

IN THE DISTRICT COURT OF BECKHAM COUNTY
STATE OF OKLAHOMA

City of Elk City and Elk City Public Works Authority,
Plaintiffs,
vs.
Beckham County Rural Water District No. 3,
Defendant.

Case No. CV-05-73

BECKHAM COUNTY
FILED

DEC 13 2005

LINDA BROWN, COURT CLERK
BY _____ DEPUTY

PETITION

The Plaintiffs, the City of Elk City and the Elk City Public Works Authority, by and through their counsel of record, James C. Milton of Doerner, Saunders, Daniel & Anderson, L.L.P., state as follows for its claim against the Defendant, Beckham County Rural Water District No. 3:

Jurisdiction and Venue

1. Plaintiff City of Elk City is a legally incorporated city located in the County of Beckham, State of Oklahoma.
2. Plaintiff Elk City Public Works Authority is a public trust organized by and for the benefit of the City of Elk City.
3. The Defendant, Beckham County Rural Water District No. 3 ("the District"), claims to be a rural water district formed by order of the Board of County Commissioners for Beckham County. As such, the Defendant may be sued pursuant to Okla. Stat. tit. 82, § 1324.10(1).
4. The District Court has subject-matter jurisdiction pursuant to Okla. Const. art. VII, § 7.

5. Venue is proper in Bookham County pursuant to Okla. Stat. tit. 12, §§ 131(1), 133(First), 134, 182.

Background Allegations

6. The District incorporated on November 17, 1986.

A. The District's federal loan agreements.

7. On April 11, 1990, the District borrowed funds from the Farmers Home Administration division ("FmHA") of the United States Department of Agriculture ("USDA"), in the original amount of \$1,350,000.00.

8. On April 14, 1995, the District borrowed funds from the Farmers Home Administration division ("FmHA") of the United States Department of Agriculture ("USDA"), in the original amount of \$1,458,462.49.

9. On June 2, 2000, borrowed funds from the Rural Utilities Service ("RUS") of the United States Department of Agriculture ("USDA"), in the original amount of \$58,000.00.

10. Each of these three loans between the District and the USDA were finalized by the execution of certain documents by and between the District and the USDA.

B. Representations and promises by the District to the USDA regarding authority to borrow and compliance with state law.

11. In a bond counsel opinion letter dated December 18, 1989, written by Phillips McFall McCaffrey McVay Sheets & Lovelace, P.C., and addressed to the USDA, the Phillips McFall law firm stated, "It is our opinion that the District has the legal right to . . . repay the loan subject only to changes during the advances of funds such as litigation resulting from the failure to advance loan funds and receipt of closing certificates. It is our further opinion that the District has the power to issue revenue bonds or notes which will constitute valid and legally binding special obligations of said District (a body politic and corporate and an agency of the State of Oklahoma) . . ."

12. In a bond counsel opinion letter dated April 11, 1990, written by the Phillips McFall law firm, and addressed to the USDA, the Phillips McFall law firm stated, "In our opinion the indebtedness evidenced by the Promissory Note [dated April 11, 1990] has been authorized and issued in accordance with the statutes of the State of Oklahoma and the proceedings above and constitutes a valid and legally binding obligation of the District (a body politic and corporate and an agency of the State of Oklahoma) secured by a first lien on and first pledge of the revenues of the water distribution system of said District and a first mortgage on all real property, easements and rights-of-way owned or acquired by the District. . . . In our opinion the documents and proceedings referred to above are valid and binding in accordance with their terms."

13. In a bond counsel opinion letter dated June 2, 2000, written by the Phillips McFall law firm, and addressed to the RUS, the Phillips McFall law firm stated, "In our opinion the indebtedness evidenced by the [June 2, 2000] Promissory Note has been authorized and issued in accordance with the statutes of the State of Oklahoma and the proceedings above constitutes a valid and legally binding obligation of the District (a body politic and corporate and an agency of the State of Oklahoma) . . . In our opinion the documents and proceedings referred to above are valid and binding in accordance with their terms."

14. In Section 5(b) of the USDA-FmHA Form FmHA 1942-9, titled "Loan Resolution Security Agreement," dated December 9, 1989 and apparently applicable to both the April 11, 1990 and April 14, 1995 loans, the District "covenants and agrees that so long as the indebtedness hereby authorized remains unpaid: (b) It will comply with applicable State laws and regulations and continually operate and maintain the Facility in good condition."

15. In a Real Estate Mortgage executed by the District in favor of the USDA on June 2, 2000, the District covenanted and agreed "To comply with all laws, ordinances, and regulations affecting the property."

16. In a Real Estate Mortgage executed by the District in favor of the USDA on June 2, 2000, the District covenanted and agreed "This instrument shall be subject to the present regulations of the Government, and to its future regulations not inconsistent with the express provisions hereof."

C. Federal requirements on borrowing funds from USDA.

17. In accordance with § 1926(b), the USDA promulgated a set of regulations designed to govern the qualification, application and administration of the loans guaranteed by the Federal Government and given to rural communities. Among the relevant regulations pertaining to water and waste facilities is 7 C.F.R. § 1780.

18. The FmHA has since changed its name and is now referred to as the Rural Utilities Services Division (the "RUS").

19. Title 7, C.F.R. § 1780.15 requires the District, as a condition precedent to the disbursement of funds, to comply with applicable state laws regarding, *inter alia*, borrowing money and giving a security interest as a condition to obtaining the USDA loan. Specifically, Section 1780.15 states in part:

Applicants will be required to comply with Federal, State, and local laws and any regulatory commission rules and regulations pertaining to: (a) Organization of the applicant and its authority to own, construct, operate, and maintain the proposed facilities; (b) Borrowing money, giving security therefore, and raising revenues for the repayment thereof; (c) Land use zoning; and (d) Health and sanitation standards and design and installation standards unless an exception is granted by RUS.

Id. (emphasis added).

20. Through the loan agreements and related documents described previously in this Petition, the District agreed to comply with, and represented compliance with, all federal, state, and local laws relating to its authority to borrow from the USDA.

D. The Spending Clause.

21. Title 7, U.S.C. § 1926(b) and the rules promulgated thereunder were enacted pursuant to Article I, § 8, cl. 1 of the United States Constitution (the "Spending Clause").

22. It is well settled that legislation enacted pursuant to the Spending Clause operates in the nature of a contract. See *Pennhurst v. Halderman*, 451 U.S. 1, 17 (1981). The federal funds are conditioned upon the receiving state's voluntary and knowing acceptance of the terms of the "contract." *Id.*

23. The required terms of the contracts entered into between the District and the USDA are set forth in § 1780 and in the loan documents themselves. The loans are conditioned upon the authority and ability of the District to borrow money and grant a security interest in a sufficient amount to protect the USDA's loan. 7 C.F.R. § 1780.15(b).

E. The lack of state-law authority for the District to enter into its loans with the USDA that carry with them exclusive rights to serve a federal service area broader than existing customers.

24. In entering into the abovementioned loans with the USDA, the District relied upon Title 82, section 1324.10 of the Oklahoma Statutes, as providing its authority to enter into such contractual obligations.

25. Okla. Stat. tit. 82 § 1324.10 provides:

A. Every district incorporated hereunder shall have perpetual existence, subject to dissolution as provided by the Rural Water, Sewer, Gas and Solid Waste Management Districts Act, and shall have power to:

...

(4.) Borrow money and otherwise contract indebtedness for the purposes set forth in this act, and, without limitation of the generality of the foregoing, to borrow money and accept grants from the United States of America, or from any

corporation or agency created or designated by the United States of America, and, in connection with such loan or grant, to enter into such agreements as the United States of America or such corporation or agency may require; and to issue its notes or obligations therefore [sic], and to secure the payment thereof by mortgage, pledge or deed of trust on all or any property, assets, franchises, rights, privileges, licenses, rights-of-way, easements, revenues, or income of the said district;

...

(9.) Make any and all contracts necessary or convenient for the exercise of the powers of the district;

....

26. Section 1324.10 and its predecessor statutes are unconstitutional under Oklahoma state constitutional law, to the extent that they purport to authorize rural water districts to enter into federal contracts that invoke monopoly power.

27. Article V, section 51, of the Oklahoma Constitution provides: "The Legislature shall pass no law granting to any association, corporation, or individual any exclusive rights, privileges, or immunities within this State."

28. In 1972, the Oklahoma Supreme Court rejected the theory that an Oklahoma water district can hold exclusive franchise rights to distribute water. The Oklahoma Supreme Court held that a rural water district cannot enter into a contract that has the effect of cloaking the rural water district with prohibited exclusive rights. The Supreme Court held that rural water districts are prohibited from "creat[ing] for [themselves] an exclusive franchise by entering into [a] loan contract with the [Rural Utilities Service]." *Comanche County Rural Water District No. 1 v. City of Lawton*, 1972 OK 117, 501 P.2d 490. The Court reasoned that this would "ascribe to our Legislature an intention to violate Art. 5, § 51 of the Oklahoma Constitution." *Comanche County Rural Water Dist. No. 1 v. City of Lawton*, 501 P.2d 490, 493 (Okla. 1972).

29. In 1979, the *Comanche County* decision was addressed by the U.S. District Court for the Northern District of Oklahoma. *Rural Water District # 3 v. Owasso Utils. Auth.*, 530 F.

Supp. 818 (N.D. Okla. 1979). The *Owasso* decision distinguished *Comanche County* on the basis that “[t]he *Comanche County* case did not involve an ‘encroachment’ by the municipality into areas within the confines of the Water District territory by either annexation or otherwise.” *Owasso*, 530 F. Supp. at 822. The *Owasso* court determined that, while the *Comanche County* court struck down an Oklahoma Attorney General opinion dealing with Section 1926(b), “[t]he Court did not deal with the constitutionality of § 1926(b), nor did the Court consider the question of the supremacy of the Federal Act.” *Id.* The *Owasso* decision is inapplicable to the issues raised by this Petition because the *Owasso* court did not address the impact of *Comanche County* or the Oklahoma Constitution on the rural water district’s authority to borrow federal funds, or the impact of the district’s lack of authority on the conditions imposed by the federal government pursuant to the Spending Clause.

30. In 1988, the U.S. Court of Appeals for the Tenth Circuit addressed the impact of the Oklahoma Constitution on rural water districts’ authority to enter into loans that carried with them Section 1926(b) protection. *Glenpool Util. Servs. Auth. v. Creek County Rural Water Dist. No. 2*, 861 F.2d 1211 (10th Cir. 1988), *cert. denied*, 490 U.S. 1067 (1989). Unfortunately, the Tenth Circuit was silent on the *Comanche County* decision and its impact on the state-law issues regarding rural water districts’ authority to enter into such contracts. Indeed, the *Glenpool* decision contradicts *Comanche County* on issues of Oklahoma state law regarding the types of contracts that are prohibited under Okla. Const. art. 5, § 5. On page 1216 of the *Glenpool* decision, the Tenth Circuit quoted from Section 1324.10(4) and concluded that “Oklahoma thus authorized [the rural water district] to borrow from the federal government and to enter into any required agreements in connection with those loans.” *Glenpool*, 861 F.2d at 1216. The Tenth Circuit concluded that Section 1324.10(4) did not contravene the Oklahoma constitution because it “authorized the acceptance of a condition rather than having granted an exclusive right. The

district's right to exclude Glenpool's water service here was granted to the rural water district by the *federal* legislature through section 1926(b), and not by the Oklahoma state legislature." *Glenpool*, 861 F.2d at 1216. The *Glenpool* decision contains a number of specific findings regarding issues of state law. The Tenth Circuit has already retraced its steps on one such finding regarding Oklahoma state law. Specifically, the *Glenpool* decision contained a statement regarding the rural water district's obligation to provide service to those within its state-law geographic boundaries. But in 1999, the Tenth Circuit retraced its steps and held that "*Glenpool* did not expressly hold that Oklahoma water districts have a legal duty to provide service; it merely referred to a specific water district's 'responsibilities to applicants within its territory' in affirming a factual finding by the district court." *Sequoyah County Rural Water District No. 7 v. Town of Muldrow*, 191 F.3d 1192, 1202 (10th Cir. 1999), *cert. denied*, 529 U.S. 1037, 529 U.S. 1049 (2000).

31. In 2002, the Oklahoma Supreme Court reaffirmed the *Comanche County* rule. The Oklahoma Supreme Court was faced with an argument to expand the anticompetitive protection offered by a state statute, Okla. Stat. tit. 82, § 1085.36. The rural water district argued that Section 1085.36 should be given the same broad protection associated with Section 1926(b). The Oklahoma Supreme Court rejected the argument. "The Water District's proposed territorial approach to application of section 1085.36 would not, however, be consistent with the public policy of encouraging and promoting the development of water and sewer facilities. Okla. Stat. tit. 82, § 1085.31 (2001). It would limit County Commissioners' ability to release and separate areas from a water district even when it was in the best interests of the landowners and the water district to do so. Additionally, a territorial approach would impose provisions of a water district's loan agreement with the Water Resources Board on non-customer landowners who are not parties to the contract. Finally, such an approach would result in the granting of an exclusive

right to provide water and sewer services within the geographical boundaries of a water district in contravention of Article V, section 51, of the Oklahoma Constitution and this Court's holding in *Comanche County Rural Water District No. 1 v. City of Lawton*, 501 P.2d 490 (Okla. 1972)." *Rural Water & Sewer Dist. No. 4 v. Coppage*, 2002 OK 44, ¶ 13, 47 P.3d 872, 874-75.

32. The *Coppage* decision clarified that, in the context of a rural water district that borrows money from the federal government, "the [state] constitutional prohibition could not be evaded by entering into a contract with the Farmers Home Administration." *Id.*

33. In *Coppage*, the Court limited the protection offered by a state statute that is similar to Section 1926(b), providing that the state statute could only protect water sales to existing customers of the rural water district. Otherwise, the state statute would violate the Oklahoma Constitution.

34. The federal protection associated with Section 1926(b) is far broader than the protection authorized by *Coppage*, and, as a result, is violative of the Oklahoma Constitution. According to Tenth Circuit decisions, the federal protection applies to the rural water district's territory – its "service area" as defined by the "made service available" test. The "service area" is not limited to actual existing customers of the rural water district. As a result, the Oklahoma statute that purportedly authorizes a rural water district to borrow federal money and thereby invoke federal Section 1926(b) protection is unconstitutional under the Oklahoma Constitution, the *Comanche County* decision, and the *Coppage* decision.

ii. Graduation provisions contained in the District's federal loan agreements.

35. Each of the District's federal loan agreements contain what is known as a graduation provision.

36. The April 11, 1990 promissory note states that "If at any time it shall appear to the Government that Borrower may be able to obtain a loan from a responsible cooperative or

private credit source at reasonable rates and terms for loans for similar purposes and periods of time, Borrower will, at the Government's request, apply for and accept such loan in sufficient amount to repay the Government."

37. The Loan Resolution Security Agreement associated with the April 11, 1990 loan states that "If at any time it shall appear to the Government that the Organization is able to refinance the amount of the indebtedness then outstanding, in whole or in part, by obtaining a loan for such purposes from responsible cooperative or private credit sources, at reasonable rates and terms for loans for similar purposes and periods of time, the Organization will, upon request of the Government, apply for and accept such loan in sufficient amount to repay the Government and will take all such actions as may be required in connection with such loan."

38. The April 14, 1995 promissory note states that "If at any time it shall appear to the Government that Borrower may be able to obtain a loan from a responsible cooperative or private credit source at reasonable rates and terms for loans for similar purposes and periods of time, Borrower will, at the Government's request, apply for and accept such loan in sufficient amount to repay the Government."

39. The June 2, 2000 promissory note states that "If at any time it shall appear to the Government that Borrower may be able to obtain a loan from a responsible cooperative or private credit source at reasonable rates and terms for loans for similar purposes and periods of time, Borrower will, at the Government's request, apply for and accept such loan in sufficient amount to repay the Government."

40. In a Real Estate Mortgage executed by the District in favor of the USDA on June 2, 2000, the District covenanted and agreed "If at any time it shall appear to the Government that Borrower may be able to obtain a loan from a production credit association, a Federal land bank, or other responsible cooperative or private credit source, at reasonable rates and terms for loans

for similar purposes and periods of time, Borrower will, upon the Government's request, apply for and accept such loan in sufficient amount to pay the note and any indebtedness secured hereby and to pay for any stock necessary to be purchased in a cooperative lending agency in connection with such loan."

41. The District executed a document dated June 2, 2000, stating as follows:

The following items were discussed with the Beckham County Rural Water District No. 3

Water Project, \$58,000.00 Loan

1. Rural Development loans are a temporary source of credit. Borrowers will be requested to refinance their loans with other lenders when credit is available at reasonable rates and terms.

2. Rural Development expects compliance with graduation requirements as evidenced by the legally enforceable graduation clause contained in the note, real estate mortgage and loan resolution that will be signed prior to or at loan closing.

3. This loan will be reviewed on a regular basis for graduation as required by Rural Development regulations even though the loan has not matured.

4. A meeting may be requested by Rural Development to discuss graduation requirements and specific types of financial information will be required upon request.

5. In certain cases there are prepayment restrictions or other limiting conditions which must be considered in the graduation process.

6. A request for an additional loan, subordination or consent to additional indebtedness will not normally be approved until the graduation request is resolved.

42. In addition, the District executed an undated document containing substantially the same terms, apparently related to the April 11, 1990 loan.

43. The District has the financial capability to retire or refinance the loans that originated with its loan agreements with the USDA.

**Count One
(Declaratory Judgment)**

44. The above allegations are incorporated by reference.

45. Declaratory relief is proper in this case because an actual controversy exists between the parties, concerning all issues outlined in this Petition, pursuant to Okla. Stat. tit. 12, § 1651 et seq.

46. The Plaintiffs respectfully ask this Court to declare that in light of Article V, section 51 of the Oklahoma Constitution and its interpretation by the Oklahoma Supreme Court in *Coppage* and *City of Lawton*, Title 82, section 1324.10 of the Oklahoma Statutes, is unconstitutional under the Oklahoma Constitution to the extent that it provides the District with the authority to enter into loan agreements with the USDA that carry with them exclusive rights to serve a particular territory, its service area – an area broader than its existing customers.

47. The Plaintiffs further request that the Court enter an order declaring that complying with state law is a contractual condition precedent upon which § 1926(b) funding is based; and that under Oklahoma law, the District is without the authority to enter into an agreement that grants exclusive rights to an entity; and that by applying the appropriate contractual analysis required in Spending Clause cases, the District has failed to meet a condition precedent for § 1926(b) funding and the protection that comes with it, and as a result, the District is not entitled to enforce its claimed unconstitutional monopoly protection.

48. The Plaintiffs further request a declaratory judgment that the loan agreements upon which the District bases its claims of monopoly protection are void for reasons that they are based upon misrepresentations by the District to the USDA regarding the District's state-law authority to borrow funds under a contract that carries with it exclusive rights.

49. The Plaintiffs further request a declaratory judgment that the loan agreements upon which the District bases its claims of monopoly protection are void for the reasons that they exceed the authority of the District under Oklahoma law.

50. The Plaintiffs further request a declaratory judgment that the District violated Oklahoma law in entering into its loan agreements with the USDA.

51. The Plaintiffs further request a declaratory judgment that the District has the financial capability to retire or refinance the loans that originated with its loan agreements with the USDA.

52. The Plaintiffs further request a declaratory judgment that the District should retire or refinance the loans that originated with its loan agreements with the USDA.

**Count Two
(Injunction)**

53. The above allegations are incorporated by reference.

54. Injunctive relief is proper in this case because the harm to the Plaintiffs by the District's unauthorized and illegal actions is irreparable. The Plaintiffs will be irreparably harmed without a judgment from the Court restraining the continuance of these actions by the District.

55. The Plaintiffs request a judgment preventing the District from any further assertion of exclusive rights that are violative of state constitutional law.

56. The Plaintiffs request a judgment requiring the District to perform its duties and obligations under the graduation requirements of its loans and either retire or refinance its federal indebtedness.

57. The Plaintiffs request a judgment preventing the District from entering into any further agreement that carries with it exclusive rights that are prohibited by state constitutional law.

Count Three
(Action in the Nature of Quo Warranto)

58. The above allegations are incorporated by reference.

59. The District has usurped and exceeded its lawful power and authority and is exercising powers without lawful authority.

60. The City and Authority are persons claiming an interest adverse to the illegal exercise of power by the District.

61. Through its unauthorized and illegal actions, the District has engaged in efforts to compete with the City and Authority for the sale of water to landowners and occupants within the corporate boundaries of the City and Authority.

62. Through its unauthorized and illegal actions, the District has engaged in efforts to compete with the City and Authority for the sale of water to landowners and occupants within the service area for water services provided by the City and Authority.

63. Through its unauthorized and illegal actions, the District has interfered with or attempted to interfere with the City and Authority's water sales to the City and Authority's existing water services customers.

64. Through its unauthorized and illegal actions, the District has interfered with or attempted to interfere with the City and Authority's water sales to the City and Authority's potential water services customers.

65. Through its unauthorized and illegal actions, the District has provided inadequate water services to properties owned by residents of the City and Authority, or by City and Authority taxpayers.

66. Through its unauthorized and illegal actions, the District seeks to circumvent and avoid reasonable requirements imposed by the City and the Authority on development and

construction within the corporate boundaries of the City and Authority and within the proper geographical jurisdiction of the Regional Planning Commission.

67. Through its unauthorized and illegal actions, the District seeks to impose economic waste upon residents and landowners within the City and Authority's corporate boundaries.

68. Dissolution of the District is proper in this case pursuant to Okla. Stat. tit. 12, § 1537.

**Count Four
(Receivership)**

69. The above allegations are incorporated by reference.

70. A receivership is proper in this case because of the need to continue provision of necessary public services that have been provided on an illegal basis by the District. Receivership is authorized by Okla. Stat. tit. 12, § 1538 and Okla. Stat. tit. 12, § 1551(3), (5), & (6).

Request for Relief

For the reasons outlined above, the Plaintiffs, City of Elk City and Elk City Public Works Authority, demand that the Court enter a judgment in their favor and against the Defendant, Beckham County Rural Water District No. 3, providing as follows:

A. Judgment declaring that in light of Article V, section 51 of the Oklahoma Constitution and its interpretation by the Oklahoma Supreme Court in *Coppage* and *City of Lawton*, Title 82, section 1324.10 of the Oklahoma Statutes, is unconstitutional under the Oklahoma Constitution to the extent that it provides the District with the authority to enter into loan agreements that carry with them exclusive rights to serve a particular territory, its service area -- an area broader than its existing customers.

B. Judgment declaring that complying with state law is a contractual condition precedent upon which Section 1926(b) funding is based; and that under Oklahoma law, the District is without the authority to enter into an agreement that grants exclusive rights to an entity; and that by applying the appropriate contractual analysis required in Spending Clause cases, the District has failed to meet a condition precedent for § 1926(b) funding and the protection that comes with it, and as a result, the District has no claim against the Plaintiffs for violation of the monopoly protections found in Section 1926(b).

C. Judgment declaring that the loan agreements upon which the District bases its claims of monopoly protection are void for reasons that they are based upon misrepresentations by the District to the USDA regarding the District's state-law authority to borrow funds under a contract that carries with it exclusive rights.

D. Judgment declaring that the loan agreements upon which the District bases its claims of monopoly protection are void for the reasons that they exceed the authority of the District under Oklahoma law.

E. Judgment declaring that the District violated Oklahoma law in entering into its loan agreements with the USDA.

F. Judgment declaring that the District has the financial capability to retire or refinance the loans that originated with its loan agreements with the USDA.

G. Judgment declaring that the District should retire or refinance the loans that originated with its loan agreements with the USDA.

II. Judgment preventing the District from any further assertion of exclusive rights violative of state constitutional law.

I. Judgment requiring the District to perform its duties and obligations under the graduation requirements of its loans and either retire or refinance its federal indebtedness.

J. Judgment preventing the District from entering into any further agreement that carries with it exclusive rights that are violative of state constitutional law.

K. Dissolving Beckham County Rural Water District No. 3.


The Plaintiff further requests, as an interim remedy, the appointment of an independent receiver to manage the operation of Beckham County Rural Water District No. 3 until further order of the Court, pending consideration and determination of the proper remedy for Beckham County Rural Water District No. 3's unauthorized activities, including but not limited to dissolution of the District or liquidation of the assets and liabilities of Beckham County Rural Water District No. 3.

Finally, the Plaintiffs, City of Elk City and Elk City Public Works Authority, demand judgment in their favor and against the Defendant, Beckham County Rural Water District No. 3, for their attorney fees and costs incurred in this action.

Respectfully submitted,

DOERNER, SAUNDERS, DANIEL & ANDERSON, L.L.P.

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