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WASHINGTON STATE COURT OF APPEALS
DIVISION II

FEDWAY MARKETPLACE WEST, LLC, a Washington limited liability company, and GARLAND & MARKET INVESTORS, LLC, a Washington limited liability company, on behalf of themselves and all others similarly situated,

Appellants,

v.

THE STATE OF WASHINGTON,

Respondent.

PETITION FOR DISCRETIONARY REVIEW

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Statutes

Cases

Other Authorities

Rules

I. IDENTITY OF PETITIONER

The persons filing this petition for discretionary review are Appellants Fedway Marketplace West, LLC and Garland & Market Investors, LLC (collectively, "Petitioner").

II. COURT OF APPEALS DECISION

Petitioner seeks review of the Published Decision of the Court of Appeals, Division II, which was filed on September 30, 2014 in this case. A copy of the Published Decision is included as Appendix 1.

III. ISSUES PRESENTED FOR REVIEW

The issues presented for review are as follows:

1. The Washington State Liquor Control Board was expressly directed by the people, in Initiative No. 1183, to sell at public auction "the right at each state-owned store location of a spirits retail licensee to operate a liquor store upon the premises." Section 102(4)(c) (codified at RCW 66.24.620(4)(c)) (emphasis added). In flagrant disobedience of that directive, and without any public rule-making procedure, the Liquor Board sold at public auction the right to operate a liquor store ***within one radius mile of*** each state-owned store location. This decimated the economic interests of state store landlords, including Petitioner. The issue

presented for review is whether, in adopting the one-mile rule, the Liquor Board exceeded its lawful authority under Initiative 1183.

2. The Liquor Board felt that the law as written – requiring the auction of licenses to operate at existing state store locations only – would reduce the price that bidders would pay for the licenses at auction. To circumvent that express requirement and drive up auction prices it invented a one-mile rule out of whole cloth, although it knew the rights of state store landlords would be sacrificed in the process. The second issue for review is whether the State's appropriation of Petitioner's private property rights in order to drive up public auction prices was a taking of property without due process of law in violation of the state and federal constitutions for which the State must compensate Petitioner.

IV. STATEMENT OF THE CASE

Plaintiffs Fedway Marketplace West, LLC and Garland & Market Investors, LLC are former lessors of two state-owned liquor stores. The tenant of each was the Washington State Liquor Control Board (hereafter, the "LCB").[1] (The leases are referred to herein as the "Store Leases.") Each lease was for a 10-year term. Tenant improvements conforming to LCB's strict specifications

[1] Unless otherwise indicated, "LCB" as used herein refers to the agency, not to the Board itself.

were constructed at lessors' expense. LCB agreed to pay rent for the term of each lease. (See Store Leases [CP 20-39].)

Initiative No. 1183 ("I-1183"), approved by the voters in the November 8, 2011 election, privatized the sale of liquor in Washington. I-1183 directed the LCB to close state-owned liquor stores and to sell "all assets of state liquor stores and distribution centers, and all other assets of the state over which the board has power of disposition." RCW 66.24.620(3). I-1183 also directed the LCB to sell by auction "the right at each state-owned store location of a spirits retail licensee to operate a liquor store upon the premises." RCW 66.24.620(4)(c) (emphasis added). This section further provided that acquisition of the operating rights was a precondition to receiving a license "at the location of a state store" and that those rights would be subject to all zoning and land use laws applicable to "the property."

Petitioner's Complaint specifically alleged that the Store Leases were assets over which the LCB had power of disposition. (Complaint at ¶ 38 [CP 13].) For purposes of the State's motion for judgment on the pleadings, the lower courts were required to accept that allegation as true. *Tenore v. AT&T Wireless Services*, 136 Wash.2d 322, 330, 962 P.3d 104 (1995).

At the time I-1183 took effect on December 8, 2011, LCB clearly understood that the initiative directed it to auction the right to operate a liquor store at each existing store location (hereafter the "Existing Location Requirement"). Board Member Chris Marr testified, "Yes, that fits with my understanding of what the initiative addressed." (Marr Dep. at 19:24-20:9 [CP 127]. Agency Director Patricia Kohler admitted that "the initiative directed the agency to auction stores at existing location[s]." (Kohler Dep. at 18:15-19:2 [CP 143].) Director of Business Enterprise Pat McLaughlin, tapped to manage the agency's asset divestiture under I-1183, testified "that the auction that was going to be conducted was for the right to operate a liquor store at the existing state store location." (McLaughlin Dep. at 18:5-19, 86:20-24 [CP 171].) And District Manager Steven Meissner, appointed to lead the Auction Team, prepared an Auction Paper stating, "Initiative 1183 requires the LCB to conduct public auctions for the right to sell spirits at the existing location of each state liquor store." (Meissner Dep. at 30:24-31:9 [CP 201].)

Despite this unanimous understanding within the agency that the initiative required the agency to auction the right to sell liquor at existing store locations, LCB management felt that the Existing Location Requirement gave landlords too much leverage

with bid winners, such that honoring the requirement would reduce auction proceeds. An email by Director of Retail Chris Liu stated that the Existing Location Requirement could create a "landlord oligarchy" and "lessen[ ] the value of the license" being auctioned. (McLaughlin Dep. Exh. 7 at 3391 [CP 347].) Director Kohler also believed that the requirement "would give the landlords a lot of control." (Kohler Dep. at 38:25-39:4 [CP 150].)

Plans to implement the Existing Location Requirement and fulfill I-1183's directive that the LCB sell "all assets" over which it had power of disposition were made. The plan was that the Store Leases would be sold and assigned as part of the auction. (See Meissner Dep. Exh. 7 [CP 383] ("bundling and selling store contents **and lease**") (emphasis added); McLaughlin Dep. Exh. 10 at 46 [CP 350] (landlords to have right to opt-in or opt-out.) However, this plan was killed. Aided by the Attorney General's Office, the LCB did a complete about-face and decided – without any public notice or comment or rule-making procedure – to give bid winners free rein to relocate from the existing store locations. So, instead of auctioning "the right **at** each state-owned store location" to operate a liquor store "**upon the premises**," as I-1183 commanded, the LCB unilaterally decided to auction the right at

the existing location or within one radius mile of the existing location (hereafter the "Relocation Policy").

This Relocation Policy was directly contrary to the Official Explanatory Statement the Attorney General's Office had prepared for the Voter's Pamphlet. The Explanatory Statement stated that I-1183 "directs the Board to sell assets connected with liquor sales and distribution, and to sell at auction the right to operate a private liquor store at the location of any existing state liquor store." (Appendix 2 at 2, emphasis added.)

The LCB knew its Relocation Policy was of doubtful validity. It advised its third-party auctioneer that "[a]llowing for alternate locations could be interpreted as violating the intent of I-1183." (McLaughlin Dep. Exh. 17 at 006 [CP 361].) It also recognized that relocation "gives [the] potential bidder a lot of control." (Meissner Dep. Exh. 5 at 032 [CP 380]; McLaughlin Dep. at 44:19-45:4 [CP 176-177] (Q: "If the bidder can move the liquor rights to another location, that takes away from the amount of landlord control and gives control to the bidders, do you agree? A: I can see that, yes. Q: And that's what you were referencing here at this February 1st meeting? A: Yes.").)

Despite these serious concerns and obvious red flags, the Board adopted the Relocation Policy. (McLaughlin Dep. at 92:17-

22 [CP 191].) But it was done quietly and informally, without any public notice, comment or rulemaking. (Id.; Kohler Dep. at 57:24-58:5 [CP 156-157].) It was not until many months later, long after the auction and after multiple drafts and revisions, that an ex post facto written policy document was adopted. (Kohler Dep. Exh. 10 [CP 326-327]; Kohler Dep. at 59:16-22 [CP 157].)

LCB's executive team admitted there is nothing in I-1183 that provides for relocating the right being auctioned and nothing authorizing a one-mile exception to the Existing Location Requirement. See Marr Dep. at 39:4-25 [CP 132] ("I'm not aware that the word 'relocation' appears in the initiative. Q: Does the word or words 'one mile from existing location' – A: Not to my understanding."); Kohler Dep. at 55:10-14 [CP 155] ("nothing in I-1183 about a one radius mile relocation"); McLaughlin Dep. at 49:22-50:3 [CP 178-179] (same).

Worried about the legal exposure posed by the Relocation Policy, LCB management consulted the Attorney General's Office. See Kohler Dep. at 54:9-55:9 [CP 155]; McLaughlin Dep. at 51:4-8 [CP 179] ("I think much of the areas that you're asking questions around were based on our legal advice and I could see, you know, the court, they could decide to uphold or to challenge that advice. I can see that."); Marr Dep. at 31:14-32:2 [CP 131] ("not saying

AG's interpretation is infallible"). The Attorney General's Office recommended new phraseology describing the auction as offering the right to a retail license "associated with" the former state store location. (McLaughlin Dep. Dep. Exh. 24 at 400 [CP 370] ("A successful bidder owns the exclusive rights to apply for a spirit retail license *associated with* the location of the former state liquor store") and McLaughlin Dep. at 96 [CP 193]: the "associated-with" wording "was developed in consultation with our legal counsel.") This fig leaf could not change the fact that the agency had radically altered I-1183's requirement that it auction "the right **at** each state-owned store location . . . to operate a liquor store upon **the premises**." RCW 66.24.620(4)(c) (emphasis added).

The obvious purpose of the Relocation Policy was to drive up the bidding for the rights being auctioned in order to generate higher returns to the LCB. (See Kohler Dep. at 53:17-19 [CP 154].) "If licenses and locations are not transferable it lessens the value of the license." (McLaughlin Dep. Exh. 7 at 3991 [CP 347].)

And, to take advantage of the Relocation Policy, all a bid winner had to do was fill out a form stating he or she was unable to reach agreement with the landlord at the existing state-owned store location. The LCB did not fact-check the representation by the bid winner; did not require a statement from the landlord; and

approved every single request that was made. (McLaughlin Dep. at 61-66 [CP 182-185]; Kohler Dep. at 72:5-10 [CP 163]; Marr Dep. at 61:4-62:7 [CP 135-136].) A hypothetical bid winner who offered to pay a landlord a mere $100 a month in rent and then requested relocation on the grounds that she could not reach agreement with the landlord would satisfy the relocation criteria. (McLaughlin Dep. at 89:19-90:12 [CP 190].

Petitioner and other state-store landlords had constructed expensive tenant improvements to LCB specifications. With the LCB declaring the leases terminated, Director Kohler expected the LCB to pay landlords for the unamortized tenant improvements. (Kohler Dep. at 64:15-19 [CP 160]; Lewis Dep. Exh. 16 at 233 [CP 433].) But in the end, payment was not made unless the lease had an express clause. (Rafel Decl. Exh. K at 17:4-10 [CP 468].) Petitioner received no reimbursement. (Complaint ¶ 21 [CP 9].)

In June 2012, after the auction was completed, LCB Chair Sharon Foster gave a speech to LCB staff, stating: "We got into the auction business. We essentially auctioned off a concept that generated a $32 million windfall for the state." (Marr Dep. Exh. 13 [CP 285-290]; see also Marr Dep. at 68-69 [CP 137].) Unfortunately, the State's "windfall" was generated by stripping Petitioner and other state store landlords of their property rights

without compensation. Review is necessary to correct this unconstitutional taking and provide a remedy.

V. ARGUMENT

A. Review Should be Accepted Pursuant to RAP 13.4(b)(4) Because the State's Disregard of I-1183's Clear Mandate Presents an Issue of Substantial Public Interest that Should be Determined by the Supreme Court

This case presents an issue of substantial public interest, one that the United States Supreme Court addressed at the federal level last term. In *Utility Air Regulatory Group v. Environmental Protection Agency*, 134 S.Ct. 2427, 189 L.Ed.2d 372 (2014), the Court rejected an effort by the EPA to rewrite a statute to suit its own purposes. Using language that can readily be applied to the LCB's conduct in this case, the Court held that the power to execute the laws "does not include a power to revise clear statutory terms that turn out not to work in practice." The Court reaffirmed "the core administrative law principle that an agency may not rewrite clear statutory terms to suit its own sense of how the statute should operate." 134 S.Ct. at 2446. "Instead, the need to rewrite clear provisions of the statute should have alerted EPA that it had taken a wrong interpretive turn." Id.

The same core principle of law needs to be declared applicable in the State of Washington, given the LCB's shocking

arrogation of authority to rewrite I-1183 to suit its own purposes. The Court of Appeals sidestepped this issue entirely. The court cited *Edmonds Shopping Center Associates v. City of Edmonds*, 117 Wash. App. 344, 71 P.3d 233 (2003), for the threshold question of "whether the challenged action seeks less to prevent a public harm than to provide an affirmative benefit to the public agency." (Opinion at 15-16.) But it then held that, because "the legislature's [sic] purpose to prevent proliferation of private liquor stores" was "directed at preventing a public harm," no taking occurred and "further analysis is not required." (Opinion at 16.)

This was a cop-out for two reasons. First, the LCB has never asserted that its purpose in adopting the Relocation Policy was to prevent proliferation of private liquor stores.[2] Second, the LCB admitted in discovery that the Relocation Policy was adopted in order to drive up the price bidders would pay at public auction for the operating rights to the state-owned liquor stores, knowing

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[2] There were 167 state-owned liquor stores in operation before I-1183 took effect. [CP 370] I-1183 required the LCB to auction the rights to operate a liquor store "at each state-owned store location." RCW 66.24.620(4)(c). The Relocation Policy did not increase or reduce the number of licenses being auctioned. With or without relocation, there were 167 licenses to auction.

The Court of Appeals' reference to preventing a proliferation of private stores is therefore a red herring: not only didn't the State make any reference to that alleged purpose in its papers below, the Relocation Policy did not impact the *number* of allowable liquor stores at all.

full well that it was a zero-sum game and that those auction-price gains could be generated only by diminishing property rights held by state store landlords. (See McLaughlin Dep. at 44:19-45:4 [CP 176-177]; Dep. Exh. 7 at 3991 [CP 347] (I-1183 created "landlord oligarchy").)

In fact, LCB Chair Sharon Foster crowed about the "$32 million windfall" the auction produced for the agency. (Marr Dep. Exh. 13 [CP 289].) If this evidence does not show that there was an "affirmative benefit" to the agency from the Relocation Policy it adopted, see *Edmonds Shopping Center*, 117 Wash. App. at 362 (quoting *Guimont v. Clarke*, 121 Wash.2d 586, 603, 854 P.2d 1 (1993)), it is difficult to imagine a set of facts the Court would find sufficient.

The lower court's facile attempt to justify the LCB's breathtaking rewrite of the statute by citing to the purpose of preventing a proliferation of private stores does not withstand scrutiny but does show the need for a clear statement by this Court that an agency may not simply revise a law to pump up its revenue, without constitutional consequence to the citizens whose rights it sacrificed in the process. The lower court's opinion is all the more problematic because the Relocation Policy was adopted in flagrant derogation of the Administrative Procedure Act ("APA").

"Rules are invalid unless adopted in compliance with the APA." *Hillis v. State Dept. of Ecology*, 131 Wash.2d 373, 398, 932 P.2d 139 (1997). A "rule" is defined as including "any agency order, directive, or regulation of general applicability . . . (c) which establishes, alters, or revokes any qualification or requirement relating to the enjoyment of benefits or privileges conferred by law." RCW 34.05.010(16). The LCB's Relocation Policy easily fits this definition: it is an agency order, directive or regulation of general applicability to all bid winners, and it alters a qualification relating to the enjoyment of benefits or privileges conferred by law – namely, that the benefit or privilege of operating a liquor store pursuant to RCW 66.24.620(4)(c) be exercised only "at each state-owned store location" and "upon the premises" thereof.

In *McGee Guest Home, Inc. v. Dep't of Social & Health Servs.*, 142 Wash.2d 316, 323, 12 P.3d 144 (2000), the Court invalidated agency action that "functionally added" a requirement that was not contained in applicable law. Here, the LCB functionally erased a requirement clearly set out in the governing statute. That was rulemaking, and the purported rule is invalid for failing to satisfy the public participation requirements of the APA. See, e.g., RCW 34.05.320, .325 & .328.

Whether or not LCB had a right to terminate the Store Leases after I-1183 directed it to close state-owned liquor stores does not matter here. The duty to close liquor stores did not confer any authority on the LCB to alter I-1183's unambiguous statutory scheme requiring auction of the rights to operate liquor stores at existing state store locations only and to sell all assets, including Store Leases, over which it had power of disposition. Before it reversed course and adopted the Relocation Policy, the agency was planning to do just that by including the unexpired leases in the bundle of rights to be sold at public auction. (See Meissner Dep. Exh. 7 [CP 383] ("bundling and selling store contents and lease").) Nor did the LCB's power to terminate Store Leases, if it existed, confer immunity from liability for failing to pay for property rights taken by the State without compensation.

Petitioner's right to the substantial benefits conferred by I-1183 was a property interest. The initiative was structured so that landlords of state-owned liquor stores would have "leverage" with persons purchasing at auction the right to operate the former store. This consisted of the Existing Location Requirement and the LCB's obligation to sell "all assets," including unexpired leases. These landlord rights were "built-in" to the statute presumably to mitigate the obvious harm landlords would suffer from the closure

of the state stores. See *Manufactured Housing Communities of Washington v. State*, 142 Wash.2d 347, 366, 13 P.3d 183 (2000) (right of first refusal, "even one created by statute," can create a property interest). It was not for the LCB to take those rights by executive fiat.

The State's argument below, that it had the right to terminate the Store Leases and upon termination the landlords had no remaining rights, is clearly wrong. See Brief of Respondent at 32 ("if the leases terminate by their own terms there is no property left to be taken"). I-1183 gave state-store landlords a property interest so potent that the LCB characterized it as an "oligarchy." [CP 347] Termination of the leases, even if such a right existed[3], did not extinguish Petitioner's constitutional right not to have that property interest taken for public purposes without just compensation. It is well established that a contracting party may be liable for breach of duties that arise independent of contract. See *Eastwood v. Horse Harbor Found., Inc.*, 170 Wash.2d 380, 393, 241 P.3d 1256, 1264 (2010) (lessee's duty to avoid waste).

For these reasons, the Court of Appeals' holding that "the State did not commit an unconstitutional taking *by exercising the lease termination provision* when enactment of the new law

[3] Petitioner does not agree that the LCB had a right to terminate the leases.

prohibiting the State from selling liquor rendered it unable to perform under the leases" (Opinion at 16, emphasis added) misses the mark entirely. The State committed an unconstitutional taking when it summarily altered the law to bolster agency profit by eliminating the property interest that I-1183 gave Petitioner in dealing with the licensee who acquired at auction the right "to operate a liquor store upon the premises." RCW 66.24.620(4)(c).

This case presents an issue of substantial public interest that warrants Supreme Court review under RAP 13.4(b)(4). Dismissal of the case on the pleadings was improper and denied Petitioner the opportunity to seek compensation for the taking of its property rights by a runaway state agency that adopted, without any rule-making procedure, a rule that contradicted the express terms of I-1183.

B. Review Should be Accepted Pursuant to RAP 13.4(b)(3) Because a Significant Question of Law Concerning Taking of Private Property Under the Constitutions of Washington and the United States is Involved

In addition to presenting an issue of substantial public interest, this case presents a significant question of law under the state and federal constitutions. Review is therefore also merited under RAP 13.4(b)(3).

Article I, section 16 of the Washington Constitution provides in relevant part that "No private property shall be taken or damaged for public or private use without just compensation having been first made." The Fifth Amendment to the United States Constitution similarly provides that "[N]or shall private property be taken for public use, without just compensation."

A fundamental rule governing application of these provisions in cases of this kind is that state action or regulation may constitute an unconstitutional taking "if it goes beyond preventing a public harm [to] actually enhance a publicly owned right in property." *Sintra, Inc. v. City of Seattle,* 119 Wash.2d 1, 14, 829 P.2d 765 (1992), citing *Presbytery of Seattle v. Seattle,* 114 Wash.2d 320, 329, 787 P.2d 907 (1990). In this case the LCB actually and substantially enhanced the publicly-owned liquor sale rights that it sold at auction by diminishing the property rights of Petitioner and other state liquor store property owners.

This enhancement, which resulted in a "$32 million windfall for the state," had nothing to do with preventing a public harm. Indeed, the record is devoid of any evidence showing – or even argument contending – that the LCB's decision to rewrite the unequivocal Existing Location Requirement was based in any way on a desire to prevent public harm. Instead the numerous

statements in the record from LCB officials acknowledging the real reasons behind their lawless transformation of the Existing Location Requirement into the Relocation Policy show that the State's goal here was increasing agency revenue from the sale of publicly-owned liquor sale rights, not prevention of any public harm. The evidence also compellingly shows that the LCB's action was taken with knowing disregard for the devastating effects it would have on state store landlords. (See Meissner Dep. Exh. 5 at 032 [CP 380]; McLaughlin Dep. at 44:19-45:4 [CP 176-177].)

Ultimately the determination of whether or not an unconstitutional taking has occurred begins with analysis of two threshold questions: first, whether the challenged state action destroys or derogates any fundamental attribute of property ownership such as the rights to possess, to exclude others, etc. and second, whether that action seeks less to prevent public harm than to provide an affirmative public benefit. *Guimont v. Clark,* 121 Wash.2d 586, 603, 854 P.2d 1 (1993). Regardless of how the first question is answered the second question must be answered in the affirmative given the LCB's admissions that in adopting the Relocation Policy it was seeking to maximize profit rather than avert some perceived public harm. Accordingly, the Court must

engage in additional analysis. *Guimont,* 121 Wash.2d at 604. The Court of Appeals neglected to perform that analysis. (See Opinion, Appendix 1 at 16.)

The required additional analysis is another two-question inquiry – first, whether or not a legitimate state interest is advanced and second, whether the State's interest is outweighed by the adverse economic impact on the landowner. *Guimont,* 121 Wash.2d at 604. Given the State's failure to identify what legitimate public interest was advanced by its actions and the substantial adverse impact its actions had on Petitioner and other state-store landowners, there should be little doubt here that the State's blatant disregard and rewrite of the clear language of I-1183 that resulted in that impact was an unlawful taking of Petitioner's property in violation of the Washington Constitution and the United States Constitution. The record presented below demonstrates that dismissal on the pleadings was precipitous and unwarranted.

This case presents a significant constitutional question that merits acceptance of review by the Supreme Court under RAP 13.4(b)(3).

VI. CONCLUSION

The State Liquor Control Board brazenly exceeded its authority in adopting, without the inconvenience of formal rule-making procedures, a Relocation Policy that stripped Petitioner of valuable property rights in direct contravention of Initiative 1183. The State's actions present a substantial question of public interest and raise a significant constitutional issue whether Petitioner is entitled to just compensation for the taking of its property. The Court should accept review.

DATED: October 30, 2014.

RAFEL LAW GROUP PLLC

By: 

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Attorneys for Petitioners Fedway Marketplace West, LLC and Garland & Market Investors, LLC

CERTIFICATE OF SERVICE

I certify that on October 30, 2014, I caused a true and correct copy of the foregoing *Petition for Discretionary Review*, including Appendix, to be served on counsel of record for Respondent the State of Washington, via electronic service to Assistant Attorney General Brian T. Faller and Assistant Attorney General Mary Tennyson, at the following email addresses: brianf@atg.wa.gov; maryt@ atg.wa.gov.

DATED: October 30, 2014.

Anthony L. Rafel
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INDEX TO APPENDIX

APPENDIX 1

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

DIVISION II

FEDWAY MARKETPLACE WEST, LLC, a Washington limited liability company, and GARLAND & MARKET INVESTORS, LLC, a Washington limited liability company, on behalf of themselves and all others similarly situated, Appellant, v. STATE OF WASHINGTON, Respondent.	No. 44509-3-II PUBLISHED OPINION

HUNT, J. — Fedway Marketplace West, LLC, and Garland & Market Investors, LLC, landlords of former state liquor store locations (Landlords), appeal the superior court's entry of a CR 12(c) judgment on the pleadings and dismissal of Landlords' complaints against the State of Washington for terminating its leases of Landlords' properties the State had used for selling liquor. After Initiative 1183 (I-1183) privatized the sale of liquor in Washington, the State's Liquor Control Board terminated its leases with the landlords of state-owned liquor store locations and auctioned the right to sell liquor at these locations to private retailers. Landlords argue that (1) the State deliberately misinterpreted I-1183, wrongfully terminated their leases, and illegally gave auction buyers the right to sell liquor within a one-mile radius of the Landlords' locations; (2) the superior court erred in striking Landlords' extrinsic evidence that the State acted in bad faith in deliberately misinterpreting I-1183 and terminating their leases; (3) the State breached the duty of

good faith and fair dealing in terminating their leases; and (4) the State's termination of their leases violated the contract clauses[1] and takings clauses[2] of the federal and state constitutions.

The State responds that (1) its decision to permit auction buyers to sell liquor within a one-mile radius was irrelevant to the lease terminations, which I-1183 required; (2) Landlords failed to state a claim for a breach of the duty of good faith and fair dealing; (3) Landlords' extrinsic evidence was not admissible to interpret an unambiguous contract; and (4) the superior court properly dismissed Landlords' constitutional claims because, once the leases terminated, there could be no contract and no taking. We hold that, because I-1183 triggered the termination provision in the State's leases with Landlords, Landlords cannot state a claim against the State under their former leases. We affirm the superior court's dismissal of Landlords' complaints.

FACTS

I. LEASES

Fedway Marketplace West, LLC and Garland & Market Investors, LLC are former lessors of State liquor store locations. In 2007, Garland leased its Spokane premises to the State; in 2010, Fedway leased its Federal Way premises to the State. Each lease was for a 10-year term. Both leases included a termination clause ("Paragraph 3"), which provided that if a newly enacted law prevented either party from complying with the lease,[3] then the lease would terminate and both

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[1] WASH. CONST. art. I, § 23; and U.S. CONST. art I, § 10.

[2] WASH. CONST. art. I, § 16; and U.S. CONST. amend. V.

[3] Both leases included a "use" provision that stated: "The premises shall be occupied by the Washington State Liquor Control Board and *used solely for the purposes of selling alcoholic* beverages and lottery products. The Board shall and may peaceably and quietly have, hold and enjoy the premises for these purposes." CP at 21-22, 32 (emphasis added).

parties would be released from all liability. As the leases required, Landlords made improvements according to the Liquor Control Board's specifications, and the State paid Landlords rent for using the premises to sell liquor.

On November 8, 2011, Washington voters approved Initiative 1183, which privatized the State-controlled system of liquor distribution and sale, effective December 8, 2011. I-1183, now codified as RCW 66.24.620[4], also directed the Liquor Control Board to cease all liquor sales no later than June 1, 2012, and to auction "the right at each state-owned store location of a spirits[5] retail licensee to operate a liquor store upon the premises." RCW 66.24.620(4)(c).

To implement I-1183, the State auctioned the rights to sell liquor at its 167 state-run liquor store locations. Each of the 128 successful bidders received the exclusive right to apply for a license to sell liquor at the store on which the bid had been placed. The State advised each bid winner (1) to secure a lease with the store's landlord; and (2) if unable to secure such a lease, to consider (a) re-selling the right to sell liquor at that location or (b) requesting "an alternative location within a one-mile radius of the existing location." Clerk's Papers (CP) at 8. Before terminating its leases, the State sent its liquor store lessors, including Landlords, letters notifying them of the upcoming lease terminations. The State terminated its Fedway lease effective May

[4] LAWS OF 2012, ch. 2, § 102.

[5] "'Spirits' means any beverage which contains alcohol obtained by distillation, except flavored malt beverages, but including wines exceeding twenty-four percent of alcohol by volume." RCW 66.04.010(41).

31, 2012, and its Garland lease effective July 31, 2012.[6]

II. PROCEDURE

Landlords brought a class action against the State, alleging that it had (1) anticipatorily repudiated and breached their liquor store lease contracts; (2) violated an implied covenant of good faith and fair dealing; (3) violated the state and federal contract clauses[7] by engaging in legislative action that impaired the State's contractual obligations; and (4) violated the state and federal takings clauses[8] by taking private property for public use without just compensation. The State moved for judgment on the pleadings under CR 12(c).

Landlords opposed the State's motion with extensive exhibits purporting to show that (1) the State knew its decision—to permit bid winners to sell liquor in alternative locations within a one-mile radius of the existing location—could violate I-1183 and would significantly erode Landlords' leverage in renegotiating lease agreements with bid winners; (2) the State did not require bid winners to accept assignment of the State's existing leases; (3) in February 2012, the State made a commitment to pay for unamortized improvements that Landlords had made to meet the Liquor Control Board's specifications; and (4) the State Department of Revenue failed to perform its duty under RCW 66.24.620 to develop rules and procedures "'to address claims that

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[6] After the State terminated its lease, Fedway entered into a 12-month lease with the bid winner for its Federal Way location at a rent that was $3,832 less per month than the State had been paying. Two months later, Fedway's new tenant defaulted and ceased operating. The bid winner for Garland's Spokane store location did not enter into a lease with Garland; Garland found no tenant to lease its store space and received no rental income.

[7] WASH. CONST. art. I, § 23, and U.S. CONST. art I, § 10, respectively.

[8] WASH. CONST. art. I, § 16, and U.S. CONST. amend. V, respectively.

[I-1183] unconstitutionally impairs any contract.'" CP at 116 (citation omitted). The superior court granted the State's motion to strike Landlords' exhibits, reasoning that it could not consider such extrinsic evidence to "interpret" unambiguous contract terms. Verbatim Report of Proceedings (VRP) at 32.

The superior court also (1) ruled that because I-1183 had forced the State to terminate its liquor store leases, the State did not improperly terminate its leases or breach a duty of good faith and fair dealing; (2) granted the State's motion for judgment on the pleadings; and (3) dismissed Landlords' complaint with prejudice. Landlords appeal.

ANALYSIS

I. ANTICIPATORY REPUDIATION AND BREACH OF CONTRACT

Landlords appeal the superior court's dismissal of their complaint when it granted the State's CR 12(c) motion for judgment on the pleadings. They argue that the hypothetical facts in their complaint and the additional evidence they submitted stated a justiciable claim that the State deliberately misinterpreted I-1183 and that the State breached its lease obligations and anticipatorily repudiated its leases. The State responds that it fully complied with the leases and that lease provision Paragraph 3 gave the State the right to terminate the leases when the voters' initiative took away the State's previously exclusive right to sell liquor, thus preventing the State from carrying out the lease terms. We agree with the State.

A. Standard of Review

We review de novo CR 12(c) dismissal rulings. *P.E. Sys., LLC v. CPI Corp.*, 176 Wn.2d 198, 203, 289 P.3d 638 (2012). We examine the pleadings "to determine whether the claimant can prove any set of facts, consistent with the complaint, that would entitle the claimant to relief."

Parrilla v. King County, 138 Wn. App. 427, 431, 157 P.3d 879 (2007). On a CR 12(c) motion, the court presumes that the allegations asserted in the complaint are true. *Tenore v. AT&T Wireless Servs.*, 136 Wn.2d 322, 330, 962 P.2d 104 (1998).

B. Unambiguous Lease Termination Provision

Here, both leases included identical termination provisions, which provided, in part:

> [I]n the event that *the enactment of any law* or the decision of any court of competent jurisdiction shall prevent either party hereto from complying with or carrying out the terms of this Lease . . . then this Lease shall terminate and the parties hereto shall be released from any and all liability for any damage or loss which may result from such inability to comply therewith.

CP at 22, 33 (emphasis added).

Codifying I-1183, RCW 66.24.620 expressly provided, in part: "[The Liquor Control Board] must effect orderly closure of all state liquor stores no later than June 1, 2012, and must thereafter refrain from purchase, sale, or distribution of liquor." RCW 66.24.620(2). This new law plainly prohibited the State from selling alcohol and, thus, prevented the State from "complying with or carrying out"[9] the "use"[10] provision of its leases with Landlords. Regardless of whether the State permitted bid winners to choose alternate liquor store locations, or instead required bid winners to use the Landlords' original store locations bid upon,[11] the State could not

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[9] CP at 22, 33.

[10] CP at 21-22, 32.

[11] *See* Landlords' argument that the State understood that I-1183 did not expressly permit the Liquor Control Board to expand potential liquor sale locations to within a one-mile radius of the former state liquor stores and, thus, deliberately misinterpreted the initiative in implementing a "Relocation Policy" that conflicted with the law. Br. of Appellant at 24.

continue leasing Landlords' properties for the leases' contractual purpose of providing locations for the State to sell liquor.[12]

We hold that (1) I-1183 and its RCW 66.24.620 codification triggered the lease termination provisions; (2) under the leases' plain language, enactment of this new law made it impossible for the State to continue selling liquor at Landlords' premises; and (3) therefore, the State did not anticipatorily repudiate or breach its leases with Landlords.

C. Striking Landlords' Extrinsic Evidence

Landlords also argue that in striking their extrinsic evidence—offered to show that the State had deliberately misinterpreted I-1183—the superior court erred because such evidence is admissible even when the court believes that contract terms are unambiguous. The State responds that none of Landlords' extrinsic evidence was relevant to prove the meaning of any specific term in the leases. We agree with the State and hold that the superior court properly excluded the evidence.

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[12] Landlords argue that the State could have assigned its rights to sell liquor under the leases because neither I-1183 nor the leases precluded the State's assigning its lease obligations to the bid winners, thereby avoiding lease terminations. This argument fails: Although the leases refer to Landlords "and assigns," there is no corresponding lease provision granting the State assignment rights. CP at 21, 31. Moreover, at the time the parties entered into these leases, the law gave the State the exclusive right to import and to sell liquor and, thus, there was no possibility that the State could assign this exclusive right to another. Former WAC 314-36-020 (2011); former RCW 66.16.010, .040 (2011). *See Colorado Structures, Inc. v. Ins. Co. of the West*, 161 Wn.2d 577, 588, 167 P.3d 1125 (2007) (courts construe contracts as a whole to effectuate all of the contract's provisions, so as not to render words superfluous); *see also Dep't of Ecology v. Tiger Oil Corp.*, 166 Wn. App. 720, 762, 271 P.3d 331 (2012) (We "avoid 'a strained or forced construction'" of contract provisions "and avoid interpretations 'leading to absurd results.'") (quoting *Eurick v. Pemco Ins. Co.*, 108 Wn.2d 338, 341, 738 P.2d 251 (1987)).

1. Standard of review

We review de novo all trial court rulings, including evidentiary rulings, made in conjunction with a summary judgment dismissal order. *See Cornish Coll. of the Arts v. 1000 Virginia Ltd. P'ship*, 158 Wn. App. 203, 215, 242 P.3d 1 (2010) (citing *Folsom v. Burger King*, 135 Wn.2d 658, 663, 958 P.2d 301 (1998)), *review denied*, 171 Wn.2d 1014 (2011). On a CR 12(c) motion, the court "may consider hypothetical facts not included in the record." *Tenore*, 136 Wn.2d at 330. When reviewing judgments on the pleadings under CR 12(c),

> "Washington follows the objective manifestation test for contracts." . . . Mutual assent to definite terms is normally a question of fact for the fact finder. . . . But a question of fact may be determined as a matter of law if reasonable minds could not differ.

P.E. Sys., 176 Wn.2d at 207 (internal citations omitted) (quoting *Keystone Land & Dev. Co. v. Xerox Corp.*, 152 Wn.2d 171, 177, 94 P.3d 945 (2004)).[13]

To interpret a contract, we must determine the parties' intent, for which we apply the "'context rule.'" *Roats v. Blakely Island Maint. Comm'n, Inc.*, 169 Wn. App. 263, 274, 279 P.3d 943 (2012) (quoting *Shafer v. Bd. of Trs. of Sandy Hook Yacht Club Estates*, 76 Wn. App. 267, 275, 883 P.2d 1387 (1994)). This context rule allows a court, when "'viewing the contract as a whole, to consider extrinsic evidence, such as the circumstances leading to the execution of the contract, the subsequent conduct of the parties and the reasonableness of the parties' respective

[13] *See also Spradlin Rock Prods., Inc. v. Pub. Util. Dist. No. 1 of Grays Harbor County.*, 164 Wn. App. 641, 654-55, 266 P.3d 229 (2011) ("[S]ummary judgment on an issue of contract interpretation is proper where 'the parties' written contract, viewed in light of the parties' other objective manifestations, has only one reasonable meaning.'") (quoting *Hall v. Custom Craft Fixtures, Inc.*, 87 Wn. App. 1, 9, 937 P.2d 1143 (1997)).

interpretations.'" *Roats*, 169 Wn. App. at 274 (quoting *Shafer*, 76 Wn. App. at 275). This rule applies "even when the disputed provision is unambiguous." *Id.*[14]

But our consideration of "surrounding circumstances and other extrinsic evidence" is limited "'to determin[ing] the meaning of *specific words and terms used*' and not to 'show an intention independent of the instrument' or to 'vary, contradict or modify the written word.'" *Hearst Commc'ns, Inc. v. Seattle Times Co.*, 154 Wn.2d 493, 503, 115 P.3d 262 (2005) (quoting *Hollis v. Garwall, Inc.*, 137 Wn.2d 683, 695, 974 P.2d 836 (1999)). *See also* ER 402 ("Evidence which is not relevant is not admissible.").

2. Extrinsic evidence irrelevant

Here, the superior court could admit Landlords' extrinsic evidence only if it would help the court "'to determine the meaning of *specific words and terms used*'" in the leases. *Hearst*, 154 Wn.2d at 503 (quoting *Hollis*, 137 Wn.2d at 696). Landlords argue that, in addition to the context for the parties' understanding of I-1183's requirements, the evidence showed (1) the State "had been discussing and making contingency plans for privatization for five years before I-1183 was

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[14] The Washington Supreme Court first adopted the "'context rule'" in *Berg v. Hudesman*:

> [The *Berg* Court] recognized that intent of the contracting parties cannot be interpreted without examining the context surrounding an instrument's execution. If relevant for determining mutual intent, extrinsic evidence may include (1) the subject matter and objective of the contract, (2) all the circumstances surrounding the making of the contract, (3) the subsequent acts and conduct of the parties, and (4) the reasonableness of respective interpretations urged by the parties.

Hearst Commc'ns, Inc. v. Seattle Times Co., 154 Wn.2d 493, 502, 115 P.3d 262 (2005) (citing *Berg v. Hudesman*, 115 Wn.2d 657, 667, 801 P.2d 222 (1990)). But later, in *Hearst*, the Supreme Court (1) cautioned that its *Berg* holding may have been "misunderstood as it implicates the admission of parol and extrinsic evidence"; and (2) expressly "acknowledge[d] that Washington continues to follow the objective manifestation theory of contracts." *Hearst*, 154 Wn.2d at 503.

adopted," yet the State had "made no provision for privatization in the leases"[15]; (2) after I-1183 was adopted, the State acknowledged in internal agency documents that introducing a Relocation Policy "'could be interpreted as violating the intent of I-1183'"[16]; and (3) the State considered but rejected the idea of assigning leases to bid winners, which Landlords contend would not have "'prevent[ed]'" the State from "'complying with or carrying out'" the lease terms. Br. of Appellant at 44 (quoting CP at 22, 33). Landlords' reasoning fails.

Neither the State's potential privatization contingency plan nor its intent in implementing a Relocation Policy is relevant to the meaning of any lease terms; nor are the State's interpretations of I-1183 or its alleged assignment rights under the leases relevant to understanding any lease terms. Because the extrinsic evidence at issue did not "'determine the meaning of *specific words and terms used*'" in the leases, it was not relevant for the superior court's consideration. *Hearst*, 154 Wn.2d at 503 (quoting *Hollis*, 137 Wn.2d at 696). We hold, therefore, that the superior court properly granted the State's motion to strike this extrinsic evidence.

II. Duty of Good Faith and Fair Dealing

Landlords further argue that, even if the State could terminate their leases based on I-1183's asset disposal requirements, the manner in which the State accomplished these lease terminations breached its duty of good faith and fair dealing. The State responds that a party breaches the duty of good faith and fair dealing only when performing a specific contract term; thus, the State did not breach such duty when it had fully performed under the leases until the point that the new law triggered the leases' termination provision. We agree with the State.

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[15] Br. of Appellant at 40.

[16] Br. of Appellant at 41 (quoting CP at 361).

The duty of good faith and fair dealing "does not inject substantive terms into the contract; rather, 'it requires only that the parties perform in good faith the obligations imposed by their agreement'" and "'arises *only* in connection with the . . . underlying'" contract. *GMAC v. Everett Chevrolet, Inc.*, 179 Wn. App. 126, 149-50, 317 P.3d 1074 (2014) (emphasis added) (quoting *Badgett v. Sec. State Bank*, 116 Wn.2d 563, 569, 807 P.2d 356 (1991)), *petition for review filed*, No. 90366-2 (Wash. June 12, 2014). Having already held that the State did not breach its leases, we further hold that it did not breach its duty of good faith and fair dealing when I-1183 provided the State with no alternative but to cease liquor sales, to terminate its leases with Landlords, and to auction to private parties the right to sell liquor at the Landlords' locations.[17] *See* RCW 66.24.620(2).

III. CONSTITUTIONAL CLAIMS

Last, Landlords argue that the superior court committed legal error in dismissing their contracts clause and takings clause claims. They contend that (1) I-1183 did not require the State to terminate its leases; and (2) thus, the State's lease terminations "impaired" its contracts with Landlords, which constituted an unconstitutional taking of private property without just compensation. Br. of Appellant at 8. The State responds that it neither impaired a contract nor took private property without just compensation because the leases terminated by their own terms when enactment of the new law rendered the State unable to perform: By operation of law the State could no longer sell liquor on the Landlords' properties, or anywhere else; and, consequently,

[17] Again, as we have already remarked, termination of the leases was the State's only option because the lease terms (1) expressly provided that the Landlords' properties could be used only to sell alcoholic beverages and lottery products, and (2) did not provide for the Liquor Control Board to assign the leases.

there was no longer a contract to impair. Again, we agree with the State and we affirm the superior court's dismissal of Landlords' constitutional claims.

A. Contracts Clause Claims

Both state and federal constitutions prohibit legislatures from enacting laws that impair existing contractual obligations. WASH. CONST. art. I, § 23; U.S. CONST. art I, § 10. "It is 'fundamental' that this prohibition against impairing contracts reaches any form of legislative action, including direct action by the people through the initiative process." *Pierce County v. State*, 159 Wn.2d 16, 27-28, 148 P.3d 1002 (2006) (quoting *Ruano v. Spellman*, 81 Wn.2d 820, 825, 505 P.2d 447 (1973)). In determining whether legislation unconstitutionally impairs an existing contractual obligation, our threshold inquiry is "'whether the state law has, in fact, operated as a substantial impairment of a contractual relationship.'" *Optimer Int'l., Inc. v. RP Bellevue, LLC*, 151 Wn. App. 954, 965, 214 P.3d 954 (2009) (quoting *Margola Assocs. v. City of Seattle*, 121 Wn.2d 625, 653, 854 P.2d 23 (1993)), *aff'd*, 170 Wn.2d 768, 246 P.3d 785 (2011).

"An 'impairment is substantial if the complaining party relied on the supplanted part of the contract, and contracting parties are generally deemed to have relied on existing state law pertaining to interpretation and enforcement.'" *Optimer*, 151 Wn. App. at 965-66 (quoting *Margola*, 121 Wn.2d at 653). A "'contract is impaired by a statute which alters its terms, imposes new conditions or lessens its value.'" *Optimer*, 151 Wn. App. at 966 (quoting *Caritas Servs., Inc. v. Dep't of Soc. & Health Servs.*, 123 Wn.2d 391, 404, 869 P.2d 28 (1994)). But this prohibition against contract impairment "'is not an absolute one,'" and we do not read it "'with literal exactness.'" *Optimer*, 151 Wn. App. at 965 (quoting *Tyrpak v. Daniels*, 124 Wn.2d 146, 151, 874 P.2d 1374 (1994)). Moreover, "legislation does not unconstitutionally impair contractual

obligations where the legislation constitutes an exercise of the police power in advancing a legitimate public purpose." *Optimer*, 151 Wn. App. at 966 (citing *Birkenwald Distrib. Co. v. Heublein, Inc.*, 55 Wn. App. 1, 9, 776 P.2d 721 (1989)).

Here, both parties were sophisticated, understood the lease terms, and acknowledged by the leases' express termination provision that a change in the law might prevent compliance with the contracts or terminate the leases.[18] By including Paragraph 3 as their remedy for lease termination, the parties anticipated that a change in the law could prevent either party from "complying with or carrying out"[19] the lease terms, and they "intended the prescribed remedy as the sole remedy for the condition." *United Glass Workers' Local No. 188 v. Seitz*, 65 Wn.2d 640, 642, 399 P.2d 74 (1965); *Rainier Nat'l Bank v. Wells*, 65 Wn. App. 893, 899, 829 P.2d 1168 (1992). Thus, in exercising this lease termination provision (after the law was passed prohibiting the State from continuing to sell liquor), the State did not impair the contracts because the parties' rights and expectations remained the same as before the new law was passed.

The superior court correctly ruled that the "leases ceased to exist once [the] termination

[18] Neither party disputes the validity of Paragraph 3's lease termination provision.

[19] CP at 22, 33.

provision was triggered." VRP at 44. We hold that the superior court properly dismissed Landlords' contracts clause claims.

B. Takings Clause Claims

The takings clause of the Fifth Amendment to the United States Constitution protects individuals against uncompensated takings of private property by both the federal and state governments. U.S. CONST. amend. V. Article I, section 16 of the Washington Constitution similarly provides, "No private property shall be taken or damaged for public or private use without just compensation having been first made."

In addressing Landlords' takings challenges to the State's implementation of I-1183, we begin with two threshold questions:

> First, whether the regulation destroys or derogates any fundamental attribute of property ownership, including the right to possess, to exclude others, to dispose of property, or to make some economically viable use of the property. If the landowner claims less than a "physical invasion" or a "total taking" and if a fundamental attribute of ownership is not otherwise implicated, we proceed to the second question. That question is whether the challenged regulation safeguards the public interest in health, safety, the environment, or the fiscal integrity of an area or whether the regulation "seeks less to prevent a harm than to impose on those regulated the requirement of providing an affirmative public benefit."

Edmonds Shopping Ctr. Assocs. v. City of Edmonds, 117 Wn. App. 344, 362, 71 P.3d 233 (2003) (footnotes and citations omitted) (quoting *Guimont v. Clarke*, 121 Wn.2d 586, 603, 854 P.2d 1

(1993)).[20]

Landlords argue that an agency regulation, such as the Liquor Control Board's adopting the Relocation Policy, "may constitute a taking 'if it goes beyond preventing a public *harm* [to] actually enhance . . . a publicly owned right in property.'" Br. of Appellant at 48 (some alterations in original) (internal quotation marks omitted) (quoting *Sintra, Inc. v. City of Seattle*, 119 Wn.2d 1, 14, 829 P.2d 765 (1992)). Landlords further argue that, by implementing the Relocation Policy, "the [Liquor Control Board] enhanced public ownership of the liquor rights the [Board] was selling by public auction by diminishing the property rights of state store landlords. [Landlords] should have been permitted to pursue their proper remedies: either invalidation of I-1183 or just compensation." Br. of Appellant at 48. These arguments fail.

Returning to the two threshold questions set out in *Edmonds Shopping Ctr.*, 117 Wn. App. at 362, we first note that Landlords do not allege any State action that destroyed or diminished any fundamental attribute of property ownership. On the contrary, the record shows that Landlords retained these fundamental property rights attributes: the rights to possess and to dispose of their properties, to exclude others, and to make some economically viable use of their properties. *Guimont*, 121 Wn.2d at 595. We next address the second threshold question—whether the

[20] We engage in additional analysis only if, in answering these two threshold questions, we determine either that the regulation (1) infringes on a fundamental attribute of ownership; or (2) goes beyond safeguarding the public interest in health, safety, the environment or the fiscal integrity of an area and instead imposes on those being regulated the requirement of providing an affirmative public benefit. *Guimont*, 121 Wn.2d at 603; *Edmonds Shopping Ctr. Assocs.*, 117 Wn. App. at 362. Such additional analysis would require us to answer two more questions: "First, whether the regulation advances a legitimate state interest"; and second, using a balancing test, whether "the state interest in the regulation is outweighed by its adverse economic impact to the landowner . . . , the extent the regulation interferes with investment-backed expectations, and the character of the government action." *Edmonds Shopping Ctr.*, 117 Wn. App. at 362-63 (citing *Guimont*, 121 Wn.2d at 604).

challenged action seeks less to prevent a public harm than to provide an affirmative benefit to the public agency. *Edmonds Shopping Ctr.*, 117 Wn. App. at 362. Although the exclusivity of the right to sell liquor, which the State auctioned to private bidders, may increase the value of this right, the legislature's purpose for such exclusivity is to prevent proliferation of private liquor stores. This purpose lies at the heart of the State's police power and is directed at preventing a public harm. *See Edmonds Shopping Ctr.*, 117 Wn. App. at 362; *State v. Audley*, 77 Wn. App. 897, 901, 894 P.2d 1359 (1995). Answering these *Edmonds Shopping Ctr* threshold inquiries in the affirmative, we hold that the State's actions did not constitute a taking; thus, further analysis is not required.

We hold that the State did not commit an unconstitutional taking by exercising the lease termination provision when enactment of the new law prohibiting the State from selling liquor rendered it unable to perform under the leases.

We affirm.

Hunt, J.

Hunt, J.

We concur:

Bjorgen, A.C.J.

Bjorgen, A.C.J.

Lee, J.

Lee, J.

APPENDIX 2

Initiative Measure

1183

Proposed by initiative petition:

Initiative Measure No. 1183 concerns liquor: beer, wine, and spirits (hard liquor).

This measure would close state liquor stores and sell their assets; license private parties to sell and distribute spirits; set license fees based on sales; regulate licensees; and change regulation of wine distribution.

Should this measure be enacted into law?
[ ] Yes
[ ] No

The Official Ballot Title was written by the Attorney General as required by law and revised by the court. The Explanatory Statement was written by the Attorney General as required by law. The Fiscal Impact Statement was written by the Office of Financial Management as required by law. The Secretary of State is not responsible for the content of arguments or statements (WAC 434-381-180). The complete text of Initiative Measure 1183 is located at the end of this pamphlet.

Explanatory Statement

Written by the Office of the Attorney General

The Law as it Presently Exists

In Washington, the state sells and controls the distribution and sale of "spirits." The term "spirits" refers to alcoholic beverages also called "hard liquor" (whiskies, vodka, gin, etc.). Spirits include beverages containing distilled alcohol and wines exceeding twenty-four percent alcohol by volume. Spirits do not include lower alcohol content beverages such as flavored malt beverages, beer, or wines containing less than twenty-four percent alcohol by volume.

In Washington, spirits are sold at retail at state-run liquor stores and at "contract liquor stores." Contract liquor stores are private businesses that sell spirits and other liquor under a contract with the state. Washington has approximately 165 state liquor stores and 160 contract liquor stores.

The Washington State Liquor Control Board ("the Board") operates the state liquor stores and oversees the contract liquor stores. Among its responsibilities, the Board regulates liquor advertising in the state. The Board, however, cannot advertise liquor sales.

The Board sets the price for spirits sold at state-run and contract liquor stores based on the wholesale cost of the spirits, taxes, and a markup authorized by statute. The Board also collects the taxes imposed on the retail sale of spirits, and collects license fees and penalties. The proceeds received from the sale of spirits, the tax revenues on spirits, and license fees are distributed to cities, counties, and the state. Certain revenues are dedicated to funding programs addressing alcohol and drug abuse treatment and prevention.

In Washington, manufacturers and suppliers of spirits may only sell spirits to the Board. The Board acts as the sole distributor of spirits sold in the state liquor stores and contract liquor stores, and sold by restaurants and certain other licensed sellers. Under a law effective June 15, 2011, the state must examine whether to lease the state's liquor distribution facilities to a private party, and whether such a lease would produce better financial returns for the state.

Existing law allows private parties to sell or distribute alcoholic beverages that are not spirits, such as wine or beer. Wine and beer sellers are licensed by the state. There are different licenses for each of "three tiers" of the wine and beer business: (1) manufacturing; (2) distribution; and (3) retail sales. Existing law regulates the financial relationships and business transactions allowed between manufacturers, distributors, and retailers. While there are some exceptions, retailers are allowed to purchase wine or beer only from distributors. Similarly, distributors are allowed to purchase only from manufacturers, with certain exceptions.

Existing law requires wine and beer manufacturers and distributors to maintain published price lists and offer the same price to every buyer. This requirement of uniform pricing prevents manufacturers or distributors from selling wine or beer at discounted prices to select customers, such

as a quantity discount or other business reason for a discount. Existing law also requires wine and beer retailers to receive all wine and beer at their retail store and to not take delivery or store wine or beer at a separate warehouse location.

The Effect of the Proposed Measure, if Approved

Initiative 1183 allows private parties to sell and distribute spirits, and alters the Liquor Control Board's powers and duties. It eliminates the Board's power to operate state liquor stores, to supervise the contract liquor stores, to distribute liquor, and to set the prices of spirits. Initiative 1183 directs the Board to close state liquor stores by June 1, 2012. It directs the Board to sell assets connected with liquor sales and distribution, and to sell at auction the right to operate a private liquor store at the location of any existing state liquor store. Initiative 1183 repeals a 2011 law that directed the state to examine the financial benefit of leasing the state liquor distribution facilities to a private party.

Under Initiative 1183, qualifying private parties may obtain licenses to distribute spirits or to sell spirits at retail. A retail spirits license allows the retailer to sell spirits directly to consumers, and allows the sale of up to 24 liters of spirits for resale at a licensed premise, such as to a restaurant. Initiative 1183 allows private distributors to start selling spirits on March 1, 2012, and private retail spirits sales to start on June 1, 2012.

To obtain a retail spirits license, a store must have at least 10,000 square feet of enclosed retail space in a single structure. However, Initiative 1183 also allows a retail spirits license for a store at the location of a former state liquor store or contract liquor store, even if the store is smaller than 10,000 square feet. It also allows smaller stores where there are no 10,000 square foot licensed spirits stores in the area. Initiative 1183 requires retail stores to participate in training their employees to prevent sales of alcohol to minors and inebriated persons.

Initiative 1183 allows local governments and the public to provide input before issuance of a license to sell spirits. Initiative 1183 preserves local government power to zone and regulate the location of liquor stores.

Initiative 1183 would not change the existing taxes on spirits. Initiative 1183 would require spirits retailers and distributors to pay license fees to the state. Retail stores would pay a fee of seventeen percent of gross revenues from spirits sales under the license, plus an annual $166 fee. Spirits distributors would pay an annual $1,320 fee, plus a percentage of gross revenues from spirits sales under the license. During the first two years of a spirits distributor license, the distributor license fee would be ten percent of the distributor's gross spirits sales. After two years, the spirits distributor fee would drop to five percent of the distributor's gross spirits sales.

Initiative 1183 also requires that all persons holding spirits distributor licenses must have together paid a total of one hundred fifty million dollars in spirits distributor license fees by March 31, 2013. If the total license fees received from all distributor license holders is less than one hundred fifty million dollars, the Board must collect additional spirits distributor license fees to make up the difference. This additional fee would be allocated among the persons who held a spirits distributor license at any time before March 31, 2013.

In addition to existing laws controlling the distribution of moneys received by the Board, a portion of fees from retail spirits licenses and spirits distributor licenses would be distributed to border areas, counties, and cities to enhance public safety programs.

Initiative 1183 also changes laws that regulate the retailers, distributors, and manufacturers of wine. Initiative 1183 eliminates the requirement that distributors and manufacturers of wine sell at a uniform price, which would allow the sale of wine at different prices based on business reasons. Spirits could also be sold to different distributors and retailers at different prices. Beer manufacturers and distributors, however, would continue to be regulated by existing laws requiring uniform pricing. Under Initiative 1183, retailers could accept delivery of wine at a retail store or at a warehouse location. Under Initiative 1183, a store licensed to sell wine at retail may also obtain an endorsement allowing the store to sell to license holders who sell wine for consumption on the premise. For example, this would allow the store to sell wine to a restaurant that resells the wine by the glass or bottle to its customers.

Fiscal Impact Statement

Written by the Office of Financial Management

The fiscal impact cannot be precisely estimated because the private market will determine bottle cost and markup for spirits. Using a range of

APPENDIX 3

RCW 66.24.620
Sale of spirits by a holder of a spirits distributor or spirits retail license — State liquor store closure.

(1) The holder of a spirits distributor license or spirits retail license issued under this title may commence sale of spirits upon issuance thereof, but in no event earlier than March 1, 2012, for distributors, or June 1, 2012, for retailers. The board must complete application processing by those dates of all complete applications for spirits licenses on file with the board on or before sixty days from December 8, 2011.

(2) The board must effect orderly closure of all state liquor stores no later than June 1, 2012, and must thereafter refrain from purchase, sale, or distribution of liquor, except for asset sales authorized by chapter 2, Laws of 2012.

(3) The board must devote sufficient resources to planning and preparation for sale of all assets of state liquor stores and distribution centers, and all other assets of the state over which the board has power of disposition, including without limitation goodwill and location value associated with state liquor stores, with the objective of depleting all inventory of liquor by May 31, 2012, and closing all other asset sales no later than June 1, 2013. The board, in furtherance of this subsection, may sell liquor to spirits licensees.

(4)(a) Disposition of any state liquor store or distribution center assets remaining after June 1, 2013, must be managed by the department of revenue.

(b) The board must obtain the maximum reasonable value for all asset sales made under this section.

(c) The board must sell by auction open to the public the right at each state-owned store location of a spirits retail licensee to operate a liquor store upon the premises. Such right must be freely alienable and subject to all state and local zoning and land use requirements applicable to the property. Acquisition of the operating rights must be a precondition to, but does not establish eligibility for, a spirits retail license at the location of a state store and does not confer any privilege conferred by a spirits retail license. Holding the rights does not require the holder of the right to operate a liquor-licensed business or apply for a liquor license.

(5) All sales proceeds under this section, net of direct sales expenses and other transition costs authorized by this section, must be deposited into the liquor revolving fund.

(6)(a) The board must complete the orderly transition from the current state-controlled system to the private licensee system of spirits retailing and distribution as required under this chapter by June 1, 2012.

(b) The transition must include, without limitation, a provision for applying operating and asset sale revenues of the board to just and reasonable measures to avert harm to interests of tribes, military buyers, and nonemployee liquor store operators under then existing contracts for supply by the board of distilled spirits, taking into account present value of issuance of a spirits retail license to the holder of such interest. The provision may extend beyond the time for completion of transition to a spirits licensee system.

(c) Purchases by the federal government from any licensee of the board of spirits for resale through commissaries at military installations are exempt from sales tax based on selling price levied by RCW 82.08.150.

[2012 c 2 § 102 (Initiative Measure No. 1183, approved November 8, 2011).]

Notes:

Finding -- 2012 c 2 (Initiative Measure No. 1183): "(1) The people of the state of Washington, in enacting this initiative measure, find that the state government monopoly on liquor distribution and liquor stores in Washington and the state government regulations that arbitrarily restrict the wholesale distribution and pricing of wine are outdated, inefficient, and costly to local taxpayers, consumers, distributors, and retailers. Therefore, the people wish to privatize and modernize both wholesale distribution and retail sales of liquor and remove outdated restrictions on the wholesale distribution of wine by enacting this initiative.

(2) This initiative will:

(a) Privatize and modernize wholesale distribution and retail sales of liquor in Washington state in a manner that will reduce state government costs and provide increased funding for state and local government services, while continuing to strictly regulate the distribution and sale of liquor;

(b) Get the state government out of the commercial business of distributing, selling, and promoting the sale of liquor, allowing the state to focus on the more appropriate government role of enforcing liquor laws and protecting public health and safety concerning all alcoholic beverages;

(c) Authorize the state to auction off its existing state liquor distribution and state liquor store facilities and equipment;

(d) Allow a private distributor of alcohol to get a license to distribute liquor if that distributor meets the requirements set by the Washington state liquor control board and is approved for a license by the board and create provisions to promote investments by private distributors;

(e) Require private distributors who get licenses to distribute liquor to pay ten percent of their gross spirits revenues to the state during the first two years and five percent of their gross spirits revenues to the state after the first two years;

(f) Allow for a limited number of retail stores to sell liquor if they meet public safety requirements set by this initiative and the liquor control board;

(g) Require that a retail store must have ten thousand square feet or more of fully enclosed retail space within a single structure in order to get a license to sell liquor, with limited exceptions;

(h) Require a retail store to demonstrate to state regulators that it can effectively prevent sales of alcohol to minors in order to get a license to sell liquor;

(i) Ensure that local communities have input before a liquor license can be issued to a local retailer or distributor and maintain all local zoning requirements and authority related to the location of liquor stores;

(j) Require private retailers who get licenses to sell liquor to pay seventeen percent of their gross spirits revenues to the state;

(k) Maintain the current distribution of liquor revenues to local governments and dedicate a portion of the new revenues raised from liquor license fees to increase funding for local public safety programs, including police, fire, and emergency services in communities throughout the state;

(l) Make the standard fines and license suspension penalties for selling liquor to minors twice as

strong as the existing fines and penalties for selling beer or wine to minors;

(m) Make requirements for training and supervision of employees selling spirits at retail more stringent than what is now required for sales of beer and wine;

(n) Update the current law on wine distribution to allow wine distributors and wineries to give volume discounts on the wholesale price of wine to retail stores and restaurants; and

(o) Allow retailers and restaurants to distribute wine to their own stores from a central warehouse." [2012 c 2 § 101 (Initiative Measure No. 1183, approved November 8, 2011).]

Application -- 2012 c 2 (Initiative Measure No. 1183): "This act does not increase any tax, create any new tax, or eliminate any tax. Section 106 of this act applies to spirits licensees upon December 8, 2011, but all taxes presently imposed by RCW 82.08.150 on sales of spirits by or on behalf of the liquor control board continue to apply so long as the liquor control board makes any such sales." [2012 c 2 § 301 (Initiative Measure No. 1183, approved November 8, 2011).]

Rules -- 2012 c 2 (Initiative Measure No. 1183): "The department of revenue must develop rules and procedures to address claims that this act unconstitutionally impairs any contract with the state and to provide a means for reasonable compensation of claims it finds valid, funded first from revenues based on spirits licensing and sale under this act." [2012 c 2 § 303 (Initiative Measure No. 1183, approved November 8, 2011).]

Effective date -- Contingent effective date -- 2012 c 2 (Initiative Measure No. 1183): "This act takes effect upon approval by the voters. Section 216, subsections (1) and (2) of this act take effect if Engrossed Substitute House Bill No. 5942 is enacted by the legislature in 2011 and the bill, or any portion of it, becomes law. Section 216, subsection (3) of this act takes effect if any act or part of an act relating to the warehousing and distribution of liquor, including the lease of the state's liquor warehousing and distribution facilities, is adopted subsequent to May 25, 2011, in any 2011 special session." [2012 c 2 § 305 (Initiative Measure No. 1183, approved November 8, 2011).]