



CITY OF KIRKLAND
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MEMORANDUM

To: Kurt Triplett, City Manager

From: Robin S. Jenkinson, City Attorney
Tracey Dunlap, Director of Finance and Administration

Date: October 4, 2011

Subject: Memorandum of Understanding Regarding Utility Tax

RECOMMENDATION

Approve the attached Resolution authorizing the City Manager to execute the Memorandum of Understanding Regarding Utility Taxes Between the Cities of Bellevue, Medina, Issaquah and Kirkland, and the Towns of Hunts Point and Yarrow Point.

BACKGROUND DISCUSSION

In October 2008, the Washington State Supreme Court issued its opinion in the case of *Lane v. City of Seattle* holding that "fire hydrants" are a general government responsibility and cannot be paid through water rates.¹ Based on this ruling, Seattle removed fire protection costs from its water rate and allocated the cost to its General Fund. Fire protection costs were not defined in the *Lane* opinion, but Seattle interpreted fire protection costs to mean the total cost of providing fire protection capacity, including hydrants, oversized pipe, and reservoir storage. Seattle elected to recover ongoing fire protection costs by raising the utility tax on water services and by charging other jurisdictions in its service area.

The City of Bellevue's Water Utility provides fire protection capacity to customers in Bellevue, Medina, Clyde Hill, Hunts Point, Yarrow Point and small portions of Issaquah, Kirkland and King County. Following the *Lane* opinion, Bellevue determined that the full "fire protection" element of its rates should be charged as a general government expense and, in addition to charging its General Fund, billed to other jurisdictions in its service area for a share of fire protection capacity. As a result, Bellevue billed Kirkland for the eight Bellevue hydrants and related infrastructure within the Kirkland city limits (\$2,769 in 2010).

Certain of the cities and towns protested Bellevue's request for payment. (The allocation of fire protection costs to some of the other jurisdictions was significantly higher than Kirkland's.) These jurisdictions requested that Bellevue amend its Utility Occupation Tax Code to tax the gross receipts from water service ratepayers served by Bellevue's water utility outside Bellevue city limits to cover Bellevue's costs of providing these customers with fire protection capacity. This action does not adversely impact the City of Kirkland's utility rate payers.

¹ 164 Wn.2d 875, 194 P.3d 977 (2008).

Bellevue has agreed to this approach. In exchange, the cities and towns joining the Memorandum of Understanding agree that in the event of a successful legal challenge by any taxpayer, customer or ratepayer relating to Bellevue's amendment of its Utility and Occupation Tax, the cities and towns will remit the 2010-2011 amounts requested by Bellevue for fire protection capacity. The Memorandum of Understanding sets forth these terms and conditions.

RESOLUTION R-4899

A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF KIRKLAND AUTHORIZING THE CITY MANAGER TO EXECUTE A MEMORANDUM OF UNDERSTANDING REGARDING UTILITY TAXES BETWEEN THE CITIES OF BELLEVUE, MEDINA, ISSAQUAH AND KIRKLAND, AND THE TOWNS OF HUNTS POINT AND YARROW POINT.

WHEREAS, the City of Bellevue Utilities Department provides water utility services to residents and ratepayers of the cities of Issaquah, Kirkland and Medina, and to the towns of Hunts Point and Yarrow Point, including the provision of fire hydrants and fireflow water capacity for the purpose of fire suppression; and

WHEREAS, Bellevue has historically included the costs associated with fireflow capacity in water utility rates for customers throughout its water utility service area; and

WHEREAS, in October of 2008, the Washington Supreme Court issued a decision in *Lane v. Seattle Public Utilities*, 164 Wn.2d 875 (2008), holding that the provision of fireflow capacity is a governmental function separate from the proprietary functions of a water utility; and

WHEREAS, the Court further held that the costs of providing fireflow capacity must therefore be paid out of a local government's general fund and that such costs may not be charged directly to water utility ratepayers; and

WHEREAS, in compliance with the Court's ruling, Bellevue transferred the cost of providing fireflow capacity charges to its general fund as a general governmental expense; and

WHEREAS, to offset the impact to Bellevue's general fund from providing fireflow capacity to water utility customers outside of its city limits, Bellevue has agreed to amend its Utility Occupation Tax Code to tax the gross receipts from water service to ratepayers outside its city limits to cover Bellevue's costs of providing those customers with fireflow capacity;

NOW, THEREFORE, be it resolved by the City Council of the City of Kirkland as follows:

Section 1. The City Manager is hereby authorized and directed to execute on behalf of the City of Kirkland a Memorandum of Understanding substantially similar to that attached as Exhibit "A", which is entitled "Memorandum of Understanding Regarding Utility Taxes Between the Cities of Bellevue, Medina, Issaquah and Kirkland, and the Towns of Hunts Point and Yarrow Point."

Passed by majority vote of the Kirkland City Council in open meeting this ____ day of _____, 2011.

Signed in authentication thereof this ____ day of _____,
2011.

MAYOR

Attest:

City Clerk

**MEMORANDUM OF UNDERSTANDING REGARDING UTILITY TAXES BETWEEN
THE CITIES OF BELLEVUE, MEDINA, ISSAQUAH
AND KIRKLAND, AND THE TOWNS OF HUNTS POINT AND YARROW POINT**

This Memorandum of Understanding is made as of the _____ day of _____, 2011 Between the Cities of Bellevue, Medina, Issaquah and Kirkland all municipal corporations, which are located in and existing under the laws of the State of Washington and between the towns of Hunts Point and Yarrow Point, both municipal corporations located in and existing under the laws of the State of Washington (which governmental entities may be referred to collectively as “Parties”).

I. RECITALS

WHEREAS, the City of Bellevue Utilities Department (referred to as the “Utility”) provides water utility services to residents and ratepayers of the cities of Issaquah, Kirkland and Medina, and to the Towns of Hunts Point and Yarrow Point. Such utility services include the provision of fire hydrants and fireflow water capacity for the purpose of fire suppression (otherwise referred to as “fireflow capacity”);

WHEREAS, the Utility has historically included the costs associated with fireflow capacity in water utility rates for customers throughout its water utility service area; and

WHEREAS, in October of 2008, the Washington State Supreme Court issued a decision in *Lane v. Seattle Public Utilities*, 164 Wn.2d 875, 194 P.3d 977 (2008) holding that the provision of fireflow capacity is a governmental function separate from the proprietary functions of a water utility. The Court further held that the costs of providing fireflow capacity must therefore be paid for out of a local government’s general fund and that such costs may not be charged directly to water utility ratepayers; and

WHEREAS, in compliance with the Court’s ruling, the City of Bellevue transferred the costs of providing fireflow capacity charges to its General Fund as a general governmental expense; and

WHEREAS, the City of Bellevue, to offset the impact to its General Fund from providing fireflow capacity to water utility customers outside the City limits, requested payment from the Parties for their respective proportionate share of the utility facility costs associated with the Utility’s provision of fireflow capacity to each jurisdiction; and

WHEREAS, certain Parties to this Memorandum of Understanding have protested the City of Bellevue’s request for such a payment for various reasons and have requested that Bellevue amend its Utility Occupation Tax Code to tax the gross receipts from water service ratepayers outside the City limits to cover Bellevue’s costs of providing customers outside the Bellevue City limits with fireflow capacity; and

WHEREAS, the Parties agree that it is inequitable to require the taxpayers of the City of Bellevue to subsidize the provision of fireflow capacity to utility customers located outside of the city limits of Bellevue; and

WHEREAS, the Washington Supreme Court ruled, in *Burba v. Vancouver*, 113 Wn.2d 800, 783 P.2d 1056 (1989), that a municipality may lawfully impose a tax on revenue generated by a utility from customers served outside the city limits provided a reasonable relationship exists between the event taxed and the benefit conferred; and

WHEREAS, the Parties agree that a reasonable relationship exists between the event taxed and the benefit conferred with respect to the Utility's provision of fireflow capacity; and

NOW, THEREFORE, the Parties agree as follows:

II. PRINCIPLES OF UNDERSTANDING

1. Amendment to Bellevue City Code (BCC). Bellevue shall take all necessary steps, including any required public notice, to amend BCC 4.10.025 ("Utility Occupation Tax") to provide for application of its utility tax rate as measured against the gross proceeds of sales from customers of the utility throughout its entire water service area.

2. Adjustment of Rates or Charges. It is expressly understood and agreed to by the Parties that the Utility may adjust rates or charges for utility customers located throughout the service area in order to offset the increase in Utility Occupation Tax imposed on the Utility occasioned by an amendment to BCC 4.10.025 to allow for collection of utility taxes outside of the City of Bellevue's municipal boundaries, and further that nothing herein shall be deemed to prohibit Bellevue from adjusting rates and charges within its lawful authority to recoup costs incurred by the Utility associated with the Court's ruling in *Lane, supra*.

3. Agreement to Pay for Costs Associated with Provision of Fireflow Capacity. Should a successful legal challenge be made by any taxpayer, customer or ratepayer relating to Bellevue's authority to amend the scope of its Utility Occupation Tax or relating to the Utility's authority to tax customers located outside of the City of Bellevue's municipal boundaries, or related to any adjustment in rates or charges to offset the increase in the Utility Occupation Tax imposed on the Utility, each of the Parties shall remit payment to the City of Bellevue for its proportionate share of the cost associated with the Utility's provision of fireflow capacity within ninety (90) days of receipt of a request for payment from the City of Bellevue. PROVIDED, however, that the Parties retain the right to challenge the amount of the payment requested by Bellevue and the right of Bellevue to pass the costs of individual elements of fireflow capacity costs on to the Parties.

4. Term and Termination. This Memorandum of Understanding shall remain in effect so long as the provision of fireflow capacity is legally characterized as a governmental function of a

water utility or municipality and the costs of that service are required to be paid for out of a local government's general fund. PROVIDED, however, that any Party to this Memorandum of Understanding may choose to opt out by giving at least ninety (90) days written notice to the Utility that it has secured alternative fireflow capacity service. If the Utility chooses to cease provision of fireflow capacity service to any Party, it shall provide at least 365 days written notice to the affected Party. If any other binding Agreement or Contract between the Utility and one or more of the other Parties provides for greater notice of cessation of fireflow capacity service, that longer period shall apply.

5. Modification and Amendment. No modification or amendment of any of the terms or provisions of this Memorandum of Understanding shall be binding upon any Party unless made in writing and signed by all Parties or by a duly authorized representative or agent of such Parties.

6. Severability. In the event that any court shall find any portion of this Memorandum of Understanding unenforceable, the remaining portion shall remain in full force and effect.

7. Governing Law. This Agreement shall be governed in all respects by the law of the State of Washington.

8. Execution in Counterparts. This Memorandum of Understanding may be executed in several counterparts, each of which when so executed shall be deemed an original copy and shall become effective upon all signatures by all Parties upon one or more of such identical counterparts. It is further agreed that a signature page sent by facsimile or by electronic mail shall be deemed to be an original.

IN WITNESS WHEREOF, the PARTIES have executed this Memorandum of Understanding as of the day and year first written above.

CITY OF BELLEVUE

CITY OF KIRKLAND

By: _____

By: _____

Title: _____

Title: _____

Date: _____

Date: _____

CITY OF ISSAQUAH

CITY OF MEDINA

By: _____

By: _____

Title: _____

Title: _____

Date: _____

Date: _____

CITY OF YARROW POINT

TOWN OF HUNTS POINT

By: _____

By: _____

Title: _____

Title: _____

Date: _____

Date: _____

Approved as to form:

Lori Riordan
City Attorney
City of Bellevue

Date

Approved as to form:

Robin Jenkinson
City Attorney
City of Kirkland

Date

Approved as to form:

Wayne Tanaka
City Attorney
City of Issaquah

Date

