TO: Supervisor Richard S. Gordon, President of the Board
Supervisor Mark Church
Supervisor Jerry Hill
Supervisor Rose Jacobs Gibson
Supervisor Adrienne J. Tissier

April 15, 2005

CC: Director of Environmental Services Marcia Raines
Chief Deputy County Counsel Michael Murphy

ALL SUPERVISORS RECEIVED

Planning Commissioners David Bomberger, Steve Dworetzky, Ralph Nobles, John Silver, William Wong

FAX: 650/599-1027

RE: Harbor Village Development Agreement

Honorable Supervisors:

We understand that the owner/developer of Harbor Village has applied for an extension to the project's development agreement, expiring this June. His principal claim is that the attacks of 9/11 have materially contributed to his difficulties in obtaining full financing for the projects and that this triggers an automatic extension of the development agreement under the contract's *force majeure* clause.[1]

We do not believe that the developer's claims about *force majeure* are correct, nor do they require you to extend the agreement. Of course, you have broad powers and may extend the agreement based on its own merits, subject to statutory constraints on procedure. Any consideration of those merits must, we think, take into account the recent troubled history of the project and whether or not the development agreement is still an appropriate instrument for planning in the spirit of the State law that governs such agreements.

Force majeure: war and acts of God

The developer's claims about force majeure do not hold up to either common sense or case law.[2] Insurers for lives and property lost on 9/11 have agreed to pay billions of dollars in claims, so can the developer expect relief from economic difficulties that are quite possibly more related to the merits of the project and the collapse of the "dot com bubble" than to the horrible attacks in New York and Washington? We don't believe so.

The insurance companies paid these claims not totally out of civic pride; case law going back over 30 years (to the 1970 hijacking and destruction of a TWA plane by Palestinians in eerie parallel to 9/11) is nearly unanimous in disallowing terrorist events and secondary economic effects under standard *force majeure* clauses. In his reply[3] to us, Mr. Michael Murphy apparently confirms much of our lay understanding of the relevant law.

But the *force majeure* claims are not the most important issues awaiting your deliberation.

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1 Michael Murphy to Fred Lyon, February 15, 2005

2 Larry DeYoung & Don Johnson to Supervisor Gordon, March 2, 2005

3 Michael Murphy to Larry DeYoung & Don Johnson, March 11, 2005

Why now?

Perhaps the most important question to ask about extending the development agreement is: "Why now?"

If the developer has been without funding for key portions of the project for (apparently) several years now and knew better than anyone the difficulties of meeting this June's construction deadlines, both he and the County could prudently have taken that into account before requesting and issuing a building permit and beginning construction.

The developer's case for requesting the extension on the merits of the project would have been no weaker a year ago than it is today, and receiving an extension before beginning any construction would seemingly have removed some uncertainty and helped his chances of getting the additional funding required to complete the full project.

By beginning construction without an extension to the development agreement, the developer assumed substantial schedule and financial risks that were apparently not necessary and may have been counter-productive. The developer could have been approaching financial backers for the last year saying "I've done everything I can to reduce your risk; the development agreement has been extended to 2011 and there's only clear sailing ahead."

But he didn't, and instead created a situation where raising additional funding might quite possibly have been even more difficult than it had been as the end of the development agreement drew closer.

The developer choose to go ahead with construction even after the County's warnings[4] of "severe consequences" should he default on the responsibilities he willingly assumed:

> "You should clearly understand that once you have initiated work at the site that you must complete construction of all of the elements of the projects including public improvements required by the Development Agreement by June 22, 2005.
> ...
> "[I]f you take permits, begin construction, and do not complete the project by June 22, 2005, one possible outcome could be that you be required to abate the work in progress and return the property to its current natural state. Your failure to complete the Development Agreement requirements by that date may result in severe consequences."

In short, the difficult situation in which the developer finds himself is one of his own making, easily avoidable but freely chosen. We do not believe that the County's support for the general business environment should extend to protecting individual developers from the effects of their own business decisions.

"Operating memoranda"

Let us return to Ms. Raines' letter to the developer, immediately above.

Before communicating a policy of such consequence, it would only have been prudent for Ms. Raines to obtain the agreement of County Counsel and Supervisor Gordon, who has been actively involved with the Harbor Village project for years. Anything less would have been improper and would reduce Ms. Raines' statements to idle threats.

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[4] Marcia Raines to Keet Nerhan, August 9, 2004

In particular, Ms. Raines' letter to the developer and his implicit acceptance of it may be exactly the kind of clarification explicitly foreseen in paragraph 13 of the development agreement:

> "13. Operating Memoranda. The provisions of this agreement require a close degree of cooperation between County and Owner and the refinements and further development of the Project may demonstrate that clarifications are appropriate with respect to details of performance of County and Owner. ...
>
> "The County Counsel shall be authorized to make the determination whether a requested clarification may be effectuated pursuant to this Paragraph 13 or whether the requested clarification is of such a character to constitute and amendment hereof pursuant to Paragraph 12. "

Thus, we will take Ms. Raines' warnings to be County policy, reviewed and approved by County Counsel as provided in this paragraph and therefore part of its understanding of the development agreement. As such, we believe it should enjoy the full support of the County's legal staff and the President of the Board.

State law

The reasons for considering funding and reasonable construction schedules before granting a building permit go beyond prudence, however, into the requirements of State law. Both the developer and the County are to participate in yearly progress reviews, as required by California Government Code Section 65865.1, which we include here with our emphases added:

> 65865.1. Procedures established pursuant to Section 65865 shall include provisions **requiring periodic review at least every 12 months, at which time the applicant, or successor in interest thereto, shall be required to demonstrate good faith compliance with the terms of the agreement.** If, as a result of such periodic review, the local agency finds and determines, on the basis of substantial evidence, that the applicant or successor in interest thereto has not complied in good faith with terms or conditions of the agreement, **the local agency may terminate or modify the agreement.**

The salient requirement of the development agreement – and the standard against "good faith performance" is to be determined[5] – is that the entire project must be completed by the agreement's tenth anniversary, this June 22.

As you may know, this is a huge project::

- An 84-room hotel, with an additional 11 "family suites" (seven of them with two bedrooms) for a total of 102 bedrooms.
- A 280-seat restaurant and 60-seat bar
- 15 to 25 retail shops

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[5] We understand that the "estoppel" provisions of paragraph 21 allow the developer to request that the County certify that there are no uncured defaults. Please note that this section has no force unless the developer formally requests such a notification. While there may be constraints on retrospective judgments by the County, we don't believe that anything in this section bars you from considering the history and current status of the developer's good faith compliance in your deliberations concerning an extension or modification of the development agreement. In fact, the developer has already asked you to consider the history of his difficulties in obtaining full financing.

- Street-level and underground parking for 450 cars
- 209,000 sq feet of construction on 18.7 acres

(The only construction on the project as of last August – a small, detached office building of less than 1,500 sq ft, much smaller than the average new home on the Coastside – had been started in 2000, but not finished; as of last fall, the building permit had expired.)

Time and money

As always, ambitious projects require time and money, and by last summer it should have been clear to the County that the developer did not have enough of either. Any of the State-mandated reviews over the past few years would have turned up this problem, as they are designed to do, so in July we requested[6] copies of all of these reviews, including the section of code above with our request.

We heard nothing for weeks until August 9th when we learned that the County had recently granted the building permit and read this in a letter[7] to us from Ms. Raines:

> "Due to the inactive status of the Project, the Planning Department did not generate written reports as there was nothing to report."

"Nothing to report" – no significant progress toward meeting the contractually required construction deadline – is exactly what the annual reviews are intended to catch. The law, as you can see for yourself, leaves no doubt that these reviews are required and not optional.

Assuming, again, that a County executive would not comment on specific provisions of State law without involving County Counsel and quite possibly other senior decision makers, we believe that this statement may well be an official admission that the County knowingly violated State law in granting last August's building permit.

We further believe that, had the County conducted a full and properly documented review as required by State law, an objective comparison of the plain requirements of the development agreement and the current state of financing and construction would necessarily have required the County to find the developer in default of the agreement.

Thus, the building permit was quite possibly granted illegally and should not be recognized as valid. Further, since the developer is now and has been for some time in default of the agreement, it should be terminated, not allowed to expire and definitely not extended.

Is it easier to receive forgiveness than permission?

Please return to our prior question: "Why now?"

If it is difficult to understand the developer's decision to apply for a building permit instead of an extension last summer, you might consider whether, in the owner's estimate, having concrete in the ground would subsequently incline you to consider an extension more favorably.

Though we cannot comment on the developer's actions in this regard, we believe that you might well consult with the developer and satisfy yourselves on this issue since you will be interested in determining the developer's good faith as part of your deliberations.

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[6] Larry DeYoung, email to Supervisor Richard Gordon and Director of Environmental Services Marcia Raines

[7] Marcia Raines to Larry DeYoung, August 9, 2004

Over the history of this project, we have often been referred to sections of the agreement that might be read to guarantee that, once the developer has obtained a building permit, the County effectively gives up its right and responsibility to enforce the terms of the agreement.

In our experience, the County has focused on these sections to the exclusion of the main contractual requirements for progress and completion, almost as though the exceptions – rather than the requirements – were the main purpose of the development agreement. When the emphasis shifts from scrupulous enforcement before the fact to finding loopholes after the fact, we feel disserved by our government.

Here's a fragment from paragraph 15.B:

> "[T]ermination of this agreement shall not render invalid any action taken by either party in good faith prior to the date on which the termination becomes effective."

The operative phrase here is "in good faith."

It will be your decision whether the circumstances surrounding last August's building permit qualify as "good faith" on the part of both parties. Since, we believe, there is a possibility that both the County and the developer were in violation of both the development agreement and State law at that time, your determination of "good faith" might well address such concerns.

A bit further on in the same paragraph[8] we read:

> "[T]he liability of the Owner and the remedy of the County shall be limited to the termination of this Agreement."

We believe that must be read in context of the County's broader responsibilities to its own ordinances and regulations, and within the context of State law.

If the County places additional conditions on this project – for example the requirement for traffic mitigation, a very real example in this case – can it waive its responsibility to the public to enforce those conditions after the development agreement expires, or are your options limited to terminating the agreement? We believe you are obligated to enforce conditions placed on a building permit regardless of the status of the development agreement. In fact, we believe that any reading if this provision that disavows broader County responsibilities would be inappropriate.

In that light, we may ask: if the County places other conditions on the project through "operating memoranda" – for example, the requirements set out in Ms. Raines' letter that the developer must complete the project by this June or possibly be required to return the site to its pre-construction natural state – is it barred from enforcing those conditions on behalf of the public it serves?

Surely the County cannot sign away all its responsibilities, and this almost certainly had been considered by County Counsel who, we believe, would necessarily have reviewed Ms. Raines' letter to the developer of August 9th.

But if the County had no intention of enforcing the conditions mentioned by Ms. Raines in the manner described, and if the County's position would later be to claim that the development

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[8] Our copy of the agreement, which we obtained directly from the County, reads as though some phrases or sections are missing even though the page numbers are in sequence.

agreement prevented enforcement of what was once presented as County policy ... what then are we to make of Ms. Raines' letter to the developer?

We have often been referred to section 20 of the development agreement, as we believe you will be, too:

> "Following the expiration of said term [of the development agreement], this Agreement shall be deemed terminated and of no further force and effect; provided, however, such termination shall not affect any right or duty arising from County Permits, including, without limitation, the Project Approvals, the Future Permits or the Ministerial Permits."

Does this really mean that a building permit, granted in apparent violation of State law to a developer in possible default of the development agreement, is immune to question? It would be unfortunate if the County interpreted its own contracts to include a safe harbor for improperly granted privileges, and fortunately that is not necessary, for two reasons.

First, if you read this section again, you'll notice that it refers only to normal expiration at the end of the development agreement's term; it does not extend its protections to terminations for cause, as are explicitly allowed elsewhere in the agreement, nor does it disallow the effect of special conditions placed on permits, such as those in Ms. Raines' letter to the developer last August.

In fact, paragraph 20 explicitly states that the normal termination of the development agreement does not "affect any right or duty arising from County Permits," including, we would imagine, the right of the County to enforce the conditions placed on the permit in Ms. Raines' letter, and the duty of the developer to comply.

In section 11 of the agreement, which places obligations on both owner and County to participate in the annual reviews, we read:

> "Any termination or modification of the Agreement shall be effected pursuant to the procedures set forth in Paragraph 15 regarding defaults hereunder. ...
>
> "If the Board of Supervisors determines that Owner is not then in good faith compliance with the terms of this Agreement, then the Board of Supervisors shall take such actions as it finds appropriate to enforce or interpret the parties' rights and obligations under the terms of this Agreement."

Please note that terminations for cause are covered by paragraph 15 ... not paragraph 20, which governs normal terminations at the expiration of the agreement ... and that your Board "shall take such actions as it finds appropriate" in case of default. There is nothing here that provides either County or Owner immunity from corrective action such as mentioned in Ms. Raines' letter of August 9th to the developer. In fact, such actions seem to be anticipated and explicitly allowed.

As we have already explained, we believe that the "severe consequences" described by Ms. Raines are current County policy and are therefore first among the actions you may consider. You may, of course, take other action instead but we believe you must first repudiate Ms. Raines' statements and the internal consultation and policy decisions behind them.

Second, it is only termination of the agreement that "shall not affect any right or duty". Nothing here shields a building permit from other County ordinances or State laws, nor does the State Code establishing development agreements allow them that latitude. This section is properly

read, we believe, to mean that nothing in the agreement adds to other laws, not that the agreement invalidates other laws.

So the question is not "does the development agreement give special protection to building permits that other laws do not?" but rather "does last August's building permit and the application leading to it satisfy all County and State laws?"

Old business before new business

We believe that, before you can consider any modification to the agreement ... which is allowed but optional ... you must first conduct a good faith performance review as required by State law. As we have discussed above, the County did not do any reviews for the first nine years of the development agreement. In particular the County failed to perform such a review, despite our explicit reminder to the County of this obligation – before granting last August's building permit.

Furthermore, the County is unable to produce documentation[9] of the review said to have been conducted by September 2, 2004, nor has it yet been able to explain how the conclusions of that review – that "the developer is in good faith compliance" – square with the facts regarding financing and construction progress as publicly known or documented by County correspondence.

Your Planning Commission recommended last September that your Board conduct this review in public session and, given the County's troubled internal handling of prior reviews, we believe that a public discussion of the facts is most appropriate.

Once you begin that review, you must, we feel, compare the status of the project with the requirements of the development agreement as it stands today. A fair and objective comparison will, we believe, surely require that the developer be found in default. This finding, in turn, triggers events prescribed by the development agreement, including the requirement that the developer "cure" the default. Any consideration of modification or extension should, we believe, come only after any defaults have been cured.

You have considerable, but not unbounded, discretion in modifying or extending the agreement. In addition to the developer's history of good faith compliance, we believe you will need to take other factors into account.

Trapped in the past?

The purpose of the development agreement, in paragraph A, is excerpted ... with changes ... from California Government Code Section 65864(b): The Legislature finds and declares that:

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[9] In a memo dated September 2, 2004, Ms. Raines and Mr. Jim Eggemeyer write:

> "The Planning Division has reviewed compliance with the Development Agreement, and the Planning Director has concluded that, based on our review to date, the owner is in good faith compliance with the terms of the Development Agreement."

We asked for a copy of this review, since we were curious how the County had come to this conclusion. We were told (by Deborah Hirst of Supervisor Gordon's office) that there is no documentation of the review, so it remains a mystery how the County thought the developer could complete a huge project like this in ten months, especially since he didn't have money even to begin the full project.

Our request for clarification on this issue has gone unanswered.

> "Assurance to the applicant for a development project that upon approval of the project, the applicant may proceed with the project in accordance with existing policies, rules and regulations, and subject to conditions of approval, will **strengthen the public planning process, encourage private participation in comprehensive planning, and reduce the economic costs of development."** (our emphasis added)

Please note that State law cites reducing "the economic costs of development" (arguably in the general public interest) and says nothing about reducing "the economic risks of development" as the development agreement has it. The State code does not include the word "risk."

By exempting the project from changes in applicable policies for ten years, the development agreement provided a more-favorable-than-normal risk environment for economic backers for a very long time. But once the developer assumed additional risks by beginning construction without first obtaining an extension, in possible violation of law and contract, we believe he unnecessarily increased the uncertainty for prospective lenders, quite against the spirit of the governing State code, and stepped outside the protections of the development agreement.

Will an extension of the agreement "strengthen the public planning process (and) encourage private participation in comprehensive planning?"

This is highly doubtful. The design of the project is nearly 20 years old[10] ... and poorly designed even then for a Coastside that no longer exists ...and was strongly opposed by the Coastal Commission staff on environmental grounds. The recent history of the process has been far less public than we would prefer, and hardly as strong as either your own development agreement or State law require.

There is nothing to be gained by continuing a failure.

The development agreement, in fact, actively discourages[11] "private participation in comprehensive planning" since changing the project to meet current day needs (and avoiding out-dated economic assumptions such as the need for more hotel space) would require abandoning the development agreement as written.

The only modification in this project from its original mid-80s design is the deletion of a 75-foot decorative lighthouse; not a single change has been allowed in nearly 20 years to bring the project closer to the needs of a changing community.

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[10] While the development agreement dates from May 1995, the project went through years of County approvals, our appeal to the Coastal Commission and suit against the County and the developer. The original application for the project dates from May 1988 and, we can assume, came only after a few years of design work.

[11] A few years ago, at the initiative of Supervisor Gordon, we met with the developer, the Supervisor and senior County staff to discuss how we could address a common problem: we didn't like the project and the developer told us that he didn't want to build it as designed either. (He has told others in the community the same thing subsequently.)

We offered to work with the developer and the County in gaining public support for a suitably redesigned project, but the developer did not agree since he didn't want to reopen the work to public review. Since no substantial change to the project was possible under the development agreement and any such change would require the full public process, the agreement acted as a quite effective impediment to "private participation in comprehensive planning."

It is ironic that the developer did not want to re-enter the public forum partly since it would slow things down. But had he agreed to redesign the project years ago, he might today actually be farther along in building a good project with contemporary design and possibly greater appeal to prospective financial backers.

Twenty years ago, the prospect of more jobs as chambermaids, busboys and retail clerks may have been attractive. But today the Coastside is different; we need good local jobs so people can pay $750,000 mortgages without commuting out of the community.

The agreement still requires construction of a 102-bedroom hotel, even though many hotels have been built subsequently and the overall vacancy rate is rather high. The project's huge hotel is not only a bad idea for the Coastside, it may even be a bad investment for potential financial backers.

In short, the development agreement is an idea whose time has passed. It has not achieved the purposes for which it was adopted. It does not "strengthen the public planning process" but rather prevents that freezes that process in the 80s and prevents it from considering and meeting the current needs of your constituents. It is an effective disincentive for "private participation in comprehensive planning." It is a failure.

Fix it ... or forget it?

We do not think that you can modify the development agreement to fix its inherent and fatal flaws, either, since the "all or nothing" constraint on the project is out of your hands. Since the legal approvals for the project rest on a decision of the Sixth District Court of Appeals, we believe that you are bound by the terms of that judgment, which found that the project could be justified (despite its environmental drawbacks) only by the overriding financial considerations of the entire project under CEQA.

Since the County is the agency responsible for enforcing CEQA for the Harbor Village project, you face additional constraints of State law. We believe that CEQA, as a State law, takes precedence over the particulars of the development agreement where there are conflicts and that, when forced to choose, you must enforce State law first and always, and County development policies as allowed.

Should you, for example, allow the current construction to continue without extending the development agreement, you would, we believe, be sanctioning an explicit violation of CEQA.

Similarly, if you extend the development agreement without requiring that the developer produce irrevocable guarantees of full financing prior to your decision, you would be, in our opinion, being less than attentive in your administration of the development agreement or your enforcement of CEQA.

You are in a difficult position, but it is one that your own staff created for you, quite possibly in consultation with County Counsel, as would be prudent, and perhaps in agreement with members of your Board who have, quite properly, been following this project closely. You may find that enforcement of the terms of the development agreement and CEQA could put you at some risk for civil liability with regard to enforcement of the terms placed on the building permit by Ms. Raines' letter of last August 9th.

But a difficulty is not an excuse, as we believe many will advise you. A difficulty is a responsibility, and this particular responsibility will require your best efforts on behalf of the community you serve.

A summary

Before turning to our suggestions, we'd like to offer this summary:

As of last September, we believe that:

- There is a *prima facia* case to be made, based partly on Ms. Raines' letter to us of August 9, 2004, that the County knowingly violated State law in administering the development agreement and, in particular, in granting the building permit for the retail shell.
- There is a *prima facia* case to be made that the developer was in violation of State law since he had not participated, according to Ms. Raines, in any State-mandated review during his ownership of the project.
- There is a case to be made that the developer was in violation of the development agreement when he applied for the building permit since, with less than a year to go in the development agreement, he had neither completed a single part of the project nor did he have funding for the entire project.
- There is a case to be made that the County knowingly violated the development agreement by granting a building permit while the developer was in default and had neither the time nor money to meet the terms of the development agreement.
- In so doing, County staff improperly prejudiced decisions that, under State law governing development agreements, are to be made by your Board.
- The County did, nonetheless, incorporate additional conditions and severe sanctions into the development agreement via an operating memorandum written by Ms. Raines – and quite possibly reviewed by County Counsel and approved by other senior decision makers.
- The testimony before the Planning Commission by Ms. Raines "that the owner is in good faith compliance with the terms of the Development Agreement" is undocumented and at strong (and as yet unexplained) variance with the facts as we know them through County documents.

As for the situation facing you today, we also believe that:

- The situation in which the developer finds himself is one of his own choice and making, and any appeal to hardship and request for special consideration by your Board should be dismissed.
- The situation in which your Board finds itself is one of the County's own design and creation, and one that requires creative problem solving and hard choices.
- The building permit is not protected by an overly simple reading of sections of the development agreement mentioned earlier.
- There has not yet been a complete and properly documented good faith performance review, and furthermore, we believe:
    - This State-imposed obligation must be discharged before any optional consideration by your Board of the developer's application for extension. Thus, any consideration of an extension must come only after default has been declared and cured under the terms of the unmodified development agreement.

- The proper venue for such a review is before your Board in public session, as recommended to you last September by your Planning Commission.

- You have broad discretion in modifying the agreement but your actions are also under significant constraints:
  - The requirement to build the entire project or nothing at all is not open to your changes, and your requirements to enforce CEQA may color many of your decisions.
  - Any extension or modification of the development agreement must, we believe, serve the purposes set forth by State law for such agreements. These purposes quite notably do not include reducing the risks of unfortunate business decisions, (wording of the development agreement not withstanding) but do focus on exactly what we need on the Coastside today: good planning for current and future needs. The current development agreement stands in the way of what it is primarily intended to achieve, and therefore is a disservice to the community.
  - Any extension, we feel, must be granted only after the developer's financial backers give irrevocable guarantees of full financing for the project. Anything less merely excuses what we believe to be a violation of the development agreement and compounds the County's difficulties in enforcing that agreement and the requirements on it under CEQA.

Our suggestions

We suggest this course of action:

1. Immediately impose a stop-work order on the project pending the outcome of a full good faith performance review as requested[12] by our attorney last August.
2. Conduct the review yourselves, in public session, as suggested by your Planning Commission last September.
3. If you find, as we believe you must, that the developer is in default, follow the required sequence of events laid out in the development agreement, including giving the developer notice of your requirement to "cure" specific defaults within 30 days (or by June 22, 2005).
4. If the defaults are cured, you may consider modification and extension of the development agreement subject to the several constraints we believe are placed on you, as outlined above.
5. If the defaults are not cured by June 22, you would declare the development agreement terminated by default of the developer.
6. The stop-work order on the current construction would remain in place and the developer would be encouraged to submit a new design for the site, possibly incorporating much of the current work. Those portions of the current construction that are not incorporated into a revised an fully approved project after a reasonable time (perhaps a very few years, as determined by your Board) would be returned to their pre-construction state per Ms. Raines' letter of August 9th to the developer.

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[12] Kent Mitchell to Mary Raftery, August 17, 2004. We have so far not received a reply to this letter.

7. Since the development agreement would no longer be in force, such a new design would be considered *de novo* by the County, including all public reviews and input. The Coastal Development Permit, however, does not lapse with the development agreement, and it is possible that Coastal Commission approvals could be expedited by considering the new project as a modification of the old project.

This last item has been our goal for 15 years and we would be ready to help the developer, the County and most especially the community work together on a project for this site that meets the community's current needs, protects our environment and offers financial rewards for the developer and his backers.

Sincerely,

Larry DeYoung, President
Concerned Citizens of the Coastside

Don Johnson