No. 909873

SUPREME COURT OF THE STATE OF WASHINGTON

FEDWAY MARKETPLACE WEST, LLC, and GARLAND & MARKET INVESTORS, LLC,

Petitioners,

v.

THE STATE OF WASHINGTON,

Respondent.

RESPONDENT'S ANSWER TO PETITION FOR DISCRETIONARY REVIEW

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I. INTRODUCTION

Discretionary review is not warranted here. Fedway Marketplace West, LLC, and Garland & Market Investors, LLC, (Landlords) do not seek review of any of the causes of action in their complaint, which was dismissed on a motion for judgment on the pleadings.

Instead, abandoning the causes of action actually stated in their complaint and rejected by the Court of Appeals, the Landlords seek discretionary review regarding a cause of action they waited to raise until their reply brief in the Court of Appeals. In that reply brief, they alleged for the first time that Initiative 1183 (I-1183) conferred upon them a property right, and that alleged right, not the property rights of the leases, was taken by the State. Further, they allege that the taking did not occur through termination of the leases as stated in the complaint but rather by adoption of a relocation policy that the complaint does not allege was ever applied to them. This is an entirely new and different takings claim than the one Landlords proffered in their complaint, in the Superior Court, and in their opening brief to the Court of Appeals, where they contended that the Liquor Control Board (Board) took a property interest in their leases via lease termination.

Settled principles of law mandate denial of the petition for discretionary review under these circumstances. It is settled law that new

causes of action may not be raised on appeal. It is settled law that plaintiffs such as the Landlords must establish standing, but here they have failed to show any injury-in-fact resulting from the relocation policy. It is settled law that indispensable parties must be joined; but here, the persons who bought the right to sell liquor at the former state liquor stores are not parties.

Even if the Court were to consider the new cause of action, discretionary review is still not justified under RAP 13.4(b) because the Landlords have raised no constitutional issue or substantial issue of public interest meriting this Court's review. The Landlords' claim of a statutorily conferred property right in increased bargaining power over tenants is totally lacking in support. No language in I-1183 mentions or contemplates that landlords exist, let alone that I-1183 was intended to provide them increased bargaining power. Rather, the drafters of I-1183 evidenced their belief that the stores were owned by the state and not the landlords when they referred to the stores in I-1183 as "state-owned stores."

Further, I-1183 directed the Board to administer the initiative in a way to avert harm to certain affected groups. None of the groups listed included landlords. The only apparent reason in I-1183 for not allowing relocation, if it actually does not allow relocation, is to prevent relocation

to a "trade area" already served by a retail spirits license holder. Nothing in I-1183 indicates that providing a special benefit to landlords would be a primary reason for a relocation prohibition, if one exists.

In summary, the Landlords possess no property right conferred by I-1183 on which to base their new takings claim.

II. RESTATEMENT OF THE ISSUES

Discretionary review is not merited in this case, but if review were granted, the following issues would be presented:

1. Is the Landlords' takings claim based on a property right allegedly conferred by I-1183 procedurally barred because (i) the claim presents a new cause of action not included in their complaint that cannot be initially raised on appeal, (ii) Landlords have not met their burden to show standing to raise that takings claim, and (iii) Landlords have failed to join indispensable parties to that claim.

2. Does I-1183 confer a property right to increased bargaining power for which the Landlords are, under the facts presented, entitled to takings compensation?

III. RESTATEMENT OF THE CASE

A. The Leases and I-1183.

Landlords are former lessors of two State liquor store locations. Clerk's Papers (CP) 4. The leases for both stores were for a term of ten

years and included a termination clause, which provided that if a newly enacted law prevented either party from complying with the lease, then the lease would terminate and both parties would be released from all liability. CP 22, 33. In November 2011, Washington voters approved I-1183, which privatized the State-controlled system of liquor distribution and sale, effective December 8, 2011, now codified as RCW 66.24.620. I-1183 directed the Board to cease all liquor sales no later than June 1, 2012, and to auction "the right at each state-owned store location of a spirits retail licensee to operate a liquor store upon the premises." RCW 66.24.620(4)(c).

To implement I-1183, the Board auctioned the rights to sell liquor at its 167 state-run liquor store locations. Each of the successful bidders received the exclusive right to apply for a license to sell liquor at the store on which the bid had been placed. The Board advised each bid winner (1) to secure a lease with the store's landlord; and (2) if unable to secure such a lease, to consider (a) re-selling the right to sell liquor at that location or (b) requesting "an alternative location within a one-mile radius of the existing location." CP 8. Before terminating its leases, the Board sent letters to its liquor store lessors, including Landlords, notifying them of the upcoming lease terminations. CP 41-42. The

Board terminated its Fedway lease effective May 31, 2012, and its Garland lease effective July 31, 2012. *Id.*

B. Proceedings Below and Inadmissible Extrinsic Evidence.

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

The Amended Complaint limited its takings claims to alleged takings of property interests created by the leases, stating as follows: "A contract with the state is a property interest that is protected by the State Takings Clause . . . If the [State] is correct that the Store Leases were automatically terminated by the enactment of I-1183, then the enactment of I-1183 eliminated the Class members' contractual property interest."[1]

The State moved for judgment on the pleadings under CR 12(c). Landlords opposed the State's motion with extensive exhibits. The State moved to strike the evidence as irrelevant to showing the meaning of the specific terms of the leases (CP 472-505), and the superior court granted

[1] CP at 17-18. A copy of the takings claims in the Amended Complaint is attached as Appendix A.

the State's motion to strike (CP 538-39). The superior court also granted the motion for judgment on the pleadings, ruling that I-1183 triggered the termination clause under the leases and therefore the Board had not improperly terminated the leases, breached a duty of good faith and fair dealing, or caused a taking or impairment of a property interest in the leases. Verbatim Report of Proceedings at 43-44.

The Court of Appeals affirmed the superior court in all respects. It found the termination provision to be unambiguous in terminating the leases due to the closure of the state-stores mandated by I-1183. *Fedway Marketplace West, LLC v. State*, __Wn. App. __, 336 P.3d 615, 619-20 (2014). The Court of Appeals specifically rejected the Landlords' extensive arguments relating to the Board's policy to allow relocation as "irrelevant" to the question of termination.[2] Based upon its holding that the Board lawfully terminated the leases pursuant to their termination provisions, the court affirmed the entry of judgment on the pleadings of all claims set forth in the complaint. *Id.*

The Court of Appeals also affirmed the order striking the Landlords' extrinsic evidence relating to relocation and other topics on

[2] The court stated: "Regardless of whether the State permitted bid winners to choose alternate liquor store locations, or instead required bid winners to use the Landlords' original store locations bid upon, the State could not continue leasing Landlords' properties for the leases' contractual purpose of providing locations for the State to sell liquor." *Fedway*, 336 P.3d at 620 (footnote omitted).

grounds that it was irrelevant to showing the meaning of any specific terms of the leases. *Fedway,* 336 P.3d at 621. The Landlords' Petition does not seek review of the Court of Appeals' ruling striking the extrinsic evidence. For that reason, the extensive citations to and descriptions of the extrinsic evidence in the Petition are improper. The excluded extrinsic evidence referenced in the Petition that should not be considered in this review is shown in strike-out on the pages of Petition attached as Appendix B.[3]

C. The Landlords' Takings Claims.

The Court of Appeals upheld the dismissal of the "takings" claims in the complaint summarizing its holding as follows: "We hold that the State did not commit an unconstitutional taking by exercising the lease termination provision when enactment of the new law prohibiting the State from selling liquor rendered it unable to perform under the leases." *Fedway,* 336 P.3d at 624.

The Petition seeks review of the claim that a takings occurred of property rights allegedly "conferred by I-1183" rather than property rights created by the leases, as alleged in the complaint.[4] No mention of an

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[3] *See Engstrom v. Goodman*, 166 Wn. App. 905, 909 n.2, 271 P.3d 959, *review denied*, 175 Wn.2d 1004, 285 P.3d 884 (2012) (party may point out improper evidence that the Court should not consider in a brief; it is not necessary to file a motion to strike).

[4] Compare takings claims set forth in paragraphs X and XI of Amended Complaint (attached in Appendix A) to Petition for Discretionary Review at 14

alleged property right conferred by I-1183 appears in the Landlords' Opening Brief in the Court of Appeals. The only reference to "rights conferred on landlords by I-1183" came on the last page of the Reply Brief of Appellants, filed in the Court of Appeals (Appendix C), but without any description of the alleged rights or reference to the language in the I-1183 that allegedly supports such rights.

The Court of Appeals did not discuss the issue whether I-1183 confers any property rights on Landlords. Immediately after discussing the Landlords' regulatory takings argument, the court summarized its holding on the takings claims by referring to the lawful lease termination. *Fedway,* 336 P.3d at 624.

The Petition seeks review solely of the new takings claim alleging that the Board's relocation policy caused a taking of property rights that Landlords allege I-1183 conferred on landlords to have increased bargaining power in leasing the former store to the persons who bought the right to sell liquor at the store. Pet. at 14-15. The Petition describes the property rights as arising from the "existing location requirement" in I-1183. Pet. at 15. It asserts the existing relocation requirement was "structured so that landlords of state-owned liquor stores would have 'leverage' with persons purchasing at auction the right to operate the

("Petitioner's [sic] right to the substantial benefits conferred by I-1183 was a property interest") & 15 ("I-1183 gave state-store landlords a property interest . . . ").

former store" and was intended "to mitigate the obvious harms landlords would suffer from the closure of the state stores." Pet. at 14-15.

The Petition does not seek review of any of the causes of action contained in the complaint that were dismissed on the motion for judgment on the pleadings, including the holding that I-1183 triggered the termination clause of the leases and that no takings occurred of the lease property rights.

IV. REASONS WHY REVIEW SHOULD BE DENIED

A. The Petition Seeks Review of a Takings Claim that is Procedurally Barred Because (i) It Raises A New Cause of Action Not Alleged in the Complaint and Raised First in An Appeals Brief; (ii) Landlords have not met their burden to show standing; and (iii) Indispensable Parties to the Takings Claim Have Not Been Joined.

Numerous procedural bars make this case particularly ill- suited for this Court's review. As described above, the Petition seeks review of a new cause of action for takings of property not contained in the complaint that the superior court dismissed on the State's motion for judgment on the pleading. The new takings claim asserts a different act of taking than the one in the complaint (State's adoption of a relocation policy *versus* State's termination of the leases) and a different property right than the one in the complaint (a right to bargaining leverage alleged to be conferred by I-1183 *versus* a right to damages for breach conferred

by the leases). *See supra* n. 4. New causes of action require the amendment of a complaint under CR 15 and cannot first be raised on appeal. *Prater v. City of Kent*, 40 Wn. App. 639, 642, 699 P.2d 1248, 1251 (1985) (new causes of action may not be raised for the first time on appeal).

Because the Landlords did not raise this cause of action in the trial court, critical procedural issues prevent this claim from being heard on appeal. With respect to the factual allegations required to establish injury-in-fact standing, the Landlords have failed to meet their burden to show injury-in-fact standing on the record before this court.[5] The complaint contains no allegations that the State granted a relocation request for the location of each of the two former state-operated stores that the landlords own or that the buyers of rights to sell liquor at the stores applied for or imminently intend to apply for such relocation. See CP at 8. And even if the Court considered evidence stricken by the trial

[5] Where a party lacks standing for a claim, the courts refrain from reaching the merits of that claim. *Org. to Preserve Agric. Lands v. Adams County,* 128 Wn.2d 869, 896, 913 P.2d 793 (1996). To prove standing, Landlords must show an actual "injury fairly traceable to the challenged conduct and likely to be redressed by the requested relief." *See State v. Johnson*, 179 Wn.2d 534, 552, 315 P.3d 1090, 1099 (2014). *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560-61, 112 S. Ct. 2130, 2136, 119 L. Ed. 2d 351 (1992) (three elements required for constitutional standing: (1) the plaintiff must have suffered an "injury in fact"—an invasion of a legally protected interest which is (a) concrete and particularized, and (b) "actual or imminent, not 'conjectural' or 'hypothetical,' "; (2) There must be a causal connection between the injury and the conduct complained of—the injury has to be "fairly . . . trace[able] to the challenged action of the defendant; (3) It must be "likely," as opposed to merely "speculative," that the injury will be "redressed by a favorable decision." (Citations omitted.))

court, we are aware of no evidence in the record that addresses this issue. The bare claim that a relocation policy exists does not constitute proof of actual injury to either landlord.

Further, the Landlords have failed to join indispensable parties to their new takings claim, namely, the two buyers of the rights to sell liquor at the location of the former Fedway and Garland state-liquor stores. Those buyers' interests are directly and substantially impacted by this new claim that I-1183 gave the Landlords a property right to prevent the buyers from relocation. CR 19 requires dismissal of such a claim for failure to join those parties. *See Veradale Valley Citizens' Planning Commission v. Board of County Commissioners of Spokane County.*, 22 Wn. App. 229, 234-35, 588 P.2d 750, 755 (1978) (property owner necessary and indispensable to zoning appeal that involves its property).

The State did not argue previously the issue whether I-1183 prohibits the Board from allowing buyers to relocate their rights because that issue was simply irrelevant to the issues raised in the complaint, all dealing with the leases. The Court of Appeals agreed that the relocation issue was "irrelevant" to termination of the leases and upheld the exclusion of evidence dealing with relocation on that basis. *Fedway,* 336 P.3d at 620-21. The Court of Appeals also did not address the merits of the relocation authority issue in its decision.

Landlords' attempt to initially litigate the issue of relocation authority by injecting a new cause of action in the Supreme Court is contrary to the orderly administration of justice and procedural fairness.

B. I-1183 Is Clearly Not Intended to Confer a Property Right to Increase Bargaining Power on the Landlords Even if I-1183 Prohibits Relocation.

Landlords assert that I-1183 confers on them a property right to increased bargaining power in leasing their property to persons holding the right to sell liquor at the location.[6] They then assert that the Board's relocation policy exacted a takings of that right for which compensation is owed under article I, section 16 of the Washington Constitution, and the Fifth Amendment to the U.S. Constitution.[7] However, no basis exists in I-1183 to support a property right to increased bargaining in favor of former state landlords.

On December 11, 2014, this Court issued its decision in *Durland v. San Juan County*, No. 89745-0, addressing the question whether a county building code confers a property interest to protect views of neighbors for purposes of determining a violation of procedural due process under the federal and state constitutions. In *Durland*, the plaintiffs asserted they had a property interest to have the

[6] Pet. at 14-15.

[7] Pet. at 17. The takings clause of Fifth Amendment to the U.S. Constitution does not apply to Washington State.

county consider the view impact of a second floor addition to a neighbor's garage in reviewing a building permit. Slip Op. at 3. To determine whether such a property interest exists, the Court said it must determine "whether the regulation at issue mandates protection of the third party's interest." Slip Op. at 16. As applied in *Durland*, the Court had to "determine whether the [county code] requires the permitting authority to consider the views of neighboring property owners." *Id.*

The Court found that the garage addition had in fact violated the size limitations for such additions in the county code and that "a building permit to add the garage could not be lawfully issued," although a building permit was in fact issued. Slip Op. at 17. However, the Court found no indication in the code that the "size limitations are intended to protect the views of the neighboring property." Slip Op. at 17-18. Because the size limitations were not intended to protect the neighbors' view, the Court concluded that the plaintiffs had no property entitlement to denial of the permit due to the violation of the size limitations. *Id.*[8]

[8] *Durland* specifically distinguished (Slip Op. at 19-20) its holding from that of *Asche v. Bloomquist*, 132 Wn. App. 784, 133 P.3d 475 (2006). In *Asche*, the court found that the county code in question created a property interest in the neighbor's view because the code specifically required that "buildings more than 28 feet and less than 35 feet high can be approved only if the views of adjacent properties . . . are not impaired." *Id.* at 798. Clear intent to protect neighboring views was present in *Asche* and for that reason a property interest existed.

The Landlords assert that a relocation would violate an "existing location requirement" in I-1183 "structured so that landlords of state-owned liquor stores would have 'leverage' with persons purchasing at auction the right to operate the former store." Pet. at 14. Assuming for the sake of argument that I-1183 does not allow the Board to approve a relocation,[9] then the critical question applying the *Durland* analysis is whether this relocation prohibition rises to the level of an entitlement for the landlords because it was intended to protect their bargaining leverage.

Here, not only does I-1183 contain no indication of intent to provide landlords bargaining leverage, it does not even mention landlords or apparently contemplate their existence. I-1183 section 102(4)(c) refers to the stores as "state-owned stores," indicating that drafters believed that the stores were in fact owned by the State and not by landlords. RCW 66.24.620(4)(c). Simply put, if the drafters of I-1183 were not even aware that the state stores were owned by landlords, one cannot sensibly claim that the drafters implicitly intended to create a property interest to benefit landlords whom they were unaware existed.

[9] The State does not concede that I-1183 does not allow the Board to approve a relocation, but that issue need not be reached since, as discussed below, Landlords clearly lack a property interest sufficient to state a compensable takings claim.

Moreover, other provisions in I-1183 cut against finding a property interest to benefit landlords. Section 102(6)(b) lists the groups to which the Board was to take "reasonable measures to avert harm." Those groups were "tribes, military buyers, and non-employee liquor store operators under then existing contracts for supply by the board of distilled spirits." RCW 66.24.620(6)(b). None of the groups that that I-1183 identified to be protected included landlords.

Additionally, the fact I-1183 expressly provides for some property interests of buyers of the right to sell liquor at former stores in section 102(4)(c), but is completely silent with respect to landlords, further evidences that even if the drafters were aware of landlords, the landlords were not intended beneficiaries of any statutory entitlements.[10]

Finally, if a relocation prohibition does exist, the most likely reason in I-1183 for such a prohibition is provided in the section 103(3)(c)(i) standard for when the Board may issue a license for new

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[10] Section 102(4)(c), codified at RCW 66.24.620(4)(c), provides as follows:

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

liquor stores under 10,000 square feet.[11] That standard allows the Board to issue a liquor license, if other requirements are met, when "[t]here is no retail spirits license holder in the trade area that the applicant proposes to serve." RCW 66.24.630(3)(c)(i). Thus, prevention of an excess supply of small liquor stores in a trade area, not protection of landlords, appears to be the primary rationale in I-1183 that would support a relocation prohibition, if one exists.

As the Court stated in *Bd. of Regents v. Roth,* 408 U.S. 564, 577, 92 S. Ct. 2701, 33 L. Ed. 2d 548 (1972):

> To have a property interest in a benefit, a person clearly must have more than an abstract need or desire for it. He must have more than a unilateral expectation of it. He must, instead, have a legitimate claim of entitlement to it.

Thus, because no firm basis exists in the language of I-1183 to support the claim that it confers a property right on landlords to bargaining leverage, they lack a legitimate claim of entitlement to that benefit.

V. CONCLUSION

The Court of Appeals' unanimous decision affirming the Superior Court's entry of judgment on the pleadings in favor of the State is carefully reasoned and consistent with existing law, and as such is not even contested by Landlords. Instead, the Landlords seek to have this

[11] The Fedway and Garland stores were both below 10,000 square feet. *See* CP 4, 5.

Court review a cause of action that is not even part of the Amended Complaint. Landlords' attempt to add a new takings cause of action via their Petition for Discretionary Review should be denied because it is procedurally barred, contrary to the orderly administration of justice, and clearly without merit.

RESPECTFULLY SUBMITTED this 15th day of December, 2014.

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CERTIFICATE OF SERVICE

I certify that on the 15th day of December, 2014, I caused a copy of the Respondent's Answer to Petition for Discretionary Review to be served on the date below as follows:

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

Signed this 15th day of December, 2014, in Olympia, Washington.

/s/ Katherine Kerr
KATHERINE KERR
Legal Assistant

APPENDIX A

X. FIFTH AND ALTERNATIVE CLAIM FOR RELIEF: VIOLATION OF ARTICLE 1, SECTION 16 OF THE WASHINGTON STATE CONSTITUTION

57. Plaintiffs incorporate by reference the preceding allegations.

58. Article 1, section 16 of the Washington State Constitution (State Takings Clause) provides in part that "[n]o private property shall be taken or damaged for public or private use without just compensation having first been made."

59. A contract with the state is a property interest that is protected by the State Takings Clause.

60. Where the state is a party to a contract and enacts legislation that eliminates or abrogates a remedy under that contract, a taking of a private property interest has occurred.

61. If WSLCB is correct that the Store Leases are automatically terminated by the enactment of I-1183, then the enactment of I-1183 eliminated the Class members' contractual remedy for breach. This elimination of a contractual property interest constitutes a taking without just compensation in violation of the State Takings Clause.

62. If the Court determines that I-1183 constitutes a violation of the State Takings Clause, Plaintiffs and the Class members are entitled to just compensation in an amount to be proven at trial.

XI. SIXTH AND ALTERNATIVE CLAIM FOR RELIEF: VIOLATION OF THE FIFTH AMENDMENT TO THE UNITED STATES CONSTITUTION

63. Plaintiffs incorporate by reference the preceding allegations.

64. The Fifth Amendment to the United States Constitution provides that private property shall not "be taken for public use, without just compensation" (Federal Takings Clause).

65. A contract with the state is a property interest that is protected by the Federal Takings Clause.

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66. Where the state is a party to a contract and enacts legislation that eliminates or abrogates a remedy under that contract, a taking of a private property interest has occurred.

67. If WSLCB is correct that the Store Leases are automatically terminated by the enactment of I-1183, then the enactment of I-1183 eliminated the Class members' contractual remedy for breach. This elimination of a contractual property interest constitutes a taking under the Federal Takings Clause.

68. If the Court determines that I-1183 constitutes a violation of the Federal Takings Clause, Plaintiffs and the Class members are entitled to just compensation in an amount to be proven at trial.

XII. PRAYER FOR RELIEF

WHEREFORE, Plaintiff Fedway Marketplace West, LLC and Garland & Market Investors, LLC, on their own behalf and on behalf of the Class, pray for the following relief against Defendant the State of Washington:

A. Entry of an order determining that this action may be maintained as a class action, appointing Fedway Marketplace and Garland & Market as class representatives, and appointing undersigned counsel as counsel for the Class.

B. Entry of judgment for monetary damages or an award of just compensation in an amount to be proved at trial.

C. In the alternative to the monetary relief requested, issuance of a declaratory judgment that I-1183 violates the Washington State and United States Constitutions.

D. For costs and attorney's fees to the maximum extent allowed by law.

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APPENDIX B

~~At the time I-1183 took effect on December 8, 2011, LCB clearly understood that the initiative directed it to auction the right to operate a liquor store at each existing store location (hereafter the "Existing Location Requirement"). Board Member Chris Marr testified, "Yes, that fits with my understanding of what the initiative addressed." (Marr Dep. at 19:24-20:9 [CP 127]. Agency Director Patricia Kohler admitted that "the initiative directed the agency to auction stores at existing location[s]." (Kohler Dep. at 18:15-19:2 [CP 143].) Director of Business Enterprise Pat McLaughlin, tapped to manage the agency's asset divestiture under 1-1183, testified "that the auction that was going to be conducted was for the right to operate a liquor store at the existing state store location." (McLaughlin Dep. at 18:5-19, 86:20-24 [CP 171].) And District Manager Steven Meissner, appointed to lead the Auction Team, prepared an Auction Paper stating, "Initiative 1183 requires the LCB to conduct public auctions for the right to sell spirits at the existing location of each state liquor store." (Meissner Dep. at 30:24-31:9 [CP 201].)~~

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

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

Plans to implement the Existing Location Requirement and fulfill 1-1183's directive that the LCB sell "all assets" over which it had power of disposition were made. The plan was that the Store Leases would be sold and assigned as part of the auction. (See Meissner Dep. Exh. 7 [CP 383] ("bundling and selling store contents **and lease"**) (emphasis added); McLaughlin Dep. Exh. 10 at 46 [CP 350] (landlords to have right to opt-in or opt-out.) However, this plan was killed. Aided by the Attorney General's Office, the LCB did a complete about-face and decided — without any public notice or comment or rule-making procedure — to give bid winners free rein to relocate from the existing store locations. So, instead of auctioning "the right **at each state-owned store location" to operate a liquor store "upon the premises," as 1-1183 commanded, the LCB** unilaterally decided to auction the right at

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

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

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

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

~~22 [CP 191].) But it was done quietly and informally, without any public notice, comment or rulemaking. (Id.; Kohler Dep. at 57:24-58:5 [CP 156-157].) It was not until many months later, long after the auction and after multiple drafts and revisions, that an ex post facto written policy document was adopted. (Kohler De 1. Exh. 10 [CP 326-327]; Kohler Dep. at 59:16-22 [CP 157].)~~

~~LCB's executive team admitted there is nothing in 1-1183 that provides for relocating the right being auctioned and nothing authorizing a one-mile exception to the Existing Location Requirement. See Marr Dep. at 39:4-25 [CP 132] ("I'm not aware that the word 'relocation' appears in the initiative. Q: Does the word or words 'one mile from existing location' — A: Not to my understanding."); Kohler Dep. at 55:10-14 [CP 155] ("nothing in I-1183 about a one radius mile relocation"); McLaughlin Dep. at 49:22-50:3 [CP 178-179] (same).~~

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

~~AG's interpretation is infallible"). The Attorney General's Office recommended new phraseology describing the auction as offering the right to a retail license "associated with" the former state store location. (McLaughlin Dep. Dep. Exh. 24 at 400 [CP 370] ("A successful bidder owns the exclusive rights to apply for a spirit retail license *associated with* the location of the former state liquor store") and McLaughlin Dep. at 96 [CP 193]: the "associated-with" wording "was developed in consultation with our legal counsel.") This fig leaf could not change the fact that the agency had radically altered I-1 183's requirement that it auction "the right at each state-owned store location . . . to operate a liquor store upon the premises." RCW 66.24.620(4)(c) (emphasis added).~~

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

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

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

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

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

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

V. ARGUMENT

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

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

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

arrogation of authority to rewrite I-1 183 to suit its own purposes. The Court of Appeals sidestepped this issue entirely. The court cited *Edmonds Shopping Center Associates v. City of Edmonds,* 117 Wash. App. 344, 71 P.3d 233 (2003), for the threshold question of "whether the challenged action seeks less to prevent a public harm than to provide an affirmative benefit to the public agency." (Opinion at 15-16.) But it then held that, because "the legislature's [sic] purpose to prevent proliferation of private liquor stores" was "directed at preventing a public harm," no taking occurred and "further analysis is not required." (Opinion at 16.)

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

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

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

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

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

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

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

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

Whether or not LCB had a right to terminate the Store Leases after I-1183 directed it to close state-owned liquor stores does not matter here. The duty to close liquor stores did not confer any authority on the LCB to alter I-1 183's unambiguous statutory scheme requiring auction of the rights to operate liquor stores at existing state store locations only and to sell all assets, including Store Leases, over which it had power of disposition. Before it reversed course and adopted the Relocation Policy, the agency was planning to do just that by including the unexpired leases in the bundle of rights to be sold at public auction. (See Meissner Dep. Exh. 7 [CP 383] ("bundling and selling store contents and lease").) Nor did the LCB's power to terminate Store Leases, if it existed, confer immunity from liability for failing to pay for property rights taken by the State without compensation.

Petitioner's right to the substantial benefits conferred by 1-1183 was a property interest. ~~The initiative was structured so that landlords of state-owned liquor stores would have "leverage" with persons purchasing at auction the right to operate the former store.~~ This consisted of the Existing Location Requirement and the LCB's obligation to sell "all assets," including unexpired leases. These landlord rights were "built-in" to the statute presumably to mitigate the obvious harm landlords would suffer from the closure

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

The State's argument below, that it had the right to terminate the Store Leases and upon termination the landlords had no remaining rights, is clearly wrong. See Brief of Respondent at 32 ("if the leases terminate by their own terms there is no property left to be taken"). ~~**1-1183 gave state-store landlords a property interest so potent that the LCB characterized it as an "oligarchy." [CP 347]**~~ **Termination of the leases, even if such a right existed, did not extinguish Petitioner's constitutional right not to have that property interest taken for public purposes without just compensation. It is well established that a contracting party may be liable for breach of duties that arise independent of contract. See** *Eastwood v. Horse Harbor Found., Inc.,* **170 Wash.2d 380, 393, 241 P.3d 1256, 1264 (2010) (lessee's duty to avoid waste).**

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

*** Petitioner does not agree that the LCB had a right to terminate the leases.**

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

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

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

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

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

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

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

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

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

APPENDIX C

44509-3-II

WASHINGTON STATE COURT OF APPEALS
DIVISION II

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

Appellants,

v.

THE STATE OF WASHINGTON,

Respondent.

REPLY BRIEF OF APPELLANTS FEDWAY MARKETPLACE WEST, LLC AND GARLAND & MARKET INVESTORS, LLC

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The evidence shows that the LCB took away rights conferred on landlords by I-1183 for the purpose of enhancing the rights it was selling at public auction. The record also shows that this strategy generated what LCB Chair Sharon Foster said was "a $32 million windfall for the state." (Marr Exh. 13 [CP 289].) That windfall was obtained by stripping plaintiffs and other state store landlords of their rights under I-1183. Plaintiffs should be allowed to pursue their proper remedies: either invalidation of I-1183 or just compensation. (See Complaint, Prayer for Relief ¶¶ B & C [CP 18].)

III. CONCLUSION

The trial court's orders should be reversed and the case remanded for trial.

DATED: November 4, 2013.

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Please find attached **Respondent's Answer to Petition for Discretionary Review** (Appendices included in pdf) in the following matter:

Case Name: FEDWAY MARKETPLACE WEST, LLC, and GARLAND & MARKET INVESTORS, LLC, Petitioners, v. THE STATE OF WASHINGTON, Respondent.

Case Number: 909873

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