GUIDELINES FOR THE TRANSFER OF WATER SERVICE TERRITORY BETWEEN CITIES AND RURAL WATER DISTRICTS (FEBRUARY 2010 DRAFT BY COMMITTEE)

I. BACKGROUND

RURAL WATER DISTRICTS

Rural Water Districts were originally formed for the purpose of providing adequate water supplies to rural areas where there were none. They were constructed using funds provided by loans and grants from the USDA. Each RWD has territory established by the Board of County Commissioners. An RWD is a special unit of government, governed by a board of directors elected by the participating members (customers). As special districts, rural water districts are governed by Kansas Statutes, K.S.A. 82-612 *et. seq.* Their boundaries may change, generally upon petitions of the affected landowners and approval of the County Commission.

There are approximately 300 rural water districts in Kansas. Many continue to serve widely dispersed populations with drinking water and provide no other services. Some RWD's have evolved to the point that they provide high level service through large capacity systems, including fire protection. Some RWD's sell water to cities at wholesale, and others serve as the retail supplier to parts or all of some cities. These highly developed districts tend to be located in urbanizing areas and may adjoin growing cities. Districts can partner with cities; Rural Water Districts can help cities serve outside city limit landowners by providing cost of service at no expense for infrastructure to City.

CITIES

Cities are general jurisdictions of government having powers granted by Kansas Statutes as well as constitutional home rule authority. Cities have statutory authority through K.S.A. 12-801 to purchase, construct, or extend the infrastructure and works necessary to supply the city and its inhabitants with public utilities including water. Many cities in Kansas have been supplying water to their respective community for well over 100 years. Municipal water supplies were originally developed to provide fire protection and safe drinking water in an urban setting. Today municipal water suppliers in Kansas range from the very small more rural communities to the state's largest cities.

City water systems are integrally involved in the development and growth of their communities. Not only are municipal water systems involved in supplying fire protection and drinking water for public safety and sanitation purposes, they must also be involved in the planning and development for: existing or new water supplies, annexed territories, new subdivisions, new commercial and industrial development; fire protection (ISO) ratings, and other issues within a more dense urban environment. Cities' jurisdictional limits may change over time due to the annexation of land as allowed by State law. These annexations may include land located within the service territory of a rural water district.

CONFLICTING WATER SERVICE TERRITORY- LEGAL BACKGROUND

In the case of an annexation of land located within RWD territory, the city's limits and the district's territories may overlap and potential for water service territory conflicts may arise. In the case of annexation of rural water district territory, Kansas Statutes, K.S.A. 12-527, provide a procedure to follow. In summary, in the event that the city elects to replace the rural water district as the water supplier to the annexed territory, the city and the RWD are to negotiate an agreement for the city to acquire the title to the facilities owned by the district that are used in the transportation or utilization of water to serve the annexed area. If no agreement can be reached, a three-member panel of appraisers is appointed for determination of this value. The appraisal is "open ended" and may include a consideration of the going concern value. The payment is due following completion of the appraisers' valuation, and either party may appeal the reasonableness of the appraisers' award to the District Court.

Additional considerations must be made if the rural water district whose territory is annexed has a loan payable to the USDA or guaranteed by the USDA. In these cases, a Federal Statute, 7 U.S.C. § 1926(b) applies. In summary, this Statute provides that if the district is providing water service or has made water service available to the annexed territory, then the RWD has the right to continue to provide that service notwithstanding the annexation. Although the annexing city may require a specified level of water service for fire protection within the city, the RWD need only demonstrate the ability to provide water service for domestic use without fire protection capability in order to assert that it has "made service available". In such case, the city might find it necessary to extend the fire service lines through the annexed area without opportunity to provide domestic water service (which would still be provided by the district), or decline the annexation altogether.

Water utilities, both rural and urban, have an infrastructure to maintain and to serve current and future benefit unit water users. The larger the number of water users in the district, the more that operational cost is shared and the more reasonable the monthly cost per residential user for water. Similarly, as that number of water users diminishes with City annexation, the greater the Rural Water operational costs are for each remaining user. The additional problem of an aging water system: distribution lines need to be maintained and replaced, new booster pump/chlorine systems are expensive. Both rural water districts and cities are burdened by these cost issues.

II. PREVENTING CONFLICT BETWEEN WATER SERVICE PROVIDERS

In some cases, these overlapping service area issues have resulted in protracted and expensive litigation, resulting in delays and expense ultimately borne by the landowners/developers and consumers of the respective water utilities. In other cases the parties have attempted to negotiate agreements but found their efforts complicated by a lack of guidelines or formula to service the framework for the negotiations and eventual agreement. This policy is an attempt to create guidelines that are respectful of the interests of all of the parties concerned in an effort to create an environment in which these water service and/or compensation agreements can be more readily achieved.

There are several factors that contribute to conflicts between cities and rural water districts over water service territory. They include: (1) lack of awareness of the legal rights and responsibilities that each have for water service to their residents; (2) lack of understanding concerning service capabilities and limitations; (3) lack of communication regarding future plans, and (4) emphases on the utilities goals and desires at the expense of those of the present and future customers of the utility.

Cities and neighboring rural water districts should make a concerted effort to address these potential sources of conflict by implementing the following:

(1) Educate staff and governing body members with the laws concerning the rights and responsibilities of the respective utilities. Network with other cities and rural water districts in an effort to understand how these rules can relate to specific situations in order to be able to apply problem solving techniques successfully used in other places to given situations.

(2) Periodically perform system service capability studies in order to understand future service capabilities, and share those studies with neighboring rural water districts and cities. Meet with staff and/or representatives of governing bodies of neighboring cities and rural water districts to review future service capabilities of water systems.

(3) The water system staff and/or representatives of the governing bodies of neighboring cities and rural water districts should conduct joint meetings with planning staff in order to review potential growth and resultant water system demand and to the extent possible, intermediate and long range plans that each have concerning expansion of boundaries and how those may relate to water system capabilities and limitations regarding future service to those areas. Cities should give as much advance warning to RWD's as possible of plans for annexation of RWD territory and not make commitments about water service to landowners/developers until all of the relevant factors have been considered. RWD's should give advance notice to neighboring cities of plans to construct significant infrastructures (large capacity lines and tanks) or develop or contract for new or expanded water supplies or treatment facilities designed in whole or in part to serve areas presently unserved or with limited service adjoining neighboring cities.

(4) Commit to the principle that the interests of the customer, whether rural or urban, present and future, should be the primary concern of all water utilities. (This principle may be easier to embrace when the costs of litigation are considered which have exceeded $1.0 million in at least one case in Kansas.)

(5) Lack of regard for citizens who are not their own constituents, coupled with a belief that their fiduciary duty to their own constituents negates any need to consider other's positions.

Examples of the application of these principles may include:

a) RWD's should yield their territory to an annexing city for water service if the land is planned for development of a type and density that exceeds the capabilities of the district to provide all of the needed services, including water necessary for fire protection (including capacity for pressure and flow volume required for urban development), with due consideration to its effect on the balance of RWD's service area.

b) The inefficiencies inherent in duplicative water facilities, one set of lines for drinking water provided by one utility and a separate, parallel, high volume set for fire protection by a different utility, is not in the public's interest and should be avoided.

c) Due consideration should be given to the advantages that can be obtained from water service by a RWD to land that already is in its district, that has the capacity and ability to meet the demands for water service following the annexation, and whose existing customers would be hurt by loss of future growth represented by the addition of new service to this area.

d) If the annexing city i) has given notice of its intent to annex and provide water service to the land and ii) thereafter within _____ months in fact annexes such land and gives notice of its intent to assume water service to such land, the RWD in whose territory such land is located should not be compensated for any improvements made to serve such land after the notice under i) above has been given. This limitation should not apply where a city gives more than two notices under i) above for the same land within a _____ year period, and does not relieve a city for compensating for the value of any improvements that were already in process at the time the notice under i) above was given or for any emergency replacements or upgrades of facilities to serve such areas.

Employing these techniques and principles should lead cities and rural water districts toward a cooperative effort to resolve potential disputes without need for litigation. In most instances the neighboring utilities should consider creation of a long term territorial or service agreement that will govern the provision of water service to their respective territories in the event of future boundary changes and development. Such agreements may include permanent service territory lines that will remain in effect despite changes in political boundaries; emergency interconnect or mutual aide provisions where appropriate; minimum service standards to be achieved within any overlapping areas for which a RWD is to provide service, and/or compensation formulas when territory is surrendered pursuant to the terms of the agreement. Three sample agreements are attached to this paper. These are samples only. No particular form should be considered as the only one suitable to a particular situation. Care should be taken to adapt an agreement form as necessary to fit the specific case.

In the event that disputes arise, the parties should employ alternative dispute resolution measures, including mediation services offered by the Kansas Water Office and others. Litigation should be employed only as a last resort when vital interests are at stake and all efforts at resolution have failed.

There will be some instances in which it will be necessary for one utility to compensate another due to changes in service territory. These include but are not limited to the compensation that is payable under K.S.A. 12-527 when a portion of rural water district territory has been annexed and the city designates a supplier other than the RWD to serve the annexed area. This compensation is to compensate for the reasonable value of the property, facilities and improvements in the annexed area, including an analysis of their going concern value. No specific formula for computing reasonable value is required, and each case may be different. There will be times when going concern value will be enormously influential and a high-dollar component of reasonable value, and other times when it will have minimal impact and may reasonably set at zero. Fair consideration should be given to all factors in a given case in an effort to reach a reasonable valuation and settlement. It could also include situations in which neighboring utilities agree to designate one as the service provider to a particular area, whether or not annexation of that area has occurred. These could also include situations in which a rural water district has a USDA loan and is entitled to protection against compensation under § 1926(b), but such district and a neighboring utility agree that a transfer of service responsibility is appropriate upon payment of adequate compensation.

In all of these cases, the following factors should be considered in arriving at reasonable compensation:

(1) The value of any property rendered useless or valueless or diminished in value to the Rural Water District. An example of applications of this factor would be an annexation that servers territory of the District, resulting in an inability by the District to use certain facilities and improvements necessary to serve other areas of the District;

(2) The amount of loss of value or increase in cost to property remaining in the ownership of the water district following the transfer;

(3) The reasonable and prudent costs of detaching the water system facilities to be sold and all reasonable and prudent costs of reintegrating the remaining water system facilities of the water supplier whose service rights are terminated;

(4) The impact on the existing indebtedness of the system and that system's resulting ability to repay that debt;

(5) The value of the service facilities of the system located within the area transferred, and the impact on those facilities located outside the area. This value may be calculated based on a variety of methods, including any one or a combination of the following: depreciation cost, replacement cost, depreciated replacement cost, projected income stream reduced to present value, or other suitable method;

(6) The amount of expenditures for planning, design or construction of service facilities of the system located outside of the transferred area that are allocable to the service of that area;

(7) The amount of the systems contractual obligations allocable to the area transferred;

(8) Any demonstrated impairment of service or increase of costs to the consumers of the system remaining after the transfer of the area in question and the impact on future revenues lost from existing and potential customers of that system;

(9) The necessary and reasonable legal expenses and professional expenses incurred by the system as a result of the transfer;

(10) Any factors relevant to maintaining the current financial integrity of the system following the transfer;

(11) The growth and the number of customers in the area transferred during the three years immediately preceding the transfer;

(12) If the area transferred consists of land for which no water service is being provided by the system at the time of the transfer, the value of such land based on the planning, design and/or construction of improvements located outside the transferred area reasonably made to provide future water service to the transferred area.

(13) The potential for development of area transferred compared to cost of that development.

Information should be developed and shared with the other party to the transfer as quickly as possible. Both parties share responsibility for insuring that this process proceeds timely and that determination of value and compensation is made as quickly as possible.

Neither the City nor the Water District should be working in a vacuum. The secret is communication, but it is imperative that this communication be honest and timely. Reference is made to the Checklist attached for additional emphasis of this point.