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Overview of Public and Private Options for Evolving Water Organizations

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Citation Information

Kapaloski, Lee, "Overview of Public and Private Options for Evolving Water Organizations" (1993). *Water Organizations in a Changing West (Summer Conference, June 14-16)*.
<https://scholar.law.colorado.edu/water-organizations-in-changing-west/28>

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Lee Kapaloski, *Overview of Public and Private Options for Evolving Water Organizations*, in *WATER ORGANIZATIONS IN A CHANGING WEST* (Natural Res. Law Ctr., Univ. of Colo. Sch. of Law 1993).

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**OVERVIEW OF PUBLIC AND PRIVATE OPTIONS
FOR EVOLVING WATER ORGANIZATIONS**

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**Water Organizations in a Changing West
14th Annual Water Conference**

**National Resources Law Center
University of Colorado School of Law
June 14-16, 1993**

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WATER ORGANIZATIONS IN A CHANGING WEST

INTRODUCTION

Water organizations are the personification of the evolving tension and, at times, conflict between public and private control of the most precious Western natural resource, water. Viewing this conflict as a historical paradigm, the current conflict has its roots in a very early history ironically based on the need for irrigation districts or water organizations to supplant the at times, incompatible conflicts between independent water users and their strong views of private property with the necessity for cooperation and the development of water as a community or cooperative enterprise.¹ The Summary Table outlines this as a historical paradigm. The historical delivery of water by these organizations, a mixture of public and private, has operated with relatively little involvement of the general public. The infamous description of the hidden government carried forth for a long period of time wherein general public awareness or concern about water service or the cost of water was very sporadic at best.

In recent years, however, particularly in the West, water supplies are evolving from stable agricultural uses to ever-changing and increasing urban uses. This has caused different combinations and reorganization of entities to occur as shown in the Summary Table. The interest and, therefore, scrutiny of the general public in these new organizational structures for urban water delivery has increased. Specifically, one very real and

¹ W. Hutchins, "Summary of Irrigation District Statutes of Western States" 2 (U.S. Dept. of Agriculture Misc. Publication No. 103, 1931).

direct public focus on this phenomena of urban water transfer has been the accountability, i.e., regulation and control of these new or evolving water delivery organizations.

In determining the level of regulation or scrutiny of such organizations, however, the first issue is defining what these organizations are. In a recent study conducted by this institution,² it was evident that one of the more difficult problems is actually defining or categorizing these various institutions. Many have been organized with their roots in public law or statute; others with their roots in a cooperative association of private water right holders.

As we now view these organizations evolving into major players in the urban water delivery therefore urbanization of the West, the demand by the general public and the financing community for accountability is ever increasing. With this focus comes pressure from the ultimate users, i.e., the water rate payers and taxpayers to have public oversight or regulation either by statute or imposition by a regulatory commission. These demands and pressures initially and naturally cause resistance or a cultural avoidance by many of these organizations, especially those that evolved out of a cooperative assembly of private water right holders. This is particularly true in states such as Utah, Colorado and Idaho where the majority of the irrigation water delivery organizations historically have been privately owned. The question remains as to

² See generally James N. Corbridge, Jr. Ed. Special Water Districts: Challenge for the Future, Natural Resources Law Center, University of Colorado School of Law, Boulder, Colorado, 1983.

where the privately owned water organizations fit and the relationship of these organizations to the regulatory authorities. The focus of regulation has historically been focused on the requirement of oversight as a regulated public utility by a public service commission in areas when the entity delivers water to the public generally.

As private water organizations become increasingly more active in delivering water in urban areas, the historic relationship between the company and its owners and the new urban water users is becoming somewhat muddled. This has created a situation where the historic exemptions in many states' public utility laws have been challenged. Among other arguments for regulation, the equitable argument is that, in fact, these organizations which served only their own shareholders are now either purposely or implicitly delivering water to the general public who have a very small or, in many cases, nonexistent ownership relationship with the company.

This issue has come to recent focus in the State of Utah and is illustrative of this tension between regulation of public utilities and the goals and history of water delivery by private water organizations.

The Public Service Commission of Utah ("PSC" or "Commission") is the State agency to which the legislature has delegated the responsibility of regulating utility companies which have monopoly power.

Traditionally, regulatory commissions have not had a significant impact over water service, largely because of the type of water organization which have historically provided that service. As shown in the Summary Table, the types of organizations providing water in, and the type of water provided, fall generally into the following categories:

1. Government organizations providing water service;
2. Privately owned irrigation companies delivering water to shareholders for irrigation uses;
3. Privately owned water companies which provide either culinary service and/or non-traditional irrigation service, i.e. residential secondary water;
4. Privately owned water companies created by land developers specifically to serve the needs of a development.
5. Privately owned water utilities providing either culinary or secondary water service.

Only the last of the foregoing types fall clearly within the jurisdiction of regulatory commissions. Pressures from the public have caused the Utah PSC to examine its possible role and responsibility to regulate the other categories of water organizations.

In Utah, like most states, PSC's jurisdiction is based on a series of definitions set forth in Utah Code Ann. § 54-2-1 which deal with the type of physical facilities owned, the type of entity

which owns those facilities and, finally, the class of customers which are provided the service in order for the utility to be subject to PSC jurisdiction.

The statutory framework begins by defining "water system"

"Water system" includes all reservoirs, tunnels, shafts, dams, dikes, headgates, pipes, flumes, canals, structures, and appliances, and all other real estate, fixtures, and personal property owned, controlled, operated, or managed in connection with or to facilitate the diversion, development, storage, supply, distribution, sale, furnishing, carriage, appointment, apportionment, or measurement of water for power, fire protection, irrigation, reclamation, or manufacturing, or for municipal, domestic, or other beneficial use. It does not include private irrigation companies engaged in distributing water only to their stockholders.³

This broad definition of water system, excluding only "private irrigation companies" allows for the inclusion by the PSC of most systems.

The statute then goes from the type of system to the type of entity owning the system:

"Water corporation" includes every corporation and person, their lessees, trustees, and receivers, owning, controlling, operating, or managing any water system or public service within this state. It does not include private irrigation companies engaged in distributing water only through their stockholders, or towns, cities, counties, water conservancy districts, improvement districts, or other governmental entities created or organized under any general or special law of this state.⁴

In order to determine whether the Commission's jurisdiction applies to water corporations, the following definition is applied:

³ Utah Code Ann. § 54-2-1(35).

⁴ Utah Code Ann. § 54-2-1(34).

"Public utility" includes every . . . water corporation . . . where the service is performed for, or the commodity delivered to, the public generally⁵

The above statutes have traditionally been applied to exclude from Commission jurisdiction municipalities as well as mutual water companies and are typical of most state statutes in the West. The argument for exclusion of mutual water companies is generally based on the premise that such companies only serve their own stockholders, and therefore do not provide service to the "public generally" as required by § 54-2-1(19) (a).⁶

As is apparent from the definitions cited above, privately owned irrigation companies distributing water only to their shareholders are not included within the definition of either "water system" or "water corporation." The Utah PSC in a recent rule making⁷ quoted the statutory definitions:

The Utah Code gives the Commission jurisdiction over "water corporations" but specifically exempts "private irrigation companies engaged in distributing water only to their shareholders."

The statute does not define "irrigation," but in Utah, the term has a decidedly agriculture connotation, as evidenced by the fact, of which we take administrative notice, that a distinction is customarily drawn (for very good, human health - related reasons) between "irrigation" and "culinary" water.⁸

⁵ Utah Code Ann. § 54-2-1(19) (9); see also e.g. NMSA 1978 (1992 Cum. Supp.) § 62-3-1 et seq.

⁶ See also NMSA 1978 (1992 Cum. Supp.) § 62-3-4(A), excluding person supplying water only to himself, his tenants, or employees.

⁷ In The Matter of the Amendment to Rule R746-331, Exemption of Mutually Owned Water Companies from Commission Regulation, Docket No. 91-331-01, June 12, 1992, Utah Public Service Commission.

⁸ Id. at 3-4.

The PSC then used that distinction to justify its promulgation of a rule which allows the PSC to assert, in special circumstances, jurisdiction over culinary mutual water companies:

Under the familiar cannon of statutory construction that inclusio unius est exclusio alterius, we conclude that cooperatives furnishing culinary water to their members are not explicitly exempted from our jurisdiction by statute. The conclusion is not unreasonable or arbitrary; the provision of culinary water is fraught with a wide and crucial public interest, justifying treatment different from rurally based agriculture-oriented co-ops.⁹

In that rule making, the Utah Commission also noted another rationale restricting the Commission's jurisdiction over mutual water companies or co-ops. Specifically, citing an older Utah case¹⁰ they noted that the Utah Supreme Court found that an electric cooperative which provided electricity only to its stockholder members did not provide service to the "public generally" and was therefore outside of the jurisdiction of the Public Service Commission. Other courts have similarly reviewed the actual practice over the institutional form to evaluate the issue of jurisdiction. For example, Justice Traynor went behind the corporate structure of a mutual water company and reviewed the actual function to make the jurisdictional determination.¹¹

⁹ Id. at 4.

¹⁰ Garkane Power Company, Inc. v. PSC, 100 P.2d 571 (Utah 1940).

¹¹ Yucaipa Water Co. v. Public Utilities Commission, 357 P.2d 795 (California, 1960); see also Nelson v. Lake Canal Co. of Colorado, 644 P.2d 55 (Colo. App., 1981) (distinguishing mutual water company from carrier ditch companies).

There are two situations in the urbanization of water where a mutual water company may provide more than purely agricultural water service to its stockholders which invite regulatory scrutiny. The first is when a mutual water company is the logical and at times only entity to provide culinary service in an area. In some situations, as formerly rural areas have become more urbanized, mutual water companies now provide culinary service to heretofore nonexistent suburban communities.

A variation on the foregoing occurs where mutual water companies have begun providing pressurized, secondary water service to more urbanized areas, sometimes to stockholders only and sometimes pursuant to arrangements with local governmental entities. Again, these arrangements do not seem to be the target of the regulators, including Utah and would likely be excluded by the Commission's "culinary" versus "irrigation" dichotomy. It is unclear, however, whether the Utah PSC meant to exclude secondary water service to a residential area from that which it believes should be regulated or whether such service would be defined as exempted irrigation in other states.

If desirable certain arguments against regulatory jurisdiction are available to water organizations which find themselves the subject of regulatory scrutiny.

To the extent that mutual water companies provide either culinary or secondary water service to the citizens of a governmental entity, those companies may choose to enter into interlocal agreements with public entities where state statutes

allow such public/private contractual cooperation. In Utah, a recently enacted statute allows a political subdivision of the state (which includes municipalities, county improvement districts, water conservancy districts, special service districts, drainage districts, metropolitan water districts, irrigation districts or separate entities created under the Interlocal Cooperation Act) to chose to "privatize" the provision of certain services with a private company. The type of public services covered include drinking water, water, and waste water collection, treatment and disposal services. Through such an agreement, termed "privatization project agreement", the local governmental entity and the private water company or individuals watering together can in effect craft the manner in which service will be provided and the rates which may be charged. To clarify the regulation issue, the Utah statute specifically provides that the "private owner/operator is not a 'public utility'".¹² This may be a model for other states to examine where the meshing of privately held water rights into public water service is a possible variation of the regulatory exemption wherein the public entity could be the ultimate deliverer of retail service from water provided by the private water company or individuals. However, the issue of accountability and serving the public generally is still important.¹³

¹² Utah Code Ann. § 73-10d-5(4).

¹³ See Yucaipa, pps. 298-299.

The major impetus behind the Utah rulemaking, and the focus of other state commissions' and court scrutiny are the perceived problems with land developers who create a mutual water company to provide service to a development, and thereafter provide a share or fraction of a share to persons who purchase lots as a prerequisite to receiving water service. It is argued that such developers can retain unchallenged control of the companies by retaining the majority of share ownership, thereby effectively denying most persons receiving water a role or voice in the affairs of the company.

As a consequence, in Utah it was ultimately agreed that asserting jurisdiction over mutual water companies was appropriate with respect to certain companies where control is concentrated. In promulgating the rule, the Utah Commission closely reviewed the language of the *Garkane* case, which exempted co-operatives where service was provided to shareholders only. Specifically, the Commission quoted the following language from the *Garkane* case:

The Courts will always scrutinize closely to determine whether or not a certain organization or method conduct has for its purpose evasion of the law, and where it finds such evasion will declare such organization to be what it truly is.

. . . .

We hold, therefore, that a non-profit electric cooperative which serves only its members, and is completely consumer owned with each consumer limited to one membership, is not a public utility within the purview of our statute.¹⁴

¹⁴ Yucaipa at 573 and 574.

In its rule making, the PSC used Garkane to conclude as follows:

We conclude that, regardless of historical practice, if culinary water co-ops wish to bring themselves within the exemption delineated in Garkane, they are going to have to meet all the criteria established in that case, which includes equal voting rights for all members of the co-op.

It follows that ownership and voting rights are legitimate subjects of inquiry for the Commission in making a jurisdictional determination. We are unwilling to say that any violation of a "one - owner - one - vote" rule will, ipso facto, put an entity within our jurisdiction, but in making that determination we will scrutinize closely any entity in which voting control is likely to remain in one or a few hands for any substantial time. It will be the burden of the entity claiming exemption to show that the other members are in some fashion otherwise adequately protected.¹⁵

The language of R746-331 which governs this issue requires that the Commission must conclude, in order to exempt a company from jurisdiction, that "voting control of the entity is distributed in a way that each member enjoys a complete commonality of interest, as a consumer, such that rate regulation would be superfluous . . . " R 746-331-1C. Obviously, this language can be used to argue that most mutual water companies, of whatever kind, should not and do not fall within the Commission's jurisdiction. If a mutual water company, whether it provides secondary or culinary service, has its shares widely dispersed among shareholders such that no one person or group controls the company, and therefore, rates, a regulatory commission is unlikely to assert jurisdiction.

¹⁵ supra note 2, at 10.

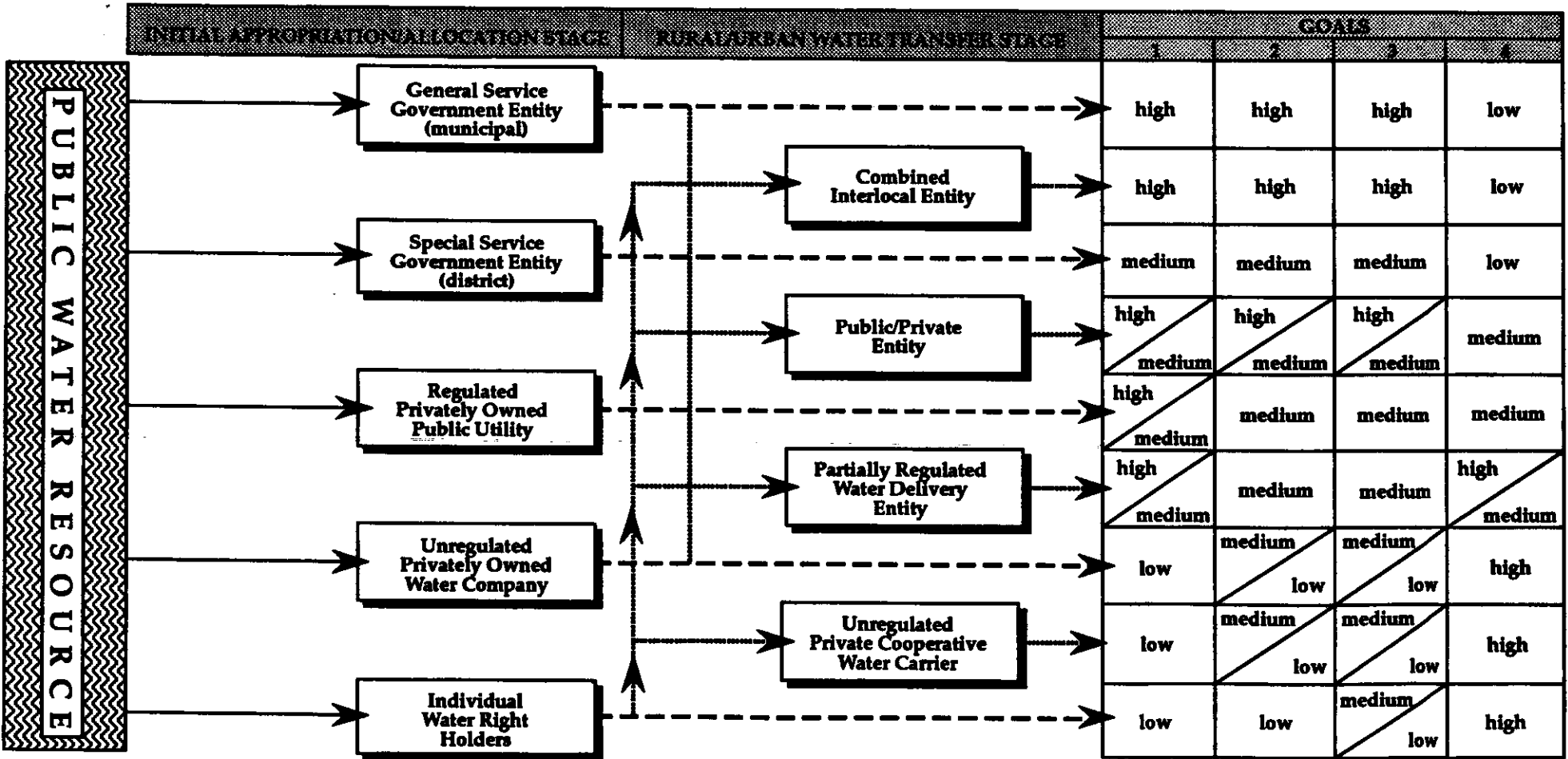
The difficulty is in predicting the meaning and application of "commonality of interest" or similar terms. Such an inquiry will require the commission or courts to review, in detail, the corporate workings of any company which is brought to their attention. Courts have generally gone to the specific factual context to make this determination and there appears to be a presumption of regulatory jurisdiction inherent in the rulings.¹⁶

¹⁶ See especially, Lewandowski v. Brockwood Musconetcong River, etc. Association, 181 A.2d 1506 (N.J. 1962) where the court concluded, "As the character and extent of the use make it public, we conclude the [water organization] is operating a water system for 'public use.'" at 513, endorsed in Griffith v. New Mexico Public Service Commission, 520 P.2d 269 (N.M. 1966).

SUMMARY TABLE

"Overview of Public and Private Options for Evolving Water Organizations"

1. Maximum general public involvement.
2. Maximum financial integrity.
3. Minimum public liability.
4. Maximum private property rights.



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