MEMO TO: City Council

FROM: John Marchione, Mayor

DATE: February 16, 2010

SUBJECT: Authorizing the Mayor to Enter into a Joint Defense Agreement with Ogden

Murphy Wallace in regard to Claims Entered by Verizon Northwest Inc. for

Refund of DSL Utility Taxes Collected

I. RECOMMENDED ACTION

Authorizing the Mayor to sign the attached Joint Defense Agreement, Potential Conflict of Interest Waiver, and subsequent Conflict of Interest Waivers, with Ogden Murphy Wallace and neighboring affected cities regarding Verizon's request for refund of taxes based on DSL revenue.

II. DEPARTMENT CONTACT PERSONS

Mike Bailey, Finance and Information Services Director

425-556-2160

III. DESCRIPTION

On December 31, 2009, the City of Redmond received correspondence from Verizon Northwest Inc. ("Verizon"), via the Perkins Coie legal firm, regarding Verizon's demand for refund of city utility taxes paid by them on the sales of digital subscriber line ("DSL") service during the period January 1, 2005, through June 30, 2008, in the amount of \$585,635. The same request for refund was made of several other cities.

On January 15, 2010, the City of Redmond received correspondence from Ogden Murphy Wallace, regarding the development of a consortium to defend against Verizon's refund request. The agreement has been provided to the Council under separate confidential cover, as the agreement reveals the strategies that will be used by the consortium to address the claim and thus falls under the attorney-client privilege. If the Council has questions concerning the claim, the potential defenses, or the strategies, an executive session can be held to discuss those matters.

The proposed joint agreement will become effective as soon as two cities sign the joint agreement. As more cities join, it will be necessary for Ogden Murphy Wallace to obtain the City of Redmond's consent to sign conflict waivers respectively.

The purpose of the joint agreement would be for the cities to express their intent to jointly collaborate, share information, negotiate and defend against the Refund Claim and any litigation arising there from. By signing the agreement, the parties would as well express their desire to coordinate their efforts and retain joint counsel to review, analyze, negotiate and defend, if necessary, against the Refund Claim.

We believe there are legal defenses to the claim by Verizon and this agreement would enable us to explore them fully before providing any refunds. It would also provide information that may prove necessary to defend a subsequent lawsuit should one develop.

IV. IMPACT

A. **Service/Delivery:** There are no service delivery impacts.

B. Fiscal:

Verizon's Requested Refund Amount

\$ 585,635

Cost of Defense:

Ogden Murphy Wallace's Proposal:

Senior Members	\$360/hr
Junior Members	\$300/hr
Associates	\$200/hr
Paralegals	\$145/hr

To be billed hourly at tenths of an hour. Any and all associated costs will be directly charged to the Parties. All fees and costs will be split equally between the parties to the joint defense agreement, so the actual hourly rate paid by the City will be less than that set forth above and will depend upon the number of cities who sign up for the consortium.

V. ALTERNATIVES

The City Council could choose to not enter the agreement, in which case, the City of Redmond could retain separate counsel if litigation arises out of said Claim, or the City could also choose not to defend against the Refund Claim of Verizon if litigation arises.

VI.	TIME	CONSTR	AINTS

None

VII.	LIST	\mathbf{OF}	AT	TA	CHN	ИEN	JTS

A. Letter from Perkins Coie Re: Verizon's Claim for Refund
 B. Proposed Joint Agreement distributed under separate cover (Attorney-Client privilege)

/s/		02/08/10	
Mike Bailey, Director of Finance	and Information Services	Date	
Approved for Council Agenda	/s/	02/08/10	
	John Marchione, Mayor	Date	

ATTACHMENT'A AM No. 10-024 (C4)



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EMAIL RMahon@perkinscole.com

December 31, 2009

VIA CERTIFIED MAIL RETURN RECEIPT REQUESTED

City Clerk City of Redmond PO Box 97010 Redmond, WA 98073-9710

Finance Director City of Redmond PO Box 97010 Redmond, WA 98073-9710

Re

Verizon Northwest Inc. Petition for Refund

On behalf of our client Verizon Northwest Inc. (VZNW), we respectfully request a refund of \$585,635 in city utility tax paid by VZNW on its sales of digital subscriber line ("DSL") service during the period January 1, 2005 through June 30, 2008.

RCW 35.21.714(1) and 35A.82.060(1) prohibit cities from imposing taxes on any charges "for access to, or charges for, interstate services." The Washington Supreme Court has held that the sale of telecommunications services that are part of a taxpayer's Federal Communications Commission ("FCC") tariff are "interstate" as a matter of law and, accordingly, not subject to city taxation. *Qwest Corp. v. City of Bellevue*, 161 Wn.2d 353, 361-63, 166 P.3d 667 (2007). *See also Vonage America, Inc. v. City of Seattle*, 151 Wash.App. 1003 (2009) (describing the inclusion of services in an FCC tariff as "a point critical to the court's holding [in *Qwest*]."). During the period January 1, 2005 through March 18, 2006, VZNW's DSL services were provided under an FCC tariff and, accordingly, are not subject to city utility tax as a matter of law. *See In re GTE Telephone Operating Cos.*, GTOC Tariff No. 1, 13 F.C.C.R. 22466, 13 FCC Rcd. 22466, 1998 WL 758441 (F.C.C.), *recon.*, 17 F.C.C.R. 27409, 17 FCC Rcd. 27409, 1999 WL 98039 (F.C.C.). For periods after March 18, 2006, VZNW's DSL service remained an

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interstate service subject to FCC jurisdiction but the FCC removed tariffing requirements. *In re Verizon Telephone*, F.C.C. Dkt. No. 04-440, 2006 WL 707632 (F.C.C.) (March 20, 2006). As the court of appeals explained in Vonage, the prohibition on municipal taxation of interstate service includes but is not limited to federally tariffed services. *Vonage America, Inc. v. City of Seattle*, 152 Wash.App. 12, 23-24, 216 P.3d 1029 (2009) ("[T]he State's prohibition on municipal taxation of services that are interstate is not limited to those that are subject to federal tariffs.")

The City's utility tax on VZNW's DSL service is further barred RCW 35.21.717, which limits municipal taxation of internet service to "generally applicable business taxes or fees, at a rate not to exceed the rate applied to a general service classification." *Community Telecable of Seattle, Inc. v. City of Seattle,* 164 Wn.2d 35, 186 P.3d 1032 (2008).

Finally, the City's utility tax on VZNW's DSL service is preempted by the federal Internet Tax Freedom Act, Pub. L. No. 105-277, codified at 47 U.S.C. § 151 (note), as amended by the Internet Tax Nondiscrimination Act, Pub. L. 108-435.

Please contact me at (206) 359-6360 if you have any questions or need any additional information to process VZNW refund claims.

Very truly yours,

Robert L. Mahon

cc:

Cindy Gonzales, Senior Tax Counsel – State and Local Tax, Verizon