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REPORT TO THE HONORABLE
MAYOR AND CITY COUNCIL

RE: RECENT LITIGATION

City of San Diego v. CB Richard Ellis, Inc.
San Diego Superior Court Case No. GIC 793213

On January 8, 2004, a Superior Court jury unanimously found CB Richard Ellis Inc. [CBRE] liable for misrepresentation (fraud) and violations of the California False Claims Act with respect to its billing of the City for excess operating expenses for City office space in the Civic Center Plaza building at 1200 Third Avenue. Prior to the damages phase of the trial, in which there was a likelihood of an award of treble damages under the False Claims Act and punitive damages on the fraud claim, CBRE agreed to pay the total sum of \$3 million to settle the case. The City had been overcharged \$1.65 million over the ten years of the relevant lease term, and had also incurred litigation costs and professional auditing fees totaling nearly \$500,000.

Under the lease, in addition to ordinary rent, the City pays a percentage share of the building's operating and maintenance expenses, customarily referred to as Common Area Maintenance (CAM) charges. In this lease, CAM charges were calculated under a "gross up" provision. A Base Year was designated as 1992, the year preceding occupancy by the City, for which the operating expenses for the entire building were stated. Once the Base Year expenses were established, that figure became "locked in concrete" for the remainder of the term of the lease. After the first year of the lease, the City was required to pay a prorated share, based on its percentage occupancy, of the operating expenses that exceeded those in the Base Year.

The landlord delegated the responsibility of the Base Year calculation and the billing of operating expenses, along with other aspects of building management, to defendant CBRE, the property manager for the building. CBRE represented to the City the amount of \$1,532,589 for 1992 Base Year operating expenses as being accurately grossed up pursuant to the contract. As the lease years ran, the City continued to incur excess costs for each and every year, despite determined efforts to conserve electricity and save other maintenance expenses. Diana Monaco, who was hired by Real Estate Assets in 1996 to oversee the City's Office Space Program, began catching CBRE in numerous billing errors, and upon closer examination, determined that the Base Year needed to be audited. Rod Greek from the City Auditor's staff confirmed

Ms. Monaco's suspicion, but was unable to fully audit the Base Year because documents reflecting the Base Year were withheld by CBRE. Mr. Greek recommended retaining an independent lease consultant and the City retained the auditing firm of Deloitte & Touche to evaluate the excess operating expenses.

In its audit, Deloitte & Touche determined that the 88% Base Year occupancy figure used by CBRE had been grossly overstated. Deloitte recalculated the City's actual Base Year occupancy percentage at 41.58%. CBRE had taken the actual operating expenses for 1992 and had grossed them up from 88% to 95% resulting in the base year figure of \$1,532,589. Deloitte, using 41.58% and grossing that figure to 95%, calculated a Base Year operating expense figure of \$2,037,751. Since the operating expenses for the building never exceeded the Base Year grossed up figure, the City should never have been billed for excess operating expenses. The subject Base Year ended at the expiration of the initial lease term in March 2003, and a new Base Year is currently in effect.

CBRE refused to recognize the overcharges and the City thus contacted the landlord, Civic Center Associates, Inc. [CCA], and provided it a copy of the Deloitte and Touche report establishing the overcharges. CCA, relying on CBRE's representations, threatened the City with default if the City did not pay all rent demanded under the remainder of the lease. The City paid under protest and filed this action. After determining that CCA was not a party to the misrepresentation, the City proceeded to trial against CBRE on causes of action for fraud and violations of the California False Claims Act, which ultimately resulted in the jury verdict in favor of the City. The City received the settlement check in the sum of \$3 million on January 23, 2004.

Senior Deputy City Attorney James M. Chapin tried the case on behalf of the City of San Diego. The ultimate settlement was a tremendous tribute to the teamwork between the staff in the Real Estate Assets Department, the City Auditor's Office, our outside auditors, and the City Attorney's Office. Mr. Chapin did a tremendous job in coordinating the entire effort.

Respectfully submitted,

CASEY GWINN
City Attorney

JMC:vtc
RC-2004-5
cc: Will Griffith
Diana Monaco