AD-HOC FRANCHISE AGREEMENTS

COMMITTEE AGENDA

May 3, 2016 –North Conference Room

21630 11th Avenue South – Des Moines 98198

7:30 a.m.-9:00 a.m.

1. Approval of minutes of the April 25th Committee meeting.

2. Discussion of Staff's Discussions with District Staff and Attorney on the Eight Unresolved Issues.

3. Discussion of next steps/proposal.

MINUTES

Ad Hoc Franchise Committee Meeting
Monday, April 25, 2016
7:30 a.m. – 8:30 p.m.
South Conference Room

Council Members	City Staff
Chair Matt Pina	Tony Piasecki, City Manager
Dave Kaplan	Dan Brewer – PBPW Director
Melissa Musser	Brandon Carver – Engineer Services Manager

Chair Pina called the meeting to order at 7:30 a.m.

1. **Approval of minutes of the March 3rd, March 22, and April 19th Committee meetings.**
   The minutes of the March 3rd, March 22, and April 19th Committee meetings were approved

2. **Discussion of April 20, 2016, meeting with Utility Districts.**
   Chair Pina and City Manager Piasecki provided the Committee a summary of the meeting held with the utility districts on April 20th. The Midway Sewer District provided a list of their bottom line positions on the following items:

   - The franchise fee must be $500 per year or a one-time fee of $5,000.
   - The term of the franchise must be at least ten years.
   - The franchise payment must be as follows:
     - 4% for 2016-2019
     - 5% for 2020-2022
     - 6% for 2023-2025
   - No "hook"/no auto renewal
   - Relocation: 50/50 split cost

   The City and the Districts then discussed the list of eight outstanding issues that the Committee had discussed at its last meeting. The eight issues and the current status or next steps on each are as follows:

   1. Relocation – Dan to discuss with District staff.
   2. Franchise Annual Fee – Tony and Dunyele to review cost. Dan reported actual staff cost on annual basis strictly for franchise administration is minimal. We may be willing to reduce the annual fee to $2,500. Dan will provide examples of non-ROW permit fee work that staff does with regards to managing utility franchises.
   3. Hydrants – Tim to discuss with attorney for Districts (Milne). Pat is getting additional information from WSAMA conference next week April 27-29 to assist

in legal arguments. We may propose leaving out any reference to the fire hydrant/fire suppression issue.

4. Franchise Percentage Payment – Tim to discuss terms regarding legal challenge. made by ratepayer with Milne. We will try to come up with a different name for this payment.
5. Abandoned Facilities – Dan to discuss with District staff.
6. Vacation - Dan to discuss with District staff.
7. Definition of Revenue/late payment fee/timeframe – Tony discussed with Dunyele. City will likely agree to use District definition. We may also be willing to reduce the late payment fee and increase the time frame for payment.
8. Term – City and District tentatively agreed to 10 year initial term with one 5 year extension unless notice given by either party prior to 180 days of end of first term.

3. Discussion of next steps/proposal.

The Committee will wait to discuss next steps until after staff has worked through the discussions as outlined above.

Adjourned at 8:30 a.m.
Respectfully submitted by,
Tony Piasecki, City Manager

TALKING POINTS: FRANCHISE NEGOTIATIONS WITH WATER AND SEWER DISTRICTS

by

Tom Brubaker
Kent City Attorney

WATER-SEWER DISTRICT FRANCHISES

King County v. Algona, 101 Wn.2d 789 (1984)

- Algona tried to impose B&O tax on King County's solid waste utility
- Solid waste handling is a governmental function
- One municipality cannot tax another municipality without express statutory authority

WATER-SEWER DISTRICT FRANCHISES

***Okeson v. Seattle*, 150 Wn.2d 540 (2003)**

- Customers are metered for their actual electricity use, but
- Customers aren't metered for street lights; street lights are for everyone
- Providing electricity is a proprietary, or business, function
- Providing street lights is a governmental function.

WATER-SEWER DISTRICT FRANCHISES

***Okeson v. Seattle*, 150 Wn.2d 540 (2003)**

- Footnote 4:

  Although city electric utility can't charge customers for streetlights, it's OK for a water-sewer district to do so….

WATER-SEWER DISTRICT FRANCHISES

Lane v. Seattle, 164 Wn.2d 875 (2008)

- Metered water to residents and businesses is a proprietary function
- Water for fire hydrants* is a governmental function
- City water utility can't charge customers for part of water system that serves fire hydrants
- Caused tax workaround gambit within cities

WATER-SEWER DISTRICT FRANCHISES

Burns v. Seattle, 161 Wn.2d 129 (2007)

- Seattle charged tax on all electric utility revenue, including customer revenue from outside Seattle.
- Areas outside Seattle incorporated—could Seattle continue to impose utility tax?
- Court approved contract between cities that charged amount equal to tax in exchange for new city promise not to form its own electric utility.

WATER-SEWER DISTRICT FRANCHISES

Wenatchee v. Chelan County P.U.D. No. 1, 181 Wn.App 326 (2014)

- *Algona* misunderstood: City *can* tax other municipality utility within its boundaries
- *But only* for that portion of service that is proprietary, not governmental.
- How to decide what part of water in pipe is proprietary and what part is governmental?

WATER-SEWER DISTRICT FRANCHISES

- So, solid waste, street lights, and fire hydrants operated by a separate special purpose district in a city are all

Governmental and not taxable

- But, water, sewer, and drainage operated by a separate special purpose district in a city are all

Proprietary and taxable

WATER-SEWER DISTRICT FRANCHISES

- Plus, no cap on amount of utility tax a city can impose on water, sewer, or drainage utilities, whether operated by city or operated by a separate municipality.
- *Wenatchee* is a court of appeals, Div. III, decision; never appealed.
- With all this confusion and with the right to bargain provided in *Burns,* water-sewer districts have begun to consider franchises to settle the confusion.

WATER-SEWER DISTRICT FRANCHISES

Franchise Proposal Framework

District to pay city amount essentially equal to agreed utility tax rate on gross revenues on all operations—proprietary *and* governmental— in exchange for promise not to assume district within city boundaries.

WATER-SEWER DISTRICT FRANCHISES

Franchise Terms

- "Revenue" definition:
  - Based on gross receipts—
    - Should be all gross receipts from operations,
    - Should not include money received to fund capital investment
  - Scrutinize proposed definition closely
    - Telecommunications? Street lights?

WATER-SEWER DISTRICT FRANCHISES

Franchise Terms

- Term of franchise:
  - District will want long term—up to 20 years
  - District needs certainty
  - But a short term provides city more flexibility
  - Likelihood that case law or statutes may change balance increases with length of term

WATER-SEWER DISTRICT FRANCHISES

Franchise Terms

- Payment percentage:
  - Under current law, no cap on city's utility tax; city can tax district on proprietary functions same as city taxes its own utilities
- District will want low tax rate—
  - Start at 1% or 2%
  - 1% annual increase; council motion
  - Up to 6% cap

WATER-SEWER DISTRICT FRANCHISES

Franchise Terms

Fire hydrant responsibilities:

- *Lane* said fire hydrants are government's responsibility
- But *Okeson* said the same, then made a special exemption for water-sewer districts.
- Legislature has clarified that provision of water for people is inextricably wrapped with water for fire. Chapter 70.315

WATER-SEWER DISTRICT FRANCHISES

Facility relocation requirements:

- Utility will want city to pay as much as possible when city requires relocation
- These are your streets. Your city purchases, designs, builds, maintains, etc.
- Utility should have some relocation reimbursement in certain instances—installed in last 5 years?

WATER-SEWER DISTRICT FRANCHISES

Coordination of planning documents:

- Don't allow district to control your land use plan by limiting water availability

Court or legislative invalidity of **fee** agreement:

- If this occurs, abrogate franchise, don't allow remainder to stay in effect

TALKING POINTS: FRANCHISE NEGOTIATIONS WITH WATER AND SEWER DISTRICTS

by

Tom Brubaker
Kent City Attorney

TALKING POINTS: FRANCHISE NEGOTIATIONS WITH WATER AND SEWER DISTRICTS

by

Tom Brubaker, Kent City Attorney
April 29, 2016

Some cities in Washington operate their own water and sewer utilities, some have water and sewer provided by utility districts, and some have a mix of both. These districts are separate municipal corporations, formed under Title 57 RCW. Understandably, they tend to want to preserve their own existence and can be fiercely territorial, resisting any attempt by cities to regulate, limit, or remove district authority. A prime area of district resistance is in the area of taxation. Districts have long held that a city has no authority to charge a utility tax on district operations. Some districts, too, assert they do not even need a franchise to operate in city streets.

But water and sewer district commissioners have, almost without exception, lived in fear that a city would assume their district. Cities have the right, essentially by the stroke of a legislative pen, to take over water-sewer districts to the extent the district's boundaries lie within the city's corporate boundaries. RCW 35.13A.020-.050. Districts have strongly resisted any city's attempt to assume them, however, never hesitating to spend a significant amount of time and money to litigate the action and the process.

A series of court decisions has tossed a large degree of legal and financial uncertainty into this tension between cities and water and sewer districts. The result is that some districts are reaching out to cities and seeking contractual agreements in the form of street franchises to resolve the uncertainties that now exist under Washington law.

LEGAL BACKGROUND:

This series of court cases supports the context behind these requests for franchises:

- *King County v. Algona*, 101 Wn.2d 789 (1984). This decision held that the city of Algona could not impose a B&O tax on King County for the county's operation of a solid waste plant. The court said solid waste operations are a part of general government. King County was immune Algona's attempt to impose its B&O tax because the state constitution doesn't allow one municipal organization to tax another.

  For years it was generally accepted that this case finally determined that a city cannot impose its utility tax on a water-sewer district.

- *Okeson v. Seattle*, 150 Wn.2d 540 (2003). This case distinguished SPU's street lighting rate from its electrical rates. The court held that street lighting was a general government service, unlike the provision of electricity, which is a proprietary (business-like) service.
    - General government services revenue comes from taxes; rates pay for specific, individual, metered usage; rates for street lighting are really just *de facto* taxes because no one "owns" their streetlight—they are there for everyone's use, not just a single ratepayer; charging ratepayers for street lighting then amounts to imposition of an unconstitutional tax.
    - City of Seattle, not SPU, had to pay for all street lighting, and SPU had to pay back its customers for 3 years of wrongly billed street lighting charges.
    - The court stated in a footnote (footnote 4) that water and sewer districts had separate authority to provide street lighting and include it in the district's rate structure.
- *Lane v. Seattle,* 164 Wn.2d 875 (2008). This case extended the street lighting rationale of *Okeson* to fire hydrants. It declared that the provision of fire hydrants (implying, but not stating, that the total cost of fire suppression) is a general government service. Seattle had to pay for hydrants/fire suppression out of its general fund (i.e., tax) revenue and SPU could not include the cost of that function as part of its water rates.
    - This caused a weird work-around where cities raised their internal utility tax on their water utilities, so that the utility paid more tax to the general fund, and the general fund then, in turn, paid the utility back for the provision of fire hydrants.
    - Again, the court did not decide whether a utility can or cannot provide fire suppression services; it left that question open (unlike the *Okeson* court). It only decided that that cost was not chargeable through utility rates because it was a general governmental service.
- *Burns v. Seattle*, 161 Wn.2d 129 (2007). The court approved a unique workaround to Seattle's utility district taxation challenge: a city could agree by contract not to assume the district and, in exchange for that forbearance, the district could agree to pay a percent of its gross revenues to the city. In essence, the district would be "buying" a promise from the city not to be assumed for a term of years by agreeing to pay the city an amount equal to the same percentage of the district's gross revenues as the city would charge if the utility were subject to a utility tax. The court viewed the gross revenue fee as a purely contractual arrangement, and because the negotiated contract was just another cost of doing business, it was not a tax.
- *Wenatchee v. Chelan County P.U.D. No.1*, 181 Wn.App 326 (2014). This case modified the *Algona* decision. It clarified that a city can tax a special purpose district, but only for that portion of the district's operations within the city's boundaries that are proprietary in nature and not governmental. The *Okeson* and *Lane* decisions make it clear that fire hydrants (suppression) and street lights are governmental services and not subject to utility taxation. Provision

of water, generally through meters, is proprietary and subject to taxation. (Sewer service is also proprietary.)

So, solid waste, street lights, and fire hydrants are general government services, but water and sewer are proprietary services. Cities cannot impose a utility tax on general services, but they can for proprietary services. Plus, state law does not limit the amount of utility tax a city can charge—many cities have utility tax rates ranging from ten to twenty percent.

With part of their system taxable and part not and facing potentially steep tax rates, some water and sewer districts are looking to the contractual solution approved in *Burns* to secure certainty and control over their revenue stream. The basic bargain is that a city agrees not to assume a district for a period of years, and in exchange, the district agrees to pay a franchise fee that acts as a substitute for utility tax revenue.

FRANCHISE TERMS TO CONSIDER:

As you consider entering into a franchise, consider some of these issues:

1. "Revenue" definition. Utility tax is generally imposed on the gross revenue of the utility. Water and sewer districts can receive revenue from streetlights, telecommunications providers, system development charges, late fees, penalties, and interest. The districts will want to limit these income streams. All of these should be thoughtfully considered when defining the revenue that will be subject to the franchise fee.

2. Term. You can expect a district to want as long a term as they can bargain for. Again, districts issue debt, invest in infrastructure, and have to make long-range plans for their future. They are looking for long-term certainty that the city will not take their jurisdiction away.

   Remember, there can and likely will be changes in legislation and in case law that might cause the deal you strike to become more unfavorable than the new laws allow. Look to shorten the term so that your city is not locked into this contract in the event the law changes in your favor.

3. Franchise payment. Under the *Wenatchee* decision, your city can impose a utility tax on a district's water—not fire—operations right now, and the district theoretically could do nothing about it. Balance that option against any franchise fee proposal a district makes.

   The kicker here is that water for commercial and residential use and water for fire both run in the same pipe. Fire systems require larger diameter pipes to maintain fire flows and they require higher pressure than generally required for residential and commercial purposes. Any attempt to apportion a single system like this involves guesswork, and guesswork can lead to disagreement, and disagreement can lead to litigation.

   Some districts propose a graduated franchise fee payment, starting low at one or two percent, then—if your council votes to increase it—raising it not

more than once a year in one percent increments to a total fee of six percent.

Plus, the *Wenatchee* case is a court of appeals case only. Division 1 or 2 may decide the case differently, and then all bets would be off until the Supreme Court settled the matter once and for all.

I see no reason at all to implement the fee over a period of years. Increasing the fee gradually softens the blow for the utility's customers, but it constantly puts the issue back on your council's back and each year puts them in the place where they are raising rates (customers will see them as taxes) year after year. Better for your city to bite the bullet and get it over with all at once and get the full revenue stream, rather than to go through the process again and again, year after year.

You can expect districts to adamantly oppose any franchise fee in excess of six percent of the agreed gross revenues, drawing a parallel with the six percent cap cities have with other independent utilities like power and telephone. It is not an unreasonable cap, but it has to be considered in light of the rest of the bargain—if your other franchise terms are not favorable—like a restrictive definition of the revenues subject to the fee—then your city could consider arguing for a fee higher than six percent.

4. Fire hydrant responsibilities. There is a tendency for districts to offer language that *assumes* the city is responsible for the provision, operation, and maintenance of fire hydrants. The applicable case law does not shift the responsibility to provide fire hydrants to the city; it only states that the provision of fire hydrants is a governmental activity not subject to a *city* utility tax. Nothing in the case law says a *utility district* cannot provide fire hydrants. The *Lane* court left this question open for water-sewer districts. The *Okeson* court, however, did specifically state that a special purpose district could provide and charge its ratepayers for streetlights. The provision of fire protection services is inextricably wrapped into the provision of water. See 70.315.010 RCW. We cannot predict what a court will do, but it seems just as likely that a court would decide a water district has the authority to provide and charge its ratepayers for hydrants just as it does for streetlights.

   The district language I have reviewed is carefully crafted to transfer the responsibility to provide hydrants to the district, but not to shift the *duty* to provide fire hydrants from the city. That could give rise to city liability where none should exist—e.g. for gross negligence in the maintenance of a system over which the city has no control. Plus, after clarifying that the city has the duty to provide fire suppression, then the agreement requires the city to indemnify the district for the system only the district controls.

   I recommend that any franchise agreement you consider say absolutely nothing about fire hydrants or fire suppression. The franchise agreement, after all, is about trading a city's right of assumption in return for payment of a fee. In so doing, the agreement clarifies and simplifies a complicated and

uncertain state of current law, but there is no need to raise fire hydrants at all.

Finally, for cities that do not even have a fire department—if they are covered by a fire protection district or a regional fire authority, your role in fire suppression is minimal. To the extent responsibility should be shifted around, that responsibility should be brokered between the water-sewer utility and the fire district or RFA. There is no reason for a city in that situation to get in the middle of that at all.

5. General facility relocation requirements. Once a district puts its facilities in your streets, they obviously would prefer not to move them. If the cost to move district facilities is steep, or if it has only been a short amount of time since the facilities were installed, they will ask the city to pay for some or all of the cost of relocation.

   When dealing with power and telecommunications companies, where state law does not allow us to charge any kind of a franchise fee, we typically require that those companies relocate at their cost upon our demand. But even that approach has been restricted by WUTC tariff and court interpretation of state law. Some sort of cost protection for recently constructed facilities is probably in order. But consider carefully the extent your city should pay for relocating utility district facilities in your city's roads.

6. Coordination of planning documents. It makes sense that the two entities may want to coordinate their short and long-term land use plans. But the agreement should be clear that the district acts in an advisory capacity and does not have veto power over the city's planning documents.

7. Court or legislative invalidity of franchise fee or agreement. If a court or the legislature decides or acts to render the fee agreement invalid, then I recommend that the entire agreement terminate at that point. The benefit of the bargain for cities is the fee; if the fee goes away, so should the other promises, including the promise not to assume the district.

CONCLUSION.

Cities have the authority to impose a utility tax on a special purpose district's water and sewer operations right now. The utility tax would not apply to the portions of their revenues incurred for the provision of fire hydrants and streetlighting. Taking this approach would give your city a continuous, reliable, predictable, recurring revenue stream.

But this has its dangers. *Wenatchee* is an appellate court decision that was not appealed to the state supreme court. A different division of the court of appeals could decide the case differently, upending the law and forcing an appeal to the supreme court to resolve the differing lower court opinions.

Plus, your district might attempt to describe as much of their operations as governmental as possible to reduce the amount of tax owed, and the city and the

district would have to bargain—or litigate—over which portion is or is not governmental.

Still, a city's ability to impose the tax is a very hefty bargaining point. Your city does not have to enter into a franchise. Your city does not have to waive its assumption authority. It need only do these things if it receives valuable consideration for that waiver.

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