by Elizabeth M. Dietzmann, JD

What USDA could do to help resolve 1926(b) cases – The Solution, Part II

Anyone who read Part I of this article (*The Kansas Lifeline*, July 2006, "Why the USDA will not help water districts with 1926(b) cases") may remember that I discussed the fact that even though water districts are technically *required* to protect their territory under the terms of their loan agreements, USDA does not do anything to assist beleaguered districts in resolving territorial disputes with neighboring municipalities. I also discussed the fact that there are water districts that fall on both sides of the fence – some that do nothing to protect their territory at all and some that attempt to use 1926(b) as an offensive weapon in territory grabs. Clearly, both extremes could benefit from a dispute resolution process that avoids litigation altogether.


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Under a standard USDA loan agreement, the borrower (district) pledges all its right to sell water (the loan documentation says that the district will pledge all its rights, interests, privileges, licenses, ordinances, franchises...) as the collateral for the loan. In plain English this means that the repayment of the loan is tied to the user fees collected. The loan agreement further provides that no portion of any interest pledged shall be assigned, sold, transferred or encumbered "voluntarily or otherwise" (i.e. involuntarily) without the consent of the USDA. Any failure or breach of the obligations in the loan agreement is deemed a default. If a municipality takes over water district territory and customers then the district may be violating the loan agreement if it does not attempt to resolve the territorial dispute with the municipality. Keep in mind that this does not necessarily mean litigation! There are viable alternatives to litigation, but the trouble is that USDA-RD does nothing to resolve disputes before they escalate to litigation, nor does it voluntarily participate in these cases once litigation is initiated, either as a witness for the water districts or as a party to the case.

However, there is a way that USDA could help resolve these disputes, and save municipalities and water districts untold sums of money in legal expense and expert witness fees that could instead be spent on infrastructure improvements. Most *local* Rural Development offices recognize this problem. Many of them are ready, willing and able to assist water districts, but they get no authorization at the national level. This article lays out some fairly simple ideas that could be fleshed out in order to create an even-handed mechanism pursuant to federal mandates for resolution of territorial disputes between municipalities and water districts. In fact, it turns out that the Kansas Water Office, the state's water planning agency, already has a facilitation program for resolution of water conflicts that could incorporate some of these strategies. The Kansas Water Authority adopted a policy establishing the use of Alternative Dispute Resolution (ADR) in November of 2004 as a way to resolve water resource conflicts. The program, (see Dispute Resolution Web site: http://www.kscourts.org/adr/) defines facilitation as "the intervention into a dispute by a third party who has no decision making authority, is impartial to the issues being discussed, assists the parties in defining the issues in dispute, facilitates communication between the parties and assists the parties in reaching resolution." This is exactly the approach to take in resolving 1926(b) disputes. I have also learned in recent discussions with KRWA personnel that with help from KRWA, the Kansas Water Office may be in the process of expanding these ADR services to include 1926(b) and other local water system disputes.

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So how could this work? Some entity is needed to act as a

gatekeeper for a facilitation or dispute mediation process. A state rural water association, such as KRWA, with its strong rapport with nearly all water systems in the state, would be the ideal entity to spearhead a process under which water districts and municipalities could come to the table and discuss issues in a calm and reasoned manner. Public water systems could benefit from a process which is readily accountable to changes. By the time water systems approach litigation, there is usually such a negative history of personality conflicts, hurt feelings and misinformation that it is nigh well impossible to get both sides to even sit down in the same room together. I am not joking. I have seen negotiations wither on the vine because the two sides could not even agree on where to meet!

I can see an organization like KRWA organizing a pool or cadre of facilitators who are familiar with 1926(b) issues and who could work individually or in small teams to assist both sides with realistic resolutions. I have tried mediating 1926(b) cases, usually with retired judges who knew nothing about the statute, the issues or the law. I have never had much success. Dennis O'Toole, from Ohio and Steve Harris, from Oklahoma, both attorneys who handle 1926(b) cases, share my views on mediating 1926(b) cases. In Kansas the approach could be different from traditional mediation. The goal would be to have a team of 1926(b) experts, financial, legislative, technical, and legal experts available. In addition, appropriate work sheets should be developed for the initial data gathering on the disputed issues.

One of the many problems I see with 1926(b) cases is that often times neither the utility board nor the city council have any idea of their boundaries, dates areas were annexed or served, what it costs them to produce their water or the status of the federal loans. Now since this is all information that will come out in litigation discovery anyway, but only after many thousands of dollars are spent on attorneys' fees, why not have both parties complete a workbook or at least a series of checklists and gather all this information ahead of time for the facilitators? Not only does this force the elected bodies (not just the managers and attorneys who may be shielding their boards) to learn about the case, this workbook could also be used to introduce some of the compromise options, which I assure you both sides may not have considered! There are many creative ways to

A comment on the Dietzmann Proposal

By Dennis M. O'Toole, Esq.

Elizabeth Dietzmann is to be congratulated on her insight and effort to bring USDA/RD to the 1926(b) litigation table to avoid costly and lengthy litigation proceedings. As a trial lawyer, my view has been somewhat different in terms of dealing with the issue of territorial infringement by competing suppliers of water. My opinion was, and continues to be, that any attempts at infringement must be unqualifiedly met with total and complete resistance, including the initiation of legal proceedings to enjoin such action.

Having said that, the idea of compulsory mediation because of a USDA/RD mandate (read loan condition) is a very good idea provided the right criteria are in place. First, there must be a price paid by the loser in the event the mediation process does not resolve the dispute. That price should be the cost of litigation, including attorney fees, expert fees and the like. (While these damages are available under a properly plead 1983 claim, many lawsuits fail to include such claims and litigants are not aware of such rights) This process would or should give pause to all that initiate or defend or contemplate the entire palette of territorial district claims and defenses.

Second, the mediators assigned to such cases must be well qualified and well versed in 1926(b) matters. I actually do believe in the mediation process, but only when the mediators are true professionals and good at their craft. There is nothing more frustrating than preparing for mediation and then attending a session where the mediator is neither versed in the law nor experienced as a professional mediator. Such a process is doomed from the beginning.

Lastly, the parties to such proceedings must be motivated to be receptive to the mediation process. They, and their lawyers, must one, be prepared to present their best case (as if going to trial) and two, be receptive to opinions of its weaknesses and the strengths of their opponent's case. Elizabeth's idea of having a mandatory checklist process for each party is an excellent way of accomplishing this.

settle differences between municipalities and water districts. Sometimes you just have to get past the old grudges and conflicting personalities and get both sides to realize what is at stake. The process of completing the workbook would help both sides realize the tremendous amount of work and expense that a 1926(b) case or other dispute can require and also help them clarify their objectives. On the practical side, completing the workbook would help prepare both sides for trial so it would involve no duplication of expense or effort. If you think about it, figuring out boundaries, tracking down incorporation documents, providing old audits and current budgets – this starts to look a whole lot like the elaborate process for applying for that federal money in the first place!

Which brings me to my next point. As both Dennis O'Toole and Elmer Ronnebaum have pointed out: 1) no one values anything they get for free, and; 2) the parties may not agree to voluntarily participate. Ah, but I have possible solutions! First, even though KRWA may be able to get funding from a state organization in order to put this program together, the challenge may be in getting folks to feel that the mediation process has any value if they don't have to pay for it. Well, first, perhaps systems should have to pay to participate. The program could always be set it up so that each side pays a base fee to participate and if the mediation is successful, systems receive a refund. That is certainly one incentive. Another incentive as Dennis O'Toole suggested, might be some variation of the Michigan mediation process. Briefly, (this is a really simplified description) in Michigan, the parties meet with a panel of mediators/arbitrators and have their attorneys make opening statements in which the basic facts of the case are presented. Then the panel evaluates the case and meets with the plaintiff and makes a settlement award based on their evaluation of the merits of the case. If the plaintiff accepts, they go to the defendant. Obviously there is some back and forth but if the case gets worked out – great. The key is what happens if the case does not get settled. If the plaintiff is the one to say no to the settlement award, and the final verdict at trial is less than the settlement award, then the plaintiff pays all costs and attorneys' fees. If the defendant is the one to say no and the final verdict is more than the settlement award, the defendant pays all costs and attorneys' fees. Attorneys' fees add up quickly in 1926(b) cases and this could be a powerful incentive to get both sides to make realistic compromises.

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Steve Harris has stated that this concept would be difficult for him to recommend to his water district clients, since the current status of the law for 1926(b) enforcement is that the water district gets attorneys' fees if it wins, but does not have to pay them if it loses. While I agree with Steve's statement on its face,

I think that water districts need to take into consideration the hidden costs in a 1926(b) case – the employee overtime, the negative publicity, the copying costs, the personal and political stress on volunteer board members, and the many hours of extra work for board members before they rule out mediation just because they might give up the right to attorneys' fees. I still feel very strongly that some water districts need this incentive to bring them to the table and I would not hesitate to recommend it to any of my clients.

But second, how to get both sides to the table in the first place. Well that is where we need to look at some top down management concepts and face the fact that USDA is going to have to get involved no matter what bureaucratic lethargy enfolds it. As mentioned above, there are loan documents on every federal loan that *mandate* a water district's protection of its territory and customers. Why doesn't USDA simply treat those loan clauses as a requirement for participation in some sort of facilitated dispute resolution process and work with the state rural water association and the local Rural Development office to implement some sort of process similar to KRWA? I have news for all of you. The USDA- RD has a tremendous amount of power. They have the most money to spend on projects out of the three funding agencies – CDBG, SRF, and USDA-RD, which means that they call the shots. In a number of states, I have seen the local RD office *unilaterally* decree that a municipality or water district would be ineligible for any RD funding if it did not do such things as sign intergovernmental service agreements, initiate a water project before a sewer project, participate in regional water/sewer projects, and agree to serve certain customers outside its boundaries. I have also seen special conditions along these lines added to new loans, so it would not be too difficult to make mediation of any 1926(b) disputes a part of new and existing loans. Another even more proactive concept is that USDA-RD could make water districts that apply for new loans do a 1926(b) assessment. It is not hard to figure out where future territorial disputes will occur and if in fact the water district and the neighboring municipality have NO disputes looming, then they should be able to provide a letter to that effect – or even better – work out a simple territorial agreement then and there (approved by USDA-RD of course). If it looks like a dispute is on the horizon, then USDA-RD should loan the water district additional monies for a 1926(b) war chest – money that is held in a reserve account for a certain period of time in the event that the water district has to protect its territory. The water district could only access those funds if the municipality refuses to participate in negotiations. That would put some pressure on the municipality to work something out or face a well-funded water district.

Requiring a municipality or water district in a 1926(b) dispute to sit down and work with a facilitation group, as a condition of a new or existing loan or upon pain of losing future

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funding opportunities, is clearly within the scope of USDA-RD's power! Admittedly, some municipalities would be ineligible for USDA-RD loans, so they might not be persuaded by this tactic. These same municipalities may still be eligible for SRF or CDBG funds and in most states USDA-RD has tremendous influence with these agencies as well. In Missouri, you can't even apply for a CDBG, SRF, or USDA-RD loan without going through a central clearinghouse made up of all three agencies, and the reality is that because USDA-RD has the majority of the funds, they have great weight in deciding who is allowed to apply for what funding. State laws could also be amended to require a cooling off period for all public water providers, followed by a mandatory negotiation process. Many state statutes contain language similar to this already and it would be analogous to the cooling off periods for other public service sector groups like teachers and firefighters. When municipalities and water districts fight the customers pay the price so it is not much of a stretch to argue that this is a public policy issue that states could address.

Ask anyone who has ever applied for USDA-RD money and they will tell you of the many requests, many of them seemingly meaningless, with which they had to comply before their loan application could move forward. Surely if USDA-RD cares enough to make us fill out the 13-page checklists and sign many inches of loan documents, they could care enough to help resolve these disputes. This would also allow the local RD offices to start working with groups like KRWA in order to come up with a facilitation process, instead of sitting stubbornly on the sidelines. Local RD offices could even be used as neutral meeting places and regional RD attorneys could assist in training of facilitators.

Another real concern for USDA-RD needs to be the fact that the conflicts between municipalities and water districts are escalating. Municipalities are now regularly and aggressively trying to prevent water districts from even *applying* for the 1926(b) protected federal loan in the first place! This tactic is spreading and if USDA-RD is serious about making loans to continue to improve the rural water infrastructure, then they need to nip this in the bud by taking an active role in resolving the problem. Initially, there were two suits involving the loan prevention tactic: *Melissa Indus. Development Corp. v. North Collin Water Supply Corp.* 256 F.Supp.2d 557, (E.D.Tex., 2003) and City *of College Station v. U.S. Dept. of Agriculture* 395 F.Supp.2d 495, *504 (S.D.Tex.,2005). According to Steve Harris, there are now many more municipalities who are using any means possible to stop water districts from ever getting past the loan application. How can USDA-RD allow this usurpation of its power? Any municipality that actively prevents another entity from seeking federal loans should be banned from applying for any federal money itself. I also think that State Attorney Generals should be investigating public entities that are using public resources to interfere with the autonomy and funding efforts of another public entity. This smacks of an abuse of fiduciary responsibility and I know of water districts and municipalities alike who have faced state audits, quo warranto actions and recall elections for lesser offenses.

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I cannot help but see this facilitated dispute resolution process as a win-win. Grant money is all but non-existent these days and loan funds have to be stretched further and further for water and sewer projects. ALL water providers are facing increasingly stringent and mostly un-funded water quality mandates, and when the American Society of Civil Engineers released its 2005 report card on the nation's infrastructure, we got a D- in water and sewer infrastructure! So something needs to be done about these pointless and expensive disputes. The Kansas Water Office and KRWA may be as good a place to start as any. Hopefully this article will stimulate, offend, annoy or even outrage enough people to start a dialogue!