Public and Private Options for Evolving Water Organizations

Tim De Young
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PUBLIC AND PRIVATE OPTIONS
FOR EVOLVING WATER ORGANIZATIONS

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WATER ORGANIZATIONS IN A CHANGING WEST
14TH ANNUAL WATER CONFERENCE

Natural Resources Law Center
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I. INTRODUCTION AND PURPOSE

A. Public and Private Water Organizations

1. Prevalence: The Western states have authorized the creation of both private and public water organizations, ranging in complexity from informal agreements between neighbors who share a ditch or well, to water user associations and companies, to complex special districts and municipalities. Although public institutions prevail, there are a significant number of private water organizations. See generally 3 Waters & Water Rights § 25.01 to § 27.03 (1991); J. Sax et al., Legal Control of Water Resources, 418-420 (2d Ed. 1991) (publicly owned water companies estimated to serve 85% of all commercial and residential water utility customers nationwide).

2. Problems related to limited resources: Regardless of status, water organizations often face increasing costs due to several factors including urban development and growth, the need to rebuild aging systems, and increasing regulation primarily in the area of water quality testing and protection. Some water organizations also have had resources diminished or seriously threatened by litigation and skyrocketing liability insurance costs. In response, water organizations increasingly consider organizational changes.

3. Hypothetical cases: Two hypothetical cases demonstrate typical situations faced by private water organizations.
a. **Los Ricos Water User Association** is an unincorporated rural subdivision commuting distance from a growing southwestern city. The Los Ricos Water Users Association, an unincorporated private association, has grown steadily in response to the development of the subdivision. In fact, the association recently exceeded the state's minimum number of connections and now must undergo periodic water quality testing. The first state water quality inspection revealed contamination due to a leaky water delivery system. Replacement and expansion of the system could be funded by water users' fees. However, that option is perceived to be too expensive by association members. The subdivision could request an extension of services from a nearby municipality but costs would be prohibitive in comparison to continuing the use of its own ground water supply. Financing opportunities are limited but if the association is willing to reorganize as a water and sanitation district or other public organization, then it may have better access to capital in the form of loans or grants and may be able to access the credit markets by use of its taxing powers to secure repayment of bonds.

b. **Early Springs** is an isolated rural community of approximately 250 residents. The town was founded approximately 100 years ago by a small group of settlers who built an earthen dam across a narrow river canyon. Irrigation water is delivered by an extensive gravity flow irrigation system which serves the fields below through earth-lined ditches. The Early Springs Mutual Ditch Company is a private corporation governed by customs,
traditions, and out-dated by-laws. Company expenses are funded by users’ fees and from revenues from the Department of Game and Fish which pays a small annual storage fee for use of the reservoir for recreational purposes. A recent dam safety inspection by the State Engineer indicates significant problems with the dam. Cost estimates to repair the dam are approximately $500,000. Private financing opportunities are limited whereas public financing options appear to be more readily available and less costly both from state and federal agencies. However, the Early Springs Company is not eligible for these monies unless it reorganizes as a special district or public ditch association.

B. Purpose: This presentation provides information to organizations such as Los Ricos and Early Springs, private water companies and associations that are considering reformation as a public entity. The information also may be useful to public and quasi-public water agencies. Section II provides basic information on financial options and programs available to public organizations. Section III describes private and public organizational options with a particular focus on statutory powers, public utility regulation, and operator liability.

II. FINANCIAL CONSIDERATIONS FOR EVOLVING WATER ORGANIZATIONS

A. Overview of Section: This section provides a general review of the legal principles applicable to financial options available to public organizations. Only the more basic types of debt and obligations available to public entities are described and the sections relating to
federal tax law considerations are more in the way of a warning than advice. The description of credit markets and funding sources comes primarily from hands-on experience with smaller public entities and does not encompass various issues that would be encountered in higher dollar transactions with complicated credit enhancement and interest cost hedging devices.

B. State Law Restrictions on Governmental Powers

1. Generally: Local political subdivisions and governmental units are creatures of state statute with only those powers specifically granted by the state legislature. Dillon's rule provides that a municipal corporation can possess and exercise the following powers and no others: (a) those granted in express words; (b) those necessarily or fairly implied or incident to the powers expressly granted; and (c) those essential to the declared objects and purposes of the corporation. Dillon, Municipal Corporations § 55 (1st Ed. 1872). Financing options may be limited depending on the wording of an antiquated or inartfully drafted statute; however, the courts variously apply Dillon's rule in a strict or lenient fashion, c.f., Adams v. Pritchard, 399 P.2d 252 (Idaho 1965); Chemical Bank v. Washington Public Power Supply System, 666 P.2d 329 (Wash. 1983), cert. denied, 471 U.S. 1065 (1985). In any event, by becoming a public entity, a water organization becomes dependent upon the legislative enactments and judicial decisions interpreting those enactments for its powers. A private entity does not necessarily have the same constraints and may, through its own corporate resolutions or other
forms of official action, undertake projects or financings not prohibited or not authorized for a public entity. For example, public entities in Colorado, as a result of indefatigable efforts by anti-tax proponents, are now faced with new burdens in obtaining financing by virtue of a constitutional amendment approved in November, 1992. See Colorado Constitution Article X, § 20.

2. **Voter's Rights:** Public entities, by constitution or statute, are generally governed by popular election and most voters within a particular political subdivision are allowed to vote. Elections are typically required for initial organization, selection of officers and authorization to issue general obligation debt. Some limited restrictions on the elective franchise are available if the particular district operates for the benefit of and is financed by certain property owners. For example, property owners can be excluded from voting in certain cases where the political subdivision has a limited purpose or there is a rational basis for excluding certain electors from voting. See *Ball v. James*, 451 U.S. 355 (1981); *Snead v. City of Albuquerque*, 663 F. Supp. 1084 (D.N.M.), aff'd, 841 F.2d 1131 (10th Cir. 1987), cert. denied, 485 U.S. 1009 (1988). In addition, the federal Voting Rights Act also applies to most types of elections requiring Justice Department pre-clearance in certain areas and further requiring minority language translations in bond elections and organizational elections. Voting Rights Act of 1965, 79 Stat. 437, as amended. Numerous counties in western states have been specifically identified as areas
where notice of elections and election assistance must be provided in Spanish and/or American Indian languages as well as English. 28 C.F.R. Ch. 1, Part 55.

3. **Anti-Donation Clause:** Most constitutions in the western states prohibit the use of public credit or funds for private purposes. See New Mexico Constitution, Article IX, § 14, Colorado Constitution, Article XI, § 1. These constitutional provisions may prohibit certain types of joint public/private development, and certainly prohibit a grant of funds or a credit guarantee for private parties. However, so long as consideration is received in return for the use of a particular facility which furthers the public interest, the courts will generally uphold the ability of the public entity to proceed. See Utah Power & Light Co. v. Campbell, 703 P.2d 714 (Idaho 1985). The prohibition is generally deemed not to apply to cooperative agreements or arrangements between governmental entities.

C. **Types of Debt Financing Mechanisms for Public Entities**

1. **General Obligation Bonds:** General obligation bonds are secured by the full faith and credit and general taxing power (usually ad valorem taxes) of the issuer. Typically, voter approval is required prior to issuance of general obligation bonds. See e.g. New Mexico Constitution, Article IX, §§ 10, 11, and 12. A specific limitation on the millage rate or the amount of general obligation bonds that may be outstanding is often contained in the constitutional provision or statute creating the
political subdivision. These types of general obligation debt limitations are often applicable to special water districts or other limited purpose districts. See, e.g., Colo. Rev. Stat. Ann. § 37-45-122 (1990). The limitation may be based on a particular percentage of the assessed value of property included within the political subdivision or on a stated principal amount of bonds. Some states, such as New Mexico, allow general obligation bonds to be issued without limit for water and sewer systems. New Mexico Constitution, Article IX, § 13.

2. Revenue Bonds: Revenue bonds are payable solely from revenues from a designated special fund thereby avoiding the need for voter approval. Ginsberg v. City and County of Denver, 436 P.2d 685 (Colo. 1986); Denver Urban Renewal Authority v. Byrne, 618 P.2d 1374 (Colo. 1980). Revenue bonds are typically project-based and payable from user fees such as water or sewage charges. Revenue producing projects are usually self-liquidating projects with sufficient revenues to first pay operational costs and second to pay debt service on bonds. See, e.g., §§ 3-31-1 et seq., NMSA 1978. However, some bond issues can be secured with a gross revenue pledge in order to provide adequate security to bondholders. In addition, revenue bonds usually include debt service reserve funds and restrictive covenants as to use, maintenance of insurance, continued existence of the political subdivision and management. One type of politically sensitive covenant usually found in water system financings is a covenant to set user fees and rates at sufficient levels to provide debt
service coverage at least equal to 110% to 125% of annual debt service after payment of operating and maintenance expenses. Such a covenant can be difficult to meet in the face of rate increase resistance from users and escalating operational costs.

3. **Special Assessment Bonds**: Special assessment bonds are payable from special assessments on property deriving a special benefit from the public improvements financed with the bond proceeds. Special assessment bonds are similar to revenue bonds in that special assessments are not deemed to be property (ad valorem) taxes; however, assessments are typically secured by a lien on real property on a parity with claims for property taxes. Assessments have to be in a reasonable proportion to the benefit accruing to the property from the public improvement. The public improvement must concur a special benefit to the assessed property (as opposed to a general benefit to the community at large) and the amount of the assessment may not exceed the special benefit. See, e.g., Garden Development Co. v. City of Hastings, 436 N.W.2d 832 (Neb. 1989); Harrison v. Board of Supervisors of San Mateo County, 44 Cal.App.3d 852 (1975). Statutory procedures for establishing a special assessment district are usually complex, requiring public hearings and numerous separate actions by the issuing authority. § 3-33-1 et seq., NMSA 1978. Special assessments are a good financing method to use for discrete extensions of existing public infrastructure where actual benefits to particular properties can be identified.
4. Municipal Leases and Contingent Obligations: Certain political subdivisions may incur debt so long as the obligation of the entity is not absolute and is subject to annual appropriation. See Gude v. City of Lakewood, 636 P.2d 691 (Colo. 1981); Municipal Building Authority of Iron County v. Lowder, 711 P.2d 273 (Utah 1973). Because the lessee is obligated only on an annual basis and not over a long term, courts have held that no debt is created thereby avoiding voter approval or special fund doctrine requirements. The fact that the facility being leased may be essential for the functioning of the political subdivision thereby making impractical foregoing of the annual appropriation and subsequent loss of use of the facility is usually deemed irrelevant. The New Mexico Supreme Court has specifically declined to approve contingent lease agreements for public entities in New Mexico. See Montaño v. Gabaldon, 103 N.M. 226, 766 P.2d 1328 (1989); Hamilton Test Systems, Inc. v. City of Albuquerque, 103 N.M. 226, 704 P.2d 1102 (1985). Any debt issued in violation of a constitutional provision is considered to be void.

D. Federal Tax Law Considerations

1. Introduction: The interest on most bonds issued by political subdivisions for essential function purposes is excluded from gross income for purposes of federal income taxation in the hands of bondholders. Sections 103 and 141-150, Internal Revenue Code of 1986. In addition, most interest is excluded from gross income for state income taxes on bonds of the state and its political
subdivisions held by residents of that state. Most states tax interest paid on bonds of another state or on out-of-state political subdivision. Because of the federal and state tax exemptions, interest rates on governmental bonds typically are significantly lower than interest rates available on taxable debt from banks or other lending institutions.

2. **Section 103**: The obligation must be an exercise of the borrowing power of the governmental entity with an obligation to repay, in order for the interest to be tax exempt. A bond, loan or lease is typically required and the obligation may not be simply an obligation owed by virtue of formal government operations or exercise of powers of eminent domain. Furthermore, the bonds must be valid under local law in order to qualify for federal tax exemption. See Rev. Ruling 87-116.

3. **Tax Exempt Issuer**: A political subdivision has been defined in Regulation 1.103-1(b) as any division of a state or local government unit which is a municipal corporation or which has been delegated the right to exercise part of the sovereign power. Particular powers such as eminent domain, power to tax, and police powers are treated as parts of the sovereign power. Political subdivisions generally include special assessment districts and other special districts formed for particular public purposes such as water and sewer services. In addition, entities that act "on behalf of" a state or local government unit can be authorized to issue bonds that qualify for tax
exemption. See Rev. Ruling 77-164 and Regulation Section 1.103-1(b).

4. **Registration Requirement**: All bonds must be registered to be tax exempt. Section 149(a) of the Internal Revenue Code requires that all bonds must be registered in order to be tax exempt. Typically, requires a bank with trust powers or a trust company to act as bond registrar and paying agent with respect to a bond issue in order that the United States Treasury can track bondholders and require certain information reporting with respect to bondholders. The annual cost of paying agent and registrar services is usually not significant.

5. **Information Reporting**: Section 149(e) of the Internal Revenue Code requires an 8038-G Information Return be filed within a certain number of days after issuance of bonds setting forth various details concerning the bond issue. Certain certifications must be made in the Information Return and the information is used by the Internal Revenue Service for tracking purposes.

6. **Reissuance**: Adjustment of the interest rates and various terms of a bond may result in a reissuance of the bond, thereby picking up new tax law considerations. See PLR 8834090. Reissuance regulations can make revision of bond terms difficult without undergoing complete new federal tax analysis to ensure that no newly imposed or adopted tax requirements become applicable to the issue. Obviously, these restrictions do not apply to adjustment of the terms of taxable debt.
7. **Arbitrage and Rebate:** Section 148 of the Internal Revenue Code generally prohibits investment of bond proceeds at a rate materially higher than the yield on the bonds. Typically a temporary period of three years is allowed after issuance of bonds to expend the proceeds and to avoid yield restriction concerns. However, Section 148 requires that rebate of the arbitrage profits be made to the Internal Revenue Service. Certain exceptions are applicable with respect to rebate requirements if all of the bond proceeds are spent within an eighteen-month or a two-year construction period. In addition, there is an exception for governmental units issuing $5 million or less of bonds in any particular year, so long as the governmental unit has general taxing powers, no part of the bond issue is a private activity bond and 95% of the net proceeds are used for local governmental activities of the issuer. Section 148(f)(4)(D).

8. **Tax Compliance Certificate:** Typically based on reasonable expectations of the issuer at the time of issuance of the bonds and sets forth all of the relevant details about use of the bond proceeds. Prohibits any private activity bond use; i.e., (1) use of more than 10% of the facility by a private party and (2) payment of more than 10% of the debt service with revenues derived from use of the facility by a private party. Use by the general public does not constitute a private activity use. Section 103(b). The certificate also sets forth various expectations based on use of the proceeds and no future change in use of the facility. Management contracts with private parties can be permitted so long as the contracts comply with
certain restrictions concerning payments to a private party and reserving termination rights to the public entity. See Rev. Proc. 93-19.

9. **Exempt Facility Bonds:** Some private entities can benefit from tax exemption as an "exempt facility bond" with respect to water supply facilities under Section 142 of the Internal Revenue Code. The regulations typically provide that exempt facilities must satisfy a public use test which requires a facility to serve the public or be available on a regular basis for general public use. See Reg. Section 1.103-8(d)(2). Public use for a water facility means that it must be made available for members of the general public (including electric utility, industrial, agricultural or commercial users) and, either the facility is operated by governmental unit or the rates for the furnishing or sale of the water have been established or approved by a state or political subdivision. Consequently, most water facilities can qualify for tax exempt financing under Section 142(e) so long as at least 95% of the bond proceeds are used for a water facility. Certain other requirements may be applicable such as an allocation of the state volume cap for private activity bonds.

10. **Reimbursement Regulations:** If a political subdivision intends to use general fund moneys to undertake construction projects with the expectation of later reimbursement with proceeds from a tax exempt bond issue, a declaration of intent is required under Treasury Regulation Section 1.103-18. The process for declaring intent
to reimburse is relatively simple; however, except for limited exceptions for preliminary engineering and design expenditures, it is critical that the reimbursement declaration be made prior to spending general fund moneys in order to preserve tax exempt-reimbursement options.

E. Credit Markets and Public Funding Sources

1. **General Bond Markets**: Any bond or financing option will require credit analysis by a financial advisor or investment banker for the bonds. The investigation can be complicated and often will require imposition of rate covenants or increases in existing rates prior to issuing bonds. In addition, certain management covenants may also be required. If the bonds are to be rated by Moody's or Standard or Poor's Corporation, the rating process can be rigorous. Historical audits, budgets and other financial information will nearly always be required prior to a rating or marketing of bonds.

2. **Revenue Streams**: In any situation with respect to marketing bonds, revenue streams will have to be identified and established prior to undertaking sale of bonds. These concerns generally apply even in the event of general obligation bonds secured by ad valorem taxes, when the entity is a new public entity without an established operating history.

3. **Method of Sale**: Most bonds can be sold at a negotiated sale directly to an investment banker or private party; however, some general obligation bonds are required to be sold only at a public
sale. See, e.g., § 6-15-1 et seq., NMSA 1978. Bonds are typically sold through the use of detailed disclosure documents prepared by or with the assistance of the public entity and must be "final" prior to marketing the bond. Securities and Exchange Commission Rule 15c2-12. An opinion approving the bonds from national recognized bond counsel (listed in The Municipal Bond Buyer’s Municipal Marketplace Directory, aka, "The Red Book") is also generally required.

4. Public Funding Sources: Public funding sources vary from state to state with respect to amounts available, but all probably come with strings attached and detailed procedures to follow. Fortunately, most programs also come with dedicated and professional staffs willing and able to assist with the procedures to the extent governing law and regulations allow administrative flexibility.

a. Farmers Home Administration: The United States Department of Agriculture, through the Farmers Home Administration, has a program aimed primarily at "rural" water and waste facilities. Rural facilities can serve up to 20,000 inhabitants. The program consists of both grant and loan functions, with loans typically taking the form of bonds to be repaid by the political subdivision or non-profit corporation. FmHA Instruction 1942-A.

b. Wastewater Facility Construction: This program was established in 1986 in New Mexico to create a revolving loan fund for federal monies distributed under the federal Clean
Water Act of 1977. §§ 74-6A-1 through -15, NMSA 1978. The program is generally administered by the Environment Department. Demand for loans has been somewhat less than anticipated probably as a result of competition from other programs that have grant components.

c. **Interstate Stream Commission**: The New Mexico Interstate Stream Commission has some funds available for lending to political subdivisions. §§ 72-14-1 through -42, NMSA 1978. However, the lending program is constrained by laws that have been on the books for a number of years and the ISC has little latitude in tailoring loans to particular circumstances.

d. **Rebuild America Program**: The Clinton Administration is pursuing a program to provide funds for a drinking water program for distribution to states, but Congressional approval has not been obtained.

e. **Access to Public Funding Sources**: Public entities, through the political process, likely have better access to federal and state funds than private entities. The trade-off, as described above, is less flexibility in structuring debt obligations and more regulations governing formation and continuation of the public entity.
III. LEGAL AND POLITICAL CONSIDERATIONS

A. Overview of Section: This section presents information on organizational options, public utility regulations, and liability. Sections B and C compare selected private and public water organizations according to purpose, methods for formation, governance, and powers. Public and private organizational options authorized by New Mexico statutes are provided as examples. Similar organizations are found in the other Western states but there will be variations and different options from state to state. Although organizations are categorized as either private or public, such distinctions often are artificial because private water organizations have public attributes and provision of water by public organizations may be considered a proprietary function. See generally 78 Am. Jur. 2d "Waterworks and Water Companies," §§ 1, 4 (1975). Sections D and E respectively consider liability issues and public utility regulation.

B. Private Options.

1. Cooperative arrangements: Private persons may informally maintain a diversionary structure such as a ditch, canal, or well. See 3 Waters and Water Rights § 26.01. These arrangements may be formalized in water rights documents, property deeds, or as an association.

   a. E.g., Unincorporated Associations. §§ 53-10-1 et seq., NMSA 1978.

      1) Purpose: Two or more persons who desire to form an association for promotion of their mutual pleasure or recreation or an
association not for individual profit of the members.

2) Formation: Organizers may file a statement describing the organization, its purposes, members, location, articles of association, and rules or regulations with the County Clerk.

3) Governance: Determined by association rules or by-laws.

4) Powers: Associations may hold real or personal property. See generally, Annot. "Power and Capacity of Unincorporated Association, Lodge, Society, or Club to Convey, Transfer or Encumber Association Property," 15 A.L.R.2d 1451. Also, associations have the right to sue or be sued without making individual members parties. § 53-10-5.

5) Comments: Although generally used for other purposes, an unincorporated association probably can be used to provide water-related services.

2. Cooperative Associations. E.g., mutual ditch, mutual domestic. These organizations are governed by custom and tradition and/or written by-laws. They also may be organized as incorporated cooperatives, or incorporated pursuant to special state statutes.
a. **E.g., Water User Association.** §§ 73-5-1 et seq., NMSA 1978.

1) **Purpose:** For irrigation only in New Mexico.

2) **Formation:** Incorporation certificate with specified information must be filed with State Corporation Commission and County Clerk. §§ 73-5-2 and -3. Certificate may be amended by two-thirds vote of shareholders.

3) **Governance:** Determined by association by-laws or rules and regulations. Officers are optional. § 73-5-8.

4) **Powers:** Right to sue and be sued and right to condemn right-of-way and other property via exercise of eminent domain powers as provided by the Eminent Domain Code §§ 42A-1-1 et seq., NMSA 1978. Generally, the power of eminent domain can be given to private water companies on the grounds that such companies serve public purposes. See, e.g., Kaiser Steel Corp. v. WS Ranch Co., 81 N.M. 414, 420, 467 P.2d 986, 992 (1970); 78 Am.Jur.2d "Waterworks and Water Companies," § 2; 26 Am.Jur.2d "Eminent Domain," § 59.

b. **E.g. 2, Cooperative Associations.** §§ 53-4-5 et seq.

1) **Purpose:** Transaction of any lawful business including provision of goods or services.
2) **Formation:** Any five or more natural persons or two or more associations may form a cooperative by filing articles of incorporation with the State Corporation Commission. § 53-4-6. Amendment requires two-thirds vote of board of directors or of members.

3) **Governance:** By-laws are optional. There shall be a minimum of five directors who shall be directed by and from members of the association. § 53-4-18. A one member, one vote formula must be used and no proxy voting is allowed. §§ 53-4-13 and -14. Officers shall include a president, one or more vice presidents, a secretary and treasurer or secretary/treasurer. Officers shall be elected annually. Directors or officers may be removed with or without cause by a two-thirds vote of the membership. § 53-4-20. Any natural person, association, other cooperative, or nonprofit group that meets membership qualifications is eligible for membership.

4) **Powers:** A cooperative has the same capacity to act as possessed by natural persons, can sue and be sued in its corporate name, acquire any property incident to its purposes, borrow money, and make contracts including agreements of mutual aid or federation with other cooperatives, and exercise any power granted to an ordinary business corporation. § 53-4-4.
3. **Water Companies:** Usually a non-profit corporation organized for the exclusive benefit of the users in a particular area who become its stockholders. *Waters and Water Rights, § 26.02.* Some are corporations organized as commercial ventures to sell water for profit whereas others are created by residential developers for subdivisions outside of municipal boundaries. Often incorporated under general statutes applicable to private business corporations but these private corporations may be formed as non-profits or pursuant to statute for the purpose of supplying water for irrigation, mining, manufacturing, domestic and other public uses.


1) **Purpose:** To construct and maintain reservoirs and canals, or ditches and pipelines, to supply water for irrigation, mining, manufacturing, domestic and other public uses including to municipalities. §§ 62-2-1 et seq.

2) **Formation:** Any five persons may file articles of incorporation with the State Corporation Commission and a copy must be filed with the County Clerk of each county where the waterworks are located. In addition, a certificate of public convenience and necessity may be necessary to provide certain services. *See § 62-11-4 and discussion of public utility regulation, infra.*
3) **Governance:** A board of directors of not less than three stockholders, at least one-third of whom shall be state residents, govern waterworks companies. Directors shall be elected annually; the method of selection is pursuant to provisions in the by-laws. § 62-2-6.

4) **Powers:** Waterworks are deemed a body politic and corporate, can sue and be sued, own real and personal property, adopt by-laws, etc. § 62-2-4. Additional powers include the right to take "surplus water" provided no detriment to water rights owners, impose rates so long as equal to each class of consumers, enter upon and condemn and appropriate any lands or material that may be necessary. § 62-2-5; see also *Albuquerque Land & Irrigation Co. v. Gutierrez*, 10 N.M. 177, 179, 61 P. 357 (1900), aff'd, 188 U.S. 545 (1903) (irrigation companies may go upon private lands to survey for right-of-way by eminent domain for this is a public purpose); § 62-2-6 (eminent domain power conferred).

5) **Comments:** A 1967 Attorney General Opinion (No. 67-50) confirms that the powers conferred to waterworks are limited to corporations incorporated under §§ 62-2-1 et seq. Mutual domestic water associations have no similar power of eminent domain. Section 62-2-22 provides special protection to public ditch associations or acequias, discussed *infra*, by providing that no waterworks may divert water between February 15 and October
15 unless unanimous consent of all water rights owners is first obtained.

B. Public Options.

1. Community Associations: Acequias traditionally supplied water for irrigation and domestic purposes. Today, they provide water for irrigation whereas mutual domestic associates or individual wells serve domestic needs.


1) Purpose/Background: A community acequia is a public ditch that allocates and distributes irrigation water to parciantes, landowners that are its members. The origin of acequias in New Mexico has been traced by archeologists and historians to pueblo Indians and Spanish explorers and settlers who first came to the region in the 1500s. Under Spanish law, the acequia madre was regarded as public property, and its management was the responsibility of the municipal government or pueblo. Outside of the pueblos, where there was no municipal government, the acequias were voluntarily developed by cooperative endeavors of water users. In 1851, soon after New Mexico became a Territory, the legislature protected acequias by prohibiting the disturbance of their courses. Acequias were recognized as community organizations in 1895 when the Territorial Legislature declared them public involuntary quasi-corporations with the
power to sue or be sued. See generally, New Mexico State Engineer, Acequias (Pamphlet, June, 1991).

2) Formation: Any inhabitant of New Mexico has the right to construct, either private or common acequias but must pay any landowner through whose land the acequia must pass. § 73-2-1. If the landowners where a new ditch for an acequia is to be made should ask an exorbitant price as compensation, the probate judge of the county in which the acequia is to be located is authorized to appoint "three skillful men of well-known honesty" to determine the compensation amount. § 73-2-2.

3) Governance: Each acequia must be managed by four officers consisting of three commissioners and one mayordomo, each of whom must own an interest in the acequia or the water therein. The commissioners must elect one of their number as chairperson, a second as secretary, and the third as treasurer. The treasurer and mayordomo must be bonded in a sum fixed by the commissioners for the accounting of all money and the faithful performance of their duties. § 73-2-12, § 73-3-1. Officers are elected every two years pursuant to rules and regulations prescribed by the commissioners. Only members not delinquent in their payment of assessments or those who offer payment on delinquent assessments at the time they vote are eligible to vote. Proxy votes are allowed and are allocated in proportion to the interest of the
voter in the ditch or water, or in proportion to the number or amount of the voter's water rights. § 73-2-14. Acequia commissioners must develop by-laws, rules and regulations, and provide a printed copy to each water right owner in the acequia. An election or written consent of the members is required for reconstruction or modification of existing works.

4) **Powers:** Commissioners may assign work, contract, make assessments, and otherwise control the affairs of the ditch. Acequias are authorized to borrow money and otherwise contract indebtedness, to acquire and hold property and water rights, to use and transfer water rights pursuant to law, and sue and be sued. Water rights and land owned by an acequia may not be lost by prescription or adverse possession or for non-use except for statutory forfeiture as provided in § 72-5-28. §§ 73-2-22 and -22.1.

5) **Comments:** Acequias have been declared to be political subdivisions of the state. § 73-2-28; but see *Storrie Project Water Users Association v. Gonzales*, 53 N.M. 421, 424-27, 209 P.2d 530, 532-34 (1949) (unlike community ditches, an earthen dam for impounding of water for irrigation system owned by a non-profit corporation is subject to taxation). As political subdivisions, acequias are given the power of eminent domain to condemn land for the construction or repair of ditches. 1960 Op. Atty. Gen. No. 69-96. It is well-
established that the rights of ownership of
the ditch are rights separate and apart from
owners of water rights. Snow v. Abalos, 18
N.M. 681, 695, 140 P. 1044, 1048 (1914) (a
ditch or carrier system, having been
constructed by the joint labor of all the
water users, is owned by them as tenants in
common); Holmberg v. Bradford, 56 N.M. 401,
244 P.2d 785 (1952) (owner of community ditch
in effect has an easement for purposes of
transporting water). Consequently, it has
been held that each individual water right
owner is a proper and necessary party in an
action for adjudication of water rights where
such rights are exercised through a community
ditch. However, the acequia may represent its
members where parties represented have a
common interest and no issue is raised with
respect to water rights of individual users.
La Luz Community Ditch Co. v. Town of
Alamogordo, 34 N.M. 127, 134-35, 279 P. 72, 76
(1929).

2. Special Districts: Generally, independent
political subdivisions of the state whose powers
are statutorily defined in general or special
legislation. See generally Special Water
Districts: Challenge for the Future (J. Corbridge,
ed. 1983); "Special Project: Irrigation
Districts," 1982 Ariz. St. L.J. 345; De Young,
"Special Water Districts: Their Role in Western
Water Use" in Proceedings, Western Water:
Expanding Uses/ Finite Supplies (June 2, 1986).
Special districts for agriculture include
irrigation and conservancy districts. Special
districts for municipal water include water and sanitation districts, municipal utility districts, and others.

a. **E.g., Water and Sanitation Districts.** §§ 73-21-1 et seq., NMSA 1978.

1) **Purpose:** Purchasing, acquiring, establishing or constructing waterworks for domestic, commercial and industrial purposes within or without the boundaries of the district. In addition to domestic water services, districts may provide sanitary sewers, garbage or refuse disposal, streets, parks and recreational improvements. § 73-21-3.

2) **Formation:** Petition by not less than 25% of taxpaying electors, none of whom may be officers, directors or shareholders of any business entity with an economic interest in the subdivision and sale of land within the district. However, the petition also may be filed by a county, signed by the chairman of the board of county commissioners. § 73-21-6. The petition is filed with the district court and county clerk in the county in which all or part of the real property of the proposed district is situated. The petition must contain certain information and a bond approximating the amount of costs of organization also is required. § 73-21-7. After approval of a special district commission in certain situations, the petition is submitted to the court who holds a public
hearing on the petition and any petitions for exclusion as allowed under § 73-21-9. After required consultations with state water quantity and quality agencies, the district court may grant or deny the petition. If the petition is granted, an election by taxpaying electors must be held. A majority vote is required.

3) **Governance:** Three directors are elected in the initial formation election. Elections are required every two years thereafter for six year rotating terms. The board of directors may be expanded to five members upon petition. Monthly meetings are required. Removal of director is allowed upon petition to district court. § 73-21-12. Budgets must be approved annually by the local government division. § 73-21-52. Water and sanitation districts are not subject to the Public Utility Act but may submit to regulation by the Public Utility Commission. § 73-21-55.

4) **Powers:** Districts may levy ad valorem taxes and user fees. Bonds may be issued upon approval of majority of electors in elections. Elections also are required for any indebtedness over $5,000.

5) **Comments:** These districts are creatures of the district courts but once created, are considered political subdivisions of the state with powers of public or quasi-municipal corporations. § 73-4-9(i); 1971 Op. Atty. Gen., No. 71-56; *Lower Valley Water &*
Sanitation District v. Public Service Commission, 96 N.M. 532, 534-35, 632 P.2d 1170, 1172-73 (1981) (because water and sanitation districts have the authority to impose ad valorem taxes, such districts perform a general governmental function involving the administration of sanitation and health services and are not special proprietary interests).

C. Liability: Evolving water organizations, their directors, and their members should be concerned with the potential for legal liability. Generally, special districts and municipalities have less exposure to legal challenges based on negligence because of the applicability of certain doctrines such as the doctrine of sovereign immunity. In addition, public organizations may be provided legal insurance coverage by the state or at a reduced fee by private providers and generally have more resources at their command to withstand legal challenges. However, public organizations generally are more visible to the public and consequently may be challenged. Less obviously, public employees may be afforded causes of action not available to their private counterparts. In addition, public bodies may face challenges based upon alleged violations of state or federal procurement codes.

1. **Tort Liability for Injuries to Persons or Property:**
   As a general proposition, any person is liable for his/her/its own negligence. Private and public water organizations generally have the same duty to use reasonable care and diligence in maintaining works and managing organizational affairs.
a. The negligence standard has been applied to a wide range of public and private water organizations. See, e.g., Bigler v. Mapleton Irrigation Canal Co., 669 P.2d 434, 436-37 (Utah 1983) (ordinary care required for distribution and inspection of irrigation waters and ditches); Kunz v. Utah Power & Light Co., 117 Id. 901, 792 P.2d 926 (Id. 1990) (in action against private utility, flooding damages recoverable on negligence theory, not on strict liability, trespass, or private nuisance theories); but see Gossner v. Utah Power & Light, 612 P.2d 337, 341 (Utah 1980) (strict liability appropriate where power company reduced carrying capacity of flows by regulating releases); Hitti v. Montezuma Valley Irrigation Co., 599 P.2d 918, 921 (Colo. 1979) (liability possible for negligence in use and repair of ditch); DeWitt Properties, Inc. v. New York, 377 N.E.2d 461 (N.Y. 1978) (municipal corporations are held to the same duty of care as a private supplier of water, that of maintaining and repairing water works so as to avoid injury to persons or property); see generally, Annot., "Liability of Water District for Damage Caused by Water Escaping From Main," 20 A.L.R.3d 1294 (1968); Annot., "Water District Liability for Injury Due to Condition of Service, Lines, etc.," 20 A.L.R. 3d 1363 (1968).

2. Applicability of Doctrine of Sovereign Immunity: This doctrine precludes a litigant from asserting an otherwise meritorious cause of action against a sovereign or a party with sovereign attributes unless the sovereign consents to the suit. Federal and state governments, and derivatively political subdivisions of the state, traditionally were immune from tort liability arising
from activities which were governmental in nature. Most states have abandoned this doctrine in favor of statutory tort claims acts which waive immunity for certain activities.

a. Relevance of proprietary versus governmental distinction: It has been held that a city operating a waterworks system acts in its proprietary or business capacity, not in its governmental or political capacity. E.g., Ridge v. City of Englewood, 657 P.2d 961, vacated, 686 P.2d 780 (Colo. Ct. App. 1982); Safransky v. Helena, 39 P.2d 644, 649 (Mont. 1935). Accordingly, an argument can be made that the doctrine of sovereign immunity should not apply. See Brizendine v. Nampa Meridian Irrigation District, 548 P.2d 80, 88, 91 A.L.R.3d 170 (Id. 1976) (Idaho tort claims act not applicable to irrigation district whose purpose is acquisition and operation of irrigation system, a business enterprise for the benefit of shareholders); see also Truckee-Carson Irrigation District v. Baber, 392 P.2d 46 (Nev. 1964); East Larimer County Water District v. Centric Corp., 693 P.2d 1019, 1021 (Colo. Ct. App. 1984) (a district is subject to private contract law when entering into contractual relations). However, fire protection, sewer, or other water quality protection services have been deemed public safety uses that are considered an exercise of the police power of a municipality. County of Nassau v. South Farmingdale Water District, 405 N.Y.S.2d 742 (1978) (the distinction between governmental and proprietary functions is an artificial and illogical distinction judicially created to alleviate the hardships of the application of the

c. The doctrine also has been applied to other types of public water organizations: Marty v. State, 786 P.2d 524 (Idaho 1989) (department of
water resources, its agents, and flood control district held immune); Jones v. Northeast Durango Water District, 622 P.2d 92 (Colo. Ct. App. 1980) (municipal water district and directors held immune); but see Gunn v. Consolidated Rural Water & Sewer Dist. No. 1, 839 P.2d 1345 (Okla. 1992) (Tort Claims Act does not protect a water and sewer district from liability for retaliatory discharge).


3. Water organizations generally are not subject to the doctrine of attractive nuisance: This doctrine provides that a person who has a condition or instrumentality upon his own premises that may reasonably be apprehended as a source of danger to children, is under a duty to take such precautions as a reasonably prudent person would take to prevent injury to children of tender years who may be expected to come there to play. See Restatement (Second) of Torts § 339. Because water organizations often have reservoirs, ditches, and other facilities that might be considered an attractive nuisance to children, strict application of the doctrine could result in significant exposure to liability. Generally, courts have been reluctant to impose such a duty on water organizations. See, e.g., Limberhand v. Big Ditch Co., 706 P.2d 491, 496 (Mont. 1985); Loveland v. Orem City Corp., 746 P.2d 763, 773 (Utah 1987); but see Abbott v. West Extension Irrigation District, 822 P.2d 747, 749
(Or. Ct. App. 1991) (municipal corporation owner of canal held not liable under doctrine because child knew the canal was dangerous).

4. **Dignitary torts**: A tort is a legal wrong committed upon a person or property independent of contract. Personal torts include direct invasions of some legal right of the individual as well as the more common tort actions which involve physical injuries. In addition, a cause of action may lie for the infraction of some public duty by which special damages accrue to the individual.

   a. **Civil Rights actions**: A constitutional tort is allowed under 42 U.S.C. § 1983 when any citizen is deprived of any rights, privileges, or immunities secured by the Constitution and laws by a person "who under color of any statute, ordinance, regulation, custom, or usage, of any state or territory." In some cases, special districts have been held exempt from § 1983 actions. See, e.g., *Gorenc v. Salt River Project Agr., Imp. & Power District*, 869 F.2d 503 (1989) (holding that the district, although a political subdivision under the Arizona constitution, was not a "state actor." Therefore, employee of district not allowed to file a civil rights suit alleging the district had terminated employment under color of state law). In conjunction with the Fourteenth Amendment and state constitutional and statutory protections, public agencies nevertheless have exposure to a wide range of tort actions not available to their private counterparts.

5. **Challenges to Governance**: Although public water organizations may be preferred for financial reasons, the
methods for both forming and managing such districts are
being called into question more frequently. Established
interests may oppose the formation of new organizations.
Persons within or outside of a district but affected by
its activities may demand that the district be regulated
or provide better access for voicing their concerns, and
as a result of expansion of services, districts may be
serving new constituencies who have new and potentially
contradictory demands. See generally 3 Waters and Water
Rights § 27.01(d); Corbridge, "An Overview of Special
Districts," in Special Water Districts: Challenge for
the Future 8 (J. Corbridge, ed. 1983).

a. Challenges to district voting systems: Salyer
Land Co. v. Tulare Lake Basin Water Storage
District, 410 U.S. 719 (1974); Ball v. James, 451
U.S. 355 (1981); People ex rel. Cheyenne Soil
Erosion District v. Parker, 192 P.2d 417 (1948);
Foster v. Sunnyside Valley Irrigation District, 687
P.2d 841 (Wash. 1984) (constitutionally qualified
elector significantly affected by district
decisions must be given an opportunity to vote);
Millis v. Board of County Commissioners of Larimer
County, 626 P.2d 652, 657 (Colo. 1981) (14th
Amendment and Colorado constitution not violated by
exclusion of out-of-state property owners from
voting in water district matters); Porterfield v.
1987) (irrigation district elections were not
general elections so allowing voting by non-
resident corporations did not violate Arizona
constitutional requirement that voters be Arizona
residents); Timpanogos Planning & Water Management
Agency v. Central Utah Water Conservancy District,
690 P.2d 562, 570 (Utah 1984) (appointment of
conservancy district board by district court violated separation of powers doctrine).

b. **Applicability of procurement codes**: State procurement codes in each of the western states apply to every expenditure by state agencies and local public bodies for the procurement of items of tangible personal property, services and construction. See, e.g., § 13-1-30 et seq., NMSA 1978 (1992 Repl. Pamp.). When a procurement involves the expenditure of federal funds, the procurement must be conducted in accordance with mandatory applicable federal law and regulations. Whether a particular water organization is considered a public body subject to the procurement code will vary from state to state. If applicable, the failure to follow procurement code procedures may subject a water organization to legal challenges.

D. **Public Utility Regulation**: Local water organizations such as Los Ricos and Early Springs often have a strong tradition of autonomy and freedom from unnecessary state regulation. Consequently, organizational options that do not involve public utility regulation may be preferred. Regardless, a private company or association may acquire regulatory status as a public utility if it has dedicated itself to a public use by holding itself out as willing to supply water to the public or any portion thereof. If the organization only serves particular individuals, then it may not be regulated. Although state public utility statutes may explicitly exempt certain types of organizations, such statutes more often define the attributes of a public utility. If a particular water organization conforms to the definition,
then it will be subject to regulation unless exempted. See generally 3 Waters and Water Rights, § 26.03(b).

1. Private water companies may become subject to public utility regulation by conduct: E.g. Yucaipa Water Co. No. 1 v. Public Utilities Commission, 54 Cal.2d 823, 357 P.2d 295 (1960). In this case, the mutual water company had purposefully increased its number of service connections, supplied water to lessees of its shareholders, and enabled new applicants to obtain water by referring them to stockholders willing to lease their shares. The California Public Utility Code, § 2705, exempted any corporation or association organized solely for the purpose of delivering water to its stockholders or members at cost. The court upheld the commission's finding that the company was subject to regulation because it had delivered water not just to stockholders but to lessees and one other person and "such activity coupled with its other activities . . . clearly supported the commission's finding that it had dedicated its property to public use." See also Keystone, a Division of Ralston Purina Co. v. Flynn, 769 P.2d 484 (Colo. 1989).

2. The New Mexico Public Utility Act, § 62-3-1 et seq., NMSA 1978 (1992 Cum. Supp.): Public utilities are defined to include any plant, property or facility for the supplying, storage, distribution, or furnishing to or for the public water for manufacturing, municipal, domestic or other uses except irrigation. § 62-3-3. Companies subject to regulation are those where a substantial portion of the business involves rendition of services to a large number of the public, financing involves large investments of money including capital financed by the public, and the development of the
business affects the general welfare, business and industry of the state. § 62-3-1(A).

a. **Statutory exemptions:** A person that supplies water only to himself, his tenants, or employees. § 62-3-4(A). Municipalities. § 62-3-4.

b. **Case law interpreting the Act’s coverage:**

Movston v. New Mexico Public Service Commission, 76 N.M. 146, 157, 412 P.2d 840, 847 (1966) (the Act does not distinguish between public and private ownership); Llano Investment v. Southern Union Gas Co., 75 N.M. 7, 17, 399 P.2d 646, 653 (1964) (the principle characteristic of a public utility is the readiness to serve the public which has the legal right to demand service).

c. **Special districts such as water and sanitation districts may not be exempt:** See 1971 Op. Atty. Gen. No. 71-56 (water and sanitation districts exempt except in limited area of approving rates, tolls, and charges).

d. **A water association controlled by a residential developer may qualify as a public utility:** Griffith v. New Mexico Public Service Commission, 86 N.M. 113, 116, 520 P.2d 269, 272 (1974) (a water association in control of a residential developer serves all of the public who buy lots with a prime necessity of life).

IV. **CONCLUSION**

The information provided in the preceding sections hopefully represents the main areas to be considered by evolving water
organizations such as Los Ricos and Early Springs. After presenting such information along with recommendations to the real life counterpart of the Los Ricos Water User Association, the private organization decided to form a water and sanitation district. The district was formed after considerable effort and time. Fortunately, formation was not opposed which would have increased costs and time considerably. After formation, a general obligation bond was obtained in the private capital market allowing the district to acquire the water system from the association and make needed repairs.

The fate of the real life counterpart of Early Springs is still undetermined. However, the mutual ditch company has been assured by state officials that the company qualifies as an acequia and therefore is eligible for state and federal grant monies. This case is instructive because in many situations, the water organization does not need to reorganize in order to make needed changes.

Although there are distinct advantages that accrue to the public water organization, some of the apparent advantages are more imagined than real. Although public entities generally have better access to federal and state grant and loan monies, obtaining public funding subjects the organization to more red tape and less flexibility in structuring debt obligations. Private entities also may need not reorganize to benefit from tax exemptions to the extent that they satisfy a public use test. Immunity from liability also seems to be a plus, but that doctrine has been eroded and the public agency in fact may have more exposure to liability than its private counterpart. For these reasons, evolving private water organizations should carefully consider the pros and cons before "solving" their problems by reorganization.