



1106 Vernon Road • Suite A • Lake Stevens, WA 98258

(425) 334-8588 • Fax (425) 335-5947

Web Address: lkstevenssewer.org

January 23, 2019

RECEIVED

JAN 28 2019

CITY OF LAKE STEVENS

Sent via e-mail and certified mail

The Hon. John Spencer, Mayor
City of Lake Stevens
PO Box 257
Lake Stevens, WA 98258-0257
JSpencer@lakestevenswa@gmail.com

Re: Unified Sewer Services and Annexation Agreement

Dear Mayor Spencer:

This letter is a detailed response to the letter received on December 28, 2018 in which you raised numerous issues concerning the Unified Sewer Services And Annexation Agreement (“Unification Agreement”) entered into by the Lake Stevens Sewer District (the “District”) and the City of Lake Stevens (the “City”). I have previously acknowledged the District’s receipt of that letter. This letter will specifically address each of the items to which the City has requested that the District provide a response. Because the questions of Unification Agreement performance, in several of the cases raised by the City, are matters of contract interpretation, before getting to the specific issues you have raised, we have set forth an analysis of the necessary background components to allow those specific issue to be reviewed. As you will see, in an effort to be thorough, this letter is a collaborative effort of the District Commissioners, Staff and attorneys.

It is my hope that by going into some greater detail in this response, the District is able to put to rest some of the issues raised in the Letter so that the parties can begin 2019 with a goal of working productively together.

Unification Agreement. A brief review of the background surrounding the Unification Agreement helps provide context to that Agreement. Leading up to the 2005 finalization and execution of the Unification Agreement, the City System had significant deficiencies with a number of major components that were in marginal condition. At that time, the City did not have current revenues or capital reserve revenue to address the City System upgrade needs.

Also, leading up to the 2005 finalization and execution of the Unification Agreement, the District needed to design and build a new Treatment Plant which the parties agreed needed to be online by 2011 and its cost would be borne by District System and City System rate payers. The

District and the City anticipated growth in and around the City and expansion of the City boundaries. The parties determined that it was in the interest of both parties to have the District take over the ailing City System, the initial unification of the systems, to anticipate annexations and then with the New Treatment Plant, in the future, there would be an ultimate unification of the two systems in the hands of the City. Thus, the Unification Agreement was structured with these various aspects in mind.

To appreciate the structure of the Unification Agreement, Article 3 is a good starting place. That is the Summary of Sewer Services Transition Plan. It describes Step 1 (Section 3.1) and Step 2 (Section 3.2).

- 3.1 Step 1 provides for the transfer of the assets of the City System to the District after which the District shall own, operate and maintain the entire wastewater collection conveyance, treatment and discharge system in the UGA (the Unified Sewer System), until Step 2.
- 3.2 Step 2 provides for the ultimate transfer of the Unified Sewer System from the District to the City.

It is clear from Section 3.1 is that in Step 1, the District *shall own, operate and maintain the Unified Sewer System*. Article 4 establishes the implementation of Step 1. Section 4.1 requires the City to transfer the assets of the City System (not including the real property and certain specific assets) to the District on the effective date of the Unification Agreement. Section 4.2 states:

Upon the effective date of Step 1, and subject to the *conditions*¹ of Articles 6 & 7, the District shall be solely responsible for the collection of rates and charges, planning, administration, operation, financing, maintenance, improvements, repair, replacement, upgrade and expansion of the Unified Sewer System, including funding of the City sewer obligations as described below. Such transfer shall continue until the effective date of Step 2. Upon the effective date of Step 1, the District System and City System shall be combined and integrated and managed as one complete system (i.e. the Unified Sewer System). [Italics and footnote added]

Municipal Contract Interpretation Principles. The Washington State Supreme Court provides some assistance in the case of *City of Tacoma v. City of Bonney Lake*² in interpreting municipal contracts. First, the District and the City, in contracting concerning the District System, the City System and the Unified Sewer System are both acting in their proprietary capacities.³ Second, for proprietary agreements, the same tools are used for contractual interpretation as would be used for private parties.⁴ Third, when interpreting a contract, courts give ordinary meaning to

¹ The Unification Agreement makes Section 4.2 subject to the *conditions* of Articles 6 & 7 not the entire Articles. Thus, in interpreting Section 4.2, it is important to read Articles 6 and 7 and determine what portions of those Articles are *conditions* and what portions are not.

² 173 Wn.2d 584, 269 P.3d 1017 (2012).

³ 173 Wn.2d at 589.

⁴ 173 Wn.2d at 590.

the words in a contract and try to give effect to the parties' mutual intent.⁵ Fourth, the court may look to course of dealings in defining a contract's terms. *Course of dealings* is a " 'a sequence of previous conduct between the parties to an agreement which ... establish[es] a common basis of understanding for interpreting their [agreement].' " ⁶

Thus, without belaboring legal principles, the Unification Agreement should be interpreted with ordinary meanings generally given to the words to give effect to the parties' intent. The parties' course of dealings also defines terms of the Agreement.

Role of the District in Step 1. As indicated above, in Step 1, the City's System is transferred to the District so that the District System and the City System became the Unified Sewer System. As of the effective date of Step 1, and subject to the conditions of Articles 6 and 7, it is the District that is solely responsible for that Unified System.

The conditions referenced concerning Article 6 involve Comprehensive Planning. The District is required to amend its Comprehensive Plan and upon approval by it and then the City, that becomes the Sewer Element of the City's Comprehensive Plan. That process continues with each amendment. The District is to coordinate with the City on certain capital improvements within the City limits and the parties are to seek to coordinate capital projects where the opportunities arise.

The conditions referenced concerning Article 7 involve the Utility Committee. Those are addressed in the following section.

Role of the Utility Committee in Step 1. Article 7 of the Unification Agreement continued the parties' Utility Committee and gave it a role of providing "recommendations and oversight for planning, coordination and management of the Unified Sewer System"⁷. In addition to the recited role, Article 7 also specified certain other duties for the Utility Committee that are more specific and will be discussed below. Important in reconciling the general quoted language of Section 7.1 with Section 4.2 which is the singular authority of the District in Step 1's management and operation of the Unified Sewer System is the contract principle of the parties' course of dealings. In other words, how have the parties interpreted "recommendations and oversight for planning, coordination and management" over the course of the last 13 years in developing the working relationship of the Utility Committee.

Clearly, the drafters of the Unification Agreement did not mean that the Utility Committee was going to "oversee" the "management" of the District's sole responsibility for collection of rates and charges, planning, administration, operation, financing maintenance, improvements, repair, replacement, upgrade and expansion of the Unified Sewer System. That is not practical. The intent is not in the Unification Agreement to have meant that; the Utility Committee was originally intended to meet once per quarter. Rather, the Utility Committee is intended to address those matters that are important for the ultimate transition to Step 2. An example of these different roles is Section 4.15 where if the District decides to undertake a utility local improvement district

⁵ *Id.*

⁶ 173 Wn.2d at 591.

⁷ Section 7.1.

(ULID), it *notifies* the Utility Committee. The Utility Committee does not recommend, oversee or manage the matters related to a Section 4.15 ULID.

Article 7 express conditions include: (i) authority for the Utility Committee to make changes to the amount of the Utility Agreement Fee and/or Franchise Fee⁸ with a quorum of all six Utility Committee members; (ii) authority for the Utility Committee to review any proposed change in rates or charges prior to implementation by the District; (iii) responsibility for the Utility Committee to prepare and implement a transition plan for employees as part of Step 2; responsibility for the Utility Committee to plan for the transfer of service prior to the effective date of Step 2; and, (iv) responsibility for the Utility Committee to review all Planning Documents and provide recommendations where it feels appropriate.

In the final analysis, the Unification Agreement puts most of Step 1 in the hands of the District with a joint role to be played by the City and the District through the Utility Committee but that joint role is not to usurp the role of the District. The role of the Utility Committee is quite specifically defined in Sections 7.4, 7.6, 7.7, 7.8 and 7.9. Where the role of the Utility Committee is generally described in Section 7.1, it has been defined by the course of conduct of the parties over the last 13 years to make practical sense. The oversight role is to assure that the goal of Step 2 is maintained. That has been accomplished by the developed course of conduct. The goal is not to get involved in the day-to-day operations of a sewer district.

Specific Issues Cited in your Letter.

1.(A) Dealing with Old Waste Water Treatment Plant Property. There have been many public discussions involving the old Waste Water Treatment Plant (WWTP) property. A significant number of those public discussions have involved the Utility Committee. Currently, the status of the old WWTP property is that it has no functional purpose in support of the Unified Sewer System. It was not part of the City System so the real property does not belong to the City. The final approval from the Department of Ecology (Ecology) has been received for the plan and removal/treatment of the remaining biosolids. Once the approval has been received from Ecology, the question will need to be dealt with as to whether it is in the interest of the Unified Sewer System to continue to have the District, as part of Step 1, maintain ownership of the old WWTP property. Assuming a decision is made to surplus the old WWTP property, it would seem appropriate to discuss this with the Utility Committee. There is nothing in the Unification Agreement that suggests property that is surplus to the Unified Sewer System needs to be “ratified by the City Council” particularly when Section 4.2 of the Unification Agreement places the District solely responsible for “improvements”, “replacement” and “upgrade and expansion of the Unified Sewer System”, each of which created the surplus nature of the old WWTP property.

1.(B) Selling 1926 Vernon Road Surplus Property. The essence of the Mayor’s issue with respect to the real property at 1926 Vernon Road (the “Vernon Road Property”) is that it was sold by the District without Utility Committee review and recommendation and without agreement by the City Council. In fact, while the sale of the Vernon Road Property occurred somewhat after the fact (November 22, 2016), it was declared surplus property of the District on February 10,

⁸ Section 7.4; note, Section 4.7 mistakenly refers to this Section as “7.3”.

2005 by the Commission⁹. This declaration of surplus property by the District Commissioners occurred prior to May 23, 2005 which is the date the parties entered into the Unification Agreement. As a side note, once property is surplus, it is no longer a functioning part of the Unified Sewer System. In this case, that declaration had been made before the Unified Sewer System was created. As a further answer to the Mayor's question, the confusion in the legal description that resulted from closing is in the process of being rectified.

2. Annexation Covenants. The District has provided past cooperation and will continue to do so into the future.

3. Franchise Fee Considerations. Your letter references some internal City discussions concerning the prospect of a franchise fee and specifically refers to Section 4.4. The Unification Agreement, in Section 4.4, does discuss a franchise fee with a maximum of \$2,000 per year unless the Utility Committee agrees otherwise. The records the District has indicate that when the topic of a franchise fee has come up in the past, the Utility Committee has declined to recommend the parties initiate the franchise fee feeling that the Utility Agreement Fee is actually sufficient. Having indicated what the parties have done in the past, the District is prepared to discuss the prospect of a franchise fee with the City; the Unification Agreement provides for one with an amount set or a provision for consideration by the Utility Committee for change (e.g., Section 7.4).

4. Easements. Your letter takes issue with the District not specifically designating the City as "the future assignee on all future easements." The District submits that this issue being raised by the City is a 'distinction without a difference'. The easement form utilized by the District has the following provision:

This easement shall be a covenant running with the land and shall be binding on the successors, heirs and assigns of both parties hereto.

So when Step 2 occurs, the City will be the District's successor and receive the easement both by virtue of the language of the easements and by virtue of the transfer that will occur as required by Section 5.3. The District's standard form easement has been in use throughout the time period raised in your letter. The more general way of dealing with designating the City as a future assignee of the easements has been the course of dealing between the parties. There is no reason why the purposes behind Section 4.6 of the Unification Agreement will not be achieved.

5. Utility Agreement Fee. The Unification Agreement has established the Utility Agreement Fee schedule and it has provided that the Utility Agreement Fee may be adjusted after January 1, 2007 by a majority vote of a quorum of all six of the Utility Committee. Your letter states that the City Finance Department is evaluating whether to make a submittal to the Utility Committee to seek a change in the Utility Agreement Fee. It is the District's recollection that for

⁹ See February 10, 2005 District Commission Minutes, New Business.

a period of time, the City would come to the Utility Committee meetings and show how much time City resources were spent on sewer matters. In the last three years (at least), the City has not provided such information. The District understands that is the City's prerogative pursuant to Section 7.4 to seek a change to the Utility Agreement Fee if the information convinces the majority of the quorum of six members of the Utility Committee.

6. Utility Committee Review of Developer Extension Agreements. In your letter, you state that the required process is for developer extension agreements to be reviewed by the Utility Committee and, then based on the recommendation from the Utility Committee, those agreements are to be processed by the District Board of Commissioners. For this position, you reference Section 4.14 of the Unification Agreement. First, that section of the Agreement does not pertain to developer extension agreements; rather, it pertains to sewer facilities constructed by the City for which there is a distinct involvement of the Utility Committee. As discussed below, there has been a course of dealing that has developed in what the Utility Committee has and has not been involved in. Developer extension agreements have not been something that routinely have been submitted for Utility Committee review.

7. Industrial Zone Expansion Projects. The District and the City have previously discussed sewer expansion to the industrial areas. The prospect of that expansion into the industrial zone was a topic of discussion and action in the Utility Committee in 2007 with respect to inclusion in the Comprehensive Plan of the proposed D6 gravity sewer line to be paid as a donated facility and then that was circulated for review. ULID's were not property owner friendly methods for financing public infrastructure in the years following 2008 until the economy and commercial property stabilized in about 2012 to 2014. It may be time to evaluate some benefit areas and meet with property owners to determine interest since it is the property owners that will ultimately service the debt. As is required by Section 4.15, the District will notify the Utility Committee of the District's intent to utilize this process for construction of sewer facilities after it determines the interest of the property owners in areas where ULID projects might be feasible.

8. Quality Assurance/Control Workshops. The Unification Agreement at Section 4.17 does place the initiative on the District to invite the City to participate in quality assurance/quality control workshops. Your letter recognizes this activity in the context of the old WWTP. Clearly, the discussions involving the Comprehensive Plan and the new Waste Water Treatment Plant are similar activities. The District will be mindful of the City's interest and initiate further quality assurance/quality control workshops. Those discussions also help the parties' working relationships.

9. Contracts, Loan Agreements, etc. Your letter focuses on two concepts that the City has previously asserted in a broader context: Does the Unification Agreement require City approval (through the Utility Committee) of contracts, debt obligations or other commitments as long as they are assumable by the City without penalty which is required by Section 4.18. Clearly, Section 4.18 states *both parties* when they negotiate all new contracts, etc. So, the District is

allowed to engage in its Section 4.2 activities as the parties' course of dealings have defined those duties without having the City, through the Utility Committee, weigh in on every contract negotiation. Further, if those contract negotiations were to get as broadly discussed as the City desires, the advantage of closer held negotiations is potentially lost.

10. Industrial Wastewater Pretreatment. Section 4.19 of the Unification Agreement calls on the District to prepare and implement an Industrial Wastewater Pretreatment program. The District has done that in conjunction with the Department of Ecology. Your letter seeks clarity on the Pretreatment program. That can be provided. Please provide the names of the City contact persons and District Staff will make arrangements for the appropriate follow up.

11. Written Protocols and Standards. Written protocols and standards (bylaws) were adopted in 2005. They are enclosed with this letter. We have been operating under those protocols and standards since their adoption.

12. Coordinated Plans. Your letter addresses coordination between the District's Comprehensive Plan and the City's Comprehensive Plan. The District's Comprehensive Sewer Plan and Sewer Capital Facilities Plan element, once adopted by the District, is to be adopted by the City as its sewer element of its Comprehensive Plan. The parties can always improve this interaction. The Utility Committee is a very good place to discuss how efficiencies may be achieved.

13. Utility Committee. As discussed above, there is a certain dynamic tension between Sections 4.2 and 7.1 to define the scope of the jurisdiction of the Utility Committee. Other provisions of Article 7 are more specific as to the authority of the Utility Committee. The course of dealings of the parties helps provide practical definition to the scope of the Utility Committee jurisdiction. Discussion on this topic is worthwhile.

14. Employee Transition. This point in your letter seems to be that "... [employee transition] was previously negotiated and codified in the 2005 Agreement." You reference Section 7.7 which discusses the "transition of employees as part of Step 2" and that is currently scheduled to occur in 2032 unless the date is changed by mutual agreement. Thus, your Compliance Date of January 1, 2019 and the Unification Agreement reference are not consistent. In fact, there will not be a focus on Employee Transition until it makes sense because there is a plan for implementing Step 2. The plan is not present. The Unification Agreement has set a date and the parties have not mutually agreed to change that date.

15. Insurance Coverage. Your letter is correct that Article 8 addresses insurance coverage that is to be provided by the District as part of Step 1. The District has provided the required coverages. Section 8.1 has certain things the City can do as part of the insurance coverage

review and assurance. City Administrator Gene Brazel has previously asked for and received information concerning the District's insurance coverages. Your letter also speaks to want to have insurance as a topic of discussion at a Utility Committee meeting. Since the District has the responsibility to coordinate the Utility Committee meetings for 2019, we can discuss scheduling something with respect to the insurance program for Step 1 as a possible agenda item that may justify the time when we have a sense for what it is we are trying to accomplish with the discussion.

16. Mediator Selection. Before public funds are expended on an RFP process for a mediator, the parties should determine what, if any, issues remain in disagreement.

Very truly yours,



Kevin Kosche
President, Lake Stevens Sewer District

cc: Commissioner Mariah Low
Commissioner Dan Lorentzen
City Utility Committee Members
Tonya Christoffersen
Gene Brazel