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Appellate Cases – Takings

■ SPOTTED OWL RULES DID NOT EFFECT A TAKING, SAYS OREGON COURT OF APPEALS

Seiber v. State ex rel. Board of Forestry, 210 Or App 215, 149 P3d 1243 (2006), is the latest in a series of cases in which Oregon landowners have demanded compensation under the Oregon and federal constitutions after being prevented from logging their properties by rules that protect imperiled wildlife species. In this case, the Oregon Court of Appeals largely implemented recent rulings by higher courts on dispositive legal issues, but also examined the specific facts of the case under *Penn Central Transportation Co. v. New York City*, 438 US 104, 98 S Ct 2646 (1978), to conclude there had been no taking.

Pursuant to an Oregon Department of Forestry rule, the plaintiffs were prevented from logging 40 acres of a 200-acre parcel for a period of seven years while a pair of northern spotted owls (*Strix occidentalis caurina*) occupied a property adjacent to theirs. After several prior rounds of litigation, the Linn County Circuit Court jury found that a temporary taking had occurred and returned a verdict in favor of the landowners, awarding them \$148,473 in damages plus \$211,333 in attorney fees. The plaintiffs appealed, assigning error to the amount of the attorney fee award. The state cross-appealed, arguing that the trial court should have granted the state's motions for directed verdicts.

The court of appeals first addressed the state's argument that the appropriate denominator for determining whether a taking had occurred under the Oregon constitution was the entire 200-acre parcel, rather than the 40 affected acres. While the appeal and cross-appeal were pending, the Oregon Supreme Court held that courts must look to the property as a whole, rather than the affected portion, when determining whether the landowner retains any economically viable use of the property. *Coast Range Conifers, LLC v. State ex rel. Bd. of Forestry*, 339 Or 136, 117 P3d 990 (2005). The facts in *Coast Range Conifers* and the instant case were strikingly similar: in both cases, the landowners were prevented from logging portions of their properties to preserve habitat for protected wildlife species, but retained the ability to log roughly 80 percent of their properties. Applying the "whole parcel" rule to the instant case, the court of appeals held that the state had not deprived the plaintiffs of all economically viable use of their 200-acre property. The court of appeals thus reversed the trial court's holding under the Oregon constitution.

The court of appeals next turned to the plaintiffs' federal takings claim, which had three counts. In the first count, the plaintiffs demanded compensation under *Agins v. Tiburon*, 447 US 255, 260, 100 S Ct 2138 (1980), which held that a regulation violates the Takings Clause if it "does not substantially advance legitimate state interests." In 2005, the U.S. Supreme Court overruled *Agins* in *Lingle v. Chevron U.S.A., Inc.*, 544 US 528, 540-45, 125 S Ct 2074. Because *Agins* is no longer good law, the court of appeals reversed the plaintiffs' first federal count.

In the second count, the plaintiffs demanded compensation under *Lucas v. South Carolina Coastal Council*, 505 US 1003, 1015, 112 S Ct 2886 (1992), which established that a taking occurs when a landowner is deprived of all economically productive use of the property. The court of appeals pointed out that the whole parcel rule established under the Oregon constitution by *Coast Range Conifers* also applies under the federal Constitution per *Lucas*. Because the court had already found that the logging regulations had not rendered the entire parcel valueless, the court reversed the second federal count.

Finally, the court turned to the plaintiffs' third federal count, which was based on *Penn Central*. The plaintiffs and the state agreed that, even if the plaintiffs had no claim under *Lucas*, they may still have a valid *Penn Central* claim. Both *Penn Central* and *Tahoe-Sierra Preservation Council, Inc. v. Tahoe Regional Planning Agency*, 535 U.S. 302, 122, S Ct 1465 (2002), require an inquiry

■ SIGN, SIGN, EVERYWHERE A SIGN

into the specific facts of the case to determine whether a taking occurred. In evaluating *Penn Central* claims with undisputed facts, courts must examine two primary factors as questions of law. First, courts must evaluate “the economic impact of the regulation on the claimant and, particularly, the extent to which the regulation has interfered with distinct investment-backed expectations.” *Penn Central*, 438 US at 124. Second, courts must examine “the character of the governmental action.” *Id.*

In evaluating the economic impact of the restrictions under *Penn Central*, the court began by stating that the interference with the plaintiffs’ use of the 200-acre parcel had been “limited in area, time, and interest.” 210 Or App at 219. The restrictions applied to only one fifth of the plaintiffs’ parcel, were in effect for only seven years, and interfered with only one “stick” in the plaintiffs’ “bundle” of property rights. *Id.* As for investment-backed expectations, the court noted that the restrictions had not affected any preexisting contractual arrangements between the plaintiffs and other parties, and the plaintiffs retained the ability to sell future contingent logging interests for the 40 acres of timber.

The plaintiffs argued that the jury’s answers to several questions amounted to evidence of a taking, but the court of appeals rejected this argument on two primary grounds. First, three of the five questions focused solely on the economic impact associated with the 40 acres of timber, rather than the full 200 acres, and were thus faulty under the “whole parcel” rule. The remaining two questions improperly called on the jury to decide legal issues rather than factual issues, and one of those two questions involved the plaintiffs’ *Agins* claim, which the appellate court had already deemed invalid under *Lingle*.

The court next examined the character of the governmental action. The court found that the restrictions against logging were not a physical invasion of the plaintiffs’ property. Rather, the restrictions were designed to protect an imperiled wildlife species for the benefit of society at large. Under *Penn Central*, a physical invasion is more likely to result in a taking than is a governmental program that “adjust[s] the benefits and burdens of economic life to promote the common good.” 438 US at 124. Thus, the court asserted that “the character of the government action does not weigh heavily in plaintiffs’ favor.” 210 Or App at 223.

The court concluded by dismissing the plaintiffs’ *Penn Central* claim. In doing so, the court reiterated that the logging restrictions were only temporary, affected only 20 percent of the property, and were part of a governmental program to preserve wildlife resources for future Oregonians rather than a physical invasion of the plaintiffs’ property.

Nathan Baker

Seiber v. State ex rel. Board of Forestry, 210 Or App 215, 149 P3d 1243 (2006).

[NOTE: Mr. Baker is the staff attorney for Friends of the Columbia Gorge. Along with several other conservation groups, Friends filed an amicus brief with the Oregon Supreme Court in the Coast Range Conifers case].

In light of the Oregon Supreme Court’s decision in *Outdoor Media Dimensions v. Department of Transportation*, 340 Or 275, 132 P3d 5 (2006) (See RELU Digest, Vol 28, No. 4 (June 2006) for a summary), the Oregon Court of Appeals on remand reconsidered its decision in *Drayton v. Department of Transportation*, 186 Or App 1, 62 P3d 430 (2003) (*Drayton I*) in *Drayton v. Department of Transportation*, 209 Or App 656, 149 P3d 331 (2006) (*Drayton II*).

At issue in *Drayton I* was the Oregon Department of Transportation’s (ODOT) order requiring the petitioner to remove six outdoor advertising signs that ODOT found to be in violation of the Oregon Motorist Information Act (OMIA). See ORS 377.715. The OMIA only allowed outdoor advertising signs to be erected and maintained along state highways if their owner secured a permit from ODOT, which the petitioner had not applied for or received. The statute at ORS 377.710(23) defines an “outdoor advertising sign” as one that advertises:

- (a) Goods, products or services which are not sold, manufactured or distributed on or from the premises on which the sign is located;
- (b) Facilities not located on the premises on which the sign is located; or
- (c) Activities not conducted on the premises on which the sign is located.

Signs that advertised goods or services available on the premises upon which the sign was located were not subject to a permit requirement under the OMIA. Because ODOT determined that the six signs owned by petitioner were outdoor advertising signs and the petitioner did not possess a permit to erect or maintain them, ODOT required the signs to be removed.

The court of appeals ruled in *Drayton I* that ODOT correctly found three of the six signs to be in violation of the OMIA and affirmed ODOT’s order requiring their removal. With respect to the remaining three signs, the court reversed ODOT’s decision because the court found that ODOT had not provided petitioner with proper notice as required under the administrative rules that were the basis for its order. *Drayton I*, 186 Or App at 12–13. The petitioner appealed the *Drayton I* ruling to the Oregon Supreme Court.

While the appeal was pending, the supreme court handed down its decision in *Outdoor Media Dimensions*. In that case, the court ruled the OMIA’s distinction between on-premises and off-premises signs was an unconstitutional restriction on the content of speech in violation of Article I, section 8, of the Oregon Constitution. As such, the court held that the appropriate remedy in light of that constitutional infirmity was to strike from the OMIA the permit and fee requirements for outdoor advertising signs. Based on its decision in *Outdoor*

Media Dimensions, the supreme court vacated *Drayton I* and remanded it to the court of appeals for reconsideration.

On reconsideration, the Oregon Court of Appeals in *Drayton II* found that the *Outdoor Media Dimensions* decision did not affect that portion of its decision in *Drayton I* reversing ODOT's order for failing to provide petitioner with proper notice. With respect to the remaining three signs whose removal the *Drayton I* court affirmed, the court ruled in *Drayton II* that ODOT's order to petitioner to remove those signs must also be reversed pursuant to the *Outdoor Media Dimensions* decision.

As *Drayton II* and *Outdoor Media Dimensions* demonstrate, billboard regulation in Oregon is currently in a state of significant flux. Many local codes mimic the OMIA's distinction of on-premise/off-premise advertising whereby the former is allowed while the latter is prohibited. Methods to regulate billboards going forward may include limits on the overall size of any sign regardless of whether it advertises off-premise goods or services or permit requirements for signs if the owner of the property upon which the sign is located is remunerated by a third-party for the sign's placement. Such methods are likely to be found to be constitutional under Article I, section 8, of the Oregon Constitution.

David Doughman

Drayton v. Oregon Department of Transportation, 209 Or App 656, 149 P3d 331 (2006).

■ LOCAL GOVERNMENT PLANNERS ESCAPE FROM LIABILITY FOR BAD ADVICE

In *Wild Rose Ranch Enterprises, LLC v Benton County*, 210 Or App 166, 149 P3d 1281 (2006), the Oregon Court of Appeals reversed a jury verdict and resulting judgment against a local government for advice given by its employees concerning a land use matter.

Slaters owned land in rural Benton County, but a third party, Western Timber Company (WTC), owned the mineral rights to a previously used pit on the property. Slaters told Scoggin, a rock crushing business operator, that WTC might be willing to sell and that a conditional use permit was probably necessary.

Scoggin approached Minard, a Benton County Planner who said he did not think a conditional use permit would be necessary. Minard's Benton County Planning Manager, Schneider, ventured the opinion that Scoggin could proceed without a conditional use permit and wrote a letter in March of 1998 to Scoggin stating that "the County [was] not opposed to your company resuming mining activities," provided it was within the Department of Geological and Mineral Industries (DOGAMI) identified boundaries for the pit. 210 Or App at 169.

Based on the letter, Slaters formed Wild Rose to purchase the rights from WTC for \$125,000, and Wild Rose entered into a mining contract with Scoggin's company. On September

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11, 1998, Schneider wrote another letter to Scoggin directing him to cease operations until a conditional use permit had been issued. Wild Rose then applied for the permit, but it was denied.

Wild Rose sued Benton County for the \$125,000 loss plus \$60,000 in lost profits. Wild Rose argued that the requirement in the Benton County Code that the Planning Official is responsible for administration and for providing the official interpretation of the Code imposed a heightened duty to the plaintiffs. After denial of a motion for a directed verdict by the government defendants, the jury returned a verdict of \$163,866, which was reduced by the trial court to the tort claims limit of \$100,000 under ORS 30.270.

After reviewing several cases the Oregon Court of Appeals held that because the plaintiff had failed to establish a “special relationship” between the plaintiff and the defendant that gave rise to a duty by the defendant to protect the plaintiff from economic loss, the directed verdict was improperly denied. Thus, the court reversed the trial decision.

Under Oregon tort law, the court found that a negligent representation cannot serve as a basis for recovery of economic losses unless “there is some duty of the negligent actor to the injured party beyond the common law duty to exercise reasonable care to prevent foreseeable harm.” 210 Or App at 170 (quoting *Onita Pacific Corp v. Trustees of Bronson*, 315 Or 149, 159, 843 P2d 890 (1992)). The court found that the Benton County code provisions cited did not give rise to a duty on the part of Benton County to protect the public from economic loss.

The court also found consistency with its earlier decision in *Indian Creek Development Co. v. City of Hood River*, 203 Or App 231 (2006). In that case, an application to subdivide property was approved and the land was platted. However, when building permits were applied for, the builders were told incorrectly (i.e., a negligent misrepresentation) the entire cost of a traffic intersection improvement had to be paid for before issuance. When the developer sued for loss of sales, no “special relationship” was found notwithstanding the following findings: (1) the subdivision approval without any such condition, (2) the city attorney’s letter stating a belief that the city could not impose such a condition on the builders, and (3) provisions in the code regarding how development could be conditioned on developers paying for improvements.

Likewise, in *SFG Income Fund, LP v. May*, 189 Or App 269 (2003), the county planner gave improper zoning information to an appraisal company, which was incorporated into an appraisal on which a lender relied in making a loan on which a borrower defaulted. The court found that the duty to keep records did not provide any indication of intent to protect the public from inaccurate information caused by inaccurate records.

A number of lessons can be taken from *Wild Rose*. First, it is only the latest in a number of cases illustrating that land use lawyers should not rely on over the counter advice from planners. There is no substitute for looking at the code.

Second, many jurisdictions have formal interpretation processes where an application is made and a fee paid. If that process had been followed here, the court of appeals might have had a harder time not finding a “special relationship.” Third, it is significant that in several cases trial courts and juries have found liability against governments for misinformation, even though the court of appeals reverses on the ground of “no special relationship.” Fourth, notwithstanding the court’s finding of the need for a “special relationship,” Measure 37 seems to illustrate the public’s perception that the current Oregon planning system needs greater integrity of representations to the public. Finally, it is important for the courts to realize that merely applying tort law, and thereby creating a *de facto* defense for public entity employees who give bad advice, may undermine public trust in government. The question of responsibility for bad advice given by public employees charged with particular knowledge should be a topic for further examination, possibly from the legislative branch of government.

Steven R. Schell

Wild Rose Ranch Enterprises, LLC v Benton County, 210 Or App 166, 149 P3d 1281 (2006).

Appellate Cases – Real Estate

■ ORIGINAL CONDITION: WHAT IT MEANS IN A SUCCESSIVE LANDLORD – TENANT RELATIONSHIP

In *Harris v. Warren Family Properties LLC*, 207 Or App 732, 143 P3d 548 (2006), the Oregon Court of Appeals wrestled with the obligation of a tenant, the holder of a leasehold interest through three successive leases, to restore the premises to the condition that existed prior to the commencement of the first lease.

The plaintiffs’ action sought a declaration that they had no duty upon termination of the final leases to restore the premises to the condition existing at the commencement of the first lease. The defendant counterclaimed for breach of contract, alleging as damages the cost to restore the premises to the condition when first occupied by the plaintiffs. The trial court entered judgment in favor of the defendant for damages of approximately \$300,000 and attorneys’ fees of \$230,000. The plaintiffs appealed and the defendant cross-appealed, challenging the court’s failure to award all of the relief that it sought in its counterclaim. In primarily siding with the plaintiffs, the Oregon Court of Appeals vacated and remanded the trial court’s judgment and dismissed the defendant’s cross-appeal as moot.

The plaintiffs first executed a lease for space in the defendant’s office park in 1990. In 1995, the parties entered into a replacement lease for a larger amount of space. In 2000, the parties entered into two separate replacement leases covering

even more space. Over the course of the leases, the plaintiffs made numerous alterations and trade fixture installations in the leased space.

In 2002, the plaintiffs exercised their rights under the 2000 leases to terminate the leases by a paying a required early termination fee. On termination, the defendant asked the plaintiffs to remove all alterations, trade fixtures, and equipment and restore the premises to the condition they were in prior to the plaintiffs' initial occupation in 1990. The plaintiffs removed trade fixtures and equipment, but refused to remove alterations made under the 1990 and 1995 leases. The plaintiffs admitted liability for the cost of removing alterations made during the 2000 leases, but failed to undertake any such action because this dispute arose.

Although many provisions of all the leases were identical, there was different language regarding the construction and removal of alterations throughout the leases. The court initially concluded that 1995 and 2000 leases were new, stand-alone leases and not extensions or renewals of the prior leases. Thus, the terms of each lease needed to be analyzed to determine the plaintiffs' responsibility. The 1990 lease gave the plaintiffs the right to install and remove trade fixtures without the defendants' consent, but required consent for other alterations. Additionally, it gave the defendant the right to require the removal of the trade fixtures, but not the other alterations. The 1995 lease allowed the defendant to require the plaintiffs to remove alterations upon the termination of the lease and restore the premises to the original condition. The 2000 leases kept this language.

The plaintiffs argued that each lease stood on its own. Under the 1990 lease, there was no obligation to remove any alterations or restore the premises. Under the 1995 lease, the plaintiffs argued that, although the defendant had the right to require the premises be restored, the defendant failed to do so at the termination of that lease. The plaintiffs acknowledged that, under the 2000 leases, they had they obligation to restore the premises to its "original condition." The plaintiffs contended that the "original condition" referred to the condition as of the commencement of the 2000 lease.

The court of appeals examined the phrase "original condition" in detail. It initially concluded that the language was unambiguous and should be construed in favor of the plaintiff. The court found that the phrase "original condition" means "the condition of the premises before tenant makes any 'alterations.'" 207 Or App at 747. Since each lease stood alone, this referred to the condition at the inception of the 2000 lease. The court's opinion was bolstered by an integration clause in the 2000 lease.

The defendant argued that Oregon law presumes that a party's removal rights under an earlier lease survive implicitly through successive lease periods for the same premises, relying on *Lilenquist v. Pitchford's Inc.*, 269 Or 339, 25 P2d 93 (1974), and *Blake-McFall Co. v. Wilson*, 98 Or 626, 193 P 902 (1921). *Id.* at 753. The court rejected the defendant's argument, holding first that the defendant misread the cited cases, and second, that there is no authority under Oregon

law for a presumption that any party's removal rights under an earlier lease survive implicitly in successive leases of the same premises. *Id.* at 754.

The defendant also argued that it would be unreasonable to expect a landlord to have exercised its rights under the 1995 lease to require the removal of alterations when the leasehold continues. *Id.* The court concluded that the defendant could have addressed this issue by including appropriate language in the 2000 leases.

Because of the holding vacating the judgment and remanding the matter to the trial court, the defendant's cross-appeal was dismissed as moot.

Gary Kahn

Harris v. Warren Family Properties LLC, 207 Or App 732, 143 P3d 548 (2006).

■ **"EFFECTIVE" MEANS "STARTING NOW" IN A REMEDIAL STATUTE**

In *Stizver v. Wilsey*, 210 Or App 33, 150 P3d 10 (2006), an upset homeowner was required to comply with statutory procedural requirements prior to initiating legal action against the contractor, even though the statute was enacted and became effective after work on the home was completed. In 2003, the legislature passed amendments to ORS 701.560 to 701.595, which were to go into effect January 1, 2004. The new law required the homeowner to, among other things, send the contractor a notice of defect, receipt of which notice triggered specific rights and obligations for the contractor. The new law also required the contractor to deliver a statutory notice of procedure to the homeowner at the time the contractor delivered the consumer notification required under ORS 701.055(13).

The homeowner did not send the contractor the notice of defect. Instead in September 2004, the homeowner filed the action for breach of a residential construction contract. Interpreting the new law as being applicable to any action filed on or after January 1, 2004, the court dismissed the action without prejudice, in accordance with ORS 701.595. The statute states that the "owner may not commence a new arbitration or action unless the owner follows the procedure" set forth in ORS 701.565 and 701.575.

In a straightforward exercise of statutory construction, the Oregon Court of Appeals affirmed the trial court's dismissal of the action without prejudice. The court concluded that the statute was remedial in nature—pertaining to or affecting a remedy as distinguished from affecting or modifying a substantive right or duty. As a consequence of the determination, the court held that all court actions commenced on or after January 1, 2004, must comply with ORS 701.595 regardless of when construction took place or the contract was entered into.

The court determined that the statute applied even though the contractor did not comply and could not have complied with the requirement that it deliver notice of the

procedure to the homeowner at the time the contract was entered into. The court ruled that receipt of the notice was not required for plaintiff to bring the action. Thus, the contractor's failure to comply did not excuse the homeowner's obligation to send a preliminary "notice of defect."

The court acknowledged that applying the statute this way could affect a homeowner's ability to file an action in January 2004 since the new notice period would allow a contractor some time to respond to the alleged defects. However, since the plaintiff's suit was initiated more than nine months after the effective date of the statute, the potential problems did not arise in this case.

Tod Northman

Stizver v. Wilsey, 210 Or App 33, 150 P3d 10 (2006).

■ **RELATED-PARTY EXCHANGES: IT IS NOT AS BAD AS YOU THINK**

An exchange between related parties will generally be taxable under the provisions of IRC § 1031(f). This code section was enacted to deny tax-free treatment for an exchange in which a taxpayer exchanges low-basis relinquished property with a related party for high-basis replacement property with the understanding that the related party will sell the relinquished property with little or no taxable gain. The general rule denying tax-free treatment has a number of exceptions, which are discussed below. Also discussed are related-party exchange transactions that just do not work.

What is a related party? Generally, it includes a spouse, parent, child, or sibling. A taxpayer is not related to an in-law. A person is related to a corporation or a partnership if he or she owns more than 50 percent of the corporation or partnership.

The related-party exchange rules are often a problem for unwary taxpayers who find themselves in the middle of an exchange and learn all too late that they have a taxable transaction. The taxpayer is usually not aware of the related-party issue with a transaction until the 45-day identification period has expired, after which it is often too late to resolve the problem.

Fortunately, there are significant exceptions to the related-party exchange prohibition.

1. Sell Relinquished Property to Related Party and Wait Two Years.

The most commonly invoked exception is for a taxpayer to sell the relinquished property to the related party and acquire the replacement property from an unrelated party. However, this exception will only work if the taxpayer does not sell or otherwise dispose of the replacement property for two years *and* the related party also does not sell or otherwise dispose of the relinquished property for two years. It is advisable that an agreement be entered between the related party and the taxpayer whereby the related party agrees not to sell or otherwise dispose of the relinquished property for two years.

There are certain exceptions to the two-year rule that permit the replacement property or the relinquished property to be disposed of within the two-year period without causing the transaction to be taxable. These exceptions include dispositions because of death, involuntary conversions, and other transactions in which there was no intent to avoid tax. Exceptions 3, 4, and 5 listed below have their origin in the "no intent to avoid tax" exception. Also, the IRS has held that if the property exchanged was timberland, cutting the timber within the two-year period does not violate the two-year rule. Priv Ltr Rul 200541037 (Oct. 14, 2005).

2. "True" Exchange With a Related Party and Wait Two Years.

In this exception, the taxpayer transfers the relinquished property to a related party and acquires the replacement property from the related party. Both parties must then wait two years. Under this exception, the relinquished property cannot be transferred to an unrelated party and the replacement property cannot be acquired from an unrelated party.

This exception is a wonderful boon to clever taxpayers because it can allow huge tax savings by use of a "basis swap." Let us assume that a taxpayer owned relinquished property with a value of \$1 million and a basis of zero and that a partnership it controlled owned replacement property with a value of \$1 million and a basis of \$1 million. If the taxpayer sold the relinquished property, it would have a \$1 million taxable gain. Now assume that the taxpayer exchanges the relinquished property for the related partnership's high-basis replacement property. After waiting two years, the partnership can now sell the relinquished property for \$1 million with no gain or loss! This is because the partnership's basis of \$1 million in the replacement property is substituted and now becomes a \$1 million basis in the relinquished property.

3. The Taxpayer and the Related Party Together Do Not Save Tax.

Another exception to the related-party exchange rules is a related-party transaction in which the related party will pay as much tax as the taxpayer will save, or more, by completing a tax-free exchange. The basic reason behind the related-party exchange rules is that the IRS does not want to give the taxpayer the opportunity to save taxes by completing basis swap transactions as described above (unless the parties waited two years). The related-party exchange rule is not needed if the related parties did not save any taxes. For example, if the taxpayer were to complete an exchange by which he acquired the replacement property from his sister (deferring \$300,000 of taxable income), the exchange would be tax free as long as the sister had to pay tax on her sale of at least \$300,000. No one knows what would happen if the sister had to pay tax on \$280,000 of taxable income, but it would probably work. At some point, if the sister's tax liability was substantially less than her brother's savings in taxable income, the IRS could treat the transaction as taxable.

This exception will not apply if the sister's \$300,000 in taxable income did not generate a tax liability for some reason (e.g., she had a net operating loss carryover that sheltered the gain. See *Teruya Bros. Ltd. & Subs. v. Comm'r*, 124 TC 45 (2005)).

4. Purchase the Replacement Property From a Related Party and the Related Party Also Completes Exchange.

Another exception is a related-party transaction where neither the taxpayer nor the related party cash out of their investment. See Priv Ltr Rul 200440002 (Oct. 1, 2004) (nontaxable transaction when the taxpayer sold the relinquished property in a transaction structured as a tax-free exchange, purchased the replacement property from his sister, and the sister also completed a tax-free exchange).

5. No Intent to Avoid Tax.

Another exception is a transaction in which there was no intent to avoid tax in the exchange. An example of this exception is a tax-free exchange between family members when the family members converted their ownership of several inherited parcels of property from ownership as tenants in common to each family member owning individual parcels outright. See Priv Ltr Rul 199926045 (Apr. 2, 1999). Another example of this exception is a series of circular tax-free exchanges between related parties followed by a spin-off of a corporation when the purpose of the spin-off is not to avoid taxes, but rather to resolve disagreements between shareholders as to the management of the corporation. See Priv Ltr Rul 200012064 (Dec. 21, 1999). An additional example of this exception comes from the legislative history that indicates that the disposition of the replacement property in connection with another nontaxable transaction (e.g. using the property as a capital contribution in a limited liability company). A transaction with no tax-advantageous basis shift does not constitute bad intent on the part of the taxpayer.

However, be cautious. Taxpayers have tried several approaches that will not work:

1. Buy Replacement Property From Related Party.

The most common way that the related-party rules apply is that the taxpayer sells the relinquished property to a buyer, but wants to purchase the replacement property from a related party. This does not work. The two-year exception cannot apply because **both** the taxpayer and the related party must hold the exchange property for two years, which is not possible if the relinquished property has been sold to an unrelated buyer.

2. Transfers to Third Persons to Avoid Related-Party Rules.

IRC § 1031(f)(4) provides that the exchange is fully taxable if the taxpayer attempts to complete a series of transactions to avoid the related-party rules. For example, the

related-party rules cannot be avoided by using an accommodator and taking the position that the exchange was with only the accommodator and not the related party. See Rev Rul 2002-83, 2002-2 CB 927. It is also likely that if the related party transfers the replacement property to his or her spouse with the purpose of avoiding the related-party rules, the transfers of the replacement property by the spouse to the taxpayer will probably result in a fully taxable exchange.

3. Transfers Without Risk of Loss.

If the taxpayer completes a transaction and structures the transaction in such a way that during any part of the two-year waiting period a party has no risk of loss, the two-year holding period is suspended. IRC §1031(g). For example, if the taxpayer completes an exchange with a related party and provides that the related party has a put to sell the relinquished property back at cost plus interest, and the taxpayer has a call right to purchase the relinquished property at cost plus interest, the two-year holding period will be extended.

The related-party rules are not always easy to understand. They can certainly be a trap for the unwary. As with many other complex exchange rules, taxpayers are advised to consult with knowledgeable tax counsel before attempting to structure a related-party exchange.

Ron Shellan

Appellate Cases – Outside Jurisdiction

■ WASHINGTON SUPREME COURT (AGAIN) READS THE GMA BROADLY TO HOLD THAT GMA MATTERS ARE NOT SUBJECT TO REFERENDUM

In *1000 Friends of Washington v. McFarland*, 159 Wash. 2d 165, 149 P.3d 616 (2006), the Washington Supreme Court affirmed its earlier holding that the local implementation of Growth Management Act (GMA) planning is not subject to the power of referenda. In this case, the court was also called upon to determine whether non-GMA legislation, adopted in a comprehensive scheme to fulfill GMA purposes, also enjoys this immunity. This decision will have a significant impact on the availability of referenda in all land use matters.

Washington's GMA, Chapter 36.70A RCW, requires local governments to adopt development regulations to designate and protect critical areas. In 2004, King County adopted over 400 pages of land use regulations comprised of critical areas, storm water, and clearing and grading regulations. The adopting ordinances apparently declared that when taken together the regulations provided a comprehensive scheme to protect critical areas.

Petitioner McFarland initiated the referendum process one month after adoption of the King County ordinances. The referendum was successfully challenged in a declaratory judgment action in which the superior court held that these ordinances were not subject to the referenda process. The Washington Supreme Court granted direct review.

The supreme court was asked to reverse its decision in *Whatcom County v. Brisbane*, 884 P.2d 1326 (Wash. 1994). In *Brisbane*, the court applied the rule that “where the state law requires local government to perform specific acts, those local actions are not subject to local referendum” and specifically held that the GMA implementation was delegated to local government and not to the people. 149 P.3d at 629. The Washington Supreme Court declined the invitation to reverse and upheld the *Brisbane* decision.

The problem facing the court was that *Brisbane* alone did not resolve the referendum in this particular case. In *1000 Friends*, only the critical areas regulations were expressly required (or even authorized) by the GMA, and yet King County had declared that the three ordinances operated together to form a comprehensive regulatory scheme. Under these circumstances, the majority appropriately recognized that a simple “relation” test between the GMA and referenda subjects could isolate *all* land use regulation from local referendum. In an attempt to alleviate this concern, the majority adopted a case-by case test “considering, at the least, the scope of the statutory schema undergirding the ordinance, and whether the ordinances were *necessary to or passed for the purposes of* implementing that statutory scheme.” 149 P.3d at 626 (emphasis added).

The dizzying question is how this analysis will be applied. If immunity from local referenda originates in a state delegation to local governments, we might expect the analysis to begin at the state level. However, the majority opinion did not inquire into whether the GMA discusses, contemplates, or identifies storm water, clearing, or grading regulations. This court took the opposite approach and concluded that the “expressed intent” of the local legislative body deserved “appropriate deference” in determining the availability of referenda. With such deference in mind, it is difficult to believe that the court will *ever* look beyond the local legislative statement. The court summarizes, “an ordinance is needed if the county reasonably concludes that it furthers the goals of the GMA, and this court will not second guess that holding without some showing that the decision was arbitrary and capricious.” 149 P.3d at 628.

The short lesson of this case is that local legislation will enjoy immunity from referenda so long as the local legislative body *states* a relation to GMA implementation. Indeed, it is difficult to imagine subject matters that bear *no* relationship to the subject matters of planning identified in the GMA. Washington's broad planning goals include urban growth, sprawl, transportation, housing, economic development, property rights, permits, natural resources, industries, open space and recreation, environment, citizen participation and coordination, public facilities and services, and historic preservation.

The breadth of the court's holding is further illustrated by the court's rejection of the petitioner's argument “that the storm water and grading ordinances regulate land outside of critical areas.” *Id.* The court found the petitioner's argument irrelevant since “[w]ater flows are indifferent to such boundaries.” *Id.* The difficulty is that the GMA critical areas mandate is *not* “indifferent to such boundaries” and indeed requires local governments to *establish* such boundaries. RCW 36.70A.170. Otherwise stated, in determining whether the non-GMA ordinances were sufficiently necessary to implement the critical areas mandate, the court found irrelevant the basic purpose of critical areas regulation.

Keith Hirokawa

1000 Friends of Washington v. McFarland, 159 Wash. 2d 165, 149 P.3d 616 (2006).

■ WASHINGTON SUPREME COURT RESTRICTS MUNICIPAL MEASURES INTENDED TO COMBAT GREENHOUSE GAS EMISSIONS.

In *Okeson v. City of Seattle*, __ Wash. 2d __, 150 P.3d 556 (2006), the Washington Supreme Court addressed the question of whether a municipal utility may finance the mitigation of their own greenhouse gas emissions by paying public and private entities to reduce their emissions and then passing these costs on to ratepayers. The court held that Seattle City Light's emissions offset contracts were neither proprietary nor sufficiently related to the utility's statutory purpose because combating global warming is a “general government

purpose.” This decision affects municipal utilities’ ability to finance mitigation of greenhouse gas emissions through the purchase of “offset” contracts.

The dispute arose from the city of Seattle’s approval of negotiations to buy power from a gas-fired cogeneration power plant owned by the city of Klamath Falls, Oregon. In the process, the city of Seattle established a “no net impact” policy and directed Seattle City Light, the city’s municipal utility, to “fully mitigate or offset” all emissions associated with the Klamath Falls power contract. The city then directed Seattle City Light to “immediately pursue the possibility” of purchasing offset measures to combat the “clear and increasingly imminent danger[s]” posed by such emissions. Consequently, Seattle City Light entered into “offsetting” contracts with entities such as King County Metro, Washington State Ferries, and Dupont (mitigation was to occur at a plant located in Kentucky).

The petitioners filed a class action suit against the city of Seattle, alleging that Seattle City Light’s “offsetting” contracts would constitute illegal gifts of public funds or unconstitutional taxes and also would violate statutory limitations in local government accounting. The trial court granted summary judgment to the city of Seattle, and the Washington Supreme Court granted direct review.

The petitioners conceded that a municipal utility is authorized to reduce its own greenhouse gas emissions. The question in this case was whether municipal utilities have authority to participate more globally, creatively, and proactively by paying for such reductions in another entity’s operations. The court applied a three-prong analysis: 1) whether the municipal utility has express powers, 2) if not, whether the municipal utility has implied powers, and 3) if authority is neither expressly granted or fairly implied, whether the activity is “essential to” the purpose of a municipal utility.

The ratepayers argued that Seattle City Light’s purchase of “offsetting” contracts was within the general government interest, not the interest of utility ratepayers. The city of Seattle argued for the statutory authority to choose the means necessary for achieving its goal of providing the people with electricity without regard to whether Seattle City Light’s or another entity’s emissions were ultimately reduced.

The court rejected the notion of express authority, finding that the city utility enabling statute (RCW 35.92.050) does not expressly authorize contracts for the reduction of greenhouse gas emissions. The court then analyzed whether the city utility has implied or incidental authority under the *Taxpayers of Tacoma* analysis. The *Taxpayers of Tacoma* analysis requires that all of the following conditions be met: 1) the city is exercising a proprietary power; 2) the action is within the purpose and object of the enabling statute; 3) the action is not contrary to express statutory or constitutional limitations; and 4) the action is not arbitrary, capricious, or unreasonable. *City of Tacoma v. Taxpayers of Tacoma*, 108 Wash. 2d 679, 743 P.2d 793 (1987).

The court held that the offset contracts were not proprietary because they were not services for which individual

customers were billed based on their usage; thus, there was no nexus between the amount paid by the ratepayer and the benefit received by the ratepayer. The court held that an electric utility’s action was proprietary only if it was part of the production of the sale of electricity and for the “comfort and use” of individual customers who control and pay for their own use, not for the general public use.

Next, the court found that the offset contracts lacked the required nexus to the purpose expressed in the enabling statute: supplying electricity. The court determined that the offset contracts were not within the utility’s implied powers because they did not fall within “the object and purpose” of the utility enabling statute.

Justice Owens published a dissenting opinion on the ground that the offset contracts promoted long-term efficiency, which in turn was a proprietary function and within Seattle City Light’s implied authority. Justice Owens opined that the mitigation program was closely connected to the utility’s express purpose of providing electricity and that there was a “sufficient nexus” between electricity generation and mitigation of pollution caused by its generation. She further argued that the majority misunderstood the funding structure of the mitigation program—the ratepayers do in fact pay for their usage based on the amount of electricity they consume. Justice Owens reasoned that the more energy a ratepayer uses, the more emissions the ratepayer is responsible for producing, and thus, the more the ratepayer contributes to the mitigation program through paying higher bills.

There are two significant aspects of this holding. First, the court specifically found that the control of greenhouse gas emissions was within the purview of a “governmental purpose.” Second, insofar as this purpose serves a governmental function, the available financing mechanisms for this effort are limited. Although the court’s holding specifically addressed only the authority of municipal utilities to enter into offset contracts, this decision strikes at the heart of creative and innovative efforts to mitigate greenhouse gas emissions.

Courtney Lords

Okeson v. City of Seattle, 159 Wash. 2d 436, 150 P.3d 556 (2006).

■ INDIANA SUPREME COURT AFFIRMS DISMISSAL OF TAKINGS CLAIM IN AIRPORT NOISE CASE

Biddle v. BAA Indianapolis LLC, 860 N.E.2d 76 (Ind. 2007), involved damage claims under a takings theory from neighbors affected by airport noise. The defendant BAA operates the Indianapolis International Airport under an agreement with the Indianapolis Airport Authority and had previously paid damages in a settlement agreement in another case. Under the settlement terms of the original case, the plaintiffs were required to make a noise disclosure to future transferees of their property in exchange for a payment of \$16,000 and

a commitment that if these landowners could not sell their homes at a market price without airport influence, the airport authority would make up the difference.

The plaintiffs filed the instant suit in 2001, two years after the settlement of the original claims. The trial court granted the defendants' motions for summary judgment and the plaintiffs appealed only the inverse condemnation and promissory estoppel claims. The Indiana Court of Appeals reversed and remanded, but the Indiana Supreme Court granted transfer.

The first issue was whether a taking existed and whether the trial court correctly granted the defendants' motion for summary judgment as a question of law. If a taking is found, the amount of damages is a fact question for the jury. In this scholarly opinion, the court traced the history of the takings clause, which it noted did not exist under Colonial law and began only with the Northwest Ordinance of 1787. It was then added to the federal constitution by James Madison, who believed it only applied to physical seizures. The United States Supreme Court applied the takings clause to the states under the Fourteenth Amendment in *Chicago, Burlington and Quincy R.R. Co. v. City of Chicago*, 166 U.S. 226, 241 (1897). Later that court found that a taking could occur short of seizure of land in *Pennsylvania Coal v. Mahon*, 260 U.S. 393 (1922). Looking particularly at cases involving airport noise, the Indiana Supreme Court found that though *Thornburg v. Port of Portland*, 233 Or 178, 376 P2d 100 (1962), allowed a taking claim on the grounds of nuisance, the great weight of federal authority required the aircraft to be in the airspace that could reasonably be occupied by the owner for her own use in order for a taking to occur. Specifically, the court reviewed *United States v. Causby*, 328 U.S. 256 (1946), where only those flights that were so low and frequent to be a direct and immediate interference with the use of land were found to be compensable under the theory that a temporary or permanent easement had been acquired. Later, in *Griggs v. Allegheny County*, 369 U.S. 84 (1962), the county and the United States Civil Aviation authority, which had set the boundaries for aircraft takeoff and landings, were found liable because those aircraft operations could and did use the airspace between 30 and 300 feet over the plaintiffs' roof. In a series of later cases, the United States Court of Federal Claims refined *Causby* and *Griggs* and set a rule that a valid takings claim must involve flights that constituted a practical destruction or substantial impairment of a plaintiff's property to be valid.

The Indiana Supreme Court considered whether the aircraft operations at issue in this case occurred in the navigable airspace above the property or within the area that could be used by the landowner. The Indiana Supreme Court also applied the *per se* takings rule that a property with no viable economic use was generally taken under the Fifth Amendment. The court did so because it felt that this approach would provide a more consistent basis for decisions in this area. In this case, the evidence showed that the flights were several times higher than the navigable airspace on the plaintiffs' property. The court determined that the plaintiffs'

use of their properties were not disrupted or substantially impaired and affirmed the grant of summary judgment in favor of the defendants.

The second issue was that of promissory estoppel based on the representations by airport officials that all landowners would be treated alike. The statements were made before the first litigation was settled. The court said that estoppel generally does not run against the government because dishonest and competent or negligent public officials may make unauthorized representations that could damage the public. The court found no liability under the facts of this case because there were no promises made. There was only a policy statement that all landowners would be treated alike, a statement the court found did not relate to the settlement of litigation, but rather to the operations of the airport. Moreover, the plaintiffs failed to demonstrate any detrimental reliance on those promises.

Finally, the court affirmed the dismissal of one family that had bought property with knowledge contained in a disclosure statement that there were noise issues that damaged property value. The court found a very different investment-backed expectation under the *Penn Central* as a result of that disclosure, so it precluded recovery on a takings theory. The trial court dismissal of the case on all grounds was thus affirmed.

This case contains an excellent discussion of the history of the takings clause in the context of the Fifth Amendment and considers the damages that can be made if promissory estoppel were able to be asserted successfully against a public body.

Ed Sullivan

Biddle v. BAA Indianapolis LLC, 860 N.E.2d 76 (Ind. 2007).

■ COLORADO APPEALS COURT REVERSES DISMISSAL OF RLUIPA AND RELATED STATE CLAIMS

Town of Foxfield v. Archdiocese of Denver, 148 P.3d 339 (Colo. Ct. App. 2006), involved a town ordinance that prohibited short-term parking on residential property for more than two occasions. Under the terms of the ordinance, enforcement would occur when the complaints were received from three separate households within a certain radius of the site. The town received three such complaints against the defendant church organization, which allowed its members to park on its residentially zoned property in connection with religious meetings. Upon receiving the complaint, the plaintiff town brought a suit for declaratory and injunctive relief against the defendant. The church asserted that the ordinance violated the Religious Land Use and Institutionalized Persons Act (RLUIPA) and the Colorado Freedom to Gather to Worship Act (FGWA). On cross motions for summary judgment, the court found for the town, but granted a stay of its judgment until an appellate court determined the matter on appeal.

The appellate court reviewed the matter *de novo*, but declined to address the constitutionality of RLUIPA since the matter had not been raised before the trial court. Instead, the court reviewed whether the parking ordinance imposed a “substantial burden” on the defendant’s religious activities. The trial court found the ordinance was facially neutral, directed to legitimate local interests (i.e. safety, noise, pollution, and neighborhood character) and was not clearly excessive. Moreover, the trial court found the ordinance offered no opportunity for a discretionary decision that would implicate the “individualized assessment” portions of RLUIPA.

The appellate court disagreed and found that there was an “individualized assessment” under the ordinance because enforcement was predicated upon the complaint of three households within a certain radius of the site.

The court then examined whether the ordinance violated RLUIPA and the FGWA. The trial court found the ordinance exempt under the FGWA because it was only a traffic regulation. However, the appellate court said the ordinance delegated authority over enforcement to private persons and limited enforcement to the owners of residentially-zoned property. Moreover, the town admitted that the ordinance was targeted at the parking on defendant’s property.

Because RLUIPA applied, the appellate court found the town was required to show that the ordinance was justified under a compelling state interest. Because the record showed the ordinance targeted the defendant’s property, could be enforced by private persons, and involved individualized assessments, the court found strict scrutiny applied and the case was remanded for application of that test.

This case is hardly procedural in nature, even though it determines only which test applies, since the requirement of the use of the strict scrutiny test virtually determines the outcome in a case. This is a rare case in which the targeted property is able to prevail against a local government. The Colorado Supreme Court has granted review in this case.

Ed Sullivan

Town of Foxfield v. Archdiocese of Denver, 148 P.3d 339 (Colo. Ct. App. 2006).

■ CONDEMNATION OF POTENTIAL SUBDIVISION PROPERTY LAWFUL SAYS NEW JERSEY SUPREME COURT

Mt. Laurel Township v. MiPro Homes, LLC, 910 A.2d 617 (N.J. 2006), involved an attempt by the plaintiff municipality to condemn the defendant’s newly approved subdivision land for open space use. The defendant claimed the condemnation was intended to prevent its residential development and noted that the plaintiff municipality had been the defendant in a long and famous case involving affordable housing. The defendant inferred that while the plaintiff municipality lost that case, it was attempting to achieve the same result of excluding housing through its eminent domain powers. The

trial court refused to uphold the township’s use of its eminent domain power, but the appellate court reversed. The New Jersey Supreme Court took review of the case and affirmed the appellate court decision.

The court found the desire to limit development and its attendant evils was not inconsistent with a desire to acquire land for open space and that defendant would receive full market value for its land for the subdivision approved 22 days before the instant proceedings were initiated.

Judge Rivera-Sota dissented, finding this case to be an abuse of the power of eminent domain. The dissent characterized the township’s condemnation rationale as an after-the-fact justification and scored the appellate court’s action based on its comparison of open space with upper class housing to determine that a comparable public interest was not served. He suggested that a greater balance needs to be achieved by stating:

In my view, a judge’s individualized and idiosyncratic view of what is or is not socially redeeming has no place in determining whether the sovereign’s exercise of the power of eminent domain is proper. The issue here was and remains whether the Township – and *not* MiPro – acted unreasonably, in bad faith, or in circumstances revealing arbitrary or capricious actions. Applying that yardstick, the trial court held – in my view, correctly – that the Township failed to meet its burden. I would not disturb that determination, least of all in the pursuit of some ill-defined social goal.

910 A.2d at 620.

Moreover, the dissent said the measure of damage was also improper because it was based on the recent subdivision approval and the condemnation was undertaken to prevent that development and its effects. In this case, the defendant was denied the benefit of its bargain and had a right, in justice, to be made whole. The dissent suggested use of both restitution damages plus expectancy damages to avoid

NOTICES:

The Real Estate and Land Use Section of the Oregon State Bar seeks an **Assistant Editor** and a **LUBA Case Summary Author** for the *Oregon Real Estate and Land Use Digest*. For consideration, e-mail Kathryn Beaumont at kbeaumont@ci.portland.or.us by April 30 with “Assistant Editor” or “LUBA Case Summary Author” in the subject line of your-email.

The *Oregon Real Estate and Land Use Digest* would also like to extend its best wishes to Ben Martin, who has been one of the digest’s most diligent and reliable contributors. We are sad to see him go.

an unconstitutional taking under the state constitution. Nevertheless, the appellate division was affirmed in this case and the condemnation was allowed to proceed.

This is an interesting case that may be more amenable to a legislative, rather than a judicial, resolution. Perhaps requiring justification of the open space use in terms of the local plan might be a means to avoid judges insinuating themselves in the planning process.

Ed Sullivan

Mt. Laurel Township v. MiPro Homes, LLC, 910 A.2d 617 (N.J. 2006).

**LUBA DECIDES
MEASURE 37 ISSUE**

In *Department of Land Conservation and Development v. Jackson County*, No. 2006-2003 (3/27/2007), LUBA issued its first decision involving Ballot Measure 37. DLCD challenged the county's approval of a subdivision for which the county had previously granted a waiver of regulations under the measure. LUBA reversed the county's decision, agreeing with DLCD that the county lacked authority to approve the subdivision because the applicant had not filed a Measure 37 claim with the state. DLCD asserted the state-wide planning goals applied directly to the property at the time the applicant became the owner. In the absence of a waiver by the state, LUBA concluded the county's decision violated state law.

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