

# Legally (Relevant



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## Water supply contracts (Part III)

**T**his is the third part of a series concerning water supply contracts. This article concerns existing contracts between a buyer and a seller, and focuses on how disputes occur, how they may be prevented and how they are resolved once they occur.

Disputes arise between the parties to a water supply contract from a variety of sources including inadequate or unreliable pressure or volume, water quality and curtailment during shortage. But, by far

the majority of these disputes revolve around price, with the seller demanding higher rates than the buyer believes are justified under the contract.

Once a dispute occurs, if the parties are unable to resolve it themselves, the dispute may ultimately be resolved by a court. This article will look at what is involved in water supply contract litigation, but before getting to that, consider some thoughts on how these disputes may be avoided:

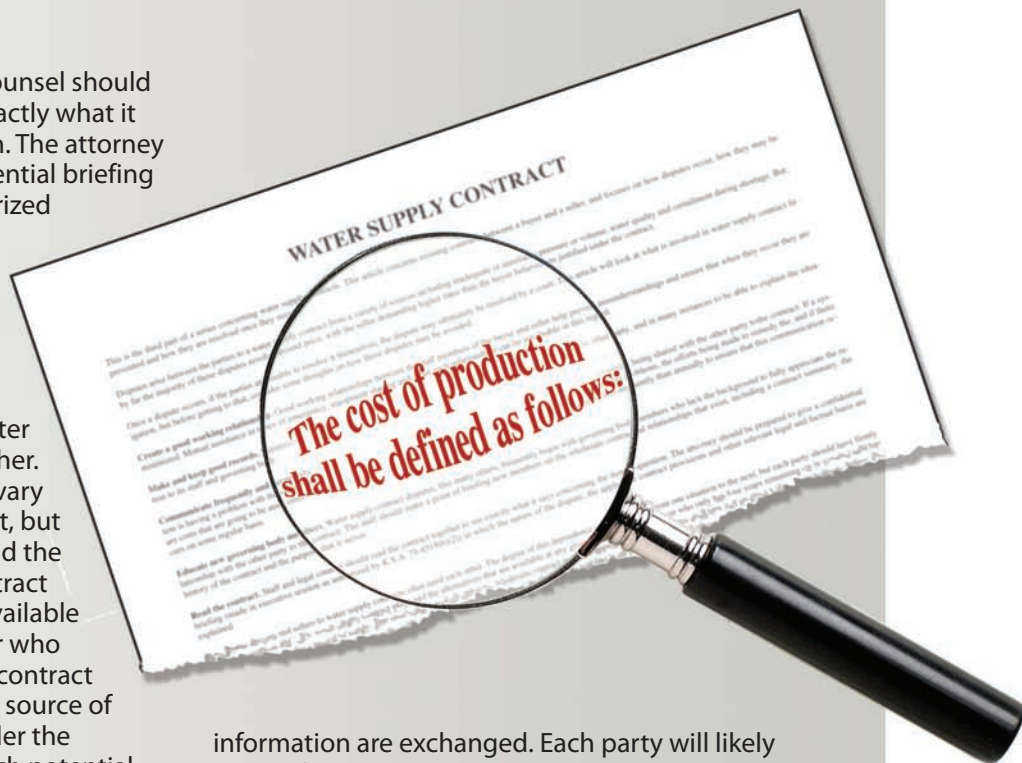
- **Create a good working relationship.** Good working relationships between the staff members of the buyer and seller help prevent misunderstandings and ensure that when they occur they are minimized. Mutual assistance in times of emergency, equipment sharing and other such relationships can be invaluable in this regard.
- **Make and keep good records.** Maintaining adequate records is essential for the seller to be able to explain its position to the other party, and in many instances to be able to explain the situation to its staff and governing body.
- **Communicate frequently and accurately.** Many disputes are the result of lack of information or incomplete or incorrect information being shared with the other party to the contract. If a system is having a problem with its water treatment process, then that system should notify any wholesale purchasers of it. Explain the problems, the efforts being made to remedy them and if there are costs that are going to be associated with that, what they may be. Some water supply contracts even require a meeting no less frequently than annually to ensure that this communication occurs on some regular basis.
- **Educate new governing body members.** Water supply contract disputes, like many others, frequently begin with governing body members who lack the background to fully appreciate the relationship with the other party to the contract. The staff should make a point of briefing new members on the wholesale contractual relationships that exist, including a contract summary, the history of the contract and the purpose that it serves.

■ **Read the contract.** Staff and legal counsel should read the contract together to see exactly what it says concerning the item in question. The attorney should be prepared to give a confidential briefing (made in executive session as authorized by K.S.A. 75-4319(b)(2)) in which the nature of the dispute, the applicable contract provisions and other relevant legal and factual basis are explained and options analyzed.

■ **Be realistic.** Buyers and sellers to water supply contracts often need each other. The degree of this dependence can vary widely from one situation to the next, but each party should have firmly in mind the purpose that such water supply contract plays and the alternatives that are available at any given time. A wholesale buyer who only has four years remaining on its contract and has no practical alternative for a source of supply than that being supplied under the wholesale contract needs to approach potential disputes with that fact in mind. Likewise, wholesale sellers who are dependent on wholesale contracts to support its water production facility similarly need to consider that fact as it deals with its wholesale customers.

Sometimes, there is simply no way to avoid or resolve a dispute. In those cases, for one reason or another, the dispute may head to court. The parties need to consult extensively with their legal counsel and staff before the governing body directs that court action begins, but once that occurs the course these cases takes is fairly predictable. Action begins by the governing body of one of the parties authorizing the filing of a petition in court. This is followed by an answer filed by the opposing party. The judge assigned to the case then makes a schedule that directs the conduct of the case through discovery, pretrial motions, pretrial and trial. From the time a petition is filed until a trial is held will frequently take a year or more.

The time while the case is pending will be busy, with much of staff's time required to assist lawyers with the discovery process in which documents and



information are exchanged. Each party will likely need a financial expert such as an accountant, financial analyst or engineer, depending on the issues in the dispute.

A special caution is in order for sellers in these cases. Be patient, and carefully consider the consequences of any attempt or threat to terminate service to a wholesale customer with whom there is a dispute. In cases where the buyer is highly reliant on this supply, it is unlikely that a court is going to allow interruption of service that would affect the

buyer's customers. The attempt may cause the seller other problems in the case, too. Heavy-handed tactics, aimed at punishing the buyer before a dispute is resolved, will not improve the seller's chances with the judge or jury on the real issues in the case.

Litigation is expensive, and water supply contract litigation is no exception. In some instances one party or another may have their attorneys' fees paid by an insurer, but even that would be subject to deductibles and other exceptions. Experts will need to be retained and paid, and regular consultants will often need to be utilized. Every case is different, but a party to a water

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supply contract lawsuit may well incur fees and expenses in the range of \$25,000 to \$50,000, but there will be exceptions on the lower and higher ends of that estimated range.

Cost is certainly a deterrent to litigation, but not the only one. Particularly in water rate cases, the seller's record keeping will be a critical part of the evidence in the case. The requirement found in many water supply contracts that the seller must demonstrate an increase in costs of performance can be an especially high hurdle, particularly in cases where the seller has shared employees who perform services for more than one department or function. Labor is a large variable cost in such cases. It may be exceedingly difficult to "demonstrate" the labor costs with any degree of certainty. A great deal of staff time, and as a result a direct or indirect expense, may be incurred in trying to answer the questions that will be presented in such a case.

Also consider the damage that each party may suffer in its relationship with the other as a result of such a case. It is difficult to litigate a dispute without creating hurt feelings. The good will that may have developed between the parties over the years may be lost. There are cases in which litigation is necessary and this is simply a consequence. But consider this carefully if some joint effort, such as a replacement for a water treatment plant is desperately needed and can only occur with the cooperation of these parties. Such cooperation is going to be almost certainly delayed, if not lost altogether as a consequence of the litigation.

A lawsuit sometimes has a way of helping the parties to better understand the strengths and weaknesses of their positions. While such understanding may have been lacking at the outset of the case, if allowed to take its course, a lawsuit is going to produce answers to hard questions. These answers may help the respective governing bodies rethink their positions. When they do, every consideration should be given to some alternative to ultimate resolution of the dispute in court.

One option available to public water suppliers is the use of the Kansas Water Office's (KWO) Alternative Dispute Resolution (ADR) program. The KWO offers mediation services to all Kansas public water systems

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#### **Conclusion**

Water supply contracts are a vital part of the public water supply industry in Kansas. A great deal of care needs to be taken in entering into a new contract, or amending an existing contract, and in managing contracts in order to avoid misunderstandings. Most disputes can be avoided through the efforts of the parties, but when they cannot, the courts can ultimately resolve them. Court action is expensive, time consuming and can potentially inflict long-term damage on the relationship – and as a result, the long-term goals of the parties. When necessary, and given the parties' willingness to spend the time, energy and money necessary, the courts will resolve the dispute in a way that one or the other, and sometimes both of the parties, do not like.