



How to Get Funding into Water Systems

Rural water customers in Kansas are in the minority and are lucky to be there. Unlike the majority of other states, a for-profit or private water company cannot make an unsolicited offer and buy a rural water system in Kansas with nothing more than a vote of the board. The process for consolidating, expanding or dissolving a rural water system in Kansas is almost as complicated than forming one, and at a minimum it can require a vote of a majority of benefit unit holders, review by the county commissioners, and even after all that is completed, the system assets must be transferred to a similar public utility. So a private water company cannot buy a rural water system in Kansas. Unfortunately, that is not the case in most other states. In fact, in many states a private water company can make an unsolicited bid to a small town or rural system and convince the board or council to sell. This can happen without a vote of the users and with no input from residents. In fact, that is exactly what could happen very soon in a small town on the Eastern Shore of Virginia. One of the big private water companies made an unsolicited bid for the purchase of a small town's water/sewer utility and within two weeks the offer had been presented to the city council and placed

on the next meeting agenda. The only citizens who will know about it would be the ones who read the online weekly report of the city manager to the council. There is no legal requirement for a referendum vote or even an independent assessment before the sale occurs.

Kansas is ahead of the game and really smart about protecting public water companies from private encroachment and making sure that customers pay reasonable rates. But it is good to be aware that many small systems end up selling to private water companies even though their customers will pay more for services. We all know that running a small utility is a challenge and it gets harder every day. In order to do it successfully, a system needs a long-term plan to address infrastructure upgrades, meet water quality standards, and manage debt service. Boards and council may have to increase rates and seek out state and federal funding in order to make system improvements that maintain water quality. Utility workers need to be informed in human resources, Freedom of Information Act, acquisition, and water pollution. Some systems may even have to face a declining customer base and lower revenue. And the system may be 30, 40, or 50 years old and require massive

upgrades, as water quality standards get tougher and infrastructure fails. All of that is a lot to ask of unpaid volunteers – the boards and councils. That's especially true when it would be so easy to let a private water company handle all of the capital infusions and system upgrades and day-to-day operations. That is the real dilemma for small systems: how to get infusions of much-needed capital without giving up control of the system. And it often looks like selling to a private water company is the only way to get that capital.

However, no matter how tempting it looks, a private water company is going to make money or they wouldn't be in business, and the only way that they can make money is by increasing rates and layering their profit on top of the operational costs of the utility. Outside of Kansas, there are quite a few states that have very lenient laws that favor acquisitions by private water companies. Those laws exist because private water companies lobby hard for these laws at the state level. Private water companies are already doing business in nearly half the states in the country and regularly push for changes to state laws to support their long-term business strategy. Several states even allow private systems to spread their costs and price increases among

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customers from other water systems they own in the same state. So, a private water company can buy a water system and then bill all its customers in the same state for the expenses of buying that system. Those expenses include the purchase price, plus the percentage profit that state regulators allow the company to earn, business and property taxes AND the money that would have to be spent to fix the aging infrastructure – which is the main reason that small systems sell in the first place. The take away? In those states, every dime that the private water company spends plus a statutory percentage of profit will get passed on to the customer in the form of increased rates. And the purchase price? Let's talk about that. There has been a private water lobbying effort at the state level for several years to pass "fair market value" legislation. It

allows a public utility to sell its water system for an appraised value closer to what it would cost to replace the system, rather than the much lower "book value", which reflects the age and original purchase price of the assets. That seems like a good deal for the small systems because they can charge a higher price, but it benefits the private companies too, since they can turn around and recoup the higher purchase price from ratepayers.

Ownership = control

Don't think that an operating agreement with a private water company will get a local system out of trouble either. I have worked with rural water systems in states with no protective legislation that basically became captives of a private water company. Once they entered into an operating agreement with the private

water company the elected board was basically powerless because all their employees were replaced by private water company employees. The board was forced to increase rates in order to cover the costs of the contract, which had an escalation clause in it after the first year. The board even received a copy of the agenda that they were told to present at monthly meetings. Clawing back ownership or control of a utility system after it has been sold is almost impossible and very expensive. It could involve eminent domain, litigation and higher rates in the long run, while the system pays off those costs.

It is disturbing to think that rural water systems and small utilities are being silently gobbled up by private water companies in states without the kinds of customer protections that Kansas has. The decision to sell a system is complicated, usually happens under regulatory duress and leaves the customers with little say in the process. It is unlikely that the utility boards really understand the true costs to their customers of such a sale, because the process is complicated and rarely



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transparent. Not only do private water companies promote their business at the state level, they are backing a federal lobbying effort as well. There was a big push by private water in the 2018 American Infrastructure Improvements Act to include mandatory consolidation as the only solution for failing systems to comply with the Safe Drinking Water Act. A compromise was reached, thanks to the efforts of many public interest groups as well as state associations and National Rural Water. As it stands now, if a water system has compliance issues, there are many options available so that the system can work with state and federal authorities in order to meet compliance standards without incurring penalties. But that could change with

Senate Bill 2596, the Voluntary Water Partnership for Distressed Communities Act of 2019, because private water is lobbying hard to be the only solution for non-compliant systems. In a nutshell, private water lobbies have proposed language that only gives immunity to non-compliant systems that enter into partnerships with another system, which could include a private water company. So, if a system is in violation of the Safe Drinking Water Act (SDWA), the system could still be subject to penalties even if the utility decided to install new treatment, modify operations, negotiate extra-time to meet deadlines or seek out variances and exemptions. Ask your state association for technical assistance,

pursue SRF & USDA funding, etc. These all seem like reasonable approaches to solving compliance problems but they would still not obtain immunity for a system. Under this proposed bill, the only way to obtain immunity is to enter into a partnership with a compliant system. There is no reason that this incentive shouldn't apply to any compliance option that a utility board chooses. The reality is that under this legislation non-compliant systems are at risk of being coerced into partnerships with private water companies or run the risk of facing penalties. That alone will be enough to strong arm plenty of volunteer boards into selling their systems. I personally know one private water company employee who told me that he would get a list of the systems with permit violations and start calling on them with a "solution" to their problems. Imagine if he was able to tell them that under federal law, they would only avoid penalties if they sold their system?

But what if there was a way to sell a system to a private water company but also guarantee some accountability and control over rates and other key issues? We all agree that a failing utility wouldn't be failing if it had the capital and resources to improve its infrastructure and meet SWDA quality standards. Clearly the private water business sector has access to capital, and capital either from outside sources or revenue, is the key to keeping systems compliant, because systems deteriorate as they age. But the customers are the ones who bear the burden of making money for the private water company and once a water system is sold, the utility literally has no vote in how rates are set or how the system is operated. The trick is how to balance transparency with profit. Kansas does not allow consolidation, dissolution, or expansion of rural water systems without some degree of customer and local government approval. This is a fantastic model because it addresses the underlying difference between public and private water companies, which is profit. The

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for-profit company will charge higher rates to the customers in order to cover its profit. Privatization of public infrastructure has been demonstrated again and again to lead to increased rates because the private company gets to add profit on top of all the other system expenses. But if you listen to private water companies, the only way that failing systems can be fixed is to let private water make a profit.

Why not take the profit out of the equation and add transparency? One approach would be to require that a failing system only be transferred to another public company or a benefit corporation after a vote of the customers. What is a benefit corporation, you ask? And how would that help balance the need for private water investment with customer protection? A benefit corporation is a for-profit corporation that is legally committed to creating public benefit and gathering input from stakeholders in addition to making a profit for their shareholders. Benefit corporations are required to report on these efforts, in most states annually and must use a third party standard to show their

progress towards achieving social and environmental impact to their shareholders and in most cases the wider public. Benefit corporations are required to look out for the interest of all their stakeholders, not just shareholders. Thirty-six states have benefit corporation laws on the books and there are a number of companies in the water and wastewater reuse and decentralized wastewater systems as well as electric co-ops that are benefit corporations. Some of these companies even agree up front to a fixed amount of profit and to stakeholder “rights”. In fact, this is similar to the 2003 Department of Defense Utility Privatization project, where the profit, rate increases and customer rights were all negotiated up front during the award of privatization contracts with private companies. A benefit corporation could be the ideal way to blend customer rights with a reasonable profit and to have all the numbers visible for everyone to see.

I am not suggesting that it never makes sense for a small utility to sell its system. But it does not make sense for the customers of small utilities to

have the system sold out from under them with no vote and no say in how future operations are conducted or rates are set. The goal is to find a balance between operating small utilities so that they are in compliance with state and federal drinking water laws and be able to provide affordable drinking water to customers, and acknowledging that failing systems may not be able to recover without capital infusions from the private sector. If the private water sector is genuinely interested in improving the standards of drinking water, then it should welcome the benefit corporation as a model for making a reasonable profit but acknowledging that the customers should have a voice and a clear understanding of how that profit is calculated.

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