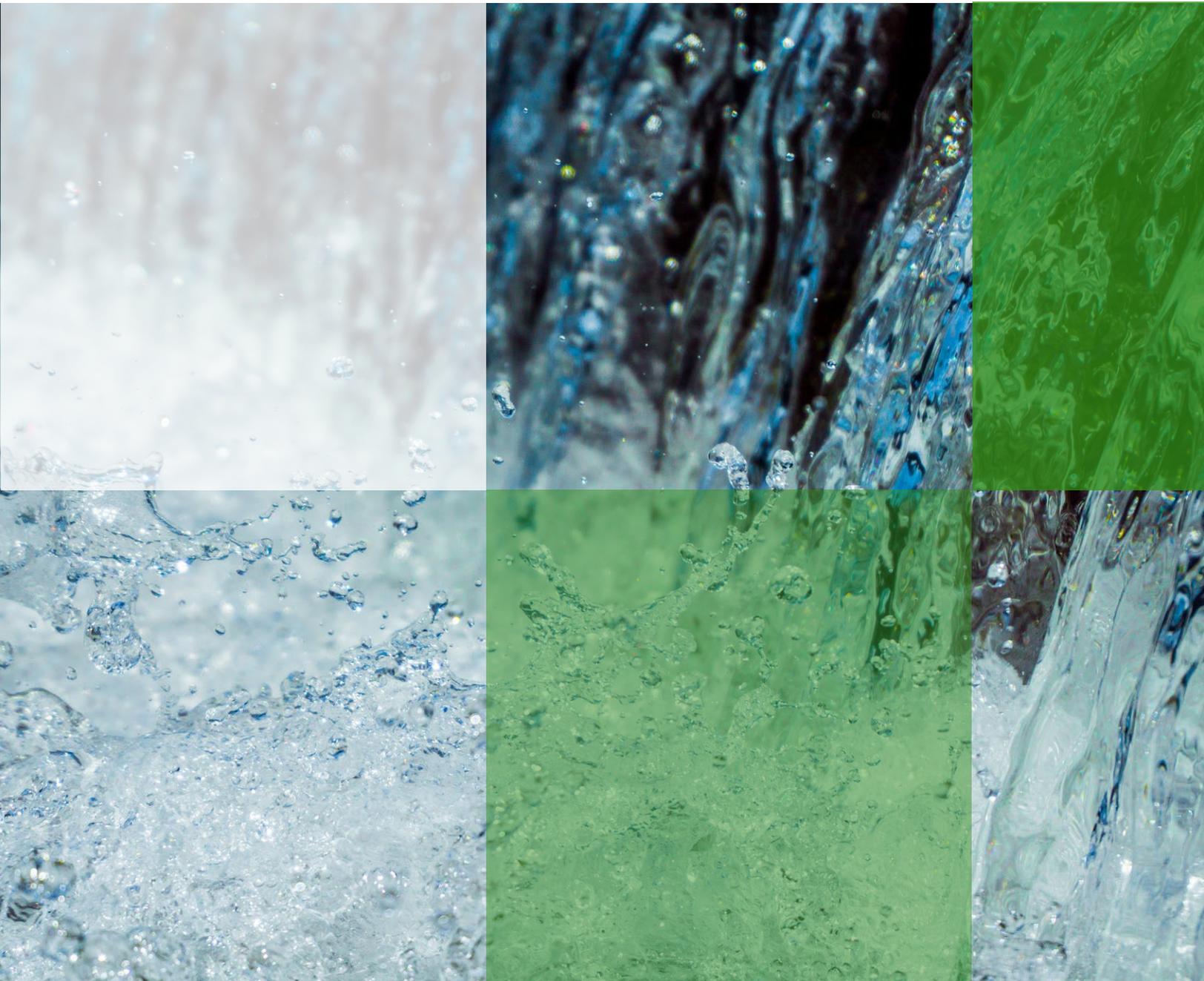


Consolidation of Water and Wastewater Systems: Options and Considerations





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Environmental Finance Center

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About the EFC

The EFC is part of a network of centers that works on environmental issues, including water resources, solid waste management, energy, and land conservation. The EFC partners with organizations across the United States to assist communities, provide training and policy analysis services, and disseminate tools and research on a variety of environmental finance and policy topics. The EFC is dedicated to enhancing the ability of governments to provide environmental programs and services in fair, effective, and financially sustainable ways.

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Introduction

Utilities across the country are seeking ways to best serve their customers by providing safe drinking water and wastewater treatment in the most effective and efficient manner. However, some utilities struggle to remain viable as they face degrading infrastructure, shrinking customer bases, tragic devastation from significant weather events, and decreasing revenues due to decreased sales. For many utilities, the focus (and perhaps motivating factor) to investigate regional solutions is to address these pressing needs. Sometimes, the best solution to address challenges like these is through consolidation. This guide seeks to provide insight on how to develop fair, effective, and efficient consolidated services by focusing on organizational approaches currently allowed under North Carolina state law, and to flag and highlight considerations that should be addressed during evaluation and implementation. In a 2019 briefing paper, [*Utility Strengthening through Consolidation*](#), the US Water Alliance defines the three general approaches to water sector consolidation as direct acquisition, joint merger, and balanced merger, which are defined below.

Direct Acquisition

Direct Acquisition refers to one higher-capacity utility absorbing another in its entirety. The utility being acquired ceases to exist altogether and the acquiring utility takes on the assets, operations, and customers of the acquired utility. In this scenario, Utility A acquires the assets and customers of Utility B. Utility A subsequently owns and operates Utility B's facilities, and the customers of Utility B now pay Utility A directly. At the end of the consolidation, there is only Utility A.

Joint Merger

A joint merger involves two or more utilities often, but not necessarily, of similar capacity consolidating to become a new entity that is jointly owned by the participating utilities. In this scenario, Utility A and Utility B both contribute their individual system revenues and assets to create a new Utility C. Each utility modifies its previous independent governing structure and participates in forming a new joint governance structure in the new utility. At the end of the consolidation, there is only Utility C.

■ **Balanced Merger**

A balanced merger is a hybrid of the other two types and involves two or more utilities consolidating and creating a governance structure that is designed to allow for participation by the previously existing utilities in future decision-making. The primary difference between this approach and the Joint Merger is that, like a Direct Acquisition, one utility may be acquiring another rather than both contributing equally to form something separate.

In this scenario, Utility B merges with Utility A. The assets, operations and customers of Utility B now are all a part of Utility A; however, a new or modified governance structure is created which provides some say in decisions such as rate setting and design from representatives of Utility B. One example would be the creation of an advisory board which has seats allocated for any merged communities.

While the approaches described above cover a large range of consolidation models, they all rely on a consolidation process occurring which involves some type of merger or acquisition. Much has been written about the impacts of consolidation including a series of [case studies](#) prepared by the Environmental Finance Center at the University of North Carolina at Chapel Hill (EFC), but less has been written on the process behind consolidation. These utility transformations can be complex and challenging to implement. This guide is designed to help communities considering consolidation navigate some of the challenges.

This guide is not designed to cover more basic types of regionalization such as using an interlocal agreement to allow one utility to buy treated water from another utility. The EFC recently updated a considerations guide related to this matter, [Crafting Interlocal Water and Wastewater Agreements](#).

1. Water and Wastewater Service Provision Models in North Carolina and their Role in Consolidation

A variety of governance models exist for providing water and wastewater services in North Carolina. In many situations, a unit of government—such as a municipality or county—provides service primarily to the residents in its jurisdiction; however, there has been an increasing trend in the development of regional utilities in which multiple existing utilities merge to provide services to a larger geographic area or one utility¹ expands and begins providing services well beyond its traditional border or governmental jurisdiction. North Carolina law provides multiple legal pathways for the creation and management of these utilities. While there are many similarities in how these different types of regional utilities operate, there are important differences depending on what type of enabling legislation created them. The major forms are described below.

1.1 Single municipality operating as a regional utility

Model At A Glance

- Multipurpose local government utility model with far reaching authority
- Governed by city council
- Prevalence in NC: Common, 10 to 15²
- Primary Authorizing Statutes: G.S. § 160A, Article 16

Pro

Can integrate general city management, planning, and economic development with utility operations

Con

Customers that live outside city limits may feel like they do not have a voice in utility management since they do not vote for a utility

Multiple cities in North Carolina manage utilities that serve customers outside their boundary. It is a common practice for a municipal utility to extend their lines slightly outside their boundary and to charge “outside customers” different (typically higher) rates. Although less common, some cities have followed a more regional strategy that has involved expanding their service area to take over service areas of entire neighboring cities and to

¹ For the purpose of the paper, the term “Utility” is used to reference a unique governance structure that oversees the provision of water and/or wastewater services to a customer base. State law, the Safe Drinking Water Act, and the Clean Water Act have subtle differences in how they view water and wastewater utilities and “systems.” The most reliable source of information on utilities is maintained by the Local Government Commission for governmental utilities and by the Safe Drinking Water Information System for water systems. The two sources are used for the analysis and statistics presented in this paper.

² There is no set definition for what determines a regional city utility. This number is an estimate.

set up policies and rates where all customers are treated relatively equally. For example, the City of Charlotte’s water utility ([Charlotte Water](#)) provides water and wastewater services throughout the entire Mecklenburg County metro area, which includes six other towns. While Charlotte Water owns the water and wastewater assets and the Charlotte city council maintains ultimate legal responsibility and authority for the utility, a series of agreements stipulates a number of consensus-supported governance conditions related to service expansion and rates, making Charlotte Water a unified regional utility.

In another example, starting in 2000, the [City of Raleigh’s](#) water and wastewater utility transformed from a single, city-focused utilities department to a regional, full service provider by entering into separate interlocal agreements with Raleigh’s surrounding communities. Each consolidation agreement allowed for Raleigh to provide all aspects of water and wastewater provision, including asset ownership and customer service. The result is one consolidated utility that is built upon multiple interlocal agreements and merger transactions. North Carolina also has several utilities linked to municipalities but governed by special legislation that operate regionally with some requirements not shared by other municipal utilities, such as [Fayetteville Public Works Commission](#).

1.2 Single county government

Model At A Glance

- Multipurpose local government utility model with far reaching authority to serve large areas
- Governed by county board
- Prevalence in NC: Common, 10 to 15³
- Primary Authorizing Statutes: § G.S. 153 A, Article 15

Pro

Can integrate general county management, planning, and economic development with utility operations

Con

Can be difficult to coordinate with municipalities that have legacy systems

While North Carolina cities have historically played a bigger role in water and wastewater provision in the state than county governments, county government-owned utilities in a number of areas have evolved into the dominant regional providers serving customers that live in multiple incorporated cities as well as other counties. For example, [Harnett County](#) provides service to 125,000 people in multiple counties and cities, most of whom pay the same rates and operate under the same policies. County systems are governed by elected county commissioners but other local governments may have the opportunity to provide nominal governance input similar to what can be done for regional city utilities.

³ There is no set definition for what determines a regional county utility. This number is just an estimate.

1.3 Joint Management Agency

Model At A Glance

- Creates a multi-utility shared governance structure
- A statutory defined type of inter-local agreement
- Prevalence in NC: Limited, likely less than 5
- Primary Authorizing Statutes: G.S. § 160A-460, § 160A-466

Pro

Allows for more integrated joint management

Con

Joint management agencies cannot own assets (assets must be owned by one of the participating utilities)

The Interlocal Cooperation Act allows local governments to jointly establish a special type of interlocal agreement called a **joint management agency**.⁴ Joint management agencies maintain some authority that resembles an autonomous utility, but they lack the full set of powers that would designate them as a truly independent entity or local government. The statutes provide very general authority with respect to the partnership. They provide permissible mechanisms for generating revenue, essentially providing general authority for any unit of local government to enter into contracts with any other unit of local government in North Carolina or another state, to the extent allowed by law. One key restriction related to water and wastewater agreements that might be executed under this provision is that a joint management agency is not permitted to hold legal title to property⁵. This authority has been infrequently used in the water sector in the state, but there are a few examples, including the [Winston Salem and Forsyth County Utility Commission](#).

1.4 Water and Sewer Authority

Model At A Glance

- A special purpose unit⁶ of government focusing on water services
- Can be used to consolidate all utility operations or a portion of operations such as water supply and treatment
- Governed by an appointed board
- Prevalence in NC: Approximately 15
- Primary Authorizing Statutes: G.S. § 162A, Article 1

Pro

Permits a range of governing board options

Con

Cannot use taxes or issue general obligation bonds

⁴ See Interlocal Cooperation Act, North Carolina General Statutes (hereinafter G.S.) § 160A-460 - § 160A-466.

⁵ See also G.S.. § 160A - 462.

⁶ Special purpose units describe units of government that specialize in one sector or service rather than providing many services such as a city or county.

Existing utilities and local governments that want to join together to form a new utility have the possibility of creating a water and sewer authority under North Carolina law⁷. The statutes are very specific about some financial powers of authorities, such as allowing them to set user fees and issue revenue bonds, and prohibiting them from setting property taxes or issuing general obligation debt. However, the statutes provide broad discretion on governing board creation, and allow the initial establishing entities to set the number of board seats, the number of seats allocated to each member unit, and the criteria or qualifications for board member appointment. This governance approach can allow communities that transfer their assets to the authority to retain some control and a formalized role in governance decisions through their board member appointments. The authority structure has been used to create utilities such as [Orange Water and Sewer Authority](#) and [Onslow Water and Sewer Authority](#) where multiple governments came together to create a large area retail utility that is responsible for all aspects of treatment, distribution or collection, and customer service. There have also been authorities created to provide one aspect of water service such as raw water distribution ([Lower Cape Fear Water and Sewer Authority](#)) or wholesale wastewater treatment ([Water and Sewer Authority of Cabarrus County](#)).

1.5 Metropolitan Water District and Metropolitan Sewerage District

Model At A Glance

- Special purpose units of government with broad powers
- Governed by appointed boards
- Prevalence in NC: less than 5
- Primary Authorizing Statutes: G.S. § 162A, Articles 4 and 5

<p>Pro</p> <p>Permits a range of governing board options</p>	<p>Con</p> <p>Can be difficult to create</p>
---	---

North Carolina also has specific statutes authorizing metropolitan water districts⁸ and metropolitan sewerage districts⁹ that have some similarities to water and sewer authorities but which have been used less frequently. Unlike authorities, they require a referendum to be created. Additionally, these districts have broader powers than authorities which enable them to levy property taxes and issue general obligation bonds as well as rates-backed revenue bonds.

⁷ See G.S. § 162A.

⁸ See G.S. § 162A, Art. 4.

⁹ See G.S. § 162A, Art. 5.

1.6 Sanitary District

Model At A Glance

- Special purpose unit of government with wide authority
- Popularly elected governing board
- Prevalence in NC: A number of legacy districts exist (more than 20) but a few new ones have been created
- Primary Authorizing Statutes: G.S. § 130A - 47-85

Pro

Creates a powerful new unit of government

Con

Can be difficult to set up and coordinate authority with existing units of government

North Carolina allows for the creation of **sanitary districts** that, while similar in name to metropolitan sewerage districts, have a very different make-up and set of powers¹⁰. Sanitary districts were originally seen as a method of providing a range of public health services to areas of the state without other governmental capacity. Some sanitary districts provide service to very small geographic areas, but some (such as [Cleveland County Water](#) and [Roanoke Rapids Sanitary District](#)) have evolved into more regional providers. Sanitary districts are the only water service special-purpose local government unit with directly elected governing board members, similar to the process of choosing city council members and county commissioners. Sanitary districts also have far-reaching taxing authority and can issue revenue bonds.

1.7 Private Nonprofit Associations/Water Cooperatives

Model At A Glance

- A special category of tax-exempt non-profit corporations
- Member owned
- Prevalence in NC: 10 to 15
- Primary Authorizing Statutes: IRS section 501 (c) (12) (US Tax Code)

Pros

Flexible management and organization possibilities; Typically focus on a single public service

Con

Fewer capital funding options

There are several important non-governmental regional utility models operating in North Carolina. Water cooperatives/non-profit water corporations are similar in form and function to those in other states and operate throughout the state. [Davidson Water](#) is one of the largest non-profit water corporations in the country, serving over 50,000 connections through a large geographic area in the state. Water cooperatives are not regulated in any way by either local government boards or the North

¹⁰ See G.S. § 130A, Art. 2, Part 2.

Carolina Utilities Commission. Instead, these utilities are governed by Boards of Directors that are elected by their member customers often during an annual member meeting. Under this model, the Board of Directors has wide discretion in managing the utility and can enact policies that promote or deter regionalization. Water cooperatives do not have taxing authority. These utilities are most prevalent in rural areas and have relied on subsidized USDA water program funding for most of their capital financing. Some larger water cooperatives with strong credit have also been successful accessing private loans through commercial banks.

1.8 Investor-Owned Utilities

Model At A Glance

- Governed by investor owner and regulated by NC Utilities Commission
- Primarily serve subdivisions (do not serve any significant areas of cities)
- Prevalence in NC: Hundreds of small systems primarily serving unincorporated communities but many of them are owned by a few large companies
- Primary Authorizing Statutes: § G.S. 62

Pros

Able to share resources over multiple systems and large geographic basis

Con

Fewer capital funding options

For-profit water companies provide service to many suburban and large subdivision customers throughout North Carolina, but provide relatively little service to customers within incorporated areas. [Aqua NC](#) and [Carolina Water Service](#), two of the largest consolidated private providers in the state, own and manage the assets of hundreds of community water systems in the state that provide water and, to a much lesser extent, sewer services to hundreds of thousands of residents. Private utilities are generally under the oversight of the North Carolina Utilities Commission. Under North Carolina Utilities Commission regulations, investor-owned utilities are permitted to use single tariff pricing such that all their costs are pooled across all their separate systems across the state and almost all their customers pay the same rates regardless of where they are in the state.

Many regulated utilities have stated that they believe new “fair market value” legislation codified in G.S. § 62-133.1A may provide a new opportunity for private utilities to purchase and add existing water systems to their network by changing the way the acquired systems can be valued. This new valuation can create incentives for existing system owners, particularly local governments, to sell their systems and receive a one-time source of funds that can be used for non-utility purposes.

2. Consolidation Considerations

This section presents some of the important considerations that should be addressed when creating new or modifying existing utilities.

2.1 How will the feasibility of consolidation be evaluated?

When a new consolidation of services is being considered, it is important to carefully evaluate the feasibility of different options depending on who is at the table, what assets are already in existence, what the drivers for consolidation are, and what will be the likely financial projections for each of the communities. In some cases, a utility's need may be a resolution for a failing system that can't be replaced. In others, there may be a challenging or unattainable regulatory compliance need. And for others, there may be long-term water supply concerns that would be better approached from a regional standpoint than by an individual utility. Regardless of the end goals, the first step in the process should involve determining *if* there is a path forward, and then what that path could look like and mean for everyone at the table.

Why is this important?
Sets the stage for all that follows

Setting the Stage with a Task Force or Other Collaborative Advisory Group

At the forefront of the consolidation process, it is essential to establish some simple ground rules for working together. What are the expectations of the entities at the table? What is the commitment level of the different entities in working toward a solution?

Additionally, it is key that entities have a consistent understanding of what the end goals are for the consolidation in order to move the process forward, despite the inevitable technical and financial challenges that will arise. If everyone is on the same page about what the ground rules will be, and agrees on the general goals of the consolidation, then entities can focus on identifying the tasks that need to be addressed and how they can work together to address those tasks.

Because of the complexity of the initial tasks, it is probably best to establish a small work group or task force to conduct the initial evaluation of consolidation options. The evolution of services to a more consolidated approach can be extremely challenging. There are many examples of communities that studied consolidation and identified options with significant benefits, but which never went from plan to implementation. It is essential that communities considering consolidation and the individuals involved in the process be open minded and willing to champion options that have clear community benefits, even if it means overcoming the status quo. Questions to think about in establishing such a group include:

- How will the communities be represented on the task force?
- What specific skills or interests should be represented?
 - o Engineering
 - o Finance
 - o Legal
 - o Planning
- Do some of the participants have credibility and leadership skills to champion findings if beneficial consolidation options are found?

Legal Counsel

During the initial evaluation process for consolidation, it is also important to ensure that all the communities have access to legal counsel to advise them on key decisions and to help them evaluate potential consolidation scenarios. Additionally, because consolidation may involve two or more systems merging into one, legal counsel are necessary to help systems protect their separate interests and, at the same time, look forward to becoming a single entity with shared interests.

Many consolidations involve relatively small systems that may not have staff attorneys. For these systems, there may be state or local resources to assist with free or discounted legal services during the consolidation process. In North Carolina, organizations such as the [UNC School of Government](#) and its [Environmental Finance Center](#) can use publications and direct advising to provide communities with an interpretation of existing laws and general guidance on things to avoid.

Soliciting Input from Customers and the Community

In some circles, the mention of the words “consolidation” or “merger” raise eyebrows and trigger resistance. This is understandable, given the community pride in ownership that accompanies many community-run systems. For many communities, the water and wastewater systems may feel like the backbone of the community, with the name of the town displayed proudly on the water tower. In rural areas, water and wastewater services are a sign of progress and opportunity: offering the possibility of industries operating in the area, providing a revenue stream to the county or municipality, and allowing for future residential and business development. Some of the questions where feedback may be important include:

- What does the current customer landscape look like? How do customers generally feel about water and wastewater provision in their community?
- What are the water and wastewater concerns facing customers that could be addressed by a consolidation?
- What opportunities (i.e. economic development) could consolidation provide for the communities?

- What role and authority will the community have in governing under different consolidation options?
- Will there be a change to the name/branding of the current systems?

For those consolidations that will involve a community's system being absorbed by another community, representatives from all communities or the task force should identify if there are ways to mitigate concerns of those customers. These accommodations can range from maintaining the name of a town on a water tank even if the town no longer owns the tank all the way to using interlocal agreements to provide the communities with authority over future utility expansion and rate setting.

Arranging Engineering, Facilitation and Planning Assistance

Assessing the feasibility of consolidation options will likely involve lots of technical and planning assistance and expertise early in the process. Entities will need to take inventory of things like individual system assets, current connections, current staff, water or wastewater needs, and capacity issues. Often the systems looking to consolidate are short-staffed and have not engaged in some of the more complex asset management practices that are helpful when evaluating the feasibility of consolidation options. Thus, for many entities, it will be necessary to first identify specific technical and planning assistance needs to facilitate the consolidation, and then to evaluate who may be able to assist with such needs. For systems with limited resources, the first step may be to see what sort of federal and state financial resources are available to help with planning efforts.

Depending on the complexity of the situation, thoroughly investigating and if appropriate deciding to move forward with consolidation could require engineering consultants, financial analysts, legal counsel, and skilled external facilitators. While an organization or company may claim to be able to offer all these services, communities should carefully assess the experience and expertise of the organizations they work with. Often an organization has strength in one area but very limited strength in another area. It is imperative that the communities involved trust in the competence and impartiality of those assessing consolidation options. This often prevents reliance on advisors that have long-term relationships with one, but not others, of the communities involved to avoid concerns about partiality. In some situations, the same advisors that help evaluate consolidation options may look to be involved in the implementation. For example, an engineering firm that studies costs of different options may later wish to be hired to design projects needed to implement consolidation or conversely some of the options may impact their business in the future. For instance, an engineering firm that has traditionally worked for a small community that is considering a merger may lose a client if the merged system uses another engineer in the future. Most professionals will be transparent and disclose these types of issues, but these perceived conflicts of interest have led some funding agencies to prohibit engineers and others that study consolidation from actively being involved with the construction projects that may be needed.

Entities should identify all costs associated with evaluating the feasibility of a consolidation, planning for the consolidation, and transitioning the systems. Entities should agree on how such costs can be shared between the participating entities and if there are sources of financial assistance at the state or federal level that can help offset some of these planning costs.

Transparent financial analysis and potential future scenarios

Not surprisingly, one of the first questions that will arise when examining consolidation options is how any change will affect both the budget and customer rates. There will likely be a variety of financial options and impacts, and a transparent process for evaluating and deciding on such options is essential to addressing concerns about the consolidation. In some situations, it may be beneficial to create an even smaller focused task force just to look at the financial possibilities for any consolidation model. Such a group will want to effectively communicate and document the various options for projected future finances after the consolidation. They will also want to clearly identify who has conducted any financial analysis and how it was done to ensure a feeling of accountability for all involved. Because different situations will likely benefit entities differently, the task force will need to create a process for how future scenarios will be evaluated. Specifically, consideration should be given to the possibility for a voting or approval process, and how all entities can be represented in the decision making for any potential scenarios.

2.2 How will the physical assets of the systems be valued?

As is discussed above, entities must identify early on in the consolidation process what their current assets are and a transition plan for multiple systems' assets working together. But once a consolidation seems feasible from an engineering and planning standpoint, many of the key financial questions and issues will have to be dealt with in order for the systems to successfully move forward.

Why is this important?

Water system assets are often the most valuable thing a government owns

One of the first financial issues that will need to be addressed is valuing the assets that will be transferred. There are several different valuation approaches that may be appropriate for different situations, however, in most cases, the final valuation approach takes on some combination of the following:

- Book Value – What is the value based on generally accepted accounting principles?
- Cash Flow Value – What is the value based on the future revenues and costs related to the assets?
- Market Value – What if any comparable asset transactions have occurred in the market?

It is important to recognize that there may be different views about the value of assets. For example, an entity acquiring asset(s) may be most concerned about the regulatory and future financial liability they are acquiring along with the assets and as a result place a low or no value on the assets. It may be the case that the acquiring entity does not even plan on using some of the physical assets that get transferred. On the other hand, the entity transferring asset(s) may consider all their past investments in the assets and expect some reimbursement. Also, having a utility may have allowed the community to share costs among different services in a way that will not be possible after the transfer. For example, utility revenue may have covered part of the salaries of employees tasked with both utility and non-utility tasks. Eliminating the utility will mean eliminating the revenue that went to these shared services.

Different perspectives can lead to different expectations related to the financial transactions involving the consolidation. Each situation is unique, but the general financial transactions related to asset transfer/acquisition include:

- Acquirer purchases assets from transferring entity based on a mutually agreeable value
- Acquirer accepts assets at no cost as-is or after they have been improved
- Acquiring entity accepts customers and assets from transferring entity under stipulation that the transferring entity covers the construction costs of connecting the systems and/or purchases the capacity their customers will use in the other's system.

Many situations involve some hybrid of the above models. Coming up with a mutually "fair" transaction can be one of the more challenging aspects in merging utilities. While accounting has a role in asset valuation, a consolidation negotiator may also have to consider harder to quantify things such as community pride and the value of local control in determining the ultimate value of the assets to be transferred.

2.3 How will outstanding obligations and responsibilities be addressed?

Debt

Realistically, entities coming to the table to negotiate a consolidation may have existing debt on the system that they are considering transferring. Additionally, such a system is likely still providing a revenue source for the utility, which would be used to continue paying that debt. If an entity is going to transfer ownership of its system, the consolidation arrangement should address the question of how that debt can be covered after there is no longer revenue coming in from its utility. This may be an important factor in deciding how to value the assets.

Why is this important?

Prevents unwanted surprises

Staffing considerations

Consolidations can have multiple staffing impacts – in some situations staff from different utilities have different salaries and benefits that must be harmonized. In other situations, a consolidated system may need fewer staff than separate independent systems. For many small communities, the staff (and equipment) that maintains the water system may also be essential for non-utility services such as landscaping, snow plowing, building maintenance, etc. In some situations, the consolidation arrangement may include some new positions for staff, which can be offered to staff of the transferring utility. Additionally, it's possible that some of the service needs of a small community could be addressed as part of the consolidation agreements.

2.4 What impact will consolidation have on customer rates?

Establishing how rates will be adjusted as part of the consolidation process is likely the financial decision that will draw the most attention of customers and local government leaders. Consolidation of water and wastewater systems is often thought of as having the ability to lower future rates for systems where high regulatory costs, infrastructure needs, and debts may appear to be driving rates upward.

However, lower rates following a consolidation are not a guarantee, and even where rates will be lower in the long run, customers may not see reductions immediately. In many cases, the financial benefits of consolidation are offset by the costs of addressing regulatory requirements, so while customers don't see any immediate changes, future rates and rate increases are lower than they would have been without consolidation efforts. If rates among nearby utilities differ significantly prior to consolidation and the difference has created conflict or a sense of unfairness, equalizing the rates among all the different utilities may be just as important a consolidation goal as reducing rates.

Why is this important?

Often most important customer concern

When two or more utilities with different customer rates are combined, there are multiple approaches to modifying rates immediately after the consolidation and into the future. Utilities with higher rates going into a merger and which required significant capital expenditures to complete the interconnection may be asked to continue to pay higher rates for a certain period to pay off the investments or they may see their rates reduced immediately but are asked to pay a capacity/connection charge (see section 2.2). In other cases, the economics may be favorable such that rates of different systems can be equalized without significant additional costs to either party.

2.5 How will the consolidated utility be governed?

As is discussed in the first section of this guide, there are many governance models for consolidation, and there will be a slightly different list of considerations and questions depending on the model that is selected. To start off, the entities need to determine what type of model will serve their needs best.

Why is this important?
Governance will impact every aspect of service provision

The feasibility assessment should address governance issues as well as technical issues that will impact different consolidation options. Some of the specific drivers and circumstances that might influence this decision include:

- Number of utilities
- Size of combined service area
- Anticipated growth or decline in the area to be served
- Financial health of partnering entities
- Future cost of meeting regulatory requirements

While in some cases forming a new entity such as an authority will offer the needed structure, there are a variety of other creative arrangements and tools that entities can use to consolidate that will not include forming a new entity.

For many of the models described in Section 1, a new entity will be formed, which will require participating entities to establish a new governance structure that will be responsible for future management decisions. One common governance option analysis will be related to a board of directors, which is required. Some of the key decision points that entities will need to think through include:

- Number of board seats
- Rationale for assigning board seats
- Number of utilities on the board
- Rate setting process

For example, can seats be based on expertise rather than utility or community representation? In other words, if the end goal is having a board that can advise on how rates should be set, is it possible for an engineer, a finance expert, a regulatory compliance specialist, etc. to serve on the board?

It is important to note that some of the current models for forming governing boards have not thoroughly addressed two key questions:

1. How can boards modify their make-up if unincorporated areas in their service area later incorporate and seek representation; and
2. Is there potential for future modifications to the board if additional communities consolidate/merge?

These and other questions should be some of the key discussion points in working through any new governance structure for any new consolidated utility.

2.6 How will disputes be resolved?

Entities should think through how conflicts should be handled early in the process. Whether there is a formal dispute resolution process depends on the consolidation model that will be used. In some situations, entities may wish to just use their individual legal counsel and resolve things through traditional litigation routes if conflicts arise. But, particularly with partnerships involving multiple systems that do not have their own staff attorneys, there are some contractual options for setting up a process that will help systems navigate conflict more efficiently and effectively.

Why is this important?
Some disagreements are inevitable

Local governments in North Carolina may opt to voluntarily agree to binding arbitration but may find that process limiting. Binding arbitration will prevent any participating entity from appealing the decision and will also preclude the entities from an opportunity to move into formal litigation if the arbitration does not resolve an issue. Thus, entities may instead choose to include language requiring a non-binding mediation process, which preserves the option for formal litigation if necessary.

Conclusion: Putting it All Together

Water and wastewater systems face many challenges and in some cases, well implemented consolidation may provide an opportunity to maintain or improve service more cost effectively than less consolidated service models. It is a management solution that requires commitment, intention, and patience. This document provides communities with basic information on consolidation models in North Carolina as well as guidance on the types of questions that should be addressed when considering this approach. The document does not provide a single road map for communities considering moving to a more consolidated service model because there isn't a single road map – water and wastewater systems and communities differ in important ways. The appropriate path will depend on local conditions, but the material in this document can provide structure and guidance to communities that choose to look into this important approach.

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