

COURT OF APPEALS
DIVISION I
OF THE STATE OF WASHINGTON

SATWANT SINGH and DHALIWAL REAL ESTATE, LLC,

Appellants,

v.

COVINGTON WATER DISTRICT,

Respondent.

BRIEF OF RESPONDENT
COVINGTON WATER DISTRICT

INSLEE, BEST, DOEZIE & RYDER, P.S.
Eric C. Frimodt, WSBA #21938
Attorneys for Covington Water District
Skyline Tower, Suite 1500
10900 NE 4th Street
P.O. Box 90016
Bellevue, Washington 98009
Telephone: (425) 455-1234

FILED
APR 10 2014
COURT OF APPEALS
DIVISION I
SEATTLE, WASHINGTON



TABLE OF CONTENTS

I. INTRODUCTION 1

II. STATEMENT OF THE CASE 1

 A. Relevant Facts.. 1

 B. Procedural History. 13

III. ARGUMENT 14

 A. The District’s “Duty To Serve” And Important
 Public Policy Implications. 14

 B. The District’s Policy Relating To The Non-
 Refundable Nature Of Incremental Connection
 Charge Payments Is Authorized By Statute. 20

 C. The District’s Policy Relating To The Non-
 Refundable Nature Of Incremental Connection
 Charge Payments Is Not Arbitrary, Capricious Or
 Unreasonable. 25

 D. The Developer’s Challenge Based On An Asserted
 Unlawful Monopoly Power Should Be Rejected. 30

 E. The Developer’s Assertion That The Non-
 Refundability Provision In The SEAs Is An
 Unlawful Tax or Penalty Should Be Rejected. 33

 F. The Developer’s Assertion That The System
 Extension Agreements Are Void As Being
 Against Public Policy Should Be Rejected. 39

 G. Plaintiffs’ Assertion That The Loss Of Its
 Incremental Connection Charge Payments Results
 In An Unlawful Windfall To The District Should
 be Rejected. 43

IV. CONCLUSION 45

TABLE OF AUTHORITIES

Cases

<i>Abbenhaus v. Yakima</i> , 89 Wn.2d 855, 858-59, 576 P.2d 888 (1978)	28
<i>Branson v. Port of Seattle</i> , 152 Wn.2d 862, 870, 101 P.3d 67 (2004)	27
<i>Burns v. Seattle</i> , 161 Wn.2d 129, 143-45, 154-55, 164 P.3d 475 (2007)	26, 28, 29
<i>Cook v. Johnson</i> , 37 Wn.2d 19, 23, 221 P.2d 525 (1950)	43
<i>Covell v. Seattle</i> , 127 Wn.2d 874, 879, 905 P.2d 324 (1995).....	33, 35
<i>Eagle Livery & Transfer Co. v. Lake Chelan Recl. Dist.</i> , 155 Wash. 101, 105-06, 283 P. 678 (1930)	39
<i>Ebling v. Gove’s Cove, Inc.</i> , 34 Wn. App. 495, 499, 663 P.2d 132 (1983)	43
<i>Furth v. West Seattle</i> , 37 Wash. 387, 392-93, 79 P. 936 (1905)	39
<i>Metro Seattle v. Div. 587, Amalgamated Transit Union</i> , 118 Wn.2d 639, 643, 826 P.2d 167 (1992).....	26, 27, 29
<i>Motor Contract Co. v. Van Der Volgen</i> , 162 Wash. 449, 454, 298 P. 705 (1931)	41
<i>Pub. Util. Dist. No. 1 v. Newport</i> , 38 Wn.2d 221, 227, 228 P.2d 766 (1951)	28
<i>Samis Land Co. v. Soap Lake</i> , 143 Wn.2d 798, 23 P.3d 477 (2001)	33, 34, 35

<i>State Farm Gen. Ins. Co. v. Emerson</i> , 102 Wn.2d 477, 481, 687 P.2d 1139 (1984)	40, 41
<i>Sudden Valley Community Ass'n v. Whatcom Co. Water District No. 10</i> , 113 Wn. App. 922, 926 fn. 4, 55 P.3d 653 (2002)	26
<i>Tacoma v. Bonney Lake</i> , 173 Wn.2d 584, 589, 269 P.3d 1017 (2012)	26, 28, 29
<i>Tukwila Sch. Dist. v. Tukwila</i> , 140 Wn. App. 735, 748, 167 P.3d 1167 (2007)	36
<i>Viking Properties, Inc. v. Holm</i> , 155 Wn.2d 112, 126, 118 P.3d 322 (2005).....	41
<i>Washington Fed. Sav. & Loan v. Alsager</i> , 165 Wn. App. 10, 14, 266 P.3d 905 (2011).	24

Statutes & Codes

RCW 43.20.260	2, 14, 15
RCW 57.08.005	20
RCW 57.08.005(11)	17, 19, 21
RCW 57.08.005(3)	21, 41
RCW 57.08.007	32
RCW 57.22.010	22, 35, 40
RCW 57.22.010(5)	23, 29
RCW 57.22.010(6)	7, 23, 24, 25, 29, 41
Chapter 70.116 RCW	31

RCW 70.116.010.....	31, 32
RCW 70.116.020.....	31
RCW 70.116.050.....	32
RCW 70.116.060(3)	32
WAC 246-290-100(1).....	14
WAC 246-290-100(4).....	14

I. INTRODUCTION

This case is essentially a contract dispute between the Respondent Covington Water District (“District”) and the Appellants Satwant Singh and Dhaliwal Real Estate, LLC (referred to herein collectively as the “Developer”) who defaulted on the terms of a developer extension contract with the District by failing to complete the project in accordance with the terms and conditions of the contract. The Developer concedes that the contract between the District and Developer was an enforceable contract at the time it was entered into. Developer’s Brief, at 6. However, the Developer is seeking a refund of \$74,800 in incremental connection charge payments made over a nearly six year period which the contract clearly indicated were non-refundable in the event of the Developer’s default. The Developer asserts that the non-refundability provision is unreasonable and should not be enforced. The Court should reject the Developer’s arguments and affirm the trial court’s decision dismissing the Developer’s lawsuit.

II. STATEMENT OF THE CASE

A. Relevant Facts. The following facts are relevant to the issues before the Court.

1. Covington Water District.

The District provides water service to approximately 50,000 customers in the cities of Covington, Maple Valley and Black Diamond, and unincorporated areas of King County. The District has a total of 11 production wells, 3 treatment plants, 20.5 million gallons of storage in steel tanks at seven sites throughout the District, and over 267 miles of pipeline. (CP 39-40). From 1994 to 1997, the District experienced a severe water supply shortage that resulted in the imposition of a water and building moratorium. As a result, the District invested in the Howard Hanson Dam project (the Regional Water Supply System) in order to obtain additional water resources at a cost of approximately \$63,000,000 which is being financed over a 20 year period. The District secured this additional water resource as part of its “duty to serve” under the Municipal Water Law (RCW 43.20.260) which requires the District to provide service to new connections within the District’s retail service area under certain conditions. The District’s investment in the Howard Hanson Dam project has had a significant impact on the rates and connection charges the District must charge its existing and new customers in order to recover its costs. (CP 41).

2. Victorian Meadows Development.

The Developer was engaged in a residential development consisting of approximately 30-31 lots located in the City of Covington. The proposed development was generally referred to as the “Victorian Meadows” project (“Project”). The Developer first began its development activities in 2005. (CP 134). Mr. Singh was a college graduate, a licensed real estate agent, and an experienced real estate developer. (CP 130-133).

In order to provide water service to the Project, as well as other properties located in the vicinity, the District participated in a joint project with the City of Covington referred to as the “SE Wax Road / 180th Avenue SE Improvement Project.” The designs for this project were completed in April 2007. As part of the City of Covington’s project, the District paid for the design and construction of new water facilities and the replacement of certain water facilities located in SE Wax Road and 180th Avenue SE. The total cost of the new water facilities paid for by the District was \$1,326,106.67. The District accepted these water facilities as being complete in February 2010 and

these water facilities were available to provide water service to the Developer's Project. (CP 58, 94).

The Developer argues that the District never informed the Developer of this SE Wax Road / 180th Avenue SE Improvement Project or the fact that the District obtained additional water rights by participating in the Howard Hanson Dam project. Developer's Brief, at 4-5. It is undisputed that these actions were taken by the District and allowed the District to be able to provide water service to the Developer's Project and other properties in the vicinity. The fact that the Developer claims not have known about these projects is irrelevant to the issues on appeal. Further, the District didn't have any duty to specifically inform the Developer about the project. The Court should ignore the Developer's arguments in this regard.

The Victorian Meadows Project ultimately failed as a result of the recession which led to a drop in land values and the loss of funding when the Developer's bank called the loan. The Developer acknowledges that the District was not responsible for the Project's failure. (CP 146).

3. Water Availability Certificate and System Extension Agreement Process.

The City of Covington required the Developer to provide water and sewer availability certificates for the Project as a condition of issuing a building permit. The Developer approached the District for a water availability certificate because the Project was located within the District's approved water service boundary. (CP 134, 154).

When a developer approaches the District about obtaining water service, the first step in the process is for the developer to complete what the District refers to as a "Water Availability Certificate Application Form." The Application provides the District with basic information about the proposed development project so the District can determine whether it has the ability to serve the development. The District refers to a Water Availability Certificate as a "WAL" which is an acronym for "Water Availability Letter." WALs issued by the District expire after one year, unless renewed or extended. (CP 48-50).

Once a WAL is issued by the District, the developer continues to work with the applicable land use jurisdiction (i.e., city or county) to obtain approval and permits for the development. The next significant interaction that the District has with a developer will be in connection

with the requirement that the developer complete a “System Extension Application and Agreement” for any needed water system improvements to serve the development. The District refers to the System Extension Application and Agreement as a “SEA.” Once the SEA is approved by the District, it becomes a binding contract relating to the proposed development. The SEA requires that the new water facilities be constructed by the developer in full compliance with plans approved by the District Engineer and in accordance the District’s standards and specifications. Once the new water facilities are constructed and approved of by the District Engineer, the water facilities are conveyed and transferred to the District and become part of the District’s public water system. (CP 50).

Importantly, a developer is not required to enter into the SEA with the District until such time as it is ready to begin work on the project for design and construction. Since a developer is required to pay the District certain fees, including incremental connection charge payments, when it enters into the SEA, developers generally wait to enter into the SEA until the project is approved or nearing final approval of the applicable land use jurisdiction. Once the SEA is approved by the

District, the SEA requires that the construction of the water facilities be completed within one (1) year. However, District policy and the terms of the SEA allow for the extension of the time period to complete the system extension. (CP 51).

One way of ensuring that developers proceed with their developments with due diligence is to place time limits on the effective dates of WALs and SEAs, and to require the payment of non-refundable incremental connection charges which serve as a form of security to ensure completion of the particular project and other performance required under the terms of the SEA. The District believes this policy encourages developers to pursue their projects in a timely manner which allows the District to better track and account for both current and future water demands, which often include the need to construct expensive water facilities to serve the contemplated development. The policy also recognizes the water supply commitment the District makes to the developer. (CP 43-44, 61).

RCW 57.22.010(6) specifically authorizes the District to include terms in the SEA that provide adequate security to the District that the developer will complete the water system extension project and

otherwise perform its contract obligations. (CP 61). The Developer acknowledged that the District's incremental connection charge policy provided an incentive for him to complete the Project. (CP 151).

On or around May 30, 2005, the Developer signed and submitted a WAL Application to the District for a proposed 30 lot residential development. Paragraph 5 of the WAL Application specifically provides as follows: "The Applicant is required to pay \$100.00/ERU (Equivalent Residential Unit) non-refundable incremental payment towards final connection charges before the Water Availability Certificate will be released." (CP 51-52, 64) (emphasis added). Paragraph 7 of the WAL Application also provides as follows: "CERTIFICATES SHALL BE ISSUED FOR 12 MONTHS. TO AVOID LOSING THE NON-REFUNDABLE INCREMENTAL PAYMENTS TOWARD CONNECTION CHARGES PRIOR TO EXPIRATION, THE APPLICANT MUST APPLY FOR A NEW CERTIFICATE." (CP 51-52, 65) (emphasis added). The Developer paid \$3,000 in incremental connection charge payments on June 2, 2005 (\$100 per lot for the then anticipated 30 lot development). (CP 52).

The initial WAL issued to the Developer was renewed and revised several times after its issuance in June 2005 through September 2007. As part of the WAL process, the Developer paid a total of \$9,700 in incremental connection charge payments during the WAL phase of the Project. (CP 51-54, 67, 69, 71, 73).

In late 2007, the Developer advised the District that the Project was moving forward. In response, the District prepared the SEA and mailed it to the Developer for his review. (CP 54, 75-80, 82-83). The Developer signed the SEA on January 11, 2008 and the SEA was approved by District resolution. The Developer paid an additional \$15,500 in incremental connection charge payments on January 11, 2008 (\$500 per lot for the then anticipated 31 lot development). (CP 54, 75-80).

Paragraph 3 of the SEA required that construction of the new water facilities be completed within one (1) year, unless extended. The SEA could be extended for a total of 4 one-year time extensions by paying an additional \$1,000 per ERU as a non-refundable incremental payment toward connection charges for each year an extension was requested. Paragraph 3 of the SEA specifically provided as follows:

“Failure to request a time extension before the one in force expires or expiration of the maximum five years allowed for system extensions, will result in the termination of the ERU allocation and forfeiture of all connection charge deposits.” (CP 54, 76) (emphasis added). Paragraph 5 of the SEA also provides as follows: “At the time of application for System Extension, Owner will pay \$500.00 per ERU (Equivalent Residential Unit) non-refundable incremental payment toward final Connection Charges (Future Facilities and Existing System Charges). All Connection Charges will be paid in full prior to District acceptance, except the Meter Installation Fee.” (CP 54-55, 76) (emphasis added). As a result, the Developer had clear notice that the incremental connection charges payments made under the prior WALs and the SEA were non-refundable if the Project was not completed as required by the terms of the SEA.

The Developer failed to request an extension of the SEA and the SEA expired in January of 2009. The Developer acknowledges that the District sent him advance notices of the Developer’s need to renew the WAL and SEA. (CP 135). As a result, all the prior incremental connection charge paid by the Developer under the WALs and SEA were

forfeited to the District. Several months after the first SEA expired, the Developer approached the District and asked that a new SEA be prepared so he could proceed with the Project. The District prepared and provided the Developer with a new SEA for the Project. The new SEA was signed by the Developer on April 20, 2009 and was approved by District resolution. The Developer paid an additional \$15,500 in incremental connection charge payments on April 28, 2009 (\$500 per lot for the anticipated 31 lot development). This new SEA contained the same provisions in Paragraphs 3 and 5 of the SEA regarding the non-refundable nature of the incremental connection charge payments. (CP 55-56, 85-90).

Near the one year expiration date of the second SEA, the Developer requested a one year extension of the SEA and paid an additional \$31,000 in incremental connection charge payments on May 20, 2010 (\$1,000 per lot for the anticipated 31 lot development) as required by the SEA. Although the SEA was extended for an additional year, the Developer once again failed to proceed with the Project as required by the SEA. (CP 56). In May of 2011, the Developer requested another one year extension of the SEA and paid an additional \$3,100 in

incremental connection charge payments on May 17, 2010 (\$100 per lot for the anticipated 31 lot development) as required by the terms of the SEA. The reduced payment of \$100 per ERU was due to a new policy adopted by the District in October 2010 in recognition of the economic slowdown that was affecting development activities. (CP 56). The Developer made a total of \$74,800 in incremental connection charge payments under the WALs and SEAs over a period of approximately six years. (CP 57, 92).

The second SEA would have remained in effect until May of 2012. However, in October of 2011 the Developer notified the District that he was abandoning the Project. (CP 56-57, 145).

The Developer requested that the District provide him with a refund of all amounts paid under the WALs and SEAs. However, since the incremental connection charge payments were non-refundable under the District's adopted policy and under the express terms of the SEA, the District informed the Developer that he would not receive a refund of the incremental connection charge payments. However, in accordance with the terms of the SEAs, the District refunded to the Developer \$2,516.26 which was the remaining balance of the Developer Receivable Account

which included amounts paid in advance to cover District costs and staff time in the review and processing of the Project application and designs. (CP 56-57).

The Developer acknowledged signing the two SEAs but claims not to have read the contracts because he wasn't concerned about being able to complete the Project. (CP 140, 144). The Developer also admitted that the District did not pressure him to sign the SEAs. (CP 141, 144).

B. Procedural History.

The Developer filed its lawsuit against the District on September 20, 2013 seeking the recovery of the non-refundable incremental connection charge payments under various legal theories. (CP 1-4). On May 13, 2014, the District filed its motion for summary judgment against the Developer seeking the complete dismissal of the Developer's lawsuit. (CP 15-38). On July 29, 2014, the trial court entered an order granting the District's motion for summary judgment and dismissed the Developer's lawsuit in its entirety. (CP 226-228).

III. ARGUMENT

A. The District's "Duty To Serve" And Important Public Policy Implications.

As the Court considers the issues on appeal, it is important for the Court to understand the potential ramifications of a decision that would limit the District's ability to use the incremental connection charge payments as they are collected. The Municipal Water Law adopted by the Legislature in 2003 imposed upon municipal water suppliers a "duty to serve" new customers within their approved water service areas, provided that sufficient water rights are available and service can be provided in a "timely and reasonable manner." This statutory requirement is codified in RCW 43.20.260.

As a result of the "duty to serve," municipal water suppliers have been required to plan proactively for delivering water to unserved or under-served areas located within their approved retail service areas. In fact, under applicable Department of Health regulations, the District is required to adopt a Water System Plan in order to demonstrate how the District's water system will address present and future needs for a planning period extending at least twenty (20) years into the future. WAC 246-290-100(1) and (4).

The Developer argues, without citation to legal authority, that the “duty to serve” relates only to a requirement to meet minimum standards of water quality. Developer’s Brief, at 11. A simple reading of the plain language of RCW 43.20.260 demonstrates the Developer’s lack of understanding regarding the requirements of the duty to serve. *See* RCW 43.20.260. As a result, the Court should ignore the Developer’s arguments as it relates to the duty to serve.

Contrary to the Developer’s arguments, the District cannot simply ignore the fact that future development will occur within the District’s service area and the District must be prepared to provide water service to meet this demand. In the District’s case, this means that significant financial resources had to be expended in order secure adequate water resources (e.g. Howard Hanson Dam project) for current and future use and to build new water facilities (e.g., reservoirs, pump stations and transmission main lines) in order to extend the District’s public water system to areas not currently served. (CP 41-42).

In fact, the Developer’s Project was a direct beneficiary of the joint project between the District and the City of Covington called the “SE Wax Road / 180th Avenue SE Improvement Project” which included

offsite water facilities and improvements that were required to provide water service to the Developer's Project, as well as other properties located within the vicinity. The District spent \$1,326,106 on this project. (CP 58, 94). While the Developer was required to construct the "onsite improvements" required to distribute water throughout its development, the Developer's Project would not have been able to proceed had the District not proactively brought sufficient water facilities to that area to facilitate the Developer's development activities. Therefore, it is ironic that the Developer now argues to this Court that the District could have simply rejected the Developer's request for a WAL or imposed another moratorium. Developer's Brief, at 12. The Developer's Project was made possible by the proactive planning efforts engaged in by the District in order to meet its duty to serve customers within its service area.

There are two primary sources of revenue to fund District capital improvement projects, like the SE Wax Road / 180th Avenue SE Improvement Project. One source of revenue is through the adoption of rates and charges for water service that are paid by customers already connected to the District's water system on a bi-monthly basis. The other

primary source of revenue is through the collection of connection charges which must be paid as a condition of connecting to the District's water system as authorized by RCW 57.08.005(11). (CP 42-43).

RCW 57.08.005(11) specifically authorizes the District to charge property owners seeking to connect to the District's water system a connection charge. This statute gives the District's Board of Commissioners discretion to establish a connection charge so that developers and property owners connecting to the District's water system bear their equitable share of the cost of the system. The statute also describes what components can be included in the calculation of a connection charge. For example, RCW 57.08.005(11) specifically authorizes a connection charge to include a pro rata share of the cost of existing facilities, as well as a pro rata share of facilities planned for construction within the next ten years, provided that the new facilities are contained in an adopted comprehensive plan. This is important to note because it is an acknowledgment that the District must engage in prospective planning efforts to build water facilities to serve new customers in the future. As a result, there is nothing improper with the District using revenues from connection charges, including incremental

connection charge payments, to pay for the cost of new water facilities that are required to serve new areas located within the District. (CP 42-43).

From a policy perspective, the District has determined that it is more equitable to its existing customers that the District recover a significant portion of the cost of constructing its future facilities through connection charges rather than through rates. That way, as development occurs, the developers are helping pay for their fair and equitable share of existing and future capital facilities through the payment of connection charges (i.e., “growth pays for growth”). If the District were required to finance the construction of all future water facilities through water rates, the rates charged to the District’s existing customers would have to be significantly higher and all of the District’s existing customers would essentially be paying for costs incurred by the District to construct water facilities to serve new development. (CP 43).

If the District is required to treat the incremental connection charge payments as refundable deposits, the District would be prohibited from using those funds to help pay for the cost of constructing new water facilities necessary to fulfill the District’s duty to serve. This is due to

the fact that applicable accounting standards would require that the refundable deposit be reported as a liability in the District's financial records, and therefore would be unavailable for current use. The loss of this funding source would mean that the District would have to significantly increase the water rates charged to existing customers in order to fund improvements that are intended to serve future development. (CP 44).

For legitimate public policy reasons, the District has determined that it is more equitable to its existing customers to use connection charge revenues received as development occurs, including incremental connection charge payments as they are made, to pay for the cost of the District's existing water system, including future improvements planned within the next ten (10) years as authorized by RCW 57.08.005(11). (CP 44). In contrast, the Developer would like this financial burden placed on the backs of the District's existing customers which the District has refused to do. While the Developer may not like this policy, the District feels strongly that its existing customers should not bear undue financial burdens relating to growth and serving future development that should

properly be shouldered by the developers. There is nothing arbitrary, capricious or unreasonable about the District's policy.

B. The District's Policy Relating To The Non-Refundable Nature Of Incremental Connection Charge Payments Is Authorized By Statute.

The Developer asserts that the District's policy relating to the non-refundable nature of incremental connection charge payments made in connection with developer extension projects is unenforceable because it exceeds the District's statutory authority. Developer's Brief, at 6-10 and Complaint, ¶¶ 3.1, 3.2 and 3.7 (CP 3). However, because the District has clear statutory authority to adopt the challenged policy, the Developer's claims must be rejected.

The District is a special purpose municipal corporation formed under, and governed by, Title 57 RCW. The District has been granted certain powers and authority by the Legislature that are set forth in RCW 57.08.005. Importantly, the Legislature granted the District the following general powers and authority:

3) To construct, . . . add to, maintain, and supply waterworks to furnish the district and inhabitants thereof and any other persons, . . . district, with an ample supply of water for all uses and purposes public and private with full authority to regulate and control the use, content,

distribution, and price thereof in such a manner as is not in conflict with general law . . .

RCW 57.08.005(3) (emphasis added). Therefore, it is indisputable that the District has the statutory authority to adopt regulations and policies relating to the conditions pursuant to which a developer seeks water service from the District. The only limitation on this general power is that the regulations and policies must not be in conflict with general law. No such conflict exists.

Further, the District has been granted the power and authority to adopt and impose connection charges against developers and property owners seeking to connect to the District's water system. *See* RCW 57.08.005(11). It is important to note that the Developer is not challenging the District's authority to impose a connection charge, the amount of the connection charge, or the authority to require incremental connection charge payments under the SEA. Developer's Brief, at 7. Rather, the Developer is challenging the District's policy providing that incremental connection charge payments made by the Developer are non-refundable in the event of a default. However, the Developer's argument ignores the clear statutory authority granted the District under RCW

57.22.010 to adopt regulations and policies relating to developer extension projects.

RCW 57.22.010 provides as follows:

If the district approves an extension to the system, the district shall contract with owners of real estate located within the district boundaries, at an owner's request, for the purpose of permitting extensions to the district's system to be constructed by such owner at such owner's sole cost where such extensions are required as a prerequisite to further property development. The contract shall contain such conditions as the district may require pursuant to the district's adopted policies and standards. The district shall request comprehensive plan approval for such extension, if required, and connection of the extension to the district system is conditioned upon:

(1) Construction of such extension according to plans and specifications approved by the district; . . .

(4) Payment of all required connection charges to the district;

(5) Full compliance with the owner's obligations under such contract and with the district's rules and regulations;

(6) Provision of sufficient security to the district to ensure completion of the extension and other performance under the contract; . . .

RCW 57.22.010 (emphasis added).

Pursuant to RCW 57.22.010, when the District approves of an extension to the District's water system, the District is required to enter

into a contract with the developer or property owner. The contract is authorized to contain such conditions as the District may require pursuant to the District's adopted policies and standards. Further, RCW 57.22.010(5) specifically authorizes the District to include in the contract such conditions as the District determines are necessary to ensure full compliance with the developer's obligations under the contract and with the District's rules and regulations. More importantly, RCW 57.22.010(6) expressly authorizes the District to include terms in the contract that provide sufficient security to the District to ensure that the developer completes the approved extension and otherwise performs all obligations under the contract.

In this case, the District entered into two SEAs with the Developer. The second SEA was required because the Developer failed to renew the first SEA in accordance with District policy and it expired. As security to ensure full compliance with the Developer's obligations under the SEAs and to ensure completion of the system extension in accordance with the terms of the SEAs, the Developer was required to make incremental connection charge payments to the District. The SEAs, as well as the previously issued WALs, clearly disclosed to the

Developer that the incremental connection charge payments were non-refundable in the event of a default. (CP 51-52, 54-56, 64-65, 82-83, 85-90). Although the Developer testified that he signed the SEAs without reading the terms of the contract, he is still bound by the terms of the SEAs. *See Washington Fed. Sav. & Loan v. Alsager*, 165 Wn. App. 10, 14, 266 P.3d 905 (2011).

As indicated in the Declarations of Gwenn Maxfield (recently retired District General Manager) and Brian Borgstadt (District Engineer), the incremental connection charge payments served as a form of security to ensure the Developer's performance of its contractual obligations under the SEA and the completion of the system extension work. (CP 43-44, 61). The Developer even acknowledged that the District's policy provided the Developer with an incentive to complete the Project. (CP 151).

The District wants to emphasize to the Court that pursuant to RCW 57.22.010(6) the District could have required the Developer to provide a performance bond to ensure completion of the Project. Had the District required a performance bond, the District would have been able to make a demand upon the surety to complete the Project which was

estimated to cost in excess of \$200,000, an amount far in excess of the incremental connection charges payments made by the Developer. Further, if a performance bond had been required by the District, Mr. Singh would also likely have been subject to personal liability since surety companies typically require personal guarantees by the owners of entities as a condition of issuing a bond. (CP 61). As such, the District's policy is actually more lenient than what it expressly authorized by RCW 57.22.010(6).

Based on the above, it is clear that the District had the statutory authority to include the non-refundability provision in the SEAs. Therefore, the Developer's arguments to the contrary should be rejected.

C. The District's Policy Relating To The Non-Refundable Nature Of Incremental Connection Charge Payments Is Not Arbitrary, Capricious Or Unreasonable.

The Developer also asserts that the District's policy relating to the non-refundability of the incremental connection charge payments is arbitrary and capricious, and unreasonable, and therefore unenforceable. Developer's Brief, at 10. The Developer's assertions in this regard should be rejected.

Although the District believes its SEA policy is expressly authorized by the statutes referenced above, it may be useful for the Court to be reminded of the applicable legal standard relating to the Developer's argument. "[A] municipal corporation's powers are limited to powers granted expressly in the statute, and powers which are necessarily or fairly implied in or incident to the powers expressly granted, and also those essential to the declared objects and purposes of the corporation." *Metro Seattle v. Div. 587, Amalgamated Transit Union*, 118 Wn.2d 639, 643, 826 P.2d 167 (1992). Further, when a municipal corporation acts as a business in a proprietary capacity, its powers are construed even more broadly. *Id.*, at 645.

A government acts in a proprietary capacity "when it engages in a business-like venture as contrasted with a governmental function." *Sudden Valley Community Ass'n v. Whatcom Co. Water District No. 10*, 113 Wn. App. 922, 926 fn. 4, 55 P.3d 653 (2002). The operation of a public water system has clearly been recognized by the Washington Supreme Court as being a proprietary function and not governmental. *See Tacoma v. Bonney Lake*, 173 Wn.2d 584, 589, 269 P.3d 1017 (2012); *Burns v. Seattle*, 161 Wn.2d 129, 143-45, 154-55, 164 P.3d 475 (2007).

Therefore, the District was acting in a proprietary capacity when it entered into the SEAs with the Developer. The Developer's arguments to the contrary, which were made without citation to any applicable legal authority, should be rejected.

The distinction between the District acting in a proprietary versus governmental capacity is important due to the more liberal legal standard to be applied. If a statutorily granted municipal power is classified as being proprietary, "then the extent of that municipal power can be liberally construed." *Branson v. Port of Seattle*, 152 Wn.2d 862, 870, 101 P.3d 67 (2004). In addition, the Court in *Metro Seattle* acknowledged that:

Actions taken pursuant to a proprietary function are authorized unless they are beyond the purposes of the statute, or contrary to an express statutory or constitutional provision. Thus, if municipal utility actions come within the purpose and object of the enabling statute and no express limitations apply, this court leaves the choice of means used in operating the utility to the discretion of municipal authorities. We limit judicial review of municipal utility choices to whether the particular contract or action was arbitrary or capricious, or unreasonable."

Metro Seattle, at 645-46 (citations omitted). In addition, the *Burns* Court stated as follows:

In exercising its proprietary power, a municipality may not act beyond the purposes of the statutory grant of power or contrary to express statutory or constitutional limitations. But a municipality has broad discretion to operate within those parameters, and its choices will be upheld on judicial review unless a particular action or contract is arbitrary and capricious.

Burns, at 154.

Arbitrary and capricious conduct means “willful and unreasoning action, taken without regard to or consideration of the facts and circumstances surrounding the action.” *Abbenhaus v. Yakima*, 89 Wn.2d 855, 858-59, 576 P.2d 888 (1978). “Where there is room for two opinions, an action taken after due consideration is not arbitrary and capricious even though a reviewing court may believe it to be erroneous.” *Id.* Under the facts of this case, the Developer is not able to show that the District’s policy as it relates to the non-refundability of the incremental connection charge payments is arbitrary and capricious, or unreasonable.

Further, *Burns* Court found that: “[A] municipality may exercise its proprietary powers ‘very much in the same way as a private individual.’” *Burns*, at 154 (quoting *Pub. Util. Dist. No. 1 v. Newport*, 38 Wn.2d 221, 227, 228 P.2d 766 (1951)); *See also, Tacoma v. Bonney*

Lake, 173 Wn.2d at 590 (courts should employ the same tools of contractual interpretation that would be used for contracts involving private parties).

It is clear that the District was operating in a proprietary capacity when it entered into the SEAs with the Developer. Therefore, under the Court's rulings in *Metro Seattle* and *Burns*, this Court should not substitute its judgment for that of the District when it adopted a policy that provides that the incremental connection charge payments would be non-refundable in the event of a developer's default. The District's policy is clearly within the purpose and object of RCW 57.22.010(5)-(6) which authorized the District to include provisions in the SEAs to ensure full compliance with the Developer's obligations under the SEAs and to provide sufficient security to the District to ensure the Developer's completion of the system extension and other performance under the SEAs. In addition, the District's policy allows it to utilize incremental connection charge payments when they are received in order to offset the costs of its existing water facilities and to fund the construction of additional water facilities in order to fulfill its duty to serve.

For the reasons stated above, the Court should reject the Developer's assertion that the District's decision to make incremental connection charge payment non-refundable in the event of a default was arbitrary, capricious or unreasonable.

D. The Developer's Challenge Based On An Asserted Unlawful Monopoly Power Should Be Rejected.

Commingled with its arguments relating to the District's "duty to serve" and the proprietary versus governmental argument, the Developer implies that the District has used its "monopoly" powers to impose the non-refundable provisions upon it. Developer's Brief, at 11-14. Because the issues relating to the duty to serve and the distinction between proprietary and governmental functions were already addressed above, the District will limit its response here to the monopoly issue raised by the Developer.

In its Complaint, the Developer asserted that the District's policy relating to the non-refundable nature of incremental connection charge payments is voidable due to the fact that the Developer had no choice but to enter into a SEA with the District due to the District's "monopoly authority." (CP 4). The Developer's arguments should be rejected because the assignment of service area boundaries to municipal water

purveyors is required as part of the Public Water System Coordination Act, Chapter 70.116 RCW, and does not constitute unlawful monopoly authority.

The Public Water System Coordination Act (the “Act”) was adopted by the Legislature in 1977. The Legislature specifically declared as follows:

The legislature hereby finds that an adequate supply of potable water for domestic, commercial, and industrial use is vital to the health and well-being of the people of the state. Readily available water for use in public water systems is limited and should be developed and used efficiently with a minimum of loss or waste.

In order to maximize efficient and effective development of the state's public water supply systems, the department of health shall assist water purveyors by providing a procedure to coordinate the planning of the public water supply systems.

RCW 70.116.010. The stated purposes of the Act are as follows:

(1) To provide for the establishment of critical water supply service areas related to water utility planning and development;

(2) To provide for the development of minimum planning and design standards for critical water supply service areas to insure that water systems developed in these areas are consistent with regional needs; . . .

RCW 70.116.020.

Under the Act, municipal water purveyors engaged in coordinated water system planning efforts pursuant to which water supply service areas were established for each water purveyor within a particular area. *See* RCW 70.116.050. Once a coordinated water system plan is approved by the Department of Health, all water purveyors constructing or proposing to construct public water facilities within an area covered by the plan are required to comply with the plan. *See* RCW 70.116.060(3). In addition, RCW 57.08.007 specifically states a water or sewer district may not provide services within an area where service is available from another water or sewer district or within an area in which that service is planned to be made available under an effective comprehensive plan of another district.

What the Developer characterizes as unlawful monopoly authority is actually part of the Legislature's plan to ensure that an adequate supply of potable water is available for domestic, commercial, and industrial use which was declared to be "vital to the health and well-being of the people of the state." RCW 70.116.010.

For the reasons stated above, the Court should reject the Developer's implied argument that the SEAs are voidable because the District was operating under unlawful monopoly authority.

E. The Developer's Assertion That The Non-Refundability Provision In The SEAs Is An Unlawful Tax or Penalty Should Be Rejected.

The Developer acknowledges that the SEAs were enforceable when they were entered into by the parties. Developer's Brief, at 6. However, the Developer argues that the non-refundability provision in the SEAs should not be enforced because it turned into an illegal tax or penalty once the Developer defaulted on its obligations under the SEAs. Developer's Brief, at 14.

The Developer asserts that this case is controlled by *Samis Land Co. v. Soap Lake*, 143 Wn.2d 798, 23 P.3d 477 (2001). However, the facts of the *Samis Land* case are quite different and have no bearing on the case before this Court. The issue in *Samis Land* was whether a "standby charge" imposed unilaterally by the City of Soap Lake upon vacant, unimproved, uninhabited lots that abut but are unconnected to its water and sewer lines is a regulatory fee or a property tax. *Samis Land*, at 801. After applying the "Covell test" set forth in *Covell v. Seattle*, 127 Wn.2d 874, 905 P.2d 324 (1995) the *Samis Land* Court concluded that the

standby charge at issue in that case was an unconstitutional tax against real property. *Id.*, at 813-14.

In comparison, the incremental connection charges payments at issue in this case were imposed pursuant to a voluntary contract entered into between the District and the Developer. Unlike the facts in *Samis Land*, the District did not impose a charge or fee against any property or property owner that wasn't seeking to connect to the District's water system pursuant to the terms of the SEA. As a result, the Developer's reliance on *Samis Land* is fatally flawed.

The District doesn't believe the *Covell* test even applies to this case because this case is governed by contract law principles as it relates to the Developer's failure to fulfill its contractual obligations under the SEAs which resulted in the loss of the incremental connection charge payments. However, even assuming for the sake of argument that this case was subject to the *Covell* test, this Court would have to conclude that the loss of the incremental connection charges paid by the Developer due to his default under the SEAs does not constitute an unlawful tax.

Under the *Covell* test, the determination of whether a charge imposed by a government agency is a tax or a regulatory fee depends upon the three factors: (1) Whether the primary purpose of the legislation is to

regulate the fee payer or to raise revenue to finance broad-based public improvements?; (2) Whether the money collected is segregated and allocated exclusively to regulating the entity or activity being assessed?; and (3) Whether there is a direct relationship between the fee charged and the service received by the fee payers or a burden to which they contribute? *Samis Land Co.*, at 806 (citing *Covell v. Seattle*, 127 Wn.2d 874, 879, 905 P.2d 324 (1995)).

The Developer concedes that under the first *Covell* factor the incremental connection charge payment is a charge and not a tax. Developer's Brief, at 15-16. However, without citation to any supporting legal authority, the Developer argues that the acknowledged lawful incremental connection charge payment was converted to an unlawful tax upon the Developer's default. Developer's Brief, at 16. There is no legal support offered for the Developer's novel argument. Further, the record before the Court is clear that the primary purpose and "overall plan" of the incremental connection charge payment, including the non-refundability provision of the SEA, was to serve as security to ensure the Developer fulfilled its contractual responsibilities under the SEAs as specifically authorized by RCW 57.22.010. *See Samis Land*, at 808. Importantly, the District does not unilaterally impose connection charges on developers

against their will. Rather, the District and developers enter into SEAs, which are voluntary contractual agreements governing the terms and conditions relating to specific system extension projects, only when developers seek to connect to the District's water system.

With respect to the second *Covell* factor, all connection charge payments, including incremental connection charge payments made by the Developer, are used by the District to pay for capital improvement projects to improve or maintain the District's public water system. (CP 181). Unlike counties and cities, the District is a single purpose entity, which is to operate and maintain a public water system for the benefit of its current and future customers. Therefore, connection charge payments collected by the District are not being funneled to support some other non-water system related improvements. Importantly, the construction of capital facilities (e.g., water system improvements) is a recognized regulatory activity. *See Tukwila Sch. Dist. v. Tukwila*, 140 Wn. App. 735, 748, 167 P.3d 1167 (2007). Furthermore, under the Developer's argument, the District was free to use the connection charge as it deemed appropriate, at least until the Developer defaulted on its contractual obligations. It is nonsensical to allow the Developer's own default to turn an otherwise lawful payment into an unlawful tax or penalty.

It should also be noted that the Developer also mischaracterizes the District's answer to an Interrogatory by implying that the District cannot provide an actual accounting of how funds collected from connection charge payments (including incremental connection charge payments) are spent. Developer's Brief, at 5. The Developer's Interrogatory asked about how the funds collected from the Developer were used. The District's answer indicated that incremental connection charge payments, as well as connection charge payments, collected from all developers are deposited in a Maintenance Account and periodically transferred to a Construction Account to pay for capital improvement projects (i.e., new water facilities) and, therefore, the District could not state specifically how the Developer's funds were spent. However, the District's answer clearly indicated that the District would be able to identify what particular capital improvement projects were undertaken and paid for in any particular year. (CP 180-81).

With respect to the third *Covell* factor, there is a direct relationship between the fee charged and the service or burden to which the Developer and other developers contribute. The Developer was seeking to connect to the District's water facilities which is what triggered the requirement to make incremental connection charge payments. The fact that the

Developer acknowledges that the District has the authority to impose a connection charge and the fact that the Developer is not contesting the amount of the connection charge speaks for itself. Moreover, it should be noted that the total amount of the incremental connection charges paid by the Developer over time was due to the Developer's own inability to proceed with the Project. Every time that the Developer sought an extension of the WAL or the SEA, he was required to pay additional incremental connection charge payments. The Developer could have held off on paying these additional incremental connection charge payments until he was prepared to proceed with the Project. However, the Developer elected voluntarily to extend his WAL and SEAs and accepted the risks associated with development which is an inherently risky business.

Therefore, even if the *Covell* test is applied to this case, the Court should conclude that the incremental connection charge payments made by the Developer over the nearly six year period were not an unlawful tax. The Court should reject the Developer's argument that the loss of the incremental connection charge payments made by the Developer due to its own default transformed legal payments into an unlawful tax.

The District believes that the non-refundability provision in the SEAs (that only applies in the case of a default) is more analogous to the

loss or forfeiture of a “bid bond” due to a contractor’s failure to enter into a contract on a public works project which is a well-established practice. The Washington Supreme Court has previously upheld the forfeiture of a bid bond when the contractor refused to enter into a contract. *Eagle Livery & Transfer Co. v. Lake Chelan Recl. Dist.*, 155 Wash. 101, 105-06, 283 P. 678 (1930). Similarly, the Washington Supreme Court has upheld the forfeiture of a \$2,000 security deposit relating to the failure of a person to construct and maintain street railways in West Seattle pursuant to the terms of a franchise agreement. *Furth v. West Seattle*, 37 Wash. 387, 392-93, 79 P. 936 (1905). Both of these cases provide support for the District’s position that the Developer is not entitled to a refund because he defaulted on the terms of the SEAs. Under the Developer’s argument, contractual remedies that provide for the forfeiture or loss of a bid bond or security deposit would become unlawful and would essentially allow the breaching party an opportunity to avoid the consequences of its default. The Court should reject the Developer’s argument.

F. The Developer’s Assertion That The System Extension Agreements Are Void As Being Against Public Policy Should Be Rejected.

The Developer has previously asserted that the District’s SEAs are void as being against “public policy” due to the provision relating to

the non-refundability of the incremental connection charge payments. (CP 4). However, in its brief under the heading “Public Policy” the Developer cites to a case relating to the test for determining whether a contract is against public policy but the Developer makes only a cursory argument in this regard. Developer’s Brief, at 18. Following the citation to the public policy case, the Developer proceeds to argue that the SEAs between the District and the Developer are unenforceable due to a lack of consideration. Developer’s Brief, at 18-19. Out of an abundance of caution, the District will respond to both the public policy and legal consideration arguments raised by the Developer.

As discussed in Section III.B above, the District is specifically authorized by RCW 57.22.010 to include in the SEAs conditions that provide sufficient security to ensure completion of the Project and other performance under the terms of the SEAs. Moreover, the Developer cannot possibly demonstrate that the SEAs are against public policy using the legal standards established for such determinations.

“In general, a contract which is not prohibited by statute, condemned by judicial decision, or contrary to public morals contravenes no principle of public policy.” *State Farm Gen. Ins. Co. v. Emerson*,

102 Wn.2d 477, 481, 687 P.2d 1139 (1984). Further, a court “shall not invoke public policy to override an otherwise proper contract even though its terms may be harsh and its necessity doubtful.” *Id.*, at 483. The test of whether a contractual provision violates public policy is whether the contract as made has a “tendency to evil,” to be against the public good, or to be injurious to the public. *Viking Properties, Inc. v. Holm*, 155 Wn.2d 112, 126, 118 P.3d 322 (2005). The question of whether a contract is against public policy is a question of law for the court to decide. *Motor Contract Co. v. Van Der Volgen*, 162 Wash. 449, 454, 298 P. 705 (1931).

RCW 57.08.005(3) provides the District with full authority to regulate and control the use, content, distribution and price of its water service in a manner that is not in conflict with general law. Further, RCW 57.22.010(6) specifically authorizes the District to include in the SEA terms and conditions sufficient to provide the District with security that the Developer will complete the extension project and otherwise perform all of the obligations under the SEAs. The inclusion of contract language that provides that the incremental connection charge payments

are non-refundable can hardly be said to have “a tendency to evil” or is “injurious to the public.”

In fact, just the opposite is true. The SEAs were intended to avoid damages to the District and its ratepayers (i.e., the public) by including terms to encourage the Developer to complete the Project on a timely basis and connect to the District’s public water system. Now that the Developer has defaulted in his obligations under the SEAs, he is seeking a refund from the District which would only harm the public and benefit the Developer. Therefore, the Court should reject the Developer’s argument that the non-refundability provision in the SEAs are unenforceable because they are against public policy.

With respect to the Developer’s legal consideration argument, the Developer has already conceded this issue. In Section IV of the Developer’s Brief, the Developer states: “The issue is not whether the SEA is unenforceable but whether a provision within the SEA is enforceable” Developer’s Brief, at 6. In other words, the Developer concedes that the SEA is an enforceable contract, except for the provision which provides that the incremental connection charge payments are nonrefundable in the event of the Developer’s default.

It is a fundamental principle of contract law that reciprocal

promises are sufficient legal consideration to support a contract. *See Ebling v. Gove's Cove, Inc.*, 34 Wn. App. 495, 499, 663 P.2d 132 (1983); *Cook v. Johnson*, 37 Wn.2d 19, 23, 221 P.2d 525 (1950). The terms of the SEAs contain sufficient mutual promises for the Court to conclude that adequate consideration was present. The District agreed to provide the Developer with water service and the Developer agreed to construct certain water facilities in accordance with District standards and to pay the applicable connections charges and other fees which provides the requisite legal consideration.

The Court should reject the Developer's public policy and legal consideration arguments.

G. Plaintiffs' Assertion That The Loss Of Its Incremental Connection Charge Payments Results In An Unlawful Windfall To The District Should be Rejected.

The Developer asserts that the District's policy relating to the non-refundability of the incremental connection charge payments results in an unlawful financial windfall. Developer's Brief, at 19-20 (CP 3). For the reasons discussed in Section III.B above, because the District has clear statutory authority to adopt the challenged policy, the Developer's "windfall" argument must be rejected.

The District finds it interesting that the Developer asserts a windfall argument because the facts of this case conclusively establish that there is no windfall to the District. The District spent in excess of \$1,325,000 in order to construct new water facilities that were intended to serve the Developer's Project, as well as other properties in the vicinity of Wax Road and 180th Avenue. (CP 58). The design effort for this Project was completed in April of 2007, which means that the District began incurring engineering and administrative expenses associated with this Project prior to that time. Further, the water facilities constructed as part of this Project were accepted by the District as being complete in February of 2010 and were available to serve the Developer's Project. (CP 58).

The connection charges due for the Developer's Project would have provided revenue to the District that would have been used to offset the cost of these new water facilities, as well as providing a source of revenue for other capital improvements planned for the District's water system. Nearly nine (9) years have passed since the Developer first approached the District about this Project and over four (4) years have passed since the District expended over \$1,325,000 to build new water

facilities which serve the Developer's Project. Since the subject real property has still not connected to the District's water system, the District has not received the full amount of the connection charges originally anticipated to be received under the SEAs.

Under the facts of this case, it is difficult to see how the District has enjoyed a financial windfall in this matter. Therefore, the Court should reject the Developer's argument.

IV. CONCLUSION

The District's policy relating to the non-refundability of the incremental connection charge payments is specifically authorized by statute. Because the Developer defaulted in his obligations under the SEAs, the Developer has no contractual or legal right to seek a refund of the incremental connection charge payments made. Further, the non-refundability provision in the SEAs are not arbitrary and capricious, or unreasonable, nor does the enforcement of this provision result in an unlawful tax or penalty on the Developer.

Therefore, the District respectfully requests that the Court affirm the trial court's decision granting summary judgment in favor of the District.

RESPECTFULLY SUBMITTED this 24th day of December, 2014.

INSLEE, BEST, DOEZIE & RYDER, P.S.

By Eric C. Frimodt
Eric C. Frimodt, W.S.B.A. #21938
Attorneys for Respondent
Covington Water District