by Elizabeth M. Dietzmann

Some perspectives on 1926(b) cases

As an attorney who has worked with water districts on a number of 1926(b) cases, I am slowly changing my attitude about the value and necessity of this type of litigation. Don't get me wrong, under certain circumstances, it may be the only option for a water district. In situations where a city would take so many existing customers that the water district will not survive economically, the district has no choice but to fight. However, more and more I am seeing water districts that are ill-prepared launch this expensive litigation in order to secure the right to serve undeveloped areas. Unless a water district has prepared internally, exhausted all other options and carefully reviewed the impact on the district, it should think twice about filing a 1926(b) case. At best a 1926(b) defense should be merely one tool used to resolve territorial disputes.

Elizabeth Dietzmann and her horse, Hollywood, at home in Rolla, Missouri.

Up front considerations

That is pretty strong language, but water districts are rarely ready to deal with the reality of a 1926(b) case. Merely having federal debt, making service available and being encroached upon (the three threshold requirements of a 1926(b) case) are not going to win the case. Does the water district have anywhere from $250,000 to $500,000 to spend on the lawsuit, which will probably include an appeal and last two or three years? While every single 1926(b) case will have different facts, I am definitely seeing a trend towards multiple lawsuits being filed in retaliation by land owners in cahoots with the cities. Rarely can the water district's general counsel handle all this alone, so outside attorneys are often brought in to assist. That gets expensive quickly. Even though it is possible to receive attorney's fees if the water district wins, the reimbursement is not usually one hundred percent, as the trial judge makes the final determination and all this happens at the end of the case. One of the first determinations that needs to be made is whether or not it is really worth it to the district to spend that kind of money on one or two growth areas. Has the district done an analysis of the potential profit – not gross revenue

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– that can be made on that area? Many districts do not have any idea what their actual cost to produce water is and therefore they don't know what their actual profit is. It is one thing if the district has already spent the money and stands to lose existing customers after it has made the investment to serve them. But should districts fight to keep areas that they are not yet serving? Does that make sense?

Even if the district has money to burn, is it in perfect working order? This means perfect! During litigation, every aspect of the water district's operations will be picked over with a fine toothed comb and any deficiencies can and will be used by opposing counsel to challenge the authority of the board to bring the lawsuit. Are the board members properly elected? Does anyone even remember when the terms are up and what election procedures are to be followed? Are all the state laws for bidding and contracts followed? Are minutes properly maintained? Are the actual formation documents and federal loan documents available? Can the district produce complete sets of its minutes for the last five years or so? Even more importantly, does the district have a current boundary map which reflects all additions to the district since its formation? Does anyone really know where the district and city boundaries overlap? Does the district have key employees who know where the actual pipes are laid and does the district have a system map that shows all the pipes in the ground? Has the district complied with all audit requirements and does it have copies of previous audits? Does the district have records covering the disputed areas which identify the development history and potential revenue loss?

Is the board aboard?

Assuming that the district has money, is flawlessly operated and no one can find any fault with its internal procedures, the next question concerns the board members. Are they unanimous in their intent to fight the city? A divided board has serious weaknesses, because board members who do not support the litigation may collude with the city and disclose confidential information. Are they tough enough to withstand two to three years of negative publicity, harassing late night phone calls from water customers in the disputed areas, nasty articles about them in the local newspapers, threats against their businesses? More importantly, are they willing to fight to keep their seat on the board? Let's face it, most districts are lucky to find enough folks willing to volunteer for board duty. But once a 1926(b) case is filed, contested board elections will become commonplace. The opposing city will secretly encourage sympathetic candidates to run for board seats and if enough board seats are lost, a new majority of the board can vote to drop the litigation in the middle. Yes this can actually happen. The city may also send direct mail to district customers in order to attempt to get them to dissolve the district, request a state audit or

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recall board members for their actions. There are always disgruntled customers or malcontents who will allow themselves to be used by the city. The days of peaceful board meetings will be over with almost every meeting requiring a closed session and often confused and angry customers showing up at meetings. The board will have to be ready to be proactive, unified and tough in order to withstand these types of pressures.

Winning may not be forever

The real irony is that even if a water district overcomes these obstacles and wins the case, the victory may be a hollow one. The old adage "be careful what you wish for" holds true. In a typical scenario, a water district fights a city over a few choice areas. If the water district wins, it has pretty much made an enemy for life out of the city and now it has to serve the area it has secured. In some circumstances, the district has spent so much money on the litigation that it can never realistically hope to recoup that in revenues from the disputed area. And if the area was already built out and being served by the city, and now it has been turned over to the district, the district has some very unhappy new customers. Their water bills will be at least double what the city charged them and they will never understand why they had to switch water providers. These folks get to vote in board elections and can present long term problems to the district. I even know of cities who have lost 1926(b) litigation but who take the long term approach. They decide to slowly but surely run candidates against the board so that some day they will have a board that favors the city and they can take future territory without any opposition. This is one key issue that should be noted – winning a 1926(b) case will not automatically give a district blanket protection from all future actions that the city takes. The case law seems to indicate that a district will have to file a future action if a new territorial dispute occurred in the future, because it has to prove the three threshold issues mentioned at the start of this article for each encroachment.

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Planning and partnering avoids litigation

So what is a district supposed to do if 1926(b) protection is so expensive and difficult to obtain? Well, first of all districts need to start thinking like real utilities and planning for growth. I am not criticizing all districts but too many districts are still operating like subsidized utilities. They don't plan to serve future growth areas, they are hesitant to extend lines into areas where growth might occur and they don't have clearly laid out developer policies. Many districts wake up one day and find that a city has encroached into their territory, but that did not happen overnight. Every water district should have a long term plan and should have some sort of planning study done that makes some projections about growth. I assure you, that if you just get a map of the district out, and compare that to an ownership plat book, common sense will tell you where you can expect growth and where it looks like the city may

expand. Cities don't operate in secret either. The district should keep up with city annexations and planning and zoning requests. The district should regularly contact landowners with large tracts of land adjacent to the city and start a dialogue. Explain what the district has to offer to a developer – simple approval process, no planning and zoning, cost-sharing on construction and operations of wastewater systems. Districts need to get out there and pursue those folks. The district also needs to educate the city before matters become adversarial as well. The time to work out territorial agreements is before disputes become apparent. Many cities have never even heard of 1926(b) protection and if they are educated about it in a non-threatening manner, it is often possible to work with cities. Once cities understand that they can still annex land and receive the tax benefits, but that the district has the exclusive right to serve water customers, there are many ways that districts and cities can partner on projects. Territorial agreements can spell out who serves the customers and who receives the revenue and there are many different ways to resolve those issues. Some cities lay the lines and provide the actual water service, but allow the district to charge the district rate to the customers. The city then receives some revenue for the sale of its water and with district rates usually being so much higher than city rates; this can work for both sides. Some districts decide to buy water wholesale from the city and serve the customers themselves. In the bigger picture, it may not make sense for the district to spend $250,000 securing the right to serve an area that they do not serve now and have not invested any money in serving. Some districts have agreed with the city to allow the city to serve certain undeveloped areas adjacent to the city for a fee, and the district has spent the money it would have spent in litigation in developing new service areas away from the city. The trend in recent years has been for developers to go out into rural areas and build subdivisions. There is no reason that districts can't take advantage of that trend and do some investing in infrastructure now that will allow them to work with developers in areas the city won't ever want to annex. Districts need to take a seat at the table and start a dialogue with county officials, rural electric cooperatives and city officials so that everyone can figure out in advance the best ways to deal with growth in rural areas.

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Be sure to attend!

Territorial Agreements and 1926(b) Issues,
a session presented by Elizabeth Dietzmann on Wednesday, March 30 at 10:45 a.m., at KRWA's 38th Annual Conference & Exhibition in Wichita.