April 15, 1988

REPORT TO THE HONORABLE
MAYOR AND CITY COUNCIL
BELMONT PARK - "BAD FAITH" ISSUES

BACKGROUND

At the City Council meeting on March 21, 1988, the City Council considered the issue of whether or not the Belmont Park development project has obtained "vested rights" under the provisions of the initiative known as "Proposition G," which was approved by the voters at the November, 1987, election.

Two basic questions were referred to this office for response prior to April 18, the date to which the vested rights issue for the project was continued. They are:

(1) What are "vested rights" and "good faith" as defined by the various court decisions? and

(2) Has there been "bad faith" on the part of the Belmont Park developer, which might justify the City in either terminating the Belmont Park lease or seeking monetary damages or equitable relief against the developer?

This report will address only the second issue, i.e., "bad faith." A separate report is being prepared on the issue relating to "vested rights."

The "bad faith" issue arose at the City Council meeting on March 21 after questions had been raised by the Mayor and various Councilmembers with regard to several specific improvements on the project site. Significant discussion took place with regard to the following issues:

SQUARE FOOTAGE BUILT

(1) Why has approximately 73,000 square feet of buildings been constructed when the City Council had apparently been told earlier that only 70,000 square feet would be constructed?

RESTROOM REFURBISHMENT

(2) Why was only the exterior of the restroom on the south westerly portion of the site refurbished when the City Council had apparently been informed that the restroom would be "restored?"

PLUNGE STRUCTURE

(3) Why have certain structural changes been made to the historic Plunge when the City Council was

apparently informed that the Plunge structure would not be modified or aesthetically altered? and

EXTERIOR STAIRS

(4) Why have exterior stairs been added to the second story decks of two restaurants when such stairs were not shown on the original plans?

OTHER ISSUES

In addition, questions were raised at the Council meeting with regard to access ramps that encroached into the public right-of-way; a "jog" in the sidewalk along Mission Boulevard in the south easterly corner of the site; and the height of the new steel structure covering the Plunge building.

We have met with representatives of the Property Department and the Building Inspection Department, and have reviewed the option and lease agreement for the project together with the approved development plans. The construction site was also visited to review the development in progress.

CONCLUSION

Based upon the information developed in our inquiry, we are not persuaded that the evidence reflects "bad faith" actions (as defined by law) which would give rise to justifiable termination of the lease, or other legal or equitable relief against the developer at the present time.

ANALYSIS

As background it is necessary to review the contractual relationship between the City and the developer. The basic contractual relationship is contained in the lease, which was executed on behalf of the City and became effective on March 5, 1987. The lease contains the following provisions:

> 7.10 Entire Understanding. This Lease contains the entire understanding of the parties. . . . Each of the parties to this Lease agrees that no other party, agent or attorney of any other party has made any promise, representation or warranty whatsoever, which is not contained in this Lease. The failure or refusal of any party to read the Lease or other documents, inspect the Premises and obtain legal or other advice relevant to this transaction, constitutes a waiver of any objection, contention or claim that might have been based on these actions. No modification, amendment or alteration of this Lease will be valid unless it is in writing and signed by all parties.
>
> 7.03 CITY Approval. The approval or consent of the

CITY, wherever required in this Lease, shall mean the written approval or consent of the City Manager unless otherwise specified, without need for further resolution by the City Council, which approval shall not be unreasonably withheld.

6.13 Failure to Meet Development Schedule. In the event that construction of the improvements described in the Development Plan are not completed within twenty-four (24) months following the Commencement Date, CITY may, at its option, terminate this Lease.

6.12 Development Plan. LESSEE agrees to develop the leased premises in accordance with the Development Plan approved by the City Manager and filed in the Office of the City Clerk which plan is hereby incorporated by this reference. The general contents and provisions of the Development Plan are described in Exhibit C, hereof. The City Manager or his designee shall have the authority to authorize changes to the plan provided that the basic concept may not be modified without City Council approval and a document evidencing any approved changes shall be filed in the Office of the City Clerk. Failure by LESSEE to comply with the Development Plan shall constitute a default under the terms hereof.

A copy of Exhibit C, the Development Plan, is attached as "Attachment 1" for reference.

It should be noted that the above-quoted provisions indicate that the lease is the entire agreement between the parties; that the City Manager is authorized to provide any consents required under the lease without additional City Council action; that the developer is required to proceed expeditiously with the development; that the development is described generally in Exhibit C; and that the City Manager is specifically authorized to approve changes to the development plan without Council approval so long as such changes do not alter "the basic concept" of the project.

A review of the law with regard to the definition of "bad faith" yields the following statements:

> The terms "bad faith" and "fraud" are synonymous. (See page 21 Words and Phrases, Vol.5.)
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> In general, "bad faith" extends beyond fraud or dishonesty and embraces unfair dealings; it often denotes a deliberate refusal to perform without just or

reasonable cause or excuse. Inyo County v. City of Los Angeles, 144 Cal.Rptr. 71, 77, 78 Cal.App.3d 82 (1978).

"Bad faith" is not mere carelessness; it is nothing less than guilty knowledge or willful ignorance. Matthysse v. Securities Processing Services, Inc., D.C.N.Y., 444 F. Supp. 1009, 1021.

There is no statutory provision in California law defining "bad faith." However, recent cases have indicated that a lease is a contract as well as an estate in real property and as such includes the "implied covenants of good faith and fair dealing" implied in all contracts. Kendall v. Ernest Pestana, Inc., 40 Cal.3d 488, 500, 220 Cal.Rptr. 818, 709 P.2d 837, cert.gr., in part (1985), California v. Brown, 90 L.Ed.2d 717 (1986, U.S.); Schweiso v. Williams, 150 Cal.App.3d 883, 887, 198 Cal.Rptr. 238 (1984); Cohen v. Ratinoff, 147 Cal.App.3d 321, 322, 195 Cal.Rptr. 84 (1983). See .. 1:40A, 12:66A, supra.

The above cited provisions will be applied to the specific issues raised seriatim.

SQUARE FOOTAGE BUILT

(1) As was noted at the March 21 City Council meeting, the "development plan" for the project attached as a portion of Exhibit C, included a letter dated February 20, 1987, from Pacific Diversified Capital Company, which letter was in effect a construction loan commitment for the project. That letter

describes the security for the loan as: "Seven proposed retail/restaurant buildings totaling approximately 70,000 square feet on City Ground Lease and two proposed buildings containing a refurbished Plunge and shower, locker and exercise facility with public meeting rooms."

No other specific reference to square footage was contained in the lease. However, the Coastal permit issued for the project likewise referred to, among other things, "construction of seven (7) new commercial retail buildings, totaling 70,000 square feet of floor area, restaurants, food and beverage concessions and retail shops."

The option agreement approved by the City Council on June 26, 1986, required, among other things, that the developer submit a precise plan of development reasonably satisfactory to the City Manager. The development plan was required to conform to schematic plans which were approved by various City committees and boards and the City's environmental impact report and the developer's coastal permit. The precise plan of development was, in fact, prepared during the option period. It was approved by the City Manager prior to the exercise of the option and the signing of the lease by the City on March 5, 1987. The

development plan had a cover sheet entitled "Project Data" which described the property and gave a gross building area for buildings one through seven of 71,634 square feet.

The actual construction plans submitted to the Building Inspection Department indicated a total square footage for the new retail space as 72,377 square feet. Those plans were signed off by both the Planning Department and the Property Department on behalf of the City on March 5, 1987. There is no indication that there was any attempted fraud or bad faith on the part of the developer in presenting plans which had, in fact, been reviewed by the various boards and committees as required under the option agreement. The fact that the new construction retail portion of the project was described as "approximately 70,000 square feet" and turned out to be an actual 72,377 square feet does not provide any basis for an allegation of "fraud" or "bad faith" since the actual square footages were approved by the City and did not alter the "basic concept" of the project. As to the coastal permit reference to "70,000 square feet," it was determined that the actual commercial square footage is 70,127 square feet, the difference being that for the purpose of determining square footage under coastal permits, mechanical rooms and restrooms are not included.

RESTROOM REFURBISHMENT

(2) At the March 21 Council meeting concerns were also raised as to why the restroom on the south westerly portion of the site was not refurbished on the interior as well as the exterior. While the cost summary attached to the lease included a line item described as "remodel restroom - $77,396," the project description attached to the lease specifies in part "the facades of the existing public restroom and lifeguard building will be renovated to relate to the architectural theme of the development."

Discussions with City staff and the developer indicate that only approximately $45,000 of the budgeted $77,396 was spent for the renovation of the restroom facade and other minor restroom improvements. The developer will, of course, only receive a rent credit for the actual cost of the improvements.

We are informed that the developer's total anticipated cost for the public improvements required under the lease are now expected to be in excess of $5,900,000, whereas the lease specifies that no rent credit shall be given for any cost for public improvements in excess of $5,617,000.

The excess cost is due to the fact that some of the public improvements are costing more than the line item amounts contained in the "Cost Summary" attached to the lease, and that

the $32,000+ "savings" on the restroom facade improvements is more than made up for by the excess costs of the other public improvements.

However, it is our understanding that as a result of the concerns raised by the Council, the developer is working with Councilman Henderson and has tentatively agreed to make additional interior repairs and aesthetic improvements to the restroom at no cost to the City.

In view of the fact that the developer has accomplished the restroom improvements described in the City-approved plans and has tentatively agreed to additional interior repairs and improvements at no cost to the City, this office cannot, at this time, find any basis for a conclusion that bad faith or fraudulent action has occurred on the developer's part in connection with the restroom improvements.

PLUNGE STRUCTURE

(3) Another matter raised at the March 21 meeting was the fact that structural modifications are being made to the Plunge and that the City Council had felt that commitments had been made to leave the Plunge structurally in its preexisting form. Section 24102 of the State Health and Safety Code provides in part as follows:

> . . . The state department shall make and enforce such rules and regulations pertaining to public swimming pools as it deems proper and shall enforce building standards published in the State Building Standards Code relating to public swimming pools; provided, that no rule or regulation as to design or construction of pools shall apply to any pool which has been constructed before the adoption of such rule or regulation, if such pool as constructed is reasonably safe and the manner of such construction does not preclude compliance with the requirements of such rules and regulations as to bacteriological and chemical quality and clarity of the water in such pool. . . .

In connection with the refurbishment of the pool and the reconstruction of the structure surrounding the pool, the developer was aware of State Health and Safety Code requirements regarding water quality for both new and existing pools. The County Department of Health Services inspected the pool and required that the floor of the pool be raised, as shown on the developer's plans, in order to accommodate updated facilities needed to provide an adequate water purification system for the pool. This is a matter within the jurisdiction of the County Health Services Department under the authority of the above

quoted provision in the state code.

The only other significant potential structural modification to the pool involves the proposed removal of the steps at the deep end and the pedestal at the shallow end. This office and the Intergovernmental Relations Department are continuing in attempts to have the State Health Services Agency and its legal counsel advise the County Health Services Department that the County Department does not have jurisdiction to require the removal of individual preserved structural devises unrelated to water quality in the absence of evidence supporting a conclusion that the pool itself is not "reasonably safe." Please see the attached letter to the State Department of Health Services ("Attachment 2") The state agency has reacted positively to the

letter and it appears that the stairs and pedestal will be allowed to remain on condition that handrails be installed on the stairs and on condition that some contrasting tile be placed on the underwater portion of the pedestal so that the underwater portion can be more easily seen by pool users. We will continue to pursue retention of the stairs and pedestal.

The developer has not attempted to make any changes in the Plunge. The developer has merely responded to the dictates of the state law and the County Health Services Department. There is no apparent "bad faith," since the developer is, under the lease, specifically under Section 7.02, required to comply with all applicable laws relating to construction, maintenance and operation of the improvements.

EXTERIOR STAIRS

(4) The two major restaurants fronting upon the ocean were shown on the construction plans approved by the City on March 5, 1987, as having structural provisions to support an open second story deck and were designated on the plans as "future restaurant deck." The construction plans were modified and approved by the City on October 19, 1987, and included the proposed location and layout of two exterior stairways for each restaurant. The stairway locations were signed off by the Planning Department but were not apparently routed through the Property Department. A notation was made by the Planning Department on October 15, 1987, indicating that the final configuration must be approved by that department. The final stairway design for the four exterior stairways was in fact approved by the Planning Department on February 3, 1988. Again, the plans were not routed through the Property Department. However, Property Department staff has been on the site and has been aware of the construction of the exterior stairs.

It is our understanding that a complaint has been made to the

Coastal Commission regarding the exterior stairs and that the Coastal Commission staff is reviewing the issue of the stairs. Once again, however, there is no indication of any "fraud" or "bad faith" on the part of the developer in connection with the stairs location, since City staff approved the location and construction of the stairs.

OTHER ISSUES

(5) The two access ramps which encroached into the public right-of-way without the benefit of an encroachment removal agreement were removed as a result of the objections raised at the City Council meeting on March 21. Discussions with City staff indicate, however, that an encroachment removal agreement would probably have been issued for the access ramps had the objections not been made and that the installation of the ramps was accomplished following discussions with City staff by the developer. No "fraud" or "bad faith" was involved.

(6) The "jog" in the sidewalk proposed along Mission Boulevard, which would have resulted in something other than a straight public sidewalk at the south easterly corner of the site, has been removed from the plans as a result of objections raised at the March 21 Council meeting. Once again, however, the developer had conferred with City staff and the proposed improvements had been approved. Once again, no indication of "bad faith" is involved.

(7) Finally, there is the issue of the height of the new steel structure covering the Plunge building. We have attached as "Attachment 3" a copy of a 1980 opinion of this office relating to the exemption of the City from the height limitation. We are informed that the new steel structure is similar in design to the wooden structure it replaces and that it will perform the same function, i.e., as a skylight for the pool.

It must be noted that while the City Council also directed this office to opine on the subject of "good faith" of the developer in complying with the lease requirements met in constructing facilities as directed to the City Council in the project documents, the historical, as well as present, legal means of obtaining relief for any alleged violation of a lease or other contract involves the giving of a "notice of default." The subject lease contains a Section 4.04 entitled "Defaults and Remedies." While there is no known default under the subject lease at this time, in the event a default does occur, the City would be required under the lease terms to give thirty days written notice to the lessee of any such default and the lessee would be entitled to thirty days to cure the default, and if the default cannot, as a practical matter, be cured within such

thirty-day period, the lessee is allowed such time as is necessary to "diligently pursue the cure to completion."

In any event, neither any default nor any "bad faith" has been found by this office in its investigation of the facts. While some Councilmembers may be justifiably concerned that certain understandings they may have had relating to pamphlets, brochures, news articles, and such by the opponents and

proponents of the project, were not reflected in the actual option or lease and development plan, such fact does not allow the City, as a legal matter, any right to demand, at this time, a project different than the project which was described in the lease, the development plan and in the construction drawings, all of which were approved by the City and City staff in accordance with the terms of the option and lease.

Respectfully submitted,
JOHN W. WITT
City Attorney

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Attachments 3
RC-88-23