WASHINGTON HEARINGS BOARD CLARIFIES RELINQUISHMENT EXEMPTION FOR "DETERMINED FUTURE DEVELOPMENT"

***Orondo Fruit Company, et al., v. Ecology,* PCHB Nos. 10-164 & 10-165**
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In a significant decision applying Washington's water right relinquishment statute, the Pollution Control Hearings Board (PCHB) has upheld a county water conservancy board's approval of changes to three water rights to enable development and irrigation of a new orchard. The PCHB's unanimous ruling is a dramatic repudiation of the Department of Ecology's overly-restrictive legal interpretations and its approach to reviewing conservancy board decisions. In *Orondo Fruit Company v. Ecology*, the PCHB has brought clarity and common sense to application of the "determined future development" exemption from relinquishment.

Background: The "Determined Future Development" Exemption

Under the Washington Water Code, if a water right holder voluntarily fails to use a water right, in whole or in part, for a period of five consecutive years, the unused portion can be relinquished to the state and made available for appropriation by others. RCW 90.14.160-.180. The code sets forth numerous exemptions from relinquishment, including an exemption for a water right "claimed for a determined future development" to take place within fifteen years of the most recent beneficial use of the water right. RCW 90.14.140(2)(c).

"Determined future development" is not defined in the Water Code. In *R.D. Merrill Co. v. Pollution Control Hearings Bd.*, 137 Wn.2d 118, 969 P.2d 458 (1999), the Washington Supreme Court provided a lengthy discussion of the "determined future development" exemption. *Merrill* enunciated two distinct requirements: First, the party asserting the exemption must demonstrate the existence of a firm, definitive, or fixed development plan before the end of the five-year period of non-use. *Id*. at 142-44. Second, the development

need not be completed within fifteen years after the last use of the water right; rather, "some affirmative steps toward realization of the fixed development plans must occur within the 15-year period." *Id*. at 146.

Merrill lists numerous examples "which may serve as objective evidence indicating actual implementation" of the development plan, including applying for necessary permits, notifying Ecology of plans to use the water right in connection with a future development, actual physical development such as clearing land or commencing construction, and acquiring additional lands, rights, or materials needed to implement the determined development plan. The court explained that "whatever steps are taken to implement the development plans, the water right holder must proceed in the exercise of reasonable due diligence within the 15-year period." *Id*. at 146.

In *City of Union Gap v. Ecology*, 148 Wn. App. 519, 528-30, 195 P.3d 580 (2008), the Court of Appeals additionally required the claim of a "determined future development" to be made by the holder of the water right: "[I]t is the water rights owner who must demonstrate the existence of a 'determined future development.'" *Id*. at 530. In *Union Gap*, a developer and the city's mayor had a "handshake" agreement for the city to purchase water rights from a closed industrial facility. The "handshake" occurred shortly before the end of five years of non-use; but considerable time elapsed before execution of a written purchase and sale agreement. Although the city obviously hoped and intended to use the water rights in its municipal system, the court held that the city's plan was not "fixed" where the city held no interest in the water rights prior to the end of the five-year period of non-use, and the developer's plan – to sell the rights to the city – did not, alone, constitute a "development" sufficient to trigger the exemption. *Id*. at 530-31.

For its part, the PCHB has emphasized the highly fact-specific nature of the determined future development exemption, resisting a formulaic approach and looking "at the totality of the circumstances" to ascertain whether the exemption applies. *E.g.*, *Protect Our Water v. Ecology*, PCHB No. 03-102 (2004). The conduct of both parties may be relevant to determining whether a fixed development plan exists. *See City of Union Gap v. Ecology*, PCHB No. 05-078 (2006).

Background: The Water Right Change Process

Questions of relinquishment frequently arise in connection with applications to change or transfer existing water rights. In Washington, change applications are decided initially either by Ecology or a county water conservancy board.

Under legislation enacted in 1997, counties were authorized to establish water conservancy boards "for the purpose of expediting voluntary water transfers" that would otherwise require approval by Ecology. *See* RCW chapter 90.80. Ecology was given

authority to approve or deny the creation of a water conservancy board, and to establish training requirements for individual board members. RCW 90.80.030; 90.80.040. Water conservancy boards are generally empowered to decide the same water right change applications as Ecology. RCW 90.80.055. At present, water right change applications filed with Ecology typically languish in a multi-year application backlog; hence the popularity of water conservancy boards in recent years.

Public notice is required for all applications filed with a water conservancy board, after which the board holds a public meeting or hearing on the proposed water right transfer. RCW 90.80.070. When it acts on an application, a water conservancy board must prepare a detailed written decision documenting the basis for its action. *Id*.

All water conservancy board decisions must be reviewed by Ecology "for compliance with applicable state water law." RCW 90.80.080. Ecology is required to complete its review and to affirm, reverse or modify the conservancy board decision within 45 days, although Ecology can (and nearly always does) extend this time period to 75 days. RCW 90.80.080(4). If Ecology fails to act within that time, the water conservancy board's decision becomes Ecology's decision. *Id*. Either way, Ecology's decision is appealable to the PCHB. RCW 90.80.090.

In reviewing water right change applications, Ecology, water conservancy boards, and the PCHB must make tentative findings as to the extent and validity of each water right sought to be changed. *See Okanogan Wilderness League v. Twisp*, 133 Wn.2d 769, 778-79, 947 P.2d 732 (1997). This tentative determination of extent and validity includes an analysis of whether any non-use of water gives rise to relinquishment.

Facts in *Orondo Fruit Company*

Marcus Griggs, members of his extended family, and various family-owned businesses operate orchards in the Orondo area, located along the Columbia River in Douglas County northeast of Wenatchee. During the 2001 growing season, Mr. Griggs noticed a single cherry tree that displayed new and different attributes than the rest of the surrounding Rainier cherry trees. Over the next two growing seasons, Mr. Griggs and his family monitored and artificially reproduced this apparent mutation. In 2003, having concluded they had a viable new type of cherry, they began the process of obtaining a patent for the Orondo Ruby® cherry and developed a plan to expand their orchard holdings to produce the new variety.

From 2003 onward, the family worked in concert with one another to advance their plans of developing the new cherry variety into a commercially viable business venture. Their plan required acquisition and transfer of sufficient water rights to irrigate a viable orchard. Mr. Griggs already held a sizeable parcel of vacant land and a 1971 water right certificate

for irrigation of multiple parcels including property controlled by Orondo Fruit Company, one of the family's businesses. The Orondo Fruit Company orchard previously irrigated with a portion of that 1971 water right was taken out of production in 2002.

In 2008, Mr. Griggs executed a purchase and sale agreement for property located in Okanogan County, together with appurtenant water rights. The agreement was contingent on the successful transfer of the water rights from Okanogan County to Orondo. The agreement also contained language allowing either the seller or the purchaser to terminate the transfer at any time. The appurtenant water rights, known as the Waddell claim and the Thorson claim, had been used for irrigated orchards but had been unused since 2004.

In February 2009, Mr. Griggs applied to the Douglas County Water Conservancy Board to change the Waddell and Thorson water right claims for use in the new orchard in Orondo. The conservancy board approved both applications. Separately, the conservancy board also approved a change to an unrelated owner's portion of the 1971 Griggs water right certificate. In the course of reviewing the latter decision, Ecology decided that the Orondo Fruit Company portion of the 1971 right had been relinquished due to non-use since 2003, and modified the water conservancy board's decision. Ecology also reversed the conservancy board and denied the transfer of the Waddell and Thorson claims, contending that there was "insufficient documentation" of a determined future development to exempt the water rights from relinquishment due to non-use since 2004. Appeals of all three decisions were consolidated for hearing before the PCHB.

The PCHB Decision

On September 20, 2011, the PCHB issued a decision rejecting all of Ecology's objections to the water conservancy board's decisions. In particular, the PCHB held that the "determined future development" exemption shielded all three water rights from relinquishment for non-use.

Ecology staff had not attended the water conservancy board hearing. Defending its decision before the PCHB, Ecology pointed to the lack of a written "business plan" and "a lack of documentation" explaining the ownership interests and relationships between the various Griggs family members and the family business entities. "It would have been obvious from a cursory look at the water right files that these were all related entities," reports Mark Peterson, attorney for the Griggs family. "After testimony by Ecology staff about all the facts they weren't aware of, and all the relationships they didn't understand, one of the PCHB members asked an Ecology witness, in effect, 'Couldn't you have just picked up the phone?'" Peterson recalled.

After listening to the testimony before the PCHB, Ecology staff conceded that "it was not difficult to conclude that the family wholly owned and controlled these various business

entities," and that "compelling" evidence existed of the family's plan. The PCHB found: "It was not clear to Ecology until listening to the testimony at the hearing that all family members were in agreement about the development of an orchard with the new cherry."

Ecology staff testified about their difficulty in determining the point in time that Mr. Griggs' plans became conclusively "fixed" rather than merely speculative or investigatory. Ecology staff were concerned that the 2008 purchase and sale agreement between Mr. Griggs and the owner of the Waddell and Thorson water rights "contained language that allows the purchaser or seller to terminate the transfer at any time at the purchaser's or seller's sole discretion," and "decided that these options for termination did not allow the DFD to become fixed."

Ecology offered three arguments for why the exemption should not apply to non-use of the Waddell or Thorson claims or the 1971 certificate: (1) Mr. Griggs' plans were not conclusively or authoritatively fixed within five years of the date of last use of the water rights; (2) Mr. Griggs lacks the "requisite ownership" of the Waddell and Thorson rights to assert a DFD for those rights; and (3) "more than five years is unnecessary to plant a new cherry orchard."

The PCHB rejected each of Ecology's arguments: "The evidence amply demonstrated that Griggs' plans to develop the new cherry into a marketable crop crystallized in the spring of 2003. At that point in time Griggs confirmed that the new cherry variety could be reproduced, and [Orondo Fruit Company] decided to transfer the excess portion of its newly acquired water right onto Mr. Griggs' vacant land, as well as locate the additional water that would be needed to support a new orchard. We conclude the DFD was conclusively and authoritatively fixed at this time, and all subsequent actions taken by the Griggs and Clennon families, and their related business entities, are properly characterized as steps to implement their plan." Reviewing the actions taken by the family, the PCHB "concludes that all of these facts serve as affirmative steps toward realization of the development plan, and objective evidence indicating actual implementation of a plan, which had already been *determined*, as discussed in *R.D. Merrill* and *City of Union Gap*."

The PCHB's detailed analysis provides new clarity regarding the application of the relinquishment exemption for water rights claimed for a determined future development. Key holdings are summarized below.

A purchaser under a written agreement can claim a DFD

The PCHB held that a purchaser under a written purchase and sale agreement has a sufficient ownership interest in a water right to assert the determined future development exemption to relinquishment. This had been suggested but left open by the Court of Appeals' decision in *Union Gap,* where the city had no written agreement to buy the rights

before the expiration of the five-year period of non-use, and the court stated that "it is the water rights owner who must demonstrate the existence of a 'determined future development.'" The PCHB interpreted *Union Gap* to mean the party claiming the "determined future development" exemption must have a legally sufficient interest in the water right to do so.

The PCHB clarified its understanding of what constitutes a legally sufficient interest: "In the case of a transfer it will be the purchaser of the water right that will most likely have the fixed plan for a determined future development because the purchaser has identified the need for water for some beneficial use. The purchase and sale agreement . . . will typically be conditioned on Ecology's approval of the transfer of the water right. . . . When the purchaser and seller have executed a purchase and sale agreement, and are only awaiting Ecology's approval of the transfer, the terms of the agreement are known and the decision is essentially out of the hands of the parties. At this point in time, the purchaser has a sufficient ownership interest in the water right to assert the determined future development exception to relinquishment."

Contractual termination provisions do not render a plan "unfixed"

Language in a purchase and sale agreement allowing termination at either party's discretion does not "unfix" a determined future development plan. The PCHB held: "Every contract contains an implied duty of good faith and fair dealing. This duty obligates the parties to cooperate with each other so that each may obtain the full benefit of performance." Ecology staff had not considered these fundamental rules of contract law when they "decided that these options for termination did not allow the DFD to become fixed."

A DFD can be fixed before final approval of a water right transfer

As part of its persistent refusal to recognize a "fixed" plan until after expiration of five years of non-use, Ecology argued that the determined future development exemption can be asserted only when a water right transfer has been finalized by Ecology. The PCHB rejected this argument: "Once the purchaser has established a sufficient ownership interest in the water right, there is no reason why the purchaser's fixed plan for the use of that water should not be applicable."

A DFD can be fixed before acquiring an interest in a water right

The PCHB ruled that a development plan may be fixed before (rather than after) the purchaser enters into a purchase and sale agreement, as long as both the plan and the purchaser's interest in the water right exist before the end of the five-year period of non-use of the water right. The act of purchasing a water right can be but is not necessarily the

event that fixes a development plan; it can be evidence of steps to implement a development plan that is already well underway. Here, "both the determined future development, and the applicant's interest in the water right, existed before the end of the five-year period of nonuse of the water right."

Agricultural plans are not *per se* ineligible for DFD

Ecology argued that agricultural operations "typically" can be put in place in fewer than five years, and that the DFD exemption applies only to plans requiring more than five years to come to fruition. This argument relies entirely on a misreading of the Supreme Court's shorthand reference to the five-year period of nonuse in *R.D. Merrill; see* 137 Wn.2d at 143. Read in context, the Court's statement in *R.D. Merrill* does not limit the exemption to "complex" development plans.

The PCHB noted that Ecology's adopted policy addressing the DFD exemption does not include any such restriction. The PCHB acknowledged that it had made a similar statement, citing *Merrill,* in *Pacific Land Partners v. Ecology*, PCHB No. 02-037 (2005). Signaling its skepticism about its questionable 2005 statement but finding it "unnecessary in reaching a decision in this case to reexamine that point," the PCHB concluded the Griggs family's plans were "sufficiently complex so as to require more than five years to come to fruition." The PCHB may be poised to overrule its 2005 statement in *Pacific Land Partners* in a case where the issue is appropriately presented (for example, where a plan becomes "fixed" during the fourth year of non-use but requires two years to implement).

Land development is not required to "fix" an agricultural DFD

The PCHB ruled that land development during the initial five-year period is unnecessary to fix a development plan involving agriculture. Pointing out that in *Merrill*, "the Supreme Court rejected the assertion that development must be actual physical development during its discussion of what affirmative steps needed to occur within the 15-year period," the PCHB held: "Although physical development is a factor to consider when looking at the fixing and implementation of a DFD, an activity such as land clearing is not necessarily required during the five-year period of non-use or the 15-year period to take steps to realize the DFD."

"Bring Me a Rock": Ecology's Procedural Objections

During the PCHB appeal, Ecology raised a litany of procedural objections to the conservancy board's authorization of the Waddell and Thorson water right changes. Most of these alleged procedural errors relate to signatures on the applications, notice of applications, descriptions of overlapping water rights, and compliance with consultation

requirements. Ecology raised many of these issues for the first time only after its decisions were appealed to the PCHB.

The PCHB first considered whether Ecology should be allowed to raise new and different issues on appeal, or whether the Board's *de novo* review should be limited to the grounds for denial actually identified by Ecology in its decision. The PCHB explained that it gives "considerable latitude to all parties to frame legal issues" after an appeal is filed, and generally requires all issues to be listed in a prehearing order so as to give each party adequate time to address other parties' issues. However, the PCHB was obviously disturbed by the possibility of Ecology raising a series of ever-changing reasons for denial during the conservancy board review process, observing that "in this case it is very troubling that Ecology's review of the conservancy board decision may have caught the applicants in the middle of a 'bring me a rock' exercise, with a series of changing reasons for reversal." Despite this concern, the PCHB decided not to preclude any party from raising issues in an appeal, but instead to simply address Ecology's procedural objections on the merits.

Characterizing Ecology's reasoning as "strained" and its interpretation of the water right claims as erroneous, the PCHB concluded that Ecology's procedural arguments do not warrant denial of the water right changes.

Conclusion and Implications

In *Orondo,* the PCHB has reaffirmed the vitality of the "determined future development" exemption from relinquishment, as well as a common sense approach to evaluating its applicability. *Orondo* clarifies the rule first announced in *Union Gap* by firmly establishing that a purchaser under a written water right purchase and sale agreement may claim a water right for a determined future development. *Orondo* reaffirms that the totality of the circumstances, including the conduct of both parties to a water right transaction, must be examined to decide whether a determined future development exists. *Orondo* also hints at the PCHB's willingness to revisit, in an appropriate case, its 2005 suggestion that the exemption applies only to developments requiring more than five years to implement. The PCHB's sensible approach in *Orondo* – faithful to the law and mindful of how water right transactions occur in the real world – will encourage water right transfers.

Procedurally, *Orondo* highlights inherent flaws in the water conservancy board review process, in which Ecology remains aloof from conservancy board proceedings but is entrusted with a veto power. In *Orondo*, Ecology wielded that veto power unconstrained by knowledge of the facts (or, as the PCHB pointed out, by an understanding of basic contract law). On appeal, regardless of the grounds for its actual decision, Ecology is free to raise new and different objections to the conservancy board's action – essentially presenting the appellant with a moving target. The Legislature may take notice, and

consider whether it would not be fairer and more efficient to simply require Ecology to appeal to the PCHB when it disagrees with a water conservancy board decision, and shift the burden of proof accordingly.