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**COURT OF APPEALS, DIVISION II  
OF THE STATE OF WASHINGTON**

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NORTHWEST ALLOYS, INC. and MILLENNIUM BULK  
TERMINALS-LONGVIEW, LLC,

Respondents,

v.

STATE OF WASHINGTON DEPARTMENT OF NATURAL  
RESOURCES, and THE HONORABLE HILARY S. FRANZ, and  
COLUMBIA RIVERKEEPER, WASHINGTON ENVIRONMENTAL  
COUNCIL, and SIERRA CLUB,

Appellants.

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**OPENING BRIEF OF APPELLANTS STATE OF WASHINGTON  
DEPARTMENT OF NATURAL RESOURCES AND THE  
HONORABLE HILARY S. FRANZ**

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ROBERT W. FERGUSON  
Attorney General  
EDWARD D. CALLOW  
WSBA No. 30484  
TERENCE A. PRUIT  
WSBA NO. 34156  
Assistant Attorneys General  
1125 Washington Street  
PO Box 40100  
Olympia, WA 98504-0100  
(360) 664-2854

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## I. INTRODUCTION

A commercial landlord, faced with a request for a sublease from a tenant with a history of lax oversight of an environmentally destructive subtenant, acts in a reasonable and prudent manner when requesting financial and other business records regarding the proposed subtenant. This is especially true here, where the proposed subtenant seeks to dramatically expand operations on state-owned aquatic lands to construct the largest coal terminal on the West Coast, despite a drastic downturn in the market for coal and the bankruptcy of one of that subtenant's parent corporations.

The Washington State Department of Natural Resources and Commissioner of Public Lands Hilary S. Franz<sup>1</sup> (DNR), Respondents at the trial court and Appellants here, acted prudently on behalf of the State when requesting audited financial records and other business information from Northwest Alloys, Inc. (NWA) and its proposed subtenant, Millennium Bulk Terminals-Longview, LLC (Millennium). DNR was entitled to review this information under its lease with NWA and, despite repeated requests, NWA failed to provide these documents. Without them, DNR was unable to complete its review of the proposed sublease.

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<sup>1</sup> Commissioner of Public Lands Hilary S. Franz was elected in 2016 and sworn in after the events leading to this case arose. Commissioner Franz was substituted in this matter in place of former Commissioner Peter Goldmark.

Despite recognizing, based on these undisputed facts, that DNR had legitimate concerns over the financial viability of Millennium as a subtenant, the trial court nevertheless erroneously concluded that DNR's request for audited financial information was arbitrary and capricious. The Court found "two things really are deciding factors based on the record . . . ." First, the court concluded that "Northwest Alloys is entitled to pursue exactly the same project [as planned by Millennium] for a coal export terminal under the existing lease with no input from DNR." Second, the trial court found that DNR should have asked, "[h]ow are you going to make this pencil out, subtenant?" rather than making its requests for financial and business information. The Court erred on both counts.

DNR's requests for information were authorized under the Lease and expressly aimed at evaluating Millennium's financial condition. The financial documents NWA and Millennium refused to provide would have answered the exact question posed by the court. DNR was not required to accept the representations of NWA and Millennium on faith. DNR was entitled to review Millennium's financial condition for itself.

The court's conclusion that NWA "is entitled to pursue exactly the same project for a coal export terminal . . . with no input from DNR" ignores the plain language of the Lease. When it signed the Lease in 2008, NWA provided a warranty that the docks shown on Exhibit A to the Lease

accurately described the improvements planned for the property. Millennium's plans for much larger docks, first revealed in 2012, correspond to a far more intensive use of the property than contemplated in 2008. Millennium's plans also conflict with the permitted use of the property. The Lease confirms the smaller docks identified in Exhibit A were intended for unloading as well as loading and that multiple products, not just coal, would be shipped and received. In fact, the Lease states one dock would be dedicated to loading and unloading packaged products by crane. Because Millennium's plans call for far larger docks than contemplated to be used for a different purpose than permitted, NWA cannot pursue those plans without input from DNR as the superior court concluded.

DNR's request for audited financial documents and other business information from NWA and Millennium was reasonable, prudent, and based on the facts, and the trial court's reversal of DNR's denial of the proposed consent to sublease was erroneous. Accordingly, this Court should reverse the trial court and reinstate DNR's decision.

## **II. ASSIGNMENTS OF ERROR AND ISSUES PRESENTED**

### **A. Assignments of Error.**

1. The superior court erred by concluding that NWA's aquatic lands lease allows NWA "to pursue exactly the same project for a coal

export terminal [as planned by Millennium] under the existing lease with no input from DNR.” CP 17690, 17692 (Order on the Merits ¶¶ 6, 12).

2. The superior court erred by concluding that DNR should have asked “how are you going to make this [project] pencil out, subtenant?” rather than making its requests for financial statements and other information to assess the viability of Millennium and its planned coal terminal for itself. CP 17690, 17692 (Order on the Merits ¶¶ 11, 12).

3. The superior court erred by concluding that “there was no useful information to be gained from” DNR’s requests for Millennium’s financial and business information, and, therefore, the requests were arbitrary and capricious because “the legitimate [financial] concerns that DNR had were not converted into the requests for information that DNR made.” CP 17692-93 (Order on the Merits ¶¶ 11, 13).

4. The superior court erred by finding that DNR’s reasons for denying the proposed consent to sublease in the January 5, 2017, letter were not supported by the facts and by further concluding that DNR’s reasons for denying the proposed consent to sublease were arbitrary and capricious. CP 17693 (Order on the Merits ¶¶ 14-15).

5. The superior court erred by reversing DNR’s denial of NWA’s proposed sublease to Millennium and ordering DNR to reconsider its denial. CP17693, 17815 (Order on the Merits ¶ 15; Order ¶¶ 2; 2-3).

**B. Issues Related to Assignments of Error.**

1. Whether Millennium's proposed coal terminal expansion, which would make its proposed coal terminal the largest on the West Coast, is beyond the scope of what is allowed under the Lease.

2. Whether the superior court erred by concluding that DNR did not request the correct information when DNR requested financial and other business documents that were directly related to Millennium's ability to perform as a subtenant under NWA's lease.

3. Whether the superior court erred by concluding DNR's requests for audited financial records and other business documents were arbitrary and capricious, when DNR's requests were reasonable and based on legitimate financial concerns for Millennium's viability as a subtenant.

4. Whether the superior court erred by finding DNR's reasons for denying the proposed consent to sublease in the January 5, 2017, letter were not supported by the facts, and by further concluding DNR's reasons for denying consent were arbitrary and capricious, when DNR based denial on reasonable and legitimate concerns, including Respondents' failure to provide any of the requested financial and other business information.

5. Whether the superior court erred by reversing DNR's denial of NWA's proposed consent to sublease to Millennium and ordering DNR to reconsider its denial.

### III. STATEMENT OF THE CASE

#### A. Factual Background.<sup>2</sup>

NWA entered into a lease with DNR effective January 1, 2008, for state-owned aquatic lands in the Columbia River in Longview (Lease). CP 1873; AR 001528 (Lease); CP 1860; AR 001517 (lease survey exhibit). Under the terms of the Lease, NWA may not assign the Lease or sublease the property without the written consent of DNR, which DNR may not unreasonably withhold. CP 1891-92; AR 001546-47. When evaluating a sublease request, the Lease provides DNR “may consider, among other items, the proposed transferee’s financial condition, business reputation and experience, and the nature of the proposed transferee’s business. . . .” *Id.*

The leased property abuts a smelter built by Reynolds Metals Company in 1941, which closed in 2001 after NWA’s parent company, Alcoa Inc., purchased Reynolds and sold the smelter but not the land to Longview Aluminum. CP 2259, 3259; AR 001910, 0002870. The leased property contains a dock built in the mid-1960s to import alumina, a raw

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<sup>2</sup>Citations to the Clerk’s Papers are designated “CP” and corresponding designations to the Administrative Record are designated “AR.” Note, the Clerk’s Papers present a small portion of the Administrative Record out of order. Page 415 of the Clerk’s Papers corresponds to page 0000259 of the Administrative Record, but the next page of the Clerk’s Papers, CP 416, corresponds to page 000337 of the Administrative Record. The omitted pages of the Administrative Record (i.e., AR 000260-000336) can be found at CP 548-625. Additionally, the Clerk’s Papers omit AR 013798-013816 from the record as certified by DNR, but the documents are included in the condensed record submitted to the Superior Court by NWA and Millennium after briefing at CP 17573-91.

material for aluminum production, for the Reynold's facility. CP 2636; AR 002251. After the Reynolds smelter shut down in 2001, the facility remained idle until Chinook Ventures, Inc. (Chinook) purchased the smelter improvements in Longview Aluminum's bankruptcy in 2004. CP 2259, 1864; AR 001910, 001520. Chinook then entered into a long-term ground lease with Reynolds. CP 3259; AR 002870. Alcoa transferred the property from Reynolds to NWA in 2005. *Id.*

After signing the Lease with DNR for the submerged land surrounding the dock in 2008, NWA subleased it to Chinook. CP 1862; AR 001518. In addition to importing alumina as an operator for NWA, CP 423; AR 000343, Chinook used the property to store petroleum coke and transfer it onto ships at the dock. CP 2169-74, 2085-86, 2092; AR 001822-27, 001738-39, 001745. Chinook lacked the required state and local regulatory permits for its petroleum coke business and failed to provide adequate environmental controls. *Id.* Chinook also built improvements, including a ship loader and overwater conveyor system, without required permits or required authorization under the Lease. CP 6057-58, 160; AR 005656-57, 000025. As a result, Chinook amassed a significant number of environmental violations issued by the Department of Ecology, CP 2170-74; AR 001823-27; received a stop work order from Cowlitz County, CP 6057; AR 005656; received a notice of violation from

the U.S. Army Corps of Engineers, CP 2610; AR 002227; exacerbated environmental concerns at the site, CP 2047; AR 001700; and put NWA in default of its lease with DNR. CP 160; AR 000025.

Millennium Bulk Terminals-Longview, LLC (Millennium) is a limited liability company organized in 2010 for the sole purpose of acquiring Chinook's assets, leasing the smelter property, and subleasing the aquatic lands occupied by the dock. CP 131; AR 000171. In late 2010, NWA and DNR began discussions regarding a sublease from NWA to Millennium. CP 240; AR 000098. Soon after, DNR informed NWA that DNR could not approve the sublease request without environmental review of Millennium's plans for the property under the State Environmental Policy Act (SEPA). CP 447, 506; AR 000363, 000404. DNR continued to work with NWA to find a way to meet NWA's professed need for a sublease: "Northwest Alloy's sister facility in Wenatchee, which is a smelter, is critically dependent upon Millennium operating the dock . . . to load and transport alumina." CP 542-43; AR 000437-38. Throughout those negotiations with NWA, however, DNR remained consistent that it could not consent to a sublease to Millennium unless SEPA requirements were met. *See, e.g.*, CP 15227, 1259, 1418-19; AR 014131, 001003, 001136-37.

DNR's concerns with SEPA compliance were well founded. Millennium's corporate parent at the time NWA made its sublease request

in 2010, Millennium Bulk Logistics, Inc., a subsidiary of Ambre Energy, Inc., had begun applying for permits to add new infrastructure to the dock. CP 325, 3304-05; AR 000171, 002915-16. According to the permit application, the infrastructure project was designed to allow coal handling and export of 5.2 million metric tons of coal per year from the dock. CP 3416, 3419; AR 003027, 003030. But after internal company documents revealed Millennium Bulk Logistics intentionally concealed its plans to greatly expand its coal export facility in order to avoid environmental review, CP 494-95, 498-99; AR 000395-96, 000398-99, Millennium Bulk Logistics withdrew its infrastructure proposal. CP 502-03; AR 000401-02.

In early 2012, Millennium then filed a revised permit application, which revealed the full scope of its plans, including facilities on the property leased from DNR for the export of 44 million metric tons of coal per year. CP 6166; AR 005754. If approved, Millennium would be responsible for building, operating, and maintaining the largest coal export terminal on the West Coast. CP 533; AR 000429. That facility would add two new docks to receive up to 840 panamax and handymax vessels per year on the state-owned aquatic lands under lease to NWA. CP 8933, 9046, 9052; AR 008504, 008617, 008623.

The docks planned by Millennium would be much larger than the docks contemplated under the Lease. CP 1860 (Exhibit A), 1877

(Lease § 1.2(a); AR 001517, 001532. At the time NWA signed the Lease in 2008, NWA warranted that the survey in Exhibit A to the Lease provided an accurate description of the docks planned for the property. *Id.* The docks planned by Millennium, first described in 2012, are far larger. According to Exhibit A, the docks contemplated in 2008 would have added 132,950 square feet of new dock and trestle to the existing 55,682-square-foot dock and trestle under the Lease. CP 1860; AR 001517 (“LEASE AREA CONTAINS . . .”). The new dock plans from Millennium would have added 233,841 square feet of overwater structure, a difference of greater than 100,000 square feet and an increase of over 75 percent. CP 6175; AR 005763. To operate the docks would require significant new dredging of the property in areas within and outside the Lease. CP 6124, 6132; AR 005714, 005722 (map showing dredge and lease boundaries). Millennium’s plans for a dedicated coal export facility were also inconsistent with the permitted use of the property. CP 6166; AR 005754. The permitted use of the property as described in Exhibit B to the Lease contemplated that all the docks on the property would be used for *importing* and exporting, and that multiple products would be shipped and received. CP 1877 (Section 2.1), CP 1916-17 (“Berth 3 will be an open dock . . . used for cargo that is palletized, baled . . . or contained . . . [to] be off loaded by

crane.”), CP 1919 (“in the future all three docks will be used for loading and off loading of various products.”); AR 001532, 001571-72, 001574.

In late 2014, Ambre Energy, Inc., owner of Millennium Bulk Logistics, sold its North American assets, including a 62 percent ownership stake in Millennium, to a creditor, Resource Capital Funds, CP 14058; AR 013620, amid a severe coal market downturn. CP 14039, 14067; AR 013605, 013628. Resource Capital Funds then renamed those assets Lighthouse Resources. CP 14058; AR 013620.

Poor economic conditions at that time were not limited to coal, but also had a direct impact on operations at NWA’s dock. CP 7613-14, 1559; AR 007185-86, 001256. In late 2015, Alcoa announced it would curtail production at its Wenatchee Works, an affiliate of NWA that imported the alumina unloaded by Millennium at the dock leased by NWA. *Id.* Prior to curtailment, the dock was used to unload alumina from approximately six to eight ships per year. *Id.*; CP 9055; AR 008626. Following the curtailment, the dock was not in use. CP 15559, 7613-14; AR 001256, 007185-86.

Poor market conditions for coal continued in 2016. Several large United States coal producers filed for bankruptcy protection. CP 14242, 14202; AR 013795, 013758. Arch Coal, Inc. (Arch Coal), which owned 38 percent of Millennium, declared bankruptcy in early 2016. CP 1564; AR 001260. As part of its efforts to shed liabilities in bankruptcy, Arch Coal

sold its interest in Millennium to Lighthouse Resources, Millennium's remaining corporate parent. CP 14208 (motion), 17573 (order); AR 013763 (motion), AR 013798 (order) . In return for its interest in Millennium, Arch Coal received only a release of its obligation to provide capital to support Millennium's activities, including Millennium's development of the coal export terminal, and an option to purchase a small percentage of the terminal's capacity at market rate. CP 14210-12; AR 013765-67.

Thus, in early 2016, DNR was faced with the following situation:

- One of Millennium's corporate parents, Arch Coal, was in bankruptcy amid a severe downturn in the coal market;
- Alcoa, the parent of NWA, had shuttered its Wenatchee Works which supplied the business for the dock operated by NWA and Millennium;
- Millennium's other corporate parent, Ambre Energy, had recently sold its interest in Millennium to a creditor; and
- In the face of the significant economic headwinds battering the coal markets, Millennium was planning to build the largest coal export terminal on the West Coast using public land.

In light of these facts, DNR requested that NWA provide additional information related to Millennium's financial condition and the nature of its business, among other things, under Section 9.1 of the Lease. CP 1539;

AR 001240. Neither NWA nor Millennium provided the requested financial and business information. CP 1597, 1598, 15555-56; AR 001290-91.

The subsequent bankruptcy sale of Arch Coal's interest in Millennium to Lighthouse Resources heightened DNR's concerns regarding Millennium. CP 1741; AR 001418. In seeking approval for the sale in bankruptcy, Arch Coal stated that the capital contributions Millennium needed from Arch Coal to stay afloat were so significant that Arch Coal's entire ownership share in Millennium, which it valued at nearly \$38 million when the bankruptcy was filed, CP 14157; AR 013715, would have been drawn down to nothing in a matter of weeks. CP 14210-11; AR 013765-66. The sale also left Millennium with a single corporate owner, a coal company, which faced the same poor economic conditions. CP 14211, 14057; AR 013766, 013619.

Following Arch Coal's sale of its interest in Millennium to Lighthouse Resources, DNR reiterated its request to NWA for information concerning Millennium's financial condition and its business plans, and asked for "any information" NWA could provide that would "shed light on Millennium's financial condition." CP 1741; AR 001418. Neither NWA nor Millennium responded. CP 15559.

On January 5, 2017, DNR notified NWA in a letter of its decision to deny the request for DNR's consent to a sublease to Millennium. DNR's

letter discussed a number of issues, including “Northwest Alloys’ failure to provide requested information regarding the financial condition and business of Millennium” as well as other factors, such as the history of subleasing at the site and the experience of the proposed sublessee. CP 1850-52; AR 001509-11.

**B. Proceedings Below.**

NWA and Millennium timely appealed DNR’s January 5, 2017, denial of their request for consent to sublease to the Cowlitz County Superior Court under RCW 79.02.030. CP 1. After a hearing, the trial court issued an Order on the Merits dated November 29, 2017, reversing DNR’s denial. CP 17687. The court found there were two deciding factors supporting its decision. CP 17692. First, the court concluded that “Northwest Alloys is entitled to pursue exactly the same project [as planned by Millennium] for a coal export terminal under the existing lease with no input from DNR.” *Id.* Second, the trial court found that DNR had legitimate concerns about Millennium’s financial ability to perform under the Lease, but that DNR did not ask the right question. CP 17691-92. Instead of requesting audited financial information, the trial court found that DNR should have asked, “[h]ow are you going to make this pencil out, subtenant?” CP 17692. The trial court therefore concluded that DNR’s request was arbitrary and capricious, CP 17693, and in a subsequent Order

entered on January 31, 2018, directed DNR to reconsider its denial of the consent to sublease. CP 17815. The parties appealed both trial court orders to this Court, initially appealing the November 30, 2017, Order on the Merits, and then subsequently appealing the January 31, 2018, Order. CP 17818-51. After considering the appealability of these orders, this Court determined that they were appealable as a matter of right, and on March 20, 2018, accepted review.

#### IV. STANDARD OF REVIEW

When reviewing the trial court's decision on a written agency record, the standard of review is generally de novo. *Dolan v. King Cty.*, 172 Wn.2d 299, 310-11, 258 P.3d 20 (2011). Thus, the Court is in the same position as the trial court in reviewing DNR's decision. *Progressive Animal Welfare Soc'y v. Univ. of Wash.*, 125 Wn.2d 243, 252, 884 P.2d 592 (1994). This Court is reviewing DNR's decision under RCW 79.02.030, which also establishes de novo review, but requires deference to DNR. *See* RCW 79.02.030 (Appellate review of DNR's certified record is "de novo before the court . . . upon the pleadings and papers so certified . . ."). *See also Haynes v. Seattle Sch. Dist. No. 1*, 111 Wn.2d 250, 254, 758 P.2d 7 (1988), *cert. denied*, 489 U.S. 1015, 109 S. Ct. 1129, 103 L. Ed. 2d 191 (1989) (where appeal statute calls for de novo review of an agency decision, judicial review is ordinarily limited to whether the agency acted arbitrarily,

capriciously, or contrary to law). Accordingly, applying RCW 79.02.030 to the DNR record, this Court will review questions of law de novo and will review DNR's actions under an arbitrary and capricious standard.

## V. ARGUMENT

### A. **The Superior Court Erred by Reversing DNR's Denial of NWA's Request for Consent to Sublease to Millennium.**

DNR based its decision to deny NWA's sublease request on NWA's "failure to provide requested information regarding the financial condition and business of Millennium as well as other factors that bear on the suitability of Millennium as a subtenant." CP 1850; AR 001509. The decision is rooted in Section 9.1(a) of the Lease, which identifies factors DNR may consider whenever NWA as tenant proposes a sublease. Under the provision, anytime NWA proposes a sublease, DNR may "consider . . . the proposed transferee's financial condition, business reputation and experience, the nature of the proposed transferee's business . . . and such other factors as may reasonably bear on the suitability of the transferee as a tenant of the Property." CP 1891; AR 001546.

The superior court erred when it concluded that DNR's requests under Section 9.1(a), and its decision based on NWA's failure to comply with them, were arbitrary. As explained below, under RCW 79.02.030, the Court must give deference to DNR's decision because the decision to deny

the sublease request was an administrative decision reserved to DNR under the Lease. Regardless of any deference, however, the facts of this case demonstrate that DNR had compelling reasons to examine Millennium's financial condition and business plans. DNR's requests for information to enable it to do so were entirely reasonable—they were certainly not arbitrary. By any standard, NWA's failure to comply with DNR's reasonable requests justified DNR's decision to deny the sublease request.

**1. The Standard of Review Under RCW 79.02.030 Requires Deference to DNR's Use of Discretion Reserved Under the Lease.**

State-owned aquatic lands, including the Columbia River bed leased by NWA, are a valuable and finite natural resource subject to conflicting use demands. RCW 79.105.010. The State holds these lands in trust for the public. *Pope Res. v. Wash. State Dept. of Nat. Res.*, \_\_\_ Wn.2d \_\_\_, 418 P.3d 90, 95 (2018). Given the competing demands for the resource and the State's obligation to the public, the Legislature has directed DNR to manage the state's aquatic lands to provide a balance of public benefits for all state citizens through its management decisions. RCW 79.105.030. The public benefits DNR must balance include providing public use and access, fostering water dependent use, ensuring environmental protection, and use of renewable resources. *Id.* Consistent with the State's obligations under the public trust doctrine, DNR balances

those public benefits in part through leases. *Pope Resources*, \_\_\_ Wn.2d \_\_\_, 418 P.3d at 96; RCW 79.130.020. It is up to DNR to determine lease terms and conditions. RCW 79.105.210(4).

Exercising the discretion the Legislature vested in DNR to determine whether and under what conditions use of state-owned aquatic lands should be authorized is an administrative function. *See Hood Canal Sand & Gravel, LLC v. Goldmark*, 195 Wn. App. 284, 307-08, 381 P.3d 95 (2016) (issuance of easement was not quasi-judicial for purposes of statutory writ of review); *State ex rel. White v. Bd. of State Land Comm'rs*, 23 Wash. 700, 705, 63 P. 532 (1901) (reversing issuance of writ of prohibition because decision to issue harbor area lease was solely an administrative action). Review of such decisions under RCW 79.02.030 is therefore limited under the state constitution to whether DNR acted arbitrarily, capriciously, or contrary to law, despite the language of RCW 79.02.030 authorizing de novo review. *Haynes*, 111 Wn.2d at 254 (“If the power exercised by an agency is essentially administrative, the superior court . . . is limited to a consideration of whether the agency acted arbitrarily, capriciously, or contrary to law”) (analyzing RCW 28A.88.010 authorizing de novo review).

The fact DNR’s decision was made under the Lease does not alter the conclusion that DNR’s action was administrative. Although the Lease

provides that DNR may not unreasonably withhold consent to a sublease request, DNR reserved significant discretion to determine how to respond to a sublease request under the Lease. When considering whether to approve a sublease request, DNR may consider the financial condition, reputation, and business plans of a proposed sublessee, as well as any other reasonable factor, under Section 9.1 of the Lease. Section 9.1 also permits DNR to condition consent to sublease by amending the Lease itself. CP 1891; AR 001546. The Court cannot exercise the discretion necessary to make such administrative determinations in DNR's place. *Household Fin. Corp. v. State*, 40 Wn.2d 451, 456, 244 P.2d 260 (1951) (issuance of license was a legislative and administrative function that cannot constitutionally be assigned to courts). Where DNR exercises discretionary authority under a contract, its actions are administrative and reviewed under an arbitrary and capricious standard under RCW 79.02.030. *Malmo v. Case*, 28 Wn.2d 828, 835, 184 P.2d 40 828 (1947) ("we conclude that, under the contracts, the Commissioner of Public Lands had the power to grant, or refuse to grant, extensions. His refusal to do so was in entire good faith. He did not act arbitrarily or capriciously").

**2. DNR's Decision Was Reasonable and Based on the Facts and Thus Was Not Arbitrary and Capricious.**

Under ordinary circumstances, a landlord has a legitimate interest in assessing the financial condition and business plans of a tenant's proposed sublessee. *Ernst Home Ctr. v. Sato*, 80 Wn. App. 473, 486, 910 P.2d 486 (1996). DNR's Lease expressly permits DNR to do so in this case. CP 1891; AR 001546. DNR's requests for financial and business information were thus consistent with reasonable business practices and a straightforward use of DNR's lease right. Moreover, DNR's requests were based on compelling evidence of cause for concern that Millennium and its plans faced financial difficulty. Accordingly, the superior court erred in concluding the requests were arbitrary. Because NWA failed to comply with DNR's reasonable efforts at due diligence, DNR's decision to deny NWA's sublease request was justified. The superior court's decision should be reversed.

**a. DNR's Requests for Information Were Authorized Under the Lease and Based on the Facts. They Were Not Arbitrary.**

An arbitrary action is one taken without consideration that disregards the facts or circumstances. *Hood Canal*, 195 Wn. App. at 307. A decision based on evidence, even disputed evidence, is not arbitrary. *Id.* Because DNR based its requests on the abundant evidence supporting its concerns over Millennium's financial condition and business plans, the

requests were not arbitrary. Given the facts, DNR's requests for financial and business information regarding Millennium were entirely reasonable.

The Lease here expressly allows DNR to consider certain factors whenever the tenant presents a request to sublease or otherwise transfer an interest in the Lease. Under Section 9.1 of the Lease, DNR may consider "the proposed transferee's financial condition, business reputation and experience, the nature of the proposed transferee's business" and any other reasonable factor whenever a sublease or other transfer is proposed. CP 1891; AR 001546. DNR's authority under Section 9.1(a) of the Lease to consider the financial condition of any proposed subtenant clearly encompasses DNR's inquiries here. DNR's right to consider the financial condition of a proposed subtenant in Section 9.1(a) necessarily means that DNR may make requests for adequate financial information to judge the subtenant's financial condition. By definition, supplying that information is the purpose of a financial statement. *Financial Statement, Black's Law Dictionary* (10th ed. 2014); Vincent J. Love, *Generally Accepted Accounting Principles*, SM076 ALI-ABA 25, 27 (2007) ("the purpose of financial statements is to organize, summarize, and present to the public the financial performance and condition of an enterprise.").

Because the Lease expressly allows DNR to consider the financial condition of any proposed subtenant, DNR has a right to do so in this case.

The parties to a lease may negotiate conditions which the tenant must meet to transfer an interest in the lease, regardless of whether the conditions are later deemed reasonable. *Ernst Home Ctr.*, 80 Wn. App. at 487 (citing *Leonard, Street & Deinard v. Marquette Assocs.*, 353 N.W.2d 198 (Minn. App. 1984)). Thus, under the Lease, whenever a sublease is proposed, DNR may consider the financial condition and business plans of the proposed sublessee. Because DNR's decision to exercise its lease right was based on the facts, DNR did not act arbitrarily.

The circumstances facing the proposed sublessee of which DNR was aware shows even more clearly that DNR's request for financial information was not arbitrary or capricious. DNR's initial request for information regarding Millennium in 2016 came in February and included a request for the company's audited financial statements. CP 1539; AR 001240. The request followed the bankruptcy of a corporate owner of Millennium, less than a month before, CP 1564; AR 001260, and the announcement of the closure of the Wenatchee Works, which had supplied the business at the dock operated for NWA by Millennium, approximately three months prior. CP 1559, 7613-14; AR 001256, 007185-86. DNR's request also came at a time of historically poor market conditions for coal, in which even the largest U.S. coal producers were declaring bankruptcy. CP 14242, 14202, 14067-68; AR 013795, 013758, 013628-29. Facing those

conditions, Ambre, Millennium's other corporate owner, had recently sold its interest in Millennium to a creditor. CP 14058, 14211; AR 013620, 013766. Yet, in the face of those significant financial headwinds, Millennium was proposing to build and operate the largest coal export terminal on the West Coast of the United States, CP 8933, 533; AR 008504, 000429, at a cost of hundreds of millions of dollars, CP 14203, 536; AR 013759, 000432, on public land managed by DNR. Given those facts, it would have been highly imprudent for DNR *not* to seek information regarding Millennium's current financial condition.

DNR's need to review Millennium's financial condition became even more compelling after Arch Coal sold its interest in Millennium in June 2016. DNR then reiterated its request for financial statements and business information. CP 1741; AR 001418. In seeking approval for selling its stake in Millennium, Arch Coal stated the sale was needed because Millennium's development plans were so capital intensive that Arch Coal's entire ownership interest, which it valued at \$38 million when the bankruptcy was filed, CP 14157; AR 013715, would have evaporated in a matter of weeks unless it sold the interest. CP 14210-11; AR 013765-66. Additionally, Arch Coal sold its interest to its creditor, CP 14211-12; AR 013766-67, Lighthouse Resources, and received little more than a release from its contractual obligation to pay its share of Millennium's

capital needs and an option to buy a small percentage of the capacity of Millennium's project at market rate. *Id.* The sale left Millennium with one corporate owner, a coal company facing the same difficult market conditions. CP 14057, 17574, 14226; AR 013799, 013780, 013619.

As the superior court noted, those facts "raise legitimate dollar [financial] concerns on the part of DNR," CP 17691, and DNR as "the primary landlord certainly has the right to know how a subtenant's business is going to operate." CP 17692. The superior court held, however, that DNR's requests for Millennium's financial statements were arbitrary because the statements "would not be of any value in alleviating the expressed [financial] concern." CP 17693. The superior court was incorrect.

Without reliable information showing a proposed sublessee's assets, liabilities, income, and cash flow, the landlord cannot obtain an adequate picture of the financial condition of the proposed sublessee. As Judge Easterbrook noted, without such financial information, the landlord would "not be able to tell whether there would be money left over, after paying the existing debts, to maintain [the property] and pay the taxes, let alone pay the rent." *Nat'l Distillers & Chem. Corp. v. First Nat'l Bank of Highland Park*, 804 F.2d 978, 980 (7th Cir. 1986) (pro forma balance sheet showing potential assignee's \$42 million in assets and \$37.8 million in liabilities insufficient); *see also Robinson v. Weitz*, 171 Conn. 545, 370 A.2d

1066, 1069 (1976); *Kazarinov v. L. B. Kaye Assocs.*, 111 Misc.2d 944, 949, 445 N.Y.S.2d 915, 919 (1981) (financials showing sublessee's income of five times rent was insufficient without debt information). Those concerns are magnified here where the proposed subtenant would be responsible not only for the existing facilities but also for building and operating a large new industrial facility on the property. Without an adequate picture of Millennium's financial condition, DNR would not have been able to assess whether Millennium had sufficient resources to meet the requirements of the Lease and build and operate a large new industrial facility on the Columbia River without harm to the property, environment, or the public.

The superior court found that DNR should have simply asked Millennium "how are you going to make this pencil out, subtenant?" The superior court mistakenly reasoned that there was no useful information to be learned from Millennium's financial statements because "everyone knew MBTL-Longview was a single purpose startup entity, bleeding cash with no source of revenue, and it was reliant on essentially daily infusions of cash from its owner . . ." The superior court fundamentally misunderstood the State's interest as landlord. As landlord, the State "was entitled to the information necessary to make this decision for itself." *Nat'l Distillers*, 804 F.2d at 981. Knowing the assets, liabilities, income, and cash flow of Millennium are critical to DNR making its own informed judgment about

whether Millennium can make its plans pencil out. *Id.* at 980. Clearly, DNR had reason to believe that there was cause for concern, as the court found. But, even in the absence of those circumstances, DNR was entitled under the Lease to look at the facts and make its own judgment regarding Millennium's financial condition in light of its business plans. DNR was not required to accept whatever Millennium or NWA might care to share about how they believed Millennium could make its plans "pencil out."<sup>3</sup>

DNR had good reason not to simply accept Millennium's representations. It is undisputed that Millennium had deliberately concealed the full scope of its plans for the coal export terminal as part of a permitting strategy to avoid environmental review. CP 508, 511-12; AR 000406, 000409-10. A memo, directed to Millennium's then CEO, Joe Cannon, CP 326; AR 000172, identified two phases of Millennium's plans: Phase 1 Existing, which Millennium was then permitting, and Phase 1 New, "targeting annual coal throughput of 20 million tonnes per annum" with new infrastructure. The memo acknowledged that closely related projects must be considered together under SEPA and that an EIS would be required

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<sup>3</sup> While a Landlord's review of financial statements for any entity would yield important information, such as whether the entity is adequately capitalized or is overburdened by debt, the superior court's characterization of Millennium as a startup entity is off base. Millennium was formed in 2010 and had been operating for over five years as a contractor for NWA, presumably earning income, expending funds, and accumulating assets and liabilities. It was not a traditional, newly formed, startup entity.

for Phase 1 Existing if the two phases were considered together. CP 511-12; AR 000409-10. Thus, to avoid delay in review of the Phase 1 Existing plans, the memo advised Millennium not reveal plans for Phase 1 New to government agencies for at least two months following approval of permits for the Phase 1 Existing plans. CP 513; AR 000411. Millennium followed this scheme in seeking approval of Phase 1 Existing plans. CP 290, 3497, 2463; AR 00140, 003108, 002102. DNR was entitled to judge Millennium's financial condition for itself under the Lease and, based on Millennium's history of concealment, DNR had particularly good reason to independently review the facts for itself and make its own determination.

DNR's requests for financial and business information regarding Millennium were authorized under the Lease. The requests were expressly based on undisputed evidence, including the sharp downturn in the market for coal, the bankruptcy of Millennium's parent, Arch Coal, and the closure of the Wenatchee Works. Because DNR's requests were based on the evidence showing cause for concern over Millennium's financial condition and business plans, the requests were not arbitrary.

**b. DNR's Actions Were Commercially Reasonable. The Superior Court's Conclusion to the Contrary Was Erroneous.**

DNR's requests in this case were not only authorized under the Lease, they were also consistent with reasonable business practices. It is

well-settled that when confronted with a tenant's request to assign or sublet, it is reasonable for a landlord to consider the financial strength and responsibility of the proposed transferee as well as the nature and legality of its intended use and occupancy of the leased property, among other factors. *Ernst Home Ctr.*, 80 Wn. App. at 486. This well-settled notion is almost certainly the reason why the Lease expressly allows DNR to consider such factors in any case. To determine whether a landlord acted reasonably in refusing consent, courts ask if a reasonably prudent person in the position of the landlord would have done so. *Ernst Home Ctr.*, 80 Wn. App. at 484. Because NWA and Millennium did not provide reasonably requested financial and business information, DNR acted reasonably in refusing its consent. *See, e.g., McKeon v. Williams*, 104 Or. App. 106, 110, 799 P.2d 198, 200 (1990) ("Because defendants did not provide the requested [financial] information, plaintiff did not unreasonably refuse to consent").

A tenant has the burden to provide sufficient information to allow the landlord to evaluate the tenant's request for a sublease or assignment. 1 Andrew R. Berman, *Friedman on Leases* § 7.3.4[D][3] at 7-58 (6th ed. 2016); *Evans v. Waldrop*, 220 So.3d 1066 (Ala. Civ. App. 2016) ("the burden to furnish sufficient information . . . is the lessee's. . . . In the absence of information . . . , the lessor is justified in withholding consent") (quoting *D'Oca v. Delfakis*, 130 Ariz. 470, 472, 636 P.2d 1252, 1254

(1981)). If the tenant fails to provide sufficient information, the landlord is justified in refusing to consent to the transfer. *Id.*; see also *McKeon*, 799 P.2d at 200; *Fahrenwald v. LaBonte*, 103 Idaho 751, 757, 653 P.2d 806, 812 (1982); *200 Eighth Ave. Rest. Corp. v. Daytona Holding Corp.*, 740 N.Y.S.2d 330, 293 A.D.2d 353 (2002) (“refusal to consent to the assignment was reasonable . . . since the proposed assignee did not timely tender adequate financial background information.”).

A landlord’s request for audited financial statements in response to a tenant’s request to sublease or assign is a reasonable and prudent business practice. *Robinson*, 370 A.2d at 1069 (“[landlord’s] request for certification of the [financial] statements was not only in accordance with prudent business practice, but was certainly reasonable.”). Commercial landlords routinely request audited financial statements to assess the financial condition of a proposed subtenant or assignee. See S. H. Spencer Compton & Joshua Stein, *Landlord’s Checklist of Silent Lease Issues (Third Edition)*, 29 *Prac. Real Est. Law* 4, 16 (2013) (“For any assignment/sublet [Landlord should] . . . require . . . delivery of certain documents satisfactory to the landlord (such as assignee/subtenant’s certified financial statements . . .”). Indeed, it may be reasonable to request far more financial information than requested by DNR. See *General Elec. Capital Corp. v. Gary*, No. 11 Civ. 3671, 2013 WL 390959, \*5-6 (Fed. Dist. Ct. S.D. N.Y. Jan. 31, 2013)

(unpublished) (request for three years of financial statements and tax returns was “essential financial information,” and failure to provide them and cooperate with due diligence “fully justified GECC’s refusal to consent.”).

In this case, NWA did not provide sufficient information for DNR to evaluate Millennium’s financial condition and business plans. After DNR made its request for financial statements in February 2016, CP 1539; AR 001240, neither NWA nor Millennium provided any financial information related to Millennium. CP 15555-56, 1597-98; AR 001290-91. Instead, they argued, alternatively, that DNR could not request such information and that it was not necessary to provide it. *Id.* When DNR reiterated its request for financial statements in June, DNR also requested “any information NWA could provide that would shed light on Millennium’s financial condition.” CP 1742; AR 001419. NWA and Millennium provided no response. CP 15559 (NWA and Millennium “chose not to respond”). They chose to ignore the request altogether because they “had enough.” *Id.*

Given the facts of this case, it would have been irresponsible for DNR not to examine Millennium’s financial condition. DNR’s requests for information to conduct its due diligence were entirely reasonable. NWA’s failure to comply with the requests fully justified DNR’s decision to refuse to consent to the sublease.

**3. DNR, as the Manager of the State's Aquatic Lands on the Columbia River, Has a Compelling Interest in the Solvency and Stability of Millennium as a Proposed Subtenant.**

Regardless of whether a tenant will remain bound by the lease, a landlord has a reasonable interest in ensuring a tenant's proposed assignee or subtenant is financially responsible because the assignee or subtenant has a significant effect on the landlord's interest in the property.

Regardless of the type [of] business conducted by the proposed subtenant, the enterprise has a tenor which can detract from the value of the entire premises. Thus a given business can be acceptable in name, but unacceptable in the way it is conducted. The capital and credit of an entrepreneur controls to some extent the manner of his business. So, too, does the financial responsibility bear on the day-to-day upkeep, and day-to-day appearance of the premises. Another more remote consideration based to some degree on financial strength involves labor difficulties. So, too, would a series of rapid turnovers caused by the weakness of subtenants' businesses detract from the value of the overall premises.

*Jack Frost Sales, Inc., v. Harris Trust & Sav. Bank*, 104 Ill. App. 3d, 433 N.E.2d 941, 946-47 (1982) (quoting *Reget v. Dempsey-Tegler & Co.*, 70 Ill. App. 2d 32, 37, 216 N.E.2d 500, 503 (1966) ("the sublessee's credit is a meaningful factor in lessor's determination.")); see also *Kazarinov*, 445 N.Y.S.2d at 920 ("the landlord has the right to expect reasonably prompt and reliable performance of all lease covenants . . . [which] is directly related to the evidence as to the dependability, solvency and

stability of the actual occupant.”) (discussing sublease) (quoting *Popovic v. Florida Mech. Contractors, Inc.*, 358 So. 2d 880, 884-85 (Fla. Ct. App. 1978)). Thus, although the tenant typically remains bound by the lease under either a sublease or assignment, a landlord is entitled to a financially responsible assignee or subtenant. Berman, *supra*, § 7.3.4[D][3] at 7-68, 69. As the Seventh Circuit recognized, “[p]erhaps Landlord could proceed against [the original Tenant] as assignor, but a chose in action is not a perfect substitute for a good tenant.” *Nat’l Distillers*, 804 F.2d at 981.

Under the facts of this case, DNR’s interest in the financial condition of Millennium is not only reasonable, it is compelling. As a preliminary matter, DNR has a greater interest in the financial stability of Millennium as a subtenant because the Lease is a triple net lease, under which the tenant must maintain the property and improvements, CP 1898; AR 001553; pay all utilities, taxes, and other expenses, CP 1882; AR 001537; and comply with all applicable laws and regulations, CP 1878; AR 001533. For such leases, the landlord has greater interest in the financial stability of the actual occupant of the property than simply payment of rent. The financial condition of a subtenant is thus of even greater importance. *See Popovic*, 358 So. 2d at 884-85 (landlord has interest in sublessee’s dependability, solvency, and stability “particularly . . . in a total performance lease of the type employed . . .”).

The financial condition of Millennium is of even greater significance given the risks attendant to operating an industrial facility on the Columbia River. A default resulting from Millennium's failure to properly invest in sound construction, maintenance, or operation of the existing or planned facilities could have immediate public health and safety and environmental consequences, given the location of the facility. *See, e.g.,* CP 6048; AR 005647 (Chinook's unauthorized improvements were "threat . . . to human health and the environment."). Regardless of whether DNR may ultimately look to NWA to cure a default, DNR has a strong interest in ensuring default does not occur, especially where a default could threaten public safety or the environment. Additionally, as explained below, defaults at an industrial facility on the Columbia River may be difficult to cure and persist for years. Thus, DNR's interest in the financial condition of Millennium, regardless of whether NWA has continuing Lease liability, is particularly evident under the facts of this case.

Because Millennium's plans would greatly intensify the use of the property, Millennium's financial capacity to perform is all the more important. The new docks planned by Millennium would be used to export up to 44 million metric tonnes of coal by up to 840 Panamax and Handymax vessels a year, CP 8933, 9046, 9052; AR 008504, 008617, 008623, which is far more than the 14 vessels per year that Millennium projects will use at

the site in the absence of the docks, CP 9055; AR 008626, and the six to eight vessels per year that used the dock historically. CP 9032-33, 9055; AR 008603-04, 008626. Thus, there will be far more product moving over the leasehold and far more vessels visiting the property. To provide access to the docks for that size and number of vessels, far more dredging will take place. New areas of the leasehold will need to be dredged, and it will be re-dredged on an annual or semi-annual basis. Previously, dredging occurred approximately once every 10 years. CP 2617, 533 (“dredging is not a major issue and is required only once about every ten years.”); AR 002233, 000429. Given the nature of the Lease, the significant increase in the intensity of use of the property, and Millennium’s responsibility for building, operating, and maintaining a new industrial facility of this scale, Millennium’s financial condition and responsibility is critical.

**4. The Lease History Demonstrates the Financial Condition of a Sublessee Is Critical to the Protection of the State’s Interests Under the Lease.**

As noted in DNR’s January 5, 2017, decision, the recent history of default and bankruptcy under the Lease demonstrates that DNR has a strong interest in reviewing the financial condition and business plans of any proposed subtenant under the Lease. CP 1851; AR 001510. The bankruptcy of Longview Aluminum shows that when a tenant or subtenant declares bankruptcy, the landlord may lose control over the leased property. That

loss of control, in turn, could result in an assignment in bankruptcy to an irresponsible party, over landlord objection, as happened here with Chinook Ventures. Chinook's activities show a subtenant's irresponsibility may lead to defaults, create dangerous conditions, threaten the environment, and take years to rectify, particularly given NWA's lax approach to its sublessees.

As noted by the superior court, NWA's previous subtenant on the property presents an "object lesson . . . in terms of what a bad subtenant can do at the property. . ." CP 17691. As a subtenant for NWA, Chinook cut corners and caused a number of lease defaults. CP 129-32; AR 000001-3. Chinook installed piling, a ship loader, and an overwater conveyor system without required permits, structural engineering analysis, or required authorization under the Lease. CP 6048, 6057-58, 160; AR 005647, 005656, 000025. Cowlitz County declared the ramshackle improvements "a threat or potential threat to human health and the environment." CP 6048; AR 005647. Chinook also operated its facilities in a way that caused numerous regulatory violations that harmed the environment. CP 2169-74, 2077-78, 2104-05; AR 001822-27, 001730-31, 001756-57.

Although DNR notified Chinook of the default for failure to obtain authorization for its improvements in May 2009, CP 129; AR 000001, it was years before work to remove the unauthorized structures was completed. Two years after the initial notice, in June 2011, DNR took issue with

NWA's failure to cure the default. CP 628; AR 000443. It was not until March 2012, nearly three years after DNR sent its initial notice, that NWA, through Millennium, had completed the work to remove unpermitted structures. CP 1098; AR 000878.

A landlord has a right to expect reasonably prompt compliance with all the terms of the Lease. *See Pepper & Tanner, Inc. v. Kedo, Inc.*, 13 Wn. App. 433, 535 P.2d 857 (1975); *Kazarinov*, 445 N.Y.S.2d at 952; *Popovic*, 358 So. 2d at 884. Chinook's defaults show that cure, particularly at an industrial site on a navigable river, can take a very long time. Accordingly, DNR has a significant interest in taking prudent steps to ensure it has a financially responsible subtenant so that defaults will not occur, particularly where, as here, defaults could threaten public safety and the environment.

The history under the Lease also shows how NWA's lax oversight of its subtenants makes a responsible subtenant all the more important here. Issues with Chinook arose soon after Chinook began operations at the site. CP 2169-74; AR 001822-27. As early as April 2006, the Department of Ecology noted violation of environmental regulations by Chinook for fugitive emissions of petroleum coke, yet Chinook continued to have such environmental violations for years. CP 2171; AR 001824. Similarly, Chinook violated its NPDES permit for discharge into the Columbia River

soon after it commenced operations and persisted in doing so for years. CP 2172-74; AR 001825-27. Ultimately, the Department of Ecology imposed a large fine on Chinook in 2009, CP 2108-09; AR 001761-62, and, when that proved ineffective, suspended Chinook's petroleum coke handling activities in 2010. CP 2078; AR 001731. As noted in the report commissioned by Ecology to investigate the 2010 spill of petroleum coke from the facility into the Columbia River, the abundant evidence of "sloppy and un-permitted handling of wastes, [and] poor and unsafe working conditions . . ." demonstrates a lack of effective oversight of the facility. CP 2047-48; AR 001700-01. NWA's failure to effectively oversee Lease operations underscores DNR's need to ensure a proposed subtenant is financially reliable.

The Lease history also illustrates why the specter of bankruptcy provided a compelling reason for DNR's inquiries. Even in ordinary circumstances, "[i]t is not irrational for a lessor to be concerned about ending up as a creditor in its tenant's bankruptcy—unable to evict the tenant . . . while senior creditors realize on their security." *Nat'l Distillers*, 804 F.2d at 980-81. In addition, a bankruptcy court may order the assignment of an unexpired sublease over the objections of a landlord. *See, e.g., In re Peaches Records & Tapes*, 51 B.R. 583 (9th Cir. 1985), thus depriving the landlord of control over the lease. Longview Aluminum's

2003 bankruptcy shows just how detrimental to a landlord's interest in the leased property that may be. As NWA and Millennium have pointed out, the bankruptcy of Longview Aluminum caused NWA's predecessor at the site, Reynolds Metals, to lose control of its lease with Longview. CP 15539 (Opening Br. at 6, n.2). Over the objections of Reynolds, the bankruptcy court ordered the sale of Longview Aluminum's smelter and the assignment of its ground lease to an irresponsible third party, Chinook Ventures. *Id.*; see also CP 6630; AR 006204. Chinook then promptly caused Lease defaults that threatened public safety and the environment and took years to remedy.

The facts surrounding DNR's requests for information regarding Millennium show DNR's concerns regarding bankruptcy were very real. Following a string of bankruptcies among the largest coal producers, CP 14242, 14202; AR 013795, 013758, Millennium's parent company, Arch Coal, declared bankruptcy and sold its interest in the company to a creditor, which was also a coal company facing the same difficult conditions in the coal markets. CP 14210-11, 14058; AR 013765-66, 013620. The history of this case illustrates DNR's strong interest in avoiding bankruptcy by a subtenant. The principal mechanism DNR has to accomplish that goal is by ensuring that a subtenant is financially sound before consenting to a sublease. Accordingly, DNR's requests for financial information from Millennium were objectively reasonable given the facts of this case.

**B. The Superior Court Erred by Concluding Millennium’s Proposed Terminal Expansion Is Allowed Under the Lease. Operating the Largest Coal Export Facility on the West Coast Is Well Beyond the Scope of the Lease.**

In support of its decision, the superior court held that “Northwest Alloys is entitled to pursue exactly the same project [as proposed by Millennium] for a coal export terminal” with no input from DNR. CP 17692 (Order on the Merits ¶ 12). The superior court erred. The issue of whether Millennium’s plans were within the scope of the Lease was not part of DNR’s decision on appeal, CP 9, and was not before the court. CP 1 (notice of appeal).<sup>4</sup> In any event, the court’s conclusion was erroneous because, as explained below, Millennium’s plans call for facilities that are far larger than any contemplated under the Lease, and Millennium’s proposed use of those facilities conflicts with the permitted use of the leased property.

The Court reviews the superior court’s interpretation of the Lease de novo. *Viking Bank v. Firgrove Commons 3, LLC*, 183 Wn. App. 706, 712, 334 P.3d 116 (2014). In doing so, the court’s objective is to ascertain

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<sup>4</sup> In addition, at the time of the superior court’s order on the merits, DNR had already determined in a separate decision, not appealed by Millennium or NWA, that Millennium’s plans did not fit within the scope of the Lease and further authorization from DNR would be needed to build them for several reasons. NWA submitted plans and specifications for Millennium’s proposed docks to DNR in September 2017. DNR denied its approval for the plans under Section 7.3 of the Lease on October 24, 2017. DNR’s decision was filed by Millennium’s corporate parent, Lighthouse Resources, in a related dispute in federal court. *Lighthouse Res., Inc. v. Inslee*, No. 3:18-cv-05005, Dkt. #1-2 (W.D. Wash. filed January 3, 2018). DNR’s denial was without prejudice.

the intent of the parties. *Id.* Intent is derived primarily from the language of the Lease viewed in the context of the Lease as a whole. *Id.* at 713.

To the extent the Lease is ambiguous, the Lease is to be strictly construed in favor of DNR. *See Davidson v. State*, 116 Wn.2d 13, 802 P.2d 1374 (1991) (“ordinary rules of contract interpretation do not apply here. Where a deed or grant from the State fails to define or limit the boundary of the grant, the boundary will be interpreted most strongly against the grantee rather than the grantor state.”). The Columbia River bedlands leased by NWA are part of the body of navigable waters identified in article XVII of the state constitution to which the State obtained title upon statehood. *See Caminiti v. Boyle*, 107 Wn.2d 662, 666-67, 732 P.2d 989 (1987). Although DNR has leased the property at issue to NWA, the property remains subject to the rights of the public under the public trust doctrine. *Chelan Basin Conservancy v. GBI Holding Co.*, 190 Wn.2d 249, 261, 413 P.3d 549 (2018). As the Supreme Court recently noted for such lands, “[t]he general rule of construction applying to grants of public lands by a sovereignty to corporations or individuals is that the grant must be construed liberally as to the grantor and strictly as to the grantee, and that *nothing shall be taken to pass by implication.*” *Chelan Basin Conservancy*, 190 Wn.2d at 263 (emphasis added) (citations omitted). Thus, authority to pursue Millennium’s coal export terminal cannot be implied under the Lease.

The unambiguous language of the Lease shows the superior court erred in construing the Lease to authorize NWA to pursue the same project Millennium planned without DNR's input. As explained below, the Lease shows Millennium's terminal was not contemplated and is not part of the bargain NWA made when it signed the Lease for three reasons. First, the docks Millennium plans are very different and far larger than the docks NWA warranted were the planned improvements when it signed the Lease. Second, Millennium's plans require significant dredging of the leased property and areas outside the Lease area, but the Lease does not authorize dredging. Third, the use of the property for a dedicated coal export facility as planned by Millennium conflicts with the permitted use of the property defined in the Lease. For all these reasons, additional authorization from DNR would be required to build and operate Millennium's planned coal export terminal. The superior court should be reversed.

**1. The Docks Planned by Millennium are Far Larger Than Those NWA Represented as the Planned Improvements When the Lease Was Signed.**

The docks planned by Millennium are far larger than any improvements contemplated under the Lease. A conceptual description of two docks planned for the Lease was included in Exhibit A to the Lease at the time when NWA signed it in 2008. CP 1877, 1905; AR 001532, 001560. The docks planned by Millennium were first described in 2012. CP 1080;

AR 000863. Millennium's docks are much larger. Because DNR's approval is necessary under Section 7.3 of the Lease to build any improvements, the superior court erred in concluding that NWA could pursue Millennium's coal export project with no input from DNR.

In 2008, NWA's subtenant was Chinook Ventures. Chinook prepared the survey identified in the Lease as Exhibit A. CP 1860; AR 001517. Exhibit A describes the existing dock on the Lease property and two additional "Proposed Docks." *Id.* Under Section 1.2(a) of the Lease, NWA warranted that Exhibit A provides a "true and accurate description of the Lease boundaries and *the improvements to be constructed* or already existing in the Lease area." CP 1877; AR 001532 (emphasis added). Thus, NWA, as tenant, warranted that any new docks planned for the Lease were shown on Exhibit A prepared by Chinook in 2008. There is no basis to conclude Chinook planned improvements on the scale of Millennium's coal export terminal.<sup>5</sup>

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<sup>5</sup> Moreover, there is no evidence that NWA would pursue Millennium's project. NWA expressly informed DNR that "Millennium's plans . . . to accommodate their coal handling plans . . . are solely Millennium's . . . Northwest Alloys' involvement . . . is to ensure the plans provide for the continuing supply of alumina to Alcoa's Wenatchee Works and adhere to [the Lease] . . ." CP 543; AR 000438.

The new docks planned by Millennium are much larger than those shown on Exhibit A.<sup>6</sup> According to Exhibit A, Chinook's docks would have added 132,950 square feet of new dock and trestle to the existing 55,682-square-foot dock and trestle under the Lease. CP 1860; AR 001517. Millennium's docks as described in the Environmental Impact Statement (EIS) for the project would have added 233,841 square feet of overwater structure, a difference of greater than 100,000 square feet, and a 75 percent increase. CP 6175; AR 005763. A direct comparison of the docks, without trestles, reveals an even greater disparity. The docks planned by Millennium were 90.5 feet wide and 891 and 1311 feet long, respectively (199,281 square feet). CP 6184; AR 005772. Based on the scale shown on Exhibit A, the docks contemplated by Chinook were each approximately 525 feet long and 55 feet wide (a total of 57,700 square feet). CP 1860; AR 001517. Thus, Millennium's docks were over three times as large as those NWA warranted as planned improvements for the Lease in Exhibit A.

A threefold increase in the size of the docks depicted in Exhibit A would correlate to a profound increase in the intensity of the use of the

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<sup>6</sup> The plans and specifications NWA submitted to DNR in September 2017 shortened the combined length of the docks by approximately 142 feet. The revisions were not before DNR at the time of its decision and are, therefore, not material to the analysis here. In any case, the plans as revised still called for far larger docks than contemplated under Exhibit A. DNR denied its approval for the plans under Section 7.3 of the Lease on October 24, 2017. *See* note 4 *supra*.

leased property. According to the EIS for the project, Millennium plans to use the two new docks to load approximately 840 Panamax and Handymax vessels with up to 44 million metric tonnes of coal per year. CP 8933, 9052; AR 008504, 008623. In the absence of the proposal, Millennium estimates approximately 14 vessels a year would be loaded or unloaded on site. CP 9055; AR 008626. Historically, approximately six to eight vessels a year were loaded at the dock. *Id.*; CP 9032-33; AR 008603-04. There is no support for the conclusion that at the time the Lease was signed NWA and DNR contemplated use of the property on the scale proposed by Millennium.<sup>7</sup> The superior court's conclusion to the contrary was in error.

Authorization from DNR would be required for the construction of the new docks planned by Millennium. Because DNR has not approved plans and specifications for the docks contemplated by Millennium, NWA cannot pursue construction of the docks at this time. Section 7.3(a) prohibits the Tenant from placing any improvements on the leased property without DNR's consent. CP 1884; AR 001539. Under Section 7.3(a), DNR may

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<sup>7</sup> Even assuming for argument that Millennium's plans were consistent with the docks described in Exhibit A, warranted by NWA as the planned improvements, NWA would still need to submit final plans and specifications to DNR for approval. Under Section 7.3(b), NWA must submit plans and specifications to DNR prior to construction of any Improvements. NWA's sublease with Chinook Ventures confirms that consent from DNR was required for the docks identified in Exhibit A. CP 1910; AR 001565. The sublease provides "Sublessor shall first obtain the prior written consent of both the Department and Sublessor, and any such alterations or improvements shall be made in accordance with the Lease." *Id.*

deny its consent if DNR determines that “denial is in the best interest of the State.” *Id.* DNR’s consent is obtained by submitting plans and specifications to DNR under Section 7.3(b). *Id.* Because DNR has not provided its approval of plans and specifications, NWA could not proceed with building the proposed terminal without input from DNR.<sup>8</sup>

**2. The Lease Does Not Authorize the Dredging Required for Millennium’s Plans.**

Additional authorization from DNR would also be required to operate Millennium’s planned facilities. To operate a new terminal for continuous access by the deepest draft vessels that can navigate the Columbia River as Millennium plans, CP 8131; AR 007703, would require a significant increase in dredging of the property. As noted by the U.S. Army Corps of Engineers, before dredging in 2011, the property was last dredged in 2000 to an authorized depth of -40 feet. CP 2617; AR 002233. To restore the berth at the existing dock to the depth authorized in 2000 by the Corps, Millennium was authorized to remove 31,300 cubic yards of material 10 years later. *Id.* To build Millennium’s new facility would require dredging a large swath of Columbia River bed to a depth of 43 feet, removal of more than 10 times the amount of dredge material than

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<sup>8</sup> DNR denied consent to build the docks on October 24, 2017. *See supra* note 4. DNR’s denial was without prejudice and was not appealed.

authorized in 2011, and annual or biannual dredging to maintain depth. CP 6124; AR 005714. The area Millennium plans to dredge includes significant areas outside the boundary of the Lease. CP 6132; AR 005722 (map showing dredge boundary in relation to Lease).

Authorization is required for the dredging needed to operate the terminal. It is axiomatic that the Lease does not authorize dredging in areas outside the boundaries of the Lease. Thus, authorization from DNR in addition to the Lease would be required for those areas. Additional authorization from DNR would also be required for dredging areas within the Lease boundary. The Lease does not allow NWA to dredge the property. Section 1.1(c) expressly provides the Lease does not authorize NWA to excavate or withdraw sand, gravel, or other valuable materials from the leased property. CP 1876-77; AR 001531-32. Section 1.1(c) reflects DNR's obligation under RCW 79.140.150 to ensure that removal of sand, silt, and other valuable materials from the Columbia River is in the public interest and, if so, that the State is compensated. Without a specific proposal for dredging in the Lease, DNR cannot determine if the requirements of RCW 79.140.150 have been met. *See* RCW 79.140.160 ("each application shall set forth the estimated quantity and kind of materials . . . to be removed and shall be accompanied by a map . . ."). Thus, DNR approves dredging

under the Lease on a case-by-case basis. The Lease does not give NWA a right to dredge for Millennium's planned facility.<sup>9</sup>

Because DNR's consent under the Lease is required for building the docks planned by Millennium and conducting the necessary dredging to operate the docks, the superior court erred when it concluded that NWA could pursue exactly the same project as proposed by Millennium for a coal export terminal with no input from DNR. CP 17692.

**3. Millennium's Plans for a Dedicated Coal Export Terminal Conflict With the Permitted Use Under the Lease.**

The superior court concluded that NWA could pursue Millennium's plans without input from DNR in part based on its finding that "[t]he notion of a dedicated coal transshipment facility fits within the terms of the lease that DNR negotiated some years ago." CP 17690 (Order on the Merits ¶6). The court is incorrect. Because Millennium's plans for a dedicated coal-export terminal conflict with the permitted use of the property defined in the Lease, NWA has no authority to pursue the plans without DNR's input. Section 2.1 of the Lease defines the use of the property allowed under the Lease. Under Section 2.1, NWA "shall use the Property for three

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<sup>9</sup> The fact the Lease makes no provision of dredging is another indication that NWA and DNR never contemplated a use on the scale planned by Millennium. Historically, dredging of the property was needed infrequently. CP 2617, 533; AR 002233, 000429 ("dredging is not a major issue and is required only once about every ten years.").

220' ship docks and . . . outfall pipelines *shown in Exhibit A and for no other purpose.*" (emphasis added). CP 1877; AR 001532. The "Proposed Docks" in Exhibit A compare favorably with the existing dock on the property and the "220' dock description" in Section 2.1. Millennium's proposed docks do not.

The permitted use identified in Section 2.1 of the Lease is further described in Exhibit B to the Lease. CP 1877; AR 001532. Exhibit B explains that the existing structure on the property is comprised of three breasting dolphins, two mooring dolphins, and 220 feet of dock as well as an approach trestle. CP 1916; AR 001571. The 220 feet of dock is sandwiched between two of the dolphins described in Exhibit B. CP 3331-32; AR 002942-43 (site plan). Thus, although the dock appears to be 220 feet in length, the overall structure including the two dolphins is larger. *Id.*; CP 1860; AR 001517 (survey). The overall scale of the existing structure is roughly consistent with the scale of the "Proposed Docks" identified in Exhibit A. In contrast, the docks planned by Millennium dwarf the existing dock. CP 6278; AR 005857. The docks as planned by Millennium at the time of DNR's decision in January 2017 measured 891 feet long and 1,311 feet long respectively.<sup>10</sup> CP 6280; AR 005859. There is

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<sup>10</sup> See *supra* note 4.

simply no way to construe Millennium's plans to be consistent with the 220-foot docks permitted under Section 2.1 of the Lease and shown on Exhibit A.

Millennium's plans for a dedicated coal export facility are also inconsistent with the use of the docks described in Exhibit B. Exhibit B to the Lease describes a flexible import and export facility in which the new docks contemplated by Chinook Ventures would be used for multiple dry bulk and packaged products. CP 1916-17; AR 001571-72. According to Exhibit B, Chinook would have used one of the two new docks it planned as an open dock with no equipment on which cargo bagged or packaged for handling by crane would be loaded or offloaded from vessels. CP 1917; AR 001572. Millennium's planned use of its two new docks as part of a dedicated coal export facility is inconsistent with an open dock used to load and unload packaged cargo by crane. Exhibit B states the other dock planned by Chinook Ventures would have onload and offload conveyors used for multiple general dry bulk products. CP 1917, 1919; AR 001572, 001574. While coal is identified as one product that will be loaded and unloaded at the site, Exhibit B expressly states "all three docks will be used for loading *and off loading of various products.*" CP 1919; AR 001574 (emphasis added). Millennium's plans for a dedicated coal export terminal are simply inconsistent with the permitted use under the Lease.

Because Millennium's docks are far larger than any improvements contemplated under the Lease and would be used for a different purpose than the Lease permits, NWA could not build or operate the terminal without additional approval from DNR. The superior court's conclusion to the contrary is erroneous and should be reversed.

## VI. CONCLUSION

For the foregoing reasons, DNR respectfully requests this Court reverse the superior court and reinstate DNR's denial of consent to NWA's proposed sublease to Millennium.

RESPECTFULLY SUBMITTED this 6th day of July, 2018.

ROBERT W. FERGUSON  
Attorney General



EDWARD D. CALLOW

WSBA No. 30484

TERENCE A. PRUIT

WSBA No. 34156

Assistant Attorneys General

Natural Resources Division

1125 Washington Street SE

PO Box 40100

Olympia, WA 98504-0100

(360) 664-2854

*Attorneys for Appellants Department  
of Natural Resources and  
Commissioner of Public Lands  
Hilary S. Franz*

**CERTIFICATE OF SERVICE**

I certify that I caused a copy of the foregoing document to be served on all parties or their counsel of record on July 6, 2018, through the Washington State Appellate Courts' eFiling Portal.

I certify under penalty of perjury, under the laws of the state of Washington, that the foregoing is true and correct.

DATED this 6th day of July, 2018, at Olympia, Washington.



KIM L. KESSLER  
Legal Assistant  
Natural Resources Division

# APPENDIX

## UNPUBLISHED CASE

*General Elec. Capital Corp. v. Gary*  
2013 WL 390959

Pursuant to GR 14.1(d)

2013 WL 390959  
Only the Westlaw citation is currently available.  
United States District Court,  
S.D. New York.

GENERAL ELECTRIC CAPITAL CORPORATION,  
a Delaware Corporation, Plaintiff,

v.

Willie E. GARY, a resident of Florida, Gary  
Williams, Finney, Lewis, Watson and Lewis, P.L.,  
a Florida corporation, Gary 737 LLC, a Florida  
limited liability company, and Sussman &  
Watkins, a New York partnership, Defendants.

No. 11 Civ. 3671(ALC)(MHD).

Jan. 31, 2013.

**REPORT & RECOMMENDATION**

MICHAEL H. DOLINGER, United States Magistrate  
Judge.

**\*1 TO THE HONORABLE ANDREW L. CARTER,  
JR., U.S.D.J.:**

Plaintiff General Electric Capital Corporation ("GECC") commenced this lawsuit to recover moneys owed to it on a loan made to defendant Gary 737 LLC for the purchase of a Boeing 737 aircraft. Following default on the loan, plaintiff filed suit against Gary 737 LLC, as well as guarantor Willie E. Gary and Mr. Gary's law firm. In view of defendants' admission to having defaulted on the loan (*see* Stipulation entered Nov. 22, 2011), we now conduct an inquest to assess damages owed by defendants to plaintiff.

Defendants have raised no objections to the amounts of principal, interest, and late charges that are owed; however, they argue (1) that they are entitled to a set-off because plaintiff unreasonably withheld its consent to a sub-lease of the collateralized aircraft, thereby impeding defendants' repayment of the loan, and (2) that plaintiff's request for an award of attorney's fees is inflated and unreasonable.

Based on the evidence adduced at a hearing conducted on

April 9, 2012, and in the parties' post-hearing briefing, we conclude that judgment should be entered in favor of plaintiff in the amount of \$3,074,728.09 in principal, \$465,730.50 in interest as of April 9, 2012, \$51,973.24 in late charges, \$111,667.73 in fees and \$3,263.58 in expenses.

*I. The Factual Background*

*A. The Loan*

On July 31, 2000, Boeing 226260 Holdings, Inc. ("Boeing") and CIT Group/Equipment Financing, Inc. ("CIT") entered into an agreement embodied in two documents, the Secured Term Promissory Note and the Loan Agreement. Under the terms of the agreement, CIT loaned Boeing \$9,367,460.00 to purchase and upgrade a Boeing 737 aircraft for use by Mr. Gary and his law firm, Gary, Williams, Finney, Lewis, & McMannus. (Pl.'s Post-Inquest Exs. 1 & 2; Tr. 6). Boeing agreed to make 180 consecutive fixed monthly payments of \$98,780.53, followed by a balloon payment of \$4,722,616.39. (Pl.'s Post-Inquest Ex. 2 § 3). It also agreed to cover CIT's costs and expenses, including attorney's fees. (*Id.* Ex. 2 at § 13; Tr. 9).

Boeing and CIT also entered into a Security Agreement, which granted CIT a security interest in the Boeing 737 aircraft ("the Aircraft") that was to be purchased with the loan. (Pl.'s Post-Inquest Ex. 3). The Security Agreement included several provisions that restricted the borrower's ability to transfer rights under the agreement. Section 5.01 of the Security Agreement stated, in general terms, that "the Borrower may not assign or transfer any of its rights under this Agreement without the prior written consent of the Secured Party." More specifically, the Security Agreement prohibited the transfer of any rights in the Aircraft (*id.* Ex. 3 at § 3.14(c)) or in any part of the Aircraft, without the lender's prior written consent. (*Id.* Ex. 3 at § 3.24). In addition, the Security Agreement provided that all covenants would be binding on each party and its successors and assigns. (*Id.* Ex. 3 at § 5.01). In the event of a default on the loan, the Security Agreement stipulated, *inter alia*, that "[a]ll reasonably necessary costs and expenses incurred by the Secured Party in connection with enforcement and/or exercise of any of its rights or remedies herein shall be immediately payable by the Borrower, upon demand." (*Id.* Ex. 3 at § 4.02(e)).

\*2 As further protection to the lender, defendant Mr. Gary executed a Loan Guaranty Agreement, under which he guaranteed Boeing's debt to CIT. (*Id.* at Ex. 4). In the

event of a default on the loan, Mr. Gary also agreed to pay the costs of collection, including reasonable attorney's fees. (*Id.* Ex. 4 at § 18). He further agreed that his obligations under the Guarantee Agreement would not be subject to reduction, limitation, impairment, or termination for any reason, including any asserted right to a setoff. (*See id.* Ex. 4 at § 4).

On July 30, 2003, Boeing assigned all of its rights, duties, and obligations under the Promissory Note, the Original Loan Agreement, and the Security Agreement to the defendant Gary 737, LLC. (*Id.* at Ex. 5). Subsequently, on August 12, 2005, CIT assigned all of its rights under the various loan documents to plaintiff GE Capital. (*Id.* at Ex. 6).

#### B. Restructuring and Modifying the Loan Agreement

In 2009, defendants approached plaintiff seeking to restructure the terms of the loan, due to economic difficulties that defendants were experiencing. (Tr. 14). On May 29, 2009, the parties entered into an agreement ("Amended Promissory Note") to modify the terms of the Promissory Note. (Pl.'s Post-Inquest Ex. 7). At the time, the outstanding principal balance on the loan was \$3,405,638.53. (*Id.* Ex. 7 at 1). Under the terms of the Amended Promissory Note, defendants' monthly payments were reduced to \$25,000.00 for a period of seven months, to be followed by twenty-two monthly payments of \$98,780.50 and a final balloon payment. (*Id.* Ex. 7 at 1-2). In a Restructuring and Security Agreement, defendants further agreed to pay "all expenses incurred in collection, including Lender's actual attorney's fees." (*Id.* Ex. 8 at § 7). The defendants also reaffirmed their obligations as set forth in the original loan documents. (*Id.* Ex. 8 at §§ 3, 4). Under the Restructured Security Agreement, the law firm Gary, Williams, Finney, Lewis, Watson & Sperando, P.L. pledged additional collateral, consisting of \$1,000,000.00 in anticipated attorney's fees associated with two specific lawsuits. (*Id.* Ex. 8 at § 2; Tr. 19-20).

On March 31, 2010, the parties once again agreed to modify the loan ("2010 Modification Agreement"), providing for a revised schedule of payments under the Amended Promissory Note. (Pl.'s Post-Inquest Ex. 9). Under the terms of the 2010 Modification Agreement, defendants were to make five monthly payments of \$25,000.00, followed by six monthly payments of \$50,000.00, then eight monthly payments of \$98,780.50, to be followed by a balloon payment of all outstanding debt, fees, costs and expenses owed to GECC. (*Id.* Ex. 9 at §§ 9(a)-(d)). The defendant law firm pledged additional anticipated attorney's fees as collateral for the loan. (*Id.*

Ex. 9 at § 2; Tr. 19-21).

Despite the numerous modifications to facilitate defendants' repayment of the loan, as of April 9, 2012, when the inquest hearing was conducted, defendants owed \$3,074,728.09 in outstanding principal alone. (Tr. 27). Documentation and testimony from the inquest hearing reflects that accumulated unpaid interest as of April 9, 2012 amounted to \$465,730.50, with late charges totaling \$51,973.21. (Pl.'s Post-Inquest Ex. 10; Tr. 27-28).

#### C. Requests to Lease the Aircraft

\*3 Before defendants approached plaintiff seeking a modification to the loan, they sought to obtain plaintiff's consent to several proposed sub-leases of the Aircraft. In each case, plaintiff refused to grant its consent. Accordingly, defendants now argue that they are entitled to a set-off, presumably because they believe that plaintiff failed to mitigate its damages by denying defendants a potential source of cash-flow that could have serviced the loan.

On June 15, 2008, a representative of Gary's law firm, Keith Swirsky, contacted GECC seeking GECC's consent to a sub-leasing of the Aircraft to a Swiss entity, Savfin Air. Shortly thereafter, Swirsky revised defendant's request, substituting JP Air OU as the proposed sub-lessee. Defendants provided GECC with a draft lease agreement setting forth the terms of the proposed sub-lease, which included monthly payments of \$120,000.00. (Tr. 86; Pl.'s Post-Inquest Ex. 12).

On July 23, 2008, a representative of GECC contacted the broker for the proposed sub-lease, seeking further information concerning (i) the identity of the ultimate lessor in the arrangement; (ii) whether JP Air OU was operating as a special purpose entity for a charter company; and (iii) the reason for JP Air OU's incorporation in Estonia, when the proposed lease contemplated that the aircraft would be hangared in Dubai. (Def.'s Ex. M). Plaintiff also requested copies of JP Air OU's articles of incorporation, ownership information, and information concerning the company's principals. (*Id.*).

In his August 28, 2008 answer to plaintiff's query, the broker responded tersely, noting that JP Air OU had been established in Estonia "because of tax reasons" and because Estonia had a "first class world wide recognized European EASA AOC." (Def.'s Ex. N). In lieu of providing the requested corporate documents, the broker sent GECC a link to the JP Air OU website and offered

his endorsement of JP Air OU's owner's experience in cargo movements. (*Id.*). Plaintiff reports that it received no additional information from defendants concerning JP Air OU. (Tr. 11).

On September 3, 2008, GECC emailed defendants, notifying them that it did not consent to sub-leasing the aircraft to JP Air OU. (Def.'s Ex. O). GECC's representative indicated that if Mr. Gary wished to lease the aircraft, he could either provide a letter of credit for the outstanding balance, "pay off the note on the Aircraft, or seek alternate funding." (*Id.*). In explaining GECC's refusal of consent to the JP Air OU lease, GECC's representative testified that GECC's experience was limited to financing aircraft hangared and operated within the United States and registered with the Federal Aviation Administration. He further stated that if the aircraft had been stationed in Dubai and registered to an Estonian company, it would cease to have any value as collateral to GECC. (Tr. 113).

In March 2009 defendants approached plaintiff with a second proposed lease of the Aircraft, this time to a company called Propjet, which apparently intended to sub-lease the Aircraft to another entity, Starjet. (*Id.* at 104). As before, GECC requested certain financial information about the potential lessee and sublessee, including three years of financial statements and tax returns. On March 13, 2009, plaintiff sent defendants' representative an email advising that such financial information was necessary for plaintiff to evaluate the proposal. (Pl.'s Post-Inquest Ex. 12). Nonetheless, defendants failed to provide any such information, and their representative did not inquire further regarding the proposed Propjet/Starjet deal. (Tr. 105-06).

\*4 Plaintiff subsequently prepared an internal memorandum that summarized its reasons for rejecting the proposed Propjet/Starjet lease and sub-lease. It stated that defendants' application had been rejected because (1) defendants had refused to provide the documents that GECC requested as part of its normal due diligence process; (2) defendants' representative had refused to allow GECC to speak directly with representatives from either Propjet or Starjet; and (3) defendants' representatives had later informed plaintiff that they did not wish to continue with the transaction. (Pl.'s Post-Inquest Ex. 13).

## II. Analysis

### A. The Set-Off Issue

Defendants acknowledge that the terms of the loan

agreement between the parties prohibited defendants from leasing or otherwise transferring control of the aircraft without prior written consent from GECC. Defendants assert, however, that they proposed to plaintiff a reasonable leasing arrangement with JP Air OU, which would have paid plaintiff \$120,000.00 per month, an amount exceeding defendants' monthly payment obligation under the terms of the parties' loan agreement. Accordingly, defendants argue that they are entitled to a set-off of the amounts that would have been realized under the proposed leasing agreement with JP Air OU, but for plaintiff's allegedly unreasonable refusal of consent to the agreement. For the reasons set forth below, defendants' argument cannot stand.

First, the Loan Guarantee Agreement explicitly specified that defendants waived any right to assert a set-off in the event of a default. (*Id.* Ex. 4 at § 4). This alone is a sufficient basis to reject defendants' theory.

Second, the Loan Agreement and subsequent loan documents specified that any assignment, lease or other transfer of any interest in or possession of the Aircraft or any of its parts required prior written approval by the lender. Notably, the agreement did not require the lender to have a reasonable basis for withholding such consent (*see id.* Ex. 3 at § 3.14(c)), and under New York law, when "a contract negotiated at arm's length lacks specific language preventing plaintiff from unreasonably withholding consent, the Court can not and should not rewrite the contract to include such language which neither of the parties saw fit to insert in the contract." *Teachers Ins. & Annuity Ass'n of Am. v. Wometco Enters., Inc.*, 833 F.Supp. 344, 349 (S.D.N.Y.1994); *see, e.g., State St. Bank & Trust Co. v. Inversiones Errazuiriz Limitada*, 374 F.3d 158, 170 (2d Cir.2004) (addressing a bank's right to unreasonably withhold consent under a credit agreement); *United States v. Epstein*, 27 F.Supp.2d 404, 413 (S.D.N.Y.1998) (addressing landlord's ability to arbitrarily withhold consent to sub-lease of real estate). Indeed, absent an explicit requirement that any withholding of consent must be reasonable, a provision requiring a lessor's prior consent will be interpreted to allow the refusal of consent "for any reason or no reason." *Dress Shirt Sales, Inc. v. Hotel Martinique Assocs.*, 12 N.Y.2d 339, 342, 239 N.Y.S.2d 660, 662 (1963); *see also Sharma v. Chem. Bank*, 723 F.Supp. 200, 201-02 (S.D.N.Y.1989); *Lippman v. Dime Savings Bank of New York, FSB*, 262 A.D.2d 52, 53, 691 N.Y.S.2d 437, 438 (1st Dep't 1999).

\*5 In this case, defendants agreed under the Security Agreement that they would "not directly or indirectly assign, convey or otherwise transfer any of [their] right,

title or interest in the Collateral without the prior written consent of the Secured Party,” (Pl.’s Post-Inquest Ex. 3 § 3.14(c)) and that, without prior consent of plaintiff, they would not “transfer any right, title, or interest in Airframe, Engine, or any Part.” (*Id.* Ex. 3 at § 3.24). These provisions were unconditional and did not limit the lender’s right to refuse consent to such a transfer, unreasonably or otherwise. We note that these terms were reincorporated in the successor versions of the parties’ loan agreement. (*See id.* Ex. 8 at § 4, Ex. 9 at § 5). Plaintiff acted within its contractual rights in refusing to consent to defendants’ various leasing proposals. Since defendants do not allege any legal or factual basis for invalidating the loan agreement, they are bound by the terms of their contract and are not entitled to any set-off of damages.

As an aside, we note that, even if the parties’ agreement had included a requirement that plaintiff could not unreasonably withhold consent to a proposed lease, defendants still would not be entitled to a set-off because, under the circumstances, plaintiff’s conduct was entirely reasonable. In assessing the reasonableness of a party’s withholding of consent for a sub-lease, courts will consider (a) the proposed sub-lessee’s financial responsibility, (b) the “identity” or “business character” of the sub-lessee, (c) the legality of the proposed use and (d) the nature of the use or occupancy. *See Am. Book Co. v. Yeshiva Univ. Dev. Found., Inc.*, 59 Misc.2d 31, 33–34, 297 N.Y.S.2d 156, 160 (Sup.Ct.1969). The “subjective concerns and personal desires” of a lessor are not taken into account in assessing the lessor’s decision to withhold consent; rather, the lessor’s decision must be judged by an objective standard. *See Saved v. Rapp*, 10 A.D.3d 717, 720, 782 N.Y.S.2d 278, 281 (2d Dep’t 2004); *Astoria Bedding, Mr. Sleeper Bedding Ctr. Inc. v. Northside P’ship*, 239 A.D.2d 775, 776, 657 N.Y.S.2d 796, 797 (3d Dep’t 1997); *Ontel v. Helasol Realty Corp.*, 130 A.D.2d 639, 640, 515 N.Y.S.2d 567, 568 (2d Dep’t 1987).

Given these criteria, plaintiff cannot be said to have acted unreasonably in refusing consent to either of the proposed leases of the Aircraft. When advised of the possible lease to Safvin, which was subsequently recast as a proposed lease to JP Air Ou, GECC requested essential financial information and other background documentation about the proposed lessee, as well as an explanation as to why the arrangement involved a Estonia-based company with the aircraft to be located in Dubai. Defendants did not provide plaintiff with the requested information. Instead, defendants’ representative simply directed plaintiff to JP Air Ou’s website, volunteered its own opinion that the proposed lessee was reliable, and provided the unenlightening explanation that JP Air Ou was based in

Estonia for “tax” reasons. Defendants’ failure to provide “timely [and] adequate information” about a proposed lessee is itself a proper basis to refuse consent because defendants did not provide plaintiff with sufficient information from which to ascertain whether the proposed lessee was likely to be financially responsible. *See 200 Eighth Ave. Rest, Corp. v. Daytona Holding Corp.*, 293 A.D.2d 353, 353, 740 N.Y.S.2d 330, 331 (1st Dep’t 2002). Such failure by defendants to cooperate with plaintiff’s effort at due diligence fully justified GECC’s refusal of consent to the proposed lease.

\*6 Even if defendants had provided plaintiff with adequate information and documentation on which to independently assess JP Air Ou’s financial security and responsibility, plaintiff still might have reasonably refused consent to the lease in view of the fact that, by relocating the Aircraft to Dubai under the supervision of an Estonian company, the arrangement would have made it more difficult for plaintiff to repossess the Aircraft, which served as collateral securing defendants’ loan. In short, to consent to the proposed lease would have exposed GECC to far greater risk than it originally faced under the operative loan arrangements, and GECC was fully justified in refusing to consent to such a proposal.

As for the second proposed leasing/sub-leasing agreement, we conclude that defendants failed to provide plaintiff with any meaningful information that could have informed plaintiff of the financial viability of the proposed arrangement. As with the first proposal, we conclude that plaintiff acted reasonably in refusing its consent to defendants’ request.

In sum, there is no basis to allow defendants a set-off on the amounts that they owe under the loan and guarantee agreements.

#### B. Attorneys’ Fees

Plaintiff has asserted a claim for fees and expenses in the amount of \$114,931.31, of which \$111,667.73 represents fees incurred (1) in dealing with the various amendments of the loan payment schedules and (2) in pursuit of GECC’s contractual remedies for defendants’ default. Defendants argue that the fee request is unreasonable because the amount of legal work required by the case is far less than what would justify such a substantial fee.

The parties’ original loan agreement entitled plaintiff to “reasonable” fees and actual expenses in connection with the preparation of the loan documents and the enforcement of its rights in the event of a default. (*See* Pl.’s Post-Inquest Ex. 2 § 7(a)). However, this term was

subsequently modified by the parties, rendering defendants responsible for fees and expenses actually incurred by plaintiff. (See *id.* Ex. 3 at § 4.02(e)). Plaintiff nonetheless submits that its request for fees and expenses should be assessed under a reasonableness standard, typically referred to as a lodestar analysis. (Pl. Post-Inquest Mem. at f 24); see, e.g., *AXA Inv. Mgrs. UK Ltd. v. Endeavor Cap. Mat. LLC*, 2012 WL 6217168, \*1 (S.D.N.Y. Dec. 6, 2012) (applying lodestar analysis to contractual award of fees and expenses).

In determining a “presumptively reasonable fee,” *Arbor Hill Concerned Citizens Neighborhood Ass’n v. Crty. of Albany*, 522 F.3d 182, 190 (2d Cir.2008), the court takes into account “(1) a consideration of the number of hours actually spent by counsel and other personnel that are deemed reasonably necessary to the successful outcome for the client and (2) the setting of reasonable hourly rates for counsel, a criterion most recently, if opaquely described as ‘the rate a paying client would be willing to pay.’” *Briese Lichttechnik Vertriebs GmbH v. Langton*, 2011 WL 4756252, at \*1 (S.D.N.Y. Oct. 7, 2011) (quoting *Briese Lichttechnik Vertriebs GmbH v. Langton*, 2010 WL 3958737, at \*1 (S.D.N.Y. Oct. 4, 2010)). The resulting figure, commonly referred to as the lodestar,<sup>2</sup> is not “conclusive in all circumstances,” but “there is ‘a strong presumption’ that the lodestar figure is reasonable.” *Perdue*, 130 S.Ct. at 1673; accord *Millea*, 658 F.3d at 166.

\*7 In determining how much attorney time should be compensated, the court looks to the amount of time spent on each category of tasks, as reflected in contemporaneous time records, e.g., *Malletier v. Dooney & Bourke, Inc.*, 2007 WL 1284013, at \*1 (S.D.N.Y. Apr. 24, 2007) (citing *New York Ass’n for Retarded Children, Inc. v. Carey*, 711 F.2d 1136, 1142–43, 1147 (2d Cir.1983)), and then, to the best of its ability, should determine how much of that time was “reasonably expended.” *Id.* (internal quotations omitted). To do so “the court looks to its own familiarity with the case and ... its experience generally as well as to the evidentiary submissions and arguments of the parties.” *Clarke v. Frank*, 960 F.2d 1146, 1153 (2d Cir.1992) (internal quotations omitted). If the court finds that some of the time spent was not reasonably necessary to the outcome, it should reduce the time for which compensation is awarded. See, e.g., *Hensley v. Eckerhart*, 461 U.S. 424, 433–37 (1983); *Gierlinger v. Gleason*, 160 F.3d 858, 876 (2d Cir.1998). Such reductions are appropriate not only for work on unsuccessful claims and arguments, but also for inefficient or duplicative work. See *Hensley*, 424 U.S. at 434–35; *In re Agent Orange Prod. Liab. Litig.*, 818 F.2d 226, 237 (2d Cir.1987). “In reducing a claim for time

spent, the court may ‘use a percentage deduction “as a practical means of trimming fat from a fee application.”’ *Malletier*, 2007 WL 1284013, at \*1 (quoting *McDonald v. Pension Plan of the NYSA-ILA Pension Trust Fund*, 450 F.3d 91, 96 (2d Cir.2006)).

To determine an appropriate hourly rate, the court initially “looks to ‘the prevailing market rates in the relevant community.’” *Perdue*, 130 S.Ct. at 172 (quoting *Blum v. Stenson*, 465 U.S. 886, 895 (1984)). This traditional rule requires the court to look to rates “prevailing in the community for similar services by lawyers of reasonably comparable skill, experience and reputation.” *Blum*, 465 U.S. at 895 n. 11; see also *McDonald*, 450 F.3d at 96. Recently the Second Circuit has suggested that the court should engage in a somewhat broader and more variegated analysis, under which it not only looks to the community-based measure of rates, but also takes into consideration a broader array of factors, first proposed by the Fifth Circuit in *Johnson v. Ga. Highway Express, Inc.*, 488 F.2d 714 (5th Cir.1974), in order to arrive at a presumptively reasonable fee.<sup>3</sup> According to *Arbor Hill*, the aim is to arrive at a rate that “a paying client would be willing to pay,” with the court expected to “bear in mind that a reasonable, paying client wishes to spend the minimum necessary to litigate the case effectively.” 522 F.3d at 190; see *Simmons v. N.Y.C. Transit Auth.*, 575 F.3d 170, 174 (2d Cir.2009).

In this case, plaintiff seeks reimbursement for approximately 373 hours of legal work by an array of senior and junior attorneys from 2008 to 2012, at hourly rates ranging from \$300.00 to \$440.00, although the top rates were reduced to \$300.00 in 2009. (See Pl.’s Post-Inquest Ex. 11 at 47; Tr. 51). As for expenses, they reflect modest amounts for travel, copying, filing fees and related matters. (See Pl.’s Post-Inquest Ex. 11 at 47).

\*8 Defendants do not challenge the hourly rates at which counsel billed plaintiff. Rather, they assert that the fees are unreasonable because the amount of legal work warranted by the nature of the case seems disproportionate to the amount of work allegedly performed. (Def.’s Post-Inquest Brief 12). In particular, defendants rely on the facts that they conceded liability at the first court conference and that there have been no depositions or other discovery taken in this lawsuit.<sup>4</sup> In response, plaintiff notes that defendants do not specify any time entries or work done by plaintiff’s attorneys’ that is unreasonable, and observes that the work involved more than simply litigating this case. (Pl.’s Post-Inquest Brief 9). We agree that defendants’ largely *pro forma* criticism of the fee total is unconvincing.

The work reflected in the billings extended beyond “merely drafting a complaint and appearing for a court conference.” (Tr. 51–56). The law firm was involved in negotiating and drafting a series of restructuring agreements, and it later engaged in settlement efforts, as well as preparing the ground for a successful litigation of GECC’s claims. (Tr. 59).

An examination of the attorneys’ billing report reveals that the attorneys spent time reviewing the existing loan documents, negotiating and drafting the new restructuring documents, communicating with other lawyers and with defendants’ representatives in person as well as over the phone and via email, performing legal research and analysis, discussing the case with their client and, finally, drafting the necessary pleading (including an amended complaint), attending several pretrial conferences and otherwise pursuing the case through to the damages hearing. (Pl.’s Post-Inquest Ex. 13) In addition, plaintiff’s counsel significantly discounted the otherwise defensible hourly rates of its senior attorneys for a large part of the time they worked, thereby mitigating any doubts about the number of hours reasonably expended.

In sum, based upon our review of plaintiff’s attorneys’ billable hours, and in the absence of any specific or persuasive critique of the hours by defendants, we conclude that the time spent and the total of the fees charged are not unreasonable. As for the disbursements, defendants do not address them, and we conclude that they are also reimbursable under the contract.

## CONCLUSION

For the reasons stated, we recommend that judgment be entered in favor of plaintiff GECC awarding it \$3,074,728.09 in principal, \$465,730.50 in interest as of April 9, 2012, \$51,973.24 in late charges, \$111,667.73 in attorney’s fees, and \$3,263.58 in expenses. Otherwise stated, judgment should be entered for plaintiff in the sum of \$3,607,363.14.

Pursuant to Rule 72 of the Federal Rules of Civil Procedure, the parties shall have fourteen (14) days from this date to file written objections to this Report and Recommendation. Such objections shall be filed with the Clerk of the Court and served on all adversaries, with extra copies to be delivered to the chambers of the Honorable Andrew L. Carter, Jr., and to the chambers of the undersigned. Failure to file timely objections may constitute a waiver of those objections both in the District Court and on later appeal to the United States Court of Appeals. See *Thomas v. Arn*, 474 U.S. 140, 150 (1985); *Small v. Sec’y of Health & Human Servs.*, 892 F.2d 15, 16 (2d Cir.1989); 28 U.S.C. § 636(b)(1); Fed.R.Civ.P. 72, 6(a), 6(e).

## All Citations

Not Reported in F.Supp.2d, 2013 WL 390959

## Footnotes

- 1 In a recent opinion the Supreme Court has articulated a somewhat different description of what the goal of the analysis is, albeit in the context of a civil rights case, when it said that “a ‘reasonable’ fee is a fee that is sufficient to induce a capable attorney to undertake the representation of a meritorious civil rights case.” *Perdue v. Kenny A.*, 130 S.Ct. 1662, 1672 (2010).
- 2 The term “lodestar” has recently had a somewhat up-and-down fate in the Second Circuit. After years of usage of this term, the Second Circuit seemed to banish it in the series of *Arbor Hill* opinions, see *Arbor Hill*, 522 F.3d at 188–90, but it has since made a comeback after the Supreme Court utilized it in 2011 without questioning its appropriateness as a descriptor of the required fee analysis. *Perdue*, 130 S.Ct. at 1672–73; see also *Millea v. Metro-N. R.R. Co.*, 658 F.3d 154, 166–69 (2d Cir.2011); *Blessing v. Sirius XM Radio Inc.*, 2012 WL 6684572, \*2 (2d Cir. Dec. 20, 2012); *Lucerne Textiles, Inc. v. H.C.T. Textiles Co., Ltd.*, 2013 WL 174226, \*5 (S.D.N.Y. Jan. 17, 2013).
- 3 The court in *Johnson* invoked a series of twelve factors to inform a reasonable-fee determination, including: (1) the time and labor required; (2) the novelty and difficulty of the questions; (3) the level of skill required to perform the legal service properly; (4) the preclusion of employment by the attorney due to acceptance of the case; (5) the attorney’s customary hourly rate; (6) whether the fee is fixed or contingent; (7) the time limitations imposed by the client or the circumstances; (8) the amount involved in the case and the results obtained; (9) the experience, reputation, and ability of the attorneys; (10) the ‘undesirability’ of the case; (11) the nature and length of the professional relationship with the client; and (12) awards in similar cases. *Arbor Hill*, 522 F.3d at 186 n. 3 (citing *Johnson*, 488 F.2d at 717–19).

- 4 Defendants also claim that had plaintiff genuinely wished to resolve this case, it would have joined this case to a similar action by another creditor brought in the Northern District of New York. (Def.'s Post-Inquest Brief, 12). Defendants are presumably suggesting that plaintiff is incurring unnecessary fees by litigating this claim separately in this district. Although efficiency is a laudable goal, plaintiff is entitled to bring its case in the forum that it deems most convenient and appropriate. See *Domoch Ltd. ex rel. Underwriting Members of Lloyd's Syndicate 1209 v. PBM Holdings, Inc.*, 666 F.Supp.2d 366, 372 (S.D.N.Y.2009); *Schmidt v. Am. Flyers Airline Corp.*, 260 F.Supp. 813, 815 (S.D.N.Y.1966). There is no legal basis for barring recovery of attorney's fees based on this argument.

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