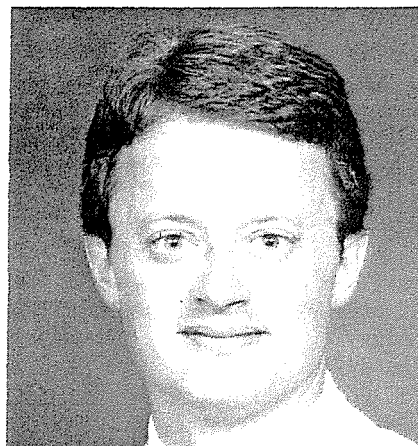


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OVERVIEW OF THE TEXAS V. NEW MEXICO SETTLEMENT

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Earlier this year, I was asked to help out in the *Texas v. New Mexico* lawsuit. I was happy to do so, and I am quite proud of the results we achieved this past summer. We were not faced with the question of do you pay or don't you pay, but rather how much. When you compare the evidence both states put forth to the settlement ultimately reached, I think you are compelled to reach the conclusion that New Mexico must have put on the better case.

I would like to take a moment to thank publicly the legal team members with whom I had the good fortune to work. Peter White and Vickie Gabin are lawyers with the State Engineer Office. Peter, previous to my getting involved in the case, had put together an excellent group of experts--hydrologists, and economists. Our success in the case is due in large part to Peter's effort. The southeastern part of the state owes the State Engineer Office and the Attorney General's office a debt of gratitude for this last phase of the trial.

Let me summarize what happened in the trial. I will try to explain what the basic issues were, what happened, and give you a few thoughts on why we obtained the result that we did.

THE ISSUES

The overall question was: what should be the remedy for the 385,000 acre-foot debt the U.S. Supreme Court, in 1987, had determined New Mexico owed? There were three possible remedies. One is what lawyers call "specific performance"; a non-lawyer would simply call it having to repay with water rather than money. It would involve repayment over time, over and above the ongoing delivery obligations under the Pecos River Compact. For example, on average, New Mexico has to deliver about 80,000 or 90,000 acre-feet of water at the state line. If New Mexico had to repay the debt over ten years, it would have to send an additional 38,500 acre-feet down the river, over and above the 80,000 or 90,000 acre-feet it already had an obligation to deliver.

The second possible remedy was a monetary remedy, based on Texas' loss. Through hydrologic and economic evidence, a determination would be made as to how much profit Texas farmers could have made with the water, had New Mexico delivered it. The third alternative was also a monetary remedy, but one measured by the amount by which

New Mexico farmers profited by using the water that should have been delivered to Texas.

WHAT HAPPENED

Texas argued its case first. Texas claimed that what it really wanted was the water. But it put on no evidence of the relative benefits and burdens of such a remedy. Under the case law, Texas would have to establish that the benefits to Texas of a water remedy outweighed the burdens to New Mexico in order to get that kind of a remedy. Texas did not present any evidence on that critical issue. Instead, Texas focused its case on proving a right to a money remedy, which appears to me to have been its strategy all along.

On money damages, Texas' expert testified that, if New Mexico had delivered the water between 1950 and 1986, farmers in the Red Bluff project near Pecos, Texas, would have made approximately \$51 million in profits. Texas' economist also claimed that farmers in Roswell who had been using the water that should have gone to Texas during that same period of time made \$1 billion in profits with the water. Of course, Texas asked the special master to award damages based on New Mexico's gain, not Texas' loss. Its theory was that New Mexico had acted in bad faith in not complying with the compact during these years, and therefore, punishment in the form of requiring New Mexico to disgorge all of these profits was justified.

Then it was New Mexico's turn to put on its case. We first argued that a water remedy would be extremely wasteful. It would hurt New Mexico far more than it ever could have helped Texas. Our economists testified that the loss to New Mexico of having to deliver that extra water in the future would have been \$85 million. The scenario again was 38,500 acre-feet per year for ten years. Texas over those ten years would have made about \$2.5 million in profits from using that water. Thus, there was about a forty-fold difference between the loss to New Mexico and the benefits to Texas. Texas did not put on any contrary evidence.

On the money damages questions, we argued first of all that, as a legal matter, the question of how much profit New Mexico farmers made with that water was irrelevant. New Mexico had not acted in bad faith. In the absence of a showing of bad faith, the standard remedy for a breach of contract was appropriate here: the loss to the plaintiff caused by the breach, not the gain to the defendant of breaching the contract. Furthermore, our economists testified that if you really wanted to

look into the question of how much New Mexico gained, it was far less than the \$1 billion that Texas claimed.

Finally, our economists testified that, because of numerous problems Texas has in delivering water to its farmers and getting crops to grow with it, Texas actually could have made only about \$8 million--and that figure includes compounding to a present value--in profits over thirty-five years.

In an unusual move, the special master gave us his tentative thoughts about the evidence at the end of the first two weeks of trial. He thought Texas had struck out! First, he indicated he was not willing to give Texas the water because it would be extremely wasteful to shut down numerous New Mexico farmers in order to gain only a very small benefit to Texas. Second, he told us that he was not inclined to grant damages based on New Mexico's gain because there had been no showing of bad faith. Texas had argued that New Mexico never did anything over this thirty-five year period to increase the flow of water down the Pecos River. The problem with that argument, which the special master saw, was that New Mexico during that entire period never thought or realized it was under-delivering and it had very good reasons for maintaining that belief. The U.S. Supreme Court ultimately rejected those reasons and found to the contrary, but the fact of the matter was that New Mexico was acting in good faith. On the third optional remedy, the special master did not give us a specific figure on Texas' loss that he had in mind, but he did tell us that the loss was "fairly significantly less" than the \$51 million that Texas claimed.

We had a two-week break before we were scheduled to come back for another week of evidence. During that period there was some give and take in negotiating between the sides, but we ultimately struck a deal at \$14 million. Again, it was not a question of whether or not we paid, it was only a question of how much. Our experts made solid, conservative, credible assumptions in coming up with their figures, and they concluded that New Mexico had damaged Texas by \$8 million. That was probably the best result we could have obtained. Texas had their \$1 billion claim. We struck the deal at \$14 million. I think we won.

WHY THE STATES SETTLED FOR \$14 MILLION

I am biased, of course, but I think we obtained this result because we put on a better case. The state engineer and the attorney general also had the foresight to invest the necessary resources, and I am

Overview of the Texas v. New Mexico Settlement

talking about tax dollars, to win this case. They had to spend some money on hiring good experts, and those experts had to spend an awful lot of time trying to reconstruct thirty-five years of records. I also had to spend a lot of time putting the case together. But your state government was willing to go ahead and spend, and I think the money paid off. We saved tens of millions of dollars on a possible judgment in exchange for tens or hundreds of thousands of dollars in expenses in getting prepared for the trial.

But in the final analysis, reality dictated the result in the trial. There are three fundamental problems with irrigation down in the Red Bluff District. Some people from Texas who are in the audience might not like what I have to say, but I am going to say it anyway. The first problem is carriage losses. If you start with 10,000 acre-feet at the state line, by the time you divert it into the Red Bluff irrigation canals you are left with about 6,000 acre-feet. By the time that water gets to the farmers' headgates, you are left with 3,000 acre-feet of water. Thus, you have a 70% carriage loss from the state line to the farms. In terms of absolute amounts, we were talking about 6 cubic-feet per second at the farmers' headgates. The special master, who himself was familiar with agriculture, realized that this amount of water, even under the best of circumstances, could not produce many crops.

The second fundamental problem that exists in the Red Bluff District is salinity. There is a place in the river south of Carlsbad called the Malaga Bend, where there is a lot of brine accretions. In other words, lots of salt is dumped into the river, naturally and continuously, every year. Mr. Davis, I think, mentioned earlier today that Carlsbad has a salinity problem at 3,500 parts per million (ppm). The average salinity of the water that Texas could have expected to receive, even had New Mexico delivered the extra water, would have been around 7,000 ppm. During some of the years between 1950 and 1986, Red Bluff would have received water with a salinity of twenty tons per acre-foot.

Finally, the third problem the Red Bluff District faces is the extreme variability in the flows of the Pecos River. New Mexicans have that problem, too, but it was exacerbated for Texas by the fact that the Red Bluff Dam, as far as we could figure out, has never been used to even out the flows of the river in Texas. The water comes down, and next year it is released to the maximum extent possible.

The bottom line was, faced with these natural problems, the Texas farmers never could make much of a profit from Pecos water, while New Mexico

farmers can. For this reason, the special master refused to grant the water remedy, and the amount of money that Texas could obtain was far less than the amount requested.