

To: Supervisor Richard Gordon (via fax: 650/363-1856)

March 2, 2005

RE: Harbor Village: Letter from Michael Murphy to Fred Lyon, Feb 15, 2005

Dear Supervisor Gordon:

We have reviewed the letter of February 15 from Michael Murphy to Fred Lyon regarding what appears to be an extension to the Harbor Village Development Agreement and have questions regarding the procedures used by the County. It would be most helpful if we could receive the County's clarification of these points well before the matter is first considered in public hearing, either at the Planning Commission or at the Board of Supervisors.

Furthermore, such an upcoming meeting of the Board would be an opportune time to act on the recommendation of the Planning Commission (4-1 on September 8, 2004) that the Board hold a public hearing to investigate compliance with the Development Agreement. The scope of such a meeting, we propose, would go far beyond the particulars of the correspondence at hand.

Force Majeure – It seems that the events of September 11, 2001 are being used to excuse apparent difficulties in obtaining timely financing for the entire project. While we are pleased to see this matter being raised now, we must remind you again that under California law, "the owner was required to demonstrate good faith compliance with the terms of [the Development] Agreement at least every 12 months, and the County was required to make a periodic review and make a determination of such good faith compliance at least every 12 months."¹

- Our first question is why the question of funding, which the County itself calls out as a substantial issue, was not considered earlier, as required by law. In particular, why was this question not documented and settled before the building permit for major construction granted last August, or in the review that Marcia Raines and Jim Eggemeyer reported to the Planning Commission in September?²

Next, we are drawn to Mr. Murphy's statement that "we have no difficulty with the concept" that the terrorist acts of 9-11 would form sufficient grounds to invoke the *force majeure* provisions of the Development Agreement since terrorism (which is not mentioned in the Agreement) is rather like war (which is).

Mr. Murphy's view is starkly in contrast to actual practice in the insurance industry after 9-11 and with case law. Within days of the 9-11 attacks, insurance companies had announced that they were paying hundreds of millions of dollars in claims rather than holding that the terrorist

¹ Letter from our attorney Kent Mitchell to Mary Raftery, Deputy County Counsel on August 17, 2004. More than six months later, we have still not received an answer to this letter.

² Memo from Marcia Raines and Jim Eggemeyer to the Planning Commission regarding "Harbor Village," dated September 2, 2004. "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 had asked for a copy of this review, but Deborah Hirsh in your office investigated our request and informed us that there was no documentation for this review.

"In order for a force majeure clause to excuse performance, the law requires that the force majeure event actually or proximately cause the party's inability to perform. Hong Kong Islands Line America S.A. v. Distribution Servs. Ltd., 795 F. Supp. 983, 989 (C.D. Cal. 1991) ('It is well-established that in order to constitute a force majeure, an event must be the proximate cause of non-performance.') ...

"Precedent makes clear that where a force majeure event does not render performance impossible, but rather creates conditions which in turn render performance economically burdensome, the force majeure event is not the proximate cause of non-performance. See N. Ind. Pub. Serv. Co., 799 F.2d at 274-75; Coquina Oil Corp v. Transwestern Pipeline Co., 1986 U.S. Dist. LEXIS, at *14-16."⁵

It is impossibility, rather than inconvenience or economic burden, that would apply:

"The fact that performance has become economically burdensome or unattractive is not sufficient legal grounds for performance to be excused. ... A party may be excused from a contract obligation if performance has become objectively impossible as a result of an unexpected event. Numerous cases have stated the impossibility doctrine will not apply if performance will be excessively expensive. ...

"Courts generally do not view price increases, even when dramatic, to be unforeseen. A case often cited to support this is the 1975 case Eastern Airlines Inc. v. Gulf Oil Corp. In this case, Gulf Oil sought to be excused from supplying jet fuel to Eastern Airlines at the negotiated contract price because of dramatic increases in fuel costs caused by the OPEC oil embargo and events in the Middle East. The Florida U.S. District court hearing the case declined to relieve Gulf Oil from its contract, finding the instability in the Middle East and price volatility were not unforeseen."⁶

Thus, we believe that Mr. Lyon must show that it was impossible, not merely financially unattractive, for his client to obtain financing after 9-11. This seems improbable; the banking industry did not collapse after 9-11 and commercial loans continued to be available to qualified applicants (even if the standards and costs were higher than before).

⁵ "Was September 11 a Force Majeure event as Defined in Labor-Protective Provisions in the Airline Industry?" Joseph Guerrerri, Jr. at: <http://www.bnabooks.com/ababna/railway/2002/majeure.doc>

⁶ "Legal Ease" column in *Professional Roofing Magazine*, February 2005, by Stephen M. Phillips http://www.professionalroofing.net/article.aspx?A_ID=586 This article also mentions, as "the only significant widely reported exception" was Aluminum Co. of America (Alcoa) v. Essex Group Inc. "In this case, Alcoa was experiencing a 485 percent increase in production costs as a result of increased electricity costs instigated by the 1973 OPEC oil embargo and would lose \$75 million ... and the buyer would receive a concomitant unexpected gain." It seems unlikely that the developer is facing a five-fold increase in costs due to 9-11, or that the County would thereby receive a large unexpected gain."

attacks fell within their policies' *force majeure* exclusions. If insurance companies who were directly affected by the events of this day did not invoke these exclusions, under what reasoning can these same exclusions be granted to a construction project across the continent?

To some degree, these decisions rose out of a nation unified in grief and resolve; but there were also very practical legal reasons behind them. One of the salient court decisions rose out of events with tragic similarities to those of 9-11.

On September 6, 1970, the Popular Front for the Liberation of Palestine hijacked and destroyed aircraft operated by Pan Am, TWA and SwissAir. In *Pan American World Airways, Inc. v. Aetna Casualty & Surety Co*, the court ruled that these terrorist acts did not constitute an "act of war" in the sense of the *force majeure* exceptions since "war" applies only to hostilities with sovereign or quasi-sovereign nations.³

And, more generally:

"[T]here is significant case law developed over the past 25 years (mostly in the insurance law area) indicating courts will narrowly construe the phrase "act of war" to mean hostilities between entities with significant attributes of sovereignty."⁴

Indeed, there was no formal declaration of war after 9-11 as required under the Constitution (but rather a "national emergency"). Further, the Administration has declared that prisoners at Guantanamo and elsewhere are "unlawful combatants" and do not qualify for treatment as prisoners of war, reinforcing the conclusion that the events of 9-11 are not "war" in a legal sense.

It appears to us as non-lawyers that acts of terrorism have not been allowed as "acts of war" for the purposes of enforcing language such as we find in Section 15.E of the Development Agreement.

- Thus, for our second question we request written elaboration (and substantiation) of the reasoning by which the County, in the face of contradictory practice and case law, entertains the proposition that the events of 9-11 fall within the scope of those cited in the Development Agreement's *force majeure* clause.

We do agree with Mr. Murphy's request for more documentation and detailed justification from Mr. Lyon, but do not think his request goes far enough to avoid simplistic *post hoc* reasoning. Rather than assuming that there is a necessary connection between 9-11 and this particular project's difficulties ... and merely asking for its quantification ... we believe that the County should require a much stronger demonstration of cause and effect even if it were to accept the terrorist attacks of 9-11 as legitimate *force majeure* events:

³ See, for example, "Exclusions for War and Terrorism: Who Will Pay for Man-Made Catastrophes?" at <http://www.umt.edu/law/MunroExclusions%20for%20War.pdf> The Pan Am case is to be found at 505 F.2d 989 (2d Cir. 1974)

⁴ "Reconsidering force majeure clauses in the wake of increased acts of terrorism," by Cathryn A. Reynolds and Alexander P. Steffan, originally published in the Fall 2004 newsletter of the Real Estate Bar Association of Massachusetts; at http://www.rc.com/documents/Force%20Majeure_REBA11.04.pdf

And, of course, the attacks of 9-11 are not the only significant events of recent years. Did the end of the "dot com" bubble and the subsequent difficulties in the State and local economy have a role in the project's difficulties? Can we be sure that these difficulties have nothing to do with the project's inherent appeal against tough competition in a crowded market ... especially when other hotels have recently been built nearby? These are risks of doing business, and not exceptional events qualifying for the treatment of Section 15.E.

- Thus, our third question is by what process and evidence will the County determine that the funding difficulties arise directly and only from the events of September 11? Coincidence is not enough when asking for exceptional treatment.

Sewer permits and Half Moon Bay Fire approvals – We will deal with these together since our root concerns are common to each.

These concerns appear to us to be very close if not identical to two requirements laid out in the County's letter of December 15, 1989 to Mr. George Auld ("Final Local Decision" on Pillar Point Harbor Village), specifically item B.6 on page 6 and item B.12 on page 7.

The County quite correctly asks for more information to excuse incomplete performance in these two instances, especially since it appears that Mr. Lyon's client (and prior owners of the development) have had ample time to attend to them. We, too, have been frustrated by unresponsive bureaucracies, but "processing delays" of 15 years are not common.

We attended a meeting of the El Granada Sanitary District where Mr. Neerhan asked to purchase sewer permits at a discount (and spoke against his request). The GSD Board denied his request, feeling that such a discount would be unfair to other rate-payers.

Thus, it would appear that the matter has been decided already and there is no "processing delay." It may, of course, be possible to obtain the requisite sewer permits for more than Mr. Lyon's client would like to pay, but that is a business decision ... not an uncontrollable external event ... that should play no role in the County's consideration of the developer's non-performance.

- Thus, our fourth question of the County is: What reasoning and evidence would excuse non-performance on requirements that have been outstanding for 15 years, especially if and where such non-performance appears to be due to Mr. Neerhan's personal business decisions?

But there is a far more serious issue with the fact that these two requirements are still outstanding at this point in the project's long history. In a note to us on 11/19/99, Mr. Dave Holbrook of the Planning and Building Division wrote that these conditions (referring again to the 1989 memo)

"must be met prior to our approval of their pending building permit for Phase I. (Detached retail building to be built first & used as construction office during remainder of project construction.)"

The "detached retail building" appears to be the one for which a building permit was granted on April 24, 2000 in satisfaction of item D.5 of the Development Agreement (requiring that construction begin before the fifth anniversary of the agreement).

If our understanding is correct, it appears that not only was the permit of August 8, 2004 for major construction granted improperly, but also that construction of the small office building was begun five years ago in the absence of required approvals. Thus it appears that the

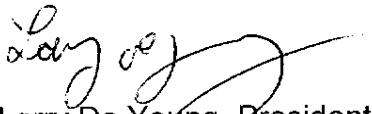
developer has not satisfied condition D.5 of the Development Agreement and has therefore been in violation of that Agreement for nearly five years.

In addition, it appears that all building permits for this project may have been granted improperly, raising serious concerns about the County's management of the Development Agreement.

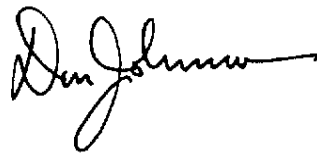
- Our fifth question, then, is: Under what interpretation of documents and events does the County consider all building permits to be granted properly, and requirement D.5 of the Development Agreement met?

These, we believe, are serious questions that deserve prompt and complete answers. Since it can only benefit the County to have these questions quickly and firmly put to rest, may we anticipate your full and written reply soon?

Sincerely,



Larry De Young, President
Concerned Citizens of the Coastsides
Fax: 866-522-5006



Don Johnson
Concerned Citizens of the Coastsides

CC (via fax):

- Michael Murphy, Chief Deputy to the County Counsel (650-363-4034)
- Planning Commissioners William Wong, David Bomberger, Jon Silver, Ralph Nobles, Steve Dworetzky (650-363-4849)