In answer to your question as to whether there are any cases which hold that 1926(b) protection is extinguished once the water association's USDA loan is paid off, take a look at Rural Water System No. 1 v. City of Sioux Center, Iowa, 967 F. Supp. 1483 (1987), a federal district court case which held that the rural water association lost 1926(b) protection against municipal encroachment when it bought back its notes from FmHA. The case further held that although the water association regained 1926(b) protection when it subsequently became indebted to the federal government, the city "was not liable to association on claims asserting violation of [1926(b)] arising from city's annexation of portions of association's asserted service area during period association was not indebted to government." This decision by the district court was affirmed on appeal to the United States Court of Appeals for the Eighth Circuit in 2000 [202 F. 3d 1035 (2000)] and the Supreme Court of the United States denied the city's petition for writ of certiorari in this matter in 2000 and declined to grant any further review of the district court's ruling. 121 S. Ct. 61 (2000).

The Sioux Center decision has been challenged on other grounds in other Federal Circuits and I am sure there are other cases dealing with when and how 1926(b) protections remain in place. However, I believe the Sioux Center decision on the issue we are discussing makes sense.

It should be noted, however that in many states, including Mississippi, a rural water association's clearly defined service area has been ruled to be a valuable property right and survives as such after a city's annexation of the water association's exclusive service area, regardless of whether 1926(b) protections are available. Thus, in Mississippi, the removal of 1926(b) protection would only allow a city to condemn the service area of the water association through eminent domain proceedings; and in such a case the city would be required to pay the water association fair market value as a result of the condemnation. In my experience, fair market value would include the present value of future income that the water association would have otherwise received for at least ten years in the future had the condemnation not taken place…

Finally, although we know that 1926(b) is still alive and well, we also know that there are powerful forces, particularly among municipal groups, that would like to see the statute repealed. In my recent experience, municipalities are becoming more and more brazen in their attempts to simply trespass on the franchise areas of rural water providers and are becoming more and more confident that USDA will not intervene in any federal action filed by the rural water providers to protect their exclusive franchise rights. Thus, even those water associations that can afford to pay the very expensive costs of such litigation must still pay a heavy price on behalf of their ratepayers to protect themselves.

Any effort that could be made to convince USDA to once again aggressively protect the 1926(b) rights of rural water providers by regularly intervening in such federal litigation on behalf of the water providers would be extremely helpful as we continue to ensure that 1926(b) remains alive and well, because the federal courts usually give great weight to the government's position on these matters.
Question: 1926(b) Protection When USDA Loan Is Paid Off

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7 U.S.C. Section 1926(b) protection is alive and well. Periodically there is a rumor circulated that 1926(b) has been repealed but that is not the case. Relative to an overlap between a city and a federally indebted water district, the water district would normally easily prevail over a city that is either demanding that the city serve, or the city demanding that a franchise fee be paid for the right to serve. Both are clearly forbidden by 1926(b). Even the threat of such a demand can result in the entry of an injunction against the city. (In Moore Bayou v. Jonestown, a letter indicating an intent to condemn water district assets was enough to trigger declaratory relief and an injunction in favor of the district. In Madison v. Bear Creek, the court held that even a nominal level of interference with the district will result in a violation of 1926(b).)

Overlapping areas can be quite complex depending on the applicable state law. One key issue is whether the district was federally indebted at the time of the overlap. I don't recall any franchise fee cases as described below, but the case law repeatedly states that 1926(b) must be liberally interpreted and any limitation or requirement of a franchise, license, permit etc. is forbidden. In Kansas an overlap (annexation) can have a very dramatic impact on the legal right to sell water in the overlap area (absent 1926(b) protection), whereas an overlap in Missouri or Oklahoma will have no impact. (Missouri in fact has a very strong state statute precluding service by the city if it overlaps the territory of a water district, unless the city complies with 247.165 or 247.170 which requires a buy-out. These state statutes are trumped by 1926(b) but are very beneficial to districts that are not federally indebted.) New Mexico is far more complex regarding overlaps. The 10th Circuit follows the rule that federal law not state law controls the protected territory whereas the 6th Circuit takes a more narrow approach, linking protection to state political boundaries. Careful review of the facts and applicable state law is required to be certain the water district is on strong ground relative to 1926(b) protection.

Hope this provides some assistance.