material costs, including all original invoices and receipted bills, and on request will give Owner an accurate, documented accounting of these costs.

*Cost Plus Percentage, Not to Exceed a Certain Amount***Clause 20-5-7**

This clause may be placed under "Terms of Payment" or at the end of the mechanic's lien contract before the notices.

Owner will pay Contractor the actual cost of all labor and materials furnished by Contractor and used in the Construction, plus [percent] percent of the actual cost of all labor and materials furnished by Contractor and used in the Construction. The total contract price, however, will not exceed \$[amount not to exceed that of the mechanic's lien note]. Contractor will keep an accurate record of the labor and material costs, including all original invoices and receipted bills, and on request will give Owner an accurate, documented accounting of these costs.

*Liability Disclaimer***Clause 20-5-8**

If one spouse will not be liable on the debt, the following clause should be inserted in the mechanic's lien contract before the signature lines.

[Name of spouse not liable on the debt] is signing this instrument solely to create a lien on the property, and [he/she] is not personally liable on the debt.

Clause for Use with Subordinate/Second Lien Mechanic's Lien Contract

Insert in mechanic's lien contract, form 20-1, section F.

Clause 20-5-9

OWNER MAY FURNISH ANY INSURANCE REQUIRED BY THIS MECHANIC'S LIEN CONTRACT EITHER THROUGH EXISTING POLICIES OWNED OR CONTROLLED

BY OWNER OR THROUGH EQUIVALENT COVERAGE FROM ANY INSURANCE COMPANY AUTHORIZED TO TRANSACT BUSINESS IN TEXAS.

Clause 20-5-10

The lien created by this mechanic's lien contract will be subordinate to the lien securing payment of the note, and any renewals, extensions, and modifications thereof, in the original principal amount of [amount] DOLLARS (\$[amount]), dated [date], executed by [name], payable to the order of [name], and more fully described in a deed of trust recorded in [recording data] of the real property records of [county] County, Texas. If default occurs in payment of any part of principal or interest of that \$[amount] note or in observance of any covenants of the deed of trust securing it, the entire debt secured by this mechanic's lien contract will immediately become payable at the option of Contractor or its transferees.

Clause 20-5-11

If Owner fails to pay any part of principal or interest secured by a prior lien or liens on the Property when it becomes payable or defaults on any prior lien instrument, the entire debt secured by this mechanic's lien contract will immediately become payable at the option of Contractor or its transferees.

Form 20-6

New Home Closing Certificate

Basic Information

Owner[s]:

Contractor:

Closing Date:

Credit Account:

Credit Amount:

Property: [address]

1. [I am/We are] the only Owner[s] of the Property.
2. [I/We] have received all of the documents related to the closing of the loan for the new home construction by Contractor on the Property at least one business day before the Closing Date.
3. [I/We] received the residential construction contract disclosure statement at least one business day before the Closing Date.
4. As of this date, none of the improvements contracted for by Owner[s] are located on the Property and no construction has commenced, nor have any materials or supplies been delivered to the Property to be used in the construction of the improvements by Owner[s].

5. [I am/We are] signing this certificate at the same time as [I am/we are] signing the mechanic's lien contract and mechanic's lien note and documents related to construction of the new home by Contractor on the Property.

Owner

Repeat signature line as needed.

Form 20-7

Home Improvement Closing Certificate

Basic Information

Owner[s]:

Contractor:

Closing Date:

Property: [address]

1. [I am/We are] the only Owner[s] of the Property.
2. [I/We] have made written application for an extension of credit for construction of improvements to the Property. The amount of the loan is intended to be used for the purpose indicated in the mechanic's lien contract of even date between [me/us] and Contractor.
3. [I/We] have not executed any contract for work or materials with the Contractor before the fifth day after the above-mentioned application for an extension of credit or before today's closing.

The closing must occur at the office of the lender, an attorney at law, or a title company.

4. This transaction is being closed at the following office: [name and address].
5. At closing, [I/we] received two copies of the notice of right to cancel. [I/We] understand that [I/we] can cancel or rescind this contract and any other contract for the contemplated construction at any time within three days after the signing of the contract by all parties, without penalty or charge of any kind whatever.

6. [I/We] received the residential construction contract disclosure statement at least one business day before the Closing Date.

7. [I/We] have received all of the documents related to the closing of the loan for the construction of improvements by Contractor on the Property at least one business day before the Closing Date.

8. As of this date, none of the improvements to be constructed are now located on the Property and no construction has commenced, nor have any materials or supplies been delivered to the Property to be used in the construction of the improvements to the Property.

9. [I am/We are] signing this certificate at the same time as [I am/we are] signing the mechanic's lien contract and mechanic's lien note and documents related to construction of the improvements by Contractor on the Property.

Owner

Repeat signature line as needed.

Form 20-8

Election Regarding Right of Rescission

Basic Information

Date:

Borrower:

[Borrower's Spouse:]

Borrower's Mailing Address:

[Borrower's Spouse's Mailing Address:]

Contractor:

Contractor's Mailing Address:

Mechanic's Lien Contract

Date:

Amount:

Property: **[address]**

In accordance with section 50(a)(5)(C), article XVI, of the Texas Constitution, Borrower [and Borrower's Spouse] provide[s] Contractor with the following notice regarding the Mechanic's Lien Contract and any other related contract between Borrower and Contractor for improvements to the Property:

- I have elected not to rescind the Mechanic's Lien Contract (or any other related contract with the Contractor for improvements to the Property). I acknowledge that more than three days have expired from the date that the Mechanic's Lien Contract (and any other related contract with the Contractor for improvements to the Property) was signed by all the parties.

- I have elected to rescind the Mechanic's Lien Contract (and all related contracts with the Contractor for improvements to the Property). This notice is given within three days from the date that the Mechanic's Lien Contract (and related contracts with the Contractor for improvements to the Property) was made.

[Name of borrower]

Include the following if applicable.

[Name of borrower's spouse]

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Form 21-13	Release of Mechanic's and Materialman's Lien	21-13-1 to 21-13-2
Form 21-14	Partial Release of Mechanic's and Materialman's Lien	21-14-1 to 21-14-2
Form 21-15	Notice of Termination of Work or Abandonment of Performance by Original Contractor or Owner.	21-15-1 to 21-15-2

Chapter 21

Involuntary Mechanic's Lien Documents

§ 21.1 Texas Constitutional Lien

§ 21.1:1 Generally

This chapter discusses primarily statutory mechanic's liens and provides related forms based on Tex. Prop. Code ch. 53. The Texas Constitution provides a separate constitutional lien in addition to the statutory mechanic's lien provided in the Texas Property Code. Tex. Const. art. XVI, § 37.

The constitutional lien requires no special notice to owners. It is considered self-enacting and arises solely from the claimant's performance of the work. Two important features of constitutional liens should be noted: first, they arise only in favor of "original contractors" (persons with contracts directly with the owner of the property interest improved), and second, bona fide purchasers or lienholders without notice of the constitutional lien claim do not take subject to it.

Even though the constitutional lien is considered self-enacting, as a practical matter the claimant must take some action to put the world on notice of the lien claim before an intervening sale or other encumbrance of the property. Such notice might be given either by filing an affidavit claiming the lien in the real property records in the county in which the property is located or by filing suit and *lis pendens* notice. *See* Tex. Prop. Code § 12.007.

The forms presented in this chapter are for documenting statutory rather than constitutional lien claims. Form 21-4, however, could be adapted for use in filing notice of a constitutional claim. For the constitutional lien affidavit, a phrase may be included in paragraph 8. of the form spe-

cifically referring to the constitutional lien, Tex. Const. art. XVI, § 37. Paragraph 6. can also be changed to reflect the fact that the claimant is the original contractor (for example, "Claimant is also the original contractor on the above-referenced project"). No special form of notice is required; the claimant is merely placing constructive notice of the constitutional lien claim in the real property records by filing the affidavit. Of course, as a practical matter, the claimant should send a copy of the filed affidavit or *lis pendens* to the owner.

§ 21.1:2 Homestead Considerations

Necessity for Written Contract to Improve Homestead: No involuntary mechanic's lien may attach to homestead property unless the homestead owner and the contractor sign a qualifying written contract for the improvements. This requirement applies to both constitutional and statutory mechanic's liens. The qualifying written contract for the improvements must satisfy certain constitutional and statutory requirements. Tex. Const. art. XVI, § 50(a)(5); Tex. Prop. Code §§ 41.001, 53.254; *Cavazos v. Munoz*, 305 B.R. 661 (S.D. Tex. 2004). The required elements of a qualifying contract to improve the homestead are discussed in section 20.1:2 in this manual.

While the underlying written contract for the improvements is a prerequisite to the existence of an involuntary mechanic's lien against the homestead, it is not the source of the lien. Rather, the lien arises from the performance of work by the claimant and (in the case of a statutory lien) the satisfaction of certain requirements necessary to perfect the lien.

Subcontractors do not have to sign the written contract to improve the homestead. Its lien qualifying effects vicariously inure to the benefit of all subcontractors and materialmen who furnish labor or materials through the original contractor. Tex. Prop. Code § 53.254(d).

Required Admonitions for Statutory Mechanic's Liens against Homestead: As a general rule, a statutory mechanic's lien against the homestead may be perfected in the same manner prescribed for all such liens. However, in addition to the general requirements of chapter 53 of the Property Code, there are special admonitions required to be given by the lien claimant to the homestead owner that are unique to involuntary mechanic's liens against the homestead. For a discussion of these special admonitions refer to section 21.5:1 below.

§ 21.2 General Considerations for Statutory Liens

Texas courts consistently have followed two interpretive principles in evaluating the validity of involuntary mechanic's lien claims. First, the mechanic's lien statutes are to be liberally interpreted for the purposes intended, to provide lien claimants security for their labor and materials furnished on construction of improvements on real property. *First National Bank v. Whirlpool Corp.*, 517 S.W.2d 262 (Tex. 1974). Second, however, the time deadlines for sending required notices and filing the mechanic's lien affidavit are critical. Missing the notice deadline or mechanic's lien filing deadline is fatal to the mechanic's lien in almost every instance. See *First National Bank v. Sledge*, 653 S.W.2d 283 (Tex. 1983).

Residential Construction: If a construction project is on residential property, the claimant must comply with the provisions of Tex. Prop. Code ch. 53, subch. K, in addition to the other statutory requirements. The portions of subchapter K that relate to involuntary liens are dis-

cussed or cited in the following sections of these practice notes. Residential projects are defined for purposes of the mechanic's lien statute as construction or repair of a single-family house, duplex, triplex, quadruplex, or unit in a multi-unit structure used for residential purposes that is owned by one or more adult persons and is used or intended to be used as a dwelling by one or more of its owners. Tex. Prop. Code § 53.001(8), (9), (10).

§ 21.3 Construction Project Participants

To understand the rights and time deadlines for notice according to the statute, the attorney must first understand how the claimant fits into the chain of parties on the project: owner, original contractor, subcontractor, and supplier. Notice requirements fall into three basic categories based on the definitions of participants on a construction project.

§ 21.3:1 Original Contractor

An original contractor is a person or entity contracting with the owner of the interest in the real estate being improved—either directly or through an agent for the owner. An original contractor creates a statutory lien against the property by filing a lien affidavit with the county clerk of the county in which the property is located and sending a copy of the affidavit to the owner of the property. Original contractors have no notice requirements other than sending a copy of the affidavit claiming the mechanic's lien to the owner. See Tex. Prop. Code § 53.052. As discussed in section 21.1 above, original contractors also have a constitutional lien.

§ 21.3:2 First-Tier Subcontractors and Suppliers

First-tier subcontractors or suppliers have a subcontract, purchase order, or other agreement directly with the original contractor. In addition

to filing a lien affidavit, they must provide notice of unpaid claims to the owner to create mechanic's lien rights. This notice authorizes the owner to withhold payment from the contractor to pay the claims. A copy of the notice of unpaid claims must be sent by certified mail to the original contractor. Tex. Prop. Code §§ 53.056, 53.081, 53.252. This statutory procedure is referred to as the trapping of funds.

§ 21.3:3 Second-Tier and Lower-Tier Subcontractors and Suppliers

Second-tier and lower-tier subcontractors or suppliers have subcontracts or agreements with a first-tier, second-tier, or lower-tier subcontractor. In other words, they have no contract with the original contractor. Therefore, they are required to give notice to the original contractor in addition to sending the same notice described in section 21.3:2 above to the owner as a prerequisite to perfecting a valid mechanic's lien. Tex. Prop. Code §§ 53.056(b), 53.252(b).

Although the notice requirements differ, the mechanic's lien rights to trapped funds and retainage are the same for second-tier and lower-tier subcontractors as for first-tier subcontractors and suppliers. In this chapter all second- and lower-tier subcontractor and supplier claimants will be referred to as 'second-tier' claimants.

§ 21.4 Owner Liability for Mechanic's Lien Claims

§ 21.4:1 Original Contractors

Owners are liable for the amount of the mechanic's lien perfected by original contractors. Disputes may exist about the underlying merits of claims for the amount of indebtedness owed to the original contractor. However, owners are liable to pay the face amount of original contractor perfected mechanic's lien claims, if the amount is owed.

§ 21.4:2 Derivative Claimants: First- and Second-Tier Claims, Statutory Retainage, and Fund Trapping

The owner's liability to both first- and second-tier subcontractor or supplier lien claimants is the sum of two amounts described in Tex. Prop. Code § 53.084. First, an owner is liable for the mandatory 10 percent statutory retainage that owners are required to withhold from the original contractor on every nonbonded construction job. Tex. Prop. Code §§ 53.101–.103; *Page v. Structural Wood Components*, 102 S.W.3d 720, 722 (Tex. 2003). In addition, an owner is liable for "fund trapping, which means 'trapping' or withholding remaining contract funds otherwise owed to the original contractor once the owner receives a mechanic's lien notice letter (Tex. Prop. Code § 53.056(b), (d)) containing language telling the owner to withhold payment from the contractor for the claim amount. If an owner receives a lien notice letter containing the required fund-trap warning but fails to withhold payment from the contractor, the owner is personally liable and his property subject to a lien for such amounts paid out in spite of receipt of such notice. This fund trapping liability is in addition to the owner's liability for the 10 percent statutory retainage.

Aiken v. State, 36 S.W.3d 131 (Tex. App.—Austin 2000, no pet.), provides a good example of owner liability for fund trapping and retainage. *Aiken* involved criminal prosecution of a contractor on a residential construction project. The contractor was accused of taking a bank loan advance for the construction and misapplying the funds by not using them to pay project bills due on the job. This is ordinarily a violation of chapter 162 of the Texas Property Code (the Texas Construction Trust Funds Act). However, in this case, the prosecution chose to pursue a conviction under Texas Penal Code section 32.45, misapplication of fiduciary property. One of the elements of this offense is to prove that

the defendant dealt with property of the victim in a manner that involves substantial risk of loss to the owners. In this case, because the owners had withheld 10 percent retainage, the court determined that the owners suffered no substantial risk of loss. Their liability was limited to the 10 percent retainage since no funds had been trapped by lien claimants, as described above. The case provides a good example of how owner liability is calculated.

To summarize, owners have to withhold or "trap" funds they otherwise owe the contractor on receipt of a proper lien notice letter. In addition, owners must withhold 10 percent retainage from the original contractor throughout the duration of the project. If owners fail to trap funds or retain the 10 percent retainage throughout the course of the job, they are nevertheless liable for such amounts they should have withheld.

§ 21.5 Instructions for Completing Forms

§ 21.5:1 Affidavit Claiming Lien

Original contractors and first- and second-tier subcontractors and suppliers create a statutory mechanic's lien against property by filing a lien affidavit with the county clerk of the county in which the property is located and sending a copy of the affidavit to the owner of the property.

It is best to have the affidavit claiming mechanic's and materialman's lien, form 21-4 in this chapter, executed by a claimant with knowledge of the amount due on the account, the work performed, and the particular project involved. The mechanic's lien affidavit is invalid unless it contains a jurat. *Sugarland Business Center, Ltd. v. Norman*, 624 S.W.2d 639, 641 (Tex. App.—Houston [14th Dist.] 1981, no writ).

Paragraph 4. of form 21-4 must state the type of labor performed and materials furnished.

The legal description of the property, sufficient to distinguish it from other tracts in the area, is required in paragraph 7. of form 21-4. The lien applies to the original tract at the time construction commenced. Subsequent conveyances of parts of the property, even if conveyed before the filing of the lien affidavit, are still subject to the lien. *See Valdez v. Diamond Shamrock Refining & Marketing Co.*, 842 S.W.2d 273 (Tex. 1992).

The notice at the top of form 21-4 states "NOTICE: THIS IS NOT A LIEN. THIS IS ONLY AN AFFIDAVIT CLAIMING A LIEN. This notice is required to assert a mechanic's lien against homestead property and must appear at the top of the page in a minimum of ten-point bold-faced type or equivalent. Tex. Prop. Code § 53.254(f).

Also, for first- and second-tier claimants (other than original contractors), the lien affidavit must contain a statement as to each month in which material was delivered or work performed (paragraph 4.) and a description of the date and method of giving required notice to the owner (paragraph 10.). Tex. Prop. Code § 53.054(a)(3), (8).

A copy of the lien affidavit must be sent to the original contractor and the owner within five days of filing the affidavit. Tex. Prop. Code § 53.055. Form 21-5 is a cover letter for this purpose. Failure to send the lien affidavit within the time prescribed has been held fatal to the validity of the lien. *Cabintree, Inc. v. Schneider*, 728 S.W.2d 395 (Tex. App.—Houston [1st Dist.] 1986, writ ref'd); *but see Arias v. Brookstone, L.P.*, 265 S.W.3d 459 (Tex. App.—Houston [1st Dist.] 2007, pet. denied) (declining to follow dicta from *Cabintree* that notice must be given after the lien affidavit has been filed).

§ 21.5:2 Notice to Original Contractor by Second-Tier Claimant

Form 21-1 in this chapter must be sent by certified mail to the original contractor and is self-explanatory. Copies of statements or billings should be attached.

§ 21.5:3 Notice of Unpaid Claim to Owner and Original Contractor

All derivative claimants, first-tier and second-tier, must send a written notice of unpaid claim to the owner and original contractor. Form 21-2 in this chapter is meant to satisfy this notice requirement. It contains language prescribed by Tex. Prop. Code §§ 53.056(d), 53.252(c), advising the owner that a failure to withhold payment from the contractor may result in the owner becoming personally liable and the property subjected to a lien. This language is required to trap funds on the project pursuant to Tex. Prop. Code § 53.081(b).

Form 21-2 includes a reference to the Texas Construction Trust Fund Act, Tex. Prop. Code §§ 162.001-.033. This statute states that all recipients of payment under a construction contract in Texas (including an owner who receives construction loan funds secured by a deed of trust on real property and the contractor who receives a construction draw) become trustees of the funds and must see to it that the funds received are used to pay actual expenses directly related to the job. Tex. Prop. Code §§ 162.002, 162.031(b). Diversion of funds to other jobs or expenses not directly related to the project on which the funds were received is a violation of the statute and, in some circumstances, is a crime. Tex. Prop. Code §§ 162.031(a), 162.032.

§ 21.5:4 Notice of Unpaid Claim—Homestead Property

Form 21-3 in this chapter is a statutory disclosure and warning that must be included verbatim in any notice of unpaid claim given on homestead property against which a contractor, subcontractor, supplier, or other claimant wishes to assert a mechanic's lien. Tex. Prop. Code § 53.254(g).

§ 21.5:5 Special Notices

Specially Fabricated Materials: The notice regarding specially fabricated materials, form 21-6 in this chapter, is to be sent by the fifteenth day of the second month after the claimant receives and accepts an order for a specially fabricated material. Tex. Prop. Code §§ 53.058, 53.253.

This notice must be sent by certified mail, return receipt requested, to the owner or reputed owner and also to the original contractor, unless the claimant's subcontract is with the original contractor. Tex. Prop. Code §§ 53.058(b), (d), 53.253(c), (e).

Sending this notice allows the claimant to later perfect a mechanic's lien by filing an affidavit at the applicable time, even if the claimant has not yet delivered the specially fabricated materials. Tex. Prop. Code §§ 53.058, 53.253. Taking advantage of this procedure has the potential of allowing the lien claimant to retain specially fabricated materials while still asserting a mechanic's lien claim.

Different or additional notices may be required if the specially fabricated materials have (or should have) already been delivered. *See* Tex. Prop. Code §§ 53.058(e), 53.253(b).

Contractual Retainage: Contractual retainage is the right expressed in a subcontract or other agreement to withhold, from progress payments otherwise due, a percentage of money due

a first- or second-tier claimant pending completion of the work, final payment released on the project, or other later date. Retainage provisions in Texas Property Code chapter 53 were amended by the 2011 legislature. For projects on which the original contract was executed before September 1, 2011, form 21-7, notice of agreement providing for retainage, must be sent by the claimant by registered or certified mail to the last known business or residence address of the owner, reputed owner, or original contractor to later perfect a lien claim for retainage on the project, if the claimant has entered into an agreement that provides for retainage. Tex. Prop. Code § 53.057. Form 21-8 is the notice of retainage agreement applicable to projects for which the original contract was executed on or after September 1, 2011. Tex. Prop. Code § 53.057(c). Form 21-8 need not be sent by registered or certified mail.

§ 21.5:6 Requests for Information

Tex. Prop. Code § 53.159 provides that the various participants in the construction project (owner, contractor, subcontractor, and supplier) may request information of each other. Forms 21-9 through 21-12 in this chapter are letters that indicate the information that may be requested. Failure to provide information requested in accordance with the statute triggers liability for the reasonable and necessary costs of obtaining the information elsewhere. Tex. Prop. Code § 53.159(f). Also, a subcontractor who does not timely receive the notice of the date of execution of the original contract for the project is not required to file a mechanic's lien by the early retainage deadlines, but instead may file by the later dates specified by Tex. Prop. Code § 53.052. See the discussion in section 21.8:2 below.

§ 21.5:7 Release Required of Claimant

Once a claim is paid or otherwise satisfied, a mechanic's lien claimant must furnish a release in recordable form to the person paying the claim. The release of mechanic's and materialman's lien, form 21-13 in this chapter, must be furnished by the claimant within ten days of receipt of a written request. *See* Tex. Prop. Code § 53.152.

If the claim is only partially paid, a partial release of lien, form 21-14, may be used to preserve the lien securing the balance owed.

§ 21.6 Time Limits for Contractual Retainage Claims

A first- or second-tier claimant has two alternative methods for sending lien notices covering the claimant's contractual retainage claim. The claimant may send the notices, which are due each month, by the deadlines provided by Texas Property Code sections 53.056 or 53.252. (See section 21.7 below.) Alternatively, the claimant may send a simplified, one-time notice for contractual retainage agreement, given according to Tex. Prop. Code § 53.057. See forms 21-7 and 21-8 in this chapter. The claimant who gives the retainage notice by the Tex. Prop. Code § 53.057 deadline does not have to give other retainage notices, except notice of the filing of the mechanic's lien affidavit. Tex. Prop. Code § 53.057(e). Note, however, that a claim consisting in part of retainage and in part of other billings on a job must comply not only with the retainage notice deadlines but also with the other applicable notice time limits as set out in section 21.7 below. Tex. Prop. Code §§ 53.056, 53.257.

The following deadlines are for contractual retainage notices. These apply to both residential and nonresidential projects. Because the retainage provisions in Texas Property Code

chapter 53 were amended by the 2011 Texas legislature, two sets of deadlines are provided, the application of which depends on the date of execution of the original contract between the original contractor and owner.

Original Contract Executed before September 1, 2011. Notice to the original contractor and to the owner by second-tier and lower-tier claimants (subcontractors or suppliers with no contract with the original contractor) must be given not later than the fifteenth day of the second month following the first month of delivery or work. Tex. Prop. Code § 53.057(b).

Notice to the owner by first-tier claimants (subcontractors or suppliers with contracts directly with the original contractor) must also be given not later than the fifteenth day of the second month following the first month of delivery or work. Tex. Prop. Code § 53.057(b).

Original Contract Executed on or after September 1, 2011. Notice to the original contractor and to the owner by second-tier and lower-tier claimants (subcontractors or suppliers with no contract with the original contractor) must be given by the earlier of—

1. the thirtieth day after the claimant's agreement (i.e., the subcontract work or delivery of material) is completed, terminated, or abandoned; or
2. the thirtieth day after the date the owner's or original contractor's agreement is terminated or abandoned.

Tex. Prop. Code § 53.057(b-1).

Notice to the owner by first-tier claimants (subcontractors or suppliers with subcontracts or other agreements directly with the original contractor) must also be given by the earlier of the deadlines stated above for second-tier claimants. Tex. Prop. Code § 53.057(b)-(d).

§ 21.7 Time Limits for Notices of Claims Other than for Contractual Retainage

§ 21.7:1 Nonresidential Projects

Second-Tier Claimants—Original Contractor Notice: Notice to the original contractor by second-tier and lower-tier claimants must be given not later than the fifteenth day of the second month following each month of delivery or work. Tex. Prop. Code § 53.056(b). See the chart at section 21.9:1 below.

First- and Second-Tier Claimants—Owner Notice: Notice to the owner and to the original contractor of all derivative claims must also be given not later than the fifteenth day of the third month following each month of delivery or work. Tex. Prop. Code § 53.056(b). See the chart at section 21.9:1 below.

§ 21.7:2 Residential Projects

First- and Second-Tier Claimants—Owner and Original Contractor Notice: Notice to the owner and to the original contractor of all derivative claims must be given not later than the fifteenth day of the second month following each month of delivery or work. Tex. Prop. Code § 53.252. See the chart at section 21.9:2 below.

§ 21.8 Deadlines for Filing Lien Affidavit

In addition to sending the notices by the times described above, the claimant must file a lien affidavit in the real property records of the county in which the property is located.

§ 21.8:1 Accrual of Indebtedness

The deadline for filing the lien affidavit depends on several factors, including the date the claimant's indebtedness accrues.

A claimant's 'indebtedness accrues' by the earliest of the following:

1. For original contractors, the earlier of (a) the last day of the month of receipt by the owner or contractor of a written declaration by the other party that the original contract has been terminated or (b) the last day of the month in which the project was completed or abandoned. Tex. Prop. Code § 53.053(b).
2. For a first- or second-tier claimant, the last day of the last month in which that claimant's labor was performed or material furnished. Tex. Prop. Code § 53.053(c).
3. For a claimant furnishing specially fabricated material, the last day of the last month in which (a) the material was furnished; (b) the material would have been furnished; or (c) the owner, contractor, or subcontractor breached or terminated the contract or subcontract with the claimant. Tex. Prop. Code § 53.053(d).
4. For claims for unpaid contractual retainage, the earliest of the last day of the month in which the whole project is completed, finally settled, terminated, or abandoned. Tex. Prop. Code § 53.053(e).

§ 21.8:2 Original Contractor Lien Affidavit Filing Deadlines

The original contractor lien affidavit filing deadline for residential projects is the fifteenth day of the third calendar month after the "indebtedness accrues." Tex. Prop. Code § 53.052.

For nonresidential projects, the deadline is the fifteenth day of the fourth calendar month after

the "indebtedness accrues." Tex. Prop. Code § 53.052.

§ 21.8:3 First- and Second-Tier Claimant Lien Affidavit Filing Deadlines

To obtain an enforceable lien claim and also claim a share of the owner's required 10 percent statutory retainage, first- and second-tier subcontractor and supplier lien claimants must file their lien affidavits by the earlier of the deadlines indicated in sections 21.8:4 and 21.8:5 below. Because the retainage provisions affecting first- and second-tier claimants were amended by the 2011 Texas legislature, two sets of deadlines are provided, application of which depends on the date of execution of the original contract between the original contractor and owner.

§ 21.8:4 Original Contract Executed before September 1, 2011

First- and second-tier subcontractor and supplier lien claimants' lien affidavit filing deadlines are determined as follows:

1. For residential projects, by the fifteenth day of the third calendar month after the 'indebtedness accrues.' Tex. Prop. Code § 53.052. See the chart at section 21.9:2 below.
2. For nonresidential projects, by the fifteenth day of the fourth calendar month after the 'indebtedness accrues.' Tex. Prop. Code § 53.052. See the chart at section 21.9:1 below.

However, if the deadline provided for in Tex. Prop. Code § 53.103 occurs earlier than the deadlines above, the claimant must file by the earlier date to share in the owner's 10 percent statutory retainage. *See* Tex. Prop. Code § 53.103. This thirty-day deadline applies to both residential and nonresidential projects.

Note that for determining "final completion," warranty work does not count to extend time limits.

§ 21.8:5 Original Contract Executed on or after September 1, 2011

A claimant may rely on the deadlines described in section 21.8:4 above, based on the pre-2011 version of the statute. Alternatively, a claimant may choose instead to file by the earliest of the following four deadlines for projects in which the original contract was executed on or after September 1, 2011.

1. The normal lien-filing date provided by Tex. Prop. Code § 53.052, which is (a) the fifteenth day of the fourth month following the last month of work or delivery by the claimant for nonresidential projects or (b) the fifteenth day of the third month following the last month of work or delivery by the claimant for residential projects. (See the charts at sections 21.9:1 and 21.9:2 below.)
2. The fortieth day after the date stated in the affidavit of completion for the original contract, if the owner sent the claimant notice of the affidavit. This affidavit of completion is provided for in Tex. Prop. Code § 53.106, which allows, but does not require, the owner to file such an affidavit stating the date of final completion for the project. See form 18-7 in this manual. Notice of filing and a copy of the affidavit must be sent to claimants making a written request for them or to claimants who have sent out owner lien notices. However, regardless of whether a claimant makes a request for such an affidavit or sends a lien notice, if the affidavit is not sent to a claimant, then the forty-day deadline provided in this section does not apply to that claimant. The affidavit is prima facie evidence of the actual final completion date for the project if it is sent to claimants as required.
3. For nonresidential projects only, the fortieth day after the date of termination or abandonment of the original contract if notice of termination or abandonment was sent by the owner to the claimant as required by Tex. Prop. Code § 53.107. The notice of termination or abandonment is required to be sent to each claimant who requests notice in writing or who sends the owner a lien notice. However, regardless of whether a claimant makes a request for a notice of termination or abandonment or sends a lien notice, if that notice is not sent to a claimant, then the forty-day deadline provided in this section does not apply. See form 21-15. This deadline option is not applicable to residential projects. Tex. Prop. Code § 53.107(e).
4. The thirtieth day after the day the owner sends written notice to the claimant demanding that the claimant file its mechanic's lien affidavit. The notice must contain a legal description of the project property, the owner's name and address, and it must specify that the lien affidavit must be filed within thirty days of when the notice was sent. Tex. Prop. Code § 53.057(g).

Interestingly, this fourth alternative provides that the notice is effective only for the amount of contractual retainage earned by the claimant as of the day this owner notice was sent. Therefore, Tex. Prop. Code § 53.057(g) indicates that claimants who fail to file within thirty days of the owner demand may have only their contractual retainage impacted.

§ 21.8:6 Owner Notice of Termination or Abandonment by Contractor—Nonresidential Projects

For nonresidential projects only, a notice of termination or abandonment is required of the owners. The notice must be sent not later than the tenth day after the date the original contract is terminated or the original contractor abandons the project. Tex. Prop. Code § 53.107.

The owner must send this notice to every claimant who has either provided the owner with notice of a lien claim or sent a request to the owner for notice of termination or abandonment. Tex. Prop. Code §§ 53.103, 53.107. A notice of termination or abandonment by owner is included as form 21-15 in this chapter.

If the owner fails to give the notice of termination or abandonment, the claimant will not be subject to the early retainage filing deadlines described in sections 21.8:4 or 21.8:5 (3) above. Tex. Prop. Code §§ 53.103, 53.107.

§ 21.8:7 Owner Failure to Withhold 10 Percent Retainage

If the owner fails to withhold statutory retainage, then the claimants are entitled to perfect their claims by notice and affidavit either by the longer deadlines described in sections 21.8:4 and 21.8:5 (1) above (the fifteenth day of the third month (residential) or the fifteenth day of the fourth month (nonresidential) following the last month of work/delivery). No thirty-day or forty-day deadlines under Tex. Prop. Code § 53.057(f) are applicable if the owner fails to withhold the statutory retainage.

§ 21.9 Timetables Outlining Deadlines

Caution: The following tables outline only the timetables for various deadlines; the attorney must have a clear understanding of the statutes to properly apply the tables.

If the retainage deadline, provided for in Tex. Prop. Code § 53.103, is earlier than the lien affidavit deadlines provided for by Texas Property Code sections 53.056 and 53.252, the affidavit must be filed by that earlier deadline.

§ 21.9:1 Nonresidential Projects (Tex. Prop. Code § 53.056)¹

Month of activity	Deadline for notice to original contractor by 2nd-tier & lower claimants	Deadline for notice to owner/original contractor by 1st-tier, 2nd-tier & lower claimants	Deadline for filing lien affidavit by all claimants ¹
January	March 15	April 15	May 15
February	April 15	May 15	June 15
March	May 15	June 15	July 15
April	June 15	July 15	August 15
May	July 15	August 15	September 15
June	August 15	September 15	October 15
July	September 15	October 15	November 15
August	October 15	November 15	December 15
September	November 15	December 15	January 15
October	December 15	January 15	February 15
November	January 15	February 15	March 15
December	February 15	March 15	April 15

§ 21.9:2 Residential Projects (Tex. Prop. Code § 53.252)

Month of activity	Deadline for notice to owner & original contractor by 1st-tier, 2nd-tier & lower claimants	Deadline for filing lien affidavit by all claimants ¹
January	March 15	April 15
February	April 15	May 15
March	May 15	June 15
April	June 15	July 15
May	July 15	August 15
June	August 15	September 15
July	September 15	October 15
August	October 15	November 15
September	November 15	December 15
October	December 15	January 15
November	January 15	February 15
December	February 15	March 15

1. These deadlines are based on the last calendar month in which the claimant delivered labor or material. Determine the affidavit filing date by finding the last month in which the claimant furnished labor or delivered material in the "Month of activity" column. The affidavit must be filed by the thirtieth day after completion of the entire project, if earlier than the date specified by this column.

§ 21.10 Texas Prompt Payment Statute

Chapter 28 of the Texas Property Code provides that for private work, as contrasted with public works projects, the owner has thirty-five days from the date of receipt from a contractor of a written request for payment to pay the invoiced amount—less retainage required by law—for work properly performed or materials specially fabricated or suitably stored. Tex. Prop. Code § 28.002(a). Once the contractor receives payment, he must pay his subcontractors or suppliers their proportionate share of the draw not more than seven days later. Tex. Prop. Code § 28.002(b). A subcontractor who receives payment must in turn pay his subcontractors or suppliers their proportionate share not later than seven days thereafter. Tex. Prop. Code § 28.002(c). Unpaid bills earn interest at the rate of 1.5 percent per month. Interest stops accruing on the date of receipt of payment, the date payment is mailed, or the date a judgment is rendered in a suit filed under this statute, whichever occurs first. Tex. Prop. Code § 28.004. Recovery of attorney's fees in a suit to collect the interest is also allowed. Any attempt to waive this section is void. Tex. Prop. Code §§ 28.005–.006.

If a good-faith dispute exists concerning the amount owed on a residential job (construction of a single-family residence, duplex, triplex, or quadruplex), the owner, contractor, or subcontractor disputing the payment may withhold no more than 110 percent of the difference between the amounts claimed due. Tex. Prop. Code § 28.003(a).

If a good-faith dispute exists on projects not involving construction of a single-family residence, duplex, triplex, or quadruplex, no more than 100 percent of the amount in dispute may be withheld. Tex. Prop. Code § 28.003(b).

If the construction lender's late release of funds is the reason for the delay in payment, the owner

is protected because the payment required of the owner pursuant to Tex. Prop. Code § 28.002(a) changes from the thirty-fifth day after the date the owner receives the payment request to the fifth day after the date the owner receives loan proceeds, if a construction loan exists and the owner has timely and properly requested disbursement but the lender failed to disburse in time to meet the thirty-five-day deadline. Tex. Prop. Code § 28.008.

Right to Suspend Work: Section 28.009 of the Texas Property Code provides a statutory right of the contractor or subcontractor to suspend work on private commercial projects if he has not been paid in accordance with this statute. Subpart (e) of section 28.009 provides that this part does not apply to a contract for the construction of improvements to a detached single-family residence, duplex, triplex, or quadruplex. Tex. Prop. Code § 28.009(e).

Work cannot be suspended until the tenth day after the claimant gives written notice to the owner or contractor, as applicable, stating that payment has not been received and stating the intent of the contractor or subcontractor to suspend performance. If a construction loan exists, the lender must also be given this notice of intent to suspend work. The claimant is not required to perform further work until the amount due is paid, plus costs of demobilization and remobilization. The claimant is not responsible for damages due to suspension of work if the claimant was not notified in writing before suspension either that payment has been made or that a good-faith dispute about payment exists. However, a notice of good-faith dispute must include a list of specific reasons for nonpayment. If one of the reasons for nonpayment is alleged defective or incomplete work, the claimant must be given a reasonable opportunity to cure the listed items or offer a deduction of a reasonable amount to compensate for the listed items that cannot be promptly cured. Tex. Prop. Code § 28.009.

Additional Resources

Beyer, Gerry W. *Real Property*. 2nd ed. West's Texas Forms 13–15. St. Paul, MN: West, 2001. Supplement 2016.

Flores, J. Paulo. "Mechanic's Liens—How to Deal with Invalid Liens." In *Residential Real Estate Construction Law Course*, 2007. Austin: State Bar of Texas, 2007.

St. Claire, Frank A., and William V. Dorsaneo III. *Texas Real Estate Guide*. New York: Matthew Bender & Co., 2001.

Walthall, Thomas J. Jr. 'Mechanic's Lien 'Removables' Representing the Contractor in Default Situations. In *Advanced Real Estate Law Course*, 2009. Austin: State Bar of Texas, 2009.

[Reserved]

Form 21-1

Notice to Original Contractor by Second-Tier Claimant

[Date]

[Name and address of original contractor]

Re: Claims of [name of claimant] (“Claimant”) for unpaid billings totaling \$[amount] (“Claim Amount”); [specify] construction project (“Project”)

[Salutation]

This is to provide you with the required notice, in accordance with section 53.056 of the Texas Property Code, that Claimant is owed the Claim Amount for its billings to [name of customer] for [labor/materials/labor and materials] furnished on the Project. Claimant’s [labor/materials/labor and materials] are generally described as [description of work and/or materials furnished].

Enclosed are copies of Claimant’s unpaid statements or billings. Please contact me regarding this notice. Thank you for your attention to this matter.

Sincerely yours,

[Name of attorney]

Certified Mail No. [number]
Return Receipt Requested

[Reserved]

Form 21-2

Notice of Claim to Owner and Original Contractor

[Date]

[Name and address of owner]

[Name and address of original contractor]

Re: Claims of [name of claimant] ("Claimant") for unpaid billings totaling \$[amount] ("Claim Amount"); [specify] construction project ("Project")

[Salutation]

This is to provide you with notice that Claimant is owed the Claim Amount for its past-due and unpaid billings for [labor/materials/labor and materials] furnished on the Project. Claimant furnished [description of work and/or materials furnished] for the Project under Claimant's agreement with [name of customer].

This notice is sent in compliance with the Texas Property Code's mechanic's lien provisions. Accordingly, we must notify you that if the Claim Amount remains unpaid, the owner of the premises may be personally liable, and the owner's property may be subjected to a lien unless the owner withholds payment from the contractor for payment of the claim or the claim is otherwise paid or settled.

Also, further notice is given that all of the Claim Amount has accrued and is past due. Accordingly, demand for payment of the claim in the Claim Amount is hereby made.

Enclosed are copies of the statements or billings that constitute this claim.

This also constitutes notice pursuant to section 162.001 *et seq.* of the Texas Property Code (the Trust Fund Act) that Claimant has a priority interest in the construction funds for this project in your possession now or released to you in the future. The Trust Fund Act states

that project owners and contractors are trustees of the construction funds they receive. Such funds must be used to pay for the labor and materials on the Project and cannot be used for other purposes. The owner and contractor are deemed to be trustees of the Project funds for the benefit of unpaid subcontractors and suppliers, including Claimant, to see that payment is made. Consequently, you are directed to set aside such construction funds to cover the Claim Amount. Diversion of construction trust funds constitutes violation of the Trust Fund Act.

Please contact me immediately regarding this notice.

Sincerely yours,

[Name of attorney]

Certified Mail No. [number]
Return Receipt Requested

Certified Mail No. [number]
Return Receipt Requested

Attach the notice at form 21-3 in this chapter if the lien is against homestead property.

Form 21-3

To fix a lien on homestead, the following statement must be included in or attached to form 21-2 in this chapter, the notice required to be given to the owner under Tex. Prop. Code § 53.252. Tex. Prop. Code § 53.254. The language is derived from the statute, and the practitioner must be careful not to alter the prescribed language.

Notice to Owner Regarding Liens against Homestead Property

If a subcontractor or supplier who furnishes materials or performs labor for construction of improvements on your property is not paid, your property may be subject to a lien for the unpaid amount if:

1. after receiving notice of the unpaid claim from the claimant, you fail to withhold payment to your contractor that is sufficient to cover the unpaid claim until the dispute is resolved; or
2. during construction and for 30 days after completion of construction, you fail to retain 10 percent of the contract price or 10 percent of the value of the work performed by your contractor.

If you have complied with the law regarding the 10 percent retainage and you have withheld payment to the contractor sufficient to cover any written notice of claim and have paid that amount, if any, to the claimant, any lien claim filed on your property by a subcontractor or supplier, other than a person who contracted directly with you, will not be a valid lien on your property. In addition, except for the required 10 percent retainage, you are not liable to a subcontractor or supplier for any amount paid to your contractor before you received written notice of the claim.

[Reserved]

Form 21-4

If the lien relates to a homestead, the affidavit must contain the notice preceding the title of this form. The language of the notice is prescribed by Tex. Prop. Code § 53.254(f) and must appear at the top of the page in a minimum of ten-point bold-faced type or equivalent.

NOTICE: THIS IS NOT A LIEN. THIS IS ONLY AN AFFIDAVIT CLAIMING A LIEN.

Affidavit Claiming Mechanic's and Materialman's Lien

Affiant, [**name of affiant**], on oath swears that the following statements are true and are within the personal knowledge of Affiant:

My name is [**name of affiant**]. I am the [claimant/[**title**] of [**name of claimant**]] ("Claimant"). This affidavit is made to perfect a mechanic's and materialman's lien against the real property described below:

1. Claimant has an unpaid claim in the amount of \$[**amount**] ("Claim Amount") for [labor/materials/labor and materials] furnished on the construction of improvements generally known as the [**specify**] construction project. The Claim Amount is, within my personal knowledge, just and true, the same is due and unpaid, and all just and lawful offsets, payments, and credits have been allowed. The Claim Amount is for [labor/materials/labor and materials] furnished and described below, on which a systematic record has been kept.
2. The name and last known address of the owner or reputed owner ("Owner") of the real property and improvements on which this claim is made are [**name and address**].
3. The Claim Amount represents the unpaid contract price due Claimant, or, in the alternative, is the reasonable value of the unpaid portion of Claimant's [labor/materials/labor and materials] furnished, which are described below.

4. Claimant's [labor/materials/labor and materials] furnished for construction of improvements on the real property described below [is/are] generally described as [**describe, e.g.,** specially fabricated and installed plumbing, heating, ventilating, and air-conditioning duct work, equipment, and allied systems]. Payment of the Claim Amount is requested for work performed or materials furnished during each of the following months: [**specify months**].

5. Claimant furnished the above-described [labor/materials/labor and materials] under a [subcontract/contract/purchase order] with [**name of customer**], whose last known address is [**address**].

6. The name and last known address of the original contractor on the above-referenced project are [**name and address**].

7. The legal description of the real property improved by Claimant's above-described [labor/materials/labor and materials] is [**legal description**]. That real property and improvements on it are sought to be charged with Claimant's lien.

8. Claimant claims a mechanic's and materialman's lien on the above-described real property and improvements thereon to secure payment of its Claim Amount in accordance with the Texas Property Code.

9. Claimant's physical address is [**address**]. Claimant's mailing address is [**address**].

10. Claimant's notice[s] of mechanic's lien [was/were] sent to Owner by United States certified mail, return receipt requested, on the following date[s]: [**specify date[s]**].

11. In compliance with the Texas Property Code, Claimant is sending one copy of this affidavit to Owner at its last known address and also one copy to the above-referenced original contractor at its last known address.

[Name of affiant]

SUBSCRIBED AND SWORN TO before me on _____ by [name of affiant].

Notary Public, State of Texas

[Reserved]

Form 21-5

Copies of the lien affidavit must be sent within five days of filing the lien affidavit. Tex. Prop. Code § 53.055(a).

Cover Letter Sending Copy of Lien Affidavit

[Date]

[Name and address of owner]

[Name and address of original contractor]

Re: Claim of [name of claimant] ("Claimant"); mechanic's and materialman's lien

[Salutation]

Enclosed is a copy of Claimant's affidavit claiming a mechanic's and materialman's lien ("Affidavit").

In accordance with the Texas Property Code, we notify you again that if the claim described in the Affidavit remains unpaid, the owner of the property described may be liable, unless the owner withholds payment from the contractor for the amount of the claim or it is otherwise settled or paid.

Claimant was forced to proceed with securing its lien rights because Claimant has not received payment from any source on the claim set forth in the Affidavit.

Include the following if applicable.

Previous written demand by Claimant for payment of this claim was made on [date]. No notice of dispute regarding this claim was submitted. Therefore demand for payment of the claim amount is hereby made in accordance with section 53.083 of the Texas Property Code.

Continue with the following.

Please contact me on receipt of this letter so that we may discuss a prompt resolution of this matter.

Sincerely yours,

[Name of attorney]

Enc.

Certified Mail No. [number]
Return Receipt Requested

Certified Mail No. [number]
Return Receipt Requested

Attach a copy of the lien affidavit (form 21-4 in this chapter).
For residential construction on a homestead, also attach the
notice at form 21-3.

Form 21-6

This notice must be sent to the owner by the fifteenth day of the second month following the claimant's receipt and acceptance of an order for the specially fabricated material. The original contractor must also be sent notice if the indebtedness was incurred by a person other than the original contractor. Tex. Prop. Code §§ 53.058, 53.253.

Notice Regarding Specially Fabricated Material[s]

[Date]

[Name and address of owner]

[Name and address of original contractor]

Re: [specify] construction project ("Project")

[Salutation]

[Name of claimant] ("Claimant") has received and accepted an order from [name of customer] for specially fabricated [description] to be delivered to your Project after [they are/it is] made. The price of the specially fabricated order is \$[amount]. This notice is sent to you in compliance with the mandatory provisions of Texas law regarding receipt of orders for specially fabricated materials. This is not intended as a comment in any way on Claimant's customer, [name of customer], but is merely sent in compliance with the state law.

Claimant is pleased to be a participant in this Project and looks forward to working with [name of customer] toward the Project's successful conclusion.

Sincerely yours,

[Name of attorney]

Certified Mail No. [number]
Return Receipt Requested

Certified Mail No. [number]
Return Receipt Requested

Form 21-7

This notice is for use on projects in which the original contract was executed before September 1, 2011. This notice must be sent to the owner by the fifteenth day of the second month following the first delivery of materials or performance of labor by the claimant. The original contractor also must be sent notice if the claimant's contract is not with the original contractor. Tex. Prop. Code § 53.057.

Notice of Agreement Providing for Retainage

[Date]

[Name and address of owner]

[Name and address of original contractor]

Re: Notice for Contractual Retainage Claim—[describe in detail the name and location of the construction project] (“Project”)

[Salutation]

[Name of claimant] (“Claimant”) is pleased to have been selected as a [subcontractor/supplier] for the Project. Claimant's contract with [name] provides that [10/[specify other percentage]] percent of the contract price may be withheld as retainage. Claimant therefore respectfully submits its notice of contractual retainage agreement. This notice is required by section 53.057 of the Texas Property Code.

The general nature of the agreement is as follows: [specify, e.g., 10 percent of contract price as adjusted by the change orders].

The date or dates when retainage is payable are as follows: [specify, e.g., thirty days after final completion of our portion of the work on the Project].

We believe the total amount to be retained under our contract will be \$[amount]. Also [percent] percent of increases to Claimant's contract by change order(s) will be subject to retainage.

This notice is not in any way to be considered a negative comment regarding Claimant's customer, **[name of customer]**, and Claimant looks forward to working toward a successful completion of your Project.

Sincerely yours,

[Name of attorney]

Certified Mail No. **[number]**
Return Receipt Requested

Certified Mail No. **[number]**
Return Receipt Requested

Form 21-8

This notice is for use on projects in which the original contract was executed on or after September 1, 2011. This notice must be sent to the owner by the thirtieth day after the claimant's agreement providing for retainage is completed, terminated, or abandoned. Certified mail is no longer required for this notice. *See* Tex. Prop. Code § 53.057(b).

Notice of Retainage Agreement

[Date]

[Name and address of owner]

Include the following if the claimant's contract is not with the original contractor.

[Name and address of original contractor]

Continue with the following.

Re: Notice of Contractual Retainage; [name] construction project located at [address] ("Project")

[Salutation]

This letter is to give you notice that [name of claimant] is a [subcontractor/supplier] on the Project and that a requirement for retainage exists in its agreement with [other party to claimant's agreement] for the Project.

The complete name and address of [name of claimant] is [name and address of claimant].

[Name of claimant]'s agreement for the Project is with [name and address of other party to claimant's agreement].

Sincerely yours,

[Name of attorney]

Form 21-9

Request for Information to Owner

[Date]

[Name and address of owner]

Re: Request for information on [specify] construction project ("Project")

[Salutation]

[Name of claimant] is furnishing [labor/materials/labor and materials] for the Project. This is to respectfully request that you, as owner of the Project, furnish to us the following information within ten days of your receipt of this request. This information is required by sections 53.106, 53.107, and 53.159 of the Texas Property Code:

1. a sufficient legal description of the real property being improved;
2. whether there is a surety bond and, if so, the name and last known address of the surety and a copy of the bond;
3. whether there are any prior recorded liens or security interests on the Project property being improved and, if so, the name and address of the person or entity having the lien or security interest;
4. the date on which the original contract for the project was executed;
5. whether there is an affidavit of commencement or affidavit of completion filed, and, if so, a copy of each affidavit; and
6. notice of original contractor termination or abandonment.

Thank you for your cooperation and prompt attention.

Sincerely yours,

[Name of attorney]

Certified Mail No. [number]
Return Receipt Requested

Form 21-10

Request for Information to Original Contractor

[Date]

[Name and address of original contractor]

Re: Request for information on [specify] construction project ("Project")

[Salutation]

[Name of claimant] is furnishing [labor/materials/labor and materials] for the Project. This is to respectfully request that you, as original contractor for the Project, furnish to us the following information not later than the tenth day after you receive this request, as required by section 53.159 of the Texas Property Code:

1. the name and last known address of the person to whom you furnished labor and materials for the Project;
2. whether you have furnished or have been furnished any payment bonds for any work on the Project and, if so, the name and last known address of the surety or sureties and a copy of each bond; and
3. the date on which the original contract for the project was executed.

Thank you for your cooperation and prompt attention.

Sincerely yours,

[Name of attorney]

Certified Mail No. [number]
Return Receipt Requested

[Reserved]

Form 21-11

Request for Information to Subcontractor

[Date]

[Name and address of subcontractor]

Re: Request for information on [specify] construction project ("Project")

[Salutation]

[Name of claimant] has furnished [labor/materials/labor and materials] for the Project under your subcontract on the Project. This is to respectfully request that you, as a subcontractor for the Project, furnish to us the following information not later than the tenth day after you receive this request, as required by section 53.159 of the Texas Property Code:

1. the name and last known address of each person from whom you purchased labor or materials for the Project, other than the materials that were furnished from your inventory;
2. the name and last known address of each person to whom you furnished labor and materials for the Project; and
3. whether you have furnished or have been furnished any payment bonds for any work on the Project and, if so, the name and last known address of the surety or sureties and a copy of each bond.

Thank you for your cooperation and prompt attention.

Sincerely yours,

[Name of attorney]

Certified Mail No. [number]
Return Receipt Requested

Form 21-12

Request for Copy of Affidavit of Completion

[Date]

[Name and address of owner]

Re: Request for copy of affidavit of completion on [specify] construction project ("Project")

[Salutation]

This is to respectfully request, on behalf of [name of claimant], a copy of the affidavit of completion, if any, on the Project. This request is made in accordance with the provisions of section 53.106 of the Texas Property Code. The claimant has furnished labor or material or both for the Project.

Sincerely yours,

[Name of attorney]

Certified Mail No. [number]
Return Receipt Requested

[Reserved]

Form 21-13

Release of Mechanic's and Materialman's Lien

Basic Information

Date:

Claimant:

Property:

Claimant has on or about [date] attempted to assert a mechanic's and materialman's lien on the Property [include if applicable: by affidavit filed in [recording data] of the real property records of [county] County, Texas].

The owner of the Property, [name of owner], has reached an agreement with Claimant for the release of the lien against the Property.

Claimant hereby releases the Property from the mechanic's and materialman's lien in consideration of good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged.

[Name of claimant]

Include acknowledgment.

[Reserved]

Form 21-14

Partial Release of Mechanic's and Materialman's Lien

Basic Information

Date:

Claimant:

Property:

Project: [**describe project**]

Claimant filed its affidavit claiming a mechanic's and materialman's lien on the Property on [**date**].

The lien was asserted by Claimant for its [labor/materials/labor and materials] generally described as [**describe, e.g.,** specially fabricated and installed plumbing, heating, ventilating, and air-conditioning duct work, equipment, and allied systems] furnished for the Project located on the Property.

The described [labor/materials/labor and materials] were furnished by Claimant for construction of the Project under [a contract/an agreement] with [**name of original contractor**], as original contractor for the Project.

An agreement has been reached for a partial release of the lien claim against the Property.

Claimant hereby releases \$[**amount**] of its mechanic's and materialman's lien against the Property but specifically preserves the balance of its lien in the amount of \$[**amount**].

[Name of claimant]

Include acknowledgment.

Form 21-15

Notice of Termination of Work or Abandonment of Performance
by Original Contractor or Owner

Basic Information

Date of Notice: [date]

Project: [describe improvements]

Owner: [name and address]

Original Contractor: [name and address]

Legal Description of Project: [sufficient for identification of the project real property]

Date of Termination or Abandonment: [date]

This constitutes formal notice that the original contract on the project has been terminated or performance under the contract has been abandoned.

A MECHANIC’S LIEN CLAIMANT MAY NOT HAVE A LIEN ON RETAINED FUNDS FOR THE PROJECT UNLESS THE CLAIMANT FILES AN AFFIDAVIT CLAIMING A LIEN NOT LATER THAN THE FORTIETH DAY AFTER THE DATE OF THE TERMINATION OR ABANDONMENT.

[Name of owner]

By _____

Printed Name

Title







2

1



2

1



1

