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Consolidation and Acquisition of Rural Water Districts

Kansas has a large number of public water supplies, including approximately three hundred rural water districts. These RWDs are extremely diverse, ranging from the largest with almost 4,600 connections to the smallest having fewer than 20.

The smallest systems can often be the most difficult to operate. Lack of economy of scale can mean that their customers bear a disproportionately heavy financial burden in trying to meet regulatory standards. Meeting all of the other requirements that go with being a unit of government can be equally difficult. Many of these very small systems would be better off if they could be combined with another larger system in order to share these burdens more equitably.

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Small size is not the only reason to consider combination with another system. Any number of other reasons, including water supply, management or staffing efficiencies, land use changes and other reasons can point toward the benefits of some form of a combination with one or more other public water supplies.

For RWDs, there are a variety of ways that combinations can occur. Some of these involve cities, either through annexation or acquisition. These options will be covered in a future article.

When concerning combinations of RWDs with other RWDs, there are two options: consolidation and acquisition.

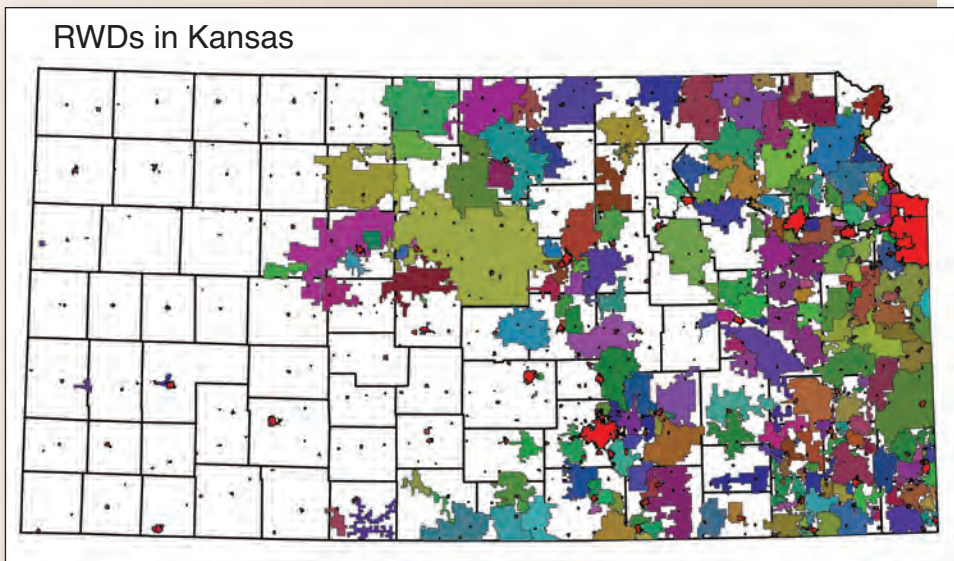
Consolidation

Consolidation has been part of state law since 1976. There are currently 17 consolidated RWDs in Kansas. The process is fairly straightforward, and districts will certainly need the assistance of their attorneys to accomplish a consolidation properly, but the steps to be followed under state law, K.S.A. 82a-639 through 645, are generally as follows:

- The districts to be consolidated first develop an agreement to consolidate. The agreement need not be complicated but must approve of the assumption and payment of all liabilities of the

districts to be consolidated by the consolidated district. Once negotiated, the agreement needs to be approved by each consolidating district's board of directors.

- Each district must hold a special meeting to discuss and vote on the proposed consolidation. All members of each district must be sent notice by first class mail of their respective meetings at least 10 days prior to the meetings.
- A majority of the members attending each special meeting must approve of the consolidation agreement.
- After each consolidating district has approved of the consolidation, a petition requesting consolidation must be sent to the Board of County Commissioners. The petition is to be signed by the chairman and secretary of each district, contain all the information provided by state law and be accompanied by maps of the consolidating districts.
- The County Commission is to hold a hearing within 30 days of the receipt of the petition. Notice of the hearing must be sent by the County Clerk by registered or certified mail to each district's chairman and to the Division of Water Resources' (DWRs) chief engineer. A notice must also be published in the official county newspaper.
- Following the hearing, if the county commissioners vote to approve, the consolidation is complete upon the county commissioners entering an order of consolidation.
- Following consolidation, the members of the board of directors of the consolidated districts must meet and elect from themselves new officers. The members of the consolidated boards must also



adopt by-laws for the consolidated district. The consolidated boards will then continue to serve as the board of directors for the consolidated district until the next annual meeting of the consolidated district as provided by the newly adopted by-laws. At that time, a new board is elected in the same fashion that rural water district boards are elected according to state law and the by-laws.

The effects of consolidation are generally spelled out under state law. Following the consolidation, all of the property of the original districts is combined into the consolidated district, including all property, accounts, contracts and other rights and interests.

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The debts of the consolidated districts are to be paid "only from revenues derived from the services and facilities of the original district unless the same have been approved for payment by the consolidated district" according to the agreement. (K.S.A. 82a-643). It may be possible to do, but tracking revenues from the facilities of the original districts before

consolidation may prove to be extremely difficult over the long term. It is also not very conducive to a

“merger” to keep the finances of the merged districts separate like this. The better course, and the one generally followed in RWD consolidations, is to provide in the consolidation agreement that all debts will be paid from all of the combined revenues of the districts following consolidation, eliminating that need to track revenues like this. In all other respects, the consolidated RWD is to function like other RWDs under state law.

Acquisition

If a consolidation can be viewed as a merger of equals, then an acquisition, the other alternative for combination of RWDs under Kansas law, can be viewed as a takeover. The RWD acquisition statute, K.S.A. (2012 Supp.) 82a-650, was just authorized by the Kansas legislature in 2005. Creation of this alternative to consolidation was an effort to overcome some obstacles to the consolidation statute.

In the case of an acquisition, the board of directors of each district enter into a “Memorandum of Understanding” (“MOU”). By state law, the MOU must contain certain provisions including the transfer to the acquiring district of ownership and control of the acquired district’s property, contracts, funds and accounts, records and the like; continued service, at an agreed upon rate, by the acquiring district; the acquiring district’s assumption of all debts and obligations of the acquired district; establishment of a policy for connecting new customers to the acquired district’s system; and acquisition of all of the territory of the acquired district by the acquiring district.

Unlike the consolidation process, no meeting or vote is necessarily required to approve of the

HELP IS AVAILABLE

When circumstances dictate that a combination be considered, there is help available through two KDHE programs. The first is a program by which KDHE can participate in the cost of a study to evaluate a reorganization of two or more RWDs that would result in consolidation or acquisition. This program allows KDHE to participate on a 50-50 basis with the districts involved, up to \$25,000.00 (KDHE’s share not to exceed \$12,500.00).

A second program provides for incentives in the State Revolving Fund (“SRF”) loan program for up to twenty percent (20%) principal forgiveness on loans made for construction of projects needed to accomplish a consolidation or acquisition.

These are extremely helpful programs for accomplishing combinations of districts. The first hurdle to be crossed in considering a combination is whether the systems are compatible from the operations and financial standpoints. Help may be needed in the form of an engineering study, financial analysis, or other study to properly evaluate this, and KDHE’s program helps incentivize systems to fully study their options in this regard. The next hurdle is that in many instances, some project will be needed to integrate the combining systems. The SRF twenty percent (20%) loan forgiveness program is a strong incentive to development of such projects. Interested districts should contact the Public Water Supply Section at KDHE with questions regarding the availability of these programs.

KRWA staff are also available to help systems evaluate the advantages of the merger or consolidation of rural water districts.

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acquisition. Instead, a copy of the MOU is filed with the county clerk of each county served by the acquired district; a notice of the approval of the MOU and an explanation of the reasons for its adoption must be mailed to each member of the district and the MOU must be published in a newspaper. The acquisition becomes final unless within 60 days after

publication of the notice a petition is signed and filed with the district containing the signatures of not less than ten percent of the participating members of the acquired district requesting that there be an election. In the event such a petition is filed, then the acquisition does not become final unless a majority of the members voting on the question

have approved the acquisition either by mail-in ballot election or at a special meeting called for that purpose.

Following completion of the acquisition, the acquired district is dissolved and all of its assets are

transferred to the acquiring district. Likewise, all of the indebtedness of the acquired district is assumed by the acquiring district, to be paid from revenues derived from all of the facilities of the acquired district, and the acquired district is dissolved.

Consider the Options

When thinking about a combination with another RWD, both the consolidation and acquisition option should be considered. Principal differences include that in the case of consolidation, the consolidation can only occur following a vote by the members of both consolidating districts. A vote is not necessarily required in the case of an acquisition so long as there is not a sufficient petition from members requesting one. In a consolidation there may be a time during which the consolidated district may be governed by a board of up to 18 directors (in the case of a consolidation of two districts; possibly even more if the consolidation is of more than two districts). This may be viewed as an unwieldy board, even if it is just for a few months until the next election. Although not necessarily recommended, in the case of a consolidation the debts and obligations of the consolidated districts may be kept separate, to be paid only from revenues derived from the previously consolidated districts. In the case of an acquisition, they must be paid from all of the assets of the acquiring district. Finally, a consolidation results in a change of name, whereas in the case of an acquisition the acquiring district's name is unchanged. Districts considering a combination with another district should carefully review these alternatives with their counsel to decide which one is best for them.

Catalysts for Combination

Invariably, a combination, whether it be a consolidation or acquisition, is the result of some catalyst that forces consideration of this option. This catalyst is most often an inability to meet some regulatory requirement, or some other demand that simply cannot be feasibly met by one district standing alone. As mentioned at the outset, this most often falls on the smallest districts that have little choice under these circumstances but to look for a

1926(b) Protection:

RWD 4, Douglas County, loses 10th Circuit Appeal

In a stunning reversal, the 10th Circuit Court of Appeals reversed a jury verdict in favor of RWD 4 in the latest chapter of its six-year legal battle with the City of Eudora.

In a two-week trial in Kansas District Court, RWD 4 had won a verdict against the City for violation of the District's 1926(b) protected territory. The verdict was appealed to the 10th Circuit, which ordered a new trial on the limited question of whether the RWD 4 loan guaranty was "necessary" as required by Kansas law. This resulted in a new round of legal arguments by both sides before the Kansas District Court, which denied judgment in favor of Eudora on the question. In the interim, some changes were made to Kansas law which RWD 4 argued eliminated the need to show necessity for the guaranty and should be given retroactive effect to include RWD 4's loan.

The Kansas District Court allowed both the District and the City to appeal once again to the 10th Circuit. The 10th Circuit ruled that the changes to Kansas law should not be given retroactive effect (without answering whether they did or did not eliminate the need for showing necessity) and ruled in favor of Eudora that RWD 4's guaranteed loan was, in fact, not necessary and therefore there was no right to 1926(b) protection. RWD 4 intends to request that the U.S. Supreme Court review the decision.

The Supreme Court's decision of whether to hear the case is expected in 2014.

larger district to spread that obligation across a broader customer base. However, the catalyst can come from many other directions, such as loss of a manager, operator, or other key employee. The bookkeeper's retirement, resulting in the loss of her home as an office, may cause a district to look at its options.

Conclusion

Many RWDs in Kansas would benefit from consolidation or acquisition. Many events can serve as catalysts for consideration of one of these options, and when they do, help is available at KDHE to study and accomplish these combinations. Careful consideration should be given to these options, including whether consolidation or acquisition is right for any given situation.