Legally Relevant

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Water service territories: recent court decision answers important questions

In a recent court decision, United States District Court Judge Julie Robinson answered several important questions that impact the relationship of public water supplies across Kansas. This remarkable 59-page decision is so important that it warrants interrupting the series of articles this column had been doing on water supply contracts. We will return to that topic in a later *Lifeline* article.

Before digging into Judge Robinson's decision, consider some background on courts in Kansas. Everyone is familiar with the state court system, where there is a court in each county in Kansas. These courts can decide all types of cases, including those that involve issues of federal law. Appeals from these courts are taken to the Kansas Court of Appeals and to the Kansas Supreme Court, both of which are located in Topeka.

Judge Robinson is a Federal District Court Judge for the District of Kansas. That court is found in only three places: Kansas City, Topeka and Wichita. These courts hear only certain types of cases, usually those involving primarily federal law. Appeals are taken to the Tenth Circuit Court of Appeals in Denver, Colorado.

Judge Robinson's recent decision was filed in the case of Rural Water District No. 4, Douglas County v. City of Eudora. It involves a dispute to be decided principally under Federal law, 11 U.S.C. § 1926(b). While her decision contains important points of law specific to 1926(b) cases, it also interprets and applies state law on matters that would be important to many rural water districts and cities across the state.

This decision was entered on questions of law to be decided before the trial which will likely be held later in 2009. The decision is also subject to appeal to the Tenth Circuit Court of Appeals. So the decision discussed below, while containing important and interesting points, is still subject to modification by the appeals court.

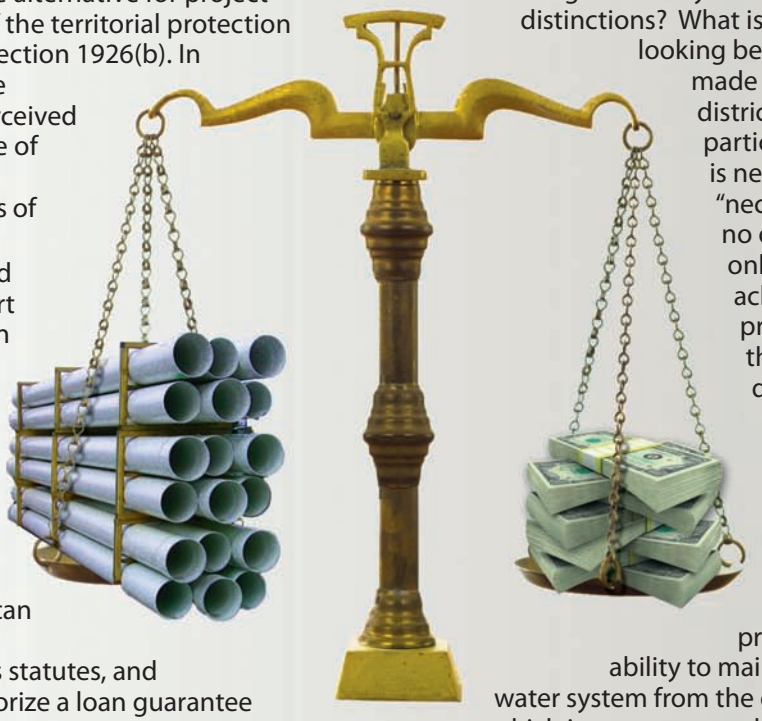
With this background in mind, the following is a summary of some of the highlights of the case:

A guaranteed loan is the same as a direct loan for purposes of 1926(b)

This comes as no particular surprise but had not been squarely decided by any court to this point. There are more rural water districts located in urbanizing areas in Kansas with guaranteed loans than there are with direct loans however, so this is an important and definitive answer to that question.

For a rural water district to validly obtain the guarantee of the USDA to a loan, such guarantee must be "necessary"

For some districts in urbanizing areas, USDA loans, or more particularly USDA guaranteed loans, were a very attractive alternative for project financing because of the territorial protection they offered under Section 1926(b). In some instances these advantages were perceived as outweighing some of their disadvantages, including higher rates of interest.



Eudora challenged RWD 4's right to assert 1926(b) protection on the basis that this guaranteed loan was obtained solely for the purpose of obtaining the monopoly that 1926(b) provides. Rural water districts can do only those things authorized by Kansas statutes, and Kansas statutes authorize a loan guarantee agreement to be made with the USDA only if "necessary to carry out the purposes" of the district, and maintaining a monopoly is not "necessary". The court sided with the City, and left it to the jury at trial to determine whether the RWD 4's purpose of obtaining the USDA guarantee was in fact to obtain a service territory monopoly and therefore unauthorized.

This part of the decision is notable because it had been widely assumed that the purpose for obtaining a USDA loan or guarantee to a loan was irrelevant. In fact, in some instances it was openly discussed that in considering various funding options, a district should consider USDA for precisely the purpose of obtaining the monopoly status afforded by 1926(b). This decision makes such purpose or motive an issue in 1926(b) territory dispute cases.

However, this portion of the decision is likely far from settled. In an earlier decision in the case, the Judge had ruled that there is nothing in Kansas statutes that limits a water district's authority to obtain loans (as opposed to guarantees to loans) to those that are necessary. The statutes restrict districts to constructing facilities that are "necessary" and to obtaining loans to finance projects that are "necessary", but technically does not restrict the loans to being "necessary". Are these merely technical distinctions? What is the role of the court in looking beyond the determination made by USDA and the district's board that a particular loan or agreement is necessary? And does "necessary" mean there are no other alternatives, or only that it helps the district achieve the purpose of providing potable water to the people within the district?

The opinion makes an even more difficult distinction between obtaining monopoly protection, which it concludes to not be necessary, and protection of a district's ability to maintain its facilities and water system from the effects of annexation, which it suggests may be necessary. Is there really a difference, or doesn't one follow from the other? These questions may be further resolved through reconsideration or on appeal.

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Fire protection is not relevant to the "service available" test

To assert 1926(b)'s territorial protection, a district must have a debt to the USDA (or guaranteed by USDA) and demonstrate that it has made "service available". Kansas follows the "pipes-in-the-ground" test, requiring that the district have adequate

facilities within or adjacent to the area necessary to provide adequate service within a reasonable time after the request for service is made. According to the Post Rock case (Rural Water District No. 1, Ellsworth County v. City of Wilson) this also means the cost of providing that service cannot be excessive. These determinations have to be made on a case-by-case basis and are the source of most of the litigation that occurs.

The ability to provide fire protection is important whenever a city annexes land subject to development. In fact, it may be the most important consideration in many developments. However, this case makes it clear that however important it may be as a practical matter, it has no relevance to the "service available" test that the courts apply under Section 1926(b). In other words, so long as the district has pipes located in or in the vicinity of the area to be served and can make water service available to that area within a reasonable time after request is made, the district is still entitled to be the exclusive supplier to that area despite its inability to provide fire protection.

There are now several procedures available under state law for formally adjusting the boundaries of a rural water district.

Boundaries still matter

The court also examined the question of the district's right to serve land located outside of its territory. The court pieced together various state statutes from which it concludes that a district has no right to serve land outside the territory of the district. There are now several procedures available under state law for formally adjusting the boundaries of a rural water district. This decision reinforces the need for districts to comply with state law in making sure that they are extending water service only to land within their district territories.

Cities not required to buy RWD's out of annexed area

One of the questions presented in the case was whether the procedures contained in the statute that applies when cities annex land located in rural water districts, K.S.A. 12-527, is "mandatory" or "discretionary". In short, the question is whether a city must buy the facilities of a rural water district located within land annexed by the city, or whether it may make some other arrangement with the district. To a large extent, the concept of territorial agreements – agreements that apply in the event that rural water district land is annexed by a city – rests on the premise that the city is not required under state statute to purchase the district's facilities.

The court analyzed state law and determined that K.S.A. 12-527 is discretionary, and that districts and cities are free to reach agreements that provide for some arrangement other than for the city to purchase the facilities of the district in the case of annexation. This part of the Judge's decision bolsters the view that cities and districts may enter into territorial agreements and need not necessarily result in the sale of the district's facilities or a change in suppliers simply because an annexation has occurred. This part of the decision seems not only well grounded in the law, but makes practical sense as well. It bears mentioning that nothing in the decision tells a city that it can unilaterally choose to ignore the statute altogether, so if the district is unwilling to enter into an agreement that would allow it to bypass the sale provisions contained in 12-527, compliance is still required.

Conclusion

It has been more than fifty years since the Kansas rural water district statutes were first enacted, and never has a court made a more comprehensive explanation of many important aspects of this law and how it related rural water districts with their neighbors. The law is constantly evolving, and the last chapter on this case has not been written. The trial of this case was recently completed and the jury found in favor of Rural Water District No. 4, although an appeal by the city of Eudora to the Tenth Circuit Court of Appeals is likely. We will keep you posted.