



MEETING DATE: 6/07/04
ITEM NO. 21

COUNCIL AGENDA REPORT

DATE: JUNE 2, 2004
TO: MAYOR AND TOWN COUNCIL
FROM: DEBRA J. FIGONE, TOWN MANAGER
SUBJECT: DIRECTION REGARDING THE TRANSFER OF MAINTENANCE RESPONSIBILITIES FOR THE LOS GATOS SEWER COLLECTION SYSTEM FROM THE TOWN OF LOS GATOS TO THE WEST VALLEY SANITATION DISTRICT

RECOMMENDATION:

Provide direction regarding the transfer of maintenance responsibilities for the Los Gatos sewer collection system from the Town of Los Gatos to the West Valley Sanitation District.

BACKGROUND:

The Town of Los Gatos has maintained the Town's public sewer system since 1977, when the Town entered an agreement with the West Valley Sanitation District (District). The District provides complete wastewater and collection disposal services for the cities of Campbell, Monte Sereno, Saratoga, and unincorporated areas of the County. In Los Gatos, the District is responsible for permitting, repairs, construction, inspection, engineering, and collection of all sewer-related fees. A portion of the fees collected by the District is used to reimburse the Town for maintaining the Los Gatos system. The Town's current agreement with the District expires on June 30, 2004.

DISCUSSION:

Assessment of the Sewer System Operation and Management

Since 2001, the Town and District have been in discussions to re-evaluate the current operational arrangement due to recent action by the San Francisco Bay Regional Water Quality Control Board to require collection systems to develop Sanitary Sewer Management Plans (SSMPs) and pending regulations from the US Environmental Protection Agency, known as Capacity, Management,

PREPARED BY: JOHN E. CURTIS, Director of Parks and Public Works; PAMELA JACOBS, Assistant Town Manager

Reviewed by: Assistant Town Manager, Attorney, Clerk, Finance, Community Development. Revised: 6/3/04 7:25 am

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Operations, and Maintenance (CMOM) requirements. The District retained the firm of Brown and Caldwell to evaluate options for modifying the arrangement between the Town and the District. In May, 2004, the firm completed an *Assessment and Analysis of the Public Sewer System Operation and Management*. The report assessed the current level and cost of services provided by the Town and District and identified potential additional services and costs associated with the new regulations. The report evaluated the following four alternatives for providing maintenance and other services for the Los Gatos system:

1. Town continues to provide maintenance services and the District provides other services.
2. Town takes sole responsibility for Los Gatos sewers.
3. District takes sole responsibility for the entire service area including duties currently provided by the Town.
4. Town takes sole responsibility for Los Gatos sewers but most of the work is outsourced.

District Analysis and Decision

At the District's Board meeting held May 19, 2004, the Board adopted alternative #3, which calls for the District to take sole responsibility for the entire service area including duties currently provided by the Town. The Board recommended that the Town and the District extend their agreement for a period up to one year to develop and implement a transition plan that achieves the transfer of maintenance responsibility to the District. Attachment 1 is the staff report from the District's general manager, which recommends the adopted action.

The Board's key reasons for adopting alternative #3 are liability issues and the principle of equity of service. Attachment 2 is a white paper prepared by the general counsel for the District discussing the liability issue. The concern for the District is that the new regulations categorically prohibit sanitary sewer overflows (SSOs) and associated penalties for violations can be severe. The District, as the holder of the NPDES permit, has more exposure regarding civil liability and regulatory compliance, and the precise delineation of responsibilities between the Town and the District would be difficult, if not impossible, to describe in a way that would appropriately assign liability if the Town were to continue to be responsible for maintenance of the system.

The second District concern regards equity of service among all of the cities served by the District. According to the Brown and Caldwell analysis, Town costs for maintaining Los Gatos sewers are greater than the District's maintenance costs in other areas. Thus, the District believes that rate payers in the rest of the district are subsidizing Town residents. Unless Town costs and/or the level of service to Town residents were lowered, the District would seek to add a surcharge to the Los Gatos sewer use fee under Proposition 218 rules if the Town continued to provide the maintenance for the system.

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Town Analysis and Recommendation

The Town has been engaged in the ongoing discussion about the operation and management of the sewer system over the past few years. The Town's sewer crew has demonstrated exemplary service to the Town, providing professional, quality sewer maintenance service and responsive customer service to Town residents for many years. At the same time, it has been important to evaluate the current arrangement to determine if it is the most cost-effective and efficient approach, particularly in light of the new regulations. As part of the evaluation, Town staff contributed to and reviewed the Brown and Caldwell report.

Town staff shares the District's concerns about liability and costs. With regard to liability, the Town's continued maintenance of the system does present concerns about increased penalties associated with new regulations calling for lower tolerances for SSOs. Staff agrees that it would be difficult to delineate responsibilities between the District and the Town to sufficiently mitigate liability concerns.

The Brown and Caldwell report identifies a cost differential between the Town's maintenance costs and those of the District. Most of the difference is due to economies of scale related to overhead and management the District can realize as a single service provider. Although this cost difference could result in a surcharge for Los Gatos residents, if Los Gatos were to continue to provide maintenance, the surcharge is not likely to be a significant amount. Nevertheless, the most cost-effective way to provide the maintenance service in Los Gatos appears to be though a transfer of this service to the District.

A third issue that is important for Los Gatos is compliance with the requirements added pursuant to the new regulations. The requirements for an SSMP and CMOMs would be challenging for Los Gatos to implement due to the many Town priorities in other areas and to the lack of capacity to focus on this responsibility. The District, on the other hand, is much better positioned to implement the new requirements which relate to their sole area of expertise and responsibility.

Based on the issues of liability, costs, and compliance with the new regulations, staff recommends that the Town transfer the responsibility for maintenance of Los Gatos sewers from the Town to the District. It is estimated that this transfer of responsibility will take about one year to implement; thus, the Town and District would need to extend the agreement that expires on June 30, 2004 until June 30, 2005. During this period, the Town and the District would negotiate and implement a transition plan which would include the following elements:

Expertise/Knowledge Transfer – The Los Gatos crew is intimately familiar with the Los Gatos sewer system and customers. The transition plan would need to include a method for transferring this information and expertise to the District to ensure seamless service delivery.

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Performance Requirements – Los Gatos residents have enjoyed quick, courteous service from the Los Gatos sewer crew. The transition plan should include assurances that our residents will continue to receive this level of service from the District.

Valuation and Transfer of Assets – In 1977, the Town paid the District \$358,742 to acquire the underground sewer system assets. The District and Town would need to determine current value of the system and negotiate an acquisition price. The disposition of sewer-related Town vehicles and equipment purchased with sewer program funds would also need to be determined.

Communication Plan – The transition plan would include a comprehensive communication plan for informing Los Gatos residents about the transfer, and for ensuring seamless communication once the transfer is completed.

In addition to these elements addressed collaboratively by the Town and the District, the Town would address the transition of the sewer crew to other Town positions during the one-year extension of the agreement. Because the sewer crew has provided other services to the Town, staff would also identify any additional resources needed to continue providing these non-sewer services and to compensate for any administrative fees that the District will no longer cover following the transition. These may need to be addressed through the Town's budget process next year.

If Council concurs with staff's recommendation, staff will bring forward to the Council on June 21st the extension of the agreement between the Town and District, along with a schedule for developing and implementing the transition plan.

CONCLUSION:

Efficient and effective maintenance of the sewer system is the Town's primary concern. Given the issues regarding liability, costs and compliance with the new regulations, it appears to be in the best interest of the community to transfer the responsibility for maintenance of the Los Gatos sewer system to the District. Staff recommends that Council direct staff to pursue the transfer and to bring back to the Council an extension to the agreement for a period of one year to allow for the implementation of a transition plan..

ENVIRONMENTAL ASSESSMENT:

Is not a project defined under CEQA, and no further action is required.

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FISCAL IMPACT:

The fiscal impact of this action is yet to be determined; however, it is expected that there will be some reimbursement to the Town for the sewer assets and that there will be costs associated with the loss of the administrative fee received from the District, and potentially with the provision of non-sewer related services currently provided by the sewer crew.

Attachments:

1. Staff report from Robert Reid, General Manager of the West Valley Sanitation District
2. White paper prepared by Charles Kilian, General Counsel for the West Valley Sanitation District

DATE: May 12, 2004

TO: Board of Directors

AGENDA ITEM NO. 4
5/19/04FROM: R Robert Reid, District General ManagerSUBJECT: ALTERNATIVES ANALYSIS FOR LOS GATOS SEWER OPERATIONS**Background**

At the regular meeting of April 14, 2004 staff presented the report prepared by Brown and Caldwell titled *Assessment and Analysis of Public Sewer System Operation and Management* for the board's consideration. It was determined at the April 14 meeting that two of the four "alternative service models" developed in the consultant's report were not worth further consideration at this time. The purpose of this report is to analyze the significant impacts and differences between the two remaining alternatives and recommend a preferred alternative for future long term sewer operations in Los Gatos. These two alternatives are: Alternative 1) Town would continue to provide maintenance services and the district provides other services, and Alternative 3) District takes sole responsibility for the entire service area including duties currently provided by the Town.

Discussion**GENERAL CONSIDERATIONS.**

In 2002 the Board of Directors adopted certain core principles to be included in any future operating agreement between the Town and the district. For the purposes of this analysis it is assumed that one of those principles ('uniform performance standards') is inherently equal for either alternative service model under consideration. Although the Brown and Caldwell report examined current operations and identified a number of performance related deficiencies, it must be assumed that they would be corrected under either alternative. Therefore the two service options will be compared based primarily on the principles of 'equity of service' and 'clear delineation of responsibilities and liabilities.' In addition, issues concerning organizational and customer impacts will be discussed in relation to the two service alternatives. It is also intended that this report should be reviewed in conjunction with the white paper prepared by District Counsel titled *General legal issues surrounding Option 1 and Option 3 of the Brown and Caldwell Report.*

EQUITY OF SERVICE.

There are two major components included in the principle of service equity. First is the overall level of service which includes specific objectives such as emergency response time, number of sewer stoppages/overflows per mile of pipe, customer complaint response/satisfaction, etc. This type of service equity must be assumed under Alternative 3 whereby the district provides all sewer services throughout the entire service area including Los Gatos. In order to ensure this type of service equity under Alternative 1 (Town provides sewer system O&M), the agreement would need to stipulate the targeted

level of service for all identifiable service objectives. Such defined service levels, as well as defined performance standards, will be required in any case under the pending state and/or federal regulations for sewer collection systems.

Cost of Service. The second major component of service equity is cost of service. The underlying foundation for cost equity is based on the principle that each user pays their proportional share of the overall cost of providing sewage collection, disposal and treatment. Currently all district sewer users within the same classification (i.e. 'single-family residential') pay the same annual sewer service and use charge. Under the 1977 agreement the district paid the Town for its cost of maintaining and operating the sewer system. There was nothing written in the agreement specifying that Town costs could not exceed equivalent costs in the rest of the district. For many years it was assumed that operating costs were approximately equal. However Town operating costs have increased substantially in the past few years. The cost differences between the two agencies are detailed in the Brown and Caldwell report. Based on current operating costs the Town is being subsidized by rate payers in the rest of the district. This situation would need to be rectified in a new operating agreement for Alternative 1. Again it can be stated that for Alternative 3 cost equity is a given.

Other Cost Considerations. Certain higher operating costs for the Town to provide sewer system operations and maintenance are largely unavoidable. Currently the Town sewer maintenance program is based on paying 4 full-time sewer maintenance workers with some part-time clerical and supervisory personnel costs, equipment and other expenses, as well as general administrative overhead. The Town has cross-training for other Public Works department employees to provide enough personnel to provide 24-hour, 365 days per year emergency response service. The Town also requires a certain number of vehicles and equipment necessary for sewer maintenance. None of these costs can be considered excessive, particularly for an equivalent-sized 'stand alone' sewage collection system. However the district has the advantage of size and geographic proximity that would result in the elimination of a number of duplicative costs under the Alternative 3 service model. Comparative cost details are summarized at the end of this report.

The district's chief comparative cost advantage is reduced staffing requirements. The district would not require more than two additional trained maintenance workers to provide full collection system operation and maintenance for Los Gatos. Under Alternative 3, redundancy of trained maintenance staff is not an issue and would actually increase for the district as a whole. The district also has a sufficient amount of sewer cleaning equipment to provide Los Gatos coverage as well. Other district costs, including supervisory and administrative support and general overhead, would not increase with implementation of Alternative 3.

Cost Equity under Alternative 1. Town staff has been supportive of efforts to find creative ways to reduce operating costs for sewer system operations. For instance the Town is willing to utilize the district software system (GBA Master Series) to provide sewer maintenance scheduling and work order tracking. Implementing this system in the Town would facilitate development of uniform performance standards and provide

continuous feedback on level of service objectives. It could also be used to reimburse the Town for sewer system work based on district-wide full overhead rates for each type of operation. While a performance-based reimbursement system would ensure cost equity under an Alternative 1 agreement, it could actually cost the Town more to provide the service than the amount reimbursed because of the factors previously discussed.

The Town and the district have explored the possibility of sharing major sewer cleaning and/or repair equipment. Both agencies have some equipment redundancy and under-utilization for certain equipment. For instance, the district has recently purchased a new 'continuous power rodding' machine which could provide all the power rodding necessary for the entire district including Los Gatos. The major hurdle for developing a 'time share' arrangement with Los Gatos for this expensive piece of equipment is insurance coverage and liability. Our insurance would not cover non-district employees using district equipment. On the other hand, if the district was to provide all power rodding services in Los Gatos it could seriously undermine the intent of Alternative 1 whereby Los Gatos personnel would continue to provide all sewer maintenance within the Town.

To ensure equity of service under Alternative 1 will require an agreement that stipulates not only performance standards and level of service objectives but uniform reimbursement rates for each type of service that apply throughout the district. The problem for the Town with such an agreement would be the real possibility of costs exceeding reimbursement because of inherently higher overhead. Unless subsidized by the Town's other revenues the only potential solution, without decreasing level of service, would be a surcharge added to the sewer use fee for all Los Gatos sewer connections. As discussed in the legal white paper this action would require compliance with Proposition 218 procedures. Public perception regarding paying a higher cost for the same service as residents of Monte Sereno, for instance, could make it difficult to pass such a measure.

RESPONSIBILITIES AND LIABILITIES.

In general terms, the 'clear delineation' of responsibilities and liabilities applies only to Alternative 1 because all responsibilities and liabilities would ultimately be assumed by the district under Alternative 3. Therefore the intent of this section of the report is to focus on certain responsibility and liability issues under an Alternative 1 agreement. At the same time it is understood that much of the legal implications of various liability issues have already been addressed in the District Counsel's white paper.

Responsibility Considerations. The existing agreement between the Town and the district is not too explicit about enumerating the specific responsibilities of each agency. Over the years this has occasionally resulted in some confusion and lack of customer satisfaction. For many years recurring wet-weather sewer overflows on Main Street in Los Gatos were considered a Town maintenance problem. Repeated customer complaints finally resulted in the district undertaking an engineering study of the entire basin. The results of that study led ultimately to the complete reconstruction of the sewer system in

that basin. This example is related here to underscore the problems that can occur with a division of responsibilities coupled with a lack of good communication and coordination procedures.

Both the Brown and Caldwell report and the legal white paper discuss the ramifications of pending 'CMOM' regulations for owner/operators of public sewer systems. For this reason it is expected that a new agreement based on Alternative 1 would need to be very explicit in defining responsibilities. In addition to assigning tasks for various aspects of collection system services to one or the other agency, the agreement would need to specify such things as standard operating procedures for each maintenance activity. Both agencies would need to be responsible for increased record keeping and increased public outreach as well as defining and tracking performance objectives. A key component of the new regulations is an agency-specific written 'sewer system management plan' or SSMP. The SSMP has eight basic elements including everything from 'goals' and 'legal authority' to 'system evaluation and capacity assurance.' Some elements of the SSMP would be identical for both agencies, however other parts would need to be specific for the Town only. In addition to the written SSMP, an annual report of actual collection system performance and an update on SSMP implementation will be required under the new regulations.

In summary, delineation of responsibilities in an Alternative 1-based agreement would be extremely detailed and very complex. Although utilization of new technologies such as the district's maintenance scheduling software would help to enable better coordination and communication between the two agencies, continuing vigilance by both jurisdictions would be necessary to ensure regulatory compliance. This could result in some degree of overlap in services in order to prevent any gaps from occurring. The agreement would also require updating on a regular basis to include any new regulatory requirements. Finally it is a certainty that pending CMOM regulations will add a cost to collection system operation even for agencies that are in total compliance. Under an Alternative 1 agreement the duplicative SSMP and annual reporting cost will add to the pre-existing duplicative service costs for the Town of Los Gatos and increase the potential cost equity gap comparative to the rest of the district.

Liability Considerations.

The legal white paper discusses the liability problems that could arise under an Alternative 1 agreement. Generally, delineation of responsibilities, as discussed above, should also be sufficient to set the limits for liability under a well-written indemnification clause. However District Counsel contends that "the most comprehensive indemnity clauses cannot address every unforeseen eventuality." This is certainly true, but it is also true that the district has to assume risks for 'unforeseen eventualities' every day as an unavoidable condition inherent in the sewer business. In order to make a case for an Alternative 1 agreement it is necessary to examine what level of liability exposure the district can accept and determine if an agreement can be crafted to suit.

Many of the questions that counsel raises concerning assignment of responsibilities, whether for pipe ownership, maintenance, or a deteriorating system can be assigned to one or the other agency in an agreement. Essentially all aspects of the design, construction, repair, maintenance and operation of a pipe network can be analyzed in detail and allocated to a specified agency as the responsible party. Again as stated in the previous section, it would result in a very complex agreement. However the liability exposure that is the most problematic in an Alternative 1 agreement is associated with third party lawsuits for potential regulatory compliance violations. Before addressing this issue in more detail a brief overview of what is currently taking place in California is in order.

State and Regional Sewer Regulation and Local Liability. The federal CMOM regulations have been pending for the last five years and have yet to be issued. However, as is usually the case with environmental regulations, California is taking the lead and promulgating its own variations of CMOM around the state. 26 local agencies in Orange County were issued a joint collection system GWDR permit in 2002. Fast growth coupled with aging infrastructure and resulting sewer overflows led to the first NPDES permit in California issued for a collection system in the City of Folsom the same year. A year later the City of San Diego was issued a similar permit. Here in the Bay Area the Regional Board has partnered with the Bay Area Clean Water Agencies (BACWA) to develop a standard internet-based sewer overflow reporting system, and develop regional SSMP guidelines. According to their current schedule the Regional Board will also issue Section 13267 letters to all 106 local agencies that own or operate a sewer collection system in the fall of this year. A '13267 letter' is a request for information and is very specific in asking for all the details of each agency's sewer operations. Non-compliance with the request is not an option.

Even more troubling for local sewer agencies are some recent citizen lawsuits that have been filed under the Clean Water Act. The City of Pacific Grove in Monterey County recently settled such a suit filed by a local environmental group. The suit was filed because the city had experienced what was considered by the plaintiff to be an excessive number of sewer system overflows. The consent decree sets a compliance schedule for what is essentially a CMOM-based program. That is a reasonable outcome, except that the city is also required to pay \$300,000 for the plaintiff's attorney fees and costs, as well as a further \$250,000 for specified supplemental environmental projects. In the last week of April of this year the City of Oakland was also issued a consent decree based on a similar sewer overflow lawsuit. Given that Section 13267 letters are public information, the potential for these kinds of citizen suits could increase dramatically in the next year or two all over the Bay Area.

Limiting District Liability under Alternative 1. To ensure that the district does not assume unreasonable liability in an Alternative 1 scenario, the agreement would need to stipulate the following conditions: 1) all sewers within the Town's jurisdiction, except for those specifically built or rehabilitated by the district, are owned 100 percent by the Town; 2) the Town is fully responsible for the operation and maintenance of all sewers within their jurisdiction, including those built or rehabilitated by the district; 3) the Town

is fully responsible for all repairs to the sewers within their jurisdiction; 4) the Town is fully responsible for all sewer back-ups, surcharges, stoppages or overflows except for those caused by a lack of capacity as confirmed by an engineering hydraulic analysis; 5) the Town is fully responsible for complying with all existing and future regulations affecting local sewage collection systems; 6) the Town fully indemnifies the district from all legal actions, suits and judgments brought against the Town for any cause concerning the operation, maintenance, repair or regulatory compliance of the sewer system within the Town's jurisdiction; and 7) the Town has the duty to defend the district at its own cost against all legal actions, suits and judgments concerning the operation, maintenance, repair or regulatory compliance of the sewer system within the Town's jurisdiction.

Another potential liability consideration concerns marking sewer locations when other construction is scheduled in the right-of-way or adjacent to a public sewer main or lateral. Current Underground Service Alert (USA) regulations do not require the marking of non-pressurized pipes, however the district responds to all USA requests within the district, except for the Town, in order to ensure that various construction activities do not inadvertently cause damage or non-approved repairs made to district sewers. Such damage can go undetected for a considerable time before a potential problem occurs. The simplest way to limit the district's liability for underground construction-caused sewer damage within the Town is to make it a condition of the agreement that the Town will mark all public sewers according to USA guidelines and assumes full responsibility for any construction-related damage to the system within their jurisdiction.

For its part the district would continue to be responsible for engineering design and inspection of sewer improvements, maintaining sufficient capacity for existing and future sewer users, televising sewer basins, and scheduling and constructing sewer rehabilitation projects for reaches of pipe that require more than a few point repairs. The agreement would also need to stipulate that any reach of pipe identified as needing rehabilitation or replacement was still the Town's responsibility to maintain in working condition until the new construction took place.

Summary of Liability Issues. An agreement can be written that limits the district's liability based on a very detailed allocation of responsibilities between the two agencies and strict indemnification language. At the same time it is an unavoidable fact that in addition to the ongoing risks and liabilities that are inherent in the ownership and operation of a sewer system there are new and increasing liabilities associated with both existing environmental law and emerging regulations. Regardless of strict liability and 'duty to defend' provisions in a new agreement, the district could face risks associated with legal interpretations of the fine line between each agency's contractual responsibilities. As expressed in the legal white paper this situation "may put the District and the Town of Los Gatos on opposite sides of the table." There is also a high probability that the district may be issued a separate NPDES permit within the next few years. Under an Alternative 1 agreement such a permit "creates an uneasy dichotomy between the control of system maintenance and the ultimate responsibility for how it is maintained." As stated earlier, the district has to assume responsibilities for unforeseen

eventualities every day, but the question for both the district and the Town is how much risk should be taken for known and/or likely eventualities?

CUSTOMER IMPACTS.

The Brown and Caldwell report examines several 'implementation issues' for each of the alternative service models. One of those issues was 'customer convenience' which the consultant interpreted only as "having a local office to visit to obtain permits." By this definition the consultant concluded there was no difference between Alternatives 1 and 3. However the real customer convenience issues to be considered when comparing the two service options relate to response to service requests, reliability of service, emergency response procedures, and customer satisfaction with service provided. It is a fact that residents of Los Gatos give the municipality very high marks for Town-provided services. Also the Town has prided itself on being (nearly) a full service community with Town staff providing a broad range of municipal services. Under an Alternative 3 arrangement the district would need to take extra care to reassure Los Gatos sewer customers that service response and reliability would in no way be diminished. It should also be noted that customers in the other areas served by the district have been very satisfied with the professionalism and helpfulness of district staff and the timeliness of service provided.

Over the years most of the customer problems the district has experienced have been in Los Gatos and are more often than not the result of confusion concerning agency responsibility. As previously discussed, an Alternative 1 agreement would need to be written carefully in terms of allocating responsibility and minimizing potential customer dissatisfaction. However it is still possible that future customer problems would occur. Over time agency personnel and practices change, and the intent of certain provisions in an agreement are forgotten or interpreted differently. It would require continuing diligence, year in and year out, to ensure each agency was fully cognizant of its responsibilities under an Alternative 1 agreement to minimize customer impacts.

ORGANIZATIONAL IMPACTS.

The Brown and Caldwell report states that "Each alternative will require some degree of organizational change for the Town and the District because of shifting responsibilities and CMOM/SSMP practices." The report notes that Alternative 1 would impact the Town more than the district due to the "small size of its current sewer maintenance staff" and enhancements to existing operations necessary to meet CMOM standards. This is arguably correct. However in considering Alternative 3, the report ignores the actual organizational impact on the Town, stating that "the Town would simplify its organization by eliminating sewer maintenance." Based on the current Town organization chart there are 10 positions (1 vacant) in the classifications of traffic, street and sewer maintenance. Four of these full-time positions are included in the Town's sewer maintenance program and paid for under the existing agreement with the district. Given the area within the Town's jurisdiction relative to the number of maintenance staff, it can be assumed that street and sewer maintenance workers are often used interchangeably based on work priorities. Four maintenance workers may spend most of their work time

on sanitary sewers, but it is likely that if funding was cut for these positions under Alternative 3 it would result in some impact on other maintenance functions in the Town. Certainly Alternative 3 has the most organizational impact of the two service options under consideration for both agencies. However it can also be said that these impacts are relatively short term in nature and would be addressed in a transition plan.

Conclusion

Alternative 1 has the advantage of the least organizational impact in the narrow sense of the term, that is as applied to current staffing and work assignments in both the Town and the district. In a broader context the organizational impact of this service option could be substantial for both agencies. In addition to meeting the challenge of enhancing services to satisfy new regulatory requirements, the Town is likely to experience a funding shortfall due to unavoidably higher costs compared to equity cost of service in the rest of the district. Imposing a service surcharge for Town sewer users to correct the shortfall could have further detrimental impacts for the district as well as the Town. Strict liability provisions under an Alternative 1 agreement would be onerous for the Town in the event of a third party lawsuit for anything from property damage claims to Clean Water Act violations.

For the district, Alternative 1 demands increased effort in the short term to develop a new agreement that would ensure uniform performance standards, service and cost equity, and strict liability provisions, as well as the continuing effort to sustain all agreement provisions over the long term. At the same time the continuing division of responsibilities coupled with increasing regulatory risks would always present a liability challenge to the district. In addition, there remains the strong likelihood that the district will be issued an NPDES permit for the entire area within our jurisdiction. This eventuality would place the district in the uncomfortable position of being the responsible party for permit compliance without the corresponding authority to directly control all sewer operations.

Alternative 3 presents new challenges for both agencies. It would require a carefully considered transition plan to ensure success. However it has certain long term advantages for the Town as well as the district. The Town would be freed from all future liability associated with owning and operating a sewer system. The Town would also be released from an increasingly difficult regulatory burden. Alternative 3 would allow the district to stabilize its risk and would ensure future service equity throughout the entire service area. Compliance with CMOM/SSMP standards and any other future wastewater regulations is unavoidable for the district because wastewater collection and disposal is our sole purpose as a public agency. Based on all available data and considerations for the future, Alternative 3 is the best service option for the district. District management strongly recommends that the Board of Directors support this option for future long term sewer operations in the Town of Los Gatos.

Recommendation

1. After discussion, note and file this report.
2. Adopt Alternative 3 as the preferred service option for further negotiation and agreement with the Town of Los Gatos.

Comparative Cost Data

Overview. A consultant (Lorick Associates) has developed a performance-based work planning and budgeting tool for all operations provided by the district. The inputs into the program include employee pay rates, equipment costs, materials and supplies, in addition to all infrastructure inventory such as lineal feet of sewer mains, number of manholes and number of service connections. Based on actual district operations and experience, each separate work activity is assigned an average daily production rate (ADP), a crew size, and an annual goal amount or estimated annual work quantity. Using all of these inputs the program calculates crew days, total labor days, and all labor, equipment and material costs for each work activity. Labor costs can be calculated using one of two overhead rates. For all work activities conducted by the district the overhead rate is based on 'avoidable cost.' The avoidable cost overhead rate is considered the standard preferred method for comparative cost analysis, benchmarking, and outsourcing evaluation for the public sector.

Estimated District Costs for Los Gatos Sewer Operations. The projected work plan for comparing district operational costs for Los Gatos includes 20 work activities grouped in eight different 'management unit areas' (Administration, Rolling Stock, Sewer Main Cleaning, etc.). The projected total of 432 labor days for all work activities can be used to derive the actual number of 'full time equivalent' employees needed for the work assignments. The result is 1.66 FTEs. One of the advantages of the district's operational budgeting tool is the ability to compare actual work performance with goal amounts. A good example is 'HVC cleaning' of sewer mains which is the largest single activity category in district operations. The assigned ADP is 5000 lineal feet for a two person crew. Actual district ADP for this activity in the 10 months beginning July 1 and ending April 30 is 5214 feet. This kind of comparison confirms that input parameters are realistic and goals are achievable.

Using current district costs and applying the 'avoidable cost multiplier' of 220.82 percent to district labor rates, the estimated total cost for completing all annual work activities in Los Gatos is \$191,286. Applying projected cost changes from the district's Proposed Budget for Fiscal Year 2004-05 increases the total cost to \$204,125. This figure can be compared directly to the Los Gatos Sanitary Sewer Maintenance Program proposed budget of \$543,590. Under an Alternative 1 agreement each Los Gatos sewer connection would need to pay an average annual surcharge of \$28 (plus notification, hearing and tax roll costs) to avoid subsidization, or service cost inequity, during the coming fiscal year. Projected operational cost savings under Alternative 3 is \$339,465 annually.

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*Charles T. Kilian
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White Paper

**General legal issues surrounding Option 1 and Option 3 of the
Brown and Caldwell Report: Assessment and Analysis of Public Sewer
System Operation and Management – April 2004**

Summary:

This report examines legal issues implicit in Option 1 and Option 3 of the Brown and Caldwell report. Because no actual controversy exists this paper merely touches on the potential legal questions that may arise. As negotiations proceed, more specific legal issues may evolve, which will be examined in supplemental papers at the request of the board.

At the outset, there is no apparent legal impediment to either of these options. The only obvious restriction to Option 1 is Health & Safety Code § 4742.4, which limits a long-term contract of this kind to fifty years or less.

Background:

In 1988, County Sanitation District No. 4, formed in 1948 under the provisions of the County Sanitation Act (Health & Safety Code § 4700 et seq.), became the West Valley Sanitation District of Santa Clara County, a name change that reflected its service area. While over time the original size of the district was reduced by annexations of some of the unincorporated areas into the City of San Jose, the population burgeoned.

Currently the West Valley Sanitation District serves a population of 118,500 and encompasses 18,477 acres. The current wastewater collection system maintained and operated by the District includes 429 miles of sewers lines.

West Valley Sanitation District provides wastewater and collection and disposal services for the cities of Campbell, Monte Sereno, Los Gatos, most of Saratoga, and the intervening unincorporated areas of the County.

The Town of Los Gatos operates its own collection system under an agreement with the District whereby the District reimburses the Town for its sewer operating and maintenance costs. The agreement between the Town of Los Gatos, which dates back to 1977 will expire on June 30, 2004.

Recent increases (as high as 65%) in the costs of sewer maintenance for the Town of Los Gatos have triggered a cost analysis study by the District and the Town. With the agreement about to expire, the parties are closely examining the cost increase impact on the development of a new long-term operating agreement. The governing boards of both the Town of Los Gatos and the West Valley Sanitation District are giving thoughtful consideration as to whether the Town should continue to retain the maintenance and operational responsibilities or whether they should pass them fully to the West Valley Sanitation District. Under discussion are the increased costs to Los Gatos, possible inequities for other sewer rate payers, and potential liabilities and responsibilities.

Inherent in all discussions regarding a long-term operations agreement are the potential effects of new state and federal regulation. Efforts to promulgate a federal sanitary sewer overflow (SSO) regulation under the Clean Water Act (CWA) have been ongoing. The U.S. Environmental Protection Agency (EPA) has proposed a draft regulation, which is currently under review.

The draft EPA rule contains four principal components: (1) a proposed capacity, management, operation and maintenance (CMOM) standard permit condition for sanitary sewer collection systems (to be codified in 40 CFR 122.44(e)); (2) the proposed prohibition against discharges from sanitary sewer collection systems (to be codified in 40 CFT 122.44(f)); (3) proposed permit requirements for satellite collection systems (to be codified in 40 CFR 122.38); and (4) proposed standard permit conditions for reporting, public notification and public record keeping for sanitary sewer systems and SSOs (to be codified in 40 CFR 122.44(g)).

The CMOM standards appear to be an attempt to go upstream with regulations that currently only affect dischargers through their NPDES permits to reach collectors and others with liability regulation and enforcement that could include fines, civil and possibly criminal prosecution with almost no viable affirmative defenses. The new regulations will affect West Valley Sanitation District as a collector. If it will affect the Town of Los Gatos in its currently limited role is unclear. If Los Gatos takes over the entire system and West Valley Sanitation District de-annexes that portion of the district, Los Gatos will become subject to the CMOM regulations, liabilities and enforcement policies.

While the final draft of the proposed regulations is yet to be finalized, it is sure to become effective during the term of any long-term agreement entered into by West Valley Sanitation District and Los Gatos. In anticipation of new federal regulation and, in addition, facing increased costs for sewer services in Los Gatos creating possible inequities for other District ratepayers, the Town of Los Gatos and the District retained Brown and Caldwell, a consulting firm, to do an analysis of the current sewer operations and to provide options for the future. The recently completed study offered four possible scenarios for providing sewer services in Los Gatos:

- 1) Los Gatos would continue to provide maintenance services and the District would provide other services.
- 2) Los Gatos would take sole responsibility for Los Gatos sewers.
- 3) The District would take sole responsibility for the entire service area including duties currently provided by Los Gatos.
- 4) Los Gatos would take sole responsibility for its sewers but most of the work would be outsourced.

These options were reviewed at the District board meeting on April 14, 2004. At that time it was determined that the Town of Los Gatos preferred Option 1 or Option 3.

Originally, this office was enlisted to examine the legal ramifications of each of the four options offered by Brown and Caldwell. At this time we will consider the legal and jurisdictional issues in regards to Option 1 and Option 3.

Legal analysis:

Option 1: Los Gatos would continue to provide maintenance services and the District would provide other services.

Option 1 closely resembles the current relationship between Los Gatos and the District. Health and Safety Code § 4742 authorizes the District to join with other districts, cities or government agencies in the purchase, ownership, use, construction, maintenance or operation of a sewerage system either within or without the District. Pursuant to this statute, Los Gatos and the District entered into a loosely drawn agreement in 1977 for the operation and maintenance of the Los Gatos sewers. In 1991 the agreement was amended to add changes in procedures regarding the Town sewer system operation, funding of sewer extensions and replacement, and staffing at each agency. In 2001 the agreement was extended and amended. At this time a mutual indemnification clause was added to the agreement. Further, according to the 2001 agreement, in light of fact that, "pursuant to the Federal Clean Water Act, the United States Environmental Protection Agency is in the process of promulgating new regulation for the operation of public sanitary sewer systems" and because Town and District intended to "analyze current and projected costs of sewer service

and determine how best to provide Town sewer users with the most cost-effective service after said regulations are in effect” the agreement was extended to finally terminate on July 1, 2004. This is the state of the Agreement today.

Effect of New Federal and State Regulations

As previously stated, the anticipated new regulations for the operation of public sanitary sewer systems have not yet been promulgated except in draft form. However, the draft federal sanitary sewer overflow (SSO) regulation does outline the Environmental Protection Agency’s position with regard to SSOs, which would be categorically prohibited and could only be excused through the exercise of “enforcement discretion” (in emergency situations when there is no feasible alternative to the overflow) or on the basis of an extremely limited “affirmative defense” (when caused by severe natural conditions such as hurricanes, tsunamis and earthquakes). According to a “white paper” released by the Association of Metropolitan Sewerage Agencies (AMSA), in the draft the EPA claims that the prohibition would be a “technology-based limitation” based on Clean Water Act § 301(b), which prohibits discharges except in compliance with the Act. The EPA notes that certain provisions in the federal construction grant regulation require grantees to assure proper and efficient operation and maintenance of treatment works and their associated collection systems. (See Draft SSO Rule preamble at 64, citing 40 CFR 35.925-10; 35.935-12; 35.2106; and 35.2206.) The EPA states that its legal basis for regulating satellite collection systems “derives from the definition of ‘publicly owned treatment works’” which, according to CWA § 212(2)(A) includes “any devices and systems used in the storage, treatment, recycling and reclamation of municipal sewage or industrial wastes of a liquid nature...including...intercepting sewers, outfall sewers, sewage collection systems...” The AMSA white paper states that EPA’s intention is that the CMOM provisions in the Draft SSO Rule would be implemented throughout the entire publicly owned treatment works, which is “defined to include the POTW treatment plant and collection system.”

While the EPA draft is under fire as a flawed document, it is clear that the intent is that new regulations, whenever they are promulgated, will reach as far as possible to include every agency with an interest in a publicly owned treatment works. Even though the EPA regulations are still in draft form, the State of California is moving ahead with CMOM-based regulations for all collection agencies. New California regulations, already promulgated in southern California, may be statewide as early as the Fall of 2004. At this time, the California regulations are considered guidelines with some reporting requirements. No permits are being issued at this time. While the legal implications of the new state regulations are not currently ascertainable, it is expected that in the very near future they will be more comprehensive and more restrictive than they are today.

With this in mind, the effect of the proposed regulations on both the Town of Los Gatos and West Valley Sanitation District is of crucial importance when considering a long-term operational agreement for sewer service. It is imperative that any new agreement between Los Gatos and the District provide the strictest delineation of duties and responsibilities and the broadest protections for each agency. Alternative 1 offered by Brown and Caldwell has suggested that Los Gatos' normal maintenance duties be expanded to include repairs normally performed by sewer maintenance crews and outsourced to local contractors. According to Brown and Caldwell, "With this modification of work, the responsibility and liability of SSOs could be more easily delineated with the Town responsible for all dry weather SSOs/stoppages and wet weather SSOs related to roots, grease, and other problems except flow. The District would be responsible for ensuring hydraulic capacity in the collection system." A precise delineation of responsibilities will help identify SSOs and prevent both agencies from getting caught up in a morass of State and Federal reporting, recordkeeping, penalties and fingerpointing.

Federal penalties for violation of the Clean Water Act can be severe. Section 309 of the Act sets out the factors for determining the appropriate type and amount of penalty for violations. 33 U.S.C. § 1319. Criminal, civil, or administrative penalties may be imposed. Each day of a violation is considered a separate offense for the purpose of assessing penalties.

Civil and criminal penalties are imposed in civil enforcement proceedings in United States District Court for the district in which the defendant is located or resides or is doing business. 33 U.S.C. § 1319(b). Criminal penalties may be sought for negligent or knowing violations, or violations that consist of knowing endangerment. 33 U.S.C. § 1319(c). Under the Clean Water Act, simple negligence can subject one to criminal penalties. See *United States v. Hanousek*, 176 F. 3d 1116 (9th Cir. 1999), *cert. denied* 528 U.S. 1102 (2000). Criminal penalties range from fines of up to \$50,000 per day and imprisonment terms of up to 15 years. In theory, corporate officers can be held personally liable for criminal acts committed by subordinates without their knowledge. (*California Land Use and Planning Law*, 24th Ed., Daniel J. Curtin at 188.)

Civil and administrative penalties are equally onerous with fines reaching a maximum of \$27,500 per day for each violation.

A Surcharge to Balance Inequities

Los Gatos has had significant cost increases over the past few years that exceed the costs for services in the rest of the District. It has been recommended that the Los Gatos users pay for their proportional share of District provided costs and all of the Town's maintenance costs. This would be accomplished with a surcharge for Los Gatos customers. A surcharge of this nature is, arguably, a property related fee subject to the Proposition 218

procedures for the imposition of such fees. Notably, requiring notice and a public hearing.

It has been a District policy to treat all users in similar circumstances the same. Los Gatos users may object to a surcharge because the service they receive is the same service that any other resident in the district receives. Without the surcharge for Los Gatos users the increased cost would be spread districtwide, and District customers outside the Los Gatos service area would, in effect, subsidize the Los Gatos system.

No solution other than the surcharge has been presented for balancing this inequity of costs.

Responsibility for Civil Liability

Civil liabilities for a failing system may result in lawsuits claiming causes of action for negligence or other torts or claims of inverse condemnation.

The Government Code states, "Whenever any public entities enter into an agreement, they are jointly and severally liable upon any liability which is imposed by any law other than this chapter upon any one of the entities or upon any entity created by an agreement for injury caused by a negligent or wrongful act or omission occurring in the performance of such agreement." Government Code § 895.2

However, there is some protection offered by Government Code § 895.4 which states that, "As a part of any agreement, the public entities may provide for contribution or indemnification by any or all of the public entities that are parties to the agreement upon any liability arising out of the performance of the agreement." Pursuant to this section, the 2001 Amendment to the agreement between Los Gatos and the District added a mutual indemnification clause to the agreement for the first time. Delineation of responsibilities and duties will help to insure that, if and when the need arises, indemnification is appropriately applied.

Nevertheless, even the most precise division of responsibilities and the most comprehensive indemnity clauses cannot address every unforeseen eventuality. Given the physical state of the system, even the agencies themselves may be challenged to ascribe responsibility. If, for instance, a leak should occur causing damages to property owners, will the following questions be answerable? Who owned the pipe? Who was responsible for maintenance? Is it leaking because the system is antiquated? Was someone negligent, careless or did the pipe just wear out?

The District, as the holder of the NPDES permit, has more exposure regarding both civil liability and regulatory compliance. The Brown and Caldwell recommendation for the delineation of duties separates the District from the day-

to-day maintenance duties. At first glance this appears to offer some insulation to the District for possible CMOM violations and penalties. In fact, it creates an uneasy dichotomy between the control of the system maintenance and the ultimate responsibility for how it is maintained.

This disconnection could be remedied in the agreement by giving the District oversight of the system, a remedy that, in turn, defeats the objective of the separation of duties.

Option 3: The District would take sole responsibility for the entire service area including duties currently provided by Los Gatos.

Under this option the existing agreement between Los Gatos and the District would not be renewed or extended and Los Gatos would no longer perform collection system maintenance.

Transfer of Assets

The District is authorized to accept the transfer of the Los Gatos collection system by the Health & Safety Code which states, "The district may acquire by gift, purchase, condemnation, or otherwise, in the name of the district, and own, control, manage, and dispose of any interest in real or personal property necessary or convenient for the construction, maintenance, and operation of a sewerage system and sewage disposal or treatment plant..." (Health & Safety Code § 4740.)

Under Option 3 the District would take ownership of the entire sewer system including the portion of the system now belonging to the Town of Los Gatos. As cited above, adding this portion to the District's system can be accomplished in several ways, most commonly by purchase or gift.

Valuation of the system is complicated by the fact that some of the system is over fifty years old and much of the system is inadequately mapped. It must be determined whether or not some of the system is depreciated out and has no value at all. Due to the age of the system, the District, if purchasing the system, may wish to require some period of warranty, to insure the system's fitness for its ordinary purpose. A warranty would protect the District in the event that, soon after the transfer, the system failed. However, it would be unusual to warrant the system if it is gifted to the District.

Transfer of the system would include transfer of all rights-of-way and all easements, which would be recorded to the benefit of the District.

If the agencies cannot reach an agreement on either Option 1 or Option 3, or some variation thereof, the District can, with some preparation, pursue Option

3 by initiating an action in eminent domain. (CCP § 1245.240.) However, that is a discussion for another day.

Regulatory compliance and civil liability

The District, as owner, operator and manager, would accept responsibility for compliance with CMOM and other state and Federal regulations for the entire Los Gatos sewer system just as it does in the rest of the district.

If the District had ownership of the entire Los Gatos sewer system, the District would accept liability for any claims for injury or damages arising out of or caused by District's sewer maintenance in Los Gatos.

Conclusion:

While there is no legal impediment that prevents either of the options discussed herein, Option 1 has more potential for legal issues, some remedial, some more challenging. Even a very carefully drafted agreement will not anticipate every unforeseeable legal issue, some of which may put the District and the Town of Los Gatos on opposite sides of the table.

A long term agreement entered into at this time will be finalized prior to the actual enactment of crucial Federal regulations that may affect the relationship of the parties. The drafters of the agreement can speculate on what the final regulations will be and try to tailor the agreement to cover all contingencies.

Prior to drafting the agreement the District and the Town of Los Gatos will have to address the conundrums of the surcharge and the delineation of duties.

If, under Option 3, the District assumes ownership of the entire sewer system, it also assumes all the liability for a system with several unknowns. Parts of the existing Los Gatos system is antiquated and in poor repair. Some of the system is unmapped. Easements and rights-of-way may need to be verified, corrected or renegotiated.

The District may also need additional staff and equipment immediately upon taking on Los Gatos' 12,300 connections.

However, for the District these problems are not insurmountable. The District routinely deals with similar problems in the rest of the district. With over 50 years of sanitation district management experience, the District is eminently qualified to take over the Los Gatos system