

# Fire Service Impacts on Water Utilities

*Managing the Effect of Lane Vs. City of Seattle*

Edward Cebron, FCS Group

John Milne, Inslee, Best, Doezie & Ryder, P.S.



# Background on Lane v. City of Seattle



# Disclaimer

- The ruling of the Washington State Supreme Court in the Lane v. City of Seattle case, in October 2008, potentially affects all municipal water utilities in Washington relating to allocation and recovery of fire suppression costs. The impacts on “business and usual” for water utilities may extend to legal, contractual, financial, rate and system planning activities. You are strongly encouraged to consult with your own legal counsel and financial consultant to understand and address the impacts of the Lane decision.
- Inslee, Best, Doezie & Ryder, P.S. and FCS Group do not warrant or guarantee the application of the general information and guidelines provided in this presentation to your utility’s circumstances and provide no specific advice or recommendation regarding factual, legal, contractual and system planning activities your utility may experience or undertake.

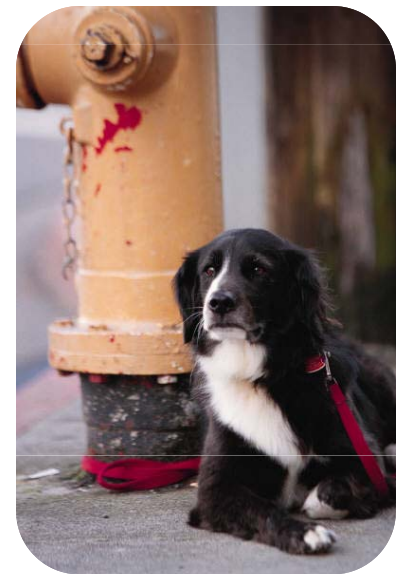
# Relationship of Okeson Street Light Decision Is Key to Understanding Lane Fire Hydrant Decision

- In 1999, Seattle adopted an ordinance transferring responsibility to pay for street lights from Seattle's general fund to all City Light ratepayers.
- In 2003, the Washington State Supreme Court ruled in *Okeson v. City of Seattle* that street lights were a basic governmental function because they benefit the general public and must be paid for by Seattle's general fund.
- Seattle City Light was ordered to refund the cost of street lights to ratepayers.



# Lane v. City of Seattle

- In *Okeson*, Seattle argued that the cost to maintain fire hydrants is also a governmental function, yet that cost has been paid by water ratepayers. After the *Okeson* decision, Seattle (SPU) removed the cost of fire hydrants from retail water rates.
- Seattle then increased the utility excise tax on SPU from 10% to 14% to pay for its new general fund costs for fire hydrant services; SPU then raised its rates to retail customers to cover the utility tax.
- Seattle also billed certain fire districts and cities where SPU provided retail water services, including fire hydrants, and sued them when they refused to pay.
- Seattle was also sued by a ratepayer class for a refund of fire hydrant costs charged in water rates from 2002 to 2004, plus interest, and challenging Seattle's utility tax on SPU.



# Lane v. City of Seattle – the Decision

- The Supreme Court confirmed that fire hydrants are a general governmental responsibility and that SPU must refund fire hydrant costs for three years with 12% interest.
- The Court ruled that the City of Lake Forest Park must pay SPU for cost to maintain fire hydrants within the City. (Burien withdrew from the appeal before the decision.)
- Burien also sued certain fire districts but after that city withdrew from the appeal there was no party suing the fire districts so the Supreme Court did not address the trial court's decision that fire districts had no obligation to pay for fire hydrants.
- The trial court previously ruled that the City of Shoreline and King County were not required to pay SPU for fire hydrant costs because Seattle had waived its right to recover payment in its franchise agreements with those entities. (The trial court's decision on that basis was not appealed by Seattle.)
- The Seattle City Council subsequently enacted an ordinance to pay customer refunds by raising water rates about 10% for 20 months.





# Lane v. City of Seattle – Summary

- ✓ Providing fire hydrants is a governmental function providing a general benefit and must be paid for out of the general fund.
- ✓ Seattle Utility Tax on SPU was lawful.
- ✓ Lake Forest Park, as a general purpose government, had to pay for the fire hydrants provided by Seattle. (But Shoreline and King County did not because Seattle waived its right to reimbursement in franchise agreements.)
- ✓ Seattle was required to calculate and make a refund to retail ratepayers for a 3-year period (statute of limitations), plus 12% interest.



# Potential Legal Requirements and Approaches





# Application of Lane v. City of Seattle to Water Utilities

- Lane v. City of Seattle arguably applies to all municipal water utilities (e.g., counties, special purpose districts), with fire hydrant/fire suppression service because a governmental function providing a general benefit; therefore, those non-city municipal water utilities must reconfigure the way in which fire hydrants are paid for.
- General purpose governments, like cities, may impose a utility tax (like Seattle) to recover fire hydrant costs for the general fund; and bill other general purpose governments like cities and the county for water service provided within their corporate boundaries.



# Application Options: Status Quo to the Full Monty

- **Status quo:** do nothing regarding the allocation/reallocation of fire hydrant and fire suppression system costs.
- **Status quo:** but undertake a study to identify fire hydrant/fire suppression system costs.
- **Modest change:** perform an allocation study for fire hydrants only (operation and maintenance?) and bill those costs to the city's and/or counties' general fund; maybe work with the general purpose governments served by your water system (the County and any cities or portions thereof served to arrange some form of equivalent payment in return for consideration.
- **Full study:** Undertake a full allocation study like Seattle's for all portions of the water system (supply, pumping, water mains, reservoirs & hydrants) providing fire suppression service; then remove from retail revenue requirement, cost allocations and rates and recover as above.



"GOOD SCHOOLS... NICE NEIGHBORHOODS...  
PLENTY OF HYDRANTS..."

# Potential Approaches and Consequences for Rates & Finance

by Edward Cebron, FCS GROUP



# Useful Background Information

- Several noteworthy quotes taken from the American Water Works Association Manual M1, Chapter 30:
  - Fire protection service is essentially “a standby service that the utility makes available on demand.”
  - “Although most fire hydrants and sprinkler connections are rarely used, the utility must be ready to provide adequate water quantities and pressures at all times throughout the distribution system.”
  - “The costs associated with maintaining the supply, treatment, pumping, storage and distribution capacity for fire protection services include annual O&M costs and capital costs invested in facilities that are sized larger than necessary for non-fire fighting purposes.”



# Useful Background Information (cont.)

- The majority of municipal water utilities have adopted cost-of-service based water rates generally following AWWA guidelines.
- As part of those cost-of-service guidelines, the most commonly referred to “functional cost components” are:
  - Base
  - Extra Capacity
  - Customer Meters and Services
  - Direct Fire-Protection Services





# Understanding the Court Rulings (cont.)

- The Lane decision may seem to offer some easy options, but beware:
  - You likely have a public document, such as a past rate study, that identifies a cost of fire protection and has been adopted or accepted by your Board or Council.
  - You likely have another public document, your water system plan, that may casually refer to myriad projects needed to “meet fire flows”.
  - The Lane case appears to directly offer the “solution” to not being the general government requiring service, namely billing the general governments for service.
  - Reliance on franchise agreements was not tested on appeal; currently the subject of a Tacoma lawsuit.



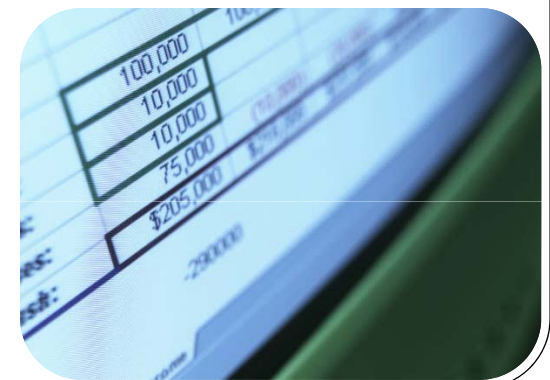
# Understanding the Court Rulings (cont.)

- From this perspective, the question becomes...
  - Is it preferable to manage this problem within the range of reasonable discretion?
  - Is the desired outcome a high or low cost?
  - Should you have analytical support for the outcome you implement?



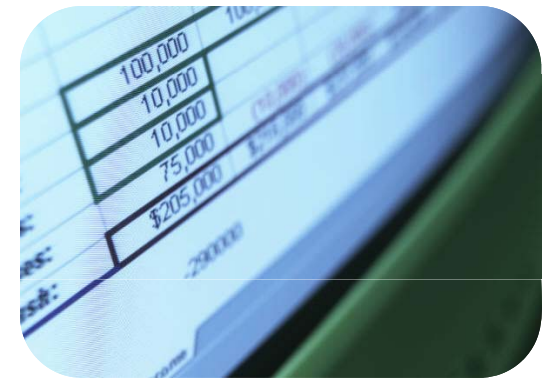
# AWWA M-1 Rates for Fire Protection (5<sup>th</sup> Edition, pg. 218)

- Three approaches are generally used in allocating costs of service to fire protection:
  1. “Allocating primary cost to general water service, with incremental costs allocated to fire protection service”. Most Common
  2. “Allocating primary cost to fire protection service, with incremental costs allocated to general water service”. Very Rare
  3. “Allocating costs to general water service and fire protection on a proportional basis” (Seattle/AWWA support). Seattle Approach
- The three options will likely result in materially different cost allocations to fire protection.

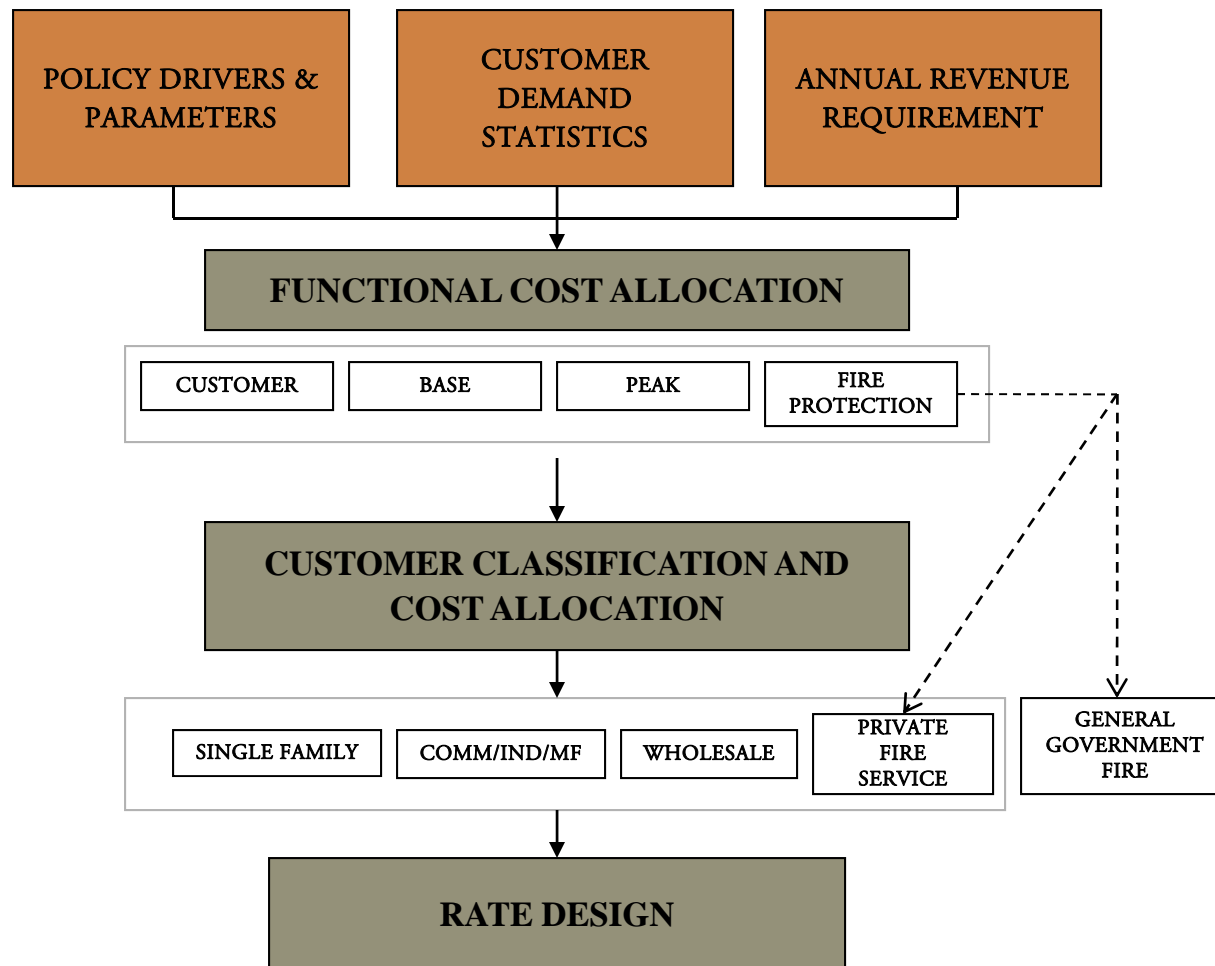


# AWWA M-1 Rates for Fire Protection (cont.)

- It is common to calculate fire protection costs of service in the 5% to 10% range and sometimes higher for larger, more complex supply and delivery systems.
- **EXAMPLE:** If a water utility generates \$4 million in annual retail revenues, then the fire protection costs could range between \$200K and \$400K per year.

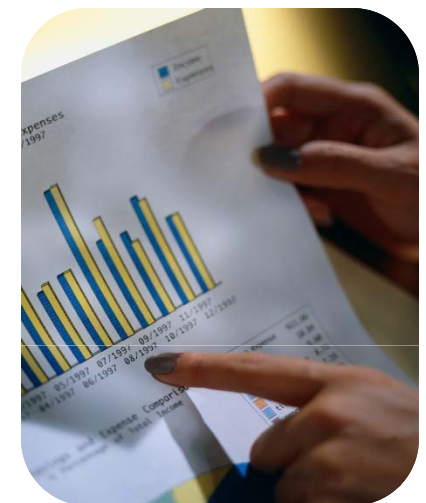


# AWWA M-1 Rates for Fire Protection (cont.)



# Managing the Outcome: Fire Protection Costs

- How might the relative share of costs attributed to fire protection be calculated?
  - Proportional to engineering capital allocations
  - Use the incremental (oversizing) approach.
  - Look for overlap of a major function with other water delivery purposes (e.g. flushing through hydrants, demand criteria, storage requirements).
  - Reconsider general allocations of O&M, administrative costs, taxes and debt service.
  - Develop “hydrant equivalents” for fire service cost recovery





# Managing the Outcome: Fire Protection Costs

(cont.)

- What about private fire protection service such as commercial fire lines and residential sprinklers?
  - Similar cost allocation rules would apply.
  - This would offset some of the costs otherwise charged to general governments; may be necessary in order to demonstrate equitable charges for third-party general governments
  - Might be waived if general government agrees to support cost.



# Managing the Outcome: Fire Protection Costs

(cont.)

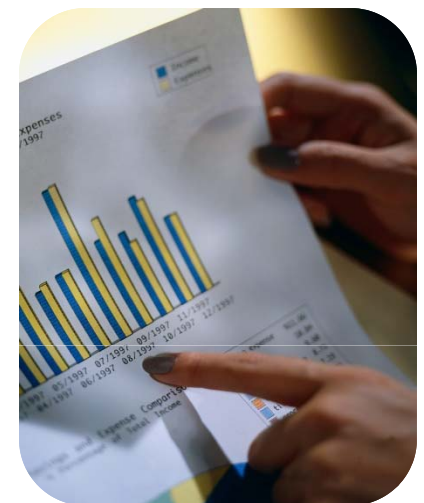
- Utilities within General Governments (Cities and Counties)
  - Determine Public Fire Protection Cost
  - Resolve Related Policy Issues (private fire lines, franchise costs, etc.)
  - Charge General Fund for Fire Service
  - Establish/Increase water utility tax to generate necessary funds
  - No net effect on utility revenues or costs
  - Differential rate effect dependent on cost allocation principles



# Managing the Outcome: Fire Protection Costs

(cont.)

- Utilities serving in “third party” general government jurisdictions
  - Determine public fire protection cost
  - Evaluate existing agreements for authority to charge
  - Charge general governments as public fire service customers
  - Evaluate likelihood of collection
    - Add “Bad A/R” provision for utility until duty to pay is fully resolved
  - Differential rate effect dependent on cost recovery and cost allocation principles

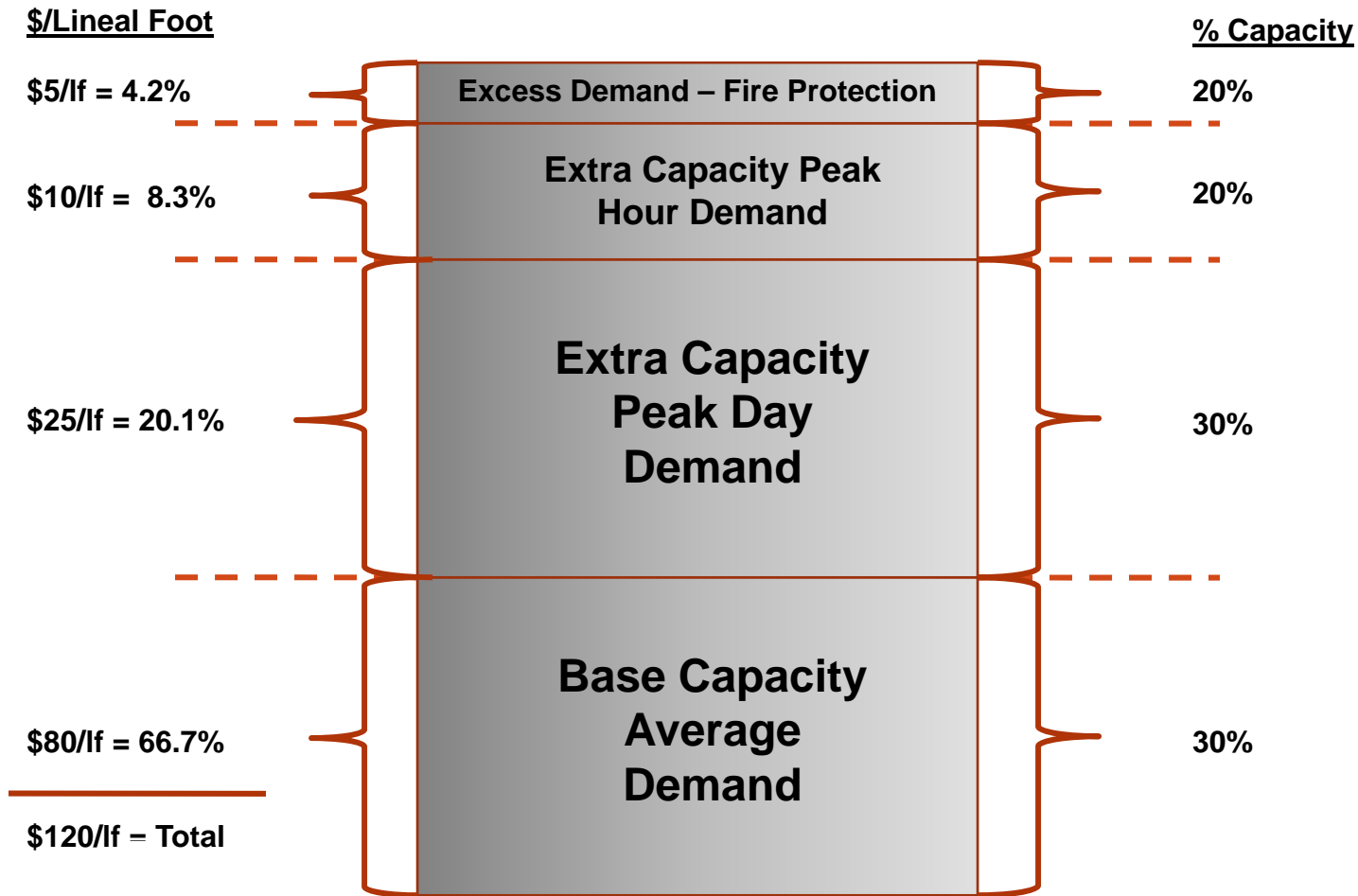


# FCS Group's Ideas in Process

- Examples related to fire allocations:
  - Does fire capacity overlay or nest within other system requirements?
  - Are the highest allocation facilities generally developer-funded, e.g., not a part of debt service or CIP funding?
  - Can we develop incremental (oversizing) allocation principles to avoid overstatement of fire costs?
  - Are allocations of O&M and administrative costs consistent with cost causation?



# Theoretical Example COSA Toward Minimizing Allocation to Fire Protection-Hydrant Costs



# Implications and Approaches for Financial Planning

- Not all consequences of Lane are yet known. Pending test of franchise agreement indemnity will determine whether the “loophole” holds.
- Fire costs are best defined on an incremental basis, consistent with AWWA, minimize the financial issue.
- A conservative provision for fire receivables would be prudent until issues are further resolved and revenues assured.
- Even so, costs are reallocated with differential rate impacts.
- Big Brother is watching; State Auditor has indicated that this will be a reviewed issue for audits of 2009 financials.





# OPEN DISCUSSION, Q&A

