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IN THE SUPERIOR COURT OF ARIZONA
IN AND FOR THE COUNTY OF YAVAPAI

SEDONA GRAND, LLC, Plaintiff, vs. CITY OF SEDONA, Defendant.	**Case No.: CV 82008-0129** **PLAINTIFF'S REPLY IN SUPPORT OF ITS MOTION FOR PARTIAL SUMMARY JUDGMENT** **ORAL ARGUMENT REQUESTED** *(Assigned to Hon. Mark M. Moore)*

INTRODUCTION

In its Response to Plaintiff's Motion for Partial Summary Judgment ("City's Response") the City diverts attention from the core issue in this case–whether the 2008 Occupancy Ban reduced Sedona Grand's property rights–to the irrelevant matter of whether Sedona Grand properly executed its option agreements under the 1995 Rental Ban. The Court need not chase after this red herring. Whether Sedona Grand properly used a particular option agreement is a suitable question for a code enforcement action and may be relevant to assessing the amount of

just compensation the City owes. It is not germane to the question of whether the 2008 Occupancy Ban reduces property rights that were previously valid under the 1995 Rental Ban.

It is clear that the 2008 Occupancy Ban has diminished Plaintiff's property rights. The Arizona Court of Appeals has already ruled that the new ordinance is far more expansive in its restrictions than the 1995 Rental Ban. *Sedona Grand, L.L.C. v. City of Sedona*, 229 Ariz. 37, 41 270 P.3d 864, 868 (App. 2012), *review denied* (Aug. 28, 2012). Although the City would like to limit the focus of this inquiry to whether the 1995 Rental Ban prohibited Sedona Grand's option agreements, the issue before this Court is much broader in scope. Option agreements are only one of many activities that were previously legal and now prohibited under the 2008 Occupancy Ban. The plain language of the 2008 ordinance encompasses option agreements for the first time, a clear indication that they were previously legal under the 1995 Rental Ban.

Thus, the City is left with the following arguments:

1) The City told Sedona Grand that its option agreement violated the 1995 Rental Ban;

2) The option agreements conveyed the same interests as a rental agreement (City's Response at 5); and

3) Sedona Grand used option agreements as rental agreements.

For the reasons set forth below, none of these arguments is persuasive.

1. The City's Characterization of Option Agreements Under the 1995 Rental Ban is Invalid.

The City claims that Sedona Grand's option agreements were invalid under the previous 1995 Rental Ban (City's Response at 5-6), but fails to cite to any authority to support this bald proposition besides its own *ipse dixit*. Arizona courts have a longstanding rule *against* deferring

to government's interpretation of its own zoning ordinances. As a general rule, because land use regulations are in "derogation of common law property rights", they are "strictly construed . . . [to] favor property owners." *Kubby v. Hammond*, 68 Ariz. 17, 22, 198 P.2d 134, 138 (1948).

Additionally, the City knew that Sedona Grand was using its option agreements before it enacted the Occupancy Ban. (PSOF ¶¶ 12-13.) The City conducted an investigation of "rental practices" at the property before it enacted the Occupancy Ban. (PSOF ¶ 15.) However, the City did not prosecute Sedona Grand or any principal of Sedona Grand until after it passed the Occupancy Ban, which contained the language specifically prohibiting the use of option agreements. (PSOF ¶ 18; City's Controverting SOF ¶ 18.) In failing to bring any enforcement action and then passing an ordinance specifically prohibiting the use of option agreements, the City has effected an admission that the 1995 Rental Ban did not limit the rights of landowners to use option agreements.

2. <u>Option Agreements Convey Different Interests than Rental Agreements and Were Previously Legal Under the 1995 Rental Ban.</u>

The City claims, without authority, that "Plaintiffs' [sic] Option Agreements Were Not Permitted Under the SLDC [the 1995 Rental Ban]." (City's Response at 5.) The argument fails to address the real question of whether *any* option agreement was permitted under the 1995 Rental Ban. Since the 2008 Occupancy Ban prohibits *all* option agreements that permit occupancy for under 30 days, the loss of the right to use *any* option agreement that was previously lawful under the 1995 Rental Ban would trigger liability under the Private Property Rights Protection Act ("PPRPA"). A.R.S. ¶ 12-1131 *et seq*.

The City declares that an option agreement with an inspection clause is the same as a rental agreement because it construes the definition of "rent" as the payment of a sum for the

temporary possession of a house. (City's Response at 5-6.) This construction is overbroad as under it a life tenancy or any defeasible or reversionary fee could also constitute a "rental". Moreover, when an option is purchased, the payment is for the right to purchase the property after inspecting it for a short period of time, not the right to *possess* it. In fact, Sedona Grand's option agreements do not grant either possessory rights as against the owner or the right to quiet enjoyment of the premises (other rights that a rental provides). Options to sell land contain an unconditional covenant to convey real property. Rental Agreements do not. Arizona law recognizes significant differences in the obligations, rights, and remedies of parties to leases and options. (*See* Sedona Grand's Motion for Summary Judgment at 9.) The 1995 Rental Ban is unambiguously limited to "rentals" and does not include option agreements, which convey distinct interests that differ greatly from the interests conveyed by rental agreements. Accordingly, in prohibiting option agreements for the first time, the 2008 Occupancy Ban diminished Sedona Grand's previously existing property rights.

3. Sedona Grand's Use of Option Agreements Was Valid But Ultimately Immaterial to the Question of Whether Property Owners Had the Right to Use Option Agreements Prior to the Adoption of the 2008 Occupancy Ban.

Unable to prevail on the issue of whether a right to use option agreements existed under the 1995 Rental Ban, the City tries to reframe the argument into a question of whether Sedona Grand's specific option agreements were lawfully used or executed. (City's Response at 6-11.) This diversion is irrelevant to the question of whether the 2008 Occupancy Ban diminished previously existing property rights. Notwithstanding, when viewed in context, the City fails to make a convincing argument that Sedona Grand's use of option agreements was improper.

Sedona Grand's option agreements, being unambiguous, require no extrinsic evidence. They provide the holder an unconditional right to purchase property upon exercise of its terms.

(*See* PSOF ¶ 8 ("By entering a purchase option agreement, a prospective property purchaser obtained the exclusive right to purchase the Property plus exclusive rights to inspect the Property for a set time period.")) Yet the City argues that it is appropriate to consider the context in which each of the option agreements was executed. It cites *Smith v. Melson, Inc*. 135 Ariz. 119, 121, 659 P.2d 1264, 1266 (Ariz. 1983) and *Miller v. Hehlen*, 209 Ariz. 462, 104 P.3d 193 (App. 2005) for the proposition that the circumstances surrounding a contract can assist in interpreting the agreement. (City's Response at 6.) However, surrounding facts are inapposite when "[t]he construction of a contract is a question of law where the terms of the agreement are plain and unambiguous." *Smith v. Melson, Inc*., 135 Ariz. at 121, 659 P.2d at 1266. Moreover, extrinsic evidence cannot "contradict or vary the meaning of the agreement." *Miller*, 209 Ariz. at 197, 104 P.3d at 466 n.3.

Construing the plain language, Sedona Grand's own option agreements were not rentals and were previously lawful under the 1995 Rental Ban:

a. Although the options agreements provided a right to occupy the property for purposes of inspection, they did so in the context of conveying an obligation to transfer a fee interest in property to the option holder, which a rental agreement does not convey. Each option agreement by its terms grants, for a defined period, an enforceable right to a prospective purchaser to purchase the property at a certain price. (PSOF ¶ 7, Exhibit 8.) The exercise of that right by a prospective purchaser would create an enforceable contract of sale. The City does not and cannot refute this.

b. The City argues that Sedona Grand's option agreements are somehow invalid because the purchase price of the property was set higher than the appraised value. (City's

Response at 7.) The offer price of a home is ultimately subjective to the homeowner. If that price were set too high, a prospective buyer could always make a counter-offer.

Moreover, the price is irrelevant to the question of whether Sedona Grand can recover just compensation for a reduction in property values, although the property's value is relevant to determining the amount of just compensation.

c. The City argues that Sedona Grand's payment policy information demonstrates that the Options were rentals. (City's Response at 7-9.) However, the Payment Policy did not alter the terms of the Option Agreement. (*See* PSOF ¶ 7, Exhibit 8; City's SOF Exhibit Q.) Sedona Grand used to rent the Property until it received a letter from the City advising it to cease. (*See* PSOF ¶ 5.) Due to burdensome regulations, Sedona Grand decided to sell its property and notified the City. (*See* PSOF ¶ 6.) Thereafter, it began using option agreements as a sales tactic to help sell the property. Sedona Grand needed to facilitate the sale of its options and simply used the forms that it had on hand and had previously used when renting the property. But these payment forms do not alter the nature of the option agreements between the parties.

Moreover, the City's argument that the "Terms and Conditions" section of the payment policy (City's SOF Exhibit R) "indicate[s] that the purchaser is agreeing to sign a Residential Lease Agreement" (City's Response at 8), is deeply misleading. Exhibit R is irrelevant to this case because Sedona Grand used it for rentals of 30 days or more and has only recently begun using the document, well after initiating this case and after the 2008 Occupancy Ban went into effect. Rentals of 30 days or more were not prohibited under the 1995 Rental Ban, are not prohibited under the 2008 Occupancy Ban, and are not at issue in this case.

d. The City's claim that there is "no admissible evidence that Plaintiff listed the property for sale until May 25, 2007" (City's Response at 7 n.3), is not relevant to the question of whether Sedona Grand can recover under the PPRPA for the diminishment of its property rights under the 2008 Occupancy Ban. Moreover, the City's assertion is false and misleading. The City relies on the active date of the MLS listing. Although an MLS listing may be conclusive evidence that a property is listed for sale, the converse is not true. Indeed, one need not even employ a real estate agent to offer one's home for sale. And the City was, in fact, on notice that Sedona Grand was selling its property because Sedona Grand sent correspondence to that effect to the City in January. (*See* PSOF ¶6.)

Yet the City continues down that rabbit hole, arguing that Sedona Grand did not produce signed option agreements before May 2007 (City's Response at 10); that option agreements were not signed until after the City "declared that the option agreement would violate the [1995 Rental Ban]" (*Id.* at 11); and that the agreements were not used until after the City received complaints that the property was being used for short term rentals. (*Id.*) But these facts are perfectly consistent with Sedona Grand's use of the option agreement to facilitate a sale of the property. Indeed, the City's rental and property regulations were the impetus behind Sedona Grand's decision to sell its property, and it began using option agreements to do so. (PSOF ¶ 6, Exhibits 6, 7.)

e. The City's claim that in April 2007, Sedona Grand's website continued to list the property as available for rent for fewer than thirty days (City's Response at 9-10), is irrelevant to the issue of whether Sedona Grand can recover under the PPRPA for a diminishment of its property rights under the 2008 Occupancy Ban. Short-term rentals were illegal under both the 1995 Rental Ban and the 2008 Occupancy Ban. The City's contention that Sedona Grand

unlawfully rented its property during this time period is relevant to a code enforcement action, but not to the question of whether the 2008 Occupancy Ban restricted rights to a greater degree than the 1995 Rental Ban.

f. Finally, in the eleventh hour, the City has produced affidavits from individuals who purchased option agreements seven years ago about their intention at the time of the purchase. (City's Response at 9-10.) Though these declarations may be relevant in a code enforcement action, they have no bearing on the legality of option agreements under the 1995 Rental Ban. Moreover, all these affidavits demonstrate that, like many sales tactics, purchase options are not 100% successful in attracting serious buyers. However, the sales tactic did attract some serious buyers. Loretta Peak made clear in her 2007 affidavit that she purchased the option agreement to examine the property with an interest in purchasing. (PSOF ¶ 17, Exhibit 13.)

4. <u>The City Has Not Met and Cannot Meet its Burden to Prove the Principal Purpose of the 2008 Occupancy Ban was Protecting the Public's Health and Safety.</u>

In order to evade liability to provide just compensation, the City bears the burden to prove the principal purpose of the 2008 Occupancy Ban was protecting the public's health and safety. Since the City bears the burden on this issue, summary judgment should be granted to Sedona Grand if "the facts produced in support of the claim [ ] have so little probative value, given the quantum of evidence required, that reasonable people could not agree with the conclusion advanced by [the City]." *Orme School v. Reeves*, 166 Ariz. 302, 309, 802 P.2d 1000, 1008 (1990) (footnotes omitted). The City's reference to *Nat'l Bank of Ariz. v. Thruston*, 218 Ariz. 112, 180 P.3d 977 (App. 2008) (City's Response at 13) is inapposite. Unlike *Thruston*, here the City moved for summary judgment and offered evidence to support its burden of proof and claim to judgment. In its Response to Defendant's Motion for Partial Summary Judgment,

Sedona Grand demonstrated that for a variety of reasons, the City did not meet its burden of proof and was not entitled to evade liability (Sedona Grand's Response at 6-7), thus meeting its *Thruston* obligation to point to the absence of evidence to support the opposing party's burden. The City simply cannot meet its burden because its evidence does not meet any of the criteria necessary to establish a nexus between an alleged health and safety issue and the ordinance purportedly addressing it. As Sedona Grand set forth fully in its Response, the City has failed to (1) show cognizable health and safety problems within the city, (2) establish an essential nexus between community health concerns and the wide array of activities the 2008 Occupancy Ban now forecloses (such as contracting for home improvements, nanny services, babysitting, and entering into purchase option agreements with prospective homeowners), or (3) show that the 2008 Occupancy Ban is proportional to the purported public health problems. (Sedona Grand's Response at 6-10.)

Yet the City, paying no obeisance to the Court of Appeals ruling in this case, continues to argue that "it is simply not the providence [sic] of the courts to second-guess the legislative determinations made by [the City]." (City's Response at 13.) This familiar argument, that the City's legislative determination is entitled to unqualified deference from the judiciary has previously been disposed of, *Sedona Grand, L.L.C. v. City of Sedona*, 229 Ariz. 37, 41, 270 P.3d 864, 868 (App. 2012), *review denied* (Aug. 28, 2012), since granting deference would amount to shielding the City's findings from judicial review and gutting the PPRPA of its robust protections.

5. <u>The Bifurcation Agreement</u>

Finally, the City bizarrely complains that Sedona Grand's Motion for Summary Judgment exceeds the permissible scope of the bifurcation agreement. The bifurcation agreement split the

case into liability and damages phases. This case is currently in the liability phase. The question before this Court is simply whether there has been a diminution in rights. As the City recognizes, determining whether rights have been reduced is a "question of law" that involves comparing the ordinances. (City's Response at 6.) At this stage, Sedona Grand does not assert a "demand for damages," as the City contends. (City's Response at 14.) Rather, Sedona Grand seeks a finding that it is entitled to just compensation because its rights have been reduced. The precise value of that just compensation, whether it be millions of dollars or nothing at all, will be determined at the second phase and will depend on the extent of diminution in the property's value.

To be clear, at this stage Sedona Grand contends it is entitled to the following findings: (1) that the City's 2008 Occupancy Ban diminished property owners' rights to use their property; and (2) that the principal purpose of the 2008 Occupancy Ban was not for the public's health and safety. This is fully consistent with the bifurcation agreement.

If anyone has violated the bifurcation agreement, it is the City, which improperly introduced evidence that could only be relevant to the damages phase. The City's entire argument on the propriety of Sedona Grand's use of its option agreements is immaterial to the question of whether the 2008 Occupancy Ban diminished property owners' rights to use, divide, sell or possess private real property.

Conclusion

For the reasons stated above, in Plaintiff's Motion for Partial Summary Judgment and in Plaintiff's Response to Defendant's Motion for Partial Summary Judgment, Sedona Grand respectfully requests a finding that: (1) that the City's 2008 Occupancy Ban diminished property owners' rights to use their property; and (2) that the principal purpose of the 2008 Occupancy

Ban is not for the public's health and safety. As such, Sedona Grand respectfully requests that its Motion for Partial Summary Judgment be GRANTED and the City's Motion for Partial Summary Judgment be DENIED.

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Respectfully submitted,

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FILED this 31st day of October, 2014 with:

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