VIRGINIA:

IN THE CIRCUIT COURT OF ARLINGTON COUNTY

TOM CLINTON, COMMISSIONER OF THE REVENUE FOR THE CITY OF FALLS CHURCH, VIRGINIA,	
Plaintiff,	
v.	**CASE NO.** CL 10-2140
CHERYL R. ARVIDSON; THOMAS W. BROOKE; MARY ALICE COLE; PHYLLIS FRIEDLANDER; BLAINE FRIEDLANDER; RICHARD JOHNSON; WILLIAM D. KELLY; JEANNE C. KLINGELHOFER; VICTOR G. KLINGELHOFER; JONATHAN S. LANG; JON D. LURIA; CARY MELTZER; BERT ROSECAN; LAUREN ROSENBLATT; SAM'S FARM, INC.; LARRY J. SEXTON; JIM SOBER; PATRICIA A. SULLIVAN; JERRY WAGNER; ARMAND B. WEISS; AND YVES WONG,	
Defendants.	

COMPLAINT FOR DECLARATORY JUDGMENT AND INJUNCTIVE RELIEF

Plaintiff, Tom Clinton, Commissioner of the Revenue for the City of Falls Church, Virginia, by counsel, pursuant to Va. Code § 8.01-184, et seq., requests this Court to issue a declaratory judgment and award injunctive relief against the Defendants, Cheryl R. Arvidson, Thomas W. Brooke, Mary Alice Cole, Phyllis Friedlander, Blaine Friedlander, Richard Johnson, William D. Kelly, Jeanne C. Klingelhofer, Victor G. Klingelhofer, Jonathan S. Lang, Jon D.

Luria, Cary Meltzer, Bert Rosecan, Lauren Rosenblatt, Sam's Farm, Inc., Larry J. Sexton, Jim Sober, Patricia A. Sullivan, Jerry Wagner, Armand B. Weiss, and Yves Wong, and in support thereof states as follows:

1. Plaintiff is the Commissioner of the Revenue for the City of Falls Church ("the Commissioner"). All of the books and records of the Commissioner are located in the City of Falls Church.

2. Defendants, Cheryl R. Arvidson, Thomas W. Brooke, Mary Alice Cole, Phyllis Friedlander, Blaine Friedlander, Richard Johnson, William D. Kelly, Jeanne C. Klingelhofer, Victor G. Klingelhofer, Jonathan S. Lang, Jon D. Luria, Cary Meltzer, Bert Rosecan, Lauren Rosenblatt, Sam's Farm, Inc., Larry J. Sexton, Jim Sober, Patricia A. Sullivan, Jerry Wagner, Armand B. Weiss, and Yves Wong (collectively "Defendants"), claim that they are customers of the water system operated by the City of Falls Church ("the City").

3. The Commissioner has received a letter dated December 27, 2010 ("the Demand Letter"), in which Defendants, through their attorney, demand that the Commissioner issue refunds of alleged "improper tax[es] on water utility services customers served at locations within Fairfax County" by the City. The Demand Letter also asserts that "[a]ll of these erroneous assessments should be corrected in order that the ends of justice may be served." For all intents and purposes, the Demand Letter requests tax refunds from the Commissioner. A copy of the Demand Letter is attached as Exhibit A.

4. The Demand Letter purports to be a "notice" pursuant to Va. Code § 58.1-3984(B) that the Commissioner is obligated "to correct the improper tax" or file suit on behalf of Defendants to correct the alleged erroneous assessments.

5. The City's water system serves residents of the City as well as a number of residents of Fairfax County who consent to receive public water from the City's water system. Defendants state in the Demand Letter that they are customers of the City's water system "at properties located outside the City limits, within Fairfax County." See Ex. A at 1.

6. The Demand Letter also asserts the following:

> Accordingly, unless you find yourself able to correct the improper tax pursuant to Code of Virginia § 58.1-3981, we call upon you to apply to the appropriate court, in the manner set forth in § 58.1-3984A, for relief of the above referenced taxpayers. We further call upon you to act promptly to avoid the adverse consequences of any applicable statute of limitations.

7. In the Demand Letter, Defendants rest their claim that the City "has assessed an improper tax" solely on a ruling by the Circuit Court of Fairfax County regarding the City's future water rates (FY2009 and after) in a lawsuit styled Fairfax County Water Authority v. City of Falls Church ("the Water Authority Case"). See Ex. A at 1-2. The only parties in the Water Authority Case were the Fairfax County Water Authority and the City. Enclosed with the Demand Letter was a copy of the January 6, 2010, opinion letter ("the Opinion Letter") of the Circuit Court of Fairfax County in the Water Authority Case. A copy of the Opinion Letter is attached as Exhibit B, although the Commissioner does not agree with or acquiesce in its purported statement of facts or legal analysis.

8. The ruling in the Water Authority Case was prospective only and did not require the refund of any money to any customer of the City's water system. A copy of the Final Decree entered in the Water Authority Case ("the Final Decree") is attached as Exhibit C.

9. In fact, the Fairfax County Water Authority, the only plaintiff in the Water Authority Case, did not request and was not awarded any monetary refund, and the Opinion

Letter explicitly recognizes that: "Fairfax Water is not seeking disgorgement of fees." See Exhibit B at 10.

10. Defendants were not parties to the Water Authority Case, and they have no right to assert a claim for any refund based on the ruling in that case.

11. By relying on the decision in the Water Authority Case, Defendants are effectively seeking greater rights than those held by the Fairfax County Water Authority, the only plaintiff in that case. Defendants are not entitled to any such rights, and the Commissioner is not required to grant rights to Defendants based on the ruling in the Water Authority Case.

12. Assuming, arguendo, Defendants could rely on the ruling of the Circuit Court of Fairfax County in the Water Authority Case, what that court found unconstitutional was the transfer of funds from the water system to the City's general fund. See Ex. B at 10. Thus, even if Defendants could properly rely on the ruling in the Water Authority Case, they would not be entitled to any refund, because the City could transfer any such refund amount from the general fund to the water fund in order to remedy the purported unconstitutionality relative to Defendants' alleged "taxes."

13. Defendants fail to specify, among other things, the period for which they are seeking refunds. The Final Decree provides that the FY2009 transfer from the City's water fund to the City's general fund was restrained. In a Consent Decree entered on January 27, 2010 ("the Consent Decree"), in the Water Authority Case, the parties agreed that the City could transfer funds for FY2009 from the water fund to the general fund, provided that the City was required to return that money to the water fund, plus interest at the amount of 6% from October 7, 2009, the date the FY2009 transfer was made to the City's general fund. On December 10, 2010, the City

returned the foregoing FY2009 transfer to the City's water fund, plus interest at the amount of 6% from October 7, 2009. A copy of the Consent Decree is attached as Exhibit D.

14. Based on the return of the City's FY2009 transfer to the City's water fund, Defendants have no basis to make any claim for any refund of water fees covered by the FY 2009 transfer under the Final Decree in the Water Authority Case. In addition, the Commissioner has no control over the water fund.

15. There was no transfer for FY2010 from the City's water fund to the general fund. Thus, Defendants have no basis to make any claim for any refund of FY2010 water fees under the ruling in the Water Authority Case.

16. Assuming, arguendo, that Defendants could stand in the shoes of the Fairfax County Water Authority based on the ruling in the Water Authority Case, they would be barred by the doctrine of res judicata because asserting a right to a refund now, after failing to do so in the earlier case, would constitute claim-splitting.

17. The Commissioner was also not a party to the Water Authority Case; therefore, the Commissioner is not bound by the Final Decree in that case.

18. The provisions of Va. Code §§ 58.1-3980 to -3995 do not apply to the payment of water fees that are charged by the City because, for example, such fees are not "imposed" by the Commissioner and do not constitute, under any circumstances, a "local tax authorized by this title," as required by Va. Code § 58.1-3980.

19. None of the Defendants has filed an application with the Commissioner under Va. Code § 58.1-3980 for correction of an erroneous tax assessment based on the theory asserted in the Demand Letter.

20. Under these circumstances, the Demand Letter wrongly asserts that the Commissioner has some obligation or authority "to correct the improper tax pursuant to Code of Virginia § 58.1-3981."

21. In addition, even if Defendants were entitled to rely on a ruling of the Circuit Court of Fairfax County in a case in which they were not parties, the Demand Letter omits any essential details, such as the amount of the claimed tax refunds, the period for which such refunds are allegedly due and owing, the manner in which the Commissioner is required to calculate any such refund, and, to the extent Defendants request refunds for unspecified others, any basis upon which Defendants have been authorized to or are entitled to request such refunds.

22. Contrary to the assertions in the Demand Letter, the Commissioner is not bound by the decision of the Circuit Court of Fairfax County in the Water Authority Case and is not legally obligated to issue any tax refunds under these circumstances or to "apply to the appropriate court, in the manner set forth in § 58.1-3984A, for relief of the above referenced taxpayers."

23. In addition, Va. Code § 58.1-3984(A), the statute relied upon by Defendants in the Demand Letter for the Commissioner "to apply to the appropriate court . . . for relief of the above referenced taxpayers," imposes no legal obligation on the Commissioner to do anything. In fact, Va. Code § 58.1-3984(A) has no application to the Commissioner in any respect.

24. The provisions of Title 58.1 of the Virginia Code do not apply to the collection of water fees paid to the City for public water service. In fact, the Commissioner plays no role and has no duty with respect to such fees.

25. The Commissioner disputes the assertions of Defendants that they are entitled to any tax refunds based on the ruling of the Circuit Court of Fairfax County in the Water Authority

Case. At the very least, the Commissioner is not certain that the assessment of any tax is improper or is based on obvious error. He is unwilling, therefore, to issue any tax refunds or file any suit on behalf of Defendants.

26. Assuming, arguendo, that Defendants could rely on the ruling of the Circuit Court in the Water Authority Case, that the Commissioner were bound by that ruling, and that Defendants had provided sufficient detail in the Demand Letter to delineate the amount of taxes they claim were unconstitutional, the Commissioner is not certain that any refund to Defendants or any other parties would be appropriate. Even in that hypothetical situation, for example, the City could take the amount claimed by Defendants and remedy their claim by transferring that amount from the City's general fund to its water system fund.

27. The Commissioner disputes Defendants' assertion that he has any authority or statutory duty to issue the requested tax refunds or to file suit to secure such refunds.

28. The Commissioner is entitled to use his discretion in determining whether to issue any tax refunds such as those requested by Defendants in the Demand Letter, and he is authorized to decline Defendants' demands relating to the requested tax refunds.

29. The Commissioner is also entitled to use his discretion in determining whether to commence an action in court on behalf of any taxpayers, and he is authorized to decline the demands of Defendants in the Demand Letter relating to the commencement of an action in court "for relief of the above referenced taxpayers." See Ex. A at 2.

30. Based on the Demand Letter, the Commissioner is concerned that Defendants will file suit against him seeking a writ of mandamus regarding the purported duties and obligations of the Commissioner that Defendants wrongfully claim in the Demand Letter.

31. There exists an actual controversy between the Commissioner and Defendants regarding the authority and duty of the Commissioner either to issue the tax refunds requested by Defendants or to commence an action in court on behalf of Defendants as claimed in the Demand Letter.

32. Venue in this Court is proper pursuant to Va. Code § 8.01-261, as this suit concerns the Commissioner, a constitutional officer who regularly and systematically conducts his business in the City of Falls Church, and seeks to enjoin any mandamus action relating to records or proceedings in the City of Falls Church. See Va. Code §§ 8.01-185 and -261.

REQUESTED RELIEF

WHEREFORE the Commissioner, by counsel, respectfully requests that the Court:

A. Issue a declaratory judgment that

(i) Defendants are not entitled to rest any claim for a tax refund on the ruling of the Circuit Court of Fairfax County in the Water Authority Case;

(ii) The Commissioner is not required to rely upon and is not bound by the decision of the Circuit Court of Fairfax County in the Water Authority Case with regard to the claims and demands of Defendants in the Demand Letter;

(iii) The Commissioner is not obligated to issue any tax refunds based on the claims in the Demand Letter; and/or

(iv) The Commissioner is not obligated to commence an action in court on behalf of Defendants regarding the tax refunds demanded in the Demand Letter.

B. Enjoin Defendants from filing and/or maintaining any action seeking a writ of mandamus or other relief against the Commissioner regarding the claims asserted in the Demand Letter.

C. Grant the Commissioner such other and further relief as the Court may deem appropriate.

Respectfully submitted,

TOM CLINTON, COMMISSIONER OF THE REVENUE FOR THE CITY OF FALLS CHURCH, VIRGINIA

By Counsel

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December 27, 2010

BY TELECOPIER & CERTIFIED MAIL

Honorable Tom Clinton
Commissioner of the Revenue
City of Falls Church
300 Park Avenue, Suite 104 East
Falls Church, VA 22046

Re: Cheryl R. Arvidson, 7125 Gordons Road, Falls Church VA 22043; Thomas W. Brooke, 7316 Pinecastle Road, Falls Church, VA 22043-3018;Mary Alice Cole, 2331 Dale Drive, Falls Church VA 22043; Phyllis Friedlander and Blaine Freidlander, 2341 Dale Drive, Falls Church VA 22043; Richard Johnson, 7610 Salem Road, Falls Church VA 22043; William D. Kelly, 7203 Leesburg Pike, Falls Church VA 22043; Jeanne C. Klingelhofer and Victor G. Klingelhofer, 7340 Pinecastle Road, Falls Church VA 22043; Jonathan S. Lang, 7307 Gordons Road, Falls Church VA 22043; Jon D. Luria, 7204 Green Oak Drive, McLean VA 22101-1551; Cary Meltzer, 2414 Lancaster Court, Falls Church VA 22043; Bert Rosecan, 1117 Chain Bridge Road, McLean VA 22101; Lauren Rosenblatt, 7123 Gordons Road, Falls Church VA 22043; Sam's Farm, Inc., 7129 Leesburg Pike, Falls Church VA 22043-2303; Larry J. Sexton, 7205 Gordons Road, Falls Church VA 22043-3035; Jim Sober, 7607 Salem Road, Falls Church VA 22043; Patricia A. Sullivan, 2234 Dale Drive, Falls Church VA 22043; Jerry Wagner, 7507 Colonel Lindsay Drive, Falls Church VA 22043; Armand B. Weiss, 6516 Truman Lane, Falls Church VA 22043; Yves Wong, 7609 Salem Road, Falls Church VA 22043

Dear Commissioner Clinton:

We represent the above referenced clients, all of whom are customers of the City of Falls Church for water utility services at properties located outside the city limits, within Fairfax County.

Please take notice, in accordance with Code of Virginia § 58.1-3984B, that the City of Falls Church has assessed an improper tax on water utility services customers served at locations within Fairfax County, as set forth in the enclosed

Exhibit A

decision of the Circuit Court of Fairfax County in the case of Fairfax *County Water Authority v. City of Falls* Church, 2010 Va. Cir. Lexis 10 (Law No. 2008-16114, January 6, 2010). All of these erroneous assessments should be corrected in order that the ends of justice may be served.

Accordingly, unless you find yourself able to correct the improper tax pursuant to Code of Virginia § 58.1-3981, we call upon you to apply to the appropriate court, in the manner set forth in § 58.1-3984A, for relief of the above referenced taxpayers. We further call upon you to act promptly to avoid the adverse consequences of any applicable statute of limitations.

Very truly yours

John Charles Bennison

Enclosure:

NINETEENTH JUDICIAL CIRCUIT OF VIRGINIA
Fairfax County Courthouse
4110 Chain Bridge Road
Fairfax, Virginia 22030-4009
703-246-2221 • Fax: 703-385-4432 • TDD: 703-863-4139

DENNIS J. SMITH, CHIEF JUDGE
MICHAEL P. McWEENY
MARCUS D. WILLIAMS
STANLEY P. KLEIN
JANE MARUM ROUSH
LESLIE M. ALDEN
JONATHAN C. THACHER
R. TERRENCE NEY
GAYLORD L. FINCH, JR.
RANDY I. BELLOWS
CHARLES J. MAXFIELD
BRUCE D. WHITE
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DAVID S. SCHELL
JAN L. BRODIE
JUDGES

COUNTY OF FAIRFAX CITY OF FAIRFAX

BURCH MILLSAP
BARNARD F. JENNINGS
THOMAS J. MIDDLETON
THOMAS A. FORTKORT
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M. LANGHORNE KEITH
ARTHUR B. VIEREGG
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January 6, 2010

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Counsel for Defendant, City of Falls Church

Re: *Fairfax County Water Authority v. City of Falls Church*, Law No. 2008-16114

Dear Counsel:

This matter came before the Court on September 23, 2009. Subsequent to a bench trial and after considering the pleadings and the arguments of counsel, the

OPINION LETTER

Exhibit B

Court took the matter under advisement. The following embodies the Court's ruling.

FACTS

This is a dispute between providers of municipal water service in the northeastern part of Fairfax County. No evidence was presented as to the history of how the City of Falls Church (the "City") and the Fairfax County Water Authority ("Fairfax Water") became two separate water authorities and which was the initial provider. From prior litigation between these parties, however, it appears clear that the City – actually, its predecessor the Town of Falls Church – was from at least the 1940's providing water service to Falls Church as well as portions of Fairfax County.[1] The resolution creating Fairfax Water was adopted on September 4, 1957, and on September 26, 1957, the charter was filed with the State Corporation Commission.

The historical evidence offered in this case began as of 1959 when, after various disputes and a lawsuit brought by Fairfax Water against the City, the City and Fairfax Water entered into a thirty year agreement identifying exclusive service areas for each provider of public water service. The agreement permitted the City to provide water services for residents and businesses outside its city limits to include an eastern portion of Fairfax County (the "Extended Service Region"). While the agreement was in effect, the City developed a public water supply system capable of serving the Extended Service Region. Although the agreement expired in 1989, the City continues to serve that area.

The City operates its water service on a for-profit basis and charges about twice the rate charged by Fairfax Water.[2]

The City transfers the profits from the water service revenues into its general fund as surplus profit[3] and uses the funds to provide other services to residents of

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[1] *See City of Falls Church, Virginia v. Fairfax County Water Authority*, 2007 U.S. Dist. LEXIS 36004 (2007); *see also City of Falls Church, Virginia v. Fairfax County Water Authority*, 272 Fed. Appx. 252, (4th Cir. 2008).

[2] The City's commodity charge for water is $3.03 per 1,000 gallons, a rate set in June 2005. (Tr. 496:20-497:4; 1476:18-1477.7). The City's water rates are significantly higher than Fairfax Water's currently commodity charge of $1.83. (Tr. 496:5-15).

[3] Although the City calls the current profit transfer a "management fee," its corporate designee admitted that the "management fee" does not pay for any management at all because all such management costs are included under "administration." (Tr. 230:2-7).

the City. In the past it has charged County residents a higher rate than the rate charged to its own residents.[4] About ninety-two percent of the City's customers are residents of Fairfax County.

Fairfax Water's Complaint alleges monopolization and attempted monopolization in violation of the Virginia Antitrust Act, and that the City's current practice of overcharging for municipal water service and transferring the profit to its general fund to subsidize other services in the City of Falls Church establishes an unconstitutional extra-territorial tax. This Opinion Letter addresses the constitutional issue only.

ANALYSIS

Two questions are presented for decision. First, whether the City is acting in violation of the terms of its charter with regard to the financial operation of its water company? Secondly, whether charges for water to non-residents of the City amount to unconstitutional taxation on those non-resident purchasers?

I. The City's Practice of Setting Its Water Rates to Generate Surplus Profits For Transfer to the General Fund Violates the City's Charter.

The City Council of Falls Church set the City's water rates in 2003, 2004, and 2005 so that receipts would not only exceed expenses but create a substantial profit.[5] The City's transfers to the general fund, ninety-two percent of which is generated by Fairfax County customers, have significantly reduced the local tax burden on Falls Church citizens without any corresponding benefit to the City's Fairfax County ratepayers. The Fairfax County ratepayers do not sit on the Falls Church City Council or elect its members.

Since 1950 the City's Charter has required that it set water rates so that "receipts [are] equal to expense."[6]

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[4] A typical Fairfax County customer pays $86.19 quarterly to the City compared to $50.97 for a customer of Fairfax Water.

[5] The annual profit from 1985 to 1998 ranges from $1 million to $1.6 million per year. These sums doubled and tripled from 1999 to 2002, totaling nearly $4.9 million in 2002. Since 1999 the profit transfers have averaged about $2.3 million per year.

[6] *Compare* 1950 Va. Acts ch. 323, § 13.09 *with* 1995 Va. Acts ch. 655, § 13.09.

> The rates to be charged for the respective services of the water and sanitary sewage utilities shall be fixed from time to time by the council on the recommendation of the director of public utilities and the city manager. If for any three consecutive fiscal years the average annual receipts of any utility shall be less than its average annual expense, it shall be the duty of the director of public utilities and the city manager to recommend and the council to adopt for that utility a schedule of rates which in its judgment will produce receipts equal to expense.[7]

Although the General Assembly has over time amended several portions of the City's Charter, none of these changes has altered the basic rate-making methodology. That section continues to require that the water rates are to be set with "receipts equal to expense," without building any surplus or "return on equity" into the rates themselves.

In short, the Charter has always made clear that the water rates were to be set so that anticipated receipts equaled anticipated expenses without resulting in a surplus created by the rates themselves. The City points out that § 13.07 provides that the City Council, by a two-thirds vote, may transfer any surplus to either the general fund or the renewal fund.[8] Notwithstanding, this transfer provision confounds the broader mandate of the charter, namely, that the City should be operating the water company in a manner whereby receipts are to equal – not exceed – expenses. There should not be a "surplus" profit to transfer to any fund, by a two thirds vote or otherwise.

In short, the City's rate making for its water services is plainly at odds with the mandate of its charter. Receipts with a profit do not equal expenses.

II. Transferring Water Fund Surpluses to the General Fund Constitutes an Unconstitutional Tax.

The Virginia Supreme Court in *Marshall v. Northern Virginia Transportation Authority* ("NVTA") stated that the Commonwealth's taxing power is different from other powers circumscribed by the Virginia Constitution. 275 Va. 419, 657 S.E.2d 71 (2008). The court observed that the constitution, particularly Art. I, § 6, "prohibits taxation of citizens without their consent or that of their elected representatives."[9]

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[7] 1995 Va. Acts ch. 655, § 13.09.

[8] *Id.* § 13.07.

[9] *Id.* at 434, 657 S.E.2d at 79.

Notwithstanding the presumption in favor of constitutionality, the court invalidated the General Assembly's 2007 plan to fund transportation improvements in Northern Virginia. The legislation in question allowed the NVTA to impose seven different transportation fees and taxes and to use the money to repay revenue bonds for transportation improvements. The proposed fees raised moneys greater than the cost of service to which they related. This, the court held, constituted a "tax."[10] As such, the court concluded that although the General Assembly specified the amount of each charge, the statute constituted taxation-without-representation because the elected legislature delegated to the NVTA – an unelected body – the decision whether to impose the fees.[11]

In this case the Falls Church City Manager's Memorandum of May 13, 2005, made clear that the then-existing rates were more than sufficient to operate the water system and pay for all capital improvements. It also showed that the rate increase was needed simply in order to transfer more money to the general fund.[12] As in *Marshall*, the positive difference between expenses and revenues constitutes a tax.

The City, similarly to the NVTA in *Marshall*, imposes this tax primarily on persons who do not elect representatives or themselves sit on the City's governing board. Indeed, ninety-two percent of that transfer was funded by Fairfax County customers who are not represented on the Falls Church City Council. The Court finds that the profits derived from the rates charged to Fairfax County residents violate the principle of no-taxation-without-representation and, thus, amount to an unconstitutional tax.

In *Robinson v. City of Norfolk*, 108 Va. 14, 60 S.E. 762 (1908), the Supreme Court of Appeals[13] held that the General Assembly did not have the power to authorize Norfolk, a city, to levy a license fee on a circus located just outside the city limits "for the sole purpose of raising revenue to defray the general expenses of such city."[14] The Supreme Court reasoned that:

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[10] *Id.* at 431, 657 S.E.2d at 77 (holding that "when the primary purpose of an enactment is to raise revenue, the enactment will be considered a tax, regardless of the name attached to the act.").

[11] *Id.* at 432, 657 S.E.2d at 78.

[12] Tr. 366:4-374:16.

[13] The Supreme Court of Appeals and the later named Supreme Court of Virginia will be referenced throughout as the Supreme Court.

[14] *Id.* at 21, 60 S.E. at 764.

> To any extent that one man is compelled to pay in order to relieve others of a public burden properly resting upon them, his property is taken for private purposes ... It is certainly difficult to understand how the taxation of a district can be defended where people have no voice in voting it, in selecting the purposes, or in expending it.[15]

The Supreme Court extended *Robinson* in *City of Charlottesville v. Marks' Shows, Inc.*, 179 Va. 321, 18 S.E.2d 890 (1942). Like Norfolk, Charlottesville attempted to impose a fee to cover the costs of police service for a carnival located just outside the City limits. The fee was two to three times more than the cost of the service, and the City transferred the moneys to its general fund.[16] The Supreme Court, in addition to finding that the tax improperly taxed non-residents of Charlottesville, found the fee unconstitutionally void and explained that "[t]he exacted charge must bear some reasonable relation to the additional burdens imposed upon the municipality and the necessary expenses involved in the police supervision."[17]

This cost-of-service principle was extended to government-run utilities in *McMahon v. City of Virginia Beach*, 221 Va. 102, 267 S.E.2d 130 (1980). The Supreme Court there held that a Virginia Beach ordinance requiring non-resident owners to pay for new water lines on their properties was valid because it did not exceed the actual cost of service.[18] Because "a reasonable correlation arose between the benefit conferred and the cost exacted," the ordinance was not a "revenue measure."[19]

The Supreme Court in *Tidewater Ass'n of Homebuilders, Inc. v. City of Virginia Beach*, similarly upheld another municipal water charge because the "fee revenues will not exceed the City's cost in providing the service."[20] Also, in *Mountainview LP v. City of Clifton Forge*, the Supreme Court held that municipal

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[16] *Id.* at 17, 60 S.E. at 763 (*quoting* Cooley on Taxation (2d ed.), ch. 5, pp. 140, 141-142).

[17] *Id.* at 330, 18 S.E.2d at 895.

[17] *Id.* at 329, 18 S.E.2d at 895.

[18] *Id.* at 107, 267 S.E.2d at 134.

[19] *Id.* at 107-108, 267 S.E.2d at 134.

[20] 241 Va. 114, 121, 400 S.E.2d 523, 527 (1991).

fees for trash service were reasonable, despite the fact that they generated a surplus, because the surplus was collected "in anticipation of future expenses."[21]

The Supreme Court reviewed these cases in *Eagle Harbor, LLC v. Isle of Wight County* and reaffirmed that "*McMahon* and its progeny establish that the judicial inquiry as to reasonable correlation relating to a municipal fee is directed to whether that fee is a bona fide fee-for-services or an 'invalid revenue generating device.'"[22]

The City attempts to distinguish the *McMahon* line of cases by arguing that the "reasonable correlation test" is limited to charges that a locality levies on its own residents. This argument ignores the fact that these cases flowed from *Robinson* and *Marks' Shows*, both of which involved extraterritorial taxation. The fact that the plaintiffs in the *McMahon* line of cases lived within the particular locality does not demonstrate that those cases overruled *Robinson or Marks' Shows*, or that the cost-of-service principle does not apply to municipal fees charged to non-residents.

The Loudoun County Circuit Court recently applied the cost-of-service principle in *Giordano v. Town of Leesburg* to invalidate the higher charges for water and sewer service that the Town of Leesburg imposed on its Loudoun County customers.[23] The trial judge there struck down the higher rates, concluding that they were not supported by any cost-based rationale.[24] (The question of an extraterritorial tax was not presented in that case because all of the fee revenues received were "used exclusively to fund water and sewer service."[25]) Here it is undisputed that the water rates generate surpluses that exceed the cost of service, and that the surpluses are also diverted to the City's general fund.

The City relies on language in *Corporation of Mount Jackson v. Nelson* which addresses whether a municipality may consider matters of "profit" in deciding whether to provide utility service to a single, new customer located outside its territorial limits. 151 Va. 396, 145 S.E. 355 (1928). In *Mount Jackson*, the town

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[21] 256 Va. 304, 311, 504 S.E.2d 371, 375 (1998).

[22] 271 Va. 603, 615, 628 S.E.2d 298, 304 (2006).

[23] *Giordano v. Town of Leesburg*, No. 42736 (Loudoun County Mar. 6, 2009).

[24] *Id.*

[25] *Id.* at 2-3.

reneged on a contract to extend a water line to a gas station 1,000 feet north of town, claiming the contract was *ultra vires*.[26] The Supreme Court disagreed. In dictum, the Court said that surplus water should not be permitted "to run to waste when it can be sold at a profit."[27] It was common for Virginia municipalities "to furnish water to those who live beyond their limits. This is a source of profit to them."[28]

Similar dictum appeared in *Town of Rocky Mount v. Wenco of Danville, Inc.*, 256 Va 316, 506 S.E.2d 17, 20 (1998). In that case, a Wal-Mart store agreed to pay $250,000 to induce the Town to extend a new sewer line to the property, which was located outside the Town's limits.[29] No other customers were served by this line. When an adjacent fast food restaurant requested permission to connect, the Town demanded $125,000 in order to do so.[30] The restaurant argued that the Town had a legal duty to provide sewer service and could not charge a connection fee that was higher than what it charged "to other users both inside and outside the Town."[31] The restaurant relied on the "holding out" doctrine, an exception to the general rule that a municipality does not have to provide service outside of its service area.[32] Under this doctrine, a town that provides utility service generally to a particular area cannot then pick and choose its customers; it must offer service as a public utility on a non-discriminatory basis.[33]

The Supreme Court in *Rocky Mount* ruled that, while it had not yet adopted the "holding out" principle, the principle would not apply under the facts presented as the Town had not held itself out as providing sewer service generally to the area in question.[34]

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[26] *Id.*

[27] *Id.* at 403, 145 S.E. at 357.

[28] *Id.* at 407, 145 S.E. at 358.

[29] *Id.*

[30] *Id.*

[31] *Id.* at 319 & n.2, 506 S.E.2d at 19 & n.2.

[32] *Id.* at 321, 5-6 S.E.2d at 20.

[33] *See* 12 Eugene McQuillin, *The Law of Municipal Corporations* § 35.52 at p. 795-96 (3d ed. 2006).

[34] *Id.* at 321, 506 S.E.2d at 20.

Mt. Jackson and *Rocky Mount* are plainly quite different from the situation here. Unlike the towns there, the City here has held itself out for decades as the public water provider in eastern Fairfax County. In fact, the City's own expert admitted that the City's Fairfax County customers are "captive" and have nowhere else to go.[35] They are captives to a tax that they cannot challenge by election. That is plainly unconstitutional.

III. Waiver, Estoppel, and Laches

The City asserts in its affirmative defenses that Fairfax Water may not assert its constitutional claims because it has waited too long to bring them. These positions are without merit.

These parties have had a long history with one another – including prior litigation in both the state and federal courts – and each has long been well aware of the other's position and wishes. For more than half a century Fairfax Water and the City have been circling one another in order to determine which would be the primary water service provider to parts of eastern Fairfax County.

Both Fairfax Water and the City may quarrel with such a broad characterization. Each insists that its prime purposes are to serve the public and provide quality water service at a reasonable price. Notwithstanding, though each may be correct in such an assertion, each wishes – in addition to its public responsibilities – to be if not the primary at least a major water provider for Fairfax County. It is telling that even with the Court's view of the correctness of Fairfax Water's constitutional challenge, not a single citizen from Fairfax County who is served by the City has complained of the City's service or its charges, much less joined in this litigation. Not one. This underscores the fact that this suit is ultimately about power – market power – more than anything else.

In all events, no one can through inaction render an unconstitutional act constitutional. The Court does not find that Fairfax Water has slept on its rights or is barred now from asserting them. Even if it had – and it has not – a constitutional challenge, which legally is what this case presents, may be brought at any time.

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[35] Tr. 888:13-19. The doctrine has been embraced in Virginia both by the Attorney General, 1989 Op. Att'y Gen. Va. 137, 1989 Va. AG LEXIS 161 (1989), and by other circuit courts, *e.g.*, *Stoneleigh Group Inc. v. Town of Round Hill*, 50 Va. Cir. 42, 43 (Loudoun County 1999) ("The [holding out] exception is very reasonable and just plain 'makes sense.'").

CONCLUSION

Because the City is in violation of its charter and because the transferring of the profit derived from the sale of water and related service into its general fund amounts to an unconstitutionally void tax on non-residents of the City, Fairfax Water is entitled to injunctive relief. Such relief is warranted because the remedy at law is inadequate.[36] Fairfax Water is not seeking disgorgement of fees improperly paid in the past. It only wants for what is plainly an illegal and unconstitutional practice to come to an end.

An Order is enclosed.

Very truly yours,

R. Terrence Ney

Enclosure

[36] *See Thompson v. Smith*, 155 Va. 367, 386-87, 154 S.E. 579, 586 (1930) ("It is recognized that an injunction will lie to enjoin the threatened enforcement of an invalid statute or ordinance where the lawful use and enjoyment of private property will be injuriously affected by its enforcement ... unless the remedy at law be manifestly as complete and adequate as an injunction suit.").

VIRGINIA:

IN THE CIRCUIT COURT OF FAIRFAX COUNTY

FAIRFAX COUNTY WATER AUTHORITY,	)	
Plaintiff,	)	
v.	)	
CITY OF FALLS CHURCH,	)	CL-2008-16114
Defendant.	)	

FINAL DECREE ON COUNT V CONCERNING THE CITY'S WATER RATES AND WATER FUND TRANSFERS

Count V of the Amended Complaint came before this Court for a trial and hearing *ore tenus* on September 14, 15, 16, 17, 21, 22 and 23, 2009, and the parties subsequently submitted written briefs, and

IT APPEARING TO THE COURT, for the reasons stated in the Opinion Letter of January 6, 2010, that Fairfax Water is entitled to judgment on Count V, it is, therefore,

ADJUDGED, ORDERED AND DECREED that:

1. Judgment is entered in favor of Fairfax Water and against the City of Falls Church on Count V of the Amended Complaint.

2. The City of Falls Church is enjoined from transferring any moneys from its water fund to its general fund for purposes unrelated to the water system, including the "management fee" transfer for the City's Fiscal Years 2009 and 2010. This restriction shall not prevent the City from transferring from the water fund to

Exhibit C

the general fund an amount corresponding to compensation for reasonable direct and indirect costs associated with operating the water system, and a reasonable payment in lieu of taxes (PILOT) with regard to water system property owned by the City within its corporate limits.

3. The City of Falls Church must comply with § 13.09 of the City Charter, 1995 Va. Acts ch. 655, in setting water rates that, in the judgment of the City Council, will result in receipts equal to expense (including any future expense of the water system). In setting its water rates, the City may not include as an "expense" any surplus to be transferred to the general fund in violation of paragraph two of this Decree.

4. The last sentence of Section 13.07 of the City Charter, 1993 Va. Acts ch. 969, is declared unconstitutional to the extent it permits the City to transfer water moneys to the general fund in a manner inconsistent with paragraphs two and three.

5. Count V is hereby severed from the remaining counts in this case, and this judgment is final and conclusive as to Count V.

THIS DECREE IS FINAL AS TO COUNT V.

ENTERED this 6 day of January, 2010.

JUDGE R. TERRENCE NEY

ENDORSEMENT OF THIS ORDER BY COUNSEL OF RECORD FOR THE PARTIES IS WAIVED IN THE DISCRETION OF THE COURT PURSUANT TO RULE 1:13 OF THE RULES OF THE VIRGINIA SUPREME COURT.

VIRGINIA:

IN THE CIRCUIT COURT OF FAIRFAX COUNTY

FAIRFAX COUNTY WATER AUTHORITY,	)	
	)	
Plaintiff,	)	
	)	
v.	)	No. 2008-16114
	)	
CITY OF FALLS CHURCH,	)	
	)	
Defendant.	)	

CONSENT ORDER

THIS ACTION came before the Court on January 27, 2010, on the Motion of the City of Falls Church to Clarify or Amend the Court's Final Decree on Count V, Motion to Stay the Final Decree Pending Appeal, and Motion to Order Fairfax Water to Post a Bond Pursuant to § 8.01-631 ("Post-Final Judgment Motions"), and

IT APPEARING TO THE COURT that the parties have resolved the City's Post-Final Judgment Motions, as set forth below, in a manner that this Court finds to be reasonable and appropriate, it is, therefore,

ORDERED that:

1. The injunctive relief contained in the Court's Decree of January 6, 2010, paragraph 2, is hereby suspended during the pendency of the City's forthcoming appeal of that Decree;

2. In the event that the Supreme Court of Virginia declines or denies the City's appeal, or otherwise affirms this Court's rulings in all material respects, the City shall, within 30 days of the Supreme Court's mandate, restore to the water fund the full amount of any "management fee" (or any other surplus revenue or profit) transferred from the water fund to the general fund for the City's Fiscal Year 2009, and for any later fiscal year, if such transfer occurs before a final determination by the Supreme Court, plus interest at the amount of 6% from the

Exhibit D

date such money was transferred to the general fund (*i.e.*, 6% interest from October 7, 2009 with respect to the management fee transfer for FY 09);

3. In light of the parties' agreement to this Consent Order, the City's Post-Final Judgment Motions are withdrawn.

ENTER.

Date: January 27, 2010

JUDGE, CIRCUIT COURT OF FAIRFAX COUNTY

SEEN AND AGREED:

FAIRFAX COUNTY WATER AUTHORITY

By: _____
Counsel

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WE ASK FOR THIS (PRESERVING ALL OBJECTIONS TO THE FINAL DECREE OF JANUARY 6, 2010, BUT CONSENTING TO THE RESOLUTION OF THE CITY'S MOTIONS IN THE MANNER SET FORTH ABOVE):

CITY OF FALLS CHURCH

By: _____
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