By Elizabeth Dietzman, JD

When Having a Great Board of Directors Is Not Enough

For almost ten years, I worked with a water district that appeared to be a model for small rural systems. In fact, it won numerous management awards from state and regional agencies. The manager was experienced; there were no territorial squabbles or rash decisions to expand; the operations personnel were well-trained. The staff often volunteered to assist neighboring systems with water system problems. The board of directors was also a model board. They attended water association meetings, followed Freedom of Information Act (FOIA) procedures, and overall, represented a well-run district. They were a typical rural water board, of course, made up of district residents, some of them small business owners, who showed up faithfully at meetings and conscientiously reviewed the monthly financials. When the state regulators required that the system have a backup well, the board asked the electorate to support enough revenue bonds to fund a USDA loan for the construction of a second well. And the board was proud that the district was able to service the debt with existing revenue, so there was no need for a rate increase. The 1,500 or so customers were happy and there was a nice chunk of change in the bank. All in all, this was the picture of a perfectly run district. Then, in less than nine months, most of the board quit, the district imploded and a for-profit water company was installed as the operational manager of the district. The remaining board was forced to enter into a long-term contract that required them to follow the recommendations of the for-profit water company or pay penalties under the long-term contract, and as the district no longer had any employees, let alone one with an operator's license, the district will probably never operate independently again. So rates have increased and a portion of those rates is the profit that the water company now earns. That's money that could have been used for the benefit of the current and future customers of the district; instead it is now paid to a for-profit company. This change has been a huge shock because this was the perfect board, running the perfect small rural water system. Or so it seemed.

How did this happen? How did this well-run, financially secure district collapse and have to turn over operations to a for-profit water company? It happened because even though the district had a great board and was conservatively and cautiously managed, the district was not being run in the best interest of its existing or future customers. In reality, the board was doing a terrible job and should have been removed exactly because they were cautious and conservative. This is the underlying problem facing a large proportion of rural water system boards. They sit on cash reserves like a dragon in a cave guarding its hoard of gold. They don't act enough like a for-profit company. It sounds shocking to say that a PUBLIC water district should be run like a PRIVATE water company. However, any board that just sits on its reserve funds, refuses to expand service to include new customers, and spends more time debating CD rates than it does planning system expansion should be fired. They would be fired if they ran a real life business that way, and that's often the irony. Many board members run successful businesses and yet they seem to check all their business sense at the door when they come to a board meeting. All the board training in the world doesn't seem to help them realize that small systems should continuously strive to serve new customers, not just agonize over what shade of blue to repaint the water tower.

I'm not sure where this attitude came from. Certainly it was never the intent of the federal government to have water districts serve a limited pool of initial customers. If you dig down and read the legislative minutes in the Congressional Record, since 1961, the year the Consolidated Farmers Home Administration Act was passed, the goal of Congress was basically to do the same thing for rural water that they had done so successfully for rural electricity. The goals were to provide rural water to as many people as possible. The Farmers Home Administration (FmHA) funding mechanism was designed to provide the seed money to create an initial core group of customers in a water (or sewer) district and then to allow that system to pay off its loan and get another loan in order to continue to expand its services. The underlying concept was that rural water districts would continue to expand and provide services to more residents within their territorial boundaries.

The concept of the continuous expansion of service within a water district territory was further outlined by language in the state laws which created the legal entities which were applying for the federal funds. So then why do so many boards fail to run their district for the benefit of both current and FUTURE customers? Why do they hunker down and circle the wagons and refuse to raise rates or spend reserve funds on serving new customers? Why do they make the cost of becoming a new customer so high that for many people it's cheaper to drill a well?

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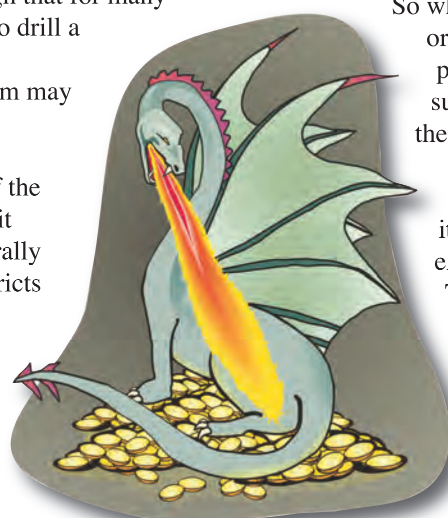
Part of this problem may originate from a fundamental misunderstanding of the nature of a non-profit water district. Generally speaking, water districts are quasi-governmental, single purpose entities created under state law, whose primary goal is to provide potable water for public consumption. They are governed by an elected board and are non-profit, in that they do not pay taxes and are not privately owned. However, nonprofit or not-for-profit (the terms get used interchangeably) does NOT mean that they can't make money. Loosely paraphrasing Wikipedia, a nonprofit organization is simply an organization that uses surplus revenues to achieve its goals rather than distributing them as profit or dividends.



So while nonprofit organizations are permitted to generate surplus revenues, they must be retained by the organization for its self-preservation, expansion, or plans. This is a critical distinction. Water districts should use the surplus revenue to expand and plan, not maintain the status quo. And unfortunately, this is what all too many boards do. They maintain the status quo. They accumulate enough cash to maintain an even keel and avoid debt and they do nothing to foster growth. They just tread water but never move forward.

How about that water district that got gobbled up by the for-profit water company? It was a classic example of the well-run status quo district. It was a district where the board should have been fired for never moving forward. Time and time again, the board would focus on the minutiae of operations but refuse to look at the big picture and plan for the future. The district was well-managed on a micro level but disastrously managed on a macro level. And when a series of events struck, a perfect storm of change, the board didn't know what to do and basically walked away rather than buckle down and make hard decisions and do hard work. It was interesting if frustrating to observe.

Rather than spend any of their precious reserve funds or increase rates, the board was determined to stay in a time warp. They did an excellent job of haggling over the purchase of a new truck with local car dealers and debating CD rates as each precious CD was renewed. They really did spend hours deciding what shade of blue to paint the water tower. And customer records were meticulously updated, shut-offs and service changes were made promptly and water quality was excellent. But the blinders remained on whenever any issues that involved planning beyond twelve months were suggested. Why enter into a joint purchase of automated meter reading with a neighboring town, when the old meters worked just fine and the field guys could still go out and read meters a few days a month? Why invest in a new billing system that could be used with an automated meter reading system when the old billing system still worked? Why replace the manager, who was semi-retired, with a full-time manager? Why send the senior field guy to school to upgrade his operator's license? Why borrow money and drill a new well just for one subdivision, when that might necessitate a rate increase and the developer could drill a small community well for the twenty houses he hoped to build? Why partner with an adjoining rural electric cooperative to run distribution lines and provide water to a new prison when that too could lead to a rate increase? Why subsidize a new distribution line with district cash reserves in order to serve a handful of new houses, when the homeowners could be forced to pay for the cost themselves? These were the types of short-term decisions that were routinely made in order to further the goal of hoarding cash reserves, keeping rates the same and ignoring growth opportunities. It was much easier to focus on the little issues – the easy issues – rather than the more difficult policy issues. And this outlook is what crushed the district.

Because they had refused to hire a full-time manager, the board was caught short when their part-time manager had health problems and had to retire on very short notice. The senior field guy didn't have the necessary operator's license, so the board felt forced to begin a hasty search for a manager. They were lucky to find a manager who had worked in a large system near a major city, but relocated to the area due to his wife's job. But his salary was far more than the board had paid his predecessor and some of the board members were angry that they had to hire such an expensive employee, because that meant they had to either pay him out of reserves or face an eventual rate increase. Then forty-five days into the new manager's tenure, the billing system crashed and the board discovered that the office clerk had failed to pay for any of the system updates over the years. So the board was forced to upgrade the billing system, and purchase all new computers, and hire additional help to start manually entering all the billing records into the new system. The billing system changeover did not happen overnight and this district was basically unable to send out bills for almost sixty days, which also put a financial strain on the district.

Then during this chaotic period, the new manager completed his assessment of the district and presented the board with a five-year plan for system improvement, which included sending the field guys to school for upgraded licenses and giving them raises, hiring an engineer to create a long-term plan for system expansion, re-exploring joint ventures with the electric cooperative, completely re-writing the policy for line extensions, seeking USDA funding to upgrade water mains and offering to purchase several private community wells in order to incorporate them into the district. Of course all this would necessitate a rate increase, a bond election and continued spending of reserve funds. This was all in the name of moving forward and serving future customers. And the board exploded. They refused to implement the changes and had huge fights with the manager. One board member (the president) was notable for standing up and announcing that he hadn't run for the board and been the president for fifteen years in order to raise rates and borrow money and if the rest of the board decided to do this, he would quit. So the board fired the new manager. But the district then had no certified operator and was in violation of state regulations. So they decided to do without a manager and instead hired a new field guy with an operator's license. This upset the current field guys, of course. And they were still in the middle of the billing crisis. The neighboring town, which still wanted to pursue a joint venture for automated meter reading, offered to provide billing services for the district at an affordable cost if the district would participate. The board continued to implode and refused to allow the town to help because the office clerk said that she would quit if they allowed the town do the billing. Three board members quit over this struggle, over complaints from customers over the billing fiasco, and over the difficulty of suddenly dealing with things like consumer confidence reports. Then one of the field guys, who was frustrated by the board's refusal to send him to training for a higher level of certification, and angry that they had hired a new employee, started job hunting with a private water company. As soon as that company heard what was going on, they managed to arrange a face-to-face meeting with the two remaining board members and convinced them to agree to appoint three hand-selected candidates for the open board seats. Those three folks were "friendly" to the private water company and they voted at a hastily convened meeting to sign a contract giving full control of the water district to the private water company. The private water company then promptly hired the senior field operative, sent him to school and once he had his license, made him the manager.

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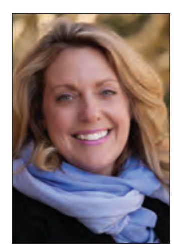
The former board members have no one to blame but themselves. Their lack of vision, their refusal to create a transition plan for the manager, to enter into joint ventures, to upgrade operational systems, or to expand the scope of service were all inexcusable. If you sit on a water district board your prime objective should be to figure out ways to expand service to future customers and look to the future – not maintain the status quo.



Elizabeth Dietzmann is an attorney who has worked with rural and municipal utility boards across the country as general and special counsel on various issues. She can be reached at edietzmann@earthlink.net.