

**FILED**

DEC 24 2012

COURT OF APPEALS  
DIVISION III  
STATE OF WASHINGTON  
By \_\_\_\_\_

NO. 311953

IN THE COURT OF APPEALS  
FOR THE STATE OF WASHINGTON  
DIVISION III

CITY OF WENATCHEE, a  
municipal corporation,

Appellant,

vs.

CHELAN COUNTY PUBLIC  
UTILITY DISTRICT NO. 1 , a  
municipal corporation

Respondent.

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RESPONDENT'S BRIEF

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Carol A. Wardell  
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Phone: 509-661-4465  
Counsel for Respondent

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## **I. INTRODUCTION**

Public Utility District No. 1 of Chelan County, Washington (the “District”) is a municipal corporation. The District owns and operates a domestic water system in Chelan County which includes customers located within the Wenatchee city limits (the “City”). The District’s system includes a water delivery system for customers’ individual domestic uses and fire hydrants.

There are over 2,000 retail water customers of the District located within the City limits. The City has imposed a utility tax of 16% on the District’s retail revenues derived from those customers. The tax rate has increased over the years. The District’s customers are billed for and pay this tax to the District which in turn pays the City. The tax is noted as a separate line item on the billings to the customers.

The City and the District jointly filed a declaratory judgment action. The trial court ruled in favor of the District that the tax was unlawful. The court properly held that the City does not have authority to tax the revenues received by the District (another municipality) for providing water service to City residents. The trial court’s Findings of Fact and Conclusions of Law (CP 61-68) detail the court’s reasoning.

As to the City's Introduction and Statement of Facts, the District accepts the same but takes exception to the City's characterization of the District's argument as being that the "governmental immunity doctrine is irrelevant," and that the doctrine "does not apply" in this case. (Appellant's brief at pp. 1 and 3). The District's position is that the constitutional prohibition against one municipality taxing another unless there is express statutory authority to do so (also known as the governmental immunity doctrine) does apply and makes the tax on the water service revenues unlawful.

## **II. LEGAL ARGUMENTS**

**A. The trial court properly held that express taxation authority is required for the City to impose a tax on the District's water service revenues.**

The analysis begins with the Washington State Constitution, Articles VII and XI.

Washington State Constitution, Article VII, Section 9 provides:

The legislature may vest the corporate authorities of cities, towns and villages with power to make local improvements by special assessment, or by special taxation of property benefited. For all corporate purposes, all municipal corporations may be vested with authority to assess and collect taxes and such taxes shall be uniform in respect to persons and property within the jurisdiction of the body levying the same.

Washington State Constitution, Article XI, Section 12 provides:

The legislature shall have no power to impose taxes upon counties, cities, towns or other municipal corporations, or upon the inhabitant or property thereof, for county, city, town, or other municipal purposes, but may, by general laws, vest in the corporate authorities thereof, the power to assess and collect taxes for such purposes.

These constitutional provisions are not self-executing. A county, city or other municipal body is not automatically vested with tax levying power. Rather, such political subdivisions must have an express grant of taxing power either by legislative act or another constitutional provision. *Carkonen v. Williams*, 76 Wn.2d 617, 627, 458 P.2d 280 (1969).

As stated in *King County v. City of Algona*, 101 Wn.2d 789, 790, 681 P.2d 1281 (1984):

We have consistently held that municipalities must have express authority, either constitutional or legislative, to levy taxes [on other municipalities]. *Citizens for Financially Responsible Government v. Spokane*, 99 Wn.2d 339 ... *Hillis Home, Inc. v. Snohomish Cy*, 97 Wn.2d 804; *Carkonen v. Williams* [76 Wn.2d 617]. (emphasis added)

This prohibition on a city taxing another municipality without express authority to do so has been referenced as the “governmental immunity” doctrine.

Other general principles of law are also applicable. If there is any doubt about a legislative grant of taxing authority to a municipal corporation, it must be denied. *Pacific First Fed. Sav & Loan v. Pierce*

*Cy.*, 27 Wn.2d 347, 353, 178 P.2d 351 (1947); *Ivy Club Investors Ltd. Partnership v. Kennewick*, 40 Wn. App. 524, 528, 699 P.2d 782 (1985). Further, if a tax statute is ambiguous, the statute must be construed against the taxing authority. *Group Health Coop. of Puget Sound, Inc. v. Dept. of Revenue*, 106 Wn.2d 391, 401, 722 P.2d 787 (1986); *Arborwood Idaho LLC v. City of Kennewick*, 151 Wn.2d 359, 367, 89 P.3d 217 (2004).

Both parties agree that the *Algona* case is the most applicable. It is also important to consider the cases *Algona* cited, distinguished and overruled.

The court in *Algona* held that a City's tax on the gross revenues of a county solid waste transfer station was unlawful because the City had no express authority granted to it to impose the business and occupation tax.

The *Algona* court cited *City of Seattle v. State of Washington*, 59 Wn.2d 150, 367 P.2d 123 (1961). In the *Seattle* case, the court held that the State had specific authority to impose an excise tax on the revenues of the City of Seattle derived from certain park operations. The basis for the tax was RCW Chapter 82.04. The reason for the court's finding that specific authority for this tax existed was that the excise tax imposed under RCW 82.04 specifically applied to all "taxable persons" which explicitly included "municipal corporations" in the definition. RCW

82.04.030. The *Seattle* court indicated that the statute itself authorized the excise tax against the municipality and did not make a distinction between the type of activity (proprietary or governmental).

The next case of interest to an understanding of *Algona* and its impact on this case is *City of Bellevue v. Patterson*, 16 Wn. App. 386, 556 P.2d 944 (1976), which was overruled in part by *Algona*. In *Bellevue*, the court held that RCW 35.23.440 authorizing license taxes on “all occupations and trades ... and every kind of business authorized by the law,” was a sufficient grant of authority to authorize the city of Bellevue to tax a water district. RCW 35.23.440 was a general tax applicable to all businesses. The statute relied upon by *Bellevue* is similar to the statute now being relied upon by the City to tax the District (RCW 35A.82.020). The *Algona* court held that express, not general, statutory authority was required to support taxation on two other municipal entities serving water and sewer customers inside the Bellevue City limits. The *Algona* court reversed *Bellevue* to the extent it was inconsistent with that holding.

The court in *Algona* analyzed both the *Seattle* and *Bellevue* cases. The *Algona* court noted that the *Bellevue* court’s use of the *Seattle* case to buttress its holding that the general tax was lawful was incorrect. The reasoning of *Algona* was clear. The *Seattle* case involved a statute granting

specific authority to tax another municipality. The *Bellevue* case did not. Further, the concept of immunity from the tax and need for express authority was never raised in *Bellevue*, as noted by the *Algona* court. *Algona*, 101 Wn.2d at 792.

In *Algona*, the City of Algona attempted to rely upon the very same general taxing statutes (general business and occupation tax) cited by the City here to impose a tax on county revenues. In particular, the City of Algona relied upon RCW 35A.82.020 and the authority to generally impose business and occupation taxes. The *Algona* case recognized that the statutes gave the city a “general grant of taxation” but “no express authority to levy a tax on the State or another municipality.” *Algona*, 101 Wn.2d at 794. The court in *Algona* held the tax was unlawful.

It is true, as noted by the City in this case, that *Algona* involved a governmental action, not proprietary. This aspect of *Algona* is not dispositive in this case as discussed in the next section of this brief.

The Attorney General has also opined on the subject relying on *Algona* to opine that City B did not have the authority to impose tax on City A for the business of operating an electric energy business (a proprietary business of City A) within the corporate limits of City B. The Attorney General took a close look at *Algona*, *Seattle* and *Bellevue* cases

and opined that the starting premise for analysis is that there must be specific legislative authority to levy a particular tax on another municipality. *AGO 1990 No. 3*.

The need for express statutory authority by the City to tax the District makes sense in light of the constitutional provisions. If a municipality could rely solely upon a statute which is general in nature (i.e., a tax on all businesses), then there would be no meaning to the constitutional provisions. The court must give meaning to the constitutional provisions. The way to give meaning to these provisions is to require express statutory authority for the City to tax the District's water service revenues – just as the *Algona* court did for solid waste services revenues.

The City argues that *Burns v. City of Seattle*, 161 Wn.2d 12, 162 P.3d 1122 (2007), supports its argument that the general business and occupation tax statute is sufficient for taxing a proprietary activity of another municipality. But, a review of *Burns* and its holding makes it clear that it does not stand for the proposition that a tax by the City on the District's water service revenues is appropriate. Further, *Burns* does not stand for the proposition that the governmental immunity doctrine is inapplicable just because a service is proprietary in nature. The holding of

*Burns* was that an electric utility (Seattle City Light) could pay other cities a fee for its operation of the electric utilities within their boundaries. The fee was paid in exchange for a promise by the other cities that they would not establish their own electric utilities. The court held that the contractual payment was an appropriate contract within Seattle City Light's legal authority. The holding of *Burns* is that cities may contract for payments to keep the municipalities from forming their own electric systems and those contractual provisions do not violate the restriction on franchise fees or other fees for purposes of RCW 35.21.860(1) *Burns*, 161 Wn.2d at 15.

The discussion in the *Burns* court about taxation and the *Algona* case is clearly dicta even by the court's own admission: "We do not, of course, decide the issue [taxation] here. We merely observe that the Cities' ability to impose a utility tax on SCL is an unresolved question of law." *Id.* at 47. The court's comments in *Burns* about the application of *Algona* and the governmental immunity doctrine are not decisive of any issue in this case. The issue of taxation was not before the *Burns* court.

The City also cites to cases out of Arizona and Alabama<sup>1</sup> to support its position that general business and occupation tax authority is sufficient authority for it to tax the District's water revenues. The Arizona

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<sup>1</sup> *Salt River Project Agriculture Improvement and Power District v. City of Phoenix*, 631 P.2d 553 (1981); *Town of Mulga v. Town of Maytown*, 502 So.2d 731 (1987)

or Alabama decisions do not apply. The Arizona case does not even discuss any applicable constitutional provisions. The Alabama case does look to its constitution, but the Alabama constitution is very different than Washington's. The Alabama constitution exempts property of a municipality from being taxed, but does not contain any provision about other types of taxes.

Interestingly, the *Burns* court cites *McQuillin, Law of Municipal Corporations*, §44.60 as “noting conflict in decisions” about taxation of municipal electric systems, but that section does not reference any Washington cases for this “conflict.” There is good reason for there being no conflict in Washington on this issue. The Washington legislature specifically and expressly authorized a tax on electric service revenues. RCW 54.28.070.

The City attempts to dismiss the impact of RCW 54.28.070 as having been adopted in 1941, years before the business and occupation tax statute. The argument misses the point. RCW 54.28.070 is an express statute allowing taxation of another municipality's activity (proprietary in nature). RCW 35A.82.020 is a general business and occupation taxing authority statute that does not authorize a tax on another municipality's operations, whether the activity is proprietary or governmental.

When RCW 54.28.070 was adopted, the District was authorized to provide electric and water service. But the tax was only allowed by the legislature on electric service revenues.

The City must have a specific statute allowing it to tax the revenues received by the District from its water system. The City cannot lawfully rely on general business and occupation taxes to tax the District water ratepayers located in the city limits. The legislature certainly could have made it clear that it was authorizing cities to tax the water system revenues of a public utility district just as it did regarding the District's electric service revenues. But that has not been done.

**B. The trial court properly ruled that the characterization of the District's water service as governmental or proprietary is not dispositive.**

The City attempts to distinguish the clear statement in *Algona* requiring express authority (not general authority) for a tax because water service is a proprietary function, not governmental. This distinction is not dispositive of the tax analysis.

It is true that the service provided in *Algona* (solid waste) was governmental in nature. But, that does not mean that the *Algona* ruling should be limited to only activities that are governmental in nature. The

cases cited by *Algona* for the holding do not discuss any such limitation. And, the constitutional provisions make no such distinction. The fact that the concept is known as the “governmental” immunity doctrine lends absolutely no support to the City’s arguments.

The *Algona* court did not rule that the requirement of a specific taxing authority is unnecessary for one municipality to impose a tax on another municipality operating a utility in its proprietary function. It did not have to reach that ruling – it was clearly dealing with the governmental service as noted in its opinion. *Algona*, 101 Wn.2d at 794.

The law supports the need for express legislative authority for the clearest of proprietary functions: electric service. It is undisputed that the provision of electric service is a proprietary function. *Hite v. Public Utility District No. 2 of Grant County*, 112 Wn.2d 456, 772 P.2d 481 (1989). It is also undisputed that a 6% tax imposed on electric revenues by the City is lawful. Why? The answer is quite simple: because there is express statutory authorization for the tax on electric service revenues. RCW 54.28.070 provides:

Any city or town in which a public utility district operates works, plants or facilities for the distribution and sale of electricity shall have the power to levy and collect from such district a tax on the gross revenues derived by such district from the sale of electricity within the city or town, exclusive of the revenues derived from the sale of

electricity for purposes of resale. Such tax when levied shall be a debt of the district, and may be collected as such. Any such district shall have the power to add the amount of such tax to the rates or charges it makes for electricity so sold within the limits of such city or town. (emphasis added)

This statute was adopted and has been unchanged since 1941. Correspondingly, RCW 35.21.870 limits such tax to six percent (6%). The limit of six percent (6%) was adopted in 1982.

If the legislature intended the City to have the authority to tax the District's water service revenues without running afoul of the constitutional provisions, then there would and should be an express statute – just as there is for electricity. But, there are no such statutes.

If all that was needed for imposing a tax under a general statute was that the services be proprietary in nature, then there would be no need for RCW 54.28.070 and RCW 35.21.870. This court must give meaning to all statutes. Further, the same argument must be rejected for the same reasons the *Algona* court rejected the *Bellevue* holding.

This court does not and should not base a taxing decision on the distinction between governmental and proprietary functions in this case. The trial court was correct in observing that the distinction between governmental and proprietary functions is not always clear cut. In fact, the City quotes from *McQuillin's Law of Municipal Corporations* §2:13 (3d

ed.) (Appellant's brief at pp. 13 and 14) for the proposition that water service is proprietary. That section of *McQuillin* goes on to include the following statements, not quoted by the City:

However, there is much conflict and confusion regarding whether a particular activity is to be classified as governmental or private. The situation has been summarized as follows: while general rules and tests have been evolved and stated in the cases and textbooks to distinguish the two, none of these rules is conclusive, and each case is a subject for individual determination in the light of its own facts.

The cases cited by the City for the proposition that water service is proprietary all relate to issues other than taxation. *Russell v. Grandview*, 39 Wn.2d 551, 236 P.2d 1061 (1951) (tort liability for combustible gas in water system); *Public Utility District No. 1 of Pend Oreille v. Town of Newport*, 38 Wn.2d 221, 228 P.2d 766 (1951) (whether a city and public utility district could serve electric power and operate associated "water works" within the same geographic area); and *City of Moses Lake v. United States*, 430 F. Supp.2d 1164 (2006) (tort liability for contaminated water system and application of statute of limitations to city).

Moreover, the proprietary/governmental distinction is just not that clear with respect to a water system such as the District's. The District's water system is designed to provide potable water for domestic use and water for fire hydrants. The same system is used to provide both services.

This is generally the way water systems are designed and operated. As noted in *City of Tacoma v. Bonney Lake*, 173 Wn.2d 584, 269 P.3d 1017 (2012), “municipalities must have hydrants in their jurisdictions and water flow to those hydrants to make them useful. Therefore, any discussion of a ‘water system’ by a public utility most likely includes hydrants by default.” *Id.* at 17. This is true of the District’s water system. The reservoirs and pipes are sized for domestic use and fire flow and hydrants are part of the system.

The Supreme Court has recently held that the provision of hydrants and water for fire flow is governmental in nature. *Lane v. City of Seattle*, 164 Wn.2d 875, 194 P.3d 977 (2008).

Thus, the District’s water system is not so clearly proprietary in nature as the City argues. Further, if the tax is deemed appropriate, then the City will be taxing water customers within City limits for hydrant and fire flow services that the City is responsible for providing as the general government.

The *Lane* decision illustrates the point that the proprietary versus governmental nature of the service should not lead to any conclusive answer in the taxation arena. As noted by the trial court (CP 65), taxation requires more certainty than this.

Whether the District's water service is proprietary, governmental or both, there must be express statutory authority for the City to tax the District's water service revenues. And, that express authority does not exist.

**C. The legislature knows how to authorize taxes by one municipality on another and did not authorize the City to tax the District's water revenues.**

The City argues that its general taxing authorities set forth in RCW 35A.11.020 and 35A.82.020 are sufficient to grant it the necessary authority to tax the District's water service revenues. As noted above, that position is not supported by the law for many reasons.

This court must presume that the legislature knows the proper way to authorize one municipality to tax another. RCW 54.28.070, the 1941 statute allowing tax on a public utility district's electric revenues, is a good example of that. Certainly, if the legislature intended that the City could tax water revenues, it would have adopted statutes similar to RCW 54.28.070.

Another way the legislature could have authorized a tax by the City on the District's water revenues would be to follow the example of RCW 82.04. RCW 82.04 includes municipal entities in the definition of a

“taxable person.” As the court held in *City of Seattle v. State of Washington*, 59 Wn.2d 150, 367 P.2d 123 (1961), this definition was explicit in its inclusion of municipal entities. That is not the case with RCW 35A.82.020 upon which the City relies. RCW 35A.82.020 simply provides for a tax on businesses, trades and other activities. No mention of taxing the activities of another municipal entity is ever made.

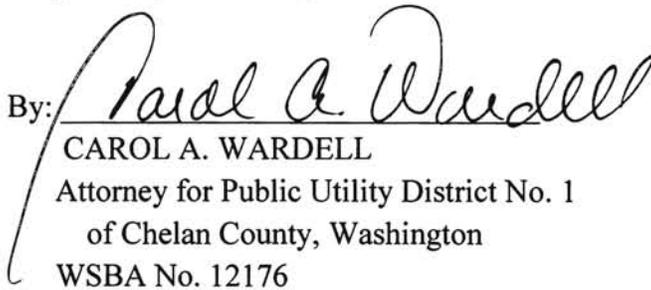
There is no explicit authority for the City to tax the District’s water system revenues. Thus, the trial court was correct: the business and occupation tax on the District’s water system revenues is unlawful.

### III. CONCLUSION

The court should uphold the trial court’s determination that the taxes imposed by the City on the District’s water service revenues pursuant to Wenatchee City Code 5.84 and RCW 35A.82.020 are invalid and unlawful.

DATED: December 21, 2012

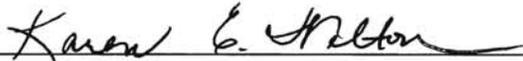
Respectfully submitted,

By:   
CAROL A. WARDELL  
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WSBA No. 12176



1 and on the said day deposited same so addressed with the postage prepaid, in the United  
2 States Mail in Wenatchee, Washington.

3 DATED at Wenatchee, Washington this 21<sup>st</sup> day of December 2012.

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6 Karen E. Welton