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COURT OF APPEALS, DIVISION II
OF THE STATE OF WASHINGTON

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STATE OF WASHINGTON
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CITY OF BONNEY LAKE, a Washington municipal corporation,

Appellant and Cross-Respondent,

v.

PALERMO AT LAKELAND, LLC, a Washington limited liability
company,

Respondent and Cross-Appellant.

REPLY BRIEF OF RESPONDENT AND CROSS-APPELLANT

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A. INTRODUCTION

Palermo at Lakeland LLC has raised four issues in its cross-appeal.

In its response, the City contends with respect to the first issue that it is entitled to seek to defend its SDC Ordinance fee schedule with after-the-fact evidence and analysis never considered by the Council when it adopted the fee schedule. This contention runs directly contrary to the Court's holding in *Teter v. Clark County*, 104 Wn.2d 227, 704 P.2d 1171 (1985) and should accordingly be rejected.

As to the second issue, the City defends the methodological flaws of its after-the-fact expert analysis. It defends the inclusion of developer contributions in its SDC fee schedule computations despite the fact that doing so results in developers paying twice for water system improvements. This is neither reasonable nor equitable, and the City's own expert acknowledges that to be the case. The City also asserts it is fair to charge 100% of the cost of new water acquisition to new customers, despite the fact that this new water is required by its existing customers, whether or not any new customers are added to the system. This too is neither reasonable nor equitable.

With respect to issue three, the City defends its 80.7% multi-family customer equivalency factor despite the fact that the evidence in the record does not support it. The City merely states it is "close enough" to the 77%

factor the trial court found to be reasonable. The issue, of course, is not whether the City's fee schedule exercise was a "close enough" exercise in throwing darts at a target. The issue is whether, based on the evidence, the City's fee schedule is reasonable and equitable. This is not a case where the City needs to, or should be allowed to, guess. The evidence is clear, and supports, a factor of 70% -- nothing higher.

Finally, the City does not deny that it has been enjoying the "use value" of Palermo's money since the date that Palermo paid its fees under protest. The City seeks, however, to avoid refunding that 'use value' by paying prejudgment interest on the sum it is required to reimburse. It wants instead to retain all the interest income it has illegally obtained. This is neither equitable nor consistent with applicable law. Palermo should be awarded prejudgment interest.

B. REPLY IN SUPPORT OF PALERMO'S ASSIGNMENTS OF ERROR

1. The Testimony of Edward Cebron Did Not Form a Part of the Data Considered by the City Council in Making its Decision and is thus Not Relevant to the Court's Review.

Palermo retained an expert, Gregory Hill, to review the data considered by the City Council in making its decision. Based on those data, Mr. Hill concluded that the SDC Ordinance fee schedule was neither reasonable nor equitable.

Edward Cebron, however, was retained not to review the data

considered by the City Council in making its decision. Specifically, he did not review the analysis of Geoffrey Dillard, the City's consulting engineer. Instead, he conducted an entirely new analysis, with different assumptions, and different data. Exhibit 78.

The Washington Supreme Court, in *Teter v. Clark County*, 104 Wn.2d 227, 236, 704 P.2d 1171 (1985), specifically held that such after-the-fact evidence is irrelevant and inadmissible. Data developed after the City Council makes its decision are not relevant to the Court's review of the decision.

The City makes two responses in its effort to distinguish the holding in *Teter*. First, the City seeks to confine the holding to data offered by parties other than the City. The City contends, in other words, that persons challenging SDC fee schedules may not submit after-the-fact evidence, but that cities themselves may offer such after-the-fact evidence. This contention is fanciful, however, and unsupported by *Teter*. *Teter* no more allows cities to provide after the fact justifications for its fee schedule than it allows persons challenging the schedule to go outside the data considered by the City Council when it adopted the schedule. It would obviously be inequitable for the Court to adopt such a "one way" evidentiary rule.

The City also cites *Prisk v. Poulsbo*, 46 Wn.App. 793, 732 P.2d

1013 (1987) for the proposition that it is appropriate for the City to offer expert testimony to support the reasonableness of SDCs. However, in that case, the expert testimony supported the comprehensiveness of the analysis set forth in the study considered by the City as the basis for the adoption of the fee schedule:

[T]he City acted deliberately and only after consideration of a comprehensive analysis of the historical costs of the system. The analysis identified historical costs paid by customers to construct the systems and calculated reasonable connection fees based upon those costs and the number of connections. Considerable expert opinion was adduced in support of the study and reasonableness of the charges.

46 Wn.App. at 804-805. There is no suggestion, however, that the expert testimony at trial relied on data and analyses never considered by the City Council.

Second, the City relies on *Teter*, 104 Wn.2d 227, and *Duckworth v. Bonney Lake*, 91 Wn.2d 19, 586 P.2d 860 (1978), for the proposition that the SDC fee schedule should be affirmed if there is any set of facts that could support it. In other words, the City takes the position that the City can adopt the fee ordinance with no rational basis whatsoever, and then justify it after the fact when and if a citizen files a lawsuit to challenge it – this is, after all, the strategy which the City actually adopted in this case.

Teter and *Duckworth* do not, however, support the City's argument. The issue in *Teter* was whether the utility charges at issue were

constitutional, and in *Duckworth* whether a City zoning ordinance was *constitutional*. The test in the event of a constitutional challenge is indeed whether any set of facts exist to support the City's charges. Here, however, Palermo is not contesting the constitutionality of the City's determination. Rather, Palermo has challenged whether the City has adopted a fee schedule that is consistent with the limitations set forth in state law--the statutory requirement that the City adopt a fee schedule based on, as the Court held in *Prisk*, a comprehensive analysis of the cost of the existing water system and of the cost of the planned improvements to the water system. The City in this case utterly failed to do so, and under the holding in *Teter* may not seek to justify its failure with after-the-fact adduced expert testimony.

2. The Edward Cebron Analysis Was Methodologically Flawed.

The Cebron analysis was methodologically flawed in two ways. First, Mr. Cebron failed to deduct the value of developer contributions from the cost of the water system. Second, he imposed 100% of the cost of new water supply to new users of the system. Both of these flaws resulted in inequitable allocation of costs to new users of the system.

The City defends Mr. Cebron's failure to deduct the value of developer contributions by relying on *Landmark Development v. Roy*, 138 Wn.2d 561, 980 P.2d 1234 (1999). However, the City concedes that the

holding in *Landmark* dealt with the issue not of developer contributions, but of governmental grants. While there is dictum in the case related to developer contributions, that issue was not presented to the Court nor argued. Moreover, the holding in *Landmark* specifically states that SDCs, as statutorily authorized fees, “provide the means by which a purveyor may *equitably allocate* to new users access to an existing system possessing an existing value.” *Id.* at 572 (emphasis added). The testimony at trial in this case established that failure to deduct developer contributions results in an inequitable allocation, because it results in paying double for water system improvements. Gregory Hill, Palermo’s consultant, testified that failure to deduct such contributions is inequitable (“The net effect of it has growth subsidizing existing customers,” RP 321). Edward Cebron, the City’s consultant, testified that he would normally “leave [developer contributions] out of there.” RP 563.

As to the second methodological flaw, the City’s response is that new water is more expensive than old water, and that it is equitable to charge new customers the cost of new water. To the contrary, however, as Gregory Hill established, existing customers require the new water sources just as much as the new customers. RP 348-353; Exhibits 20, 59. The existing customers have been benefiting from the less costly old water since the inception of the system. All of the cost of the new water, then,

should not be borne by the new customers. It is only equitable for that cost to be shared by all the users in the system.

Accordingly, the trial court should have required the cost of developer contributions to be deducted from the existing system cost, and the cost of new water supply should have been required to be shared by all ratepayers.

3. The City's Multi-Family Customer Equivalency Factor Should Not Have Exceeded 70%.

The evidence at trial confirmed that the data set forth in the City's Comprehensive Water System Plan supported a multi-family customer equivalency factor of 70% or less. See, e.g., RP 183, 338, 436-437, 579.

The City defends its use of the 80.7% factor on three grounds. First, it asserts that the City has historically used that factor. While that may be true, it does not, of course, meet the City's obligation to assess a charge that is "equitable" or "reasonable." There must be a factual basis for such a determination, not mere historical practice.

Second, the City defends its use of the 80.7% factor based on Mr. Cebron's "composite equivalency factor," which supported a higher factor based on the assumption that multi-family structures required greater fire protection than single family structures. However, that assumption was proven to be groundless at trial. In fact, because of their greater residential density, multi-family structures impose a *reduced* per capita

impact on fire protection needs than single family structures. Finding of Fact 59 (to which no assignment of error was made).

Third, the City asserts that the Court's holding in *Irvin Water District No. 6 v. Jackson Partnership LLC*, 109 Wn.App. 113, 34 P.3d 840 (2001) allows a city to impose charges that are "close enough." In other words, the City asserts that the law allows it to guess. This is a misreading of the law, however. Cities may not guess in this domain – to do so would be arbitrary and capricious, while RCW 35.92.025 requires SDC charges to be both "equitable" and "reasonable."

Accordingly, the data set forth in the City's Plan supports a factor of at most 70%.

4. Palermo is Entitled to Pre-Judgment Interest.

The public policy supporting Palermo's claim was stated in *Bailie Communications v. Trend Business Sys.*, 61 Wn.App. 151, 162, 810 P.2d 12 (1991): "The plaintiff should be compensated for the 'use value' of the money representing his damages for the period of time from his loss to the date of judgment."

Despite this public policy, the City contends it should not be obligated to compensate Palermo for the 'use value' of the money representing its damages for the period of time from its loss to the date of judgment. Indeed, without showing the slightest hint of ambivalence, the

City argues it should itself retain that 'use value,' despite the fact that it has illegally held onto Palermo's money for, at this point, several years.

The City's sole argument in its defense is the contention that Palermo's claim was "unliquidated." However, the contrary is true. Palermo claimed that the City's SDC fee ordinance was void, and that it was accordingly entitled to a refund of the fees that it had paid under protest. The trial court agreed, and found the ordinance to be void. In substance, the trial court allowed the City, in equity, to re-determine a lawful fee schedule according to guidelines identified by the Court based on the evidence presented at trial, and to retain that portion of Palermo's fees as appropriate under the lawfully recomputed fee schedule. Under the "*Mall Tool*" exception, interest is accordingly payable on the amount of the refund remaining after the City's setoff. *Gemini Farms v. Smith-Kem*, 104 Wn.App. 267, 269, 16 P.3d 82 (2001).

The City argues that "for the sum to be liquidated, the amount must be clear before trial, not after." City Response Brief at p. 22.

Here, the amount due was crystal clear before trial. The ordinance was void. Without more, the entire sum paid by Palermo is due. The City's "setoff" reduced that sum to be refunded. However, it was the amount of the City's "setoff," not the amount that Palermo had paid to the City, that was subject to "opinion and discretion."

Palermo is entitled to the 'use value' of the money that the City has unlawfully taken from it. Palermo is accordingly entitled to an award of prejudgment interest.

C. CONCLUSION

Palermo respectfully asks the Court of Appeals to correct the four errors made by the trial court identified in Palermo's cross appeal. First, the after-the-fact evidence contained in the testimony of Edward Cebon should not have been allowed, because it had not been part of the Council's decision-making process when it adopted the fee ordinances. Second, the value of developer contributions should be deducted from the existing system cost, and the cost of new water supply should be required to be shared by all ratepayers. Third, the multi-family customer equivalency factor should have been no higher than 70%. And finally, the trial court should have awarded Palermo prejudgment interest.

Respectfully submitted this 19th day of February, 2008.

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CERTIFICATE OF SERVICE

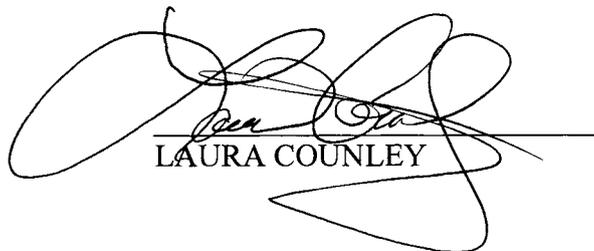
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I, LAURA COUNLEY, under penalty of perjury under the laws of the State of Washington, declare as follows:

I am employed with McCullough Hill, PS, attorneys for Palermo at Lakeland LLC, Plaintiff. On the date indicated below, I caused a copy of **REPLY BRIEF OF RESPONDENT AND CROSS-APPELLANT** and this **CERTIFICATE OF SERVICE** to be served via Washington Legal Messenger on:

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DATED this 19th day of February, 2008, at Seattle, Washington.


LAURA COUNLEY